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DIVISION ONE  
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No. 73956-5-I

KUNG DA CHANG and MICHELLE CHEN,

Appellants,

v.

SHANGHAI COMMERCIAL BANK LIMITED,

Respondent.

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APPEAL FROM THE WASHINGTON STATE SUPERIOR COURT  
IN AND FOR THE COUNTY OF KING

*Shanghai Commercial Bank Limited v. Chang, et al*

Case No. 12-2-21293-7 SEA

The Honorable Laura G. Middaugh

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OPENING BRIEF OF APPELLANTS KUNG DA CHANG AND  
MICHELLE CHEN

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## I. INTRODUCTION

In 2004, Clark Chang moved his multi-million dollar investment portfolio to Respondent Shanghai Commercial Bank Limited ("SCB") in Hong Kong. Clark Chang was in his late-80s at the time, so his SCB accounts were maintained in the name of his son, Appellant Kung Da ("KD") Chang, in case Clark Chang passed away. Although the accounts were maintained in KD Chang's name, Clark Chang was the sole decision-maker and beneficiary of the accounts, a fact known to SCB.

Clark Chang's portfolio was managed by his long-time investment advisor and SCB employee, Daniel Chan. Daniel Chan briefly left SCB in 2007 for the Bank of East Asia ("BEA"), returning to SCB in early-2008. Clark Chang followed Daniel Chan to BEA in 2007 and then back to SCB in 2008.

Starting in 2004, while at SCB, Daniel Chan began recommending that Clark Chang invest in Equity Linked Notes ("ELNs") and other high-risk investments. Unaware of the risks and dangers of the investments, Clark Chang followed Daniel Chan's advice. When Clark Chang transferred his accounts to BEA, most of his \$20 Million portfolio was invested in these high-risk investments. Daniel Chan then arranged credit facilities for Clark Chang through BEA and recommended using the loans to invest in even more of the high-risk investments.

By the time Clark Chang transferred his portfolio back to SCB, Daniel Chan had amassed \$15 Million in outstanding loans to BEA purchasing high-risk investments for the portfolio. Using Clark Chang's portfolio of high-risk investments as collateral, which had already suffered massive losses, Daniel Chan arranged for a \$16 Million credit facility at SCB and surreptitiously used the funds to pay off the BEA loans.

The high-risk investments in Clark Chang's portfolio continued to fail and SCB sought additional security. Clark Chang suspected he had been defrauded and refused to provide any additional collateral. SCB subsequently sued KD Chang and Clark Chang in Hong Kong for the deficiency between the outstanding loan amount owed to SCB and the value of Clark Chang's portfolio. KD Chang and Clark Chang countersued SCB for fraud, but their claims were dismissed when the Changs could not put up a \$838,000 securities for costs cash bond.

SCB ultimately obtained a \$9 Million judgment against KD Chang and filed a petition in King County Superior Court seeking recognition and enforcement of the Hong Kong judgment in Washington.

In June 2013, the trial court granted SCB's motion for summary judgment seeking recognition and enforcement of the

Hong Kong judgment with respect to KD Chang's separate property. In August 2015, the trial court granted a second motion for summary judgment by SCB seeking enforcement of the Hong Kong judgment against Appellants KD Chang and Michelle Chen's marital community.

The main issue before the trial court was whether Hong Kong law or Washington law governed whether or not KD Chang and Michelle Chen's marital community property may be used to satisfy the Hong Kong Judgment. The trial court determined Hong Kong law applied and that the Hong Kong judgment is enforceable against all of Appellants' property except Michelle Chen's separate property.

Appellants KD Chang and Michelle Chen now appeal the trial court's order granting SCB's Second Motion for Summary Judgment.

## **II. ASSIGNMENTS OF ERROR**

1. The trial court erred by granting SCB's Second Motion for Summary Judgment and denying Appellants' Motion for Reconsideration.

## **III. ISSUES PERTAINING TO ASSIGNMENTS OF ERROR**

1. Did the trial court error in finding that the Facility Letter contains a controlling Hong Kong choice-of-law provision?
2. When a claim for breach of contract has been reduced to a

final judgment, does a choice-of-law provision in the contract underlying the original claim apply to enforcement of the judgment?

3. Is a choice-of-law provision enforceable against a spouse who did not sign, consent to, or benefit from the contract?

4. Under RCW 6.40A, does Washington law govern the enforcement of the foreign judgments in Washington?

5. If a conflicts of law analysis is required, does the Court determine the jurisdiction with the “most significant relationship” to the enforceability issue using the general principles of conflicts of law or does the Court look to the transaction underlying the foreign judgment?

6. Under a conflict of law analysis, does Washington law or Hong Kong law govern the enforceability of the Hong Kong Judgment against Appellants’ marital community property?

7. Under Washington law, is the Hong Kong Judgment KD Chang’s separate debt or Appellants’ community obligation?

#### **IV. STATEMENT OF THE CASE**

##### **A. Factual Background**

Clark Chang is the 97 year-old father of Appellant Kung Da (“KD”) Chang. In 2004, Clark Chang, who was into his late-80s at the time, transferred his financial accounts with Respondent Shanghai Commercial Bank Limited (“SCB”) in New York to SCB in

Hong Kong. Clark Chang's SCB Hong Kong accounts were maintained in KD Chang's name because he trusted that KD Chang would distribute the funds fairly between himself and his siblings should Clark Chang pass away. When Clark Chang's SCB Hong Kong accounts were opened, the value of his account portfolio exceeded \$20 Million.<sup>1</sup>

Although the SCB accounts were maintained in KD Chang's name, Clark Chang was the sole beneficiary of the accounts and the only person authorized to make decisions on the accounts. Clark Chang did not gift the funds to KD Chang and KD Chang had no authority to access the funds in the accounts, unless his father passed away. SCB knew this and Clark Chang's investment advisor at SCB, Daniel Chan, looked solely to Clark Chang for instructions on the account. Daniel Chan only contacted KD Chang when he needed KD Chang's signature.<sup>2</sup>

After Clark Chang's SCB Hong Kong accounts were opened, Daniel Chan began recommending to Clark Chang that he invest in Equity Linked Notes ("ELNs"). Daniel Chan did not inform Clark Chang that ELNs were very high-risk investments and that they were only suitable for sophisticated investors. Daniel Chan

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<sup>1</sup> CP 208-209 (Decl. of Clark Chang at ¶¶ 3-4) and CP 288-289 Decl. of KD Chang at ¶ 4).

<sup>2</sup> CP 209 (Decl. of Clark Chang at ¶¶ 3-4) and CP 288-289 Decl. of KD Chang at ¶ 4).

also recommended that Clark Chang invest in a variety of other high-risk investments, but again failed to disclose the dangers of those investments. Unaware that the investments were very high-risk and trusting that Daniel Chan would only recommend suitable investments, Clark Chang followed Daniel Chan's advice.<sup>3</sup>

In early-2007, Daniel Chan left SCB to work for the Bank of East Asia ("BEA"). By that time, Daniel Chan had more than \$20 Million of Clark Chang's portfolio at SCB invested in high-risk ELNs. When he left SCB, Daniel Chan asked Clark Chang to transfer his investment portfolio to BEA so that Daniel Chan could continue to manage the portfolio. Clark Chang agreed to follow Daniel Chan to BEA.<sup>4</sup>

After Clark Chang transferred his accounts to BEA, Daniel Chan arranged for Clark Chang to receive lending facilities from BEA. Daniel Chan then recommended that Clark Chang use the funds obtained through the lending facilities to acquire additional ELNs and other high-risk investment products. Just as before, Daniel Chan failed to explain to Clark Chang that this was an extremely high-risk proposal that could result in huge losses and expose Clark Chang to massive liabilities. Unaware of the dangers, Clark Chang agreed to take out lending facilities through BEA and

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<sup>3</sup> CP 209 (Decl. of Clark Chang at ¶¶ 3-4). See also CP 314-319 at ¶¶ 25-41.

<sup>4</sup> CP 209 (Decl. of Clark Chang at ¶¶ 6-7). See also CP 319-322 at ¶¶ 42-55.

to allow Daniel Chan to use the funds to acquire additional investments for Clark Chang's portfolio.<sup>5</sup>

During the next year, Daniel Chan used more than \$15 Million in funds obtained through BEA lending facilities to acquire high-risk investments for Clark Chang's portfolio. At the same time, many of these high-risk investments were failing and Clark Chang's overall portfolio was suffering significant losses.<sup>6</sup>

In March 2008, Daniel Chan informed Clark Chang that he would be leaving BEA and returning to SCB. Clark Chang was unaware that his portfolio had suffered millions of dollars in losses and he did not know the extent Daniel Chan had used BEA lending facilities to acquire high-risk investments in his portfolio. So, Clark Chang again agreed keep Daniel Chan as his investment advisor and to transfer his accounts back to SCB.<sup>7</sup>

Unbeknownst to Clark Chang, BEA would only allow Clark Chang's account portfolio to be transferred over to SCB if Clark Chang repaid the \$15 Million in loans obtained through BEA lending facilities. Therefore, Daniel Chan arranged a \$16 Million credit lending facility for Clark Chang through SCB, which Daniel

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<sup>5</sup> CP 209 (Decl. of Clark Chang at ¶ 7). See also CP 321-322 at ¶¶ 47-55 and CP 324-326 at ¶¶ 59-67.

<sup>6</sup> CP 210 (Decl. of Clark Chang at ¶ 8, and 10-11). See also CP 330-333 at ¶¶ 80-90.

<sup>7</sup> CP 210 (Decl. of Clark Chang at ¶ 8, and 10-11). See also CP 330-333 at ¶¶ 80-90.

Chan then used to repay the BEA lending facilities. The value of Clark Chang's portfolio would be used as collateral for the SCB lending facility. At the time of the repayment to BEA, Clark Chang's portfolio was worth several million dollars less than what Daniel Chan told Clark Chang it was worth and the actual value barely covered the SCB lending facility.<sup>8</sup>

Clark Chang's new accounts at SCB were again maintained in KD Chang's name. The SCB credit facility was also in KD Chang's name. Around March 14, 2008, SCB sent the credit facility agreement (the "Facility Letter") and four other agreements to KD Chang at his father's address in Shanghai. Clark Chang called KD Chang and informed KD Chang that he was sending the documents to him in Seattle and that KD needed to sign the documents and return them to him as soon as possible. KD Chang received the documents, signed them, and then mailed them back to his father in Shanghai.<sup>9</sup>

In October 2008, Daniel Chan contacted Clark Chang and informed Clark Chang that he needed to transfer funds into his account at BEA because of a shortfall. The "shortfall" was, in fact, a \$2 million margin call by BEA. Daniel Chan did not inform Clark Chang what had caused the shortfall in Clark Chang's BEA

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<sup>8</sup> CP 210 (Decl. of Clark Chang at ¶¶ 10-11)

<sup>9</sup> CP 210 (Decl. of Clark Chang at ¶ 9) and CP 289 (Decl. of KD Chang at ¶ 5).

account. Clark Chang informed Daniel Chan that he did not have the funds to pay BEA.<sup>10</sup>

Later that same October, Daniel Chan informed Clark Chang that now SCB was requesting additional collateral to secure his accounts. Clark Chang then realized that Daniel Chan had been misleading him about his investment accounts and he refused to provide SCB with further collateral.<sup>11</sup>

On or about November 5, 2008, SCB's counsel in Hong Kong contacted KD Chang and Clark Chang via letter demanding repayment of the SCB lending facility. The demand letter to Clark Chang stated, "We act for Shanghai Commercial Bank Limited with whom you maintain an account in the name of Kung Da Chang, but which you are the principal and you at all times operated the accounts as an authorized signatory".<sup>12</sup> At the time, Clark Chang's SCB portfolio had a negative account value exceeding \$5 million. The portfolio continued to decline in value over the next couple of months.<sup>13</sup>

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<sup>10</sup> CP 210 (Decl. of Clark Chang at ¶ 12). See also CP 338-340 at 113-123.

<sup>11</sup> CP 210-211 (Decl. of Clark Chang at ¶ 13). See also CP 338-340 at 113-123.

<sup>12</sup> CP 211 and 214-215 (Decl. of Clark Chang at ¶ 14 and Clark Chang Exhibit 1) and CP 289 (Decl. of KD Chang at ¶ 6). See also CP 340-341 at ¶¶ 124-125.

<sup>13</sup> CP 211 (Decl. of Clark Chang at ¶ 15). See also CP 338-343 at ¶¶ 113-137.

## 1. The Hong Kong Lawsuits.

On March 21, 2009, SCB instituted Hong Kong High Court Action 806/2009 (“HCA 806”) against Clark Chang and KD Chang for breach of the Facility Letter.<sup>14</sup> On September 24, 2009, KD Chang filed his Defence and Counterclaim to HCA 806 and later filed an Amended Defence and Counterclaim.<sup>15</sup> On the same date, Clark Chang and KD Chang brought action HCA 1996/2009 (“HCA 1996”) against SCB and BEA based on the fraudulent activities of Daniel Chan while managing Clark Chang’s investment portfolio at SCB and BEA.<sup>16</sup> The claims asserted by Clark Chang and KD Chang in HCA 1996 were identical to the counterclaims asserted by KD Chang in HCA 806.<sup>17</sup> SCB subsequently amended its claims in HCA 806 to include KD Chang only.<sup>18</sup>

Hong Kong allows defendants to make applications for security for costs, including attorney fees, prior to the verdict against foreign plaintiffs to ensure any judgment in their favor is secure. SCB subsequently filed a motion and obtained an award for security for costs in the amount of \$838,000 cash against Clark

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<sup>14</sup> CP 211 (Decl. of Clark Chang at ¶ 16) and CP 289 and 295-304 (Decl. of KD Chang at ¶ 7 and KD Chang Exhibit 1).

<sup>15</sup> CP 211 (Decl. of Clark Chang at ¶ 17) and CP 289 (Decl. of KD Chang at ¶ 8).

<sup>16</sup> CP 211 (Decl. of Clark Chang at ¶ 18) and CP 289-290 (Decl. of KD Chang at ¶ 9).

<sup>17</sup> CP 211 (Decl. of Clark Chang at ¶ 19) and CP 290 (Decl. of KD Chang at ¶ 10).

<sup>18</sup> CP 290 (Decl. of KD Chang at ¶ 11).

Chang and KD Chang to be paid into the Court within 14 days.<sup>19</sup> Clark Chang and KD Chang were not able to make the \$838,000 cash payment for the security for costs awarded in HCA 1996.<sup>20</sup>

Since Clark Chang and KD Chang were not able to pay the security for costs, the Hong Kong Court issued an order dismissing the claims of KD Chang and Clark Chang in HCA 1996 on June 21, 2011. KD Chang and Clark Chang did not defend SCB's claims against them in HCA 806 and HCA 1996. As a result, on June 28, 2011, SCB obtained two identical \$9 Million judgments on the same set of facts.<sup>21</sup>

## **2. KD Chang and Michelle Chen's Marital Community.**

KD Chang moved to Washington State in 1989 where he was employed by Microsoft for several years.<sup>22</sup> Michelle Chen moved to Washington State in 1993. The following year, KD Chang and Michelle Chen were married. KD Chang and Michelle Chen have resided in Washington since moving to the state.<sup>23</sup>

Michelle Chen was unaware that Clark Chang's SCB and BEA accounts were opened under KD Chang's name. She was

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<sup>19</sup> CP 290 and 500-514 (Decl. of KD Chang at ¶¶ 12 and KD Chang Exhibit 5).

<sup>20</sup> CP 211 (Decl. of Clark Chang at ¶ 20) and CP 290 (Decl. of KD Chang at ¶ 13).

<sup>21</sup> CP 211 (Decl. of Clark Chang at ¶ 20) and CP 290 and 516-523 (Decl. of KD Chang at ¶ 15 and KD Chang Exhibits 6 and 7).

<sup>22</sup> CP 290 (Decl. of KD Chang at ¶ 16).

<sup>23</sup> CP 290 (Decl. of KD Chang at ¶ 17) and CP 206-207 (Decl. of Michelle Chen at ¶ 5).

also unaware that KD Chang had signed multi-million dollar lending facilities with both BEA and SCB for the benefit of his father. It was not until after SCB filed its lawsuit against Clark Chang and KD Chang that Michelle Chen finally learned of the lending facilities signed by KD Chang. Michelle Chen was not named as a defendant in any of the Hong Kong lawsuits filed by SCB against Clark Chang and KD Chang.<sup>24</sup>

#### **B. Procedural History**

On June 20, 2012, pursuant to RCW 6.40A, *et seq*, SCB filed a Petition for Recognition of and Enforcement of Foreign-Country Judgment (the “Petition”) in King County Superior Court (Case No. 12-2-21293-7 SEA).<sup>25</sup> The Petition sought recognition of the \$9 Million judgment obtained against KD Chang in Hong Kong HCA 806 (the “Hong Kong Judgment”).<sup>26</sup> KD Chang subsequently filed counterclaims against SCB that arose out of the fraudulent activities of SCB employee Daniel Chan while managing KD Chang’s father’s investment portfolios at SCB and at the Bank of East Asia (“BEA”).<sup>27</sup>

On May 10, 2013, SCB filed a motion for summary judgment

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<sup>24</sup> CP 290 (Decl. of KD Chang at ¶ 18) and CP 207 (Decl. of Michelle Chen at ¶ 6).

<sup>25</sup> CP 1-5.

<sup>26</sup> *Id.*

<sup>27</sup> CP 24-52.

on the issues of recognition and enforcement of the Hong Kong Judgment against KD Chang and whether or not the Hong Kong Judgment was enforceable against KD Chang and Michelle Chen's community property. The Court granted summary judgment on the issue of recognition and enforcement of the Hong Kong Judgment against KD Chang's separate property and left the community property issue for further proceedings.<sup>28</sup>

On July 2, 2015, SCB filed a second motion for summary judgment seeking enforcement of the Hong Kong Judgment against KD Chang and Michelle Chen's marital community property in Washington ("SCB's Second Motion for Summary Judgment").<sup>29</sup> SCB argued that Hong Kong law applies to enforcement of the Hong Kong Judgment and that, because Hong Kong is a non-community property jurisdiction, KD Chang and Michelle Chen's community property in Washington is subject to the Hong Kong Judgment. KD Chang and Michelle Chen argued that Washington law applies and that the Hong Kong Judgment is KD Chang's separate debt, unenforceable against the marital community.<sup>30</sup> The trial court determined Hong Kong law applied and granted SCB's

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<sup>28</sup> KD Chang appealed the trial court's order granting summary judgment

<sup>28</sup> Washington Court of Appeals, Division I. The appellate court denied the motion and KD Chang subsequently filed a petition for review with the Washington State Supreme Court, which was denied. KD Chang then filed a petition for writ of certiorari with the United States Supreme Court, which was also denied.

<sup>29</sup> CP 53-74.

<sup>30</sup> CP 184-205.

Second Motion for Summary Judgment.<sup>31</sup>

KD Chang and Michelle Chen filed a motion to reconsider the trial court's order granting SCB's Second Motion for Summary Judgment, which the trial court subsequently denied.<sup>32</sup>

## V. ARGUMENT SUMMARY

The trial court erred in granting SCB's Second Motion for Summary Judgment because Washington law, not Hong Kong law, governs the enforcement of the Hong Kong Judgment against KD Chang and Michelle Chen's marital community in Washington. The trial court determined that the Facility Letter underlying SCB's breach of contract claim contained a Hong Kong choice-of-law provision applicable to enforcement of the Hong Kong Judgment in Washington and that Hong Kong law was also applicable under a conflicts of law analysis.

The trial court erred in its determination that Hong Kong law applied because: 1) the Facility Letter does not contain an explicit Hong Kong choice-of-law provision; 2) under the merger doctrine, any choice-of-law provision ceased to exist once SCB's breach of contract claim was reduced to the Hong Kong Judgment; 3) Michelle Chen did not sign the Facility Letter, so a choice-of-law provision in the agreement would be unenforceable against

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<sup>31</sup> CP 532-534.

<sup>32</sup> CP 535-538 and 539.

Michelle Chen; 4) under RCW 6.40A.060(2), Washington law governs enforcement of foreign judgments in Washington and no conflicts of law analysis is required; and 5) if conflicts of law analysis is required, Washington state has the most significant relationship under the conflicts of law analyses. For each of these reasons, Washington law applies to the enforcement of the Hong Kong Judgment against KD Chang and Michelle Chen's marital community in Washington.

Furthermore, under Washington law, the Hong Kong Judgment is KD Chang's separate obligation, unenforceable against the marital community because the underlying debt was incurred solely for Clark Chang's benefit and not for community purposes.

## VI. STANDARD OF REVIEW

This matter comes before the Court on review of the trial court's order granting SCB's Second Motion for Summary Judgment on the issue of whether or not KD Chang and Michelle Chen's marital community property may be used to satisfy the Hong Kong Judgment SCB obtained solely against KD Chang.<sup>33</sup>

The appellate court reviews all rulings made in conjunction with a summary judgment motion *de novo*.<sup>34</sup> The appellate court

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<sup>33</sup> CP 532-534.

<sup>34</sup> Folsom v. Burger King, 135 Wn.2d 658, 663, 958 P.2d 301 (1998).

conducts the same inquiry as the trial court.<sup>35</sup> "An appellate court would not be properly accomplishing its charge if the appellate court did not examine all the evidence presented to the trial court[.]"<sup>36</sup> Furthermore, the determinations and decisions made by the trial court are not entitled to any deference.<sup>37</sup>

Summary judgment is only proper when the pleadings, affidavits, depositions, and admissions on file demonstrate there is no genuine issue of material fact and the moving party is entitled to judgment as a matter of law.<sup>38</sup> The party moving for summary judgment has the initial burden of showing the absence of a genuine issue of material fact.<sup>39</sup> On a motion for summary judgment, "the inferences to be drawn from the underlying facts ... must be viewed in the light most favorable to the party opposing the motion."<sup>40</sup>

There are genuine issues of material fact in this case and SCB was not entitled to summary judgment as a matter of law.

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<sup>35</sup> Jones v. Allstate Ins. Co., 146 Wn.2d 291, 300, 45 P.3d 1068 (2002).

<sup>36</sup> Folsom, 135 Wn.2d at 663.

<sup>37</sup> Jones, 146 Wn.2d at 300.

<sup>38</sup> CR 56(c).

<sup>39</sup> Zoslaw v. MCA Distrib. Corp., 693 F.2d 870, 883 (9th Cir. 1982).

<sup>40</sup> Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp., 475 U.S. 574, 587-588 (1986).

## II. ARGUMENT

- A. There is no controlling choice-of-law provision requiring application of Hong Kong law to the enforceability of the Hong Kong Judgment in Washington.
1. The trial court erred in finding that Hong Kong law applies to enforcement of the Hong Kong Judgment in Washington, because the Facility Letter does not contain an explicit Hong Kong choice-of-law provision.

In its Second Motion for Summary Judgment, SCB argued that the agreement underlying its claim against KD Chang in Hong Kong HCA 806 that resulted in the Hong Kong Judgment contains a Hong Kong choice-of-law provision. SCB asserted that, the Facility Letter - the sole basis for SCB's breach of contract claim - contained an explicit Hong Kong choice-of-law provision by incorporating the Terms and Conditions for Bank Accounts and General Services and four other documents executed by KD Chang in connection with the Facility Letter.<sup>41</sup>

First, as discussed below, choice-of-law provisions are inapplicable to the enforcement of final judgments. Rather, courts look to the law of the state where the judgment creditor is seeking to enforce the judgment.

Second, while Appendix I to the Facility Letter references the Terms and Conditions for Bank Accounts and General Services and other documents executed in relation to banking facilities with

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<sup>41</sup> CP 58-59.

SCB, the choice-of-law provisions in those documents are clearly specific to the agreement in which they appear:

- 1) The General Letter of Hypothecation provision states:  
“This Instrument shall be governed by and construed in accordance with the laws of the Hong Kong Special Administrative Region (“Hong Kong”)[.]”<sup>42</sup>
- 2) The Charge Over Securities states: “This deed is governed by and shall be construed in accordance with the laws of Hong Kong”.<sup>43</sup>
- 3) The Securities Finance Agreement states: “This Securities Finance Agreement shall be governed by and interpreted in accordance with the Laws of Hong Kong.”<sup>44</sup>
- 4) The Deed of Charge on Account(s) and Set Off states:  
“The laws of Hong Kong shall be applicable to and governing this Deed[.]”<sup>45</sup>
- 5) The Terms and Conditions for Bank Accounts and General Services states, “The validity, construction, interpretation and enforcement of the Agreement and/or the Relevant Terms and Conditions shall be governed by

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<sup>42</sup> CP 154-155.

<sup>43</sup> CP 157-158.

<sup>44</sup> CP 160-163.

<sup>45</sup> CP 165-168.

the laws of HKSAR[.]<sup>46</sup>

The Facility Letter itself does not contain an explicit Hong Kong choice-of-law provision.<sup>47</sup> Therefore, the trial court erred by applying Hong Kong law to the enforcement of the Hong Kong Judgment against KD Chang and Michelle Chen's marital community.

2. **Under the merger doctrine, any choice-of-law provision in the Facility Letter is no longer applicable because the agreement and its provisions were terminated upon entry of the Hong Kong Judgment.**

The "merger doctrine", or the "rule of merger", is a fundamental aspect of res judicata.<sup>48</sup> Under the "merger doctrine", when a claim is reduced to a final money judgment, the original underlying claim merges into the judgment and the claim is extinguished.<sup>49</sup> The judgment creditor can then no longer maintain an action on the original claim and, instead, has a new cause of action on the judgment.<sup>50</sup> When the original claim was based on a contract, the contract, and provisions therein, merge into the judgment and cease to exist.<sup>51</sup> Thereafter, the parties' relationship

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<sup>46</sup> CP 170-172.

<sup>47</sup> CP 148-152.

<sup>48</sup> Caine & Weiner v. Barker, 42 Wn. App. 835, 837, 713 P.2d 1133 (1986).

<sup>49</sup> Caine & Weiner v. Barker, 42 Wn. App. 835, 837, 713 P.2d 1133 (1986). Woodcraft Constr. v. Hamilton, 56 Wn. App. 885, 888 (1990). See also Restatement (Second) of Judgments, § 18.

<sup>50</sup> Caine & Weiner v. Barker, 42 Wn. App. 835, 837, 713 P.2d 1133 (1986).

<sup>51</sup> Caine & Weiner v. Barker, 42 Wn. App. 835, 837-838, 713 P.2d 1133 (1986) and Woodcraft Constr. v. Hamilton, 56 Wn. App. 885, 888 (1990) (Both held,

is governed by the judgment and not by the contract or its provisions.<sup>52</sup>

A judgment creditor seeking to enforce a foreign-country money judgment in Washington must file a petition under Washington's Uniform Foreign-Country Money Judgments Recognition Act ("UFCMJRA").<sup>53</sup> The cause of action is not based on the original underlying claim, but instead is a new claim based solely on the foreign judgment. Although the contract underlying the original claim may have contained a choice-of-law provision, entry of a final judgment extinguishes that and all other contractual terms and conditions in the contract.<sup>54</sup> As discussed below, Washington's UFCMJRA mandates that courts look to Washington caselaw to determine the extent to which the judgment is enforceable in Washington.

In this case, SCB obtained a judgment in Hong Kong solely against KD Chang - not against Michelle Chen and not against their marital community - for breach of the Facility Letter. Once SCB's breach of contract claim was reduced to the final Hong Kong

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once judgment was obtained on breach of contract claim, underlying promissory note merged into the judgment and the note and provisions therein ceased to exist); See also Amaprop Ltd. v. Indiabulls Fin. Servs., 2012 U.S. Dist. LEXIS 146166, 27 (S.D.N.Y. 2012) (citing FCS Advisors, Inc. v. Fair Fin. Co., 605 F.3d 144, 148 (2d Cir. 2010)).

<sup>52</sup> Huntington Nat. Bank v. Sproul, 116 N.M. 254, 257-258, 861 P.2d 935 (1993) (discussing choice-of-law and enforcement of foreign judgments).

<sup>53</sup> RCW 6.40A.050.

<sup>54</sup> Huntington Nat. Bank v. Sproul, 116 N.M. 254, 257-258, 861 P.2d 935 (1993).

Judgment, the underlying contract merged into the Hong Kong Judgment and any contractual terms or obligations, including any choice-of-law provision, were terminated. As such, under Washington's UFCMJRA, Washington law determines the enforceability of the Hong Kong Judgment against KD Chang and Michelle Chen's marital community.

**3. If the choice-of-law provision in the Facility Letter survived entry of the Hong Kong Judgment, Michelle Chen is not bound by it because she did not sign the contract or benefit from the contract.**

Ordinarily, arbitration clauses, forum selection clauses, choice-of-law clauses, and other similar provisions cannot be invoked against non-parties to a contract in which the provision appears.<sup>55</sup> Moreover, a non-signing spouse will not be bound by a choice-of-law provision in an agreement signed solely by the other spouse, especially in instances in which the spouse did not agree to the contract.<sup>56</sup> Unless the non-signing party has attempted to

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<sup>55</sup> State ex rel. Electric Prods. Consol. v. Superior Court, 11 Wn.2d 678, 679, 120 P.2d 484 (1941); State ex rel. Lund v. Superior Court, 173 Wash. 556, 558, 24 P.2d 79 (1933). *See also* Paracor Fin., Inc. v. Gen. Elec. Capital Corp., 96 F.3d 1151, 1165 (9th Cir. 1996); Townsend v. Quadrant Corp., 173 Wn.2d 451, 460-461 (2012); Howsam v. Dean Witter Reynolds, Inc., 537 U.S. 79, 83, 123 S. Ct. 588, 154 L. Ed. 2d 491 (2002) (“[A]rbitration is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit.”); Britton v. Co-op Banking Group, 4 F.3d 742, 744 (9th Cir. 1993); Manetti-Farrow, Inc. v. Gucci Am., Inc., 858 F.2d 509, 514 n.5 (9th Cir. 1988); and Coppock v. Citigroup, Inc., 2013 U.S. Dist. LEXIS 40632, 19 (W.D. Wash. 2013).

<sup>56</sup> Oltman v. Holland Am. Line USA, Inc., 163 Wn.2d 236, 250 (2008), *cert. denied*, 554 U.S. 941, 129 S.Ct. 24, 171 L.Ed.2d 927 (2008).

benefit from the contract, then these types of provisions will not be enforceable against the non-signing party.<sup>57</sup>

Even if the Facility Letter contains an operable choice-of-law provision, it is not enforceable against Michelle Chen or the marital community. Michelle Chen did not sign the Facility Letter. She did not sign any of the four other documents related to the Facility Letter. Michelle Chen was completely unaware that KD Chang signed the Facility Letter or that he had signed a similar agreement for his father's benefit while Clark Chang's accounts were at BEA. It was not until sometime after SCB filed its lawsuit against Clark Chang and KD Chang that Michelle Chen eventually learned about the BEA and SCB credit facilities.

In addition, Michelle Chen did not benefit or seek to benefit from the Facility Letter. KD Chang signed the Facility Letter and related documents solely for the benefit of his father, Clark Chang. Neither the funds from the SCB credit facility nor the funds from the BEA credit facility were ever used by KD Chang for his benefit or the benefit of his marital community. As acknowledged by SCB in its original demand letter to Clark Chang and the complaint SCB filed against KD Chang and Clark Chang in Hong Kong HCA 806, Clark Chang was the sole beneficiary and decision-maker on the

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<sup>57</sup> Comer v. Micor, Inc., 436 F.3d 1098, 1102 (9<sup>th</sup> Cir. 2006).

SCB accounts. Daniel Chan only contacted KD Chang when his signature was required.

Since Michelle Chen did not sign the Facility Letter, was unaware that KD Chang had signed the Facility Letter, and did not benefit or seek to benefit from the Facility Letter in any way, the alleged Hong Kong choice-of-law provision cannot be enforced against her. By applying Hong Kong law to enforcement of the Hong Kong Judgment, the trial court erroneously held Michelle Chen to a choice-to-provision on which she cannot be bound.

**B. Because RCW 6.40A.060(2) mandates that enforceability is determined by Washington law, no conflicts of law analysis is required.**

"Matters relating to the enforcement of judgments are governed by the law of the forum".<sup>58</sup> In order to enforce a foreign judgment in Washington, a judgment creditor must initiate a new claim seeking recognition of the judgment under the Uniform Foreign-Country Money Judgments Recognition Act.<sup>59</sup> Recognition of the foreign judgment creates a Washington judgment<sup>60</sup> and enforceability of that judgment is determined in accordance with RCW 6.40A.060(2), which states that a foreign-country money

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<sup>58</sup> Huntington Nat. Bank v. Sproul, 116 N.M. 254, 258, 861 P.2d 935 (1993) (citing 46 Am.Jur.2d *Judgments* § 897 (1969)).

<sup>59</sup> RCW 6.40A.

<sup>60</sup> See Huntington Nat. Bank v. Sproul, 116 N.M. 254, 257-258, 861 P.2d 935 (1993).

judgment is “[e]nforceable in the same manner and to the same extent as a judgment rendered in this state”.

SCB argued in its Second Motion for Summary Judgment that, absent a controlling Hong Kong choice of law provision, then the conflicts of law "most significant relationship" test determines whether Hong Kong law or Washington law applies to enforcement of the Hong Kong Judgment.<sup>61</sup> In support of its position, SCB cited two different Washington cases Pacific States<sup>62</sup> and Pacific Gamble<sup>63</sup>. A third Washington case, Potlatch No. 1 Fed. Credit Union v. Kennedy, is factually similar to Pacific States and Pacific Gamble and it is cited throughout Pacific Gamble.<sup>64</sup> In all three cases, the courts applied the "most significant relationship" test to determine whether or not a spouse's separate obligation was enforceable against the marital community.

There is a key fundamental and factual difference, though, between Potlatch, Pacific States, and Pacific Gamble and the case at hand. As in this case, in each case, a spouse incurred a separate debt in a jurisdiction other than Washington. However, unlike this

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<sup>61</sup> CP 61-62.

<sup>62</sup> Pacific States Cut Stone Co. v. Goble, 70 Wn.2d 907, 425 P.2d 631 (1967).

<sup>63</sup> Pac. Gamble Robinson Co. v. Lapp, 95 Wn.2d 341, 622 P.2d 850 (1980).

<sup>64</sup> Potlatch No. 1 Fed. Credit Union v. Kennedy, 76 Wn.2d 806, 459 P.2d 32 (1969). See Pac. Gamble Robinson Co. v. Lapp, 95 Wn.2d 341, 350-356, 622 P.2d 850 (1980).

case, none of the cases were actions seeking enforcement of a foreign judgment. In Potlatch, Pacific States, and Pacific Gamble, the original underlying claim was brought in Washington and the marital community was sued in the original action.<sup>65</sup> Thus, the "most significant relationship" test was used to determine against whom the court could enter a judgment on the original underlying claim.

Here, though, the Court does not need to apply the "most significant relationship" test. Under RCW 6.40A.060(2), the origin of the foreign-country money judgment is irrelevant to a Washington court's analysis of the manner and extent a recognized judgment may be enforced. The Court's inquiry in this matter is simply, "If SCB had sued KD Chang individually in Washington and obtained a judgment solely against him, to what extent could KD Chang and Michelle Chen's community property be used to satisfy that judgment?" The answer is that the debt is presumed to be a community obligation, but, as explained below, that presumption is rebutted by the evidence. The debt is KD Chang's separate obligation and unenforceable against KD Chang and Michelle Chen's marital community.

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<sup>65</sup> Potlatch, 76 Wn.2d 806; Pac. Gamble, 95 Wn.2d 341; and Pacific States Cut Stone Co. v. Goble, 70 Wn.2d 907, 425 P.2d 631 (1967).

**C. If conflicts of law principles apply, Washington has the most significant relationship to the issue of whether the Hong Kong Judgment is enforceable against KD Chang and Michelle Chen's marital community.**

"When parties dispute choice-of-law, there must be an actual conflict between the laws or interests of Washington and the laws or interests of another state before Washington courts will engage in a conflict of laws analysis."<sup>66</sup> If there is a real conflict, then the applicable law is decided by determining which jurisdiction has the "most significant relationship" to that particular issue.<sup>67</sup> When applying the "most significant relationship" test, courts only look at the issue on which the two jurisdictions differ. The "most significant relationship" test is then applied in light of that particular issue.<sup>68</sup>

If the Court determines that there is no controlling Hong Kong choice-of-law provision, then it need not engage in a conflicts of law analysis because Washington law applies under RCW 6.40A.060(2). If the Court decides a conflicts of law analysis is necessary, then it only looks at the issue of whether or not a foreign judgment against one spouse may be enforced against the non-separate property of the other spouse. In this case, under Washington law, the Hong Kong Judgment is enforceable against

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<sup>66</sup> Seizer v. Sessions, 132 Wn.2d 642, 648, 940 P.2d 261 (1997).

<sup>67</sup> Seizer, 132 Wn.2d at 648-650 (citing Pacific Gamble Robinson Co., 95 Wn.2d at 344-45).

<sup>68</sup> Potlatch, 76 Wn.2d at 813; Pac. Gamble, 95 Wn.2d at 352-353.

KD Chang's separate property, may be enforceable against KD Chang and Michelle Chen's marital community property, and is not enforceable against Michelle Chen's separate property. Under Hong Kong law, the Hong Kong Judgment is enforceable against KD Chang's separate property and property acquired by KD Chang and Michelle Chen during their marriage that is not Michelle Chen's separate property.

To resolve the conflicts of law, the Court evaluates the forgoing issue in light of the following conflicts of law factors: 1) the needs of the interstate and international systems, 2) the relevant policies of the forum, 3) the relevant policies of other interested states and the relative interests of those states in the determination of the particular issue, 4) the protection of justified expectations, 5) the basic policies underlying the particular field of law, 6) certainty, predictability and uniformity of result, and 7) ease in the determination and application of the law to be applied.<sup>69</sup>

The most important factors in this case are the protection of justified expectations and the relevant policies of the forum. Washington public policy shields community property from recovery of a judgment arising from debt obligations entered into by one spouse.<sup>70</sup> "[W]hen management of community property is at

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<sup>69</sup> Restatement 2d of Conflict of Laws, § 6.

<sup>70</sup> Haley v. Highland, 142 Wn.2d 135 (2000) (separate debt obligations are enforceable only against the separate property of the debtor spouse).

issue, the state with the most significant interests is typically the state where the spouses reside".<sup>71</sup>

Relying upon this public policy, Michelle Chen, who has been married to KD Chang since 1994 and a Washington resident since 1993, and other Washington residents expect that their community property will not be subject to the separate obligations of their spouses that in no way benefitted the marital community. Together, these two factors alone outweigh SCB's expectation that it will be able to collect on any judgment it obtains.

In addition, applying Washington law does not stifle SCB's expectation. In Washington, a separate debt is presumed to be a community obligation, though the presumption may be overcome.<sup>72</sup> By applying Washington law, the Court is able to serve SCB's interests and protect Michelle Chen's interests at the same time.

Applying Washington law also promotes certainty, predictability, and uniformity of result. Any foreign creditor, whether from another state or another country, can be certain that if they obtain a judgment against only one spouse and later seek recognition and enforcement of that judgment in Washington, that

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<sup>71</sup> G.W. Equip. Leasing, Inc. v. Mount McKinley Fence Co., Inc., 97 Wn. App. 191, 196-97, 982 P.2d 114 (1999).

<sup>72</sup> Merritt v. Newkirk, 155 Wash. 517 (1930) (the presumption that a judgment is presumably a community obligation is rebuttable when the basis of the original judgment arises from a clearly separate obligation).

debt will be presumed to be a community obligation unless the other spouse overcomes the presumption.

1. **Even if the Court looks to the underlying Hong Kong transaction, Washington has the most significant relationship to the enforceability issue.**

In its Second Motion for Summary Judgment, SCB argued that the relevant conflicts of law analysis involves looking at the transaction underlying the Hong Kong Judgment to determine whether Washington or Hong Kong has the "most significant relationship" to the enforcement issue. However, as noted above, the underlying contract and transaction have merged into the judgment and the contract is no longer relevant to an inquiry by this Court. Moreover, by applying the contracts conflicts of law factors, the Court necessarily ignores the interests of Michelle Chen, who was not a party to the contract and against whom a choice-of-law provision would be unenforceable. However, should the Court apply the underlying transaction conflicts of law analysis, Washington is still the jurisdiction with the "most significant relationship".

As stated above, when applying the "most significant relationship" test, courts only look at the issue on which the two states differ. The "most significant relationship" test is then applied

in light of that particular issue.<sup>73</sup> In this case, the sole issue of conflict is whether or not non-separate property of one spouse can be used to satisfy a debt incurred by the other spouse that did not benefit the marital community in any way.

To evaluate the “most significant relationship” based on the underlying transaction, courts take into consideration five types of contacts and evaluate them based on their relative importance to the issue creating the conflict: (a) the place of contracting; (b) the place of negotiation of the contract; (c) the place of performance; (d) the location of the subject matter of the contract, and (e) the domicile, residence, nationality, place of incorporation and place of business of the parties.<sup>74</sup>

However, the Washington Supreme Court has stated, “Certainly an identification of contacts is meaningless without consideration of the interests and public policies of potentially concerned states and a regard as to the manner and extent of such policies as they relate to the transaction in issue”.<sup>75</sup> These are the principles set forth in Section 6 of the Second Restatement of Conflict of Laws and discussed above.

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<sup>73</sup> Potlatch, 76 Wn.2d at 813; Pac. Gamble, 95 Wn.2d at 352-353.

<sup>74</sup> Potlatch, 76 Wn.2d at 809; Restatement (Second) of Conflict of Laws, § 188.

<sup>75</sup> Potlatch, 76 Wn.2d at 810.

In the Potlatch case referenced above, the Washington Supreme Court applied Washington law to determine whether or not community property could be used to satisfy a separate debt incurred by the husband in Idaho.<sup>76</sup> As in this case, the sole issue of conflict in Potlatch was whether or not community property can be used to satisfy a debt arising out of a debt that did not benefit the community in any way.<sup>77</sup>

In Potlatch the husband had personally guaranteed a loan to his brother.<sup>78</sup> The credit union filed suit against the husband and his wife and their marital community.<sup>79</sup> A conflict of law arose because Washington's community property laws differed from the community property laws in Idaho.<sup>80</sup> In resolving the conflict of law, the court in Potlatch applied the "most significant relationship" test.<sup>81</sup> The court determined that protecting the wife's interest in her community property, as well as the restrictions upon her husband encumbering the community property without benefiting the community, outweighed the interests of the Idaho creditor.<sup>82</sup>

Applying the "most significant relationship" test, it is clear that the most important factors are Michelle Chen's and KD

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<sup>76</sup> Potlatch, 76 Wn.2d 806.

<sup>77</sup> Id.

<sup>78</sup> Id. at 807.

<sup>79</sup> Id.

<sup>80</sup> Id. at 808-814.

<sup>81</sup> Id.

<sup>82</sup> Id. at 813-814.

Chang's Washington residency and Washington's public policy in favor of protecting community property interests.<sup>83</sup> In this case, KD Chang agreed to allow his father to open accounts and take out loans in KD Chang's name. It is clear from the evidence that SCB knew this and that KD Chang had no authority with respect to any of his father's accounts. KD Chang received absolutely no benefit from the loan funds, nor did Michelle Chen, or their marital community. Michelle Chen was completely unaware that KD Chang had signed the credit facilities and she has absolutely no connection with the underlying transaction or Hong Kong with respect to the community property issue. Yet, it is Michelle Chen's interest in her community property that is at stake.

It is Washington public policy to protect community property from separate debts that do not benefit the community.<sup>84</sup> Therefore, the Court must protect Michelle Chen's interest and apply Washington law to the community property enforcement issue.

**D. Under Washington law, the Hong Kong Judgment is KD Chang's separate obligation and cannot be enforced against Appellants' community property.**

While a debt incurred by one spouse is presumptively a

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<sup>83</sup> KD Chang has resided in Washington since 1989 and Michelle Chen has resided in Washington since 1993. They have been married since 1994.

<sup>84</sup> Potlatch No. 1 Fed. Credit Union v. Kennedy, 76 Wn.2d 806, 808, 459 P.2d 32 (1969).

community obligation under Washington law, the presumption may be overcome by the party objecting to enforcement.<sup>85</sup> When one spouse has borrowed money and executed a promissory note, courts still look to the purpose for which the spouse incurred the debt.<sup>86</sup> If the money was borrowed for a community purpose, then the debt is community obligation.<sup>87</sup> If the money was not borrowed for a community purpose, but instead a separate interest, then the debt is separate obligation of the spouse who executed the document.<sup>88</sup> A debt obligation used for the benefit of separate property is considered a separate debt obligation, enforceable only against the separate property of the debtor.<sup>89</sup>

Under Washington law, inherited or gifted funds are presumed to be the separate property of the heir.<sup>90</sup> The party arguing that the inherited funds are community property has the burden of proving that the funds are in fact community property.<sup>91</sup> Separate property is presumed to remain separate and a claimant

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<sup>85</sup> Merritt v. Newkirk, 155 Wash. 517 (1930) (the presumption that a judgment is presumably a community obligation is rebuttable when the basis of the original judgment arises from a clearly separate obligation).

<sup>86</sup> National Bank of Commerce v. Green, 1 Wn. App. 713, 717, 463 P.2d 187 (1969).

<sup>87</sup> Id.

<sup>88</sup> Id.

<sup>89</sup> Fies v. Storey, 37 Wn.2d 105, 110 (1950) (the acid test to determine the character of a debt obligation requires courts to determine if the encumbrance was incurred to benefit the community or a separate interest); Pac. Gamble Robinson Co. at 351.

<sup>90</sup> RCW 26.16.010.

<sup>91</sup> Id.

must produce overwhelming evidence to re-characterize separate property as community property.<sup>92</sup>

In this case, KD Chang did not sign the Facility Letter and incur that debt for a community purpose and he and Michelle Chen in no way benefitted from the debt. Moreover, Michelle Chen was completely unaware that KD Chang had signed the Facility Letter for Clark Chang's benefit. Rather, the facts overwhelmingly demonstrate that KD Chang signed the Facility Letter solely for a separate interest - providing a benefit to his father in case Clark Chang were to pass away.

Clark Chang maintained his accounts at BEA and SCB in KD Chang's name because he trusted that KD Chang would distribute the contents of the accounts fairly to his siblings and himself should he pass away. Although the SCB and BEA accounts were in KD Chang's name, all of the funds in the accounts were the funds of Clark Chang and Clark Chang was the principal and decision-maker on all accounts that were opened in KD Chang's name, a fact SCB admitted it knew in a November 5, 2008 letter to Clark Chang and in its original claim filed in Hong Kong HCA 806. Clark Chang had not yet gifted any funds in the SCB and BEA

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<sup>92</sup> *In re Marriage of Zier*, 136 Wn. App. 40, 45 (2006) (the burden of proof of re-characterization lies with the party asserting that separate property has transmuted into community property).

accounts to KD Chang or any other family members. At most, KD Chang had an unvested beneficial interest in Clark Chang's estate.

When KD Chang entered into the BEA and SCB lending facilities, the investment portfolio was used as collateral. Unbeknownst to KD Chang and Clark Chang, the funds from the SCB lending facility were used to pay off the BEA lending facility. Even if the funds in the portfolio were considered KD Chang's - whether through gift or unvested inheritance, under Washington law, the funds are presumed to be KD Chang's separate property. Under this scenario, since the SCB lending facility was used to repay the BEA lending facility, that obligation to SCB could only be considered a debt obligation for the benefit of KD Chang's separate property interest in the investment portfolio, unenforceable against community property.

Regardless, there are genuine issues of material fact as to whether or not the Hong Kong Judgment is a community obligation and SCB was not entitled to summary judgment as a matter of law.

#### **VIII. CONCLUSION**

The trial court erred in granting SCB's Second Motion for Summary Judgment because Washington law, not Hong Kong law, governs the enforceability of the Hong Kong Judgment against KD Chang and Michelle Chen's marital community. There are genuine

issues of material fact regarding whether or not the Hong Kong Judgment is KD Chang's separate debt or a community obligation of KD Chang and Michelle Chen and SCB was not entitled to judgment as a matter of law. Therefore, the trial court's orders granting SCB's Second Motion for Summary Judgment and denying Appellant Motion for Reconsideration should be reversed and the case should be remanded for further proceedings.

DATED this 1<sup>st</sup> day of February, 2015.

**TOLLEFSEN LAW PLLC**



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Chris Rosfjord, WSBA #37668  
John J. Tollefsen, WSBA #13214

APPENDIX

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STATE OF WASHINGTON

IN THE COURT OF APPEALS OF THE STATE OF WASHINGTON  
DIVISION 1

SHANGHAI COMMERCIAL BANK  
LIMITED,

Div. I Case No. 73956-5-1

Respondents,

King County Superior Court  
Case No. 12-2-21293-7 SEA

vs.

KUNG DA CHANG and "JANE DOE"  
CHANG, husband and wife, and the marital  
community comprised thereof, ,

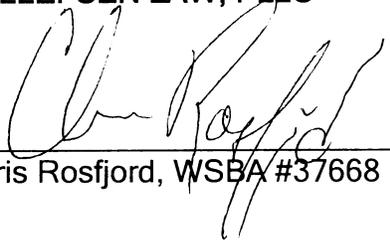
PROOF OF SERVICE OF  
OPENING BRIEF OF APPELLANTS  
KUNG DA CHANG AND MICHELLE CHEN

Appellants.

I hereby certify that on January 16, 2014, the Opening Brief of Appellants  
Kung Da Chang and Michelle Chen was served on the following via hand delivery:

**Counsel for Respondents:**  
Stellman Keehnel / Stephen Hsieh /  
Katherine Heaton / Patsy Howson  
DLA Piper LLC (US)  
701 Fifth Ave., Ste 7000  
Seattle WA 98104-7044

Dated this 1<sup>st</sup> day of February, 2015, I certify under penalty of perjury under the  
laws of the State of Washington that the foregoing is true and correct. Signed in  
Lynnwood, Washington.

TOLLEFSEN LAW, PLLC  
  
Chris Rosfjord, WSBA #37668



# APPENDIX 1

**RCW 6.40A.050**

**Recognition—How raised.**

(1) If recognition of a foreign-country judgment is sought as an original matter, the issue of recognition shall be raised by filing an action seeking recognition of the foreign-country judgment.

(2) If recognition of a foreign-country judgment is sought in a pending action, the issue of recognition may be raised by counterclaim, cross-claim, or affirmative defense.

[2009 c 363 § 6.]

## APPENDIX 2

**RCW 6.40A.060**

**Judgments entitled to recognition—Enforceability.**

If the court in a proceeding under RCW 6.40A.050 finds that the foreign-country judgment is entitled to recognition under this chapter then, to the extent that the foreign-country judgment grants or denies recovery of a sum of money, the foreign-country judgment is:

- (1) Conclusive between the parties to the same extent as the judgment of a sister state entitled to full faith and credit in this state would be conclusive; and
- (2) Enforceable in the same manner and to the same extent as a judgment rendered in this state.

[2009 c 363 § 7.]

# APPENDIX 3

**RCW 26.16.010****Separate property of spouse.**

Property and pecuniary rights owned by a spouse before marriage and that acquired by him or her afterwards by gift, bequest, devise, descent, or inheritance, with the rents, issues and profits thereof, shall not be subject to the debts or contracts of his or her spouse, and he or she may manage, lease, sell, convey, encumber or devise by will such property without his or her spouse joining in such management, alienation or encumbrance, as fully, and to the same extent or in the same manner as though he or she were unmarried.

[2008 c 6 § 602; Code 1881 § 2408; RRS § 6890. Prior: See Reviser's note below.]

**NOTES:**

**Reviser's note:** For prior laws dealing with this subject see Laws 1879 pp 77-81; 1873 pp 450-455; 1871 pp 67-74; 1869 pp 318-323.

**Part headings not law—Severability—2008 c 6:** See RCW 26.60.900 and 26.60.901.

**Construction:** "The rule of common law that statutes in derogation thereof are to be strictly construed has no application to this chapter. This chapter establishes the law of the state respecting the subject to which it relates, and its provisions and all proceedings under it shall be liberally construed with a view to effect its object." [Code 1881 § 2417.]

"This chapter shall not be construed to operate retrospectively and any right established, accrued or accruing or in any thing done prior to the time this chapter goes into effect shall be governed by the law in force at the time such right was established or accrued." [Code 1881 § 2418.] This applies to RCW 26.16.010 through 26.16.040, 26.16.060, 26.16.120, 26.16.140 through 26.16.160, and 26.16.180 through 26.16.210.

*Descent of separate real property: RCW 11.04.015.*

*Distribution of separate personal estate: RCW 11.04.015.*

*Rights of married persons or domestic partners in general: RCW 26.16.150.*

# APPENDIX 4

## Restat 2d of Conflict of Laws, § 6

Restatement 2d, Conflict of Laws - Rule Sections > Chapter 1- Introduction

### § 6 Choice-Of-Law Principles

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(1) A court, subject to constitutional restrictions, will follow a statutory directive of its own state on choice of law.

(2) When there is no such directive, the factors relevant to the choice of the applicable rule of law include

- (a) the needs of the interstate and international systems,
- (b) the relevant policies of the forum,
- (c) the relevant policies of other interested states and the relative interests of those states in the determination of the particular issue,
- (d) the protection of justified expectations,
- (e) the basic policies underlying the particular field of law,
- (f) certainty, predictability and uniformity of result, and
- (g) ease in the determination and application of the law to be applied.

#### COMMENTS & ILLUSTRATIONS

##### Comment on Subsection (1):

*a. Statutes directed to choice of law.* A court, subject to constitutional limitations, must follow the directions of its legislature. The court must apply a local statutory provision directed to choice of law provided that it would be constitutional to do so. An example of a statute directed to choice of law is the Uniform Commercial Code which provides in certain instances for the application of the law chosen by the parties (§ 1-105(1)) and in other instances for the application of the law of a particular state (§§ 2-402, 4-102, 6-102, 8-106, 9-103). Another example is the Model Execution of Wills Act which provides that a written will subscribed by the testator shall be valid as to matters of form if it complies with the local requirements of any one of a number of enumerated states. Statutes that are expressly directed to choice of law, that is to say, statutes which provide for the application of the local law of one state, rather than the local law of another state, are comparatively few in number.

*b. Intended range of application of statute.* A court will rarely find that a question of choice of law is explicitly covered by statute. That is to say, a court will rarely be directed by statute to apply the local law of one state, rather than the local law of another state, in the decision of a particular issue. On the other hand, the court will constantly be faced with the question whether the issue before it falls within the intended range of application of a particular statute. The court should give a local statute the range of application intended by the legislature when these intentions can be ascertained and can constitutionally be given effect. If the legislature intended that the statute should be applied to the out-of-state facts involved, the court should so apply it unless constitutional considerations forbid. On the other hand, if the legislature intended that the statute should be applied only to acts taking place within the state, the statute should not be given a wider range of application. Sometimes a statute's intended range of application will be apparent on its face, as when it expressly applies to all citizens of a state including those who are living abroad. When the statute is silent as to its range of application, the intentions of the legislature on the subject can sometimes be ascertained by a process of interpretation and construction. Provided that it is constitutional to do so, the court will apply a local statute in the manner intended by the legislature even when the local law of another state would be applicable under usual choice-of-law principles.

##### Comment on Subsection (2):

*c. Rationale.* Legislatures usually legislate, and courts usually adjudicate, only with the local situation in mind. They rarely give thought to the extent to which the laws they enact, and the common law rules they enunciate, should apply to

## Restat 2d of Conflict of Laws, § 6

out-of-state facts. When there are no adequate directives in the statute or in the case law, the court will take account of the factors listed in this Subsection in determining the state whose local law will be applied to determine the issue at hand. It is not suggested that this list of factors is exclusive. Undoubtedly, a court will on occasion give consideration to other factors in deciding a question of choice of law. Also it is not suggested that the factors mentioned are listed in the order of their relative importance. Varying weight will be given to a particular factor, or to a group of factors, in different areas of choice of law. So, for example, the policy in favor of effectuating the relevant policies of the state of dominant interest is given predominant weight in the rule that transfers of interests in land are governed by the law that would be applied by the courts of the situs (see §§ 223-243). On the other hand, the policies in favor of protecting the justified expectations of the parties and of effectuating the basic policy underlying the particular field of law come to the fore in the rule that, subject to certain limitations, the parties can choose the law to govern their contract (see § 187) and in the rules which provide, subject to certain limitations, for the application of a law which will uphold the validity of a trust of movables (see §§ 269-270) or the validity of a contract against the charge of commercial usury (see § 203). Similarly, the policy favoring uniformity of result comes to the fore in the rule that succession to interests in movables is governed by the law that would be applied by the courts of the state where the decedent was domiciled at the time of his death (see §§ 260 and 263).

At least some of the factors mentioned in this Subsection will point in different directions in all but the simplest case. Hence any rule of choice of law, like any other common law rule, represents an accommodation of conflicting values. Those chapters in the Restatement of this Subject which are concerned with choice of law state the rules which the courts have evolved in accommodation of the factors listed in this Subsection. In certain areas, as in parts of Property (Chapter 9), such rules are sufficiently precise to permit them to be applied in the decision of a case without explicit reference to the factors which underlie them. In other areas, such as in Wrongs (Chapter 7) and Contracts (Chapter 8), the difficulties and complexities involved have as yet prevented the courts from formulating a precise rule, or series of rules, which provide a satisfactory accommodation of the underlying factors in all of the situations which may arise. All that can presently be done in these areas is to state a general principle, such as application of the local law "of the state of most significant relationship", which provides some clue to the correct approach but does not furnish precise answers. In these areas, the courts must look in each case to the underlying factors themselves in order to arrive at a decision which will best accommodate them.

Statement of precise rules in many areas of choice of law is made even more difficult by the great variety of situations and of issues, by the fact that many of these situations and issues have not been thoroughly explored by the courts, by the generality of statement frequently used by the courts in their opinions, and by the new grounds of decision stated in many of the more recent opinions.

The Comments which follow provide brief discussion of the factors underlying choice of law which are mentioned in this Subsection.

*d. Needs of the interstate and international systems.* Probably the most important function of choice-of-law rules is to make the interstate and international systems work well. Choice-of-law rules, among other things, should seek to further harmonious relations between states and to facilitate commercial intercourse between them. In formulating rules of choice of law, a state should have regard for the needs and policies of other states and of the community of states. Rules of choice of law formulated with regard for such needs and policies are likely to commend themselves to other states and to be adopted by these states. Adoption of the same choice-of-law rules by many states will further the needs of the interstate and international systems and likewise the values of certainty, predictability and uniformity of result.

*e. Relevant policies of the state of the forum.* Two situations should be distinguished. One is where the state of the forum has no interest in the case apart from the fact that it is the place of the trial of the action. Here the only relevant policies of the state of the forum will be embodied in its rules relating to trial administration (see Chapter 6). The second situation is where the state of the forum has an interest in the case apart from the fact that it is the place of trial. In this latter situation, relevant policies of the state of the forum may be embodied in rules that do not relate to trial administration.

The problem dealt with in this Comment arises in the common situation where a statute or common law rule of the forum was formulated solely with the intrastate situation in mind or, at least, where there is no evidence to suggest that the statute

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or rule was intended to have extraterritorial application. If the legislature or court (in the case of a common law rule) did have intentions with respect to the range of application of a statute or common law rule and these intentions can be ascertained, the rule of Subsection (1) is applicable. If not, the court will interpret the statute or rule in the light of the factors stated in Subsection (2).

Every rule of law, whether embodied in a statute or in a common law rule, was designed to achieve one or more purposes. A court should have regard for these purposes in determining whether to apply its own rule or the rule of another state in the decision of a particular issue. If the purposes sought to be achieved by a local statute or common law rule would be furthered by its application to out-of-state facts, this is a weighty reason why such application should be made. On the other hand, the court is under no compulsion to apply the statute or rule to such out-of-state facts since the originating legislature or court had no ascertainable intentions on the subject. The court must decide for itself whether the purposes sought to be achieved by a local statute or rule should be furthered at the expense of the other choice-of-law factors mentioned in this Subsection.

*f. Relevant policies of other interested states.* In determining a question of choice of law, the forum should give consideration not only to its own relevant policies (see Comment *e*) but also to the relevant policies of all other interested states. The forum should seek to reach a result that will achieve the best possible accommodation of these policies. The forum should also appraise the relative interests of the states involved in the determination of the particular issue. In general, it is fitting that the state whose interests are most deeply affected should have its local law applied. Which is the state of dominant interest may depend upon the issue involved. So if a husband injures his wife in a state other than that of their domicile, it may be that the state of conduct and injury has the dominant interest in determining whether the husband's conduct was tortious or whether the wife was guilty of contributory negligence (see § 146). On the other hand, the state of the spouses' domicile is the state of dominant interest when it comes to the question whether the husband should be held immune from tort liability to his wife (see § 169).

The content of the relevant local law rule of a state may be significant in determining whether this state is the state with the dominant interest. So, for example, application of a state's statute or common law rule which would absolve the defendant from liability could hardly be justified on the basis of this state's interest in the welfare of the injured plaintiff.

*g. Protection of justified expectations.* This is an important value in all fields of the law, including choice of law. Generally speaking, it would be unfair and improper to hold a person liable under the local law of one state when he had justifiably molded his conduct to conform to the requirements of another state. Also, it is in part because of this factor that the parties are free within broad limits to choose the law to govern the validity of their contract (see § 187) and that the courts seek to apply a law that will sustain the validity of a trust of movables (see §§ 269-270).

There are occasions, particularly in the area of negligence, when the parties act without giving thought to the legal consequences of their conduct or to the law that may be applied. In such situations, the parties have no justified expectations to protect, and this factor can play no part in the decision of a choice-of-law question.

*h. Basic policies underlying particular field of law.* This factor is of particular importance in situations where the policies of the interested states are largely the same but where there are nevertheless minor differences between their relevant local law rules. In such instances, there is good reason for the court to apply the local law of that state which will best achieve the basic policy, or policies, underlying the particular field of law involved. This factor explains in large part why the courts seek to apply a law that will sustain the validity of a contract against the charge of commercial usury (§ 203) or the validity of a trust of movables against the charge that it violates the Rule Against Perpetuities (§§ 269-270).

*i. Predictability and uniformity of result.* These are important values in all areas of the law. To the extent that they are attained in choice of law, forum shopping will be discouraged. These values can, however, be purchased at too great a price. In a rapidly developing area, such as choice of law, it is often more important that good rules be developed than that predictability and uniformity of result should be assured through continued adherence to existing rules. Predictability and uniformity of result are of particular importance in areas where the parties are likely to give advance thought to the legal consequences of their transactions. It is partly on account of these factors that the parties are permitted within broad limits to choose the law that will determine the validity and effect of their contract (see § 187) and that the law that would be

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applied by the courts of the state of the situs is applied to determine the validity of transfers of interests in land (see § 223). Uniformity of result is also important when the transfer of an aggregate of movables, situated in two or more states, is involved. Partly for this reason, the law that would be applied by the courts of the state of a decedent's domicile at death is applied to determine the validity of his will in so far as it concerns movables (see § 263) and the distribution of his movables in the event of intestacy (see § 260).

*j. Ease in the determination and application of the law to be applied.* Ideally, choice-of-law rules should be simple and easy to apply. This policy should not be overemphasized, since it is obviously of greater importance that choice-of-law rules lead to desirable results. The policy does, however, provide a goal for which to strive.

*k. Reciprocity.* In formulating common law rules of choice of law, the courts are rarely guided by considerations of reciprocity. Private parties, it is felt, should not be made to suffer for the fact that the courts of the state from which they come give insufficient consideration to the interests of the state of the forum. It is also felt that satisfactory development of choice-of-law rules can best be attained if each court gives fair consideration to the interests of other states without regard to the question whether the courts of one or more of these other states would do the same. As to whether reciprocity is a condition to the recognition and enforcement of a judgment of a foreign nation, see § 98, Comment *e*.

States sometimes incorporate a principle of reciprocity into statutes and treaties. They may do so in order to induce other states to take certain action favorable to their interests or to the interests of their citizens. So, as stated in § 89, Comment *b*, many States of the United States have enacted statutes which provide that a suit by a sister State for the recovery of taxes will be entertained in the local courts if the courts of the sister State would entertain a similar suit by the State of the forum. Similarly, by way of further example, some States of the United States provide by statute that an alien cannot inherit local assets unless their citizens in turn would be permitted to inherit in the state of the alien's nationality. A principle of reciprocity is also sometimes employed in statutes to permit reciprocating states to obtain by cooperative efforts what a single state could not obtain through the force of its own law. See, e. g., Uniform Reciprocal Enforcement of Support Act; Uniform (Reciprocal) Act to Secure Attendance of Witnesses from Without a State in Criminal Proceedings; Interpleader Compact Law.

### REPORTER'S NOTES

The rule of this Section was cited and applied in *Mitchell v. Craft*, 211 So.2d 509 (Miss.1968). Subsection (1) of the rule was cited and applied in *Oxford Consumer Discount Company v. Stefanelli*, 102 N.J.Super. 549, 246 A.2d 460 (1968).

See generally Leflar, *Choice-Influencing Considerations in Conflicts Law*, 41 N.Y.U.L.Rev. 267 (1966); Leflar, *Conflicts Law: More on Choice-Influencing Considerations*, 54 Calif.L.Rev. 1584 (1966); Traynor, *Is This Conflict Really Necessary?* 37 Texas L.Rev. 657 (1954); Cheatham and Reese, *Choice of the Applicable Law*, 52 Colum.L.Rev. 959 (1952); Reese, *Conflict of Laws and the Restatement Second*, 28 Law & Contemp. Prob. 679 (1963).

Cases where the court explicitly looked to similar factors in deciding a question of choice of law are *Clark v. Clark*, 107 N.H. 351, 222 A.2d 205 (1966); *Heath v. Zellmer*, 35 Wis.2d 578, 151 N.W.2d 664 (1967).

*Comment k:* On the subject of reciprocity, see Lenhoff, *Reciprocity and the Law of Foreign Judgments*, 16 La.L.Rev. 465 (1956); Lenhoff, *Reciprocity in Function*, 15 U. Pitt.L.Rev. 44 (1954); Lenhoff, *Reciprocity: The Legal Aspect of a Perennial Idea*, 44 Nw.U.L.Rev. 619, 662 (1952).

On rare occasions, the courts have incorporated the reciprocity principle into a common law rule of choice of law. See e. g., *Forgan v. Bainbridge*, 34 Ariz. 408, 274 Pac. 155 (1928); *Union Securities Co. v. Adams*, 33 Wyo. 45 236 Pac. 513 (1925).

### Cross Reference

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ALR Annotations:

Restat 2d of Conflict of Laws, § 6

Duty of courts to follow decisions of other states, on questions of common law or unwritten law, in which the cause of action had its situs. 73 A.L.R. 897.

Digest System Key Numbers:

Action 17

Restatement of the Law, Second, Conflict of Laws  
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# APPENDIX 5

## Restat 2d of Conflict of Laws, § 188

Restatement 2d, Conflict of Laws - Rule Sections > Chapter 8- Contracts > Topic 1- Validity of Contracts and Rights Created Thereby > Title A- General Principles

### § 188 Law Governing in Absence of Effective Choice by the Parties

(1) The rights and duties of the parties with respect to an issue in contract are determined by the local law of the state which, with respect to that issue, has the most significant relationship to the transaction and the parties under the principles stated in § 6.

(2) In the absence of an effective choice of law by the parties (see § 187), the contacts to be taken into account in applying the principles of § 6 to determine the law applicable to an issue include:

- (a) the place of contracting,
- (b) the place of negotiation of the contract,
- (c) the place of performance,
- (d) the location of the subject matter of the contract, and
- (e) the domicile, residence, nationality, place of incorporation and place of business of the parties.

These contacts are to be evaluated according to their relative importance with respect to the particular issue.

(3) If the place of negotiating the contract and the place of performance are in the same state, the local law of this state will usually be applied, except as otherwise provided in §§ 189-199 and 203.

#### COMMENTS & ILLUSTRATIONS

##### Comment:

*a. Scope of section.* The rule of this Section applies in all situations where there has not been an effective choice of the applicable law by the parties (see § 187).

##### Comment on Subsection (1):

*b. Rationale.* The principles stated in § 6 underlie all rules of choice of law and are used in evaluating the significance of a relationship, with respect to the particular issue, to the potentially interested states, the transaction and the parties. The factors listed in Subsection (2) of the rule of § 6 can be divided into five groups. One group is concerned with the fact that in multistate cases it is essential that the rules of decision promote mutually harmonious and beneficial relationships in the interdependent community, federal or international. The second group focuses upon the purposes, policies, aims and objectives of each of the competing local law rules urged to govern and upon the concern of the potentially interested states in having their rules applied. The factors in this second group are at times referred to as "state interests" or as appertaining to an "interested state." The third group involves the needs of the parties, namely the protection of their justified expectations and certainty and predictability of result. The fourth group is directed to implementation of the basic policy underlying the particular field of law, such as torts or contracts, and the fifth group is concerned with the needs of judicial administration, namely with ease in the determination and application of the law to be applied.

The factors listed in Subsection (2) of the rule of § 6 vary somewhat in importance from field to field and from issue to issue. Thus, the protection of the justified expectations of the parties is of considerable importance in contracts whereas it is of relatively little importance in torts (see § 145, Comment *b*). In the torts area, it is the rare case where the parties give advance thought to the law that may be applied to determine the legal consequences of their actions. On the other hand, parties enter into contracts with forethought and are likely to consult a lawyer before doing so. Sometimes, they will intend

that their rights and obligations under the contract should be determined by the local law of a particular state. In this event, the local law of this state will be applied, subject to the qualifications stated in the rule of § 187. In situations where the parties did not give advance thought to the question of which should be the state of the applicable law, or where their intentions in this regard cannot be ascertained, it may at least be said, subject perhaps to rare exceptions, that they expected that the provisions of the contract would be binding upon them.

The need for protecting the expectations of the parties gives importance in turn to the values of certainty, predictability and uniformity of result. For unless these values are attained, the expectations of the parties are likely to be disappointed.

Protection of the justified expectations of the parties by choice-of-law rules in the field of contracts is supported both by those factors in Subsection (2) of § 6 which are directed to the furtherance of the needs of the parties and by those factors which are directed to implementation of the basic policy underlying the particular field of law. Protection of the justified expectations of the parties is the basic policy underlying the field of contracts.

Protection of the justified expectations of the parties is a factor which varies somewhat in importance from issue to issue. As indicated above, this factor is of considerable importance with respect to issues involving the validity of a contract, such as capacity, formalities and substantial validity. Parties entering a contract will expect at the very least, subject perhaps to rare exceptions, that the provisions of the contract will be binding upon them. Their expectations should not be disappointed by application of the local law rule of a state which would strike down the contract or a provision thereof unless the value of protecting the expectations of the parties is substantially outweighed in the particular case by the interest of the state with the invalidating rule in having this rule applied. The extent of the interest of a state in having its rule applied should be determined in the light of the purpose sought to be achieved by the rule and by the relation of the transaction and the parties to that state (see Comment *c*).

Protection of justified expectations plays a less significant role in the choice-of-law process with respect to issues that involve the nature of the obligations imposed by a contract upon the parties rather than the validity of the contract or of some provision thereof. By and large, it is for the parties themselves to determine the nature of their contractual obligations. They can spell out these obligations in the contract or, as a short-hand device, they can provide that these obligations shall be determined by the local law of a given state (see § 187, Comment *c*). If the parties do neither of these two things with respect to an issue involving the nature of their obligations, as, for example, the time of performance, the resulting gap in their contract must be filled by application of the relevant rule of contract law of a particular state. All states have gap-filling rules of this sort, and indeed such rules comprise the major content of contract law. What is important for present purposes is that a gap in a contract usually results from the fact that the parties never gave thought to the issue involved. In such a situation, the expectations of the parties with respect to that issue are unlikely to be disappointed by application of the gap-filling rule of one state rather than of the rule of another state. Hence with respect to issues of this sort, protection of the justified expectations of the parties is unlikely to play so significant a role in the choice-of-law process. As a result, greater emphasis in fashioning choice-of-law rules in this area must be given to the other choice-of-law principles mentioned in the rule of § 6.

*c. Purpose of contract rule.* The purpose sought to be achieved by the contract rules of the potentially interested states, and the relation of these states to the transaction and the parties, are important factors to be considered in determining the state of most significant relationship. This is because the interest of a state in having its contract rule applied in the determination of a particular issue will depend upon the purpose sought to be achieved by that rule and upon the relation of the state to the transaction and the parties. So the state where a party to the contract is domiciled has an obvious interest in the application of its contract rule designed to protect that party against the unfair use of superior bargaining power. And a state where a contract provides that a given business practice is to be pursued has an obvious interest in the application of its rule designed to regulate or to deter that business practice. On the other hand, the purpose of a rule and the relation of a state to the transaction and the parties may indicate that the state has little or no interest in the application of that rule in the particular case. So a state may have little interest in the application of a rule designed to protect a party against the unfair use of superior bargaining power if the contract is to be performed in another state which is the domicile of the person seeking the rule's protection. And a state may have little interest in the application of a statute designed to regulate or to deter a certain business practice if the conduct complained of is to take place in another state.

Whether an invalidating rule should be applied will depend, among other things, upon whether the interest of the state in having its rule applied to strike down the contract outweighs in the particular case the value of protecting the justified expectations of the parties and upon whether some other state has a greater interest in the application of its own rule.

Frequently, it will be possible to decide a question of choice of law in contract without paying deliberate attention to the purpose sought to be achieved by the relevant contract rules of the interested states. This will be so whenever by reason of the particular circumstances one state is obviously that of the applicable law.

*d. The issue involved.* The courts have long recognized that they are not bound to decide all issues under the local law of a single state. Thus, in an action on a contract made and to be performed in a foreign state by parties domiciled there, a court under traditional and prevailing practice applies its own state's rules to issues involving process, pleadings, joinder of parties, and the administration of the trial (see Chapter 6), while deciding other issues -- such as whether the defendant had capacity to bind himself by contract -- by reference to the law selected by application of the rules stated in this Chapter. The rule of this Section makes explicit that selective approach to choice of the law governing particular issues.

Each issue is to receive separate consideration if it is one which would be resolved differently under the local law rule of two or more of the potentially interested states.

**Comment on Subsection (2):**

*e. Important contacts in determining state of most significant relationship.* In the absence of an effective choice of law by the parties (see § 187), the forum, in applying the principles of § 6 to determine the state of most significant relationship, should give consideration to the relevant policies of all potentially interested states and the relative interests of those states in the decision of the particular issue. The states which are most likely to be interested are those which have one or more of the following contacts with the transaction or the parties. Some of these contacts also figure prominently in the formulation of the applicable rules of choice of law.

*The place of contracting.* As used in the Restatement of this Subject, the place of contracting is the place where occurred the last act necessary, under the forum's rules of offer and acceptance, to give the contract binding effect, assuming, hypothetically, that the local law of the state where the act occurred rendered the contract binding.

Standing alone, the place of contracting is a relatively insignificant contact. To be sure, in the absence of an effective choice of law by the parties, issues involving the validity of a contract will, in perhaps the majority of situations, be determined in accordance with the local law of the state of contracting. In such situations, however, this state will be the state of the applicable law for reasons additional to the fact that it happens to be the place where occurred the last act necessary to give the contract binding effect. The place of contracting, in other words, rarely stands alone and, almost invariably, is but one of several contacts in the state. Usually, this state will be the state where the parties conducted the negotiations which preceded the making of the contract. Likewise, this state will often be the state of the parties' common domicile as well. By way of contrast, the place of contracting will have little significance, if any, when it is purely fortuitous and bears no relation to the parties and the contract, such as when a letter of acceptance is mailed in a railroad station in the course of an interstate trip.

*The place of negotiation.* The place where the parties negotiate and agree on the terms of their contract is a significant contact. Such a state has an obvious interest in the conduct of the negotiations and in the agreement reached. This contact is of less importance when there is no one single place of negotiation and agreement, as, for example, when the parties do not meet but rather conduct their negotiations from separate states by mail or telephone.

*The place of performance.* The state where performance is to occur under a contract has an obvious interest in the nature of the performance and in the party who is to perform. So the state where performance is to occur has an obvious interest in the question whether this performance would be illegal (see § 202). When both parties are to perform in the state, this state will have so close a relationship to the transaction and the parties that it will often be the state of the applicable law even with respect to issues that do not relate strictly to performance. And this is even more likely to be so if, in addition, both parties are domiciled in the state.

On the other hand, the place of performance can bear little weight in the choice of the applicable law when (1) at the time of contracting it is either uncertain or unknown, or when (2) performance by a party is to be divided more or less equally among two or more states with different local law rules on the particular issue.

It is clear that the local law of the place of performance will be applied to govern all questions relating to details of performance (see § 206).

*Situs of the subject matter of the contract.* When the contract deals with a specific physical thing, such as land or a chattel, or affords protection against a localized risk, such as the dishonesty of an employee in a fixed place of employment, the location of the thing or of the risk is significant (see §§ 189-193). The state where the thing or the risk is located will have a natural interest in transactions affecting it. Also the parties will regard the location of the thing or of the risk as important. Indeed, when the thing or the risk is the principal subject of the contract, it can often be assumed that the parties, to the extent that they thought about the matter at all, would expect that the local law of the state where the thing or risk was located would be applied to determine many of the issues arising under the contract.

*Domicil, residence, nationality, place of incorporation, and place of business of the parties.* These are all places of enduring relationship to the parties. Their significance depends largely upon the issue involved and upon the extent to which they are grouped with other contacts. So, for example, when a person has capacity to bind himself to the particular contract under the local law of the state of his domicil, there may be little reason to strike down the contract because that person lacked capacity under the local law of the state of contracting or of performance (see § 198). The fact that one of the parties is domiciled or does business in a particular state assumes greater importance when combined with other contacts, such as that this state is the place of contracting or of performance or the place where the other party to the contract is domiciled or does business. As stated in § 192, the domicil of the insured is a contact of particular importance in the case of life insurance contracts. At least with respect to most issues, a corporation's principal place of business is a more important contact than the place of incorporation, and this is particularly true in situations where the corporation does little, or no, business in the latter state.

Illustrations: 1. A, who is domiciled in state X, is declared a spendthrift by an X court. Thereafter, A borrows money in state Y from B, a Y domiciliary, who lends the money in ignorance of A's spendthrift status. Under the terms of the loan, the money is to be repaid in Y. A does not pay, and B brings suit in state Z. A would not be liable under X local law because he has been declared a spendthrift; he would, however, be liable under the local law of Y. The first question for the Z court to determine is whether the interests of both X and Y would be furthered by application of their respective local law rules. This is a question that can only be determined in the light of the respective purposes of these rules (see Comment c). The purpose of the X local law rule is obviously to protect X domiciliaries and their families. Hence the interests of X would be furthered by application of the X spendthrift rule. On the other hand, Y's interests would be furthered by the application of its own rule, which presumably was intended for the protection of Y creditors and also to encourage persons to enter into contractual relationships in Y. Since the interests of X and Y would each be furthered by application of their respective rules, the Z court must choose between them. Among the questions for the Z court to determine are whether the value of protecting the justified expectations of the parties and the interest of Y in the application of its rule outweigh X's interest in the application of its invalidating rule. Factors which would support an affirmative answer to this question, and which indicate the degree of Y's interest in the application of its rule, are that A sought out B in Y, that B is domiciled in Y, that the loan was negotiated and made in Y and that the contract called for repayment in Y (see § 195). If it is found that an X court would not have applied its rule to the facts of the present case, the argument for applying the Y rule would be even stronger. For it would then appear that, even in the eyes of the X court, X interests were not sufficiently involved to require application of the X rule (see § 8, Comment k).

2. A, a married woman, who is domiciled in state X, comes to state Y and there borrows money from B. The loan contract provides that the money is to be repaid in Y. A does not pay, and B brings suit in state Z. A defends on the ground that under Y local law married women lack capacity to bind themselves by contract; they do have such capacity, however, under the local law of X. It is questionable in this case whether the interests of either X or Y would be furthered by application of their respective rules. Y's rule of incapacity was presumably designed to protect Y married women. On the other hand, X's rule of capacity was presumably designed, at least primarily, to protect X transactions. It seems clear in any event that the

value of protecting the justified expectations of the parties is not outweighed in this case by any interest Y may have in the application of its rule of incapacity. Under the circumstances, the contract should be upheld on the issue of A's capacity by application of the X rule.

**Comment on Subsection (3):**

*f. When place of negotiation and place of performance are in the same state.* When the place of negotiation and the place of performance are in the same state, the local law of this state will usually be applied to govern issues arising under the contract, except as stated in §§ 189-199 and 203. A state having these contacts will usually be the state that has the greatest interest in the determination of issues arising under the contract. The local law of this state should be applied except when the principles stated in § 6 require application of some other law. As stated in Comment *c*, the extent of a state's interest in having its contract rule applied will depend upon the purpose sought to be achieved by that rule.

*g.* For reasons stated in § 186, Comment *b*, the reference is to the "local law" of the state of the applicable law and not to that state's "law" which means the totality of its law including its choice-of-law rules.

*h.* As to the situation where the local law rule of two or more states is the same, see § 186, Comment *c*.

**REPORTER'S NOTES**

See *Rungee v. Allied Van Lines, Inc.*, 92 Idaho 718, 449 P.2d 378 (1968) (quoting and applying rule of Section).

See generally *Vanston Bondholders Protective Committee v. Green*, 329 U.S. 156, 161-162 (1946) (a case involving the validity of a covenant contained in a mortgage indenture where the Court said: "In determining which contract is the most significant in a particular transaction, courts can seldom find a complete solution in the mechanical formulae of the conflicts of law. Determination requires the exercise of an informed judgment in the balancing of all the interests of the states with the most significant contacts in order best to accommodate the equities among the parties to the policies of those states."); *Rutas Aereas Nacionales, S. A. v. Robinson*, 339 F.2d 265 (5th Cir. 1964); *Whitman v. Green*, 289 F.2d 566 (9th Cir. 1961) (note executed in Idaho by Idaho resident and secured by Idaho realty upheld against charge of usury by application of local law of Washington where note was delivered and payable. "In the case at bar the lender did not seek out the borrower in the State of Idaho, nor sit in wait for him in that state. Rather, the borrower sought out the lender in the State of Washington."); *Perrin v. Pearlstein*, 314 F.2d 863 (2d Cir. 1963); *Teas v. Kimball*, 257 F.2d 817, 824 (5th Cir. 1958) ("... the focus of the contract was so centered in Texas that its validity should be determined by the laws of contract of that state"); *Global Commerce Corp. v. Clark-Babbitt Industries*, 239 F.2d 716 (2d Cir. 1956); *Alaska Airlines, Inc. v. Stephenson*, 217 F.2d 295 (9th Cir. 1954); *Grace v. Livingstone*, 195 F.Supp. 933, 935 (D.Mass.1961), *aff'd per curiam* 297 F.2d 836 (1962), *cert. den. sub. nom.* 369 U.S. 871 (1962) ("In the silence of the parties, Massachusetts law governs for reasons well explained in the notes accompanying the April 22, 1960, amendments to the Second Restatement of Conflict of Laws, Tentative Draft No. 6."); *Metzenbaum v. Golwynne Chemicals Corp.*, 159 F.Supp. 648 (S.D.N.Y.1958); *Mutual Life Ins. Co. v. Simon*, 151 F.Supp. 408 (S.D.N.Y.1957); *Fricke v. Isbrandtsen Co., Inc.*, 151 F.Supp. 465, 467 (S.D.N.Y.1957) ("Ordinarily the federal courts determine which law governs a contract by 'grouping of contacts' or 'finding the center of gravity' of the contract. The law of the jurisdiction having the closest relation to the contract is selected because, it is felt, the parties contracted probably with that law (if any law) in mind, and that jurisdiction would probably have the greatest interest in defining the rights of the contracting parties. This doctrine, however nebulous in its statement, seems to fulfill more adequately the expectations of the parties than the definitively worded, but often artificially applied, doctrine of *lex loci contractus*."); *Mulvihill v. Furness, Withy & Co.*, 136 F.Supp. 201, 206 (S.D.N.Y.1955) ("... the most salutary resolution of the conflicts problem is to ascertain the forum having the closest connection with the matters raised by the litigation."); *Bernkrant v. Fowler*, 55 Cal.2d 588, 360 P.2d 906 (1961) (application of Nevada local law to uphold an oral contract to make a will which would be invalid under the statute of frauds of California, the state of the decedent's domicile, based upon the interests of the two states, protection of the justified expectations of the parties, and the relevant contacts); *Cochran v. Ellsworth*, 126 Cal.App.2d 429, 437, 272 P.2d 904, 909 (1954) ("In this situation the bare physical act of signing the written instrument was a fortuitous, fleeting and relatively insignificant circumstance in the total contractual relationship between the parties. It should not be elevated to paramount importance, particularly when to do so will serve only the purpose of rendering invalid an otherwise legal agreement."); *Graham v. Wilkins*, 145 Conn. 34, 138

A.2d 705 (1958) (contract made in Pennsylvania to be performed in various states held governed by Connecticut local law on the ground that it had its "beneficial operation and effect" in Connecticut); *Gregg v. Fitzpatrick*, 54 Ga.App. 303, 187 S.E. 730 (1936) (contacts enumerated and local law of state in which majority of contacts were grouped applied); *W. H. Barber Co. v. Hughes*, 223 Ind. 570, 586, 63 N.E.2d 417, 423 (1945) ("The court will consider all acts of the parties touching the transaction in relation to the several states involved and will apply as the law governing the transaction the law of that state with which the facts are in most intimate contact."); *H I M C Investment Co. v. Sicialiano*, 103 N.J.Super. 27, 246 A.2d 502 (1968); *Spahr v. P. & H. Supply Co.*, 223 Ind. 591, 63 N.E.2d 425 (1945); *Auten v. Auten*, 308 N.Y. 155, 161, 124 N.E.2d 99, 102 (1954) ("Although this 'grouping of contacts' theory may, perhaps, afford less certainty and predictability than the rigid general rules . . . the merit of its approach is that it gives to the place 'having the most interest in the problem' paramount control over the legal issues arising out of a particular factual context, thus allowing the forum to apply the policy of the jurisdiction 'most intimately concerned with the outcome of [the] particular litigation' . . . . Moreover, by stressing the significant contacts, it enables the court not only to reflect the relative interests of the several jurisdictions involved . . . but also to give effect to the probable intention of the parties and consideration to 'whether one rule or the other produces the best practical result.'"); *Rubin v. Irving Trust Co.*, 305 N.Y. 288, 113 N.E.2d 424 (1953); *Lilienthal v. Kaufman*, 239 Or. 1, 395 P.2d 543 (1964); *Johnston v. Commercial Travelers Mut. Acc. Ass'n*, 242 S.C. 387, 131 S.E.2d 91 (1963); *Boston Law Book Co. v. Hathorn*, 119 Vt. 416, 423, 127 A.2d 120, 125 (1956) (" . . . where the contract contains no explicit provision that it is to be governed by some particular law the courts 'examine all the points of contact which the transaction has with the two or more jurisdictions involved, with the view to determine the "center of gravity" of the contract, or of that aspect of the contract immediately before the court, and when they have identified the jurisdiction with which the matter at hand is predominantly or most intimately concerned, they conclude that this is the proper law of the contract which the parties presumably had in view at the time of contracting.'"); *Peterson v. Warren*, 31 Wis.2d 547, 143 N.W.2d 560 (1966) (citing §§ 332 and 346 of Tent.Draft No. 6, 1960 and § 599d of Tent.Draft No. 11, 1965); *Wojciuk v. United States Rubber Co.*, 19 Wis.2d 224, 122 N.W.2d 737 (1963) (rights of parties for breach of warranty will be determined by the law of the place "most closely associated with the transaction"); *Potlatch No. 1 Federal Credit Union v. Kennedy*, Wash.2d , 459 P.2d 32 (1969) (quoting and applying rule of Section); *Baffin Land Corp. v. Monticello Motor Inn, Inc.*, 70 Wash.2d 893, 425 P.2d 623 (1967) (quoting and applying rule as stated in § 332 of Tent.Draft No. 6, 1960); *In re Estate of Knippel*, 7 Wis.2d 335, 96 N.W.2d 514 (1959).

*Comment b:* The importance of protecting the justified expectations of the parties in contract choice-of-law cases has been frequently emphasized. See, e. g., *Kossick v. United Fruit Co.*, 365 U.S. 731, 741 (1961) (" . . . we are dealing here with a contract, and therefore with obligations, by hypothesis, voluntarily undertaken. . . . This fact in itself creates some presumption in favor of applying the law tending toward the validation of the alleged contract."); *Pritchard v. Norton*, 106 U.S. 124 (1882); *Teas v. Kimball*, 257 F.2d 817 (5th Cir. 1958); *Heede, Inc. v. West India Machinery and Supply Co.*, 272 F.Supp. 236 (S.D.N.Y.1967); *Bernkrant v. Fowler*, *supra*; *Ehrenzweig, Contracts in the Conflict of Laws*, 59 Colum.L.Rev. 973, 1171 (1959). This policy is of little assistance in situations where the question is whether an individual provision of a contract should be invalidated in order to preserve the principal obligation. See, e. g., *Zogg v. Penn Mutual Life Insurance Co.*, 276 F.2d 861 (2d Cir. 1960); *Auten v. Auten*, *supra*.

The desire of the courts to uphold contracts is demonstrated by the usury cases cited in the Reporter's Note to § 203.

The Uniform Commercial Code provides in § 1-105 that, in the absence of an effective choice of law by the parties, its provisions are applicable to "transactions bearing an appropriate relation to this state."

For a suggestion that where the parties are to perform in different states the obligations of each party under the contract will be determined, at least on occasion, by the local law of the state where he was to perform, see *Auten v. Auten*, *supra*.

For a suggested alternative formulation, see *Weintraub, Choice of Law in Contract*, 54 Iowa L.Rev. 399 (1968).

## Cross Reference

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ALR Annotations:

Restat 2d of Conflict of Laws, § 188

Validity and effect of stipulation in contract to the effect that it shall be governed by the law of a particular state which is neither the place where the contract is made nor the place where it is to be performed. 112 A.L.R. 124.

Digest System Key Numbers:

Contracts 2, 101, 144, 276, 325

Restatement of the Law, Second, Conflict of Laws

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# APPENDIX 6

## Restat 2d of Judgments, § 18

Restatement 2d, Judgments - Rule Sections > Chapter 3- Former Adjudication: The Effects of a Judicial Judgment > Topic 2- Personal Judgments > Title B- Effects on the Original Claim

### § 18 Judgment for Plaintiff -- The General Rule of Merger

When a valid and final personal judgment is rendered in favor of the plaintiff:

- (1) The plaintiff cannot thereafter maintain an action on the original claim or any part thereof, although he may be able to maintain an action upon the judgment; and
- (2) In an action upon the judgment, the defendant cannot avail himself of defenses he might have interposed, or did interpose, in the first action.

#### COMMENTS & ILLUSTRATIONS

##### Comment:

*a. The doctrine of merger.* When the plaintiff recovers a valid and final personal judgment, his original claim is extinguished and rights upon the judgment are substituted for it. The plaintiff's original claim is said to be "merged" in the judgment. It is immaterial whether the defendant had a defense to the original action if he did not rely on it, or if he did rely on it and judgment was nevertheless given against him. It is immaterial whether the judgment was rendered upon a verdict or upon a motion to dismiss or other objection to the pleadings or upon consent, confession, or default.

*b. Action not maintainable on the original claim in the same state.* After merger of the original claim in a judgment for the plaintiff, the plaintiff may not maintain an action on the original claim in the state that rendered the judgment. If he attempts to do so, the defendant can set up the prior judgment as a defense.

This rule has practical effects because it might be advantageous to the plaintiff, despite his judgment, to bring a new action on the original claim. It is true that if the judgment was obtained on a liquidated claim, it would not be of any advantage to bring another action; but if the claim was unliquidated, the plaintiff might hope to recover a larger sum than that awarded to him by the judgment. Thus, if he brought an action against the defendant for negligently causing him personal injury, and after a trial the jury awarded him a certain sum and judgment was given for that sum, he might later be able to prove that the injury was more serious than had appeared at the trial. Even though he had no further evidence to offer, he might hope that new jury would award a greater sum. Since, however, his claim has been merged in the judgment, he cannot maintain an action on the original claim. See Illustrations 1-2, and § 25, Comment *c*, where certain exceptional situations are noted.

The same principle holds where the judgment obtained in the original action required the defendant to perform acts other than the payment of money or to refrain from such acts. The judgment precludes an action on the original claim seeking, perhaps, alternative or additional relief. See Illustration 3, and compare § 25, Comment *j*.

The fact that the judgment was based on error does not preclude the defendant from setting the judgment up as a defense to an action on the original claim. If it was erroneous, the plaintiff might have taken steps to have it set aside or reversed in the original proceeding.

##### Illustrations:

1. A brings an action against B for negligently causing injury to A. At the trial A is unable to prove any serious injury to his person. Verdict is given for A for \$ 100 and judgment is entered thereon. Thereafter it appears that A's injuries are more serious than proved at the trial. A is precluded by the judgment from maintaining a second action against B for the collision.
2. The facts are the same as stated in Illustration 1, except that at the trial of the first action A offers evidence of nervous shock, and the court erroneously excludes such evidence. A is precluded by the judgment from maintaining a second action against B for the collision.

3. A and B enter into a contract for the sale of land located in State X. B refuses to convey the land. A brings an action for specific performance in State X, and a judgment is entered in his favor ordering B to convey the land. A is precluded by the judgment from maintaining a second action in State X to secure money damages in lieu of specific performance, or to obtain damages for delay in conveying the land in addition to the specific performance already adjudged.

*c. Enforcement of a judgment in the same state.* A judgment for the plaintiff awarding him a sum of money creates a debt in that amount in his favor. He may maintain proceedings by way of execution for enforcement of the judgment. He may also be able to maintain an action upon the judgment. Ordinarily no useful purpose is served by bringing an action in the same state upon the judgment instead of executing upon it, but if the period for executing upon a judgment has run or the period of the statute of limitations applicable to the judgment has almost run, the plaintiff can by appropriate proceedings revive the executability of the judgment or bring an action upon the judgment and obtain a new judgment upon which the limitations period will run again.

Similarly, when a plaintiff has obtained a judgment other than one for the payment of money -- such as a judgment ordering the defendant to engage or refrain from engaging in certain conduct -- the plaintiff may seek enforcement of the judgment by proceedings in the nature of execution or by application for contempt or other sanctions, and with the passage of time, revivor or suit upon the judgment may become necessary to effectuate or preserve the plaintiff's rights.

When the plaintiff brings an action upon the judgment, the defendant cannot avail himself of defenses which he might have interposed in the original action. See Illustration 4. It is immaterial whether he interposed the defense or failed to do so or even defaulted in the original action. Nor does the fact that the judgment was erroneous preclude the plaintiff from maintaining an action upon it. See Illustrations 5 and 6.

In an action on the judgment the defendant may interpose matters which have arisen since the rendition of the judgment and constitute defenses to its enforcement such as payment, release, accord and satisfaction, or the statute of limitations. He may also interpose a counterclaim. It is immaterial that he might have interposed that counterclaim in the original action but did not do so, see § 22, unless the counterclaim was required to be interposed in the original action for the reasons set forth in § 22(2).

When the judgment calls for performance, positive or negative, over a period of time, the question may arise whether circumstances have so changed as to make enforcement inequitable.

A special problem arises when a plaintiff obtains judgment in an action based on a prior judgment and that prior judgment is then reversed on appeal. This question is considered in § 16.

**Illustrations:**

4. A brings an action against B on a promissory note. B defaults. Judgment is given for A. A brings an action against B on the judgment. In this action B is precluded from denying that he executed the note and from setting up an affirmative defense such as fraud or illegality.

5. A brings an action against B for breach of contract. B defends on the ground that his promise was without consideration. The court erroneously rules that the promise, although without consideration, is enforceable. Verdict and judgment are given for A. A brings an action against B on the judgment. B is precluded from setting up the lack of consideration as a defense to the action.

6. A brings an action against B for negligently injuring him. Verdict is given for A for \$ 10,000. B moves for a new trial on the ground that the damages awarded by the jury are excessive. The court erroneously denies the motion and judgment is given for A on the verdict. A brings an action against B on the judgment. B is precluded from defending on the ground that the damages awarded in the first action were excessive.

*d. Effect of judgment in another state -- full faith and credit.* This subject is dealt with in Restatement, Second, Conflict of Laws §§ 93-121, but a summary statement in this and the following Comments may be found useful.

Under the Full Faith and Credit Clause of the Constitution, a large category of judgments must be given the same res judicata effects by sister states as they are accorded in the respective states of rendition. Thus, valid, final, nonmodifiable judgments for the payments of money are entitled to such full respect in sister states. See id. §§ 100-01, and Illustrations 7 and 8 below.

Certain judgments, although valid and final, may constitutionally be denied all res judicata effects in the courts of sister states, but sister states may choose to give these judgments res judicata effects including that of merger. Thus, under current constitutional interpretation, a sister state may deny all effect to a judgment for support or the like insofar as it remains subject to modification in the state of rendition either as to sums that have accrued and are unpaid or as to sums that will accrue in the future; on the other hand, the sister state may elect to accord to such judgments the res judicata consequences that would attach in the respective states where rendered. See id. § 109. So also a judgment which involves an improper interference with important interests of a sister state may be denied res judicata effects by that sister state. See id. § 103. A judgment denying equitable relief is entitled to effect in a sister state under the rules of bar. And a judgment ordering the doing of an act other than payment of money or enjoining the doing of the act is entitled to effect in a sister state by way of issue preclusion; arguably the Constitution does not require that such a judgment be given effect in a sister state by way of merger, but the current tendency is to accord that effect also. See id. § 102, and Illustration 9 below.

**Illustrations:**

7. A brings an action in State X against B for battery. B denies the battery. Verdict and judgment are given for A for \$ 100. A sues B in State Y for the same battery. B sets up the prior judgment as a defense. The court in State Y is bound to give full faith and credit to the judgment and thus may not entertain the action.

8. A brings an action for divorce against B, her husband, in State X, in which A and B are domiciled. The court grants the divorce and directs B to pay A the sum of \$ 10,000 as alimony, the amount being based upon the resources of the defendant including land in State Y. After receiving payment of the \$ 10,000, A sues in State Y to obtain further alimony out of the land of B in that state. The court in State Y is bound to give full faith and credit to the judgment by dismissing the action.

9. A and B enter into a contract for sale of land located in State Y. B refuses to convey the land. A brings an action for specific performance in State X and judgment is entered in his favor ordering B to convey the land. State Y may perhaps be within its constitutional rights in refusing to entertain an action by A against B to enforce the State X judgment. On the other hand, it is constitutionally permissible for State Y to entertain such an action and respect the State X judgment fully, and correspondingly to refuse to entertain an action on A's original claim. See also Illustration 10.

*e. Action on original claim in another state.* When State Y is not required by the Constitution to regard a State X judgment as merging the claim, and State Y accordingly, in exercising its discretion, refuses to allow enforcement of the judgment as such, the plaintiff is not precluded from maintaining in State Y an action on the original claim. As indicated in Comment *d*, in certain cases State Y is then at liberty to deny all carry-over effects from the State X judgment; in other cases, as where the State X judgment ordered or prohibited acts other than the payment of money, State Y is required to accept the judgment as conclusive upon the issues actually litigated and determined in the State X action. See Restatement, Second, Conflict of Laws §§ 95, 102, and Illustration 10 below. In the latter class of cases, therefore, State Y will be entitled to deviate from the State X adjudication only in respect to the form of relief it is prepared to provide; the practical distinction between, on the one hand, allowing an action on the original claim but with issues concluded by direct estoppel based on the State X judgment, and, on the other hand, granting enforcement of the State X judgment, may be quite narrow. See Comment *f* below.

**Illustration:**

10. On the facts of Illustration 9, if State Y chooses to entertain an action on the original claim, it is nevertheless required to give direct estoppel effect to issues determined by State X.

*f. Enforcement of judgment in another state.* State Y may be required by the Constitution or, when not so required, may as a matter of comity choose to regard a State X judgment as merging the underlying claim and accordingly to enforce the

State X judgment. When the State X judgment is for payment of money, the customary way to secure enforcement of the judgment in State Y is to bring an action there upon the judgment. But a more direct method of enforcement may be available in State Y; for example, the Uniform Enforcement of Foreign Judgments Act provides for the registration of the State X judgment in State Y and facilitates its enforcement there. See also Title 28, U.S. Code, § 1963; Restatement, Second, Conflict of Laws § 99. When the State X judgment orders or forbids acts other than the payment of money, enforcement of the judgment in State Y is obtained in some situations by bringing an action on the judgment but in other cases by less direct procedures as prescribed by State Y. See Restatement, Second, Conflict of Laws § 99; § 102 and Comment *e* thereon.

*g. Incidents of claim preserved.* When by reason of the plaintiff's obtaining judgment upon a claim the original claim is extinguished and rights arise upon the judgment, advantages to which the plaintiff was entitled with respect to the original claim may still be preserved despite the judgment. Thus if a creditor has a lien upon property of the debtor and obtains a judgment against him, the creditor does not thereby lose the benefit of the lien. Similarly, where by statute an employee is given priority as to a claim for personal injuries in the reorganization of a railroad, such priority is not lost when the employee has obtained a judgment against the railroad.

*h. Effect on claim based on federal law.* When a judgment has been rendered on a claim based on state law, there are circumstances in which a claim based on federal law may still be asserted. See § 86.

*i. Counterclaim.* This Section is applicable not only when the plaintiff brings a subsequent action against the defendant, but also when he attempts to interpose a counterclaim in a subsequent action brought by the defendant against him. When the plaintiff has obtained a judgment against the defendant which has the effect under this Section of merging the original claim, he cannot avail himself of the original claim by interposing it as a counterclaim in a subsequent action brought by the defendant against him. See Illustration 11. On the other hand he may interpose the judgment by way of counterclaim. See Illustration 12.

#### **Illustrations:**

11. A brings an action against B on a promissory note. B denies that he executed the note. Verdict and judgment are given for A in the amount of the note, with interest and costs. Thereafter B brings an action against A for the breach of a contract. Since A's right of action on the note is merged in the judgment, A is precluded from relying on the note by way of counterclaim.

12. The facts are as stated in Illustration 11. A can set up the judgment by way of counterclaim.

*j. Merger in a judgment on a judgment.* When the plaintiff has obtained a judgment against the defendant and brings an action upon the judgment, and obtains a judgment in that action, the first judgment is not merged in the second judgment, whether the second action is brought in the same State in which the first judgment was rendered or is brought in another State. The plaintiff can enforce either judgment by execution or otherwise, but satisfaction of one of the judgments operates also as satisfaction of the other.

*k. Judgment of a federal court.* When the judgment is that of a federal court, federal law in general governs its effects. See § 87.

#### **REPORTER'S NOTES**

(§ 47, Tent. Draft No. 1.) *Comment a* corresponds to § 47, *Comment a* of the first Restatement, but reflects the new position that plaintiffs' personal judgments of all types -- not only those for the payment of money -- have the effect of merging the underlying claims. See "Scope" paragraph of Reporter's Note to § 17, and remarks below on *Comments b* and *c*.

*Comment b.* As to personal judgments for payment of money, this *Comment* is consistent with § 47, *Comment b*, of the first Restatement. However, the first Restatement, § 46, *Comment a*; § 47, *Comment h*, denied merger effects, even in the state of rendition, to a personal judgment for the plaintiff in an action other than one for payment of money -- typically a judgment requiring the defendant to perform or to refrain from performing given acts. Here the first Restatement seems

to have been extrapolating unduly from the interstate situation as it was then understood. It was then believed that there was no Constitutional obligation under the Full Faith and Credit Clause to enforce such a judgment. As the claim was thus "unmerged" in the interstate situation, considerations of symmetry suggested that the claim should be regarded as unmerged even in the state that had rendered the judgment, with the consequence that an action might be maintained there as elsewhere upon the claim. The first Restatement was evidently uncomfortable with this result, for it said, § 46, Comment *a*: "Where he [the plaintiff who has recovered nonmoney judgment] brings an action in the same State on his original claim, he will not be precluded by the doctrine of *res judicata*, but the court may dismiss the action on the ground that it is unnecessary to permit the plaintiff to maintain such an action and that it would be a hardship to the defendant to subject him unnecessarily to a second action." The first Restatement, § 46, went on to concede that a personal judgment in an action not for payment of money should have the usual effects of bar and of collateral and direct estoppel.

At present the Constitutional assumption as to the interstate cases has become tenuous, and in situations where it may still be constitutionally permissible for the states to deny respect to nonmoney judgments, the states have increasingly chosen to respect them as a matter of comity (see discussion in Comments *d-f* with references to the Restatement, Second, of Conflict of Laws). Even at the time of the first Restatement there was authority and reasoned argument for according merger effect in the state of rendition to personal judgments without regard to whether they were for payment of money. See 2 Freeman, *Law of Judgments* § 547 and n.15 (2d ed. 1925); 2 Black, *Judgments* §§ 517, 675 (2d ed. 1902); *Collins v. Gleason*, 47 Wash. 62, 91 p. 566 (1907); *Brown v. Fletcher*, 182 F. 963, 968 (6th Cir. 1910), cert. denied, 220 U.S. 611, 31 S.Ct. 715, 55 L.Ed. 609 (1911). Today that conclusion is reinforced, and seems indeed to be regularly assumed, for example, in the cases holding that an action for money damages is precluded by a former judgment in the same state awarding specific relief on the same claim. See § 25, Comments *i(2)* and *j*, and Reporter's Note thereon.

Illustrations 1 and 2 are the same as Illustrations 1 and 2 to former § 47. As to Illustration 3, cf. Illustration 10 to former § 47.

*Comment c*, insofar as it treats of money judgments, is consistent with § 47, Comments *e* and *g* of the first Restatement, but extends the same principle to nonmoney judgments. Usually it is unnecessary for the plaintiff to bring suit upon such a judgment in the state of rendition because he can secure direct enforcement by an application for contempt or the like, but if the judgment, though not for the payment of money, is or may be subject to a period of limitation (see, for example, N.J.Stat. Ann. 2A:14-5-1952), the plaintiff should be permitted to extend the running of the period by an action on the judgment, just as he may maintain an action on a money judgment. Historical analogy may be found in a bill to execute a decree. See Cook, *The Powers of Courts of Equity*, 15 Colum.L. Rev. 228, 235-37 (1915); Story, *Equity Pleadings* § 429 (1838); *State ex rel. Waring v. Mobile*, 24 Ala. 701 (1854).

Illustrations 4, 5, and 6 are the same as Illustrations 5, 6, and 7 to former § 47.

In *Comment d*, Illustration 7 is the same as Illustration 3 to former § 47. As to Illustration 8, see Illustrations 4 and 9 to former § 47. Illustration 9 is new.

*Comments g, h, and i* parallel § 47, Comments *d, j, and k* of the first Restatement. Illustration 10 is new. Illustrations 11 and 12 are the same as Illustrations 11 and 12 to former § 47.

## Cross Reference

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Digest System Key Numbers:

Judgment 540 et seq., 585(4), 815, 900 et seq., 925 et seq.

Restatement of the Law, Second, Judgments  
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# APPENDIX 7

## Amaprop Ltd. v. Indiabulls Fin. Servs.

United States District Court for the Southern District of New York

October 5, 2012, Decided; October 5, 2012, Filed

10 Civ. 1853 (PGG) (JCF); 11 Civ. 2001 (PGG) (JCF)

### Reporter

2012 U.S. Dist. LEXIS 146166; 2012 WL 4801452

AMAPROPLIMITED, Petitioner, - against - INDIABULLS FINANCIAL SERVICES LIMITED, Respondent.

**Prior History:** Amaprop Ltd. v. Indiabulls Fin. Servs., 483 Fed. Appx. 634, 2012 U.S. App. LEXIS 10586 (2d Cir. N.Y., May 25, 2012)

### Core Terms

Subpoena, Convention, Notice, Restraining, arbitration, personal jurisdiction, overnight, documents, proceedings, Appearance, confirming, provisions, post-judgment, delivery, procedures, parties, abroad, mail, attempted service, purposes, courts, restraining order, discovery, courier, Declaration, attorneys, contempt, summons, confer, international agreement

### Case Summary

#### Overview

There was no dispute that respondent appeared in the 2010 Action. Similarly, it appeared in the 2011 Action and participated in the case for months without objection. Respondent indisputably consented to personal jurisdiction by litigating these cases in the court. If a party entered a case, made no objection to jurisdiction, and asked the court to act on its behalf in some substantive way, it would be held to have waived further objection to the court's exercise of personal jurisdiction. The court retained such jurisdiction for the purposes of these post-judgment proceedings.

#### Outcome

Petitioner's motion to compel was granted in part and denied in part, and petitioner's request to declare service effective was granted.

### LexisNexis® Headnotes

Civil Procedure > ... > In Rem & Personal Jurisdiction > In Personam Actions > Consent

**HN1** If a party enters a case, makes no objection to jurisdiction, and asks the court to act on its behalf in some substantive way, it will be held to have waived further objection to the court's exercise of personal jurisdiction. An individual may submit to the personal jurisdiction of the court by appearance.

Civil Procedure > Preliminary Considerations > Jurisdiction > General Overview

Civil Procedure > Judgments > Enforcement & Execution > General Overview

**HN2** Without jurisdiction to enforce a judgment entered by a federal court, the judicial power would be incomplete and entirely inadequate to the purposes for which it was conferred by the Constitution.

Civil Procedure > ... > Service of Process > Methods of Service > Foreign Service

Civil Procedure > ... > Service of Process > Methods of Service > Service on Corporations

International Law > Dispute Resolution > Service of Process

**HN3** The conjunction of Fed. R. Civ. P. 4(h)(2) and Rule 4(f)(1) allows for service of a summons on a foreign corporation by any internationally agreed means of service that is reasonably calculated to give notice, such as those authorized by the Hague Convention on the Service Abroad of Judicial and Extrajudicial Documents in Civil and Commercial Matters, Nov. 15, 1965, 20 U.S.T. 361, 658 U.N.T.S. 163, or by other means not prohibited by international agreement, as the court orders. Both the United States and India are signatories to the Hague Service Convention; it has been in force in the United States since 1969, and in India since 2007.

Civil Procedure > Judgments > Enforcement & Execution > Discovery of Assets

**HN5** Fed. R. Civ. P. 69(a)(2) permits discovery in aid of judgment or execution as provided in the Federal Rules of Civil Procedure or by the procedure of the state where the court is located.

Civil Procedure > ... > Service of Process > Methods of Service > Foreign Service

International Law > Dispute Resolution > Service of Process

**HN4** The Hague Convention on the Service Abroad of Judicial and Extrajudicial Documents in Civil and Commercial Matters, Nov. 15, 1965, 20 U.S.T. 361, 658 U.N.T.S. 163, provides for several alternate methods of service: (1) service through the Central Authority of member states; (2) service through consular channels; (3) service by mail if the receiving state does not object; and (4) service pursuant to the internal laws of the state. India has objected to Hague Service Convention, art. 10, which allows service "by "postal channels." Hague Service Convention, art. 10; India's Hague Service Convention Reservations.

Civil Procedure > ... > Service of Process > Methods of Service > Foreign Service

International Law > Dispute Resolution > Service of Process

**HN6** Fed. R. Civ. P. 4 advisory committee's note to 1993 Amendments states that use of the procedures of the Hague Convention on the Service Abroad of Judicial and Extrajudicial Documents in Civil and Commercial Matters, Nov. 15, 1965, 20 U.S.T. 361, 658 U.N.T.S. 163, when available, is mandatory if documents must be transmitted abroad to effect service. If such procedures fail, a litigant may serve a foreign entity in compliance with a court order allowing service by other methods of service not prohibited by international agreements. Fed. R. Civ. P. 4 advisory committee's note to 1993 Amendments. The Hague Service Convention should be read together with Rule 4.

Civil Procedure > Pleading & Practice > General Overview

**HN7** Ex parte contact is contact with the court without the advance knowledge or contemporaneous participation of all other parties.

Civil Procedure > Discovery & Disclosure > Discovery > Subpoenas

Civil Procedure > Sanctions > Contempt > General Overview

Civil Procedure > Appeals > Reviewability of Lower Court Decisions > General Overview

**HN8** As a rule, denial of a motion to quash becomes appealable only after the person served with the subpoena refuses to comply and has been held in contempt.

Civil Procedure > Judgments > General Overview

Contracts Law > General Overview

**HN9** Under the merger doctrine, a contract is deemed to merge with the judgment, thereby depriving a plaintiff from being able to assert claims based on the terms and provisions of the contractual instrument.

Civil Procedure > ... > Service of Process > Methods of Service > General Overview

Civil Procedure > ... > Service of Process > Methods of Service > Foreign Service

International Law > Dispute Resolution > Service of Process

**HN10** "Resort may be had" to alternative means of service when the foreign state's Central Authority does not promptly effect service. Fed. R. Civ. P. 4 advisory committee's note to 1993 Amendments. This requires that the serving party have attempted to use those procedures without success. Case law as well supports the notion that a party must attempt service in compliance with the Hague Convention on the Service Abroad of Judicial and Extrajudicial Documents in Civil and Commercial Matters, Nov. 15, 1965, 20 U.S.T. 361, 658 U.N.T.S. 163, before petitioning for permission to serve by alternative means.

Civil Procedure > ... > Service of Process > Methods of Service > General Overview

Civil Procedure > ... > Service of Process > Methods of Service > Foreign Service

International Law > Dispute Resolution > Service of Process

**HN11** To be sure, a court has asserted that a plaintiff is not required to attempt service through the other provisions of Fed. R. Civ. P. 4(f) before the court may order service pursuant to Rule 4(f)(3). This may-be true in a case where no international agreement, such as the Hague Convention on the Service Abroad of Judicial and Extrajudicial Documents in Civil and Commercial Matters, Nov. 15, 1965, 20 U.S.T. 361, 658 U.N.T.S. 163, governs service in the receiving country. However, if the Hague Service Convention applies, its provisions are mandatory and pre-empt inconsistent methods of service allowed or required by state or federal statute or rule.

Civil Procedure > ... > Service of Process > Methods of Service > Foreign Service

Constitutional Law > ... > Fundamental Rights > Procedural Due Process > General Overview

International Law > Dispute Resolution > Service of Process

**HN12** The U.S. Supreme Court has emphasized that the Hague Convention on the Service Abroad of Judicial and Extrajudicial Documents in Civil and Commercial Matters, Nov. 15, 1965, 20 U.S.T. 361, 658 U.N.T.S. 163, is mandatory where it is applicable, that is, in cases in which there is "occasion to transmit" a document "for service abroad." The Court then held that whether a document must be served abroad is to be determined by the law of the forum. If that law requires the transmittal of documents abroad, then the Hague Service Convention applies. However, where service on a domestic agent is valid and complete under both forum law and the Due Process Clause, the inquiry ends and the Hague Service Convention has no further implications.

Civil Procedure > ... > Service of Process > Methods of Service > General Overview

Civil Procedure > Judgments > Enforcement & Execution > Discovery of Assets

**HN13** Fed. R. Civ. P. 69(a)(2) allows a judgment creditor to utilize discovery devices available, under both the Federal Rules of Civil Procedure and the laws of the forum state. Rule 69(a)(2) has been interpreted to permit judgment creditors wide latitude in using the discovery devices provided by the Federal Rules in post-judgment proceedings. As set out in the Rule, a judgment creditor may also utilize any discovery procedures that are authorized in the forum state, in aid of execution of the judgment. Therefore, a judgment creditor may use the service procedures established by the Federal Rules or by state law.

Civil Procedure > ... > Service of Process > Methods of Service > General Overview

Civil Procedure > ... > Service of Process > Methods of Service > Personal Delivery

**HN14** Under New York law, a restraining notice must be served on the target personally in the same manner as a summons. N.Y. C.P.L.R. § 5222(a). Similarly, a subpoena requiring attendance and a subpoena duces tecum, authorized under N.Y. C.P.L.R. § 5224(a)(1), (2), shall be served in the same manner as a summons. N.Y. C.P.L.R. § 2303(a). Under N.Y. C.P.L.R. § 311(a)(1), personal service of a summons on a domestic or foreign corporation is made by delivering the summons to an officer, director, managing or general agent, or cashier or assistant cashier or to any other agent authorized by appointment or by law to receive service. In addition, if

such service is impracticable, service upon the corporation may be made in such manner as the court, upon motion without notice, directs. N.Y. C.P.L.R. § 311(b).

Civil Procedure > ... > Service of Process > Methods of Service > Personal Delivery

Civil Procedure > ... > Service of Process > Methods of Service > Service on Agents

**HN15** Under federal law, if a party is represented by an attorney, service must be made on the attorney unless the court orders service on the party. Fed. R. Civ. P. 5(b)(1). The Federal Rules allow service to be made by "handing it to the person" authorized to receive service or by "leaving it at the person's office," among other methods. Fed. R. Civ. P. 5(b)(2)(A), (B). Neither Fed. R. Civ. P. 69(a)(2) nor any other federal rule has a requirement analogous to the New York rule that the permitted discovery devices must be served as though they were summonses. Thus, it has been held that when Rule 69 discovery (including a subpoena and restraining notice) is sought from a party represented by an attorney, service may proceed under Rule 5(b).

**Counsel:** [\*1] For AMA Prop Limited, Petitioner (1:10-cv-01853-PGG-JCF): Katherine Laswell Maco, Richard Scott Goldstein, Robert L. Sills, LEAD ATTORNEYS, Orrick, Herrington & Sutcliffe LLP (NYC), New York, NY.

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For Amaprop Limited, Petitioner (1:11-cv-02001-PGG-JCF): Erica P. Taggart, PRO HAC VICE, Quinn, Emanuel, Urquhart, & Sullivan LLP, Los Angeles, CA; Richard Scott Goldstein, Robert L. Sills, Orrick, Herrington & Sutcliffe LLP (NYC), New York, NY; Richard Irving Werder, Jr, Quinn Emanuel Urquhart Oliver & Hedges LLP, New York, NY.

For Indiabulls Financial Serviced Limited, Respondent (1:11-cv-02001-PGG-JCF): John L. Gardiner, LEAD ATTORNEY, Skadden, Arps, Slate, Meagher & Flom, L.L.P., New York, NY; Timothy Graham Nelson, Skadden, Arps, Slate, Meagher & Flom LLP (NYC), New York, NY.

For ICICI Bank [\*2] Limited, Respondent (1:11-cv-02001-PGG-JCF): Steven Bruce Malech, LEAD ATTORNEY, Wiggin and Dana LLP(New York), New York, NY.

For The Clearing House Association L.L.C., Institute of International Bankers, Amici (1:11-cv-02001-PGG-JCF): Bruce Edward Clark, Sullivan and Cromwell, LLP(NYC), New York, NY.

**Judges:** JAMES C. FRANCIS IV, UNITED STATES MAGISTRATE JUDGE.

**Opinion by:** JAMES C. FRANCIS IV

## Opinion

### MEMORANDUM AND ORDER

JAMES C. FRANCIS IV

UNITED STATES MAGISTRATE JUDGE

In February 2011, Petitioner Amaprop Limited ("Amaprop") and Respondent Indiabulls Financial Services ("Indiabulls") engaged in an international arbitration arising from a dispute under the Shareholders Agreement entered into by the parties on May 31, 2005 (Share Subscription and Shareholders Agreement dated May 31, 2005 (the "Agreement"), attached as Exh. 1 to Declaration of John L. Gardiner dated May 3, 2012 ("Gardiner Decl.")). On March 21, 2011, the arbitral tribunal issued an award (the "Award") in favor of Amaprop in the amount of approximately \$48.9 million, and on September 9, 2011, in Case No. 11 Civ. 2001 (the "2011 Action"), the Honorable Paul G. Gardephe, U.S.D.J., granted Amaprop's petition to confirm the Award in this Court (the "Judgment"). [\*3] Amaprop now moves pursuant to Rule 69(a) (2) of the Federal Rules of Civil Procedure, and New York Civil Practice Law and Rules ("CPLR") §§ 5222, 5223, and 5224 to compel Indiabulls to comply with a post-Judgment subpoena and restraining

notice served upon it on October 14, 2011 (the "Oct. 14 Subpoena and Restraining Notice"), and to grant Amaprop leave to serve Indiabulls with a revised restraining notice to obtain its compliance with the Judgment. In addition, Amaprop requests a ruling that a subpoena and restraining order delivered to Indiabulls' attorneys on July 18, 2012 (the "July 18 Subpoena and Restraining Notice") in Case No. 10 Civ. 1853 (the "2010 Action"), was properly served on Indiabulls.

For the following reasons, the motion to compel is granted in part and denied in part, and the request to declare service effective is granted.

### Background

Because the parties are familiar with the facts and procedural history of the underlying arbitration, as well as the award of attorneys' fees in the 2010 Action and the confirmation of the Award and entry of the Judgment in the 2011 Action, I will limit my discussion of the facts to those relevant to the pending motions. Additional background [\*4] information is available in Judge Gardephe's Memorandum Opinion and Order of March 16, 2011 ("March 16 Order") (No. 10 Civ. 1853, Docket no. 35) and his Memorandum Opinion and Order of September 9, 2011 ("Sept. 9 Order") (No. 11 Civ. 2001, Docket no. 16).

Since entry of the Judgment in the 2011 Action on September 14, 2011, Indiabulls has not paid any part of the Award.<sup>1</sup> (Memorandum in Support of Amaprop Limited's Motion to Compel Indiabulls to Comply with the Subpoena Served Upon It by Petitioner and to Hold Indiabulls in Civil Contempt ("Pet. Memo.") at 1). Nor has it paid any of the attorneys' fees ordered in the March 16 Order, which was affirmed by the Second Circuit. (Letter of Robert L. Sills dated July 13, 2012 ("Sills July 13 Letter") at 2). On October 14, 2011, Amaprop served Indiabulls with a subpoena and a restraining notice: the subpoena included a subpoena for the production of documents, which requires the respondent "to disclose information identifying the

<sup>1</sup> Although the respondent did not oppose Amaprop's petition to confirm the Award, it sought to set aside the Award in India by initiating a proceeding pursuant to Section 34 of the Indian Arbitration Act, which would have vacated the Award and prevented its enforcement in India. (Memorandum of Law by Indiabulls Financial Services Limited in Opposition to Amaprop Limited's Motion (1) to Compel and (2) for an Order of Contempt ("Resp. Memo."), at 5-6). However, the Indian court ultimately "dismissed th[at] petition on the basis that it lacked jurisdiction under Section 34 of the Indian Arbitration and Conciliation Act" which, according to Indiabulls, "has the effect of lifting the stay of enforcement [of the Award] in India but does not amount to an affirmative order permitting enforcement in India." (Letter of Timothy [\*6] G. Nelson dated May 21, 2012). Although the ultimate relevance of the Section 34 Proceeding to the instant petition is disputed (Letter of Robert L. Sills dated May 22, 2012), the conclusion of that proceeding means that its pendency can no longer be asserted as a basis for excusing the respondent's noncompliance with the Judgment or the Oct. 14 Subpoena and Restraining Notice.

value, form and location of its worldwide assets," and a subpoena to testify, which requires the respondent "to produce a witness to testify on Indiabulls's behalf with respect to those assets"; the restraining notice [\*5] "prohibits Indiabulls from selling, assigning or transferring any of its assets, up to and including the amount of the Judgment." (Pet. Memo. at 1; Declaration of Robert L. Sills dated April 19, 2012 ("Sills Decl."), ¶ 5). The deadlines for compliance with the Oct. 14 Subpoena and Restraining Notice were between October 24, 2011, and November 15, 2011. (Pet. Memo. at 3).

Amaprop served these documents in India by overnight mail, which, it contends, was "expressly authorized by Sections 12.6 and 12.10(b)" of the Agreement. (Pet. Memo. at 2). Further, the petitioner argues, overnight delivery was expressly authorized by an Order signed by Judge Gardephe on October 18, 2011. (Pet. Memo. at 2; Order dated October 18, 2011 ("Oct. 18 Order")). Amaprop also hand delivered copies to Indiabulls' counsel, Skadden, Arps, Slate, Meagher & Flom LLP ("Skadden"), in New York. (Letter of Robert L. Sills dated Oct. 14, 2011 ("Sills Oct. 14 Letter"), attached as Exh. E to Sills Decl., at 1).

In a letter to petitioner's counsel dated November 7, 2011, Indiabulls argued that its noncompliance with the Oct. 14 Subpoena was justified because the Court lacks personal jurisdiction over Indiabulls; because [\*7] service of process by overnight mail was improper; because the subpoena bears an incorrect caption; and because the requests for documents and testimony were defective on their face. (Letter of Gregory A. Litt dated Nov. 7, 2011 ("Litt Nov. 7 Letter"), attached as Exh. J to Sills Decl.). The letter did not mention the Oct. 14 Restraining Notice. Amaprop set forth its counter-arguments in a letter dated November 9, 2011 (Letter of Robert L. Sills dated Nov. 9, 2011 ("Sills Nov. 9 Letter"), attached as Exh. K to Sills Decl.), and Indiabulls, in turn, responded with another letter explaining why it believed both the Oct. 14 Subpoena and Restraining Notice to be ineffective (Letter of Gregory A. Litt dated Nov. 14, 2011 ("Litt Nov. 14 Letter"), attached as Exh. L to Sills Decl.). On December 22, 2011, Amaprop sent a letter to Indiabulls asking to meet and confer with respect to its intention to bring a motion to compel compliance with the Oct. 14 Subpoena and reserving the right to seek an order of contempt. (Letter of Robert L. Sills dated Dec. 22, 2011 ("Sills Dec. 22 Letter"), attached as Exh. 8 to Declaration of John L. Gardiner dated May 3, 2012 ("Gardiner Decl.")). Counsel for the [\*8] respondent indicated its availability to meet and confer in a letter dated January 3, 2012, (Letter of Gregory A. Litt dated Jan. 3, 2012 ("Litt Jan. 3 Letter"), attached as Exh. 9 to Gardiner Decl.), but Amaprop did not respond.

The petitioner then filed the instant motion on April 19, 2012. In its opposition papers, Indiabulls represented that it had not violated the restrictions imposed upon it by the Oct. 14 Restraining Notice and contended that it had maintained assets sufficient to pay the Judgment. (Resp. Memo. at 21-22). Accordingly, Amaprop has since withdrawn its contempt motion and now seeks permission to serve the respondent with an Amended Restraining Notice "to obtain the broadest restraint against Indiabulls allowable under the New York law, in hope that Indiabulls will finally meet its obligations." (Letter of Robert L. Sills dated May 14, 2012 ("Sills May 14 Letter")). The petitioner also seeks to serve the Amended Restraining Notice upon Indiabulls directly, by overnight delivery service and by e-mail, pursuant to Rules 4(h)(2) and 4(f)(3). (Sills May 14 Letter).

In addition, Amaprop asks the Court to declare that its attempted service in the 2010 Action of the July [\*9] 18 Subpoena and Restraining Notice on Indiabulls through Skadden, which Skadden rebuffed, "was proper and effective." (Letter of Robert Sills dated July 25, 2012 ("Sills July 25 Letter") at 1, 3; Letter of Robert Sills dated July 27, 2012).

The respondent continues to assert that this Court lacks personal jurisdiction over it, arguing that Indiabulls' consent to arbitrate disputes related to the Agreement in New York does not extend to "an action to enforce a court judgment confirming an arbitral award" and that the clause in the Agreement selecting as a forum for disputes "the courts of the State of New York located in New York" refers only to New York state courts, rather than federal courts. (Resp. Memo. at 9, 10-11; Agreement, §§ 12.10(b), 12.11). Indiabulls further contends that service in India of the Oct. 14 Subpoena and Restraining Notice by overnight mail was insufficient, notwithstanding the Oct. 18 Order, because Amaprop failed to attempt service in accordance with the Hague Convention on the Service Abroad of Judicial and Extrajudicial Documents in Civil or Commercial Matters ("Hague Service Convention"), 20 U.S.T. 361, T.I.A.S. 6638. (Resp. Memo. at 14-18). The respondent [\*10] asserts that the attempted service of the July 18 Subpoena and Restraining Notice was ineffective for similar reasons. (Letter of John L. Gardiner dated July 26, 2012 ("Gardiner July 26 Letter")).

I heard oral argument on the disputes on August 21, 2012. (Transcript ("Tr.") at 1).

## Discussion

### A. Personal Jurisdiction

Amaprop cites two provisions in the Agreement to support its position that Indiabulls consented to this Court's exercise of personal jurisdiction -- an arbitration clause requiring that "[a]ny [a]ction [] relating to th[e] Agreement . . . shall be settled by arbitration in the State of New York" (Agreement, § 12.11(a)) and a forum selection clause choosing "the courts of the State of New York located in New York" for "any [a] ction with respect to th[e] Agreement" (Agreement, § 12.10(b)).

Indiabulls quibbles with the scope of these provisions, asserting that neither confers jurisdiction in this Court for these post-judgment proceedings. More specifically, the respondent. argues that its agreement to arbitrate in New York constituted consent to the jurisdiction of courts in New York only "for certain specified matters directly affecting the arbitration" such as a motion to compel [\*11] arbitration or a motion to confirm an award -- that is, to proceedings relating to the enforcement of the arbitration agreement, itself, and not to proceedings to enforce the judgment confirming an award. (Resp. Memo, at 9-10 (emphasis omitted) ). In addition, Indiabulls argues (1) that the forum selection clause consents to the exercise of personal jurisdiction only by New York state courts rather than by federal courts, and (2) that the judgment confirming the arbitration award extinguished Amaprop's contract claim -- and with it any jurisdictional consent included in the contract -- and replaced it with a new claim known as a judgment debt, which has no relation to the provisions in the Agreement. (Resp. Memo, at 11-13). Therefore, according to the respondent, the proper interpretation of these contractual provisions does not demonstrate that it consented to this Court's exercise of jurisdiction over this enforcement proceeding.

However, the Agreement is irrelevant to this jurisdictional question, because Indiabulls indisputably consented to personal jurisdiction by litigating these cases in this Court. *HNI* "If a party enters a case, makes no objection to jurisdiction, and asks the court [\*12] to act on its behalf in some substantive way, it will be held to have waived further obj ection" to the court's exercise of personal jurisdiction. *Grammenos v. Lemos*, 457 F.2d 1067, 1070 (2d Cir. 1972); see also *Insurance Corp. of Ireland, Ltd. v. Compagnie des Bauxites de Guinee*, 456 U.S. 694, 703, 102 S. Ct. 2099, 72 L. Ed. 2d 492 (1982) (" [A]n individual may submit to the

[personal] jurisdiction of the court by appearance."); *India Steamship Co. v. Kobil Petroleum Ltd.*, 620 F.3d 160, 161 (2d Cir. 2010) ("[The defendant] concedes that its general appearance conferred on the district court jurisdiction that is general and in personam."). There is no dispute that Indiabulls appeared in the 2010 Action, litigating it up to the Second Circuit and back to this Court, where it has been re-opened for the purpose of enforcement of the attorneys' fees award. (Memorandum Endorsement dated July 16, 2012). Similarly, Indiabulls appeared in the 2011 Action and participated in the case for months without objection, even submitting to the entry of a permanent injunction constraining its prosecution of certain proceedings in India.<sup>2</sup> (Memorandum Endorsement dated June 1, 2011; Stipulation and Order for Permanent Injunction dated June [\*13] 16, 2011; Notice of Appearance by John L. Gardiner dated June 20, 2011; Notice of Appearance by Timothy Graham Nelson dated June 20, 2011; Tr. at 11, 28). Indeed, at oral argument, counsel for Indiabulls admitted that it was not until November 2011 that it interposed any objection to personal jurisdiction. (Tr. at 37; Litt Nov. 7 Letter at 1). By then, however, Indiabulls' conduct had already waived such an objection.<sup>3</sup>

*First American Bulk Carrier Corp. v. Van Ommeren Shipping (USA) LLC*, 540 F. Supp. 2d 483 (S.D.N.Y. 2008), does not undermine this conclusion. In that admiralty case, which arose from a charter relationship, the court ruled [\*14] on two discrete matters. The court first granted plaintiff First American leave to amend its complaint to add Strong Vessel Operators LLC ("SVO") as a defendant in order that the court could "determine . . . whether SVO [wa]s the successor-in-interest to [defendant] Van Ommeren" and thus bound by an agreement between Van Ommeren and First American to arbitrate disputes. *Id.* at 485. Next, the court ruled on First American's application to file pleadings to obtain an attachment under Rule B of the Federal Rules of Civil Procedure, Supplemental Rules for Admiralty or Maritime Claims, which allows attachment of a defendant's property in the hands of a garnishee when the defendant "is not found within the district." SVO argued that it had submitted to arbitration in New York and was consequently subject to the court's personal jurisdiction. *Id.* Because the court had personal jurisdiction over it, SVO contended that it could be "found" in the district, thus confounding the attachment application. *Id.* However, under Rule B, the fact

<sup>2</sup> The fact that Indiabulls chose not to oppose the confirmation of the arbitration award (Tr. at 27-28) does not undermine the fact that the company appeared in and litigated this action without jurisdictional objection for months.

<sup>3</sup> Indiabulls has not and cannot now argue that its appearance was somehow involuntary because it was required by the Agreement. Indiabulls is adamant that nothing in the Agreement granted this Court personal jurisdiction over it for these proceedings. (Resp. Memo, at 8-14). Therefore, any appearance had to have been voluntary.

that a defendant has consented to the personal jurisdiction of a court will not defeat attachment unless that defendant has a "real presence" in the district; [\*15] otherwise, a defendant could impede attachment by the simple expedient of appearing and thereby leave the plaintiff without any reasonable means to enforce its rights. Parkroad Corp. v. China Worldwide Shipping Co., No. 05 Civ. 5085, 2005 U.S. Dist. LEXIS 11122, 2005 WL 1354034, at \*2 (S.D.N.Y. June 6, 2005) (internal quotation marks omitted) (cited in First American, 540 F. Supp. 2d at 485). SVO's agreement to arbitrate, then, did not demonstrate "that it ha [d] the requisite contacts to be \*found' in th[e] district." First American, 540 F. Supp. 2d at 485. The case therefore does not stand for the proposition that a party who has appeared in an action can later circumvent the court's personal jurisdiction by relying on the reputed jurisdictional limits of an agreement to arbitrate. Indeed, the cases that might support Indiabulls' argument that an agreement to arbitrate in a forum confers personal jurisdiction over a defendant only for certain proceedings invariably were resolved on motions to dismiss brought at the outset of the action, rather than on objections made after a defendant had participated in a case through judgment. See, e.g., Mariac Shipping Co. v. Meta Corp., N.V., No. 05 Civ. 2224, 2005 U.S. Dist. LEXIS 10315, 2005 WL 1278950, at \*1 (S.D.N.Y. May 31, 2005); [\*16] Kahn Lucas Lancaster, Inc. v. Lark International Ltd., 956 F. Supp. 1131, 1133 (S.D.N.Y. 1997); Sterling National Bank & Trust Co. of New York v. Southern Scrap Export Co., 468 F. Supp. 1100, 1101 (S.D.N.Y. 1979).

The respondent repeatedly insists that the 2011 Action "is not an action relating to an arbitration or arbitration agreement, but rather is an action to enforce a court judgment . . . confirming the arbitral award." (Resp. Memo, at 1-2, 9). That ignores the fact that (1) the 2011 Action began with a petition to confirm the arbitral award (Complaint and Petition, ¶ 1); (2) Indiabulls has submitted to the personal jurisdiction of this Court for the purposes of such an action; and (3) Indiabulls conceded that Amaprop was not required to file a new action in which to press these claims<sup>4</sup> (Tr. at 46). Really, the crux of Indiabulls argument is that "things change post-judgment." (Tr. at 38). But it has provided no support for the notion that a court that has

personal jurisdiction over the parties loses that jurisdiction for the purpose of post-judgment proceedings in the same case. In FCS Advisors, Inc. v. Fair Finance Co., 605 F.3d 144 (2d Cir. 2010), [\*17] the Second Circuit held that a contractual choice-of-law provision does not generally apply to the issue of post-judgment interest because, once a contract claim is reduced to judgment, that claim is extinguished in favor of a claim on the judgment, which is no longer governed by the contract that was part of the underlying dispute.<sup>5</sup> However, there was no indication that the district court needed to revisit the issue of personal jurisdiction in order to preside over post-judgment proceedings. Moreover, to the extent that FCS Advisors can be read to support the position that a contract-based consent to jurisdiction is extinguished for post-judgment proceedings even if they are part of the same action, it is irrelevant here, because personal jurisdiction over Indiabulls was established not on the basis of the Agreement, but because Indiabulls waived objection to the court's personal jurisdiction by appearing in and litigating this action.

Samsun Logix Corp. v. Bank of China, 740 F. Supp. 2d 484 (2010), is even further afield. In that case, the court had, in an earlier, separate action, confirmed a foreign arbitral award in favor of the plaintiff. Id. at 485. Samsun then filed an action in state court against a number of banks, which were not parties to the original action, seeking to require them to turn over property of the judgment debtor. Id. at 485-86. The case was removed to federal court pursuant to the broad removal provision of the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the "Convention"), [\*19] which allows removal of an "action or proceeding . . . relat[ing] to an arbitration agreement or award falling under the Convention." 9 U.S.C. § 205; see Samsun, 740 F. Supp. 2d at 486-87. On Samsun's motion for remand, the court held that there was no basis for federal subject-matter jurisdiction, because the turnover action did not "relate" to an arbitral agreement or award, even though it was seeking garnishment to satisfy an award governed by the Convention. Id. at 487, 489. Samsun means that federal subject-matter jurisdiction in a new action for garnishment cannot be premised on a prior case's judgment confirming a foreign arbitral award. It does not indicate that personal jurisdiction attached through participation in an

<sup>4</sup> Specifically, counsel for Indiabulls stated, "[T]here's been a suggestion that it's the same action for all purposes. It's certainly the same captioned action. and we don't contest the Court's subject matter jurisdiction to conduct a post-enforcement [\*18] proceeding . . ." (Tr. at 46). Moreover, Indiabulls neither briefed nor argued during the hearing the previously-asserted defense that the Oct. 14 Subpoena included an improper caption because it reflected the case number of the 2011 Action. (Litt Nov. 7 Letter at 2). Therefore, Indiabulls has abandoned the claim that the Oct. 14 Subpoena is unenforceable because it was mis-captioned.

<sup>5</sup> There is an exception when the underlying contract clearly and unambiguously demonstrated the parties' intent that its provisions should survive the merger of the claim into the judgment. Id. at 148

action confirming an arbitral award dissolves for the purposes of post-judgment proceedings in the same case.

In short, by its conduct Indiabulls has submitted to the Court's personal jurisdiction. The Court retains such jurisdiction for the purposes of these post-judgment proceedings. Indeed, any other resolution would have constitutional implications. See Peacock v. Thomas, 516 U.S. 349, 356, 116 S. Ct. 862, 133 L. Ed. 2d 817 (1996) (*HN2* "Without jurisdiction to enforce a judgment entered by a federal [\*20] court, 'the judicial power would be incomplete and entirely inadequate to the purposes for which it was conferred by the Constitution.'" (quoting Riggs v. Johnson County, 73 U.S. 166, 6 Wall. 166, 187, 18 L. Ed. 768 (1868))).

#### B. Service of the October 14 Subpoena and Restraining Notice in India by Overnight Delivery

*HN3* The conjunction of Rules 4(h)(2) and 4(f)(1) of the Federal Rules of Civil Procedure allows for service of a summons on a foreign corporation "by any internationally agreed means of service that is reasonably calculated to give notice, such as those authorized by the Hague Convention" or "by other means not prohibited by international agreement, as the court orders."<sup>6</sup> Both the United States and India are signatories to the Hague Service Convention; it has been in force in the United States since 1969, and in India since 2007. See Status Table, Members of the Organization, available at [http://www.hcch.net/index\\_en.php?act=conventions.status&cid=17](http://www.hcch.net/index_en.php?act=conventions.status&cid=17) (last visited Oct. 2, 2012).

*HN4* The Hague Convention provides for several alternate methods of service: (1) service through the Central Authority of member states; (2) service through consular channels; (3) service by mail if the receiving state does not object; [\*21] and (4) service pursuant to the internal laws of the state.

Burda Media, Inc. v. Viertel, 417 F.3d 292, 300 (2d Cir. 2005). India has objected to Article 10 of the Hague Service Convention, which allows service "by "postal channels."<sup>7</sup> "Hague" Service Convention, Art. 10; India's Hague Service Convention Reservations.

The advisory committee's notes to *HN6* Rule 4 of the Federal Rules of Civil Procedure state that "[u]se of the [Hague Service] Convention procedures, when available, is mandatory if documents must be transmitted abroad to effect service." Fed. R. Civ. P. 4 advisory committee's note to 1993 Amendments. If such procedures fail, a litigant may serve a foreign entity in compliance with a court order allowing service "by other methods of service not prohibited by international agreements." Fed. R. Civ. P. 4 advisory committee's note to 1993 Amendments; see also Burda Media, 417 F.3d at 301 [\*23] (noting that "the Hague Convention should be read together with Rule 4"); Surung v. Malhotra, 279 F.R.D. 215, 218-19 (S.D.N.Y. 2011) (finding use of court-ordered alternative means of service under Rule 4(f)(3) sufficient).

Amaprop purportedly served the Oct. 14 Subpoena and Restraining Order on Indiabulls by overnight delivery. (Sills Decl., ¶ 5). On October 17, 2011, in order to "avoid an unnecessary dispute over service," Amaprop requested permission from the Court to use such a method of service. (Letter from Robert L. Sills dated Oct. 17, 2011 ("Sills Oct. 17 Letter"), attached as Exh. 6 to Gardiner Decl.). Judge Gardephe issued the requested order, which declared that service by overnight delivery "shall be, for all purposes, deemed good and sufficient." (Oct. 18 Order). Indiabulls challenges the sufficiency of that service under the Hague Service Convention.

#### 1. The Oct. 18 Order

The Oct. 18 Order presents a hurdle for Indiabulls. Judge Gardephe's order clearly authorizes Amaprop to serve the

<sup>6</sup> Amaprop proceeds under *HN5* Rule 69(a)(2) of the Federal Rules of Civil Procedure (Pet. Memo, at 4, 8), which permits discovery "[i]n aid of [] judgment or execution ... as provided in the [] [Federal Rules of Civil Procedure] or by the procedure of the state where the court is located." Amaprop has chosen to utilize discovery devices available under the laws of New York State, having issued the Restraining Notice pursuant to CPLR § 5222 and the Subpoena pursuant to CPLR § 5224. (Pet. Memo, at 4, 8). However, it may utilize the service procedures established in either the Federal Rules or the rules of service for New York. See First City, Texas-Houston, N.A. v. Rafidain Bank, 197 F.R.D. 250, 256 (S.D.N.Y. 2000).

<sup>7</sup> Article 10 also preserves "the freedom of judicial officers, officials or other competent persons of the State of origin to effect service of judicial documents directly [\*22] through the judicial officers, officials or other competent persons of the State of destination," and "the freedom of any person in a judicial proceeding to effect service of judicial documents directly through the judicial officers, officials or other competent persons of the State of destination." Hague Service Convention, Art. 10(b), (c). India "is opposed" to all of these methods. India's Declarations and Reservations to the Hague Convention ("India's Hague Service Convention Reservations"), available at [http://www.hcch.net/index\\_en.php?act=status.comment&csid=984&disp=resdn](http://www.hcch.net/index_en.php?act=status.comment&csid=984&disp=resdn) (last visited Oct. 2, 2012).

Oct. 14 Subpoena and Restraining Notice on Indiabulls "either personally or by overnight delivery." (Oct. 18 Order). Indiabulls' counterargument -- that the order did not authorize service [\*24] in this manner because "it did not specify service in India" or mention the Hague Service Convention (Resp. Memo, at 17; Tr. at 41) -- is, at best, difficult to parse. As I understand it, Indiabulls claims that the Oct. 18 Order did not authorize service by overnight delivery because the Federal Rules of Civil Procedure allow a court to order service on a corporation in a foreign country only by means "not prohibited by international agreement." Fed. R. Civ. P. 4(f) (3). Because, according to Indiabulls, service in India by overnight delivery is prohibited by the Hague Service Convention, the Oct. 18 Order cannot have meant to authorize that means of service. (Resp. Memo, at 17). But this presupposes that Judge Gardephe was somehow unaware that Indiabulls was located in India, which is extremely unlikely given that he has presided over two actions against the corporation and knew of Indiabulls' efforts to evade its obligations under the Agreement and the arbitral award, often by filing actions in India. (March 16 Order at 5-7; Tr. at 27-28, 41).

While denying any intention of doing so (Tr. at 42), Indiabulls is effectively contending that the Oct. 18 Order is incorrect, and it insists [\*25] that the order is not binding in the case (or on me) because it was issued ex parte. (Tr. at 42, 63). But HN7 ex parte contact is "contact with the Court without the advance knowledge or contemporaneous participation of all other parties." Newell Operating Co. v. Shalaby, No. C 09-0185, 2009 U.S. Dist. LEXIS 20446, 2009 WL 533092, at \*2 n.1 (N.D. Cal. March 3, 2009). Here, Indiabulls' counsel was contemporaneously provided with a copy of the proposed order and the letter application supporting it. (Sills Oct. 17 Letter at 2-3). The fact that Indiabulls chose not to challenge the order when it was issued or to move to quash the Oct. 14 Subpoena when it was served does not mean that the order was issued ex parte.

Nevertheless, Judge Gardephe did not have the benefit of the parties' briefing and extensive letter-writing campaign when he issued the order. That, and the fact that he has referred this dispute to me for a decision, militates in favor of re-examining the service of the Oct. 14 Subpoena and Restraining Notice. See Brentwood Pain & Rehabilitation Services, P.C. v. Allstate Insurance Co., 508 F. Supp. 2d 278, 289 (S.D.N.Y. 2007) (revisiting decision made by a different judge because additional papers were subsequently [\*26] submitted). Moreover, addressing the dispute now serves purposes of efficiency and judicial economy. Given Indiabulls' conduct in this litigation to date, it is unlikely to comply voluntarily with the Oct. 14 Subpoena. In order to

review the propriety of service, then, the respondent would have to be held in contempt so that the Indiabulls could appeal that holding to the Second Circuit. See In re Grand Jury Subpoena Duces Tecum Dated May 29, 1987, 834 F.2d 1128, 1130 (2d Cir. 1987) (HN8 "As a rule, denial of a motion to quash becomes appealable only after the person served with the subpoena refuses to comply and has been held in contempt."). That would be a waste of judicial resources on the seemingly straightforward task of enforcing a judicially-confirmed arbitral award.

## 2. Service in India by Overnight Delivery

Governing law establishes that, because (1) Indiabulls did not waive the provisions of the Hague Service Convention and agree to service of Oct. 14 Subpoena and Restraining Notice by mail in the Agreement and (2) Amaprop did not make any attempt to serve them pursuant to the Hague Service Convention, service in India by overnight courier was ineffective.

### a. Provisions for Service [\*27] in the Agreement

There are two provisions in the Agreement that relate to service. Section 12.6 requires "[a]ll notices, demands or requests under th [e] Agreement," to be "made by hand delivery, certified mail, Federal Express or a similarly internationally recognized overnight courier service or facsimile." (Agreement, § 12.6). In Section 12.10(b), the parties (1) agreed that any action with respect to the Agreement "may be brought in the courts of the State of New York located in New York" and (2) "consent[ed] to the service of process of any of th [ose] courts ... by the mailing of copies of the process to the parties [] as provided in Section 12.6." (Agreement, §12.10(b)(underlining omitted)). Neither of these provisions, however, authorized service in India of the Oct. 14 Subpoena and Restraining Notice by overnight courier.

This is the point on which FCS Advisors supports Indiabulls' position. As discussed above, in that case the court held that under the "merger doctrine" a contractual choice of law provision does not govern the question of post-judgment interest, because the provisions of a contract no longer govern the relationship between the parties once a contract claim [\*28] has been reduced to judgment. FCS Advisors, 605 F.3d at 148; see also In re A&P Diversified Technologies Realty, Inc., 467 F.3d 337, 341 (3d Cir. 2006) (HN9 "Under the merger doctrine, a contract is deemed to merge with the judgment, thereby depriving a plaintiff from being able to assert claims based on the terms and provisions of the contractual instrument."); Figueiredo Ferraz Consultoria E

Engenharia de Proiecto Ltda. v. Republic of Peru, 865 F. Supp. 2d 476, 478, 2012 U.S. Dist. LEXIS 78836, 2012 WL 2052402, at \*2 (S.D.N.Y. June 6, 2012) (holding that contractual choice of law provision did not control in action confirming arbitration award).

Here, Amaprop relies on provisions of the Agreement in this post-judgment enforcement action, asserting that, "because not allowing for post-judgment enforcement proceedings would render the arbitration clause meaningless, service under the terms of the [ ] Agreement is allowed." (Reply Memorandum in Support of Amaprop Limited's Motion to Compel Indiabulls to Comply with the Subpoena Served Upon it by Petitioner ("Reply Memo.") at 6). But there is no question that enforcement proceedings are allowed. No party has argued otherwise. Amaprop's problem is that the Agreement no [\*29] longer controls issues of service in these proceedings because that contract has merged into the judgment.<sup>8</sup> See FCS Advisors, 605 F.3d at 148; In re A&P Diversified Technologies Realty, Inc., 467 F.3d at 341.

b. Service Pursuant to the Oct. 18 Order

Indiabulls recognizes that Rule 4 (f) (3) allows a court to order service upon a foreign corporation by means not set out in the Hague Service Convention. (Resp. Memo, at 16). It argues, however, that such alternative service may be ordered only if the party seeking it has attempted service in compliance with the Hague Service Convention and failed because the Central Authority was dilatory or failed to cooperate. (Resp. Memo, at 16). Because Amaprop did not attempt to serve the Oct. 14 Subpoena and Restraining Notice through India's Central Authority, Indiabulls argues, alternative service via overnight courier as allowed by the Oct. 18 Order was ineffective. [\*30] (Resp. Memo, at 16).

Indiabulls is correct. The advisory committee indicates that *HN10* "resort may be had" to alternative means of service when the foreign state's Central Authority does not promptly effect service. Fed. R. Civ. P. 4 advisory committee's notes to 1993 Amendments. This requires that the serving party have attempted to use those procedures without success. Case law, as well, supports the notion that a party must attempt service in compliance with the Hague Service Convention before petitioning for permission to serve by alternative means. See Burda Media, 417 F.3d at 301 (approving alternate service when plaintiff "attempted in good faith to comply with the Hague Convention"); Gurung,

279 F.R.D. at 217 (approving alternate service when plaintiff "had demonstrated the futility of service of process through the Central Authority in New Delhi, India"); In re South African Apartheid Litigation, 643 F. Supp. 2d 423, 433-34 (S.D.N.Y. 2009) (noting that recourse to alternative means of service is appropriate when Hague Service Convention procedures have failed); United States v. Shehyn, No. 04 Civ. 2003, 2008 U.S. Dist. LEXIS 108951, 2008 WL 6150322, at \*3 (S.D.N.Y. Nov. 26, 2008) ("However, if a Central Authority [\*31] is dilatory or refuses to cooperate, a plaintiff may request a U.S. court to order alternative service methods pursuant to Rule 4(f)(3). . . ."); Arista Records LLC v. Media Services LLC, No. 06 Civ. 15319, 2008 U.S. Dist. LEXIS 16485, 2008 WL 563470, at \*1 (S.D.N.Y. Feb. 25, 2008) ("[A] plaintiff seeking relief under Rule 4(f)(3) must adequately support the request with affirmative evidence of the lack of judicial assistance by the host nation . . . ."); RSM Production Corp. v. Fridman, No. 06 Civ. 11512, 2007 U.S. Dist. LEXIS 58194, 2007 WL 2295907, at \*2 (S.D.N.Y. Aug. 10, 2007) ("The May Opinion held that court-directed service pursuant to Rule 4(f) (3) on defendant [ ] was warranted because plaintiffs had shown that they were unable to serve him in the Russian Federation pursuant to procedures set forth by the Hague Convention . . . .").

*HN11* To be sure, the court in Securities & Exchange Commission v. Anticevic, No. 05 Civ. 6991, 2009 U.S. Dist. LEXIS 11480, 2009 WL 361739 (S.D.N.Y. Feb. 13, 2009), asserted that "[a] plaintiff is not required to attempt service through the other provisions of Rule 4(f) before the Court may order service pursuant to Rule 4(f) (3)." 2009 U.S. Dist. LEXIS 11480, [WL] at \*8. This may-be true in a case where no international agreement, such as the Hague Service Convention, [\*32] governs service in the receiving country. See Rio Properties, Inc. v. Rio International Interlink, 284 F.3d 1007, 1015 n.4 (9th Cir. 2002) (noting that Rule 4(f)(3) provides options for alternative service when no international agreement applies), cited in Anticevic, 2009 U.S. Dist. LEXIS 11480, 2009 WL 361739, at \*3; Export-Import Bank of the United States v. Asia Pulp & Paper Co., No. 03 Civ. 8554, 2005 U.S. Dist. LEXIS 8902, 2005 WL 1123755, at \*2-5 (S.D.N.Y. May d11, 2005) (allowing alternative means of service when receiving country was "not party to any applicable treaty or agreement"), cited in Anticevic, 2009 U.S. Dist. LEXIS 11480, 2009 WL 361739, at \*3. However, if the Hague Service Convention applies, its provisions are "mandatory" and "pre-empt[] inconsistent methods of

<sup>8</sup> Because my resolution of this issue relies on the merger doctrine, I do not address the parties' arguments regarding whether the Agreement's forum selection clause (and accompanying consent to service) specifies only New York state courts, or includes federal courts located in New York.

service” allowed or required by state or federal statute or rule. See Volkswagenwerk Aktiengesellschaft v. Schlunk, 486 U.S. 694, 699, 108 S. Ct. 2104, 100 L. Ed. 2d 722 (1988); Rio Properties, 284 F.3d at 1015 n.4 (stating that applicability of Hague Service Convention would restrict federal court’s options under Rule 4(f)(3)). Indeed, in Anticevic, the court ultimately allowed service by publication pursuant to Rule 4(f)(3) only after the plaintiff had attempted service in accordance with the Hague Service Convention in two [\*33] countries over a period of more than a year. Anticevic, 2009 U.S. Dist. LEXIS 11480, 2009 WL 361739, at \*1-2 (describing plaintiff’s attempt to serve in compliance with Hague Service Convention in 2006 in Germany and in 2007 in Croatia).

Because Amaprop did not attempt to serve Indiabulls pursuant to the Hague Service Convention, its request for an order allowing alternative service was premature. Notwithstanding the Oct. 18 Order, then, the attempted service of the Subpoena and Restraining Order in India on October 14, 2011, was ineffective.<sup>9</sup>

#### C. Service of Amended Restraining Notice

Amaprop requests permission to serve an Amended Restraining Notice on Indiabulls in India by commercial courier and e-mail. (Sills May 14 Letter). Apparently, it has not attempted to utilize the Hague Service Convention procedures for service in India. Therefore, for the reasons discussed [\*34] above, Amaprop’s request is denied.

#### D. Service on Skadden

Amaprop hand-delivered the Oct. 14 Subpoena and Restraining Notice in the 2011 Action to Indiabulls’ New York attorneys at Skadden. (Sills Oct. 14 Letter at 1). It engaged a process server who attempted service on Indiabulls via Skadden of the July 18 Subpoena and Restraining Notice in the 2010 Action. (Sills July 25 Letter). Skadden’s arguments regarding service of the documents from the 2011 Action indicate that it does not concede that its receipt of the Oct. 14 Subpoena and Restraining Notice effected proper service; Skadden refused to accept service of the documents in the 2010 Action on Indiabulls’ behalf, asserting that it was not authorized to do so (Sills July 25 Letter). Indiabulls contends that, because under New York law, restraining notices and subpoenas (other than subpoenas requesting written answers to written questions) must be

served personally in the same manner as a summons, the Hague Service Convention procedures apply to these attempts at service pursuant to Rule 4 of the Federal Rules of Civil Procedure. (Gardiner July 26 Letter; Tr. at 29).

Indiabulls is not precisely correct on either count. First, in Volkswagenwerk, [\*35] the Supreme Court ruled on the applicability of the Hague Service Convention. The plaintiff at trial had served the complaint on defendant Volkswagen of America (“VWoA”), a wholly-owned subsidiary of German corporation Volkswagen Aktiengesellschaft (“VWAG”), and attempted to serve a complaint on VWAG by serving VWoA as its agent. 486 U.S. at 696-97. The state trial court rejected VWAG’s argument on its motion to quash that VWAG could be served only in accordance with the Hague Service Convention. Id. at 697. Instead, it ruled that, under Illinois law, VWoA was VWAG’s agent for service as a matter of law, and that “because service was accomplished within the United States, the Hague Service Convention did not apply.” Id. When the case was reviewed on appeal, HNI2 the United States Supreme Court emphasized that the Hague Service Convention is mandatory where it is applicable, that is, in cases in which there is “occasion to transmit” a document “for service abroad.” Id. at 699-700 (internal quotation marks omitted). The Court then held that whether a document must be served abroad is to be determined by the law of the forum. Id. at 700-02. If that law requires “the transmittal of documents [\*36] abroad, then the Hague Service Convention applies.” Id. at 700. However, “[w]here service on a domestic agent is valid and complete under both [forum] law and the Due Process Clause, [the] inquiry ends and the Convention has no further implications.” Id. at 707.

HNI3 As noted above, Rule 69(a)(2) allows a judgment creditor to utilize discovery devices available, under both the Federal Rules of Civil Procedure and the laws of the forum state. See, e.g., GMA Accessories, Inc. v. Electric Wonderland, Inc., No. 07 Civ. 3219, 2012 U.S. Dist. LEXIS 72897, 2012 WL 1933558, at \*4 (S.D.N.Y. May 22, 2012) (“Rule [69(a)(2)] has been interpreted to permit judgment creditors wide latitude in using the discovery devices provided by the Federal Rules in post-judgment proceedings. As set out in the Rule, a judgment creditor may also utilize any discovery procedures that are authorized in the forum state, in aid of execution of the judgment.” (internal quotation marks and citation omitted) ). Therefore, a judgment creditor may use the service procedures established

<sup>9</sup> Because it is clear that the attempted service was improper, there is no need to address Indiabulls’ argument that service in India via commercial courier is never effective because India has objected to Article 10 of the Hague Service Convention. (Resp. Memo, at 17; Letter of Timothy G. Nelson dated Aug. 20, 2012 (“Nelson Aug. 20 Letter”); Tr. at 50).

by the Federal Rules or by state law. First City, 197 F.R.D. at 256. So, if service on Indiabulls via Skadden was proper under either federal or New York law, the Hague Service [\*37] Convention does not apply.

**HN14** Under New York law, a restraining notice must be served on the target "personally in the same manner as a summons."<sup>10</sup> CPLR § 5222(a). Similarly, a subpoena requiring attendance and a subpoena duces tecum, authorized under CPLR § 5224(a)(1) and (2), "shall be served in the same manner as a summons." CPLR § 2303(a). Under CPLR § 311(a) (1), "personal service" of a summons on a domestic or foreign corporation<sup>11</sup> is made by delivering the summons "to an officer, director, managing or general agent, or cashier or assistant cashier or to any other agent authorized by appointment or by law to receive service." In addition, if such service is "impracticable," service upon the corporation may be made "in such manner ... as the court, upon motion without notice, directs."<sup>12</sup> CPLR § 311(b). Thus, it appears that there are two situations in which Amaprop can avoid service abroad and the applicability of the Hague Service Convention: (1) if it personally serves the documents on a domestic agent authorized to receive service or (2) if service abroad is impracticable and the court directs alternative domestic service. It should be obvious that the attempted service of the [\*38] documents on Indiabulls through Skadden does not fit into the second category because Amaprop has not shown that service abroad is impracticable, as it has not yet attempted such service. See Yamamoto v. Yamamoto, 43 A.D.3d 372, 373, 842 N.Y.S.2d 10, 11 (1st Dep't 2007) ("In view of the procedures in place for effectuating service upon defendant in Japan, and the absence of any evidence that service in that manner is 'impracticable,' the court properly denied plaintiff's request . . . for an order directing that service on defendant be effectuated by personal delivery of process upon his attorneys."). However, if Skadden were authorized to receive service under state law, then the delivery of the documents to the firm would be effective, especially in light of the fact that Indiabulls obviously has actual notice of the subpoenas and restraining orders in both cases.

But there is no need to determine the answer to this possibly thorny question, because **HN15** under federal law, "[i]f a party is represented by an attorney, service . . . must be made on the attorney unless the court orders service on the

party." Fed. R. Civ. P. 5(b) (1). The Federal Rules allow service to be made by "handing it to the person" authorized to receive service or by "leaving it [] at the person's office . . .," among other methods. Fed. R. Civ. P. 5(b) (2) (A) & (B). Neither Rule 69(a) (2) nor any other federal rule has a requirement analogous to the New York rule that the permitted discovery devices must be served as though they were summonses. Thus, it has been held that "when Rule 69 discovery [including a subpoena and restraining notice] is sought from a party represented by an attorney, service may proceed . . . under Rule 5(b) of the Federal Rules of Civil Procedure." First City, 197 F.R.D. at 256.

There is no question that Indiabulls is represented by Skadden. Skadden has filed notices of appearance in both the 2010 Action (Notice of Appearance of John L. Gardiner dated April 4, 2011; Notice of Appearance of Timothy Graham [\*40] Nelson dated April 4, 2011) and the 2011 Action (Notice of Appearance of John L. Gardiner dated June 20, 2011; Notice of Appearance of Timothy Graham Nelson dated June 20, 2011). Skadden is actively and ably representing its client in both open cases. Skadden has not moved to withdraw in either case -- nor could it withdraw without permission of the Court. In addition, it is clear that Indiabulls has actual notice of each of the documents at issue here. Therefore, Indiabulls was properly served with the Oct. 14 Subpoena and Restraining Notice in the 2011 Action, and with the July 18 Subpoena and Restraining Notice in the 2010 Action when the documents were delivered to Skadden.

#### Conclusion

For the reasons discussed, Amaprop Limited's Motion to Compel Indiabulls to Comply with the Subpoena Served Upon It (Case No. 11 Civ. 2001, Docket no. 83) is granted in part and denied in part. Indiabulls was properly served with a subpoena and restraining order on October 14, 2011. Amaprop's request to serve an amended subpoena and restraining order via overnight courier and e-mail is denied. Finally, Amaprop's request for a ruling (in Case No. 10 Civ. 1853) that the July 18, 2012 delivery to Skadden [\*41] of a subpoena and restraining order was effective service is granted. This Order decides only whether service was adequate. It expresses no opinion on the substance of those documents.

<sup>10</sup> A restraining notice can also be served "by registered or certified mail, return receipt requested." CPLR 5222(a). However, for our purposes, service by mail on Indiabulls in India would be service abroad, and therefore the Hague Convention would apply.

<sup>11</sup> Indiabulls is a "foreign corporation" under New York law. CPLR § 105(h).

<sup>12</sup> In [\*39] this regard, New York law mirrors Rule 4(f) (3).

2012 U.S. Dist. LEXIS 146166, \*41

SO ORDERED.

/s/ James C. Francis IV

JAMES C. FRANCIS IV

UNITED STATES MAGISTRATE JUDGE

Dated: New York, New York

October 5, 2012

# APPENDIX 8

## Britton v. Co-Op Banking Group

United States Court of Appeals for the Ninth Circuit

April 14, 1993 \*; September 1, 1993, Filed

No. 91-16851

### Reporter

4 F.3d 742; 1993 U.S. App. LEXIS 22026; Fed. Sec. L. Rep. (CCH) P97,752; 93 Cal. Daily Op. Service 6577; 93 Daily Journal DAR 11264

JOSEPH BRITTON, Plaintiff-Appellee, v. CO-OP BANKING GROUP, Defendant. JEFF LIEBLING, Defendant-Appellant.

**Prior History:** [\*\*1] Appeal from the United States District Court for the Eastern District of California. D.C. No. CIV-S-87-0817-EJG. Edward J. Garcia, District Judge, Presiding.

### Core Terms

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arbitration, class member, arbitration clause, district court, compel arbitration, investors, securities, successor in interest, default, contractual, soliciting, container, invoke, monies, judicial estoppel, lack of standing, allegations, beneficiary, obligations, services, parties

### Case Summary

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#### Procedural Posture

Defendant sought review of an order of the United States District Court for the Eastern District of California, which denied his motion to compel arbitration in plaintiffs' class action for securities fraud.

#### Overview

Plaintiffs brought an action for securities fraud. Defendant, a non-signatory to the contract plaintiffs entered into with a company later purchased by defendant, sought to invoke the contract's arbitration clause. Affirming the decision of the district court, the court held that defendant had no standing to invoke the contract's arbitration clause because he was not a third party beneficiary or successor in interest to the contract. The court reasoned that defendant failed to show that the parties to the contract intended to benefit a third

party. Likewise, the court found that defendant's contract for the purchase of the company did not include an assignment of rights under the contract with plaintiffs. The court also found that defendant was not within the class of agents intended to benefit from the arbitration clause because the acts of fraud with which he was charged were unrelated to any provision of the contract with plaintiffs. The court concluded that, because defendant lacked standing to compel arbitration, the default judgment entered against him as a discovery sanction remained in effect.

#### Outcome

The court affirmed the decision of the district court finding that defendant lacked standing to compel arbitration under a contract between plaintiffs and a company he later purchased. The court found that defendant could not invoke the arbitration provision because he was not a beneficiary or successor in interest to the contract, and therefore the default judgment, which was entered against him as a discovery sanction, remained in effect.

### LexisNexis® Headnotes

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Civil Procedure > Pretrial Matters > Alternative Dispute Resolution > Mandatory ADR

Civil Procedure > Appeals > Standards of Review > De Novo Review

**HNI** The denial of a motion to compel arbitration is reviewed de novo.

Civil Procedure > ... > Alternative Dispute Resolution > Arbitration > General Overview

Civil Procedure > Pretrial Matters > Alternative Dispute Resolution > Mandatory ADR

Contracts Law > Third Parties > Beneficiaries > Claims & Enforcement

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\* The panel unanimously finds this case suitable for decision without oral argument. Fed. R. App. P. 34(a); Circuit Rule 34-4.

**HN2** The right to compel arbitration stems from a contractual right. That contractual right may not be invoked by one who is not a party to the agreement and does not otherwise possess the right to compel arbitration. An entity that is neither a party to, nor agent for, nor beneficiary of the contract lacks standing to compel arbitration.

Administrative Law > Agency Adjudication > Alternative Dispute Resolution

Contracts Law > Contract Conditions & Provisions > Arbitration Clauses

Contracts Law > Third Parties > Delegation of Performance

**HN3** Nonsignatories of arbitration agreements may be bound by the agreement under ordinary contract and agency principles.

Contracts Law > Third Parties > Beneficiaries > Claims & Enforcement

**HN4** If the parties to the contract had no intention to benefit a third party, that third party has no rights under the contract.

Contracts Law > Standards of Performance > Assignments > General Overview

**HN5** An assignee of a contractual right must prove the validity of his ownership claims. To prove an effective assignment, the assignee must come forth with evidence that the assignor meant to assign rights and obligations under the contracts. A contract provision specifying such is evidence of such an intent.

**Counsel:** Jeff Liebling, Bakersfield, California, appellant, pro se.

William P. Torngren, Andrea M. Miller, David C. Adams, Bartel, Eng, Miller and Torngren, Sacramento, California, for the appellees.

**Judges:** Before: William C. Canby, Melvin Brunetti, Circuit Judges, and Robert E. Jones, \*\*Opinion by Judge Jones; Dissent by Judge Brunetti.

**Opinion by:** JONES

## Opinion

[\*743] OPINION

JONES, District Judge:

The issue on appeal is whether Jeff Liebling, a non-signatory to a contract entered into by a company he later purchased, may invoke the contract's arbitration clause.

We find that Liebling may not invoke the contract's arbitration clause because: (1) Plaintiffs<sup>1</sup> are not estopped from claiming Liebling has no standing to compel arbitration; (2) Liebling was not a third party beneficiary or successor in interest to the contract; and (3) Although Liebling became an agent, officer and employee of the original contracting party, none of his allegedly [\*\*2] wrongful acts arose out of or were related to the contract.

The decision of the district court is affirmed.

### *Facts and proceedings below*

This appeal is part of a class action alleging that defendants perpetuated a securities fraud scheme by selling a fraudulent tax shelter investment and that Liebling engaged in fraudulent activity after the initial sales. Plaintiffs signed a contract for the allegedly fraudulent securities with Gold Depository and Loan Company ("GDL"). This contract contained an arbitration provision. Liebling, a non-signatory to the contract who later bought GDL, demanded arbitration but the plaintiffs refused. His motion to compel arbitration was denied by the district court, which found that he had waived arbitration. Liebling appealed, and while his appeal was pending, the district court entered a default judgment against him as a discovery sanction.

This Court reversed. *Britton v. Co-op Banking Group*, 916 F.2d 1405 (9th Cir. 1990). [\*\*3] The *Britton* panel, which chronicled the facts and proceedings in this case in more detail, concluded that Liebling had not waived his right to compel arbitration. The panel also found that the district court had not addressed the threshold issue of Liebling's standing to compel arbitration and remanded the case to the district court for further determination and fact-finding on that issue. The panel concluded that if Liebling does not have the right to have this dispute submitted to arbitration, the "default [\*744] judgment" may stand. On the other

\*\* Honorable Robert E. Jones, United States District Judge for the District of Oregon, sitting by designation.

<sup>1</sup> We refer to appellees as "plaintiffs" in this opinion.

hand, if Liebling proves to be correct on the arbitration question, the "default judgment" will have to be set aside.

The district court, on remand, concluded that Liebling lacked standing under the contract to assert a right to arbitrate and that the "default judgment" therefore remains in effect. Liebling timely appealed and we have jurisdiction pursuant to 28 U.S.C. § 1292(a)(1) and 9 U.S.C. § 15(a)(1)(A).

#### *Standard of review*

**HNI** The denial of a motion to compel arbitration is reviewed *de novo*. *Pipe Trades Council, Local 159 v. Underground Contractors Ass'n*, 835 F.2d 1275, 1278 (9th Cir. 1987).

#### [\*\*4] *Discussion*

*Plaintiffs are not estopped from claiming Liebling has no standing to compel arbitration.*

Liebling argues that judicial estoppel should bar the plaintiffs from denying the allegations in their complaint regarding his status as an agent or successor in interest of GDL. We disagree. This circuit has declined to adopt either the majority or minority view of judicial estoppel. See, e.g., *Yanez v. Broco*, 989 F.2d 323 (1993).

This court recently described the two competing views of judicial estoppel as follows:

Under the majority view, judicial estoppel does not apply unless the assertion inconsistent with the claim made in the subsequent litigation "was adopted in some manner by the court in the prior litigation." [*Stevens Tech. Services, Inc. v. SS Brooklyn*, 885 F.2d 584, 588 (9th Cir. 1989).] Under the minority view, judicial estoppel can apply even when a party was unsuccessful in asserting its position in the prior judicial proceeding, "if the court determines that the alleged offending party engaged in 'fast and loose' behavior which undermined the integrity of the court." [*Stevens*, 885 F.2d at 589.]

[\*\*5] *In re Corey*, 892 F.2d 829, 836 (9th Cir. 1989).

Under the majority view, Liebling's estoppel argument fails, simply because he has neither alleged nor proven that the court below ever adopted plaintiffs' prior position that he was liable as agent or employee of GDL. To the contrary, the granting of a default was a sanction for discovery violations, unrelated to the allegations in the complaint.

Under the minority view, it is a closer question, but the argument still fails. Plaintiffs did not truly obtain relief by "asserting and offering proof to support one position" and then contradict themselves to establish a second claim. *Arizona v. Shamrock Foods Co.*, 729 F.2d 1208, 1215 (9th Cir. 1984), *cert. denied*, 469 U.S. 1197, 83 L. Ed. 2d 982, 105 S. Ct. 980 (1985). Again, they obtained relief via Liebling's refusal to comply with the discovery order.

Neither do we consider plaintiffs to be playing "fast and loose" with the courts. This characterization is reserved for more egregious conduct than just "threshold" inconsistency, *Yanez, supra*, especially where, as here, the complainant has not been prejudiced by the inconsistency.

[\*\*6] *Liebling did not have standing to compel arbitration.*

Liebling contends that he has standing to enforce the contract's arbitration clause for one or more of three reasons: (1) he is a third party beneficiary of the contract; (2) he is a successor in interest to the contract; or (3) he is an agent, officer, and employee of GDL.

**HN2** The right to compel arbitration stems from a contractual right. *Britton*, 916 F.2d at 1413. That contractual right may not be invoked by one who is not a party to the agreement and does not otherwise possess the right to compel arbitration. *Lorber Industries of California v. Los Angeles Printworks Corp.*, 803 F.2d 523, 525 (9th Cir. 1986). An entity that is neither a party to nor agent for nor beneficiary of the contract lacks standing to compel arbitration, *E.E.O.C. v. Goodyear Aerospace Corp.*, 813 F.2d 1539, 1543, n. 2 (9th Cir. 1987) (citing *Lorber*).

With that framework in mind, the following facts regarding the relationship between GDL, plaintiffs and Liebling become pivotal:

[\*745] Defendant GDL allegedly sold marine dry cargo containers and then acted as an agent [\*7] for purchasers in leasing those containers. According to plaintiffs, GDL was sued as a principal actor in the alleged securities fraud scheme. Eventually, plaintiffs obtained an order of default against GDL, but never proceeded to judgment.

According to Liebling's motion to intervene, he is an international business consultant and the sole proprietor of International Business Services ("IBS"). In May, 1985, he claims he was offered a seat on the board of USA/GDL, a California corporation that later acquired GDL. During the summer of 1985, USA/GDL hired Liebling, doing business as IBS, to serve as its representative agent. In September,

Liebling/IBS was retained to handle contacts with investors in GDL's allegedly fraudulent container program. At that time, Liebling relates:

I knew almost nothing of GD&L's past business history or details regarding the Program except was told an IRS summons enforcement action was being fought (supposedly) to protect the privacy rights of program investors. . .

He says he learned of allegations of wrongdoing in October, 1985, and as he learned more facts he became suspicious about whether his supposed job - "to protect GD&L's goodwill by helping [\*\*8] program investors" - was the true motive of USA. He continues:

By late November my suspicions that both the investors and the board were being screwed seemed true. In the belief that GD&L could be helpful to investor's interest if it was in friendly hands, and with an eye to re-establishing GD&L's commercially valuable goodwill, I engineered a necessarily "hostile takeover."

He claims to be "president, board and shareholder" of GD&L. Documentation proving his ownership includes a sales contract signed by Liebling and an officer of USA-GDL on Nov. 25, 1985. Plaintiffs' complaint against Liebling (reprinted below) charges him with acts starting in June, 1985 and continuing through 1987.

The original sale and leasing contracts GDL entered into with various plaintiffs contained the following arbitration clause:

Any controversy or claim *arising out of or relating to this Agreement or the breach thereof*, shall be settled by arbitration in accordance with the Commercial Arbitration Rules of the American Arbitration Association, and judgment upon the award rendered by the Arbitrator(s) may be entered in any Court having jurisdiction thereof. (Emphasis added.)

As the district [\*\*9] court noted, this arbitration clause is broad on its face, and in fact, it is routinely used in many securities and labor agreements to secure the broadest possible arbitration coverage. However, as explained above, because Liebling was not a party to the agreement, he must fit into one of the three categories that follow in order to invoke the right to arbitrate.

#### 1. Was Liebling a third-party beneficiary to the contract?

Courts have held that **HN3** nonsignatories of arbitration agreements may be bound by the agreement under ordinary contract and agency principles. *Letizia v. Prudential Bache Securities, Inc.*, 802 F.2d 1185, 1187 (9th Cir. 1986).

**HN4** If the parties to the contract had no intention to benefit a third party, that third party has no rights under the contract. *Sherman v. British Leyland Motors, Ltd.*, 601 F.2d 429, 440, n. 13 (9th Cir. 1979) (citing *Martinez v. Socoma Cos., Inc.*, 11 Cal. 3d 394, 113 Cal. Rptr. 585, 521 P.2d 841 (1974)). Liebling offers declarations that he believes GDL officers and others connected with the company meant for the arbitration clause to be very broad and allow invocation by employees [\*\*10] and other third parties. However, he has offered no evidence that that was actually the parties' intent.

As stated above, the law requires a showing that the *parties to the contract* intended to benefit a third party. Liebling has made no such showing, as the district court noted, and accordingly has failed to establish that he was a third-party beneficiary under the contract.

#### [\*\*746] 2. Was Liebling a successor in interest to the contract?

**HN5** An assignee of a contractual right must prove the validity of his ownership claims. *Federal Deposit Ins. Corp. v. WH Venture*, 607 F. Supp. 473, 476 (E.D.Pa. 1985). Additionally, general contract principles dictate that to prove an effective assignment, the assignee must come forth with evidence that the assignor meant to assign rights and obligations under the contracts. *See generally Restatement (Second) of Contracts*, § 317(1) (1981) ("an assignment of a right is a manifestation of the assignor's intention to transfer it"); *id.* at § 324 ("it is essential to an assignment of a right that the [assignor] manifest an intention to transfer the right to another person"). A contract provision specifying such is [\*\*11] evidence of such an intent, of course.

The sales contract between IBS and GDL, which provides a purchase price of \$ 10, does not contain language that could be considered an effective assignment of rights specified in the container contracts.

Indeed, the plain language of the contract indicates that the parties had just the opposite intent: that USA-GDL would defend any lawsuits related to the container program. In analyzing whether or not Liebling was a true successor in interest, the district court considered relevant contract clauses and found that the intent of IBM and USA-GDL was that USA would defend all lawsuits. The relevant clause reads:

(2) [USA agrees to] strictly abide by all lawful obligations made by it in the GDL acquisition agreement dated April 29, 1985, except for those specifically and expressly assumed

by IBS in this contract, especially to defend against all law suits.<sup>2</sup>

[\*\*12] (CR 833 Ex. A.)

An additional clause specifies that Liebling will not be responsible for any "debts, obligations, defenses and liabilities" of GDL incurred prior to the date of the sale contract. As the district court concluded:

Because Liebling did not succeed to the obligations, defenses and liabilities of GD&L, and because USA-GDL specifically agreed to defend all lawsuits, Liebling is not a successor in interest or an assignee for purposes of standing to enforce GD&L's contractual arbitration clause.

We agree that Liebling is not a successor in interest to the contract for purposes of standing to compel arbitration.

*3. Is Liebling within a class of agents intended to benefit from the arbitration clause?*

Here Liebling is on stronger ground. He claims that from May to December 1985, he had an "ever increasing active role in the activities of GD&L as its corporate agent and as an officer and director." He says his work included:

a broad range of tasks arising from the problems plaintiffs were having would in connection with the contract such as investigating and informing plaintiffs of the factual and legal situation, acting as liaison [sic] with plaintiffs attorneys [\*\*13] and accounts, protecting plaintiffs interests regarding the IRS. . .and much more.

(Emphasis added). On remand the district court restricted review to Liebling's sale of investments to plaintiffs and ruled Liebling's agency theory failed because, "Liebling has presented no evidence that he, as agent of GDL, sold investments to plaintiffs." The district judge cramped his review too tightly. He should have examined any acts of Liebling as an agent that arose from the contract. We now undertake to do so because there is no factual dispute on this issue.

As mentioned, the first amended complaint filed by plaintiffs, who are now trying to defrock Liebling as an agent of GDL, alleged that Liebling "sought to profit from the events alleged in this complaint and from the class members." The complaint further states:

On June 3, 1985 he became an officer and director of USA-GDL, INC. and, in those [\*\*747] capacities, accepted the resignations of the other board members of USA-GDL, INC. On June 18, 1985, LIEB-LING formed the Investors Assistance and Restitution Corporation ("IARC"). Later, he sent letters to class members soliciting monies from them to join IARC and for copies of documents and [\*\*14] indicating that he was seeking out a law firm to represent the class members. On February 1, 1986, LIEBLING sent a newsletter to class members in which he solicited additional monies, suggested that class members not start or pursue lawsuits against salespersons who sold the securities described in this complaint, and implied that he had arranged with a law firm to represent the class members' interests. Between June 3, 1985, and February 1, 1986, LIEBLING mailed 4 letters to the class members throughout the United States; in each letter, he solicited monies and implied that he was acting to assist class members. During the same time frame, LIEBLING acquired ownership of GOLD DEPOSITORY & LOAN CO., INC. and its assets for no consideration, on March 5, 1986, was retained by CO-OP INVESTMENT BANK LTD. to provide security and consulting services and thus purported to be assisting the class members and some defendants at the same time [sic]. On June 18, 1986, LIEBLING mailed another newsletter to class members soliciting more monies and advising that those failing to join IARC by July 7, 1986, might forfeit their rights to receive restitution payments. On March 2, 1987, LIEBLING sent [\*\*15] a similar letter to class members. Based on information from newsletters and class members, plaintiffs believe that LIEBLING received monies from class members for services to be provided to them and for membership in several groups which he formed including IARC, "The Legal Action Group," "The GD&L Investors Group" and "The Tax Assistance Group." Based on a letter dated April 7, 1986, from LIEBLING to CO-OP INVESTMENT BANK LTD., plaintiffs believe LIEBLING was an agent of some other defendants. By virtue of his conduct, LIEBLING joined and participated in the conspiracy, plan or scheme as early as June 1985 and has carried on that conspiracy, plan or scheme by discouraging class members from pursuing their legal remedies and by purporting to pursue their remedies when in truth and in fact he was not.

Significantly, plaintiffs allege that the operative time for these acts was starting in June, 1985. Liebling presented an affidavit documenting that he became an officer and director of GDL in May, 1985, and later that same year bought the company.

<sup>2</sup> The district court noted that the proper interpretation of the phrase, "especially to defend against all law suits," appears to be that it modifies the first clause of the sentence, "to strictly abide by all lawful obligations," etc.

Plaintiffs do not present any rebuttal evidence to Liebling's factual proffer and the district court made no factual findings to contradict [\*\*16] Liebling's role as director, agent and employee of GDL. Thus, we accept Liebling's assertion that he was an agent, officer and employee of GDL, starting in May and running through the end of the operative period, for acts, if any, arising under the contract.

That leads us to the key question: Did any of Liebling's alleged wrongdoing as agent, officer or employee of GDL during this alleged period of time relate to or arise out of the contract containing the arbitration clause?

Plaintiffs' only contact with GDL appears to have been through the container lease investments, but that does not answer the key question. The only relevant acts charged against Liebling are set forth in the complaint and none of them seek to impose liability from the contract. In abbreviated form, the allegations are essentially as follows:

- (1) He sent letters to class members soliciting money to join an investors' assistance group;
- (2) He suggested class members not start or pursue law suits against salespersons who sold the securities under the contract;
- (3) He sent letters to class members soliciting monies and J1 implied he was acting to assist them;
- (4) He bought GDL to provide consulting services to class [\*\*17] members; and

[\*748] (5) He discouraged class members from pursuing their remedies by purporting to pursue their remedies when in fact he was not.

The sum and substance of these allegations are that he in some way attempted to defraud the investors into not pursuing their law suits against the persons who originally sold the securities under the contract. These acts are subsequent, independent acts of fraud, unrelated to any provision or interpretation of the contract. They simply do not impose any contractual liability, vicariously or otherwise, upon Liebling. As such, we find that Liebling has no standing to compel arbitration, even though he was an agent, officer and employee of GDL during its later months of existence.

### Conclusion

We conclude that the district court was correct in determining that Liebling lacked standing to enforce the arbitration

clause. Accordingly, we affirm the district court's order denying Liebling's motion to compel arbitration.

AFFIRMED.

**Dissent by: BRUNETTI**

### Dissent

BRUNETTI, Circuit Judge, dissenting:

The majority holds that the acts Liebling allegedly committed were "unrelated to any provision or interpretation of the contract" between plaintiffs and GDL. As a result, it [\*\*18] finds that Liebling lacks standing to invoke the arbitration provision in that contract. The panel's interpretation ignores contemporary federal principles on the issue of arbitrability, and its erroneous conclusion proves fatal to an otherwise well-reasoned opinion. Accordingly, I dissent.

The Supreme Court has emphasized repeatedly the strong federal policy in favor of arbitration:

Where the contract contains an arbitration clause, there is a presumption of arbitrability in the sense that "an order to arbitrate the particular grievance should not be denied unless it may be said with positive assurance that the arbitration clause is not susceptible of an interpretation that covers the asserted dispute. Doubts should be resolved in favor of coverage."

*AT&T Technologies, Inc. v. Communications Workers of America*, 475 U.S. 643, 650, 89 L. Ed. 2d 648, 106 S. Ct. 1415 (1986), quoting *Steelworkers v. Warrior & Gulf Navigation Co.*, 363 U.S. 574, 582-83, 4 L. Ed. 2d 1409, 80 S. Ct. 1347 (1960). The balance of this presumption is the principle that "arbitration is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed to so submit." [\*\*19] *Warrior & Gulf*, 363 U.S. at 582; *Southern California Dist. Council of Laborers v. Berry*

Constr., 984 F.2d 340, 343 (9th Cir. 1993).

We are not free to disregard the presumption in favor of arbitration and weigh the arbitrability of this dispute on an even scale. Because I believe the arbitration clause in this case is unquestionably "susceptible of an interpretation that covers the asserted dispute," I would follow the Court's mandate and direct the matter to arbitration.

The majority recognizes that the arbitration clause in this case is a broad one. It errs, however, in ignoring the settled consequence of that breadth. The clause provided as follows:

Any controversy or claim arising out of or relating to this Agreement or the breach thereof, shall be settled by arbitration . . . and judgment upon the award rendered by the Arbitrator(s) may be entered in any Court having jurisdiction thereof.

Memorandum Opinion and Order at 3.

The majority concludes that the arbitration clause does not cover the instant dispute because Liebling's actions, which formed the basis for the complaint, were "subsequent, independent acts [\*\*20] of fraud, unrelated to any provision or interpretation of the contract," and because "they simply do not impose any contractual liability, vicariously or otherwise, upon Liebling." The scope of this clause, however, is not restricted to controversies [\*749] relating to interpretation or performance of the contract itself.

We travelled this ground in *Mediterranean Enterprises v. Ssangyong*, 708 F.2d 1458 (9th Cir. 1983). In that opinion, we explained the "significant" difference between broad arbitration clauses, which direct to arbitration disputes "arising out of or relating to [an] agreement," and clauses limited to disputes or controversies "under" or "arising out

of" the contract. *Id.* at 1464. The *Ssangyong* court had "no difficulty" finding that the latter type of clause "is intended to cover a much narrower scope of disputes, i.e., only those relating to the interpretation and performance of the contract itself." *Id.* The broader clause, like the one we interpret today, is not so limited.

The majority ignores this distinction. It attributes to our broad clause the effect we have expressly described for the "much narrower" [\*\*21] clause which omits the "or relating to this agreement" language. See *Id.*, quoting *Michele Amoruso e Figli v. Fisheries Development Corp.*, 499 F. Supp. 1074, 1080 (S.D.N.Y. 1980). The majority's construction cannot stand in the shadow of *Ssangyong*.

I would reverse the district court's determination that Liebling lacks standing to invoke the arbitration provision in the GDL contract and direct the court to grant Liebling's request for an order to arbitrate pursuant to that agreement. I would also direct the district court to set aside its earlier order of default in accordance with our prior decision in this case. *Britton v. Co-Op Banking Group*, 916 F.2d 1405, 1414 (9th Cir. 1990). I respectfully dissent.

# APPENDIX 9

## Comer v. Micor, Inc.

United States Court of Appeals for the Ninth Circuit

October 18, 2005; February 1, 2006, Filed

No. 03-16560

### Reporter

436 F.3d 1098; 2006 U.S. App. LEXIS 2442; 36 Employee Benefits Cas. (BNA) 2377

KEVIN COMER, Plaintiff-Appellee, v. MICOR, INC.; KENNETH C. SMITH; ELLIOT H. WAGNER; BARBARA ARBUCCI, Defendants, and SALOMON SMITH BARNEY, INC., Defendant-Appellant.

**Prior History:** **[\*\*1]** Appeal from the United States District Court for the Northern District of California. D.C. No. CV-03-00818-SBA. Sandra B. Armstrong, District Judge, Presiding.

Comer v. Micor, Inc., 278 F. Supp. 2d 1030, 2003 U.S. Dist. LEXIS 20062 (N.D. Cal., 2003)

**Disposition:** AFFIRMED.

### Core Terms

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arbitrate, arbitration clause, nonsignatories, arbitration agreement, plans, third party beneficiary, fiduciary, parties, investment management, agency principles, ordinary contract, principles, estoppel, cases

### Case Summary

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#### Procedural Posture

Appellant, a company that provided investment advice, sought review of an order from the United States District Court for the Northern District of California, which denied the company's motion to stay the proceedings and to compel arbitration of appellee plan participant's action alleging breach of fiduciary duty under 29 U.S.C.S. §§ 1109, 1132(a)(2) of the Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C.S. § 1001 et seq.

#### Overview

Defendant plan trustees retained the company to provide investment advice for two ERISA plans operated by the participant's employer, also a named defendant. The relationship between the trustees and the investment

company was governed by investment management agreements that contained arbitration clauses. The participant, who did not sign the agreements, filed the ERISA action after the plans suffered heavy investment losses. Although the court concluded that a nonsignatory could be bound by an arbitration agreement under ordinary contract and agency principles, it held that the arbitration agreements did not apply to the participant's ERISA claim against the company. The participant was not bound by the arbitration clauses as a matter of equitable estoppel or as a third-party beneficiary. As to equitable estoppel, the company's attempt to shoehorn the status as a passive participant in the plans into the participant's knowing exploitation of the investment management agreements failed. As to the third-party beneficiary claim, there was no evidence that the signatories to the agreements intended to give plan participants the right to sue under the agreements.

#### Outcome

The court affirmed the judgment.

### LexisNexis® Headnotes

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Contracts Law > Contract Conditions & Provisions > Arbitration Clauses

**HNI** Nonsignatories of arbitration agreements may be bound by the agreement under ordinary contract and agency principles. Among these principles are: (1) incorporation by reference; (2) assumption; (3) agency; (4) veil-piercing/alter ego; and (5) estoppel. In addition, nonsignatories can enforce arbitration agreements as third party beneficiaries.

Contracts Law > Contract Conditions & Provisions > Arbitration Clauses

Contracts Law > ... > Estoppel > Equitable Estoppel > General Overview

Contracts Law > ... > Estoppel > Equitable Estoppel > Elements of Equitable Estoppel

**HN2** Equitable estoppel precludes a party from claiming the benefits of a contract while simultaneously attempting to avoid the burdens that contract imposes. In the arbitration context, this principle has generated two lines of cases. Under the first of these lines, nonsignatories have been held to arbitration clauses where the nonsignatory knowingly exploits the agreement containing the arbitration clause despite having never signed the agreement. Under the second line of cases, signatories have been required to arbitrate claims brought by nonsignatories at the nonsignatory's insistence because of the close relationship between the entities involved.

Contracts Law > Third Parties > Beneficiaries > General Overview

Contracts Law > Third Parties > Beneficiaries > Claims & Enforcement

**HN3** To sue as a third-party beneficiary of a contract, the third party must show that the contract reflects the express or implied intention of the parties to the contract to benefit the third party. A third party beneficiary might in certain circumstances have the power to sue under a contract; it certainly cannot be bound to a contract it did not sign or otherwise assent to.

Contracts Law > Contract Conditions & Provisions > Arbitration Clauses

**HN4** The United States Court of Appeals for the Ninth Circuit joins many of its sister circuits who, in the wake of *Waffle House*, have recognized that contract and agency principles continue to bind nonsignatories to arbitration agreements.

Contracts Law > Contract Conditions & Provisions > Arbitration Clauses

**HN5** The federal policy favoring arbitration does not apply to the determination of whether there is a valid agreement to arbitrate between the parties; instead ordinary contract principles determine who is bound.

**Counsel:** Peter R. Boutin and Benjamin W. White, Keesal, Young & Logan, P.C., San Francisco, California, for the defendant-appellant.

Daniel Feinberg and Thuy T. Le, Lewis & Feinberg, P.C., Oakland, California, for the plaintiff-appellee.

**Judges:** Before: Alex Kozinski and Ferdinand F. Fernandez, Circuit Judges, and Terry J. Hatter, Jr., \* District Judge. Opinion by Judge Kozinski.

**Opinion by:** ALEX KOZINSKI

## Opinion

[\*1099] KOZINSKI, Circuit Judge:

We consider whether an ERISA-plan participant can be compelled to arbitrate an ERISA claim brought on behalf of the plan where the plan--but not the participant--has signed an arbitration agreement.

### Facts

Kevin Comer was a participant in two ERISA plans operated by Micor, Inc. The [\*1100] plan trustees retained Salomon Smith Barney, Inc. (Smith Barney) to provide investment advice. The relationship between Smith Barney and the trustees is governed by [\*\*2] investment management agreements. The agreements contain arbitration clauses, pursuant to which "all claims or controversies" between the trustees and Smith Barney "concerning or arising from" any of the trustees' accounts managed by Smith Barney must be submitted to binding arbitration.

From 1999 through 2002, Smith Barney allegedly concentrated the plans' assets in high-tech and telecom stocks. Even after the bubble burst in early 2000, Smith Barney allegedly maintained its concentrated positions. The plans suffered heavy investment losses.

Comer sued Smith Barney under the Employee Retirement Income Security Act of 1974, 29 U.S.C. §§ 1001-1461 (ERISA), for breach of fiduciary duty. *See id.* §§ 1104(a)(1)(A)(i), 1109(a), 1132(a)(2).<sup>1</sup> As the district court explained, "by bringing suit under 29 U.S.C. § 1132(a)(2), Plaintiff is seeking relief available under 29 U.S.C. § 1109 [for breach of fiduciary duty], which provides for the making good to the Plans--not to Plaintiff himself--of any losses incurred as a result of [Smith Barney's] alleged breach of fiduciary duty." *Comer v. Micor, Inc.*, 278 F. Supp. 2d 1030, 1038 (N.D. Cal. 2003); [\*\*3] *see also Parker v. BankAmerica Corp.*, 50 F.3d 757, 768 (9th Cir. 1995) ("Although individual beneficiaries may bring a breach of fiduciary duty claim

\* The Honorable Terry J. Hatter, Jr., Senior United States District Judge for the Central District of California, sitting by designation.

<sup>1</sup> Smith Barney is a fiduciary under ERISA because it provided investment advice to the plans for a fee. *See* 29 U.S.C. § 1002(21)(A)(ii).

against an ERISA plan administrator, they must do so for the benefit of the plan. 'Any recovery for a violation of [§ 1132(a)(2)] must be on behalf of the plan as a whole, rather than inuring to individual beneficiaries.'" (alteration in original) (quoting *Horan v. Kaiser Steel Ret. Plan*, 947 F.2d 1412, 1418 (9th Cir. 1991))).<sup>2</sup>

[\*\*4] Smith Barney unsuccessfully petitioned the district court to stay the proceedings against Smith Barney and compel arbitration, and it now appeals.<sup>3</sup>

## Discussion

We have, in the past, expressed skepticism about the arbitrability of ERISA claims, see *Amaro v. Cont'l Can Co.*, 724 F.2d 747, 750 (9th Cir. 1984), but those doubts seem to have been put to rest by the Supreme Court's opinions in *Shearson/American Express Inc. v. McMahon*, 482 U.S. 220, 226, 107 S. Ct. 2332, 96 L. Ed. 2d 185 (1987) ("[The] duty to enforce arbitration agreements is not diminished when a party bound by an agreement raises a claim founded on statutory rights."), and *Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477, 481, 109 S. Ct. 1917, 104 L. Ed. 2d 526 (1989) [\*\*5] (enforcing agreement to arbitrate claims arising under the Securities Act of 1933 and stating that prior decisions holding such clauses unenforceable had "fallen far out of step with our current strong endorsement of the federal statutes favoring this method of resolving disputes"). In [\*1101] fact, on the force of *McMahon*, we have held other statutory claims arbitrable. See, e.g., *Simula, Inc. v. Autoliv, Inc.*, 175 F.3d 716, 724 (9th Cir. 1999) (antitrust and Lanham Act claims). Curiously, however, we have echoed the doubts expressed in *Amaro* without taking account of the intervening Supreme Court cases. See *Graphic Commc'ns Union, Dist. Council No. 2 v. GCIU-Employer Ret. Benefit Plan*, 917 F.2d 1184, 1187 (9th Cir. 1990); *Johnson v. St. Frances Xavier Cabrini Hosp.*, 910 F.2d 594, 596 (9th Cir. 1990).

We need not resolve this tension in our caselaw because the parties seem to agree that ERISA claims are arbitrable. Nor need we consider whether the scope of this particular arbitration clause, which does not mention statutory claims or ERISA, is sufficiently broad to cover Comer's claim. We assume, as do the parties, [\*\*6] that were this claim brought by the trustees, rather than by Comer, it would have to be submitted to arbitration.<sup>4</sup>

We turn, then, to the single issue that was briefed and argued by the parties: whether the arbitration agreements apply to Comer's ERISA claim against Smith Barney. In *Letizia v. Prudential Bache Securities, Inc.*, 802 F.2d 1185 (9th Cir. 1986), we explained that *HNI* "nonsignatories of arbitration agreements may be bound by the agreement under ordinary contract and agency principles." *Id.* at 1187-88.<sup>5</sup> Among these principles are "1) incorporation by reference; 2) assumption; 3) agency; 4) veil-piercing/alter ego; and 5) estoppel." *Thomson-CSF, S.A. v. Am. Arbitration Ass'n*, 64 F.3d 773, 776 (2d Cir. 1995). In addition, nonsignatories can enforce arbitration agreements as third party beneficiaries. See *E.I. DuPont de Nemours & Co. v. Rhone Poulenc Fiber & Resin Intermediates*, 269 F.3d 187, 195 (3d Cir. 2001). [\*\*7]

Smith Barney argues that Comer is bound by the arbitration clauses as a matter of equitable estoppel and as a third party beneficiary. *HN2* Equitable estoppel "precludes a party from claiming the benefits of a contract while simultaneously attempting to avoid the burdens that [\*\*8] contract imposes." *Wash. Mut. Fin. Group, LLC v. Bailey*, 364 F.3d 260, 267 (5th Cir. 2004). In the arbitration context, this principle has generated two lines of cases.

Under the first of these lines, *nonsignatories* have been held to arbitration clauses where the nonsignatory "knowingly exploits the agreement containing the arbitration clause despite having never signed the agreement." *DuPont*, 269

<sup>2</sup> Smith Barney does not challenge Comer's Article III standing, probably because Comer, as a plan participant, has alleged sufficient "injury in fact" on account of Smith Barney's investment advice and because Comer would share in any recovery by the plans. See *Friends of the Earth, Inc. v. Laidlaw Envtl. Servs. (TOC), Inc.*, 528 U.S. 167, 180-81, 120 S. Ct. 693, 145 L. Ed. 2d 610 (2000).

<sup>3</sup> Comer's complaint also names Micor and the trustees as defendants. The trustees joined in Comer's opposition to Smith Barney's petition to compel arbitration. *Comer*, 278 F. Supp. 2d at 1032. Neither Micor nor the trustees are parties to this appeal.

<sup>4</sup> We do not express any opinion as to litigation that might ensue between the trustees and Smith Barney.

<sup>5</sup> Our holding in *IT Corp. v. General American Life Insurance Co.*, 107 F.3d 1415 (9th Cir. 1997), is not to the contrary. There, we held that "a fiduciary's contract with an employer cannot get it off the hook with the employees who participate in the ERISA plan. They did not sign a contract *exonerating* the fiduciary." *Id.* at 1418 (emphasis added). Unlike an exoneration clause--which has the drastic effect of extinguishing a claim entirely--an arbitration clause merely determines where, not whether, a claim will be heard. We do not read *IT Corp.* as casting doubt on *Letizia*'s core holding that a nonsignatory can be bound by an arbitration agreement under ordinary contract and agency principles.

F.3d at 199 (citing *Thomson-CSF*, 64 F.3d at 778). Under the second line of cases, *signatories* have been required to arbitrate claims brought by nonsignatories "at the nonsignatory's insistence because of the close relationship between the entities involved." *Id.* (quoting *Thomson-CSF*, 64 F.3d at 779 (quoting *Sunkist Soft Drinks, Inc. v. Sunkist Growers, Inc.*, 10 F.3d 753, 757 (11th Cir. 1993))) (internal quotation marks omitted).

Because Smith Barney is invoking equitable estoppel against a nonsignatory, it is [\*1102] the first line of cases that is relevant. The insurmountable hurdle for Smith Barney, however, is that there is no evidence that Comer "knowingly exploited the agreement[s] containing [\*\*9] the arbitration clause[s] despite having never signed the agreement[s]." *Id.* at 199. Prior to his suit, Comer was simply a participant in trusts managed by others for his benefit. He did not seek to enforce the terms of the management agreements, nor otherwise to take advantage of them. Nor did he do so by bringing this lawsuit, which he bases entirely on ERISA, and not on the investment management agreements. Smith Barney's attempt to shoehorn Comer's status as a passive participant in the plans into his "knowing[] exploitation" of the investment management agreements fails.

Smith Barney argues an alternate theory--that Comer is bound by the arbitration clauses as a third party beneficiary. **HN3** "To sue as a third-party beneficiary of a contract, the third party must show that the contract reflects the express or implied intention of the parties to the contract to benefit the third party." *Klamath Water Users Protective Ass'n v. Patterson*, 204 F.3d 1206, 1211 (9th Cir. 2000). Smith Barney has not produced any evidence that the signatories to the investment management agreements intended to give every beneficiary of the plans, such as Comer, the right to [\*\*10] sue under the agreements. <sup>6</sup> It follows that Comer cannot be bound to the terms of a contract he didn't sign and is not even entitled to enforce. A third party beneficiary might in certain circumstances have the power to sue under a contract; it certainly cannot be *bound* to a contract it did not sign or otherwise assent to. See *Motorsport Eng'g, Inc.*

*v. Maserati SPA*, 316 F.3d 26, 29 (1st Cir. 2002); *Abraham Zion Corp. v. Lebow*, 761 F.2d 93, 103 (2d Cir. 1985). <sup>7</sup>

[\*\*11] Finally, we consider the Third Circuit's position that "whether seeking to avoid or compel arbitration, a third party beneficiary has been bound by contract terms where its claim *arises out of* the underlying contract to which it was an intended third party beneficiary." *DuPont*, 269 F.3d at 195 (emphasis added). <sup>8</sup> One problem with the Third Circuit's approach is that it is not grounded in "ordinary contract and agency principles." *Letizia*, 802 F.2d at 1187. As discussed above, neither principles of equitable estoppel nor third party beneficiary apply here. Nor can the Micor trustees be said to have acted as Comer's agents in entering into the investment management agreements. See Restatement (Second) of Trusts § 8 ("An agency is not a trust."). Similarly, there is no evidence that Comer's "subsequent conduct indicates that [he] is assuming the obligation to arbitrate." [\*1103] *Thomson-CSF*, 64 F.3d at 777. Nor has Comer "entered into a separate contractual relationship with [Smith Barney] which incorporates the existing arbitration clause." *Id.* And theories of veil-piercing and alter ego [\*\*12] are inapplicable, given the absence of either fraud or a failure to observe corporate formalities. Because the Third Circuit's "arises out of" test is not grounded in any principle of contract or agency law of which we are aware, we are precluded by *Letizia* from adopting it.

Even if the Third Circuit's test were grounded in ordinary principles of contract or agency law, it appears to have been superseded by *EEOC v. Waffle House, Inc.*, 534 U.S. 279, 122 S. Ct. 754, 151 L. Ed. 2d 755 (2002). [\*\*13] In *Waffle House*, the Supreme Court held that "an agreement between an employer and an employee to arbitrate employment-related disputes [did not bar] the Equal Employment Opportunity Commission . . . from pursuing victim-specific judicial relief." *Id.* at 282, 294. The EEOC's suit in *Waffle House*, on behalf of a Waffle House employee, "arose from" an employment agreement containing an arbitration clause. Nevertheless, the EEOC was not required to arbitrate its claim. *Id.* at 294.

<sup>6</sup> We note, once again, that Comer's lawsuit is not based on contract law, but on a statutory provision that allows him to bring suit under ERISA on behalf of the plans.

<sup>7</sup> Trust law provides a similar answer. Under trust law, the beneficiary of a trust "is not personally liable upon contracts made by the trustee in the course of the administration of the trust." Restatement (Second) of Trusts § 275 (1959). In contrast to agents--who *can* subject their principals to personal liability--"a trustee *cannot* subject the beneficiary to such liabilities." *Id.* § 8 cmt. c (emphasis added).

<sup>8</sup> This principle, or something like it, was applied by a New Jersey district court in *Bevere v. Oppenheimer & Co.*, 862 F. Supp. 1243 (D.N.J. 1994), a case that involved facts quite similar to our own. There, the district court held that "individuals who are not direct signatories to an arbitration agreement may nevertheless be bound by it when their claims *arise from* the very contract that contains the arbitration clause." *Id.* at 1249 (emphasis added). For the reasons discussed below, we do not consider *Bevere*'s holding persuasive.

Smith Barney tries in vain to distinguish *Waffle House* by arguing that, whereas Comer is suing in an entirely derivative capacity, the EEOC was suing in a non-derivative capacity. We agree that the EEOC in *Waffle House* was not suing in a wholly derivative capacity. *See, e.g., id.* at 297 (“It simply does not follow from the cases holding that the employee’s conduct may affect the EEOC’s recovery that the EEOC’s claim is merely derivative. We have recognized several situations in which the EEOC does not stand in the employee’s shoes.”); *id.* at 298 (“The fact that ordinary principles of res judicata, mootness, or mitigation [\*\*14] may apply to EEOC claims does not . . . render the EEOC a proxy for the employee.”). But that doesn’t help Smith Barney because our own precedents hold that an ERISA claimant *also* sues in a non-derivative capacity. *See Landwehr v. DuPree*, 72 F.3d 726, 732-33 (9th Cir. 1995).

In *Landwehr*, we considered whether the statute of limitations for an ERISA claim ran from when the individual plaintiff, rather than the plan, became aware of the claim. Citing the “unfairness” that would result from a rule that

extinguished a plaintiff’s claim where the plan became aware of the claim—and did nothing—long before the individual plaintiff had notice of it, we held that the statute of limitations ran from the time when the individual plaintiff had actual knowledge of the claim. *Id.* at 732. In so holding, we expressly declined to treat the “real plaintiff” as the plan. *See id.* Even though money recovered on the ERISA claim would go to the plan, we held that the cause of action belonged to the individual plaintiff.<sup>9</sup> Comer’s cause of action is materially indistinguishable from the EEOC’s suit in *Waffle House*, which appears to have overruled [\*\*15] the Third Circuit’s approach.

\* \* \*

Because Smith Barney’s petition comes within the general rule that a nonsignatory [\*\*1104] is not bound by an arbitration clause,<sup>10</sup> [\*\*16] Comer is not required to arbitrate his ERISA claim against Smith Barney.<sup>11</sup>

**AFFIRMED.**

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<sup>9</sup> The Court in *Waffle House* relied on a similar precedent in determining that the EEOC was not suing in a wholly derivative capacity. *See Waffle House*, 534 U.S. at 287 (“We recognized the difference between the EEOC’s enforcement role and an individual employee’s private cause of action in *Occidental Life Ins. Co. of Cal. v. EEOC*, 432 U.S. 355, 97 S. Ct. 2447, 53 L. Ed. 2d 402 (1977) . . . *Occidental* presented the question whether EEOC enforcement actions are subject to the same statutes of limitations that govern individuals’ claims.”).

<sup>10</sup> We note in passing that *Waffle House* made a number of categorical statements that cannot be taken at face value. For example, the Court’s statement that “it goes without saying that a contract cannot bind a non-party,” *Waffle House*, 534 U.S. at 294, and its statement that “the [Federal Arbitration Act] directs courts to place arbitration agreements on equal footing with other contracts, but it does not require parties to arbitrate when they have not agreed to do so,” *id.* at 293 (quoting *Volt Information Sciences v. Board of Trustees*, 489 U.S. 468, 478, 109 S. Ct. 1248, 103 L. Ed. 2d 488 (1989)), would, if taken literally, jettison hundreds of years of common law under which nonparties can be contractually liable under ordinary contract and agency principles. *See pp.* 1238-39 *supra*. **HN4** We thus join many of our sister circuits who, in the wake of *Waffle House*, have recognized that contract and agency principles continue to bind nonsignatories to arbitration agreements. *See, e.g., CD Partners, LLC v. Grizzle*, 424 F.3d 795, 799 (8th Cir. 2005); *Zurich Am. Ins. Co. v. Watts Indus., Inc.*, 417 F.3d 682, 687 (7th Cir. 2005); *Wash. Mut. Fin. Group, LLC*, 364 F.3d at 267; *Intergen N.V. v. Grina*, 344 F.3d 134, 145 (1st Cir. 2003); *Merrill Lynch Inv. Managers v. Optibase, Ltd.*, 337 F.3d 125, 129 (2d Cir. 2003) (per curiam); *Javitch v. First Union Sec., Inc.*, 315 F.3d 619, 629 (6th Cir. 2003). *But cf. Miles v. Naval Aviation Museum Found., Inc.*, 289 F.3d 715, 720 (11th Cir. 2002) (holding that, under *Waffle House*, nonsignatory could not be bound by contractual exculpation clause).

<sup>11</sup> Although we agree with Smith Barney that the Federal Arbitration Act reflects “a liberal federal policy favoring arbitration agreements,” that policy is best understood as concerning “the scope of arbitrable issues.” *Moses H. Cone Mem’l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24-25, 103 S. Ct. 927, 74 L. Ed. 2d 765 (1983). The question here is not whether a particular issue is arbitrable, but whether a particular party is bound by the arbitration agreement. Under these circumstances, the liberal federal policy regarding the scope of arbitrable issues is inapposite. *See Fleetwood Enters., Inc. v. Gaskamp*, 280 F.3d 1069, 1073 (5th Cir. 2002) **HN5** (“[The] federal policy favoring arbitration does not apply to the determination of whether there is a valid agreement to arbitrate between the parties; instead ordinary contract principles determine who is bound.” (second alteration in original) (quoting *Daisy Mfg. Co. v. NCR Corp.*, 29 F.3d 389, 392 (8th Cir. 1994))).

# APPENDIX 10

## Coppock v. Citigroup, Inc.

United States District Court for the Western District of Washington

March 22, 2013, Decided; March 22, 2013, Filed

CASE NO. C11-1984-JCC

### Reporter

2013 U.S. Dist. LEXIS 40632; 2013 WL 1192632

GLORIA I. COPPOCK, Plaintiff, v. CITIGROUP, INC., CITIBANK, N.A., successor in interest to Citibank (South Dakota), N.A., DOES 1-10 and COLLECTION AGENTS 1-10, Defendants.

**Prior History:** Hicks v. Citigroup, Inc., 2012 U.S. Dist. LEXIS 8979 (W.D. Wash., Jan. 26, 2012)

### Core Terms

arbitration, arbitration agreement, card, terms, unconscionable, discovery, applies, arbitration clause, parties, notice, cardholder, motion to compel arbitration, opt out, vindicating, credit card, Consumer, provides, binding, arbitration provision, notice of change, procedurally, responses, changes, cases, procedural unconscionability, forum selection clause, compel arbitration, quotation marks, statutory right, arbitration-related

**Counsel:** [\*1] For Gloria I. Coppock, Plaintiff: Duane M. Dawson, DAWSON LAW, MARYSVILLE, WA; Kim Williams, LEAD ATTORNEY, Roblin John Williamson, WILLIAMSON & WILLIAMS, SEATTLE, WA.

For Citigroup Inc, Citibank, N.A., successor in interest Citibank (South Dakota), N.A., Defendants: John R Bachofner, Russell D Garrett, JORDAN RAMIS PC, VANCOUVER, WA.

**Judges:** THE HONORABLE John C. Coughenour, UNITED STATES DISTRICT JUDGE.

**Opinion by:** John C. Coughenour

### Opinion

#### ORDER GRANTING DEFENDANTS' MOTION TO COMPEL ARBITRATION AND DENYING PLAINTIFF'S MOTION TO COMPEL DISCOVERY

This matter comes before the Court on Defendants Citigroup, Inc.'s and Citibank, N.A.'s ("Citi's") motion to compel arbitration and stay this action pending arbitration (Dkt. No. 43) and Plaintiff Gloria Coppock's motion to compel discovery (Dkt. No. 55). Having thoroughly considered the parties' briefing<sup>1</sup> and the relevant record, the Court finds oral argument unnecessary and hereby GRANTS Defendants' motion to compel arbitration (Dkt. No. 43) and denies Coppock's motion to compel discovery (Dkt. No. 55) for the reasons explained herein.

#### I. BACKGROUND

This is a putative class action asserting violations of the Telephone Consumer Protection Act ("TCPA"), the Fair Debt Collection Practices Act ("FDCPA"), and Washington's Consumer Protection Act ("CPA"). (Dkt. No. 40 § III.) Coppock alleges that, "on ten to fifteen occasions, [Citi] . . . plac[ed] calls to [her] cellular telephone" using "'automatic telephone dialing equipment,' including predictive dialer equipment," "in order to collect a debt allegedly owed by" her under her Citi credit card. (*Id.* at 3-4 ¶¶ 2.3, 2.5.) Citi moves to compel arbitration of Coppock's claims.

Coppock opened a credit card account with Citi in 1994. (*Id.* ¶ 7.) The card agreement governing the account authorized Citi to change the terms of the agreement at any time, with changes binding on the card holder. (Dkt. No. 44 Exs. 1 at 5, 9 at 2, 12 at 10, [\*3] 15 at 12.) In October 2001, Citi mailed its card holders, including Coppock, a "Notice of

<sup>1</sup> This case represents the second time a federal district court has considered—and rejected—Plaintiff's arguments. That is because Plaintiff's [\*2] attorneys lifted almost all of her brief—and almost verbatim—from the brief filed by the plaintiffs in *Cayanan v. Citi Holdings, Inc.*, No. 12-CV-1476-MMA(JMA), \_\_\_F. Supp. 2d \_\_\_, 2013 U.S. Dist. LEXIS 28597, 2013 WL 784662 (S.D. Cal. Mar. 1, 2013). See Plaintiffs' Opposition to Motion of Defendants to Compel Arbitration and Stay Action (Dkt. No. 20), *Cayanan* (Dec. 3, 2012).

Change in Terms Regarding Binding Arbitration to Your Citibank Card Agreement.” (Dkt. No. 44 ¶¶ 10-11, 13-16 & Exs. 2 & 5.) Coppock’s October and November 2001 billing statements also included messages in all-capital letters alerting Coppock to the notice of change in terms. (*Id.* ¶¶ 11-12 & Ex. 3-4.) The notice added to the card agreement an arbitration agreement allowing either party to demand individual (non-class) arbitration. (*Id.* Ex. 2.) It further provided:

If you do not wish to accept the binding arbitration provision contained in this change in terms notice, you must notify us in writing within 26 days after the Statement/Closing date indicated on your November 2001 billing statement stating your non acceptance . . . . If you notify us by that time that you do not accept the binding arbitration provisions contained in this change in terms notice, you can continue to use your card(s) under your existing terms until the end of your current membership year or the expiration date on your card(s), whichever is later. At that time your account will be closed and you will be able to pay off your [\*4] remaining balance under your existing terms.

(*Id.* ¶ 17 & Ex. 2 at 5.) Coppock did not contact Citi to reject the arbitration provision. (*Id.* ¶¶ 18-19 & Ex. 6.) Citi sent another notice of change in terms, making certain amendments to the arbitration agreement, in 2005, and again alerted Coppock to the notice in her billing statement and gave her the option of opting out of the changes. (*Id.* ¶ 21 & Exs. 7-8.) Citi sent Coppock several subsequent card agreements, all of which contained the arbitration agreement. (*Id.* ¶¶ 22-30, Exs. 9-10, 12-13, 15-16.) Coppock continued to use her Citi credit card following receipt of these agreements, until shortly after she began receiving the phone calls from Citi at issue in this case. (*Id.* ¶¶ 24, 27, 30; Dkt. No. 40 at 3 ¶ 2.4.)

## II. DISCUSSION

The Federal Arbitration Act (“FAA”) provides that arbitration agreements “shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.” 9 U.S.C. § 2. In deciding a motion to compel arbitration, a court’s role is “limited to determining (1) whether a valid agreement to arbitrate exists and, if it does, (2) whether the agreement encompasses [\*5] the dispute at issue.” *Chiron Corp. v. Ortho Diagnostic Sys., Inc.*, 207 F.3d 1126, 1130 (9th Cir. 2000). The court applies a summary judgment-like standard to factual disputes. *Concat LP v. Unilever, PLC*, 350 F. Supp. 2d 796, 804 (N.D. Cal. 2004).

## A. Whether A Valid Arbitration Agreement Exists

### 1. Choice Of Law

“[A] federal court sitting in diversity applies the conflict-of-law rules of the state in which it sits,” but where jurisdiction is based on the existence of a federal question, “federal common law applies to the choice-of-law rule determination.” *Daugherty v. Experian Info. Solutions, Inc.*, 847 F. Supp. 2d 1189, 1194 (N.D. Cal. 2012) (quoting *Schoenberg v. Exportadora de Sal, S.A. de C.V.*, 930 F.2d 777, 782 (9th Cir. 1991)). This Court has jurisdiction over Coppock’s complaint under both 28 U.S.C. §§ 1331 and 1367(a) (federal question and supplemental jurisdiction) and 1332(a) (diversity jurisdiction). Both Washington and the federal common law follow the Restatement (Second) of Conflict of Laws. *Daugherty*, 847 F. Supp. 2d at 1194; *Erwin v. Cotter Health Ctrs.*, 161 Wn.2d 676, 167 P.3d 1112, 1121 (Wash. 2007). Restatement § 187(2) provides:

The law of the state chosen by the parties to govern [\*6] their contractual rights and duties will be applied . . . unless either

(a) the chosen state has no substantial relationship to the parties or the transaction and there is no other reasonable basis for the parties’ choice, or

(b) application of the law of the chosen state would be contrary to a fundamental policy of a state which has a materially greater interest than the chosen state in the determination of the particular issue and which, under the rule of § 188, would be the state of the applicable law in the absence of an effective choice of law by the parties.

Coppock’s card agreement with Citi provides that “[t]he terms and enforcement of this Agreement shall be governed by federal law and the law of South Dakota, where we are located.” (Dkt. No. 44 Exs. 1 at 5, 9 at 2, 12 at 10, 15 at 16.) Coppock asserts that, notwithstanding this forum selection clause, Washington law applies. The only argument she makes in support is that, under Restatement § 188, Washington would be the state of the applicable law in the absence of the forum selection clause. (Dkt. No. 47 at 9.) But even if Coppock were correct, in order for Washington law to apply under § 187(2)(b), South Dakota law would have [\*7] to contravene a fundamental policy of Washington, and Washington would have to have a materially greater interest than South Dakota in determining whether Coppock agreed to the arbitration provisions. Coppock has argued nothing to that effect. And nor does the exception in §

187(2)(a) apply. South Dakota has a substantial relationship to Citi: The card agreement provides that South Dakota is “where we [Citi Defendants] are located” (Dkt. No. 44 Exs. 1 at 5, 9 at 2, 12 at 10, 15 at 16), and thus there is a “reasonable basis for the parties’ choice” of South Dakota. Restatement § 187(2)(a). The Court thus applies South Dakota law. *See, e.g., Daugherty*, 847 F. Supp. 2d at 1195 (applying South Dakota law “to resolve the question of whether the arbitration provision is valid,” where Citi card holder “has not argued, let alone established that South Dakota law is contrary to a fundamental policy of . . . California”); *Guerrero v. Equifax Credit Info. Servs., Inc.*, No. CV 11-6555 PSG (PLAx), 2012 U.S. Dist. LEXIS 150428, 2012 WL 7683512, at \*6 (C.D. Cal. Feb. 24, 2012) (applying South Dakota law to resolve question of whether Citi card holder “entered into the arbitration agreement when he was mailed the 2001 Change-in-Terms, [\*8] failed to take advantage of the optout provision, and continued to use the card”).

Coppock confusingly cites to a case in which there was a “chicken and egg” problem in deciding which state’s law applied—because the parties disputed whether the plaintiff had ever agreed to the contract that contained the forum selection clause in the first place—and in which the court concluded it did not need to decide which state’s law governed because the outcome was the same under both. *Nguyen v. Barnes & Noble, Inc.*, No. 8:12-cv-0812-JST (RNBx), 2012 U.S. Dist. LEXIS 122455, 2012 WL 3711081, at \*3 & n.3 (C.D. Cal. Aug. 28, 2012). Coppock says that here, as in *Nguyen*, “application of South Dakota law ‘stems from the as-yet-undetermined proposition that [the] parties agreed to [Citi’s] Terms of Use[,]’ a question the Court need not decide now: . . . ‘the validity of the arbitration provision[] does not hinge on whether [Washington] or [South Dakota] law applies.’” (Dkt. No. 47 at 13 (quoting *Nguyen*, 2012 U.S. Dist. LEXIS 122455, 2012 WL 3711081, at \*3).) But there is no “chicken and egg” problem here as there was in *Nguyen*, since the forum selection clause here is in the card agreement—which undisputedly governs Coppock’s account—not the arbitration agreement. [\*9] Equally off-point is Coppock’s citation to an inapposite case involving an “agreement [that was] *ambiguous* concerning whether English [or U.S.] law . . . applie[d] . . . .” *Cape Flattery Ltd. v. Titan Mar., LLC*, 647 F.3d 914, 921 (9th Cir. 2011) (emphasis added). Unlike in *Cape Flattery*, here, the agreement clearly provides for the application of South Dakota law, and Coppock has not shown that an exception to the general rule applying the law of the contractually-chosen state applies.

## 2. Analysis

“The party seeking to enforce an arbitration agreement bears the burden of showing that the agreement exists and that its terms bind the other party.” *Gelow v. Cent. Pac. Mortg. Corp.*, 560 F. Supp. 2d 972, 978 (E.D. Cal. 2008) (citing *Sanford v. Memberworks, Inc.*, 483 F.3d 956, 962 (9th Cir. 2007), and *Three Valleys Mun. Water Dist. v. E.F. Hutton & Co.*, 925 F.2d 1136, 1139-41 (9th Cir. 1991)). “This burden is a substantial one[.]” *Id.* at 979. “Before a party to a lawsuit can be ordered to arbitrate . . . , there should be an express, unequivocal agreement to that effect . . . The district court . . . should give to the opposing party the benefit of all reasonable doubts and inferences that [\*10] may arise.” *Three Valleys*, 925 F.2d at 1141.

In October 2001, the South Dakota statute on modification of credit card agreements provided:

Upon written notice, a credit card issuer may change the terms of any credit card agreement, if such right of amendment has been reserved, . . . so long as the card holder does not, within twenty-five days of the effective date of the change, furnish written notice to the issuer that he does not agree to abide by such changes. . . . Use of the card after the effective date of the change of terms . . . is deemed to be an acceptance of the new terms, even though the twenty-five days have not expired.

S.D. Codified Laws § 54-11-10 (2001); *see Cayanan*, 2013 U.S. Dist. LEXIS 28597, 2013 WL 784662, at \*12 (“[U]nder South Dakota law, an agreement to arbitrate exists between [plaintiff] and Defendants if [plaintiff] continued to use her credit account after she received the ‘bill stuffer’ notices.”). The statute governing the creation of a contract between a card holder and an issuer further provided:

The use of an accepted credit card or the issuance of a credit card agreement and the expiration of thirty days from the date of issuance without written notice from a card holder to cancel [\*11] the account creates a binding contract between the card holder and the card issuer with reference to any accepted credit card, and any charges made with the authorization of the primary card holder.

S.D. Codified Laws § 54-11-9 (2001).

Here, consistent with the terms of the card agreement, Citi notified Coppock that it was adding the arbitration agreement to the card agreement effective November 2001. Coppock did not notify Citi that she did not agree to abide by the changes, and she continued to use her card. Moreover, she

received at least three more complete card agreements that incorporated the arbitration agreement, did not opt out, and continued to use her card. By her actions, under South Dakota law, Coppock assented to the terms of the arbitration agreement. *See, e.g., Daugherty*, 847 F. Supp. 2d at 1195-96 & n.5 (2006) (Citi change in terms validly amended card agreement); *Cayanan*, 2013 U.S. Dist. LEXIS 28597, 2013 WL 784662, at \*12 (holding, under South Dakota law, that plaintiff "assented to arbitration when she continued to use her [Citi] Thank You Card account after receiving change-of-terms notices and failed to opt out of the changed terms"); *Guerrero*, 2012 U.S. Dist. LEXIS 150428, 2012 WL 7683512, at \*6 ("Applying South Dakota law, [\*12] the Court finds that Plaintiff entered into the arbitration agreement when he was mailed the 2001 Change—in—Terms, failed to take advantage of the optout provision, and continued to use the card."); *Ackerberg v. Citicorp USA, Inc.*, No. C 12-03484 SI, 898 F. Supp. 2d 1172, 2012 U.S. Dist. LEXIS 149297, 2012 WL 4932618, at \*3 (N.D. Cal. Oct. 16, 2012) (collecting "[n]umerous" cases in which "courts have found that continued use or failure to opt out of a card account after the issuer provides a change in terms, including an arbitration agreement, evidences the cardholder's acceptance of those terms"). Coppock cites to a slew of cases applying other states' laws, or concerning changes in terms that gave card holders effectively no ability to opt out. Those cases do nothing to call into question the effectiveness of the notice of change in terms, Coppock's failure to opt out, and her continued use of her card to bind her to the arbitration clause under South Dakota law.

Coppock objects that "Citibank d[id] not produce with its Motion the agreement it claims was entered into by Ms. Coppock in 1994," when Coppock opened the account. (Dkt. No. 47 at 5.) But the relevant agreement is the one in effect in October 2001, when [\*13] Citi added the arbitration clause to it, since the issue here is whether that addition was a valid amendment to the agreement. Coppock has produced no evidence that the 2001 agreement (an exemplar of which Citi submitted with its motion (Dkt. No. 44 Ex. 1)) is *not* the agreement that governed her account in October 2001. Coppock also states that she does not recall "entering into an arbitration agreement with Citibank," "reading any documents from Citibank informing [her] that [she] was to be bound by an arbitration agreement," or receiving the 2001, 2005, 2006, or 2009 card agreement or the 2001 or 2005 change in terms. (Dkt. No. 49 ¶¶ 10-11.) Coppock's failure to recall does not create a genuine issue of fact as to whether she received the notice of change in terms and subsequent card agreements and whether by her actions she assented to those terms. *See Grabowski v. Robinson*, 817 F.

Supp. 2d 1159, 1168 (S.D. Cal. 2011); *see, e.g., Cayanan*, 2013 U.S. Dist. LEXIS 28597, 2013 WL 784662, at \*21 n.10 ("the mere assertion that [plaintiff] did not receive the [notice of change in terms] is insufficient to establish this fact without additional evidence"); *Daugherty*, 847 F. Supp. 2d at 1196.

#### **B. Whether The Arbitration [\*14] Agreement Encompasses Coppock's Claims**

"[A]n order to arbitrate . . . should not be denied unless it may be said with positive assurance that the arbitration clause is not susceptible of an interpretation that covers the asserted dispute. Doubts should be resolved in favor of coverage." *AT & T Techs., Inc. v. Comm'cns Workers of Am.*, 475 U.S. 643, 650, 106 S. Ct. 1415, 89 L. Ed. 2d 648 (1986) (quoting *United Steelworkers of Am. v. Warrior & Gulf Nav. Co.*, 363 U.S. 574, 582-83, 80 S. Ct. 1347, 4 L. Ed. 2d 1409 (1960)); *see Warrior & Gulf* 363 U.S. at 584-85 ("In the absence of any express provision excluding a particular grievance from arbitration, . . . only the most forceful evidence of a purpose to exclude the claim from arbitration can prevail . . ."). The party resisting arbitration bears the burden of showing that the agreement does not cover the claims at issue. *Green Tree Fin. Corp.-Ala. v. Randolph*, 531 U.S. 79, 91-92, 121 S. Ct. 513, 148 L. Ed. 2d 373 (2000).

Coppock argues that her TCPA and FDCPA claims are outside the scope of the arbitration agreement. The agreement provides:

All [c]laims relating to your account, a prior related account, or our relationship are subject to arbitration . . . , no matter what legal theory they are based on or what remedy . . . they seek. This [\*15] includes [c]laims based on contract, tort (including intentional tort), fraud, agency, your or our negligence, statutory or regulatory provisions, or any other sources of law . . .

(Dkt. No. 44 Exs. 2 at 2-3, 9 at 4, 12 at 8, 15 at 14.) The arbitration agreement clearly covers the TCPA and FDCPA claims. Citi made the calls to collect a debt it thought Coppock owed on her credit card account. Her claims based on those calls are thus "[c]laims relating to [her] account . . . or [her and Citi's] relationship." *See Mediterranean Enters., Inc. v. Ssangyong Corp.*, 708 F.2d 1458, 1464 (9th Cir. 1983) ("relating to this agreement" [is] . . . broad arbitration clause" language) (quotation marks omitted). That Citi may have mistakenly believed that Coppock's account was in arrears does not change the fact that the collection call was related to the account. Indeed, Citi

allegedly stopped calling Coppock after she transferred her outstanding balance to a different credit card company. (Dkt. No. 40 at 3 ¶ 2.4.) That only reinforces the conclusion that the calls were related to her account and her relationship with Citi.

The cases to which Coppock cites are distinguishable. In *In re Jiffy Lube International, Inc., Text Spam Litigation*, 847 F. Supp. 2d 1253 (S.D. Cal. 2012), [\*16] the court held that an arbitration agreement purporting to subject “any and all disputes” between Jiffy Lube and the plaintiff—“not limited to disputes arising from or related to the transaction or contract at issue”—was unconscionable because it would render “a tort action arising from a completely separate incident [subject to] arbitration.” *Id.* at 1262-63. The arbitration agreement here is not so unconscionably unlimited; it applies only to claims “relating to your account, a prior related account, or our relationship.” *Smith v. Steinkamp*, 318 F.3d 775 (7th Cir. 2003), is distinguishable for the same reason. *See id.* at 777-78. And *Jiffy Lube* is further distinguishable in that the text message Jiffy Lube sent to the plaintiff in that case was a proactive marketing message offering a discount on future Jiffy Lube services—*i.e.*, a message not related in any way to the contract the plaintiff had previously signed when he visited one of Jiffy Lube’s locations for an oil change. *Jiffy Lube*, 847 F. Supp. 2d at 1263. By contrast, here, the phone calls were clearly related to Coppock’s card account. *See, e.g., Cayanan*, 2013 U.S. Dist. LEXIS 28597, 2013 WL 784662, at \*20 (calls made to plaintiffs “because Plaintiffs [\*17] had failed to make timely payments on their accounts,” “for the limited purpose of collecting money owed them,” and “not . . . for advertising, marketing, or other purposes unrelated to the accounts,” were “related to’ the delinquent credit accounts” and thus TCPA claims based on those calls were covered by Citi arbitration clause).

*Cape Flattery, Mediterranean Enterprises, and Tracer Research Corp. v. National Environmental Services Co.*, 42 F.3d 1292 (9th Cir. 1994), are also off-point. Those cases dealt with agreements mandating arbitration of disputes “arising under” the agreement, which the Ninth Circuit interpreted to mean “relating to the interpretation and performance of the contract itself.” *Cape Flattery*, 647 F.3d at 924 (quotation marks omitted); *see Mediterranean Enters.*, 708 F.2d at 1463-64 (“arising under’ is narrower in scope than the phrase ‘arising out of or relating to’” and is “relatively narrow as arbitration clauses go”) (quotation marks omitted); *Tracer*, 42 F.3d at 1295 (“The ‘arising out of language is of the same limited scope as the ‘arising under’ language in *Mediterranean Enterprises*.”). Nor is *Coors Brewing Co. v. Molson Breweries*, 51 F.3d 1511 (10th

Cir. 1995), [\*18] relevant. In that case, involving an arbitration clause that subjected to arbitration “[a]ny dispute arising in connection with the implementation, interpretation or enforcement of this Agreement,” the court held merely that the plaintiff’s “claims that d[id] not implicate the contract [we]re litigable.” *Id.* at 1513, 1516. Coppock appears to believe that, “with respect to the alleged wrong, it is simply fortuitous that the parties happened to have a contractual relationship.” *Id.* at 1517. Coppock is mistaken. Citi did not coincidentally call a customer with a preexisting account to market a product unrelated to that account; it deliberately called a customer about a debt owed on her account. Coppock’s claims based on those calls unquestionably relate to her account.

*Harrier v. Verizon Wireless Personal Communications*, No. 8:12-cv-1588-T-30AEP, 903 F. Supp. 2d 1281, 2012 U.S. Dist. LEXIS 142428, 2012 WL 4525318 (M.D. Fla. Oct. 2, 2012), and *Pereira v. Santander Consumer USA, Inc.*, No. 11 C 8987, 2012 U.S. Dist. LEXIS 45627, 2012 WL 4464893 (N.D. Ill. Apr. 2, 2012), are equally unavailing. In *Harrier*, the court held that Verizon could not compel arbitration of the plaintiffs’ TCPA claim because “the plaintiffs’ bankruptcy discharge rendered the [\*19] parties’ arbitration agreement unenforceable.” 2012 U.S. Dist. LEXIS 142428, 2012 WL 4525318, at \*2. And in *Pereira*, the court held that the wife of the signatory to the arbitration agreement—who herself did not sign it—could not be forced to arbitrate her TCPA claims against the defendant, since none of the doctrines allowing a non-signatory to be bound to an arbitration agreement applied. 2012 U.S. Dist. LEXIS 45627, 2012 WL 4464893, at \*1.

Coppock cites to a treatise and several cases discussing arbitration agreements requiring arbitration of claims relating to *the agreement* to argue that “[t]ort claims may be compelled to arbitration **only** if they necessarily relate to and arise from the contract itself, and are, in essence, a breach of contract claim pled as a tort.” (Dkt. No. 47 at 16.) But the arbitration clause here is not limited to claims relating to the card agreement between Coppock and Citi; it subjects to arbitration “[a]ll [c]laims relating to your account, a prior related account, or our relationship.” In any event, Coppock’s complaint raises claims created by federal statute, and “[i]t is . . . clear that statutory claims may be the subject of an arbitration agreement, enforceable pursuant to the FAA.” *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 26, 111 S. Ct. 1647, 114 L. Ed. 2d 26 (1991); [\*20] *see Shearson/Am. Exp., Inc. v. McMahon*, 482 U.S. 220, 226, 107 S. Ct. 2332, 96 L. Ed. 2d 185 (1987) (“Th[e] duty to enforce arbitration agreements is not diminished when a party bound by an agreement raises a claim founded on

statutory rights.”); *In re Thorpe Insulation Co.*, 671 F.3d 1011, 1020 (9th Cir. 2012) (same).

### C. Whether The Arbitration Agreement Prevents Coppock From Effectively Vindicating Her Statutory Rights

“[C]laims arising under a statute designed to further important social policies may be arbitrated . . . so long as the prospective litigant effectively may vindicate his or her statutory cause of action in the arbitral forum.” *Green Tree*, 531 U.S. at 90 (quotation marks and indications of alteration omitted). For example, “the existence of large arbitration costs could preclude a litigant . . . from effectively vindicating her federal statutory rights in the arbitral forum,” in which case the litigant’s claims could not be subject to arbitration. *Id.* The party seeking to avoid arbitration bears the burden of showing that submitting her claims to arbitration would prevent her from effectively vindicating her statutory rights. *Id.* at 92.

Coppock has not met this burden. She simply asserts that “[t]he vindication [\*21] principle enunciated in [*Green Tree* and other Supreme Court cases] remains intact.” (Dkt. No. 47 at 20.) That is true, but Coppock does not explain how arbitration of *her* claims in *this case* would violate the vindication principle. In a final, giant, single-spaced footnote in 8-point font, Coppock argues that the arbitration agreement prevents her from vindicating her statutory rights because the terms of the agreement differ in several respects from the arbitration clause considered in *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740, 179 L. Ed. 2d 742 (2011), which “ha[d] a number of fee-shifting and otherwise pro-consumer provisions.” *Coneff v. AT & T Corp.*, 673 F.3d 1155, 1159 (9th Cir. 2012). This argument relies on the mistaken belief that *Concepcion* established some sort of consumer-friendliness floor to arbitration agreements, below which the consumer cannot, as a matter of law, vindicate her statutory rights. Merely comparing the arbitration agreement here to that in *Concepcion* does not suffice to meet Coppock’s heavy “burden of showing the likelihood of incurring” such “prohibitive expense[s]” in conjunction with arbitrating her claims that she is effectively prevented from vindicating her [\*22] TCPA and FDCPA rights. *Green Tree*, 531 U.S. at 92; *see, e.g., Livingston v. Assocs. Fin., Inc.*, 339 F.3d 553, 557 (7th Cir. 2003) (reversing denial of motion to compel arbitration where “[plaintiffs] have not offered any specific,” “individualized . . . evidence of arbitration costs that they may face in this litigation, prohibitive or otherwise,

and have failed to provide any evidence of their inability to pay such costs”). Indeed, that the arbitration agreement here requires Citi to reimburse the initial filing fee if the claimant prevails, to pay the fees and costs for the first day of the hearing, to advance or reimburse the filing and other fees under certain circumstances, and to pay attorneys’ fees and expenses if allowed by applicable law and determined by the arbitrator (Dkt. No. 44 Ex. 15 at 15-16), and that Citi has agreed, pursuant to the agreement, to advance Coppock’s portion of the arbitration fees (Dkt. No. 53 at 13), call seriously into question Coppock’s claim that requiring her to arbitrate her claims on an individual basis effectively deprives her of them. *See, e.g., Cayanan*, 2013 U.S. Dist. LEXIS 28597, 2013 WL 784662, at \*18-19 (addressing identical argument and holding Citi arbitration provisions [\*23] did not prevent plaintiffs from vindicating their TCPA rights); *cf., e.g., Guerrero*, 2012 U.S. Dist. LEXIS 150428, 2012 WL 7683512, at \*6 (identical Citi arbitration agreement, “[a]lthough not as consumer friendly as the arbitration provision addressed in *Concepcion*, . . . is not substantively unconscionable”).

### D. Whether The Arbitration Agreement Is Unconscionable

An “arbitration clause[] . . . [may be] unenforceable under state common law principles [of unconscionability] that are not specific to arbitration and [are not] pre-empted by the FAA.” *Marmet Health Care Ctr., Inc. v. Brown*, 132 S. Ct. 1201, 1204, 182 L. Ed. 2d 42 (2012) (per curiam). Coppock argues that the arbitration agreement here is unconscionable.

#### 1. Choice of Law

Coppock assumes, without establishing, that Washington unconscionability law applies, and then asserts in four lines of a footnote that, in any event, “Citibank’s clause would be unconscionable and void under S.D. [South Dakota] law.” (Dkt. No. 47 at 21-22 & n.19.) As discussed *supra*, South Dakota unconscionability law applies unless (1) applying South Dakota law would be contrary to a fundamental policy of Washington, (2) Washington has a materially greater interest than South Dakota in the unconscionability [\*24] determination, and (3) Washington would be the state of the applicable law in the absence of the forum selection clause. Restatement (Second) of Conflict of Laws § 187(2). It is far from evident that all three of these criteria are met, and Coppock advances no real argument that they are.<sup>2</sup> The Court thus applies South Dakota unconscionability law. *See,*

<sup>2</sup> Under *Concepcion*, the Court cannot consider Washington’s policy on unconscionability of class-action waivers—“fundamental” or not, and of “materially greater interest” to Washington than South Dakota or not—in the § 187 analysis, since the FAA preempts that

*e.g.*, *Cayanan*, 2013 U.S. Dist. LEXIS 28597, 2013 WL 784662, at \*14 (applying South Dakota law to evaluate conscionability of Citi arbitration agreement).

## 2. Analysis

South Dakota law requires that a contract be both procedurally and substantively unconscionable to be unenforceable. *Hoffman v. Citibank (South Dakota), N.A.*, 546 F.3d 1078, 1083 n.2 (9th Cir. 2008) [\*25] (per curiam) (quoting *Nygaard v. Sioux Valley Hosps. & Health Sys.*, 2007 SD 34, 731 N.W.2d 184, 195 (S.D. 2007)). The court “looks not only at the bargaining power between the parties but also at the specific terms of the agreement”; it “focus[es] on both overly harsh or one-sided terms . . . and how the contract was made (which includes whether there was a meaningful choice) . . . .” *Nygaard*, 731 N.W.2d at 194-95 (quotation marks omitted).

Coppock’s procedural unconscionability argument rests entirely on the false premise that “[s]tandardized, adhesive contracts drafted by the stronger party are procedurally unconscionable . . . .” (Dkt. No. 47 at 24.) As the South Dakota Supreme Court has explained, “simply because [a] contract is standardized and preprinted” does not mean that, “ipso facto, it is unenforceable as a contract of adhesion.” *Rozeboom v. Nw. Bell Tel. Co.*, 358 N.W.2d 241, 245 (S.D. 1984); *see Concepcion*, 131 S. Ct. at 1750 (“[T]he times in which consumer contracts were anything other than adhesive are long past.”); *Cicle v. Chase Bank USA*, 583 F.3d 549, 555 (8th Cir. 2009) (“These sorts of take-it-or-leave-it agreements between businesses and consumers are used all the time in today’s [\*26] business world. If they were all deemed to be unconscionable and unenforceable contracts of adhesion, or if individual negotiation were required to make them enforceable, much of commerce would screech to a halt.”).

Coppock has not shown a lack of meaningful choice here. The notice of change in terms explicitly provided that Coppock could opt out by notifying Citi in writing, and that if she did so, she could continue to use her card under the preexisting terms until the later of the end of her membership year and the expiration date of her card. Coppock did not opt out, and nothing stopped Coppock thereafter from closing her account at any time; indeed, shortly after she started receiving the phone calls at issue in this case, she transferred her Citi card balance to a different credit card company. (Dkt. No. 40 at 3 ¶ 2.4.) There is simply no

evidence here of procedural unconscionability. *See, e.g.*, *Cayanan*, 2013 U.S. Dist. LEXIS 28597, 2013 WL 784662, at \*14 (Citi arbitration clause not procedurally unconscionable under South Dakota law where plaintiff “was given [identical] realistic opportunity to opt out of arbitration”); *Guerrero*, 2012 U.S. Dist. LEXIS 150428, 2012 WL 7683512, at \*4-6 (same, under California law); *Circuit City Stores, Inc. v. Ahmed*, 283 F.3d 1198, 1199-1200 (9th Cir. 2002) [\*27] (no procedural unconscionability in large part because clause contained opt-out provision); *compare, e.g., In re Currency Conversion Fee Antitrust Litig.*, 361 F. Supp. 2d 237, 252 (S.D.N.Y. 2005) (banks’ arbitration clauses unconscionable where “banks possessed information [relevant to the decision to opt out of the arbitration agreement] which they withheld from their cardholders when they added the clause to their contracts”). Indeed, in a case involving virtually identical facts—a Citibank card holder since 1994 who received the 2001 notice of change in terms and the message regarding the notice in her November 2001 billing statement, and who did not opt out and continued to use her card—the Ninth Circuit “agree[d] with the district court’s conclusion that Citibank’s class arbitration waiver [was] *not* procedurally unconscionable under South Dakota Law . . . .” *Hoffman*, 546 F.3d at 1079-83 & n.2 (citing S.D. Codified Laws § 54-11-10).

Because Coppock has not shown procedural unconscionability, and because a showing of both procedural and substantive unconscionability is necessary to void the contract, the Court need not—and does not—address Coppock’s arguments that the agreement was [\*28] substantively unconscionable. *See Hoffman*, 546 F.3d at 1083 n.2 (because “Citibank’s class arbitration waiver is *not* procedurally unconscionable under South Dakota law,” it “*is* enforceable if South Dakota law controls”); *see, e.g., Cayanan*, 2013 U.S. Dist. LEXIS 28597, 2013 WL 784662, at \*14 (“Because the Court finds the Thank You Card arbitration agreement was not procedurally unconscionable, the Court’s inquiry ends here.”); *Ahmed*, 283 F.3d at 1200 (declining to inquire into substantive unconscionability after finding no procedural unconscionability).

## E. Coppock’s Motion To Compel Arbitration-Related Discovery

A month and a half after both the deadline to complete arbitration-related discovery and Coppock’s filing of her response to Citi’s motion to compel arbitration, and almost

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policy and precludes a court from taking it into account in conducting the unconscionability analysis. *See Coneff*, 673 F.3d at 1160-61 (“*Concepcion* controls,” and “the FAA preempts the Washington state law invalidating the class-action waiver . . . .”).

three weeks after that motion noted for the Court's consideration, Coppock filed a motion to compel Citi to provide "full responses" to her arbitration-related discovery requests (Dkt. No. 55 at 4). The Court DENIES the motion. On November 2, 2012, the parties submitted a joint status report requesting that the Court set a deadline of February 1, 2013 for "Completion of Limited discovery on Motion to Compel Arbitration," followed by a [\*29] deadline of February 8, 2013 for Coppock to file her response to Citi's motion to compel arbitration. (Dkt. No. 38 at 2.) The Court granted that request on December 7, 2012. (Dkt. No. 42.) Citi served Coppock with its responses to her arbitration-related discovery requests by the deadline. (Dkt. No. 55 at 3.) Coppock now objects that, "[b]ecause the responses of Defendants to the written discovery [requests] were served [on Coppock] only a week before [her] Opposition to the Motion to Compel Arbitration was due, and because Defendants objected to and declined to respond to most of the discovery, Plaintiff filed her Opposition without the benefit of facts which could support her Opposition." (*Id.*) But Coppock explicitly stipulated to having only a week between completion of arbitration-related discovery and the deadline for filing her response to Citi's motion to compel arbitration. And if Coppock believed that

Citi's responses to her discovery requests were inadequate, the time to object was when she received those responses—*before* she filed her opposition to Citi's motion. Coppock's motion is DENIED.

### III. CONCLUSION

For the foregoing reasons, the Court GRANTS Citi's motion to compel [\*30] arbitration (Dkt. No. 43), DENIES Coppock's motion to compel "full responses to all of the discovery," and for leave to file a supplemental brief in support of her opposition to Citi's motion to compel arbitration (Dkt. No. 55), and STAYS this case pending arbitration. *See* 9 U.S.C. § 3. The Clerk is respectfully directed to STATISTICALLY CLOSE this case.

DATED this 22nd day of March 2013.

/s/ John C. Coughenour

John C. Coughenour

UNITED STATES DISTRICT JUDGE

# APPENDIX 11

## FCS Advisors, Inc. v. Fair Fin. Co.

United States Court of Appeals for the Second Circuit

February 22, 2010, Argued; May 24, 2010, Decided

Docket No. 09-2609-cv

### Reporter

605 F.3d 144; 2010 U.S. App. LEXIS 10545

FCS ADVISORS, INC.,  
Plaintiff-Counter-Defendant-Appellee, v. FAIR FINANCE  
COMPANY, INC., Defendant-Counter-Claimant-Appellant.

rate under 28 U.S.C.S. § 1961(a), or at the rate provided for under New York law, in a case based on diversity jurisdiction. The parties' agreement contained a choice of law provision directing the general application of New York law.

**Subsequent History:** As Amended July 27, 2010.

**Prior History:** **[\*\*1]** The question presented is whether post-judgment interest should be calculated at the federal rate provided for under 28 U.S.C. § 1961(a) or at the rate provided for under New York law where our jurisdiction is premised on the diversity of the citizenship of the parties and the contract giving rise to the action contains a choice-of-law provision directing application of New York law. We hold that the federal rate applies and that, although parties may agree by contract to a different rate, the choice-of-law provision at issue here is insufficient to indicate that the parties intended a different rate to apply.

The judgment of the District Court is affirmed, in part (in a separate summary order), insofar as it entered summary judgment in favor of plaintiff, and vacated, in part, insofar as it calculated the rate of post-judgment interest in accordance with New York law.

FCS Advisors, Inc. v. Fair Fin. Co., 2009 U.S. Dist. LEXIS 48472 (S.D.N.Y., June 9, 2009)

### Core Terms

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post-judgment, district court, choice-of-law, calculation, parties, interest rate, unequivocal, Finance, diversity case, judgment debt, unambiguous, applies, merged

### Case Summary

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#### Procedural Posture

Following entry of judgment in the United States District Court for the District of Connecticut, the issue was whether postjudgment interest should be calculated at the federal

### Overview

The district court entered judgment in the underlying diversity action against defendant in the amount of \$ 1,716,248.43, which included both prejudgment and postjudgment interest calculated at a rate of 9 percent per annum in accordance with New York law. The court of appeals affirmed the order granting summary judgment in a separate summary order, but considered the plaintiff's argument that the federal rate provided for in 28 U.S.C.S. § 1961(a) should apply to the postjudgment interest. The issue was whether the choice of law provision for New York law in the parties' signed letter of intent could be deemed a clear expression of intent to have New York law, rather than federal law, apply to the calculation of postjudgment interest. The court of appeals held that the choice of law provision was general, and could not require that the New York rate be applied. The federal statutory rate of postjudgment interest applied in the absence of clear intent that a different rate apply.

### Outcome

The judgment was vacated only as to the calculation of postjudgment interest, which was recalculated at the federal rate.

### LexisNexis® Headnotes

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Civil Procedure > Remedies > Judgment Interest > Postjudgment Interest

**HNI** See 28 U.S.C.S. § 1961(a).

Civil Procedure > Remedies > Judgment Interest > General Overview

**HN2** New York law provides that interest shall be at the rate of nine per centum per annum, except where otherwise provided by statute. N.Y. C.P.L.R. § 5004.

Civil Procedure > Remedies > Judgment Interest > Postjudgment Interest

Civil Procedure > Appeals > Standards of Review > De Novo Review

**HN3** Appellate review of a district court's determination of the proper rate of postjudgment interest is de novo, which is informed by interpretation of the relevant documents.

Civil Procedure > Remedies > Judgment Interest > Postjudgment Interest

Civil Procedure > Remedies > Judgment Interest > Prejudgment Interest

**HN4** In a diversity case, state law governs the award of prejudgment interest but in contrast, postjudgment interest is governed by federal statute.

Civil Procedure > Judgments > Entry of Judgments > General Overview

Civil Procedure > Remedies > Judgment Interest > Postjudgment Interest

**HN5** The general rule under New York and federal law is that a debt created by contract merges with a judgment entered on that contract. Once a claim is reduced to judgment, the original claim is extinguished and merged into the judgment; and a new claim, called a judgment debt, arises.

Civil Procedure > ... > Federal & State Interrelationships > Choice of Law > General Overview

Civil Procedure > Remedies > Judgment Interest > Postjudgment Interest

**HN6** The United States Court of Appeals for the Second Circuit holds that, absent clear, unambiguous and

unequivocal language expressing an intent that a particular interest rate apply to judgments or judgment debts, a general choice-of-law provision does not alter the application of the federal rate to the calculation of postjudgment interest in diversity cases.

Civil Procedure > Remedies > Judgment Interest > Postjudgment Interest

**HN7** The United States Court of Appeals for the Second Circuit holds that: (1) In diversity cases, postjudgment interest should ordinarily be calculated in accordance with the federal rate provided for under 28 U.S.C.S. § 1961(a); (2) Although parties may agree to a different rate by contract, absent clear, unambiguous, and unequivocal language expressing an intent that a particular interest rate apply to judgments or judgment debts, a general choice-of-law provision does not alter the application of the federal rate to the calculation of postjudgment interest.

**Counsel:** GREGORY E. GALTERIO (Ira N. Glauber, of counsel), Jaffe & Asher, LLP, New York, NY, for Appellant Fair Finance Company, Inc.

ROGER E. BARTON (Randall L. Rasey, of counsel), Barton Barton & Plotkin LLP, New York, NY, for Appellee FCS Advisors, Inc.

**Judges:** Before: CABRANES and B.D. PARKER, Circuit Judges, and UNDERHILL, District [\*\*2] Judge. \*

## Opinion

[\*145] PER CURIAM:

The question presented is whether post-judgment interest should be calculated at the federal rate provided for under 28 U.S.C. § 1961(a)<sup>1</sup> or at the rate provided for under New York law where our jurisdiction is premised on the diversity of the citizenship of the parties and the contract giving rise to the action contains a general choice-of-law provision requiring the application of New York law.

\* The Honorable Stefan R. Underhill of the United States District Court for the District of Connecticut, sitting by designation.

<sup>1</sup> This subsection provides as follows:

**HN1** Interest shall be allowed on any money judgment in a civil case recovered in a district court. Execution therefor may be levied by the marshal, in any case where, by the law of the State in which such court is held, execution may be levied for interest on judgments recovered in the courts of the State. Such interest shall be calculated from the date of the entry of the judgment, at a rate equal to the weekly average 1-year constant maturity Treasury yield, as published by the Board of Governors of the Federal Reserve System, for the calendar week preceding[] the date of the judgment. The Director of the Administrative [\*\*3] Office of the United States Courts shall distribute notice of that rate and any changes in it to all Federal judges.

Defendant-appellant Fair Finance Company, Inc. ("FairFin" or "defendant") appeals from a judgment of the United States District Court for the Southern District of New York (Denny Chin, *Judge*) entered on May 20, 2009 and amended on June 10, 2009, granting summary judgment to plaintiff FCS Advisors, Inc. d/b/a Brevet Capital Advisors ("Brevet" or "plaintiff") on plaintiff's breach of contract claim. The District Court entered judgment against defendant in the amount of \$ 1,716,248.43, which included post-judgment interest calculated at a rate of 9% per annum in accordance with New York law.

In a separate summary order entered today, we affirm the judgment of the District Court insofar as it granted summary judgment to plaintiff. In this opinion, we address solely whether the District Court erred in applying New York law rather than federal law to determine the rate of post-judgment interest.

We hold that the federal rate of interest applies in diversity cases such as this one. Although the parties may contractually agree to a different rate, [\*\*4] their intent to do so must be clear and unequivocal. We hold that the choice-of-law provision in this case does not demonstrate a clear and unequivocal intent to apply New York law to the calculation of post-judgment interest. Accordingly, we vacate the judgment of the District Court only insofar as it applied the New York rate, and we remand the cause to the District Court for [\*146] calculation of post-judgment interest in accordance with the federal rate provided for under 28 U.S.C. § 1961(a).<sup>2</sup>

## BACKGROUND

This appeal arises from Brevet's lawsuit against FairFin for breach of contract. Representatives of Brevet and FairFin signed a letter of intent ("LOI") on June 1, 2007, reflecting their agreement to consider a transaction whereby Brevet would provide FairFin with up to \$ 75 million in financing. Among other things, the LOI granted Brevet a "right of first refusal," or option, to provide financing to FairFin on certain terms. If Brevet exercised its option, FairFin was required to deal exclusively with Brevet and would be liable for a \$ 1.5 million "break-up" fee if it entered into another transaction in lieu of the Brevet transaction. The LOI also contained a choice-of-law provision that required it to be governed by, and construed in accordance with, New York law.<sup>3</sup> Although Brevet exercised its option, the [\*\*6] Brevet-FairFin financing transaction was never consummated. Following the transaction's failure to close, Brevet brought the underlying suit claiming that FairFin had breached the exclusivity provisions of the LOI and that Brevet was entitled to the \$ 1.5 million break-up fee plus due diligence expenses it had incurred. The District Court agreed, and granted summary judgment in favor of Brevet. *FCS Advisors, Inc. v. Fair Fin. Co.*, No. 07 Civ. 6456, 2009 U.S. Dist. LEXIS 42879, 2009 WL 1403869 (S.D.N.Y. May 19, 2009). We affirm the District Court's order granting summary judgment in a separate summary order entered today, for the reasons stated therein.<sup>3</sup>

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28 U.S.C. § 1961(a).

<sup>2</sup> Shortly before this appeal was argued, the panel was informed that involuntary bankruptcy proceedings had been commenced against defendant in the Northern District of Ohio. *See In re Fair Finance Company*, No. 10-50494 (Bankr. N.D. Ohio filed Feb. 8, 2010). We therefore entered an order dismissing the appeal without prejudice to being reinstated, upon a letter request from either party, in the event that the automatic bankruptcy stay was lifted insofar as it applied to this appeal. *See FCS Advisors, Inc. v. Fair Finance Company, Inc.*, No. 09-2609-cv (2d Cir. Mar. 10, 2010).

On April 29, 2010, we received a letter from plaintiff's counsel seeking reinstatement based on an April 28, 2010 order of [\*\*5] the Bankruptcy Court modifying the automatic stay "to allow the Second Circuit Court of Appeals to enter a decision" in this appeal. *See In re Fair Finance Company*, No. 10-50494, Docket Entry No. 128 (Bankr. N.D. Ohio Apr. 28, 2010). Having reviewed that order and determined that there is no further obstacle to our disposition of this matter, we reinstate the appeal.

<sup>3</sup> The choice-of-law provision states in its entirety as follows:

Choice of Law/Forum. This Letter shall be governed by and construed in accordance with the laws of the State of New York. Each of the parties to this Letter submits to the jurisdiction of any state or federal court sitting in the State of New York, in any action or proceeding arising out of or relating to this Letter and agrees that all claims in respect of the action or proceeding may be heard and determined in any such court. Each of the parties waives any defense of inconvenient forum to the maintenance [\*\*7] of any action or proceeding so brought and waives any bond, surety, or other security that might be required of any other party with respect thereto.

3

After the District Court entered judgment in the amount of \$ 1,531,371.75 on May 20, 2009, plaintiff moved that the judgment be amended to include pre- and post-judgment interest. By an order entered June 9, 2009, the District Court granted plaintiff's motion and awarded both pre- and post-judgment interest at a [\*147] rate of 9% per annum in accordance with New York law. *FCS Advisors, Inc. v. Fair Fin. Co.*, 07 Civ. 6456, 2009 U.S. Dist. LEXIS 48472, 2009 WL 1616518 (S.D.N.Y. June 9, 2009) (relying on N.Y. C.P.L.R. § 5004).<sup>4</sup> Although it was undisputed that New York law governed the rate of *pre-judgment* interest, *id.*, defendant had argued that *post-judgment* interest should be calculated based on the federal rate provided for in 28 U.S.C. § 1961(a).<sup>5</sup> The District Court disagreed, and held that "[w]hile it is true . . . that there is a split of authority in [the Southern District of New York] as to whether the federal or state rate applies [\*\*8] in a diversity action, where the contract contains a choice-of-law provision, courts award postjudgment interest based on the designated law." *FCS Advisors*, 2009 U.S. Dist. LEXIS 48472, 2009 WL 1616518, at \*1 (citation omitted). Accordingly, the District Court applied the New York rate.

## DISCUSSION

We consider here whether the District Court correctly determined that the choice-of-law provision in the LOI required the application of New York law to the calculation of post-judgment interest.<sup>HN3</sup> We review *de novo* the District Court's determination of the proper rate of post-judgment interest, which is informed by interpretation of the LOI. See *Westinghouse Credit Corp. v. D'Urso*, 371 F.3d 96, 100 (2d Cir. 2004) (holding that an award of post-judgment interest under 28 U.S.C. § 1961 is subject to *de novo* review); *Oscar Gruss & Son, Inc. v. Hollander*, 337 F.3d 186, 198 (2d Cir. 2003) ("We review the district court's interpretation of contracts *de novo*.").

In 2004, in *Westinghouse Credit Corp. v. D'Urso*, we held that the federal post-judgment interest [\*\*9] rate provided for in 28 U.S.C. § 1961 applies in diversity cases. See 371 F.3d at 102; accord *Schipani v. McLeod*, 541 F.3d 158, 164-65 (2d Cir. 2008) (noting that *HN4* "[i]n a diversity case, state law governs the award of prejudgment interest"

but "[i]n contrast, postjudgment interest is governed by federal statute"); *Forest Sales Corp. v. Bedingfield*, 881 F.2d 111, 112-13 (4th Cir. 1989) (explaining that, under *Erie Railroad v. Tompkins*, 304 U.S. 64, 58 S. Ct. 817, 82 L. Ed. 1188 (1938), post-judgment interest is "better characterized as procedural" and listing the circuits that have held that the federal rate applies in diversity actions). We also expressed the view that parties are free to agree to a different post-judgment interest rate by contract, provided that they do so through "clear, unambiguous and unequivocal language." *D'Urso*, 371 F.3d at 102 (internal quotation marks omitted). The question here is whether the choice-of-law provision in the parties' LOI, *see* note 2, *ante*, can be deemed a clear expression of intent to have New York law, rather than federal law, apply to the calculation of post-judgment interest. We hold that it cannot.

As an initial matter, we note that in *D'Urso* we applied the federal rate [\*\*10] notwithstanding the fact that the contract giving rise to the claims at issue there, much like the LOI here, contained a choice-of-law provision prescribing the application of New York law. See 371 F.3d at 102 (citing *Westinghouse Credit Corp. v. D'Urso*, 278 F.3d 138, 146 n.3 (2d Cir. 2002) (noting the choice-of-law provision)). Holding that the existence of a choice-of-law provision, [\*148] standing alone, demonstrates a "clear, unambiguous and unequivocal" intent to deviate from the federal rate would therefore be contrary to our holding in *D'Urso*. See *id.*

Moreover, in *D'Urso* we applied the federal rate in spite of the parties' *explicit* agreement to apply a 15.5% interest rate to any arbitration award "from the date payment was due to the date payment is made." *Id.* We rejected the parties' agreed-upon rate because<sup>HN5</sup> the "general rule under New York and federal law is that a debt created by contract merges with a judgment entered on that contract." *Id.*; accord *Kotsopoulos v. Asturia Shipping Co.*, 467 F.2d 91, 95 (2d Cir. 1972) ("Once a claim is reduced to judgment, the original claim is extinguished and merged into the judgment; and a new claim, called a judgment debt, arises."); *Soc'y of Lloyd's v. Reinhart*, 402 F.3d 982, 1004 (10th Cir. 2005) [\*\*11] ("[W]hen a valid and final judgment for the payment of money is rendered, the original claim is extinguished, and a new cause of action on the judgment is substituted for it. In such a case, the original claim loses its character and identity and is merged in the judgment." (internal quotation marks omitted)). In other words, although a rate of 15.5%

<sup>3</sup> Although this opinion addresses only the question of post-judgment interest, the foregoing facts are provided by way of background.

<sup>4</sup> *HN2* New York law provides that "[i]nterest shall be at the rate of nine per centum per annum, except where otherwise provided by statute." N.Y. C.P.L.R. § 5004.

<sup>5</sup> See note 1, *ante*.

might have applied to the *contract debt*, “[t]he parties failed to state that this rate would apply to *judgments* rendered on that award. New York law treats this language therefore as applying only to the contract debt, and not to the judgment into which that debt is merged.” *D’Urso*, 371 F.3d at 102 (emphasis added). If the parties intended to override the general merger rule, and to specify an interest rate that applies to *judgment debts*, we held that they were required to “express such intent through clear, unambiguous and unequivocal language.” *Id.* (internal quotation marks omitted).

For the same reasons discussed in *D’Urso*, the parties’ choice-of-law provision in this case is insufficient to demonstrate an intent to apply New York law to the calculation of post-judgment interest. At most, the choice-of-law provision in the LOI expresses [\*\*12] an intent to have New York law apply to the interpretation of that *contract* and any claims arising from it. *See* note 2, *ante*. Neither the choice-of-law provision nor any other part of the LOI indicate that New York law or the New York rate of interest would apply to *judgment debts* resulting from a claim based on that contract. Accordingly, as in *D’Urso*, “New York law treats this [choice-of-law] language as applying only to the contract [claims], and not to the judgment into which [those claims are] merged.” 371 F.3d at 102; *cf. Reinhart*, 402 F.3d at 1004 (relying on *D’Urso* and holding that “agreeing to be bound by [a foreign country’s law] does not amount to agreeing to a particular post-judgment interest rate”). Accordingly, **HN6** we hold that, absent “clear, unambiguous and unequivocal” language expressing an intent that a particular interest rate apply to *judgments* or *judgment debts*, a general choice-of-law provision such as the one at issue here does not alter the

application of the federal rate to the calculation of post-judgment interest in diversity cases.

Because the District Court calculated post-judgment interest in accordance with New York law based solely on the choice-of-law [\*\*13] provision in the LOI, *see* note 2, *ante*, we vacate so much of the judgment as imposed a charge for post-judgment interest, and we remand the cause to the District Court for the calculation of post-judgment interest in accordance with the federal rate provided for under 28 U.S.C. § 1961(a).

## CONCLUSION

To summarize, we hold as follows:

[\*149] **HN7** (1) In diversity cases such as this, post-judgment interest should ordinarily be calculated in accordance with the federal rate provided for under 28 U.S.C. § 1961(a);

(2) Although parties may agree to a different rate by contract, absent “clear, unambiguous and unequivocal” language expressing an intent that a particular interest rate apply to *judgments* or *judgment debts*, a general choice-of-law provision such as the one at issue here does not alter the application of the federal rate to the calculation of post-judgment interest.

Accordingly, we **VACATE** the judgment of the District Court only insofar as it applied New York law to the calculation of post-judgment interest, and we **REMAND** the cause to the District Court for the calculation of post-judgment interest in accordance with the federal rate provided for under 28 U.S.C. § 1961(a).

# APPENDIX 12

## Howsam v. Dean Witter Reynolds

Supreme Court of the United States

October 9, 2002, Argued ; December 10, 2002, Decided

No. 01-800

### Reporter

537 U.S. 79; 123 S. Ct. 588; 154 L. Ed. 2d 491; 2002 U.S. LEXIS 9235; 71 U.S.L.W. 4019; 2002 Cal. Daily Op. Service 11847; 2002 Daily Journal DAR 13897; 16 Fla. L. Weekly Fed. S 20

KAREN HOWSAM, ETC., PETITIONER v. DEAN WITTER REYNOLDS, INC.

**Prior History:** ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT.

Dean Witter Reynolds, Inc. v. Howsam, 261 F.3d 956, 2001 U.S. App. LEXIS 17971 (10th Cir. Colo. 2001)

**Disposition:** Reversed.

### Core Terms

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arbitration, parties, time limit, gateway

### Case Summary

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#### Procedural Posture

Respondent securities dealer sued petitioner investor, seeking a declaration that arbitration of the parties' dispute was barred by a time limit imposed by Nat'l Ass'n Sec. Dealers Manual, Code Arb. P.R. 10304. Upon grant of a writ of certiorari, the investor appealed the United States Court of Appeals for the Tenth Circuit's judgment, which held that the timeliness of the arbitration was subject to judicial rather than arbitral resolution.

#### Overview

The investor contended that the dealer misrepresented the virtues of an investment, and that the question of whether arbitration of the dispute was time barred under Nat'l Ass'n Sec. Dealers Manual, Code Arb. P.R. 10304, required resolution by the arbitrator. The dealer argued that the timeliness of the arbitration raised a question of arbitrability which could only be determined by a court. The United States Supreme Court held that the applicability of the time limit rule was a matter presumptively for the arbitrator, and

did not raise a question of substantive arbitrability requiring judicial intervention. The timeliness of the arbitration was a procedural condition precedent to arbitration but did not involve a question of whether the parties were bound by the arbitration clause of their agreement. Further, it was reasonable to infer that the parties intended that the arbitrator, who was comparatively more expert about the meaning of the time limit rule, was also better able to interpret and apply the rule.

#### Outcome

The judgment requiring judicial determination of the timeliness of arbitration under the securities dealers rule was reversed.

### LexisNexis® Headnotes

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Civil Procedure > ... > Alternative Dispute Resolution > Arbitration > General Overview

Civil Procedure > Pretrial Matters > Alternative Dispute Resolution > Validity of ADR Methods

Securities Law > Regulators > Self-Regulating Entities > National Association of Securities Dealers

**HNI** Nat'l Ass'n Sec. Dealers Manual, Code Arb. P.R. 10304, states that no dispute shall be eligible for submission where six years have elapsed from the occurrence or event giving rise to the dispute.

Civil Procedure > ... > Alternative Dispute Resolution > Arbitration > General Overview

Civil Procedure > Pretrial Matters > Alternative Dispute Resolution > Validity of ADR Methods

**HN2** Arbitration is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit.

Civil Procedure > ... > Alternative Dispute Resolution > Arbitration > General Overview

Civil Procedure > ... > Alternative Dispute Resolution > Arbitration > Arbitrability

Civil Procedure > Pretrial Matters > Alternative Dispute Resolution > Judicial Review

Civil Procedure > Pretrial Matters > Alternative Dispute Resolution > Validity of ADR Methods

Contracts Law > Contract Conditions & Provisions > Arbitration Clauses

Labor & Employment Law > Collective Bargaining & Labor Relations > Labor Arbitration > Enforcement

**HN3** Although the United States Supreme Court recognizes and enforces a liberal federal policy favoring arbitration agreements, there is an exception to this policy. The question whether the parties have submitted a particular dispute to arbitration, i.e., the “question of arbitrability,” is an issue for judicial determination unless the parties clearly and unmistakably provide otherwise.

Civil Procedure > ... > Alternative Dispute Resolution > Arbitration > Arbitrability

Civil Procedure > Pretrial Matters > Alternative Dispute Resolution > Validity of ADR Methods

**HN4** The United States Supreme Court finds the phrase “question of arbitrability” applicable in the kind of narrow circumstance where contracting parties would likely have expected a court to have decided the gateway matter, where they are not likely to have thought that they had agreed that an arbitrator would do so, and, consequently, where reference of the gateway dispute to the court avoids the risk of forcing parties to arbitrate a matter that they may well not have agreed to arbitrate.

Civil Procedure > ... > Alternative Dispute Resolution > Arbitration > General Overview

Civil Procedure > ... > Alternative Dispute Resolution > Arbitration > Arbitrability

Civil Procedure > Pretrial Matters > Alternative Dispute Resolution > Validity of ADR Methods

Contracts Law > Contract Conditions & Provisions > Arbitration Clauses

Contracts Law > Formation of Contracts > Execution

**HN5** A gateway dispute about whether the parties are bound by a given arbitration clause raises a “question of arbitrability” for a court to decide. Similarly, a disagreement about whether an arbitration clause in a concededly binding

contract applies to a particular type of controversy is for the court.

Civil Procedure > ... > Responses > Defenses, Demurrers & Objections > Waiver & Preservation of Defenses

Civil Procedure > ... > Alternative Dispute Resolution > Arbitration > Arbitrability

Civil Procedure > Pretrial Matters > Alternative Dispute Resolution > Mandatory ADR

**HN6** The United States Supreme Court finds the phrase “question of arbitrability” not applicable in general circumstance where parties would likely expect that an arbitrator would decide the gateway matter. Thus “procedural” questions which grow out of the dispute and bear on its final disposition are presumptively not for the judge, but for an arbitrator, to decide. So, too, the presumption is that the arbitrator should decide allegations of waiver, delay, or a like defense to arbitrability.

Civil Procedure > ... > Defenses, Demurrers & Objections > Affirmative Defenses > Laches

Civil Procedure > ... > Alternative Dispute Resolution > Arbitration > General Overview

Civil Procedure > ... > Alternative Dispute Resolution > Arbitration > Arbitrability

Civil Procedure > ... > Arbitration > Federal Arbitration Act > General Overview

Civil Procedure > Pretrial Matters > Alternative Dispute Resolution > Mandatory ADR

Contracts Law > Contract Conditions & Provisions > Conditions Precedent

International Trade Law > Dispute Resolution > International Commercial Arbitration > Arbitration

**HN7** Rev. Unif. Arbitration Act of 2000 § 6, 7 U.L.A. 12 (Supp. 2002), states that an arbitrator shall decide whether a condition precedent to arbitrability has been fulfilled. In the absence of an agreement to the contrary, issues of substantive arbitrability are for a court to decide and issues of procedural arbitrability, i.e., whether prerequisites such as time limits, notice, laches, estoppel, and other conditions precedent to an obligation to arbitrate have been met, are for the arbitrators to decide.

Civil Procedure > ... > Responses > Defenses, Demurrers & Objections > Waiver & Preservation of Defenses

Civil Procedure > ... > Alternative Dispute Resolution > Arbitration > Arbitrability

Civil Procedure > Pretrial Matters > Alternative Dispute Resolution > Mandatory ADR

Securities Law > Regulators > Self-Regulating Entities > National Association of Securities Dealers

**HN8** The applicability of the time limit rule of Nat'l Ass'n Sec. Dealers Manual, Code Arb. P.R. 10304, is a matter presumptively for the arbitrator, not for the judge.

Civil Procedure > ... > Alternative Dispute Resolution > Arbitration > General Overview

Civil Procedure > Pretrial Matters > Alternative Dispute Resolution > Validity of ADR Methods

Contracts Law > Contract Conditions & Provisions > Arbitration Clauses

Securities Law > Regulators > Self-Regulating Entities > National Association of Securities Dealers

Securities Law > ... > Self-Regulating Entities > National Securities Exchanges > General Overview

**HN9** National Association of Securities Dealers arbitrators, comparatively more expert about the meaning of their own rules, are comparatively better able to interpret and to apply them. In the absence of any statement to the contrary in an arbitration agreement, it is reasonable to infer that the parties intended the agreement to reflect that understanding. And for the law to assume an expectation that aligns (1) decisionmaker with (2) comparative expertise will help better to secure a fair and expeditious resolution of the underlying controversy, a goal of arbitration systems and judicial systems alike.

Civil Procedure > ... > Alternative Dispute Resolution > Arbitration > Arbitrability

Civil Procedure > Pretrial Matters > Alternative Dispute Resolution > Mandatory ADR

Securities Law > Regulators > Self-Regulating Entities > National Association of Securities Dealers

**HN10** The time limit rule of Nat'l Ass'n Sec. Dealers Manual, Code Arb. P.R. 10304, falls within the class of gateway procedural disputes that do not present what United States Supreme Court cases call "questions of arbitrability."

Civil Procedure > Pretrial Matters > Alternative Dispute Resolution > Mandatory ADR

Securities Law > Regulators > Self-Regulating Entities > National Association of Securities Dealers

**HN11** See Nat'l Ass'n Sec. Dealers Manual, Code Arb. P.R. 10324.

## Lawyers' Edition Display

### Decision

National Association of Securities Dealers (NASD) arbitrator, rather than court, held to be decisionmaker that ought to apply, to particular investment-related controversy, NASD's time-limit rule for submitting controversies to arbitration.

### Summary

A controversy arose out of some investment advice which a company had provided a client at some time between 1986 and 1994. This controversy fell within a standard arbitration clause in the parties' client service agreement. The clause provided that any such controversy would be determined by arbitration before any self-regulatory organization or exchange of which the company was a member. Moreover, the agreement provided that the client could select the arbitration forum. In this instance, the client (1) chose arbitration before the National Association of Securities Dealers (NASD), and (2) in 1997, signed NASD's uniform submission agreement, which provided that the controversy was submitted in accordance with the NASD code of arbitration procedure.

One rule of this NASD code set forth a 6-year limit for submitting controversies to arbitration. The company (1) filed suit in the United States District Court for the District of Colorado; (2) asked the court to declare that the parties' controversy was ineligible for arbitration, on the theory that the controversy was allegedly more than 6 years old; and (3) sought an injunction that would have prohibited the client from proceeding in arbitration. However, the District Court dismissed the suit, on the asserted ground that a NASD arbitrator, not the court, ought to interpret and apply the NASD time-limit rule.

On appeal, the United States Court of Appeals for the Tenth Circuit, in reversing and in ordering a remand, expressed the view that (1) application of the NASD time-limit rule presented a question of the underlying controversy's arbitrability that was presumptively for a court, not an arbitrator, to decide; (2) the client service agreement, as supplemented by the submission agreement, did not "clearly and unmistakably" demonstrate the parties' intent to have the time-limit dispute decided by an arbitrator; and (3) even though the client service agreement included a general provision that the agreement would be governed by New York state law--under which law such time-limit disputes

allegedly ought to be decided by an arbitrator--"the federal law of arbitrability," rather New York law, governed the question whether an arbitrator or a court ought to apply the time-limit rule in the case at hand (261 F3d 956).

On certiorari, the United States Supreme Court reversed. In an opinion by Breyer, J., joined by Rehnquist, Ch. J., and Stevens, Scalia, Kennedy, Souter, and Ginsburg, JJ., it was held that a NASD arbitrator, rather than a court, was the decisionmaker that ought to apply, to the underlying controversy in the case at hand, NASD's time-limit rule, as:

(1) This time-limit dispute fell within the class of gateway procedural disputes which did not present what the Supreme Court's cases had called "questions of arbitrability" that were presumptively for a court to decide.

(2) Without the help of a special arbitration-disfavoring presumption, the Supreme Court could not properly conclude that the parties intended to have a court, rather than an arbitrator, interpret and apply the time-limit rule.

Thomas, J., concurring in the judgment, expressed the view that arbitrators ought to be permitted to resolve the issues concerning the NASD time-limit rule that had arisen in the case at hand, because (1) New York state case law so provided, (2) the parties had agreed to be bound by New York law, and (3) Supreme Court precedent required the Supreme Court to enforce that agreement.

O'Connor, J., did not participate.

## Headnotes

ARBITRATION §11 > EVIDENCE §385 > -- time limit -- application by arbitrator or court -- presumptions > Headnote:

*LEdHN*[1A] [1A]*LEdHN*[1B] [1B]*LEdHN*[1C] [1C]*LEdHN*[1D] [1D]*LEdHN*[1E] [1E]

With respect to an agreed-upon arbitration, before the National Association of Securities Dealers (NASD), of a controversy concerning some investment advice which a company had provided a client, a NASD arbitrator, rather than a court, was the decisionmaker that ought to apply, to this controversy, the 6-year limit for submitting controversies to arbitration that was set forth in a rule of the NASD code of arbitration procedure, as:

(1) This time-limit dispute fell within the class of gateway procedural disputes which did not present what the United States Supreme Court's cases had called "questions of

arbitrability" that were presumptively for a court to decide--and, thus, the applicability of the time-limit rule was a matter presumptively for an arbitrator, not for a judge--in that (a) this time-limit dispute closely resembled the gateway questions which the Supreme Court had found not to be such questions of arbitrability, for the time-limit dispute seemed to be an aspect of the controversy which called the grievance procedures into play; (b) it was reasonable to infer--in the absence of any statement to the contrary in the parties' arbitration agreement--that the parties intended the agreement to reflect an understanding that NASD arbitrators, comparatively more expert about the meaning of their own rule, would be better able to interpret and to apply the rule; and (c) for the law to assume an expectation that aligned the decisionmaker with comparative expertise would help better to secure a fair and expeditious resolution of the underlying controversy, a goal of arbitration systems and judicial systems alike.

(2) Without the help of a special arbitration-disfavoring presumption, the Supreme Court could not properly conclude that the parties intended to have a court, rather than an arbitrator, interpret and apply the NASD time-limit rule, as (a) the parties to an arbitration contract would normally expect a forum-based decisionmaker to decide forum-specific procedural gateway matters; and (2) any temptation to place special antiarbitration weight on the appearance of the word "eligible" (for submission) in the NASD time-limit rule was counterbalanced by a different NASD rule, which provided that arbitrators would be empowered to interpret and determine the applicability of all provisions under the NASD code.

(Thomas, J., dissented in part from this holding.)

ARBITRATION §11 > EVIDENCE §385 > -- questions for arbitrator or court -- presumptions > Headnote:

*LEdHN*[2A] [2A]*LEdHN*[2B] [2B]*LEdHN*[2C] [2C]

While the United States Supreme Court has long recognized and enforced a liberal federal policy favoring arbitration agreements, there is a policy exception, pursuant to which there is a presumption, or interpretive rule, that the question whether the parties have submitted a particular dispute to arbitration--that is, the question of arbitrability--is an issue for judicial determination, unless the parties clearly and unmistakably provide otherwise. For such purposes, the phrase "question of arbitrability" has a far more limited scope than encompassing any potentially dispositive gateway question. In regard to particular issues, a gateway dispute about whether the parties are bound by a given arbitration

clause raises such a question of arbitrability for a court to decide. Similarly, a disagreement about whether an arbitration clause in a concededly binding contract applies to a particular type of controversy is for a court to decide. However, procedural questions which grow out of a dispute and bear on its final disposition are presumptively not for a judge, but for an arbitrator, to decide. Moreover, the presumption is that an arbitrator should decide allegations of waiver, delay, or a like defense to arbitrability.

## Syllabus

Per respondent Dean Witter Reynolds, Inc.'s standard client agreement, petitioner Howsam chose to arbitrate her dispute with the company before the National Association of Securities Dealers (NASD). NASD's Code of Arbitration Procedure § 10304 states that no dispute "shall be eligible for submission . . . where six (6) years have elapsed from the occurrence or event giving rise to the dispute." Dean Witter filed this suit, asking the Federal District Court to declare the dispute ineligible for arbitration because it was more than six years old and seeking an injunction to prohibit Howsam from proceeding in arbitration. The court dismissed the action, stating that the NASD arbitrator should interpret and apply the NASD rule. In reversing, the Tenth Circuit found that the rule's application presented a question of the underlying dispute's "arbitrability"; and the presumption is that a court will ordinarily decide an arbitrability question.

*Held:* An NASD arbitrator should apply the time limit rule to the underlying dispute. Pp. 3-7.

(a) "Arbitration is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit." *Steelworkers v. Warrior & Gulf Nav. Co.*, 363 U.S. 574, 582, 4 L. Ed. 2d 1409, 80 S. Ct. 1347. The question whether parties have submitted a particular dispute to arbitration, *i.e.*, the "question of arbitrability," is "an issue for judicial determination unless the parties clearly and unmistakably provide otherwise." *AT&T Technologies, Inc. v. Communications Workers*, 475 U.S. 643, 649, 89 L. Ed. 2d 648, 106 S. Ct. 1415. The phrase "question of arbitrability" has a limited scope, applicable in the kind of narrow circumstance where contracting parties would likely have expected a court to have decided the gateway matter. But the phrase is *not* applicable in other kinds of general circumstance where parties would likely expect that an arbitrator would decide the question -- "procedural questions which grow out of the dispute and bear on its final disposition," *John Wiley & Sons, Inc. v. Livingston*, 376 U.S. 543, 557, 11 L. Ed. 2d

898, 84 S. Ct. 909, and "allegations of waiver, delay, or a like defense to arbitrability," *Moses H. Cone Memorial Hospital v. Mercury Constr. Corp.*, 460 U.S. 1, 24-25, 74 L. Ed. 2d 765, 103 S. Ct. 927. Following this precedent, the application of the NASD rule is not a "question of arbitrability" but an "aspect of the [controversy] which called the grievance procedures into play." *John Wiley & Sons, Inc.*, *supra*, at 559. NASD arbitrators, comparatively more expert about their own rule's meaning, are comparatively better able to interpret and to apply it. In the absence of any statement to the contrary in the arbitration agreement, it is reasonable to infer that the parties intended the agreement to reflect that understanding. And for the law to assume an expectation that aligns (1) decisionmaker with (2) comparative expertise will help better to secure the underlying controversy's fair and expeditious resolution. Pp. 3-6.

(b) Dean Witter's argument that, even without an antiarbitration presumption, the contracts call for judicial determination is unpersuasive. The word "eligible" in the NASD Code's time limit rule does not, as Dean Witter claims, indicate the parties' intent for the rule to be resolved by the court prior to arbitration. Parties to an arbitration contract would normally expect a forum-based decisionmaker to decide forum-specific procedural gateway matters, and any temptation here to place special antiarbitration weight on the word "eligible" in § 10304 is counterbalanced by the NASD rule that "arbitrators shall be empowered to interpret and determine the applicability" of all code provisions, § 10324. Pp. 6-7.

261 F.3d 956, reversed.

**Counsel:** Alan C. Friedberg argued the cause for petitioner.

Matthew D. Roberts argued the cause for the United States, as amicus curiae, by special leave of court.

Kenneth W. Starr argued the cause for respondent.

**Judges:** BREYER, J., delivered the opinion of the Court, in which REHNQUIST, C. J., and STEVENS, SCALIA, KENNEDY, SOUTER, and GINSBURG, JJ., joined. THOMAS, J., filed an opinion concurring in the judgment. O'CONNOR, J., took no part in the consideration or decision of the case.

**Opinion by:** BREYER

## Opinion

[\*\*590] [\*81] [\*\*\*495] JUSTICE BREYER delivered the opinion of the Court.

**LEdHN[1A]** [1A] This case focuses upon an arbitration rule of the National Association of Securities Dealers (NASD). The rule states that no dispute “shall be eligible for submission to arbitration . . . where six (6) years have elapsed from the occurrence or event giving rise to the . . . dispute.” NASD Code of Arbitration Procedure § 10304 (1984) (NASD Code or Code). We must decide whether a court or an NASD arbitrator should apply the rule to the underlying controversy. [\*\*\*496] We conclude that the matter is for the arbitrator.

### I

The underlying controversy arises out of investment advice that Dean Witter Reynolds, Inc. (Dean Witter), provided its client, Karen Howsam, when, some time between 1986 and 1994, it recommended that she buy and hold interests in four limited partnerships. Howsam says that Dean Witter misrepresented the virtues of the partnerships. The resulting controversy [\*\*591] falls within their standard Client Service Agreement’s arbitration clause, which provides:

“all controversies . . . concerning or arising from . . . any account . . . , any transaction . . . , or . . . the construction, performance or breach of . . . any . . . agreement between us . . . shall be determined by arbitration before any self-regulatory organization or exchange of which Dean Witter is a member.” App. 6-7.

[\*82] The agreement also provides that Howsam can select the arbitration forum. And Howsam chose arbitration before the NASD.

To obtain NASD arbitration, Howsam signed the NASD’s Uniform Submission Agreement. That agreement specified that the “present matter in controversy” was submitted for arbitration “in accordance with” the NASD’s “Code of Arbitration Procedure.” *Id.*, at 24. And that Code contains the provision at issue here, **HNI** a provision stating that no dispute “shall be eligible for submission . . . where six (6) years have elapsed from the occurrence or event giving rise to the . . . dispute.” NASD Code § 10304.

**LEdHN[1B]** [1B] **LEdHN[2A]** [2A] After the Uniform Submission Agreement was executed, Dean Witter filed this lawsuit in Federal District Court. It asked the court to declare that the dispute was “ineligible for arbitration”

because it was more than six years old. App. 45. And it sought an injunction that would prohibit Howsam from proceeding in arbitration. The District Court dismissed the action on the ground that the NASD arbitrator, not the court, should interpret and apply the NASD rule. The Court of Appeals for the Tenth Circuit, however, reversed. 261 F.3d 956 (2001). In its view, application of the NASD rule presented a question of the underlying dispute’s “arbitrability”; and the presumption is that a court, not an arbitrator, will ordinarily decide an “arbitrability” question. See, e.g., *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 131 L. Ed. 2d 985, 115 S. Ct. 1920 (1995).

The Courts of Appeals have reached different conclusions about whether a court or an arbitrator primarily should interpret and apply this particular NASD rule. Compare, e.g., 261 F.3d 956 (CA10 2001) (case below) (holding that the question is for the court); *J. E. Liss & Co. v. Levin*, 201 F.3d 848, 851 (CA7 2000) (same), with *PaineWebber Inc. v. Elahi*, 87 F.3d 589 (CA1 1996) (holding that NASD § 15, currently § 10304, is presumptively for the arbitrator); *Smith Barney Shearson, Inc. v. Boone*, 47 F.3d 750 (CA5 1995) (same). We [\*83] granted Howsam’s petition for certiorari to resolve this disagreement. And we now hold that the matter is for the arbitrator.

### II

**LEdHN[1C]** [1C] **LEdHN[2B]** [2B] This Court has determined that **HN2** “arbitration is a matter of contract and a party cannot be required [\*\*\*497] to submit to arbitration any dispute which he has not agreed so to submit.” *Steelworkers v. Warrior & Gulf Nav. Co.*, 363 U.S. 574, 582, 4 L. Ed. 2d 1409, 80 S. Ct. 1347 (1960); see also *First Options*, 514 U.S. at 942-943. **HN3** Although the Court has also long recognized and enforced a “liberal federal policy favoring arbitration agreements,” *Moses H. Cone Memorial Hospital v. Mercury Constr. Corp.*, 460 U.S. 1, 24-25, 74 L. Ed. 2d 765, 103 S. Ct. 927 (1983), it has made clear that there is an exception to this policy: The question whether the parties have submitted a particular dispute to arbitration, i.e., the “question of arbitrability,” is “an issue for judicial determination [u]nless the parties clearly and unmistakably provide otherwise.” *AT&T Technologies, Inc. v. Communications Workers*, 475 U.S. 643, 649, 89 L. Ed. 2d 648, 106 S. Ct. 1415 (1986) (emphasis added); *First Options*, 514 U.S. at 944. We must decide here whether application of the NASD time limit provision falls into the scope of this last-mentioned interpretive rule.

[\*\*592] **LEdHN[2C]** [2C] Linguistically speaking, one might call any potentially dispositive gateway question a

"question of arbitrability," for its answer will determine whether the underlying controversy will proceed to arbitration on the merits. The Court's case law, however, makes clear that, for purposes of applying the interpretive rule, the phrase "question of arbitrability" has a far more limited scope. See 514 U.S. at 942. **HN4** The Court has found the phrase applicable in the kind of narrow circumstance where contracting parties would likely have expected a court to have decided the gateway matter, where they are not likely to have thought that they had agreed that an arbitrator would do so, and, consequently, where reference of the gateway dispute to the court avoids the risk of [\*84] forcing parties to arbitrate a matter that they may well not have agreed to arbitrate.

Thus, **HN5** a gateway dispute about whether the parties are bound by a given arbitration clause raises a "question of arbitrability" for a court to decide. See *id.*, at 943-946 (holding that a court should decide whether the arbitration contract bound parties who did not sign the agreement); *John Wiley & Sons, Inc. v. Livingston*, 376 U.S. 543, 546-547, 11 L. Ed. 2d 898, 84 S. Ct. 909 (1964) (holding that a court should decide whether an arbitration agreement survived a corporate merger and bound the resulting corporation). Similarly, a disagreement about whether an arbitration clause in a concededly binding contract applies to a particular type of controversy is for the court. See, e.g., *AT&T Technologies, supra*, 475 U.S. 643, at 651-652 (holding that a court should decide whether a labor-management layoff controversy falls within the arbitration clause of a collective-bargaining agreement); *Atkinson v. Sinclair Refining Co.*, 370 U.S. 238, 241-243, 8 L. Ed. 2d 462, 82 S. Ct. 1318 (1962) (holding that a court should decide whether a clause providing for arbitration of various "grievances" covers claims for damages for breach of a no-strike agreement).

At the same time **HN6** the Court has found the phrase "question of arbitrability" *not* applicable in other kinds of general circumstance where parties would likely expect that an [\*\*\*498] arbitrator would decide the gateway matter. Thus "'procedural' questions which grow out of the dispute and bear on its final disposition" are presumptively *not* for the judge, but for an arbitrator, to decide. *John Wiley, supra*, 376 U.S. 543, at 557 (holding that an arbitrator should decide whether the first two steps of a grievance procedure were completed, where these steps are prerequisites to arbitration). So, too, the presumption is that the arbitrator should decide "allegations of waiver, delay, or a like defense to arbitrability." *Moses H. Cone Memorial Hospital*, 460 U.S. at 24-25. Indeed, **HN7** the Revised Uniform Arbitration Act of 2000 (RUAA), seeking to "incorporate [\*85] the

holdings of the vast majority of state courts and the law that has developed under the [Federal Arbitration Act]," states that an "arbitrator shall decide whether a condition precedent to arbitrability has been fulfilled." RUAA § 6(c) and comment 2, 7 U. L. A. 12-13 (Supp. 2002). And the comments add that "in the absence of an agreement to the contrary, issues of substantive arbitrability . . . are for a court to decide and issues of procedural arbitrability, *i.e.*, whether prerequisites such as *time limits*, notice, laches, estoppel, and other conditions precedent to an obligation to arbitrate have been met, are for the arbitrators to decide." *Id.*, § 6, comment 2, 7 U. L. A., at 13 (emphasis added).

**LEdHN[1D]** [1D]Following this precedent, we find that **HN8** the applicability of the NASD time limit rule is a matter presumptively for the arbitrator, not for the judge. The time limit rule closely resembles the gateway questions that this Court has found not to be "questions of arbitrability." *E.g., Moses H. Cone Memorial Hospital, supra*, 460 U.S. 1, at 24-25 [\*\*\*593] (referring to "waiver, delay, or a like defense"). Such a dispute seems an "aspect of the [controversy] which called the grievance procedures into play." *John Wiley, supra*, 376 U.S. 543, at 559.

Moreover, **HN9** the NASD arbitrators, comparatively more expert about the meaning of their own rule, are comparatively better able to interpret and to apply it. In the absence of any statement to the contrary in the arbitration agreement, it is reasonable to infer that the parties intended the agreement to reflect that understanding. Cf. *First Options*, 514 U.S. at 944-945. And for the law to assume an expectation that aligns (1) decisionmaker with (2) comparative expertise will help better to secure a fair and expeditious resolution of the underlying controversy -- a goal of arbitration systems and judicial systems alike.

We consequently conclude that **HN10** the NASD's time limit rule falls within the class of gateway procedural disputes that do not present what our cases have called "questions of arbitrability." [\*86] And the strong pro-court presumption as to the parties' likely intent does not apply.

### III

**LEdHN[1E]** [1E]Dean Witter argues that, in any event, *i.e.*, even without an antiarbitration presumption, we should interpret the contracts between the parties here as calling for judicial determination of the time limit matter. Howsam's execution of a Uniform Submission Agreement with the NASD in 1997 effectively incorporated the NASD Code into the parties' [\*\*\*499] agreement. Dean Witter notes the Code's time limit rule uses the word "eligible." That word,

in Dean Witter's view, indicates the parties' intent for the time limit rule to be resolved by the court prior to arbitration.

We do not see how that is so. For the reasons stated in Part II, *supra*, parties to an arbitration contract would normally expect a forum-based decisionmaker to decide forum-specific procedural gateway matters. And any temptation here to place special antiarbitration weight on the appearance of the word "eligible" in the NASD Code rule is counterbalanced by a different NASD rule; that rule states that *HNI* "arbitrators shall be empowered to interpret and determine the applicability of all provisions under this Code." NASD Code § 10324.

Consequently, without the help of a special arbitration-disfavoring presumption, we cannot conclude that the parties intended to have a court, rather than an arbitrator, interpret and apply the NASD time limit rule. And as we held in Part II, *supra*, that presumption does not apply.

IV

For these reasons, the judgment of the Tenth Circuit is

*Reversed.*

JUSTICE O'CONNOR took no part in the consideration or decision of this case.

**Concur by:** THOMAS

## **Concur**

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[\*87] JUSTICE THOMAS, concurring in the judgment.

As our precedents make clear and as the Court notes, arbitration is a matter of contract. *Ante*, at 3. In *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468, 103 L. Ed. 2d 488, 109

S. Ct. 1248 (1989), we held that under the Federal Arbitration Act courts must enforce private agreements to arbitrate just as they would ordinary contracts: in accordance with their terms. Under *Volt*, when an arbitration agreement contains a choice-of-law provision, that provision must be honored, and a court interpreting the agreement must follow the law of the jurisdiction selected by the parties. See *id.*, at 478-479 (enforcing a choice-of-law provision that incorporated a state procedural rule concerning arbitration proceedings); see also *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 67, 131 L. Ed. 2d 76, 115 S. Ct. 1212 [\*\*594] (1995) (THOMAS, J., dissenting) (concluding that the choice-of-law provision in question was indistinguishable from the one in *Volt* and, thus, should have been given effect). A straightforward application of these principles easily resolves the question presented in this case.

The agreement now before us provides that it "shall be construed and enforced in accordance with the laws of the State of New York." App. 6. Interpreting two agreements containing provisions virtually identical to the ones in dispute here, the New York Court of Appeals held that issues implicating § 15 (now § 10304) of the National Association of Securities Dealers Code of Arbitration Procedure are for arbitrators to decide. See *Smith Barney Shearson Inc. v. Sacharow*, 91 N.Y.2d 39, 689 N.E.2d 884, 666 N.Y.S.2d 990 (1997). Because the parties agreed to be bound by New York law [\*\*\*500] and because *Volt* requires us to enforce their agreement, I would permit arbitrators to resolve the § 10304 issues that have arisen in this case, just as New York case law provides. The Court follows a different route to reach the same conclusion; accordingly, I concur only in the judgment.

## **References**

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L Ed Digest, Arbitration 11; Evidence 385L Ed Index, Securities RegulationAnnotation References:.

# APPENDIX 13

## Huntington Nat'l Bank v. Sproul

Supreme Court of New Mexico

September 13, 1993, Decided ; September 13, 1993, Filed

No. 19,965

### Reporter

116 N.M. 254; 1993-NMSC-051; 861 P.2d 935; 1993 N.M. LEXIS 303; 32 N.M. St. B. Bull. 964

The HUNTINGTON NATIONAL BANK, a National Banking Association, Plaintiff-Appellee, v. Lesley G. SPROUL, Defendant-Appellant

**Subsequent History:** Rehearing Denied October 14, 1993. Released for Publication October 15, 1993. As Corrected December 14, 1993. Second Correction February 9, 1994.

**Prior History:** APPEAL FROM THE DISTRICT COURT OF BERNALILLO COUNTY. Rozier E. Sanchez, District Judge

### Core Terms

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spouse, community debt, community real property, district court, separate debt, community property, joint, marital, judgment lien, encumber, foreclose, foreclosure, requires, separate obligation, Appeals, joinder, instant case, separate property, joint tenancy, debtor spouse, choice-of-law, tenants in common, satisfy the debt, real property, signature, mortgage, default, parties, judicial sale, constitutes

### Case Summary

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#### Procedural Posture

Plaintiff bank brought a claim against defendants, husband and wife, in the District Court of Bernalillo County (New Mexico), seeking to domesticate a foreign judgment, which was against the husband, and collect the judgment from their community real property. The trial court awarded the bank a judgment and ordered the judgment lien foreclosed upon, and the wife appealed after the trial court stayed the foreclosure pending the appeal.

#### Overview

The wife asserted that the debt entered into by her husband was not a community debt, that the New Mexico trial court should not have applied New Mexico law to the out-of-state

judgment, and that she was not a party to the judgment and the judgment should not have been enforced against community property. The court affirmed the trial court judgment and the order for a judicial sale, holding that New Mexico, under the full faith and credit clause of U.S. Const. art. IV, § 1, was obligated to enforce the out-of-state judgment, as though it had been rendered by a New Mexico trial court. The court further held that under N.M. Stat. Ann. § 40-3-9 (1978), the debt was a community debt and it was not necessary for the wife to sign the documents creating the debt and the bank was entitled to presume that community assets would be used to pay the debt. The court further held that the bank was further entitled to enforce a judgment lien against community property and the lien created by the debt was not a transfer of community property, which was prohibited by the lack of the wife's signature under N.M. Stat. Ann. § 40-3-13(A).

#### Outcome

The court affirmed the judgment and order of the trial court, because the trial court was obligated to give full faith and credit to an out-of-state judgment and the bank was entitled to rely upon community property to collect a debt created by the husband, even though the wife did not sign the documents creating the debt.

### LexisNexis® Headnotes

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Family Law > ... > Property Rights > Characterization > Separate Property

Family Law > ... > Property Distribution > Characterization > Marital Property

Real Property Law > ... > Present Estates > Marital Estates > Separate Property

**HNI** Ohio is a separate property state.

Real Property Law > Estates > Concurrent Ownership > General Overview

116 N.M. 254, \*254; 1993-NMSC-051, \*\*1993-NMSC-051; 861 P.2d 935, \*\*\*935

Real Property Law > Estates > Concurrent Ownership > Joint Tenancies

Real Property Law > Estates > Concurrent Ownership > Tenancies by Entireties

Real Property Law > Estates > Concurrent Ownership > Tenancies in Common

**HN2** Ohio recognizes tenancies in common, joint tenancies, and tenancies by the entireties as the three methods by which cotenants may jointly own real property.

Civil Procedure > Parties > Capacity of Parties > General Overview

Family Law > ... > Property Rights > Characterization > Separate Property

Real Property Law > Estates > Concurrent Ownership > General Overview

Real Property Law > Estates > Concurrent Ownership > Joint Tenancies

Real Property Law > Estates > Concurrent Ownership > Tenancies in Common

Real Property Law > ... > Present Estates > Marital Estates > Separate Property

**HN3** Judgment creditors of one tenant in common may enforce their rights against that individual cotenant's property interest, but not against the separate property interests of the other cotenants. The judgment creditors of one joint tenant can reach that individual tenant's interest in the jointly owned real property.

Civil Procedure > Remedies > Judgment Liens > General Overview

Family Law > Marital Duties & Rights > Debt Liability

Real Property Law > Estates > Concurrent Ownership > Tenancies by Entireties

**HN4** Judgment creditors of an indebted spouse are completely precluded from enforcing the judgment by foreclosing against real property owned by both spouses, even with respect to the debtor spouse's interest, when the spouses own the real property as tenants by the entireties.

Civil Procedure > Remedies > Judgment Liens > General Overview

Contracts Law > Breach > Breach of Contract Actions > General Overview

**HN5** A cause of action on a judgment is different from the cause of action upon which the judgment was based.

Civil Procedure > Remedies > Judgment Liens > General Overview

Contracts Law > Breach > Breach of Contract Actions > General Overview

**HN6** When a claim on a contract is reduced to judgment, the contract between the parties is voluntarily surrendered and canceled by merger in the judgment and ceases to exist.

Civil Procedure > ... > Federal & State Interrelationships > Choice of Law > General Overview

Civil Procedure > Judgments > Enforcement & Execution > General Overview

Civil Procedure > Remedies > Judgment Liens > General Overview

Commercial Law (UCC) > ... > Application & Construction > Choice of Law > General Overview

Commercial Law (UCC) > Negotiable Instruments (Article 3) > General Overview

Commercial Law (UCC) > Negotiable Instruments (Article 3) > Definitions & General Provisions > General Overview

Commercial Law (UCC) > ... > Definitions & General Provisions > Characteristics > General Overview

Commercial Law (UCC) > ... > Definitions & General Provisions > Definitions > General Overview

Contracts Law > ... > Negotiable Instruments > Enforcement > General Overview

**HN7** A promissory note's choice-of-law clause does not require a trial court to apply the choice of law established in the clause, when a judgment creditor is enforcing the judgment rendered on the note.

Civil Procedure > Judgments > Enforcement & Execution > General Overview

Civil Procedure > Judgments > Enforcement & Execution > Foreign Judgments

Civil Procedure > ... > Preclusion of Judgments > Full Faith & Credit > General Overview

Real Property Law > ... > Liens > Nonmortgage Liens > Judgment Liens

**HN8** Under the doctrine of merger, a foreign judgment loses its separate identity and becomes a simple money judgment once a judgment on the foreign judgment is obtained in the enforcing state.

Civil Procedure > Judgments > General Overview

Civil Procedure > Judgments > Entry of Judgments > General Overview

116 N.M. 254, \*254; 1993-NMSC-051, \*\*1993-NMSC-051; 861 P.2d 935, \*\*\*935

Civil Procedure > Judgments > Enforcement & Execution > General Overview

Civil Procedure > Judgments > Enforcement & Execution > Foreign Judgments

Constitutional Law > Relations Among Governments > Full Faith & Credit

**HN9** Foreign judgments filed pursuant to New Mexico's Foreign Judgments Act are to be treated in the same manner as a judgment of the district court of New Mexico and foreign judgments are to be enforced or satisfied in the same manner as New Mexico judgments.

Estate, Gift & Trust Law > Estate Planning > Community Property > General Overview

Family Law > Marital Duties & Rights > Debt Liability

Family Law > ... > Property Rights > Characterization > Community Property

**HN10** New Mexico recognizes the distinction between community debts and separate debts by statute. N.M. Stat. Ann. § 40-3-9 (1978). Community debts are defined by exclusion in N.M. Stat. Ann. § 40-3-9(B). Section 40-3-9(B) states that a community debt is any debt contracted or incurred by either or both spouses during marriage that does not fall within one of the specifically enumerated categories of separate debt defined by N.M. Stat. Ann. § 40-3-9(A)(1)-(6). A debt created during marriage is presumed to be a community debt, and the party asserting otherwise bears the burden of demonstrating that the marital debt constitutes a separate debt under one of the categories set forth in sections 40-3-9(A)(1)-(6). Because N.M. Stat. Ann. § 40-3-9(B) defines a community debt as any debt acquired during marriage by "either or both spouses," one spouse can incur a community debt without the participation of the other spouse.

Civil Procedure > Judgments > Enforcement & Execution > Writs of Execution

Estate, Gift & Trust Law > Estate Planning > Community Property > General Overview

Family Law > Marital Duties & Rights > Debt Liability

Family Law > ... > Property Rights > Characterization > Community Property

**HN11** Under N.M. Stat. Ann. § 40-3-11(A), community debts are first satisfied from community property.

Civil Procedure > Judgments > Enforcement & Execution > Exemptions From Execution

Civil Procedure > Judgments > Enforcement & Execution > Writs of Execution

Estate, Gift & Trust Law > Estate Planning > Community Property > General Overview

Family Law > Marital Duties & Rights > Debt Liability

Family Law > Marital Duties & Rights > Property Rights > General Overview

Family Law > ... > Property Rights > Characterization > General Overview

Family Law > ... > Property Rights > Characterization > Community Property

Family Law > ... > Property Rights > Characterization > Separate Property

Family Law > Marital Duties & Rights > Property Rights > Homestead Rights

Real Property Law > Estates > Concurrent Ownership > Joint Tenancies

Real Property Law > Estates > Concurrent Ownership > Tenancies in Common

Real Property Law > Exemptions & Immunities > Homestead Exemptions

**HN12** N.M. Stat. Ann. § 40-3-11(A) states that, excluding the residence of the spouses, a community debt is first satisfied from all of the spouses' community property and from all property in which each spouse owns an undivided equal interest as a joint tenant or tenant in common. If the aforementioned property proves insufficient, the community debt must then be satisfied from the spouses' residence, subject to the homestead exemption found at N.M. Stat. Ann. § 42-10-9 (1978). N.M. Stat. Ann. § 40-3-11(A). Should the community debt still remain unsatisfied, the separate property of the spouse who incurred the debt is liable to satisfy the debt. If both spouses incurred the debt, the separate property of each is jointly and severally liable to satisfy the debt.

Civil Procedure > Judgments > Enforcement & Execution > Exemptions From Execution

Civil Procedure > Judgments > Enforcement & Execution > Writs of Execution

Estate, Gift & Trust Law > Estate Planning > Community Property > General Overview

Family Law > Marital Duties & Rights > Debt Liability

Family Law > Marital Duties & Rights > Property Rights > General Overview

Family Law > ... > Property Rights > Characterization > General Overview

Family Law > ... > Property Rights > Characterization > Community Property

Family Law > ... > Property Rights > Characterization > Separate Property

Family Law > Marital Duties & Rights > Property Rights > Homestead Rights

Real Property Law > Estates > Concurrent Ownership > General Overview

Real Property Law > Estates > Concurrent Ownership > Tenancies in Common

Real Property Law > Exemptions & Immunities > Homestead Exemptions

**HN13** N.M. Stat. Ann. § 40-3-10(A) requires that the separate debt of a spouse first be satisfied from that spouse's separate property, excluding the debtor spouse's interest in property in which each of the spouses owns an undivided equal interest as a joint tenant or tenant in common. If such property proves to be insufficient, then the debt must be satisfied from the debtor spouse's one-half interest in the community property or in property in which each spouse owns an undivided equal interest as a joint tenant or tenant in common, excluding the residence of the spouses. Section 40-3-10(A). If the debt still remains unsatisfied, then the debtor spouse's interest in the residence of the spouses shall be used to satisfy the debt, subject to the nondebtor spouse's homestead exemption under N.M. Stat. Ann. § 42-10-9 (1978). Under no circumstances would the nondebtor spouse's separate property or interest in community property be subject to satisfy the separate debt of the debtor spouse.

Family Law > Marital Duties & Rights > Debt Liability

**HN14** N.M. Stat. Ann. § 40-3-9(A)(3) (1978) denominates as a separate debt any marital debt that is designated as a separate debt of a spouse by a judgment or decree of any court having jurisdiction.

Family Law > Marital Duties & Rights > Debt Liability

**HN15** In order for a marital debt to constitute a separate debt under N.M. Stat. Ann. § 40-3-9(A)(3) (1978), the judgment or decree rendered by a court having jurisdiction must contain an express statement designating the debt as the separate debt of one spouse.

Estate, Gift & Trust Law > Estate Planning > Community Property > General Overview

Family Law > Marital Duties & Rights > Debt Liability

Family Law > ... > Property Rights > Characterization > Community Property

**HN16** N.M. Stat. Ann. § 40-3-9(A)(4) (1978) permits a spouse and the spouse's creditor to agree that a marital debt is the separate obligation of the debtor spouse at the time the debt is incurred. In order to designate a marital debt as the separate debt of one spouse, the debtor spouse must identify the debt as that spouse's separate debt in writing to the creditor at the time the debt is created. § 40-3-9(A)(4).

Family Law > Marital Duties & Rights > Debt Liability

**HN17** As between a spouse and the other spouse's creditor, N.M. Stat. Ann. § 40-3-9(A)(4) (1978) requires that the debtor spouse expressly communicate the separate nature of a marital debt to a creditor in writing when creating a marital debt intended to be that spouse's separate obligation.

Family Law > ... > Property Distribution > Characterization > Marital Property

Real Property Law > ... > Present Estates > Marital Estates > Community Property

Real Property Law > Financing > Mortgages & Other Security Instruments > Purchase Money Mortgages

**HN18** See N.M. Stat. Ann. § 40-3-13(A).

Family Law > ... > Property Distribution > Characterization > Community Property

Real Property Law > ... > Present Estates > Marital Estates > Community Property

**HN19** The joinder requirement of N.M. Stat. Ann. § 40-3-13(A) has been interpreted to require the signature of both spouses on documents transferring, conveying, mortgaging, or leasing community real property. Under § 40-3-13(A), transactions made by one spouse alone in violation of its provisions are void and of no effect.

Energy & Utilities Law > Pooling & Unitization > General Overview

Energy & Utilities Law > Pooling & Unitization > Joint Operating Agreements

Governments > Legislation > Interpretation

Securities Law > Civil Liability Considerations > Releases & Waivers > Securities Act Compliance

**HN20** Absent a contrary intent, statutory provisions are given effect as written, giving the words their plain meaning.

Civil Procedure > Remedies > Judgment Liens > General Overview

Contracts Law > ... > Secured Transactions > Attachment of Security Interests > General Overview

116 N.M. 254, \*254; 1993-NMSC-051, \*\*1993-NMSC-051; 861 P.2d 935, \*\*\*935

Contracts Law > Types of Contracts > Lease Agreements > General Overview

Real Property Law > ... > Lease Agreements > Commercial Leases > Financing, Mortgaging & Security Leases

Real Property Law > ... > Liens > Nonmortgage Liens > General Overview

Real Property Law > ... > Liens > Nonmortgage Liens > Judgment Liens

Real Property Law > ... > Liens > Nonmortgage Liens > Mechanics' Liens

Tax Law > State & Local Taxes > Administration & Procedure > Tax Liens

Tax Law > ... > Real Property Taxes > Assessment & Valuation > General Overview

**HN21** An encumbrance is a claim, lien, charge, or liability attached to and binding real property, such as a mortgage, judgment lien, mechanics' lien, lease, security interest, easement or right of way, or accrued and unpaid taxes.

Civil Procedure > Remedies > Judgment Liens > General Overview

Contracts Law > Standards of Performance > Creditors & Debtors

Contracts Law > Types of Contracts > Lease Agreements > General Overview

Family Law > Marital Duties & Rights > Property Rights > General Overview

Family Law > ... > Property Rights > Characterization > General Overview

Family Law > ... > Property Distribution > Characterization > Community Property

Real Property Law > ... > Mortgages & Other Security Instruments > Transfers > General Overview

Real Property Law > ... > Liens > Nonmortgage Liens > Judgment Liens

**HN22** N.M. Stat. Ann. § 40-3-13(A) requires only that spouses join in all transfers, conveyances, or mortgages of community real property, contracts to transfer, convey or mortgage community real property, and leases of community real property that may exceed five years. Section 40-3-13(A) does not require joinder of spouses in an underlying community debt before community real property can be encumbered by a judgment lien arising as a consequence of unfulfilled obligations on the debt. Nothing in Section 40-3-13(A) prohibits community real property from being encumbered by a judgment lien when one spouse incurs a

debt, the debtor spouse defaults on the debt obligation, the debt is adjudged to be a community debt, and the unfulfilled obligation gives rise to a judgment lien against community real property.

Governments > Legislation > Interpretation

**HN23** An act is to be read as a whole and each part construed in connection with every other part so as to produce a harmonious whole and the different statutory provisions must be reconciled so as to make them consistent, harmonious and sensible.

Civil Procedure > Remedies > Judgment Liens > General Overview

Family Law > ... > Property Distribution > Characterization > Community Property

**HN24** N.M. Stat. Ann. 40-3-13(A) does not require both spouses to join in creating a community debt for a later judgment on the debt to encumber community real property.

Civil Procedure > Judgments > Preclusion of Judgments > General Overview

Civil Procedure > ... > Preclusion of Judgments > Full Faith & Credit > General Overview

Constitutional Law > Relations Among Governments > General Overview

Constitutional Law > Relations Among Governments > Full Faith & Credit

**HN25** See U.S. Const. art. IV, § 1.

Civil Procedure > Judgments > Preclusion of Judgments > General Overview

Civil Procedure > ... > Preclusion of Judgments > Full Faith & Credit > General Overview

Constitutional Law > Relations Among Governments > Full Faith & Credit

Evidence > Authentication > General Overview

**HN26** 28 U.S.C.S. § 1738 requires that properly authenticated acts, records, and judicial proceedings be given the same full faith and credit in every court within the United States and its territories and possessions as they have by law or usage in the courts of such state, territory or possession from which they are taken.

**Counsel:** Calvin J. Hyer, Jr., Albuquerque, for plaintiff-appellee.

Atkinson & Kelsey, P.A., Thomas C. Montoya, Albuquerque, for defendant-appellant.

**Judges:** Baca, Justice. Montgomery and Franchini, JJ., concur.

**Opinion by:** BACA

## Opinion

[\*255] [\*\*\*936] *OPINION*

[\*\*1] Defendant-appellant Lesley Sproul ("Mrs. Sproul") appeals the district court's determination that an Ohio judgment domesticated in New Mexico, entered in favor of Plaintiff-appellee Huntington National Bank (the "Bank") against Sproul's husband, Elmer Sproul ("Mr. Sproul"), constituted a community debt under NMSA 1978, Section 40-3-9 (Repl.Pamp.1989). Mrs. Sproul also appeals from the district court's order subjecting the Sprouls' residence, owned as community real property, to foreclosure and judicial sale pursuant to NMSA 1978, Section 40-3-11 (Repl.Pamp.1989), to satisfy the Bank's judgment against Mr. Sproul. We address the following issues on appeal: (1) Whether the [\*256] [\*\*\*937] district court erred by applying New Mexico law to determine whether the judgment on the Bank's note constituted a community debt of Mr. and Mrs. Sproul; (2) whether the district court erred when it concluded that the judgment against Mr. Sproul was the community debt of the Sprouls under Section 40-3-9; (3) whether NMSA 1978, Section 40-3-13(A) (Repl.Pamp.1989), requires joinder of both spouses when the creation of a community debt ultimately renders community real property liable for satisfaction of the debt; (4) whether the failure of a creditor to join both spouses in an underlying action on a marital debt precludes the creditor from later foreclosing upon community real property to satisfy the debt; and (5) whether the district court misapplied principles of full faith and credit when it ordered the judicial sale of the Sprouls' residence. We note jurisdiction under SCRA 1986, 12-102(A)(1) (Repl.Pamp.1992), and affirm.

I

[\*\*2] Mr. and Mrs. Sproul, residents of Bernalillo County, New Mexico, were married on August 27, 1949. Thirty-eight years later, on July 20, 1987, Mr. Sproul signed a commercial loan note with the Bank, a banking association located in Columbus, Ohio, for the amount of \$ 112,700. The note contained a choice-of-law provision, which stated that the note would be governed by and construed under Ohio law. Mrs. Sproul did not sign the note and was not otherwise a party to the transaction between the Bank and her husband.

[\*\*3] Mr. Sproul used the funds obtained from the Bank loan to purchase 70,658 shares of stock in a company named Blandford Park Limited and pledged these shares as security for the loan. Mr. Sproul sustained losses from his investment when the stock depreciated and he subsequently defaulted on the note. Following his default, the Bank brought suit against Mr. Sproul and Garth Guy, the guarantor of Mr. Sproul's loan, in the Court of Common Pleas of Franklin County, Ohio. On February 1, 1989, the Court of Common Pleas entered default judgment against Mr. Sproul for the loan amount of \$ 112,700, accrued interest of \$ 15,431.04, future interest on the note, late charges totalling \$ 25, and costs.

[\*\*4] On March 7, 1989, the Bank filed a complaint against Mr. Sproul in the Bernalillo County District Court, requesting domestication of the Ohio judgment. On May 8, 1989, the district court domesticated the Ohio judgment in New Mexico by entering a default judgment against Mr. Sproul for the amounts specified in the Ohio judgment, attorney's fees of \$ 3,500, and costs totalling \$ 75. The Bank filed a transcript of judgment with the Bernalillo County Clerk on May 26, 1989.

[\*\*5] On February 2, 1990, the Bank filed an additional complaint against both Mr. and Mrs. Sproul, seeking to foreclose its judgment lien on the couple's New Mexico residence. The Bank requested that the district court find that the judgment against Mr. Sproul was the community debt of the Sprouls. Following a nonjury trial on October 19, 1990, the district court determined that the judgment constituted a community debt of both Mr. Sproul and Mrs. Sproul under Section 40-3-9. The district court subsequently subjected the Sprouls' residence to foreclosure and to judicial sale pursuant to the priorities for satisfaction of community debts found in Section 40-3-11. Mrs. Sproul moved for a stay of foreclosure proceedings pending appeal. The district court granted Mrs. Sproul's motion for stay, and she appealed the district court's decision to this Court.

II

[\*\*6] A threshold issue presented by this appeal is whether the district court erred when it concluded that New Mexico law applied to determine whether the judgment on the Bank's note was the community debt of Mr. and Mrs. Sproul. Mrs. Sproul contends that the district court erred by applying New Mexico law because the commercial loan note between Mr. Sproul and the Bank contained a choice-of-law provision stating that the note would "be governed by and construed in accordance with the law of the State of Ohio." Mrs. Sproul asserts that this choice-of-law

[\*257] [\*\*\*938] clause required the district court to apply Ohio law when enforcing the Bank's judgment and that under Ohio law the Bank would be precluded from foreclosing on her interest in the Sprouls' residence in order to satisfy its judgment against Mr. Sproul.<sup>1</sup>

[\*\*7] To support her argument, Mrs. Sproul asserts that the parties to a contract may select the law to govern the performance and enforcement of a contract between them and that this Court will give effect to the parties' choice-of-law provision in a contract controlled by New Mexico's Uniform Commercial Code, NMSA 1978, Sections 55-1-101 to -12-108 (Orig.Pamp., Repl.Pamp. & Cum.Supp.1992) (the "UCC"), when the law chosen bears a relationship to the contract.<sup>2</sup> *Nez v. Forney*, 109 N.M. 161, 163, 783 P.2d 471, 473 (1989); *United Wholesale Liquor Co. v. Brown-Forman Distillers Corp.*, 108 N.M. 467, 470, 775 P.2d 233, 236 (1989); *Jim v. CIT Fin. Servs. Corp.*, 87 N.M. 362, 364, 533 P.2d 751, 753 (1975). Mrs. Sproul's argument, however, fails to recognize that **HN5** a cause of action on a judgment is different from the cause of action upon which the judgment was based. *See City of Philadelphia v. Bauer*, 97 N.J. 372, 478 A.2d 773, 776 (1984) (citing *Milwaukee County v. M.E. White Co.*, 296 U.S. 268, 275, 56 S.Ct. 229, 233, 80 L.Ed. 220 (1935)). In this case, the Ohio judgment rendered on the Bank's note constitutes an obligation that is separate and distinct from the underlying note itself. The Ohio court's rendition of the final money judgment extinguished the Bank's note and replaced the claim based on the note with a new cause of action on the judgment. *See Bassett v. Eagle Telecommunications, Inc.*, 750 P.2d 73, 76 (Colo.Ct.App.1987) (upon entry of judgment, defendant's liability under preceding claims ceases to exist and is

replaced by new liability under the judgment); *Neel v. First Fed.Sav. & Loan Ass'n*, 207 Mont. 376, 675 P.2d 96, 101 (1984) **HN6** ("[W]hen a claim on a contract is reduced to judgment, '[t]he contract between the parties is voluntarily surrendered and canceled by merger in the judgment and ceases to exist.'") (citation omitted); *Woodcraft Constr., Inc. v. Hamilton*, 56 Wash.App. 885, 786 P.2d 307, 308 (1990) (a valid final money judgment extinguishes the underlying claim and gives rise to a new cause of action on the judgment). While the note itself was controlled by its choice-of-law clause, the note's contractual obligations were superseded by new rights and obligations upon rendition of judgment. No contractual basis existed following judgment that required application of the [\*258] [\*\*\*939] choice-of-law clause to enforcement of the judgment. *See id.* at 308. Accordingly, we hold that **HN7** the note's choice-of-law clause did not require the district court to apply Ohio law when enforcing the judgment rendered on the note.

[\*\*8] Absent the applicability of the note's choice-of-law clause to the judgment, we address whether the district court was correct in applying New Mexico law to the enforcement of the judgment. In this case, the Bank instituted an action in New Mexico district court to domesticate the Ohio judgment. Pursuant to the Bank's complaint and following notice to Mr. Sproul, the district court granted the Bank personal judgment against Mr. Sproul in the State of New Mexico. Once the New Mexico judgment was entered, the judgment obtained in Ohio lost its original identity as an Ohio judgment and became a money judgment of the state of New Mexico. *See City of Philadelphia*, 478 A.2d at 776 (noting that **HN8** under the doctrine of merger, a foreign judgment loses its separate identity and becomes a simple

<sup>1</sup> We agree with Mrs. Sproul's contention that Ohio law would likely preclude the Bank from satisfying its judgment against her husband from her interest in jointly owned real property. Unlike New Mexico, **HNI** Ohio is a separate property state. **HN2** Ohio recognizes tenancies in common, joint tenancies, and tenancies by the entirety as the three methods by which cotenants may jointly own real property. *See Koster v. Boudreaux*, 11 Ohio App.3d 1, 4-6, 11 BR 12, 15-18, 463 N.E.2d 39, 43-44 (1982). As a general rule, **HN3** judgment creditors of one tenant in common may enforce their rights against that individual cotenant's property interest, 4A Richard R. Powell, *The Law of Real Property* para. 605[2] (rev. ed. 1993), but not against the separate property interests of the other cotenants. *See, e.g., United States v. Estes*, 654 F.Supp. 49, 51 (S.D. Ohio 1986). Similar to the general rule applicable to tenancies in common, the judgment creditors of one joint tenant can reach that individual tenant's interest in the jointly owned real property, 48A C.J.S. *Joint Tenancy* § 32 (1981), but cannot reach the interests of the other joint tenants. *See Estes*, 654 F.Supp. at 51; *Anderson v. Southern Pac. Co.*, 264 Cal.App.2d 230, 70 Cal.Rptr. 389, 390 (Ct.App.1968); *First Nat'l Bank v. Energy Fuels Corp.*, 200 Colo. 540, 618 P.2d 1115, 1118-19 (1980), *rev'g Chatfield Bank v. Energy Fuels Corp.*, 42 Colo.App. 233, 599 P.2d 923 (1979). Finally, **HN4** judgment creditors of an indebted spouse are completely precluded from enforcing the judgment by foreclosing against real property owned by both spouses, even with respect to the debtor spouse's interest, when the spouses own the real property as tenants by the entirety. *Id.*; *Koster*, 463 N.E.2d at 47; *Donvito v. Criswell*, 1 Ohio App.3d 53, 56, 1 OBR 286, 288, 439 N.E.2d 467, 472 (1982).

<sup>2</sup> In the instant case, the commercial loan note executed by the Bank and Mr. Sproul is governed by and subject to Article 3 of the UCC. *See* NMSA 1978, § 55-3-102 (making Article 3 applicable to negotiable instruments); NMSA 1978, § 55-3-104 (defining "negotiable instrument"); NMSA 1978, § 55-3-102(4), now codified as NMSA 1978, § 55-3-103(d) (Cum.Supp.1992) (making Article 1, including NMSA 1978, § 55-1-105, applicable throughout Article 3).

money judgment once a judgment on the foreign judgment is obtained in the enforcing state); *cf. C & J Travel, Inc. v. Shumway*, 161 Ariz. 33, 775 P.2d 1097, 1099 (Ct.App.1989) (finding that New Hampshire judgments were transformed into valid Arizona judgments when creditors chose to file New Hampshire judgments in Arizona pursuant to Arizona's Uniform Enforcement of Foreign Judgments Act). Because the Ohio judgment was converted into a New Mexico judgment, New Mexico law was applicable to its enforcement. 46 Am.Jur.2d *Judgments* § 897, at 1031 (1969) ("Matters relating to the enforcement of judgments are governed by the law of the forum."); *cf. NMSA 1978, § 39-4A-3* (Repl.Pamp.1991) (requiring that **HN9** foreign judgments filed pursuant to New Mexico's Foreign Judgments Act be treated "in the same manner as a judgment of the district court of this state" and permitting foreign judgments to be enforced or satisfied in the same manner as New Mexico judgments). Accordingly, we hold that the district court correctly applied New Mexico law to determine whether the New Mexico judgment against Mr. Sproul constituted a community debt of Mr. and Mrs. Sproul.

### III

[\*\*9] We next address whether the district court erred when it concluded, under Section 40-3-9, that the judgment against Mr. Sproul was the community debt of Mr. and Mrs. Sproul. **HN10** New Mexico recognizes the distinction between community debts and separate debts by statute. *See* Section 40-3-9; W.S. McClanahan, *Community Property Law in the United States* § 10:4(b), at 484 (1982). Community debts are defined by exclusion in Section 40-3-9(B). *Beneficial Fin. Co. v. Alarcon*, 112 N.M. 420, 423, 816 P.2d 489, 492 (1991). Section 40-3-9(B) states that a community debt is any debt "contracted or incurred by either or both spouses during marriage" that does not fall within one of the specifically enumerated categories of

separate debt defined by Section 40-3-9(A)(1) through (6). We presume that a debt created during marriage is a community debt, and the party asserting otherwise bears the burden of demonstrating that the marital debt constitutes a separate debt under one of the categories set forth in Sections 40-3-9(A)(1) through (6). *See Alarcon*, 112 N.M. at 422, 816 P.2d at 491; *First Nat'l Bank v. Abraham*, 97 N.M. 288, 290, 639 P.2d 575, 577 (1982). Because Section 40-3-9(B) defines a community debt as any debt acquired during marriage by "either or both spouses," one spouse can incur a community debt without the participation of the other spouse. *Alarcon*, 112 N.M. at 422, 816 P.2d at 491; *Execu-Systems, Inc. v. Corlis*, 95 N.M. 145, 147, 619 P.2d 821, 823 (1980); *Fernandez v. Fernandez*, 111 N.M. 442, 444, 806 P.2d 582, 584 (Ct.App.1991). **HN11** Under Section 40-3-11(A), community debts are first satisfied from community property.<sup>3</sup>

[\*\*10] [\*259] [\*\*\*940] Mrs. Sproul asserts that the district court erred by classifying the judgment entered against her husband as a community debt and maintains that under provisions of Section 40-3-9(A), the judgment constitutes Mr. Sproul's separate obligation. Accordingly, Mrs. Sproul contends that under NMSA 1978, Section 40-3-10 (Repl.Pamp.1989), her one-half community interest in the residence may not be foreclosed upon to satisfy Mr. Sproul's separate obligation.<sup>4</sup>

### A

[\*\*11] Mrs. Sproul first maintains that the Bank's judgment against her husband qualifies as the separate debt of Mr. Sproul under **HN14** Section 40-3-9(A)(3), which denominates as a separate debt any marital debt that is "designated as a separate debt of a spouse by a judgment or decree of any court having jurisdiction." Mrs. Sproul reasons that although the judgment entered against Mr. Sproul by the Ohio Court of Common Pleas contained no

<sup>3</sup> **HN12** Section 40-3-11(A) states that, excluding the residence of the spouses, a community debt is first satisfied from all of the spouses' community property and from "all property in which each spouse owns an undivided equal interest as a joint tenant or tenant in common." If the aforementioned property proves insufficient, the community debt must then be satisfied from the spouses' residence, subject to the homestead exemption found at NMSA 1978, § 42-10-9. Section 40-3-11(A). Should the community debt still remain unsatisfied, the separate property of the spouse who incurred the debt is liable to satisfy the debt. *Id.* If both spouses incurred the debt, the separate property of each is jointly and severally liable to satisfy the debt. *Id.*

<sup>4</sup> **HN13** Section 40-3-10(A) requires that the separate debt of a spouse first be satisfied from that spouse's separate property, excluding the debtor spouse's interest in "property in which each of the spouses owns an undivided equal interest as a joint tenant or tenant in common." If such property proves to be insufficient, then the debt must be satisfied from "the debtor spouse's one-half interest in the community property or in property in which each spouse owns an undivided equal interest as a joint tenant or tenant in common, excluding the residence of the spouses." Section 40-3-10(A). If the debt still remains unsatisfied, then the debtor spouse's interest in the residence of the spouses shall be used to satisfy the debt, subject to the nondebtor spouse's homestead exemption under § 42-10-9. *Id.* Under no circumstances would the nondebtor spouse's separate property or interest in community property be subject to satisfy the separate debt of the debtor spouse. *Id.*

language designating the Bank debt as Mr. Sproul's separate obligation, the judgment nonetheless amounted to a judicial decree that the debt was Mr. Sproul's separate debt because the judgment was entered solely against Mr. Sproul and, under Ohio law, the judgment debt of one spouse cannot be satisfied from the nondebtor spouse's interest in jointly held property.

[\*\*12] We find no cases that consider whether a marital debt can be considered a separate debt of one spouse under Section 40-3-9(A)(3) in the absence of language in a judgment or decree designating the debt as that spouse's separate obligation. We believe, however, that the language of Section 40-3-9(A)(3) is clear. **HNI5** In order for a marital debt to constitute a separate debt under Section 40-3-9(A)(3), the judgment or decree rendered by a court having jurisdiction must contain an express statement designating the debt as the separate debt of one spouse.

[\*\*13] In the instant case, the Entry of Judgment of the Ohio Court of Common Pleas noted jurisdiction over the subject matter and the parties involved in the Bank's action, recounted that Mr. Sproul had been served with a summons and had failed to answer, and rendered judgment in favor of the Bank and against Mr. Sproul. Nowhere in the Ohio judgment did the Court of Common Pleas declare the underlying debt the sole debt of Mr. Sproul or even appear to address the issue of whether the debt constituted Mr. Sproul's separate debt or the debt of the marital community. Consequently, we cannot agree that the Ohio judgment designated that the debt incurred by Mr. Sproul was his separate debt. We hold that the trial court did not err when it decided that the debt was not Mr. Sproul's separate debt under Section 40-3-9(A)(3).

B

[\*\*14] Mrs. Sproul next argues that the judgment should be considered her husband's separate debt because the underlying debt forming the basis of the judgment against Mr. Sproul constituted his separate debt [\*260] [\*\*\*941] under Section 40-3-9(A)(4). **HNI6** Section 40-3-9(A)(4) permits a spouse and the spouse's creditor to agree that a marital debt is the separate obligation of the debtor spouse at the time the debt is incurred. William A. Reppy, Jr. & Cynthia A. Samuel, *Community Property in the United States* 266 (2d ed. 1982). In order to designate a marital debt as the separate debt of one spouse, the debtor spouse must identify the debt as that spouse's separate debt in writing to

the creditor at the time the debt is created. Section 40-3-9(A)(4).

[\*\*15] Mrs. Sproul is unable to point to a written provision in the note or to any other written agreement between Mr. Sproul and the Bank that identifies the debt as Mr. Sproul's separate obligation. Instead, Mrs. Sproul argues that the debt is identified in writing to the Bank as Mr. Sproul's separate debt because Mr. Sproul was the sole signatory of the note, because the note contained an Ohio choice-of-law provision, and because Ohio law precludes the Bank from resorting to Mrs. Sproul's property interests in order to satisfy a debt incurred solely by Mr. Sproul. In essence, Mrs. Sproul argues that these circumstances obviate the need to comply strictly with the requirements of Section 40-3-9(A)(4).

[\*\*16] We find one New Mexico case that examines whether strict compliance with the requirements of Section 40-3-9(A)(4) is necessary to establish that a marital debt is the separate debt of one spouse. In *Fernandez v. Fernandez*, a divorce action in which the former husband appealed from the final divorce decree, our Court of Appeals upheld the district court's determination that a marital debt created solely by the husband was his separate debt under Section 40-3-9(A)(4) even though the promissory note between the husband and the lender contained no statement that the loan was the husband's separate obligation. *Fernandez*, 111 N.M. at 444, 806 P.2d at 584. The Court of Appeals concluded that because the evidence in the case supported the trial court's determination that the parties intended for the debt to be the husband's separate debt, strict compliance with the requirements of Section 40-3-9(A)(4) was unnecessary.<sup>5</sup> *Fernandez*, 111 N.M. at 444, 806 P.2d at 584.

[\*\*17] We find, however, that *Fernandez* is distinguishable from the instant case. The Court of Appeals in *Fernandez* held that substantial compliance with the terms of Section 40-3-9(A)(4) was sufficient for a marital debt to be considered one spouse's separate debt *as between spouses in a divorce proceeding. Id.* The Court of Appeals expressly refused to address the issue presented by the instant case: Whether substantial compliance with Section 40-3-9(A)(4) is sufficient to establish the separate nature of the marital debt as between a nondebtor spouse and the debtor spouse's creditor. *Id.*

[\*\*18] We hold that **HNI7** as between a spouse and the other spouse's creditor, Section 40-3-9(A)(4) requires that

<sup>5</sup> As justification for its conclusion, the Court of Appeals determined that a district court's power to divide marital assets in an equitable manner also embraces the ability to give effect to the intentions of the parties, even if the parties fail to comply strictly with the community property or debt statutes. *Fernandez*, 111 N.M. at 444, 806 P.2d at 584.

the debtor spouse expressly communicate the separate nature of a marital debt to a creditor in writing when creating a marital debt intended to be that spouse's separate obligation. The fundamental purpose behind the written notice requirement of Section 40-3-9(A)(4) is to protect creditors who might be unaware that the debtor spouse intends to create a separate debt, rather than a community debt. *Id.* Such protection is necessary because the assets available to satisfy the separate debt of one spouse are limited in comparison to the assets available to satisfy a community debt. Compare § 40-3-10(A) (limiting satisfaction of separate debts to the debtor spouse's separate property and one-half interest in the community property "or in property in which each spouse owns an undivided equal interest as a joint tenant or tenant in common . . .") with § 40-3-11(A) (permitting community debts to be satisfied from all community property and from all property "in which each spouse owns an undivided equal interest as a joint tenant or tenant in common," [\*261] [\*\*\*942] and from the debtor spouse's separate property).

[\*\*19] Because Section 40-3-9(A)(4) was enacted to protect creditors, requiring anything less than strict compliance with the statute in the instant case and like cases would defeat the statute's clear purpose and effectively write the statute out of existence. Accordingly, we refuse to extend *Fernandez* to the facts of this case. We hold that the district court did not err when it declined to classify the judgment debt of Mr. Sproul as his separate debt under Section 40-3-9(A)(4).

#### IV

[\*\*20] Having upheld the district court's determination that the judgment against Mr. Sproul was the community debt of the Sprouls, we address whether the district court erred by ordering the judicial sale of the Sprouls' community residence to satisfy the judgment. Mrs. Sproul argues that the filing of judgment and foreclosure of the judgment liens is void under Section 40-3-13(A), because she neither joined in the execution of the note itself nor was joined as a party in the Ohio proceedings or the Bank's initial proceeding in New Mexico when the judgment was domesticated in New Mexico by default. Mrs. Sproul's argument raises two distinct issues: First, whether Section 40-3-13(A) requires that both spouses join in the execution of a note when community real property may eventually be liable for satisfaction of a judgment on the note in the event of default; and second, whether the creditor of a debtor spouse must join both spouses in an underlying action on a marital debt when the spouses' community real property might ultimately be subject to satisfy the debt. We address each issue in turn.

A

[\*\*21] We begin by addressing whether Section 40-3-13(A) requires both spouses to join in the execution of a note when the note creates a community debt, thus making community real property liable for satisfaction of the debt in the event of default. Section 40-3-13(A), enacted to preclude one spouse from alienating the community's real property absent the other spouse's consent, *Shadden v. Shadden (In re Estate of Shadden)*, 93 N.M. 274, 281, 599 P.2d 1071, 1078 (Ct.App.), *cert. denied*, 93 N.M. 172, 598 P.2d 215 (1979), states in pertinent part that:

*HN18* Except for purchase-money mortgages . . . , the spouses must join in all transfers, conveyances or mortgages or contracts to transfer, convey or mortgage any interest in community real property . . . . The spouses must join in all leases of community real property . . . if the initial term of the lease, together with any option or extension . . . may exceed five years, or . . . is for an indefinite term.

Section 40-3-13(A). *HN19* The joinder requirement of Section 40-3-13(A) has been interpreted to require the signature of both spouses on documents transferring, conveying, mortgaging, or leasing community real property. See *Hannah v. Tennant*, 92 N.M. 444, 446, 589 P.2d 1035, 1037 (1979). Under Section 40-3-13(A), transactions made by one spouse alone in violation of its provisions are "void and of no effect." Section 40-3-13(A); *Hannah*, 92 N.M. at 446, 589 P.2d at 1037.

[\*\*22] Mrs. Sproul first argues that under the circumstances presented in this case, the judgment against her husband is completely unenforceable because the note forming the basis of the judgment constituted a "transfer" of community real property under Section 40-3-13(A), and in the absence of her concurring signature amounted to a void transaction. We do not agree. The note in no way purported to transfer, convey, mortgage, or lease community real property. Thus, under the clear language of Section 40-3-13(A), the note did not constitute a transaction that required both spouses' signatures. See *Waksman v. City of Albuquerque*, 102 N.M. 41, 43, 690 P.2d 1035, 1037 (1984) (*HN20* absent a contrary intent, courts give effect to statutory provisions as written, giving the words their plain meaning); *Gonzales v. Oil, Chem. & Atomic Workers Int'l Union*, 77 N.M. 61, 68, 419 P.2d 257, 262 (1966) (a statute must [\*262] [\*\*\*943] be read and given effect as written) (citing *Burch v. Foy*, 62 N.M. 219, 308 P.2d 199 (1957)).

[\*\*23] Mrs. Sproul next argues that under Section 40-3-13(A), Mr. Sproul was without power to encumber the

community real property absent Mrs. Sproul's joinder. Thus, Mrs. Sproul contends that Mr. Sproul's sole signature on the note could do no more than obligate his separate property and his one-half interest in the community personal property for repayment of the debt. In this case, however, Mr. Sproul did not encumber any of the Sproul's community real property by signing the Bank note. The note, secured by the Blandford stock, merely required the Sprouls to pay back a loan incurred by Mr. Sproul. By signing the note, Mr. Sproul unilaterally created a community debt, which is permitted under New Mexico law. See Section 40-3-9(B). It was the judgment lien arising after Mr. Sproul defaulted on the note, and not the note itself, that encumbered the Sprouls' community real property. See *Black's Law Dictionary* 527 (6th ed.1990) (defining *HN21* an encumbrance as a "claim, lien, charge, or liability attached to and binding real property; e.g. a mortgage; judgment lien; mechanics' lien; lease; security interest; easement or right of way; accrued and unpaid taxes."). Thus, we understand Mrs. Sproul's argument to be that under Section 40-3-13(A), one spouse cannot unilaterally incur a community debt when a subsequent judgment on the debt would encumber community real property.

[\*\*24] Mrs. Sproul contends that New Mexico case law supports her interpretation of Section 40-3-13(A). In particular, Mrs. Sproul relies upon *Shadden*, 93 N.M. at 280, 599 P.2d at 1077, a case in which the decedent-husband made a promissory note payable to himself from the marital community and subsequently devised the note to his son. *Shadden*, however, was expressly limited to its facts and is inapplicable to the instant case. See *id.* at 276-82, 599 P.2d at 1073-79.

[\*\*25] In *Shadden*, the Court of Appeals recognized that the decedent's promissory note, not signed by his wife, constituted a community debt and that under NMSA 1978, Section 45-2-804(B) (Repl.Pamp.1989), the decedent's son, as devisee of the note, could normally subject the entire community to payment of the debt. *Shadden*, 93 N.M. at 280, 599 P.2d at 1077. Notwithstanding, the Court of Appeals construed Section 40-3-13 to prohibit the decedent from encumbering community real property absent his wife's joinder and held that neither the decedent during his lifetime, nor his son standing in the decedent's shoes, had the right to subject the community real property to payment of the debt absent the concurring signature of the decedent's

wife. *Shadden*, 93 N.M. at 282, 599 P.2d at 1079. The Court of Appeals, limiting its holding to those cases in which a member of the community takes a note from himself and is therefore charged with the knowledge that any document executed by one spouse alone cannot subject the community real property to repayment of the note, stated:

The circumstances of this case are not the same as they would be if a stranger to the community had taken decedent's note. [A stranger to the community] might well expect the entire community to answer for the debt if [the] borrower died before payment, because the law [under Section 45-2-804(B)] grants [the holder of the note] that expectation.

*Id.* at 281-82, 599 P.2d at 1078-79.

[\*\*6] In light of the foregoing language, the instant case presents the exact factual scenario to which the holding in *Shadden* does not apply. Although Mrs. Sproul did not join in the execution of the note, the Bank, a stranger to the Sprouls' marital community, was nonetheless granted an expectation under New Mexico law that the community property of Mr. and Mrs. Sproul would be subject to satisfy the community debt in the event of default. See § 40-3-9(B) (either spouse alone can create a community debt); § 40-3-11(A) (all community property is subject to satisfaction of community debts). Because *Shadden* was expressly limited to its facts and held not to apply to cases such as the instant case, [\*263] [\*\*\*944] Mrs. Sproul's reliance on *Shadden* is misplaced.

[\*\*27] While *Shadden* does not apply to the instant case, we note that a later case from this Court, *First State Bank v. Muzio*, 100 N.M. 98, 666 P.2d 777 (1983), has perpetuated a legal proposition first articulated in *Shadden*: that under Section 40-3-13(A), one spouse is without power to encumber the community real property for repayment of a community debt absent the other spouse's joinder. See *Shadden*, 93 N.M. at 280, 599 P.2d at 1077. In *Muzio*, a case that is factually similar to the instant case, this Court held that a guaranty signed only by Mr. Muzio could not encumber Mrs. Muzio's interest in the community real property because a clause in the guaranty, which automatically made all property interests of the guarantor and his spouse liable to satisfy the debt, violated

long-standing principles of New Mexico law.<sup>6</sup> *Muzio*, 100 N.M. at 99, 666 P.2d at 778.

[\*\*28] Citing *Shadden* for the proposition that Mr. Muzio's signature on the guaranty could do no more than commit his separate property and his share of the community property to satisfy a subsequent judgment on the guaranty, this Court stated that under Section 40-3-13, "a foreclosure on community real property based on a judgment entered solely against one spouse should not affect the community interest of the other spouse." *Muzio*, 100 N.M. at 99, 666 P.2d at 778. Our Court concluded that Section 40-3-13 "specifically requires both spouses to join if the entire community real property is to be encumbered." *Muzio*, 100 N.M. at 99, 666 P.2d at 778.

[\*\*29] The statement that Section 40-3-13(A) requires joinder of both spouses if the community real property is to be encumbered is essentially a correct interpretation of the law. But this statement can be given no greater effect than the clear language of Section 40-3-13(A) permits. *See Storey v. University of N.M. Hosp.*, 105 N.M. 205, 207, 730 P.2d 1187, 1189 (1986) ("An unambiguous statute should be given effect according to its clear language."). The clear language of *HN22* Section 40-3-13(A) requires only that spouses join in all transfers, conveyances, or mortgages of community real property, contracts to transfer, convey or mortgage community real property, and leases of community real property that may exceed five years. Section 40-3-13(A) does not require joinder of spouses in an underlying community debt before community real property can be encumbered by a judgment lien arising as a consequence of unfulfilled obligations on the debt. Consequently, nothing in Section 40-3-13(A) prohibits community real property from being encumbered by a judgment lien when one spouse incurs a debt, the debtor spouse defaults on the debt obligation, the debt is adjudged to be a community debt, and the unfulfilled obligation gives rise to a judgment lien against community real property.

[\*\*30] Additional reasons support construing Section 40-3-13(A) as not requiring joinder of both spouses in creating a community debt whenever a judgment lien on the debt might later encumber community real property. Because

any debt may remain unpaid, the potential exists for a judgment lien to encumber community real property in every case where one spouse creates a community debt and the spouses own community real property. The interpretation of Section 40-3-13(A) suggested by Mrs. Sproul would require a creditor to procure the signatures of both spouses in any transaction when one spouse alone attempts to create a community debt. Without both signatures, a creditor would be precluded by Section 40-3-13(A) from accessing community real property to satisfy a community debt in the event of default [\*264] [\*\*\*945] on the obligation by the debtor spouse. Such an interpretation of Section 40-3-13(A) is clearly inconsistent with Section 40-3-9(B) and Section 40-3-11(A), which together provide, without qualification, that either spouse alone can create a community debt and that community debts are to be satisfied first from community property. We refuse to adopt Mrs. Sproul's suggested interpretation of Section 40-3-13(A) because it would require a reading of this statute that would be inconsistent with the clear language of Sections 40-3-9(B) and 40-3-11(A). *See Burroughs v. Board of County Comm'rs*, 88 N.M. 303, 306, 540 P.2d 233, 236 (1975) (*HN23* An act "is to be read as a whole and each part construed in connection with every other part so as to produce a harmonious whole."); *State ex rel. Clinton Realty Co. v. Scarborough*, 78 N.M. 132, 135, 429 P.2d 330, 333 (1967) (holding that a court must reconcile different statutory provisions "so as to make them consistent, harmonious and sensible.").

[\*\*31] Finally, New Mexico law grants creditors, such as the Bank in this case, an expectation that community debts may be satisfied from community real property. *See Shadden* at 281-82, 599 P.2d at 1078-79. Because one spouse alone can incur a community debt, *see* § 40-3-9(B), and community debts are first satisfied from all community property, *see* § 40-3-11(A), the Bank, when loaning money to Mr. Sproul, could reasonably expect that the Sprouls' community real property would be liable to satisfy the community debt in the event of default. We refuse to read nonexistent language into Section 40-3-13(A) -- to require joinder of both spouses whenever a community debt might later be satisfied from community real property -- when doing so would violate the Bank's reasonable expectation under New Mexico law that

<sup>6</sup> The provision in the guaranty signed by Mr. Muzio stated in pertinent part that:

Any execution or other legal process that may issue [against the Guarantor] shall and may be satisfied from any separate property, community property, property held in joint tenancy, property held as tenants-in-common, or in any other manner . . . in which any Guarantor or his or her spouse have an interest, without regard to any priority or exemption.

*Muzio*, 100 N.M. at 99, 666 P.2d at 778 (emphasis omitted). Without elaboration, we held that this clause violated New Mexico law. *Id.* (citing, *inter alia*, *Shadden*, 93 N.M. 274, 599 P.2d 1071).

the note signed by Mr. Sproul, if adjudged to constitute a community debt, could be satisfied from all of the Sprouls' community property. *See Burroughs*, 88 N.M. at 306, 540 P.2d at 236 (a court is prohibited from reading language into a statute that is not there).

[\*\*32] For these reasons, we hold that *HN24* Section 40-3-13(A) should not be construed to require both spouses to join in creating a community debt merely because a later judgment on the debt might encumber community real property. <sup>7</sup> We overrule *Shadden* and *Muzio* to the extent that they suggest otherwise. Consequently, the trial court did not err when it ordered the judicial sale of the Sprouls' residence to satisfy the Bank's judgment.

B

[\*\*33] We next address whether the district court erred by deciding that the Bank could foreclose upon the Sprouls' community real property when the Bank failed to join Mrs. Sproul in the underlying actions on the debt. Mrs. Sproul contends that her interest in the community real property should not be affected by the judgment against her husband because she was neither joined as a defendant in the Ohio proceeding nor in the first New Mexico proceeding to domesticate the Ohio judgment. Mrs. Sproul suggests that her due process rights were violated when the Bank waited until foreclosure of its judgment lien to name her as a defendant.

[\*\*34] We find no principled reason to preclude the Bank from executing on the Sprouls' community real property to satisfy a community debt simply because it did not join Mrs. Sproul prior to foreclosure of its judgment [\*265] [\*\*\*946] lien against Mr. Sproul. The obvious purpose for joining Mrs. Sproul as a party would be to give her notice of proceedings that could potentially affect her interest in the community real property and to provide her an opportunity to argue that the debt should be considered her husband's separate obligation. *Cf. Vikse v. Johnson*, 137 Ariz. 528, 672

P.2d 193, 195 (finding that the purpose behind an Arizona statute that requires joinder of spouses in actions on community debts is to give each spouse notice of the proceedings and an opportunity to defend), *review denied* (Ct.App.1983). <sup>8</sup> Review of the record reveals that Mrs. Sproul received adequate notice and a sufficient opportunity to argue her case.

[\*\*35] Mrs. Sproul was named as a defendant when the Bank filed its action to establish the judgment against Mr. Sproul as a community debt and to foreclose its judgment lien upon the couple's residence. After Mrs. Sproul was joined as a defendant, she submitted an answer to the Bank's complaint denying that the judgment was a community debt, participated in a nonjury trial before the district court, and submitted proposed findings of fact and conclusions of law to the court that vehemently asserted that the debt was Mr. Sproul's separate obligation. Under these facts, we find that Mrs. Sproul received adequate opportunity to argue her position despite the fact that she was not joined as a defendant in the Bank's lawsuit against Mr. Sproul in Ohio and its subsequent suit to domesticate the Ohio judgment in New Mexico. Furthermore, because Mrs. Sproul received notice of the lawsuit pending against her interest in the residence and availed herself of the opportunity to be heard, the requirements of due process were satisfied. *See Rayne State Bank*, 546 So.2d at 641-42 (finding that husband's due process rights were not violated by Bank that was executing a judgment against the couple's community real property, when the husband was served and filed responsive pleadings). We hold that the district court did not err by ordering the judicial sale of the Sprouls' residence to satisfy the community debt even though the Bank did not join Mrs. Sproul as a party prior to the foreclosure proceedings.

[\*\*36] In essence, Mrs. Sproul's argument that the Bank is precluded from foreclosing upon her interest in the community real property for failing to join her as a party prior to foreclosure raises the general question of whether

<sup>7</sup> Statutes similar to Section 40-3-13(A) from every other community property jurisdiction all specifically require the joinder of both spouses before community real property is encumbered. *See* Ariz.Rev.Stat. Ann. § 25-214(C) (1991); Cal.Civ.Code § 5127 (West Cum.Supp. 1993); Idaho Code § 32-912 (Cum.Supp. 1993); La.Civ.Code Ann. art. 2347 (West 1985); Nev.Rev.Stat. § 123.230(3) (1991); Tex.Fam.Code Ann. § 5.81 (West 1993) (encumbrance of homestead); Wash.Rev.Code § 26.16.030(3) (1992). Our research fails to disclose any cases from these jurisdictions holding that a judgment lien is void for encumbering community real property when one spouse alone creates a community debt. In at least one community property jurisdiction, encumbrances imposed by law, such as a judgment recorded against one spouse, are specifically exempted from the statutory joinder requirement. *See* La.Civ.Code Ann. art. 2347, cmt. a; *Rayne State Bank & Trust Co. v. Fruge*, 546 So.2d 637, 640 (La.Ct.App.1989).

<sup>8</sup> Arizona requires by statute that both spouses be sued jointly in an action on a community debt, *see* Ariz.Rev.Stat. Ann. § 25-215(D) (1991), and has interpreted this statute to preclude subsequent satisfaction of a judgment from the community property when both spouses were not joined as parties in the underlying judgment proceedings. *See Shumway*, 161 Ariz. at 34-37, 775 P.2d at 1098-1101; *Vikse*, 137 Ariz. at 529-31, 672 P.2d at 194-96. New Mexico, however, has no comparable statute.

the creditor of one spouse can wait until foreclosure or execution of a judgment to seek judicial resolution of whether the judgment constitutes a community debt. As noted by the Court of Appeals in *Naranjo v. Paull*, 111 N.M. 165, 177, 803 P.2d 254, 266 (Ct.App.1990), our courts have commonly permitted determination of whether a marital debt constitutes a community or separate obligation at the time "an attempt is made to execute on property for purposes of collecting a judgment." *See also Dell v. Heard*, 532 F.2d 1330, 1334 (10th Cir.1976) (recognizing that the issue of whether a tort judgment against one spouse constituted a community or separate debt could be determined when suit was brought to satisfy the judgment); *McDonald v. Senn*, 53 N.M. 198, 200-01, 204 P.2d 990, 990-91 (1949) (per curiam) (permitting the determination of whether a personal tort judgment against one spouse constituted a community or separate obligation to be made when suit was brought to foreclose on a judgment lien on community real estate); *Reppy & Samuel*, *supra*, at 265 (concluding that New Mexico requires tort and contract debts to be "classified as community or separate at the time the creditor seeks to be paid").

[\*\*37] Nonetheless, our Court of Appeals, in *Naranjo*, questioned whether this Court's statement in *Muzio* -- that under Section 40-3-13(A), "foreclosure on community real property based on a judgment entered solely against one spouse should not affect [\*266] [\*\*\*947] the community interest of the other spouse," *Muzio*, 100 N.M. at 99, 666 P.2d at 778 -- could be interpreted as meaning that under certain circumstances "a creditor who waits until executing on a judgment may be barred from litigating whether a debt [is] a community debt." *Naranjo*, 111 N.M. at 178, 803 P.2d at 267. We need not decide today whether a creditor is prohibited from litigating the separate or community nature of a debt at the time of execution because in this case the Bank litigated the issue prior to execution, when seeking to foreclose upon its judgment lien. Nothing in Section 40-3-13(A), however, or related community property statutes, prohibits a creditor from adjudicating the issue of whether a debt is a separate or community debt at the time suit is brought to foreclose on a judgment lien. *But see* *Ariz.Rev.Stat. Ann. § 25-215(D)* (1991). Thus, we hold that the determination of whether a marital debt constitutes a separate or community debt can be made at the time that a creditor seeks to foreclose on its judgment lien, notwithstanding that the judgment was entered only against the debtor spouse. *Muzio* is overruled to the extent that it says otherwise. Accordingly, the district court did not err by determining that the judgment against Mr. Sproul constituted the Sprouls' community debt at the time the Bank sought to foreclose its judgment lien against the Sprouls' residence.

V

[\*\*38] Finally, we address whether the district court erred by misapplying principles of full faith and credit when it ordered that the Sprouls' residence be foreclosed upon and sold to satisfy the Bank's debt. Article IV, Section 1 of the United States Constitution states that "*HN25* Full Faith and Credit shall be given in each State to the public Acts, Records, and judicial Proceedings of every other State." The mandate of the Full Faith and Credit Clause is effectuated by *HN26* 28 U.S.C. § 1738 (1988), which requires that properly authenticated acts, records, and judicial proceedings be given "the same full faith and credit in every court within the United States and its Territories and Possessions as they have by law or usage in the courts of such State, Territory or Possession from which they are taken." Accordingly, a money judgment entered in a foreign state will be given the same effect in New Mexico as it would have been given in that foreign state. *See Reeve v. Jones*, 101 N.M. 320, 322, 681 P.2d 746, 748 (Ct.App.1984).

[\*\*39] Mrs. Sproul argues that the district court, by ordering the judicial sale of the Sprouls' residence, gave greater effect to the Ohio judgment than the State of Ohio would have given the same judgment, because her interests in jointly held property would not be liable to satisfy a judgment entered solely against her husband in Ohio. We do not agree.

[\*\*40] While the judgment of a foreign state will not be given greater effect in New Mexico than in the state where rendered, *see, e.g., In re Estate of Ikuta*, 64 Haw. 236, 639 P.2d 400, 404 (1981), the judgment, once converted into a New Mexico judgment, is entitled to the same enforcement procedures and remedies as a judgment originating in this state. *See City of Philadelphia*, 478 A.2d at 778 ("[L]ocal law may determine the scope and nature of available remedies."); Restatement (Second) of Conflict of Laws § 99 (1969) ("The local law of the forum determines the methods by which a judgment of another state is enforced."). The principles of full faith and credit are not violated simply because the New Mexico judgment has greater force as a remedy than the underlying judgment would have in Ohio. *See Weir v. Corbett*, 229 Cal.App.2d 290, 40 Cal.Rptr. 161, 163-64 (Ct.App.1964). We hold that the district court did not violate principles of full faith and credit when it ordered foreclosure and sale of the Sprouls' residence.

VI

[\*\*41] In conclusion, we hold that the Sprouls' community property, which necessarily includes Mrs. Sproul's community property interest in the residence, is available to

satisfy a debt incurred solely by Mr. [\*267] [\*\*\*948] Sproul. This result is mandated by New Mexico community property law.

[\*\*42] In the instant case, both Mr. and Mrs. Sproul had a community interest in the funds acquired from the Bank loan and in the Blandford Park stock that Mr. Sproul purchased with the loan proceeds. See NMSA 1978, § 40-3-8(A) & (B) (Repl.Pamp.1989) (defining separate and community property). Similarly, the note executed between Mr. Sproul and the Bank gave rise to the presumption of a community debt. See Section 40-3-9(B); *Alarcon*, 112 N.M. at 422, 816 P.2d at 491; *Abraham*, 97 N.M. at 290, 639 P.2d at 577. The Bank obtained a judgment against Mr. Sproul after he defaulted on his obligation to repay the Bank note. The judgment, like the underlying debt, was presumptively a community debt. See Section 40-3-9(B); cf. *Mountain v. Price*, 20 Wash.2d 129, 146 P.2d 327, 328 (1944) (nothing that under Washington's community property law, a judgment rendered against a married man is presumed to be a community obligation).

[\*\*43] As is permitted by New Mexico law, Mrs. Sproul appeared before the district court at the time the Bank

sought foreclosure of its judgment lien and attempted to overcome the presumption that the judgment was a community obligation. See *McDonald*, 53 N.M. at 200-01, 204 P.2d at 990-91; *Naranjo*, 111 N.M. at 177, 803 P.2d at 266; *Dell*, 532 F.2d at 1334; cf. *Mountain*, 146 P.2d at 328 (noting the existence of the same procedural process in Washington). The district court correctly concluded, however, that the judgment was a community debt of the Sprouls. Because the judgment constitutes a community debt, the Bank, a foreign creditor, has the same right to satisfy its judgment from the Sprouls' community property as a creditor from New Mexico executing on a similar judgment originally rendered in this state. See *Escrow Serv. Co. v. Cressler*, 59 Wash.2d 38, 365 P.2d 760, 766 (1961) (en banc) (Finley, C.J., dissenting) (noting that a creditor on a foreign contract should have access to community property to satisfy a community debt to the same extent as creditors to contracts executed in state). Accordingly, the judgment and order of the district court is AFFIRMED.

[\*\*44] IT IS SO ORDERED.

# APPENDIX 14

# Manetti-Farrow, Inc. v. Gucci America, Inc.

United States Court of Appeals for the Ninth Circuit

February 10, 1988, Argued and Submitted ; September 28, 1988, Filed

No. 87-1988

## Reporter

858 F.2d 509; 1988 U.S. App. LEXIS 13186

MANETTI-FARROW, INC., a California corporation, Plaintiff-Appellant, v. GUCCI AMERICA, INC., a New York corporation; GUCCI PARFUMS S.p.A., an Italian corporation; GUCCIO GUCCI S.p.A., an Italian corporation; MAURIZIO GUCCI, Dr.; DOMENICO DE SOLE; GIOVANNI VITTORIO PILONE, Dr., Defendants-Appellees

**Prior History:** [\*\*1] Appeal from the United States District Court for the Northern District of California, D.C. No. CV-86-4636-EFL, Eugene F. Lynch, District Judge, Presiding.

## Core Terms

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forum selection clause, federal law, venue, district court, applies, dealership, contractual, cause of action, tort claim, state law, fulfillment, parties, issues

## Case Summary

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### Procedural Posture

Appellant distributor contested dismissal of its complaint in the United States District Court for the Northern District of California, claiming that a forum selection clause in its contract with appellees, a perfumery and others, did not apply where appellant alleged tortious claims.

### Overview

Appellant distributor entered an exclusive contract with appellee perfumery, which included a forum selection clause designating Florence, Italy as the forum for resolution of any controversy regarding interpretation or fulfillment of the contract. Appellee terminated the agreement, and brought suit against appellant in Italy. Conversely, appellant filed an action in district court, contending that the forum selection clause did not apply to tort claims. Yet the district court dismissed appellant's action, concluding that the forum

selection clause required litigation in Florence, Italy. On appeal, the court held that federal interests outweighed state interests. Because the tort actions related to interpretation of the contract, they were within the scope of the forum selection clause. In affirming, the court held that the district court did not err in enforcing the forum selection clause by dismissing appellant's complaint.

### Outcome

Finding that federal interests outweighed state interests, the court affirmed the district court's dismissal of appellant distributor's action against appellee perfumery, holding that the forum selection clause in the parties' contract made the appropriate forum for adjudication in Florence, Italy.

## LexisNexis® Headnotes

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Civil Procedure > ... > Jurisdiction > Diversity Jurisdiction > General Overview

Civil Procedure > Preliminary Considerations > Federal & State Interrelationships > General Overview

Civil Procedure > Preliminary Considerations > Federal & State Interrelationships > Erie Doctrine

Contracts Law > Contract Conditions & Provisions > Forum Selection Clauses

**HN1** In diversity suits, federal district courts should apply state law to substantive issues, and federal law to procedural issues.

Civil Procedure > Preliminary Considerations > Venue > General Overview

Contracts Law > Contract Conditions & Provisions > Forum Selection Clauses

**HN2** Forum selection clauses are to be specifically enforced unless the party opposing the clause clearly shows that enforcement would be unreasonable and unjust, or that the clause was invalid for such reasons as fraud or overreaching.

Civil Procedure > Preliminary Considerations > Federal & State Interrelationships > General Overview

Civil Procedure > Preliminary Considerations > Federal & State Interrelationships > Erie Doctrine

**HN3** In making an Erie choice between applying federal or state law, the appellate court decision must be guided by the twin aims of the Erie rule: discouragement of forum shopping, and avoidance of inequitable administration of the laws. The Erie choice is best accomplished by balancing the federal and state interests.

Civil Procedure > Preliminary Considerations > Federal & State Interrelationships > Erie Doctrine

Contracts Law > Contract Conditions & Provisions > Forum Selection Clauses

**HN4** Though state policies should be weighed in the balance, the authority and prerogative of the federal courts to determine the issue should be exercised so that a valid forum selection clause is given controlling weight in all but the most exceptional cases.

Contracts Law > Contract Conditions & Provisions > Forum Selection Clauses

Contracts Law > Contract Interpretation > General Overview

**HN5** Federal law also applies to interpretation of forum selection clauses.

Contracts Law > Contract Conditions & Provisions > Forum Selection Clauses

**HN6** Forum selection clauses can be equally applicable to contractual and tort causes of action. Whether a forum selection clause applies to tort claims depends on whether resolution of the claims relates to interpretation of the contract.

Contracts Law > Contract Interpretation > Ambiguities & Contra Proferentem > General Overview

Evidence > Types of Evidence > Documentary Evidence > Parol Evidence

**HN7** Traditional contract law provides that extrinsic evidence is inadmissible to interpret an unambiguous contract.

Contracts Law > Contract Conditions & Provisions > Forum Selection Clauses

Contracts Law > ... > Affirmative Defenses > Fraud & Misrepresentation > General Overview

**HN8** Forum selection clauses are prima facie valid, and are enforceable absent a strong showing by the party opposing the clause that enforcement would be unreasonable or unjust, or that the clause is invalid for such reasons as fraud or overreaching. The opposing party has the burden to show that trial in the contractual forum would be so gravely difficult and inconvenient that he will for all practical purposes be deprived of his day in court.

**Counsel:** Richard D. Rosenberg, Alioto & Alioto, San Francisco, California, for the Plaintiff/Appellant.

Edwin B. Mishkin, Cleary, Gottlieb, Steen & Hamilton, New York, New York, for the Defendant/Appellee Gucci America.

Patrick J. Mahoney, Cooley, Godward, Castro, Huddleson & Tatum, San Francisco, California, for the remaining Defendants/Appellees.

**Judges:** Jerome Farris, Melvin Brunetti and David R. Thompson, Circuit Judges.

**Opinion by:** THOMPSON

## Opinion

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[\*510] DAVID R. THOMPSON, Circuit Judge:

Manetti-Farrow, Inc. ("Manetti-Farrow") appeals the dismissal of its complaint against Gucci Parfums, S.p.A. ("Gucci Parfums"), Gucci America, Inc. ("Gucci America"), Guccio Gucci, S.p.A. ("Guccio Gucci"), and three individual directors of the various Gucci enterprises.

Manetti-Farrow entered an exclusive dealership contract with Gucci Parfums. The contract included a forum selection clause which designated Florence, Italy as the forum for resolution of any controversy "regarding interpretation or fulfillment" of the contract. Manetti-Farrow contends the forum selection [\*\*2] clause does not apply to tort claims, and that the district court has jurisdiction to hear these claims. The district court dismissed the complaint. It concluded that the parties' forum selection clause required them to litigate their dispute in Florence, Italy. We have jurisdiction under 28 U.S.C. § 1291, and we affirm.

I

### FACTS

In 1906, Signor Guccio Gucci opened a saddlery in Florence, Italy that eventually gained world-wide acclaim for its

quality leather craftsmanship. The parent corporation of the Gucci empire, Guccio Gucci, S.p.A. ("Guccio Gucci") expanded its market to the United States in the 1950s. As the Gucci reputation spread, Gucci America was incorporated in New York to distribute [\*511] Gucci products throughout the United States. Gucci America owns the American rights to the Gucci trademark, and owns and licenses retail stores across the country specializing in sales of Gucci merchandise.

Guccio Gucci formed a subsidiary, Gucci Parfums, to market a new line of perfumes and accessory items. Gucci Parfums is incorporated in Florence, Italy, and is 80%-owned by Guccio Gucci. The Gucci Accessory Collection ("Collection") launched by Gucci Parfums includes handbags, cosmetic bags, [\*\*3] wallets, key rings and pens, all bearing the distinctive red and green Gucci stripe. Gucci Parfums sells the Collection to distributors around the world.

Manetti-Farrow, a California corporation, entered an exclusive dealership contract with Gucci Parfums in 1979. The contract designated Manetti-Farrow as the exclusive U.S. distributor of the Collection. Gucci America, the owner of the American rights to the Gucci trademark, was not a party to the exclusive dealership contract, but entered a separate Consent and Ratification Agreement, consenting to the terms of the contract.

In 1983, in Florence, Manetti-Farrow renewed its exclusive dealership contract with Gucci Parfums for an additional five years on substantially the same terms as the 1979 agreement. Due to Manetti-Farrow's success in marketing the Collection, its dealership territory was extended to include Puerto Rico, the Virgin Islands, and Tahiti. The 1979 and 1983 contracts included identical forum selection clauses, which provided: "For any controversy regarding interpretation or fulfillment of the present contract, the Court of Florence has sole jurisdiction." Gucci America signed a second Consent and Ratification Agreement, [\*\*4] consenting to the 1983 contract between Manetti-Farrow and Gucci Parfums.

Sales of the Collection merchandise boomed. Manetti-Farrow's wholesale purchases from Gucci Parfums increased from \$ 480,000 in 1979 to \$ 15 million in 1985. The Manetti-Farrow distribution network expanded to over 500 points of sale. In 1985, Gucci Parfums signed a written

agreement waiving its right to withdraw from the exclusive dealership contract in 1988, and extending Manetti-Farrow's contract for another five years.

Meanwhile, a power struggle was taking place within the Gucci empire. Manetti-Farrow alleges certain factions of the Gucci family sought to terminate its exclusive dealership relationship with Gucci Parfums, and to bring North American distribution of the Collection within the Gucci corporate structure. In July, 1986, Gucci Parfums terminated the exclusive dealership agreement, and brought suit against Manetti-Farrow in Florence for breach of contract.

One month later, Manetti-Farrow brought suit in the United States District Court for the Northern District of California, alleging eight causes of action against: Guccio Gucci; Gucci America; Gucci Parfums; Dr. Maurizio Gucci (Chairman of the [\*\*5] Board of Gucci America, and director of Gucci Parfums and Guccio Gucci); Domenico De Sole (President and Director of Gucci America); and Dr. Giovanni Pilone (President of Gucci Parfums and director of Gucci America and Guccio Gucci). Six of these causes of action are at issue in this appeal: <sup>1</sup> (1) conspiracy to interfere with contractual relations (against all defendants); (2) conspiracy to interfere with prospective economic advantage (against all defendants); (3) tortious interference with contractual relations (against Gucci America, Dr. Gucci, and De Sole); (4) tortious interference with prospective economic advantage (against Gucci America, Dr. Gucci, and De Sole); (5) breach of implied covenant of good faith and fair dealing (against Gucci America); and (6) unfair trade practices (against Gucci America). The district court held that all of these claims were covered by the forum selection clause, and [\*512] dismissed the case. Manetti-Farrow appeals.

## [\*\*6] II

### APPLICABLE LAW

Our initial task is to decide whether state or federal law applies in our analysis of the effect and scope of the forum selection clause. Our approach to this threshold question is dictated by the doctrine of *Erie Railroad v. Tompkins*, 304 U.S. 64, 82 L. Ed. 1188, 58 S. Ct. 817 (1938), and its progeny. The Supreme Court has explained that *HNI* in diversity suits such as the case before us, federal district courts should apply state law to substantive issues, and federal law to procedural issues. The application of the *Erie*

<sup>1</sup> Manetti-Farrow concedes its seventh and eighth causes of action (for breach of an implied covenant of good faith and fair dealing, and trade indebtedness) involve interpretation or fulfillment of the contract, and were properly dismissed because these causes of action are admittedly covered by the forum selection clause.

doctrine to forum selection clauses, however, has led to a split among the circuit courts of appeals as to whether state or federal law should be applied.<sup>2</sup> In this circuit, the issue has been squarely addressed only once. In *Visicorp v. Software Arts, Inc.*, 575 F. Supp. 1528 (N.D. Cal. 1983), the district court decided that federal law applies to interpret a forum selection clause, because forum selection is primarily a venue matter. *Id.* at 1532. The *Visicorp* court applied the standard announced in *The Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 32 L. Ed. 2d 513, 92 S. Ct. 1907 (1972). In *The Bremen*, the Supreme Court stated that **HN2** forum selection clauses are to be specifically enforced unless the party opposing **[\*\*7]** the clause clearly shows "that enforcement would be unreasonable and unjust, or that the clause was invalid for such reasons as fraud or overreaching." *The Bremen*, 407 U.S. at 15. Although *The Bremen* was an admiralty case, its standard has been widely applied to forum selection clauses in general. See e.g., *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 518-19, 41 L. Ed. 2d 270, 94 S. Ct. 2449 (1974) (applying *The Bremen* standard to an agreement to arbitrate disputes).

**[\*\*8]** Other Ninth Circuit opinions interpreting forum selection clauses have applied federal law without discussing whether state or federal law applies. See, e.g., *Pelleport Investors v. Budco Quality Theatres*, 741 F.2d 273, 279 (9th Cir. 1984); *Crown Beverage Co. v. Cervceria Moctezuma, S.A.*, 663 F.2d 886, 888 (9th Cir. 1981); *Republic Int'l Corp. v. Amco Eng'rs, Inc.*, 516 F.2d 161, 168 (9th Cir. 1975). But see *Colonial Leasing Co. v. Pugh Bros. Garage*, 735 F.2d 380, 382 (9th Cir. 1984) (applying Oregon law to enforce a forum selection clause). Other circuit courts of appeals have reached conflicting results. The Third Circuit treats interpretation of forum selection clauses as a contract issue,

to be resolved according to state law. *General Eng'g Corp. v. Martin Marietta Alumina, Inc.*, 783 F.2d 352, 356-57 (3d Cir. 1986); see also *Snider v. Lone Star Art Trading Co., Inc.*, 672 F. Supp. 977, 982 (E.D. Mich. 1987), *aff'd*, 838 F.2d 1215 (6th Cir. 1988). The Eleventh Circuit holds that forum selection clauses involve venue issues, are procedural and therefore federal law applies. *Stewart Org., Inc. v. Ricoh Corp.*, 810 F.2d 1066, 1068 (11th Cir.) (per curiam) (en banc), *aff'd on other grounds*, 487 U.S. 22, 108 S. Ct. 2239, 101 L. Ed. 2d 22, **[\*\*9]** 56 U.S.L.W. 4659 (1988); *accord Karl Koch Erecting Co. v. New York Convention Center Dev. Corp.*, 838 F.2d 656, 659 (2d Cir. 1988); *Luce v. Edelstein*, 802 F.2d 49, 57 (2d Cir. 1986); *Bryant Elec. Co. v. City of Fredericksburg*, 762 F.2d 1192, 1196-97 (4th Cir. 1985); *Bense v. Interstate Battery Sys. of America*, **[\*513]** *Inc.*, 683 F.2d 718 (2d Cir. 1982); *Friedman v. World Transp., Inc.*, 636 F. Supp. 685, 689 (N.D. Ill. 1986).<sup>3</sup>

**[\*\*10]** **HN3** In making an *Erie* choice between applying federal or state law, *Hanna v. Plumer*, 380 U.S. 460, 471, 14 L. Ed. 2d 8, 85 S. Ct. 1136 (1965) teaches that our decision must be guided by "the twin aims of the *Erie* rule: discouragement of forum-shopping and avoidance of inequitable administration of the laws." *Id.* at 468. The *Erie* choice is best accomplished by balancing the federal and state interests. See, e.g., *Byrd v. Blue Ridge Rural Elec. Coop.*, 356 U.S. 525, 78 S. Ct. 893, 2 L. Ed. 2d 953 (1958) (balancing state and federal interests to uphold the federal practice of trial by jury in federal courts sitting in diversity); see also 19 C. Wright, A. Miller & E. Cooper, *Federal Practice and Procedure* § 4511 (1982). In the present case, the federal interests outweigh the state interests for reasons which the Eleventh Circuit has explained:

<sup>2</sup> We note that the Supreme Court's decision in *Stewart Organization, Inc. v. Ricoh Corp.*, 487 U.S. 22, 56 U.S.L.W. 4659, 101 L. Ed. 2d 22, 108 S. Ct. 2239 (1988) does not fully resolve this problem. In *Stewart*, the Court decided that federal law applies to a motion to transfer venue under 28 U.S.C. § 1404(a) when venue is designated in a contractual forum selection clause. *Id.* at 4662. The Court stated that because there was a federal statute, 28 U.S.C. § 1404(a), directly on point, the district court was required to apply federal law. *Id.* at 4660. Our case involves a motion to dismiss, rather than to transfer venue, and because there is no federal rule directly on point the *Stewart* analysis is inapplicable. The Eleventh Circuit's en banc decision in *Stewart*, however, is helpful because it explains why federal law applies as a general principle to enforce forum clauses, without addressing the application of § 1404(a). See *Stewart Organization, Inc. v. Ricoh Corp.*, 810 F.2d 1066 (11th Cir.) (per curiam) (en banc), *aff'd on other grounds*, 487 U.S. 22, 56 U.S.L.W. 4659, 101 L. Ed. 2d 22, 108 S. Ct. 2239 (1988).

<sup>3</sup> Two panels of the Eighth Circuit have reached inconsistent results in determining whether state or federal law applies to forum selection clauses. In *Sun World Lines, Ltd. v. March Shipping Corp.*, 801 F.2d 1066 (8th Cir. 1986), one panel of the Eighth Circuit concluded in dicta that forum selection clauses involve venue issues and are therefore procedural clauses governed by federal law. *Id.* at 1068-69. Shortly thereafter, another panel of the Eighth Circuit distinguished *Sun World*, explaining that it involved admiralty law, to which federal common law always applies. *Farmland Indus., Inc. v. Frazier-Parrott Commodities, Inc.*, 806 F.2d 848, 852 (8th Cir. 1986). The *Farmland* court observed that "whether a contractual forum clause is substantive or procedural is a difficult question. On the one hand the clause determines venue and can be considered procedural, but on the other, choice of forum is an important contractual right of the parties." *Id.* On balance, the *Farmland* court opted to apply state law to the forum clause, following the Third Circuit's *General Engineering* decision. *Id.*

First, Congress has specifically provided, by statutory enactment, rules of venue to govern federal district courts in diversity actions. [28 U.S.C. §§ 1391-1412]. By providing specific provisions rather than allowing rules of venue to be governed by state common law, the statute makes clear that Congress considered this a question appropriately governed by federal legal standards. Second, Congress has approved [\*\*11] the adoption of Fed. R. Civ. P. 12(b)(3) and 41(b), federal procedural rules that direct federal courts as to the principles involved in deciding questions of venue. As the panel stated in reflection on these rules:

If venue were to be governed by the law of the state in which the forum court sat, the federal venue statute would be nugatory. Nor would there be any legitimacy to the Federal Rules that govern certain aspects of venue, for they would tread on state prerogatives. *Hanna* clearly rejected this notion.

*Stewart Org., Inc. v. Ricoh Corp.*, 810 F.2d 1066, 1068 (11th Cir.) (per curiam) (en banc), *aff'd on other grounds*, 487 U.S. 22, 108 S. Ct. 2239, 101 L. Ed. 2d 22, 56 U.S.L.W. 4659 (1988) (emphasis deleted).

We conclude that the federal procedural issues raised by forum selection clauses significantly outweigh the state interests, and the federal rule announced in *The Bremen* controls enforcement of forum clauses in diversity cases. See *Stewart*, 56 U.S.L.W. at 4662 (Kennedy, J., concurring) ("**HN4** Though state policies should be weighed in the balance, the authority and prerogative of the federal courts to determine the issue . . . should be exercised so that a valid forum selection clause is given controlling weight [\*\*12] in all but the most exceptional cases."). Moreover, because enforcement of a forum clause necessarily entails interpretation of the clause before it can be enforced, **HN5** federal law also applies to interpretation of forum selection clauses.

### III

#### SCOPE OF THE FORUM SELECTION CLAUSE

##### A. Tort Claims

Applying federal law to the forum selection clause involved in the present case, we turn to Manetti-Farrow's contention that the scope of the clause does not cover the tort claims asserted in the complaint. The forum selection clause provides [\*\*514] that Florence shall be the forum for resolving disputes regarding "interpretation" or "fulfillment" of the contract. Manetti-Farrow maintains its causes of action do not relate to "interpretation" or "fulfillment" of the contract, but are "pure" tort claims independent of the contract.

We first note that **HN6** forum selection clauses can be equally applicable to contractual and tort causes of action. *Coastal Steel Corp. v. Tilghman Wheelabrator Ltd.*, 709 F.2d 190, 203 (3d Cir.), *cert. denied*, 464 U.S. 938, 104 S. Ct. 349, 78 L. Ed. 2d 315 (1983); *Weidner Communications, Inc. v. Faisal*, 671 F. Supp. 531, 537 (N.D. Ill. 1987); *Clinton v. Janger*, 583 F. Supp. 284, 287-88 (N.D. Ill. 1984). Whether a [\*\*13] forum selection clause applies to tort claims depends on whether resolution of the claims relates to interpretation of the contract. *Weidner Communications*, 671 F. Supp. at 537; *Berrett v. Life Ins. Co.*, 623 F. Supp. 946, 948-49 (D. Utah 1985); *Clinton*, 583 F. Supp. at 288. We must, therefore, determine if Manetti-Farrow's claims require interpretation of the contract. See *Mediterranean Enter, Inc. v. Ssangyong Corp.*, 708 F.2d 1458, 1463 (9th Cir. 1983).<sup>4</sup>

Manetti-Farrow's complaint alleges that Gucci Parfums instituted a price squeeze by raising prices substantially above what it charged other customers, that Gucci America fraudulently obtained Manetti-Farrow's customer lists and business information to solicit Manetti-Farrow's customers, that Gucci Parfums wrongfully neglected delivery orders, and that Gucci Parfums wrongfully abrogated the contract. Each of these claims relates in some way to rights and duties enumerated in the exclusive dealership [\*\*14] contract. The claims cannot be adjudicated without analyzing whether the parties were in compliance with the contract.<sup>5</sup> Therefore, because the tort causes of action alleged by Manetti-Farrow relate to "the central conflict over the interpretation" of the contract, they are within the scope of the forum selection clause.

<sup>4</sup> Although *Mediterranean* involved interpretation of the scope of an arbitration clause, we apply its analysis here because an agreement to arbitrate is actually a specialized forum selection clause. See *Scherk*, 417 U.S. at 519.

<sup>5</sup> Manetti-Farrow argues the forum selection clause can only apply to Gucci Parfums, which was the only defendant to sign the contract. However, "a range of transaction participants, parties and non-parties, should benefit from and be subject to forum selection clauses." *Clinton v. Janger*, 583 F. Supp. 284, 290 (N.D. Ill. 1984) (citing *Coastal Steel Corp. v. Tilghman Wheelabrator Ltd.*, 709 F.2d 190, 202-03 (3d Cir.), *cert. denied*, 464 U.S. 938, 104 S. Ct. 349, 78 L. Ed. 2d 315 (1983)). We agree with the district court that the alleged conduct of the non-parties is so closely related to the contractual relationship that the forum selection clause applies to all defendants.

### B. Parol Evidence

Manetti-Farrow sought to introduce parol evidence to show that it did not intend the forum selection clause to apply to tort claims. **HN7** Traditional contract law provides that extrinsic evidence is inadmissible **[\*\*15]** to interpret an unambiguous contract. *Trident Center v. Connecticut Gen. Life Ins. Co.*, 847 F.2d 564, slip op. 8145, 8154 (9th Cir. 1988); *Henein v. Saudi Arabian Parsons, Ltd.*, 818 F.2d 1508, 1514 (9th Cir. 1987), *cert. denied*, 484 U.S. 1009, 108 S. Ct. 707, 98 L. Ed. 2d 657 (1988); *Telco Leasing, Inc. v. Transwestern Title Co.*, 630 F.2d 691, 693 (9th Cir. 1980). As the district court concluded, the plain meaning of the clause is that Manetti-Farrow's claims fall within the scope of the forum selection clause. Manetti-Farrow's proffered extrinsic evidence was properly excluded.

### IV

#### ENFORCEMENT OF THE FORUM SELECTION CLAUSE

**HN8** Forum selection clauses are *prima facie* valid, and are enforceable absent a strong showing by the party opposing the clause "that enforcement would be unreasonable or unjust, or that the clause [is] invalid for such reasons as fraud or overreaching." *The Bremen*, 407 U.S. at 15; *see also Pelleport Investors*, 741 F.2d at 279; *Crown Beverage*, 663 F.2d **[\*515]** at 888; *Republic Int'l*, 516 F.2d at 168. The opposing party has the burden "to show that trial in the contractual forum would be so gravely difficult and inconvenient that he will for all practical purposes be deprived of his day in **[\*\*16]** court." *The Bremen*, 407 U.S. at 18.

Manetti-Farrow contends enforcement of the clause would be unreasonable because it cannot be assured that an Italian court will adequately safeguard its rights against all the defendants. This concern is not only speculative, it "reflects something of a provincial attitude regarding the fairness of [an Italian] tribunal[]." *The Bremen*, 407 U.S. at 12. Moreover, it is a concern which the parties presumably thought about and resolved when they included the forum selection clause in their contract. Manetti-Farrow now wants to change the bargain. To permit it to do so would completely contradict the policy of enforcing forum selection clauses.

Manetti-Farrow also contends that because the alleged wrongful acts were committed principally in the United States, and the harmful effects of these acts were suffered by Manetti-Farrow in California, it should be permitted to prosecute its claims in the district court in California. This argument overlooks several important facts. The complaint centers on a dispute over a contract executed in Italy with an Italian corporation. The contract involves the distribution of Italian goods. And most important, the contract **[\*\*17]** contains a forum selection clause which designates Florence, Italy as the place for the resolution of the disputes in this case.

We conclude that the district court did not err in enforcing the forum selection clause by dismissing Manetti-Farrow's complaint.

AFFIRMED.

# APPENDIX 15

# Matsushita Elec. Indus. Co. v. Zenith Radio Corp.

Supreme Court of the United States

November 12, 1985, Argued ; March 26, 1986, Decided

No. 83-2004

## Reporter

475 U.S. 574; 106 S. Ct. 1348; 89 L. Ed. 2d 538; 1986 U.S. LEXIS 38; 54 U.S.L.W. 4319; 1986-1 Trade Cas. (CCH) P67,004; 4 Fed. R. Serv. 3d (Callaghan) 368

MATSUSHITA ELECTRIC INDUSTRIAL CO., LTD, ET AL. v. ZENITH RADIO CORP. ET AL.

**Prior History:** CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

**Disposition:** 723 F.2d 238, reversed and remanded.

## Core Terms

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prices, conspiracy, predatory, petitioners', conspirators, losses, antitrust, manufacturers, respondents', summary judgment, profits, cartel, firms, motive, inferences, products, district court, company rule, competitors, factfinder, cases, sales, export, alleged conspiracy, distributors, television, predation, monopoly, direct evidence, drive

## Case Summary

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### Procedural Posture

Petitioners challenged a decision from the United States Court of Appeals for the Third Circuit that reversed a summary judgment decision in favor of petitioners, who were defendants in an antitrust conspiracy case.

### Overview

Respondents, domestic electronics companies, brought an antitrust conspiracy suit against petitioners, Japanese electronics companies. Respondents claimed that petitioners conspired to depress prices in the American market in order to drive out American competitors. The district court granted summary judgment for petitioners, but the appellate court reversed based on its finding of direct evidence of concert of action. The Court granted certiorari to determine whether the court of appeals applied the proper standard in evaluating the summary judgment decision. The Court concluded that the court of appeals erred in two respects: First, the direct

evidence on which the court of appeals relied had little, if any, relevance to the alleged predatory pricing conspiracy. Second, the court of appeals failed to consider the absence of a plausible motive to engage in predatory pricing. The decision was reversed and remanded for the court of appeals to consider any evidence that petitioners conspired to price predatorily despite the lack of any apparent motive to do so. In the absence of such evidence, the Court instructed that petitioners were entitled to have summary judgment reinstated.

### Outcome

The decision reversing the summary judgment for petitioners was reversed and remanded based on the Court's holding that the court of appeals erred by relying on irrelevant evidence and failing to consider the absence of a plausible motive for petitioners to engage in predatory pricing.

## LexisNexis® Headnotes

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Civil Procedure > ... > Summary Judgment > Entitlement as Matter of Law > General Overview

Civil Procedure > ... > Summary Judgment > Supporting Materials > General Overview

**HN1** See Fed. R. Civ. P. 56(e).

Civil Procedure > Judgments > Summary Judgment > General Overview

Civil Procedure > ... > Summary Judgment > Entitlement as Matter of Law > Genuine Disputes

**HN2** When a moving party has carried its burden under Fed. R. Civ. P. 56(c), its opponent must do more than simply show that there is some metaphysical doubt as to the material facts. In the language of the Rule, the nonmoving party must come forward with specific facts showing that there is a genuine issue for trial. Where the record taken as

a whole could not lead a rational trier of fact to find for the nonmoving party, there is no genuine issue for trial.

[Antitrust & Trade Law > Sherman Act > General Overview](#)

[Antitrust & Trade Law > Sherman Act > Remedies > General Overview](#)

[Antitrust & Trade Law > Sherman Act > Remedies > Damages](#)

[Criminal Law & Procedure > ... > Inchoate Crimes > Conspiracy > General Overview](#)

[Evidence > Inferences & Presumptions > General Overview](#)

[Evidence > Inferences & Presumptions > Inferences](#)

**HN3** Antitrust law limits the range of permissible inferences from ambiguous evidence in an antitrust case under § 1 of the Sherman Act. Conduct as consistent with permissible competition as with illegal conspiracy does not, standing alone, support an inference of antitrust conspiracy. To survive a motion for summary judgment or for a directed verdict, a plaintiff seeking damages for a violation of § 1 of the Sherman Act must present evidence that tends to exclude the possibility that the alleged conspirators acted independently.

[Antitrust & Trade Law > Sherman Act > General Overview](#)

[Criminal Law & Procedure > ... > Inchoate Crimes > Conspiracy > Elements](#)

[Evidence > Inferences & Presumptions > General Overview](#)

**HN4** In an antitrust case, courts should not permit fact-finders to infer conspiracies when such inferences are implausible, because the effect of such practices is often to deter pro-competitive conduct.

[Antitrust & Trade Law > Sherman Act > General Overview](#)

[Evidence > Inferences & Presumptions > General Overview](#)

**HN5** Conduct that is as consistent with permissible competition as with illegal conspiracy does not, without more, support even an inference of conspiracy.

## **Lawyers' Edition Display**

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### **Decision**

Evidence of alleged predatory pricing conspiracy by Japanese television manufacturers held insufficient to preclude summary judgment dismissing antitrust action.

### **Summary**

American manufacturers of consumer electronic products, principally television sets, brought suit against a group of their Japanese competitors in the United States District Court for the Eastern District of Pennsylvania, alleging that these competitors had violated 1 and 2 of the Sherman Act (15 USCS 1, 2), 2(a) of the Robinson-Patman Act (15 USCS 13(a)), and other federal statutes. This lawsuit claimed that the Japanese companies had conspired since the 1950's to drive domestic firms from the American market, by maintaining artificially high prices for these products in Japan while selling them at a loss in the United States. In a series of decisions, the District Court excluded the bulk of the evidence on which the American companies had relied. Finally, the District Court granted the Japanese companies' motion for summary judgment dismissing the Sherman Act and Robinson-Patman Act claims, stating that it found no significant probative evidence that the Japanese companies had entered into an agreement or acted in concert with respect to exports in any way that could have injured the American firms (513 F Supp 1100). The United States Court of Appeals for the Third Circuit reversed and remanded for further proceedings, overturning the District Court's evidentiary rulings and determining that a reasonable factfinder could find a conspiracy to depress prices in the American market in order to drive out domestic competitors, funded by excess profits obtained in the Japanese market. Pointing in part to evidence of an agreement among the Japanese companies and their government to set minimum export prices, of the companies' common practice of undercutting the minimum prices through rebate schemes which they concealed from the governments of both countries, and of a further agreement among the companies to limit the number of their American distributors, the Court of Appeals concluded that there was direct evidence of at least some kinds of concerted action by the companies, and that precedents restricting the inference of conspiracy from purely circumstantial evidence of conscious parallel conduct were therefore not dispositive in this case (723 F2d 238).

On certiorari, the United States Supreme Court reversed and remanded the case for further proceedings. In an opinion by Powell, J., joined by Burger, Ch. J., and Marshall, Rehnquist, and O'Connor, JJ., it was held that the Court of Appeals had applied improper standards in evaluating the summary judgment, in that (1) the "direct evidence of concert of action" on which the Court of Appeals relied, consisting of evidence of other combinations among the Japanese companies, had little if any relevance to the alleged predatory pricing conspiracy, since a conspiracy to raise profits in one market did not tend to show a conspiracy to sustain losses in another and the remaining combinations showed a tendency to raise prices; and (2) the Court of Appeals had failed to

consider the absence of a plausible motive for the Japanese companies to engage in such a conspiracy, which involved substantial profit losses and showed little likelihood of success.

White, J., joined by Brennan, Blackmun, and Stevens, JJ., dissented, expressing the view (1) that the Court of Appeals had relied on the evidence of combinations other than the alleged predatory pricing conspiracy not to support a finding of antitrust injury to the American companies, but simply and correctly as direct evidence of concert of action among the Japanese companies distinguishing this case from traditional "conscious parallelism" cases, and (2) that the Court of Appeals was not required to engage in academic discussions about the likelihood of predatory pricing, but properly determined that expert testimony presented by the American companies was sufficient to create a genuine factual issue regarding long-term, below-cost sales by the Japanese companies.

## **Headnotes**

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APPEAL §1267 > APPEAL §1750 > RESTRAINTS OF TRADE, MONOPOLIES, AND UNFAIR TRADE PRACTICES §10 > SUMMARY JUDGMENT AND JUDGMENT ON PLEADINGS §6 > predatory pricing conspiracy -- irrelevant evidence and absence of motive -- > Headnote:

### ***LEdHN[1A]* [1A]*LEdHN[1B]* [1B]*LEdHN[1C]* [1C]**

In an action by American manufacturers of consumer electronic products which accuse their Japanese competitors of a conspiracy to monopolize the American market through predatory pricing, in violation of 1 and 2 of the Sherman Act (15 USCS 1, 2) and 2(a) of the Robinson-Patman Act (15 USCS 13(a)), a federal Court of Appeals applies improper standards in overturning a summary judgment entered by a federal District Court in favor of the Japanese companies on these claims, where (1) the "direct evidence of concert of action" on which the Court of Appeals relies, consisting of evidence of other combinations among the Japanese companies to raise prices in Japan, fix minimum export prices, and limit the number of distributors of their products in the American market, has little if any relevance to the alleged predatory pricing conspiracy, since a conspiracy to raise profits in one market does not tend to show a conspiracy to sustain losses in another and the remaining combinations show a tendency to raise prices; and (2) the Court of Appeals fails to consider the absence of a plausible motive for the Japanese companies to engage in such a conspiracy, which involves substantial profit losses and

shows little likelihood of success; on remand, the Court of Appeals is free to consider whether there is other evidence that is sufficiently unambiguous to permit a trier of fact to find the existence of such a conspiracy. (White, Brennan, Blackmun, and Stevens, JJ., dissented from this holding.)

APPEAL §1087.5 > certiorari -- point not raised in petition > Headnote:

### ***LEdHN[2A]* [2A]*LEdHN[2B]* [2B]**

The United States Supreme Court will not review a Court of Appeals decision, which reversed a summary judgment dismissing claims under a federal statute, where these claims are not mentioned in the questions presented in the petition for certiorari and have not been independently argued by the parties.

INTERNATIONAL LAW §6 > RESTRAINTS OF TRADE, MONOPOLIES, AND UNFAIR TRADE PRACTICES §21 > acts in foreign countries -- application of antitrust laws -- > Headnote:

### ***LEdHN[3A]* [3A]*LEdHN[3B]* [3B]**

American manufacturers cannot recover antitrust damages from Japanese competitors based solely on an alleged cartelization of the Japanese market, because American antitrust laws do not regulate the competitive conditions of other nations' economies; the Sherman Act (15 USCS 1 et seq.) reaches conduct outside the borders of the United States, but only when the conduct has an effect on American commerce.

RESTRAINTS OF TRADE, MONOPOLIES, AND UNFAIR TRADE PRACTICES §67 > parties entitled to damages -- lack of injury from antitrust violation -- > Headnote:

### ***LEdHN[4]* [4]**

American manufacturers cannot recover antitrust damages from Japanese competitors for any conspiracy by the latter to charge higher than competitive prices in the American market, as by setting minimum export prices in cooperation with the Japanese government, since, although such conduct would violate the Sherman Act (15 USCS 1-7), it could not injure the American companies; similarly, the American companies cannot recover for a conspiracy to impose nonprice restraints that have the effect of either raising market price or limiting output, such as the agreement among the Japanese companies limiting the number of their American distributors, since such restrictions, though

harmful to competition, actually benefit competitors by making supracompetitive pricing more attractive.

EVIDENCE §979 > RESTRAINTS OF TRADE, MONOPOLIES, AND UNFAIR TRADE PRACTICES §10 > antitrust conspiracy -- direct evidence -- actions not creating claim for damages -- > Headnote:

***LEdHN[5]*** [5]

Since neither the alleged supracompetitive pricing by Japanese manufacturers in Japan, as conduct not affecting American commerce, nor the agreements among these manufacturers to limit the number of their distributors in the United States and to set minimum export prices, as conduct not injurious to their American competitors, can by themselves give competing American manufacturers a cognizable claim against the Japanese companies for antitrust damages, it is improper to treat evidence of these alleged conspiracies as direct evidence of a further conspiracy that injured the American companies.

RESTRAINTS OF TRADE, MONOPOLIES, AND UNFAIR TRADE PRACTICES §67 > parties entitled to damages -- cognizable injury -- > Headnote:

***LEdHN[6A]*** [6A]***LEdHN[6B]*** [6B]

However one decides to describe the contours of an alleged conspiracy to violate the antitrust laws, parties suing for damages therefrom must show that the conspiracy caused them an injury for which the antitrust laws provide relief.

RESTRAINTS OF TRADE, MONOPOLIES, AND UNFAIR TRADE PRACTICES §36 > RESTRAINTS OF TRADE, MONOPOLIES, AND UNFAIR TRADE PRACTICES §67 > predatory pricing -- requisites for antitrust injury -- > Headnote:

***LEdHN[7A]*** [7A]***LEdHN[7B]*** [7B]

In an action under 1 of the Sherman Act (15 USCS 1) by American manufacturers who allege a predatory pricing conspiracy by their Japanese competitors, the American companies have not suffered an antitrust injury unless the Japanese companies have conspired to drive them out of the relevant markets by (1) pricing below the level necessary to sell their products, or (2) pricing below some appropriate measure of cost; they may not complain of conspiracies that set maximum prices above market levels, or that set minimum prices at any level. (White, Brennan, Blackmun, and Stevens, JJ., dissented from this holding.)

RESTRAINTS OF TRADE, MONOPOLIES, AND UNFAIR TRADE PRACTICES §10 > SUMMARY JUDGMENT AND

JUDGMENT ON PLEADINGS §4 > antitrust conspiracy claim -- > Headnote:

***LEdHN[8]*** [8]

In order for an action by American manufacturers, charging their Japanese competitors with a conspiracy to violate 1 and 2 of the Sherman Act (15 USCS 1, 2) and 2(a) of the Robinson-Patman Act (15 USCS 13(a)), to survive the Japanese companies' motion for summary judgment, the American companies must establish that there is a genuine issue of material fact as to whether the Japanese companies entered into an illegal conspiracy that caused the American companies to suffer a cognizable injury.

RESTRAINTS OF TRADE, MONOPOLIES, AND UNFAIR TRADE PRACTICES §10 > SUMMARY JUDGMENT AND JUDGMENT ON PLEADINGS §4 > antitrust conspiracy claim -- showing of injury -- > Headnote:

***LEdHN[9]*** [9]

In order for an action by American manufacturers, charging their Japanese competitors with various conspiracies in restraint of trade, to survive the Japanese companies' motion for summary judgment, the American companies must not only show a conspiracy in violation of the antitrust laws, but must also show an injury to them resulting from the illegal conduct; since, except for an alleged conspiracy to monopolize the American market through predatory pricing, the alleged conspiracies could not have caused the American companies to suffer an antitrust injury because they actually tended to benefit them, evidence of these "other" conspiracies cannot defeat the motion for summary judgment unless, in context, it raises a genuine issue concerning the existence of a predatory pricing conspiracy.

SUMMARY JUDGMENT AND JUDGMENT ON PLEADINGS §4 > genuine issue of material fact -- > Headnote:

***LEdHN[10]*** [10]

When a party moving for summary judgment has carried its burden under Rule 56(c) of the Federal Rules of Civil Procedure of demonstrating the absence of a genuine issue of material fact, its opponent must do more than simply show that there is some metaphysical doubt as to the material facts; the nonmoving party must come forward with specific facts showing that there is a genuine issue for trial; where the record taken as a whole could not lead a rational trier of fact to find for the nonmoving party, there is no genuine issue for trial.

RESTRAINTS OF TRADE, MONOPOLIES, AND UNFAIR TRADE PRACTICES §10 > RESTRAINTS OF TRADE, MONOPOLIES, AND UNFAIR TRADE PRACTICES §36 > SUMMARY JUDGMENT AND JUDGMENT ON PLEADINGS §4 > antitrust conspiracy claim -- implausibility -- > Headnote:

***LEdHN[11A]*** [11A]***LEdHN[11B]*** [11B]

In an action by American manufacturers charging their Japanese competitors with a conspiracy to monopolize the American market through predatory pricing, if the factual context renders the claim implausible--if the claim is one that simply makes no economic sense--then the American companies must come forward with more persuasive evidence to support their claim than would otherwise be necessary in order to defeat the Japanese companies' motion for summary judgment; the absence of any plausible motive to engage in the conduct charged is highly relevant to whether a "genuine issue for trial" exists within the meaning of Rule 56(e) of the Federal Rules of Civil Procedure, since, if the Japanese companies had no rational economic motive to conspire, and their conduct is consistent with other, equally plausible explanations such as competitive behavior or an attempt to raise prices, the conduct does not give rise to an inference of conspiracy. (White, Brennan, Blackmun, and Stevens, JJ., dissented from this holding.)

SUMMARY JUDGMENT AND JUDGMENT ON PLEADINGS §5 > inferences in favor of nonmoving party -- > Headnote:

***LEdHN[12]*** [12]

On summary judgment, the inferences to be drawn from the underlying facts must be viewed in the light most favorable to the party opposing the motion.

EVIDENCE §394 > RESTRAINTS OF TRADE, MONOPOLIES, AND UNFAIR TRADE PRACTICES §10 > inferences as to conspiracy -- antitrust case -- > Headnote:

***LEdHN[13]*** [13]

Antitrust law limits the range of permissible inferences from ambiguous evidence in a case under 1 of the Sherman Act (15 USCS 1); thus, conduct as consistent with permissible competition as with illegal conspiracy does not, standing alone, support an inference of antitrust conspiracy.

RESTRAINTS OF TRADE, MONOPOLIES, AND UNFAIR TRADE PRACTICES §10 > SUMMARY JUDGMENT AND JUDGMENT ON PLEADINGS §4 > TRIAL §197 > antitrust conspiracy -- possibility of independent action -- > Headnote:

***LEdHN[14]*** [14]

In order to survive a motion for summary judgment or for a directed verdict, a plaintiff seeking damages for a violation of 1 of the Sherman Act (15 USCS 1) must present evidence that tends to exclude the possibility that the alleged conspirators acted independently.

RESTRAINTS OF TRADE, MONOPOLIES, AND UNFAIR TRADE PRACTICES §10 > SUMMARY JUDGMENT AND JUDGMENT ON PLEADINGS §4 > antitrust conspiracy claim -- competing inferences -- > Headnote:

***LEdHN[15]*** [15]

In an action by American manufacturers charging their Japanese competitors with a conspiracy to monopolize the American market through predatory pricing, the American companies, in order to defeat a motion for summary judgment, must show that the inference of conspiracy is reasonable in light of the competing inferences of independent action or collusive action that could not have harmed them.

## **Syllabus**

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Petitioners are 21 Japanese corporations or Japanese-controlled American corporations that manufacture and/or sell "consumer electronic products" (CEPs) (primarily television sets). Respondents are American corporations that manufacture and sell television sets. In 1974, respondents brought an action in Federal District Court, alleging that petitioners, over a 20-year period, had illegally conspired to drive American firms from the American CEP market by engaging in a scheme to fix and maintain artificially high prices for television sets sold by petitioners in Japan and, at the same time, to fix and maintain low prices for the sets exported to and sold in the United States. Respondents claim that various portions of this scheme violated, *inter alia*, §§ 1 and 2 of the Sherman Act, § 2(a) of the Robinson-Patman Act, and § 73 of the Wilson Tariff Act. After several years of discovery, petitioners moved for summary judgment on all claims. The District Court then directed the parties to file statements listing all the documentary evidence that would be offered if the case went to trial. After the statements were filed, the court found the bulk of the evidence on which respondents relied was inadmissible, that the admissible evidence did not raise a genuine issue of material fact as to the existence of the alleged conspiracy, and that any inference of conspiracy was unreasonable. Summary judgment therefore was granted in

petitioners' favor. The Court of Appeals reversed. After determining that much of the evidence excluded by the District Court was admissible, the Court of Appeals held that the District Court erred in granting a summary judgment and that there was both direct and circumstantial evidence of a conspiracy. Based on inferences drawn from the evidence, the Court of Appeals concluded that a reasonable factfinder could find a conspiracy to depress prices in the American market in order to drive out American competitors, which conspiracy was funded by excess profits obtained in the Japanese market.

*Held:* The Court of Appeals did not apply proper standards in evaluating the District Court's decision to grant petitioners' motion for summary judgment. Pp. 582-598.

(a) The "direct evidence" on which the Court of Appeals relied -- petitioners' alleged supracompetitive pricing in Japan, the "five company rule" by which each Japanese producer was permitted to sell only to five American distributors, and the "check prices" (minimum prices fixed by agreement with the Japanese Government for CEPs exported to the United States) insofar as they established minimum prices in the United States -- cannot by itself give respondents a cognizable claim against petitioners for antitrust damages. Pp. 582-583.

(b) To survive petitioners' motion for a summary judgment, respondents must establish that there is a genuine issue of material fact as to whether petitioners entered into an illegal conspiracy that caused respondents to suffer a cognizable injury. If the factual context renders respondents' claims implausible, *i. e.*, claims that make no economic sense, respondents must offer more persuasive evidence to support their claims than would otherwise be necessary. To survive a motion for a summary judgment, a plaintiff seeking damages for a violation of § 1 of the Sherman Act must present evidence "that tends to exclude the possibility" that the alleged conspirators acted independently. Thus, respondents here must show that the inference of a conspiracy is reasonable in light of the competing inferences of independent action or collusive action that could not have harmed respondents. Pp. 585-588.

(c) Predatory pricing conspiracies are by nature speculative. They require the conspirators to sustain substantial losses in order to recover uncertain gains. The alleged conspiracy is

therefore implausible. Moreover, the record discloses that the alleged conspiracy has not succeeded in over two decades of operation. This is strong evidence that the conspiracy does not in fact exist. The possibility that petitioners have obtained supracompetitive profits in the Japanese market does not alter this assessment. Pp. 588-593.

(d) Mistaken inferences in cases such as this one are especially costly, because they chill the very conduct that the antitrust laws are designed to protect. There is little reason to be concerned that by granting summary judgment in cases where the evidence of conspiracy is speculative or ambiguous, courts will encourage conspiracies. Pp. 593-595.

(e) The Court of Appeals erred in two respects: the "direct evidence" on which it relied had little, if any, relevance to the alleged predatory pricing conspiracy, and the court failed to consider the absence of a plausible motive to engage in predatory pricing. In the absence of any rational motive to conspire, neither petitioners' pricing practices, their conduct in the Japanese market, nor their agreements respecting prices and distributions in the American market sufficed to create a "genuine issue for trial" under Federal Rule of Civil Procedure 56(e). On remand, the Court of Appeals may consider whether there is other, unambiguous evidence of the alleged conspiracy. Pp. 595-598.

**Counsel:** Donald J. Zoeller argued the cause for petitioners. With him on the briefs were John L. Altieri, Jr., Harold G. Levison, Peter J. Gartland, James S. Morris, Kevin R. Keating, Charles F. Schirmeister, Ira M. Millstein, A. Paul Victor, Jeffrey L. Kessler, Carl W. Schwarz, Michael E. Friedlander, William H. Barrett, Donald F. Turner, and Henry T. Reath.

Charles F. Rule argued the cause pro hac vice for the United States as amicus curiae urging reversal. With him on the brief were Acting Solicitor General Wallace, Charles S. Stark, Robert B. Nicholson, Edward T. Hand, Richard P. Larm, Abraham D. Sofaer, and Elizabeth M. Teel.

Edwin P. Rome argued the cause for respondents. With him on the brief were William H. Roberts, Arnold I. Kalman, Philip J. Curtis, and John Borst, Jr. \*

**Judges:** POWELL, J., delivered the opinion of the Court, in which BURGER, C. J., and MARSHALL, REHNQUIST,

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\* Briefs of amici curiae urging reversal were filed for the Government of Japan by Stephen M. Shapiro; and for the American Association of Exporters and Importers et al. by Robert Herzstein and Hadrian R. Katz.

Briefs of amici curiae were filed for the Government of Australia et al. by Mark R. Joelson and Joseph P. Griffin; and for the Semiconductor Industry Association by Joseph R. Creighton.

and O'CONNOR, JJ., joined. WHITE, J., filed a dissenting opinion, in which BRENNAN, BLACKMUN, and STEVENS, JJ., joined, post, p. 598.

**Opinion by: POWELL**

## Opinion

[\*576] [\*\*\*546] [\*\*1350] JUSTICE POWELL delivered the opinion of the Court.

[IA] [1A] This case requires that we again consider the standard district courts must apply [\*\*1351] when deciding whether to grant summary judgment in an antitrust conspiracy case.

I

Stating the facts of this case is a daunting task. The opinion of the Court of Appeals for the Third Circuit runs to 69 pages; the primary opinion of the District Court is more than three times as long. *In re Japanese Electronic Products* [\*577] *Antitrust Litigation*, 723 F.2d 238 (CA3 1983); 513 F.Supp. 1100 (ED Pa. 1981). Two respected District Judges each have authored a number of opinions in this case; the published ones alone would fill an entire volume of the Federal Supplement. In addition, the parties have filed a 40-volume appendix in this Court that is said to contain the essence of the evidence on which the District Court and the Court of Appeals based their respective decisions.

We will not repeat what these many opinions have stated and restated, or summarize the mass of documents that constitute the record on appeal. Since we review only the standard applied by the Court of Appeals in deciding this case, and not the weight assigned to particular pieces of evidence, we find it unnecessary to state the facts in great detail. What follows is a summary of this case's long history.

A

Petitioners, defendants below, are 21 corporations that manufacture or sell "consumer electronic products" (CEPs)

-- for the most part, television sets. Petitioners include both Japanese manufacturers of CEPs and American firms, controlled by Japanese parents, that sell the Japanese-manufactured products. Respondents, plaintiffs below, are Zenith Radio Corporation (Zenith) and National Union Electric Corporation (NUE). Zenith is an American firm that manufactures and sells television sets. NUE is the corporate successor to Emerson Radio Company, an American firm that manufactured and sold television sets until 1970, when it withdrew from the market after sustaining substantial losses. Zenith and NUE began this lawsuit in 1974,<sup>1</sup> claiming that petitioners had illegally conspired to drive [\*578] American firms from the American CEP market. According to respondents, the gist of this conspiracy [\*\*\*547] was a "'scheme to raise, fix and maintain artificially *high* prices for television receivers sold by [petitioners] in Japan and, at the same time, to fix and maintain *low* prices for television receivers exported to and sold in the United States.'" 723 F.2d, at 251 (quoting respondents' preliminary pretrial memorandum). These "low prices" were allegedly at levels that produced substantial losses for petitioners. 513 F.Supp., at 1125. The conspiracy allegedly began as early as 1953, and according to respondents was in full operation by sometime in the late 1960's. Respondents claimed that various portions of this scheme violated §§ 1 and 2 of the Sherman Act, § 2(a) of the Robinson-Patman Act, § 73 of the Wilson Tariff Act, and the Antidumping Act of 1916.

After several years of detailed discovery, petitioners filed motions for summary judgment on all claims against them. The District Court directed the parties to file, with preclusive effect, "Final Pretrial Statements" listing all the documentary evidence that would be offered if the case proceeded to trial. Respondents filed such a statement, and petitioners responded with a series of motions challenging the admissibility of respondents' evidence. In three detailed opinions, the District Court found the bulk of the evidence on which Zenith and NUE relied inadmissible.<sup>2</sup>

[\*\*1352] [2A] [2A] The District Court then turned to petitioners' motions for summary judgment. In an opinion spanning 217 pages, the court found that the admissible evidence did not raise a genuine issue of material fact as to

<sup>1</sup> NUE had filed its complaint four years earlier, in the District Court for the District of New Jersey. Zenith's complaint was filed separately in 1974, in the Eastern District of Pennsylvania. The two cases were consolidated in the Eastern District of Pennsylvania in 1974.

<sup>2</sup> The inadmissible evidence included various government records and reports, *Zenith Radio Corp. v. Matsushita Electric Industrial Co.*, 505 F.Supp. 1125 (ED Pa. 1980), business documents offered pursuant to various hearsay exceptions, *Zenith Radio Corp. v. Matsushita Electric Industrial Co.*, 505 F.Supp. 1190 (ED Pa. 1980), and a large portion of the expert testimony that respondents proposed to introduce. *Zenith Radio Corp. v. Matsushita Electric Industrial Co.*, 505 F.Supp. 1313 (ED Pa. 1981).

the existence of the alleged [\*579] conspiracy. At bottom, the court found, respondents' claims rested on the inferences that could be drawn from petitioners' parallel conduct in the Japanese and American markets, and from the effects of that conduct on petitioners' American competitors. 513 F.Supp., at 1125-1127. After reviewing the evidence both by category and *in toto*, the court found that any inference of conspiracy was unreasonable, because (i) some portions of the evidence suggested that petitioners conspired in ways that did not injure respondents, and (ii) the evidence that bore directly on the alleged price-cutting conspiracy did not rebut the more plausible inference that petitioners were cutting prices to compete in the American market and not to monopolize it. Summary judgment therefore was granted on respondents' claims under § 1 of the Sherman Act and the Wilson Tariff Act. Because the Sherman Act § 2 claims, which alleged that petitioners had combined to monopolize the American CEP market, were functionally indistinguishable from the § 1 claims, the court dismissed them also. Finally, the court found that the Robinson-Patman Act claims depended on the same supposed conspiracy as the Sherman Act claims. Since the court had found no genuine issue of fact as to the conspiracy, [\*\*\*548] it entered judgment in petitioners' favor on those claims as well.<sup>3</sup>

[\*580] B

The Court of Appeals for the Third Circuit reversed.<sup>4</sup> The court began by examining the District Court's evidentiary rulings, and determined that much of the evidence excluded by the District Court was in fact admissible. 723 F.2d, at 260-303. These evidentiary rulings are not before us. See 471 U.S. 1002 (1985) (limiting grant of certiorari).

On the merits, and based on the newly enlarged record, the court found that the District Court's summary judgment decision was improper. The court acknowledged that "there are legal limitations upon the inferences which may be drawn from circumstantial evidence," 723 F.2d, at 304, but it found that "the legal problem . . . is different" when "there is direct evidence of concert of action." *Ibid.* Here, the court

concluded, "there is both direct evidence of certain kinds of concert of action and circumstantial evidence having some tendency to suggest that other kinds of concert of action may have occurred." *Id.*, at 304-305. Thus, the court reasoned, cases concerning the limitations on inferring conspiracy from ambiguous evidence were not dispositive. *Id.*, at 305. Turning to the evidence, the court determined that a factfinder reasonably could draw the following conclusions:

1. The Japanese market for CEPs was characterized by oligopolistic behavior, [\*\*1353] with a small number of producers meeting regularly and exchanging information on price and other matters. *Id.*, at 307. This created the opportunity for a stable combination to raise both prices and profits in Japan. American firms could not attack such a combination because the Japanese Government imposed significant barriers to entry. *Ibid.*

2. Petitioners had relatively higher fixed costs than their American counterparts, and therefore needed to [\*581] operate at something approaching full capacity in order to make a profit. *Ibid.*

3. Petitioners' plant capacity exceeded the needs of the Japanese market. *Ibid.*

4. By formal agreements arranged in cooperation with Japan's Ministry of International Trade and Industry (MITI), petitioners fixed minimum prices for CEPs exported to the American market. *Id.*, at 310. The parties refer to these prices as the "check [\*\*\*549] prices," and to the agreements that require them as the "check price agreements."

5. Petitioners agreed to distribute their products in the United States according to a "five company rule": each Japanese producer was permitted to sell only to five American distributors. *Ibid.*

6. Petitioners undercut their own check prices by a variety of rebate schemes. *Id.*, at 311. Petitioners sought to conceal

<sup>3</sup> The District Court ruled separately that petitioners were entitled to summary judgment on respondents' claims under the Antidumping Act of 1916. *Zenith Radio Corp. v. Matsushita Electric Industrial Co.*, 494 F.Supp. 1190 (ED Pa. 1980). Respondents appealed this ruling, and the Court of Appeals reversed in a separate opinion issued the same day as the opinion concerning respondents' other claims. *In re Japanese Electronic Products Antitrust Litigation*, 723 F.2d 319 (CA3 1983).

[2B] [2B] Petitioners ask us to review the Court of Appeals' Antidumping Act decision along with its decision on the rest of this mammoth case. The Antidumping Act claims were not, however, mentioned in the questions presented in the petition for certiorari, and they have not been independently argued by the parties. See this Court's Rule 21.1(a). We therefore decline the invitation to review the Court of Appeals' decision on those claims.

<sup>4</sup> As to 3 of the 24 defendants, the Court of Appeals affirmed the entry of summary judgment. Petitioners are the 21 defendants who remain in the case.

these rebate schemes both from the United States Customs Service and from MITI, the former to avoid various customs regulations as well as action under the antidumping laws, and the latter to cover up petitioners' violations of the check-price agreements.

Based on inferences from the foregoing conclusions,<sup>5</sup> the Court of Appeals concluded that a reasonable factfinder could find a conspiracy to depress prices in the American market in order to drive out American competitors, which conspiracy was funded by excess profits obtained in the Japanese market. The court apparently did not consider whether it was as plausible to conclude that petitioners' price-cutting behavior was independent and not conspiratorial.

[\*582] The court found it unnecessary to address petitioners' claim that they could not be held liable under the antitrust laws for conduct that was compelled by a foreign sovereign. The claim, in essence, was that because MITI required petitioners to enter into the check-price agreements, liability could not be premised on those agreements. The court concluded that this case did not present any issue of sovereign compulsion, because the check-price agreements were being used as "evidence of a low export price conspiracy" and not as an independent basis for finding antitrust liability. The court also believed it was unclear that the check prices in fact were mandated by the Japanese Government, notwithstanding a statement to that effect by MITI itself. *Id.*, at 315.

[1B] [1B] We granted certiorari to determine (i) whether the Court of Appeals applied the proper standards in evaluating the District Court's decision to grant petitioners' motion for summary judgment, and (ii) whether petitioners could be held liable under the antitrust laws for a conspiracy in part

compelled by a foreign sovereign. 471 U.S. 1002 (1985). We reverse on the first issue, but do not reach the second.

## II

[3A] [3A][4] [4][5] [5] We begin by emphasizing what respondents' claim is *not*. Respondents cannot recover antitrust damages based solely on an alleged cartelization of the Japanese market, because American antitrust laws do not regulate the competitive conditions of other nations' economies. [\*1354] *United States v. Aluminum Co. of America*, 148 F.2d 416, 443 (CA2 1945) (L. Hand, J.); 1 P. [\*550] Areeda & D. Turner, *Antitrust Law* para. 236d (1978).<sup>6</sup> Nor can respondents recover damages for [\*583] any conspiracy by petitioners to charge higher than competitive prices in the American market. Such conduct would indeed violate the Sherman Act, *United States v. Trenton Potteries Co.*, 273 U.S. 392 (1927); *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 223 (1940), but it could not injure respondents: as petitioners' competitors, respondents stand to gain from any conspiracy to raise the market price in CEPs. Cf. *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 488-489 (1977). Finally, for the same reason, respondents cannot recover for a conspiracy to impose nonprice restraints that have the effect of either raising market price or limiting output. Such restrictions, though harmful to competition, actually *benefit* competitors by making supra-competitive pricing more attractive. Thus, neither petitioners' alleged supracompetitive pricing in Japan, nor the five company rule that limited distribution in this country, nor the check prices insofar as they established minimum prices in this country, can by themselves give respondents a cognizable claim against petitioners for antitrust damages. The Court of Appeals therefore erred to the extent that it found evidence of these alleged conspiracies to be "direct evidence" of a conspiracy that injured respondents. See 723 F.2d, at 304-305.

<sup>5</sup> In addition to these inferences, the court noted that there was expert opinion evidence that petitioners' export sales "generally were at prices which produced losses, often as high as twenty-five percent on sales." 723 F.2d, at 311. The court did not identify any direct evidence of below-cost pricing; nor did it place particularly heavy reliance on this aspect of the expert evidence. See n. 19, *infra*.

<sup>6</sup> The Sherman Act does reach conduct outside our borders, but only when the conduct has an effect on American commerce. *Continental Ore Co. v. Union Carbide & Carbon Corp.*, 370 U.S. 690, 704 (1962) ("A conspiracy to monopolize or restrain the domestic or foreign commerce of the United States is not outside the reach of the Sherman Act just because part of the conduct complained of occurs in foreign countries"). The effect on which respondents rely is the artificially depressed level of prices for CEPs in the United States.

Petitioners' alleged cartelization of the Japanese market could not have caused that effect over a period of some two decades. Once petitioners decided, as respondents allege, to reduce output and raise prices in the Japanese market, they had the option of either producing fewer goods or selling more goods in other markets. The most plausible conclusion is that petitioners chose the latter option because it would be more profitable than the former. That choice does not flow from the cartelization of the Japanese market. On the contrary, were the Japanese market perfectly competitive petitioners would still have to choose whether to sell goods overseas, and would still presumably make that choice based on their profit expectations. For this reason, respondents' theory of recovery depends on proof of the asserted price-cutting conspiracy in this country.

[3B] [3B]

[\*584] [6A] [6A] Respondents nevertheless argue that these supposed conspiracies, if not themselves grounds for recovery of antitrust damages, are circumstantial evidence of another conspiracy that *is* cognizable: a conspiracy to monopolize the American market by means of pricing below the market level.<sup>7</sup> The thrust of respondents' [\*\*\*551] argument is that petitioners used their monopoly profits from the Japanese market to fund a concerted campaign to price predatorily and thereby drive respondents and other American manufacturers of CEPs out of business. Once successful, according to respondents, petitioners would cartelize the American CEP market, restricting output and raising prices above the level that fair competition would produce. The resulting [\*\*1355] monopoly profits, respondents contend, would more than compensate petitioners for the losses they incurred through years of pricing below market level.

[6B] [6B]

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<sup>7</sup> Respondents also argue that the check prices, the five company rule, and the price fixing in Japan are all part of one large conspiracy that includes monopolization of the American market through predatory pricing. The argument is mistaken. However one decides to describe the contours of the asserted conspiracy -- whether there is one conspiracy or several -- respondents must show that the conspiracy caused them an injury for which the antitrust laws provide relief. *Associated General Contractors of California, Inc. v. Carpenters*, 459 U.S. 519, 538-540 (1983); *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 488-489 (1977); see also Note, Antitrust Standing, Antitrust Injury, and the Per Se Standard, 93 Yale L.J. 1309 (1984). That showing depends in turn on proof that petitioners conspired to price predatorily in the American market, since the other conduct involved in the alleged conspiracy cannot have caused such an injury.

<sup>8</sup> Throughout this opinion, we refer to the asserted conspiracy as one to price "predatorily." This term has been used chiefly in cases in which a single firm, having a dominant share of the relevant market, cuts its prices in order to force competitors out of the market, or perhaps to deter potential entrants from coming in. *E. g.*, *Southern Pacific Communications Co. v. American Telephone & Telegraph Co.*, 238 U. S. App. D. C. 309, 331-336, 740 F.2d 980, 1002-1007 (1984), cert. denied, 470 U.S. 1005 (1985). In such cases, "predatory pricing" means pricing below some appropriate measure of cost. *E. g.*, *Barry Wright Corp. v. ITT Grinnell Corp.*, 724 F.2d 227, 232-235 (CA1 1983); see *Utah Pipe Co. v. Continental Baking Co.*, 386 U.S. 685, 698, 701, 702, n. 14 (1967).

[7B] [7B] There is a good deal of debate, both in the cases and in the law reviews, about what "cost" is relevant in such cases. We need not resolve this debate here, because unlike the cases cited above, this is a Sherman Act § 1 case. For purposes of this case, it is enough to note that respondents have not suffered an antitrust injury unless petitioners conspired to drive respondents out of the relevant markets by (i) pricing below the level necessary to sell their products, or (ii) pricing below some appropriate measure of cost. An agreement without these features would either leave respondents in the same position as would market forces or would actually benefit respondents by raising market prices. Respondents therefore may not complain of conspiracies that, for example, set maximum prices above market levels, or that set minimum prices at *any* level.

<sup>9</sup> We do not consider whether recovery should *ever* be available on a theory such as respondents' when the pricing in question is above some measure of incremental cost. See generally Areeda & Turner, Predatory Pricing and Related Practices Under Section 2 of the Sherman Act, 88 Harv. L. Rev. 697, 709-718 (1975) (discussing cost-based test for use in § 2 cases). As a practical matter, it may be that only direct evidence of below-cost pricing is sufficient to overcome the strong inference that rational businesses would not enter into conspiracies such as this one. See Part IV-A, *infra*.

<sup>10</sup> Respondents argued before the District Court that petitioners had failed to carry their initial burden under Federal Rule of Civil Procedure 56(c) of demonstrating the absence of a genuine issue of material fact. See *Adickes v. S.H. Kress & Co.*, 398 U.S. 144, 157 (1970). Cf. *Catrett v. Johns-Manville Sales Corp.*, 244 U. S. App. D. C. 160, 756 F.2d 181, cert. granted, 474 U.S. 944 (1985). That issue was resolved in petitioners' favor, and is not before us.

[7A] [7A] The Court of Appeals found that respondents' allegation of a horizontal conspiracy to engage in predatory pricing,<sup>8</sup> [\*585] if proved,<sup>9</sup> would be a *per se* violation of § 1 of the Sherman Act. 723 F.2d, at 306. Petitioners did not appeal from that conclusion. The issue in this case thus becomes whether respondents adduced sufficient evidence in support of their theory to survive summary judgment. We therefore examine the principles that govern the summary judgment determination.

III

[8] [8][9] [9] To survive petitioners' motion for summary judgment,<sup>10</sup> respondents must establish that there [\*\*\*552] is a genuine issue of material [\*586] fact as to whether petitioners entered into an illegal conspiracy that caused respondents to suffer a cognizable injury. Fed. Rule Civ.

Proc. 56(e); <sup>11</sup>*First National Bank of Arizona v. Cities Service Co.*, 391 U.S. 253, 288-289 (1968). This showing has two components. First, respondents must show more than a conspiracy in violation of the antitrust laws; they must show an injury to them resulting from the illegal conduct. Respondents charge petitioners with a whole host of conspiracies in restraint of trade. *Supra*, at 582-583. Except for the alleged conspiracy to monopolize the American market through predatory pricing, these alleged conspiracies could not have caused respondents to suffer an "antitrust injury," **[\*\*1356]** *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S., at 489, because they actually tended to benefit respondents. *Supra*, at 582-583. Therefore, unless, in context, evidence of these "other" conspiracies raises a genuine issue concerning the existence of a predatory pricing conspiracy, that evidence cannot defeat petitioners' summary judgment motion.

**[10]** [10]Second, the issue of fact must be "genuine." Fed. Rules Civ. Proc. 56(c), (e). **HN2** When the moving party has carried its burden under Rule 56(c), <sup>12</sup> its opponent must do more than simply show that there is some metaphysical doubt as to the material facts. See *DeLuca v. Atlantic Refining Co.*, 176 F.2d 421, 423 (CA2 1949) (L. Hand, J.), cert. denied, 338 U.S. 943 (1950); 10A C. Wright, A. Miller, & M. Kane, Federal Practice and Procedure § 2727 (1983); Clark, Special Problems **[\*587]** in Drafting and Interpreting Procedural Codes and Rules, 3 Vand. L. Rev. 493, 504-505 (1950). Cf. *Sartor v. Arkansas Natural Gas Corp.*, 321 U.S. 620, 627 (1944). In the language of the Rule, the nonmoving party must come forward with "specific facts showing that there is a *genuine issue for trial*." Fed. Rule Civ. Proc. 56(e) (emphasis added). See also Advisory Committee Note to 1963 Amendment of Fed. Rule Civ. Proc. 56(e), 28 U. S. C. App., p. 626 (purpose of summary judgment is to "pierce the pleadings and to assess the proof in order to see whether there is a genuine need for trial"). Where the record taken as a whole could not lead a rational trier of fact to find for the nonmoving party, there is no "genuine issue for trial." *Cities Service, supra*, at 289.

**[IIA]** [11A]It follows from these settled principles that if the factual context renders respondents' claim implausible -- if the claim is one that simply makes no economic sense

-- respondents must come forward with more persuasive evidence to support their claim than would otherwise be necessary. *Cities Service* is instructive. **[\*\*\*553]** The issue in that case was whether proof of the defendant's refusal to deal with the plaintiff supported an inference that the defendant willingly had joined an illegal boycott. Economic factors strongly suggested that the defendant had no motive to join the alleged conspiracy. 391 U.S., at 278-279. The Court acknowledged that, in isolation, the defendant's refusal to deal might well have sufficed to create a triable issue. *Id.*, at 277. But the refusal to deal had to be evaluated in its factual context. Since the defendant lacked any rational motive to join the alleged boycott, and since its refusal to deal was consistent with the defendant's independent interest, the refusal to deal could not by itself support a finding of antitrust liability. *Id.*, at 280.

**[12]** [12][13] [13][14] [14][15] [15]Respondents correctly note that "[on] summary judgment the inferences to be drawn from the underlying facts . . . must be viewed in the light most favorable to the party opposing the motion." *United States v. Diebold, Inc.*, 369 **[\*588]** U.S. 654, 655 (1962).But **HN3** antitrust law limits the range of permissible inferences from ambiguous evidence in a § 1 case. Thus, in *Monsanto Co. v. Spray-Rite Service Corp.*, 465 U.S. 752 (1984), we held that conduct as consistent with permissible competition as with illegal conspiracy does not, standing alone, support an inference of antitrust conspiracy. *Id.*, at 764. See also *Cities Service, supra*, at 280. To survive a motion for summary judgment or for a directed verdict, a plaintiff seeking damages for a violation of § 1 must present evidence "that tends to exclude the possibility" that the alleged conspirators acted independently. 465 U.S., at 764. Respondents in this case, in other words, must show that the inference of conspiracy is reasonable in light of the competing inferences of independent action or collusive action that **[\*\*1357]** could not have harmed respondents. See *Cities Service, supra*, at 280.

Petitioners argue that these principles apply fully to this case. According to petitioners, the alleged conspiracy is one that is economically irrational and practically infeasible. Consequently, petitioners contend, they had no motive to engage in the alleged predatory pricing conspiracy; indeed,

<sup>11</sup> Rule 56(e) provides, in relevant part:

**HNI** "When a motion for summary judgment is made and supported as provided in this rule, an adverse party may not rest upon the mere allegations or denials of his pleading, but his response, by affidavits or as otherwise provided in this rule, must set forth specific facts showing that there is a genuine issue for trial. If he does not so respond, summary judgment, if appropriate, shall be entered against him."

<sup>12</sup> See n. 10, *supra*.

they had a strong motive *not* to conspire in the manner respondents allege. Petitioners argue that, in light of the absence of any apparent motive and the ambiguous nature of the evidence of conspiracy, no trier of fact reasonably could find that the conspiracy with which petitioners are charged actually existed. This argument requires us to consider the nature of the alleged conspiracy and the practical obstacles to its implementation.

#### IV

##### A

A predatory pricing conspiracy is by nature speculative. Any agreement to price below the competitive level requires the conspirators to forgo profits that free competition would offer them. The forgone profits may be considered an investment in the future. For the investment [\*\*\*554] to be rational, [\*589] the conspirators must have a reasonable expectation of recovering, in the form of later monopoly profits, more than the losses suffered. As then-Professor Bork, discussing predatory pricing by a single firm, explained:

"Any realistic theory of predation recognizes that the predator as well as his victims will incur losses during the fighting, but such a theory supposes it may be a rational calculation for the predator to view the losses as an investment in future monopoly profits (where rivals are to be killed) or in future undisturbed profits (where rivals are to be disciplined). The future flow of profits, appropriately discounted, must then exceed the present size of the losses." R. Bork, *The Antitrust Paradox* 145 (1978).

See also McGee, *Predatory Pricing Revisited*, 23 *J. Law & Econ.* 289, 295-297 (1980). As this explanation shows, the success of such schemes is inherently uncertain: the short-run loss is definite, but the long-run gain depends on successfully neutralizing the competition. Moreover, it is not enough simply to achieve monopoly power, as monopoly pricing may breed quick entry by new competitors eager to share in the excess profits. The success of any predatory scheme depends on *maintaining* monopoly power for long enough both to recoup the predator's losses and to harvest some additional gain. Absent some assurance that the hoped-for monopoly will materialize, *and* that it can be sustained for a significant period of time, "[the] predator must make a substantial investment with no assurance that it will pay off." Easterbrook, *Predatory Strategies and Counterstrategies*, 48 *U. Chi. L. Rev.* 263, 268 (1981). For this reason, there is a consensus among commentators that predatory pricing schemes are rarely tried, and even more rarely successful.

See, e. g., Bork, *supra*, at 149-155; Areeda & Turner, *Predatory Pricing and Related Practices Under Section 2 of the Sherman Act*, 88 *Harv. L. Rev.* 697, 699 (1975); Easterbrook, *supra*; Koller, *The Myth of Predatory Pricing -- An Empirical Study*, [\*590] 4 *Antitrust Law & Econ. Rev.* 105 (1971); McGee, *Predatory Price Cutting: The Standard Oil (N. J.) Case*, 1 *J. Law & Econ.* 137 (1958); McGee, *Predatory Pricing Revisited*, 23 *J. Law & Econ.*, at 292-294. See also *Northeastern Telephone Co. v. American Telephone & Telegraph Co.*, 651 F.2d 76, 88 (CA2 1981) ("[Nowhere] in the recent outpouring of literature on the subject do commentators suggest that [predatory] pricing is either common or likely to increase"), cert. denied, 455 U.S. 943 (1982).

These observations apply even to predatory pricing by a *single firm* seeking monopoly power. In this case, respondents allege that a large number of firms have conspired over a period of many years to [\*\*\*1358] charge below-market prices in order to stifle competition. Such a conspiracy is incalculably more difficult to execute than an analogous plan undertaken by a single predator. The conspirators must allocate the losses to be sustained during the conspiracy's operation, and must also allocate any gains to be realized from its success. Precisely because success is speculative and depends on a willingness to endure losses for an indefinite period, each conspirator has a strong incentive to cheat, letting its partners suffer the losses necessary to [\*\*\*555] destroy the competition while sharing in any gains if the conspiracy succeeds. The necessary allocation is therefore difficult to accomplish. Yet if conspirators cheat to any substantial extent, the conspiracy must fail, because its success depends on depressing the market price for *all* buyers of CEPs. If there are too few goods at the artificially low price to satisfy demand, the would-be victims of the conspiracy can continue to sell at the "real" market price, and the conspirators suffer losses to little purpose.

Finally, if predatory pricing conspiracies are generally unlikely to occur, they are especially so where, as here, the prospects of attaining monopoly power seem slight. In order to recoup their losses, petitioners must obtain enough market power to set higher than competitive prices, and then must sustain those prices long enough to earn in excess profits [\*591] what they earlier gave up in below-cost prices. See *Northeastern Telephone Co. v. American Telephone & Telegraph Co.*, *supra*, at 89; Areeda & Turner, 88 *Harv. L. Rev.*, at 698. Two decades after their conspiracy

is alleged to have commenced,<sup>13</sup> petitioners appear to be far from achieving this goal: the two largest shares of the retail market in television sets are held by RCA and respondent Zenith, not by any of petitioners. 6 App. to Brief for Appellant in No. 81-2331 (CA3), pp. 2575a-2576a. Moreover, those shares, which together approximate 40% of sales, did not decline appreciably during the 1970's. *Ibid.* Petitioners' collective share rose rapidly during this period, from one-fifth or less of the relevant markets to close to 50%. 723 F.2d, at 316.<sup>14</sup> Neither the District Court nor the Court of Appeals found, however, that petitioners' share presently allows them to charge monopoly prices; to the contrary, respondents contend that the conspiracy is ongoing -- that petitioners are still artificially *depressing* the market price in order to drive Zenith out of the market. The data in the record strongly suggest that that goal is yet far distant.<sup>15</sup>

[\*592] [\*\*1359] The [\*\*\*556] alleged conspiracy's failure to achieve its ends in the two decades of its asserted operation is strong evidence that the conspiracy does not in fact exist. Since the losses in such a conspiracy accrue before the gains, they must be "repaid" with interest. And because the alleged losses have accrued over the course of

two decades, the conspirators could well require a correspondingly long time to recoup. Maintaining supracompetitive prices in turn depends on the continued cooperation of the conspirators, on the inability of other would-be competitors to enter the market, and (not incidentally) on the conspirators' ability to escape antitrust liability for their *minimum* price-fixing cartel.<sup>16</sup> Each of these factors weighs more heavily as the time needed to recoup losses grows. If the losses have been substantial -- as would likely be necessary [\*593] in order to drive out the competition<sup>17</sup> -- petitioners would most likely have to sustain their cartel for years simply to break even.

Nor does the possibility that petitioners have obtained supracompetitive profits in the Japanese market change this calculation. Whether or not petitioners have the *means* to sustain substantial losses in this country over a long period of time, they have no *motive* to sustain such losses absent some strong likelihood that the alleged conspiracy in this country will eventually pay off. The courts below found no evidence of any such success, and -- as indicated above -- the facts actually are to the contrary: RCA and Zenith, not any of the petitioners, continue to hold the largest share of

<sup>13</sup> NUE's complaint alleges that petitioners' conspiracy began as early as 1960; the starting date used in Zenith's complaint is 1953. NUE Complaint para. 52; Zenith Complaint para. 39.

<sup>14</sup> During the same period, the number of American firms manufacturing television sets declined from 19 to 13. 5 App. to Brief for Appellant in No. 81-2331 (CA3), p. 1961a. This decline continued a trend that began at least by 1960, when petitioners' sales in the United States market were negligible. *Ibid.* See Zenith Complaint paras. 35, 37.

<sup>15</sup> Respondents offer no reason to suppose that entry into the relevant market is especially difficult, yet without barriers to entry it would presumably be impossible to maintain supracompetitive prices for an extended time. Judge Easterbrook, commenting on this case in a law review article, offers the following sensible assessment:

"The plaintiffs [in this case] maintain that for the last fifteen years or more at least ten Japanese manufacturers have sold TV sets at less than cost in order to drive United States firms out of business. Such conduct cannot possibly produce profits by harming competition, however. If the Japanese firms drive some United States firms out of business, they could not recoup. Fifteen years of losses could be made up only by very high prices for the indefinite future. (The losses are like investments, which must be recovered with compound interest.) If the defendants should try to raise prices to such a level, they would attract new competition. There are no barriers to entry into electronics, as the proliferation of computer and audio firms shows. The competition would come from resurgent United States firms, from other foreign firms (Korea and many other nations make TV sets), and from defendants themselves. In order to recoup, the Japanese firms would need to suppress competition among themselves. On plaintiffs' theory, the cartel would need to last at least thirty years, far longer than any in history, even when cartels were not illegal. None should be sanguine about the prospects of such a cartel, given each firm's incentive to shave price and expand its share of sales. The predation recoupment story therefore does not make sense, and we are left with the more plausible inference that the Japanese firms did not sell below cost in the first place. They were just engaged in hard competition." Easterbrook, *The Limits of Antitrust*, 63 *Texas L. Rev.* 1, 26-27 (1984) (footnotes omitted).

<sup>16</sup> The alleged predatory scheme makes sense only if petitioners can recoup their losses. In light of the large number of firms involved here, petitioners can achieve this only by engaging in some form of price fixing *after* they have succeeded in driving competitors from the market. Such price fixing would, of course, be an independent violation of § 1 of the Sherman Act. *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150 (1940).

<sup>17</sup> The predators' losses must actually *increase* as the conspiracy nears its objective: the greater the predators' market share, the more products the predators sell; but since every sale brings with it a loss, an increase in market share also means an increase in predatory losses.

the American retail market in color television sets. More important, there is nothing to suggest any relationship between petitioners' profits in Japan and the amount petitioners could expect to gain from a conspiracy to monopolize the American market. In the absence of any such evidence, the possible existence of supracompetitive profits in Japan simply cannot overcome the economic obstacles to the ultimate success of this alleged predatory conspiracy.<sup>18</sup>

## B

[\*\*557] In *Monsanto*, we emphasized that *HN4* courts should not permit factfinders to infer conspiracies when such inferences are implausible, because the effect of such practices is often to deter procompetitive conduct. *Monsanto*, 465 U.S., at 762-764. [\*594] Respondents, petitioners' competitors, seek to hold petitioners liable for [\*\*1360] damages caused by the alleged conspiracy to cut prices. Moreover, they seek to establish this conspiracy indirectly, through evidence of other combinations (such as the check-price agreements and the five company rule) whose natural tendency is to raise prices, and through evidence of rebates and other price-cutting activities that respondents argue tend to prove a combination to suppress prices.<sup>19</sup> But cutting prices in order to increase business often is the very essence of competition. Thus, mistaken inferences in cases such as this one are especially costly, because they chill the very conduct the antitrust laws are designed to protect. See *Monsanto, supra*, at 763-764. "[We] must be concerned lest a rule or precedent that authorizes a search for a particular type of undesirable pricing behavior end up by discouraging legitimate price competition." *Barry Wright Corp. v. ITT Grinnell Corp.*, 724 F.2d 227, 234 (CA1 1983).

In most cases, this concern must be balanced against the desire that illegal conspiracies be identified and punished. That balance is, however, unusually one-sided in cases such as this one. As we earlier explained, *supra*, at 588-593,

predatory pricing schemes require conspirators to suffer losses in order eventually to realize their illegal gains; moreover, the [\*595] gains depend on a host of uncertainties, making such schemes more likely to fail than to succeed. These economic realities tend to make predatory pricing conspiracies self-deterring: unlike most other conduct that violates the antitrust laws, failed predatory pricing schemes are costly to the conspirators. See Easterbrook, *The Limits of Antitrust*, 63 *Texas L. Rev.* 1, 26 (1984). Finally, unlike predatory pricing by a single firm, *successful* predatory pricing conspiracies involving a large number of firms can be identified and punished once they succeed, since some form of minimum price-fixing agreement would be necessary in order to reap the benefits of predation. Thus, there is little reason to be concerned that by granting summary judgment in cases where the [\*\*\*558] evidence of conspiracy is speculative or ambiguous, courts will encourage such conspiracies.

## V

[IC] [1C]As our discussion in Part IV-A shows, petitioners had no motive to enter into the alleged conspiracy. To the contrary, as presumably rational businesses, petitioners had every incentive *not* to engage in the conduct with which they are charged, for its likely effect would be to generate losses for petitioners with no corresponding gains. Cf. *Cities Service*, 391 U.S., at 279. The Court of Appeals did not take account of the absence of a plausible motive to enter into the alleged predatory pricing conspiracy. It focused instead on whether there was "direct evidence of concert of action." 723 F.2d, at 304. The Court of Appeals erred in two respects: (i) the "direct evidence" on which the court relied had little, if any, relevance to the alleged predatory pricing conspiracy; and (ii) the court failed to consider the absence of a plausible motive to engage in predatory pricing.

[\*\*1361] The "direct evidence" on which the court relied was evidence of *other* combinations, not of a predatory

<sup>18</sup> The same is true of any supposed excess production capacity that petitioners may have possessed. The existence of plant capacity that exceeds domestic demand does tend to establish the ability to sell products abroad. It does not, however, provide a motive for selling at prices lower than necessary to obtain sales; nor does it explain why petitioners would be willing to *lose* money in the United States market without some reasonable prospect of recouping their investment.

<sup>19</sup> Respondents also rely on an expert study suggesting that petitioners have sold their products in the American market at substantial losses. The relevant study is not based on actual cost data; rather, it consists of expert opinion based on a mathematical construction that in turn rests on assumptions about petitioners' costs. The District Court analyzed those assumptions in some detail and found them both implausible and inconsistent with record evidence. *Zenith Radio Corp. v. Matsushita Electric Industrial Co.*, 505 F.Supp., at 1356-1363. Although the Court of Appeals reversed the District Court's finding that the expert report was inadmissible, the court did not disturb the District Court's analysis of the factors that substantially undermine the probative value of that evidence. See 723 F.2d, at 277-282. We find the District Court's analysis persuasive. Accordingly, in our view the expert opinion evidence of below-cost pricing has little probative value in comparison with the economic factors, discussed in Part IV-A, *supra*, that suggest that such conduct is irrational.

pricing conspiracy. Evidence that petitioners conspired to raise prices in Japan provides little, if any, support for respondents' [\*596] claims: a conspiracy to increase profits in one market does not tend to show a conspiracy to sustain losses in another. Evidence that petitioners agreed to fix *minimum* prices (through the check-price agreements) for the American market actually works in petitioners' favor, because it suggests that petitioners were seeking to place a floor under prices rather than to lower them. The same is true of evidence that petitioners agreed to limit the number of distributors of their products in the American market -- the so-called five company rule. That practice may have facilitated a horizontal territorial allocation, see *United States v. Topco Associates, Inc.*, 405 U.S. 596 (1972), but its natural effect would be to raise market prices rather than reduce them.<sup>20</sup> Evidence that tends to support any of these collateral conspiracies thus says little, if anything, about the existence of a conspiracy to charge below-market prices in the American market over a period of two decades.

[11B] [11B] That being the case, the absence of any plausible motive to engage in the conduct charged is highly relevant to whether a "genuine issue for trial" exists within the meaning of Rule 56(e). Lack of motive bears on the range of permissible conclusions that might be drawn [\*\*\*559] from ambiguous evidence: if petitioners had no rational economic motive to conspire, and if their conduct is consistent with other, equally plausible explanations, [\*597] the conduct does not give rise to an inference of conspiracy. See *Cities Service, supra*, at 278-280. Here, the conduct in question consists largely of (i) pricing at levels that succeeded in taking business away from respondents, and (ii) arrangements that may have limited petitioners' ability to compete with each other (and thus kept prices from going even lower). This conduct suggests either that petitioners behaved competitively, or that petitioners conspired to *raise* prices. Neither possibility is consistent with an agreement among 21 companies to price below market levels. Moreover, the predatory pricing scheme that this conduct is said to

prove is one that makes no practical sense: it calls for petitioners to destroy companies larger and better established than themselves, a goal that remains far distant more than two decades after the conspiracy's birth. Even had they succeeded in obtaining their monopoly, there is nothing in the record to suggest that they could recover the losses they would need to sustain along the way. In sum, in light of the absence of any rational motive to conspire, neither petitioners' pricing practices, nor their conduct in the Japanese market, nor their agreements respecting prices and distribution in the American market, suffice to create a "genuine issue for trial." Fed. Rule Civ. Proc. 56(e).<sup>21</sup>

[\*\*1362] On remand, the Court of Appeals is free to consider whether there is other evidence that is sufficiently unambiguous to permit a trier of fact to find that petitioners conspired to price predatorily for two decades despite the absence of any apparent motive to do so. The evidence must "[tend] to exclude the possibility" that petitioners underpriced respondents to compete for business rather than to implement an economically [\*598] senseless conspiracy. *Monsanto*, 465 U.S., at 764. In the absence of such evidence, there is no "genuine issue for trial" under Rule 56(e), and petitioners are entitled to have summary judgment reinstated.

## VI

Our decision makes it unnecessary to reach the sovereign compulsion issue. The heart of petitioners' argument on that issue is that MITI, an agency of the Government of Japan, required petitioners to fix minimum prices for export to the United States, and that petitioners are therefore immune from antitrust liability for any scheme of which those minimum prices were an integral part. As we discussed in Part II, *supra*, respondents could not have suffered a cognizable injury from any action that *raised* prices in the American CEP market. If liable at all, petitioners are liable for conduct that is distinct from the check-price agreements. The sovereign compulsion [\*\*\*560] question that both

<sup>20</sup> The Court of Appeals correctly reasoned that the five company rule might tend to insulate petitioners from competition with each other. 723 F.2d, at 306. But this effect is irrelevant to a conspiracy to price predatorily. Petitioners have no incentive to underprice each other if they already are pricing *below* the level at which they could sell their goods. The far more plausible inference from a customer allocation agreement such as the five company rule is that petitioners were conspiring to *raise* prices, by limiting their ability to take sales away from each other. Respondents -- petitioners' competitors -- suffer no harm from a conspiracy to raise prices. *Supra*, at 582-583. Moreover, it seems very unlikely that the five company rule had any significant effect of any kind, since the "rule" permitted petitioners to sell to their American subsidiaries, and did not limit the number of distributors to which the subsidiaries could resell. 513 F.Supp., at 1190.

<sup>21</sup> We do not imply that, if petitioners had had a plausible reason to conspire, ambiguous conduct could suffice to create a triable issue of conspiracy. Our decision in *Monsanto Co. v. Spray-Rite Service Corp.*, 465 U.S. 752 (1984), establishes that *HN5* conduct that is as consistent with permissible competition as with illegal conspiracy does not, without more, support even an inference of conspiracy. *Id.*, at 763-764. See *supra*, at 588.

petitioners and the Solicitor General urge us to decide thus is not presented here.

The decision of the Court of Appeals is reversed, and the case is remanded for further proceedings consistent with this opinion.

*It is so ordered.*

**Dissent by:** WHITE

## **Dissent**

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JUSTICE WHITE, with whom JUSTICE BRENNAN, JUSTICE BLACKMUN, and JUSTICE STEVENS join, dissenting.

It is indeed remarkable that the Court, in the face of the long and careful opinion of the Court of Appeals, reaches the result it does. The Court of Appeals faithfully followed the relevant precedents, including *First National Bank of Arizona v. Cities Service Co.*, 391 U.S. 253 (1968), and *Monsanto Co. v. Spray-Rite Service Corp.*, 465 U.S. 752 (1984), and it kept firmly in mind the principle that proof of a conspiracy should not be fragmented, see *Continental Ore Co. v. Union Carbide & Carbon Corp.*, 370 U.S. 690, 699 (1962). After surveying the massive record, including very [\*599] significant evidence that the District Court erroneously had excluded, the Court of Appeals concluded that the evidence taken as a whole creates a genuine issue of fact whether petitioners engaged in a conspiracy in violation of §§ 1 and 2 of the Sherman Act and § 2(a) of the Robinson-Patman Act. In my view, the Court of Appeals' opinion more than adequately supports this judgment.

The Court's opinion today, far from identifying reversible error, only muddies the waters. In the first place, the Court makes confusing and inconsistent statements about the appropriate standard for granting summary judgment. Second, the Court makes a number of assumptions that invade the factfinder's province. Third, the Court faults the Third Circuit for nonexistent errors and remands the case

although it is plain that respondents' evidence raises genuine issues of material fact.

I

The Court's initial discussion of summary judgment standards appears consistent with settled doctrine. I agree that [\*1363] "[where] the record taken as a whole could not lead a rational trier of fact to find for the nonmoving party, there is no 'genuine issue for trial.'" *Ante*, at 587 (quoting *Cities Service*, *supra*, at 289). I also agree that "[on] summary judgment the inferences to be drawn from the underlying facts . . . must be viewed in the light most favorable to the party opposing the motion." *Ante*, at 587 (quoting *United States v. Diebold, Inc.*, 369 U.S. 654, 655 (1962)). But other language in the Court's opinion suggests a departure from traditional summary judgment doctrine. Thus, the Court gives the following critique of the Third Circuit's opinion:

"[The] Court of Appeals concluded that a reasonable factfinder could find a conspiracy to depress prices in the American market in order to drive out American competitors, [\*\*\*561] which conspiracy was funded by excess profits obtained in the Japanese market. The court apparently did not consider whether it was as plausible to conclude [\*600] that petitioners' price-cutting behavior was independent and not conspiratorial." *Ante*, at 581.

In a similar vein, the Court summarizes *Monsanto Co. v. Spray-Rite Service Corp.*, *supra*, as holding that "courts should not permit factfinders to infer conspiracies when such inferences are implausible . . ." *Ante*, at 593. Such language suggests that a judge hearing a defendant's motion for summary judgment in an antitrust case should go beyond the traditional summary judgment inquiry and decide for himself whether the weight of the evidence favors the plaintiff. *Cities Service* and *Monsanto* do not stand for any such proposition. Each of those cases simply held that a particular piece of evidence standing alone was insufficiently probative to justify sending a case to the jury.<sup>1</sup> These holdings in no way undermine [\*601] the doctrine that all

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<sup>1</sup> The Court adequately summarizes the quite fact-specific holding in *Cities Service*. *Ante*, at 587.

In *Monsanto*, the Court held that a manufacturer's termination of a price-cutting distributor after receiving a complaint from another distributor is not, *standing alone*, sufficient to create a jury question. 465 U.S., at 763-764. To understand this holding, it is important to realize that under *United States v. Colgate & Co.*, 250 U.S. 300 (1919), it is permissible for a manufacturer to announce retail prices in advance and terminate those who fail to comply, but that under *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911), it is impermissible for the manufacturer and its distributors to agree on the price at which the distributors will sell the goods. Thus, a manufacturer's termination of a price-cutting distributor after receiving a complaint from another distributor is lawful under *Colgate*, unless the termination is pursuant to a shared understanding between the manufacturer and its distributors respecting enforcement of a resale price maintenance scheme. *Monsanto* holds that to establish liability under *Dr. Miles*, more is needed than evidence of behavior

evidence must be construed in the light most favorable to the party opposing summary judgment.

If the Court intends to give every judge hearing a motion for summary judgment in an antitrust case the job of determining if the evidence makes the inference of conspiracy more probable than not, it is overturning settled law. If the Court does not intend such a pronouncement, it should refrain from using unnecessarily broad and confusing language.

## II

In defining what respondents must show in order to recover, the Court makes assumptions [\*\*1364] that invade the factfinder's province. The Court states with very little discussion that respondents can recover under § 1 of the Sherman Act only if they prove that "petitioners conspired to drive respondents out of the relevant markets by (i) pricing below the level necessary to sell their products, or [\*\*\*562] (ii) pricing below some appropriate measure of cost." *Ante*, at 585, n. 8. This statement is premised on the assumption that "[an] agreement without these features would either leave respondents in the same position as would market forces or would actually benefit respondents by raising market prices." *Ibid*. In making this assumption, the Court ignores the contrary conclusions of respondents'

expert DePodwin, whose report in very relevant part was erroneously excluded by the District Court.

The DePodwin Report, on which the Court of Appeals relied along with other material, indicates that respondents were harmed in two ways that are independent of whether petitioners priced their products below "the level necessary to sell their products or . . . some appropriate measure of cost." *Ibid*. First, the Report explains that the price-raising scheme in Japan resulted in lower consumption of petitioners' goods in that country and the exporting of more of petitioners' goods to this country than would have occurred had prices in Japan been at the competitive level. Increasing [\*602] exports to this country resulted in depressed prices here, which harmed respondents.<sup>2</sup> Second, the DePodwin Report indicates that petitioners exchanged confidential proprietary information and entered into agreements such as the five company rule with the goal of avoiding intragroup competition in the United States market. The Report explains that petitioners' restrictions on intragroup competition caused respondents to lose business that they would not have lost had petitioners competed with one another.<sup>3</sup>

[\*603] [\*\*1365] The [\*\*\*563] DePodwin Report alone creates a genuine factual issue regarding the harm to

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that is consistent with a distributor's exercise of its prerogatives under *Colgate*. Thus, "[there] must be evidence that tends to exclude the possibility that the manufacturer and nonterminated distributors were acting independently." 465 U.S., at 764. *Monsanto* does not hold that if a terminated dealer produces some further evidence of conspiracy beyond the bare fact of postcomplaint termination, the judge hearing a motion for summary judgment should balance all the evidence pointing toward conspiracy against all the evidence pointing toward independent action.

<sup>2</sup> Dr. DePodwin summarizes his view of the harm caused by Japanese cartelization as follows:

"When we consider the injuries inflicted on United States producers, we must again look at the Japanese television manufacturers' export agreement as part of a generally collusive scheme embracing the Japanese domestic market as well. This scheme increased the supply of television receivers to the United States market while restricting supply in the Japanese market. If Japanese manufacturers had competed in both domestic and export markets, they would have sold more in the domestic market and less in the United States. A greater proportion of Japanese production capacity would have been devoted to domestic sales. Domestic prices would have been lower and export prices would have been higher. The size of the price differential between domestic and export markets would have diminished practically to the vanishing point. Consequently, competition among Japanese producers in both markets would have resulted in reducing exports to the United States and United States prices would have risen. In addition, investment by the United States industry would have increased. As it was, however, the influx of sets at depressed prices cut the rates of return on television receiver production facilities in the United States to so low a level as to make such investment uneconomic.

"We can therefore conclude that the American manufacturers of television receivers would have made larger sales at higher prices in the absence of the Japanese cartel agreements. Thus, the collusive behavior of Japanese television manufacturers resulted in a very severe injury to those American television manufacturers, particularly to National Union Electric Corporation, which produced a preponderance of television sets with screen sizes of nineteen inches and lower, especially those in the lower range of prices." 5 App. to Brief for Appellants in No. 81-2331 (CA3), pp. 1629a-1630a.

<sup>3</sup> The DePodwin Report has this, among other things, to say in summarizing the harm to respondents caused by the five company rule, exchange of production data, price coordination, and other allegedly anti-competitive practices of petitioners:

"The impact of Japanese anti-competitive practices on United States manufacturers is evident when one considers the nature of competition. When a market is fully competitive, firms pit their resources against one another in an attempt to secure the business of

respondents caused by Japanese cartelization and by agreements restricting competition among petitioners in this country. No doubt the Court prefers its own economic theorizing to Dr. DePodwin's, but that is not a reason to deny the factfinder an opportunity to consider Dr. DePodwin's views on how petitioners' alleged collusion harmed respondents.<sup>4</sup>

[\*604] The Court, in discussing the unlikelihood of a predatory conspiracy, also consistently assumes that petitioners valued profit-maximization over growth. See, e. g., *ante*, at 595. In light of the evidence that petitioners sold their goods in this country at substantial losses over a long period of time, see Part III-B, *infra*, I believe that this is an assumption that should be argued to the factfinder, not decided by the Court.

### III

In reversing the Third Circuit's judgment, the Court identifies two alleged errors: "(i) [The] 'direct evidence' on which the [Court of Appeals] relied had little, if any, relevance to the alleged predatory pricing conspiracy; and (ii) the court failed to consider the absence of a plausible motive to engage in predatory [\*\*\*564] pricing." *Ante*, at 595. The Court's position is without substance.

individual customers. However, when firms collude, they violate a basic tenet of competitive behavior, i. e., that they act independently. United States firms were confronted with Japanese competitors who collusively were seeking to destroy their established customer relationships. Each Japanese company had targeted customers which it could service with reasonable assurance that its fellow Japanese cartel members would not become involved. But just as importantly, each Japanese firm would be assured that what was already a low price level for Japanese television receivers in the United States market would not be further depressed by the actions of its Japanese associates.

"The result was a phenomenal growth in exports, particularly to the United States. Concurrently, Japanese manufacturers, and the defendants in particular, made large investments in new plant and equipment and expanded production capacity. It is obvious, therefore, that the effect of the Japanese cartel's concerted actions was to generate a larger volume of investment in the Japanese television industry than would otherwise have been the case. This added capacity both enabled and encouraged the Japanese to penetrate the United States market more deeply than they would have had they competed lawfully." *Id.*, at 1628a-1629a.

For a more complete statement of DePodwin's explanation of how the alleged cartel operated, and the harms it caused respondents, see *id.*, at 1609a-1642a. This material is summarized in a chart found *id.*, at 1633a.

<sup>4</sup> In holding that Parts IV and V of the Report had been improperly excluded, the Court of Appeals said:

"The trial court found that DePodwin did not use economic expertise in reaching the opinion that the defendants participated in a Japanese television cartel. 505 F.Supp. at 1342-46. We have examined the excluded portions of Parts IV and V in light of the admitted portions, and we conclude that this finding is clearly erroneous. As a result, the court also held the opinions to be unhelpful to the factfinder. What the court in effect did was to eliminate all parts of the report in which the expert economist, after describing the conditions in the respective markets, the opportunities for collusion, the evidence pointing to collusion, the terms of certain undisputed agreements, and the market behavior, expressed the opinion that there was concert of action consistent with plaintiffs' conspiracy theory. Considering the complexity of the economic issues involved, it simply cannot be said that such an opinion would not help the trier of fact to understand the evidence or determine that fact in issue." *In re Japanese Electronics Products Antitrust Litigation*, 723 F.2d 238, 280 (1983).

The Court of Appeals had similar views about Parts VI and VII.

<sup>5</sup> I use the Third Circuit's analysis of the five company rule by way of example; the court did an equally careful analysis of the parts the cartel activity in Japan and the check prices could have played in an actionable conspiracy. See generally *id.*, at 303-311.

A

The first claim of error is that the Third Circuit treated evidence regarding price fixing in Japan and the so-called five company rule and check prices as "'direct evidence' of a conspiracy that injured respondents." *Ante*, at 583 (citing *In re Japanese Electronics Products Antitrust Litigation*, 723 F.2d 238, 304-305 (1983)). The passage from the Third [\*605] Circuit's opinion in which the Court locates this alleged error makes what I consider to be a quite simple and correct observation, namely, that this case is distinguishable from traditional "conscious parallelism" cases, in that there is direct evidence of concert of action among petitioners. *Ibid*. The Third Circuit did not, as the Court implies, jump unthinkingly from this observation to the conclusion that evidence regarding the five company rule could support a finding of antitrust injury to respondents.<sup>5</sup> The Third [\*\*1366] Circuit twice specifically noted that horizontal agreements allocating customers, though illegal, do not ordinarily injure competitors of the agreeing parties. *Id.*, at 306, 310-311. However, after reviewing evidence of cartel activity in Japan, collusive establishment of dumping prices in this country, and long-term, below-cost sales, the Third Circuit held that a factfinder could reasonably conclude that the five company rule was not a simple price-raising device:

"[A] factfinder might reasonably infer that the allocation of customers in the United States, combined with price-fixing in Japan, was intended to permit concentration of the effects of dumping upon American competitors while eliminating competition among the Japanese manufacturers in either market." *Id.*, at 311.

I see nothing erroneous in this reasoning.

B

The Court's second charge of error is that the Third Circuit was not sufficiently skeptical of respondents' allegation that petitioners engaged in predatory pricing conspiracy. But [\*606] the Third Circuit is not required to engage in academic discussions about predation; it is required to decide whether respondents' evidence creates a genuine issue of material fact. The Third Circuit did its job, and remanding the case so that it can do the same job again is simply pointless.

The Third Circuit indicated that it considers respondents' evidence sufficient to create a genuine factual issue regarding long-term, below-cost sales by petitioners. *Ibid.* The Court tries to whittle away at this conclusion by suggesting that the "expert opinion evidence of below-cost pricing has little probative value in comparison with the economic factors . . . that suggest that such conduct [\*\*\*565] is irrational." *Ante*, at 594, n. 19. But the question is not whether the Court finds respondents' experts persuasive, or prefers the District Court's analysis; it is whether, viewing the evidence in the light most favorable to respondents, a jury or other factfinder could reasonably conclude that petitioners engaged in long-term, below-cost sales. I agree with the Third Circuit that the answer to this question is "yes."

It is misleading for the Court to state that the Court of Appeals "did not disturb the District Court's analysis of the

factors that substantially undermine the probative value of [evidence in the DePodwin Report respecting below-cost sales]." *Ibid.* The Third Circuit held that the exclusion of the portion of the DePodwin Report regarding below-cost pricing was erroneous because "the trial court ignored DePodwin's uncontradicted affidavit that all data relied on in his report were of the type on which experts in his field would reasonably rely." 723 F.2d, at 282. In short, the Third Circuit found DePodwin's affidavit sufficient to create a genuine factual issue regarding the correctness of his conclusion that petitioners sold below cost over a long period of time. Having made this determination, the court saw no need -- nor do I -- to address the District Court's analysis point by point. The District Court's criticisms of DePodwin's [\*607] methods are arguments that a factfinder should consider.

IV

Because I believe that the Third Circuit was correct in holding that respondents have demonstrated the existence of genuine issues of material fact, I would affirm [\*\*1367] the judgment below and remand this case for trial.

## References

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Go To Supreme Court24 Federal Procedure, L Ed, Monopolies and Restraints of Trade 54:254, 54:25524 Am Jur Trials 1, Defending Antitrust Lawsuits; USCSUS L Ed Digest, Appeal 1087.5(1), 1267, 1750; Evidence 394, 979; International Law 6; Restraints of Trade, Monopolies, and Unfair Trade Practices 10, 21, 36, 67; Summary Judgment and Judgment on Pleadings 4-6; Trial 197Index to Annotations, Restraints of Trade and Monopolies; Summary JudgmentAnnotation References: .Extraterritorial application of federal antitrust.

# APPENDIX 16

## Paracor Fin., Inc. v. GE Capital Corp.

United States Court of Appeals for the Ninth Circuit

August 14, 1995; March 13, 1996, Filed

No. 94-15633

### Reporter

96 F.3d 1151; 1996 U.S. App. LEXIS 24726; 96 Daily Journal DAR 11563

PARACOR FINANCE, INC., (fka Elders Finance, Inc.), a New York corporation; CARGILL FINANCIAL SERVICES CORPORATION, a Delaware corporation; LUTHERAN BROTHERHOOD, a Minnesota corporation; FARM BUREAU LIFE INSURANCE COMPANY, an Iowa corporation, Plaintiffs-Appellants, v. GENERAL ELECTRIC CAPITAL CORPORATION, a New York corporation; JORDAN D. SCHNITZER; BURTON A. BURTON; JERRY C. HOLLAND, Defendants-Appellees.

**Subsequent History:** **[\*\*1]** As Amended on Denial of Rehearing and Suggestion for Rehearing En Banc September 20, 1996.

**Prior History:** Appeal from the United States District Court for the Northern District of California. D.C. No. CV-90-03226-CAL. Charles A. Legge, District Judge, Presiding.

Original Opinion Previously Reported at: 1996 U.S. App. LEXIS 4410.

**Disposition:** AFFIRMED in substantial part, REVERSED in one respect, and REMANDED. Each side to bear its own costs.

### Core Terms

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Investors, debentures, district court, offering, choice-of-law, Securities, Finance, parties, common-law, projections, sales, misrepresentations, summary judgment, jury waiver, violations, lender, unjust enrichment, bridge loan, representations, arbitration, documents, issue of material fact, securities law, invoke, indirectly, omissions, Partial, summary judgment motion, cause of action, participating

### Case Summary

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#### Procedural Posture

Appellant investors challenged an order of the United States District Court for the Northern District of California, which entered partial summary judgment for appellees, lender, CEO, and businessman, in an action alleging violations of 15 U.S.C.S. 78j(b) and 17 C.F.R. 240.10b-5, Oregon securities laws, and common law torts in connection with alleged misrepresentations involved in a debenture offering.

#### Overview

Appellant investors alleged that appellees, lender, CEO, and businessman, violated 15 U.S.C.S. § 78j(b), 17 C.F.R. § 240.10b-5, Or. Rev. Stat. § 59.115, and the common law based on misrepresentations in a debenture offering for a merger. The trial court granted partial judgment for appellees, and the court affirmed in substantial part. The court held that appellees lender and CEO were not primarily liable on the federal claims because they owed no duty to appellants to disclose negative sales data about the target company, because general predictions were not actionable misrepresentations, and because there was no justifiable reliance. Appellees lender and CEO were not secondarily liable because they were not "controlling persons" of the target under 15 U.S.C.S. § 78t(a). The court affirmed the dismissal of the Oregon Securities Law claims on the same grounds. The court reversed enforcement of a jury waiver clause because appellees lender and CEO were not parties to the agreement. Unjust enrichment claims were not available because there were enforceable agreements defining the parties' rights. Claims against appellee businessman were deemed abandoned. The court remanded.

#### Outcome

The court affirmed summary judgment for appellees lender and CEO on appellant investors' federal and state securities law claims because they made no actionable misrepresentations and they were not controlling persons, and on appellants' unjust enrichment claims. The court held that appellants abandoned their claims against appellee businessman. The court reversed and remanded enforcement of a jury waiver clause as to appellees, lender and CEO.

## LexisNexis® Headnotes

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Criminal Law & Procedure > Criminal Offenses > Acts & Mental States > General Overview

Securities Law > ... > Express Liabilities > Misleading Statements > General Overview

Securities Law > ... > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Deceptive & Manipulative Devices

Securities Law > ... > Implied Private Rights of Action > Elements of Proof > General Overview

**HN1** Rule 10b-5(b), enacted under § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C.S. § 78j(b), makes it unlawful to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading. 17 C.F.R. § 240.10b-5(b). The elements of a Rule 10b-5 claim are: (1) a misrepresentation or omission of a material fact, (2) reliance, (3) scienter, and (4) resulting damages.

Business & Corporate Law > Agency Relationships > Fiduciaries > General Overview

Business & Corporate Law > Agency Relationships > Fiduciaries > Fiduciary Duties

Business & Corporate Law > ... > Causes of Action & Remedies > Breach of Fiduciary Duty > General Overview

Business & Corporate Law > ... > Duties & Liabilities > Knowledge & Notice > Duty of Agent to Disclose

Governments > Fiduciaries

Securities Law > Postoffering & Secondary Distributions > General Overview

Securities Law > ... > Express Liabilities > Misleading Statements > General Overview

Securities Law > ... > Implied Private Rights of Action > Elements of Proof > Duty to Disclose

**HN2** 17 C.F.R. § 240.10b-5(b) is violated by nondisclosure only when there is a duty to disclose. The parties to an impersonal market transaction owe no duty of disclosure to one another absent a fiduciary or agency relationship, prior dealings, or circumstances such that one party has placed trust and confidence in the other. A number of factors are used to determine whether a party has a duty to disclose: (1) the relationship of the parties, (2) their relative access to information, (3) the benefit that the defendant derives from the relationship, (4) the defendant's awareness that the plaintiff was relying upon the relationship in making his

investment decision, and (5) the defendant's activity in initiating the transaction.

Securities Law > ... > Express Liabilities > Misleading Statements > General Overview

**HN3** General expressions of optimism are only actionable as misrepresentations if (1) the statement is not genuinely believed, (2) there is no reasonable basis for such expression, or (3) the speaker is aware of undisclosed facts undermining the statement.

Securities Law > ... > Express Liabilities > Misleading Statements > General Overview

Securities Law > ... > Implied Private Rights of Action > Elements of Proof > General Overview

Securities Law > ... > Elements of Proof > Reliance > Justifiable & Reasonable Reliance

**HN4** Justifiable reliance is a limitation on a 17 C.F.R. § 240.10b-5(b) action which insures that there is a causal connection between the misrepresentation and the plaintiff's harm.

Securities Law > ... > Implied Private Rights of Action > Elements of Proof > General Overview

Securities Law > ... > Elements of Proof > Reliance > General Overview

Securities Law > ... > Elements of Proof > Reliance > Justifiable & Reasonable Reliance

Torts > Business Torts > Fraud & Misrepresentation > General Overview

Torts > ... > Fraud & Misrepresentation > Negligent Misrepresentation > General Overview

Torts > ... > Fraud & Misrepresentation > Negligent Misrepresentation > Elements

**HN5** Under New York law, justifiable reliance is an element of both common-law fraud and negligent misrepresentation. The same is true under California law.

Securities Law > ... > Express Liabilities > Misleading Statements > General Overview

**HN7** There is no cause of action for aider and abettor liability under 15 U.S.C.S. § 78j(b).

Torts > Business Torts > Fraud & Misrepresentation > General Overview

**HN6** Under New York law, aiding and abetting fraud requires a showing that the defendant "knew or intended to

aid" the commission of a fraud. Mere inaction is not enough to support aider and abettor liability.

Securities Law > ... > Secondary Liability > Controlling Persons > General Overview

**HN8** See 15 U.S.C.S. § 78t(a).

Securities Law > ... > Secondary Liability > Controlling Persons > General Overview

Securities Law > ... > Secondary Liability > Controlling Persons > Defenses

**HN9** To establish "controlling person" liability, the plaintiff must show that a primary violation was committed and that the defendant "directly or indirectly" controlled the violator. In general, the determination of who is a controlling person is an intensely factual question. The plaintiff need not show the controlling person's scienter or that they "culpably participated" in the alleged wrongdoing. If the plaintiff establishes that the defendant is a "controlling person," then the defendant bears the burden of proving he acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action. 15 U.S.C.S. § 78t(a).

Securities Law > ... > Secondary Liability > Controlling Persons > General Overview

**HN10** Whether a person is a controlling person is an intensely factual question, involving scrutiny of the defendant's participation in the day-to-day affairs of the corporation and the defendant's power to control corporate actions.

Securities Law > ... > Secondary Liability > Controlling Persons > General Overview

Securities Law > ... > Secondary Liability > Controlling Persons > Definition of Control

**HN11** The Securities and Exchange Commission defines "control" as the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through ownership of voting securities, by contract, or otherwise. 17 C.F.R. § 230.405.

Securities Law > ... > Secondary Liability > Controlling Persons > General Overview

Securities Law > ... > Secondary Liability > Controlling Persons > Elements of Proof

**HN12** A court's inquiry to determine "control" must revolve around the "management and policies" of the corporation, not around discrete transactions.

Civil Procedure > ... > Jurisdiction > Jurisdictional Sources > General Overview

Civil Procedure > ... > Jurisdiction > Subject Matter Jurisdiction > General Overview

Civil Procedure > ... > Subject Matter Jurisdiction > Supplemental Jurisdiction > General Overview

Civil Procedure > ... > Federal & State Interrelationships > Choice of Law > General Overview

**HN13** In a federal question action where the federal court is exercising supplemental jurisdiction over state claims, the federal court applies the choice-of-law rules of the forum state.

Civil Procedure > ... > Federal & State Interrelationships > Choice of Law > General Overview

Contracts Law > Contract Conditions & Provisions > Forum Selection Clauses

**HN14** A choice-of-law clause is binding on the parties to a contract unless: (1) the chosen state does not have a substantial relationship to either the parties or the transaction; or (2) application of the chosen state's law would be contrary to a fundamental policy of a state with a materially greater interest in the particular issue.

Contracts Law > Contract Interpretation > General Overview

**HN15** Documents that relate to the same subject matter and that were executed as part of the same transaction are construed as part of the same instrument. This rule of interpretation applies even though the parties executing the contracts differ, as long as the several contracts were known to all the parties and were delivered at the same time to accomplish an agreed purpose.

Administrative Law > Agency Adjudication > Alternative Dispute Resolution

Civil Procedure > ... > Alternative Dispute Resolution > Arbitration > General Overview

Contracts Law > Contract Conditions & Provisions > Arbitration Clauses

Contracts Law > Contract Conditions & Provisions > Forum Selection Clauses

**HN16** A choice-of-law clause, like an arbitration clause, is a contractual right and generally may not be invoked by one who is not a party to the contract in which it appears.

Contracts Law > Third Parties > Beneficiaries > Claims & Enforcement

**HN17** The law requires a showing that the parties to the contract intended to benefit a third party.

Securities Law > Blue Sky Laws > Civil Liability > General Overview

Securities Law > Blue Sky Laws > Offers & Sales

**HN18** Or. Rev. Stat. § 59.115(1)(a) imposes liability against any person who sells a security in violation of the Oregon Securities Law.

Securities Law > ... > Civil Liability > Blue Sky Fraud > General Overview

Securities Law > Blue Sky Laws > Civil Liability > General Overview

Securities Law > Blue Sky Laws > Offers & Sales

**HN19** Or. Rev. Stat. § 59.115(1)(b) makes a person liable for selling a security by means of an untrue statement of a material fact.

Securities Law > ... > Civil Liability > Blue Sky Fraud > General Overview

Securities Law > Blue Sky Laws > Civil Liability > General Overview

**HN20** Or. Rev. Stat. § 59.115(3) provides for derivative liability of every nonselling person who (a) directly or indirectly controls a seller, and (b) every person who participates or materially aids in the sale.

Contracts Law > Contract Conditions & Provisions > Waivers > General Overview

**HN21** A jury waiver is a contractual right and generally may not be invoked by one who is not a party to the contract.

Contracts Law > Contract Conditions & Provisions > Waivers > General Overview

**HN22** Courts generally construe jury waivers narrowly.

Contracts Law > Remedies > Equitable Relief > General Overview

Contracts Law > Types of Contracts > Quasi Contracts

**HN23** Under both California and New York law, unjust enrichment is an action in quasi-contract, which does not lie

when an enforceable, binding agreement exists defining the rights of the parties.

Civil Procedure > Judgments > Entry of Judgments > Consent Decrees

Civil Procedure > Appeals > Reviewability of Lower Court Decisions > General Overview

**HN24** A court looks at the language of the consent judgment and other evidence in the record to determine whether a party may appeal following an order entered by consent.

Civil Procedure > Appeals > Reviewability of Lower Court Decisions > Preservation for Review

**HN25** Claims which are not addressed in the appellant's brief are deemed abandoned.

**Counsel:** Michael Traynor, Cooley, Godward, Castro, Huddleson & Tatum, San Francisco, California, for the plaintiffs-appellants.

Robert A. Van Nest, Kecker & Van Nest, San Francisco, California, for defendant-appellee General Electric.

Charles D. Chalmers, Skjerven, Morrill, MacPherson, Franklin & Friel, San Francisco, California, for defendant-appellee Burton.

**Judges:** Before: Betty B. Fletcher, Cecil F. Poole, and Diarmuid F. O'Scannlain, Circuit Judges. Opinion by Judge O'Scannlain.

**Opinion by:** DIARMUID F. O'SCANNLAIN

## Opinion

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[\*1154] ORDER AND AMENDED OPINION

O'SCANNLAIN, Circuit Judge:

In reviewing this saga of a debenture offering turned sour, we must decide whether any of the supporting cast on the offeror's side have violated the securities laws. In particular, we must determine [\*\*2] whether the lender in a financial transaction should be considered a "controlling person" of its borrower.

I

We begin with the facts that led up to the debenture offering at issue here as an appeal from a "Final Partial Judgment"

under Federal Rule of Civil Procedure 54(b) which recapped a series of prior orders of the district court granting summary judgments. Jordan Schnitzer, a Portland businessman, hired Bear, Stearns & Co. to locate a profitable corporation which he could purchase and [\*1155] merge with an unprofitable corporation he owned in order to utilize his corporation's net operating loss carryforwards and obtain certain tax benefits. He was directed to Casablanca Industries, Inc., a California manufacturer of ceiling fans.

In December 1988, Schnitzer approached General Electric Capital Corp. ("GE Capital") for financing for a leveraged buyout of Casablanca. After undertaking its own due diligence, GE Capital agreed to provide a bridge loan for the acquisition. One condition of the bridge loan was that the acquired Casablanca would immediately sell \$ 27 million in high-yield subordinated debentures (aka "junk bonds"), which would be used partially to pay down the loan. The bridge [\*\*3] financing would then be replaced with permanent financing by GE Capital. A bridge loan of \$ 53 million to Casablanca Acquisition Corp., a company formed by Schnitzer to make the acquisition, was eventually made in April 1989.

In March 1989, Shearson Lehman Brothers Inc. ("Shearson") was retained to place the subordinated debentures with investors. Shearson prepared a Private Placement Memorandum ("Placement Memorandum") for this purpose. The Placement Memorandum contained various representations about Casablanca including sales projections of \$ 83.3 million and earnings of \$ 8.5 million for fiscal year 1989. Shearson distributed the Placement Memorandum to various institutional investors active in the subordinated debt market.

Elders Finance, Inc. (now known as Paracor Finance, Inc.), Cargill Financial Services Corp., Lutheran Brotherhood, and Farm Bureau Life Insurance Co. (collectively "the Investors") received the Placement Memorandum. During the following weeks, analysts for the Investors performed their own due diligence on the offering. The analysts inspected Casablanca's books, met with its management, visited Casablanca's offices, and had occasional contacts with GE Capital [\*\*4] (the substance of which forms part of this dispute). By early May, the Investors had decided to purchase the debentures.<sup>1</sup> The closing of the deal was delayed until late June, however, by continuing negotiations over its terms.

By June, Schnitzer had successfully completed his tender offer and merged his corporation with Casablanca. In the interim, Casablanca's fortunes had been declining. Casablanca's April sales were only \$ 7.88 million, compared with projections of \$ 10.195 million. May and June sales were also below projections. During this time, Burton Burton was the CEO of Casablanca (though the extent of his involvement in its affairs is disputed), and Jerry Holland was the President.

A Debenture Purchase Agreement ("Purchase Agreement") was eventually negotiated between the Investors and Casablanca. [\*\*5] In the Purchase Agreement, Casablanca represented that "since March 31, 1989, Casablanca has not suffered any Material Adverse Effect." The Investors represented that they "had access to the information [they] requested from [Casablanca]" and that they "made [their] own investment decision with respect to the purchase of the Debentures . . . without relying on any other Person." On June 17, 1989, the parties signed the deal documents. On June 23, the Investors wired \$ 27 million to GE Capital as the escrow agent for the various parties to the transaction.

After its first payment of interest on the debentures in August, Casablanca defaulted. Casablanca filed for bankruptcy a little over a year later in November 1990. The Investors, needless to say, were upset.

In March 1991, the Investors filed suit against everyone involved in the transaction, including Casablanca, GE Capital and Schnitzer, Burton, and Holland (collectively "the defendants"). The Investors claimed (1) primary and secondary violations of section 10(b) and Rule 10b-5 of the Securities Exchange Act of 1934, (2) violations of Oregon Revised Statute § 59.115 (the "Oregon Securities Law"), and (3) common-law torts [\*\*6] of [\*1156] fraud and negligent misrepresentation. The Investors also brought a claim of unjust enrichment against GE Capital alone. The Investors' claims against Casablanca were subject to the bankruptcy stay.<sup>2</sup>

After a round of discovery, the defendants brought motions for summary judgment on the section 10(b) claims. The district court originally rendered a decision on statute of limitations grounds, but reset the hearing on the defendants'

<sup>1</sup> Around this time, GE Capital also hired Valuation Research Corp. ("VRC") to render a solvency opinion on Casablanca. VRC subsequently prepared a June 16, 1989 solvency opinion for the debenture offering.

<sup>2</sup> The Investors' claims against Shearson and VRC were settled early in the proceedings. The Investors' claims against captioned defendants Rand Clark, Dean Ward, and John Pearson (officers of Casablanca) were dismissed at the Investors' request.

motions after Congress altered the statute of limitations.<sup>3</sup> In January 1992, the court orally granted GE Capital's and Burton's motions for summary judgment against the Investors on the merits but denied Holland's motion. The court also denied Schnitzer's motion without prejudice because the Investors had yet to depose him.

[\*\*7] The defendants (other than Schnitzer) next moved for summary judgment on the Oregon Securities Law and common-law claims. In August 1992, the district court orally denied GE Capital's and Burton's motions on the Oregon Securities Law claims, stating: "Bottom line, I think this case is going to have to go to trial at least on the Oregon statutes." The district court granted GE Capital's and Burton's motions against the Investors on the fraud and negligent misrepresentation claims.<sup>4</sup>

In February 1993, Schnitzer re-filed his motion for summary judgment. Among other things, Schnitzer (joined by the other defendants) claimed that the Oregon Securities Law claims were precluded by a New York choice-of-law provision in the debentures. In April 1993, in its Order on Motions, the district court held that the New York choice-of-law provision precluded application of the Oregon Securities Law and therefore dismissed the Oregon [\*\*8] Securities Law claims against all of the defendants, superseding its earlier ruling. Schnitzer had also re-moved for summary judgment on the section 10(b) claims and the common-law claims. Because of the district court's previous rulings in favor of GE Capital and Burton on these claims, the Investors did not oppose Schnitzer's motion, but reserved their right to appeal.

GE Capital next moved for summary judgment on the Investors' unjust enrichment claim against it. In May 1993, the district court orally granted GE Capital's motion.

Finally, the Investors moved for reconsideration of the rulings on the section 10(b) and common-law claims and on the New York choice-of-law ruling. In December 1993, the district court denied the motion.<sup>5</sup> On March 15, 1994, the court entered its Final Partial Judgment pursuant to Federal

Rule of Civil Procedure 54(b), which recapped all of its holdings in the case.

[\*\*9] The Investors timely brought this appeal and make three primary claims. First, they claim that both GE Capital and Burton have committed violations of section 10(b) and Rule 10b-5. Second, they claim that both GE Capital and Burton are secondarily liable as "controlling persons" of Casablanca, who has allegedly also committed violations of section 10(b) and Rule 10b-5. Third, they claim that GE Capital and Burton have violated the Oregon Securities Law, and that the New York choice-of-law clause in the debentures does not preclude them from [\*\*157] bringing this claim. We address each of these claims in turn.

## II

The Investors contend that GE Capital and Burton are primarily liable for violations of section 10(b) and Rule 10b-5 for making affirmative misrepresentations and for failing to disclose material facts about Casablanca's sales. The heart of the Investors' claim is that they were not provided with the negative sales data for the three months immediately prior to the closing.

*HNI* Rule 10b-5(b), enacted under section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), makes it unlawful "to make any untrue statement of a material fact or to omit to state a material fact [\*\*10] necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading." 17 C.F.R. § 240.10b-5(b). The elements of a Rule 10b-5 claim are: (1) a misrepresentation or omission of a material fact, (2) reliance, (3) scienter, and (4) resulting damages. *Bell v. Cameron Meadows Land Co.*, 669 F.2d 1278, 1281 (9th Cir. 1982). If one of these elements is missing, the Investors' claim fails. *Id.*

## A

Regarding GE Capital, both of the first two elements pose significant obstacles to the Investors' claims. As this is an

<sup>3</sup> The district court had grounded its decision that the Investors' § 10(b) claims were time-barred on the Supreme Court's decision in *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350, 115 L. Ed. 2d 321, 111 S. Ct. 2773 (1991). However, Congress shortly thereafter repealed the retroactive effect of *Lampf* by amending the Securities Exchange Act with § 27A, 15 U.S.C. § 78aa-1. The Supreme Court has subsequently held that a portion of this amendment, § 27A(b), is unconstitutional. *See Plaut v. Spendthrift Farm, Inc.*, 131 L. Ed. 2d 328, \_\_U.S. \_\_, 115 S. Ct. 1447 (1995).

<sup>4</sup> The court took no action on the Oregon Securities Law or common-law claims against Holland.

<sup>5</sup> The court, in its Order on Motion for Reconsideration, also noted that the Investors consented to the dismissal of defendant Holland, even though Holland's earlier motion for summary judgment had been denied, so that they could take an appeal from a final judgment on the case as a whole. The district court stayed all proceedings against Holland pending the results of this appeal.

appeal from summary judgment, we will look at the facts underlying these elements in the light most favorable to the Investors. *See Jesinger v. Nevada Federal Credit Union*, 24 F.3d 1127, 1130 (9th Cir. 1994).

1

The heart of the Investors' Rule 10b-5 claim is that GE Capital knew of Casablanca's poor April-June quarter sales results and failed to disclose them. It takes more than mere knowledge, however, to amount to an actionable omission. **HN2** "Rule 10b-5 is violated by nondisclosure only when there is a duty to disclose." *Jett v. Sunderman*, 840 F.2d 1487, 1492 (9th Cir. 1988). "The parties to an impersonal market [**\*\*11**] transaction owe no duty of disclosure to one another absent a fiduciary or agency relationship, prior dealings, or circumstances such that one party has placed trust and confidence in the other." *Id.* at 1493 (citing *Chiarella v. United States*, 445 U.S. 222, 232, 63 L. Ed. 2d 348, 100 S. Ct. 1108 (1980)). A number of factors are used to determine whether a party has a duty to disclose: (1) the relationship of the parties, (2) their relative access to information, (3) the benefit that the defendant derives from the relationship, (4) the defendant's awareness that the plaintiff was relying upon the relationship in making his investment decision, and (5) the defendant's activity in initiating the transaction. *See Jett*, 840 F.2d at 1493.

Canvassing these factors, the relationship between GE Capital and the Investors did not rise to the level at which GE Capital assumed a duty to disclose. First, GE Capital had no relationship with the Investors prior to the debenture transaction. During the transaction, it had no contact whatsoever with two of the Investors (Lutheran Brotherhood and Farm Bureau Life Insurance), and its contact with the other two amounted to a couple of brief face-to-face meetings and a handful [**\*\*12**] of telephone calls. Second, the Investors' access to information was comparable to GE Capital's. After GE Capital funded the bridge loan in April, Casablanca was required to provide daily "Open Sales Order" reports and weekly "Tuesday" reports. Although the Investors did not receive these reports, they had their own channels for information. The Investors, sophisticated institutions with competent analysts, conducted their own due diligence. They also signed representations that they

were provided with all information that they requested, and conceded that such representations were accurate.<sup>6</sup>

[**\*\*13**] [**\*\*1158**] Third, GE Capital certainly benefitted from the Investors' purchase of the debentures by having their exposure on the \$ 53 million unsecured bridge loan effectively reduced. Fourth, GE Capital informed Cargill Financial Services and Elders Finance on more than one occasion and in writing that they could not rely on GE Capital. When GE Capital did provide Elders Finance with a copy of its business survey of Casablanca, it insisted that Elders Finance state in writing that it was not relying on GE Capital. Finally, GE Capital effectively initiated the debenture transaction, because its bridge loan to Schnitzer was conditioned on the debenture offering being made.

Taken together, these factors show that GE Capital initiated a financial transaction from which it stood to benefit. They do not show, however, that GE Capital assumed a relationship of trust and confidence with the Investors. The Investors, in a one-shot deal with GE Capital's participation, were expected to do their own due diligence and were carefully warned not to rely on GE Capital on the limited occasions GE Capital shared information with them. Similarly, in *Jett*, 840 F.2d at 1492-93, we held that a lender to a [**\*\*14**] limited partnership had no duty to disclose to the investors in that partnership where there was no prior relationship between the lender and the investors and the lender did not participate in the transaction in any way that would induce the investors to rely on it. The mere fact that the lender was aware of information regarding the partnership, while the investors were not, did not create a duty. *See also Gray v. First Winthrop Corp.*, 776 F. Supp. 504, 510 (N.D. Cal. 1991) (lender to real estate limited partnership had no duty to disclose to investors in that partnership). In sum, GE Capital cannot be held liable for its alleged omissions because it never had a duty to disclose to the Investors in the first place. Without actionable misrepresentations or omissions, the Investors' claim cannot be pursued.

According to the Investors, GE Capital's employees made several oral misrepresentations to employees of Elders Finance and Cargill Financial Services about Casablanca's

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<sup>6</sup> The Investors allege that Cargill's Jeff Leu requested from Shearson, but was denied, relevant financial reports for April and May. He was given the excuse that Casablanca had been distracted by the leveraged buyout and had not yet prepared the reports. However, Leu also stated: "We were always given access to the people that we wanted to talk to. We would have preferred to have the monthly financial statements that we didn't get, but we thought it was a reasonable position that the company was not able to get those out." In addition, Elders Finance's Thomas Goossens stated that he received all financial material he requested during this period.

performance.<sup>7</sup> For example, at a late April meeting, GE Capital's Steve Read stated that Casablanca was "a good property, a good investment." Similarly, at a meeting in late May, GE Capital's Peter McGurty **[\*\*15]** indicated that "the company was doing very well, and [he] had tremendous enthusiasm for the deal." The Investors also point to a handful of telephone conversations with GE Capital employees. For example, in early May, GE Capital's Jill Bengtson told Elders Finance's Jeffrey Gerstel that Casablanca was performing in accordance with expectations. According to Gerstel, Bengtson also stated that Casablanca would still be able to satisfy various financial covenants in the Purchase Agreement.

Reviewing all of the Investors' evidence, these comments merely show that GE Capital was expressing faith in the deal and optimism about Casablanca's prospects. **HN3** General expressions of optimism of this nature are only actionable as misrepresentations if (1) the statement is not genuinely believed, (2) there is no reasonable basis for such expression, or (3) the speaker is aware of undisclosed facts **[\*\*16]** undermining the statement. *In re Apple Computer Sec. Litig.*, 886 F.2d 1109, 1113 (9th Cir. 1989), *cert. denied*, 496 U.S. 943 (1990).

It is somewhat troubling that while GE Capital was smiling and nodding to the Investors it may have been grimacing in private. At the same time GE Capital's Bengtson was telling Elders Finance's Gerstel that Casablanca was performing in accordance with expectations, Bengtson had also sent a memo to her superior at GE Capital, Scott Lavie, informing him about Casablanca's declining sales. However, the Investors have not introduced evidence that GE Capital lacked at least a reasonable basis for their various representations, even though in hindsight **[\*1159]** they may now appear a little too rosy. GE Capital's Lavie stated that, as of the closing date, GE Capital was "aware that [Casablanca's fan division] itself [would] not attain its full projections, but we also realized on the twelve months year-to-date, the results were not significantly off what was projected."

In addition, the representations the Investors received from GE Capital must be viewed "in light of all the information then available to the market." *In re Convergent Technologies*

*Sec. [\*\*17] Litig.*, 948 F.2d 507, 512 (9th Cir. 1991). On several occasions, the Investors were informed that Casablanca's sales were off, even if they did not hear it from GE Capital. Cargill Financial Service's Jeff Leu stated that he "had heard [from Casablanca] that sales were off slightly, but cash flow was on track." Jouko Tamminen, another of Cargill's analysts, stated: "I think [Casablanca] mentioned that sales for [April] were off, but [they] also mentioned that profitability had not suffered." Likewise, Paul Ocenasek, Lutheran Brotherhood's chief analyst, stated that Shearson told him that "April sales had come in a little weak, but cash flow was on target. And cash flow was back on track, and everything was back on track in May." The Investors were not novices in the financial markets; these statements, although hedged with reassurances, were sufficient to put them on notice that Casablanca's fan sales were not breezing along as usual. In light of all of the information available to them, and the generality of GE Capital's statements, the Investors have failed to demonstrate an issue of material fact as to whether GE Capital made actionable misrepresentations.

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Even if **[\*\*18]** the Investors had succeeded in meeting the first element of a Rule 10b-5 claim, they would also have to demonstrate that they had relied on GE Capital. **HN4** Justifiable reliance "is a limitation on a rule 10b-5 action which insures that there is a causal connection between the misrepresentation and the plaintiff's harm." *Atari Corp. v. Ernst & Whinney*, 981 F.2d 1025, 1030 (9th Cir. 1992) (internal quotation marks omitted).

The Investors have failed to introduce an issue of material fact that they justifiably relied on GE Capital. Significantly, in Section 4.4 of the Purchase Agreement the Investors recited that they were given "access to the information [they have] requested from the Company" and that they "made [their] own investment decision with respect to the purchase of the Debentures . . . without relying on any other Person." Elders Finance's Thomas Goossens conceded that the representations in Section 4.4 were true as of the signing of the Purchase Agreement. These representations do much to defeat the Investors' claims of reliance on GE Capital.<sup>8</sup> In *Bank of the West v. Valley Nat'l Bank of Arizona*, 41 F.3d

<sup>7</sup> The Investors concede that GE Capital had no communications whatsoever with Lutheran Brotherhood and Farm Bureau Life Insurance.

<sup>8</sup> The Investors argue that Section 4.4 is a standard representation designed to qualify the transaction for exemption from registration under SEC Regulation D, 17 C.F.R. §§ 230.501-508. Even if it is - and there is no mention of Regulation D in Section 4.4 - that would not seem to be a reason to discount the substance of the representation the parties made. Otherwise, Regulation D would be reduced to a mere formality.

471, 476 (9th Cir. 1994), in the analogous situation of a [\*\*19] common-law fraud cause of action, a lead bank and a participating bank in a loan to a corporation signed a participation agreement. In the agreement, the participating bank represented that it "independently and without reliance upon any representations of [the lead bank] made and relied upon [its] own credit analysis and judgment." This language, we held, "implies that, to the extent that it did rely on [the lead bank], [the participating bank's] reliance was not justifiable." *Id.* at 478. Further, we held, "the contract could and did control whether such reliance would be 'justifiable' for purposes of a fraud claim." *Id.* Likewise, here, the Investors' contractual representation that they did not rely on any other person goes far to defeat their present claims that they did precisely the opposite and relied on GE Capital.

[\*\*20] In addition, GE Capital agreed to give Elders Finance's analysts a copy of its business survey of Casablanca only after they signed a letter stating that Elders Finance was not relying on GE Capital to "evaluate the merits, risks or value of Casablanca or [\*1160] the Debentures." Elders Finance's Gerstel said he had no problem with signing such a letter. This "non-reliance letter," though broadly worded, may have only applied to the business survey being turned over. Nevertheless, it is indicative of the relationship the parties believed pertained between them.<sup>9</sup>

Taken together, these factors suggest that, regardless of the nature of GE Capital's representations, the Investors did not justifiably rely on them.

Since the Investors [\*\*21] fail to establish either of the first two elements of their Rule 10b-5 claim against GE Capital, we do not reach the remaining two.

B

Our analysis of Burton's role in the transaction is much simpler. Even in its most favorable light, the Investors' evidence of misrepresentations by Burton is virtually

nonexistent. The Investors point to the fact that the projections for Casablanca, which Burton helped prepare, were included in the Placement Memorandum. However, they fail to note that Burton assisted with such projections back in August 1988, long before the leveraged buyout and debenture offering were in the works. The Investors also point to the fact that Roger Wood from Shearson, who was preparing the Placement Memorandum, discussed Casablanca's progress towards its 1989 projections with Burton. However, Wood only stated that he discussed Casablanca's progress with all of Casablanca's management, including Burton, and the substance of Burton's contributions is not explained. In addition, the Investors concede there is no evidence that Burton even reviewed the Placement Memorandum himself.

Regarding omissions, Burton intermittently received the "Open Sales Order" reports and "Tuesday" [\*\*22] reports, which revealed that April and May sales were below projections. Burton stated that, by June 15, "it was a concern" that the fiscal 1989 sales projections would not be met. However, the Investors fail to argue that Burton, as an individual, had a duty to disclose. Given that the Investors have failed to introduce any evidence that they even had contact with Burton on anything relevant to the debenture offering, there is no basis for a determination that Burton had assumed a relationship of trust and confidence with the Investors. Similarly, as the Investors have not shown that they had any meaningful discussions with Burton, their claim that they relied on him fails as well.

In sum, the Investors have failed to show an issue of material fact to get them over two crucial hurdles - actionable misrepresentations or omissions and reliance - to a successful Rule 10b-5 claim against either GE Capital or Burton.<sup>10</sup>

[\*\*23] C

The Investors also brought pendent common-law fraud and negligent misrepresentation claims against the defendants.

Regardless of whether we apply the law of the forum state - California - or the law of the state chosen in the debentures

<sup>9</sup> In addition, other than the business survey, the only hard data prepared by GE Capital that the Investors could have relied on was the set of projections for Casablanca allegedly prepared by GE Capital. However, Elders Finance's Goossens stated that he did not rely on these projections.

<sup>10</sup> The Investors also claim the district court failed to consider their claims under subparts (a) and (c) of Rule 10b-5. The viability of these claims independent of the Investors' Rule 10b-5(b) claims is questionable. *See In re MDC Holdings Sec. Litig.*, 754 F. Supp. 785, 805-06 (S.D. Cal. 1990). Regardless, the Investors have not demonstrated that GE Capital or Burton engaged in a "scheme to defraud" or any "course of business which operates as a fraud." They point only to Professor Joseph Grundfest's testimony that awareness of Casablanca's sales slump could have led to cancellation or repricing of the debentures. This speculation alone is insufficient to make out a claim under subsections (a) or (c).

- New York - the Investors' common-law claims sink or swim with their Rule 10b-5 **HN5** claim. Under New York law, justifiable reliance is an element of both common-law fraud and negligent misrepresentation. *See, e.g., Keywell Corp. v. Weinstein*, 33 F.3d 159 (2d Cir. 1994); *Fane v. Zimmer, Inc.*, 927 F.2d 124, 130 [\*1161] (2d Cir. 1991). The same is true under California law. *See McGonigle v. Combs*, 968 F.2d 810, 817 (9th Cir.), *cert. dismissed*, *Casares v. Spendthrift Farm, Inc.*, 506 U.S. 948, 113 S. Ct. 399, 121 L. Ed. 2d 325 (1992). As discussed above, the Investors have not raised an issue of material fact as to their reliance on either GE Capital or Burton. Therefore, the Investors' common-law claims must fail as well.

The Investors attempt to recast their common-law cause of action as a claim that GE Capital and Burton were liable for *aiding and abetting* Casablanca's common-law fraud.<sup>11</sup> **HN6** Under New York law, aiding and abetting fraud requires a showing [\*\*24] that the defendant "knew or intended to aid" the commission of a fraud. *National Westminster Bank USA v. Weksel*, 124 A.D.2d 144, 511 N.Y.S.2d 626, 629 (N.Y. App. Div.), *appeal denied*, 513 N.E.2d 1307 (1987). Mere inaction is not enough to support aider and abettor liability. *See id.* As the Investors have not shown that GE Capital or Burton took positive steps to advance any alleged fraud by Casablanca, the Investors' new spin on their common-law claims does not save them either.

### III

The Investors claim that GE Capital and Burton are secondarily liable for Casablanca's alleged Rule 10b-5 violations because they were "controlling persons" of Casablanca under section 20(a) of the Securities Exchange [\*\*25] Act of 1934, 15 U.S.C. § 78t(a).

Section 20(a) provides:

**HN8** Every person who, directly or indirectly, controls any person liable under any provision of this chapter or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled

person to any person to whom such controlled person is liable, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.

**HN9** To establish "controlling person" liability, the plaintiff must show that a primary violation was committed and that the defendant "directly or indirectly" controlled the violator. *See Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, 1575 (9th Cir. 1990), *cert. denied*, 499 U.S. 976, 113 L. Ed. 2d 719, 111 S. Ct. 1621 (1991). "In general, the determination of who is a controlling person . . . is an intensely factual question." *Arthur Children's Trust v. Keim*, 994 F.2d 1390, 1396 (9th Cir. 1993). The plaintiff need not show the controlling person's scienter or that they "culpably participated" in the alleged wrongdoing.<sup>12</sup> *Id.* at 1398. If the plaintiff establishes that the defendant is a "controlling [\*\*26] person," then the defendant bears the burden of proving he "acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action." 15 U.S.C. § 78t(a). *See Hollinger*, 914 F.2d at 1575.

Here, a material issue of fact exists as to whether a primary violation was committed by Casablanca, through its President, Holland. The district court denied Holland's [\*\*27] motion for summary judgment on the section 10(b) claims, stating: "He signed the no material adverse change certificate. It seems to me having done that, the remaining issues of liability are one of fact that can't be resolved on summary judgment motion." Whether Holland (and Casablanca) violated Rule 10b-5 is a pending issue in the district court. The question thus becomes whether there [\*\*1162] are issues of material fact as to GE Capital's or Burton's control over Casablanca.

### A

Regarding GE Capital, the Investors have introduced evidence that it had a strong hand in Casablanca's debenture offering. GE Capital's bridge loan to Schnitzer was conditioned on the debenture offering taking place. GE Capital, along with Schnitzer, retained Shearson to market

<sup>11</sup> Although the cases the Investors cite in support of this claim are Rule 10b-5 cases, the Supreme Court recently held that **HN7** there is no cause of action for aider and abettor liability under section 10(b). *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 114 S. Ct. 1439, 128 L. Ed. 2d 119 (1994).

<sup>12</sup> As an initial matter, the Investors claim the district court applied an incorrect legal standard because it apparently believed "culpable participation" was an element of the secondary liability claim. The precise legal standard applied by the district court, either in the oral hearing on January 17, 1992, or in the Final Partial Judgment, cannot be determined. Even if the court did believe "culpable participation" was required, it also found that GE Capital and Burton did not have control over Casablanca. This finding makes the court's additional finding about their culpable participation superfluous.

the debentures. GE Capital may have indirectly contributed to the Placement Memorandum by working with Casablanca's management to come up with "assumptions" for their long-term projections. GE Capital had the right to select the lead investor and exercised its right to select Elders Finance. Finally, GE Capital participated in the drafting and negotiating of the Purchase Agreement.<sup>13</sup>

[\*\*28] However, the Investors have not shown any of the traditional indicia of control of Casablanca in a broader sense. GE Capital had no prior lending relationship with Casablanca. GE Capital did not own stock in Casablanca prior to the closing and did not have a seat on its Board. GE Capital's bridge loan was unsecured by any of Casablanca's assets. In short, there is no evidence that GE Capital exercised any influence whatsoever over Casablanca on a day-to-day basis.

Other courts addressing this situation have been very reluctant to treat lenders as controlling persons of their borrowers. In *Metge v. Baehler*, 762 F.2d 621 (8th Cir. 1985), *cert. denied*, 474 U.S. 1057, 106 S. Ct. 798, 88 L. Ed. 2d 774 (1986), the Eighth Circuit held that Bankers Trust Co., the lender to the primary violator, was not a "controlling person" despite the fact that it was the borrower's primary lender, had the ability to foreclose on loans, held 17-18% of the borrower's stock, and held a controlling block of its subsidiary's stock. Similarly, in *Schlifke v. Seafirst Corp.*, 866 F.2d 935, 948-50 (7th Cir. 1989), the Seventh Circuit held that a bank which was the lender to a primary violator was not a "controlling person" despite [\*\*29] the fact that it had made extensive loans to the borrower and had directed the borrower to sell certain assets to meet its loan obligations.

Here, GE Capital did not come close to having the type of leverage over Casablanca which the *Metge* and *Schlifke* courts found to be inadequate to constitute control. To ignore the overall situation but to separate out specific actions undertaken by Casablanca, as the Investors would have us do, would be an unwarranted expansion of secondary liability under the securities laws. Although the Ninth Circuit has not faced the lender-borrower situation before, it has placed great weight on the overall situation in the "controlling person" inquiry. For example, in *Kaplan v. Rose*, 49 F.3d 1363 (9th Cir. 1994), *cert. denied*, \_\_\_ U.S. \_\_\_,

116 S. Ct. 58 (1995), we stated that *HN10* whether a person is a "controlling person is an intensely factual question, involving scrutiny of the defendant's participation in the day-to-day affairs of the corporation and the defendant's power to control corporate actions." *Id.* at 1382 (internal quotation marks omitted). We did not inquire into the defendant's involvement in an isolated corporate action.

[\*\*30] *See id.*; *see also Arthur Children's Trust*, 994 F.2d at 1397. Similarly, in *Hollinger*, 914 F.2d at 1572 n.16, we cited *HN11* the SEC's definition of "control" as "the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through ownership of voting securities, by contract, or otherwise." 17 C.F.R. § 230.405. As the definition suggests, *HN12* our inquiry must revolve around the "management and policies" of the corporation, not around discrete transactions.

[\*1163] GE Capital did not exercise control over the "management and policies" of Casablanca, nor did it direct its day-to-day affairs in any sense. As we hold that at least some indicia of such control is a necessary element of "controlling person" liability, the Investors cannot sustain a secondary liability claim against GE Capital.

## B

Our analysis of Burton's control over Casablanca shifts perspective from the lender-borrower relationship to the director-corporation relationship. "Although a person's being an officer or director does not create any *presumption* of control, it is a sort of red light." *Arthur Children's Trust*, 994 F.2d at 1396 (quoting 4 [\*\*31] *Loss & Seligman, Securities Regulation* 1724 (1990)) (emphasis in *Loss & Seligman*).

Burton founded Casablanca in 1974, sold it for \$ 30 million in 1981, and returned as CEO and Chairman in 1985. According to a management consultant's report, Holland, Clark, and Ward "managed the company on a day-to-day basis without Burton." However, Burton was "at least consulted on every major decision." By way of summary, the report stated: "Burton is the classic conceptualizer and idea man who leaves behind a long swath of details for someone else to handle."

With respect to Burton's control over the debenture offering itself, Burton was Chairman at the time, even after the

<sup>13</sup> The Investors also submitted the testimony of Professor Joseph Grundfest, a former SEC Commissioner, that GE Capital was a "controlling person" of Casablanca in the debenture transaction for the following reasons: (1) GE Capital required the sale of the debentures and required that the terms of sale be subject to its approval; (2) GE Capital received all of the proceeds from the sale of the debentures; (3) GE Capital had a contractual right, after the closing, to obtain options convertible to up to 60% of Casablanca's shares if no debentures were sold; and (4) GE Capital had a contractual right through two pledge agreements to vote or to sell 100% of Casablanca's shares in the event of a default under the bridge loan agreement.

leveraged buyout. However, Burton was not authorized by Casablanca to act on its behalf in the debenture offering, even though the other officers of the corporation were. Burton knew the debenture offering was taking place, and he understood that the Placement Memorandum "was a disclosure of what the company was all about, were going to do, or whatever private investors want to understand about the company." However, Burton stated that he did not read the Placement Memorandum himself. At 500 pages, he thought it was too [\*\*32] long and too complex. Instead, he gave the Placement Memorandum to Holland to review for accuracy.

In August 1988, Burton did assist Holland and Clark in developing Casablanca's sales projections for fiscal year 1989. However, at the time, there was no way Burton could be aware that the projections would be used in the Placement Memorandum six months later. In addition, Roger Wood from Shearson, who was preparing the Placement Memorandum, did discuss Casablanca's "progress towards its 1989 projections" with Casablanca's management, including Burton. The substance of Burton's contributions is not explained, however. In sum, even in a favorable light, the Investors' evidence of Burton's involvement in the debenture offering is slim.

We find guidance on this question from two other cases addressing an officer or director's status as a "controlling person." In *Arthur Children's Trust*, 994 F.2d 1390, we held that defendant Keim, an officer of the corporation, was a "controlling person" because: (1) he was a member of the Management Committee, which made all significant business decisions; (2) the Committee specifically had the authority to issue the securities which were at issue; [\*\*33] (3) the terms of the securities were determined by the Committee; and (4) he was a vocal and active participant on the Committee. *Cf. Wool v. Tandem Computers Inc.*, 818 F.2d 1433, 1440-42 (9th Cir. 1987) (treating officers of a corporation as controlling persons where they "had direct involvement not only in the day-to-day affairs of Tandem in general but also in Tandem's financial statements in particular"). By contrast, in *Burgess v. Premier Corp.*, 727 F.2d 826, 832 (9th Cir. 1984), this court held that defendant Schrock, a director of the corporation, was not a controlling person because: (1) he was not involved in the corporation's day-to-day business, and (2) he had nothing to do with the preparation of the prospectuses which were at issue.

On a spectrum, Burton's position is much closer to that of the director in *Burgess* than to that in *Arthur Children's*

*Trust*. The Investors have introduced some evidence that Burton was involved in the management of Casablanca, at least on major decisions. However, they have introduced no evidence that Burton exercised direct or indirect control over the debenture offering in any way. Burton was not authorized to act for Casablanca [\*\*34] [\*\*1164] on the matter and was not involved in the preparation of any of the offering materials. Nor have the Investors submitted any evidence that Burton ever discussed the debenture offering with them.

In addition, the same facts that show Burton's control over Casablanca was less than absolute are sufficient to prove his good faith defense as a matter of law in this case. Burton knew that there was a debenture offering, but the Investors have not introduced evidence that he was involved in its workings in any significant way. Thus, Burton did not "directly or indirectly induce the act or acts constituting the violation or cause of action." 15 U.S.C. § 78t(a). *See Kaplan*, 49 F.3d at 1382-83 (holding that the CEO of small company had proved good faith by submitting an uncontradicted affidavit stating that he never directed anyone to make misstatements that he knew to be misleading).

In sum, although the relationships between Casablanca and GE Capital and Casablanca and Burton differed, the result is the same - neither GE Capital nor Burton were "controlling persons."

#### IV

The choice-of-law clause in the debentures provides:

This Debenture shall be construed in accordance with [\*\*35] and governed by the laws of the State of New York, without giving effect to the principles of conflicts of laws thereunder.

The district court held that New York law governed the dispute and precluded the Investors' Oregon Securities Law claims against all of the defendants.<sup>14</sup>

The first step in interpreting the clause is to apply the correct choice-of-law rules. *HNI3* In a federal question action where the federal court is exercising supplemental jurisdiction over state claims, the federal court applies the choice-of-law rules of the forum state - in this case, California. *SEC v. Elmas Trading Corp.*, 683 F. Supp. 743, 747-49 (D. Nev. 1987), *aff'd without opinion*, 865 F.2d 265 (9th Cir. 1988); *see In re Nucorp Energy Sec. Litig.*, 772

<sup>14</sup> The Investors could not bring a comparable claim under New York law as there is no private right of action under the New York Blue Sky Laws. *Vermeer Owners, Inc. v. Guterman*, 78 N.Y.2d 1114, 585 N.E.2d 377, 378, 578 N.Y.S.2d 128 (N.Y. 1991).

F.2d 1486, 1491-92 (9th Cir. 1985) (citing *Klaxon Co. v. Stentor Elec. Mfg. Co.*, 313 U.S. 487, 496, 85 L. Ed. 1477, 61 S. Ct. 1020 (1941)). The California Supreme Court's most recent statement on the issue is *Nedlloyd Lines B.V. v. Superior Court*, 3 Cal. 4th 459, 834 P.2d 1148 (Cal. 1992). In that case, the court held that **HNI4** a choice-of-law clause is binding on the parties to a contract unless: (1) the chosen state does not have a substantial relationship to either the parties or the transaction; or (2) application of the chosen state's law would be contrary to a fundamental policy of a state with a materially greater interest in the particular issue. *See id.* at 1152 (adopting Restatement (Second) of Conflict of Laws § 187 (1971)).

The parties do not dispute that there is a substantial relationship between the transaction and New York. Thus, the issue is whether application of New York law would violate a fundamental policy of Oregon (and, if so, whether Oregon has a materially greater interest in the action). Before reaching this issue, however, there is a threshold question: Does the choice-of-law clause apply to claims against GE Capital, a party that did not sign the debentures?

The Investors argue that the defendants cannot invoke the choice-of-law clause because they **\*\*37** did not sign the debentures, in which the clause appears, or the Purchase Agreement, which also provided the terms of the debenture offering. GE Capital responds that the debentures must be read together with the other transaction documents, several of which GE Capital did sign, and construed as a single agreement. GE Capital relies on the line of cases that enunciate the following principle of contract interpretation: **HNI5** "Documents that relate to the same subject matter and that were executed as part of the same transaction are construed **\*1165** as part of the same instrument." <sup>15</sup> *Parker v. Bankamerica Corp.*, 50 F.3d 757, 763 (9th Cir. 1995). "This rule of interpretation applies even though the parties executing the contracts differ, as long as the several contracts were known to all the parties and were delivered at the same time to accomplish an agreed purpose." *Dakota Gasification Co. v. Natural Gas Pipeline Co. of Am.*, 964

F.2d 732, 735 (8th Cir. 1992) (internal quotation marks omitted), *cert. denied*, 506 U.S. 1048, 113 S. Ct. 965, 122 L. Ed. 2d 121 (1993). As GE Capital points out, the debentures were executed at the same time as the other deal documents, and Section 9.24 of the Purchase Agreement **\*\*38** also incorporates by reference the "exhibits and schedules hereto and the documents and instruments referred to herein." <sup>16</sup> However, the principle of interpretation GE Capital relies upon is simply that - a principle of *interpretation* - and does not mean that contemporaneously executed documents somehow become a single unified contract binding all signatories to all provisions, as GE Capital seems to suggest.

**\*\*39** **HNI6**

A choice-of-law clause, like an arbitration clause, is a contractual right and generally may not be invoked by one who is not a party to the contract in which it appears. *See Britton v. Co-op Banking Group*, 4 F.3d 742, 744 (9th Cir. 1993). There are exceptions to this rule, however. In the analogous situation of arbitration clauses, we have held that "nonsignatories of arbitration agreements may be bound by the agreement under ordinary contract and agency principles." *Letizia v. Prudential Bache Sec., Inc.*, 802 F.2d 1185, 1187 (9th Cir. 1986). <sup>17</sup>

In *Britton*, 4 F.3d 742, the plaintiffs had signed a contract, which contained an arbitration provision, with a corporation. The **\*\*40** defendant corporate officer, who had not signed the contract, sought to invoke the arbitration clause against the plaintiffs. This court held that, because he was not a party to the contract, the defendant could not invoke its protections unless he fit into one of three categories: a third-party beneficiary to the contract, a successor in interest to the contract, or an agent intended to benefit from the clause. 4 F.3d 742 at 745-48. On the third category, the court applied principles of agency law and looked at whether any of the defendant's alleged wrongdoing as an agent or officer of the corporation related to the contract containing the arbitration provision. Although the officer was an agent of the corporation, his alleged wrongdoing was unrelated to

<sup>15</sup> This principle of contract interpretation is equally applicable under New York or California law. *See Gordon v. Vincent Youmans, Inc.*, 358 F.2d 261, 263 (2d Cir. 1965) (applying New York law); *Heston v. Farmers Ins. Group*, 160 Cal. App. 3d 402, 206 Cal. Rptr. 585, 594 (Cal. Ct. App. 1984).

<sup>16</sup> Neither the list of Exhibits nor the list of Schedules contained in the debentures specifically references a contract signed by both GE Capital and the Investors. The only contract which GE Capital and the Investors both signed, the Option Holders Agreement, contains a *California* choice-of-law clause governing the contract.

<sup>17</sup> This rule is "an outgrowth of the strong federal policy favoring arbitration." *Letizia*, 802 F.2d at 1187. The policy in favor of recognizing parties' contractual choice-of-law clauses is also generally considered to be strong. *See, e.g., Cargill, Inc. v. Charles Kowsky Resources, Inc.*, 949 F.2d 51, 55 (2d Cir. 1991).

any provision or interpretation of the contract, and the court held that he had no standing to compel arbitration.

Applying *Britton*'s analysis to this case, GE Capital does not fit into any of the three categories. There is no indication in the debentures that GE Capital was a third-party beneficiary<sup>18</sup> (or a successor in interest), and GE Capital would be the last to argue that it was Casablanca's agent (or vice versa) in [\*\*41] the debenture offering, as this would cut against its "controlling person" arguments.

As for Burton, he was the Chairman of Casablanca at the time of the debenture offering and thus would be Casablanca's agent in most matters and would potentially be able to invoke the choice-of-law clause. However, as noted above, Burton was not authorized by Casablanca to act on its behalf in the debenture offering. Nor did Burton [\*\*1166] as a practical matter act as if he were an agent of Casablanca; as Burton himself argued in the context of the "controlling person" claims, his involvement in the transaction was minimal. In short, there is no indication that Burton was an agent intended to benefit from the choice-of-law clause.

In sum, GE Capital and [\*\*42] Burton, nonsignatories to the contract in which the choice-of-law clause appears, cannot shield themselves with its protections. Therefore, the district court erred in holding that the New York choice-of-law clause precludes the Investors' Oregon Securities Law claims.<sup>19</sup> Nevertheless, we affirm the district court's dismissal of the Investors' Oregon Securities Law claims against GE Capital and Burton substantially for the reasons expressed in Parts II and III with respect to the federal securities law claims. *See Trimble v. City of Santa Rosa*, 49 F.3d 583, 584 (9th Cir. 1995) ("we may affirm on any ground supported by the record").

[\*\*43] Since the Investors have failed to show a genuine issue of material fact regarding actionable misrepresentations or omissions, and since neither GE Capital nor Burton was a "controlling person," we conclude that the Investors are

unable to make successful claims under O.R.S. § 59.115. *See Shivers v. Amerco*, 670 F.2d 826, 831 (9th Cir. 1982) ("Since . . . Oregon . . . chose to enact laws paralleling Rule 10b-5, we think it only logical that [it] intended [ORS § 59.115] to be interpreted consistently with the federal rule."); *Badger v. Paulson Inv. Co., Inc.*, 311 Ore. 14, 803 P.2d 1178, 1182 (Or. 1991) (discussing Oregon's "controlling person" provision in context of federal securities law); *Karsun v. Kelley*, 258 Ore. 155, 482 P.2d 533, 536 (Or. 1971) ("In 1967 the Oregon Blue Sky Law was amended by ORS 59.115(1)(b) to adopt substantially the same terms as set forth in the Federal Security Act of 1933, 15 U.S.C.A. § 771(2).").

v

Section 9.9 of the Purchase Agreement, signed by the Investors, provides:

The Company and Purchasers each hereby irrevocably waive any right it may have to trial by jury in any action, suit, counterclaim or proceeding arising out of or relating to this agreement [\*\*44] or any Debenture or any other document executed in connection therewith.

During the proceedings below, the defendants moved to strike the Investors' jury demand. In its Order on Motions, the district court held that the Investors had waived their right to a jury trial against all defendants.

The Investors again argue that the defendants cannot invoke the jury waiver clause because they were not parties to the Purchase Agreement or the debentures. As with the choice-of-law clause, **HN21** a jury waiver is a contractual right and generally may not be invoked by one who is not a party to the contract.<sup>20</sup> [\*\*45] *See Britton*, 4 F.3d at 744. And, as with the choice-of-law clause, ordinary contract and agency principles do not provide GE Capital or Burton with

<sup>18</sup> **HN17** The law requires a showing that the parties to the contract intended to benefit a third party." *Britton*, 4 F.3d at 745. Here, § 9.19 of the Purchase Agreement clearly indicates that the parties "do not intend the benefits of this Agreement to inure to any third party."

<sup>19</sup> **HN18** O.R.S. § 59.115(1)(a) imposes liability against any person who "sells a security in violation of the Oregon Securities Law." **HN19** O.R.S. § 59.115(1)(b) makes a person liable for selling a security "by means of an untrue statement of a material fact." **HN20** O.R.S. § 59.115(3) provides for derivative liability of every nonselling person who (a) "directly or indirectly controls a seller," and (b) "every person who participates or materially aids in the sale." *See Badger v. Paulson Inv. Co., Inc.*, 311 Ore. 14, 803 P.2d 1178, 1181 (Or. 1991).

<sup>20</sup> The only document to which both GE Capital and the Investors are signatories, the Option Holders Agreement, also contains a jury waiver, though it is limited to disputes arising out of that document or the options which are its subject.

standing to invoke the jury waiver.<sup>21</sup> The Purchase Agreement is no different than the debentures themselves in this respect. Therefore, we reverse the order waiving jury trial.

## VI

Count V of the Investors' Complaint stated a claim, under the heading "Unjust Enrichment," [\*1167] for "equitable subrogation to any and all rights GE Capital has as against Casablanca." The district court dismissed the Investors' claim, stating:

I think the relationships among the parties are really governed by the written agreements, by general principles of fraud connected with the execution and performance of the agreements, and by state and federal securities laws. And I don't think that the broader principles of equity - of unjust enrichment . . . can control over these more specific legal applications.

On appeal, the Investors claim that GE Capital is liable for restitution "for the significant additional value of its enhanced seniority and security."

**HN23** Under both California and New York law, unjust enrichment is an action in quasi-contract, [\*46] which does not lie when an enforceable, binding agreement exists defining the rights of the parties. *Chrysler Capital Corp. v. Century Power Corp.*, 778 F. Supp. 1260, 1272 (S.D.N.Y. 1991) ("Unjust enrichment is a quasi-contract claim, and the existence of a valid and enforceable written contract governing a particular subject matter ordinarily precludes recovery in quasi-contract for events arising out of the subject matter.") (internal quotation marks omitted); see *Metropolitan Elec. Mfg. Co. v. Herbert Constr. Co.*, 183 A.D.2d 758, 583 N.Y.S.2d 497, 498 (App. Div. 1992). *Accord Wal-Noon Corp. v. Hill*, 45 Cal. App. 3d 605, 613, 119 Cal. Rptr. 646 (Ct. App. 1975). Here, the subject matter of the Investors' dispute - the debenture offering - is covered by several valid and enforceable written contracts. The particular subject matter of this claim - the Investors' rights to subrogation on GE Capital's position vis-a-vis Casablanca - is also covered by contract. Section 1.2 of the debentures provides that the right to payment of principal or interest on the debentures is "expressly made subordinate and subject in right of payment . . . to the prior payment in full . . . of the Senior Loan [between GE Capital [\*47] and Casablanca]." This provision expressly precludes the type

of subrogation sought by the Investors - having their rights to payment from Casablanca put ahead of, or on a par with, GE Capital's. As the Investors' rights to payment in relation to other obligations of Casablanca are squarely set out in the debentures, their unjust enrichment claim is precluded.

The Investors argue that they had no valid contract with GE Capital governing their rights to subrogation. Although GE Capital did not sign either the Purchase Agreement or the debentures, the Investors' unjust enrichment claim is governed by contract because (1) the debentures were executed contemporaneously with other deal documents to which GE Capital was a party, (2) the Purchase Agreement and debentures cross-reference these documents, and (3) the parties were well aware that the documents were all part of the debenture transaction. Unlike the choice-of-law and jury waiver clauses, the debentures cover the Investors' rights vis-a-vis GE Capital on this particular issue. Section 1.2 expressly sets out the Investors' rights to payment in relation to other obligations of Casablanca, including the Senior Loan made by GE Capital.

## [\*48] VII

The above discussion has been virtually silent as to one of the defendants in this action, Jordan Schnitzer. This is so because the Investors have failed to present any arguments as to his involvement in the debenture offering.

Schnitzer argues that (1) the Investors waived their right to challenge on appeal the summary judgment in his favor when they consented to entry of judgment on the section 10(b) and common-law claims, and (2) the Investors abandoned these claims by failing to make arguments in their opening brief.

Because the district court had previously granted summary judgment for the other defendants on the section 10(b) and common-law claims, the Investors filed a "statement of non-opposition" to Schnitzer's motion for summary judgment on these claims. In its Order on Motions, the district court stated: "Plaintiffs do not oppose Schnitzer's motion . . . , but without waiving plaintiffs' right to preserve the issues for appeal. Plaintiffs' non-opposition is accepted

<sup>21</sup> Unlike arbitration clauses, **HN22** courts generally construe jury waivers narrowly. See, e.g., *Pradier v. Elespuru*, 641 F.2d 808, 811 (9th Cir. 1981). Thus, we are even more hesitant to extend the protections of the jury waiver clause to a nonsignatory.

by the court on [\*1168] that basis . . . .” This holding is substantially repeated in the Final Partial Judgment.<sup>22</sup>

[\*\*49] In support of his argument that the Investors are barred from challenging the summary judgment in his favor, Schnitzer relies on the line of cases that hold that an issue will not be heard for the first time on appeal. *See, e.g., Image Technical Serv., Inc. v. Eastman Kodak Co.*, 903 F.2d 612, 615 n.1 (9th Cir. 1990), *aff’d*, 504 U.S. 451, 119 L. Ed. 2d 265, 112 S. Ct. 2072 (1992). However, this is a case where the Investors consented to entry of summary judgment by the district court, not a case where they failed to raise a particular argument in opposition. In the analogous situation of consent judgments, *HN24* we have “followed the practice of looking at the language of the consent judgment and other evidence in the record to determine whether a party may appeal following an order entered by consent.” *Blair v. Shanahan*, 38 F.3d 1514, 1521 (9th Cir. 1994), *cert. denied*, \_\_\_U.S. \_\_\_, 115 S. Ct. 1698, 131 L. Ed. 2d 561 (1995); *see also Shores v. Sklar*, 885 F.2d 760, 762 (11th Cir. 1989) (“The law is clear that consent to entry of judgment without reservation of the right to appeal a particular claim bars an appeal.”), *cert. denied*, 493 U.S. 1045, 107 L. Ed. 2d 838, 110 S. Ct. 843 (1990). Here, it is clear that at least the Investors and the district court [\*\*50] believed they had reserved the right to appeal. The bigger problem, however, is that the Investors failed to make their arguments on appeal.

“It is well established in this Circuit that *HN25* claims which are not addressed in the appellant’s brief are deemed abandoned.” *Collins v. City of San Diego*, 841 F.2d 337, 339 (9th Cir. 1988). The Investors make no argument whatsoever that there are issues of material fact regarding Schnitzer’s liability for violations of section 10(b) or for the common-law claims. The only relevant mention of Schnitzer in the Investors’ opening brief is the Investors’ concession that their arguments pertain only to GE Capital and Burton and not to Schnitzer.<sup>23</sup> Thus, the Investors’ section 10(b) and common-law claims against Schnitzer must be deemed abandoned.

[\*\*51] VIII

For the above reasons, we hold that summary judgment was properly granted for GE Capital and Burton on both the Investors’ primary liability claims under section 10(b) and Rule 10b-5 and their secondary liability claims under section 20(a). Although we hold that the district court erred in concluding that the New York choice-of-law clause precludes the Investors’ Oregon Securities Law claims, we affirm the district court’s dismissal of the Oregon Securities Law claims. We also hold that summary judgment was properly granted for GE Capital on the Investors’ unjust enrichment claims. We hold that the Investors have abandoned their claims against Schnitzer. Finally, we hold that the district court erred in enforcing the jury waiver clause. The Final Partial Judgment of the district court is therefore affirmed in substantial part, reversed only with respect to the jury waiver issue, and remanded.

AFFIRMED in substantial part, REVERSED in one respect, and REMANDED. Each side to bear its own costs.

ORDER

The panel has voted to deny appellant’s petition for rehearing and to reject the suggestion for rehearing en banc.

The full court has been advised of the suggestion for rehearing [\*\*52] en banc and no active judge has requested a vote on whether to rehear the matter en banc. Fed. R. App. P. 35.

The petition for rehearing is denied and the suggestion for rehearing en banc is rejected.

The opinion filed on March 13, 1996 at slip op. 3483 is amended as follows:

slip op. at 3519, please replace last sentence of final paragraph in text with the following:

The Final Partial Judgment of the district court is therefore affirmed in substantial part, reversed only with respect to the jury waiver issue, and remanded.

<sup>22</sup> The Investors now claim that the court’s entry of judgment was “technically in error, and the court should have left those claims unresolved pending appeal.” However, the Investors themselves consented to entry of judgment for Schnitzer. If they later decided they did not like the judgment, they could have filed a motion under Rule 60 of the Federal Rules of Civil Procedure for relief from that portion of the judgment. As the Investors did not raise this objection before the district court, they have waived it on appeal. *See Telco Leasing, Inc. v. Transwestern Title Co.*, 630 F.2d 691, 693 (9th Cir. 1980).

<sup>23</sup> The Investors respond that they failed to argue the claims against Schnitzer because the district court never addressed them on their merits. Of course, the reason the court did not address them on the merits is that the Investors consented to entry of summary judgment. To allow the Investors to keep Schnitzer in this litigation at this point would be to drag him along as a defendant even though arguments establishing his liability have never been advanced.

96 F.3d 1151, \*1168; 1996 U.S. App. LEXIS 24726, \*\*52

slip op. at 3520, replace final two lines with the following: No further petitions for rehearing will be entertained.

AFFIRMED in substantial part, REVERSED in one respect,  
and REMANDED. Each side to bear its own costs.

# APPENDIX 17

## Zoslaw v. MCA Distributing Corp.

United States Court of Appeals for the Ninth Circuit

November 9, 1981, Argued and Submitted ; December 1, 1982

Nos. 80-4330, 80-4429

### Reporter

693 F.2d 870; 1982 U.S. App. LEXIS 23681; 1982-83 Trade Cas. (CCH) P65,078

CHARLES ZOSLAW AND JANE ZOSLAW husband and wife, dba MARIN MUSIC CENTRE, Plaintiff-Appellants, v. MCA DISTRIBUTING CORPORATION, DOUG ROBERTSON ADVERTISING, INC., MTS, INC., TOWER ENTERPRISES, INC., WARNER/ELEKTRA/ATLANTIC CORPORATION, ABC RECORDS, INC., POLYGRAM DISTRIBUTION, INC., CAPITOL RECORDS, INC. and CAPITOL INDUSTRIES-EMI, Defendants-Appellees

**Prior History:** [\*\*1] Appeal from the United States District Court for the Northern District of California. Honorable Robert F. Peckham, Chief Judge, Presiding.

### Core Terms

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distributors, retailers, commerce, sales, district court, records, conspiracy, prices, tapes, appellants', Oil, manufactured, summary judgment, appellees, sections, interstate, warehouse, customers, out of state, predatory, buyer, cases, granting summary judgment, monopolization, antitrust, purchases, terms, jurisdictional, services, chain store

### Case Summary

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#### Procedural Posture

Appellants, record store owners, sought review of an order of the United States District Court for the Northern District of California, granting summary judgment in favor of appellees on claims under the Sherman Antitrust Act, 15 U.S.C.S. § 1, and the Robinson-Patman Act, 15 U.S.C.S. § 13(a), (d), and (e).

#### Overview

Appellants, former owners of a retail record store, sought review of orders granting summary judgment in favor of appellees, record distributors, retailer, and an advertiser, on various antitrust claims relating to appellants' inability to compete with large retailers. Appellants failed to satisfy the

"in commerce" requirement of the Robinson-Patman Act, 15 U.S.C.S. § 13(a), (d), and (e), and there was no private right of action under the Act for other claims. There was no evidence of conspiracies to restrain trade and no reasonable factual inference in support of claims of monopolization under the Sherman Act, 15 U.S.C.S. § 1. On appeal, the court reversed the district court's ruling as to the Robinson-Patman claims except as to the appellee advertiser, finding that summary judgment as to the other appellees was premature. The court affirmed summary judgment as to the Sherman Act claims of unreasonable restraint of trade based on vertical or horizontal conspiracy, attempted monopolization, and refusal to deal.

#### Outcome

The court affirmed the lower court's ruling granting summary judgment as to the Sherman Act claims and reversed and remanded as to the Robinson-Patman claims except as to defendant advertising company, finding summary judgment premature because there were genuine issues of material fact regarding threshold issues of jurisdiction.

### LexisNexis® Headnotes

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Antitrust & Trade Law > Robinson-Patman Act > General Overview

Antitrust & Trade Law > Robinson-Patman Act > Claims

Antitrust & Trade Law > Robinson-Patman Act > Jurisdiction

Civil Procedure > ... > Subject Matter Jurisdiction > Jurisdiction Over Actions > General Overview

**HNI** To prove jurisdiction under § 2(a) of the Robinson-Patman Act, a plaintiff must demonstrate: (1) that the defendant is engaged in interstate commerce; (2) that the price discrimination occurred "in the course of such commerce; and (3) that either or any of the purchases involved in such discrimination are in commerce.

Antitrust & Trade Law > Robinson-Patman Act > General Overview

Antitrust & Trade Law > Robinson-Patman Act > Claims

**HN2** See § 2(a) of the Robinson-Patman Act, 15 U.S.C.S. § 13(a).

Antitrust & Trade Law > Robinson-Patman Act > General Overview

Antitrust & Trade Law > Robinson-Patman Act > Claims

Antitrust & Trade Law > Robinson-Patman Act > Coverage > Commerce Requirement

Antitrust & Trade Law > Robinson-Patman Act > Jurisdiction

Civil Procedure > ... > Subject Matter Jurisdiction > Jurisdiction Over Actions > General Overview

**HN3** The jurisdictional "in commerce" language in § 2(a) of the Robinson-Patman Act, 15 U.S.C.S. § 13(a) is not as broad as the "affecting commerce" language in the Sherman Antitrust Act, 15 U.S.C.S. § 1. In particular, the court interpreted the "purchases . . . in commerce" requirement as limiting the section's application to cases where at least one of the two transactions which, when compared generate a discrimination across a state line.

Antitrust & Trade Law > Robinson-Patman Act > General Overview

Antitrust & Trade Law > Robinson-Patman Act > Claims

Antitrust & Trade Law > Robinson-Patman Act > Coverage > Commerce Requirement

Contracts Law > Types of Commercial Transactions > Sales of Goods > General Overview

**HN4** If goods from out of state are still within the practical, economic continuity of the interstate transaction at the time of the intrastate sale, the latter sale is considered "in commerce" for purposes of the Robinson-Patman Act, 15 U.S.C.S. § 13(a).

Antitrust & Trade Law > Robinson-Patman Act > General Overview

Contracts Law > Types of Commercial Transactions > Sales of Goods > General Overview

**HN5** Under the traditional intent test, the flow of commerce ends when goods reach their intended destination. In gauging the point of destination courts consider whether goods coming from out of state respond to a particular customer's order or anticipated needs. If so, the sales meet the "in commerce" requirement even though the goods may be stored in a warehouse before actual sale to the buyer. However, goods leave the stream of commerce when they

are stored in a warehouse or storage facility for general inventory purposes, that is, with no particular customer's needs in mind.

Antitrust & Trade Law > Robinson-Patman Act > General Overview

Contracts Law > Types of Commercial Transactions > Sales of Goods > General Overview

**HN6** The analysis of intent is useful in determining whether the initial sale from the out of state producer bears sufficient relationship to the subsequent allegedly discriminatory sale to conclude that the latter sale, is part of a continuous interstate transaction and hence in commerce. Conversely, where a producer simply moves goods manufactured out of state into the state and resells at the allegedly discriminatory price, there is no intermediate sale to break the flow of commerce.

Antitrust & Trade Law > Robinson-Patman Act > General Overview

**HN7** Interstate producers of goods produced out of state do not meaningfully interrupt the flow of commerce by simply storing them in the state of eventual sale.

Antitrust & Trade Law > Robinson-Patman Act > General Overview

Antitrust & Trade Law > Robinson-Patman Act > Claims

Antitrust & Trade Law > Exemptions & Immunities > Robinson-Patman Act Exemptions

Antitrust & Trade Law > Robinson-Patman Act > Jurisdiction

Civil Procedure > ... > Subject Matter Jurisdiction > Federal Questions > General Overview

Contracts Law > ... > Sales of Goods > Title, Creditors & Good Faith Purchasers > Passing of Titles

**HN8** Sales to wholly owned subsidiaries engaged in production do not necessarily remove such transactions from jurisdiction under the Robinson-Patman Act. 15 U.S.C.S. § 13. Therefore, as to sales by parent corporations to warehouses, the United States Court of Appeal for the Ninth Circuit examines the extent to which the subsidiaries acted as independent distributors in their pricing and marketing decisions, in effect, breaking the flow of commerce between the manufacturer and the local retailer. Such threshold issues of jurisdiction are normally questions of fact for the jury to resolve.

Antitrust & Trade Law > Robinson-Patman Act > General Overview

Civil Procedure > ... > Subject Matter Jurisdiction > Federal Questions > General Overview

**HN9** The principle of de minimis is usually appropriate in the light of a finding going to the substance of the action itself that a claimed price discrimination did not substantially lessen competition as required by the statute. However, in several instances courts have made de minimis findings regarding jurisdiction under the Act.

Antitrust & Trade Law > Robinson-Patman Act > General Overview

**HN10** In a "secondary line" case one buyer complains of discriminatory treatment between itself and another buyer. In such a case, the only relevant sales are those between the competing buyers. Out of state sales made by the distributors are irrelevant in this case since they were not made to stores competing with appellants.

Antitrust & Trade Law > Regulated Practices > Price Discrimination > Promotional Allowances & Services

Antitrust & Trade Law > Robinson-Patman Act > General Overview

**HN11** See 15 U.S.C.S. §§ 13(d), (e).

Antitrust & Trade Law > Robinson-Patman Act > General Overview

Antitrust & Trade Law > Robinson-Patman Act > Claims

Antitrust & Trade Law > Robinson-Patman Act > Coverage > General Overview

Antitrust & Trade Law > Robinson-Patman Act > Jurisdiction

Civil Procedure > ... > Subject Matter Jurisdiction > Federal Questions > General Overview

**HN12** Sections 2(d) and 2(e) of the Robinson-Patman Act, 15 U.S.C.S. § 13(d) and (e), were enacted to prevent sellers from circumventing § 2(a), 15 U.S.C.S. § 13(a) by discriminating between buyers in respects other than price. It would therefore be incongruous to hold that those sections go beyond the coverage of § 2(a). There are decisions to the contrary, but in general cases have concluded that §§ 2(d) and 2(e) have the same jurisdictional limitation as § 2(a).

Antitrust & Trade Law > Regulated Practices > Price Discrimination > Buyer Liability

Antitrust & Trade Law > Robinson-Patman Act > General Overview

Antitrust & Trade Law > Robinson-Patman Act > Claims

Antitrust & Trade Law > Robinson-Patman Act > Coverage > Commerce Requirement

**HN13** Section 2(f) of the Robinson-Patman Act, 15 U.S.C.S. § 13(f), makes it unlawful for a buyer engaged in commerce, in the course of such commerce, knowingly to induce or receive a discrimination in price which is prohibited by this section.

Antitrust & Trade Law > Regulated Practices > Price Discrimination > Buyer Liability

Antitrust & Trade Law > Robinson-Patman Act > General Overview

Antitrust & Trade Law > Robinson-Patman Act > Claims

**HN14** A buyer does not violate § 2(f) of the Robinson-Patman Act, 15 U.S.C.S. § 13(f), in receiving a discrimination in price unless the discrimination is unlawful under § 2(a).

Antitrust & Trade Law > Regulated Practices > Price Discrimination > Buyer Liability

Antitrust & Trade Law > ... > Private Actions > Standing > Robinson-Patman Act

Antitrust & Trade Law > ... > Private Actions > Standing > Sherman Act

Antitrust & Trade Law > Robinson-Patman Act > General Overview

Antitrust & Trade Law > Robinson-Patman Act > Claims

Civil Procedure > ... > Subject Matter Jurisdiction > Federal Questions > General Overview

**HN15** Unlike section 2(f) of the Robinson-Patman Act, 15 U.S.C.S. § 13(f), sections 2(d) and 2(e), 15 U.S.C.S. § 2(d) and (e) do not provide for a buyer's liability for receiving enumerated benefits. Consequently, there is no private right of action against buyers for violating those sections.

Antitrust & Trade Law > Regulated Industries > Communications > Sherman Act

Antitrust & Trade Law > Sherman Act > General Overview

Civil Procedure > ... > Summary Judgment > Entitlement as Matter of Law > General Overview

**HN16** The Supreme Court has admonished lower federal courts to proceed with caution in considering summary judgment in antitrust cases. However, the Court has also indicated that clever pleading does not entitle an antitrust claimant to a trial with no regard for Fed. R. Civ. P. 56.

Civil Procedure > ... > Summary Judgment > Entitlement as Matter of Law > General Overview

Civil Procedure > ... > Summary Judgment > Entitlement as Matter of Law > Legal Entitlement

**HN17** Under Fed. R. Civ. P. 56, summary judgment is appropriate where the record before the court on the motion reveals the absence of any material issue of fact and where the moving party is entitled to judgment as a matter of law.

Civil Procedure > ... > Summary Judgment > Burdens of Proof > General Overview

**HN18** The burden of demonstrating the absence of an issue of material fact lies with the moving party. The opposing party must then present specific facts demonstrating that there is a factual dispute about a material issue.

Civil Procedure > ... > Summary Judgment > Supporting Materials > General Overview

Civil Procedure > ... > Summary Judgment > Supporting Materials > Affidavits

Evidence > Authentication > General Overview

**HN19** To meet the requirements of Fed. R. Civ. P. 56 as supplemented by the Local Rules of the United States District Court for the Northern District of California, materials are required to be authenticated by affidavits or declarations of persons with personal knowledge through whom they could be introduced at trial.

Civil Procedure > ... > Summary Judgment > Opposing Materials > General Overview

Evidence > ... > Testimony > Examination > General Overview

**HN20** A party may not prevail in opposing a motion for summary judgment by simply overwhelming the district court with a miscellany of unorganized documentation.

Civil Procedure > ... > Summary Judgment > Burdens of Proof > General Overview

Civil Procedure > ... > Summary Judgment > Supporting Materials > General Overview

**HN21** Once the allegations of conspiracy made in the complaint are rebutted by probative evidence supporting an alternative interpretation of a defendant's conduct, if the plaintiff then fails to come forward with specific factual support of its allegations of conspiracy, summary judgment for the defendants becomes proper.

Antitrust & Trade Law > Sherman Act > General Overview

**HN22** The courts require that the plaintiff demonstrate that allegedly parallel acts were against each conspirator's self interest, that is, that the decision to act was not based on a good faith business judgment.

Antitrust & Trade Law > Sherman Act > General Overview

Business & Corporate Law > Distributorships & Franchises > Causes of Action > Restraints of Trade

**HN23** Evidence indicated that the distributors gave chain retailers discounts because of claims by the large retailers that they were receiving lower prices from the distributors' competitors and that failure to reduce price would adversely affect the retailers' merchandising of the distributor's records. Such evidence does not indicate a conspiracy to favor large record stores. In fact, the Sherman Act, 15 U.S.C.S. § 1, is intended to encourage such competition between sellers.

Antitrust & Trade Law > ... > Monopolies & Monopolization > Conspiracy to Monopolize > General Overview

Criminal Law & Procedure > ... > Inchoate Crimes > Conspiracy > Elements

**HN24** In the absence of any common motivation, the court concluded that there existed no grounds for inferring a conspiracy.

Antitrust & Trade Law > ... > Monopolies & Monopolization > Conspiracy to Monopolize > General Overview

Criminal Law & Procedure > ... > Inchoate Crimes > Conspiracy > Elements

**HN25** In the absence of any indication of agreement or consent to an illegal arrangement, evidence of industry meetings is not sufficient to prove a conspiracy.

Antitrust & Trade Law > ... > Price Discrimination > Competitive Injuries > Secondary & Tertiary Line Injuries

Antitrust & Trade Law > Robinson-Patman Act > General Overview

Antitrust & Trade Law > Robinson-Patman Act > Claims

Antitrust & Trade Law > Sherman Act > General Overview

**HN26** Price discrimination between individual buyers and sellers which would ordinarily form the basis of a secondary-line case under the Robinson-Patman Act, 15 U.S.C.S. § 13, is also a violation of section 1 of the Sherman Act, 15 U.S.C.S. § 1. Yet the courts have held that such an agreement, without proof of an arrangement to exclude others from the buyer's market, does not give rise to a section 1 claim.

Antitrust & Trade Law > ... > Actual Monopolization > Anticompetitive & Predatory Practices > Predatory Pricing

Antitrust & Trade Law > ... > Price Discrimination > Competitive Injuries > Primary Line Injuries

Antitrust & Trade Law > ... > Price Discrimination > Competitive Injuries > Secondary & Tertiary Line Injuries

Antitrust & Trade Law > Robinson-Patman Act > General Overview

Antitrust & Trade Law > Robinson-Patman Act > Claims

Antitrust & Trade Law > Sherman Act > General Overview

**HN27** A predatory pricing claim may form the basis of both a primary-line case under the Robinson-Patman Act, 15 U.S.C.S. § 13, alleging injury to another seller and a claim under section 2 of the Sherman Act, 15 U.S.C.S. § 1, since both statutory provisions are directed at the same evil and have the same substantive content.

Antitrust & Trade Law > Sherman Act > General Overview

**HN28** Vertical arrangements are not a per se violation of section 1. Such agreements do not violate section 1 unless they are found to be unreasonable. The reasonableness inquiry is directed to a balancing of the competitive evils of the restraint against the anticompetitive benefits asserted on its behalf.

Antitrust & Trade Law > Regulated Practices > Price Discrimination > General Overview

Antitrust & Trade Law > Robinson-Patman Act > General Overview

Antitrust & Trade Law > Robinson-Patman Act > Claims

Antitrust & Trade Law > Sherman Act > General Overview

**HN29** The Supreme Court has recognized that the price discrimination which results where buyers seek competitive advantage from sellers encourages the aims of the Sherman Act, a respect in which the Sherman Act, 15 U.S.C.S. § 1 is inconsistent with the aims of the Robinson-Patman Act, 15 U.S.C.S. § 13.

Antitrust & Trade Law > ... > Monopolies & Monopolization > Attempts to Monopolize > General Overview

Antitrust & Trade Law > ... > Monopolies & Monopolization > Attempts to Monopolize > Elements

Antitrust & Trade Law > ... > Monopolies & Monopolization > Attempts to Monopolize > Sherman Act

Antitrust & Trade Law > Sherman Act > General Overview

Antitrust & Trade Law > Sherman Act > Claims

Criminal Law & Procedure > ... > Acts & Mental States > Mens Rea > Specific Intent

**HN30** An attempted monopoly claim under section 2 of the Sherman Act, 15 U.S.C.S. § 2, consists of three elements: (1) a specific intent to control prices or destroy competition in some part of commerce; (2) predatory or anticompetitive conduct directed to accomplishing the unlawful purpose; and (3) a dangerous probability of success.

Antitrust & Trade Law > ... > Monopolies & Monopolization > Attempts to Monopolize > General Overview

Antitrust & Trade Law > Sherman Act > General Overview

**HN31** Intent to monopolize may be inferred from anticompetitive conduct but to carry such a burden the conduct must fall into one of two categories, either (1) conduct forming the basis for a substantial claim of restraint of trade, or (2) conduct that is clearly threatening to competition or clearly exclusionary. In either case the conduct must be such that its anticompetitive benefits are dependent upon its tendency to discipline or eliminate competition and thereby enhance the long-term ability to reap the benefits of monopoly power. 1030. In turn, the dangerous probability of success requirement, which is usually although not necessarily, associated with market power may be inferred from direct evidence of intent implemented by conduct, or conduct alone of the sort described above, from which intent may be inferred.

Antitrust & Trade Law > ... > Actual Monopolization > Anticompetitive & Predatory Practices > General Overview

**HN32** A predatory price exists where the firm foregoes short-term profits in order to develop a market position such that the firm can later raise prices and recoup profits.

Antitrust & Trade Law > ... > Actual Monopolization > Anticompetitive & Predatory Practices > General Overview

Antitrust & Trade Law > Sherman Act > General Overview

**HN33** A plaintiff might be able to prove a predatory pricing claim without showing that the defendant priced below its average variable cost, or even possibly below its average total cost. However, in such instances it is the plaintiff's burden to prove that the defendant sacrificed greater profits or incurred greater losses than necessary in order to eliminate the plaintiff.

Antitrust & Trade Law > ... > Price Fixing & Restraints of Trade > Horizontal Refusals to Deal > General Overview

Antitrust & Trade Law > Sherman Act > General Overview

Civil Procedure > ... > Summary Judgment > Entitlement as Matter of Law > General Overview

Civil Procedure > ... > Summary Judgment > Entitlement as Matter of Law > Appropriateness

**HN34** The United States Court of Appeals for the Ninth Circuit has previously held that a party may refuse to deal with another provided there is no effect which contravenes the antitrust laws. In such cases, the adverse effects of the termination on the party refused are not relevant when the refusal is for business reasons which are sufficient to the defendant in the absence of any agreement restraining trade. Such a determination is not appropriate for summary judgment where there is a material issue of fact regarding the defendant's unlawful intent or the anticompetitive effect of its action.

Antitrust & Trade Law > Regulated Practices > Price Fixing & Restraints of Trade > General Overview

Antitrust & Trade Law > Sherman Act > General Overview

**HN35** An acknowledged purpose of avoiding future litigation whose costs would exceed the benefits from doing business with a customer qualifies as a legitimate business reason for refusing to deal.

**Counsel:** For Zoslaw: Maxwell Keith, Esq., Keith & Duryea, San Francisco, California, for Appellant.

For WEA: M. Laurence Popofsky, Esq., Heller, Ehrman, White & McAuliffe, San Francisco, California, for MTS & Tower: Melvin R. Goldman, Esq., Morrison & Foerster, M. Laurence Popofsky, Esq., Melvin, R. Goldman, Esq., for Doug Robertson Advertising: Charles F. Gray, Jr., Esq., Gray & Thurn, Sacramento, California, for ABC Records: Alf R. Bandin, Lillickm McHose & Charles, San Francisco, California, for Capitol Records & Capitol Indiana, Emi, Inc. George A. Cumming, Jr., Esq., Brobeck, Phleger & Harrison, San Francisco, California, for Polygram, John Curran Ladd, Esq., Steinhart, Ladd & Jubelirer, San Francisco, California, For MCA: William Billick, Esq., Rosenfeld, Heyer & Susman, Beverly Hills, California, for Appellees.

**Judges:** Bazelon, \* Skopil and Poole, Circuit Judges.

**Opinion by:** POOLE

## Opinion

[\*\*2] [\*874] POOLE, Circuit Judge:

This is an appeal by Charles and Jane Zoslaw, the former owners of a retail record store, from a series of orders entered by the district court granting summary judgment in favor of appellee record distributors: Warner/Elektra/Atlantic Corporation (WEA); MCA Distributing Corporation (MCA), Polygram Distribution, Inc. (Polygram),<sup>1</sup> [\*\*3] ABC Records, Inc. (ABC) and Capitol Records, Inc. and its parent corporation, Capitol Industries-EMI (jointly, Capitol), appellee retailer, MTS, Inc. (MTS)<sup>2</sup> and appellee Doug Robertson Advertising, Inc. (Doug Robertson). In this appeal the Zoslaws claim that the district court erred in finding that they had failed to satisfy the "in commerce" jurisdictional requirement of the Robinson-Patman Price Discrimination Act, and in concluding that they had failed to raise an issue of material fact concerning their claims under sections 1 and 2 of the Sherman Antitrust Act. We reverse the district court's ruling as to the Robinson-Patman claims except as to Doug Robertson and affirm as to the Sherman Act claims.

### I. STATEMENT OF CASE

Appellants operated Marin Music Centre, a Mill Valley retail store which sold phonograph records and equipment, prerecorded tapes and related merchandise. They experienced startup losses in 1965 and 1966 and then claimed to have operated at a profit for the following two years. After that period, the store encountered financial difficulties, from which it never recovered, suffering losses from at least 1971 until it went out of business in 1977.

The district court found that during the time the Zoslaws were in business the Marin County record market "changed dramatically." 533 F. Supp. 540, 546 (N.D. Cal. 1980). Several other retail record and tape stores opened in the area and the number of department stores, grocery stores and

\* The Honorable David L. Bazelon, Senior Judge for the United States Court of Appeals for the District of Columbia Circuit, sitting by designation.

<sup>1</sup> Polygram Distribution, Inc. is the company's present name. The company was known as UDC, Inc. between 1971 and 1973, and Phonodisc, Inc. between 1974 and 1977.

<sup>2</sup> At the time of the filing of this action, MTS was the sole shareholder of Tower Enterprises, Inc., doing business as Tower Records. Since that time, Tower Enterprises, Inc. has merged into MTS.

drug stores with record departments also increased. Charles Zoslaw readily admitted that the store suffered losses because [\*\*4] other stores sold records at lower prices.

In January, 1975, appellants filed this action. They subsequently filed three amended complaints adding various defendants and factual contentions. As thus amended the complaint named all of the appellee record distributors: WEA, MCA, Polygram, Capitol and ABC. Several other named distributors, who subsequently settled with appellants, were CBS, Inc., RCA, Inc., Eric-Mainland Distributing Company, United Artists Music and Record Group, Inc. (UAMARGI) and Transamerica Company, the parent corporation of Eric-Mainland and UAMARGI. Appellants alleged that the distributor defendants violated section 2(a) of the Robinson-Patman Act, 15 U.S.C. § 13(a), by selling records and tapes to retail chain stores at lower prices than those offered to single stores, such as Marin Music Centre, and that the distributors violated sections 2(d) and 2(e) of the Act, 15 U.S.C. §§ 13(d) and 13(e), by discriminating in favor of retail chain stores in granting promotional allowances and furnishing special services. They also alleged that the distributor defendants conspired among themselves and with the retailer defendants [\*\*5] to favor the retail chain stores at the expense of individual stores in violation of section 1 of the Sherman Act, 15 U.S.C. § 1.

[\*875] Three retailers were named defendants: MTS, Integrity Entertainment Corporation (IEC), and CBS, Inc., doing business as Discount Records. The latter two subsequently settled. Also named defendant was Doug Robertson Advertising Agency, with which Tower did business. Appellants alleged that the retailers violated sections 2(d), 2(e), and 2(f) of the Robinson-Patman Act, 15 U.S.C. §§ 13(d), 13(e), and 13(f), by knowingly inducing and receiving the alleged discriminations in price and other terms, allowances and services. The retailer defendants were also charged with violating section 1 of the Sherman Act by conspiring with the distributors to receive favorable treatment. Finally, appellants accused MTS with monopolizing or attempting to monopolize the retail record market in violation of section 2 of the Sherman Act.

In the two years after appellants instituted the action, four distributor defendants moved for partial summary judgment

on the ground that the court lacked jurisdiction under Robinson-Patman [\*\*6] because the allegedly discriminatory sales were not "in commerce" as required by that Act. The district court granted each of these motions: in favor of WEA on June 21, 1976, *see Zoslaw v. Columbia Broadcasting System*, 1977-1 Trade Reg. Rep. (CCH) para. 61,756; in favor of Eric-Mainland on July 20, 1976; in favor of CBS on April 18, 1977; and in favor of Polygram (limited to the period 1974 and 1976) on August 17, 1977.<sup>3</sup>

In October, 1977, appellants filed a motion for preliminary injunction to prevent the defendant distributors from favoring chain store retailers and to prevent the defendant retailers from accepting such preferences. The motion also sought to prohibit Capitol Records from refusing [\*\*7] to sell phonograph records, tapes and cassettes to Marin Music Centre. This claim arose when Capitol, shortly after settling with the appellants, ceased selling merchandise to them. Appellants then amended their complaint to reinstate Capitol as a defendant based on its refusal to deal. The district court denied the motion, finding that appellants had failed to demonstrate a likelihood of success on the merits or a showing of irreparable injury.

In September, 1978, the district court granted Capitol's motion for summary judgment on the refusal to deal claim, finding that Capitol had legitimate business reasons for its action.<sup>4</sup> Three of the four remaining distributor defendants, WEA, MCA, and Polygram, as well as MTS and Doug Robertson, then moved for summary judgment on all of the remaining claims against them. In January, 1980, the court granted all of the defendants' pending motions. In its opinion, the district court, held, first, that appellants failed to produce competent evidence to support their factual allegations. The court noted that the appellants' opposition papers "regularly and systematically" violated Rule 56 of the Federal Rules of Civil Procedure as well as [\*\*8] Rule 220-8 of the Local Rules of the Northern District of California. The court observed that most of the documents submitted by appellants with their opposition lacked authentication and that they often failed to support the factual inference for which they had been provided.

The court then ruled that even if appellants had properly supported their factual allegations, summary judgment was

<sup>3</sup> The district court limited the summary judgment to this period because the declaration of Dale Johnson, a Polygram employee, filed in support of the motion, did not demonstrate personal knowledge for the 1971-73 period. The court denied Polygram's motion for the period 1971-73 without prejudice to its renewal.

<sup>4</sup> The court's order effectively removed Capitol as a defendant. However, since Capitol neither requested nor received a separate judgment under Rule 54(b) of the Federal Rules of Civil Procedure, it did not take an appeal until after the court entered final judgment in June, 1980.

still appropriate since they had failed to advance an adequate legal theory of the case. The remaining Robinson-Patman claims were dismissed against two of the distributor defendants, MCA and Polygram, on the finding that appellants had failed to satisfy the "in commerce" requirement of the Act. [\*876] The court also held that it lacked [\*\*9] jurisdiction over appellants' Robinson-Patman claims against MTS and Doug Robertson because the Supreme Court's decision in *Great Atlantic & Pacific Tea Co. v. FTC*, 440 U.S. 69, 99 S. Ct. 925, 59 L. Ed. 2d 153 (1979), precluded jurisdiction under section 2(f) and that there was no private right of action against buyers under sections 2(d) and 2(e).

As for the Sherman Act section 1 claims, the court found no basis in the material submitted by appellants to support any of the claims of conspiracies to restrain trade alleged by appellants, and found no reasonable factual inference in support of appellants' monopolization and attempted monopolization claims against MTS.

In May, 1980, the last remaining defendant, ABC, filed its motion for summary judgment on both the Robinson-Patman and Sherman Act claims. The district court granted this motion and entered judgment in favor of all of the defendants in June, 1980.<sup>5</sup>

[\*\*10] Appellants challenge the district court's findings that the allegedly discriminatory sales were not "in commerce" as required by *Gulf Oil Corp. v. Copp Paving Co.*, 419 U.S. 186, 200, 42 L. Ed. 2d 378, 95 S. Ct. 392 (1974), and therefore not within section 2(a) of the Robinson-Patman Act. Alternatively, they contend that even

if section 2(a) is inapplicable, the court still had jurisdiction over the distributor defendants under sections 2(d) and 2(e), and over MTS and Doug Robertson under section 2(f). As for the Sherman Act, appellants claim that the district court erred in finding no genuine issue of material fact concerning the existence of a conspiracy among distributors and retailers to favor certain chain retailers. They also contend that the district court erred in finding no evidentiary support for their claim that MTS attempted to monopolize trade. Finally, appellants contend that the district court ignored disputed factual issues when it concluded on motion for summary judgment that Capitol's refusal to deal was a unilateral act made for legitimate business reasons.

## II. ROBINSON-PATMAN JURISDICTION

### A. *The Distributor Appellees*

Although the [\*\*11] district court issued several opinions in granting summary judgment on the Robinson-Patman claims involving the distributor appellees, the relevant facts regarding the sales by each appellee can be briefly summarized.

Two of the distributor appellees, WEA and Polygram are wholly owned subsidiaries of corporations engaged in record and tape production.<sup>6</sup> [\*\*12] During the relevant period the other two appellees, ABC and MCA, manufactured and distributed records and [\*877] tapes

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<sup>5</sup> In summary, the appellees in this action include five distributors: WEA, Polygram, Capitol, ABC, and MCA; one retailer, MTS; and Doug Robertson Advertising Agency. Appellants appeal the following rulings with respect to each defendant:

*WEA*: June 21, 1976, CR 311, partial summary judgment on the Robinson-Patman claims. January 17, 1980, CR 808 summary judgment on the Sherman Act claims.

*POLYGRAM*: August 17, 1977, CR 499, partial summary judgment on the Robinson-Patman claims for 1974-76.

January 17, 1980, CR 808, summary judgment on the Robinson-Patman claims for 1971-73 and on Sherman Act claims.

*MCA*: January 17, 1980, CR 808, summary judgment on both the Robinson-Patman and Sherman Act claims.

*CAPITOL*: September 28, 1978, CR 636, summary judgment on the refusal to deal Sherman Act claim.

*ABC*: May 12, 1980, CR 851, summary judgment on both the Robinson-Patman and Sherman Act claims.

*MTS-TOWER & DOUG ROBERTSON*: January 17, 1980, CR 808, summary judgment on both the Robinson-Patman and Sherman Act claims.

<sup>6</sup> WEA is a wholly owned subsidiary of Warner Brothers Records, Inc., which in turn is owned by Warner Communications, Inc. WEA distributes records and tapes manufactured by Warner Brothers Records and two other Warner Communications, Inc. subsidiaries, Elektra Records and Atlantic Records. Polygram is a California corporation distributing records and tapes produced by affiliated corporations, Polygram, Inc. and Polydor International.

nationwide.<sup>7</sup> Each distributor maintained a regional warehouse in California which supplied records and tapes for stores in the San Francisco Bay Area, including MTS and Marin Music Centre. Depending on the distributor involved, each of the warehouses received a varying percentage of records and tapes which were manufactured out of state. For example, WEA's California warehouse received approximately 10% of its records and tapes from out of state, while Polygram's warehouse received approximately 15% of its goods from out of state.<sup>8</sup>

In certain instances, each distributor made "drop shipments" to Bay Area retail record stores. A drop shipment occurred when the distributor's California warehouse was unable to fill an order from a retail store. In that case the distributor would order the out of state manufacturing plant to send a shipment of records or tapes *directly* to the local retailer. Drop shipments occurred infrequently. [\*\*13] For example, MCA calculated its cumulative percentage of dollar sales to the San Francisco Bay Area attributable to drop shipments at 0.44%.

*HNI* To prove jurisdiction under section 2(a) of the Robinson-Patman Act, a plaintiff must demonstrate: (1) that the defendant is "engaged in interstate commerce;" (2) that the price discrimination occurred "in the course of such commerce;" and (3) that "either or any of the purchases involved in such discrimination are in commerce." *William Inglis & Sons Baking Co. v. ITT Continental Baking Co.*, 668 F.2d 1014, 1043 (9th Cir. 1981).<sup>9</sup>

[\*\*14] In *Gulf Oil Corp. v. Copp Paving Co.*, 419 U.S. 186, 42 L. Ed. 2d 378, 95 S. Ct. 392 (1974), the Supreme Court concluded that *HN3* the jurisdictional "in commerce" language in section 2(a) is not as broad as the "affecting

commerce" language in the Sherman Antitrust Act. In particular, the court interpreted the "purchases . . . in commerce" requirement as limiting the section's application to cases "where 'at least one of the two transactions which, when compared generate a discrimination . . . cross[es] a state line.'" 419 U.S. at 200 (quoting *Hiram Walker, Inc. v. A & S Tropical, Inc.*, 407 F.2d 4, 9 (5th Cir.), *cert. denied*, 396 U.S. 901, 24 L. Ed. 2d 177, 90 S. Ct. 212 (1969)). *See Inglis*, 668 F.2d at 1043.

The district court, in applying *Gulf Oil*, concluded that the sales by the distributor appellees were not "in commerce" and that the drop sales were *de minimis* and therefore would not support jurisdiction under section 2(a). Appellants challenge both of these rulings.

1. *Were the Record and Tape Sales to Bay Area Stores "In Commerce?"*

In examining the interstate sales, the [\*\*15] district court recognized that *HN4* if goods from out of state are still within the "practical, economic continuity" of the interstate transaction at the time of the intrastate sale, the latter sale is considered "in commerce" for purposes of the Robinson-Patman Act. *See Hampton v. Graff Vending Co.*, 516 F.2d 100, 102 (5th Cir. 1975) (quoting *Gulf Oil Corp. v. Copp Paving Co.*, 419 U.S. at 195). In determining whether the sales of records here were therefore in the flow of commerce the court relied on the traditional intent test derived [\*\*878] from the Fair Labor Standards Act, and subsequently applied in Robinson-Patman cases.<sup>10</sup> *See Walling v. Jacksonville Paper Co.*, 317 U.S. 564, 570, 87 L. Ed. 460, 63 S. Ct. 332 (1942); *Walker Oil Co. v. Hudson Oil Co.*, 414 F.2d 588, 590 (5th Cir.), *cert. denied*, 396 U.S. 1042, 24 L. Ed. 2d 686, 90 S. Ct. 684 (1969); *Food Basket*,

<sup>7</sup> MCA is a wholly owned subsidiary of MCA Records, Inc. From 1971 to 1979 ABC was a wholly owned subsidiary of American Broadcasting Companies, Inc. In 1979, it went out of business and its assets were sold to MCA.

<sup>8</sup> Although MCA's declaration in support of its motion for summary judgment does not contain any percentage figures on the amount of records and tapes manufactured outside of California, it seems to indicate that a substantial amount of the records in its California warehouse were manufactured in Illinois. ABC's answers to interrogatories indicate that an unidentified percentage of the records and tapes in its California warehouse were manufactured outside of California.

<sup>9</sup> The relevant jurisdictional language in section 2(a) reads:

*HN2* It shall be unlawful for any person engaged in commerce, in the course of such commerce to discriminate in price between different purchasers . . . where either or any of the purchases involved in such discrimination are in commerce.

<sup>10</sup> Appellees argue that *Gulf Oil* superseded the "flow of commerce" test and therefore requires an actual sale across state lines to invoke the Act. However, in *Gulf Oil*, the product sold, asphaltic concrete, was manufactured entirely in state from products obtained intrastate and its market was entirely local. 419 U.S. at 192. Therefore, the Court did not have to address the issue when sales of goods produced in another state are "in commerce."

*Inc. v. Albertson's Inc.*, 383 F.2d 785 (10th Cir. 1967); 4 J. Von Kalinowski, *Antitrust Laws and Trade Regulation* [\*\*16] § 26.02[3] (1969 & Supp. 1981).

[\*\*17] *HN5* Under this approach, the flow of commerce ends when goods reach their "intended" destination. Von Kalinowski, *supra*. In gauging the point of destination courts consider whether goods coming from out of state respond to a particular customer's order or anticipated needs. *Walling*, 317 U.S. at 567-70. If so, the sales meet the "in commerce" requirement even though the goods may be stored in a warehouse before actual sale to the buyer.<sup>11</sup> *Walling*, 317 U.S. at 570; *Hampton*, 516 F.2d at 102-03. However, goods leave the stream of commerce when they are stored in a warehouse or storage facility for general inventory purposes, that is, with no particular customer's needs in mind. *Hampton*, 516 F.2d at 103; *Cliff Food Stores, Inc. v. Kroger, Inc.*, 417 F.2d 203, (5th Cir. 1969).

[\*\*18] In *Walker Oil*, 414 F.2d at 588, for example, the plaintiff service station owner charged the defendant, Hudson Oil, with selling gasoline at a different price at its Florida station than at its Alabama station. Hudson purchased gasoline for the two stations from a supplier in Mobile, Alabama. The Fifth Circuit concluded that since Hudson's purchases from the Alabama supplier for its Florida station were not based on specific needs of retail customers of the service station, the flow of commerce ended when the gasoline was delivered to the station.

The district court here determined from affidavits submitted by appellees that the latter stocked their California warehouses for general inventory purposes depending on a record's anticipated performance, and did not order records

for particular customers. That conclusion is supported by the record, and appellants do not offer serious dispute. Based on this finding, the court held that the subsequent sales to Bay Area retailers were not in the flow of commerce.

This emphasis on intended destination as a key to the statute's coverage has been criticized by some commentators as providing [\*879] a means by which [\*\*19] interstate producers may avoid Robinson-Patman liability by setting up local storage facilities in the secondary states. *See* 1 P. Areeda & D. Turner, *Antitrust Law* para. 233(b) (1978); ABA Antitrust Section, *The Robinson-Patman Act: Policy and Law* 44-45 (1980). On the contrary, the cases relied on by the district court and cited by appellees primarily involve sales by out of state producers to distributors or retailers who then resell the goods intrastate at the allegedly discriminatory price. *See, e.g., Walling*, 317 U.S. at 564; *Food Basket*, 383 F.2d at 785; *Hampton*, 516 F.2d at 100. In such cases *HN6* the analysis of intent is useful in determining whether the initial sale from the out of state producer bears sufficient relationship to the subsequent allegedly discriminatory sale to conclude that the latter sale, is part of a continuous interstate transaction and hence in commerce. *See* P. Areeda & D. Turner, *supra*. Conversely, where a producer simply moves goods manufactured out of state into the state and resells at [\*\*20] the allegedly discriminatory price, there is no intermediate sale to break the flow of commerce. And indeed, it would seem that *Standard Oil Co. v. FTC*, 340 U.S. 231, 95 L. Ed. 239, 71 S. Ct. 240 (1951), in which the Supreme Court held that in state storage of gasoline by an interstate oil producer did not end the flow of commerce, imposes some limit upon the application of the intent rule.

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In fact, however, the court in *Gulf Oil* repeatedly refers to the flow of commerce test. Thus in comparing the Sherman Act and Robinson-Patman Act jurisdictional provisions the Court states:

In contrast to § 1, the distinct "in commerce" language of the Clayton and Robinson-Patman Act provisions with which we are concerned here appears to denote only persons or activities within the flow of interstate commerce -- the practical, economic continuity in the generation of goods and services for interstate markets and their transport and distribution to the customer.

419 U.S. at 195.

Accordingly, courts interpreting section 2(a) after *Gulf Oil* continued to apply the "flow of commerce" analysis. *See L & L Oil Co. v. Murphy Oil Corp.*, 674 F.2d 1113, 1116, (5th Cir. 1982); *Great Atlantic & Pacific Tea Co. v. FTC*, 557 F.2d 971, 979 (2d Cir. 1977), *revd. on other grounds*, 440 U.S. 69, 59 L. Ed. 2d 153, 99 S. Ct. 925 (1979); *Hampton v. Graff*, 516 F.2d 100 (5th Cir. 1975).

<sup>11</sup> The other indicium of intent involves whether goods have been altered or processed in some fashion after their arrival in the state of their eventual sale. Courts have generally held that where goods are processed in some substantial way, the flow of commerce ends when they arrive at the place of alteration. *See Belliston v. Texaco, Inc.*, 455 F.2d 175 (10th Cir.), *cert. denied*, 408 U.S. 928, 33 L. Ed. 2d 341, 92 S. Ct. 2494 (1972); *Baldwin Hills Building Material Co. v. Fibreboard Paper Products Corp.*, 283 F. Supp. 202 (C.D. Cal. 1968); Von Kalinowski, *supra*, at § 26.02[3].

In this case, since the records and tapes were sealed after manufacture, this factor is not relevant.

In *Standard Oil*, the defendant, accused of discriminating in selling oil to Michigan jobbers, refined the oil out of state and then shipped it to its own storage facilities in Michigan from which delivery was made to customers upon individual orders. Although the gasoline rested up to several months in the storage facility, the court held that it remained part of the flow of commerce:

Any other conclusion would fall short of the recognized purpose of the Robinson-Patman Act to reach the operations of large interstate businesses in competition with small concerns. Such temporary storage of the gasoline as occurs . . . does not deprive the gasoline of its interstate character.

340 U.S. at 237-38 (citations omitted). Moreover, the Court [\*21] specifically distinguished the early Fair Labor Standard Act cases, including *Walling*, noting that in those cases "interstate commerce ceased on delivery to a local distributor," while "the sales involved here are those of an interstate producer and refiner to a local distributor." 340 U.S. at 238 n.6.

We interpret *Standard Oil* to indicate that **HN7** interstate producers of goods produced out of state do not meaningfully interrupt the flow of commerce by simply storing them in the state of eventual sale. Viewed in this light we think the district court prematurely granted summary judgment to the appellee distributors. In particular, the declarations and answers to interrogatories submitted by ABC and MCA indicate that both manufactured records and tapes outside of California, which were then placed in California warehouses for eventual sale to retailers. Those actions were not alone sufficient to remove the goods from the stream of commerce.

WEA and Polygram did not themselves manufacture records, but they were wholly owned subsidiaries of companies engaged in record and [\*22] tape production. **HN8** Sales to subsidiaries in such instances do not necessarily remove such transactions from Robinson-Patman jurisdiction. See *Perkins v. Standard Oil Co.*, 395 U.S. 642, 648, 23 L. Ed. 2d

599, 89 S. Ct. 1871 (1969) ("We find no basis for immunizing Standard's price discrimination simply because the product in question passed through an additional formal exchange before reaching the level of Perkin's actual competitor"). Similarly, "passage of title or the terms of shipment, although relevant, do not control." *Hasbrouck v. Texaco, Inc.*, 663 F.2d 930, 934 (9th Cir.1981); *S&M Materials Co. v. Southern Stone Co.*, 612 F.2d 198, 200 (5th Cir.), cert. denied, 449 U.S. 832, 66 L. Ed. 2d 37, 101 S. Ct. 101 (1980).

Therefore, as to the record and tape sales by the parent corporations to the WEA and [\*880] Polygram warehouses in California, we examine the extent to which the subsidiaries acted as independent distributors in their pricing and marketing decisions, in effect, breaking the flow of commerce between [\*23] the manufacturer and the local retailer. See *United States v. American Building Maintenance Industries*, 422 U.S. 271, 285, 45 L. Ed. 2d 177, 95 S. Ct. 2150 (1975); <sup>12</sup> P. Areeda & D. Turner, *supra*, at para. 233(b). Such threshold issues of jurisdiction are normally questions of fact for the jury to resolve. *Hasbrouck*, 663 F.2d at 933. Since the district court did not consider these controlling principles and it appears that there are genuine issues of material fact in dispute regarding their resolution the grants of summary judgment in favor of WEA and Polygram were improper.

[\*24] 2. *De minimis interstate drop sales.*

After finding the sales to Bay Area retailers from the distributors' California warehouses not "in commerce", the district court considered the impact of the interstate drop sales. It held the sales so "scattered and insignificant" that they insufficiently support a Robinson-Patman Act claim. We have ruled that summary judgment was improperly granted as to the sales from the warehouses but to avoid uncertainty on remand, it should be stated that in our view the district court correctly excluded the drop sales as a basis for jurisdiction.

**HN9** The principle of *de minimis* is usually appropriate in the light of a finding going to the substance of the action

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<sup>12</sup> In *American Building Maintenance*, the Supreme Court held that two janitorial service corporations were not "in commerce" as required under section 7 of the Clayton Act. In particular the court rejected the United States' claim the firms' purchases of cleaning equipment manufactured out of state provided jurisdiction:

Those products were purchased in intrastate transactions from local distributors. Once again, therefore, the Benton companies were separated from direct participation in interstate commerce by the pricing and other marketing decisions of independent intermediaries. By the time the Benton companies purchased their janitorial supplies, the flow of commerce had ceased.

422 U.S. at 285. In contrast, here there is a legitimate question of material fact whether the record retailers were in fact insulated from interstate commerce by WEA or Polygram.

itself that a claimed price discrimination did not "substantially lessen" competition as required by the statute. See, e.g., *Hanson v. Pittsburgh Plate Glass Industries, Inc.*, 482 F.2d 220 (5th Cir. 1973), cert. denied, 414 U.S. 1136, 38 L. Ed. 2d 761, 94 S. Ct. 880 (1974). However, in several instances courts have made *de minimis* findings regarding jurisdiction [\*\*25] under the Act. Thus in *Food Basket*, 383 F.2d 785, the court found that certain "drop-sales" of goods from out of state suppliers to a grocery chain were not sufficient to bring the chain under the Act where it received all of its other goods from warehouses located in the state. *Accord Skinner v. United States Steel Corp.*, 233 F.2d 762 (5th Cir. 1956); *Baldwin Hills Building Material Co. v. Fibreboard Paper Products Corp.*, 283 F. Supp. 202 (C.D. Cal. 1968). But see *Von Kalinowski, supra*, at § 26.01[2] (criticizing use of the *de minimis* test for jurisdictional purposes).

Since the district court's decision in this case, we have had occasion to rule on the applicability of the *de minimis* rule to jurisdictional challenges under the Robinson-Patman Act. In *William Inglis*, 668 F.2d 1014, the defendant bakery located in California marketed its bread primarily in state. However, it also made sales to accounts in Nevada. We rejected the contention that the Nevada sales were *de minimis* and therefore insufficient to invoke jurisdiction. While recognizing that interstate sales which were merely [\*\*26] "inadvertent or incidental" to a pattern of intrastate sales might justify application of a *de minimis* rule, 668 F.2d

at 1044 n. 54, we concluded that the sales involved were part of a multi-state marketing operation and therefore not *de minimis*. Id. <sup>13</sup>

[\*\*27] [\*\*881] In contrast the drop sales here were not part of the normal marketing or distribution pattern of the distributors, which, instead focused on supplying Bay Area stores from California warehouses. Drop sales occurred when there were gaps in that distribution system. Given their relative size and sporadic nature the sales appear as an anomaly in the normal distribution pattern. See *Food Basket*, 383 F.2d at 788. We therefore determine that the circumstances here involve the narrow category in which application of *de minimis* principles to jurisdictional questions is appropriate.

### 3. Jurisdiction under Sections 2(d) and 2(e) of the Robinson-Patman Act

Appellants contend that even if section 2(a) does not apply to the distributor appellees, sections 2(d) and 2(e) apply because the jurisdictional test for those sections is more liberal than the standard under section 2(a). <sup>14</sup> Again, while we reverse the summary judgment that there was no jurisdiction under section 2(a), we conclude that the court correctly held that the jurisdictional reach of sections 2(d) and 2(e) goes no further than section 2(a).

[\*\*28] Section 2(d) relates to payments for services or facilities and requires that the seller be "engaged in

<sup>13</sup> Appellants interpret *Inglis* to suggest that any interstate sales by the record distributors here satisfy the Robinson-Patman jurisdictional requirements. However, their reliance on *Inglis* fails to recognize the structural difference between the two cases. *Inglis* was a "primary line" Robinson-Patman case in which the plaintiff alleged that another seller's discriminatory pricing scheme damaged his bakery. As the court in *Inglis* noted, in such a primary line case the relevant sales for jurisdictional purposes include all sales, both intrastate and interstate, reflecting the price disparity since the court is concerned with all sales which allegedly damaged a competitor's business.

*HN10* In contrast, this is a "secondary line" case, in which one buyer complains of discriminatory treatment between itself and another buyer. In such a case, the only relevant sales are those between the competing buyers. *Mayer Paving & Asphalt Co. v. General Dynamics Corp.*, 486 F.2d 763, 767 (7th Cir. 1973), cert. denied, 414 U.S. 1146, 39 L. Ed. 2d 102, 94 S. Ct. 899 (1974); *P. Areeda & D. Turner, supra*, at para. 233(c). Out of state sales made by the distributors are irrelevant in this case since they were not made to stores competing with appellants.

<sup>14</sup> Sections 2(d) and 2(e) of the Robinson-Patman Act, 15 U.S.C. §§ 13(d) and 13(e) provide:

(d) *HN11 Discriminatory payments for services or facilities*

That it shall be unlawful for any person engaged in commerce to pay or contract for the payment of anything of value to or for the benefit of a customer of such person in the course of such commerce as compensation or in consideration for any services or facilities furnished by or through such customer in connection with the processing, handling, sale or offering for sale of any products or commodities manufactured, sold, or offered for sale by such person, unless such payment or consideration is available on proportionally equal terms to all other customers competing in the distribution of such products or commodities.

(e) *Discrimination in furnishing services or facilities*

commerce" and that the payment or benefit be "in the course of such commerce." Section 2(e) covers the furnishing of services or facilities for processing and handling and contains no "in commerce" language. However, it has been held that the omission of such language was inadvertent. *See Elizabeth Arden, Inc. v. FTC*, 156 F.2d 132, 134 (2d Cir. 1946), *cert. denied*, 331 U.S. 806, 91 L. Ed. 1828, 67 S. Ct. 1189 (1947). Neither section contains language as does section 2(a), referring to "purchases . . . in commerce." Appellants therefore argue that those sections are not limited by the requirement that there be an interstate sale.

Sections 2(d) and 2(e) of the Robinson-Patman Act **HNI2** were enacted to prevent sellers from circumventing section 2(a) by discriminating between buyers in respects other than price. *See FTC v. Simplicity Pattern Co.*, 360 U.S. 55, 68-69, 3 L. Ed. 2d 1079, 79 S. Ct. 1005 (1959). It would therefore be incongruous [**\*\*29**] to hold as appellants suggest, that those sections go beyond the coverage of section 2(a). *See* W. Patman, *Complete Guide to the Robinson-Patman Act* [**\*\*82**] 132 (1963); F. Rowe, *Price Discrimination Under the Robinson-Patman Act* 393 (1962). There are decisions to the contrary, *see Shreveport Macaroni Manufacturing Co. v. FTC*, 321 F.2d 404, 408 (5th Cir. 1963), *cert. denied*, 375 U.S. 971, 84 S. Ct. 491, 11 L. Ed. 2d 418 (1964), but in general cases have concluded that sections 2(d) and 2(e) have the same jurisdictional limitation as section 2(a). *See L & L Oil Co. v. Murphy Oil Corp.*, 674 F.2d 1113, 1116 (5th Cir. 1982); *Sun Cosmetic Shoppe, Inc. v. Elizabeth Arden Sales Corp.*, 178 F.2d 150 (2d Cir. 1949); *R.S.E., Inc. v. Pennsy Supply, Inc.*, 489 F. Supp. 1227, 1236 (M.D. Penn. 1980), *Rohrer v. Sears, Roebuck & Co.*, 1975-1 Trade Reg. Rep. (CCH) para. 60,302 (C.D. Mich. 1975).

#### B. The Retailer Appellee -- MTS

**HNI3** Section 2(f) of the Robinson-Patman Act makes it [**\*\*30**] unlawful for a buyer "engaged in commerce, in the

course of such commerce, knowingly to induce or receive a discrimination in price *which is prohibited by this section.*" (Emphasis added). In *Great Atlantic & Pacific Tea Co.*, 440 U.S. at 69 (1979), the Supreme Court held that **HNI4** a buyer does not violate section 2(f) in receiving a discrimination in price unless the discrimination is unlawful under section 2(a).

The district court, relying on *Great Atlantic & Pacific Tea Co.*, correctly ruled that since the sales by distributors failed to meet the "in commerce" requirement of section 2(a), MTS could not be liable under section 2(f) for receiving the allegedly discriminatory prices. However, since we reverse the court's grant of summary judgment as to the section 2(a) claims, we also reverse the ruling against the section 2(f) claim for further consideration in the light of this opinion.<sup>15</sup>

#### [\*\*31] C. The Appellee Advertiser-Doug Robertson

The district court found no "factual or legal basis upon which plaintiffs hope to hold Doug Robertson Advertising Agency liable." 533 F. Supp. at 551. We agree. Doug Robertson handled MTS advertising. The uncontested declaration submitted by it indicates that the only other connection between the two appellees was that Doug Robertson owned 5% of several MTS subsidiary corporations. It is therefore clear that Doug Robertson did nothing to violate sections 2(a), 2(d) or 2(e) of the Robinson-Patman Act by providing discriminatory prices, promotional or other services to record retailers. Similarly, it received no price discrimination from the record distributors. Accordingly, given the absence of any justiciable claim against it, the district court correctly granted summary judgment to Doug Robertson on the Robinson-Patman claims.

### III. THE SHERMAN ACT CLAIMS

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That it shall be unlawful for any person to discriminate in favor of one purchaser against another purchaser or purchasers of a commodity bought for resale, with or without processing, by contracting to furnish or furnishing, or by contributing to the furnishing of, any services or facilities connected with the processing, handling, sale or offering for sale of such commodity so purchased upon terms not accorded to all purchasers on proportionally equal terms.

<sup>15</sup> The district court also dismissed appellants' claim against MTS under sections 2(d) and 2(e) for receiving discriminatory payments or services. **HNI5** Unlike section 2(f), sections 2(d) and 2(e) do not provide for a buyer's liability for receiving enumerated benefits. *See* Rowe, *supra*, at § 14.5. Consequently there is no private right of action against buyers for violating those sections. *See Grand Union Company v. FTC*, 300 F.2d 92 (2d Cir. 1962); *Rickles, Inc. v. Frances Denney Corp.*, 508 F. Supp. 4, 1980-81 Trade Reg. Rep. (CCH) P63,829 (D. Mass. 1981); *General Beverage Sales Co. v. East Side Winery*, 396 F. Supp. 590 (E.D. Wis. 1975). *Cf. American News Co. v. FTC*, 300 F.2d 104 (2d Cir.), *cert. denied*, 371 U.S. 824, 9 L. Ed. 2d 64, 83 S. Ct. 44 (1962) (FTC may reach such conduct as an "unfair trade practice" under section 5 of the Clayton Act, 15 U.S.C. § 15).

The district court granted summary judgment in favor of appellees on all of appellants' claims under the Sherman Antitrust Act. **HNI6** We are admonished by the Supreme Court to proceed with caution in considering summary judgment in antitrust cases. *Poller v. Columbia Broadcasting System*, 368 U.S. 464, 473, 7 L. Ed. 2d 458, 82 S. Ct. 486 (1962). See *Program Engineering v. Triangle Publications*, 634 F.2d 1188, 1192 (9th Cir. 1980); *Ron Tonkin Gran Turismo v. Fiat Distributors*, 637 F.2d 1376, 1381 (9th Cir. 1981), cert. denied, 454 U.S. 831, 102 S. Ct. 128, 70 L. Ed. 2d 109 (1981). However, the Court has also indicated that clever pleading does not entitle an antitrust claimant to a trial with no regard for Rule 56 of the Federal Rules of Civil Procedure. [\*883] *First National Bank of Arizona v. Cities Service, Co.*, 391 U.S. 253, 289-90, 20 L. Ed. 2d 569, 88 S. Ct. 1575 (1968). See *Ron Tonkin*, 637 F.2d at 1381; *Betaseed, Inc. v. U and I Inc.*, 681 F.2d 1203, 1207-08 (9th Cir. 1982).

**HNI7** Under Rule 56, summary judgment is appropriate "where the record before the court on the motion reveals the absence of any material issue of [\*33] fact and [where] the moving party is entitled to judgment as a matter of law." *Portland Retail Druggists Association v. Kaiser Foundation Health Plan*, 662 F.2d 641, 645 (9th Cir. 1981). **HNI8** The burden of demonstrating the absence of an issue of material fact lies with the moving party. *British Airways Board v. Boeing Co.*, 585 F.2d 946, 951 (9th Cir. 1978), cert. denied, 441 U.S. 968, 60 L. Ed. 2d 1074, 99 S. Ct. 2420 (1979). The opposing party must then "present specific facts demonstrating that there is a factual dispute about a material issue." *Program Engineering*, 634 F.2d at 1193; *British Airways*, 585 F.2d at 951.

In this case, the district court found that the appellees carried their burden in demonstrating the absence of a genuine issue of material fact. It ruled, however, that the opposition materials submitted by appellants did not comply with the requirements of Rule 56(e) Fed.R.Civ.P. or Rule 220-8 of the Local Rules of the Northern District of California. The court therefore found [\*34] that appellants failed to present competent evidence to dispute appellees' showing.<sup>16</sup>

Our review of the record amply confirms the district court's finding. In the main, appellants sought to oppose the

summary judgment motions by introducing literally hundreds of pages of documents purporting in their cumulative effect to show the existence of a genuine issue of material **HNI9** fact. To meet the requirements of Rule 56 as supplemented by the Local Rules [\*35] of the district court, such materials are required to be authenticated by affidavits or declarations of persons with personal knowledge through whom they could be introduced at trial. See *United States v. Dibble*, 429 F.2d 598, 602 (9th Cir. 1970) (writings are not admissible under motion for summary judgment without proper foundation); *California Pacific Bank v. Small Business Administration*, 557 F.2d 218, 222 (9th Cir. 1977). As the district court observed, most of the documents lacked any authentication whatsoever. Moreover, appellants made virtually no effort to organize the documents in a reasonably intelligible manner. In many particulars, entire correspondence files or sets of records were included with no attempt to sort out or identify that material which was relevant.

**HN20** A party may not prevail in opposing a motion for summary judgment by simply overwhelming the district court with a miscellany of unorganized documentation. (The district court characterized it as "ersatz evidence.") But even were that organizational prerequisite satisfied, [\*36] we would be compelled to hold that the materials offered did not, even viewed in the light most favorable to appellants, give rise to a genuine issue of material fact sufficient to prevent a motion for summary judgment. See *Cities Services*, 391 U.S. at 253; *British Airways*, 585 F.2d at 951-52.

#### A. The Section 1 Conspiracy Claims

As the district court stated, appellants' Sherman Act allegations come through as an attempt to breathe new life into their Robinson-Patman claims by recasting them in the form of a conspiracy of which appellants suggest two possibilities. The first is an overall conspiracy among the record distributors and chain retailers to favor the latter group at the expense of small record [\*884] retailers.<sup>17</sup> The second suggestion is of a vertical conspiracy to restrain competition between each distributor and each chain store retailer.

#### [\*37] 1. The Horizontal Conspiracy

<sup>16</sup> The district court observed the same evidentiary shortcomings on appellants' part in its opinion granting summary judgment in favor of Capitol on the refusal to deal claim in September, 1978, see 1978-2 Trade Cases para. 62,269 (N.D. Cal. 1978), and its subsequent opinion granting summary judgment on the Sherman Act claims in favor of appellees WEA, MCA, Polygram, MTS and Doug Robertson of June, 1980. 533 F. Supp. 540 (N.D. Cal. 1980).

<sup>17</sup> Appellants also allege a variant of the overall conspiracy consisting of a series of conspiracies between all the distributors and each chain store retailer. Summary judgment was appropriate as to this claim for the same reasons as in our discussion of the overall conspiracy set out below.

Appellants claim error by the district court in granting summary judgment on the basis that there was no genuine issue of material fact regarding the existence of an overall conspiracy. We have repeatedly articulated the test for granting summary judgment in antitrust conspiracy cases:

**HN21** Once the allegations of conspiracy made in the complaint are rebutted by probative evidence supporting an alternative interpretation of a defendant's conduct, if the plaintiff then fails to come forward with specific factual support of its allegations of conspiracy, summary judgment for the defendants becomes proper.

*ALW, Inc. v. United Air Lines, Inc.*, 510 F.2d 52, 55 (9th Cir. 1975); *Mutual Fund Investors, Inc. v. Putnam Management Co.*, 553 F.2d 620, 624 (9th Cir. 1977). In this case, since the appellees' affidavits all denied any conspiracy with the others, and since appellants presented no direct evidence of conspiracy, appellants' only chance depended on their presentation of circumstantial evidence sufficient [\*\*38] to support the inference of a "conscious parallelism" conspiracy theory and on such further inferences as appellants might be able to draw from trade association and credit managers' meetings among the various distributors.

a. *Conscious Parallelism*

In proof of the hypothesis of consciously parallel business behavior, appellants point to the distributors' use of similar account classifications, pricing structures and promotional policies. However, as the district court determined, appellants failed to make a proper showing of sufficiently similar conduct in such matters. See *Independent Iron Works, Inc. v. United States Steel Corp.*, 322 F.2d 656, 661 (9th Cir.), cert. denied, 375 U.S. 922, 11 L. Ed. 2d 165, 84 S. Ct. 267 (1963). Instead, appellees successfully demonstrated considerable variation in the distributors' account classification systems as well as variance in prices offered to retailers by distributors. Moreover, each distributor offered its own package of promotional offers and discounts which, in fact, substantially encouraged competition in the record business.

Yet, even if appellants had successfully demonstrated the requisite [\*\*39] parallel **HN22** conduct, the courts also require that the plaintiff demonstrate that the allegedly parallel acts were against each conspirator's self interest, that is, that the decision to act was not based on a good faith business judgment. See *Theatre Enterprises, Inc. v. Paramount Film Distributing Corp.*, 346 U.S. 537, 540-41, 98 L. Ed. 273, 74 S. Ct. 257 (1954); *Syfy Enterprises v. National General Theatres, Inc.*, 575 F.2d 233, 236 (9th Cir.

1978); *Dahl, Inc. v. Roy Cooper Co.*, 448 F.2d 17, 19 (9th Cir. 1971). The appellees presented sufficient evidence of legitimate business decisions to justify their actions. For example, WEA justified its two-tier account classification system between "subdistributors" and "retailers" as a means of meeting the competition of those distributors who had previously entered the market and who maintained multiple-tier account classifications. In addition, it presented evidence that the lower subdistributor price reflected cost savings to WEA because subdistributors had a centralized location for purchases, [\*\*40] billings, returns and deliveries and subdistributors made box-lot purchases of the same records.

Certain distributors did give to chain store retailers discounts in addition to those to which they were entitled under their account classification systems. For example, WEA apparently gave MTS a subdistributor price in 1975 even though MTS did not meet WEA's technical definition of a subdistributor. However, appellants' own [\*\*85] **HN23** evidence indicated that the distributors did so because of claims by the large retailers that they were receiving lower prices from the distributors' competitors and that failure to reduce price would adversely affect the retailers' merchandising of the distributor's records. Such evidence does not indicate a conspiracy to favor large record stores. In fact, the Sherman Act is intended to encourage such competition between sellers. See *Great Atlantic & Pacific Tea Co.*, 440 U.S. at 83 n.16.

Finally, appellants' conscious parallelism claim is deficient because it never established a plausible motivation for the conspirators' conduct. In [\*\*41] *Cities Service* the court found the plaintiff's conspiracy theory to be inadequate where the interests of the alleged conspirators were divergent. **HN24** In the absence of any common motivation, the court concluded, there existed no grounds for inferring a conspiracy. 391 U.S. at 287. *Accord Venzie Corp. v. United States Mineral Products Co.*, 521 F.2d 1309, 1314 (3d Cir. 1975). Here, appellants are unable to advance any plausible reason why the major record distributors would conspire to favor certain retailers, thus limiting the retail outlets for their own products. Appellants' theory of conspiracy would increase the bargaining power of the major chain stores against the distributors themselves. Indeed, the statements of Joel Friedman, of WEA, which appellants attempted to introduce into evidence, indicates that WEA viewed the buying and marketing practices of chain store retailers as a threat to the distributors. In sum, aside from the most conclusory allegations, appellants have made no attempt to show why it should be held to have been in the interest [\*\*42] of the record distributors to engage in conspiracy the

result of which would be lowering of prices offered to their largest customers.<sup>18</sup>

b. *Distributors' meetings and discussions*

Aside from their conscious parallelism theory, appellants also attempt to prove the existence of a conspiracy on the basis of trade association meetings and exchanges of credit information among distributors. They contend that the participation [\*\*43] of distributors at meetings of the National Association of Record Manufacturers (NARM) evidences a "cartel." However, *HN25* in the absence of any indication of agreement or consent to an illegal arrangement, evidence of industry meetings is not sufficient to prove a conspiracy. *Maple Flooring Manufacturers Association v. United States*, 268 U.S. 563, 575, 69 L. Ed. 1093, 45 S. Ct. 578 (1925); *Hanson v. Shell Oil Co.*, 541 F.2d 1352, 1359 (9th Cir. 1976), cert. denied, 429 U.S. 1074, 50 L. Ed. 2d 792, 97 S. Ct. 813 (1977). Moreover, appellants presented no evidence that the distributors exchanged price information such as that found objectionable in *United States v. Container Corp.*, 393 U.S. 333, 335, 21 L. Ed. 2d 526, 89 S. Ct. 510 (1969) (exchange of information among competitors as to most recent prices charged specific customers).

As for the exchange of credit information, appellants introduced evidence that the record distributors' credit managers attended meetings of the National Association of Credit Managers and its [\*\*44] regional affiliate, the Credit Managers Association of Southern California, and that at those meetings they exchanged information regarding individual retailers' credit histories.

Appellants suggest that the decision of the Supreme Court in *Catalano, Inc. v. Target Sales, Inc.*, 446 U.S. 643, 64 L. Ed. 2d 580, 100 S. Ct. 1925 (1980), is that all exchange of credit information is a *per se* violation of section 1 of the Sherman Act. On the [\*\*886] contrary, the court stated that, assuming plaintiff could prove that the defendants agreed to fix credit terms to their customers, such an agreement would be a *per se* violation of section 1. In fact the court in

*Catalano* explicitly adverted to its earlier holding in *Cement Manufacturing Protective Association v. United States*, 268 U.S. 588, 69 L. Ed. 1104, 45 S. Ct. 586 (1925), permitting exchange of credit information for the individual use of each member in determining whether to exercise credit. 446 U.S. at 648 n.12.

The appellants' evidence indicated that the information exchanged by the credit managers regarding certain retailers' credit standing was of the sort [\*\*45] the distributors could use for self protection purposes. For example, the distributors exchanged information regarding individual retailers' total indebtedness. However, there was no indication of any agreement to fix credit terms aside from appellants' observation that large retailers in fact received more favorable credit terms than Marin Music Centre -- a hardly surprising result in light of their relative volume of sales.

2. *Vertical Conspiracy*

Appellants allege a number of vertical conspiracies each based on the sales agreement between a distributor and a favored retailer which "caused discrimination in the sale of phonograph records and tapes to the named retail chain stores." In essence, appellants suggest that *HN26* price discrimination between individual buyers and sellers which would ordinarily form the basis of a secondary-line Robinson-Patman case is also a violation of section 1 of the Sherman Act. Yet the courts have held that such an agreement, without proof of an arrangement to exclude others from the buyer's market does not give rise to a section 1 claim.<sup>19</sup> See e. [\*\*46] g., *National Tire Wholesale, Inc. v. Washington Post Co.*, 441 F. Supp. 81 (D.D.C. 1977), aff'd, 595 F.2d 888 (D.C. Cir. 1979); *Rutledge v. Electric Hose & Rubber Co.*, 327 F. Supp. 1267 (C.D. Cal. 1971), aff'd, 511 F.2d 668 (9th Cir. 1975).

[\*\*47] In *National Tire*, for example, the court rejected the plaintiff's claim that a newspaper's failure to sell its advertising on the same terms as it gave to plaintiff's main competitor violated section 1, stating:

<sup>18</sup> In what appears as an afterthought, appellants also claim that the distributors engaged in resale price maintenance. Yet they offered no probative evidence in support of this proposition. Moreover, the claim is fundamentally inconsistent with their principal theory of the case -- that the Zoslaws were unable to compete with the large retailers because the distributors gave those retailers more favorable terms. Under appellants' theory, retail price maintenance would have been advantageous to them since it would have restricted the large retailers' ability to undercut their prices.

<sup>19</sup> In contrast, we have recognized that *HN27* a predatory pricing claim may form the basis of both a primary-line Robinson-Patman case alleging injury to another seller and a section 2 Sherman Act claim since both statutory provisions "are directed at the same evil and have the same substantive content." *William Inglis*, 668 F.2d at 1041 (quoting *Janich Brothers, Inc. v. American Distilling Co.*, 570 F.2d 848, 855 (9th Cir. 1977)). Here, however, appellants' secondary-line Robinson-Patman claim -- that they did not receive the same price as a competing buyer -- has no direct counterpart under section 1 of the Sherman Act.

Plaintiff does not allege any basis for a vertical combination in violation of section 1. The contract for advertising space between the Post and Market, albeit a combination, is not a combination within the scope of section 1. The contract sets forth the terms of dealings between the parties; plaintiff does not allege that the terms of the contract in any way restrict either party's dealings with others.

441 F. Supp. at 81.

Here appellants presented no evidence of any vertical agreement to exclude competitors. Instead, the record indicates that certain retailers negotiated a favorable price with individual distributors. *HN28* However, even were we to assume some evidence of an exclusionary effect, we have held that such vertical arrangements are not a *per se* violation of section 1. See *Ron Tonkin*, 637 F.2d at 1382-87; **[\*\*48]** *Gough v. Rossmoor*, 585 F.2d 381, 388 (9th Cir. 1978); *Mutual Fund Investors*, 553 F.2d at 626; *Joseph Seagram & Sons, Inc. v. Hawaiian Oke & Liquors, Ltd.*, 416 F.2d 71, 78-79 (9th Cir. 1969). Therefore such agreements do not violate section 1 unless they are found to be unreasonable. *Twin City Sportservice, Inc. v. Charles O. Finley & Co.*, 676 F.2d 1291, 1304 (9th Cir. 1982), *cert. denied*, 459 U.S. 1009, 103 S. Ct. 364, 74 L. Ed. 2d 400, 51 U.S.L.W. 3354 (1982). The reasonableness inquiry is "directed to a balancing of the competitive evils of the restraint against the anticompetitive **[\*887]** benefits asserted on its behalf." *Gough*, 585 F.2d at 388-89.

Here there is simply no indication that the sales agreements between individual distributors and retailers constituted an unreasonable restraint of trade. Indeed, *HN29* the Supreme Court has recognized that the price discrimination which results where buyers seek competitive advantage from sellers encourages the aims of the Sherman Act, **[\*\*49]** a respect in which the Sherman Act is inconsistent with the aims of the Robinson-Patman Act. See *Great Atlantic & Pacific Tea Co. v. FTC*, 346 U.S. 61, 73-74, 97 L. Ed. 1454, 73 S. Ct. 1017 (1953). And while appellants point to injury to their particular business, they do not make the necessary showing of a substantially adverse effect on competition in the record market in general. See *Ron Tonkin*, 637 F.2d at 1388; *Mutual Fund Investors*, 553 F.2d at 627. In fact, as the district court observed, appellants themselves acknowledge the competitive character of the record and tape sales market. Thus the district court correctly held that appellants had failed to raise a genuine issue of material fact in support of their vertical conspiracy charge.

B. *The Section 2 Attempted Monopolization Claim Against MTS*

Appellants claim that MTS attempted to monopolize the retail market in record and tape sales in the San Francisco Bay Area in violation of section 2 of the Sherman Act. **[\*\*50]** *HN30* An attempted monopoly claim under section 2 consists of three elements: (1) a specific intent to control prices or destroy competition in some part of commerce; (2) predatory or anticompetitive conduct directed to accomplishing the unlawful purpose; and (3) a dangerous probability of success. *Twin City Sportservice*, 676 F.2d at 1308; *Portland Retail Druggists*, 662 F.2d at 647. *William Inglis*, 668 F.2d at 1027.

In *Inglis* we discussed at length the interrelationship between the three elements. Thus we observed that *HN31* intent to monopolize may be inferred from anticompetitive conduct but that to carry such a burden the conduct "must fall into one of two categories, either (1) conduct forming the basis for a substantial claim of restraint of trade, or (2) conduct that is clearly threatening to competition or clearly exclusionary." 668 F.2d at 1029 n.11. In either case the conduct "must be such that its anticompetitive benefits [are] dependent upon its tendency to discipline or eliminate competition and thereby enhance **[\*\*51]** the firm's long-term ability to reap the benefits of monopoly power." *Inglis*, 668 F.2d at 1030. In turn, the dangerous probability of success requirement, which is usually although not necessarily, associated with market power may be inferred from direct evidence of intent implemented by conduct, or conduct alone of the sort described above, from which intent may be inferred. 668 F.2d at 1029.

As the district court observed, appellants presented no direct evidence of specific intent to monopolize, relying instead on MTS' alleged anticompetitive conduct to prove a violation of section 2. Their chief claim in this regard is that Tower engaged in predatory pricing by setting its prices for records and tapes below appellants' cost of doing business.

*HN32* A predatory price exists "where the firm foregoes short-term profits in order to develop a market position such that the firm can later raise prices and recoup profits." *Janich Brothers, Inc. v. American Distilling Co.*, 570 F.2d 848, 856 (9th Cir. 1977), *cert. denied*, 439 U.S. 829, 58 L. Ed. 2d 122, 99 S. Ct. 103 (1978). **[\*\*52]** In making such a determination we have had occasion to identify as a useful standard for predation the test set out by Professors Areeda and Turner. See P. Areeda & D. Turner, *Predatory Pricing and Related Practices Under Section 2 of the Sherman Act*, 88 Harv. L. Rev. 697 (1975); *Inglis*, 668 F.2d at 1033; *Janich Bros.*, 570 F.2d at 858. Under this approach a price is not predatory if it equals or exceeds the average variable

cost of production. [\*888] P. Areeda & D. Turner, *Predatory Pricing*, *supra*, at 711.<sup>20</sup>

[\*\*53] Pursuing such a guide, appellants' predatory pricing claim would appear to be inadequate on its face since it does not suggest that MTS priced below its *own* average variable cost -- but that it was below only some unidentified cost of appellants. In *Inglis* we indicated that **HN33** a plaintiff might be able to prove a predatory pricing claim without showing that the defendant priced below its average variable cost, *see* 668 F.2d at 1035, or even possibly below its average total cost.<sup>21</sup> However, in such instances it is the plaintiff's burden to prove that the defendant "sacrificed greater profits or incurred greater losses than necessary in order to eliminate the plaintiff." *Inglis*, 668 F.2d at 1036. In the absence of such a claim on the part of appellants, much less any evidence to that effect, appellants' predatory pricing claim is inadequate as a matter of law. Indeed, any other conclusion would support the perverse rationale that a defendant may not compete by lowering its prices "if competition would injure its competitors." *California Computer Products, Inc. v. International Business Machines Corp.*, 613 F.2d 727, 742 (9th Cir. 1979). [\*54]

Appellants' other example of MTS' predatory conduct concerns MTS' negotiation of favorable sales terms with the individual distributors. Yet we have already concluded that such conduct did not constitute an unreasonable restraint of trade under section 1 of the Sherman Act. And since, as we have previously stated, the reasonableness standard of section 1 governs parallel conduct under section 2, *see Inglis*, 668 F.2d at 1030 n.14; *California Computer Products*,

613 F.2d at 737, MTS' actions do not constitute a "substantial restraint of trade" in violation of section 2. Nor do we consider [\*55] the attempt to negotiate favorable terms here "conduct that is clearly threatening to competition or clearly exclusionary."

Our conclusion regarding MTS' conduct in this case is reinforced by the evidence in the record concerning its market power. In *Inglis* we recognized that a defendant may introduce evidence "that market conditions are such that a course of conduct described by the plaintiff would be unlikely to succeed in monopolizing the market." 668 F.2d at 1030. *See also Hunt-Wesson Foods, Inc. v. Ragu Foods, Inc.*, 627 F.2d 919, 936 (9th Cir. 1980), *cert. denied*, 450 U.S. 921, 67 L. Ed. 2d 348, 101 S. Ct. 1369 (1981). Aside from their claim of "breath-taking growth of monopoly power," appellants suggested no evidence of market power whatsoever. In contrast MTS, introduced evidence that it operated only two retail stores in the six San Francisco Bay Area counties which the appellants asserted constituted a relevant geographic market and that it accounted for no more than 10% of the total retail record and tape sales in that area.<sup>22</sup> The [\*889] absence of significant market power on the part of the MTS and the existence [\*56] of numerous other retail outlets lends further weight to our conclusion that the appellants failed to raise an issue of material fact regarding the attempted monopolization claim.<sup>23</sup>

[\*\*57] *C. Capitol's Refusal to Deal*

Appellants contended that the district court erred in granting summary judgment in favor of Capitol on their refusal to

<sup>20</sup> According to Areeda and Turner average variable cost is actually an imperfect substitute for marginal cost, made necessary because business firms rarely keep records reflecting marginal cost. P. Areeda & D. Turner, *Predatory Pricing*, *supra*, at 717. A price equal or exceeding marginal cost is the appropriate test because then only less efficient producers will suffer larger losses per unit. In addition a price equal to marginal cost signals to consumers the "true social cost" of producing the additional unit, therefore promoting the efficient allocation of resources. P. Areeda & D. Turner, *Predatory Pricing*, *supra*, at 710-713; *Inglis*, 668 F.2d at 1032.

<sup>21</sup> *Inglis* specifically reserved the question whether a price above the defendant's average total cost could ever be considered predatory. 668 F.2d at 1035 n.30. In that instance, the producer recovers the total cost of production, including fixed costs, as well as a "normal" rate of return on its investment, making the price "profitable" from an economist's view. *Id.*

<sup>22</sup> MTS did not operate any stores in Marin County during the period in question. Its two stores in the San Francisco Bay Area are in San Francisco and Berkeley.

The district court identified the relevant geographic market here as the San Francisco-Marin County market since that is the only geographic area of competition between Marin Music Centre and MTS. Yet appellants did not present any evidence nor do they even argue that MTS' share of this submarket is larger than its share of the six San Francisco Bay Area counties. Indeed, MTS only operates one store in the "San Francisco-Marin County" market.

<sup>23</sup> Appellants' complaint also charged MTS with monopolization of the retail record and tape market in violation of section 2 of the Sherman Act. The district court granted summary judgment on this claim and appellants do not raise this issue on appeal. In any event, appellants' failure to respond to MTS' evidence of its relatively small market share made summary judgment on this claim appropriate. *See, e.g., Forro Precision, Inc. v. International Business Machines Corp.*, 673 F.2d 1045, 1058 (9th Cir. 1982) (evidence of 35% of market share alone insufficient as a matter of law to support monopolization claim).

deal claims under sections 1 and 2 of the Sherman Act. *HN34* This court has previously held that a party may refuse to deal with another "provided there is no effect which contravenes the antitrust laws." *Mutual Fund Investors*, 553 F.2d at 626. In such cases, the adverse effects of the termination on the party refused are not relevant "when the refusal 'is for business reasons which are sufficient to the [defendant] in the absence of any agreement restraining trade.'" *Chandler Supply Co. v. GAF Corp.*, 650 F.2d 983, 989 (9th Cir. 1980); (quoting *Bushie v. Stenocord Corp.*, 460 F.2d 116, 119 (9th Cir. 1972)). *Accord Marquis v. Chrysler Corp.*, 577 F.2d 624, 640 (9th Cir. 1977). Such a determination is not appropriate for summary judgment where there is a material issue of fact regarding the defendant's unlawful intent or the anticompetitive effect of its action. *California Steel & Tube v. Kaiser Steel Corp.*, 650 F.2d 1001, 1004 (9th Cir. 1981); [\*\*58] *Program Engineering*, 634 F.2d at 1196.

The district court concluded that Capitol's acknowledged aim of attempting to avoid future litigation after its settlement with appellants constituted a legitimate business purpose for the termination. During the period covered by the complaint, Capitol sold approximately \$3,800 of records and tapes per year to Marin Music Centre. In June, 1975, Capitol and appellants entered into an agreement settling all of appellants' claims existing on that date for \$7,500, but expressly permitting appellants to bring an action for events occurring after the date of the settlement. Capitol introduced evidence indicating that it stopped selling to Marin Music because of the near certainty that continuing business would give rise to litigation whose costs would exceed any benefits derived from that business.

Appellants point to two Ninth Circuit cases, *Knutson v. Daily Review, Inc.*, 548 F.2d 795, 805 (9th Cir. 1976), *cert. denied*, 433 U.S. 910, 97 S. Ct. 2977, 53 L. Ed. 2d 1094 (1977), and *Germon v. Times Mirror Co.*, 520 F.2d 786, 788 (9th Cir. 1975), which suggest in dicta that a [\*\*59] court may enjoin a defendant in an antitrust action from refusing to deal with the plaintiff. However, both of those cases involve the use of injunctions to preserve the status quo during the litigation, and more importantly, they recognize that the termination must be pursuant to a plan "to foster an unlawful competitive scheme." 520 F.2d at 788.

In contrast, in *House of Materials, Inc. v. Simplicity Pattern Co.*, 298 F.2d 867 (2d Cir. 1962), the court explicitly held

that in the absence of any arrangement to restrain trade a manufacturer's refusal to deal with a retail store because of an antitrust suit filed against it by the store did not constitute an unlawful purpose in violation of the Sherman Act:

Appellee does not cite, and we have not found any case in which a "refusal to deal" based on a customer's prosecution of a suit against a manufacturer has been held to constitute an unreasonable restraint of trade. This when considered is not astonishing, for the relationship between [\*890] a manufacturer and his customer should be reasonably harmonious; and the bringing of a lawsuit by the customer may provide a sound business reason [\*\*60] for the manufacturer to terminate their relation.

298 F.2d at 871 (citations omitted). Thus Capitol's *HN35* acknowledged purpose of avoiding future litigation whose costs exceeded the benefits from doing business with appellants qualified as a legitimate business reason for refusing to deal. *See Marquis*, 577 F.2d at 620.

As the district court recognized, appellants' only attempt to prove that the termination was otherwise violative of the antitrust laws was to suggest that it was connected with the alleged horizontal and vertical conspiracies among the distributors and chain store retailers. However, appellants introduced no evidence indicating any connection between the conspiracies alleged and the termination sufficient to raise an issue of material fact. *See ALW*, 510 F.2d at 55. Indeed Capitol's action did not even prevent appellants from selling its records. Capitol introduced evidence that its records were available from independent distributors and were in fact carried in appellants' store long after the termination. In [\*\*61] any event, since we have concluded that appellants have failed to raise an issue of material fact regarding the existence of any such vertical or horizontal conspiracy, their allegations against Capitol based on those conspiracies were also appropriate for summary judgment.

#### IV. CONCLUSION

The district court's judgment in favor of appellees on appellants' Robinson-Patman claims is reversed except as to Doug Robertson. The court's judgment as to the Sherman Act claims is affirmed. The case is remanded for further proceedings consistent with this opinion.