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ORIGINAL

No. 64408-4

COURT OF APPEALS
DIVISION I
OF THE STATE OF WASHINGTON

FLUKE CORPORATION, a Washington Corporation, and DANAHER CORPORATION, a Delaware Corporation,

Appellants,

v.

MILWAUKEE ELECTRIC TOOL CORPORATION, a Washington Corporation, JON MORROW, an individual, and EVANS NGUYEN, an individual,

Respondents.

APPELLANTS' REPLY BRIEF AND OPPOSITION TO RESPONDENTS' CROSS-APPEAL

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I. APPELLANT'S REPLY

Respondent Milwaukee Electric Tool Corporation ("MET") built its Test & Measurement ("T&M") business with Appellant Fluke's[1] trade secrets and by inducing Fluke employees Jon Morrow and Evans Nguyen to breach their Fluke agreements. With all respect to the trial court, the summary and premature dismissals of Fluke's claims cannot stand under any recognizable summary judgment standard. The trial court's rulings should be reversed and this case should be remanded so that discovery can be completed and the parties' evidence may be weighed at trial.

A. THERE WAS AMPLE EVIDENCE TO SUPPORT FLUKE'S CLAIMS THAT MET, MORROW, AND NGUYEN MISAPPROPRIATED FLUKE TRADE SECRETS

1. Fluke Identified and Presented Evidence Establishing Its Trade Secrets

Respondents' primary argument for affirming the trial court's summary dismissal of Fluke's trade secrets claims is that Fluke supposedly failed to identify its trade secrets with particularity. Resp. Br. at 1, 10-12, 15, and 30-33. However, Respondents cannot sustain the ruling with a diversionary tactic that is demonstrably false and badly mischaracterizes

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[1] Consistent with their opening brief, Appellants Fluke Corporation and its parent company, the Danaher Corporation, will be referred to collectively in this brief as Fluke.

the record and the trial court's rulings. In the end, the trial court's trade secret ruling must stand or fall on the evidence in the record.

Respondents' argument initially fails because, despite their repeated claims to the contrary, the trial court expressly ruled that Fluke's disclosures were sufficient.

> . . . The documents are identified with particularity. . . . .
>
> It is somewhat general, but I think it's specific enough to allow the defense to argue that these are not trade secrets both at summary judgment and at trial. And so that motion for sanctions is denied.

RP 74:7-75:3 (August 21, 2009). Respondents' failure to challenge this ruling on appeal precludes them from raising it now as grounds for upholding the dismissal of Fluke's trade secrets claims. *See, e.g., Yousoufian v. Office of Ron Sims*, 152 Wn.2d 421, 439 (2004) (noting that "[t]he Court of Appeals correctly ignored the manner in which the records were grouped because the county failed to assign error to the trial court's method of calculation").

Nor can Respondents legitimately argue that Fluke unreasonably delayed in identifying the trade secrets at stake in this case. As Respondents acknowledge, the trade secret disclosure that the trial court found sufficient in August 2009 lists the same documents and is essentially identical to the disclosure Fluke had made more than a year earlier. Resp. Br. at 14 and n. 9.

This was a fabricated argument from the very start. Apart from its specific discovery responses, Fluke identified the trade secrets and other confidential information it believed MET, Morrow and Nguyen were misappropriating throughout the case. Fluke did so in the original Complaint. CP 5 (listing specific trade secrets Morrow was "uniquely and intimately familiar with"). Fluke also identified its trade secrets in sworn declarations filed in the very first days of the case. *E.g.*, CP 30-32 (specifically citing, among other things, Morrow's knowledge of product features, Voice of the Customer ("VOC") research, OEM performance, Fluke's 3-year strategic plan, and the "white spaces" cross-market products list Morrow had spent 6 months preparing); CP 45-46 (detailing, among other things, Nguyen's work with Fluke's OEMs); CP 38-41 (specifying, among other things, Shawn Holland's and Jim Curtin's knowledge of VOC research and planned product features).[2]

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[2] Fluke's trade secrets claims were a central part of this case from the very beginning and the trial court never suggested otherwise. Contrary to the misleading implication created by Respondents' use of carefully cropped quotes, the trial court did not "find[] that '[t]he case is not about trade secrets.'" Resp. Br. at 12. The full quotation shows that the trial court was only discussing the issues presented at the preliminary injunction hearing. Fluke's trade secrets claims and the anticipated discovery into those claims was still very much part of the case.

> The case is not about trade secrets. I was also persuaded by the defense that they didn't have enough discovery to be able to counteract that. *As the case proceeds we have to talk about the trade secret discovery*, . . .

RP at 3:6-11 (June 2, 2008) (emphasis added).

Likewise, Fluke identified the specific trade secrets at issue in the summary judgment briefing. Without citing to the record, Respondents argue that Fluke cited to "thousands of documents" yet "proffered only three in opposition to" the trade secret summary judgment motion below. Respondents Brief at 33. Neither assertion is true. Fluke identified 13 specific trade secrets that Respondents have misappropriated in its summary judgment papers, not "thousands" and not "only three." CP 1579; 1271-73; 3120-21.[3] These are the same 13 trade secrets Fluke lists in its opening brief at pages 23-25 and these same trade secrets were identified more than a year before the close of discovery. CP 4648-50. Notably, Respondents do not deny that these 13 trade secrets would be valuable to a competitor. Nor do they contest Fluke's evidence that reasonable steps were taken to keep them secret from competitors.

Instead, Respondents feign an inability to discern what within these documents might be valuable to a competitor. Resp. Br. at 33 ("Fluke failed to identify what specifically within them was a trade secret."). This is a disingenuous argument that should merit no traction with the court. First, Fluke did not provide only "vague references" or

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[3] The number of Fluke's identified trade secrets increased to 14 when MET produced documents *after* Fluke had filed its summary judgment opposition papers that showed how Nguyen had steered MET to Fluke's preferred OEM's. CP 5957-58.

"unspecified" plans or assessments. Fluke identified specific documents that *are* valuable compilations of information not known outside of Fluke. CP 4648-50; 4671-72. That is all trade secret law requires.

Respondents argue that, for each identified compilation, Fluke was required to parse its information even further and specifically tease out which discrete parts of each document were trade secrets and which were not. Washington trade secret law has never required this absurd level of granularity. To the contrary, in *Boeing v. Sierracin Corp.*, 108 Wn.2d 38, 50 (1987), the Washington Supreme Court noted that:

> A trade secrets plaintiff need not prove that every element of an information compilation is unavailable elsewhere. Such a burden would be insurmountable since trade secrets frequently contain elements that by themselves may be in the public domain but together qualify as trade secrets.

Id. (internal citations omitted).

Respondents knew from the outset exactly what trade secrets were at issue in this case because they knew exactly what Fluke information they were using to build MET's T&M business. Respondents did not raise the "show me first" argument so that they could learn more about Fluke's claims. They raised the "show me first" argument so that they could use it to delay and prevent Fluke from learning the full extent of their misappropriations. Fluke identified the trade secrets at issue in this case.

This argument is a cynical tactic that provides no basis for affirming the trial court's erroneous dismissal of Fluke's trade secrets claims.

2. Morrow Misappropriated Fluke Trade Secrets

Next Respondents argue that "there is no evidence that Morrow misappropriated anything." Resp. Br. at 34. While Fluke still does not know the full scope of Morrow's misappropriations, due to Respondents' sustained withholding of documents, *see* Opening Br. at 46, there is ample direct and circumstantial evidence of his multiple misappropriations.

a. Morrow Used Fluke's Laser Distance Meter Marketing Plan and His Own Tests and Analyses of Laser and Ultrasonic Distance Meters to Assist MET's Laser Distance Meter

There is more than enough evidence for a jury to conclude that Jon Morrow used Fluke trade secret information to help MET launch a competing line of laser distance meters. Specifically, there is substantial evidence that:

1) Morrow possessed significant knowledge about Fluke's confidential plans for releasing its own lines of laser and ultrasonic distance meters; CP 2951-56; 3518-19; 3936-41; RP 442:3-448:8;
2) Morrow volunteered to share this information with MET even before he started his first day at work;[4] CP 3943; and

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[4] Respondents are correct in pointing out that Morrow had already resigned from Fluke when he volunteered to help with the laser distance meter project. This was before he started with MET, however.

3) Upon starting his employment with MET, Morrow was promptly assigned to work on MET's own laser distance meter. RP 950:23-25; CP 3950-53; 3959-60.

In response, Respondents argue as if it was Fluke that carries the heavy burden on summary judgment. For example, Morrow says he does not remember receiving the email containing the Fluke marketing plan. CP 1745. But this was not some random distribution. The email was sent to him as a follow up to a discussion he had been having with a co-worker, with a personal note, which makes his claim that he had forgotten it implausible. CP 2955. Morrow can tell the jury that he does not remember the email, but his denial merely creates an issue of fact.[5]

Next, Morrow claims that he was volunteering to share his knowledge of Fluke's tests of ultrasonic distance meters, not his knowledge of Fluke's laser distance meter marketing plans. Respondents mischaracterize the "I know stuff" email. The product Jones was asking about did not "turn out" to be a laser distance meter. Resp. Br. at 9. The *subject line* of the email was: "Laser Distance Meter." CP 3943. Morrow can tell the jury that he was thinking about ultra-distance meter technology

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[5] It cannot seriously be disputed that the laser distance marketing report was a trade secret. Among other things, the document identified the three models of laser distance meter Fluke planned to launch in 2008 along with product pricing and the key positioning statement Fluke would use to introduce the products to market. The document identified Fluke's target market and it included a discussion of Fluke's customer research to a striking level of detail. CP 2952-53. The document also described Fluke's distribution plan and projected future sales. CP 2955-56.

when he responded to an email about laser distance meters (even though he said nothing to indicate this in the email), but this is not grounds for affirming summary judgment.

Respondents' assertion that Fluke does not claim that the information Morrow compiled about the feasibility of an ultrasonic distance meter is a trade secret is false. Resp. Br. at 34. Fluke consistently identified this as one of the trade secrets Morrow had misappropriated. *E.g.*, CP 5076 (identifying "information relating to the relative strengths and weaknesses of the Ultrasonic Distance Meter developed by Morrow during his employment with Fluke").

Respondents cite to evidence that there are ultrasonic distance meters on the market and then jump to the inference that manufacturers do not believe that knowledge gained by conducting tests of ultrasonic products is a trade secret. Resp. Br. at 6. But the evidence is that Morrow *personally tested* laser and ultrasonic distance meters shortly before he joined MET, specifically to determine which products to develop and bring to market. RP 442:3-454:24. These products were still secret when Morrow volunteered to help MET *do the very same thing*— evaluate whether to bring a distance meter to market. RP 443:1-15; CP 3943. It is the jury's permissible inference that matters, not the inferences of Respondents and their attorneys. And a jury could certainly infer that the knowledge Morrow developed evaluating distance meters for Fluke was not generally known and would be valuable to a competitor.

b. Morrow Shares "Actionable Distributor Data" to Help MET Identify "Low Hanging Fruit" in the Electrical Channel

When Morrow resigned from Fluke to join MET, he had just completed preparing his 2008 business plan. One of the primary goals in his 2008 Fluke plan was to increase growth in the electrical distribution channel. Further to achieving that goal, Morrow did three things: (1) he spent four days meeting with retailers and distributors in the electrical channel in order to gather "voice of the customer data;" Ex. 16; CP 3539-40; 4026-35; (2) he prepared a 31-page report showing Fluke's Amprobe sales for 2007 and its projected sales for 2008 for every Amprobe distributor; CP 2854-87; and (3) he prepared his Amprobe business plan which outlined his goals and strategy for increasing Amprobe's sales in the electrical channel. Ex. 5; CP 3854-57; 3537-38. All of this was in the last eight weeks of Morrow's employment with Fluke. Although there are many different distribution channels used by Fluke and MET, when Morrow joined MET, he was tasked to do the same things he had just finished doing for Fluke: analyze the electrical channel. These were the operable circumstances when Morrow volunteered to share "actionable distributor data" with MET, CP 3998, and when he prepared his list of "low-hanging-fruit" distributors for MET to target in the electrical channel. CP4000-01. It is possible, although highly unlikely, that all this is innocent, as Morrow claims. But at most, his claims only create material issues of fact. They cannot support summary judgment.

c. The Cross Market Analysis

Toward the end of his Fluke employment, Morrow spent *six months* preparing a comprehensive Cross Markets Analysis for Fluke. This analysis included every T&M product on the market with its distributor pricing. CP 32, 439, 3523, 4003-05; Ex. 6. The information Morrow compiled in this document is a road map for where to introduce a new competing line of products. Within weeks of starting at MET, Morrow was working directly to help MET determine which products to introduce into the very same market Morrow had just comprehensively analyzed for Fluke. CP 4007-12.

Respondents argue that the Cross Markets Analysis is "too large to infer that Morrow somehow memorized it." Resp. Br. at 35, n.21. Again, this is an argument for the jury. But the jury need not infer that Morrow remembered every detail of his Cross Markets Analysis. Morrow has an advanced degree from the Massachusetts Institute of Technology. Ex. 3. He was not merely gathering data. What he did, and what the jury can certainly infer that he did, was to use this data to draw critical conclusions about the T&M market, such as where to best introduce new products.

d. The Thumb Drive(s)

As described in Fluke's opening brief, during the weekend before Morrow resigned from Fluke, Morrow copied files from his Fluke laptop to a thumb drive and then deleted the files from his laptop. Although he claims that he only copied personal files, while doing this Morrow somehow deleted a file containing all of his saved Fluke emails. Fluke Br. at 31-32. Morrow has never been able to explain how his email file got mixed up with his personal files and the circumstances are, at the very least, highly suspicious, and are certainly enough to permit a jury to infer that Morrow copied his Fluke emails and took them with him to MET at the urging of Mike Jones.

Respondents claim that an expert they hired proves that Morrow did not copy his email file and take it with him. CP 1749-50. However, this expert merely says that she reviewed two flash drives. She offers no evidence that she reviewed the specific flash drive Morrow used to copy files from his Fluke laptop. *Id.* Moreover, even if there were evidence she reviewed the correct flash drive, she could only provide an opinion on a "more probable than not basis." CP 1750. Respondents' expert declaration might create a dispute of fact over whether Morrow copied his email file, but that is a dispute that needs to be resolved by a jury.

e. The SIM Card

Respondents correctly point out that Morrow's SIM card did not contain his Fluke contacts. Resp. Br. at 8. But they overlook the salient point: *Both Morrow and Jones thought it did.* CP 3534; RP 1007:10-1008:11. That's why Jones told Morrow to take it and that's why Morrow did take it. It is the evidence of intent—intent to identify and take as much useful Fluke information as possible—that matters, especially where Respondents wrongly held back so much evidence in discovery.

3. Nguyen Misappropriated Fluke Trade Secrets

Respondents' primary answer to Evans Nguyen's proven use of Fluke trade secrets to steer MET to Fluke's original equipment manufacturers or "OEMs" is to insinuate that Fluke delayed before springing "an entirely new and previously undisclosed trade secrets theory that Nguyen had misappropriated trade secrets related to OEMs." Resp. Br. at 14. Given the circumstances, this argument is remarkably brazen.

There was no delay by Fluke. At the very start of the case, Fluke served MET with discovery asking for all MET documents containing the word "Fluke," a request specifically designed to turn up instances where Fluke's former employees were using Fluke documents or information to build MET's business. CP 513. Many of the key Nguyen documents contain the word, "Fluke" and thus were directly responsive to Fluke's discovery requests. CP 4113-14; 4121-27; 4128-4134; 4136. MET had been ordered to produce these documents on April 28, 2008. CP 465. It flagrantly disobeyed this order and withheld these critical documents for 16 months, finally producing them only two weeks before the summary judgment hearing. CP 4098-4100.

These documents should have been produced at the beginning of the case, not the end. Fluke asserted trade secret claims against MET in their first Amended Complaint, specifically noting that MET was developing a line of new T&M products to compete with Fluke and had hired Evans Nguyen, Shawn Holland, and Jim Curtin to work on exactly the same products and services on which they had worked at Fluke. CP 241-42. Fluke also provided early notice that it was concerned about Nguyen's detailed knowledge of Fluke's OEMs. CP 45-46.

Respondents' claim that Fluke "never once articulated a trade secrets claim based on the identity of the "good" OEM suppliers" is a half truth at best. Resp. Br. at 27. Fluke knew that this information was valuable and it knew that Nguyen possessed it. CP 45-46; 3865-67. The issue of OEMs was also the subject of substantial testimony during the preliminary injunction hearing. E.g, RP 454:4-456:6, 514:22-516:13. The only thing Fluke did not know was the extent to which Nguyen had used his knowledge of Fluke's OEM's to steer MET away from a subsidiary company and to Fluke's OEMs.

Once Fluke received these incriminating documents, it promptly incorporated them into its summary judgment arguments (*four days later*) and it promptly moved to amend the complaint to conform to this new evidence (*two weeks later*). For Respondents to now argue that summary judgment was proper and that Fluke's motion to amend was properly denied because *Fluke* unreasonably delayed is simply astonishing.

B. IT WAS ERROR FOR THE TRIAL COURT TO RULE THAT THE UTSA PREEMPTED FLUKE'S COMMON LAW CLAIMS

Under controlling Washington law, if misappropriated information does not qualify as a trade secret a party may still recover for the misuse of this same information under a common law theory of breach of confidentiality. *Boeing v. Sierracin Corp.*, 108 Wn.2d 38, 48 (1987). Here after the trial court found as a matter of law that none of the information Fluke sought to protect qualified as a trade secret, it then summarily found that Fluke's breach of confidentiality and breach of loyalty claims were preempted.

> THE COURT: "[T]he legal issue in this case, which is is there a trade secret sufficient information for a trier of fact

> to conclude that there is trade secrets factually. I just don't think so. I am going to grant the motion.
>
> . . . The common law fiduciary duty, I think that it is preempted in this context; that is my basis on this.

RP 69:24-70:16 (September 19, 2009).

In support of the trial court's ruling, Respondents cite *Thola v. Henschell*, 140 Wn. App. 70, 82 (2007) for the proposition that a plaintiff "may not rely on acts that constitute trade secret misappropriation to support other causes of action." *Id.*, *citing Ed Nowogrowski Ins., Inc. v. Rucker*, 88 Wn. App. 350, 359 (1997); Resp. Br. at 35. Respondents misread *Thola*. What *Thola* stands for is that a party may not recover twice—under trade secret law *and* under common law theories—for the same misconduct. If evidence supports a trade secret claim, that same evidence cannot be used to support common law claims. In other words, UTSA preemption is triggered when the plaintiff *prevails* on its trade secrets claim. *Id.* ("We note that proper application of this three step analysis precludes duplicate recovery for a single wrong.").[6] Having found (albeit incorrectly) that the information misappropriated by

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[6] *Accord Callaway Golf Co. v. Dunlop Slazenger Group Am., Inc.*, 295 F. Supp. 2d 430, 437 (D. Del. 2003) (defendant "cannot have it both ways" by arguing that information is not trade secret *and* that claim premised on misuse of such information is preempted by the Trade Secret Act because such an argument is "contradictory"); *Youtie v. Macy's Retail Holding, Inc.*, 626 F. Supp. 2d 511, 523 (E.D. Pa. 2009) (common law claims not preempted by PUTSA to the extent alleged information "does not constitute a misappropriation of a trade secret").

Respondents were not trade secrets as a matter of law, it was clear error for the trial court to rule that Fluke's breach of loyalty and breach of confidentiality claims were preempted.

C. LAW OF THE CASE DOES NOT MANDATE DISMISSAL OF THE MORROW CONTRACT CLAIM

Respondents argue and the trial court ruled that this Court's opinion reversing the trial court's preliminary injunction order was "law of the case" on the issue of whether Fluke had submitted sufficient evidence that Jon Morrow's Danaher Noncompetition Agreement had been assigned from Jacobs Chuck to Fluke. Resp. Br. at 1.[7]

"In its most common form, the law of the case doctrine stands for the proposition that once there is an appellate holding enunciating a principle of law, that holding will be followed in subsequent stages of the same litigation." *Roberson v. Perez*, 156 Wn.2d 33, 41 (2005).

Law of the case does not transform factual determinations on a preliminary injunction into verities on a later motion for summary judgment. Following a grant or denial of preliminary relief, the parties remain free to continue to develop the record through additional discovery and to provide additional evidence on a party's claims, including claims

[7] Respondents' insinuation that the assignment issue "developed later," Resp. Br. at 9, like so many of their assertions, is belied by the record. Fluke raised assignment during the very first hearing before the trial judge, only 10 days into the case. RP 22:22-25:1 (March 21, 2008).

that were the subject of the preliminary hearing. *See Envtl. Tech. Council v. South Carolina*, 901 F. Supp. 1026, 1032 (D.S.C. 1995).

Moreover, the standards used to decide preliminary injunctions and summary judgments are fundamentally different. A party seeking injunctive relief bears the high burden of demonstrating a "clear legal right" and that it is "likely to prevail on the merits." *Kucera v. Dep't of Transp.*, 140 Wn.2d 200, 209 (2000). As this Court observed, injunctions do not issue in a "doubtful case." COA Opinion at 3.

This is not the standard on summary judgment. On summary judgment, the non-moving party must not eliminate all doubt. Instead, all facts must be weighed in the light most favorable to the non-moving party, *King v. Rice*, 146 Wn. App. 662, 668 (2008), and summary judgment may be granted "only if reasonable people could reach but one conclusion." *Hash v. Children's Orthopedic Hosp. and Med. Ctr.*, 110 Wn.2d 912, 915 (1988); *see also Crown Plaza Corp. v. Synapse Software Sys., Inc.*, 87 Wn. App. 495, 500 (1997) ("Disputes over the existence of oral agreements are not appropriately decided on summary judgment").

Many courts have recognized the differing burdens presented on motions for summary judgment and preliminary injunctions.[8] The trial

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[8] *E.g., Boehringer Ingelheim Animal Health, Inc. v. Schering-Plough Corp.*, 6 F. Supp. 2d 324, 333 (D.N.J. 1998) ("success in defeating the

court clearly erred in believing that the COA Opinion mandated summary judgment on the factual question of whether Morrow's agreement had been assigned from Jacobs Chuck to Fluke. *See, e.g.*, *Washington Fed. of State Employees v. State of Washington*, 99 Wn.2d 878, 888 (1983) (an appellate court does not ordinarily "adjudicate the ultimate rights of the parties in the lawsuit" in reviewing a grant of a preliminary injunction). Thus, this Court's prior opinion does not foreclose a finding of ultimate liability. *See Smith v. Ozmint*, 444 F. Supp. 2d 502, 510 (D.S.C. 2006) (denying request for preliminary injunction and noting that its decision was not a "final decision on the merits of Plaintiff's claims; rather, it [found] that he has failed to overcome the high burden necessary for preliminary relief").

Respondents also argue that Fluke and Jacobs Chuck were required to amend Morrow's agreement after it had been assigned, an argument that is easily refuted. As the authority cited by both sides indicates, once the assignment is effective, Fluke steps into the shoes of Jacobs Chuck and replaces Jacobs Chuck throughout the agreement. There is no need for a second step of amending the agreement so that "Jacobs Chuck" is replaced

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preliminary injunction motion is [not] tantamount to granting a summary judgment motion"); *Malletier v. Dooney & Bourke, Inc.*, 561 F. Supp. 2d 368, 382 (S.D.N.Y. 2008) ("[F]indings of fact and conclusions of law made on a motion for preliminary injunction are not binding on a court deciding a motion for summary judgment") (internal quotations omitted).

with "Fluke" in the document. If that were the standard, no assignment would ever be effective standing alone.[9]

In sum, summary judgment on the Morrow contract claim was only appropriate if no reasonable jury could find that Jacobs Chuck had assigned Morrow's agreement to Fluke.[10] Inasmuch as Fluke's evidence of assignment is overwhelming, reversal is required.

D. IT WAS ERROR TO GRANT SUMMARY JUDGMENT ON THE NGUYEN CONTRACT CLAIMS

There is no question that Evans Nguyen repeatedly and willfully breached his employee nonsolicitation agreement. What Respondents characterize as "alleged assistance" is more than a dozen documents and emails that show Nguyen first identifying and then actively recruiting his former Fluke colleagues under the direction and encouragement of MET.[11]

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[9] It also bears mention that Morrow's agreement provided him with a year's termination payments in the event he was laid off or otherwise terminated from the "Company" without cause. If Respondents' argument is correct, Morrow's valuable termination benefits would have also terminated once he transferred to Fluke, an absurd result that no one would have intended or wanted.

[10] Respondents twice argue that it was Fluke's burden on summary judgment to "prove equitable assignment by 'clear and specific' evidence." Resp. Br. at 37 and 13. This reveals a fundamental misunderstanding of the non-moving party's burden on summary judgment. At the summary judgment stage, Fluke did not have to "prove" anything. The time for proof is later, and in this case is for the jury, not the trial judge. What Fluke must do—and what it did, by any reasonable measure—is produce sufficient evidence to create questions of fact as to the material elements of its claims.

[11] CP 3910; 3881-83; 3157; 3159; 3161; 3163-64; 3166; 3168; 3174; 3187; 3193; 3222; 3224; 3902; 3908.

Respondents do not seriously deny Nguyen's misconduct. Instead, they seek to avoid liability by asking the Court to (a) affirm an unprecedented and ill-advised extension of the Washington Supreme Court's holding in *Labriola v. Pollard Group, Inc.*, 152 Wn.2d 828 (2004); (b) find as a matter of law that eligibility to participate in an employee stock option plan does not constitute legal consideration; and (c) strike down Nguyen's employee nonsolicitation agreement on grounds of overbreadth. Each of these arguments fails.

1. The *Labriola* Rule Should Not Be Extended Outside the Context of Noncompetition Agreements

Respondents misstate Fluke's position and miscomprehend the law when they claim that Fluke is arguing that "consideration is not required" for Nguyen's employee non-solicitation agreement. Resp. Br. at 18. All contracts require consideration. However, outside the context of noncompetition agreements, continued employment under modified or new terms and conditions provides the necessary consideration from both sides. This general rule provides flexibility that benefits and is relied upon by *both* employers and employees.[12]

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[12] *See, e.g.*, *Gaglidari v. Denny's Restaurants, Inc.*, 117 Wn.2d 426 (1991) (revised discipline policy constituted a contract; continued employment provided consideration); *Jacoby v. Grays Harbor Chair & Mfg. Co.*, 77 Wn.2d 911, 915 (1970) (continued employment provides consideration for pension plan adopted during employment); *Brydges v. Coast Wide Land, Inc.*, 2 Wn. App.

Against the backdrop of this rule, Washington and many other jurisdictions have adopted rules requiring independent consideration (beyond continued employment) when an employer requires a noncompetition agreement be signed after employment has already commenced. *See Labriola*, 152 Wn.2d 828; Resp. Br. at 17, n.10. However, no Washington court and, to Fluke's knowledge, no court from any other jurisdiction, has ever applied this heightened consideration rule to employee non-solicitation agreements. This Court should decline Respondents' invitation to be the first.

Respondents specifically argue that *Labriola* should be extended to apply to "*any* bilateral agreement entered into by an employee after the initial hire." Resp. Br. at 17. This argument finds no support in *Labriola*. The *Labriola* analysis and decision makes no mention of bilateral or unilateral contracts. Moreover, Respondents' argument, if adopted, would overturn years of precedent, undermine the current validity of uncounted existing contracts, and pose significant burdens to flexibility within the employment at will context to the detriment of both employers and employees. There is nothing in *Labriola* to suggest that the Washington Supreme Court intended such a radical outcome.

223, 226 (1970) (continued employment provided consideration for sales bonus plan).

Finally, the unilateral and bilateral distinction urged by Respondents finds no support in case law addressing other types of employment agreements. To the contrary, courts regularly find continued employment to provide sufficient consideration for employment agreements, whether bilateral or unilateral.[13]

2. Nguyen's Eligibility for Stock Option Awards Is Adequate Consideration

Respondents misstate the consideration provided by Fluke when Nguyen signed his employee non-solicitation agreement. The consideration provided by Fluke was that Nguyen would be included among the class of Fluke employees eligible for stock option awards. Had Nguyen not signed the agreement, he would not have been eligible to receive future stock options, no matter how extraordinary his work performance otherwise was. CP 1567. This was plainly a benefit to Nguyen, even if he did not deserve the kind of exceptional performance warranting stock option grants in subsequent years. Moreover, Fluke was bound by its promise to include Nguyen among the employees eligible for

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[13] *E.g.*, *Machen, Inc. v. Aircraft Design, Inc.*, 65 Wn. App. 319, 327 (1992) (employee confidentiality agreement); *Marotta v. Toll Brothers, Inc.*, 2010 WL 744174, *4, n.4 (E.D. Pa. Mar. 3, 2010) ("courts consistently find continued employment to be adequate consideration for arbitration agreements"); *Schirmer v. Principal Life Ins. Co.* 2008 WL 4787568, *6 (E.D. Pa. Oct. 29, 2008) (restricted stock agreement); *Tomasini v. Mount Sinai Med. Ctr. of Florida, Inc.*, 315 F. Supp. 2d 1252, 1254, 1257 (S.D. Fla. 2004) (enhanced severance benefits); *Kauffman v. Int'l Brotherhood of Teamsters*, 950 A.2d 44 (D.C. 2008) (agreement to provide housing allowance).

option grants and it honored that promise. Nguyen remained eligible in subsequent years and was considered for option grants. *Id.* He simply did not meet the other criteria required for an award.

The cases cited by Respondents do not warrant a different result. In *MSC Indus. Direct Co. v. Steele*, 2009 WL 2501762 (N.C. App. 2009), the employee was granted restricted shares "more than thirty days *before* either the award or the agreement was signed." *Id.* at *4 (original emphasis). In this case, Nguyen did not become eligible for future option awards until *after* he signed the agreement. CP 1567. *Heuser v. Kephart*, 215 F.3d 1186 (10th Cir. 2000) is simply inapposite as it involved an effort to enforce a settlement agreement where the attorneys for one of the parties did not have actual authority to agree to the settlement and instead had only promised to present the agreement to its client for consideration. *Id.* at 1192-93. Finally, in *Wilmar, Inc. v. Liles*, 185 S.E.2d 278 (N.C. App. 1971), the court found no consideration where the employer offered and then took back the consideration. "A consideration cannot be constituted out of something that is given and taken in the same breath.'" *Id.* 78-9. Here nothing was taken back. Nguyen remained among the class of employees eligible for option grants throughout the remainder of his employment.

3. Enforcing Nguyen's Contract Would not Restrain Trade

Lastly, Respondents argue that the court should nullify Nguyen's contract because "the employee nonsolicitation clause is unreasonably broad and violates Washington's public policy prohibiting contracts in restraint of trade." Resp. Br. at 20. Specifically, Respondents assert that Nguyen's agreement (a) protects no legitimate interest; (b) is "grossly overbroad;" and (c) would unreasonably "threaten, and overly restrict, freedom of employment." *Id.* at 20-25. Each proposition fails.

First, Fluke's interest is not simply to maintain a stable workforce. It is to prevent departing employees from unfairly using their insider knowledge and relationships they developed while working at Fluke for the benefit of a competitor. Addressing covenants not to compete, which are far more restrictive than employee non-solicitation agreements, the Washington Supreme Court confirmed that Washington courts will enforce agreements so as to prevent an employee from using his or her employer's "valuable information" for the benefit of a competitor. *Wood v. May*, 73 Wn.2d 307, 310 (1968). There is ample evidence that Nguyen did exactly this. *See fn 11 supra.* Indeed, in his very first days at MET, Nguyen included among his action items:

> Hire two PMs for Seattle branch. *Positions and expertise already identified.*

CP 4134 (emphasis added).

Second, Respondents' complaint that Nguyen's agreement prohibits him from soliciting employees, "not just of Fluke, but also of Danaher and its hundreds of subsidiaries," is a red herring that ignores settled principles of Washington law. If a contract is overbroad, the correct approach under Washington law is not to throw out the entire contract, as Respondents urge, but to enforce the contract "to the extent it is reasonable and lawful." *Wood*, 73 Wn.2d at 312-14. Nguyen identified and recruited colleagues that, by virtue of his employment with Fluke, he knew all too well. Fluke seeks to remedy *this* breach, not some hypothetical scenario involving far flung employees unknown to Nguyen.

Third, Respondents' argument that Nguyen's agreement unduly restricts employee mobility fails even the straight face test. Nothing in Nguyen's agreement impedes fair competition for employees. The agreement did not bar Nguyen from joining MET and it did not restrain Mike Jones or other MET employees from recruiting and hiring whoever they wanted, including Fluke employees. The only limit Nguyen's agreement posed was to bar Nguyen from competing *unfairly* by leveraging his insider knowledge and Fluke relationships for the benefit of a competitor.

E. RESPONDENTS CANNOT AVOID REVERSAL OF THE TRADE SECRETS SUMMARY JUDGMENT BY RAISING THE ISSUE OF DAMAGES

Relying primarily on the fact that MET's products had not yet come to market when the trial court dismissed the lawsuit, Respondents ask the Court to affirm summary judgment due to the supposed absence of evidence of damages. Resp. Br. at 40. As Respondents implicitly acknowledge, the trial court made no ruling on this issue. *Id.* at 39. n.27. This argument fails on multiple levels.

First, a trade secret misappropriation claim does not fail merely because the misappropriating party has not yet brought its product to market. A trade secret plaintiff can recover for both actual losses and unjust enrichment. RCW 19.108.030(1). While Fluke had not yet experienced lost sales, it presented direct evidence of how MET was unjustly enriched by using Fluke's trade secrets to build its T&M business. The most flagrant example was Nguyen steering MET away from using Solarwide to build their T&M products, thereby avoiding "probable risk to the speed, quality and delivery" of MET's new products. CP 4099 and 4127. But MET also benefited from having Morrow identify which T&M products to introduce, developing MET's strategy for introducing T&M products into the electrical channel and assisting in its marketing plan for laser distance meters. *See* Section I.A.2.a-c, *supra*.

Washington courts adhere to the principle that "'the wrongdoer shall bear the risk of the uncertainty which [its] own wrong has created.'" *Jacqueline's Washington, Inc. v. Mercantile Stores Co.*, 80 Wn.2d 784, 790 (1972) (quoting *Bigelow v. RKO Radio Pictures, Inc.*, 327 U.S. 251, 266 (1946)). A plaintiff is not denied substantial recovery merely because the precise amount of damage is incapable of exact ascertainment. *Id.* at 789.

Although MET had produced only *one page* in response to Fluke's discovery requests seeking information on specifically how MET was unjustly enriched, CP 3574-3582; 3546, Fluke was still able to provide a calculation of the value of MET's unjust enrichment based on publicly available financial statements of MET's parent company. CP 3514-16. This is more than enough to survive summary judgment, especially given MET's utter refusal to respond in good faith to discovery.[14]

Respondents invoke the so-called "new business rule" to suggest that Fluke could not rely on MET's own internal sales and profit projections, but instead was required to look outside MET to calculate MET's unjust enrichment. What Respondents fail to recognize is that the

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[14] Moreover, Fluke seeks both damages and injunctive relief. Even if the trial court had found Fluke's damages evidence insufficient—which it did not—the ruling would not have resulted in the dismissal of any claims, let alone all claims as Respondents ask now.

"new business rule" is a rule designed to restrict a plaintiff from relying on *its own* profit projections to prove damages it seeks to recover against a defendant. *E.g.*, *Larsen v. Walton Plywood Co.*, 65 Wn.2d 1, 16 (1964). The new business rule has never been invoked in the circumstance present here, where one party seeks to use the internal projections of the *other* party.

Moreover, the new business rule is generally inapplicable where, as here, the persons establishing the new business have significant experience in the business they are establishing. *See Butcher v. Garrett-Enumclaw,* 20 Wn. App. 361, 374-76 (1978).

Respondents next argue that Fluke is estopped from bringing damages claims because it sought an injunction on its trade secret claim. Respondents essentially argue a trade secret plaintiff, having had little or no discovery, who seeks to obtain preliminary injunctive relief to maintain the status quo while the case proceeds is thereafter precluded from recovering for the damages attributable to the misappropriation. But there is nothing "inconsistent" in arguing that Fluke could not be fully compensated through monetary relief and that *some* recoverable damages could be quantified with reasonable certainty, after the completion of discovery, for the misappropriation of its trade secrets. Injunctive relief is generally appropriate in trade secrets cases precisely because a plaintiff will ultimately "lose" some damages attributable to misappropriation because they are incapable of quantification.

The decision of the Massachusetts Court of Appeals in *Frank D. Wayne Assoc., Inc. v. Lussier*, 454 N.E.2d 109 (Mass. App. 1983) is illustrative. In *Lussier*, a master issued a preliminary injunction and, after a full hearing, awarded the plaintiff $50,000 in damages for the defendant's breach of a noncompetition agreement. *Id.* The defendant, on appeal, argued that "the plaintiff, having obtained injunctive relief, may not also recover damages." *Id.* In rejecting this contention, the court noted:

> Since [a court's] assessment of the parties' lawful rights at that time might not correspond to the final judgment, the purpose of the preliminary injunction was not to award full relief but rather to seek to minimize the harm that final relief can not redress. Only after a full hearing could the measure of relief to which the plaintiff was entitled be properly determined.

Id. (internal quotations omitted).

What is more, the estoppel doctrines Respondents rely on are inapposite. Respondents first argue that collateral estoppel bars Fluke from asserting a claim for damages. Respondents present no case law to support the applicability of collateral estoppel in this circumstance, and the doctrine is plainly inapplicable. Collateral estoppel prevents relitigation of a particular issue in a *subsequent* proceeding involving the same parties that ended with a final judgment on the merits. *Pederson v. Potter*, 103 Wn. App. 62, 69 (2000). Further, "[c]ollateral estoppel is concerned only with limiting the relitigation of factual issues [and] has nothing to do with restricting arguments on pure issues of law." 14A Washington Practice §35.33. The determination of whether damages are calculable to the requisite degree is a question of law. *Pribil v. Koinzan,* 665 N.W.2d 567, 573 (Neb. 2003) ("[T]he initial question of law for the trial court is whether the evidence of damages provides a basis for determining damages with reasonable certainty . . . .").

Nor does the doctrine of judicial estoppel help Respondents. It is well-established in Washington that the doctrine of judicial estoppel does not apply to inconsistent legal positions. *See Holst v. Fireside Realty, Inc.*, 89 Wn. App. 245, 259 (1997) (Judicial estoppel "prevents a party from taking a *factual* position that is inconsistent with his or her *factual* position in previous litigation"); *Miles v. State, Child Protective Services Dep't*, 102 Wn. App. 142, 153 (2000) (same); *see also* 14A Washington Practice § 35.37 ("The rule [of judicial estoppel] applies only to inconsistent assertions of fact; it is not applicable to inconsistent positions taken on points of law"). And again, there is nothing inconsistent in arguing that injunctive relief is appropriate because not *all* damages will be capable of reasonable ascertainment.

II. OPPOSITION TO RESPONDENTS' CROSS APPEAL

A. RESTATEMENT OF ISSUES PERTAINING TO ASSIGNMENTS OF ERROR ON CROSS APPEAL

1) Did the trial court correctly decline to award Respondents fees for dissolving an injunction where (a) the trial court did not dissolve an injunction; and (b) Respondents failed to timely request fees when the injunction was dissolved by this Court on interlocutory appeal?

2) Was the trial court correct to apply South Carolina law rather than RCW 4.84.330 in determining that Morrow was not entitled to an award of fees for his breach of contract claim, where the trial court had determined, at Respondents' urging, that South Carolina governed Morrow's contract?

3) Should the trial court have awarded fees to MET based on the Nguyen and Morrow contracts where MET was not a party to either contract?

4) Did the trial court abuse its discretion in rejecting Respondents' arguments that Fluke's trade secrets claim was maintained in bad faith?

B. THE TRIAL COURT CORRECTLY DECLINED TO AWARD FEES FOR DISSOLVING AN INJUNCTION

Respondents first argue that the trial court erred by declining to award fees under a line of cases that allow courts to award fees incurred in dissolving an injunction. Resp. Br. at 44. The trial court properly rejected this argument because this was a request that needed to be made to the Court of Appeals in the course of Respondents' interlocutory appeal.

The trial court entered its preliminary injunction on June 3, 2008. CP 837-49. Respondents then obtained interlocutory review in this Court. This Court reversed the trial court, ruling, among other things, that Fluke had failed to present sufficient evidence of assignment to show a "clear legal right" to an injunction. Respondents did not request fees on that appeal.

RAP 18.1 provides that "[i]f applicable law grants to a party the right to recover reasonable attorney fees . . . on review before . . . the Court of Appeals . . . the party must request the fees . . . as provided in this rule, unless a statute specifies that the request is to be directed to the trial court." Specifically, a party seeking fees "must devote a section of its opening brief" to the request. RAP 18.1(b). Absent a mandate or statute providing specific authorization, the trial court has no power to award appellate fees.[15]

Any fees incurred by Morrow in dissolving the injunction against him, were incurred *on appeal*, not at the trial court. Accordingly, the trial

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[15] *See* RAP 18.1(a), (h) and (i) ; *Thompson v. Lennox*, 151 Wn. App. 479, 599-601 (2009) (finding trial court had no authority to award appellate fees because "a party seeking fees on appeal must clearly set forth the request . . . before the appellate court [and a] party's failure to [do so] warrants denial of her fee request"); *Hedlund v. Vitale*, 110 Wn. App. 183, 190-91 (2002) (on remand, trial court lacks authority to award fees for an appeal where none were requested of the appellate court); *Mestrovac v. Dep't of Labor & Indus.*, 142 Wn. App. 693, 710-11 (2008) (reversing trial court's award of fees for briefing before Court of Appeals).

court had no authority to award fees on this basis and it properly denied Respondents' requests.[16]

C. RESPONDENTS' CLAIMS FOR ATTORNEYS' FEES UNDER MORROW'S AGREEMENT FAIL

1. Morrow and MET Are Not Entitled to Fees Under the South Carolina Law that Governs the Agreement

Jon Morrow's Danaher Noncompetition Agreement contains a South Carolina choice of law provision. Resp. Br., Ex. B at 7. Relying on this, Respondents successfully persuaded the trial court that South Carolina law controlled any dispute involving Morrow's agreement. *See* CP 4458-60. The trial court therefore applied South Carolina law in dismissing Fluke's breach of contract claim against Morrow. CP 1121 ¶ 2 n.1; CP 1149-50. It is worth repeating Respondents' arguments below:

> [B]oth Jacobs Chuck and Morrow expressly agreed that their rights and obligations under the Agreement would be governed *exclusively* by South Carolina law, without regard to choice of law provisions. In other words, the parties to the Agreement agreed that the application of South Carolina law *would be absolute.*
>
> . . . .
>
> Under Washington law, where a contractual choice of law provision has been agreed to, "protecting the justified expectations of the parties comes to the fore." *Erwin v.*

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[16] Even if the trial court *did* have authority to award fees for this Court's dissolution of the injunction, the decision to award or deny fees on that ground is firmly committed to the trial court's *discretion*. *Confederated Tribes of Chehalis Reservation v. Johnson*, 135 Wn.2d 734, 758 (1998) (noting that "attorney fees *may* be awarded to a party who prevails in dissolving a wrongfully issued injunction.") (emphasis added).

> *Cotter Health Ctrs.*, 161 Wn.2d 676, 699 (2007). . . . Accordingly, *South Carolina law controls the construction, interpretation and effect of the Agreement.*

CP 4459-60 (emphasis added).[17]

Having recognized that the same South Carolina law they had successfully urged the trial court to apply and invoked to obtain summary judgment would *not* authorize a fee award, Respondents reversed course. Respondents asked the trial court to apply state law piecemeal to the Morrow breach of contract claim: South Carolina law, where it benefited Respondents, and Washington law when South Carolina law was *not* favorable. Washington law, specifically RCW 4.84.330, makes unilateral fee-shifting provisions in contracts bilateral. Under South Carolina law, fees are not recoverable unless authorized by contract or statute. *See Blumberg v. Nealco, Inc.*, 427 S.E.2d 659, 660 (S.C. 1993). South Carolina has no analogue to RCW 4.84.330, and as no South Carolina statute authorizes such an award, the American Rule would apply and Morrow would *not* be entitled to an award of fees under South Carolina law.

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[17] Respondents state that "Fluke alleged the agreement was governed by Washington law." Resp. Br. at 45. This is only half true. Fluke argued for Washington law but also directly advised the trial court that it was content to proceed under either state's law. CP 292 ("Plaintiffs are equally willing to proceed under either Washington or South Carolina law . . . "); RP 30:20-12 (March 21, 2008) ("We don't care if the Court chooses to apply Washington or South Carolina law.")

Court after court has rejected precisely the kind of opportunistic law shopping that Respondents are after here.[18]

The decision in *Fairmont Supply Co. v. Hooks Industrial, Inc.*, 177 S.W.3d 529 (Tex. Ct. App. 2005), is particularly instructive because it addresses the very same arguments raised here by Respondents. After a trial, Hooks recovered a judgment of $1,200,000 in a breach of contract action. Hooks then sought to recover its attorney fees from Fairmont. The parties' contract included a Pennsylvania choice of law provision, which the trial court had applied to the underlying contract claim. Under

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[18] *See, e.g., Demitropoulos v. Bank One Milwaukee, N.A.*, 953 F. Supp. 974, 978 (N.D. Ill. 1997) (declining to "apply Illinois law piecemeal" and judicially estopping defendant "from taking clearly inconsistent legal positions [in asking for different state laws] at different stages of litigation"). *See also Omintech Int'l, Inc. v. Clorox Co.*, 1992 WL 211490, *2 (E.D. La. Aug. 19, 1992) ("[T]he law which governs the substantive claims of the note also govern[s] a claim for attorney's fees."); *Boyd Rosene & Assocs., Inc. v. Kansas Mun. Gas Agency*, 174 F.3d 1115, 1127-28 (10th Cir. 1999) (reversing trial court award of attorneys fees under Oklahoma law in breach-of-contract case where contract was governed by Kansas choice-of-law clause because the parties' "expectation would have been that Kansas law would govern the recovery of attorney's fees."); *Katz v. Berisford Int'l PLC*, 2000 WL 959721, *8 (S.D.N.Y. July 10, 2000) (concluding that law of jurisdiction named in contract's choice-of-law provision applied to question of recoverability of attorneys fees); *In re New Power Co.*, 313 B.R. 496, 514 (Bkrtcy. N.D. Ga. 2004) ("The Court is persuaded that, if a Georgia court were to conclude that, under California law, APX was entitled to prevail on its contract claim, a Georgia court would also apply California law to determine whether APX is entitled to a statutory award of attorneys' fees"); *El Paso Natural Gas Co. v. Amoco Production Co.*, 1994 WL 728816, *5 (Del. Ch. Dec. 16, 1994) (holding that Texas law applied to the issue of whether the prevailing party in a contract dispute was entitled to attorneys fees because the contract at issue provided for Texas law to apply); *cf. Oklahoma Fixture Co. v. Ask Computer Sys., Inc.*, 45 F.3d 380 (10th Cir. 1995) (noting that "that entitlement to attorney's fees in a diversity action is governed by the same state law that governs the substantive issues").

Pennsylvania law, Hook was not entitled to recover its fees. If Texas law applied, however, Hook would recover its fees from Fairmont.

The court rejected Hooks' attempted law-shopping, squarely holding that where a "choice-of-law provision . . . expressly governs issues of contractual performance" and the question of liability under the contract is governed by the law of the chosen state, "the award of attorney's fees is inextricably intertwined with the substantive issue of contractual liability [and so is] an issue that is indisputably governed by the choice-of-law provision." *Id.* at 535-36.

As the Fifth Circuit aptly put it in the course of reversing the trial court's decision to award attorneys fees under Texas law after the trial court had applied Illinois law to the underlying contract claim pursuant to a choice-of-law clause:

> We see a contradiction in saying on the one hand that the action for money had and received is inextricably intertwined with the interpretation of the contract in order to award fees under Texas law, but on the other in saying the action and the interpretation of the note are not intertwined in order to avoid the [Illinois] choice-of-law provision.

Kucel v. Walter E. Heller & Co., 813 F.2d 67, 73-74 (5th Cir. 1987).[19]

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[19] *See also Boise Tower Assoc., LLC v. Washington Capital Joint Master Trust Mortg. Income Fund*, 2007 WL 4355815, *4 (D. Idaho Dec. 10, 2007) ("[T]he parties are not entitled to attorney fees under an Idaho substantive statute

Having successfully argued for the application of South Carolina law when it benefited them to do so, Respondents cannot now be heard to take a contrary position, when their chosen law proves unfavorable. The trial court properly refused to award attorneys fees under RCW 4.84.330 because Washington law did not govern Morrow's Agreement.

D. MORROW IS NOT ENTITLED TO FEES UNDER THE DOCTRINE OF MUTUALITY OF REMEDIES

Respondents' effort to find succor in Washington's mutuality of remedy doctrine is an obvious and unavailing attempt to apply the RCW 4.84.330 to Morrow's Agreement through the backdoor. Again, South Carolina law governs the Agreement. No South Carolina court has *ever* awarded attorneys fees on a "mutuality of remedy" theory—let alone in the circumstances presented here—because, in South Carolina, "attorney's fees are not recoverable unless authorized by contract or statute."[20] *Baron Data Sys. v. Loter*, 377 S.E.2d 296, 297 (S.C. 1989). And because South

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that enlarges the rights of litigants to a commercial dispute when the [Washington] law governing the contract denies litigants that right.").

[20] Respondents completely mischaracterize the single case they cite to support the proposition that South Carolina "does apply the doctrine of mutuality of remedy in appropriate circumstances." Resp. Br. at 46 (citing *Simpson v. MSA of Myrtle Beach, Inc.*, 644 S.E.2d 663, 672 (S.C. 2007). The *Simpson* court held that an arbitration clause was unconscionable because, in part, it allowed one party to file suit in court while requiring the other to arbitrate claims. It neither held nor implied that a court could award attorneys fees in the absence of contractual or statutory authority to do so. And indeed, it expressly held that "our courts have held that lack of mutuality of remedy in an arbitration agreement, on its own, does not make the arbitration agreement unconscionable." *Id.*

Carolina law governs the Agreement, Respondents are simply not entitled to have this Court apply Washington law—whether RCW 4.84.330 or an equitable doctrine—to the Agreement.

E. AS A NON-PARTY TO THE TWO CONTRACTS MET CANNOT RECOVER FEES

Regardless of whether RCW 4.84.330 applies to Morrow's Agreement, MET is not entitled to its fees under either Morrow's or Nguyen's contracts pursuant to that statute. MET has no claim to fees under contracts to which it was neither a party nor a beneficiary. RCW 4.84.330 only "encompasses an[] action in which it is alleged that a person is liable on a contract." *Herzog Aluminum, Inc. v. Gen. Am. Window Corp.*, 39 Wn. App. 188, 197 (1984). MET cannot seriously contend that it is entitled to recover fees under RCW 4.84.330 because Fluke asserted *tort* claims against it.

It is well-established that an action is not "on a contract," where an "underlying document[] merely provide[s] the background" of a dispute, as is the case with plaintiffs' tortious interference claims against MET. *Hemenway v. Miller*, 116 Wn.2d 725, 742 (1991). As one leading treatise, analyzing the California statute that served as the template for RCW 4.84.330, explains:

> The public policy of mutuality of remedy established by the statute authorizing attorney's fees to the prevailing party

> when the contract provides for an award of attorney's fees to one party, applies only to attorney's fees for contract actions, not tort claims . . . When a contract authorizes an award of attorney's fees in an action to enforce any provision of a contract, tort claims are not covered.

William Lindsley, Alys Masek, and Nancy E. Yuenger, Ca. Jur. Damages § 128 (2009).[21]

Moreover, RCW 4.24.330 does *not* allow a stranger to a contract to recover fees from one of the parties to the contract.[22] *See, e.g.*, *G.W. Equipment Leasing, Inc. v. Mt. McKinley Fence Co.*, 97 Wn. App. 191, 200 (1999) (although husband and his marital community were the prevailing parties in an action to enforce a contract, the husband's request for fees on behalf of his wife was denied because wife was a non-party to the contract). A non-signatory defendant to a breach of contract action can only recover fees under RCW 4.84.330 where the defendant was sued "as if he were a party" to the contract.[23] *Herzog*, 39 Wn. App. at 196.

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[21] In *Herzog*, the court found California law instructive in interpreting RCW 4.84.330 because RCW 4.84.330 was based on Cal. Civ. Code § 1717. *Herzog*, 39 Wn. App. at 194.

[22] This also answers Respondents' claim that *MET* should recover fees under Washington's inapplicable equitable doctrine of mutuality of remedy. MET cannot recover fees under Morrow or Nguyen's Agreements on this ground because *Fluke* could not recover *its* fees against MET—a third party nonsignatory—pursuant to the attorneys fees provisions of those Agreements.

[23] As California courts have made clear, a nonsignatory can only take advantage of California's analogue to RCW 4.84.330 where it "is sued on the ground that [it] stands in the shoes of a party to the contract, and where [it] would be liable for fees if that claim succeeded." *Blickman Turkus, LP v. MF Downtown Sunnyvale, LLC*, 162 Cal. App. 4th 858, 897, 76 Cal. Rptr. 3d 325

Accordingly, *no* Washington court has awarded fees under RCW 4.84.330 to a third party who successfully defends against a tortious interference claim.[24] There is no legitimate argument to the contrary.

F. FEES WERE NOT WARRANTED UNDER RCW 19.108.040

Finally, Respondents ask this Court to find error in the trial court's decision that fees under RCW 19.108.040 were not warranted. CP 6021-22. Respondents fall well short of what is required to show that the trial court abused its discretion.

RCW 19.108.040 provides the court with discretion to award attorneys fees where "a claim of [trade secret] misappropriation is made in bad faith." A trial court's decision to award or deny fees under RCW 19.108.040 "is discretionary" and thus can not be reversed on appeal unless the trial court "clearly abused its discretion." *Thola*, 140 Wn. App. at 89; *see also Precision Airmotive Corp. v. Rivera*, 288 F. Supp. 2d 1151,

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(2008) (citing *Reynolds Metals Co. v. Alperson*, 25 Cal. 3d 124, 128, 158 Cal. Rptr. 1 (1979)); *see also Super 7 Motel Assoc. v. Wang*, 16 Cal. App. 4th 541, 548, 20 Cal. Rptr. 2d 193 (1993) (cases where nonsignatories recovered fees "involve[] lawsuits in which the plaintiff's claim, if successful, would have established the defendant was *in fact liable* on the contract even though the defendant was nominally a nonsignatory").

[24] Respondents cite *MP Medical Inc. v. Wegman*, 141 Wn. App. 409 (2009) for the proposition that a claim for tortious interference is an action "on a contract" within the meaning of RCW 4.84.330. Resp. Br. at 47. The case does not support the proposition. Indeed, the case involved an award of fees to a prevailing *plaintiff* and *did not involve fee-shifting under* RCW 4.84.330. Thus, the *MP Medical* court *does not so much as cite to RCW 4.84.330* in its opinion, let alone decide that a tortious interference claim asserted against a third party nonsignatory is an action "on a contract."

1155 (W.D. Wash. 2003) (noting that the court "has discretion to not award fees").

Thus, on appeal from an award granting or denying sanctions, the appellant has an "uphill battle" to "overcome . . . the 'abuse of discretion' rule." *FLIR Sys., Inc. v. Parrish*, 174 Cal. App. 4th 1270, 1275-76, 95 Cal. Rptr. 3d 307 (2009).

1. Only Truly Egregious Misconduct Supports an Award of Fees Under RCW 19.108.040

The defendant bears the burden of demonstrating bad faith. *See Precision Airmotive*, 288 F. Supp. 2d at 1155. A defendant must demonstrate that plaintiff "was fully aware that its suit was essentially frivolous."[25] *Id.* at 1155 (denying request for fees). "An action is frivolous if it cannot be supported by any rational argument on the law or facts." *Jeckle v. Crotty*, 120 Wn. App. 374, 387 (2004) (construing RCW 4.84.185) (internal quotations omitted). Because an action is brought in bad faith only "when a party intentionally brings a frivolous claim . . . with improper motive," merely "[b]ringing a frivolous claim is not enough, there must be evidence of an 'intentionally frivolous [claim] brought for

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[25] Respondents' contention that a "prevailing defendant need not prove that the claims were frivolous to establish bad faith" under RCW 19.108.040, which is premised on *California* law, is flatly contradicted by *Precision Airmotive*. No Washington court has ever defined "bad faith" as "objectively specious," whether under RCW 19.108.040 or in any other context.

the purpose of harassment.'" *Rogerson Hiller Corp. v. Port of Port Angeles*, 96 Wn. App. 918, 929 (1999) (quoting *In re Recall of Pearsall-Stipek,* 136 Wn.2d 255, 267 (1998)).

Other courts have defined bad faith similarly. *See Optic Graphics, Inc. v. Agee*, 591 A.2d 578, 587-88 (Md. App. 1991) (a defendant must provide "clear evidence" that an action "is entirely without color and taken for other improper purposes amounting to bad faith") (quoting *Needle v. White,* 568 A.2d 856, 861 (Md. App. 1990)). "[O]nly egregious behavior will support such a holding." *Needle*, 568 A.2d at 861.

Optic Graphics shows the level of misconduct needed to sustain a finding of bad faith under the UTSA. There, the marketing strategy and pricing information at issue were not trade secrets, and plaintiff "testified that he had no actual knowledge that appellees had misappropriated . . . trade secrets, and that he instituted suit 'to create a level playing field for future competition.'" *Optic Graphics*, 591 A.2d at 586-89. Worse, plaintiff pressed on to trial after learning that defendant's signature had been *forged* on a confidentiality agreement. *Id.* at 583. Nonetheless, the court vacated an award of fees, finding plaintiff had "reason to believe that it had a colorable claim" because defendant (1) had comprehensive knowledge of its confidential information; and (2) did not inform plaintiff of his intent to open a competing business until he resigned; and (3) the plaintiff required its employees to sign a confidentiality agreement. *Id.* at 590. Other jurisdictions agree. *See, e.g.*, *Colo. Supply Co. v. Stewart*, 797 P.2d 1303, 1307-08 (Colo. App. 1990) (vacating fee award where plaintiff never told [defendant] that [a customer list] was to be preserved, and . . . all the information was easily accessible" because (1) a customer list can conceivably qualify as trade secrets, (2) plaintiffs sought to maintain the list as confidential, and (3) after competitor hired defendant, it "added six new product lines in competition with plaintiff").

2. Fluke Pursued Its Claims in Good Faith

As the trial court determined, Respondents did not meet their heavy burden of showing that Fluke was "fully aware that [this] suit was essentially frivolous," *Precision Airmotive*, 288 F. Supp. 2d at 1155, and that it was "brought for the purpose of harassment." *Pearsall-Stipek,* 136 Wn.2d at 267.

While the trial court dismissed Fluke's trade secret claims, Fluke believed at the outset and still believes that MET built its T&M business with misappropriated Fluke trade secrets. CP 5911. Fluke's good faith belief in the validity of its claims was well-grounded in the evidence and precludes entry of sanctions under RCW 19.108.040.

Fluke identified fourteen specific trade secrets that it alleged that Respondents had misappropriated, CP 5911-12 ¶ 6 & CP 5946-60, and

Fluke provided specific testimony establishing that these met all the requirements for a trade secret under Washington law. *See, e.g.*, CP 807-22; 1201-03; 1594-96; 3865-67.

Fluke also presented both direct and circumstantial evidence that supported its good faith belief that Respondents misappropriated trade secrets to jumpstart MET's new T&M business. MET formed its new T&M group entirely from ex-Fluke employees and did not even attempt to hire from elsewhere because, in Evans Nguyen's words, "it's going to take us longer to do that, and I—I'm not sure we're going to get what we want." CP 4139; 4149-56. Each of those employees was then assigned tasks that were identical or similar to exactly what they had done at Fluke. Fluke presented evidence that Morrow offered to share confidential Fluke information regarding projects he had worked on shortly before joining MET. *See* CP 4139; 4160-4222; 4228-31; 5926-32; 5940-42. Likewise, Fluke showed that MET made major shifts in its strategy after hiring former Fluke employees with access to Fluke trade secrets. *See, e.g.*, CP 3865-67; 4106-08.

Lastly, Fluke presented evidence that MET sought to hide its misconduct. After Fluke filed suit, Jones instructed his team to "stop sending e-mails to suppliers" and to use personal e-mail rather than work e-mail for work purposes. CP 4233-34; 5935-37.

Fluke's trade secret claims were brought pursuant to well-established theories of liability and they were supported by specific and substantial evidence. Summary judgment was inappropriate and there is no basis at all to find that Fluke's trade secret claims were frivolous or objectively specious.

Respondents' wishful assertion that there is "ample evidence" of *actual* bad faith is even further off the mark. Respondents first suggest that Fluke's supposed "failure throughout the case to identify the trade secrets at issue" is evidence of *actual* bad faith. This is revisionist history of the first order. On the very day the complaint was filed, Fluke filed a sworn declaration from Ken Konopa, Morrow's direct supervisor, that specifically identified the trade secrets then known to be at issue. CP 28-35. Konopa's declaration identified, by name or category, nearly all of the trade secrets that later discovery would confirm were misappropriated or threatened to be misappropriated by Morrow or the other Respondents. This included Fluke's 3-year strategic plan (CP 30-31); the cross-market products list (CP 32), Voice of the Customer information (CP 29); and product performance testing results (CP 30). When Respondents propounded an interrogatory seeking identification of the trade secrets that Fluke alleged were misappropriated, Fluke responded *six different times*. CP 5911-12 ¶ 6. No answer would ever have been good enough, because the point was never to learn more about Fluke's claims. The point was to use the argument as a means of hiding evidence. In the end, the trial court eventually had to step in and put an end to this stonewalling. CP 977-80.

Next, and along the same lines, Respondents point to Fluke's supposedly "grossly overbroad" discovery requests. Tellingly, despite extensive discovery motion practice below, the trial court never entered a protective order, awarded sanctions against Fluke or otherwise indicated that a single discovery request propounded by Fluke was overbroad. To the contrary, the trial court *twice* entered orders compelling Respondents to respond to Fluke's discovery requests. CP 977-80 & CP 1558-60. Unfortunately, the trial court then ignored its own order, dismissing the case before MET had even responded to the trial court's last order compelling discovery.

Respondents' gross mischaracterization of Fluke's May 2008 settlement proposal is perhaps most remarkable.[26] They do not even attempt to explain how a settlement offer made at the outset of the case, in May 2008, evidences *subjective* bad faith a year later, after May 13, 2009. Regardless, Fluke's opening offer was tailored to the behavior alleged in the Complaint and proposed non-monetary avenues to structure an

[26] Evidence of a settlement offer is inadmissible to prove a claim's invalidity, which is precisely what Respondents offered it for. ER 408. This is improper and the Court should disregard it.

amicable resolution. CP 5912. That Respondents did not like or accept the settlement hardly demonstrates it was extended in bad faith.

Finally, Respondents point to the John Green CR 30(b)(6) deposition, which they, again, completely mischaracterize. The parties' agreed protective order included robust protection for confidential and proprietary information, including an expansive "Attorneys' Eyes Only provision" that allowed each party to protect its sensitive business information from the employees of the other. CP 5891 ¶ 4 & CP 5893-09. Thus, Fluke's business employees, including Green, were barred from knowing about the evidence of Respondents' misappropriations because MET designated all this evidence as Attorneys' Eyes Only. Mr. Green was fully prepared for every appropriate question, and at his deposition, Green testified fully about "matters known or reasonably available to the [Fluke] organization," which is all CR 30(b)(6) requires. No discovery motion was filed over this deposition and none could have been; such a motion would have been utterly groundless.

In sum, Respondents' "ample" evidence of subjective bad faith is nothing of the sort. As the trial court, in the exercise of its discretion rightly concluded, Respondents did not meet their burden of showing that Appellants were "fully aware that [this] suit was essentially frivolous," *Precision Airmotive*, 288 F. Supp. 2d at 1155, and that it was "brought for the purpose of harassment." *Pearsall-Stipek,* 136 Wn.2d at 267.

It is, therefore, no surprise that Respondents can cite *no* Washington case in which a court has awarded fees under RCW 19.108.040 after determining that a plaintiff pursued a trade secret claim in bad faith. Instead, they rely entirely on a single California case that bears no resemblance to the case at bar. *FLIR Sys., Inc. v. Parrish*, 174 Cal. App. 4th 1270 (2009). In *FLIR*, a former employer became "[f]earful that the new business would undermine FLIR's market" and sued for misappropriation. *Id.* at 1274-75. The claim was premised on the inevitable disclosure doctrine, which California courts had expressly rejected. *Id.* at 1275. And the court relied on evidence that plaintiffs had an "anticompetitive motive in filing the lawsuit," citing "remarkable" testimony that "clearly shows that the action was brought for an anti-competitive purpose." *Id.* at 1276, 1285. Indeed, when plaintiff's CEO was asked why the action was filed, he answered that he did not "think it would be good, healthy for [defendants] to go and directly compete with us" because "we can't tolerate a direct competitive threat" by defendants, and plaintiff's Senior Vice-President confirmed that plaintiff "wanted [defendant's] competition to take place as far out in the future as possible." *Id.* at 1276, 1285.

The facts of *FLIR* are, to put it mildly, inapposite. There is no evidence of any improper purpose here. Fluke pursued its claims in good faith and strongly and genuinely believes now that MET has misappropriated their trade secrets.

III. CONCLUSION

Fluke's evidence was more than enough to survive summary judgment on each of its claims. The trial court's rulings should be reversed and this case should be remanded so that discovery can be completed and the case may be tried to a jury.

RESPECTFULLY SUBMITTED this 6th day of July, 2010.

PERKINS COIE LLP

By: ______________________________
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PROOF OF SERVICE

I, Debbie Burge, declare as follows: on July 6, 2010, I caused to be served upon counsel of record, at the addresses stated below, via the methods of service indicated, a true and correct copy of the APPELLANTS' REPLY BRIEF AND OPPOSITION TO RESPONDENTS' CROSS-APPEAL:

Kelly P. Corr Steven W. Fogg Corr Cronin Michelson Baumgardner & Preece LLP 1001 Fourth Avenue, Suite 3900 Seattle, WA 98154-1051	☐ By U.S. Mail, First Class ☐ By Overnight Mail ☒ By Messenger ☐ By Facsimile ☐ By eFiling
Bradley S. Keller Keith D. Petrak Byrnes & Keller LLP 3800 Key Tower 1000 Second Avenue Seattle, WA 98104	☐ By U.S. Mail, First Class ☐ By Overnight Mail ☒ By Messenger ☐ By Facsimile ☐ By eFiling
Howard M. Goodfriend Edwards, Sieh, Smith & Goodfriend, P.S. 500 Watermark Tower 1109 First Avenue Seattle, WA 98101-0809	☐ By U.S. Mail, First Class ☐ By Overnight Mail ☒ By Messenger ☐ By Facsimile ☐ By eFiling

I declare under penalty of perjury under the laws of the State of Washington that the foregoing is true and correct.

DATED at Seattle, Washington, this 6th day of July, 2010.

Debbie Burge

Debbie Burge, Legal Secretary

ORIGINAL

No. 64408-4

COURT OF APPEALS
DIVISION I
OF THE STATE OF WASHINGTON

FLUKE CORPORATION, a Washington Corporation, and DANAHER CORPORATION, a Delaware Corporation,

Appellants,

v.

MILWAUKEE ELECTRIC TOOL CORPORATION, a Washington Corporation, JON MORROW, an individual, and EVANS NGUYEN, an individual,

Respondents.

APPENDIX OF OUT-OF-STATE CASES CITED IN APPELLANTS' REPLY BRIEF AND OPPOSITION TO RESPONDENTS' CROSS-APPEAL

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APPENDIX

(Cases attached in alphabetical order)

1.	*Baron Data Sys. v. Loter*, 377 S.E.2d 296 (1989)
2.	*Bigelow v. RKO Radio Pictures, Inc.*, 327 U.S. 251 (1946)
3.	*Blickman Turkus, LP v. MF Downtown Sunnyvale, LLC*, 162 Cal. App. 4th 858, 76 Cal. Rptr. 3d 325 (2008)
4.	*Blumberg v. Nealco, Inc.*, 427 S.E.2d 659 (S.C. 1993)
5.	*Boehringer Ingelheim Animal Health, Inc. v. Schering-Plough Corp.* 6 F. Supp. 2d 324
6.	*Boise Tower Assoc., LLC v. Washington Capital Joint Master Trust Mortg. Income Fund*, 2007 WL 4355815
7.	*Boyd Rosene & Assocs., Inc. v. Kansas Mun. Gas Agency,* 174 F.3d 1115 (10th Cir. 1999)
8.	*Callaway Golf Co. v. Dunlop Slazenger Group Am., Inc.,* 295 F. Supp. 2d 430
9.	*Colo. Supply Co., Inc. v. Stewart*, 797 P.2d 1303 (Colo. App. 1990)
10.	*Demitropoulos v. Bank One Milwaukee, N.A.*, 953 F. Supp. 974 (N.D. Ill. 1997)
11.	Duncan v. Office Depot, 973 F.Supp. 1171
12.	*El Paso Natural Gas Co. v. Amoco Production Co.,* 1994 WL 728816 (Del. Ch. Dec. 16, 1994)
13.	*Envtl. Tech. Council v. South Carolina*, 901 F. Supp. 1026 (D.S.C. 1995)
14.	*Fairmont Supply Co. v. Hooks Industrial, Inc.*, 177 S.W. 3d 529 (Tex. Ct. App. 2005)
15.	*FLIR Sys., Inc. v. Parrish*, 174 Cal. App.4th 1270, 95 Cal. Rptr. 3d 307 (2009)
16.	*Frank D. Wayne Assoc., Inc. v. Lussier*, 454 N.E.2d 109 (Mass. App. 1983)
17.	*Heuser v. Kephart*, 215 F.3d 1186 (10th Cir. 2000)
18.	*In re New Power Co.*, 313 B.R. 496 (Bkrtcy. N.D. Ga. 2004)

19.	*Katz v. Berisford Int'l PLC,* 2000 WL 959721 (S.D.N.Y. July 10, 2000)
20.	*Kauffman v. International Brotherhood of Teamsters*, 950 A.2d 44
21.	*Kucel v. Walter E. Heller & Co.*, 813 F.2d 67 (5th Cir. 1987)
22.	*Malletier v. Dooney & Bourke, Inc.*, 561 F. Supp. 2d 368
23.	*Marotta v. Toll Brothers, Inc.*, 2010 WL 744174
24.	*MSC Indus. Direct Co. v. Steele,* 2009 WL 2501762 (N.C. App. 2009)
25.	*Needle v. White,* 568 A.2d 856 (Md. App. 1990)
26.	*Oklahoma Fixture Co. v. Ask Computer Sys., Inc.*, 45 F.3d 380 (10th Cir. 1995)
27.	*Omintech Intern., Inc. v. Clorox Co.*, 1992 WL 211490 (E.D. La. Aug. 19, 1992)
28.	*Optic Graphics, Inc. v. Agee*, 591 A.2d 578 (Md. App. 1991)
29.	*Precision Airmotive Corp. v. Rivera*, 288 F. Supp. 2d 1151 (W.D. Wash. 2003)
30.	*Pribil v. Koinzan,* 665 N.W.2d 567 (Neb. 2003)
31.	*Reynolds Metals Co. v. Alperson*, 25 Cal. 3d 124, 158 Cal. Rptr. 1 (1979)
32.	*Schirmer v. Principal Life Ins. Co.* 2008 WL 4787568 (E.D.Pa.,2008)
33.	*Simpson v. MSA of Myrtle Beach, Inc.*, 644 S.E.2d 663 (S.C. 2007)
34.	*Smith v. Ozmint*, 444 F. Supp. 2d 502 (D.S.C. 2006)
35.	*Super 7 Motel Assoc. v. Wang*, 16 Cal. App. 4th 541, 20 Cal. Rptr. 2d 193 (1993)
36.	*Tomasini v. Mount Sinai Medical Center of Florida, Inc.*, 315 F.Supp.2d 1252 (S.D. Fla. 2004)
37.	*Wilmar, Inc. v. Liles,* 13 N.C.App. 71, 185 S.E.2d 278 (N.C.App. 1971);
38.	*Youtie v. Macy's Retail Holding, Inc.* 626 F. Supp. 2d 511

PROOF OF SERVICE

I, Debbie Burge, declare as follows: on July 6, 2010, I caused to be served upon counsel of record, at the addresses stated below, via the methods of service indicated, a true and correct copy of the APPENDIX OF OUT-OF-STATE CASES CITED IN APPELLANTS' REPLY BRIEF AND OPPOSITION TO RESPONDENTS' CROSS-APPEAL

Kelly P. Corr Steven W. Fogg Corr Cronin Michelson Baumgardner & Preece LLP 1001 Fourth Avenue, Suite 3900 Seattle, WA 98154-1051	☐ By U.S. Mail, First Class ☐ By Overnight Mail ☒ By Messenger ☐ By Facsimile ☐ By eFiling
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I declare under penalty of perjury under the laws of the State of Washington that the foregoing is true and correct.

DATED at Seattle, Washington, this 6th day of July, 2010.

Debbie Burge

Debbie Burge, Legal Secretary

22826-0005/LEGAL18646880.1

B

C

Supreme Court of South Carolina.
BARON DATA SYSTEMS, INC., Petitioner,
v.
Phillip H. LOTER, Gary N. Smith, and Melvin Gross, d/b/a Gross, Loter & Smith, a partnership, Respondents.
No. 22965.

Dec. 7, 1988.
Decided Feb. 21, 1989.

Appeals were taken from an order of the Court of Common Pleas of Richland County, C. Anthony Harris, J., which awarded attorney fees to plaintiff in an action for breach of two equipment leases. The Court of Appeals held that fees were excessive, and plaintiff petitioned for writ of certiorari. The Supreme Court, granted the writ, and Finney, J., held that plaintiff was entitled to attorney fees for work done in prosecuting action but not for hours devoted to defending counterclaims.

Reversed.

West Headnotes

[1] Costs 102 ⚷194.18

102 Costs
102VIII Attorney Fees
102k194.18 k. Items and Amount; Hours; Rate. Most Cited Cases
Trial court did not abuse its discretion in awarding attorney fees to plaintiff, even though fee award was greater than recovery realized by plaintiff.

[2] Costs 102 ⚷194.18

102 Costs
102VIII Attorney Fees
102k194.18 k. Items and Amount; Hours; Rate. Most Cited Cases
Trial court did not abuse its discretion in denying plaintiff attorney fees for hours plaintiff's attorney devoted to work on counterclaims.

****296 *382** Harry A. Swagart, III, and James H. Lengel, of Swagart & Lengel, P.A., Columbia, for petitioner.

Francis T. Draine, Columbia, for respondents.

FINNEY, Justice:

***383** This appeal originated from a post-trial order awarding attorney's fees and costs to petitioner, Baron Data Systems (Baron). The respondents, Melvin Gross, Phillip H. Loter, and Gary N. Smith (GLS), appealed on the grounds that the circuit court's award of $26,000 in attorney fees was an abuse of discretion. Baron cross-appealed from the same order on the grounds that it should have received additional attorney fees of $7,390 for 73.9 hours of work. The Court of Appeals reversed and remanded. We reverse the judgment of the Court of Appeals and reinstate the trial court's order.

This case began when Baron filed a summons and complaint seeking to recover damages and attorney's fees pursuant to two equipment leases between petitioner and the respondents, which leases Baron alleged had been breached by the respondents. Petitioner prayed for actual damages of $10,532.68 and liquidated damages of $69,155.25. Respondents filed an amended answer setting forth numerous affirmative defenses and counterclaims seeking in excess of $500,000 in liquidated damages.

Baron moved for summary judgment. The court dismissed respondents' counterclaims for negligence and product defects and its affirmative defenses of laches and contributory negligence. No appeal was taken from the order granting partial summary judgment.

A jury returned a verdict in favor of Baron for $16,161 actual damages. No appeal was taken. At a subsequent hearing, the trial court awarded Baron $26,000 in attorney fees and $3,252.51 in costs. Baron was denied an additional $7,390 in fees for 73.9 hours devoted to counterclaims. Both sides appealed. The Court of Appeals reversed and remanded, holding that the fees were excessive, but did not specifically address the issue of petitioner's attorney fees for the additional 73.9 hours. There is some uncertainty whether the Court of Appeals reversed the trial court's order on this issue also.

Petitioner asserts that the Court of Appeals erred in holding that the trial court's award of attorney's fees was excessive and seeks clarification concerning the trial court's denial of $7,390 in fees.

****297** The general rule is that attorney's fees are not recoverable unless authorized by contract or statute. ***384***Hegler v. Gulf Insurance Co.*, 270 S.C. 548, 243 S.E.2d 443 (1978). The contracts between the parties provided for reasonable attorney's fees and costs in the event of default by the respondents. Where there is a contract, the award of attorney's fees is left to the discretion of the trial judge and will not be disturbed unless an abuse of discretion is shown. *Smith v. Smith*, 264 S.C. 624, 216 S.E.2d 541 (1975); *Nelson v. Merritt*, 281 S.C. 126, 314 S.E.2d 840 (App.1984). Where an attorney's services and their value are determined by the trier of fact, an appeal will not prevail if the findings of fact are supported by any competent evidence. *Singleton v. Collins*, 251 S.C. 208, 161 S.E.2d 246 (1968).

[1] In awarding reasonable attorney's fees, there are six factors to be considered. *See, e.g., Wood v. Wood*, 269 S.C. 600, 239 S.E.2d 315 (1977); *Bentrim v. Bentrim*, 282 S.C. 333, 318 S.E.2d 131 (App.1984). Consideration should be given to all six criteria in establishing reasonable attorney's fees; none of these six factors is controlling. *Darden v. Witham*, 263 S.C. 183, 209 S.E.2d 42 (1974).

In making its determination, the trial court articulated each of the six factors.

(1) *The Nature, Extent and Difficulty of the Legal Services Rendered.*

Upon its evaluation of the nature, extent and difficulty of the legal services, the trial court determined that Baron had to expend considerably more time and effort on the case because the defendants had transformed a simple collection action into complex litigation.

(2) *The Time and Labor Necessarily Devoted to the Case.*

The trial court concluded that "a review of the statements and affidavits of Baron's trial attorney indicate clearly that the time and labor spent were reasonable and not duplicative." The respondents did not dispute this conclusion.

(3) *The Professional Standing of Counsel.*

The circuit court's determination that Baron's trial attorney is an experienced, skilled attorney, of high professional standing in the community was based upon a careful review of the affidavits of Baron's expert and its trial attorney, which included the attorney's resume. Respondents did not contest the trial court's determination.

***385** (4) *The Contingency of Compensation.*

Not applicable since this was not a contingency case.

(5) *The Fee Customarily Charged in the Locality for Similar Legal Services.*

Based upon a review of the attorney's resume, affidavits and its familiarity with attorney fees customarily charged in this legal community, the trial court found that the rate of $100 per hour was appropriate.

(6) *The Beneficial Results Obtained.*

The trial court decided that the total benefits obtained by Baron include a sizeable judgment ($16,151) and the avoidance of nearly half a million dollars in liability on the counterclaims. The Court of Appeals concluded that Baron sought over $70,000 and recovered only $16,151, thus the beneficial result was not significant.

A reading of the Court of Appeals' opinion indicates that the amount of the monetary judgment was the critical factor upon which the Court of Appeals relied in making its determination. However, as set forth above, the amount of recovery is but one factor to be considered in determining reasonable attorney's fees. *Darden v. Witham, supra.*

Courts in other jurisdictions have awarded attorney fees which exceeded the verdict obtained. In *Erickson Enterprises, Inc., v. Lois Wohl & Son, Inc.*, 422 So.2d 1085 (Fla.App.1982), the prayer was for $4,620.60, the verdict was $3,885 and the appellate court upheld a fee award of $6,000. In *Michael-Regan Co., Inc., v. Lindell*, 527 F.2d 653, 656 (9th Cir.1975), the court upheld a verdict (on a counterclaim) for a total of $17,907.26, exclusive of interest, and awarded $18,543 in attorney's fees. *See also Osborn v. Sinclair Refining Co.*, 207 F.Supp. 856 (D.Md.1962) (fee ****298** award of $14,000, damages of $325); and *Knutson v. Daily Review, Inc.*, 479 F.Supp. 1263 (N.D.Cal.1979) (fees of $54,079; nominal damages of $6).

We conclude that the trial court properly applied the relevant factors and that its order is supported by the record.

[2] With regard to the 73.9 hours Baron's attorney devoted exclusively to work on the counterclaims, we sustain the trial court's findings. The amount of attorney's fees to be awarded in a particular case is within the ***386** discretion of the trial judge provided the award is reasonable. *Farmers and Merchants Bank v. Fargnoli*, 274 S.C. 23, 260 S.E.2d 185 (1979). The trial court meticulously reviewed petitioner's fee request in accordance with the factors set forth by the Supreme Court and determined that 260 hours was the maximum compensable time. We find the attorney's fee award of $26,000 reasonable and hold that the denial of an additional $7,390 in attorney's fee was not an abuse of discretion.

For the foregoing reasons the Court of Appeals is reversed and the circuit court's order is reinstated.

REVERSED.

GREGORY, C.J., and HARWELL, CHANDLER and TOAL, JJ., concur.
S.C.,1989.
Baron Data Systems, Inc. v. Loter
297 S.C. 382, 377 S.E.2d 296

END OF DOCUMENT

Supreme Court of the United States
BIGELOW et al.
v.
RKO RADIO PICTURES, Inc., et al.
No. 444.

Argued Feb. 7, 1946.
Decided Feb. 25, 1946.
Rehearing Denied March 25, 1946.

See 327 U.S. 817, 66 S.Ct. 815.

Action by Florence B. Bigelow and others against RKO Radio Pictures, Inc., and others under the Sherman and Clayton Acts for injunction and to recover treble damages because of defendants' alleged monopolistic practices in exhibiting motion pictures. Judgment of the District Court for plaintiffs was reversed by the Circuit Court of Appeals with directions, 150 F.2d 877, and plaintiffs bring certiorari.

Judgment of the District Court affirmed and judgment of the Court of Appeals reversed.

Mr. Justice FRANKFURTER dissenting.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Seventh Circuit.

West Headnotes

[1] Federal Courts 170B 452

170B Federal Courts
170BVII Supreme Court
170BVII(B) Review of Decisions of Courts of Appeals
170Bk452 k. Certiorari in General. Most Cited Cases
(Formerly 106k383(1))
Where jury returned a general verdict for plaintiffs, the nature and extent of unlawful conspiracy under Sherman and Clayton Acts would be ascertained by the Supreme Court on certiorari in the light of the instructions given to jury, taking that view of the evidence most favorable to plaintiffs. Sherman Anti-Trust Act, ss 1, 2, 7, 15 U.S.C.A. ss 1, 2, 15 note; Clayton Act, ss 4, 16, 15 U.S.C.A. ss 15, 26.

[2] Antitrust and Trade Regulation 29T 977(2)

29T Antitrust and Trade Regulation
29TXVII Antitrust Actions, Proceedings, and Enforcement
29TXVII(B) Actions
29Tk973 Evidence
29Tk977 Weight and Sufficiency
29Tk977(2) k. Restraints and Misconduct in General. Most Cited Cases
(Formerly 265k28(7.5), 265k28(7))
Evidence warranted finding that during period in question a first or prior run theater possessed competitive advantages over later run theaters, because of its greater capacity to attract patronage to pictures which had not been shown elsewhere, and its ability to charge higher admission prices than subsequent run theaters, and that, other things being equal, discriminatory release system was damaging to independent exhibitors who were relegated by it to a playing position inferior to that of their competitors. Sherman Anti-Trust Act, §§ 1, 2, 7, 15 U.S.C.A. §§ 1, 2, 15 note; Clayton Act, §§ 4, 16, 15 U.S.C.A. §§ 15, 26.

[3] Antitrust and Trade Regulation 29T 985

29T Antitrust and Trade Regulation
29TXVII Antitrust Actions, Proceedings, and Enforcement
29TXVII(B) Actions
29Tk982 Damages and Other Relief
29Tk985 k. Particular Items or Elements. Most Cited Cases
(Formerly 265k28(9))
Independent film exhibitors were entitled as of

right to continue to purchase and show films which had not had a prior showing, free of the restraints of unlawful distribution system, and a fair measure of the damage to that right by the unlawful system was loss of admission receipts resulting from application of system to exhibitors. Sherman Anti-Trust Act, §§ 1, 2, 7, 15 U.S.C.A. §§ 1, 2, 15 note; Clayton Act, §§ 4, 16, 15 U.S.C.A. §§ 15, 26.

[4] Damages 115 ⚷6

115 Damages
115I Nature and Grounds in General
115k6 k. Certainty as to Amount or Extent of Damage. Most Cited Cases

Damages 115 ⚷184

115 Damages
115IX Evidence
115k183 Weight and Sufficiency
115k184 k. In General. Most Cited Cases

The jury may not render a verdict based on speculation or guesswork, even where defendant by his own wrong has prevented a more precise computation, but the jury may make a just and reasonable estimate of the damage based on relevant data and in such circumstances may act on probable and inferential as well as upon direct and positive proof.

[5] Damages 115 ⚷6

115 Damages
115I Nature and Grounds in General
115k6 k. Certainty as to Amount or Extent of Damage. Most Cited Cases

Justice and public policy require that a wrongdoer shall bear the risk of uncertainty which his own wrong has created and which prevents precise computation of damages.

[6] Antitrust and Trade Regulation 29T ⚷985

29T Antitrust and Trade Regulation
29TXVII Antitrust Actions, Proceedings, and Enforcement
29TXVII(B) Actions
29Tk982 Damages and Other Relief
29Tk985 k. Particular Items or Elements. Most Cited Cases
(Formerly 265k28(7.6), 115k6, 265k28(7))

In action by independent film exhibitors for treble damages based on discriminatory operation of film release system, comparison of exhibitors' receipts before and after unlawful system impinged on exhibitors' business afforded sufficient basis for jury's computation of damages, where the wrongful system had prevented exhibitors from making any more precise proof of the amount of damage. Sherman Anti-Trust Act, §§ 1, 2, 7, 15 U.S.C.A. §§ 1, 2, 15 note; Clayton Act, §§ 4, 16, 15 U.S.C.A. §§ 15, 26.

****575** Mr. ***253** Thomas C. McConnell, of Chicago, Ill., for petitioners.

Mr. Edward F. McClennen, of Boston, Mass., for respondents.

Mr. Chief Justice STONE delivered the opinion of the Court.

Petitioners brought this suit in the District Court for Northern Illinois under ss 1, 2 and 7 of the Sherman Act, 26 Stat. 209, and ss 4 and 16 of the Clayton Act, 38 Stat. 731, 15 U.S.C. ss 1, 2, 15, and 26, 15 U.S.C.A. ss 1, 2, 15, 26, for an injunction and to recover treble damages. Petitioners, who are owners of the Jackson Park motion picture theatre in Chicago, alleged by their bill of complaint that respondents, some of whom are distributors of moving picture films, and some of whom own or control moving picture theatres in Chicago, entered into a conspiracy which continued from ***254** some date prior to November 1, 1936 to the date the suit was brought, July 28, 1942, pursuant to which film was distributed among moving picture theatres in the Chicago district in such a manner that theatres owned by some of the conspirators were enabled to secure and show feature pictures in advance of independent exhibitors, not affiliated with respondents, such as petitioners.

The gist of the complaint is that by reason of the conspiracy, petitioners were prevented from securing pictures for exhibition in their theatre until after the preferred exhibitors had been able to show them in the earlier and more desirable runs, and that petitioners have thus been discriminated against in the distribution of feature films in favor of competing theatres owned or controlled by some of the respondents. Petitioners charged that in consequence they had been subjected to loss of earnings in excess of $120,000 during the five year period from July 27, 1937 to July 27, 1942. The matter of the injunction was reserved and the case went to trial solely on the question of damages. The jury returned a verdict for $120,000 in petitioners' favor. The trial court gave judgment for treble that amount, as prescribed by s 4 of the Clayton Act. The Circuit Court of Appeals for the Seventh Circuit reversed on the sole ground that the evidence of damage was not sufficient for submission to the jury, and directed the entry of a judgment for respondents non obstante veredicto. 150 F.2d 877. We granted certiorari, 326 U.S. 709, 66 S.Ct. 144, because of the importance of the problem presented.

[1] Respondents do not now assail the jury's verdict, so far as it found an unlawful conspiracy to maintain a discriminatory system of distribution. The sole question for decision here is whether the evidence of damage is sufficient to support the verdict. As the jury returned a general verdict, the nature and extent of the unlawful conspiracy must be ascertained in the light of the instructions***255** given to the jury, taking that view of the evidence most favorable to petitioners. Petitioners have been since November 1, 1936 the owners in partnership of the Jackson Park Theatre, located on the south side of Chicago. Respondents RKO Radio Pictures, Inc., Loew's, Inc., Twentieth Century-Fox Film Corporation, Paramount Pictures, Inc., and Vitagraph, Inc., are distributors of motion picture films. Respondent RKO also owns two large first-run theatres in the Chicago Loop. Respondent Balaban & Katz Corporation is a motion picture exhibitor, which operates a chain of some fifty theatres in Chicago and its suburbs, including the Maryland Theatre and others on the south side of Chicago which compete with the petitioners' Jackson Park Theatre. Balaban & Katz is a subsidiary of Paramount. Respondent Warner Bros. Circuit Management Corporation is an exhibitor which operates more than twenty theatres in Chicago, including several on Chicago's south side which also compete with petitioners' theatre. Warner Bros. Circuit Management Corporation and Vitagraph are subsidiaries of Warner Bros. Pictures, ****576** Inc. Respondent Warner Bros. Theatres, Inc., is also affiliated with Warner Bros. Pictures, Inc. and holds title to certain of the Warner theatres.

There was evidence from which the jury could have found that respondents maintained in the Chicago district, by a conspiracy among themselves, a discriminatory system of distributing motion pictures for showing in successive weeks of release. The release system, as described in the complaint, and shown by the proof, operated substantially as follows: Respondent distributors rent their copyrighted product to motion picture theatres for exhibition to the public. Rental contracts between distributors and exhibitors undertake to furnish films to the exhibitors for stipulated rentals, and provide for the 'playing position' in which the motion picture theatre is to exhibit the films relative to the 'playing position' of other ***256** theatres in the competitive area. In Chicago, these contracts uniformly provide that the larger theatres in the Chicago Loop, all owned, leased, or operated by one or more of the respondents, shall have the right to the 'first run' of the motion pictures distributed by the respondents, for one week or such longer period as they may desire to exhibit them. Following the 'first run', the motion picture may not be shown in any Chicago theatre outside the Loop for three weeks, a period known as 'clearance.' In the fourth week following the end of the Loop run, the film is released for exhibition in theatres outside the Loop for successive runs in various theatres, for periods known as the 'A,' 'B' and 'C' 'pre-release weeks,' followed by weeks of 'general release'.

The earlier a playing position, the more desirable it is, since it is preferable to exhibit pictures before they have been shown to the public in other theatres in the competitive area. There was evidence that respondent distributors and exhibitors conspired to give to the distributor-controlled or affiliated theatres preferential playing positions in the release system over the positions allotted to independent competing theatres, including that of petitioners, with the result that petitioners' theatre was unable to obtain feature films until the first week of 'general release,' or ten weeks after the end of the Loop run. By that time most of respondent exhibitors' theatres, with several of which petitioners' theatre competes, and which enjoyed the prior 'A,' 'B' or 'C' pre-release runs, had finished their showings. Rgardless of the price offered for rental of film, the respondent exhibitors, in execution of the conspiracy, refused to release films to petitioners' theatre except for the first week of 'general release.'

Although petitioners' ground for recovery, as stated by their bill of complaint, was the discriminatory operation of the system of releasing pictures for showing in allotted playing positions, whereby the petitioners were prevented ***257** from acquiring films for exhibition until they had been shown in respondent distributors' theatres competing with the Jackson Park, evidence was introduced in the course of the trial tending to show that respondents conspired to maintain the release system as part of a conspiracy to maintain minimum admission prices to be charged by exhibitors generally. This proof indicated that the object of this conspiracy was to make it possible to maintain high admission prices in the Loop theatres by restricting the price-competition of the subsequent run theatres. The distributors' contracts with the Loop theatres provided for film rentals based on a percentage of the admission fees collected. It appeared that the rental contracts entered into between respondent distributors and the Chicago exhibitors, including respondent exhibitors and petitioners, uniformly contained schedules of minimum admission prices fixed on the basis of the playing position assigned. There was thus evidence tending to show that the release system and the price fixing system were each an integral part of an unlawful conspiracy to give to the Loop theatres the advantages of a first-run protected from low-price competition.

Respondents' evidence, on the other hand, tended to show that the release system was a natural growth in the industry, and that the fixed price system had resulted from the individual action of distributors, not acting in concert, to market their copyrighted product in such a manner as to secure the best possible financial return from the film distributed. See Interstate Circuit v. United States, 306 U.S. 208, 59 S.Ct. 467, 83 L.Ed. 610; consent decree in ****577** United States v. Balaban & Katz Corp., C.C.H. Fed. Trade Reg. Serv., 7th Ed., Court Decisions Supplement, p. 5025.

Two classes of evidence were introduced by petitioners to establish their damage. One was a comparison of earnings during the five year period of petitioners' Jackson Park Theatre with the earnings of its competitor, the ***258** Maryland Theatre, the two being comparable in size, the Jackson Park being superior in location, equipment, and attractiveness to patrons. Under the discriminatory release system, the Maryland had been allowed to exhibit pictures in the C pre-release run, one week ahead of petitioners' first week of general release. The evidence showed that during the five year period, the Maryland's net receipts after deducting film rentals paid to distributors exceeded petitioners' like receipts by $115,982.34.

The second was a comparison of petitioners' receipts from the operation of the Jackson Park Theatre less cost of film for the five year period following July 1937, with the corresponding receipts for the four years immediately preceding, after making an allowance for the elimination of 'Bank Night' receipts. The comparison shows a falling off of petitioners' receipts during the five year period aggregating $125,659.00, which was more than $5,000 in excess of the $120,000 damage demanded by petitioners' complaint. The significance of the comparison lies in the fact that during most of the four year period, and despite the operation of the release system as described, petitioners' theatre had been able to procure some films which had not already been shown in respondents' theatres, whereas petitioners were not able to procure such films during the five year period which followed, although there is evidence that they made diligent efforts to do so. The change is attributable to the introduction of the practice of 'double features' (the showing of two films at a single performance) in theatres in the Chicago district. The evidence tended to show that when single features were being shown, exhibitors who had playing positions ahead of petitioners', in selecting films out of those which their rental contracts allowed them to show, did not exhibit all of the films distributed, so that, despite their inferior playing position, petitioners were able to exhibit pictures which had not been shown elsewhere. With the advent of double ***259** featuring, theatres with playing positions ahead of petitioners' used nearly all of the films distributed, and the pictures which petitioners were able to exhibit in the first week of general release, by reason of the distribution system, had had prior showing in nearly every case.

The trial court left it to the jury to say whether double featuring was introduced as a part of a conspiracy among respondents, or as a spontaneous manifestation in the industry. Assuming the latter, we agree with the Circuit Court of Appeals, which, in sustaining the jury's finding of an unlawful conspiracy to maintain the described system of distribution, held that when the double featuring was established, all film which had not already been shown 'was taken away by defendants' prior contracts, made pursuant to and a part of the conspiracy, and placed under the restriction of the illegal system, and thereafter was not obtainable by plaintiffs, except by use of the illegal system.' (150 F.2d 885).

In submitting the two classes of evidence of damage which we have detailed, the trial court stated to the jury: 'Plaintiff seeks to recover damages for the alleged acts of defendants on one of two theories.' It further charged that 'If plaintiffs have been injured by the alleged acts of the defendants they must choose one or the other of the said two theories of determining damages or the amount of damages.' The Circuit Court of Appeals concluded that the jury accepted the comparison of plaintiffs' earnings before and after the adoption of double billing as establishing the measure of petitioners' damage. But it held that this proof did not furnish a proper measure of damage for the reason that, while petitioners' earnings were known and proved for both the four and five year periods in question, it could not be proved what their earnings would have been during the five year period in the absence of the illegal distribution of films. It thought that the mere fact that earnings of the Jackson Park Theatre***260** was greater before the adoption of double billing did not serve to show what petitioners' earnings would have been afterwards, in the absence of the release system.

Similarly, the Court of Appeals rejected the comparison between petitioners' receipts and those of the Maryland Theatre ****578** during the five years in question, since as it thought, the comparison would not tend to prove what the earnings of either theatre would have been during the critical period under any system other than that which was the product of the unlawful conspiracy.

[2] Upon the record in this case it is indisputable that the jury could have found that during the period in question a first or prior run theatre possessed competitive advantages over later run theatres, because of its greater capacity to attract patronage to pictures which had not been shown elsewhere, and its ability to charge higher admission prices than subsequent run theatres, and that, other things being equal, the establishment of the discriminatory release system was damaging to the petitioners who were relegated by it to a playing position inferior to

that of their competitors.

Each of the two classes of evidence introduced by petitioner tended to show damage. They were not mutually exclusive, as the courts below seem to have thought, since each, independently of the other tended to show that petitioners' inability to obtain films for exhibition before they had been shown elsewhere adversely affected their receipts, in the one case by showing that those receipts decreased when petitioner could no longer purchase such films following the introduction of double, features, and in the other, that petitioners' receipts from its theatre were less by substantially the same amount than receipts of its competitor, the prior-run Maryland Theatre, operated under conditions in other respects less favorable than those affecting petitioners.

Respondents' argument is, that notwithstanding the force of this evidence, it is impossible to establish any ***261** measure of damage, because the unlawful system which respondents have created has precluded petitioners from showing that other conditions affecting profits would have continued without change unfavorable to them during the critical period if that system had not been established, and petitioners had conducted their business in a free competitive market. Respondents also contend that the jury's verdict establishes that the release system was part of a price-fixing conspiracy, and on the assumption that price-fixing and the discriminatory system of release were inseparable parts of a single scheme, argue that as the conspiracy as a whole probably enabled petitioners artificially to raise their prices to an undetermined extent, the overall effect of the conspiracy may well have been to benefit petitioners, even though the plan of distribution, one of its features, may have injured them. But we think these arguments are based on a misapprehension of the precise conditions in which the jury was permitted to and did apply the tendered measure of damages, and that it also ignores controlling principles of the law of damages.

We have already adverted to the facts that petitioners' cause of action, as stated in their complaint, was founded on the unlawful system of distributing films; that the contentions pro and con as to the existence of a conspiracy to fix prices of theatre admissions first emerged in the course of the trial; and that the jury was allowed to fix the measure of the damage with reference to the reduction of petitioners' receipts after July 1937 when petitioners were no longer able to show some films which had not been previously exhibited. Under the complaint and the instructions, the jury could, and we can assume that it did, find that the fixing of minimum prices was effectuated by the individual action of distributors, as respondents contended at the trial, and not as a part or result of the conspiracy to control distribution. The jury could have found that the only unlawful action taken by respondents was in ***262** conspiring to prevent petitioners' theatre from bidding in open competition against other exhibitors for a preferred place in an otherwise lawful system of release. This is apparent from the following portion of the charge: 'Only in the event that you find that there exists no conspiracy or combination to fix minimum admission prices or no unreasonable restraint of trade by the defendants, by virtue of the Chicago system of release. will you have occasion to consider whether or not the plaintiffs demanded and sought to obtain a playing position in C week.'

The jury's verdict was, as the court below held, based on the damage suffered by petitioners in consequence of the deprivation, by the discriminatory operation of the release system, of their demonstrated freedom to rent and exhibit some films which ****579** had not had prior showing. Hence we take it that the verdict did not establish that the fixed minimum admission prices were the result of the unlawful conspiracy, or that the petitioners' purchases of such films, and the operation of their theatre, before the double feature practice was inaugurated, were, for purposes material here, affected by the conspiracy.

[3] The record thus establishes that when petitioners acquired their theatre, it was possible for them

under the conditions then prevailing to secure films which had not had prior showing and to exhibit them in competition with theatres having preferred playing positions. Whatever restraints respondents' distribution system may then have imposed, and whether the later adopted practice of showing double features was or was not itself a product of an unlawful conspiracy, petitioners were entitled, as of right, to continue to purchase and show films which had not had prior showing free of the restraints of the unlawful distribution system. The fair value of petitioners' right thus to continue their business depended on its capacity to make profits. And a fair measure of the damage to that ***263** right by respondents' unlawful distributing system was the loss of petitioners' admission receipts resulting from the application of that system to petitioners.

Respondents only answer is that, without the conspiracy, the conditions of purchase of films might not have been the same after as they were before July, 1937; that in any case it is not possible to say what those conditions would have been if the restraints had not been imposed, and that those conditions cannot be ascertained, because respondents have not removed the restraint. Hence, it is said, petitioners' evidence does not establish the fact of damage, and that further, the standard of comparison which the evidence sets up is too speculative and uncertain to afford an accurate measure of the amount of the damage.

The case in these respects is comparable to Eastman Kodak Co. v. Southern Photo Material Co., 273 U.S. 359, 47 S.Ct. 400, 71 L.Ed. 684, and Story Parchment Co. v. Paterson Parchment Paper Co., 282 U.S. 555, 51 S.Ct. 248, 75 L.Ed. 544, in which precisely the same arguments now addressed to us were rejected. There, as here, the suits were for damages caused by restraints imposed by defendants, in violation of the Sherman Anti-Trust Act, on the operation of the business of the complainant in each case. In the one case, the defendant, in an effort to extend its monopoly, refused to sell to the plaintiff goods which had regularly been a part of his stock in trade. In the other, the defendants, competing sellers, engaged in destructive price competition with the plaintiff in execution of an unlawful conspiracy. In the first case, the plaintiff sought to establish his damage by comparing his profits before and after the unlawful interference with his business. In the other, the plaintiff sought to show his damage by proof of the difference between the amounts actually realized from his business after the conspiracy became effective, and what, but for the conspiracy, would have been realized by it from sales at reasonable prices, the evidence of which was the ***264** amount by which his current prices were higher before the conspiracy than after, and by the extent to which the value of petitioner's business property had declined after the conspiracy had begun to operate.

In each case we held that the evidence sustained verdicts for the plaintiffs, and that in the absence of more precise proof, the jury could conclude as a matter of just and reasonable inference from the proof of defendants' wrongful acts and their tendency to injure plaintiffs' business, and from the evidence of the decline in prices, profits and values, not shown to be attributable to other causes, that defendants' wrongful acts had caused damage to the plaintiffs. In this we but followed a well settled principle. See Hetzel v. Baltimore & Ohio R. Co., 169 U.S. 26, 38, 39, 18 S.Ct. 255, 259, 260, 42 L.Ed. 648. The tortious acts had in each case precluded ascertainment of the amount of damages more precisely, by comparison of profits, prices and values as affected by the conspiracy, with what they would have been in its absence under freely competitive conditions. Nevertheless, we held that the jury could return a verdict for the plaintiffs, even though damages could not be measured with the exactness which would otherwise have been possible.

[4] In such a case, even where the defendant by his own wrong has prevented a more precise computation, the jury may ****580** not render a verdict based on speculation or guesswork. But the jury may make a just and reasonable estimate of the damage

based on relevant data, and render its verdict accordingly. In such circumstances 'juries are allowed to act on probable and inferential as well as (upon) direct and positive proof.' Story Parchment Co. v. Paterson Parchment Paper Co., supra, 282 U.S. 561-564, 51 S.Ct. 250, 251, 75 L.Ed. 544; Eastman Kodak Co. v. Southern Photo Material Co., supra, 273 U.S. 377-379, 47 S.Ct. 404, 405, 71 L.Ed. 684. Any other rule would enable the wrongdoer to profit by his wrongdoing at the expense of his victim. It would be an inducement to make wrongdoing so effective and complete in every case as to preclude any recovery, by rendering the measure of damages uncertain.***265**

Failure to apply it would mean that the more grievous the wrong done, the less likelihood there would be of a recovery.

[5] The most elementary conceptions of justice and public policy require that the wrongdoer shall bear the risk of the uncertainty which his own wrong has created. See Package Closure Corp. v. Seal-right Co., 2 Cir., 141 F.2d 972, 979. That principle is an ancient one, Amory v. Delamirie, 1 Strange 505, and is not restricted to proof of damage in antitrust suits, although their character is such as frequently to call for its application. In cases of collision where the offending vessel has violated regulations prescribed by statute, see The Pennsylvania, 19 Wall.125, 136, 22 L.Ed. 148, and in cases of confusion of goods, Great Southern Gas & Oil Co. v. Logan Natural Gas & Fuel Co., 6 Cir., 155 F. 114, 115; cf. F. W. Woolworth Co. v. N.L.R.B., 2 Cir., 121 F.2d 658, 663, the wrongdoer may not object to the plaintiff's reasonable estimate of the cause of injury and of its amount, supported by the evidence, because not based on more accurate data which the wrongdoer's misconduct has rendered unavailable. And in cases where a wrongdoer has incorporated the subject of a plaintiff's patent or trademark in a single product to which the defendant has contributed other elements of value or utility, and has derived profits from the sale of the product, this Court has sustained recovery of the full amount of defendant's profits where his own wrongful action has made it impossible for the plaintiff to show in what proportions he and the defendant have contributed to the profits. Westinghouse Electric & Mfg. Co. v. Wagner Electric & Mfg. Co., 225 U.S. 604, 32 S.Ct. 691, 56 L.Ed. 1222, 41 L.R.A., N.S. 653; Hamilton-Brown Shoe Co. v. Wolf Brothers & Co., 240 U.S. 251, 36 S.Ct. 269, 60 L.Ed. 629; see also Sheldon v. Metro-Goldwyn Pictures Corp., 309 U.S. 390, 406, 60 S.Ct. 681, 687, 84 L.Ed. 825.

'The constant tendency of the courts is to find some way in which damages can be awarded where a wrong has been done. Difficulty of ascertainment is no longer confused with right of recovery' for a proven invasion of the ***266** plaintiff's rights. Story Parchment Co. v. Paterson Parchment Paper Co., supra, 282 U.S. 565, 51 S.Ct. 251, 75 L.Ed. 544; and see also Palmer v. Connecticut Railway Co., 311 U.S. 544, 559, 61 S.Ct. 379, 384, 85 L.Ed. 336, and cases cited.

[6] The evidence here was ample to support a just and reasonable inference that petitioners were damaged by respondents' action, whose unlawfulness the jury has found, and respondents do not challenge. The comparison of petitioners' receipts before and after respondents' unlawful action impinged on petitioners' business afforded a sufficient basis for the jury's computation of the damage, where the respondents' wrongful action had prevented petitioners from making any more precise proof of the amount of the damage.

We do not mean to indicate by what we have said that the jury could not, on this record, have found a conspiracy for fixing minimum prices or that the Chicago system of release was not an unreasonable restraint of trade in other respects. We conclude that there was evidence to support a verdict for damages on at least one theory on which the case was submitted to the jury. We do not imply that the verdict could not be supported on some other theory.

The judgment of the district court below will be affirmed and the judgment of the Court of Appeals is reversed.

Reversed.

Mr. Justice JACKSON took no part in the consideration or decision of this case.

****581** Mr. Justice FRANKFURTER dissenting.

The dominant purpose of the Anti-Trust Acts is protection of the public interest by prohibiting unjustifiable restrictions upon competitive enterprise. From the very nature of the public interest thus to be safeguarded and by reason of the complex and costly character of the litigation to which it normally gives rise, Congress made available to the Attorney General of the United States appropriate ***267** preventive and punitive remedies: the injunction, to put a prompt stop to illegal restraints, and the stern sanctions of the criminal law, to deter such restraints. A right of action is also given to any individual who has been 'injured in his business' by such illegality. But while action by the Government to enforce the Anti-Trust Acts merely requires proof of illegality, an individual's right of recovery is dependent on proof of legal injury to him, and legal injury is not automatically established by proof of a restraint of trade in violation of the Sherman Law. Seek Keogh v. Chicago & N.W.R. Co., 260 U.S. 156, 162, 163, 43 S.Ct. 47, 49, 50, 67 L.Ed. 183.

Therefore our real question is whether the respondents' violation of the Sherman Law illegally injured the petitioners. This necessarily involves substantial proof that the petitioners' business would have been more profitable if the distribution of movie films in Chicago had been a free-for-all and if no factor of the scheme that constituted an illegal conspiracy had been in operation, than it was under the conditions that actually prevailed. Specifically, one feature of the conspiracy was stipulated rentals by distributors in furnishing films to exhibitors. The record appears devoid of proof that, if competitive conditions had prevailed, distributors would not have made rental contracts with their respective exhibiting affiliates to the serious disadvantage of independents like the petitioners. They might individually have done so and not have offended the Sherman Law.

I agree that Eastman Kodak Co. v. Southern Photo Material Co., 273 U.S. 359, 47 S.Ct. 400, 71 L.Ed. 684, and Story Parchment Co. v. Paterson Parchment Paper Co., 282 U.S. 555, 51 S.Ct. 248, 75 L.Ed. 544, should guide the disposition of this case. But I do not find that the decisive distinction made in those cases has been observed in deciding this case. The distinction is between proving that some damages were 'the certain result of the wrong' and uncertainty as to the dollars and cents value of such injuring wrong. Such ***268** difficulty in ascertaining the exact amount of damage is a risk properly cast upon the wrong-doing defendant. But proof of the legal injury, which is the basis of his suit, is plaintiff's burden. He does not establish it merely by proving that there was a wrong to the public nor by showing that if he had been injured ascertainment of the exact amount of damages would have had an inevitable speculative element to be left for a jury's conscientious guess. This basic distinction was thus formulated in Story Parchment Co. v. Paterson Parchment Paper Co.:

'The rule which precludes the recovery of uncertain damages applies to such as are not the certain result of the wrong, not to those damages which are definitely attributable to the wrong and only uncertain in respect of their amount.' 282 U.S. at page 562, 51 S.Ct. at page 250, 75 L.Ed. 544.

In the Eastman and Story cases the plaintiffs established what their profit was when competitive conditions prevailed and that the subsequent loss properly became exclusively attributable to restraint of such conditions. Such a comparison is not revealed by this record. It was wholly speculative, as the Circuit Court of Appeals properly held in applying the rule in the Story Parchment Co. case, whether the intake of petitioners would have been more profitable if the distribution of films in Chicago had been left wholly to the haggling of a free market. 150 F.2d 877. As to the subtleties involved in such speculation, compare International Harvester Co. v. Kentucky, 234 U.S. 216, 223, 224, 34 S.Ct. 853, 855, 856, 58 L.Ed. 1284.

Where there is conceded legal injury, as for instance where one man's chattel is taken by another, as in the old case of Armory v. Delamirie, 1 Strange 505, we start with the legal injury and the problem is merely one of ascertaining damages 'uncertain in respect to their amount.' Such cases are not helpful where the crucial issue, as here, is whether there is solid proof of the existence of a legal injury.

U.S. 1946.
Bigelow v. RKO Radio Pictures
327 U.S. 251, 66 S.Ct. 574, 90 L.Ed. 652

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Court of Appeal, Sixth District, California.
BLICKMAN TURKUS, LP, Plaintiff, Cross-Defendant and Appellant,
v.
MF DOWNTOWN SUNNYVALE, LLC, et al., Defendants, Cross-Complainants and Appellants.
No. H029980.

April 30, 2008.

Background: Real estate brokerage firm retained by commercial lessee, as alleged third-party beneficiary of commission agreement between lessor and its listing broker and as alleged procuring agent for the lease, brought action against lessor and lessee, asserting lessor's breach of commission agreement, lessor's breach of covenant of good faith and fair dealing, lessor's and lessee's breach of implied promise to complete the lease transactions, and lessee's tortious interference with plaintiff's economically advantageous relationship with lessor. Lessor filed cross-complaint, alleging plaintiff breached a duty to disclose lessee's deteriorating financial condition during ten-month period between execution of lease and scheduled date for lessee to take possession. The Superior Court, Santa Clara County, No. CV814344,William J. Elfving, J., granted judgment on the pleadings and summary adjudication to lessor as to plaintiff's claims, and sustained, without leave to amend, plaintiff's demurrer to lessor's cross-complaint. Lessor appealed and plaintiff cross-appealed.

Holdings: The Court of Appeal, Rushing, P.J., held that:
(1) real estate brokerage firm retained by lessee did not have duty to disclose, to lessor, lessee's deteriorating financial condition, and
(2) lessor was not entitled to contractual award of attorney fees.

Affirmed; cross-appeal dismissed as moot.

West Headnotes

[1] Appeal and Error 30 ⚷901

30 Appeal and Error
30XVI Review
30XVI(G) Presumptions
30k901 k. Burden of showing error. Most Cited Cases

Appeal and Error 30 ⚷948

30 Appeal and Error
30XVI Review
30XVI(H) Discretion of Lower Court
30k948 k. Burden of showing grounds for review. Most Cited Cases
On appeal from a judgment of dismissal following the sustaining of a demurrer without leave to amend, the appellant has the burden to show either that the demurrer was sustained erroneously or that to sustain the demurrer without leave to amend constitutes an abuse of discretion. West's Ann.Cal.C.C.P. § 430.10.

[2] Appeal and Error 30 ⚷917(1)

30 Appeal and Error
30XVI Review
30XVI(G) Presumptions
30k915 Pleading
30k917 Demurrers
30k917(1) k. In general. Most Cited Cases
Because a general demurrer raises only a pure question of law, as to whether the facts set forth in the challenged pleading are sufficient to constitute a cause of action, a reviewing court considers it without deference to the trial court. West's Ann.Cal.C.C.P. § 430.10(e).

[3] Appeal and Error 30 ⚷837(4)

30 Appeal and Error
30XVI Review

30XVI(A) Scope, Standards, and Extent, in General
30k837 Matters or Evidence Considered in Determining Question
30k837(4) k. Pleadings and rulings thereon. Most Cited Cases

Appeal and Error 30 ⚷863

30 Appeal and Error
30XVI Review
30XVI(A) Scope, Standards, and Extent, in General
30k862 Extent of Review Dependent on Nature of Decision Appealed from
30k863 k. In general. Most Cited Cases

When reviewing a general demurrer, to determine whether the facts set forth in the challenged pleading are sufficient to constitute a cause of action, the appellate court examines the allegations of the challenged pleading, as supplemented by matters of which judicial notice is taken. West's Ann.Cal.C.C.P. § 430.10(e).

[4] Appeal and Error 30 ⚷917(1)

30 Appeal and Error
30XVI Review
30XVI(G) Presumptions
30k915 Pleading
30k917 Demurrers
30k917(1) k. In general. Most Cited Cases

Appellate court, when reviewing a general demurrer, to determine whether the facts set forth in the challenged pleading are sufficient to constitute a cause of action, must accept as true all well-pleaded allegations of material fact, but not contentions or conclusions of fact or law. West's Ann.Cal.C.C.P. § 430.10(e).

[5] Appeal and Error 30 ⚷959(1)

30 Appeal and Error
30XVI Review
30XVI(H) Discretion of Lower Court
30k959 Amended and Supplemental Pleadings
30k959(1) k. In general. Most Cited Cases

Appeal and Error 30 ⚷960(1)

30 Appeal and Error
30XVI Review
30XVI(H) Discretion of Lower Court
30k960 Rulings on Motions Relating to Pleadings
30k960(1) k. In general. Most Cited Cases

With respect to trial court's failure to grant leave to amend, when sustaining a general demurrer, a reviewing court must defer to the trial court's ruling unless the appellant demonstrates a manifest abuse of discretion. West's Ann.Cal.C.C.P. § 430.10(e).

[6] Pleading 302 ⚷225(2)

302 Pleading
302V Demurrer or Exception
302k219 Operation and Effect of Decision on Demurrer
302k225 Amendment or Further Pleading After Demurrer Sustained
302k225(2) k. Authority and discretion of court. Most Cited Cases

Ordinarily, it is an abuse of discretion to sustain a general demurrer to a complaint without leave to amend, if there is a reasonable possibility that the defect in the complaint can be cured by amendment. West's Ann.Cal.C.C.P. § 430.10(e).

[7] Pleading 302 ⚷11

302 Pleading
302I Form and Allegations in General
302k11 k. Matters of evidence. Most Cited Cases

A complaint or cross-complaint is no place to quote, paraphrase, or even allude to, the testimony of witnesses. West's Ann.Cal.C.C.P. § 425.10(a).

[8] Fraud 184 ⚷16

184 Fraud
184I Deception Constituting Fraud, and Liability Therefor
184k15 Fraudulent Concealment
184k16 k. In general. Most Cited Cases
Concealment is a species of fraud or deceit. West's Ann.Cal.Civ.Code §§ 1572(3), 1710(3).

[9] Fraud 184 ⚷16

184 Fraud
184I Deception Constituting Fraud, and Liability Therefor
184k15 Fraudulent Concealment
184k16 k. In general. Most Cited Cases
Elements of action for fraud and deceit based on concealment are: (1) defendant concealed or suppressed a material fact; (2) defendant was under duty to disclose the fact to plaintiff; (3) defendant intentionally concealed or suppressed the fact with intent to defraud plaintiff; (4) plaintiff was unaware of the fact and would not have acted as he did if he had known of the concealed or suppressed fact; and (5) as result of concealment or suppression of the fact, plaintiff sustained damage.

[10] Brokers 65 ⚷102

65 Brokers
65VIII Rights, Powers, and Liabilities as to Third Persons
65k102 k. Misrepresentation or fraud of broker. Most Cited Cases
Real estate brokerage firm that represented lessee in complex commercial lease transaction did not have duty to disclose to lessor, as element of fraud or deceit based on concealment, the lessee's deteriorating financial condition during ten-month period between execution of lease and scheduled date for lessee to take possession.
See Cal. Jur. 3d, Brokers, § 81; 2 Miller & Starr, Cal. Real Estate (3d ed. 2001) § 4:17; 3 Witkin, Summary of Cal. Law (10th ed. 2005) Agency, § 63.

[11] Fraud 184 ⚷17

184 Fraud
184I Deception Constituting Fraud, and Liability Therefor
184k15 Fraudulent Concealment
184k17 k. Duty to disclose facts. Most Cited Cases
A duty to disclose, as element of fraud or deceit based on concealment, can arise from the making of affirmative representations with knowledge of undisclosed facts that materially qualify the facts disclosed or render the disclosed facts likely to mislead.

[12] Pleading 302 ⚷18

302 Pleading
302I Form and Allegations in General
302k18 k. Certainty, definiteness, and particularity. Most Cited Cases
Commercial lessor's cross-complaint against real estate brokerage firm retained by lessee, by merely identifying a topic of brokerage firm's alleged representations to lessor before lessor and lessee entered into lease, i.e., lessee's ability to pay rent in the future, did not satisfy requirement of pleading fraud with specificity, in action for fraud or deceit based on concealment, asserting brokerage firm had a duty to disclose lessee's deteriorating financial condition during ten-month period between execution of lease and scheduled date for lessee to take possession, which duty allegedly arose from the making of affirmative representations with knowledge of undisclosed facts that materially qualified the facts disclosed or rendered the disclosed facts likely to mislead; cross-complaint did not set forth the substance of the alleged representations to lessor before lessor and lessee entered into lease..

[13] Pleading 302 ⚷18

302 Pleading
302I Form and Allegations in General
302k18 k. Certainty, definiteness, and particularity. Most Cited Cases
Fraud must be pleaded with specificity.

[14] Pleading 302 ⚷18

302 Pleading
302I Form and Allegations in General
302k18 k. Certainty, definiteness, and particularity. Most Cited Cases
To satisfy requirement of pleading fraud with specificity, a pleader asserting tort liability based on false or incomplete statements must set forth at least the substance of those statements.

[15] Fraud 184 ⚷17

184 Fraud
184I Deception Constituting Fraud, and Liability Therefor
184k15 Fraudulent Concealment
184k17 k. Duty to disclose facts. Most Cited Cases
Assuming that real estate brokerage firm retained by lessee, for complex commercial lease transaction, had made representations to lessor, before lessor and lessee entered into lease, regarding lessee's financial ability to perform its obligations, lessee did not have a duty to "correct" those representations during ten-month period between execution of lease and scheduled date for lessee to take possession, as would support fraud or deceit based on concealment.

[16] Pleading 302 ⚷11

302 Pleading
302I Form and Allegations in General
302k11 k. Matters of evidence. Most Cited Cases

Pleading 302 ⚷193(5)

302 Pleading
302V Demurrer or Exception
302k193 Grounds for Demurrer to Declaration, Complaint, Petition, or Statement
302k193(5) k. Insufficiency of facts to constitute cause of action. Most Cited Cases
An allegation of agency is deemed an allegation of ultimate fact, for purposes of ruling on a demurrer.

[17] Pleading 302 ⚷21

302 Pleading
302I Form and Allegations in General
302k21 k. Consistency or repugnancy. Most Cited Cases

Pleading 302 ⚷52(1)

302 Pleading
302II Declaration, Complaint, Petition, or Statement
302k50 Separate Causes of Action
302k52 Separate Statement and Numbering
302k52(1) k. In general. Most Cited Cases

Pleading 302 ⚷53(1)

302 Pleading
302II Declaration, Complaint, Petition, or Statement
302k53 Separate Counts on Same Cause of Action
302k53(1) k. In general. Most Cited Cases

Pleading 302 ⚷93(1)

302 Pleading
302III Responses or Responsive Pleadings in General
302III(A) Defenses in General
302k89 Pleading Different Pleas or Defenses Together
302k93 Inconsistent Defenses
302k93(1) k. In general. Most Cited Cases
The law permits the pleading of mutually inconsistent bases of liability or defense, so long as the differing grounds are separately stated and free of self-contradiction.

[18] Principal and Agent 308 ⚷69(8)

308 Principal and Agent
308II Mutual Rights, Duties, and Liabilities

308II(A) Execution of Agency
308k69 Individual Interest of Agent
308k69(8) k. Transactions after termination of agency. Most Cited Cases
While an agent's duty of disclosure to the principal ordinarily ends upon termination of the agency relationship, the agent may remain under such a duty when it is foreseeable to the agent that the principal will continue to rely on the agent for information, and the agent does not inform the principal that no further information will be provided. Restatement (Third) of Agency § 8.11 cmt. c.

[19] Principal and Agent 308 ⚷48

308 Principal and Agent
308II Mutual Rights, Duties, and Liabilities
308II(A) Execution of Agency
308k48 k. Nature of agent's obligation. Most Cited Cases

Principal and Agent 308 ⚷69(1)

308 Principal and Agent
308II Mutual Rights, Duties, and Liabilities
308II(A) Execution of Agency
308k69 Individual Interest of Agent
308k69(1) k. In general. Most Cited Cases
An agent has a duty not to use or communicate confidential information of the principal for the agent's own purposes or for those of a third party. Restatement (Third) of Agency § 8.05.

[20] Pleading 302 ⚷192(5)

302 Pleading
302V Demurrer or Exception
302k192 Grounds for Demurrer in General
302k192(5) k. Surplusage and irrelevant, immaterial, or redundant matter. Most Cited Cases
Redundancy of a cause of action is not a ground on which a demurrer may be sustained. West's Ann.Cal.C.C.P. §§ 430.10, 436(a).

[21] Negligence 272 ⚷200

272 Negligence
272I In General
272k200 k. Nature. Most Cited Cases

Negligence 272 ⚷230

272 Negligence
272III Standard of Care
272k230 k. In general. Most Cited Cases
The essence of negligence is carelessness or inadvertence.

[22] Appeal and Error 30 ⚷984(5)

30 Appeal and Error
30XVI Review
30XVI(H) Discretion of Lower Court
30k984 Costs and Allowances
30k984(5) k. Attorney fees. Most Cited Cases

Appeal and Error 30 ⚷1024.1

30 Appeal and Error
30XVI Review
30XVI(I) Questions of Fact, Verdicts, and Findings
30XVI(I)6 Questions of Fact on Motions or Other Interlocutory or Special Proceedings
30k1024.1 k. In general. Most Cited Cases

Costs 102 ⚷194.12

102 Costs
102VIII Attorney Fees
102k194.12 k. Discretion of court. Most Cited Cases
A request for an award of attorney fees is largely entrusted to the discretion of the trial court, whose ruling will not be overturned in the absence of a manifest abuse of discretion, a prejudicial error of law, or necessary findings not supported by substantial evidence.

[23] Costs 102 ⚷194.32

102 Costs
102VIII Attorney Fees
102k194.24 Particular Actions or Proceedings
102k194.32 k. Contracts. Most Cited Cases
The trial court exercises a particularly wide discretion in determining who, if anyone, is the prevailing party, for purposes of statutory award of attorney fees to prevailing party in action on contract. West's Ann.Cal.Civ.Code § 1717(a).

[24] Appeal and Error 30 ⚷893(1)

30 Appeal and Error
30XVI Review
30XVI(F) Trial De Novo
30k892 Trial De Novo
30k893 Cases Triable in Appellate Court
30k893(1) k. In general. Most Cited Cases
The determination of the legal basis for an award of attorney fees is a question of law which the reviewing court will examine de novo.

[25] Costs 102 ⚷194.32

102 Costs
102VIII Attorney Fees
102k194.24 Particular Actions or Proceedings
102k194.32 k. Contracts. Most Cited Cases
California courts liberally construe the term "on a contract," as used in statute authorizing award of attorney fees to prevailing party in action on a contract. West's Ann.Cal.Civ.Code § 1717(a).

[26] Costs 102 ⚷194.32

102 Costs
102VIII Attorney Fees
102k194.24 Particular Actions or Proceedings
102k194.32 k. Contracts. Most Cited Cases
As long as the action involves a contract, it is "on a contract," within the meaning of statute authorizing award of attorney fees to prevailing party in action on a contract. West's Ann.Cal.Civ.Code § 1717(a).

[27] Costs 102 ⚷194.32

102 Costs
102VIII Attorney Fees
102k194.24 Particular Actions or Proceedings
102k194.32 k. Contracts. Most Cited Cases
Commercial lessor's cross-complaint against real estate brokerage firm retained by lessee, alleging brokerage firm's breach of duty to disclose lessee's deteriorating financial condition during ten-month period between execution of lease and scheduled date for lessee to take possession, was an action on contract, for purposes of statute authorizing award of attorney fees to prevailing party in action on contract; lessor's cross-complaint referred at least 14 times to commission agreement between lessor and its listing agent, as to which agreement the brokerage firm had alleged, in its complaint against lessor seeking payment of commissions, the firm's status at third-party beneficiary, lessor's cross-complaint relied heavily on commission agreement's language to establish that when lessee's financial troubles first appeared the agency relationships contemplated by the agreement were still in existence, and cross-complaint's prayer included demand for attorney fees, an item of relief for which no colorable basis other than the commission agreement appeared. West's Ann.Cal.Civ.Code § 1717(a).

[28] Costs 102 ⚷194.32

102 Costs
102VIII Attorney Fees
102k194.24 Particular Actions or Proceedings
102k194.32 k. Contracts. Most Cited Cases

Commission agreement between commercial lessor and its listing broker, allowing contractual award of attorney fees to prevailing party in "any litigation between the parties hereto" to enforce any provision of the agreement, did not apply to litigation between lessor and real estate brokerage firm retained by lessee, in which brokerage firm sought to recover commissions from lessor, and lessor cross-complained against brokerage firm for breach of duty to disclose lessee's deteriorating financial condition during ten-month period between execution of lease and scheduled date for lessee to take possession; listing broker was not a party to the action, and thus, no part of the action constituted litigation between the parties to the agreement. West's Ann.Cal.Civ.Code § 1717(a).

[29] Costs 102 ⚷194.32

102 Costs
102VIII Attorney Fees
102k194.24 Particular Actions or Proceedings
102k194.32 k. Contracts. Most Cited Cases

A party claiming a reciprocal right to attorney fees, under statute authorizing award of attorney fees to prevailing party in action on a contract, must establish that the opposing party actually would have been entitled to receive them if he or she had been the prevailing party. West's Ann.Cal.Civ.Code § 1717(a).

[30] Courts 106 ⚷89

106 Courts
106II Establishment, Organization, and Procedure
106II(G) Rules of Decision
106k88 Previous Decisions as Controlling or as Precedents
106k89 k. In general. Most Cited Cases

A judicial decision is not authority for everything said in the opinion, but only for the points actually involved and actually decided.

****329** Rossi, Hamerslough, Reischl & Chuck, Ronald R. Rossi, Susan R. Reischl, San Jose, for Plaintiff, Cross-Defendant and Appellant Blickman Turkus, LP.

Keker & Van Nest, Susan J. Harriman, Steven A. Hirsch, San Francisco, Wendel, Rose, Black & Dean, Charles Hansen, Oakland, Amanda Steiner, for Defendants, Cross-Complainants and Appellants MF Downtown Sunnyvale LLC, et al.

RUSHING, P.J.

***864** The primary question in this case is whether a realtor who represented the lessee in a complex commercial lease transaction had a duty to inform the lessor, after the lease was signed but before the lessee took possession, that the lessee's ability to perform the conditions of the lease was jeopardized by its deteriorating financial condition. The trial court held that the lessor had failed to plead facts sufficient to establish any duty on the realtor's part to disclose this information. We find no error in this determination. Nor do we find any error in the trial court's refusal to award attorney fees to the lessor based upon its defeat of the realtor's claims for unpaid commissions. Since these determinations render the realtor's cross-appeal moot, we will dismiss it and affirm the judgment.

BACKGROUND

Appellant MF Downtown Sunnyvale, LLC, is described in the pleadings as a limited liability company owning certain real property in Sunnyvale. At issue in this action are two buildings, known as Buildings 2 and 3, situated on that property. Appellant Mozart Development Co. is described as the agent for MF Downtown Sunnyvale, LLC, for purposes of leasing and managing the property. Both entities are apparently affiliated with John Mozart, who is ***865** not a party to this matter. We will join the parties in referring to appellants collectively as "Mozart."

Mozart alleges in its cross-complaint that in early 1999, it entered into a written commission agreement with Commercial Property Services (CPS) by which it engaged CPS and two affiliated individuals to act as its listing broker and agent in securing a lease of the premises for a specified commission. Inferentially, the buildings had "not yet been constructed or completed," but awaited execution of a lease so that they could be completed or improved to the tenant's specifications. Under the agreement, the first half of the commission would be "due and payable upon full lease execution and the second half ... upon rent commencement."

****330** In early 2001, Mozart entered into written leases with Handspring, Inc., for buildings 2 and 3. The leases contemplated delivery of the premises in August and September, 2002, with both parties working in the interim to prepare the buildings for occupancy in accordance with Handspring's needs. Their respective rights and obligations in connection with these efforts were set forth in "[w]ork [l]etter[s]" attached to the leases. Under the work letters, Handspring was required to secure its performance by providing letters of credit in the aggregate amount of some $23 million. Additional letters of credit or security deposits may have been required to secure Handspring's obligations under the leases.

Respondent Blickman Turkus, LP, doing business as BT Commercial Real Estate (BTC), through its agent Tom Snider, represented Handspring in the lease transaction. BTC later contended that it was the "procuring agent" entitled to a commission under the commission agreement between Mozart and CPS. Mozart acknowledged this assertion in its cross-complaint, and while denying it, also adopted it hypothetically as a basis for recovery against BTC should it be sustained by the court. (See pt. I(G), *post.*)

Mozart alleged that from October 2001 through "at least" July 2002, Snider and BTC were "advised by Handspring that [it] was having financial difficulties," that "its projected growth was not as fast as [it] had originally thought," and that it was "considering possible exit strategies" from the leased buildings, including a negotiated termination of the leases and reducing Handspring's financial risk. Mozart alleged that it did not learn of these matters until mid-August, 2002, when another agent contacted it to negotiate a termination of the leases. Mozart alleged that as a result of the delay in its learning of these matters, it sustained damage. (See pt. I(D), *post.*) Mozart and Handspring eventually negotiated a termination of the leases.

This action was commenced on January 28, 2003, not by Mozart, but by BTC, which filed a complaint against Mozart and Handspring in which it ***866** alleged that as the procuring agent in the lease transaction, it was a third party beneficiary of Mozart's commission agreement with BTC and thus entitled to the commission there specified. It alleged that Mozart had paid the first half of the commission as called for in the agreement, but had refused to pay the second half. As eventually amended, the complaint asserted claims for breach of the commission agreement by Mozart, breach of the covenant of good faith and fair dealing, breach by both Mozart and Handspring of an " implied promise to complete the lease transactions," and tortious interference by Handspring with BTC's economically advantageous relationship with Mozart.

Mozart successfully attacked BTC's complaint by motions for summary adjudication and judgment on the pleadings. BTC successfully demurred to Mozart's cross-complaint, with the court ultimately dismissing the third amended cross-complaint without leave to amend. The court entered a judgment by which neither party took anything. Mozart moved to vacate the judgment and for an award of attorney fees incurred by it in opposing BTC's complaint. The court denied both motions.

Mozart filed a notice of appeal from the judgment of dismissal on its cross-complaint. BTC filed a cross-appeal from (1) the summary adjudication of its claims, and (2) an order denying sanctions under Code of Civil Procedure section 128.5. Mozart filed a separate notice of appeal from the order denying its motion to vacate the dismissal of its cross-complaint ****331** and the order denying its motion for attorney fees.

DISCUSSION

I. *Dismissal of Cross-Action*

A. *Standard of Review*

[1][2][3][4] "On appeal from a judgment of dismissal following the sustaining of a demurrer without leave to amend, the appellant 'has the burden to show either [that] the demurrer was sustained erroneously or that to sustain the demurrer without leave to amend constitutes an abuse of discretion.' [Citation.]" (*Smith v. County of Kern* (1993) 20 Cal.App.4th 1826, 1829-1830, 25 Cal.Rptr.2d 716 (*Smith*).) Because a general demurrer raises only a pure question of law-whether the facts set forth in the challenged pleading are sufficient to constitute a cause of action-a reviewing court considers it without deference to the trial court. (*Leko v. Cornerstone Building Inspection Service* (2001) 86 Cal.App.4th 1109, 1114, 103 Cal.Rptr.2d 858 (*Leko*); see Code Civ. Proc., § 430.10, subd. (e).) In doing so it examines the allegations of the challenged pleading, as supplemented by matters of which judicial notice is taken. (*Leko, supra,* 86 Cal.App.4th at p. 1114, 103 Cal.Rptr.2d 858.) The court must ***867** accept as true all well-pleaded allegations of material fact, "but not contentions or conclusions of fact or law." (*Berry v. City of Santa Barbara* (1995) 40 Cal.App.4th 1075, 1082, 47 Cal.Rptr.2d 661.)

[5][6] With respect to the second question-the trial court's failure to grant leave to amend-a reviewing court must defer to the trial court's ruling unless the appellant demonstrates "a manifest abuse of discretion." (*Smith, supra,* 20 Cal.App.4th at p. 1830, 25 Cal.Rptr.2d 716.) "Ordinarily it is an abuse of discretion to sustain a general demurrer to a complaint without leave to amend if there is a reasonable possibility [that] the defect in the complaint can be cured by amendment." (*Ibid.*)

B. *Duty to Disclose*

The gist of Mozart's claim is that for a period of some 10 months, BTC wrongfully failed to disclose information-Handspring's precarious financial condition-knowledge of which would have enabled Mozart to avoid some of the injury it allegedly suffered when Handspring finally approached it to negotiate a termination of the leases. A central issue, as the parties seem to recognize, is whether it appears from the facts alleged in the cross-complaint that BTC was, during those 10 months, under any duty to disclose those facts to Mozart. It goes without saying that no one can be liable in tort for causing injury to another unless he, or someone whose conduct is attributed to him, was legally obligated to act differently. Liability cannot arise from silence unless the law commands the defendant to speak.

A duty to speak may arise in four ways: it may be directly imposed by statute or other prescriptive law; it may be voluntarily assumed by contractual undertaking; it may arise as an incident of a relationship between the defendant and the plaintiff; and it may arise as a result of other conduct by the defendant that makes it wrongful for him to remain silent.

[7] Here, Mozart points to no statute obligating BTC to warn it of Handspring's weakened financial condition. As for a contractual duty to disclose, Mozart has alleged a number of evidentiary facts apparently intended to show that BTC expressly or impliedly assumed certain ongoing contractual obligations in connection with the lease transaction. However it does not allege that these obligations included any specific obligation to warn or ****332** advise *Mozart.* The cross-complaint may be understood to allege-if only inferentially-that BTC was under a continuing obligation of an arguably con-

tractual nature to inform its "client" of matters relevant to a transaction. [FN1] But with one ***868** qualification discussed below (see pt. I(G), *post*), there is no hint that Mozart was, or ever viewed itself as, BTC's "client." Indeed, the cross-complaint does not assert any contractual relationship between Mozart and BTC. It cannot be understood to posit a contractual duty to disclose.

> FN1. The cross-complaint is a model of improper pleading. Instead of alleging the ultimate fact of a particular custom and usage among real estate agents in the relevant community, the pleading contains several paragraphs summarizing deposition testimony and other evidence apparently intended to establish this fact. A complaint (or cross-complaint) is supposed to consist of "(1) [a] statement of the facts *constituting the cause of action,* in *ordinary and concise language,* " and "(2) [a] demand for judgment...." (Code Civ. Proc., § 425.10, subd. (a).) A pleading is no place to quote, paraphrase, or even allude to the testimony of witnesses.

This leaves us with the possibilities that a duty to disclose arose from a relationship between Mozart and BTC, or from conduct by BTC obligating it to speak. Mozart contends that BTC owed such a duty (1) as the agent for Handspring; (2) hypothetically, as an agent for Mozart itself; or (3) by virtue of statements by BTC that obligated it to speak when they ceased to be correct.

C. *Concealment: Elements*

Mozart's first cause of action asserts "concealment" against Snider and BTC in that they (1) breached a duty of full and fair disclosure they owed to Mozart as the real estate agents for Handspring; and (2) made representations at the time of Mozart's entry into the lease agreement that obligated them to speak when they learned that Handspring might be unable to perform that agreement. As reflected in the immediately preceding discussion, these are two quite distinct legal theories, which we will address separately. (See pts. I(E), I(F), *post.*) First, however, we will review general principles governing the tort of concealment.

[8][9] Concealment is a species of fraud or deceit. (See Civ.Code, §§ 1710, subd. (3), 1572, subd. (3); *Lovejoy v. AT & T Corp.* (2004) 119 Cal.App.4th 151, 158, 14 Cal.Rptr.3d 117 (*Lovejoy*).) "[T]he elements of an action for fraud and deceit based on concealment are: (1) the defendant must have concealed or suppressed a material fact, (2) the defendant must have been under a duty to disclose the fact to the plaintiff, (3) the defendant must have intentionally concealed or suppressed the fact with the intent to defraud the plaintiff, (4) the plaintiff must have been unaware of the fact and would not have acted as he did if he had known of the concealed or suppressed fact, and (5) as a result of the concealment or suppression of the fact, the plaintiff must have sustained damage." (*Marketing West, Inc. v. Sanyo Fisher (USA) Corp.* (1992) 6 Cal.App.4th 603, 612-613, 7 Cal.Rptr.2d 859; *Lovejoy, supra,* 119 Cal.App.4th at pp. 157-158, 14 Cal.Rptr.3d 117.)

The parties have focused their attention almost exclusively on the second element, i.e., whether Mozart has alleged facts from which a duty to disclose ***869** would arise. They also devote considerable attention to the question whether such duty, assuming it arose at the time of the lease execution, persisted thereafter so as to require the disclosures whose absence forms the basis for the claim. Before reaching those questions, however, we must note the deficiencies****333** attending Mozart's attempt to plead several other elements of the tort.

D. *Fraudulent Intent, Causation, Damage*

As noted above, liability for concealment requires that the defendant have "suppressed the fact with the intent to defraud the plaintiff." (*Marketing West, Inc. v. Sanyo Fisher (USA) Corp., supra,* 6

Cal.App.4th at p. 613, 7 Cal.Rptr.2d 859.) It must also appear, as with any other tort, that the defendant's wrongful conduct was a legal or proximate cause of harm to the plaintiff. These are two distinct elements. It is not enough that the misstatement (or concealment) actually harmed the plaintiff; it must have been made by the defendant with the intent to *induce action* (or inaction) by the plaintiff. Similarly, an intent to deceive the plaintiff is legally meaningless unless the deception caused injury.

In the context of fraud by affirmative false statements, the mental element is commonly stated in terms of intent to induce " '*reliance.*' " (E.g., *Lazar v. Superior Court* (1996) 12 Cal.4th 631, 638, 49 Cal.Rptr.2d 377, 909 P.2d 981, italics added.) In the context of fraud by concealment, the more precise formula is probably intent to *induce conduct*-action or inaction-that differs from what the plaintiff would have done if informed of the concealed fact. (See *Southern California Dist. Council, Assemblies of God v. Shepherd of Hills Evangelical Lutheran Church* (1978) 77 Cal.App.3d 951, 959 fn. 5, 144 Cal.Rptr. 46, (*Assemblies of God*) [fraud causes of action appeared "imperfectly pleaded" where "plaintiff never alleges in so many words that defendants' statements were made for the purpose of inducing the sale"].)

Here the only attribution of intention to BTC and Snider, for purposes of Mozart's first cause of action, appears as follows: "The aforementioned conduct of BTC and Snider was an *intentional concealment* of material facts known to them with the *intention on their part of procuring a commission without fulfilling their duties and obligations,* as a real estate broker and salesperson, to advise Cross-complainants of all material facts regarding Handspring and all knowledge they had regarding Handspring which was despicable conduct that subjected Cross-complainants to cruel and unjust hardship in conscious disregard of their rights so as to justify an award of punitive damages." This allegation fails to assert that cross-defendants intended to *induce action or inaction* on the part of cross-complainants. For that reason alone, no cause of action for concealment is stated.

***870** The quoted allegation suffers from other infirmities, including its failure to satisfactorily convey that any omission by cross-defendants in fact induced cross-complainants to engage in conduct differing from that in which they would otherwise have engaged. Typically a claim of this type rests on the straightforward premise that the defendant's concealment of facts led the plaintiff to enter into a transaction he would not otherwise have entered, or on terms he would not have accepted; or to forego an opportunity he would otherwise have taken. The pleading here does not suggest that BTC fraudulently induced Mozart to *enter into* the leases with Handspring. Mozart plainly and explicitly bases its claims on conduct and events occurring *after* the execution of those leases.

Mozart does make an attempt to allege that it was induced to forego more profitable opportunities, but it affirmatively appears from the cross-complaint that Mozart was not in a position to pursue these opportunities. Thus Mozart alleges, "Cross-complainants are informed and believe ****334** and thereon allege that if they had learned of the true facts in October, 2001, that [*sic*] they could have mitigated damages at that time and re-leased Buildings 2 and 3 at a time when commercial rents were higher than they were when the Termination Agreement was executed in January 2002, and at a time when they are higher than they are in the present market." But as the cross-complaint affirmatively alleges, Mozart had already leased the premises to Handspring. It could not have "re-leased" the buildings so long as it remained bound by its leases with Handspring. Nothing in the cross-complaint suggests that it could have unilaterally freed itself from those obligations. Nor can it be supposed that Handspring would have consented to or acquiesced in such conduct at any time before the parties actually negotiated their voluntary termination of the leases. Mozart affirmatively alleges that as late as July 2002-about a month before Handspring approached Mozart about negotiating a termination-Handspring was still hoping to *sublease* all or part of the subject buildings, or at any rate was believed by Snider to be so.[FN2] So long as that remained true, it is far from apparent-and far from likely-that knowledge of Handspring's financial situation could have made any difference to Mozart.

> FN2. Mozart alleges, "Through July, 2002, Handspring's representatives continued to tell Snider and BT[C] that Handspring's growth was not as projected. Snider contacted at least one other real estate broker advising that *there was a strong possibility Handspring would have both Buildings 2 and 3 available for sublease.*" It is also alleged that at least as late as May 2002, Handspring was still communicating with an architect and forwarding at least some of those communications to BTC.

Nor does it appear that Mozart had any "damages" to "mitigate" unless and until Handspring failed or refused to perform its obligations under the lease. Indeed, given Mozart's eventual agreement to terminate the leases, it appears highly doubtful-and the cross-complaint cannot be understood to adequately allege-that the posited concealment proximately caused any injury to ***871** Mozart. Again Mozart's allegations are perplexing: "As a direct and proximate result of the concealments of Cross-defendants BT[C] and Snider, as previously set forth, Cross-complainants have been damaged in *the amount of the commission already paid to BT[C]* by the listing broker in the transaction, Commercial Property Services, in the approximate amount of $850,873.22. Additionally, Handspring never commenced the payment of rent for Buildings 2 and 3 and terminated its Leases with Cross-complainants. Despite diligent efforts by Cross-complainants to lease said buildings they have been unable to lease a majority of the space. As a result, they have been damaged due to the conduct of BT[C] and/or Snider in the amount of the *loss of the rent they could have obtained* and *other payments to be made by Handspring* pursuant to said Leases in the excess of $100 million." We fail to see how any plausible causal connection could ever be established between allegedly tortious nondisclosures beginning in October 2001, and a payment of commissions apparently occurring some eight months earlier. It is even more difficult to see how the concealment alleged in the cross-complaint could have caused Mozart to lose rent payments by Handspring under the lease. If Handspring had been otherwise able to perform its obligations under the lease, no conduct attributed to BTC by Mozart could have reduced that capability. Instead of holding Handspring to those obligations, however, Mozart renegotiated their relationship, apparently receiving very considerable sums of money in the ****335** process.[FN3] But even if that had not occurred, neither the cross-complaint nor anything else in this record supports the notion that earlier knowledge of Handspring's finances could have somehow preserved the original lease arrangement. The allegations of damage, causation, inducement, and fraudulent intent are all woefully deficient.

> FN3. In opposition to Mozart's motion for summary adjudication, BTC offered evidence that the renegotiated transaction permitted Mozart to draw both letters of credit as well as a letter of credit on a third building, plus receive cash, notes, and stock, for a total value well in excess of $50,000,000, plus improvements paid for by Handspring. Mozart objected to this evidence as irrelevant, but did not dispute its accuracy. We do not rely on it in assessing the sufficiency of the cross-complaint, but we do take notice of it in considering whether the court abused its discretion by denying leave to amend.

These deficiencies, however, did not form a basis for BTC's challenge to the cross-complaint, and are not cited by it in defending the judgment on appeal.

This raises at least the theoretical possibility that Mozart might have been able to cure these allegations by further amendment. Therefore, rather than predicate affirmance on these defects, we will turn to the question to which the parties devote most of their attention: whether the facts alleged in the cross-complaint placed cross-defendants under a duty to disclose.

872 E. *Duty of Buyer's Agent to Disclose to Seller

As noted, Mozart's first cause of action appears to predicate a duty to disclose on two distinct theories. The first is set forth as follows: "At all times, *as a real estate agent representing Handspring,* Snider owed a duty to be truthful and honest and disclose material facts to Cross-complainants as he has admitted at his deposition in this action." FN4 (Italics added.) The legal premise for this theory, as nearly as we can discern, appears in the statement in Mozart's brief that every real estate licensee has a "fundamental duty ... to deal honestly and fairly with **all** parties in the transaction, not just his or her own principal. (*Earp v. Nobmann* (1981) 122 Cal.App.3d 270, 175 Cal.Rptr. 767 [(*Earp*)]; *Norman I. Krug Real Estate Investments, Inc. v. Praszker* (1990) 220 Cal.App.3d 35, 42-43, 269 Cal.Rptr. 228 [(*Krug*)]; *Hale v. Wolfsen* (1969) 276 Cal.App.2d 285, 81 Cal.Rptr. 23 [(*Hale*)]; *Lingsch v. Savage* (1963) 213 Cal.App.2d 729, 735, 29 Cal.Rptr. 201 [(*Lingsch*)].)"

> FN4. As we have previously observed, the inclusion in a pleading of evidentiary matter, such as the concluding phrase in the quoted sentence, is improper. On the other hand, where it does not contradict more competent allegations, we will simply disregard it as superfluous.

None of these cases sustains Mozart's claim that BTC owed it a duty to disclose changes in Handspring's financial condition arising after the parties executed the lease. In *Earp, supra,* 122 Cal.App.3d 270, 175 Cal.Rptr. 767, (disapproved on another point in *Silberg v. Anderson* (1990) 50 Cal.3d 205, 219, 266 Cal.Rptr. 638, 786 P.2d 365), a broker who acted as the go-between in an attempted real estate purchase performed his professional duties so poorly that the seller denied the existence of a contract and tried to sell the property to another, while the buyer insisted that a contract was formed, sued the seller for specific performance, and thus thwarted the subsequent sale. (See *Earp, supra,* 122 Cal.App.3d at p. 280, 175 Cal.Rptr. 767.) In the seller's cross-action, the broker was held to have acted negligently toward the *seller* in numerous respects, including his failure to inform the *buyer* that the offer presented on the buyer's ****336** behalf did not satisfy the basic criteria originally put forward by the seller. (*Id.* at p. 291, 175 Cal.Rptr. 767.) The court did not characterize this as concealment or the breach of any duty to disclose; indeed, it never used the terms "disclose," "conceal," "suppress," "fraud," or "deceit." Nor did the court find it necessary to determine the nature of the relationship between the broker and the two parties. (See *id.* at p. 290, 175 Cal.Rptr. 767.) Rather the court viewed the broker's deficient communications with the buyer as but one instance of the "negligent behavior" the court found "pervasive." (*Id.* at p. 291, 175 Cal.Rptr. 767.) As relevant here, the broker's liability was predicated on negligence. (*Id.* at pp. 276, 277-278, 281, 289, 290, 175 Cal.Rptr. 767.) The case has no apparent bearing here beyond the general proposition that a broker may be liable to those foreseeably injured by his negligence. We will discuss the applicability of that concept here in part I(I), *post.* For present ***873** purposes it is enough to conclude that *Earp* provides no authority for holding that a buyer's (or lessee's) agent has any duty of disclosure, as such, toward a seller (or lessor).

In *Krug, supra,* 220 Cal.App.3d 35, 40, 269 Cal.Rptr. 228, the seller of an apartment building told his realtor about an unrecorded deed of trust he had given to a creditor. The realtor thereafter sold the building without advising the creditor of the sale, or the buyer of the encumbrance. (*Ibid.*) The creditor sued the realtor for wrongfully causing the extinguishment of his security interest. The matter "proceeded to trial on a number of theories," but the trial court "rendered judgment for [the creditor] strictly on negligence grounds." (*Ibid.*) On appeal the realtor denied that he owed any duty to the creditor, noting the absence of privity or a special relationship between them. (*Id.* at pp. 41-42, 269 Cal.Rptr. 228.) While the court's analysis of this issue is germane to Mozart's general negligence theory (see pt. I(I), *post*), the decision is irrelevant to any duty of disclosure owed by a buyer/lessee's realtor to a seller/lessor.

In *Hale, supra,* 276 Cal.App.2d 285, 81 Cal.Rptr. 23, a realtor cooperating with the sellers' agent sued for a commission after the sellers withdrew from a purchase agreement upon discovering that the plaintiff realtor had fraudulently misrepresented the condition and value of a property to be conveyed to them under the agreement. (See *id.* at p. 291, 81 Cal.Rptr. 23.) Not surprisingly, the trial court ruled that the realtor's misrepresentations vitiated the sellers' obligations not only to perform the purchase agreement but to pay a commission to the realtor. The court also found that the realtor "was a subagent of [the sellers] and owed them a duty of utmost good faith, which she breached by failing to ascertain all of the pertinent facts about the [exchange] property and by making statements and representations to them that she did not know were true." (*Id.* at pp. 289-290, 81 Cal.Rptr. 23.) On appeal the realtor unsuccessfully attacked the latter finding (*id.* at pp. 290-291, 81 Cal.Rptr. 23) and the finding that the she had breached her fiduciary duties to the sellers (*id.* at pp. 291-292, 81 Cal.Rptr. 23). Mozart apparently cites the case for its passing dictum that "real estate brokers are under a duty to deal fairly with all parties and be well informed on current market conditions." (*Id.* at p. 292, 81 Cal.Rptr. 23.) Again, the case has no tendency to show the existence of any particular duty of disclosure on the part of a buyer/lessee's agent toward a seller/lessor.

In *Lingsch, supra,* 213 Cal.App.2d 729, 732-733, 29 Cal.Rptr. 201, the trial court sustained a demurrer by the sellers' broker to a complaint by buyers who alleged that the defendants had sold them a building**337 without disclosing, among other things, that the building had been condemned. The broker contended that no cause of action was stated because the form purchase agreement recited that the property was purchased as is and that no *874 extrinsic representations had been made. (*Id.* at p. 734, 29 Cal.Rptr. 201.) The reviewing court narrowed the issue to whether the buyers could state a claim based upon "mere nondisclosure ... occurring between parties not in a confidential relationship." (*Ibid.*) The court then cited the judicially developed rule that "where the seller knows of facts materially affecting the value or desirability of the property which are known or accessible only to him and also knows that such facts are not known to, or within the reach of the diligent attention and observation of the buyer, the seller is under a duty to disclose them to the buyer." (*Id.* at p. 735, 29 Cal.Rptr. 201.) "Failure of the seller to fulfill such duty of disclosure constitutes actual fraud." (*Id.* at p. 736, 29 Cal.Rptr. 201.) It then noted that a similar duty rests upon the seller's agent: "Where such agent or broker possesses, along with the seller, the requisite knowledge according to the foregoing decisions, whether he acquires it from, or independently of, his principal, he is under the same duty of disclosure. He is a party connected with the fraud and if no disclosure is made at all to the buyer by the other parties to the transaction, such agent or broker becomes jointly and severally liable with the seller for the full amount of the damages." (*Ibid.*) The court held that the complaint did not sufficiently state a cause of action under this theory, but could probably be amended to do so. (*Id.* at pp. 739-740, 29 Cal.Rptr. 201.)

Of the four cases cited by Mozart, *Lingsch* is the only one imposing a duty of disclosure, as such, on one who was not the plaintiff's agent at the time of the alleged concealment. The holding there rested on a duty peculiarly imposed upon the *seller's* agent to disclose inobvious facts affecting the *value of the property.* The case was later cited for the proposition that "where a real estate broker or agent, *representing the seller,* knows facts materially affecting *the value or the desirability of property offered for sale* and these facts are known or accessible only to him and his principal, and the broker or agent also knows that these facts are not known to or within the reach of the diligent attention and observation of the buyer, the broker or agent is under a duty to disclose these facts to the buyer." (*Cooper v. Jevne* (1976) 56 Cal.App.3d 860, 866, 128 Cal.Rptr. 724 (*Cooper*), citing *Lingsch, supra,* 213 Cal.App.2d at pp. 735-736, 29 Cal.Rptr. 201.) (Italics added.) This " *Cooper- Lingsch* rule" was later held to implicitly obligate the agent for a *residential seller* to disclose "reasonably discoverable defects" to the buyer, and to "conduct a reasonable investigation" to that end. (*Easton v. Strassburger* (1984) 152 Cal.App.3d 90, 99, 100, 199 Cal.Rptr. 383; see *id.* at p. 102, 199 Cal.Rptr. 383 ["affirmative duty to conduct a reasonably competent and diligent inspection" and to disclose facts affecting value to buyer].) This holding was ultimately codified in Civil Code section 2079, subdivision (a), which declares that a broker who is engaged by a seller, or who acts in cooperation with a broker engaged by a seller, has a duty "to a prospective purchaser of residential real property ... to conduct a reasonably competent and diligent visual inspection of the property offered ***875** for sale and to disclose to that prospective purchaser all facts materially affecting the value or desirability of the property that an investigation would reveal...."

Here the duty imposed by these authorities never came into existence because (1) ****338** Mozart was a seller (lessor), not a buyer; (2) BTC represented a buyer, not a seller; (3) the transaction involved commercial, not residential, property; and (4) the matter allegedly concealed went not to the value of the property, or even the desirability of the transaction, but to facts learned by the broker after the transaction had been consummated, at least to the extent of executing an agreement binding on the parties.

Nor do we see any reason to extend the duty described above to the situation before us. As the *Easton* court observed, the primary purposes of burdening a seller's broker with disclosure duties running to the buyer are "to protect the buyer from the unethical broker and seller and to insure that the buyer is provided sufficient accurate information to make an informed decision whether to purchase." (*Easton, supra,* 152 Cal.App.3d at p. 99, 199 Cal.Rptr. 383.) The duty is justified not only by the broker's likely superior knowledge of facts affecting the value of the property, but by the risk that the residential purchaser will suppose the broker to be adequately representing his interests. Thus the court observed that "in residential sales transactions the seller's broker is most frequently the best situated to obtain and provide the most reliable information on the property *and is ordinarily counted on to do so.*" (*Id.* at p. 100, 199 Cal.Rptr. 383, italics added.) " 'The real estate broker's relationship to the buyer is such that the buyer usually expects the broker to protect his interests.' " (*Ibid.*, quoting Comment, *A Reexamination of the Real Estate Broker-Buyer-Seller Relationship* (1972) 18 Wayne L.Rev. 1343, 1343; see *Easton, supra,* 152 Cal.App.3d at p. 101, 199 Cal.Rptr. 383, fn. omitted ["Not only do many buyers in fact *justifiably* believe the seller's broker is also protecting their interest in securing and acting upon accurate information and rely upon him, but the injury occasioned by such reliance, if it be misplaced, may well be substantial"]; *id.* at p. 101, fn. 5, 199 Cal.Rptr. 383, quoting Sinclair, *The Duty of the Broker to Purchasers and Prospective Purchasers of Real Property in Illinois* (1981) 69 Ill.Bar.J. 260, 263-264 [" 'In the typical residential real estate transaction ..., the buyer, in particular, may be intentionally or inadvertently led ... to believe the broker will represent his interest even where he is aware the broker has a listing agreement with the seller. Since the broker's commission is generally paid as a percentage of the sales price, the broker's interest is more closely identified with that of the seller than of the buyer. Where the buyer is unappreciative of the potentially divided loyalty of the broker, he may be lulled into relying on the broker to his significant detriment. Misplaced reliance by the buyer can extend beyond the issue of price to questions regarding quality of title, condition of the premises, and proration of closing costs, property taxes, recording fees, and other expenses' "].) ***876** Indeed the *Easton* court expressed doubt that any such duty should be imposed in commercial transactions, writing, "Unlike the residential home buyer who is often unrepresented by a broker, or is effectively unrepresented because of the problems of dual agency [citations], a purchaser of commercial real estate is likely to be more experienced and sophisticated in his dealings in real estate and is usually represented by an agent who *represents only the buyer's interests.* [Citation.]" (*Id.* at p. 102, fn. 8, 199 Cal.Rptr. 383, italics added.)

Here there is no allegation that Mozart was ever led to believe, or did believe, or rationally could have believed, that BTC was representing its interests. On the contrary, recognition pervades the cross-complaint that each party in the transaction****339** was represented by its own agent-Mozart by CPS, Handspring by BTC. Thus Mozart affirmatively alleged that Snider and BTC *represented Handspring,* not Mozart, in the lease transaction, i.e., Snider was BTC's "authorized agent *representing Handspring* in the transaction," and that he made statements to Mozart "on Handspring's behalf, and as a representative of BT[C]." Mozart further alleged that it shared the understanding with CPS that the latter would "continue to *act on [Mozart's] behalf,* with respect to any leases to be executed, until such time as the duties and obligations of [Mozart] and any tenant were fulfilled," that BTC similarly understood that it would "continue to *represent[its]client* until such time as the building(s) is/are finished, tenant improvements complete, and rent is to commence," that Mozart expected and intended CPS, and any cooperating broker or procuring agent, to "continue to *represent their respective clients* after the Leases were executed, until such time as rent commenced," and that CPS and BTC understood as between themselves "that they would continue to represent their respective clients until rent commenced...."

Nor does Mozart allege any conflict of interest tempting BTC to perniciously favor Handspring's interests over Mozart's. If anything both stood to lose from a termination of the lease agreement-Mozart would lose its expectation of rents and other payments called for by that agreement, while BTC would lose the second half of its commission, or at least a clear claim to that sum. Nowhere does the cross-complaint suggest any facts comparable to the natural alignment between broker and *seller* arising from the correlation between sale price and commission.

The record suggests no basis for any expectation by Mozart that BTC would disclose matters regarding Handspring other than as its "respective client [ ]," Handspring, might direct. The only factor in common with *Easton* is BTC's presumably superior knowledge of its client's financial condition. But so far as this record indicates, BTC only had that knowledge by virtue of its confidential relationship with Handspring. Mozart alleges that beginning in late 2001 and continuing to mid-2002, "Snider and BT[C] were advised ***877** by Handspring" of various matters, including "that Handspring was having financial difficulties and that its projected growth was not as fast as Handspring had originally thought." If the possession of superior knowledge so gained were enough to trigger a duty to disclose, every agent of any kind could be required to disclose information obtained in confidence from his principal so long as it appeared potentially germane to the interests of another party to a proposed transaction. This would of course make it impossible for any principal to conduct negotiations through an intermediary without disclosing every fact that might improve the bargaining position of the other party. Nothing known to us would justify such a revolution in the law governing business transactions.

[10] In sum, none of the cases cited by Mozart, and

no other authority known to us, supports the imposition of a duty on a lessee's agent in a commercial real estate transaction to disclose to the lessor information, acquired after execution of a lease, concerning the buyer's finances. Mozart has offered no reason to impose such a duty. We therefore decline to do so. Insofar as Mozart's cross-complaint rested upon such a duty, it failed to state facts sufficient to constitute a cause of action.

F. *Duty Arising from Prior Statements*

[11] A duty to disclose can arise from the making of affirmative representations ****340** with knowledge of undisclosed facts that " 'materially qualify the facts disclosed, or ... render [the disclosed facts] likely to mislead....' " (*Linear Technology Corp. v. Applied Materials, Inc.* (2007) 152 Cal.App.4th 115, 132, 61 Cal.Rptr.3d 221 (*Linear Technology*), quoting *Warner Constr. Corp. v. City of Los Angeles* (1970) 2 Cal.3d 285, 294, 85 Cal.Rptr. 444, 466 P.2d 996.)

[12] Mozart seeks to invoke this theory, but the allegation on which this attempt rests does not supply an adequate foundation for it: "Prior to Handspring's entering into the Leases for Buildings 2 and 3, Snider, on Handspring's behalf, and as a representative of BT[C], had made affirmative representations to Cross-complainants *regarding Handspring's ability to pay the rent into the future.* At all times, as a result, he not only had a duty to disclose all material facts known to him as a real estate agent, but also a duty to correct any information which, if previously true, had become false or had changed. These duties continued as long as Snider and BT[C] continued to act as agent and broker in the transaction, including following execution of the Leases." (Italics added.) This allegation, and the cross-complaint as a whole, fail to identify any statement that was rendered false or inaccurate, then or later, by any failure of disclosure. Instead the pleading is pregnant with potentially fatal ambiguity. It asserts that Snider made unspecified statements on an identified *topic*-"Handspring's ability to pay rent in the future."

[13][14] ***878** Concealment is a species of fraud, and "[f]raud must be pleaded with specificity." (*Linear Technology, supra,* 152 Cal.App.4th at p. 132, 61 Cal.Rptr.3d 221.) To plead tort liability based on false or incomplete statements, the pleader must set forth at least the *substance* of those statements. Mozart can hardly claim not to know what statements were made to it. We can conceive of no excuse for its failure to plead them "with specificity."

Indeed, Mozart seems to have *retreated* from the comparative specificity of an earlier version of the cross-complaint, which was itself challenged for vagueness. In its original cross-complaint Mozart alleged, "After February 18, 1999, and prior to February 14, 2001, cross-defendants' authorized agent, Thomas Snyder [*sic*], represented to John Mozart, either directly or through representations to Mozart's real estate agents ... that Handspring was fully qualified as a tenant, financially stable, creditworthy, and otherwise willing and financially able to meet its obligations under the Leases...." In its demurrer to this pleading, BTC attacked the quoted allegation as unduly vague. Mozart reiterated the allegation in its first amended cross-complaint. In demurring to that pleading, BTC did not renew its attack on this particular allegation, perhaps because, as stated in its supporting memorandum, counsel for Mozart had "recently advised BT[C] that they will be *dropping* their claims against BT[C] for fraud and negligent misrepresentation, as well as their claims for rescission based on fraud and concealment...." In Mozart's second amended cross-complaint, the allegation appeared in its present form, i.e., Snider "made representations to cross-complainants regarding Handspring's financial and other qualifications as a tenant." In demurring to this pleading, BTC apparently overlooked this allegation, stating that "BT[C] and Snider are not alleged to have spoken at all to Mozart," and therefore "cannot be liable for active concealment." Similarly, in demurring to the third amended cross-complaint, BTC stated that it "cannot be liable for active concealment" because it was "not alleged to have had **341 any communication at all with Mozart...."

BTC's failure to acknowledge the quoted allegation cannot blind us to Mozart's conduct in the face of the original vagueness objection: After apparently expressing an intent to abandon the claim altogether, Mozart reasserted it in a far more nebulous form than the original. Whatever the history of this theory, the cross-complaint in its present form utterly fails to plead any affirmative representation on which a duty to disclose might be predicated.

Mozart does not directly assert otherwise. Instead it treats the pleading *as if* it contained such an allegation, nesting the relevant assertion within an assertion on some other point, perhaps to avoid a direct misstatement of the record. Thus Mozart writes that cross-defendants "knew their assurance that ***879** Handspring was a ready, willing and able tenant had changed." But no such assurance is alleged. Later they write, "BT[C] and Snider had a duty to *correct their representation* that Handspring was ready, willing and able to enter into the Leases when they discovered that information was no longer true." (Italics added.) But the only allegation of such a representation was abandoned two cross-complaints ago. In the closest thing to a direct assertion on this point, the concept of an affirmative statement suddenly gives way to something quite different: "BT[C] and Snider deliberately and systematically concealed from Mozart that *the tenant they had* procured and *presented as a 'ready, willing and able' lessee* was actively working, with BT[C]'s assistance, to make sure that it was none of these things." (Italics added.) There is of course as much difference between "presenting" and "representing" as there is between "moving" and "removing," "porting" and "reporting," or "pressing" and "repressing." A would-be singer's agent who sends his client to an audition might be said to "present" her as an able musician, but if the impresario concludes otherwise the agent's conduct hardly constitutes fraud.

Nor do we see any evidence that Mozart could truthfully plead an affirmative representation by BTC if given yet another chance (their fifth) to do so. The centrality of the point to their theory of recovery can hardly be doubted. They refer to the concept of a "ready, willing and able" tenant at least 11 times in their opening brief. Yet nowhere do they flatly allege any representations by BTC, or for that matter Handspring itself, concerning the latter's financial condition, present or future. We may suppose that in a transaction of this magnitude some kind of financial data were provided to the lessor. But we must also suppose that Mozart was satisfied with those data, and indeed finds no fault with them now, since it has apparently never suggested that its *entry into the leases* was procured by fraud. Its apparent inability to attribute an affirmative representation to BTC is reflected in such constructions as its reference to the concealment of information that "contradicted the *basic notion* that Handspring was a ready, willing and able tenant." (Italics added.) It offers no authority for a theory of fraud by "basic notion." And like much of Mozart's presentation below and here, this statement seeks to blur the distinction between two critically different points of time: the point when the leases were executed, at which time all parties apparently believed Handspring was ready, willing, and able to perform; and the time beginning eight months later, when that supposition became clouded by doubt. The question is not what "basic notion" might have been shared by the participants at an earlier time, but whether Mozart has alleged facts sufficient to impose a duty of disclosure on BTC at the later time alleged **342 in the cross-complaint. Insofar as Mozart seeks to predicate such a duty on statements initially made by BTC, the failure to actually plead such statements dooms its theory to failure.

[15] ***880** Once again, however, the parties seem to have overlooked these rudimentary deficiencies in favor of more debatable issues-in this instance, whether Mozart's theory, if adequately pled, is vi-

able as a matter of substantive law. The question then becomes whether, supposing BTC had affirmatively assured Mozart of Handspring's financial ability to perform its obligations, BTC would thereby become obligated to notify Mozart when, following execution of the lease, Handspring betrayed doubts about its ability to perform. We do not believe that any existing authority would impose a duty on BTC to, in Mozart's words, "correct" this information under the circumstances alleged by Mozart.[FN5] Certainly none of the authorities cited by it requires, or in our view justifies, the imposition of liability here.

FN5. The weaknesses in a party's position are often betrayed by infelicities in its exposition. Thus Mozart asserts that BTC was under a "duty to correct material facts that had changed." "[F]acts," properly understood, can neither change nor be corrected. We suspect that what Mozart would like to have said, and yet could not say, is that BTC was under a duty to correct *statements* rendered untrue by later events.

In *Assemblies of God, supra,* 77 Cal.App.3d 951, 144 Cal.Rptr. 46, the representatives of a church, in selling real estate to another church, told the buyer that a driveway across an adjoining parcel would remain available for the buyer's use, and that such availability was required by city planners. However, when the local planning commission conditioned a related approval on the continuance of a driveway easement, the seller's representatives successfully objected, and the easement was extinguished. The buyer acknowledged being aware of the commission proceedings but denied knowledge that the initial ruling had been protested or scheduled for rehearing. The reviewing court reversed a summary judgment for the seller, holding that its failure to disclose its efforts to eliminate the easement breached the covenant of good faith and fair dealing. (*Id.* at p. 956, 144 Cal.Rptr. 46.) The court observed that "knowledge of what was going on 'would have provided [the buyer] with a clear basis for rescinding its contract to buy parcel 2' and prevented whatever damage [it] can prove as arising from the fact that the purchase agreement became executed four full years before [it] became aware of any problem." (*Ibid.*) The seller denied any duty to disclose, but the court found a triable issue of fact "with respect to the existence of a confidential relationship" between the parties. (*Ibid.*) The court noted allegations that none of the buyer's representatives were "experienced in real estate dealings" and that they "placed complete confidence" in the seller's representatives, who included "an experienced real estate broker...." (*Ibid.*) The buyer also insisted that it had viewed the selling church as " 'a recognized and established Christian church organization worthy of trust and belief and represented by persons of integrity.' " (*Ibid.*) Given the presence of a triable issue concerning the nature of the parties' relationship, it was immaterial whether the cause of action were viewed as sounding in contract or in tort, i.e., fraud. (*Id.* at p. 957, 144 Cal.Rptr. 46.)

***881** The situation here differs from that in *Assemblies of God* in at least four material respects. First, the defendant there gave affirmative assurances and then acted affirmatively to alter the subject matter of those assurances. Second, the direct and ****343** voluntary contractual relationship between the parties generated a duty of good faith and fair dealing that made the defendant's *conduct* (not its mere failure to disclose) potentially tortious. Third, the plaintiff presented evidence to suggest that it reasonably vested trust and confidence in the defendant to deal with it squarely. Finally, it was apparent that a timely disclosure would have permitted the plaintiff to protect itself. Here, even if Mozart were to allege that BTC made affirmative assurances to it, there is no suggestion that BTC did anything to cause the failure of those assurances. Nor does Mozart allege any contractual relationship between the parties; rather, it alleges that BTC had contractual relationships with Mozart's agent, as well as with Handspring, whose interests it represented. Third, there is no hint of any special trust placed by

Mozart in BTC, or of any factual basis for such trust. Nor is there any coherent suggestion that earlier disclosure would have done Mozart any good, since it had already bound itself to the leases with Handspring when the occasion for disclosure allegedly arose.

In *Koch v. Williams* (1961) 193 Cal.App.2d 537, 14 Cal.Rptr. 429 (*Koch*), two couples who purchased subdivision homes sued the developer over a drainage easement that he granted to the local government *while the properties were in escrow.* As relevant here, the opinion states, "One who learns that his statements, even if thought to be true when made, have become false through a change in circumstances, has the duty *before his statements are acted on* to disclose the new conditions to the party relying on his original representations." (*Id.* at p. 541, 14 Cal.Rptr. 429, italics added.) This rule applied there because the effect of the nondisclosure was to deprive the plaintiffs of "the opportunity to reject the proposal or sale of the property under these conditions." (*Ibid.*) Thus, "[h]ad [the buyers] known of [the sellers'] act in the placing of record an easement across the properties in dispute, they might have elected to rescind the escrow and purchase agreement which clearly indicated the property was not subject to such an easement." (*Id.* at p. 542, 14 Cal.Rptr. 429.) Here there is no suggestion that BTC should or could have made clarifying disclosures at a time when Mozart might yet "reject the proposal" or unilaterally rescind the lease agreement. Once that agreement was signed, whatever damage might be done was-so far as the cross-complaint shows-done. Mozart's vague suggestion that post-execution disclosure might have permitted it to "mitigate" its supposed injuries in some unspecified manner hardly brings the case within the rationale of *Koch.*

Similar divergences preclude application here of *Kretzschmar v. Janss Inv. Co.* (1932) 126 Cal.App. 698, 14 P.2d 1069. There the plaintiff buyers secured an option to purchase a lot from the defendant sellers. Two ***882** months later the sellers dedicated a strip of land crossing the lot to the county flood district. The next day the buyers and sellers entered into a formal purchase agreement. Some two years later, flood control authorities constructed a storm drain that bisected the lot with a 100-foot wide fenced ditch. Noting that the map reflecting the easement had been recorded "but a few hours before this contract was [signed]," the court observed, "It would seem that in common justice ... appellants should have at this time by some act on their part directed respondents' attention to the material change that had been made in the lot by the dedication of this easement.... The property covered by the option did materially change in character and appellants had knowledge of this change, but failed to call it to the attention of respondents and so ****344** *deprived them of the right to withdraw from the purchase.* ... [Citation.] The instant case differs from those cases where a deed is given as the closing incident of a purchase of land and constitutes an expression of the terms of the agreement reached in the transaction by the parties. Here the contract, in so far as an agreement of the parties upon the subject-matter had been reached, was evidenced by the option made some months before the contract of sale was delivered. The respondents were justified in relying upon this option and a duty rested upon the appellants to inform them of any material changes in the subject matter which had taken place subsequent to the option." (*Id.* at pp. 702-703, 14 P.2d 1069, italics added.) Here there was nothing comparable to the unilateral right conferred under an option to forego the contemplated transaction. Instead Mozart was already bound by the lease when BTC first learned of the facts on whose nondisclosure Mozart's claim depends.

In *Dyke v. Zaiser* (1947) 80 Cal.App.2d 639, 182 P.2d 344, the lessee of an amusement center brought an action to rescind the lease after the center was essentially closed by the police. The trial court found that the lessor had made certain representations about the income from the premises, that these statements were intended and understood to mean "that there existed no reason known to said defendant why the business should not continue to operate profitably in the future," that the lessee was induced by these statements to enter into the lease, and that the statements were "false and fraudulent in that defendant knew that said representations were untrue and knew that law enforcement officers of the County of San Diego contemplated and intended, within a period of twenty-four hours after the execution of said lease, to compel the closing of a substantial portion of the business...." (*Id.* at p. 644, 182 P.2d 344.) Among the lessor's contentions on appeal was that the lessee had failed to prove that the lessor knew of the impending police action at the time the parties *orally agreed* on the lease, as distinct from the time of its formal execution several days later. (*Id.* at p. 648, 182 P.2d 344.) In rejecting this contention, the court observed that at the time of execution, the lessee "was [still] relying upon [the lessor's] representations, and that ... incidents had transpired rendering the representations no longer true. [The lessor] knew that ***883** conditions had changed which materially affected the desirability of the property and he knew that [the lessee] was unaware of the changed conditions. Under these circumstances, his silence, together with the other circumstances related, would constitute fraud." (*Id.* at p. 654, 182 P.2d 344.) Despite the parties' having reached an oral understanding as to terms, the lessor knew that if the lessee were informed of the impending police action, he "would not execute the lease at all." (*Ibid.*)

In *Black v. Shearson, Hammill & Co.* (1968) 266 Cal.App.2d 362, 72 Cal.Rptr. 157, a stock brokerage house and its senior partner were held liable to certain customers to whom they sold stock in a corporation in which the partner was also a director. The sales had been induced by glowing reports of the corporation's prospects when, as known to the partner, internal communications described its situation as " 'drastic.' " (*Id.* at p. 365, 72 Cal.Rptr. 157.) On appeal the defendants argued that the evidence failed to show that the partner knew any statement by him was false *when made.* (*Id.* at p. 367, 72 Cal.Rptr. 157.). The court rejected this premise, but went on to declare that even if it had not, scienter would be adequately established by his having "permitted [the statements] to stand after he ****345** learned the truth *and before respondents relied on them.*" (*Ibid.*, italics added.)

In all of these cases (1) a seller made affirmative representations concerning the condition or value of property; (2) the seller knew of (in three cases he actively brought about) changed circumstances that rendered his representations deceptive; (3) the seller was aware of the changed circumstances at a time when the buyer could have declined to complete the purchase; (4) other circumstances justified the buyer's reliance on the seller to correct the misimpression it had created; and (5) the seller remained silent, thereby depriving the buyer of the opportunity to forego the purchase. Comparing these factors to the present case reveals the incoherence of Mozart's "duty to correct" theory. Mozart stands in the position of a seller, not a buyer, and the representations had nothing to do with the value of the property. More essentially, the harm for which Mozart seeks compensation is *not* its *entry into* the lease with Handspring, but its failure to *withdraw* from that agreement some time after executing it. As we have said, this assumes the undemonstrated and highly doubtful proposition that Mozart *could* have withdrawn from that agreement in any manner other than the one it ultimately chose: a mutual agreement with the other contracting party. It may be theoretically conceivable that the supposed delay in disclosure caused it some injury. But this is nowhere competently alleged and, more to the immediate point, none of the cited decisions rests a duty to disclose on such a slender reed.

Mozart fails to plead a cause of action on a theory of affirmative statements giving rise to a duty to disclose. Because it also fails to adequately allege a ***884** duty of disclosure arising from BTC's status as Handspring's agent, the trial court did not err by sustaining the demurrer to Mozart's first cause of action without leave to amend.

G. ***Hypothetical Allegation of Dual Agency***

Mozart's second cause of action rests on the hypothesis that although BTC primarily represented Handspring in the lease transaction, it was also a procuring or cooperating agent and thus *an agent of Mozart's,* bound as such to disclose to Mozart all facts known to BTC that might be relevant to Mozart's dealings with Handspring. This theory presents analytical challenges not because such an allegation is inherently difficult; on the contrary, realtors often find themselves in an "dual agency" relationship whereby they represent, and thus owe fiduciary duties to, both the seller and the buyer. (See 2 Miller & Starr, Cal. Real Estate (3d ed.2000) § 3 .12, pp. 64-69.) The difficulty arises from the contingent and hypothetical nature of Mozart's claim of the agency, coupled with circumstances indicating that the contingency cannot now occur.

In its cross-complaint Mozart does not simply allege, even in the alternative, that BTC was in fact its agent. This may reflect the flat denial of such a relationship in Mozart's answer to BTC's complaint. FN6 Rather than contradict this denial in its cross-complaint, Mozart there alleges that **346 BTC has *claimed* to be a procuring or cooperating agent, and then hypothesizes that *if the court were to sustain* this claim, it would follow that BTC owed Mozart, as its principal, a duty of disclosure. FN7 This hypothetical mode of pleading presents ample difficulties of its own, but the plot is thickened still further by the fact that the trial court has dismissed BTC's claims against Mozart, thus seemingly placing beyond possibility of realization the hypothesis on which the second cause of action rests, i.e., that BTC might be found to be Mozart's agent. However, BTC has cross-appealed from the dismissal of its complaint. Were we to reverse that ruling, reinstating BTC's claims, the possibility *885 would again arise that BTC might be found a procuring or cooperating agent, thereby restoring to the realm of possibility the hypothesis on which Mozart's second cause of action depends. This would seem to invite us to decide BTC's cross-appeal before attempting to assess the viability of Mozart's second cause of action. But this presents a conundrum, because BTC has designated its cross-appeal " conditional," urging us to "consider" the same " *only* if [we are] inclined to grant some aspect of Mozart's appeal...." (Italics in original.)

FN6. In its third amended complaint, BTC alleged that it was entitled to a commission under Mozart's agreement with Commercial Property Services Company because that agreement expressly contemplated payment of a commission to the "procuring agent," and BTC was the "procuring agent" in that it "procured Handspring as a tenant for two of the office buildings...." Although the present record appears not to contain an answer to this pleading, it does contain Mozart's answer to its predecessor, in which Mozart flatly denies identical allegations.

FN7. The pivotal allegation of the second cause of action is the following: "BT[C] and Snider contend that they were procuring or cooperating agents in the transaction which led to the two Lease Agreements with Handspring. If in fact the Court should find them to be a procuring or cooperating agent then it is Cross-complaints' contention that throughout the transaction and until such time as rent was to commence under the Commission Agreement, BT[C] and Snider were representing Cross-complainants as their fiduciaries and owed fiduciary duties to Cross-complainants of the highest standard of care."

The parties thus seem intent on thrusting us into a rather dizzying paradox. Mozart asserts a cause of action that depends on BTC's successful pursuit of at least a part of its claims; but those claims stand adjudicated adversely to BTC, and thus to Mozart's hypothesized cause of action; but that adjudication is exposed to reversal by BTC's cross-appeal; but BTC asks us to contemplate such a disposition only if we find some part of Mozart's appeal meritorious. The upshot of this logical merry-go-round seems to be that in order to trigger the condition on which the second cause of action depends-or more precisely, to leave the door open for that condition to be triggered-we would have to first find that some part of Mozart's appeal is meritorious, and then sustain BTC's cross-appeal (or enough of it that a finding of agency would again be possible).

This reasoning apparently precludes us from relying on the posited impossibility of the condition as a basis to affirm the judgment on the cross-complaint. We must therefore conduct a closer examination of the allegations of the second cause of action. Confined to their literal meaning and logical effect, they certainly do not set out the *factual* foundation for a cause of action. In essence they say that if the court makes a particular finding, Mozart will make a particular argument. Such a statement may be appropriate in a trial brief, but it is ineffectual in pleading a cause of action because it asserts no *facts* that would subject the defendant to liability. At its core it expresses nothing more than the pleader's intent to assert a particular *theory* under specified conditions. That is hardly the same thing as stating a claim.

The more difficult question is whether this deficiency is such that Mozart could not have cured it by amendment. BTC pointed out the deficiency in the trial court, though on different terms. It quoted the above allegation and wrote, "That is not an allegation of fact; it is a mere legal **347 conclusion." However, instead of analyzing its sufficiency in terms of the law of pleading, BTC went off on the *substantive soundness* of the proposition that a procuring or cooperating agent is the subagent of the listing agent with a fiduciary duty to the seller. BTC correctly observed that such a relationship does not necessarily arise, and that the payment of compensation, or an agreement to pay, is not necessarily determinative of the existence of an *886 agency relationship or the fiduciary duties attending it. (See Civ.Code, § 2079.19; 2 Miller & Starr, Cal. Real Estate, *supra*, §§ 3.5, 3:10, pp. 22, 44.)

[16] But an allegation of agency is deemed an allegation of ultimate fact. (*Skopp v. Weaver* (1976) 16 Cal.3d 432, 437, 439, 128 Cal.Rptr. 19, 546 P.2d 307.) BTC acknowledged this rule below but implied that it was inapplicable because "where the essential facts are not contested, the question whether an agency relationship existed may be decided as a matter of law." This is a rule applicable to the assessment of *evidence*, not to determining the sufficiency of a *pleading*. In the latter context, the existence of an agency relationship *is* the "essential fact[ ]," and where alleged must be accepted as true. (See *Id.* at pp. 436-437, 128 Cal.Rptr. 19, 546 P.2d 307.) BTC also asserted that Mozart "has not alleged the requisite agency relationship between itself and BT/Snider, but has instead alleged that its agent was CPS, while BT/ Snider represented Handspring. Those facts do not show an agency relationship between BT/Snider and Mozart-much to the contrary." This assertion rests on the premise that one cannot "represent" one party in a real estate transaction and still be an agent for the other party. If that were true this case would be very easy indeed. But it is not true. (See 2 Miller & Starr, Cal. Real Estate, *supra*, § 3.12, pp. 64-69.)

[17] Thus if the cross-complaint *unequivocally alleged* that BTC acted as the agent of Mozart, we would have no difficulty in holding this an adequate pleading of such a relationship. Instead, however, Mozart has elsewhere denied any such relationship, and alleges in the cross-complaint only that if the court finds such a relationship to have existed, in despite of Mozart's denial, then Mozart will contend that a duty of disclosure arose. This is, so far as we know, a novel mode of pleading. But it does not necessarily follow that it is improper. In substance, Mozart attempted to plead that BTC claims to have been a procuring or cooperating agent; that Mozart denies the existence of such a relationship; that if it did exist, then BTC was Mozart's agent and fiduciary; that BTC thus owed Moz-

art a duty of disclosure; and that BTC breached that duty by failing to inform Mozart of Handspring's financial difficulties. Although we know of no precedent for hypothetical pleading of precisely this type, it resembles the pleading of mutually inconsistent bases of liability or defense, which the law permits so long as the differing grounds are separately stated and free of self-contradiction. (See *Steiner v. Rowley* (1950) 35 Cal.2d 713, 718-719, 221 P.2d 9.) Tolerance for such pleading rests on the principle that uncertainty as to factual details or their legal significance should not force a pleader to gamble on a single formulation of his claim if the facts ultimately found by the court, though diverging from those the pleader might have considered most likely, still entitle him to relief.

The same rationale applies here: Mozart denies that BTC ever became its agent, but acknowledges BTC's contrary assertion, and asserts that if this ***887** claim is borne out, then BTC was Mozart's agent and fiduciary. In principle we see no reason to bar Mozart from pleading such a claim. ****348** For purposes of our analysis, therefore-and in light of BTC's failure to challenge the cross-complaint on the precise ground we have noted-we will assume that the cross-complaint can be amended to plead such a theory, such that if the pleading is otherwise sufficient, the trial court erred by denying leave to amend.

H. *Duty of Agent with Conflicting Obligations*

We have already noted several dubieties in Mozart's claims that it suffered compensable harm as a result of BTC's failure to disclose Handspring's financial condition. In particular we have observed that the cross-complaint affords no basis to suppose that an earlier disclosure of those matters would in fact have spared Mozart the harm, if any, it ultimately sustained. So long as Mozart remained bound by the lease, Handspring was entitled to explore, as it did, alternative means of extricating itself from the financial burdens imposed by the lease. Earlier notice might have enabled Mozart to threaten and bluster; it might have placed it in a different bargaining position in a renegotiation of the parties' relationship; but the premise that Mozart could actually establish these or any other liability-producing hypotheses of causation and damage is not supported by anything alleged in the cross-complaint or otherwise brought to our attention.

BTC, however, has not objected to the pleading on this ground. Rather, its chief contention is that, assuming its role as procuring agent engendered an agency relationship between it and Mozart, that relationship terminated upon the presentation of a qualified buyer. This argument delineates a chief subject of contention between the parties. The cross-complaint contains page after page of allegations intended to support the conclusion that BTC's role in the transaction was understood by all parties to continue beyond the execution of the lease at least until construction reached the agreed stage at which Handspring would commence the payment of rent.

[18] In our view this issue is largely, if not entirely, beside the point. BTC's argument conflates the duration of an agency *relationship* with the persistence of the *duties* arising from such a relationship. While an agent's duty of disclosure *ordinarily* ends upon termination of the agency relationship, this is by no means automatic; the agent may remain under such a duty "when it is foreseeable to the agent that the principal will continue to rely on the agent for information and the agent does not inform the principal that no further information will be provided." (Rest.3d, Agency, § 8.11, com. c., p. 376) "For example, if an agent arranges a transaction on behalf of a principal that is ongoing at the time their agency relationship ends, it may be ***888** foreseeable to the agent that the former principal will continue to rely on the agent to provide information relevant to the ongoing transaction." (*Ibid.*) Here Mozart has alleged precisely such a situation, and if it has neglected to allege foreseeable continued reliance by it, the defect could presumably be cured by amendment.

[19] The second cause of action fails, however, for a clearer reason: it rests on the erroneous supposition that if BTC was Mozart's agent, then BTC was obligated *ipso facto* to disclose information to Mozart. This is incorrect. It appears from the face of the cross-complaint that the information in question was acquired by BTC in confidence from Handspring. It is also alleged unequivocally that whatever BTC's relationship to Mozart, it was an agent of, and to, Handspring. Therefore disclosure of Handspring's confidential information to Mozart, without Handspring's ****349** consent, would unquestionably have constituted a breach of BTC's fiduciary duties to Handspring. (See Rest.3d, Agency, § 8.05(2).) FN8

FN8. "An agent has a duty [¶] .... [¶] (2) not to use or communicate confidential information of the principal for the agent's own purposes or those of a third party." (Rest.3d, Agency, § 8.05.)

Mozart's second cause of action erroneously supposes that BTC was obliged to disclose Handspring's confidential information to it even if doing so would violate BTC's duties to Handspring. In fact BTC's duty in such a situation would be to withdraw from one, and perhaps both, agency relationships. (See Rest.3d, Agency, § 8.03, com. b, illus. 3.) FN9 It might be supposed that BTC's failure to withdraw could itself form the basis of a cause of action, but we are unable to conceive of an adequate allegation of damage and causation. BTC's posited withdrawal from the posited agency relationship with Mozart would have had no discernible effect, since so far as this record shows BTC was neither actively representing Mozart in any transaction nor providing it with any sort of counseling or similar services. Conceivably BTC would also have been obligated to withdraw from its relationship with Handspring, though this proposition appears difficult if not impossible to substantiate. Even accepting it, we are again at a loss to see how BTC's ***889** withdrawal would have averted any harm otherwise suffered by Mozart. Handspring would presumably have engaged others to provide the services BTC was providing. Mozart might well learn of the termination of that relationship, but for all it would necessarily know, BTC and Handspring might simply have had a falling out.

FN9. The Restatement describes a hypothetical situation in which a sales agent might be obligated to disclose to his employer that a new product relevant to the employer's business was being developed by a corporation in which the agent owned an interest. The comment states in part, "It is, of course, possible that an agent may assume an adverse position in which the agent may not legally discharge the duties of disclosure that the agent owes to the principal because the agent owes a duty to another person not to disclose a fact that §§ 8.06 and 8.11 require be disclosed to the principal. In [the described hypothetical situation], for example, [the agent's] duties to [his] [c]orporation may prohibit [his] disclosure of new product developments to [its] customer, [his employer]. Unless it is possible for [his corporation] to shield [him] from access to facts that [he] will have a duty to disclose to [his employer], [the agent's] position is not tenable, and consequently *[he] must withdraw as [his employer's] agent.* " (Rest.3d, Agency, § 8.03, com. b, illus. 3, p. 294, italics added.)

For all these reasons we agree that with the trial court that the second cause of action fails to state facts sufficient to constitute a cause of action. Nor can we say that the court abused its discretion in denying leave to further amend that cause of action.

I. *Negligence*

Mozart's third cause of action seeks to predicate liability on the breach of several duties apparently not claimed to arise from any principal-agent relationship. Although the cause of action is entitled "Negligence Against Cross-Defendants BT Commercial and Thomas Snider," the quoted allegations do not confine themselves to a generalized duty of care but also assert duties of diligence, honesty, good faith and fair dealing, and investigation and disclosure.[FN10] No reliance is **350 placed on these latter allegations, however, and so far as we can discern they add nothing to the allegations elsewhere in the cross-complaint. We will therefore confine ourselves to the question whether Mozart alleged facts sufficient to establish negligence, i.e., a breach of a general duty of due care, by BTC.

> FN10. Mozart alleges: "57. Cross-defendant BT[C], as a real estate broker acting for Handspring, had a duty to Cross-complainants to diligently exercise skill and care in the performance of its duties and a duty of honesty, fair dealing and good faith, and to investigate and disclose all facts known to them [*sic*] materially affecting the value or desirability of the Lease transactions to Cross-complainants. Such duties continued until such time as rent was to commence under the Commission Agreement as set forth above. [¶] 58. Said Cross-defendant had a duty, among other things, to disclose the fact that Handspring's financial condition had changed, that it had discovered subsequent information about the status of Handspring's financial condition and its ability to perform under the long term Leases, Handspring was considering terminating the Leases or taking other action as previously set forth, and the other facts learned by Snider in or about October, 2001 through July, 2002 as previously set forth." Mozart goes on to refer of "[t]he breaches" of these duties without detailing them; presumably, it here relies upon its incorporated earlier allegations.

[20] Again our task is complicated by the fact that the parties do not join battle over the basic question whether the elements of the cause of action are adequately set forth in the pleading but choose instead to debate questions we consider secondary, if not peripheral. This problem seems to originate, once again, with BTC's misreading of the cross-complaint. In its demurrer, BTC characterized the third cause of action as resting on its allegedly having "concealed" information "negligently" rather than "intentionally." BTC went *890 on to argue that this was a distinction without legal significance, and that the court should sustain the demurrer because the third cause of action "mirrors [the] first cause of action for concealment and is duplicative." This is not a ground on which a demurrer may be sustained. (See Code Civ. Proc., § 430.10.) A quarter-century ago the code authorized a *motion to strike* "irrelevant and *redundant* " matter from a pleading. (Former Code Civ. Proc., § 453, repealed 1982.) But the parallel provision now empowers the court only to "[s]trike out any irrelevant, false, or improper matter inserted in any pleading." (Code Civ. Proc., § 436, subd. (a).) The elimination of the reference to redundancy may have rested on the irreproachable rationale that it is a waste of time and judicial resources to entertain a motion challenging part of a pleading on the sole ground of repetitiveness. (See Civ.Code, § 3537 ["Superfluity does not vitiate"].) This is the sort of defect that, if it justifies any judicial intervention at all, is ordinarily dealt with most economically at trial, or on a dispositive motion such as summary judgment.

BTC also challenged the third cause of action on the ground that BTC owed no duty to Mozart at the time of its alleged breach "because the leases had been executed when the alleged breach occurred." But once the premise is accepted that the cross-complaint alleges an arguably negligent omission, it seems highly doubtful that the duty on which such allegation depends can be categorically declared to have been extinguished or terminated by Mozart's execution of the lease. If it was foreseeable that Mozart could be harmed by the posited nondisclosure, and the facts are otherwise conceded to support a claim for negligence, it is difficult to see how we could categorically conclude that BTC and Snider ceased to owe Mozart a duty of care merely because Mozart had signed a contract with another party.

[21] Again, however, it seems to us that the cross-complaint suffers from far more fundamental defects. The essence of negligence is carelessness or inadvertence. (See **351*Solv-All v. Superior Court* (2005) 131 Cal.App.4th 1003, 1010, 32 Cal.Rptr.3d 202 [" 'negligence' implies a careless, but unintentional, failure to act with due care"]; *Davis v. Hearst* (1911) 160 Cal. 143, 172, 116 P. 530 ["Negligence necessarily implies an absence of intent or purpose," or is at least "independent of either"]; *Chetwood v. California Nat. Bank* (1896) 113 Cal. 414, 422, 45 P. 704 [allegation that defendant bankers allowed cashier to run bank so as to render it insolvent charged conduct "not ... committed inadvertently or carelessly, which would amount to negligence pure and simple, but to have been wrought against the corporation through contrivance and collusion, with a design to injure it,-a charge which establishes that the pleader must have considered that he was dealing with a case of willful tort, partaking of the nature of a fraud"].)

The cross-complaint alleges no conduct that appears, or is alleged to be, careless or inadvertent. There is no suggestion that BTC forgot to disclose the ***891** subject information to Mozart, or tried but failed to do so, or supposed that someone else had done so, or supposed that Mozart had no interest in the information. Such an allegation could scarcely be taken seriously since Mozart alleges with painful prolixity that BTC closely communicated with Handspring over some nine or 10 months about its anticipated difficulties in performing its obligations under the lease. The premise that BTC *neglected* to inform Mozart of these facts, as distinct from choosing to so behave, seems highly implausible to say the least. In any event it is not alleged.

Nor do the facts alleged resemble those on which courts have imposed liability for negligence in comparable situations. In *Earp, supra,* 122 Cal.App.3d 270, 175 Cal.Rptr. 767, the court pervasively referred to the defendant broker's conduct as negligent. (See *id.* at pp. 277-278, 276, 175 Cal.Rptr. 767 ["negligence as a real estate broker"], 281 [trial court's finding of negligence], 289 ["breach of an oral contract and ... negligence"], 290 ["negligent interference with economic advantage"].) But the gist of that case was a kind of realtor malpractice. As most pertinent here it involved not the withholding of information but a series of incompetent judgments about what to communicate, how, and to whom. Most pertinently, the defendant neglected to tell the buyer that his offer did not meet the minimum conditions the seller had said he was willing to accept. The defendant compounded this error by encouraging the buyer to stand on a nonexistent contract. Nothing like this is alleged in Mozart's cross-complaint.

The case most nearly supportive of Mozart's attempt to state a negligence cause of action is *Krug, supra,* 220 Cal.App.3d 35, 40, 269 Cal.Rptr. 228, where a realtor was held liable to the holder of an unrecorded deed of trust for causing its extinguishment in the course of a sale of the encumbered property. The court noted that a realtor is under a "fundamental duty" to "deal honestly and fairly with all parties in the sale transaction." (*Id.* at p. 42, 269 Cal.Rptr. 228.) It then noted that defining the reach of that duty in a given case depends on "weighing a number of factors, including the extent the transaction was intended to affect the third party, the foreseeability of harm, the degree of certainty the third party suffered injury, the moral blame attached to the broker's conduct, and the policy of preventing future harm." (*Id.* at p. 42, 269 Cal.Rptr. 228.) It noted that the imposition of a duty to disclose an unrecorded security interest was "supported by standards already existing in the industry." (*Ibid.*) It then observed, "The most important step in determining if a broker owes a duty of care to a third party is to examine 'whether a reasonable person would have foreseen**352 an unreasonable risk of harm to the third person and whether in view of such risk the broker exercised ordinary care under the circumstances.' [Citation.]" (*Id.* at pp. 42-43, 269 Cal.Rptr. 228.) The imposition of a duty of care on the realtor there was justified because, among other things, he knew or should have known that there was a significant risk that the plaintiff's security would be destroyed if the sale went through without its disclosure to the buyer. (*Id.* at p. 43, 269 Cal.Rptr. 228.)

***892** Here only one of the factors identified in *Krug* appears from Mozart's cross-complaint: it was certain that the "transaction" in question-whether viewed as the lease itself, or Handspring's contemplated withdrawal from it-would *affect* Mozart. However, it was far from certain or foreseeable that *BTC's silence* would *harm* Mozart. As we have already observed, Mozart failed to coherently allege that it *was* harmed by BTC's conduct. In the absence of a sound allegation to that effect, it is impossible to say whether any harm was foreseeable. Nor do the facts alleged instill confidence that this deficiency might be cured through amendment. Certainly it was foreseeable that Mozart would be harmed if Handspring defaulted on the lease. But this is not what occurred, or was contemplated, and had it been otherwise there is no basis to suppose that any disclosure to Mozart by BTC could have prevented it. BTC was evidently enlisted by Handspring to assist in finding a way out of the lease with minimal damage. The pleadings offer no basis to suppose that BTC could expect Mozart to be harmed more by Handspring's quietly exploring its options and developing a strategy for terminating the lease than it would have been if BTC had, in breach of its clear fiduciary obligations to Handspring (see pt. I(H), *ante*), notified Mozart prematurely of Handspring's efforts. The cross-complaint fails to allege facts establishing a breach by BTC of a general duty of due care.

J. *Negligent Supervision*

In its fourth cause of action, Mozart alleges that BTC negligently supervised Snider, its agent, by "allowing him to commit fraud and conceal the facts previously set forth from Cross-complainants including but not limited to his knowledge of facts which became available to him after the leases were signed including his knowledge of Handspring's financial condition, financial stability, and ability to honor the Lease agreements and abide by their terms; his knowledge that Handspring was considering either subleasing the buildings and/or terminating their leases; his knowledge that Handspring was interviewing brokers to negotiate a termination, and all of the information within his possession, custody and control from October, 2001 through July, 2002, previously set forth." We have already concluded that the fraud on which this cause of action rests is not adequately alleged. This cause of action therefore necessarily fails as well.

In sum, the trial court did not err by sustaining the demurrer to Mozart's third amended cross-complaint or by doing so without leave to amend.

II. *Denial of Attorney Fees*

A. *Background*

Around January 19, 2006, after the trial court granted summary adjudication against BTC on the remaining causes of action of its complaint, Mozart ***893** filed a cost bill claiming some $496,000 in attorney fees "pursuant to separate motion to be filed." On February 6, BTC filed a motion to tax costs, challenging the fee claim on the grounds that (1) in view of its failure to ****353** secure any relief under its cross-complaint, Mozart was not a prevailing party entitled to a fee award; and (2) Mozart had no contractual or statutory right to fees from BTC, because BTC was not a party to the underlying contract and would not itself have been entitled to fees had it prevailed on its complaint.

On March 8, 2006, Mozart brought a motion seeking some $398,000 in fees it claimed to have incurred in defeating BTC's complaint. The motion rested on the following points: (1) BTC's complaint was founded upon the commission agreement between Mozart and its broker, CPS. (2) The agreement contained a clause providing for recovery of attorney fees by the prevailing party in "any litigation between the parties hereto to enforce any provision of this Agreement." (3) Although BTC was not a party to the agreement, it claimed to be a third-party beneficiary entitled to enforce its terms, and it prayed in its complaint for attorney fees under the quoted clause. (4) BTC would thus have been entitled to fees had it prevailed upon its complaint. (5) Since Mozart prevailed instead, it was entitled to fees pursuant to Civil Code section 1717 (§ 1717) and Code of Civil Procedure section 1021. FN11

> FN11. Civil Code section 1717, subdivision (a) (§ 1717(a)), provides in part: "In any action on a contract, where the contract specifically provides that attorney's fees and costs, which are incurred to enforce that contract, shall be awarded either to one of the parties or to the prevailing party, then the party who is determined to be the party prevailing on the contract, whether he or she is the party specified in the contract or not, shall be entitled to reasonable attorney's fees in addition to other costs."
>
> Code of Civil Procedure section 1021 provides, "Except as attorney's fees are specifically provided for by statute, the measure and mode of compensation of attorneys and counselors at law is left to the agreement, express or implied, of the parties; but parties to actions or proceedings are entitled to their costs, as hereinafter provided."

BTC opposed the motion on two grounds: (1) Mozart was not "the party prevailing on the contract" for purposes of section 1717(a), because Mozart failed to obtain any relief on its cross-complaint, which was also an "action on [the] contract" for purposes of that statute. (2) Mozart had no right to recover against a nonparty to the commission agreement unless that party would itself have been entitled to fees had it prevailed; and had BTC prevailed on its complaint, it would not have been entitled to fees because the commission agreement did not manifest an intent to extend the right to fees to third parties.

Mozart met BTC's first point by arguing that its claims were not "on the contract" and that BTC had "admit[ted]" as much by failing to move for attorney fees as the prevailing party on Mozart's cross-complaint. On the ***894** second point Mozart asserted that the case on which BTC primarily depended was "a factual aberration" that diverged from paramount authority, and that BTC's position was incompatible with the allegations of its own complaint and its responses to discovery.

The trial court denied the motion for fees and granted the motion to tax them from the cost bill.

B. ***Party Prevailing on the Contract***

[22][23][24] A request for an award of attorney fees is largely entrusted to the discretion of the trial court, whose ruling "will not be overturned in the absence of a manifest abuse of discretion, a prejudicial error of law, or necessary findings not supported by substantial evidence. [Citations.]" (*Yield Dynamics, Inc. v. Tea Systems Corp.* (2007) 154 Cal.App.4th 547, 577, 66 Cal.Rptr.3d 1.) The trial court exercises a particularly "wide discretion" ****354** in determining who, if anyone, is the prevailing party for purposes of section 1717(a). (*Sears v. Baccaglio* (1998) 60 Cal.App.4th 1136, 1158, 70 Cal.Rptr.2d 769, quoting *Nasser v. Superior Court* (1984) 156 Cal.App.3d 52, 59, 202 Cal.Rptr. 552.) To overturn that determination on appeal, the objecting party must demonstrate "a clear abuse of discretion." (*Sears v. Baccaglio, supra,* 60 Cal.App.4th at p. 1158, 70 Cal.Rptr.2d 769.) However, the "determination of the legal basis for an award off attorney fees" is a "question of law" which the reviewing court will examine de novo. (

Sessions Payroll Management, Inc. v. Noble Construction Co. (2000) 84 Cal.App.4th 671, 677, 101 Cal.Rptr.2d 127 (*Sessions*).)

As framed by the parties, the dispositive question is whether the cross-complaint was an action "on a contract," i.e., the commission agreement containing the fee clause. Thus Mozart asserts that its claims in the cross-complaint "did not arise out of the Commission Agreement but instead out of a real estate agent's duties as a matter of law." As so framed, we have no difficulty in resolving this issue in favor of the trial court's finding that the cross-action was "on [the] contract," such that each party prevailed on the other's "action on a contract" and neither prevailed on the matter as a whole.

[25][26] "California courts liberally construe the term ' " 'on a contract' " ' as used within section 1717. [Citation.] As long as the action 'involve[s]' a contract it is 'on [the] contract' within the meaning of [s]ection 1717. [Citations.]" (*Dell Merk, Inc. v. Franzia* (2005) 132 Cal.App.4th 443, 455, 33 Cal.Rptr.3d 694; see *Hastings v. Matlock* (1985) 171 Cal.App.3d 826, 841, 217 Cal.Rptr. 856, quoting *Care Constr., Inc. v. Century Convalescent Centers, Inc.* (1976) 54 Cal.App.3d 701, 706, 126 Cal.Rptr. 761 [" 'as long as the action here involved a contract it was "on a contract" and within Civil Code, section 1717' "].)

[27] ***895** Mozart's cross-complaint refers to the contract containing the fee clause-the "Commission Agreement"-no fewer than 14 times. It attaches a copy of the agreement and incorporates it by reference. It relies heavily on the language of the agreement to establish that when Handspring's financial troubles first appeared, the agency relationships contemplated by the agreement were still in existence. Thus Mozart alleged, "The Commission Agreement further provided that the first half of the commission would be due and payable upon full Lease execution and *the second half due and payable upon rent Commencement.* " It noted BTC's claim to a commission under the agreement as a "cooperating ... or procuring agent." As we have noted, Mozart relied, and indeed continues to rely, on that claim-albeit conditionally-to assert that BTC became *Mozart's* agent. (See pt. I(G), *ante.*) Moreover the prayer of the cross-complaint included a demand for Mozart's attorney fees, an item of relief for which no colorable basis other than the commission agreement appears. Given these facts we detect no error in the implied determination that Mozart's cross-action was "on [the] contract" for purposes of section 1717(a).

Mozart asserts that BTC's failure to seek fees on its own behalf after securing the dismissal of Mozart's cross-complaint was a tacit concession that "the Cross-Complaint did not arise out of the Commission Agreement and that [BTC] was not entitled to any attorney's fees based thereon." But BTC never had an opportunity to *pray* for pleas in a pleading, because having successfully demurred to the cross-complaint, it never submitted a pleading in which such a prayer might have been allowed. As for BTC's failure ****355** to seek fees by motion, the sequence of relevant events strongly suggests, and the trial court could certainly find, that such failure reflected not a disbelief by BTC in its *potential right* to fees, but a well-justified belief that the trial court would not find it to be a prevailing party entitled to them.

On June 28, 2005, the court eliminated BTC's first cause of action, for breach of the commission agreement, by summary adjudication. Once that occurred it should have been obvious that the trial court was not likely to designate BTC the prevailing party on the contract. It was only on July 14, 2005-some two weeks *after* disposing of BTC's contract claim-that the court formally disposed of Mozart's cross-complaint by sustaining BTC's demurrer. Under section 1717(a), attorney fees "shall be an element of the costs of suit." Costs are to be claimed after entry of judgment or dismissal. (See Cal. Rules of Court, rule 3.1700(a)(1).) More specifically, attorney fees are to be sought by notice of motion "served and filed within the time for filing a notice of appeal...." (Cal. Rules of Court, rule

3.1702(b)(1).) Here no judgment was entered until December 22, 2005, at which time the court decreed that neither party should take anything by its respective pleading. For BTC to move for fees at that time would obviously have Quixotic at best; the odds of its being found a prevailing party were ***896** microscopic. Its failure to seek fees therefore furnishes no basis for an implied concession that it would not have been entitled to them had matters ended differently.

C. *Applicability of Fee Clause*

[28] We find much merit in BTC's contention below-not pursued in its responding brief on appeal, but addressed by Mozart in its opening brief-that Mozart had no reciprocal right to fees under section 1717(a) because, given the terms of the fee provision in the commission agreement, BTC would not have been entitled to fees even if it had prevailed on its own complaint.

The fee provision at issue allowed fees in "any litigation *between the parties hereto* to enforce any provision of this Agreement...." By its plain terms, the italicized phrase limits fees to litigation between the signatories, Mozart and its broker CPS. It does not appear that CPS was ever a party to either BTC's action or Mozart's cross-action. On the face of it, therefore, no part of this proceeding constituted "litigation between the parties hereto," and no part of it fell within the fee clause. It follows that neither party could assert a right to fees under section 1717(a).

This view is supported by a sizable body of caselaw. In *Sessions, supra,* 84 Cal.App.4th 671, 101 Cal.Rptr.2d 127, a payroll management company alleged that a subcontractor had failed to reimburse it for wages it paid to the subcontractor's employees. The company sued the general contractor on the theory that it was a third party beneficiary of the contract between the subcontractor and the general contractor, which contained a provision authorizing recovery of attorney fees by the prevailing party " '[i]n the event it becomes necessary for *either party* to enforce the provisions of this Agreement....' " (*Id.* at p. 676, 101 Cal.Rptr.2d 127, emphasis in original.) The contract also contained recitals that it created " 'absolutely no enforceable rights' " and did not " 'create any rights or confer any benefits upon' " third parties. (*Ibid.*, italics omitted.) The trial court sustained the general contractor's demurrer and then granted its motion for fees. (*Id.* at pp. 676-677, 101 Cal.Rptr.2d 127.) The reviewing court noted that in ****356***Reynolds Metals Co. v. Alperson* (1979) 25 Cal.3d 124, 128, 158 Cal.Rptr. 1, 599 P.2d 83 (*Reynolds*), the Supreme Court had "interpreted section 1717 to 'provide a reciprocal remedy for a nonsignatory defendant, sued on a contract as if he were a party to it, when a plaintiff would clearly be entitled to attorney's fees should he prevail in enforcing the contractual obligation against the defendant.' " (*Sessions, supra,* 84 Cal.App.4th at p. 679, 101 Cal.Rptr.2d 127.) In *Reynolds* the plaintiff had alleged that the nonsignatory defendants were alter egos of the corporations that executed the contracts and, on that basis, had sought attorney fees. Because the plaintiff would have been entitled to such an award had he ***897** prevailed on his alter ego claim, the Supreme Court affirmed an award of fees in favor of the defendants, who defeated that claim.

In *Reynolds* the court concluded that where a nonsignatory is sued on the ground that he stands in the shoes of a party to the contract, and where he would be liable for fees if that claim succeeded, he may recover fees under section 1717 if he defeats the claim. In *Sessions* the situation differed in two respects. First, the positions were reversed in that a nonsignatory had sued a signatory, claiming a right to recover fees; and second, the basis for the nonsignatory's claims was that he was a third party beneficiary, i.e., not one who stood in the shoes of a contracting party, but one for whose benefit the contract was made. After the signatory defeated this claim, the court found its right to fees constrained by two principles. The first is that a prevailing signatory defendant is entitled to fees only if the losing nonsignatory plaintiff " 'would have been entitled to its fees if [he] had prevailed.' " (*Sessions, supra,* 84 Cal.App.4th at p. 679, 101 Cal.Rptr.2d 127, quoting *Real Property Services Corp. v. City of Pasadena* (1994) 25 Cal.App.4th 375, 382, 30 Cal.Rptr.2d 536 (*Real Property Services*).) The second is that a nonsignatory seeking relief as a third party beneficiary may recover fees under a fee provision only if it appears that *the contracting parties intended* to extend such a right to one in his position. (*Sessions, supra,* 84 Cal.App.4th at pp. 680-681, 101 Cal.Rptr.2d 127.) The contract there did not reflect such an intent; on the contrary, it expressly disclaimed any conferral of rights on third parties, and the fee provision was expressly limited to enforcement actions by " '*either party.*' " (*Id.* at p. 681, 101 Cal.Rptr.2d 127.) Accordingly the nonsignatory plaintiff would not have been entitled to fees had it prevailed, and the signatory defendant had no reciprocal right under section 1717. (*Sessions, supra,* 84 Cal.App.4th at p. 682, 101 Cal.Rptr.2d 127.)

This approach has been embraced in a number of decisions and at least one leading treatise. (See *California Wholesale Material Supply, Inc. v. Norm Wilson & Sons, Inc.* (2002) 96 Cal.App.4th 598, 608-609, 117 Cal.Rptr.2d 390 (*California Wholesale*); *Leach v. Home Savings & Loan Assn.* (1986) 185 Cal.App.3d 1295, 1307, 230 Cal.Rptr. 553 (*Leach*); Wegner et al., Cal. Practice Guide: Civil Trials and Evidence (The Rutter Group 2007) ¶¶ 17:154.28 to 17:154.37, pp. 17-111 to 17-112.) However, a competing body of decisions may be understood to hold, with various qualifications and reservations, that even where the contract asserted by the losing party would not have allowed him fees had he prevailed, his *merely having claimed* fees will entitle his prevailing opponent to them when he loses. (See *Manier v. Anaheim Business Center Co.* (1984) 161 Cal.App.3d 503, 505-507, 207 Cal.Rptr. 508; *Jones v. Drain* (1983) 149 Cal.App.3d 484, 489, 196 Cal.Rptr. 827 (*Jones*).) This approach has been repeatedly criticized and rejected. In *Leach, supra,* 185 Cal.App.3d at page 1306, 230 Cal.Rptr. 553, it was described as resting ****357** on "an equitable estoppel theory" that "was first announced in *Pas v. Hill* (1978) 87 Cal.App.3d 521, 151 Cal.Rptr. 98 ..., a case that was criticized by legal writers ***898** and later overruled by the *Pas* court itself in *Saucedo v. Mercury Sav. & Loan Assn.* [(1980)] 111 Cal.App.3d [309,] 310-315, 168 Cal.Rptr. 552...." The *Leach* court concluded that in light of *Reynolds, supra,* 25 Cal.3d 124, 129, 158 Cal.Rptr. 1, 599 P.2d 83, a party claiming fees under section 1717 must " establish that the opposing party *actually* would have been entitled to receive them if he or she had been the prevailing party." (*Leach, supra,* 185 Cal.App.3d at p. 1307, 230 Cal.Rptr. 553.) Similarly, in *Sessions, supra,* 84 Cal.App.4th at pp. 681-682, 101 Cal.Rptr.2d 127, the court cited *Leach* and several other decisions in rejecting estoppel as a basis for awarding attorney fees against a losing nonsignatory.

But the estoppel view, or its equivalent, has also been repeatedly, if perplexingly and sometimes equivocally, resurrected. In *International Billing Services, Inc. v. Emigh* (2000) 84 Cal.App.4th 1175, 1189, 101 Cal.Rptr.2d 532 (*International Billing*), the court opined that rejecting estoppel while adhering to contract language "ma[de] little sense" because, as the court offered interrogatively, "Why would any party need to estop another party, where the provision actually-clearly-provided for fees?" We answer this question with one of our own: Why would a court predicate a holding, let alone a rule of law, on a party's "need[s]?" As the court there acknowledged, equitable estoppel generally "entails detrimental reliance" by one party on the words or conduct of the other. (*Id.* at p. 1190, 101 Cal.Rptr.2d 532.) Merely praying for relief to which one is not entitled cannot ordinarily engender either reliance or detriment. Because an equitable estoppel cannot normally arise from such conduct, the court justified its rejection of *Leach* and similar cases on "judicial estoppel," which it defined no more clearly than " 'play[ing] fast and loose with the court.' " (*International Billing, supra,* 84 Cal.App.4th at p. 1191, 101 Cal.Rptr.2d 532, quoting *Schulze v. Schulze* (1953) 121 Cal.App.2d 75, 83, 262 P.2d 646.) But all the offending party had done there was plead for attorney fees to which it was not entitled, and then, after its opponent prevailed on the underlying issues, erect its lack of entitlement as a defense to a claim for fees. This was hardly the kind of "fraud on the court" to which the doctrine of judicial estoppel is directed. (*Cloud v. Northrop Grumman Corp.* (1998) 67 Cal.App.4th 995, 1017, 79 Cal.Rptr.2d 544, quoting *Ryan Operations G.P. v. Santiam-Midwest Lumber Co.* (3d Cir.1996) 81 F.3d 355, 363; see *Gottlieb v. Kest* (2006) 141 Cal.App.4th 110, 131, 46 Cal.Rptr.3d 7.) The court also found the losing party's attempt to avoid fees "unfair" because it would permit a pleader to "threaten a litigant with the prospect of an adverse attorney fees award and avoid the same fate if unsuccessful." (*International Billing, supra,* 84 Cal.App.4th at p. 1191, 101 Cal.Rptr.2d 532.) But this happens every time a party prays for relief to which he is ultimately held not to be entitled. Thus it might be said with equal justice that a plaintiff who prays for $100,000 in damages to which he was not entitled acted "unfair[ly]" by "threaten[ing]" his opponent with the prospect of an adverse award. Yet no one would suggest that this entitles the defendant to a judgment for $100,000. ***899** To visit a losing claimant's own demands upon him might appeal to a sense of playground justice, but it has no basis in our law. We see no reason to treat attorney fees differently from any other form of relief for these purposes. We know of nothing in our law that justifies awarding such fees to a party ****358** merely because his opponent asked for them. Certainly section 1717(a) does not create such a regime. So long as there is reciprocity in the allowance or disallowance of fees, the policy of that statute is satisfied. The statute does not purport to authorize an award where *neither* party would otherwise be entitled to one.

[29] Nor have the cases embracing such a theory fared well. Three years after *International Billing,* the court that rendered that decision repudiated it, at least in substantial part. (*M. Perez Co. v. Base Camp Condominiums Ass'n No. One* (2003) 111 Cal.App.4th 456, 3 Cal.Rptr.3d 563 (*Perez*).) The court acknowledged that *International Billing* had not "made proper use of the [judicial estoppel] doctrine." (*Id.* at p. 469, 3 Cal.Rptr.3d 563.) The "correct rule," held the court, is that "a prevailing party is entitled to attorney fees only if it can prove it would have been liable for attorney fees had the opponent prevailed." (*Id.* at p. 467, 3 Cal.Rptr.3d 563; see *id.* at pp. 467-468, 3 Cal.Rptr.3d 563.) Unfortunately the meaning attributed to this formula was cast in doubt by the court's apparent conclusion that the rule of *International Billing* continued to apply where the losing party had attempted unsuccessfully to establish that the alleged contract included a fee provision: "Where a party claims that a contract allows fees and proves it, that party gets fees. Where a party claims that a contract allows fees and does not prove it, the opponent gets fees." (*Perez, supra,* 111 Cal.App.4th at p. 468, 3 Cal.Rptr.3d 563.) We believe the better rule is the one stated in *Leach, supra,* 185 Cal.App.3d at page 1307: A party claiming fees under section 1717 must "establish that the opposing party *actually* would have been entitled to receive them if he or she had been the prevailing party." FN12 (Italics in original.)

FN12. Most recently, the court that decided both *International Billing* and *Perez* appeared to adopt this approach. (*Loduca v. Polyzos* (2007) 153 Cal.App.4th 334, 341, 344, 62 Cal.Rptr.3d 780 [signatory could recover fees from losing third party beneficiary; contract named third party and contained no language suggesting intent to exclude him from reach of fee clause, making it "apparent" that signatories "intended [third party's] enforcement right to include a right to attorney fees"].) The court cited *International Billing* only on a general point of law (*Loduca v. Polyzos, supra,* 153 Cal.App.4th at p. 341, 62 Cal.Rptr.3d 780), and did not cite *Perez* at all. (See also *Dell Merk, Inc. v. Franzia* (2005) 132

Cal.App.4th 443, 450, 451, 33 Cal.Rptr.3d 694 [same court, to similar effect].)

Mozart does not contest any of this. Indeed it expressly acknowledges "that the principle of judicial estoppel does not apply and that a party must not just claim the right to attorney's fees but be entitled to attorney's fees." However it never attempts to explain how BTC could be "entitled to attorney's fees" in view of the language of the fee clause. None of the cases cited by it authorizes a court to disregard an express limitation on the *character of* ***900** *litigation* to which an attorney fee provision will apply. In *Brusso v. Running Springs Country Club, Inc.* (1991) 228 Cal.App.3d 92, 108-109, 278 Cal.Rptr. 758, the court quoted only one of the several fee provisions involved; it was very broad, allowing fees to the prevailing party " 'in case suit shall be brought for default under this Agreement, or because of the breach of any other covenant herein....' " In *California Wholesale, supra,* 96 Cal.App.4th 598, 603, footnote 3, 117 Cal.Rptr.2d 390, the contract allowed fees " '[i]f either party becomes *involved in* ... litigation arising out of this Contract or the performance of it ... to the party justly entitled to them.' " (Italics added and omitted.) This language could readily be understood to extend to any contract-related litigation in which either party was ****359** "involved." Its precise meaning was academic there, because the court held the nonsignatory to be an *assignee* of the contract who "thereby stepped into [a contracting party's] shoes as a matter of law." (*Id.* at p. 605, 117 Cal.Rptr.2d 390.) Here, as Mozart concedes, BTC claimed to be a third party beneficiary, not an assignee. There is thus no occasion to consider whether the clause before us could be successfully invoked by an assignee.

[30] In *Real Property Services Corp., supra,* 25 Cal.App.4th 375, 30 Cal.Rptr.2d 536, the fee provision resembled the one here in that it applied by its terms only to an "action or proceeding *brought by either party against the other* under this Lease...." (*Id.* at p. 377, 30 Cal.Rptr.2d 536, italics added.) The parties apparently made nothing of the italicized language, and the court seemed to overlook it in characterizing the clause as "specifically provid[ing] for the award of attorney's fees in an action to enforce the contract." (*Id.* at p. 383, 30 Cal.Rptr.2d 536.) As viewed by the court, the case turned on the sufficiency of the "nexus between the [defendant] lessor and the [plaintiff] sublessee...." (*Ibid.*) In other words, the decision turned on an issue of standing, not the scope of the fee clause. "[A decision] 'is not authority for everything said in the opinion but only "for the points actually involved and actually decided." [Citations.]' " (*Santisas v. Goodin* (1998) 17 Cal.4th 599, 620, 71 Cal.Rptr.2d 830, 951 P.2d 399.)

In *Jones, supra,* 149 Cal.App.3d 484, 196 Cal.Rptr. 827, the court identified the "critical issue" as "whether or not the plaintiff ... clearly would have been entitled to attorney's fees had it prevailed in enforcing the contract." (*Id.* at p. 489, 196 Cal.Rptr. 827.) Yet the opinion nowhere discloses the operative contract language, rendering its entire analysis doubtful as useful precedent.[FN13] Similarly, ***901** *Lewis v. Alpha Beta Co.* (1983) 141 Cal.App.3d 29, 189 Cal.Rptr. 840, is silent with respect to the wording of the fee clause there at issue. (See also *Reynolds, supra,* 25 Cal.3d 124, 127, 158 Cal.Rptr. 1, 599 P.2d 83 [stating only that notes "provided for recovery of collection costs, including attorney's fees"].)

FN13. Indeed, the facts of *Jones* are so vaguely described that it is difficult to see how it can serve as precedent for *any* particular holding. (See *Ginns v. Savage* (1964) 61 Cal.2d 520, 524, 39 Cal.Rptr. 377, 393 P.2d 689, fn. 2 ["Language used in any opinion is of course to be understood in the light of the facts and the issue then before the court, and an opinion is not authority for a proposition not therein considered"]; 9 Witkin, Cal. Procedure (4th ed. 1997) Appeal, § 945, pp. 986-988.) One case describes *Jones* as "apparently" involving "a third party beneficiary theory." (*Real Property Services, supra,* 25 Cal.App.4th 375, 381, 30 Cal.Rptr.2d 536.) This reading is difficult to reconcile with the losing plaintiff's assertion, which the court refused to address, that he "was not a party to or a beneficiary of the contract." (*Jones, supra,* 149 Cal.App.3d at p. 488, 196 Cal.Rptr. 827.) Mozart asserts that the fee provision in *Jones* appeared in a "Listing Agreement" signed by the prevailing defendant owners. This hypothesis is cast in serious doubt by the joinder in *Jones* of the would-be *buyers* as plaintiffs. (See *Jones, supra,* 149 Cal.App.3d at p. 486, 196 Cal.Rptr. 827.) This suggests that the suit rested at least in part on some instrument contended by the plaintiffs to constitute a sale contract. Perhaps the complaint rested on two instruments. All the decision reveals is that an unknown document contained a fee provision of unknown terms; the broker claimed it was a contract; the trial court found otherwise; and the reviewing court held that this finding was not a bar to a fee award in favor of the prevailing owners.

In *Manier, supra,* 161 Cal.App.3d 503, 207 Cal.Rptr. 508, an unsuccessful action was brought by the signatory to a deposit receipt and his wife, who had not signed the receipt but who apparently alleged ****360** that she, along with her husband, was a party to it.[FN14] The fee clause provided, "If any party to this agreement or the Broker institutes any legal action against any other party to this Agreement, the prevailing party in said action shall be entitled to a reasonable attorneys fee, in addition to any other judgment of the court." (*Id.* at p. 505, fn. 1, 207 Cal.Rptr. 508.) Applied literally this might permit recovery of fees by any party to the litigation, so long as a party to the agreement initiated the action. But the court little heeded the actual language of the contract. Instead it rejected the wife's attempt to take "refuge in the fact she was not a signatory to the deposit receipt" by stating, "[I]t is of no moment that [the wife] was not a signatory to the deposit receipt; she alleged entitlement to attorneys fees under it." (*Id.* at p. 508, 207 Cal.Rptr. 508.) The court also adopted the dictum in *Jones* that " 'it is extraordinarily inequitable to deny a party who successfully defends an action on a contract, which claims attorney's fees, the right to recover its attorney's fees and costs simply because the party initiating the case has filed a frivolous lawsuit.' " (*Id.* at p. 508, 207 Cal.Rptr. 508, quoting *Jones, supra,* 149 Cal.App.3d at pp. 489-490, 196 Cal.Rptr. 827.) We will not attempt to parse this rather murky declaration. Insofar as these decisions base an award of attorney fees on the mere fact that the losing party prayed for them, we decline to follow them.

FN14. The opinion suffers from some of the same vagueness as *Jones, supra,* 149 Cal.App.3d 484, 196 Cal.Rptr. 827 with respect to crucial details, most notably the legal and factual basis for the wife's claim.

Mozart also describes the fee provision here as "broad" and "analogous to those in the ***902***Xuereb v. Marcus & Millichap* (1992) 3 Cal.App.4th 1338[, 5 Cal.Rptr.2d 154] [(*Xuereb*)] and *Santisas v. Goodin* [, *supra,*] 17 Cal.4th 599, 608[, 71 Cal.Rptr.2d 830, 951 P.2d 399] line of cases." But while the fee clause in *Xuereb, supra,* 3 Cal.App.4th at page 1340, 5 Cal.Rptr.2d 154, was limited to litigation " 'between ... the parties hereto,' " that limitation had no bearing on the action there, which was between contracting parties. Nor was there any comparable issue in *Santisas v. Goodin, supra,* 17 Cal.4th at page 603, 71 Cal.Rptr.2d 830, 951 P.2d 399, where in any event the fee clause extended to any legal action " 'instituted by the Broker(s), or any party to this agreement, or arising out of the execution of this agreement or the sale, or to collect commissions....' "

We conclude that BTC could not have recovered its fees had it prevailed on its claims. Therefore Mozart had no reciprocal right to fees under section 1717.

III. *Denial of Motion to Vacate*

In the later of its two notices of appeal, Mozart expressed an intention to appeal from the order denying its motion to vacate the judgment of dismissal on its cross-complaint. However, while that order is mentioned at several points in Mozart's opening brief, no separate argument and no distinct ground of reversal is directed to it. BTC points out this omission in its brief and asserts that Mozart has thus "waived" any objection to that order. It goes on, however, to argue that the order was correct because of procedural defects in the motion. Mozart takes issue with the latter argument but does not address the effect of its own failure to argue the point in its opening brief. We agree that the failure to proffer argument in support of this severable portion of the appeal constitutes an abandonment of it. In any event we detect no error in the order denying the motion to vacate. The premise of the motion appears to have been that local real estate practice obligated BTC to continue acting as an agent in the transaction until ****361** Handspring took possession of the premises or began paying rent. For reasons stated at length in connection with the order sustaining the demurrer, acceptance of this premise would not have warranted overruling BTC's demurrer to the cross-complaint.

IV. *Cross-Appeal*

As noted above, BTC has explicitly made its cross-appeal conditional upon our sustaining some part of Mozart's appeal. Since we have rejected that appeal in its entirety, we view BTC's statements on this point as an abandonment of the cross-appeal, which we will therefore dismiss.

***903 DISPOSITION**

The judgment is affirmed. The order denying attorney fees is affirmed. The appeal from the order denying the motion to vacate is dismissed. The cross-appeal is dismissed.

Respondents and cross-appellants shall recover their costs on appeal.

WE CONCUR: PREMO and ELIA, JJ.
Cal.App. 6 Dist.,2008.
Blickman Turkus, LP v. MF Downtown Sunnyvale, LLC
162 Cal.App.4th 858, 76 Cal.Rptr.3d 325, 08 Cal. Daily Op. Serv. 5213, 2008 Daily Journal D.A.R. 6367

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Supreme Court of South Carolina.
Theresa L. BLUMBERG, Robert L. Blumberg, Frederick Trust, by Frederick J. Loef, and Frederick J. Loef, Petitioners,
v.
NEALCO, INC., and Robert O. Collins, Respondents.
No. 23809.

Heard Jan. 6, 1993.
Decided Feb. 22, 1993.

Lessors brought action for breach of lease. The Court of Common Pleas, Charleston County, Larry R. Patterson, J., entered judgment awarding past-due rents and attorney fees to lessors. Lessee appealed. The Court of Appeals, 416 S.E.2d 211, reversed on award of attorney fees without remanding issue. Certiorari was granted. The Supreme Court, Moore, J., held that trial court should have remanded question of attorney fees, clearly due under lease agreement, for determination of reasonable amount in view of judicially established criteria.

Affirmed as modified.

West Headnotes

[1] Costs 102 ⚷194.16

102 Costs
102VIII Attorney Fees
102k194.16 k. American Rule; Necessity of Contractual or Statutory Authorization or Grounds in Equity. Most Cited Cases
Attorney fees are not recoverable unless authorized by contract or statute.

[2] Costs 102 ⚷208

102 Costs
102IX Taxation
102k208 k. Duties and Proceedings of Taxing Officer. Most Cited Cases
When an award of attorney fees is requested and authorized by contract or statute, trial court must make specific findings of fact on record as to nature, extent, and difficulty of services, time and labor devoted to case, professional standing of counsel, contingency of compensation, customary fee charged in locality, and beneficial results obtained, before awarding fees.

**660 *492 Donald J. Budman, of Solomon, Kahn, Budman & Stricker, Charleston, for petitioners.

Desa A. Ballard, of Ness, Motley, Loadholt, Richardson & Poole, P.A., Barnwell, for respondents.

MOORE, Justice:

We granted certiorari to review the Court of Appeals' decision in *Blumberg v. Nealco, Inc.*, 307 S.C. 537, 416 S.E.2d 211 (Ct.App.1992). Petitioners Theresa L. Blumberg, Robert L. Blumberg, Frederick Loef, Trust, by Frederick J. Loef, and Frederick J. Loef (Blumberg) contend the Court of Appeals erred in reversing without remand the trial court's award of attorney's fees. We affirm as modified.

*493 FACTS

In September 1987, Blumberg and Respondents (Nealco) executed a five-year lease. The lease provided for reasonable attorney's fees if Nealco failed to comply with its terms. In August 1988, Blumberg filed a complaint seeking among other things past due and future rent and reasonable attorney's fees. The circuit court awarded Blumberg past due rent and reasonable attorney's fees which he found to be $5,000.00. Nealco appealed.

The Court of Appeals reversed and remanded for reconsideration both the award of damages and attorneys' fees. Nealco moved for a rehearing on the issue of remanding the award of attorney's fees claiming that Blumberg had failed to establish any attorney's fees and should not be permitted to "reopen" the record and introduce evidence on remand. The Court of Appeals modified its holding and reversed the award of attorney's fees and remanded for reconsideration only the award of damages. Blumberg now appeals the Court of Appeals' failure to remand the issue of attorney's fees.

ISSUE

The sole issue for review is whether the Court of Appeals erred in reversing the award of attorney's fees without remanding the issue.

DISCUSSION

[1] The general rule is that attorney's fees are not recoverable unless authorized by contract or statute. *Baron Data Sys., Inc. v. Loter,* 297 S.C. 382, 377 S.E.2d 296 (1989); *Hegler v. Gulf Ins. Co.,* 270 S.C. 548, 243 S.E.2d 443 (1978); *Collins v. Collins,* 239 S.C. 170, 122 S.E.2d 1 (1961). When there is a contract, the award of attorney's fees is left to the discretion of the trial judge and will not be disturbed unless an abuse of discretion is shown. *Baron, supra.* "Where an attorney's services and their value are determined by the trier of fact, an appeal will not prevail if the findings of fact are supported by *any* competent evidence." *Baron,* 297 S.C. at 384, 377 S.E.2d 296 (emphasis added).

[2] There is no dispute that the lease provided for attorney's fees. The dispute centers around whether the recovery of attorney's fees was waived because no evidence***494** was offered to establish if any fees were incurred. The only evidence which was offered at trial to establish the attorney's fees was Blumberg's testimony that the petitioners were seeking reasonable fees.

There are six factors to consider in determining an award of attorney's fees: 1) nature, extent, and difficulty of the legal services rendered; 2) time and labor devoted to the case; 3) professional standing of counsel; 4) contingency of compensation; 5) fee customarily charged in the locality for similar services; and 6) beneficial results obtained. *Collins, supra.* Nealco contends that no proof was offered at trial that any attorney's fees had been incurred and, therefore, Blumberg essentially waived an award. We disagree.

Although several cases have reversed, without remanding, an award of attorney's fees based on a lack of evidence, these cases can be distinguished. *Gainey v. Gainey,* 279 S.C. 68, 301 S.E.2d 763 (1983) (no request for attorney's fees); *Snider v. Butler,* 278 S.C. 231, 294 S.E.2d 246 (1982) (did not fall under an exception to the bar of recovering attorney's fees).

****661** Other cases have reversed an award of fees and remanded the issue when there was a lack of evidence. In *Sunrise Sav. & Loan Ass'n v. Mariner's Cay Dev. Corp.,* 295 S.C. 208, 367 S.E.2d 696 (1988), this Court remanded the issue of attorney's fees because the award was unsupported by the evidence and held it was necessary to take evidence on the reasonableness of the award. *See also Farmers & Merchants Bank v. Fargnoli,* 274 S.C. 23, 260 S.E.2d 185 (1979).

When an award of attorney's fees is requested and authorized by contract or statute, the court should make specific findings of fact on the record for each factor set forth in *Collins, supra.* On appeal, absent sufficient evidentiary support on the record for each factor, the award should be reversed and the issue remanded for the trial court to make specific findings of fact. The Court of Appeals should have remanded the issue of attorney's fees. Accordingly, the Court of Appeals' decision is

AFFIRMED AS MODIFIED.

HARWELL, C.J., and CHANDLER, FINNEY and TOAL, JJ., concur.
S.C.,1993.
Blumberg v. Nealco, Inc.

310 S.C. 492, 427 S.E.2d 659

END OF DOCUMENT

H

United States District Court,
D. New Jersey.

BOEHRINGER INGELHEIM ANIMAL HEALTH, INC., Plaintiff,
v.
SCHERING-PLOUGH CORPORATION and Schering Corporation, Defendants.
No. 96-04047 (HAA).

April 27, 1998.

Patentee brought action for infringement of patent for method of developing porcine reproductive respiratory syndrome (PRRS) vaccine. Parties moved for summary judgment, and patentee renewed motion for preliminary injunction. The District Court, Harold A. Ackerman, J., held that: (1) patent was not literally infringed; (2) fact questions precluded summary judgment on issue of infringement under doctrine of equivalents; and (3) fact questions precluded summary judgment on issue of obviousness of patent.

Motions for summary judgment denied; plaintiff's motion for preliminary injunction denied.

West Headnotes

[1] Patents 291 226.6

291 Patents
291XII Infringement
291XII(A) What Constitutes Infringement
291k226.5 Substantial Identity of Subject Matter
291k226.6 k. Comparison with Claims of Patent. Most Cited Cases
There are two steps in patent infringement analysis: the first being the construction of the claim and the second being the determination as to whether the accused method infringes the asserted claim as properly construed.

[2] Patents 291 226.6

291 Patents
291XII Infringement
291XII(A) What Constitutes Infringement
291k226.5 Substantial Identity of Subject Matter
291k226.6 k. Comparison with Claims of Patent. Most Cited Cases
A defendant literally infringes where every limitation set forth in a patent claim is found in the accused process, exactly.

[3] Patents 291 237

291 Patents
291XII Infringement
291XII(A) What Constitutes Infringement
291k233 Patents for Machines or Manufactures
291k237 k. Substitution of Equivalents. Most Cited Cases
Under the doctrine of equivalents, a product or process that does not literally infringe upon the express terms of a patent may nonetheless be found to infringe if there is equivalence between the elements of the accused product or process and the claimed elements of the patented invention.

[4] Patents 291 314(5)

291 Patents
291XII Infringement
291XII(C) Suits in Equity
291k314 Hearing
291k314(5) k. Questions of Law or Fact. Most Cited Cases
Patent infringement under the doctrine of equivalents is an issue of fact to be submitted to the jury.

[5] Patents 291 250

291 Patents
291XII Infringement
291XII(A) What Constitutes Infringement

291k249 Patents for Compositions of Matter

291k250 k. Identity in General. Most Cited Cases

Patent for method of developing porcine reproductive respiratory syndrome (PRRS) vaccine was not literally infringed by competing vaccine; accused process was not focused exclusively on reaching some degree of cytopathic effect, and patent contemplated qualitative evaluation as opposed to accused process's quantitativeness and exactitude.

[6] Patents 291 ⚷237

291 Patents
291XII Infringement
291XII(A) What Constitutes Infringement
291k233 Patents for Machines or Manufactures
291k237 k. Substitution of Equivalents. Most Cited Cases

Under one test for determining whether patent has been infringed under doctrine of equivalents, court focuses upon function served by element, way that element serves that function, and result thus obtained by it; if helpful, court should also evaluate other factors such as evidence of copying, evidence of designing around, or evidence that persons reasonably skilled in the art would have known of the interchangeability elements.

[7] Patents 291 ⚷323.2(3)

291 Patents
291XII Infringement
291XII(C) Suits in Equity
291k323 Final Judgment or Decree
291k323.2 Summary Judgment
291k323.2(3) k. Particular Cases. Most Cited Cases

Fact questions existed regarding when 25% of cytopathic effect occurred in process for developing porcine reproductive respiratory syndrome (PRRS) vaccine, thus precluding summary judgment for either party on issue of patent infringement under the doctrine of equivalents.

[8] Patents 291 ⚷312(1.2)

291 Patents
291XII Infringement
291XII(C) Suits in Equity
291k312 Evidence
291k312(1) Presumptions and Burden of Proof
291k312(1.2) k. Patentability and Validity. Most Cited Cases

There is a presumption of validity of a patent, and the defendant bears the burden of proving obviousness by clear and convincing evidence. 35 U.S.C.A. § 103(a).

[9] Patents 291 ⚷16(3)

291 Patents
291II Patentability
291II(A) Invention; Obviousness
291k16 Invention and Obviousness in General
291k16(3) k. View of Person Skilled in Art. Most Cited Cases

Patents 291 ⚷16.5(1)

291 Patents
291II Patentability
291II(A) Invention; Obviousness
291k16.5 State of Prior Art and Advancement Therein
291k16.5(1) k. In General. Most Cited Cases

Patents 291 ⚷36.1(1)

291 Patents
291II Patentability
291II(A) Invention; Obviousness
291k36 Weight and Sufficiency
291k36.1 Secondary Factors Affecting Invention or Obviousness
291k36.1(1) k. In General. Most Cited Cases

Patents 291 ⚷314(5)

291 Patents
291XII Infringement
291XII(C) Suits in Equity
291k314 Hearing
291k314(5) k. Questions of Law or Fact. Most Cited Cases
Obviousness of a patent is a question of law that involves four factual inquiries of: (1) the level of ordinary skill in the pertinent art, (2) the scope and content of the prior art, (3) the differences between the claims and the prior art, and (4) secondary considerations, if any, of obviousness. 35 U.S.C.A. § 103(a).

[10] Patents 291 ⚷36.1(2)

291 Patents
291II Patentability
291II(A) Invention; Obviousness
291k36 Weight and Sufficiency
291k36.1 Secondary Factors Affecting Invention or Obviousness
291k36.1(2) k. Imitation or Copying. Most Cited Cases

Patents 291 ⚷36.1(3)

291 Patents
291II Patentability
291II(A) Invention; Obviousness
291k36 Weight and Sufficiency
291k36.1 Secondary Factors Affecting Invention or Obviousness
291k36.1(3) k. Longstanding Need and Solution to Problems. Most Cited Cases

Patents 291 ⚷36.1(4)

291 Patents
291II Patentability
291II(A) Invention; Obviousness
291k36 Weight and Sufficiency
291k36.1 Secondary Factors Affecting Invention or Obviousness
291k36.1(4) k. Failure of Others. Most Cited Cases

Patents 291 ⚷36.2(1)

291 Patents
291II Patentability
291II(A) Invention; Obviousness
291k36 Weight and Sufficiency
291k36.2 Commercial Success
291k36.2(1) k. In General. Most Cited Cases
Secondary considerations used in analyzing a patent for obviousness include evidence of factors tending to show nonobviousness, such as commercial success of the invention, satisfying a long-felt need, failure of others to find a solution to the problem at hand, and copying of the invention by others. 35 U.S.C.A. § 103(a).

[11] Patents 291 ⚷303

291 Patents
291XII Infringement
291XII(C) Suits in Equity
291k293 Preliminary Injunction
291k303 k. Application and Proceedings Thereon. Most Cited Cases
In the preliminary injunction context, the patentee bears the burden of proving likelihood of success and thus, when the validity of the patent is challenged, the patentee must demonstrate that the alleged infringer's defense lacks substantial merit.

[12] Patents 291 ⚷323.2(2)

291 Patents
291XII Infringement
291XII(C) Suits in Equity
291k323 Final Judgment or Decree
291k323.2 Summary Judgment
291k323.2(2) k. Presence or Absence of Fact Issues. Most Cited Cases
The court may properly grant, as a matter of law, a motion for summary judgment on patent invalidity when the factual inquiries into obviousness present no genuine issue of material facts. 35 U.S.C.A. § 103(a).

[13] Patents 291 ⚿323.2(3)

291 Patents
291XII Infringement
291XII(C) Suits in Equity
291k323 Final Judgment or Decree
291k323.2 Summary Judgment
291k323.2(3) k. Particular Cases. Most Cited Cases

Fact questions existed regarding whether, in light of prior art at the time, one could have reasonably expected that the porcine reproductive respiratory syndrome (PRRS) virus could be grown and isolated on simian cells, thus precluding summary judgment for alleged infringer on issue of obviousness of patent for method of developing PRRS vaccine. 35 U.S.C.A. § 103(a).

[14] Patents 291 ⚿16(2)

291 Patents
291II Patentability
291II(A) Invention; Obviousness
291k16 Invention and Obviousness in General
291k16(2) k. Prior Art in General. Most Cited Cases

Teachings of references may be combined to establish obviousness of a patent, but there must be some teaching, suggestion, or incentive supporting the combination. 35 U.S.C.A. § 103(a).

[15] Patents 291 ⚿26(1)

291 Patents
291II Patentability
291II(A) Invention; Obviousness
291k26 Combination
291k26(1) k. In General. Most Cited Cases

In determining a patent's validity, obviousness analysis of a claimed combination must include consideration of the results achieved by that combination. 35 U.S.C.A. § 103(a).

[16] Estoppel 156 ⚿68(2)

156 Estoppel
156III Equitable Estoppel
156III(B) Grounds of Estoppel
156k68 Claim or Position in Judicial Proceedings
156k68(2) k. Claim Inconsistent with Previous Claim or Position in General. Most Cited Cases

The doctrine of judicial estoppel is an equitable doctrine, invoked by a court in its discretion, to preserve the integrity of the judicial system by preventing parties from playing fast and loose with the courts in assuming inconsistent positions, and with a recognition that each case must be decided on its own particular facts and circumstances.

[17] Estoppel 156 ⚿68(2)

156 Estoppel
156III Equitable Estoppel
156III(B) Grounds of Estoppel
156k68 Claim or Position in Judicial Proceedings
156k68(2) k. Claim Inconsistent with Previous Claim or Position in General. Most Cited Cases

The doctrine of judicial estoppel is not intended to eliminate all inconsistencies but only those where the litigants are playing "fast and loose."

[18] Estoppel 156 ⚿68(2)

156 Estoppel
156III Equitable Estoppel
156III(B) Grounds of Estoppel
156k68 Claim or Position in Judicial Proceedings
156k68(2) k. Claim Inconsistent with Previous Claim or Position in General. Most Cited Cases

Judicial estoppel looks to the connection between the litigant and the judicial system, and thus it is intended to protect the courts rather than the litigants.

[19] Estoppel 156 ⚿68(2)

156 Estoppel
156III Equitable Estoppel
156III(B) Grounds of Estoppel
156k68 Claim or Position in Judicial Proceedings
156k68(2) k. Claim Inconsistent with Previous Claim or Position in General. Most Cited Cases

Patents 291 ⚿283(1)

291 Patents
291XII Infringement
291XII(C) Suits in Equity
291k283 Defenses
291k283(1) k. In General. Most Cited Cases
Patentee's arguments regarding validity of its patent would not be estopped on basis of judicial estoppel, even though patentee's validity arguments had evolved from beginning of case; patentee had obtained more information as case had progressed, and patentee's positions had never been antithetical to each other.

Patents 291 ⚿328(2)

291 Patents
291XIII Decisions on the Validity, Construction, and Infringement of Particular Patents
291k328 Patents Enumerated
291k328(2) k. Original Utility. Most Cited Cases
5,476,778. Cited.
***326** Jonathan A. Marshall,Jennifer Gordon, Scott D. Simpson, Pennie & Edmonds, New York City, H. Curtis Meanor, William Sandelands, Podvey, Sachs, Meanor, Catenacci, Hildner & Cocoziello, Newark, NJ, for Plaintiff.

Sidney David, Paul H. Konchanski, Lerner, David, Littenberg, Krumholz & Mentlik, Westfield, NJ, for Defendants.

OPINION

HAROLD A. ACKERMAN, District Judge.

This matter comes before the court on motions for summary judgment filed by both parties in this patent litigation and upon plaintiff's renewed motion for a preliminary injunction. For the reasons detailed below, the motions are **DENIED.**

I. Background

These motions follow the court's recent denial of plaintiff's motion for a preliminary injunction. *See Boehringer Ingelheim Animal Health v. Schering-Plough Corp.*, 984 F.Supp. 239 (D.N.J.1997). Both parties have come in conflict because of their interest in developing a vaccine for a disease known as Porcine Reproductive Respiratory Syndrome ("PRRS"). Boehringer alleges that Schering has infringed upon its patent. The patent in question, Patent No. 5,476,778 ("the '778 Patent"), covers a method which, Boehringer believes, is instrumental to the development of a PRRS vaccine. The '778 Patent makes five claims, two of which are at issue here:

> 1. A method of growing and isolating swine infertility and respiratory syndrome virus, ATCC-VR2332, which comprises inoculating the virus on a full or partial sheet of simian cells in the presence of serum in a suitable growth medium and incubating the inoculated cell sheet at about 34$C, to 37$C, until CPE is observed.
>
> 2. The method as recited in claim I wherein the simian cell line is MA-104.
>
> *Id.* at 244.

Using the patented method, Boehringer developed two PRRS vaccines, RespPRRS®)) and RespPRRS/Repro®. In the instant case, plaintiff charges that Schering has infringed upon the patent in developing its own PRRS vaccine.

In June 1997, the court held a hearing on plaintiff's motion for a preliminary injunction. At the same time, it conducted a *Markman* hearing to conclusively interpret the claim language and its subsequent opinion defines each element of the '778 Patent. *See Id.* The court denied plaintiff's preliminary injunction motion because it held that Schering had raised a substantial defense on the issue of obviousness and therefore, Boehringer had failed to satisfy its burden of proving likelihood of success. *See Id.* at 258-259. In other words, Schering had raised a substantial question as to the validity of the patent under § 103(a). *See* 35 U.S.C. § 103(a) ("[P]atent may not be obtained though the invention is not identically disclosed or described as set forth in section 102 ... if the differences between the subject matter sought to be patented and the prior art are such that the subject matter as a whole would have been obvious at the time the invention was made to a person having ordinary skill in the art to which said subject matter pertains."). Based upon its resolution of the validity issue, the court did not need consider the likelihood of Boehringer's success regarding infringement, either literally ***327** or under the doctrine of equivalents. *See Id.* at 262. Additionally, plaintiff did not establish irreparable harm. *See Id.* at 264. For those reasons, the court declined to issue a preliminary injunction. In the wake of that denial, Schering filed this summary judgment motion. Boehringer responded with its own summary judgment motion and a renewed motion for a preliminary injunction.

II. Summary Judgment Standard

Federal Rule of Civil Procedure 56 provides that summary judgment may be granted only if the pleadings, supporting papers, affidavits, and admissions on file, when viewed with all inferences in favor of the nonmoving party, demonstrate that there is no genuine issue of material fact and that the movant is entitled to judgment as a matter of law. Fed.R.Civ.P. 56(c). *See also Todaro v. Bowman,* 872 F.2d 43, 46 (3d Cir.1989); *Chipollini v. Spencer Gifts, Inc.,* 814 F.2d 893, 896 (3d Cir.), *cert. dismissed,* 483 U.S. 1052, 108 S.Ct. 26, 97 L.Ed.2d 815 (1987). In other words, "summary judgment may be granted if the movant shows that there exists no genuine issue of material fact that would permit a reasonable jury to find for the nonmoving party." *Miller v. Indiana Hospital,* 843 F.2d 139, 143 (3d Cir.), *cert. denied,* 488 U.S. 870, 109 S.Ct. 178, 102 L.Ed.2d 147 (1988).

The substantive law will identify which facts are "material." *Anderson v. Liberty Lobby, Inc.,* 477 U.S. 242, 247-248, 106 S.Ct. 2505, 91 L.Ed.2d 202 (1986). Therefore, "[o]nly disputes over facts that might affect the outcome of the suit under the governing law will properly preclude the entry of summary judgment." *Id.* An issue is "genuine" if a reasonable jury could possibly hold in the nonmovant's favor with regard to that issue. *Id.*

The party seeking summary judgment always bears the initial burden of production, i.e., of making a *prima facie* showing that it is entitled to summary judgment. *Celotex Corp. v. Catrett,* 477 U.S. 317, 323, 106 S.Ct. 2548, 91 L.Ed.2d 265 (1986). This may be done either by demonstrating there is no genuine issue of fact and that as a matter of law, the moving party must prevail or by demonstrating the nonmoving party has not produced evidence relating to an essential element of the issue for which it bears the burden. *Id.* at 322-23, 106 S.Ct. 2548. Once either showing is made, the burden shifts to the nonmoving party who must demonstrate facts supporting each element for which it bears the burden as well as establish the existence of genuine issues of material fact. *Id.* at 324, 106 S.Ct. 2548.

However, at the summary judgment stage, a court may not weigh the evidence or make credibility determinations-these tasks are left to the factfinder. *Petruzzi's IGA v. Darling-Delaware,* 998 F.2d 1224, 1230 (3d Cir.), *cert. denied,* 510 U.S. 994, 114 S.Ct. 554, 126 L.Ed.2d 455 (1993). Therefore, to raise a genuine issue of material fact, " 'the [summary judgment] opponent need not match, item for item, each piece of evidence proffered by the movant,' but simply must exceed the 'mere scintilla' standard." *Id. See also Anderson,* 477 U.S. at 252, 106 S.Ct. 2505 ("The mere existence of a scintilla of evidence in support of the [nonmovant's] position will be insufficient; there must be evidence on which the jury could reasonably find for the [nonmovant]."). "Although a 'scintilla of evidence' supporting the non-movant's case is not sufficient to defeat a motion for summary judgment, it is clear that a district court should not weigh evidence and determine the truth of the matter itself, but instead should determine whether there is a genuine issue for trial." *Country Floors, Inc. v. Country Tiles,* 930 F.2d 1056, 1061-2 (3d Cir.1991).

If the court determines that there is no genuine issue of material fact and the movant is entitled to judgment as a matter of law, then summary judgment may be granted.

III. Discussion

A. Infringement

[1] There are two steps in patent infringement analysis: "the first being the construction of the claim and the second being the determination as to whether the accused method infringes the asserted claim as properly construed." *Boehringer,* 984 F.Supp. at 245 (citing ***328***Markman v. Westview,* 52 F.3d 967 (Fed.Cir.1995) (en banc), *affirmed,* 517 U.S. 370, 116 S.Ct. 1384, 134 L.Ed.2d 577 (1996)). At the time of the preliminary injunction hearing, the court, in a *Markman* hearing, conclusively interpreted the claim language. *Id.* at 247-53. Thus, all that remains is a "determination as to whether the accused method infringes the asserted claim as properly construed." *Id.* at 245. Schering has brought this summary judgment motion arguing that as a matter of law, its vaccine production process does not incubate the inoculated cell sheet "until CPE is observed" as this court has construed that element. CPE means cytopathic effect which is "change in the microscopic appearance of a cell after infection with a virus" or the killing of inoculated cells. Boehringer alleges that it should be granted summary judgment because there are no genuine issues of material fact as to any of the patent's elements. Because there are genuine issues of material fact as to whether Schering has infringed upon the element "until CPE is observed," this court will only focus upon that element.

1. The Claim Language

The claimed method uses the term "until CPE is observed" as a "timing device" to instruct the reader on how to calculate when the incubation period is completed. *See Boehringer,* 984 F.Supp. at 252. CPE means cytopathic effect which is "change in the microscopic appearance of a cell after infection with a virus" or the killing of inoculated cells. The incubation occurs "until CPE is observed." In its *Markman* hearing, the court faced the question of whether the language dictated that the process terminate at the initial observation of CPE, at some degree of CPE, or at a time period to be determined independently of any degree of CPE. Ultimately, this court construed the patent language as focusing upon the occurrence of CPE where some significant degree of CPE, either "strong" or "good" will trigger the termination of the process rather than the initial observation or some independent factor. *See Id.* The process's preferred level of CPE is somewhat inexact and not amenable to further precision. The moment contemplated by the '778 Patent is subject to a more "qualitative determination." *See Id.*

2. Generally: Infringement

a. Literal Infringement

[2] To succeed in its infringement claim, Boehringer must be able to prove that the Schering process infringed its patent, either literally or under the doctrine of equivalents. A defendant literally infringes where every limitation set forth in a patent claim is found in the accused process, exactly. *See Southwall Technologies, Inc. v. Cardinal IG Company,* 54 F.3d 1570, 1575 (Fed.Cir.), *cert. denied,* 516 U.S. 987, 116 S.Ct. 515, 133 L.Ed.2d 424

(1995). Infringement is a fact issue. *See Id.*

b. Doctrine of Equivalents

[3] Even if the accused process does not literally infringe, infringement might exist under the doctrine of equivalents. *See Warner-Jenkinson Co. v. Hilton Davis Chemical Co.,* 520 U.S. 17, 117 S.Ct. 1040, 137 L.Ed.2d 146 (1997) (reaffirming the doctrine's vitality). Under this doctrine, "a product or process that does not literally infringe upon the express terms of a patent may nonetheless be found to infringe if there is 'equivalence' between the elements of the accused product or process and the claimed elements of the patented invention." *Id.* 117 S.Ct. at 1045 (citing *Graver Tank & Mfg. Co. v. Linde Air Products Co.,* 339 U.S. 605, 70 S.Ct. 854, 94 L.Ed. 1097 (1950)). Guided by *Graver Tank, supra,* which was the Supreme Court's last consideration of the doctrine, the Court reiterated that an equivalency analysis is not a formulaic one, but rather, a contextual one which focuses on the patent, the prior art and the particular circumstances of the case. *See Id.* 117 S.Ct. at 1047 (citing *Graver Tank, supra,* at 609, 70 S.Ct. 854). As the Court explained:

> Consideration must be given to the purpose for which an ingredient is used in a patent, the qualities it has when combined with the other ingredients, and the function which it is intended to perform. An important factor is whether persons reasonably skilled in the art would have known of the interchangeability of an ingredient***329** not continued in the patent with one that was.
>
> *Id.*

Although the Supreme Court remains committed to the doctrine of equivalents, it has expressed concern that in the past, lower courts have employed such an overbroad interpretation that the doctrine "has taken on a life of its own, unbounded by patent claims." *Id.* 117 S.Ct. at 1048-49. Thus, in order to steer the doctrine back on course, the court explained that the doctrine "must be applied to individual elements of the claim, not to the invention as a whole" because it is each element which is "material to defining the scope of the patented invention." *Id.* at 1049. The Court adopted this approach because it feared that any other approach, e.g. looking at the invention as a whole, could effectively eliminate a material element in its entirety. *See Id.*

[4] According to the Federal Circuit, infringement under the doctrine of equivalents is an issue of fact to be submitted to the jury. *Hilton Davis Chemical Co. v. Warner-Jenkinson Co., Inc.,* 62 F.3d 1512 (Fed.Cir.1995). The Supreme Court has not conclusively decided this issue, but there is "ample support" for that holding and "no other decision of the Supreme Court necessitates otherwise." *Warner-Jenkinson, supra,* at 1053. For our purposes, that means that this court will only grant a motion for summary judgment "where the evidence is such that no reasonable jury could determine two elements to be equivalent." *Id.* at 1053 n. 8.

i. The Linguistic Framework

Federal courts have employed different linguistic frameworks in evaluating "equivalence." The Supreme Court has expressed its reluctance with "micromanag [ing]" the Federal Circuit's word choice and has not indicated whether it prefers the "triple identity" test-"focusing on the function served by a particular claim element, the way that element serves that function, and the result thus obtained by that element"-or the "insubstantial differences" approach. *See Warner-Jenkinson, supra,* at 1054. Suffice it to say that this court is aware that the traditional "triple identity" test might not be "the test" and in some instances, may not end the inquiry. *See Hilton-Davis, supra,* at 1518, 1521-22; *see also Sofamor Danek Group, Inc. v. DePuy-Motech, Inc.,* 74 F.3d 1216, 1222 (Fed.Cir.1996). The "equivalents" inquiry requires proof of insubstantial differences which be informed by other factors such as evidence of copying, designing around or evidence that persons reasonably skilled in the art would have known of the interchangeability elements. *See Hilton-Davis, supra,* at 1518, 1521-22; *see also Sofamor Danek Group, supra,* at 1222.

Ultimately, the "particular linguistic framework used is less important than whether the test is probative of the essential inquiry: Does the product or process contain elements identical or equivalent to each claimed element of the patented invention?" *Warner-Jenkinson, supra,* 117 S.Ct. at 1054. As the Supreme Court has noted:

> Different linguistic frameworks may be more suitable to different cases, depending on their particular facts. A focus on individual elements and a special vigilance against allowing the concept of equivalence to eliminate completely any such elements should reduce considerably the imprecision of whatever language is used. An analysis of the role played by each element in the context of the specific patent claim will thus inform the inquiry as to whether a substitute element matches the function, way, and result of the claimed element, or whether the substitute element plays a role substantially different from the claimed element.
>
> *Id.*

Eventually, the Supreme Court anticipates that the Federal Circuit will "refine the formulation of the test ... in the orderly course of case-by-case determinations." *Id.* At this time, this court will follow the standards established in *Hilton-Davis* and *Sofamor.*

3. The Instant Case

In the instant case, Schering has directed the court's attention to the element "until CPE is observed." That element dictates that the patented process terminate at the moment some significant degree of CPE, either "strong" or "good," is observed. ***330** Whether significant CPE exists is a "qualitative determination." According to Schering, by focusing upon maximum yield or titer rather than CPE, its process does not infringe upon the '778 Patent, either literally or under the doctrine of equivalents. Whereas the patented method incubates until a significant degree of CPE is observed, the Schering process operates for a fixed time period of XX hours.[FN1] Nevertheless, Boehringer asserts that there is a direct correlation between the XX hour period and the development of significant degrees of CPE.

> FN1. The exact number of hours during which the Schering process operates has been filed under seal.

There is no dispute that the Schering process involves the incubation of the virus for XX hours, but the process also requires that the technician record CPE at the end of this period. There is some debate as to the purpose of that step. Citing testimony from Dr. Hesse, one of Schering's scientists, Boehringer describes this step as a quality control check used to "red flag" any problems in this system. *See* Plaintiff's Rule 56.1 Statement at ¶ 16. Schering concedes that it records CPE to make "sure the vaccine production process work[s] properly," but it denies that the process is "quality controlled by the observation of CPE." *See* Defendant's Rule 56.1 Response. In other words, Schering suggests, the process cannot work unless CPE occurs, but it does not measure CPE to gauge the output of the process. Thus, Schering acknowledges that the development of CPE may be a "defining moment" in the initial isolation of an unknown virus, but not in the commercial production of the vaccine. With commercial production, one knows that the process is capable of isolating the virus and for that reason, need not be concerned with CPE. Commercial production focuses on yield. In further support of its argument, Boehringer relies upon the opinion of Dr. Edward Dubovi, one of its experts. According to Dr. Dubovi, there is a direct correlation between the CPE and viral titer (i.e. the amount of virus). *See* Dubovi Decl. at ¶ 53. By using scientific studies which measure CPE, Schering discovered that the

XX period would yield maximum titer. *See* Dubovi Decl. at ¶ 59. Thus, based upon his review of Schering documents, Dr. Dubovi believes:

> Schering set their harvest criteria based on extent of CPE which is interchangeable with a defined time period [(XX +/- XX hours)] and viral titer under consistent growth conditions.

Id. at ¶ 53.

From the record, it cannot be denied that the creators of the process were very much aware of CPE levels. Schering's Outline of Production notes that:

> There appears to be a twelve hour optimal harvest window; it is recommended that the virus fluids be harvested at [XX +/- XX] hours post inoculation. CPE at that time is 1-3 [25-75%]; if the CPE goes beyond 3[75%], titers will be considerably lower.

Id. at ¶ 54.

At optimal growth, there is typically "PRRS CPE ... encompassing 50-75%" and the procedure is tested by "titration ... and observing for CPE." *Id.* at ¶ 53.

Schering does not dispute that the titration testing methodology is based upon the observation of CPE. *See* Defendant's Reply Br. at 30 n. 12. Even if the degree of CPE plays a role in its process, Schering asserts that the development of significant CPE did not control the choice of XX hours. The choice of XX hours, it believes, produces the highest possible output of the virus. But, at XX hours, CPE ranges from 25 to 75%. At a minimum, the Schering process focus upon the development of CPE, but that does not necessarily mean that the process terminates when it reaches "significant" CPE. The court will look at what constitutes "significant" CPE next.

Both sides agree that significant CPE occurs between 25 and 75% CPE. *See* DuBovi Decl. at ¶ 56. Furthermore, Boehringer has not disputed Schering's assertion that one may find CPE's ranging from 25 to 50% after two days. *See* Schering Reply Br. at 26. Some of Schering's XX hour "batches" have contained only 25% CPE. *See* Boehringer ***331** Rule 56.1 Statement at ¶ 54. There is no question that after XX hours, a "significant" degree of CPE exists, but the patented method demands more than just the existence of "significant" CPE. Boehringer's intimates that the court should ignore that this element of the patented method is comprised of the word "until," but it cannot do that.

Neither this court nor any party should be permitted to eliminate the word "until." *See Boehringer,* 984 F.Supp. at 253. That means that once some "significant level of CPE develops ... the incubation period stops...." *Id.* At the *Markman* hearing, Boehringer wanted to argue that the patent imposed a minimum time period-"long enough for CPE to be observed"-but no maximum, allowing the process to continue indefinitely. *See Id.* at 252. However, the court's construction of the patent language contemplates that "incubation will be halted after the observation of some degree of CPE and rejects any wholesale adoption of Boehringer's position." *Id.* at 253. There must be some stopping point, not necessarily when minimal CPE is observed, but when there is a significant degree of CPE. If Schering establishes that 25% CPE occurs after two days, the fact that Schering's process lasts XX hours would preclude literal infringement. But some Schering batches contain 25% CPE and thus, a fact issue exists as to when significant CPE (at least 25%) occurs. Nevertheless, for reasons which I will explain, there can be no literal infringement.

a. Literal Infringement in the Instant Case

[5] Notwithstanding the continuing persisting dispute over certain fact issues, there is no literal infringement. There is a correlation between and perhaps, a focus upon, CPE and Schering's timing device (XX hours), but the elements of the two processes are not identical. Batches taken from the Schering process range from 25 to 75% and thus, it cannot be argued that the process is focused exclusively on reaching some degree of CPE. The obser-

vation of CPE, while arguably important, plays a less central role in Schering's vaccine production process. Moreover, the patent contemplates a qualitative evaluation as opposed to Schering's quantitativeness and exactitude.

b. Equivalency

[6] Because the Schering process does not literally infringe, the court must consider whether the evidence is such that no reasonable jury could find "equivalence" between the element of the Schering process and the claimed elements of the patented method. Schering contends that, as a matter of law, there is no equivalence between the "until CPE is observed" element and its timing mechanism. In making its determination, the court will focus upon the function served by the element, the way that element serves that function, and the result thus obtained by it. If helpful, it should also evaluate other factors such as evidence of copying, designing around or evidence that persons reasonably skilled in the art would have known of the interchangeability elements. *See Hilton-Davis, supra,* at 1518, 1521-22; *see also Sofamor Danek Group, supra,* at 1222.

[7] Here, there is no question that each element serves the function of indicating when to terminate the respective process. However, Schering believes, both the way of terminating the growing process and the result obtained is "totally different." *See* Defendant's Br. at 13. Generally, the "way" that the termination element of each process serves the function of indicating when to terminate the process in that it designates a particular moment to halt everything. The Schering process differs in that it chooses a fixed period of time rather than a CPE measurement, but Boehringer believes that Schering has merely used a "different unit of measurement in an attempt to confuse the issue." *See* Plaintiff's Reply Br. at 5. Even though Schering employs a unit of time rather than a degree of CPE, Boehringer contends that the two are the same. This point requires further explanation.

Undoubtedly, Schering should not be permitted to evade infringement simply by selecting a different unit of measurement. Imagine two processes for boiling water where the first process terminates at the moment that the water bubbles and the second one employs an exact period of time, e.g. ***332** 5 minutes, at which, under controlled, conditions, the water boils. Here, the two measurements are equivalent, if not identical. Unless the convergence of bubbling and five minutes is pure coincidence, the second process infringes. Similarly, if the choice of XX hours depends upon the moment that "significant" CPE is observed-which is also the moment that the patented process must be terminated-the two elements may be equivalent. Much of that depends upon what constitutes "significant" CPE. "Significant" CPE is inexact and does not necessarily correspond to an exact percentage, but both parties accept that 25% CPE corresponds to a moment when the level of CPE becomes significant. Notwithstanding other related issues, Boehringer's argument can only be successful to the extent that after XX hours of incubation, the degree of CPE hovers around 25%. Contrary to Boehringer's reasoning, the equivalence argument is substantially impaired if 25% CPE develops well before XX hours.

Whether the degree of CPE approaches 25% at XX hours remains a genuine issue of material fact. The record indicates that after XX hours of Schering's process, there is 25-75% CPE, but other facts undermine Boehringer's position. Typically, the XX hour period approaches 50-75% CPE. According to Schering, the onset of significant CPE, which is the moment that the patented process ends, occurs at 48 hours, a full XX hours before the end of the Schering process. *See* Schering Reply Br. at 26.

Boehringer wants to argue that as long as significant CPE (at least 25%) exists after XX hours, infringement exists. But that argument must fail because subsumed within it is the assumption that the word "until" cannot be read out of the patent. That means that incubation must be halted at the moment of "significant" CPE, not some unspecified time thereafter. *See Boehringer,* 984 F.Supp. at 253. Within the context of this motion, neither party has established definitively when 25% occurs. Thus, there is a genuine issue of material fact which precludes this court from granting summary judgment. Additionally, one might also argue that the convergence of 25% CPE and the XX hours is nothing more than fortuitous.

Assuming that 25% CPE occurs at forty-eight hours, but 50% occurs at XX, the factfinder must decide whether there is an insubstantial difference between stopping at 25% and 50% CPE. For instance, if Schering chose XX hours to ensure 25% CPE knowing that on some occasions that it would produce 50% CPE, but also believed the difference to be insubstantial, there may be equivalence. These are questions which should be left to the jury.

Finally, the comparison between the "results" of each process is equally inconclusive. The timing mechanism of both processes achieve the result of growing the PRRS virus. Arguably, the Schering timing mechanism produces the maximum output possible. Other than briefly referring to the argument in its original brief, Schering has not made much of this argument. Whether it is anything more than a distinction without a difference is an issue that should be left to the jury. In the instant case, summary judgment shall be **DENIED.**

B. Obviousness

[8] As in the preliminary injunction hearing, Schering has attacked the '778 Patent directly on the ground of obviousness. Under 35 U.S.C. § 103(a).

> [A] patent may not be obtained though the invention is not identically disclosed or described as set forth in section 102 ... if the differences between the subject matter sought to be patented and the prior art are such that the subject matter as a whole would have been obvious at the time the invention was made to a person having ordinary skill in the art to which said subject matter pertains. 35 U.S.C. § 103(a).

Therefore, if Boehringer's invention was not patentable under Section 103(a), its infringement action instantly melts away. However, substantial hurdles confront the party asserting a invalidity defense because there is a presumption of validity and the defendant bears the burden of proving obviousness by clear and convincing evidence. ***333***Litton Systems v. Honeywell,* 87 F.3d 1559, 1566 (Fed.Cir.1996) , *judgment vacated on other ground,* 520 U.S. 1111, 117 S.Ct. 1240, 137 L.Ed.2d 323 (1997).

[9][10] Obviousness under section 103 is a ultimately a question of law which involves four factual inquiries of:

> (1) the level of ordinary skill in the pertinent art; and
>
> (2) the scope and content of the prior art; and
>
> (3) the differences between the claims and the prior art; and
>
> (4) secondary considerations, if any, of nonobviousness.
>
> *See B.F. Goodrich Company v. Aircraft Braking Systems Corp.,* 72 F.3d 1577, 1582 (Fed.Cir.1996).

Secondary considerations include "evidence of factors tending to show nonobviousness, such as commercial success of the invention, satisfying a long-felt need, failure of others to find a solution to the problem at hand, and copying of the invention by others." *Id.*

[11][12] This is not the first time that this court has confronted the validity issue in this case. In February 1998, the court denied Boehringer's request for a preliminary injunction by finding, among other things, that Boehringer had not satisfied its burden on the validity question. The instant motion in-

volves different burdens of proof which are less favorable to Schering. In the preliminary injunction context, the patentee bears the burden of proving likelihood of success and thus, when the validity of the patent is challenged, the patentee must demonstrate that the alleged infringer's defense lacks "substantial merit." *See Boehringer,* 984 F.Supp. at 254. In stark contrast, this court may "properly grant, as a matter of law, a motion for summary judgment on patent invalidity when the factual inquiries into obviousness present no genuine issue of material facts." *Ryko Manufacturing Co. v. Nu-Star Inc.,* 950 F.2d 714, 716 (Fed.Cir.1991). It would be wrong to assume that Schering's success in defeating the preliminary injunction motion is tantamount to granting a summary judgment motion. Whereas Schering survived the preliminary injunction motion because Boehringer failed to expose Schering's defense as completely inadequate, Schering must now demonstrate that there are no genuine issues of material fact which control the obviousness analysis. That is a far more difficult burden.

At the preliminary injunction hearing, Schering made two arguments to demonstrate invalidity. First, it asserted that the '778 Patent is unenforceable because "when viewed in the context of the prior art from the perspective of an ordinarily skilled virologist ... the growing and isolating of swine infertility and respiratory syndrome virus ATCC-VR2332 on simian cell lines was nothing more than the predictable result of an application of routine prior art procedures to the prior art." Second, it took the position that the patent was made obvious by the earlier isolation of another porcine respiratory virus, swine influenza, using simian cells. This court rejected the first, but it held that the second defense raised substantial questions about the validity of the '778 Patent. *See Boehringer,* 984 F.Supp. at 259.

Before conducting the analysis, it is important to note that the court issued its previous opinion on this issue based upon an "assessment of the persuasiveness of [Schering's] evidence ... without all evidence that may come out at trial." *Id.* Contrary to the position taken by the defendant, the court may now make its determination by considering evidence previously not examined. The court will also revisit those issues within the context of a summary judgment motion.

1. Factual Inquiry

a. Level of Ordinary Skill in the Pertinent Art

[13] In the instant case, the pertinent art is veterinary virology and the level of ordinary skill is a bachelor's degree in microbiology or biology with several years experience.

b. Scope and Content of Prior Art

The parties agree as to what constitutes prior art, but there are some notable issues of dispute. I have already concluded that:

> It is commonly known by virologists that viruses may be grown by inoculating a sample of the virus onto either a full or ***334** partial sheet of cells and then incubating the virus and looking for the presence of CPE. Virologists also know that the presence of a "suitable growth medium" and "serum" may be conventionally used to facilitate the growing. Moreover, there is nothing unusual about choosing an incubation temperature of 34 to 37 degrees. Choosing a cell line is perhaps the most challenging task faced by virologists.
>
> Success is critically dependent on choosing the right cell line, but whether a particular virus will grow on a given cell and under what conditions remains uncertain and unknown. The "usefulness of any given cell line appears to depend on luck...."
>
> The daunting aspects of this complex problem do not place the virologist in complete darkness because virologists anticipate that most cell lines

> will be ineffective. Moreover, they are aware that with an unknown virus, there is a need conduct several tests with many cell lines. This knowledge makes the number of potentially viable cell lines almost infinite. Success may be achieved by using either cell lines derived from a species that differs from source of the diseased homogenate or from the actual source species. *Boehringer,* 984 F.Supp. at 255.

Boehringer asserts that its patent was not obvious because the prior art does not contain any examples of PRRS being isolated on simian cells. It posits that prior art suggests that it would be routine to use a host cell from the same species as the infected animal, e.g. using porcine alveolar macrophages as a host cell for a porcine virus, and not from another species such as a monkey.

When this court denied Boehringer's preliminary injunction motion, it noted that while the prior art is not replete with examples of simian cells being used with porcine viruses, scientists had isolated a porcine respiratory virus, swine influenza, using a simian cell line prior to Boehringer's isolation of PRRS. *See Id.* at 255. At the preliminary injunction hearing, Boehringer accepted this fact, but for purposes of this motion, it disputes that claim. According to Boehringer, the swine influenza virus referred to during the hearing was actually a "swine influenza-like virus" which had been isolated from humans on simian cells and not from monkeys. Thus, this "swine influenza-like virus" should not be considered a true porcine respiratory virus. *See* Plaintiff's Br. at 20.

To support its argument, Boehringer offers the following explanation:

> Different viruses have been called "swine influenza virus" in the prior art, and these viruses have caused some confusion in this case. One is the *true* "swine flu virus (SIV)-a porcine virus." The other virus is also commonly called "swine flu" virus because it has a certain property characteristic of true SIV, the "H1N1 antigenic phenotype." This human influenza virus is more accurately called "swine influenza-like" like virus. It has been isolated from human clinical specimens on simian cells. True swine influenza, or SIV, (from porcine sources) is not known in the prior art to have been isolated or grown on simian cells.
>
> Plaintiff's Br. at 19; *see* Easterday Decl.

If one accepts Boehringer's differentiation between influenza viruses, one must conclude that the record does not establish that virologists have isolated the porcine version of swine flu (known as "SIV") on monkey cells. Arguably, those studying PRRS would be less likely to rely upon isolation techniques employed with "swine influenza-like" viruses taken from humans than upon techniques used to isolate SIV taken from pigs. This characterization of the pertinent virological principles may be proper, but Schering's attack is factual in nature. It maintains that scientists have, indeed, grown " 'true' swine influenza " on simian cells. *See* Defendant's Reply Br. at 7-10.

Schering cites three articles to undermine Boehringer's position. First, in an article published in a 1968 entitled "Influenza in Animals," the authors point out that:

> Isolation of virus is more frequently accomplished by the intramniotic inoculation of 9 to 10 year old embryonic eggs or inoculation of primary monolayers of monkey kidney....
>
> *Id.* (quoting Rowland Decl. at Ex. C).

***335** The quoted passage comes from a section entitled "Viral Isolation" and does not mention swine influenza by name, but the chapter does speak generally about equine influenza, avian influenza, and swine influenza. According to Schering, this establishes simian cells as a suitable host for swine influenza. Second, Schering cites an article from 1970 entitled "Evaluation of Three Cell Culture Systems as Substrates for Influenza Virus Assay" to "demonstrate[ ] the propagation of what Boehringer calls 'true' A-type swine influenza on monkey cells." *Id.* at 8. The article includes a table where it appears that the "A/Swine/1976/31" strain of influenza has been isolated on a primary rhesus monkey kidney. *See Id.* Boehringer has criticized this reference because the strain of the virus was actually passaged thirty-eight times in mice, forty times in embryonated chicken eggs, and then three times in rhesus monkey kidney before being used in the subject experiment. *See* Boehringer Reply Br. at Ex. B. ¶ 10 (Easterday Supplemental Decl.). Finally, the defendant references a paper entitled "The Behavior of Some Influenza Viruses in Tissue Cultures of Kidney Cells of Various Species" showing that "influenza viruses can be isolated and propagated in monolayer cultures of human kidney ... and in monkey kidney." *Id.* at 9. It does not state what kind of influenza has been isolated. The foregoing indicates that there is a genuine factual dispute as to what kind of kind of swine influenza has been isolated.

There is another arguably important aspect of swine influenza which will be discussed below. Swine influenza is a zoonotic disease which means that it affects more than one species, e.g. humans as well as pigs. On the other hand, PRRS is nonzoonotic which means that if a human comes in contact with a PRRS infected pig, the person will not be infected by the disease. Boehringer and Schering disagree as to the significance of this distinction.

c. the differences between the claims and the prior art

[14][15] In the instant case, the court must consider whether, in light of the prior art at the time, one could have reasonably expected that the PRRS virus could be grown and isolated on simian cells. MA-104 in this case. *See Gillette, supra,* at 724 (obviousness does not require "absolute predictability of success," but only a "reasonable expectation of success"). As I have explained previously, basic virological principles teach at best that "one could attempt to isolate viruses from a mammalian tissue homogenate by inoculating a plurality of cell lines from different species." *See Boehringer,* 984 F.Supp. at 256. These basic principles did not make obvious the isolation of PRRS by trying a battery of cell lines which included simian cells such as MA-104. *See Boehringer,* 984 F.Supp. at 256. At most, this prior art would make Boehringer's patent "obvious to try," a finding which would not invalidate the patent. *See In Re Deuel,* 51 F.3d 1552, 1559 (Fed.Cir.1995). The difference between obviousness and "obvious to try" may be explained as follows:

> Prior art makes an invention "obvious to try" when a "general disclosure may pique the scientist's curiosity, such that further investigation might be done as a result of the disclosure, but the disclosure itself does not contain sufficient teaching ... or that the claimed result would be obtained if certain directions pursued." *Gillette Co. v. S.C. Johnson & Son,* 919 F.2d 720, 725 (Fed.Cir.1990). In the "obvious to try" situation, the "prior art gives either no indication of which parameters are critical or no direction as to which of many possible choices is likely to be successful." *Merck & Co., Inc. v. Biocraft Laboratories, Inc.,* 874 F.2d 804, 807 (Fed.Cir.1989). "Teachings of references [may] be combined" to establish obviousness, but there must be some teaching, suggestion or incentive supporting the combination. *In Re Fine,* 837 F.2d 1071, 1074 (Fed.Cir.1988); *In Re Geiger,* 815 F.2d 686, 688 (Fed.Cir.1987). Finally, obviousness analysis of a claimed combination must include consideration of the results achieved by that combination. *Gillette, supra,* at 724.
>
> *Boehringer,* 984 F.Supp. at 256.

Without more guidance from sources other than the conventional methodology, one could not have reasonably expected success from such a random selection. *See Id.* Even ***336** though virologists knew that MA-104 was an available cell line capable of hosting the isolation of viruses from animals other than the affected species, the conventional methodology did nothing to render the use of simian cells in isolating PRRS any less counterintuitive. *See Id.*

However, the prior art in this case includes more than just the conventional methodology. At the time of the preliminary injunction hearing, Schering offered evidence that scientists had grown swine influenza on simian cells, which like PRRS, is a respiratory disease that affects pigs. This court found that the prior art generated enough doubt about the nonobviousness of the Boehringer's patent that there was substantial merit to the defense. Boehringer did nothing to dispel that conclusion because it did not to offer any reason for why one would isolate swine influenza differently than PRRS. It did argue that the viruses can be distinguished based upon zoonosis, but it did not explain why that difference "impacts upon the methodology behind growing viruses" and thus did not satisfy its burden of proof. *Boehringer,* 984 F.Supp. at 257.

Now Boehringer makes four arguments. First, it contends that no matter what the prior art teaches, it would have been impossible to know whether virologists could successfully use simian cells to isolate PRRS at the time of the invention. *See* Boehringer Br. at 17. Because the "nutritional requirements and growth characteristics of viruses are very unpredictable," Boehringer contends, "one cannot reasonabl[y] expect in advance of experimentation that any particular host cell system will be suitable for a virus in question," especially where that virus is unknown such as PRRS in 1991. *See Id.* The logic of that argument suggests that there is some universal principle that there is no prior art which could ever make obvious the isolation of any unknown virus. *See Id.* Without knowing the name of a particular virus, one could never know which cell line was viable. Here, there is no prior art identifying PRRS by name. Schering does not address this argument directly, but there is no question that it would disagree with that characterization.

Second, Boehringer has criticized Schering's reliance upon prior art related to the isolation of swine influenza. According to Dr. Bernard Easterday, no one has ever isolated true Swine Influenza virus (SIV) from pigs using simian cells. *Id.* Rather, he believes, the "overwhelming teaching in the swine flu art was to isolate and grow SIV on embryonated chicken eggs." *Id.* at 21. The 1986 edition of *Diseases in Swine,* to which Easterday contributed, lists many cell lines which have been used to culture SIV, but does not name a single simian cell. *Id.* According to Boehringer, *Diseases in Swine* is a "very well known veterinary text likely to be considered by ordinary skilled veterinary scientists interested in porcine diseases. Therefore, the absence of simian cells would have discouraged anyone investigating porcine viruses from using simian cells." *Id.* Dr. Easterday concedes that since the 1960's, "primary monkey kidney cells have been one of the most commonly used and preferred tissue culture systems for cultivating human influenza viruses" and "preferred culture systems for cultivating human influenza viruses," but he stresses the point that these were human viruses, not porcine ones.

In response, Schering asserts that true SIV has been isolated on monkey cells. *See* Defendant's Reply Br. at 7-10. Thus, there remains a question of fact as to whether scientists have isolated SIV on monkey cells. However, Schering has also asserted that even if Boehringer is correct, the prior art would still teach that "a respiratory virus which resembled a swine respiratory virus would replicate on monkey cells." *Id.* at 7. Accordingly, that would be a "teaching, suggestion and incentive for one of ordinary skill in the art to grow swine respiratory virus such as PRRS on monkey cells." *Id.* While that may be true, the court cannot ignore the existence of facts which suggest otherwise.

As Boehringer explains in its third argument, even if the prior art includes the isolation of true swine influenza ("SIV") taken from pigs, there would have been no reason for a virologist interested in PRRS to look to isolating techniques employed with SIV. The plaintiff cites several reasons for its position. Initially, regardless of the fact that *337 both diseases are respiratory in nature, "symptoms are not a predictor of what culture system for the virus that causes the symptoms." *Id.* at 23 (citing Easterday Decl. at ¶ 35). If that principle controls, it would seriously undermine Schering's argument that the similarities between the viruses would have taught the PRRS scientists to try the same isolating techniques. To further distinguish the two viruses, Boehringer also notes that while PRRS has a respiratory component, it is "primarily a reproductive illness." *See Id.* (citing Collins Decl. at ¶¶ 20-21). That would make SIV an entirely different disease and thus, its isolation technique would teach nothing to PRRS scientists. Finally, at the time of the invention, "seriological surveys did not implicate SIV as being associated with PRRS." *See Id.*

Schering can only prevail on its obviousness defense if it can establish, by clear and convincing evidence that the similarities between SIV and PRRS are meaningful ones. If Schering proves that virologists choose cell lines to culture viruses based upon the symptoms of the disease, it enhances its position. But, here there is a genuine issue of material fact as to the importance of focusing on symptoms. Moreover, there is also a significant question as to whether PRRS reproductive component would encourage virologists to disregard techniques for isolating SIV.

Additionally, there is evidence that other porcine respiratory viruses have been isolated on monkey cells. *See* Defendant's Reply Br. at 13. That has not been disputed, but apart from that fact, Schering has not demonstrated that the undisputed factual evidence establishes a connection between those viruses and PRRS sufficient enough to avail itself of summary judgment.

Fourth, Boehringer repeats the zoonotic argument that it made at the preliminary injunction hearing. According to Boehringer, if a virologist knows that a particular virus is non-nonzoonotic, there is "no sound rationale for trying to culture it on a non-host species (such as simian cells), much less a reasonable expectation of success that the virus would grow." *Id.* at 26. In 1991, Boehringer contends, virologists considered PRRS to be nonzoonotic because "the disease had never been known to transfer to other animals or humans." *Id.* Apparently, the disease had not infected those farmers who had worked with PRRS-infected pigs. Initially, Schering challenges this argument on its fact. According to Schering, in 1991, Boehringer scientists did not know that PRRS was nonzoonotic. *See* Schering Reply Br. at 4. Schering notes that when it classified the PRRS virus with the American Type Culture Collection in Rockville, Maryland, it did so under "Biosafety Level 2" which indicates that it is "potentially harmful to humans." *See Id.* at 4. From that, it can be inferred that Boehringer believed PRRS to be zoonotic. Thus, there is a question of fact as to whether scientific community's knew PRRS to be zoonotic. In addition to its factual weakness, Boehringer's zoonosis argument is problematic because, once again, it has failed to articulate what virologists think about zoonosis. It is unclear whether that term is even a part of a virologist's vernacular.

2. Conclusion

Notwithstanding Boehringer's less than formidable zoonosis argument, the foregoing indicates that there exist genuine issues of material fact which impact upon the question of whether in light of the prior art at the time, one could have reasonably expected that the PRRS virus could be grown and isolated on simian cells. *See Gillette, supra,* at 724. Much of that determination will turn on how the jury evaluates the guidance offered by prior art related to SIV. For that reason, Schering's motion for summary judgment on validity should be **DENIED**. FN2FN3

FN2. Because the foregoing provides sufficient basis to deny Schering's summary judgment motion, I need not consider such secondary characteristics as commercial success of the vaccine, the long felt need for it, and evidence of copying. These factors are "invariably relevant" to a Section 103 determination (*Litton Systems, supra,* at 1569), but do not alter the fact that there are genuine issues of material fact which prevent this court from granting summary judgment.

FN3. I note that Boehringer has requested to permission to file a surreply in response to some of the arguments made in Schering's reply brief. Because I have denied summary judgment, further briefing is unnecessary.

***338** *3. Schering's Judicial Estoppel Argument*

The court is aware of Schering's contention that Boehringer's validity arguments should be precluded on the basis of judicial estoppel. Specifically, it takes issue with Boehringer's attempt to distinguish SIV and to argue that scientists have not isolated true SIV. Schering perceives this as an inconsistent position.

[16][17][18] The doctrine of judicial estoppel is an equitable doctrine, invoked by a court in its discretion: to "preserve the integrity of the judicial system by preventing parties from playing fast and loose with the courts in assuming inconsistent positions, and with a recognition that each case must be decided on its own particular facts and circumstances." *McNemar v. The Disney Store,* 91 F.3d 610, 617 (3d Cir.1996), *cert. denied,* 519 U.S. 1115, 117 S.Ct. 958, 136 L.Ed.2d 845 (1997). The doctrine is not intended to eliminate all inconsistencies but only those where the litigants are playing "fast and loose." *Ryan Operations v. Santiam-Midwest Lumber,* 81 F.3d 355 (3d Cir.1996). The Supreme Court has stated:

> [i]t may be laid down as a general proposition that, where a party assumes a certain position in a legal proceeding, and succeeds in maintaining that position, he may not thereafter, simply because his interests have changed, assume a contrary position, especially if it be to the prejudice of the party who has acquiesced in the position formerly taken by him.

Fleck v. KDI Sylvan Pools, Inc., 981 F.2d 107, 121 (3d Cir.1992) (quoting *Davis v. Wakelee,* 156 U.S. 680, 689, 15 S.Ct. 555, 39 L.Ed. 578 (1895)). "Judicial estoppel looks to the connection between the litigant and the judicial system" and thus, it is intended to protect the courts rather than the litigants. *Id.* at 121-22.

[19] There is no question that Boehringer's validity arguments have evolved from the beginning of this case, but I do not find them inconsistent. Originally, Boehringer took the position that the prior art did not teach that simian cells could be used to grow or isolate porcine respiratory viruses. At the preliminary injunction hearing, when confronted with evidence submitted by Schering that porcine viruses such as swine influenza and rotaviruses, Boehringer distinguished these viruses on the basis of zoonosis. Whether that is a meaningful distinction is uncertain. For the instant motion, Boehringer has accumulated more evidence and attacked the SIV prior art directly. Unquestionably, as this case has progressed, Boehringer has modified its position, but these positions have never been antithetical to each other. Boehringer has always maintained that all prior art is distinguishable. I do not find that the evolution of Boehringer's arguments reflect an attempt to play fast and loose with the court.

Schering wants the court to conclude that because, at the time of the preliminary injunction hearing, Boehringer conceded that swine flu had been isolated on monkey cells, that it should be precluded from making these arguments. Schering's argument is unavailing. At the previous hearing, Boehringer did accept that some form of swine flu had been isolated on monkey cells in a way that might be construed as a wholesale adoption of Schering's position. However, the court is cognizant of the fact that at the time of the preliminary injunction hearing, it made its decision without all of the evidence which may come out at trial. *See Boehringer,* 984 F.Supp. at 258. For the instant motion, Boehringer benefited from further discovery. Schering may treat Boehringer's recent stance as somewhat of a retreat, but it actually reflects an effort to clarify its position in order to illustrate important differences. The court has an institutional interest in obtaining full knowledge of the prior art and in learning about the pertinent differences. It is understandable that once discovery is completed, the prior art universe would be more textured. The court sees no reason to invoke judicial estoppel.

C. Boehringer's Preliminary Injunction Motion

Boehringer has renewed its request for a preliminary injunction on the ground that Schering's validity no longer has substantial ***339** merit. There is no question that the evidence submitted and the arguments made by Boehringer arguably undermines Schering's defense. Now there are more questions as to the value of the prior art is distinguishable, but for reasons discussed above, Boehringer has not conclusively distinguished the prior art. Boehringer has not demonstrated that the validity defense is devoid of substantial merit. Moreover, it is far from certain that Boehringer would be likely to succeed on the merit of its infringement claim. As the court indicated in its infringement analysis, Boehringer cannot establish literal infringement and it will encounter difficulties in proving satisfying the elements of the doctrine of equivalents. Finally, Boehringer has not satisfied its burden with respect to irreparable harm. *See Boehringer,* 984 F.Supp. at 264. Thus, Schering's request shall be **DENIED.**

IV. Conclusion

For reasons detailed in the opinions above, the motions for summary judgment are **DENIED** and plaintiff's motion for a preliminary injunction is **DENIED.**

D.N.J.,1998.
Boehringer Ingelheim Animal Health, Inc. v. Schering-Plough Corp.
6 F.Supp.2d 324

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Only the Westlaw citation is currently available.

United States District Court,
D. Idaho.
BOISE TOWER ASSOCIATES, LLC, a Washington Limited Liability Company, Plaintiff,
v.
WASHINGTON CAPITAL JOINT MASTER TRUST MORTGAGE INCOME FUND, et al., Defendants.
No. 03-141-S-MHW.

Dec. 10, 2007.

Christopher C. Burke, Jon T. Simmons, Richard H. Greener, Greener Banducci Shoemaker P.A., Eric S. Rossman, Rossman Law Group PLLC, Boise, ID, for Plaintiff.

James L. Martin, Randall A. Peterman, Moffatt Thomas Barrett Rock & Fields, Boise, ID, Bernard William McHugh, Ford Elsaesser, Elsaesser Jarzabek Anderson Marks Elliott & McHugh, Sandpoint, ID, for Defendants.

MEMORANDUM DECISION AND ORDER

MIKEL H. WILLIAMS, United States Chief Magistrate Judge.

***1** Currently pending before the Court are the Motion for Attorney Fees, Docket No. 317, and Motion for Taxation of Costs, Docket No. 319, filed by Defendants Washington Capital Joint Master Trust, Washington Capital Management, Inc., and BNY Western Trust Company (collectively, "WCM"). Pursuant to the Court's Order, Docket No. 313, WCM has elected to address its entitlement to attorney fees prior to submitting a memorandum and affidavits regarding the amount and reasonableness of claimed attorney fees. The Court heard oral argument on November 7, 2007, and took the matters under advisement. After careful consideration of the parties' arguments and written submissions, the Court will deny WCM's motions for the reasons discussed below.

I.

Background

On April 2, 2007, the Court issued its Memorandum Decision and Order finding that WCM was entitled to summary judgment on counts one and two of Boise Tower Associates, LLC's ("BTA") complaint alleging breach of contract and breach of the covenant of good faith and fair dealing. Docket No. 307.[FN1] Thereafter, the parties stipulated to dismiss WCM's counterclaim, and the Court entered final judgment in favor of WCM on July 6, 2007. Docket No. 315.

FN1. The Court also denied BTA's second motion for partial summary judgment, Docket No. 249.

WCM filed a motion under Fed.R.Civ.P. 54(d)(2) and Dist. Idaho Loc. Civ. R. 54.2 seeking attorney fees pursuant to Idaho Code § 12-120(3) as the prevailing party.[FN2] WCM also filed a motion seeking non-taxable costs under Dist. Idaho Loc. Civ. R. 54.1(c)(8), requesting $207,838.43. Docket No. 319.[FN3]

FN2. WCM also claims fees are owed under Idaho Code § 12-121. For fees to be awarded under Idaho Code § 12-121, BTA's claims must be frivolous, unreasonable, or without foundation. *Thomas v. Madsen,* 132 P.3d 392, 396 (Idaho 2006). If there is a legitimate triable issue of fact or issue of law, attorney fees may not be awarded under Idaho Code § 12-121 even if the losing party asserted factual or legal claims that were frivolous, unreasonable, or without foundation. *Thomas*, 132 P.3d at 396. WCM presented no argument or supporting facts in its memorandums, Docket Nos. 317, 330, that BTA pursued its claims frivolously or unreasonably. Accordingly, the Court finds that WCM waived any right it may have had to assert fees under that statute.

FN3. These discretionary costs are in addition to the costs outlined in WCM's Bill of Costs, Docket No. 318, requesting $33,613.16. BTA did not file an objection to WCM's Bill of Costs and there is no overlap between the two requests.

II.

Discussion

A. WCM's Motion for Attorney Fees.

WCM argues it is entitled to attorney fees under Idaho law and cites *Alyeska Pipeline Serv. Co. v. Wilderness Soc'y*, 421, U.S. 240 (1975) for support. FN4 In that case, the Supreme Court held that a court sitting in diversity must apply the forum state's attorney fee law if it does not conflict with any federal law, and it represents the "substantial policy" of the state. *Alyeska Pipeline Serv. Co.*, 421 U.S. at 260, n. 31. WCM argues that Idaho Code § 12-120(3) applies, which provides that the prevailing party "shall" be allowed a reasonable attorney fee if the action is one to recover in any "commercial transaction." An award under § 12-120(3) is mandatory. *Nelson v. Anderson Lumber Co.*, 99 P.3d 1092, 1106 (Idaho Ct.App.2004). WCM further contends that a conflict of law analysis is not required under *Alyeska*, and that even if it is required, Idaho has the most significant relationship to the issue of attorney fees, citing *Arno v. Club Med Boutique, Inc.*, 134 F.3d 1424 (9th Cir.1998).

FN4. At oral argument, WCM directed the Court to *Ward v. Puregro Co.*, 913 P.2d 582 (Idaho 1996). The Court finds that case inapplicable here. *Ward* involved a contract with an explicit choice of law provision, which the court honored as part of the parties' agreement. *Ward*, 913 P.2d at 584. The parties in this case had no such provision in their contract. *See* First Am. Compl., Ex. A, Docket No 67.

While BTA agrees state law applies, it argues that the Court's choice of law analysis utilized in its Memorandum Decision and Order, Docket No. 248, applies with equal force to the issue of attorney fees. Accordingly, BTA contends that Washington state law applies. Not surprisingly, under Washington law the prevailing party is not automatically entitled to attorney fees. Washington courts may not award attorney fees unless there is a contract, statute, or recognized equitable exception. *City of Seattle v. McCready*, 931 P.2d 156, 160 (Wash.1997). There is no corresponding statute applicable in Washington that would award attorney fees to the prevailing parties in this case, and thus BTA asserts each party must bear its own costs and fees. FN5

FN5. Wash. Rev.Code § 4.84.330 allows the prevailing party in any action on a contract to be awarded reasonable attorney fees if the "contract or lease specifically provides that attorney's fees and costs, which are incurred to enforce the provisions of such contract or lease," are recoverable. The Loan Commitment Letter BTA alleged WCM breached had no such provision, and so this statute is inapplicable. *See* First Am. Compl., Docket No 67, Exhibit A.

*2 The Court finds that the *Alyeska* criteria are met. There is no conflict between state law and federal law concerning entitlement to attorney fees. And, it has been previously held that Idaho's fee statutes represent a substantial policy of the state of Idaho. *Lockheed Martin Idaho Technologies Co. v. Lockheed Martin Advanced Environ. Sys., Inc.*, 2006 WL 2095876 *2, Case No. CV 98-316-BLW (D.Idaho July 27, 2006). However, a choice of law analysis is required, because Idaho courts have determined that Idaho Code § 12-120(3) is a substantive law that enlarges the rights of litigants in a commercial transaction. *Griggs v. Nash*, 775 P .2d 120, 127 (Idaho 1989); *Myers v. Vermaas*, 753 P.2d 296, 298 (Idaho Ct.App.1988). Consequently, the Court is directed to turn to the substantive law of the forum state, including its choice-of-law rules, to ascertain the applicable state law governing the parties' entitlement to attorney fees.[FN6] *See Sims Snowboards, Inc. v. Kelly*, 863 F.2d 643, 645 (9th Cir.1988) ("If the issue is 'substantive'-concerned with the legal rights of the parties-then a choice of law analysis must be made.").

> FN6. WCM would have the Court ignore the choice-of-law issue in its entirety, relying upon *Alyeska* and *Lockheed.* Neither *Lockheed* or *Alyeska,* however, presented a choice-of-law issue affecting entitlement to attorney fees. The Court in *Lockheed* noted that if a conflict-of-law issue was present, the Court would have to consider it. *Lockheed,* 2006 WL 2095876 at *2 n. 1 (considering a conflict-of-laws analysis, but declining to apply it because there was no conflict present in that case). The same conflict-of-law analysis is required in this case when the litigants are arguing whether Idaho or Washington law applies to determine entitlement to attorney fees in a breach of contract matter. *See McMahan v. Toto,* 256 F.3d 1120, 1131-32 (11th Cir.2001) (explaining that if the matter is substantive, the law of the state, including its choice-of-law rules, applies and considering *Alyeska* only in the context of whether the state law conflicted with a federal statute or rule).

Idaho's and Washington's attorney fee statutes are different, and so a choice must be made. As the Court discussed in its July 22, 2006 Memorandum Decision and Order, Docket No. 248, Idaho applies the most significant relationship test in resolving conflict of law issues as set forth in RESTATEMENT (SECOND) CONFLICTS OF LAWS, although it has not adopted the Restatement formulation in full. *Barber v. State Farm Mut. Ins.*, 931 P.2d, 1195, 1199 (Idaho 1997). *See also Grover v. Isom*, 53 P.3d 821 (Idaho 2002); *Rungee v. Allied Van Lines, Inc.*, 449 P.2d 378 (Idaho 1968); *DeMeyer v. Maxwell*, 647 P.2d 783 (Idaho Ct.App.1982). "The goal of this test is to identify the state most significantly related to a particular issue and to apply its law to resolve that issue." *Suebert Excavators Inc. v. Anderson Logging Co.*, 889 P .2d. 82, 85 (Idaho 1995).

Both the underlying action upon which WCM sought summary judgment and the agreement between them and their Idaho attorneys are contracts, requiring the Court to examine: 1) the domicile, residence, nationality, place of incorporation, and place of business of the parties; 2) the place of negotiations of the contract; 3) the place of contracting; and 4) the place of performance; and 5) the location of the subject matter of the contract. RESTATEMENT (SECOND) CONFLICTS OF LAWS § 188 (1971).

Once the factual contacts between the parties are identified, the court then conducts an analysis to determine which state has the most significant relationship to the transaction by considering the following policies:

(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,

> ***3** (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.

RESTATEMENT (SECOND) CONFLICT OF LAWS § 6 (1971). *See also Rungee v. Allied Van Lines, Inc.*, 449 P .2d 378, 383 (Idaho 1968) (citing the Restatement).

In support of its argument that Idaho law applies to the issue of attorney fees, WCM argues that an issue by issue analysis is required and that the Courts previous decision applying Washington law to the contract does not necessarily drive the conclusion that Washington law applies to the question of an award of attorney fees. WCM contends that Idaho has the most significant relationship because the attorney fees were generated in Idaho, the parties contracted with Idaho lawyers, and BTA chose the forum. BTA counters that this Court's prior determination that Washington law applies to the contract is conclusive on this issue. Under Idaho law, BTA argues that Idaho Code § 12-120 is "adjunct" to the contract between the parties and cites *Myers v. Vermaas*, 753 P.2d 296 (Idaho Ct.App.1988) for the proposition that § 12-120 becomes a part of any commercial transaction in Idaho whether the parties intended to or not. BTA therefore contends it is improper to apply an Idaho substantive fee provision as an adjunct to another state's contract.

The Court agrees with BTA's analysis on this point. Contracts negotiated in Idaho would be governed by the holding in *Myers* that, in commercial litigation, Idaho Code § 12-120(3) would be adjunct to the underlying contractual agreement. In *Myers*, the Idaho Court of Appeals noted:

> Unlike I.C. § § 12-121 and 61-617A, I.C. § 12-120 provides for a *mandatory*, not discretionary, award of attorney fees to the prevailing party in commercial litigation. The automatic nature of an award under I.C. § 12-120 makes it, in effect, an adjunct to the underlying commercial agreement between the parties. It establishes an entitlement. In this respect, an award under the statute is closely akin to other "contractual or vested" rights contained in the agreement itself.

Id. at 298. While parties to a contract executed in Idaho and governed by Idaho law can avail themselves of § 12-120, the converse is not true. A contract entered into between parties in another state would not automatically have a substantive Idaho statutory fee component in their commercial agreements. It would be unreasonable to conclude otherwise.

With that said, the law governing liability for the underlying cause of action, *e.g.* breach of contract, does not automatically control the fee issue. For example, in *Rungee v. Allied Van Lines, Inc.*, 449 P.2d 378 (Idaho 1968), the court was presented with a choice between Florida and Idaho law involving enforcement of an insurance contract and an award of attorney fees under the contract to the prevailing party. In that case, although the insurance contract was executed in Florida, the prevailing party sought fees under Idaho's insurance enforcement statute. *Rungee*, 449 P.2d at 381. Florida had no statute under which attorney fees would be awarded. The court viewed the issue involved in that case as which state-Florida or Idaho-had the greater concern for the protection of an insured's contractual rights when the insurance contract applied to the interstate transfer of goods delivered to Idaho. *Id.* at 383-84. The court determined that Idaho had the more significant relationship to the transaction and the parties involved in that case, and therefore permitted the plaintiff to seek fees under the Idaho insurance enforcement statute at issue. *Id.* at 384. *See also MRO Communications, Inc. v. Am. Tel. & Tel. Co.*, 197 F.3d 1276, 1282 (9th Cir.1999) (applying the law of the forum state to determine whether a party was entitled to attorney fees in an action involving a choice between Nevada and New Jersey law); *Barber v. State Farm Mut. Auto. Ins. Co.*, 931 P .2d 1195 (Idaho 1997) (following *Rungee*, and reasoning under the same insurance statute considered in *Rungee* that Washington law applied to determine the issue of attorney fees).

***4** In *Arno v. Club Med Boutique Inc.*, 134 F.3d 1424 (9th Cir.1998), the Ninth Circuit considered a tort action brought by a California resident injured while working at a resort in a territory governed by French law. In its previous decision, the court determined that the law of the place where the tort occurred, in this case a French territory, rather than the law of California, the forum state, governed the substantive issues in the case. *Arno*, 22 F.3d at1468. However, when the plaintiff sought attorney fees, the court concluded that the law governing liability for the tort action did not control the fee issue, independently considered the choice-of-law issue, and held that California had the most significant interest in the manner in which the Plaintiff's attorney was compensated. *Id.* at 1426. *See also McMahan v. Toto*, 256 F.3d 1120, 1135 (11th Cir.2001) (deciding attorney fee issue independently of underlying tort claim under Florida's choice of law rules).

Accordingly, the Court must undertake an independent choice-of-law analysis. Applied to the issue of attorney fees in the present case, the Court previously considered that, as to the underlying contract action, the majority of the factors favored applying Washington law. All of the parties resided in Washington, although Mr. Peterson maintained residences both in Idaho and Washington, and BTA had a business office in Boise. The loan agreement was negotiated in Washington, executed in Washington, and was to be performed in Washington. BTA, however, availed itself of an Idaho forum under the principles of diversity. BTA's choice of forum required the parties to either hire Idaho counsel or out-of-state counsel to associate with local Idaho counsel.

As to the agreements between WCM and Idaho counsel, these contracts on their face would appear to favor application of Idaho law. WCM argued that *Arno* favored such a result, because the employment contracts were negotiated, executed, and performed in Idaho, and the fees were generated in Idaho. However that argument has only superficial appeal if the Court were inclined to constrain itself to considering the place where the fee agreement was entered into as the controlling the issue.

But the Court is not being asked to enforce the contract between WCM and Idaho counsel.[FN7] Rather, the Court determined the litigants' rights under a Washington contract that Idaho lawyers were hired to enforce. Considering the matter in that context, the law favors application of Washington law to the issue of entitlement to attorney fees because of the policies articulated in § 6 of the Restatement. *See Grover v. Isom*, 53 P.3d at 825 (looking at the underlying policies to support its determination that Oregon law applied in a tort action). Although WCM hired Idaho counsel and litigated in the District of Idaho, counsel represented WCM in a suit alleging breach of a contract formed in Washington.

FN7. *Arno* is distinguishable, because the plaintiff and her lawyer had entered into a contingent fee agreement. Despite the contingent fee agreement, Arno filed a fee application seeking reimbursement of attorney fees from the defendant rather than pay her attorney from the settlement proceeds. *Arno*, 134 F.3d at 1425. Although the Ninth Circuit did not elaborate, it noted that contingent fee arrangements were not honored under French law, the law governing the tort action. *Arno*, 134 F.3d at 1426. Thus, the court was being asked to enforce an employment agreement between Arno and her attorney, and it found California law governing contingent fee agreements applied. *Arno*, 134 F.3d at 1426.

While the parties should certainly be free to avail themselves of Idaho's courts and to hire counsel of their choice, it would not be proper for that decision to ultimately dictate the application of an Idaho substantive statute providing for attorney fees based upon that choice, when the substantive law of Washington governs the underlying contract. In other words, the parties are not entitled to attorney fees under an Idaho substantive statute that enlarges the rights of litigants to a commercial dispute when the law governing the contract denies litigants that right. Washington's fee statute would not award attorney fees to a litigant in a contract dispute unless the contract specifically provided for such an award. Wash. Rev.Code § 4.84.330. Nor can parties litigating breach of contract actions in Washington courts avail themselves of Idaho Code § 12-120(3), and thus neither should these litigants. If the Court were to hold otherwise, the decision would impact the important policies concerning attorney fees articulated by the state of Washington in its statutes.

***5** Litigants in an Idaho forum should also not be subjected to potentially uncertain results. In cases where it is clear that another state's substantive law applies to the contract governing the parties, they should expect that the other state's substantive law concerning entitlement to attorney fees applies. Attorney fee statutes, especially when they enlarge the rights of litigants to a commercial contract dispute, should not be applied based upon the choice of forum or the choice of attorney. To do so would promote forum shopping among those litigants that could avail themselves of diversity jurisdiction in Idaho when their particular agreement did not contain a provision awarding attorney fees to a prevailing party and further assuming that under the law of their state, fees would not be otherwise recoverable. Prevailing litigants seeking fees in a contract dispute governed by Washington law that would otherwise be litigated in a Washington court but for invocation of diversity jurisdiction should be limited to Washington substantive statutes governing availability of attorney fees as well. To hold otherwise would interject uncertainty, unpredictability, and non-uniform results.

Accordingly, WCM's motion regarding its entitlement to attorney fees under Idaho Code § 12-120(3) will be denied.

B. WCM's Motion for Non-Taxable Costs.

In addition to attorney fees, WCM also seeks non-taxable costs in the amount of $207,838.43 as the prevailing party under Fed.R.Civ.P. 54(d)(1) and Dist. Idaho Loc. Civ. R. 54.1(c)(8). 18 U.S.C. §§ 1920 and 1821 grant the Court authority to assess costs in cases before it. Fed.R.Civ.P. 54(d)(1) implements those statutes and provides that "[e]xcept when express provision is made either in a statute of the United States or in these rules, costs other than attorney fees shall be allowed as of course to the prevailing party unless the court otherwise directs[.]" The corresponding local rule defines a prevailing party as "the one who successfully prosecutes the action or successfully defends against it, prevails on the merits of the main issue, and the one in whose favor the decision or verdict is rendered and judgment entered." Dist. Idaho Loc. Civ. R. 54.1(b). As a threshold issue, BTA does not dispute that WCM prevailed in the litigation.

WCM seeks costs in addition to those enumerated in the local rule under subsection (c)(8), which allows recovery of "other items" not listed in the rule with prior court approval. Dist. Idaho Loc. Civ. R. 54.1(c)(8). The local rule does not define appropriate "other" costs. BTA objects overall to the costs claimed, asserting WCM has no legal authority explaining what constitutes appropriate "other costs" under Dist. Idaho Loc. Civ. R. 54.1(c)(8) and relying upon Idaho R. Civ. P. 54(d)(1)(D) for guidance. Idaho R. Civ. P. 54(d)(1)(D) allows for a party to recover discretionary costs when that party proves the costs are "necessary and exceptional costs reasonably incurred, and should in the interest of justice be assessed against the adverse party." BTA claims that these costs were not "exceptional," and so should not be awarded. WCM argues if state law applies for guidance, Washington law should be used.

***6** Despite the absence of federal guidance concerning "other" costs, federal procedural law, not state law, governs the award of costs even though the issues, including attorney fees, were decided under Washington state law. *Aceves v. Allstate Ins. Co.,* 68 F.3d 1160, 1167 (9th Cir.1995) (deciding the issue of costs under federal law although California law governed the substantive issues). This premise has been followed for over a century. *Dodge v. Tulleys,* 144 U.S. 451, 457 (1892) (noting that state law "does not determine the procedure of courts of the United States ... or the costs which are taxable there[.]"). Contrary to the arguments advanced by both parties, there is no need to look to either Washington or Idaho procedural statutes governing the award of costs.

The non-taxable costs WCM seeks consist of the following: (1) computerized research, $8,981.85; (2) out of town travel, $9,844.64; (3) expert witness fees, $164,383.53; (4) outside printing costs, $8,724.84; (5) digital discovery, $3,776.82; (6) in-house printing costs, $10,354.04; (7) long distance telephone charges, $1,592.03; and (8) PACER access fees, $180.68.[FN8]

> FN8. WCM has reduced the actual amounts of costs claimed for all costs except expert witness fees by fifty percent. Defs.' Pet. at 2-3. The costs stated represent the amounts claimed after the reduction.

1. Expert Witness Fees.

At the hearing, WCM stated that it was withdrawing the claim for reimbursement of expert witness fees. It appears WCM has already asked for the statutory witness fees in the Bill of Costs, Docket No. 318, and so the request for additional expert witness fees will be denied.

2. Printing Costs.

WCM seeks outside and in-house printing costs in addition to those costs outlined in the Bill of Costs, Docket No. 318, arguing that the Court may interpret 28 U.S.C. § 1920 as encompassing those costs. *See Alflex Corp. v. Underwriters Laboratories, Inc.,* 914 F.2d 175, 177 (9th Cir.1990) (holding that *Crawford Fitting Co. v. J.T. Gibbons, Inc.,* 482 U.S. 437 (1987) "does not prevent courts from interpreting [28 U.S.C.] § 1920."); *Haagen-Dazs Co., Inc. v. Double Rainbow Gourmet Ice Creams, Inc.,* 920 F.2d 587, 588 (9th Cir.1990) (allowing printing costs at 50% of total costs under California local rules). 28 U.S.C. § 1920(3) permits the Court to award "fees" for "printing" with no limitation as to what those costs must relate to, while 28 U.S.C. § 1920(4) allows "fees" for copies of papers necessarily obtained for use in the case. BTA argues that such costs were not "exceptional," and so should be disallowed.

While the Court agrees *Alflex* and *Haagen-Dazs* held that the court has some leeway in interpreting what costs would be allowed under 28 U.S.C. § 1920, in those cases the court's local rules allowed for the costs claimed. For example, in *Haagen-Dazs,* the court upheld the award of costs for fifty percent of the plaintiff's cost of reproducing documents even though they were not introduced in support of the plaintiff's motion for summary judgment because the local rules allowed "the cost of reproducing documents obtained [in discovery] and used for any purpose in the case[.]" *Haagen-Dazs Co., Inc.,* 920 F.2d at 588. Similarly, in *Alflex,* the court upheld an award of costs for the cost of the original and one copy of all depositions because the local rule allowed it. *Alflex Corp.,* 914 F.2d at 176.

***7** In this district, the Court has chosen to limit costs for copies to those attached to a document required to be filed and served. Dist. Idaho Loc. Civ. R. 54.1(c)(5). "The cost of reproducing copies of motions, pleadings, notices, and other routine case papers is not taxable." *Id.* The cost of visual aids is taxable "if they are admitted into evidence." Dist. Idaho Loc. Civ. R. 54.1(c)(6). Also, the court is expressly limited to tax costs in conformity with 28

U.S.C. §§ 1920-1923. Dist. Idaho Loc. Civ. R. 54 .1(c). In the absence of an award of attorney fees such that these costs could be included in the award, the Court finds that the local rule expressly limits an award of such costs, and WCM is not entitled to claim costs for excess copying and printing other than what is enumerated in the local rule. Since WCM has already included those costs in their Bill of Costs, Docket No. 318, additional copy and printing charges are disallowed.

3. Miscellaneous Other Costs.

WCM argues that other costs claimed for computerized research, out of town travel, digital discovery, long distance telephone charges, and PACER access fees were reasonably and necessarily incurred. WCM contends that these costs are properly awarded as part of an attorney fee award. Defendant disagrees, arguing that since attorney fees are not recoverable under Washington law, these discretionary costs may not be awarded because they are not properly taxed as part of attorney fees.

This Court considers computer-aided research, like any other form of legal research, a component of attorney fees that should not always be independently taxed as an item of cost. *See Goff v. Washington County, et al.,* Case No. CV 03-268-MHW (April 10, 2006), *cited in Gomez v. Mastec North Am., Inc.,* Case No. CV 03-421-MHW (Dec. 13, 2006). The Court determined that attorney fees are not recoverable under Washington law, and so costs for computerized research may not be taxed. Nor could the Court find authority for the taxing as costs for out of town travel, long distance telephone charges, PACER fees, or digital discovery in an instance where attorney fees were not recoverable, and so finds that those costs are not appropriate.

ORDER

Based on the foregoing, the Court being otherwise fully advised in the premises, **IT IS HEREBY ORDERED that:**

1) Defendants' Motion for Attorney Fees (Docket No. 317) is DENIED.

2) Defendants' Petition for Non-Taxable Costs (Docket No. 319) is DENIED.

D.Idaho,2007.
Boise Tower Associates, LLC v. Washington Capital Joint Master Trust Mortg. Income Fund
Not Reported in F.Supp.2d, 2007 WL 4355815 (D.Idaho)

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H

United States Court of Appeals,
Tenth Circuit.
BOYD ROSENE AND ASSOCIATES, INC.,
Plaintiff-Appellant,
v.
KANSAS MUNICIPAL GAS AGENCY, an interlocal municipal agency; City of Winfield, Kansas, a municipality, Defendants-Appellees.
No. 97-5216.

April 13, 1999.

Business sued municipal gas agency and city, asserting tort and breach of contract claims. The United States District Court for the Northern District of Oklahoma, Thomas R. Brett, J., granted summary judgment for agency and city and ordered all parties to pay own attorney fees. Parties cross-appealed. The Court of Appeals affirmed, then remanded on rehearing en banc, 123 F.3d 1351. The District Court awarded attorney fees to agency and city on breach of contract claim. Business appealed. The Court of Appeals, Murphy, Circuit Judge, held that under Oklahoma law, as predicted by Court of Appeals, defendants' entitlement to attorney fee award under Oklahoma statute allowing for award in contract actions was substantive, rather than procedural, issue for choice-of-law purposes.

Reversed and remanded.

See also 1999 WL 350949.

West Headnotes

[1] Federal Courts 170B 776

170B Federal Courts
170BVIII Courts of Appeals
170BVIII(K) Scope, Standards, and Extent
170BVIII(K)1 In General
170Bk776 k. Trial De Novo. Most Cited Cases

Federal Courts 170B 850.1

170B Federal Courts
170BVIII Courts of Appeals
170BVIII(K) Scope, Standards, and Extent
170BVIII(K)5 Questions of Fact, Verdicts and Findings
170Bk850 Clearly Erroneous Findings of Court or Jury in General
170Bk850.1 k. In General. Most Cited Cases
Review of a district court's determinations of state law in a diversity case is de novo, while underlying factual determinations are reviewed for clear error.

[2] Federal Courts 170B 373

170B Federal Courts
170BVI State Laws as Rules of Decision
170BVI(A) In General
170Bk373 k. Substance or Procedure; Determinativeness. Most Cited Cases
Under first step of two-step inquiry in which federal court sitting in diversity must engage to identify governing law, court must determine whether particular matter is procedural or substantive; if matter is procedural, then federal law applies, but if matter is substantive, then court follows the law of forum state.

[3] Federal Courts 170B 373

170B Federal Courts
170BVI State Laws as Rules of Decision
170BVI(A) In General
170Bk373 k. Substance or Procedure; Determinativeness. Most Cited Cases

Federal Courts 170B 409.1

170B Federal Courts
170BVI State Laws as Rules of Decision
170BVI(C) Application to Particular Matters
170Bk409 Conflict of Laws
170Bk409.1 k. In General. Most Cited

Cases
Under second step of two-step inquiry by which diversity court identifies governing law, if court has determined that matter is substantive, it looks to substantive law of the forum state, including its choice of law principles, to determine applicable substantive law.

[4] Federal Courts 170B ⚷410

170B Federal Courts
170BVI State Laws as Rules of Decision
170BVI(C) Application to Particular Matters
170Bk409 Conflict of Laws
170Bk410 k. Particular Questions. Most Cited Cases

Federal Courts 170B ⚷415

170B Federal Courts
170BVI State Laws as Rules of Decision
170BVI(C) Application to Particular Matters
170Bk415 k. Damages, Interest, Costs and Fees. Most Cited Cases
Although attorney fees are substantive matter for diversity purposes, they are not necessarily substantive under particular state's choice-of-law rules.

[5] Action 13 ⚷66

13 Action
13IV Commencement, Prosecution, and Termination
13k66 k. Course of Procedure in General. Most Cited Cases
Oklahoma choice-of-law principles require a court to apply Oklahoma rules to procedural matters even when those principles require the application of the substantive law of another jurisdiction. Restatement (Second) of Conflict § 122.

[6] Federal Courts 170B ⚷611

170B Federal Courts
170BVIII Courts of Appeals
170BVIII(D) Presentation and Reservation in Lower Court of Grounds of Review
170BVIII(D)1 Issues and Questions in Lower Court
170Bk611 k. Necessity of Presentation in General. Most Cited Cases

Federal Courts 170B ⚷915

170B Federal Courts
170BVIII Courts of Appeals
170BVIII(K) Scope, Standards, and Extent
170BVIII(K)7 Waiver of Error in Appellate Court
170Bk915 k. In General. Most Cited Cases
Court of Appeals would not address argument that was never raised in district court and was asserted only in appellant's reply brief on appeal and thus was waived on two grounds.

[7] Statutes 361 ⚷278.7

361 Statutes
361VI Construction and Operation
361VI(D) Retroactivity
361k278.7 k. Express Retroactive Provisions. Most Cited Cases
(Formerly 361k262)
The general presumption in retroactivity determinations is that a statute will not apply retroactively unless the legislature has clearly expressed its intent that it apply retroactively.

[8] Statutes 361 ⚷278.7

361 Statutes
361VI Construction and Operation
361VI(D) Retroactivity
361k278.7 k. Express Retroactive Provisions. Most Cited Cases
(Formerly 361k265)

Statutes 361 ⚷278.9

361 Statutes
361VI Construction and Operation
361VI(D) Retroactivity
361k278.9 k. Statutes Affecting Vested

Rights. Most Cited Cases
(Formerly 361k265)

Statutes 361 ⚷278.13

361 Statutes
361VI Construction and Operation
361VI(D) Retroactivity
361k278.12 Statutes Relating to Remedies and Procedures
361k278.13 k. In General. Most Cited Cases
(Formerly 361k267(1))
Only if the legislature's intent as to a statute's retroactivity is not clear should a court consider whether the statute is substantive or procedural, and the question then becomes whether the retroactive operation of the statute would alter the parties' vested rights; if the parties' vested rights would be affected, then the statute is substantive and will not be applied retroactively, but the statute is deemed to be procedural otherwise and may apply retroactively, because parties generally have a diminished reliance interest in procedural matters.

[9] Costs 102 ⚷194.32

102 Costs
102VIII Attorney Fees
102k194.24 Particular Actions or Proceedings
102k194.32 k. Contracts. Most Cited Cases
Consistent with the primacy of party expectations in determining contractual obligations, party choice of law is a significant consideration in determining whether an attorney fees statute is substantive or procedural for state choice-of-law purposes in contract cases.

[10] Action 13 ⚷17

13 Action
13II Nature and Form
13k17 k. What Law Governs. Most Cited Cases
Although a state is free to consult the choice-of-law determinations of another state in deciding whether its own statute is substantive or procedural, state courts are not compelled to do so; rather, the forum's law controls the substantive/procedural determination.

[11] Costs 102 ⚷194.32

102 Costs
102VIII Attorney Fees
102k194.24 Particular Actions or Proceedings
102k194.32 k. Contracts. Most Cited Cases
Under Oklahoma law, as predicted by Court of Appeals, party's entitlement to attorney fee award under Oklahoma statute allowing for award in contract actions was substantive, rather than procedural, issue for choice-of-law purposes in breach of contract action; fees provided for by statute were not assessed for bad-faith litigation, but instead merely granted to prevailing party, and parties had contracted generally for their agreement to be governed by Kansas law, which did not statutorily permit recovery of attorney fees. 12 Okl.St.Ann. § 936 ; K.S.A. 84-2-710 comment; Restatement (Second) of Conflicts § 122 comment.

[12] Costs 102 ⚷194.22

102 Costs
102VIII Attorney Fees
102k194.22 k. Effect of Statutes. Most Cited Cases
Oklahoma statute providing for recovery of attorney fees and indicating that fees could be "taxed and collected as costs" did not make issue of party's entitlement to attorney fees available under statute a procedural matter, for choice-of-law purposes, rather than substantive. 12 Okl.St.Ann. § 936.

[13] Costs 102 ⚷194.16

102 Costs
102VIII Attorney Fees

102k194.16 k. American Rule; Necessity of Contractual or Statutory Authorization or Grounds in Equity. Most Cited Cases

Under Oklahoma law, attorney fees are not synonymous with costs; instead, attorney fee awards are only permitted under statutes specifically providing for recovery of attorney fees.

***1117** Mark Banner, of Hall, Estill, Hardwick, Gable, Golden & Nelson, Tulsa, Oklahoma (Steven M. Harris and Michael D. Davis, of Doyle & Harris, Tulsa, Oklahoma, with him on the briefs) for Appellant, Boyd Rosene and Associates, Inc.

Richard B. Noulles, of Gable, Gotwals, Mock, Schwabe, Kihle, Gaberino, (M. Benjamin Singletary, of Gable, Gotwals, Mock, Schwabe, Kihle, Gaberino, Tulsa, Oklahoma, with him on the brief, for Appellee, Kansas Municipal Gas Agency; J. David Jorgenson, of Inhofe, Jorgenson, Balman & Waller, P.C., Tulsa, Oklahoma, for Appellee, City of Winfield, Kansas).

Before BRORBY and MURPHY, Circuit Judges, and MARTEN,[FN*] District Judge.

FN* Honorable J. Thomas Marten, United States District Judge, United States District Court for the District of Kansas, sitting by designation.

MURPHY, Circuit Judge.

Boyd Rosene and Associates, Inc., appeals an award of attorney's fees granted to Kansas Municipal Gas Agency and the City of Winfield, Kansas. Rosene argues on appeal that under Oklahoma choice-of-law principles, Kansas law applies and the grant of attorney's fees to the defendants pursuant to Oklahoma Statute title 12, § 936 was inappropriate. Exercising jurisdiction pursuant to 28 U.S.C. § 1291, this court concludes that Oklahoma choice-of-law principles would compel the application of Kansas law on attorney's fees. Because Kansas disallows recovery of attorney's fees in the absence of a contractual or statutory provision to the contrary, the district court's award of attorney's fees is **Reversed**.

I. Background

Boyd Rosene and Associates, Inc. ("Rosene"), sued Kansas Municipal Gas Agency ("KMGA") and the City of Winfield, Kansas ("Winfield") in a breach of contract and tort action. Rosene filed its diversity action in federal court in the Northern District of Oklahoma. In a paragraph entitled "Choice of Law," the underlying contract provided that it was to be governed and construed in accordance with Kansas law but was silent on the issue of attorney's fees. The district court entered summary judgment in favor of the defendants, KMGA and Winfield, and ordered all parties to pay their own attorney's fees. The district court's decision was initially affirmed on appeal. *See Boyd Rosene & Assocs. v. Kansas Mun. Gas Agency,* Nos. 96-5199, 96-5209, 96-5211, 1997 WL 297677 (10th Cir. June 5, 1997) (*Rosene I*). KMGA and Winfield, however, successfully petitioned for rehearing *en banc* on the issue of their entitlement to attorney's fees.

Upon rehearing *en banc,* this court clarified *Bill's Coal Co. v. Board of Public Utilities,* 887 F.2d 242 (10th Cir.1989), and held that in a contract suit, "rather than automatically applying the law of the state providing the substantive contract law, a district court must first apply the forum state's choice-of-law rules in resolving attorney's fees issues." ***1118** *Boyd Rosene & Assocs. v. Kansas Mun. Gas Agency,* 123 F.3d 1351, 1353 (10th Cir.1997) (*Rosene II*). The *en banc* court remanded the case to the district court for the application of Oklahoma's choice-of-law rules in resolving defendant's claims for attorney's fees. *See id.*

In applying Oklahoma's choice-of-law rules, the district court noted that matters of procedure, in contrast to matters of substantive law, are governed by the law of the forum. The district court then held that Oklahoma's attorney's fee statutes are procedural, not substantive, and proceeded to apply Oklahoma statute title 12, § 936, which provides for the imposition of attorney's fees in a breach-of-contract claim.[FN1] The court concluded that KMGA and Winfield were entitled to reasonable attorney's fees on Rosene's breach-of-contract claim and ordered that Rosene pay $100,365.88 to KMGA and $33,727.26 to Winfield.

FN1. Section 936 provides:

> In any civil action to recover on an open account, a statement of account, account stated, note, bill, negotiable instrument, or contract relating to the purchase or sale of goods, wares, or merchandise, or for labor or services, unless otherwise provided by law or the contract which is the subject [of] the action, the prevailing party shall be allowed a reasonable attorney fee to be set by the court, to be taxed and collected as costs.
>
> Okla. St. Ann. tit. 12, § 936 (West 1988).

II. Discussion

[1] Review of a district court's determinations of state law in a diversity case is *de novo. See Salve Regina College v. Russell,* 499 U.S. 225, 231, 111 S.Ct. 1217, 113 L.Ed.2d 190 (1991); *Mitchell v. State Farm Fire & Cas. Co.,* 902 F.2d 790, 792-93 (10th Cir.1990) (reviewing choice-of-law determination in diversity case *de novo*). Underlying factual determinations are reviewed for clear error. *See Mid-America Pipeline Co. v. Lario Enters.,* 942 F.2d 1519, 1524 (10th Cir.1991).

A. Choice of law: General Principles

[2][3][4] A federal court sitting in diversity must engage in a two-step inquiry. *See Servicios Comerciales Andinos, S.A. v. General Electric Del Caribe, Inc.,* 145 F.3d 463, 479 (1st Cir.1998). First, the court must determine whether a particular matter is procedural or substantive for *Erie Railroad Co. v. Tompkins* purposes. 304 U.S. 64, 58 S.Ct. 817, 82 L.Ed. 1188 (1938). If the matter is procedural, then federal law applies; if the matter is substantive, then the court follows the law of the forum state. *See Erie,* 304 U.S. at 78 (holding that federal court sitting in diversity must apply state substantive law). Second, if the court has determined that the matter is substantive, then it looks to the substantive law of the forum state, including its choice of law principles, to determine the applicable substantive law. *See Klaxon Co. v. Stentor Elec. Mfg. Co.,* 313 U.S. 487, 496, 61 S.Ct. 1020, 85 L.Ed. 1477 (1941); *Barrett v. Tallon,* 30 F.3d 1296, 1300 (10th Cir.1994). These two steps are distinct inquiries; thus, what is substantive or procedural for *Erie* purposes is not necessarily substantive or procedural for choice-of-law purposes. *See Sun Oil Co. v. Wortman,* 486 U.S. 717, 726, 108 S.Ct. 2117, 100 L.Ed.2d 743 (1988) (rejecting notion that "there is an equivalence between what is substantive under the *Erie* doctrine and what is substantive for purposes of conflict of laws") (citing *Guaranty Trust Co. of N.Y. v. York,* 326 U.S. 99, 108, 65 S.Ct. 1464, 89 L.Ed. 2079 (1945)). Consequently, even though attorney's fees are substantive for diversity purposes, *see King Resources Co. v. Phoenix Resources Co.,* 651 F.2d 1349, 1353 (10th Cir.1981), they are not thereby necessarily substantive under Oklahoma choice-of-law rules.

B. Oklahoma Choice of Law

[5][6] Oklahoma choice-of-law principles require a court to apply Oklahoma rules to procedural matters even when those principles require the application of the substantive law of another jurisdiction. *See Veiser v. Armstrong,* 688 P.2d 796, 799 n. 6 (Okla.1984) ("In a conflict-of-law analysis matters of procedure are governed by ***1119** the law of the forum.") (citing *Northern Pac. Ry. Co. v. Babcock,* 154 U.S. 190, 194, 14 S.Ct. 978, 38 L.Ed. 958 (1894)); *cf. Restatement (Second) of Conflict of Laws* § 122 (1971) ("A court usually applies its own local law rules prescribing how litigation shall

be conducted even when it applies the local law rules of another state to resolve other issues in the case."). Unfortunately, Oklahoma law is silent [FN2] on the classification of attorney's fees as substantive or procedural for choice-of-law purposes. [FN3] Nonetheless, it is this court's responsibility to ascertain how the Oklahoma Supreme Court would decide the choice-of-law issue. [FN4] *See Klaxon,* 313 U.S. at 496-97; *First Nat. Bank of Durant v. Trans Terra Corp. Int'l,* 142 F.3d 802, 806 (5th Cir.1998).

FN2. In its reply brief, Rosene argues that UCC § 1-105's choice-of-law provision supersedes Oklahoma common-law choice-of-law rules and requires the application of Kansas law to the remedies. *See* Okla. Stat. tit. 12A, § 1-105. Rosene's argument misses the mark because it presupposes that attorney's fees are substantive. Were this court to decide that attorney's fees are procedural, the law of the forum would apply regardless of a substantive-law provision such as UCC § 1-105.

Although this court concludes that attorney's fees are substantive, we nonetheless decline to address Rosene's argument because it comes too late in the day. Rosene never raised this argument in the district court and only made the argument on appeal in its reply brief, constituting waiver on two grounds. *See Sac & Fox Nation v. Hanson,* 47 F.3d 1061, 1063 (10th Cir.1995) (issue raised for first time on appeal will not be reviewed except for most manifest error); *State Farm Fire & Cas. Co. v. Mhoon,* 31 F.3d 979, 984 n. 7 (10th Cir.1994) (failure to raise issue in opening brief constitutes waiver).

FN3. KMGA proffers *Gable & Gotwals Pension Plan & Trust v. Southwest Medical Center-Moore, Inc.* to support its claim that Oklahoma considers attorney's fees to be procedural for choice-of-law purposes. In *Gable,* the Oklahoma court of appeals held that attorney's fees are procedural for purposes of choice of law. *See* No. 84,241, slip op. at 4 (Okla.Ct.App. Apr. 26, 1996). Unfortunately, *Gable* is unpublished and Oklahoma does not permit unpublished opinions to be considered as precedential. *See* Okla. Stat. tit. 12, § 15, app. 1, Rule 1.200(b)(5) (West 1998) ("Because unpublished opinions are deemed to be without value as precedent and are not uniformly available to all parties, opinions so marked shall not be considered as precedent by any court or cited in any brief or other material presented to any court, except to support a claim of res judicata, collateral estoppel, or law of the case."). Furthermore, in making its decision, the *Gable* court relied upon the retroactivity cases discussed *infra* and made no effort to explain their applicability to choice-of-law considerations. *See id.*

FN4. KMGA argues that because the attorney's fee statute is located in the civil procedure portion of the Oklahoma statutes and not among the substantive provisions of the statutes, the Oklahoma legislature viewed § 936 as procedural and not substantive. This argument fails because Title 12 of the Oklahoma Statutes, which contains the fee statute in issue, also contains substantive-law provisions, such as Oklahoma's law on libel and slander, and its law pertaining to change of name. *See* Okla. Stat. tit. 12, §§ 1441-1449, 1631-1637 (West 1998).

Oklahoma courts have classified attorney's fees as procedural, but did so in the context of determining a statute's retroactive application. [FN5] *See, e.g., McCormack v. Town of Granite,* 913 P.2d 282, 285 (Okla.1996) ("[S]tatutes relating to the award of attorney fees to a prevailing party are procedural, and subject to retrospective operation."); *Qualls v. Farmers Ins. Co.,* 629 P.2d 1258, 1259 (Okla.1981)

(" 'Taxing of attorneys' fees as costs relates to a ***1120** mode of procedure.' " (quoting *Phoenix Fed. Sav. & Loan v. Great S.W. Fire Ins. Co.*, 603 P.2d 356, 358 (Okla.Ct.App.1979) (internal quotation omitted))); *Cox v. American Fidelity Assur. Co.*, 581 P.2d 1325, 1327 (Okla.Ct.App.1977) (same); *Jeffcoat v. Highway Contractors, Inc.*, 508 P.2d 1083, 1087 (Okla.Ct.App.1972) (holding that § 936 related only to the remedy or mode of procedure). KMGA argues that these cases resolve the issue here.

FN5. Although two cases concluded that attorney's fees are substantive for retroactivity purposes, the rulings were limited to the context of permanent-total-disability cases in which the award of attorney's fees was statutorily "dependent upon the award of compensation benefits itself, which is substantive." *Burr v. Snitker*, 865 P.2d 1258, 1259-60 (Okla.Ct.App.1993), *overruled on other grounds in Special Indem. Fund v. Weber*, 895 P.2d 292, 297-98 (Okla.1995); *see also Ailey v. D & B Constr. Co.*, 855 P.2d 147, 149 (Okla.Ct.App.1993), *similarly overruled by Weber*, 895 P.2d at 297-98. In these cases, the trial court's retroactive application of a new statute dictating periodic rather than lump-sum payment of attorney's fees resulted in a substantive change in the parties' vested rights to such fees. The issue here, in contrast, is entirely independent of an award of damages, rendering these cases inapplicable.

The characterization of an issue as procedural for retroactivity purposes cannot be so easily transplanted into a choice-of-law context. Recalling the admonition that the substantive/procedural dichotomy for *Erie* purposes is not the same for choice-of-law purposes, the *Restatement (Second) of Conflict of Laws* cautions generally that "[substantive/procedural] characterizations, while harmless in themselves, have led some courts into unthinking adherence to precedents that have classified a given issue as 'procedural' or 'substantive,' regardless of what purposes were involved in the earlier classifications." § 122 cmt. b. The *Restatement* then provides the example of a decision classifying an issue as procedural for retroactivity purposes which "might mistakenly be held controlling on the question whether [the issue] is 'procedural' for choice-of-law purposes." *Id.* The Supreme Court has iterated this principle: "The line between 'substance' and 'procedure' shifts as the legal context changes. 'Each implies different variables depending upon the particular problem for which it is used.' " *Hanna v. Plumer*, 380 U.S. 460, 471, 85 S.Ct. 1136, 14 L.Ed.2d 8 (1965) (quoting *Guaranty Trust*, 326 U.S. at 108, 65 S.Ct. 1464).

The purposes underlying the substantive/procedural dichotomies employed in retroactivity and choice-of-law cases are completely different. In the choice-of-law context, most matters are treated as substantive. Only in particular instances should a court consider a matter to be procedural. If a case "has foreign contacts and ... many issues in the case will be decided by reference to the local law of another state," a state should label an issue "procedural" and thus apply its own law only when to do so would serve the purpose of efficient judicial administration. *Restatement* § 122 cmt. a. The range of issues relating to efficient judicial administration is narrow and includes such items as "the proper form of action, service of process, pleading, rules of discovery, mode of trial and execution and costs." *Id; see generally id.* ch. 6. These are matters in which it would be especially disruptive or difficult for the forum to apply the local rules of another state, and in which failure to employ another state's law will not undermine interstate comity.[FN6] *See id.* § 122 cmt. a.

FN6. The *Restatement (Second) of Conflict Laws* notes that "[p]robably the most important function of choice-of-law rules is to make the interstate ... system[ ] work well. Choice-of-law rules, among other things, should seek to further harmonious relations between states and to facilitate commercial intercourse between them." *See id.* § 6 cmt. d.

[7][8] The general presumption in retroactivity determinations is that a statute will not apply retroactively unless the legislature has clearly expressed its intent that it apply retroactively. *See Landgraf v. USI Film Prods.*, 511 U.S. 244, 275, 114 S.Ct. 1483, 128 L.Ed.2d 229 (1994). If the legislature has made its intent clear, a court need not even consider whether the statute should be classified as substantive or procedural. *See id.* at 280, 114 S.Ct. 1483. Only if the legislature's intent is not clear should a court consider whether the statute is substantive or procedural. *See id.* at 275-80, 114 S.Ct. 1483. The question then becomes whether the retroactive operation of the statute would alter the parties' vested rights. If the parties' vested rights would be affected, then the statute is substantive and will not be applied retroactively. Otherwise, the statute is deemed to be procedural and may apply retroactively because parties generally have a diminished reliance interest in procedural***1121** matters. *See id.; see also id.* at 275 n. 29, 114 S.Ct. 1483 (noting some instances in which procedural rules will not be applied retroactively).

Thus, the considerations entertained by a court in classifying a particular matter as procedural or substantive are quite different depending upon whether the context is choice of law or retroactive application of a statute. Choice-of-law analysis concerns judicial efficiency, while retroactivity analysis primarily concerns legislative intent and only secondarily considers fairness with regard to party expectations.

While the divergent purposes of retroactivity and choice-of-law analyses render the Oklahoma retroactivity precedents inapposite in this case, this court acknowledges that both inquiries share a concern about disrupting the parties' expectations.[FN7] Nonetheless, the roles of party expectations in each inquiry are meaningfully different.

FN7. The *Restatement* offers four factors to consider in classifying an issue for choice-of-law purposes, one of which is whether the parties shaped their actions with reference to the local law of a certain state. *See Restatement* § 122 cmt. a. The parties' expectations, the *Restatement* notes, are "a weighty reason for applying [the law relied upon]." *Id.*

Because conflicts of law are inevitable in a federal system, parties to a contract are empowered to and frequently do choose a particular state's law to apply to the execution and interpretation of the contract. Absent special circumstances, courts usually honor the parties' choice of law because two "prime objectives" of contract law are "to protect the justified expectations of the parties and to make it possible for them to foretell with accuracy what will be their rights and liabilities under the contract." *Restatement* § 187 cmt. e;[FN8] *see also Williams v. Shearson Lehman Bros.*, 917 P.2d 998, 1002 (Okla.Ct.App.1995) (concluding that parties' contractual choice of law should be given effect because it does not violate Oklahoma's constitution or public policy); *Barnes Group, Inc. v. C & C Prods., Inc.*, 716 F.2d 1023, 1029 n. 10 (4th Cir.1983) ("[P]arties enjoy full autonomy to choose controlling law with regard to matters within their contractual capacity.").

FN8. Party expectation plays such a significant role in contract choice of law cases that even when the parties to a contract fail to make a choice-of-law, the test provided by the *Restatement* to assist the court in discerning which state's law ought to govern includes consideration of the parties' expectations. *See Restatement* § 188 cmt. b ("[T]he protection of the justified expectations of the parties is of considerable importance in contracts.").

[9] Consistent with the primacy of party expectations in determining contractual obligations, party choice of law is a significant consideration in de-

termining whether an attorney's fees statute is substantive or procedural for state choice-of-law purposes. *See, e.g., El Paso Natural Gas Co. v. Amoco Prod. Co.*, Civ. A. No. 12083, 1994 WL 728816, at *4-5 (Del.Ch. Dec. 16, 1994) (holding that attorney's fees are procedural for choice-of-law purposes, that issue of applicability of Texas attorney's fee statute was substantive because contract contained a Texas choice-of-law provision); *Atchison Casting Corp. v. Dofasco, Inc.*, No. 93-2447-jwl, 1995 WL 655183, at *8-9 (D.Kan.1995) (concluding that issue of entitlement to attorney's fees was substantive for choice-of-law purposes in part because parties' choice-of-law provision indicated that they relied upon law of another jurisdiction).

In contrast, the parties' expectations are not given the same elevated status in retroactivity cases. Only if legislative intent is unclear are the parties' expectations considered by the court. Because parties' expectations are not critical in retroactivity cases, they were not even considered in the Oklahoma cases holding that Oklahoma's attorney's fees statute may be applied retroactively. In contrast, when determining choice-of-law issues, Oklahoma courts prioritize party expectations. *See, e.g., Shearson Lehman*, 917 P.2d at 1002; *cf. Bakhsh v. JACRRC Enters.*, 895 P.2d 746, 747 (Okla.Ct.App.1995) (holding, in ***1122** choice-of-forum case, that "[p]arties to a contract may choose the jurisdiction in which all actions arising from their transaction shall be heard").

Finally, this court is not convinced that what counts as procedural for choice-of-law purposes is the same as what counts as procedural for retroactivity purposes. For support we look to the *Restatement*, to which Oklahoma courts routinely refer on issues relating to choice of law. *See, e.g., Beard v. Viene*, 826 P.2d 990, 994-98 (Okla.1992); *Bohannan v. Allstate Ins. Co.*, 820 P.2d 787, 795-96 (Okla.1991) ; *Shearson Lehman*, 917 P.2d at 1002. Chapter six of the *Restatement* is dedicated to the general rule that a forum should apply its own local rules "prescribing how litigation shall be conducted even when it applies the local law rules of another state to resolve other issues in the case." § 122. Oklahoma follows this general rule. *See Veiser*, 688 P.2d at 799 n. 6. Though not purporting to be exhaustive, chapter six of the *Restatement* surveys the matters normally considered procedural for choice-of-law purposes.[FN9] The section "Rules for Management of Litigation" appears to be where a loser-pays attorney's fees provision would be listed, if at all. *See id.* §§ 123-36. The procedural issues listed, however, clearly relate to vehicles by which litigation proceeds, such as service of process and notice, pleading and conduct of proceedings, burden of proof, pleading requirements for set-off or counterclaim, and enforcement of judgment, to name a few. *See id.* §§ 126, 127, 128, 131, 133. Although Oklahoma has not comprehensively addressed which matters it considers procedural for choice-of-law purposes, a few Oklahoma courts have concluded that certain issues, similar to those listed by the *Restatement*, are procedural for choice-of-law purposes. *See, e.g., Flanders v. Crane Co.*, 693 P.2d 602, 605 (Okla.1984) (summary judgment standards); *Veiser*, 688 P.2d at 799 & n. 6 (procedure to collaterally attack judgment); *Stephens v. Household Fin. Corp.*, 566 P.2d 1163, 1165 (Okla.1977) (set off, counterclaim, and recoupment).

FN9. The *Restatement* does not similarly survey substantive matters.

This court is unable to discern any relationship between a loser-pays attorney's fees provision and the *Restatement* 's classification of procedural issues for choice-of-law purposes.[FN10] Moreover, KMGA fails to explain why Oklahoma's retroactivity cases compel this court to conclude that attorney's fees are also procedural in a choice-of-law context. Consequently, the retroactivity cases are not controlling in the determination of the status of attorney's fees for choice-of-law purposes. *See also Dofasco*, 1995 WL 655183, at *7 (noting *Restatement* 's caution and rejecting contention that cases holding attorney's fees procedural in retroactivity context control in choice-of-law context (citing *Restatement (Second) of Conflict of Laws* § 122 cmt. b)).

FN10. *Restatement* § 130, "Methods of Securing Obedience to Court," might include attorney's fees awarded to sanction bad-faith conduct, but not loser-pays attorney's fees. The difference between these two types of attorney's fees is discussed *infra.*

Taking a different approach, KMGA cites to two cases to support its argument that "under Oklahoma law, the law of the forum governs the mode of procedure and remedy in breach of contract cases, regardless of the law applicable to the substantive contract issues." In *Clark v. First National Bank of Marseilles, Illinois,* the Oklahoma Supreme Court stated:

The law of the state where the contract is entered into determines matters bearing upon its execution, interpretation, and validity, but the law of the state where the contract is sought to be enforced determines the remedy and mode of procedure in enforcing the same.

157 P. 96, 96 para. 3 (Okla.1916) (syllabus by the court); *see also Aetna Cas. & Sur. Co. of Hartford, Conn. v. Gentry,* 132 P.2d 326, 326 para. 2 (Okla.1942) (similar).

***1123** *Clark* and *Aetna,* however, do not address the issue here. In *Clark,* the issue before the Oklahoma Supreme Court was whether a lender who had seized the debtor's chattel in Kansas had been entitled to avail itself of Kansas-law procedures for seizing and selling mortgaged chattels. *See id.* at 97-98. After the seizure and sale in Kansas, the lender had sued the debtor on the promissory note in Oklahoma court. *See id.* at 97. That court had refused the debtor's request to assess against the lender a penalty prescribed by Illinois law for a mortgagee who fails to strictly follow the Illinois statute's procedural requirements for chattel-mortgage foreclosures. *See id.* Rejecting the debtor's argument that Illinois law, not Kansas law, governed the remedy available to a lender because the mortgage had been created and largely performed in Illinois, the court on appeal stated that:

[T]he laws of Illinois ... could have no applicability in the state of Kansas where [lender] sought to enforce his chattel mortgage, and that the [lender] having followed the *remedy prescribed by the laws of Kansas* ... the [debtor] cannot be heard to complain.

157 P. at 99 (emphasis added). *Clark* did not purport to apply Oklahoma choice-of-law rules and the language quoted by KMGA provides no insight as to how the Oklahoma Supreme Court would decide the issue here.

Although *Aetna* did involve a choice of law issue, it is of no assistance to KMGA's position. The issue in *Aetna* was whether Kansas or Oklahoma law applied, the former creating a direct cause of action by victims against a tortfeasor's insurer and the latter rejecting direct insurer liability. 191 Okla. 659, 132 P.2d 326, 330-31 (Okla.1942). The contract at issue was made in Kansas, pursuant to Kansas law. *See id.* at 331. Despite the defendant's argument that the cause of action brought in Oklahoma "constitute [d] merely a procedural or remedial right under the law of [Kansas], and as such is not recognizable or enforceable under the law of Oklahoma, ... where such a right does not exist," the court concluded that "[t]he nature of the liability on the contract ... is governed by the law of the state where it was made." *Id.* Plainly the court concluded that the issue was substantive and thus is consistent with Oklahoma choice-of-law principles providing that the law of the state with the most significant relationship to the transaction and the parties governs the contract. *See, e.g., Shearson Lehman,* 917 P.2d at 1002 (citing to *Restatement* § 188, law governing in absence of effective choice by parties). Moreover, KMGA does not argue and we cannot find anything in *Aetna* to suggest that attorney's fees would also be considered procedural by the

Oklahoma Supreme Court.

Despite the parties' arguments to the contrary, Oklahoma law provides no guidance for the classification of attorney's fees for choice-of-law purposes.

1. Tenth Circuit Cases

Rosene cites to two Tenth Circuit cases to support its assertion that attorney's fees are substantive. In *Hess Oil Virgin Islands Corp. v. UOP, Inc.*, this court stated:

We are convinced that the district court correctly looked to the Oklahoma conflict of laws rule to determine whether Oklahoma would apply its own statute on attorney's fees or that of the Virgin Islands where the substantive claim arose.... We also agree with the trial court's view that Oklahoma would apply the law of the Virgin Islands since the right of recovery of the attorney's fee is intertwined with that of the substantive right.

861 F.2d 1197, 1210 (10th Cir.1988) (citations omitted). Although a federal court and not an Oklahoma state court applied Oklahoma choice-of-law principles, *Hess* is the only case that discusses the issue here. As precedent, however, *Hess* is so problematic it does not aid this court's decision. First, *Hess* was decided before *Salve Regina College v. Russell,* in which the Supreme Court rejected the prevailing clear-error standard of review of district courts' ***1124** determinations of state law and required instead that courts of appeals review such determinations *de novo.* 499 U.S. 225, 231, 111 S.Ct. 1217, 113 L.Ed.2d 190 (1991). More significantly, however, it is doubtful that *Hess* remains viable after *Rosene II. See Rosene II,* 123 F.3d at 1353.

Other Tenth Circuit cases also hold that attorney's fees are substantive, but they do not purport to engage in a choice-of-law analysis for Oklahoma. In *Prudential Insurance Co. of America v. Carlson,* this court stated that "[s]tatutes providing for attorneys' fees impose a liability which one may enforce as a matter of right. Such fees are put in controversy in the suit and are a part of the substantive right." 126 F.2d 607, 611 (10th Cir.1942). *Prudential,* however, employed the reasoning rejected by *Rosene II:* "Since the substantive rights of the parties are governed by the *lex loci,* it follows that the law of [the state where the contract was made] ... governs the right to recover attorneys' fees." *Id.; see also R.L. Clark Drilling Contractors v. Schramm, Inc.,* 835 F.2d 1306, 1309 (10th Cir.1987) (citing *Prudential*).

KMGA points to *A.T. Clayton & Co. v. Missouri-Kansas-Texas Railroad Co.* to support its claim that the Tenth Circuit has "effectively recognized the procedural nature of Oklahoma's attorney fee statutes." 901 F.2d 833 (10th Cir.1990). In *Clayton* the issue was whether an Oklahoma attorney's fee statute was preempted by a federal statute, the Carmack Amendment, previously determined to preempt state common-law remedies. *See id.* at 834-35. The *Clayton* court relied upon a Supreme Court decision concluding that a Texas attorney's fee statute was not preempted by the Carmack Amendment because the Texas statute did not contradict or burden the Carmack Amendment. *See id.* (quoting *Missouri, Kansas & Texas Ry. Co. v. Harris,* 234 U.S. 412, 419-21, 34 S.Ct. 790, 58 L.Ed. 1377 (1914)). The *Clayton* court concluded that, similar to the Texas statute, the Oklahoma statute "simply provides an incidental compensatory allowance for the expense of employing an attorney" and does not "substantively enlarge the responsibility of the carrier." *See id.* at 835 (construing Okla. Stat. tit. 12, § 940 A (1981)). KMGA argues that the *Clayton* court's willingness to apply the Oklahoma attorney's fee statute even when the case was substantively governed by the law of another jurisdiction indicated the court's view that the statute was procedural.

Clayton, however, is completely devoid of state choice-of-law analysis, and the court's conclusion that an Oklahoma attorney fee statute had a *de minimis* effect on a defendant's liability under the Carmack Amendment contributes nothing to the discussion here. Unlike choice-of-law principles which are a zero-sum game (either state A or state B's law will be applied), preemption law permits the concurrent application of state and federal law if the state law is not inconsistent with the federal law. *See Gade v. National Solid Wastes Management Ass'n.,* 505 U.S. 88, 98-99, 112 S.Ct. 2374, 120 L.Ed.2d 73 (1992) (discussing conflict preemption). Moreover, because federal procedural law is applicable in federal courts, the procedural or substantive nature of Oklahoma's attorney's fee statute was irrelevant. *See Hanna,* 380 U.S. at 465, 85 S.Ct. 1136.

2. Other Jurisdictions

KMGA cites the Wyoming Supreme Court decision *Smithco Engineering, Inc. v. International Fabricators, Inc.* for the proposition that § 936, the Oklahoma attorney's fee statute at issue here, is procedural. 775 P.2d 1011, 1017-1019 (Wyo.1989). The issue in *Smithco* was whether, by virtue of contract situs, the party who sued in Wyoming could nonetheless "[utilize] the Oklahoma attorneys' fees ... statute" in Wyoming. *Id.* at 1017. The Wyoming Supreme Court reiterated the proposition that matters of procedure are governed by the law of the forum, even if the applicable substantive law is from another jurisdiction. *See id.* at 1018; *see* ***1125** *also* 16 Am.Jur.2d *Conflict of Laws* § 151 nn.35 & 37 (1998) (citing *Smithco,* among other cases, for this proposition); *accord Veiser,* 688 P.2d at 800 n. 6 ("In a conflict-of-law analysis matters of procedure are governed by the law of the forum."). The court proceeded to hold that attorney's fees are procedural in Wyoming. *See id.* at 1018. KMGA relies upon dicta in which the court stated that "[w]e are buttressed in our view [that attorney's fees are procedural] by the fact that Oklahoma recognizes that the assessment of attorney's fees as costs under ... § 936 ... is procedural." *Id.*

[10] *Smithco* is not helpful because the Wyoming Supreme Court expressly engaged in an analysis of Wyoming, not Oklahoma, choice of law. *See id.* at 1017-18. Additionally, although a state is free to consult the choice-of-law determinations of another state in deciding whether its own statute is substantive or procedural, state courts are not compelled to do so. *Cf. Nesladek v. Ford Motor Co.,* 46 F.3d 734, 737 (8th Cir.1995). Rather, the forum's law controls the substantive/procedural determination, and KMGA provides no support for the proposition that Oklahoma has found Wyoming choice-of-law analysis compelling enough to adopt it. *See Klaxon,* 313 U.S. at 496 (requiring federal court sitting in diversity to apply conflict-of-law rules of state in which court sits). For these reasons, *Smithco* is no more compelling than *Dofasco,* which held that under Kansas choice-of-law principles, attorney's fees are substantive. *See Dofasco,* 1995 WL 655183, at *9. Moreover, the Oklahoma cases upon which *Smithco* relies are the retroactivity cases already discussed and rejected as insufficiently analogous for choice-of-law purposes. *See discussion supra,* at 1119-22.

Finally, KMGA cites *City of Carter Lake v. Aetna Casualty & Surety Co.,* 604 F.2d 1052 (8th Cir.1979). In *Carter,* the court considered whether the attorney's fee statute in the forum state, Nebraska, was substantive or procedural. *See id.* at 1062. The Eighth Circuit had only to look to the Nebraska Supreme Court, which had addressed the issue and held that the attorney's fee statute in question was procedural. *See id.* (citing *Hawkeye Cas. Co. v. Stoker,* 154 Neb. 466, 48 N.W.2d 623, 634 (1951)). Had Oklahoma decided the issue before us, this decision would be as easy as that in *Carter. Carter* is also unpersuasive because, like *Smithco,* it does not purport to apply Oklahoma choice-of-law principles. Moreover, to the extent that KMGA cites to *Carter* for the appearance of uniformity among courts who have considered the issue here, this court notes that other courts have decided that their attorney's fee statutes are substantive, not procedural, indicating that this is by no means an obvious or settled issue. For example, an Oregon state court held that because attorney's fees must be pleaded and proved, "awarding them is a matter of substantive, rather than procedural, right." *Seattle First Nat'l Bank v. Schriber,* 51 Or.App. 441, 625 P.2d 1370, 1373 (Or.Ct.App.1981); *see also Aries v. Palmer Johnson, Inc.,* 153 Ariz. 250, 735 P.2d 1373, 1380 & n. 3 (Ariz.Ct.App.1987) (holding that Arizona law providing for award of attorney's fees was substantive, and citing cases from several other states); *Corrosion Rectifying Co. v. Freeport Sulphur Co.,* 197 F.Supp. 291, 292 (S.D.Tex.1961) ("Texas authorities and other cases clearly hold the issue of attorneys' fees to be one of substantive rights....").

C. § 936 Attorney's Fees Are Substantive

[11] The particular factual circumstances of this case lead this court to conclude that the Oklahoma Supreme Court would classify § 936 attorney's fees as substantive. This conclusion is compelled by the nature of the attorney's fees statute at issue and the nature of the underlying contractual dispute.

1. The distinction between loser-pays and bad-faith attorney's fees

This court recognizes a distinction, as do other courts and commentators, between ***1126** loser-pays attorney's fees, that is, attorney's fees awarded to a party simply because it prevailed, and attorney's fees assessed for a willful violation of a court order or against a losing party who acted in bad faith, vexatiously, wantonly, or for oppressive reasons [hereinafter "bad-faith attorney's fees"]. *See, e.g., Servicios Comerciales,* 145 F.3d at 480 n. 9 (noting that a rule awarding loser-pays attorney's fees "has a much better claim to being 'substantive' than a rule awarding attorney's fees only as a sanction for frivolous litigation").

Loser-pays attorney's fees are normally not within a court's inherent power. Instead, they reflect a conscious policy choice by a legislature to depart from the American rule and codify the English rule. *See* 20 Am.Jur.2d *Costs* § 57 (1995) ("Fees paid to attorneys are ordinarily not recoverable from the opposing party as costs, in the absence of express statutory or contractual authority."). The authority to award bad-faith attorney's fees, though frequently codified, is usually within a court's inherent powers, which it has discretion to exercise in the interests of justice and efficient judicial administration. For example, the Oklahoma Supreme Court noted that a court's inherent power to make "an award of attorney's fees against an opponent under the 'bad faith' exception to the American Rule" was based upon its need "to manage its own affairs so as to achieve the orderly and timely disposition of cases." *Winters v. City of Oklahoma City,* 740 P.2d 724, 725 (Okla.1987) (discussing *Roadway Express, Inc. v. Piper,* 447 U.S. 752, 764-65, 100 S.Ct. 2455, 65 L.Ed.2d 488 (1980)); *see also Pennsylvania v. Delaware Valley Citizens' Council for Clean Air,* 478 U.S. 546, 562 n. 6, 106 S.Ct. 3088, 92 L.Ed.2d 439 (1986).

The attorney's fees provided by § 936 are not assessed for bad-faith litigation; they are instead simply granted to the prevailing party. While courts award bad-faith attorney's fees for reasons related to judicial administration, § 936 attorney's fees do not seem to fit the same rubric. *See Servicios Comerciales,* 145 F.3d at 481 n. 9.

2. Contractual Choice of Law

Because parties are empowered to make contractual choice-of-law provisions, their expectations about the applicability of those choice-of-law provisions are a significant factor in the determination of whether an issue is substantive or procedural for choice-of-law purposes. In determining whether an issue is substantive or procedural, the *Restatement* considers whether the parties shaped their actions with reference to the local law of a certain jurisdiction.[FN11] *See Restatement* § 122 cmt. a; *see also Dofasco,* 1995 WL 655183, at *8-9 (applying *Restatement* factors and concluding that attorney's fees are substantive for Kansas choice-of-law purposes).

FN11. The *Restatement* also considers whether: (1) the issue is one whose resolution would be likely to affect the ultimate result of the case; (2) the precedents have tended consistently to classify the issue as procedural or substantive for conflict-of-laws purposes; and (3) applying another jurisdiction's rules of judicial administration would unduly burden the forum. *See id.* § 122, cmt. a. We note that these remaining factors leave the decision in this case in equipoise. The attorney's fees issue will not affect the ultimate disposition of this case, which weighs in favor of KMGA. On the other hand, applying the Kansas law of attorney's fees would not unduly burden the court, which weighs in favor of Rosene. Finally, as already noted, there is no consistent classification of attorney's fees to be found in either Oklahoma or Tenth Circuit law.

In accord with the *Restatement,* a few courts have concluded that party reliance on contractual choice-of-law provisions compels a conclusion that attorney's fees are substantive. Even though the Supreme Court of Delaware had held that attorney's fees are "a procedural matter governed by the law of the forum," *Chester v. Assiniboia Corp.,* 355 A.2d 880, 882 (Del.1976), the Delaware Court of Chancery concluded that the parties' contractual choice of law created a substantive claim ***1127** of right to attorney's fees under Texas law. *See El Paso,* 1994 WL 728816, at *5. The facts of *El Paso* are quite similar to this case. In a breach-of-contract suit between Amoco and El Paso, the contract in question did not address attorney's fees but did contain a general choice-of-law provision designating Texas law as controlling. *See id.* Texas permits the recovery of attorney's fees and Delaware does not. *See id.* at *4. Amoco, the prevailing party, argued that because of the contractual choice-of-law provision, Texas law should govern and hence it should recover attorney's fees; El Paso argued that because Delaware considers attorney's fees to be procedural, the law of the forum should apply. *See id.*

The court stated that the core analysis should be "whether the issue is one that constitutes or is vitally bound up with the adjudication of the asserted substantive right." *Id.* The court noted, however, that certain attorney's fees statutes, for example, those which award attorney's fees as a result of bad-faith litigation, do not involve a substantive right. *See id.* Thus, the court reasoned, the application of the law of the forum in those instances would not be perceived as failing to afford full faith and credit to sister states, or as disappointing the reasonable expectations of either party. *See id.* Not confronted with this type of attorney's fee, the court found compelling the contractual provision that Texas law governed. *See id.* at *5. Even though the contract did not specifically address attorney's fees, the parties had nevertheless made the victor's entitlement to fees a "substantive contractual right by reason of designating as governing the law of ... Texas." *Id.*

The *El Paso* court is not alone. In *Dofasco* the Kansas federal district court concluded that attorney's fees were substantive in part because the contract, although silent as to attorney's fees, provided for Canadian law to control, tending to show that the parties had shaped their conduct in light of Canadian law. *See Dofasco,* 1995 WL 655183, at *8-9. *Cf. Bensen v. American Ultramar Ltd.,* No. 92 CIV. 4220, 1997 WL 317343, at *15 (S.D.N.Y. June 12, 1997) (despite conclusion that attorney's fees were procedural under New York choice of law, stating that even if law of foreign jurisdiction applied, "it would be unjust to compel plaintiff to absorb defendants' sizable legal bill when he was not aware of the possibility and did not have the opportunity to conduct the litigation accordingly").[FN12]

FN12. Without suggesting that the conclusion would have been different, this court notes that in *Du-Wel Products, Inc. v. United States Fire Insurance Co.,* perhaps the most cogent state court decision concluding that attorney's fees are procedural for choice-of-law purposes, the contract at issue did not contain a choice-of-law provision. *See* 236 N.J.Super. 349, 565 A.2d 1113, 1120 (N.J.Super.Ct.App.Div.1989).

In this case, the parties expressed in their choice-of-law provision that Kansas law would govern their agreement. They said nothing, however, about the allocation of attorney's fees. While Kansas law does not statutorily permit recovery of attorney's fees, it does not prohibit the parties from contracting to shift or allocate attorney's fees. *See* Kan. Stat. Ann. § 84-2-710, cmt. 1 (1997) ("Seller's incidental damages: Attorney's fees incurred in bringing the breach of contract action, however, are not recoverable as incidental damages under this section."); *see also T.S.I. Holdings, Inc. v. Jenkins,* 260 Kan. 703, 924 P.2d 1239, 1254 (Kan.1996). The parties' failure to provide for attorney's fees, in the face of their adoption of Kansas law, indicates their expectation that each party would bear its own costs. Moreover, the contract was created in 1994 when *Bill's Coal,* decided in 1989, was the law. Thus, if the parties contracted with an eye toward the applicable law, their expectation would have been that Kansas law would govern the recovery of attorney's fees. This court therefore concludes that, consistent with the parties' expectations, Oklahoma choice-of-law principles would apply Kansas law which does not allow recovery ***1128** of attorney's fees absent a contractual provision to the contrary.

This decision is fully in accord with *Rosene II. Rosene II* states that "rather than *automatically* applying the law of the state providing the substantive contract law, a district court must first apply the forum state's choice-of-law rules." 123 F.3d at 1353 (emphasis added). *Rosene II* thus prescribes a process by which a court must abide in determining a choice-of-law issue; it does not prescribe a result. A court is not permitted to slavishly adhere to the law of the state providing the substantive law. Neither, however, is a court prohibited from weighing heavily the expectations of the contracting parties when, as here, such parties' reliance is a consideration in the forum state's choice-of-law principles.

D. Attorney's fees as costs

[12] Because it seems incontrovertible that costs are procedural,[FN13] the question remains whether it matters that § 936 provides attorney's fees "be taxed and collected as costs." Okla. Stat. tit. 12, § 936.

FN13. *Restatement* § 122 states that "[a] court usually applies its own local rules prescribing how litigation shall be conducted even when it applies the local law rules of another state to resolve other issues in the case." Comment *a* explains that issues of judicial administration include "the proper form of action, service of process, pleading, rules of discovery, mode of trial and execution and *costs.* " *Id.* cmt. a. (emphasis added).

[13] Under Oklahoma law, attorney's fees are not synonymous with costs. *See Sisk v. Sanditen Inv., Ltd.,* 662 P.2d 317, 320 (Okla.Ct.App.1983) ("The usage of the word 'costs' in a statute providing for the award thereof is not ordinarily understood to include attorney fees."). Instead, attorney's fees awards are only permitted under statutes specifically providing for recovery of attorney's fees. *See Harlow Corp. v. Bryant Exploration & Prod. Co.,* 816 P.2d 1154, 1155 (Okla.Ct.App.1991) (holding that statute authorizing award of "costs" did not authorize trial court to award attorney's fees to prevailing party). Although costs must also be allowed by statute, Oklahoma provides for their universal award to successful plaintiffs and defendants as a matter of course. *See* Okla. Stat. tit. 12, § 928 ("Where it is not otherwise provided by this and other statutes, costs shall be allowed of course to the plaintiff, upon a judgment in his favor, in actions for the recovery of money only, or for the recovery of specific, real or personal property."); *id.* § 929 (similar, defendants). That attorney's fees are

taxed as costs is a matter of form, not substance, and does not render attorney's fees procedural for choice-of-law purposes.

V. Conclusion

This court concludes that § 936 attorney's fees are a substantive issue in the litigation arising from the contract between Rosene and KMGA. Accordingly, Oklahoma choice-of-law principles would compel the application of Kansas law to this issue. The judgment of the federal court in the Northern District of Oklahoma awarding attorney's fees to KMGA and Winfield is **REVERSED** and this case is **REMANDED** to the district court for entry of judgment consistent with this opinion.

C.A.10 (Okla.),1999.
Boyd Rosene and Associates, Inc. v. Kansas Mun. Gas Agency
174 F.3d 1115, 1999 CJ C.A.R. 2280

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C

United States District Court,
D. Delaware.
CALLAWAY GOLF COMPANY, Plaintiff/Defendant-in-Counterclaim,
v.
DUNLOP SLAZENGER GROUP AMERICAS, INC., d/b/a Maxfli, Defendant/Plaintiff-in-Counterclaim.
No. CIV.A.01-669-KAJ.

Dec. 1, 2003.

Background: Owner of patent for golf ball sued competitor for false advertising. Competitor counterclaimed for trade secret misappropriation. Competitor moved to amend counterclaim, and owner moved to dismiss counterclaim.

Holdings: The District Court, Jordan, J., held that:
(1) amendment of counterclaim would not unfairly prejudice owner, and
(2) common law counterclaims, even if preempted by California's Uniform Trade Secrets Act (CUTSA), could be pled in the alternative.

Motion granted in part and denied in part.

West Headnotes

[1] Federal Civil Procedure 170A ⚷840

170A Federal Civil Procedure
170AVII Pleadings and Motions
170AVII(E) Amendments
170Ak839 Complaint
170Ak840 k. Time for Amendment. Most Cited Cases

Federal Civil Procedure 170A ⚷841

170A Federal Civil Procedure
170AVII Pleadings and Motions
170AVII(E) Amendments
170Ak839 Complaint
170Ak841 k. New Cause of Action in General. Most Cited Cases

Trade secret misappropriation defendant would not be unfairly prejudiced by allowing claimant's untimely motion to add additional claim for negligent hiring, training or supervision; basis for new claim was not revealed until deposition held after stipulated deadline for amendments, and defendant was on notice of potential claim almost three months prior to discovery deadline. Fed.Rules Civ.Proc.Rules 15(a), 16(b), 28 U.S.C.A.

[2] Federal Courts 170B ⚷409.1

170B Federal Courts
170BVI State Laws as Rules of Decision
170BVI(C) Application to Particular Matters
170Bk409 Conflict of Laws
170Bk409.1 k. In General. Most Cited Cases

Conflict of laws rules to be applied by federal court sitting in diversity must conform to those prevailing in forum state courts.

[3] Action 13 ⚷17

13 Action
13II Nature and Form
13k17 k. What Law Governs. Most Cited Cases

Delaware state courts follow conflicts of law provisions in Restatement (Second) of Conflicts. Restatement (Second) of Conflicts § 1 et seq.

[4] Trover and Conversion 389 ⚷13

389 Trover and Conversion
389II Actions
389II(A) Right of Action and Defenses
389k13 k. Nature and Scope of Remedy in General. Most Cited Cases

Under Delaware conflict of laws rules, California law was applicable to conversion claim against company whose principal place of business was in

California; all alleged acts by company took place in California. Restatement (Second) of Conflicts § 145.

[5] Implied and Constructive Contracts 205H ⚷3

205H Implied and Constructive Contracts
205HI Nature and Grounds of Obligation
205HI(A) In General
205Hk2 Constructive or Quasi Contracts
205Hk3 k. Unjust Enrichment. Most Cited Cases

Under Delaware conflict of laws rules, California law was applicable to unjust enrichment claim against company whose principal place of business was in California; claim did not stem from any relationship between parties, and alleged benefit of enrichment was received in California. Restatement (Second) of Conflicts § 1 et seq.

[6] Statutes 361 ⚷206

361 Statutes
361VI Construction and Operation
361VI(A) General Rules of Construction
361k204 Statute as a Whole, and Intrinsic Aids to Construction
361k206 k. Giving Effect to Entire Statute. Most Cited Cases

All provisions of statute are intended to have meaning and are to be given effect.

[7] Statutes 361 ⚷206

361 Statutes
361VI Construction and Operation
361VI(A) General Rules of Construction
361k204 Statute as a Whole, and Intrinsic Aids to Construction
361k206 k. Giving Effect to Entire Statute. Most Cited Cases

When construing statute, interpretations that nullify statutory provisions or render them superfluous are, and should be, disfavored.

[8] Federal Civil Procedure 170A ⚷675.1

170A Federal Civil Procedure
170AVII Pleadings and Motions
170AVII(B) Complaint
170AVII(B)1 In General
170Ak675 Alternate, Hypothetical and Inconsistent Claims
170Ak675.1 k. In General. Most Cited Cases

Even if non-contractual common law claims involving alleged trade secret were preempted by California's Uniform Trade Secrets Act (CUTSA), claimant could plead such claims in the alternative, or as alternative recoveries, in event that information in question did not qualify as "trade secret." West's Ann.Cal.Civ.Code § 3426.7(b).

[9] Trover and Conversion 389 ⚷2

389 Trover and Conversion
389I Acts Constituting Conversion and Liability Therefor
389k2 k. Property Subject of Conversion. Most Cited Cases

Trover and Conversion 389 ⚷13

389 Trover and Conversion
389II Actions
389II(A) Right of Action and Defenses
389k13 k. Nature and Scope of Remedy in General. Most Cited Cases

Conversion of intangible property right embodied in physical documents is recognized tort in California.

[10] Federal Civil Procedure 170A ⚷1138

170A Federal Civil Procedure
170AVII Pleadings and Motions
170AVII(N) Striking Pleading or Matter Therein
170Ak1138 k. Redundant, Indirect or Prolix Matter. Most Cited Cases

Trade secret misappropriation claimant's alternative tort theories of recovery would not be stricken as redundant, even though they were based on same facts as misappropriation claim. Fed.Rules Civ.Proc.Rule 12(f), 28 U.S.C.A.

Patents 291 ⚷328(2)

291 Patents
291XIII Decisions on the Validity, Construction, and Infringement of Particular Patents
291k328 Patents Enumerated
291k328(2) k. Original Utility. Most Cited Cases
6,213,898. Cited.
***431** Jack B. Blumenfeld,Morris, Nichols, Arsht & Tunnell, Wilmington, DE, for Plaintiff.

David J. Ferry, Jr., Ferry, Joseph & Pearce, P.A., Wilmington, DE, for Defendant.

432 *MEMORANDUM ORDER

JORDAN, District Judge.

I. INTRODUCTION

This is a false advertising case brought by Callaway Golf Company ("Callaway") against Dunlop Slazenger Group Americas, Inc., d/b/a Maxfli ("Dunlop") under Section 43(a) of the Lanham Act, 15 U.S.C. § 1125(a). FN1 Currently before the Court is a motion by Dunlop for leave to amend its counterclaim (D.I.91), and Callaway's motion to dismiss, or, in the alternative, to strike certain counterclaims (D.I. 196; renewed D.I. 244). The court has jurisdiction under 28 U.S.C. §§ 1331 and 1338(a).

FN1. Callaway originally brought suit against Dunlop for patent infringement. (*See* D.I. 1.) However, the court approved a stipulation on November 12, 2003 whereby Callaway agreed to dismiss Count I of its Amended Complaint against Dunlop for patent infringement (*see* D.I. 45 at ¶¶ 6-10) in exchange for Dunlop's agreement to dismiss Counts VI and VII of its Amended Counterclaim (*see* D.I. 236 at ¶¶ 64-82). (D.I.287.) The only claim remaining in the complaint is for false and/or misleading advertising (Count II). (*Id.*)

II. BACKGROUND

On October 3, 2001, Callaway brought suit against Dunlop, alleging that certain Dunlop golf balls infringed Callaway's U.S. Patent No. 6,213,898 ("the '898 patent"). (D.I.1.) In its answer to Callaway's complaint, filed on October 15, 2001, Dunlop denied infringement and brought a counterclaim alleging misappropriation of Dunlop's trade secrets. (D.I.5.) It also asserted claims for declaratory relief. (*Id.*) On November 16, 2001, the Court entered a Scheduling Order that set January 30, 2002 as the deadline for amending or supplementing the pleadings. (D.I.15.) On that date, Dunlop filed a motion to amend its counterclaim to include an additional allegation that Callaway had engaged in inequitable conduct before the patent office. (D.I.41.) The parties also entered into a stipulation, which was approved on January 31, 2002, to extend the deadline to file motions for leave to amend until February 6, 2002. (D.I.40.) On February 6, 2002, Callaway filed a motion to amend its complaint to include an allegation against Dunlop for false advertising. (D.I.45.) The Court granted both Dunlop's and Callaway's motions to amend. (*See* D.I. 41, 45.)

Later, the parties joined in another stipulation whereby Dunlop's amended counterclaim was deemed to be withdrawn and Callaway's amended complaint was to be deemed the only one of the two amended pleadings filed. (D.I.60.) Pursuant to the court's approval of the stipulation, Dunlop was granted "leave to refile its amended counterclaims (and any motions relating thereto) as part of its Answer to Callaway's Amended Complaint" on or before March 5, 2002. FN2 (*Id.*) On March 5, 2002, rather than filing an answer to Callaway's amended complaint, FN3 Dunlop filed a motion for a more definite statement. FN4 (D.I.62.)

FN2. The stipulation was filed on March 4, 2002 and approved on March 5, 2002, the same day Dunlop's amended counterclaim was due. (D.I.60.)

FN3. Dunlop filed its amended answer and counterclaim on January 24, 2003. (D.I.236.)

FN4. Dunlop filed a motion to withdraw, without prejudice, its motion for a more definite statement on October 30, 2002. (D.I.216.)

III. DISCUSSION

A. *Dunlop's Motion for Leave to Amend its Counterclaim*

Dunlop brought this motion for leave to amend its counterclaim, on May 8, 2002, to include an allegation that Callaway was negligent in hiring, retaining and training and/or supervising former Dunlop employees. (D.I.91.) Callaway opposes Dunlop's motion because it claims that Dunlop, has ***433** failed to show "good cause" under Fed.R.Civ.P. 16(b) to modify the court's scheduling order. (D.I. 111 at 4-6.) Specifically, it asserts that "the court may modify the schedule on a showing of good cause if it cannot reasonably be met despite the diligence of the party seeking the extension." Rule 16 Advisory Comm. Notes (1983 Amend.). Callaway further argues that it would be unfairly prejudiced under Fed.R.Civ.P. 15(a) if Dunlop is granted leave to amend its counterclaim because it did not have time to take the discovery necessary to defend the claim prior to the close of the discovery period,[FN5] and it might need to obtain an expert witness, even though the time for expert reports has passed. (*Id.* at 6-7.) Finally, Callaway asserts that Dunlop's motion for leave to amend is preempted by California's Uniform Trade Secrets Act ("CUTSA"). (*Id.* at 8-10.)

FN5. The close of discovery was July 12, 2002. (*See* D.I. 111 at 6-7.)

In support of its motion to amend its counterclaim, Dunlop alleges that even though its new claim is based on the same nucleus of facts giving rise to its trade secret counterclaims, it was unaware of the basis for its negligence claim until a Callaway employee produced the relevant version of a Callaway "trade secret policy" at a March 6, 2002 deposition.[FN6] (D.I. 91 at ¶ 9; D.I. 144 at 14.) Dunlop disputes Callaway's claim that it will be prejudiced by Dunlop's amendment to the counterclaim because it states that it "put Callaway on notice" of the negligence claims almost three months prior to the July 12, 2002 discovery deadline.[FN7] (D.I. 91 at ¶ 10.) Finally, Dunlop contends that its motion to amend its counterclaim is not preempted by the CUTSA. (D.I. 144 at 4-13.)

FN6. Dunlop alleges that Callaway produced an April 2001 version of the document on February 13, 2002, but the basis of the negligence claim didn't become apparent until the November 1997 version was produced at the March 6, 2002 deposition. (D.I. 91 at ¶ 9; D.I. 144 at 14.)

FN7. Dunlop asserts that Callaway was notified of the new negligence claim on April 16, 2002 and responded, in a letter dated April 17, 2002 from Dunlop's counsel, that they had no objection to discovery into this matter. (D.I. 91 at ¶ 10, Ex. H.)

[1] Callaway's invocation of the court's Scheduling Order to preclude Dunlop from amending its counterclaim is unpersuasive. First, Dunlop alleges that it was unaware of the basis for its negligence claims until the deposition of a Callaway employee on March 6, 2002, the day after the stipulated deadline for amendments. (D.I. 91 at 9; D.I. 144 at 14). Given the Supreme Court's counsel to the "lower federal courts to heed the liberal policy of amendment embodied in Rule 15(a)" *CCPI, Inc. v. American Premier, Inc.*, 967 F.Supp. 813, 815 (D.Del.1997) (citing *Foman v. Davis*, 371 U.S. 178, 181-82, 83 S.Ct. 227, 9 L.Ed.2d 222 (1962)), Dunlop has demonstrated enough under Fed.R.Civ.P.

16(b) to permit modification of the Order. Second, the Order has already been modified at least twice for the mutual benefit of both parties. As both parties have been permitted to supplement or amend the pleadings, Callaway's attempt to use the Order exclusively for its own benefit does not bear scrutiny. Furthermore, I am not persuaded that Callaway, with more than two months of discovery remaining at the time Dunlop filed its motion for leave to amend, was unduly prejudiced by Dunlop's motion for leave to amend its counterclaim, regardless of the possible need to call an additional expert witness.

On the issue of preemption, Callaway argues that CUTSA [FN8] generally preempts ***434** common law torts based on trade secret misappropriation, and since Dunlop's proposed claim for negligent hiring, retaining, training, and supervising former Dunlop employees, which is a common law tort claim, is based on trade secret misappropriation, leave to amend would be futile because it is preempted by the CUTSA. (D.I. 111 at 8-10.) For reasons that will be discussed in the following section, I decline to hold that Dunlop's negligence claim is preempted.

FN8. Cal Civ.Code § 3426.7(b).

Accordingly, without making a judgment on the merits of the claims presented in the amended counterclaim, and in the absence of evidence of "undue delay, bad faith or dilatory motive on the part of [Dunlop], undue prejudice to [Callaway]" or "futility of amendment" as is required under the law to defeat a motion for leave to amend, Dunlop's motion for leave to amend its counterclaim is granted. *See Trueposition, Inc., & KSI, Inc. v. Allen Telecom, Inc.,* No. Civ. A. 01-823-GMS, 2002 WL 1558531 at *1 (D.Del. July 16, 2002) (holding that amendment was not precluded because there was no evidence of "undue delay, bad faith or dilatory motive" on the part of the movant, "undue prejudice" to the opposing party, or "futility of amendment").

B. *Callaway's Motion to Dismiss or Alternatively to Strike Counterclaims (D.I. 196; renewed D.I. 244)*

[2][3] Before addressing the merits of the parties' arguments, the court must determine which state's law to apply, as Dunlop's Counterclaim cites both California and South Carolina statutes as the basis for its trade secret claims. (D.I. 236 at ¶ 40.) "The conflict of laws rules to be applied by the federal court in Delaware must conform to those prevailing in Delaware's state courts." *Klaxon Co. v. Stentor Elec. Mfg. Co.,* 313 U.S. 487, 496, 61 S.Ct. 1020, 85 L.Ed. 1477 (1941). The Delaware state courts follow the conflicts of law provisions in the Restatement (Second) of Conflicts ("Restatement"). *See Travelers Indem. Co. v. Lake,* 594 A.2d 38, 47 (Del.1991).

[4] The counterclaim for conversion sounds in tort. According to the Restatement, "[t]he rights and liabilities of the parties with respect to an issue in tort are determined by the local law of the state which, with respect to that issue, has the most significant relationship to the occurrence." Restatement § 145. The factors that determine which state has the "most significant relationship to the occurrence" include (a) the place where the injury occurred, (b) the place where the conduct causing the injury occurred, (c) the location of the parties, and (d) the place where the relationship between the parties is centered. *Id.* Because the "principal location of the defendant's conduct [is] usually ... given the greatest weight in determining the state whose local law determines the rights and liabilities that arise from ... the misappropriation of trade values," and because all of the alleged acts by Callaway took place in California, the court will apply California law to Dunlop's conversion claim. *Id.* at comment f.

[5] The unjust enrichment counterclaim is a claim for restitution. The Restatement states that "[i]n actions for restitution, the rights and liabilities of the parties with respect to the particular issue are determined by the local law of the state which, with respect to that issue, has the most significant rela-

tionship to the occurrence and the parties." Restatement § 221. "Where the claim to restitution does not stem from any relationship between the parties," the factor that is usually of the greatest importance is "the place where the benefit of enrichment was received." *Id.* at comment d. Because the Dunlop's claim to restitution does not stem from any relationship between the parties ***435** and the alleged benefit of enrichment was received in California, Callaway's principal place of business, the court will apply California law to Dunlop's unjust enrichment claim.

Dunlop's patent title counterclaim is based on contract interpretation and neither party has argued that the law of any particular jurisdiction regarding contracts would substantively affect the outcome of the claim. Moreover, based on the standard discussed below, I find, at least at this stage, that Dunlop has made allegations sufficient to survive a motion to dismiss under Fed. R. Civ. P 12(b)(6).

1. Motion to Dismiss under Fed.R.Civ.P. 12(b)(6)

Callaway argues that Dunlop's counterclaims for patent title, conversion, and unjust enrichment should be dismissed under Fed.R.Civ.P. 12(b)(6) because they are preempted under CUTSA. (D.I. 197 at 7-16.) According to Callaway, Dunlop's claims are predicated on its allegation that Callaway misappropriated its trade secrets and, therefore, should be dismissed because CUTSA preempts common law causes of action that are based entirely on the same facts that form the basis of a statutory trade secret claim. FN9 (*Id.* at 10, 13-14.) Dunlop denies that CUTSA preempts its patent title, conversion and unjust enrichment claims. (D.I. 199 at 11.) In addition, Dunlop contends that it may plead in the alternative, or assert alternative recoveries, in the event that certain information does not qualify as a trade secret. (D.I. 199 at 9-11, 15.)

> FN9. Callaway points out that Dunlop provided the same four-page answer, "which was essentially a word for word copying of the factual allegations that [Dunlop's] Counterclaim identified as the basis for the trade secret 'count,' " to interrogatories seeking the factual basis for its patent title, conversion, and unjust enrichment claims. (*Id.* at 14.)

In analyzing a motion to dismiss pursuant to Fed.R.Civ.P. 12(b)(6), the court must accept as true all material allegations of the complaint and it must construe the complaint in favor of the plaintiff. *See Trump Hotels & Casino Resorts, Inc. v. Mirage Resorts, Inc.*, 140 F.3d 478, 483 (3d Cir.1998). "A complaint should be dismissed only if, after accepting as true all of the facts alleged in the complaint, and drawing all reasonable inferences in the plaintiff's favor, no relief could be granted under any set of facts consistent with the allegations of the complaint." *Id.* The moving party has the burden of persuasion. *See Kehr Packages, Inc. v. Fidelcor, Inc.*, 926 F.2d 1406, 1409 (3d Cir.1991).

The model Uniform Trade Secret Act ("UTSA") § 7(a) contains an express preemption provision that "displaces conflicting tort, restitutionary, and other law of this State providing civil remedies for misappropriation of a trade secret." When California adopted its version of UTSA, it omitted language in § 7(a). Paragraph (a) of § 7 of CUTSA instead reads: "Except as otherwise expressly provided, this title does not supersede any statute relating to misappropriation of a trade secret or any statute otherwise regulating trade secrets." Cal. Civ.Code § 3426.7(a). Paragraph (b) states that CUTSA "does not affect (1) contractual remedies, whether or not based upon misappropriation of a trade secret, (2) other civil remedies that are not based upon misappropriation of a trade secret, or (3) criminal remedies, whether or not based upon misappropriation of a trade secret." Cal. Civ.Code § 3426.7(b).

Although CUTSA does not contain an express preemption provision similar to the preemption provision found in model UTSA § 7(a), Callaway maintains that the California legislature intended to "secure the benefit of uniformity with other state [trade secret] statutes" because CUTSA expressly provides that it "shall be applied and construed to effectuate its general ***436** purpose to make uniform the law with respect to the subject of this title among states enacting it." [FN10] (D.I. 197 at 10-11.) Callaway also contends that paragraph (a)'s use of the word "statute," instead of "statute or common law," "law," or "cause of action," indicates that CUTSA preempts California common law torts based on trade secret misappropriation. (*Id.* at 11-12.) Furthermore, Callaway asserts that since paragraphs (a) and (b) should be interpreted in a manner that gives meaning to both paragraphs, the "only way to do this is to interpret paragraph (a) as stating that CUTSA does not preempt California statutory law, and paragraph (b) as stating that CUTSA does not preempt these enumerated categories of California common law." (*Id.* at 12.) Finally, Callaway argues that the "only conclusion" that can be drawn from the different language of the three sentences in paragraph (b) "is that CUTSA does preempt non-contractual common law civil remedies that are based on misappropriation of trade secrets." (*Id.* at 13.)

FN10. Cal. Civ.Code § 3426.8.

Dunlop argues that because California adopted a different subsection (a), which does not address express preemption of "conflicting tort, restitutionary, and other [state law]," California "knowingly adopted different language, with an intended difference," and therefore, Callaway's assertion that the CUTSA preempts its claims for patent title, unjust enrichment and conversion is legally wrong. (*Id.* at 18.)

[6][7] I am confronted here with territory largely untrodden by courts in California. Callaway readily admits that "no California state court has yet addressed the preemptive effect of the California UTSA." (D.I. 111 at 9.) *See Forcier v. Microsoft Corp.*, 123 F.Supp.2d 520, 528 n. 2 (N.D.Cal.2000) (declining to decide whether the California UTSA preempts civil remedies, other than contract remedies, that are based on misappropriation of a trade secret, in part, "because any such ruling would require the court to render an opinion on a subject that has not yet been addressed by any California state court"). However, in *Ernest Paper Products v. Mobil Chemical,* No. CV95-7918 LGB(AJWX), 1997 WL 33483520 at *8 (C.D.Cal. Dec. 2, 1997), the court stated that the preemptive holdings of several cases [FN11] from jurisdictions that have incorporated § 7(a) in their versions of UTSA may "properly be applied to § 3426.7(b)(2) [of CUTSA] in order to carry out the purposes of § 3426.8, 'to make uniform the law with respect to the subject of this title among states enacting it.' " The court also stated that the "California legislature did not omit § 7 entirely, but rather rewrote it, compatibly with preemptive intent." *Ernest Paper Prods.*, 1997 WL 33483520 at *9. [FN12]

FN11. *See Hutchison v. KFC Corp.*, 809 F.Supp. 68 (D.Nev.1992); *Coulter Corp. v. Leinert,* 869 F.Supp. 732, 734 (E.D.Mo.1994); *Venango River Corp. v. Nipsco Indus., Inc.*, No. 92 C 2412, 1994 WL 702759 at *8 (N.D.Ill. Dec. 15, 1994).

FN12. There are sound reasons to view the matter as the court did in *Ernest Paper.* If CUTSA § 3426.7(a) were interpreted to reject preemption as provided in model UTSA § 7(a), CUTSA § 3426.7(b) would be surplusage. Such an interpretation would also make meaningless the distinction made in the statute between contractual and criminal remedies, which are not affected "whether or not based upon misappropriation," and other civil remedies, which are not affected only if "not based on misappropriation." *See* CUTSA § 3426.7(b). Such a result would violate the canons of statutory construction that "all provisions of a statute are intended to have meaning and are to be given effect," *DeVries v. Acree,* 565 F.2d 577, 581 (9th Cir.1977) (*rev'd on other grounds*), and

> that "[i]nterpretations that nullify statutory provisions or render them superfluous are, and should be, disfavored." *Patagonia Corp. v. Board of Governors of Federal Reserve Sys.*, 517 F.2d 803, 813 (9th Cir.1975). Moreover, CUTSA expressly provides that it "shall be applied and construed to effectuate its general purpose to make uniform the law with respect to the subject of this title among states enacting it." Cal. Civ.Code. § 3426.8.

***437** [8] Dunlop argues, however, that even if its claims for patent title, conversion, and unjust enrichment are preempted by CUTSA, it may plead in the alternative, or assert alternative recoveries, in the event that certain information does not qualify as a "trade secret" under CUTSA.[FN13] (D.I. 199 at 9-11, 15.) Because I agree with that argument, I need not decide the matter of preemption, at least not at this point.

> FN13. Trade secret means:
>
> > [I]nformation, including a formula, pattern, compilation, program, device, method, technique, or process, that:
> >
> > (1) Derives independent economic value, actual or potential, from not being generally known to the public or to other persons who can obtain economic value from its disclosure or use; and
> >
> > (2) Is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.
> >
> > Cal. Civ.Code § 3426.1(d).

Although several courts have dismissed claims pled in the alternative based on the misappropriation of trade secrets,[FN14] the court in *Stone Castle Financial v. Friedman, Billings, Ramsey & Co.*, 191 F.Supp.2d 652, 658-659 (E.D.Va.2002) pointed out that "where courts have found preemption on a motion to dismiss, they repeatedly establish that the information in issue-as alleged-constitutes trade secrets before reaching the preemption question."[FN15] The court further explained that "unless it can be clearly discerned that the information in question constitutes a trade secret, the Court cannot dismiss alternative theories of relief as preempted by [Virginia's version of the uniform UTSA]." *Id.* at 659.

> FN14. *See, e.g., On- Line Techs. v. Perkin Elmer Corp.*, 141 F.Supp.2d 246, 260-61 (D.Conn.2001) (dismissing unjust enrichment claim pursuant to Connecticut Uniform Trade Secrets Act's preemption provision "because ... [the] claim does not allege any ill-gotten gains other than those resulting from the misuse of confidential information"); *Glasstech, Inc. v. TGL Tempering Sys., Inc.*, 50 F.Supp.2d 722, 730 (N.D.Ohio 1999) (finding common law claims for misuse and misappropriation of trade secrets preempted by Ohio's trade secrets act).

> FN15. *See, e.g., Combined Metals of Chicago Ltd. P'ship v. Airtek, Inc.*, 985 F.Supp. 827, 830 (N.D.Ill.1997) (holding breach of fiduciary duty claim not preempted where underlying information may not qualify as trade secrets).

Here, it has not been established that the information at issue may be classified as trade secrets. At this point, the status of the information is merely a matter of allegation. (*See* D.I. 236 at ¶ 40.) Indeed, Callaway disputes that the information constitutes protected trade secrets. (*See* D.I. 243 at ¶ 40.) Callaway's separate arguments that Dunlop's information does not constitute "trade secrets" and that Dunlop's "trade secret" allegations are preempted by CUTSA are contradictory. It cannot have it both ways. Therefore, until it is shown that the information is entitled to trade secret protection, it is premature to rule whether Dunlop's claims of conversion, unjust enrichment, patent title and negligence are preempted under CUTSA.

[9] Additionally, Callaway argues that Dunlop's conversion counterclaim should be dismissed under Fed.R.Civ.P. 12(b)(6) because Dunlop has alleged wrongful conversion of intellectual property rights, which are intangible, and only tangible property rights can be converted. (D.I. 197 at 16-18.) Conversion of intangible property, however, is a recognized tort in California. *See* ***438***A & M Records, Inc. v. Heilman,* 75 Cal.App.3d 554, 570, 142 Cal.Rptr. 390 (Cal.Ct.App.1977) (affirming that the "misappropriation and sale of the intangible property of another without authority from the owner is conversion"); *Swim v. Wilson,* 90 Cal. 126, 27 P. 33 (Cal.1891) (recognizing a conversion action for stolen stock, an intangible property); *Rotstein v. Cable & Wireless,* Inc., No. G027549, 2002 WL 691458 at *5 (Cal.App.2002) (non-precedential opinion) (stating that "courts [have] expanded the scope of conversion to include 'intangibles, represented by documents, such as bonds, notes, bills of exchange, and warehouse receipts' ").

Callaway further argues that the mere existence of an intangible property right under California law does not give rise to an action for conversion because intangible property cannot be converted "except where the intangible property is merged into a legally significant document." (D.I. 204 at 9-11.) In support of this proposition, Callaway cites *Miles, Inc. v. Scripps Clinic & Research Foundation,* 810 F.Supp. 1091 (S.D.Cal.1993) (concluding that an intangible property right in scientific discoveries from the plaintiff's cells was not subject to conversion), and *G.S. Rasmussen & Associates, Inc. v. Kalitta Flying Serv., Inc.,* 958 F.2d 896 (9th Cir.1992) (permitting a conversion action for the intangible property right represented by a Federal Aviation Administration Supplemental Type Certificate, which entitles the bearer or licensee to operate a modified aircraft). Callaway's arguments are unpersuasive. First, *Miles, Inc.* is inapposite to this case. That case dealt with a conversion claim for the right to commercialization of a cell line and the court determined plaintiff's claim was really a contract claim rather than a conversion claim. *Id.* at 1094-1098. Second, like *G.S. Rasmussen,* Dunlop's confidential and proprietary information is merged into or "embodied" in physical documents such as its manufacturing "specifications and process manual" and United States Patent No. 6,17,024. (D.I. 199 at 22.) Therefore, Dunlop has asserted a cause of action sufficient to withstand a motion to dismiss under Rule 12(b)(6).

2. Motion to Strike Under Fed.R.Civ.P. 12(f)

[10] Callaway also contends that the Court should strike Dunlop's counterclaims because they are "entirely redundant of [the] trade secret counterclaim and redundant of each other." (D.I. 197 at 14.) Pursuant to Fed.R.Civ.P. 12(f), a "court may order stricken from any pleading any insufficient defense or any redundant, immaterial, impertinent, or scandalous matter." Even though Dunlop's claims for conversion, unjust enrichment and patent title appear to be premised on the same factual basis as its trade secret claims, the Rule 12(f) prohibition on "redundant" pleadings "must be read in conjunction with the liberal pleading standards of Rule 8 in general and Rule 8(e)(2) in particular." *Gov't Guarantee Fund v. Hyatt Corp.,* 166 F.R.D. 321, 324 (D.Vi.1996). Under Rule 8(e)(2), plaintiffs may plead alternative theories of relief based on the same set of facts. *See S.A. Nutrasource, Inc. v. CNA Ins. Co.,* 140 F.Supp.2d 1049, 1056 (N.D.Cal.2001). Moreover, "[m]otions to strike under Rule 12(f) are not favored by the courts and they are infrequently granted. Any doubt as to the striking of matter in a pleading should be resolved in favor of leaving the pleading unstricken." *In re O.P.M. Leasing Svcs., Inc.,* 35 B.R. 854, 863-864 (Bkrtcy.S.D.N.Y.1983) *(rev'd on other grounds).* Callaway's motion to strike will therefore be denied.

CONCLUSION

Accordingly, IT IS HEREBY ORDERED that Callaway's motion to dismiss, or, in the alternative, to strike certain***439** counterclaims (D.I. 196; renewed D.I. 244) is DENIED, and Dunlop's motion for leave to amend its counterclaim (D.I.91) is GRANTED.

D.Del.,2003.
Callaway Golf Co. v. Dunlop Slazenger Group Americas, Inc.
295 F.Supp.2d 430

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Colorado Court of Appeals,
Div. III.

COLORADO SUPPLY COMPANY, INC., a Colorado corporation, Plaintiff-Appellant,
v.
David STEWART, and Aspen Maintenance Supply, Inc., a Colorado corporation, Defendants-Appellees.
No. 89CA0989.

Aug. 30, 1990.
Rehearing Denied Feb. 28, 1991.
Ceriorari pending March 18, 1991 (91SC171).

After sales representative who was independent contractor left product seller and began working for competitor, product seller brought action against independent contractor for breach of contract, misappropriation of trade secrets, and injunctive relief and against competitor for misappropriation of trade secrets and injunctive relief. The District Court, Jefferson County, James D. Zimmerman, J., dismissed product seller's claims and awarded attorney fees to competitor. Product seller appealed. The Court of Appeals, Dubofsky, J., held that: (1) statute rendering void covenant not to compete with enumerated exceptions applies to independent contractors, not only to employees; (2) evidence supported conclusions that product seller's customer lists, price lists, and product formulas were not "trade secrets" entitled to protection; but (3) competitor was not entitled to award of attorney fees on theory claim asserted against competitor for misappropriation of trade secrets was groundless.

Affirmed in part; reversed in part.

West Headnotes

[1] Contracts 95 116(1)

95 Contracts
95I Requisites and Validity
95I(F) Legality of Object and of Consideration
95k115 Restraint of Trade or Competition in Trade
95k116 In General
95k116(1) k. In General. Most Cited Cases
(Formerly 265k12(4))
Statute rendering void covenant not to compete with enumerated exceptions applies to independent contractors, not only to employees. C.R.S. 8-2-113 (2).

[2] Antitrust and Trade Regulation 29T 433

29T Antitrust and Trade Regulation
29TIV Trade Secrets and Proprietary Information
29TIV(B) Actions
29Tk433 k. Questions of Law or Fact. Most Cited Cases
(Formerly 382k1003 Trade Regulation, 379k28)
What constitutes trade secret is question of fact for trial court.

[3] Antitrust and Trade Regulation 29T 419

29T Antitrust and Trade Regulation
29TIV Trade Secrets and Proprietary Information
29TIV(A) In General
29Tk419 k. Vigilance in Protecting Secret; Abandonment or Waiver. Most Cited Cases
(Formerly 382k989 Trade Regulation, 379k10(5))
Alleged secret must be subject of efforts that are reasonable under the circumstances to maintain its secrecy to qualify for protection as "trade secret," but extreme and unduly expensive procedures need not be taken. C.R.S. 7-74-102(4).

[4] Antitrust and Trade Regulation 29T 432

29T Antitrust and Trade Regulation

29TIV Trade Secrets and Proprietary Information
29TIV(B) Actions
29Tk429 Evidence
29Tk432 k. Weight and Sufficiency of Evidence. Most Cited Cases
(Formerly 382k1002 Trade Regulation, 379k27)
Evidence supported conclusion that customer lists were not "trade secrets" entitled to protection; information on lists was developed by independent contractor, names on list could be obtained fairly easily, by reading through business section of telephone directory and asking prospective customers from whom they purchased certain products, no exclusivity existed as to customers, who purchased products from more than one vendor, and precautions taken to protect the information were not those taken to protect trade secrets, but were only normal business precautions. C.R.S. 7-74-102.

[5] Antitrust and Trade Regulation 29T ⚷432

29T Antitrust and Trade Regulation
29TIV Trade Secrets and Proprietary Information
29TIV(B) Actions
29Tk429 Evidence
29Tk432 k. Weight and Sufficiency of Evidence. Most Cited Cases
(Formerly 382k1002 Trade Regulation, 379k27)
Evidence supported conclusion that price lists were not "trade secrets" qualifying for protection; lists were published by seller to customers, employees, and independent contractors, no fixed prices existed for sale of products, no evidence was presented that independent contractor who allegedly misappropriated trade secrets knew costs of products, and precautions taken to protect the information were not those taken to protect trade secrets, but were only normal business precautions. C.R.S. 7-74-102.

[6] Antitrust and Trade Regulation 29T ⚷432

29T Antitrust and Trade Regulation
29TIV Trade Secrets and Proprietary Information
29TIV(B) Actions
29Tk429 Evidence
29Tk432 k. Weight and Sufficiency of Evidence. Most Cited Cases
(Formerly 382k1002 Trade Regulation, 379k27)
Evidence supported conclusion that product formulas were not "trade secrets" entitled to protection; formulas were not unique to product seller and were versions of formulas from products not created by or unique to seller, and precautions taken to protect the information were not those taken to protect trade secrets, but were only normal business precautions. C.R.S. 7-74-102.

[7] Costs 102 ⚷194.44

102 Costs
102VIII Attorney Fees
102k194.44 k. Bad Faith or Meritless Litigation. Most Cited Cases
Claim or defense is groundless, for purposes of awarding attorney fees, if allegations in complaint, while sufficient to survive motion to dismiss for failure to state a claim, are not supported by any credible evidence at trial. C.R.S. 13-17-102.

[8] Costs 102 ⚷194.44

102 Costs
102VIII Attorney Fees
102k194.44 k. Bad Faith or Meritless Litigation. Most Cited Cases
Losing position is not necessarily groundless, for purposes of award of attorney fees. C.R.S. 13-17-102.

[9] Appeal and Error 30 ⚷984(5)

30 Appeal and Error
30XVI Review
30XVI(H) Discretion of Lower Court
30k984 Costs and Allowances
30k984(5) k. Attorney Fees. Most Cited Cases

Costs 102 ⚷194.44

102 Costs
102VIII Attorney Fees
102k194.44 k. Bad Faith or Meritless Litigation. Most Cited Cases
Trial court's determination of whether claim or defense is groundless, so as to justify award of attorney fees, is discretionary and will not be disturbed on appeal if ruling is supported by the evidence. C.R.S. 13-17-102.

[10] Costs 102 ⚷194.44

102 Costs
102VIII Attorney Fees
102k194.44 k. Bad Faith or Meritless Litigation. Most Cited Cases
Although product seller was unsuccessful on claims for misappropriation of trade secrets and injunctive relief against former independent contractor who had worked as sales representative for product seller and competitor for whom independent contractor subsequently worked as sales representative, award of attorney fees to competitor was not justified on theory that claim against competitor for misappropriation of trade secrets was groundless; no Colorado cases construed Uniform Trade Secrets Act when the action was at issue in trial court, product seller introduced sufficient evidence to demonstrate that alleged trade secrets were valuable, and product seller introduced some evidence as to misappropriation of information. C.R.S. 7-74-101 et seq., 13-17-102.

[11] Costs 102 ⚷194.44

102 Costs
102VIII Attorney Fees
102k194.44 k. Bad Faith or Meritless Litigation. Most Cited Cases
Claims which involve novel questions of a law upon which there is no determinative authority in Colorado when complaint is filed cannot supply basis for awarding attorney fees on theory claim was groundless. C.R.S. 13-17-102.

[12] Costs 102 ⚷194.44

102 Costs
102VIII Attorney Fees
102k194.44 k. Bad Faith or Meritless Litigation. Most Cited Cases
Claim is not per se groundless, so as to warrant award of attorney fees, solely because plaintiff fails to establish prima facie case, if there is some credible evidence to support claim. C.R.S. 13-17-102.
***1304** Robert T. Bettenberg, Wheat Ridge, for plaintiff-appellant.

***1305** Poland & Wheeler, Scott Poland, Lakewood, for defendant-appellee David Stewart.

Oates, Hughes & Knezevich, P.C., John M. Ely, Aspen, for defendant-appellee Aspen Maintenance Supply, Inc.

Opinion by Judge DUBOFSKY.

Plaintiff, Colorado Supply, Inc., appeals the judgment dismissing plaintiff's claims for breach of contract, misappropriation of trade secrets, and injunctive relief against defendant David Stewart and claims for misappropriation of trade secrets and injunctive relief against defendant Aspen Maintenance Supply, Inc. Plaintiff also appeals the judgment granting attorney fees to Aspen. We affirm in part and reverse in part.

Prior to January 1988, Stewart worked as a sales representative for plaintiff pursuant to a series of written agreements. The parties stipulated that Stewart was an independent contractor, rather than an employee of plaintiff.

In January 1988, Stewart notified plaintiff that he would no longer be working for it. Stewart then began employment with Aspen, a competitor of plaintiff, as a sales representative. His sales territory partially overlapped the territory that he had previously worked for plaintiff.

I.

[1] Plaintiff first argues that the trial court erred in its determination that a covenant not to compete in Stewart's sales representative agreements with plaintiff was void. We disagree.

Section 8-2-113(2), C.R.S. (1986 Repl.Vol. 3B) provides:

> "Any covenant not to compete which restricts the right of any person to receive compensation for performance of skilled or unskilled labor for any employer shall be void, but this subsection (2) shall not apply to:
>
> "(a) Any contract for the purchase and sale of a business or the assets of a business;
>
> "(b) Any contract for the protection of trade secrets;
>
> "(c) Any contractual provision providing for recovery of the expense of educating and training an employee who has served an employer for a period of less than two years;
>
> "(d) Executive and management personnel and officers and employees who constitute professional staff to executive and management personnel."

The trial court concluded that none of the four enumerated exceptions applied here. Consequently, it held the noncompetition agreement to be void.

Plaintiff argues on appeal that, since Stewart was an independent contractor, the trial court erred in applying § 8-2-113(2) to his contracts. However, that statute does apply to independent contractors. *See Smith v. Sellers,* 747 P.2d 15 (Colo.App.1987). Accordingly, the trial court did not err in holding the non-competition covenants in his employment contracts to be void. *See Colorado Accounting Machines, Inc. v. Mergenthaler,* 44 Colo.App. 155, 609 P.2d 1125 (1980).

II.

Plaintiff next argues that the trial court erred in finding that plaintiff had no trade secrets entitled to protection pursuant to the Colorado Uniform Trade Secrets Act. We disagree.

Plaintiff alleges that under § 7-74-102(4), C.R.S. (1986 Repl.Vol. 3A), its customer lists, price lists, and product formulas qualify as trade secrets. It further alleges that Stewart and Aspen misappropriated these trade secrets.

Section 7-74-102(4) provides:

> " 'Trade secret' means the whole or any portion or phase of any scientific or technical information, design, process, procedure, *formula,* improvement, confidential business or financial information, *listing of names,* addresses, or telephone numbers, or other information relating to any business or profession which is *secret and of value.* To be a 'trade secret' the owner thereof must have taken measures***1306** to prevent the secret from becoming available to persons other than those selected by the owner to have access thereto for limited purposes." (emphasis added)

[2] What constitutes a trade secret is a question of fact for the trial court. *Network Telecommunications, Inc. v. Boor-Crepeau,* 790 P.2d 901 (Colo.App.1990).

Although an exact definition of a trade secret may not be possible, the following factors may be considered in the determination whether a trade secret exists:

> "1) the extent to which the information is known outside the business;
>
> "2) the extent to which it is known to those inside the business, *i.e.,* by the employees;
>
> "3) the precautions taken by the holder of the trade secret to guard the secrecy of the information;
>
> "4) the savings effected and the value to the hold-

er in having the information as against competitors;

"5) the amount of effort or money expended in obtaining and developing the information; and

"6) the amount of time and expense it would take for others to acquire and duplicate the information."

Network Telecommunications, supra.

[3] Furthermore, the alleged secret must be the subject of efforts that are reasonable under the circumstances to maintain its secrecy. Extreme and unduly expensive procedures need not be taken. Reasonable efforts have been held to include advising employees of the existence of a trade secret, limiting access to a trade secret on a "need to know basis," and controlling plant access. *Network Telecommunications, supra.*

[4] Here, the trial court concluded that plaintiff's customer lists were not trade secrets because: (1) the information was developed by Stewart, who was an independent contractor, rather than by plaintiff; (2) the names on the list can be obtained fairly easily, by reading through the business section of the telephone directory and by asking prospective customers from whom they purchase certain products; and (3) there was no exclusivity as to customers, in that customers purchased the products from more than one vendor.

[5] As to price lists, the trial court found that: (1) they were published by plaintiff to customers, employees, and independent contractors; (2) there are no fixed prices at which the products are sold; and (3) there was no evidence that Stewart knew plaintiff's costs of the products. Hence, it concluded the price lists were not trade secrets.

[6] The evidence demonstrated that the "formulas" were not unique to plaintiff and were versions of formulas from products not created by or unique to the plaintiff.

The trial court also found that the precautions taken to protect all of this information were not those taken to protect trade secrets-they were only normal business precautions. Furthermore, dissemination of this information was not limited to certain employees. Even independent contractors, who were hired as salespersons, were provided the information.

Finally, the trial court determined that there was no misappropriation because there was no improper acquisition of the information and because the sales representative agreements imposed no duty on Stewart regarding disclosure of the information. *See* § 7-74-102, C.R.S. (1986 Repl.Vol. 3A).

These findings are in accord with decisions from other jurisdictions. *See Jet Spray Cooler, Inc. v. Crampton,* 361 Mass. 835, 282 N.E.2d 921 (1972) (customer list held not to be a trade secret because no proper and reasonable steps were taken by the owner to protect the secrecy of the information); *Smith Oil Corp. v. Viking Chemical Co.,* 127 Ill.App.3d 423, 82 Ill.Dec. 250, 468 N.E.2d 797 (1984) (customer information was not a protectable trade secret, but rather general knowledge, where access to the information was not restricted, employees knew customers' names from general experience, and customers commonly dealt with more than one ***1307** supplier); *Hayden's Sport Center, Inc. v. Johnson,* 109 Ill.App.3d 1140, 65 Ill.Dec. 612, 441 N.E.2d 927 (1982) (customer list not a trade secret where information could be readily obtained from telephone books and other directories); *Catalogue Service of Westchester, Inc. v. Henry,* 107 A.D.2d 783, 484 N.Y.S.2d 615 (1985) (customer lists are not trade secrets where such customers are readily ascertainable from sources outside the former employer's business); *cf. Sigma Chemical Co. v. Harris,* 794 F.2d 371 (8th Cir.1986) (vendor and product files held to be trade secrets where owner expended great cost and effort over 40 years to develop the files and it would have been difficult for a competitor to duplicate the information).

Since here there is evidence in the record to support the trial court's conclusions, they will not be disturbed on appeal. *See People in Interest of A.J.*, 757 P.2d 1165 (Colo.App.1988).

III.

The trial court concluded that plaintiff's claim against Aspen for misappropriation of trade secrets was groundless and, therefore, awarded attorney fees pursuant to § 13-17-102, C.R.S. (1987 Repl.Vol. 6A). Plaintiff contends that the trial court erred in making such award, and we agree.

[7][8][9] A claim or defense is groundless if the allegations in the complaint, while sufficient to survive a motion to dismiss for failure to state a claim, are not supported by any credible evidence at trial. *Western United Realty, Inc. v. Isaacs*, 679 P.2d 1063 (Colo.1984). However, a losing position is not necessarily groundless. *Federal Land Bank of Wichita v. Jost*, 761 P.2d 270 (Colo.App.1988). A trial court's determination in this regard is discretionary and will not be disturbed on appeal if the ruling is supported by the evidence. *Haney v. City Court*, 779 P.2d 1312 (Colo.1989).

[10] The court here found that no credible evidence was presented that the information at issue constituted trade secrets, as defined in § 7-74-102(4), C.R.S. (1986 Repl.Vol. 3A). The court pointed out that Stewart was an independent contractor, that plaintiff never told Stewart that this information was to be preserved, and that all the information was easily accessible. Hence, the information was not a secret.

The court also found that no credible evidence was presented that the noncompetition agreement was enforceable. It noted that, by its own terms, the contract had terminated by the time Aspen hired Stewart. Additionally, there was no evidence that Aspen had induced Stewart to breach the contract.

[11] For several reasons we conclude the trial court improperly awarded attorney fees. First, claims which involve novel questions of law upon which there is no determinative authority in Colorado at the time plaintiff files his complaint cannot supply a basis to award attorney fees. *Montoya v. Bebensee*, 761 P.2d 285 (Colo.App.1988). Here, when this action was at issue in the trial court, there were no Colorado cases construing the Colorado Uniform Trade Secrets Act, which was adopted in July 1986.

Second, plaintiff introduced sufficient evidence to demonstrate that the alleged trade secrets were valuable. Furthermore, both plaintiff's president and another witness testified that they protect their customer lists from disclosure to the public. And, under the proper circumstances, customer lists can qualify as trade secrets. *See Suburban Gas of Grand Junction, Inc. v. Bockelman*, 157 Colo. 78, 401 P.2d 268 (1965); *Network Telecommunications, supra*. Thus, even though plaintiff may not have established a prima facie case with respect to trade secrets, it did present some credible evidence in support thereof.

Third, plaintiff introduced some evidence as to misappropriation of the information. For example, there was testimony that Aspen's president and Stewart used plaintiff's price list in developing a price list for Aspen, and testimony was presented that, after Aspen employed Stewart, it added six new product lines in competition with plaintiff.

***1308** [12] A claim is not per se groundless solely because, as here a plaintiff fails to establish a prima facie case if there is some credible evidence to support the claim. Accordingly, we conclude that the trial court abused its discretion in awarding attorney fees against plaintiff.

The judgment is affirmed in all respects except as to the award of attorney fees. That portion of the judgment is reversed.

TURSI and NEY, JJ., concur.
Colo.App.,1990.
Colorado Supply Co., Inc. v. Stewart

797 P.2d 1303

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D

United States District Court,
N.D. Illinois,
Eastern Division.

Bill DEMITROPOULOS, on behalf of himself and all others similarly situated, Plaintiff,
v.
BANK ONE MILWAUKEE, N.A.; and Team Chevrolet, Inc., doing business as Team Chevrolet Geo, Defendants.
No. 95 C 1753.

Jan. 17, 1997.

Automobile lessee sued lessor-bank under Consumer Leasing Act and sought interest on its security deposit under Wisconsin version of Uniform Commercial Code (UCC). The District Court, Castillo, J., held that: (1) automobile lease created security interest in lessee's cash deposits, and (2) lessor's having use of security deposit to avoid borrowing or increase lending did not constitute money received from collateral for purposes of UCC section requiring secured party to pay debtor any money received from collateral.

Ordered accordingly.

West Headnotes

[1] Contracts 95 ⚷129(1)

95 Contracts
95I Requisites and Validity
95I(F) Legality of Object and of Consideration
95k129 Obstructing or Perverting Administration of Justice
95k129(1) k. Agreements Relating to Actions and Other Proceedings in General. Most Cited Cases

Section of Wisconsin and Illinois versions of Uniform Commercial Code (UCC) prohibiting enforcement of choice of law provision in consumer lease if jurisdiction was other than jurisdiction in which lessee resided did not void choice of law provision in automobile lease providing that Wisconsin law would govern parties' disputes, even though lessee resided in Illinois, where lessee did not object to application of Wisconsin law. W.S.A. 411.106(1); S.H.A. 810 ILCS 5/2A-106.

[2] Contracts 95 ⚷129(1)

95 Contracts
95I Requisites and Validity
95I(F) Legality of Object and of Consideration
95k129 Obstructing or Perverting Administration of Justice
95k129(1) k. Agreements Relating to Actions and Other Proceedings in General. Most Cited Cases

Purpose of provision in Wisconsin and Illinois versions of Uniform Commercial Code (UCC) prohibiting enforcement of choice of law provision in consumer lease if jurisdiction was other than jurisdiction in which lessee resided was to protect consumer-lessees, not bank-lessors. W.S.A. 411.106 (1); S.H.A. 810 ILCS 5/2A-106.

[3] Estoppel 156 ⚷68(2)

156 Estoppel
156III Equitable Estoppel
156III(B) Grounds of Estoppel
156k68 Claim or Position in Judicial Proceedings
156k68(2) k. Claim Inconsistent with Previous Claim or Position in General. Most Cited Cases

Lessor was judicially estopped from claiming that choice of law provision in contract was unenforceable after taking position in earlier proceeding favoring enforcement of choice of law provision.

[4] Secured Transactions 349A ⚷115.1

349A Secured Transactions
349AIII Construction and Operation
349AIII(A) In General
349Ak115 Property Included
349Ak115.1 k. In General. Most Cited Cases

Under Wisconsin version of Uniform Commercial Code (UCC), automobile lease created security interest in lessee's cash deposits, where deposit was given not to be used as final lease payment, but was available to adjust lessee's liability in case of lease's early termination. W.S.A. 401.201(37), 409.102.

[5] Secured Transactions 349A ⚷3.1

349A Secured Transactions
349AI Nature, Requisites, and Validity
349AI(A) Nature and Essentials
349Ak3 What Law Governs
349Ak3.1 k. In General. Most Cited Cases

Security deposits paid on personal property leases, unlike security deposits paid under real property leases, are not excluded from protection of Wisconsin version of Uniform Commercial Code (UCC). W.S.A. 409.104(10).

[6] Secured Transactions 349A ⚷12

349A Secured Transactions
349AI Nature, Requisites, and Validity
349AI(A) Nature and Essentials
349Ak11 Property and Rights Subject to Security Interest
349Ak12 k. Title or Interest of Debtor. Most Cited Cases

Automobile lessee's deposit arrangement with lessor was "pledge," not debt, for purposes of secured transactions section Wisconsin version of Uniform Commercial Code (UCC) stating that section applies to security interest created by contract including pledge, where lease provided that deposit was refundable and lease's early termination provisions set out specific circumstances in which lessor was permitted to deplete deposit.

[7] Secured Transactions 349A ⚷168

349A Secured Transactions
349AIV Rights and Liabilities of Parties
349Ak164 Use and Disposition of Collateral or Proceeds
349Ak168 k. Secured Party's Rights in Proceeds. Most Cited Cases

Secured party's having use of security deposit funds to avoid borrowing or to increase lending on certain days did not constitute money received from collateral for purposes of Wisconsin version of Uniform Commercial Code (UCC) requiring secured party to remit to debtor or to apply to debtor's obligation money or interest actually received from collateral. W.S.A. 409.104(2)(c).

[8] Statutes 361 ⚷181(1)

361 Statutes
361VI Construction and Operation
361VI(A) General Rules of Construction
361k180 Intention of Legislature
361k181 In General
361k181(1) k. In General. Most Cited Cases

Statutes 361 ⚷188

361 Statutes
361VI Construction and Operation
361VI(A) General Rules of Construction
361k187 Meaning of Language
361k188 k. In General. Most Cited Cases

Under Wisconsin law, court's primary job in construing statute is to determine and advance legislature's intent, and best evidence of legislative intent is language in statute.

[9] Statutes 361 ⚷176

361 Statutes
361VI Construction and Operation
361VI(A) General Rules of Construction
361k176 k. Judicial Authority and Duty. Most Cited Cases

Statutes 361 ⚷188

361 Statutes
361VI Construction and Operation
361VI(A) General Rules of Construction
361k187 Meaning of Language
361k188 k. In General. Most Cited Cases

Under Wisconsin law, court is not under guise of liberal construction to read into statute words that do not appear there nor may court look beyond plain language of statute to search for other meanings.

[10] Statutes 361 ⚷181(2)

361 Statutes
361VI Construction and Operation
361VI(A) General Rules of Construction
361k180 Intention of Legislature
361k181 In General
361k181(2) k. Effect and Consequences. Most Cited Cases

Under Wisconsin law, statute is not to be interpreted in derogation of common sense.

[11] Secured Transactions 349A ⚷168

349A Secured Transactions
349AIV Rights and Liabilities of Parties
349Ak164 Use and Disposition of Collateral or Proceeds
349Ak168 k. Secured Party's Rights in Proceeds. Most Cited Cases

Lessor-bank which held lessee's security deposit under automobile lease did not receive money from collateral for purposes of Wisconsin version of Uniform Commercial Code (UCC) requiring secured party to remit to debtor or to apply to debtor's obligation any money received from collateral, where deposit was not held in interest bearing account and in absence of any evidence that lessor-bank's holding of money either decreased amount it borrowed or increased amount it loaned. W.S.A. 409.207 (2)(c).

[12] Federal Civil Procedure 170A ⚷2553

170A Federal Civil Procedure
170AXVII Judgment
170AXVII(C) Summary Judgment
170AXVII(C)3 Proceedings
170Ak2547 Hearing and Determination
170Ak2553 k. Time for Consideration of Motion. Most Cited Cases

Party opposing motion for summary judgment was not entitled to continuance to expand discovery, where party made request to court in footnote, time for discovery was past and requested information was not likely to produce facts necessary to defeat motion. Fed.Rules Civ.Proc.Rule 56(f), 28 U.S.C.A.

*975 Daniel A. Edelman, James O. Latturner, Cathleen Combs Cohen, Tara Leigh Goodwin, Michelle Ann Weinberg, Rick D. Young, Edelman & Combs, Chicago, IL, James Eric Vander Arend, Gessler, Hughes & Socol, Ltd., Chicago, IL, O. Randolph Bragg, Chicago, IL, for Bill Demitropoulos.

Richard F. Zehnle, Diane Marie Kehl, Christine A. Provost, Vedder, Price, Kaufman & Kammholz, Chicago, IL, for Bank One Milwaukee, N.A.

Gary Feiereisel, Terrence Franklin Guolee, Steven R. Johnson, Frank Kasbohm, Fraterrigo, Beranek, Feiereisel & Kasbohm, Chicago, IL, for Team Chevrolet Inc.

MEMORANDUM OPINION AND ORDER

CASTILLO, District Judge.

Plaintiff Bill Demitropoulos and his fellow class members claim that defendant Bank One owes them interest on security deposits paid under the Bank's standard automobile lease agreement. In a nutshell, Demitropoulos contends that Article 9 of the Uniform Commercial Code requires the Bank to pay to him the fruits of the deposit, such as interest or profits from its use, at the lease's end. Because the

Bank failed to pass along this bounty, he claims, it violated the UCC.

Count I of the amended complaint is directed to both defendants and alleges that the standard automobile lease form violates the disclosure requirements set forth in the Consumer Leasing Act, 15 U.S.C. § 1667 et seq.[FN1] The remaining counts are directed solely to Bank One. Count II of the amended complaint seeks restitution of the interest allegedly earned by the Bank. Count III claims that the Bank's failure to disclose its retention of the interest constitutes an unfair or deceptive act under the Wisconsin Consumer Fraud Act, Wis. Stat. § 100.18.

FN1. These claims are not at issue here, except as they relate to the Bank's alleged failure to disclose its policy of retaining interest on security deposits.

Early last year, this Court issued two published opinions on motions to dismiss this class action suit alleging numerous violations of federal and state consumer law. In the most recent opinion, we denied Bank One's motion to dismiss Counts II and III, holding that Wisconsin's Uniform Commercial Code applies and requires the Bank to remit to the class members any interest it may have earned on the car lease deposits. *See Demitropoulos v. Bank One Milwaukee, N.A. (Demitropoulos II),* 924 F.Supp. 894, 897 (N.D.Ill.1996). Armed with a factual record, Bank One now moves for summary judgment ***976** on the very same issue. The Bank argues that because the deposits did not in fact earn interest, none is owed to Demitropoulos. Submitting a brief as amicus curiae, the American Financial Services Association goes one step farther, claiming that the UCC is not even applicable to the security deposits. After careful consideration, we decline to reverse our previous holding that the UCC applies and commands that any interest earned on the security deposit be paid to Demitropoulos. Nevertheless, we grant Bank One summary judgment on Counts II and III because the deposits did not produce interest cognizable under the UCC.

RELEVANT FACTS [FN2]

FN2. The facts are drawn from the parties' statements of material facts and supporting exhibits. Under Rule 12(M)(3) of the Local General Rules of the United States District Court for the Northern District of Illinois, Bank One filed a statement of material facts as to which it contends there is no genuine dispute. This statement is referred to as "Def's Facts ¶ ___." Demitropoulos filed a response to Bank One's statement (cited as "Pl's Resp. ¶ ___") under Local Rule 12(N)(3)(a), designating the facts to which it claims the parties disagree. Demitropoulos also filed a statement of additional facts (cited as "Pl's Add'l Facts ¶ ___"), as permitted by Local Rule 12(N)(3)(b).

The Rule 12(M) and 12(N) statements are subject to the following constraints. The statements must contain "specific references to affidavits, parts of the record, and other supporting materials...." Local Rule 12(M)(3). All properly supported material facts are deemed admitted unless properly controverted by the responsive statement of the opposing party. Local Rule 12(M) and 12(N)(3)(b) ; *see also Flaherty v. Gas Research Inst.,* 31 F.3d 451, 453 (7th Cir.1994); *Waldridge v. American Hoechst Corp.,* 24 F.3d 918, 921-22 (7th Cir.1994). The mere denial of a particular fact without "specific references to affidavits, parts of the record, and other supporting materials" that establish a factual dispute is insufficient-where met with such a naked denial a factual assertion may be deemed admitted. *Flaherty,* 31 F.3d at 453.

In December 1994, Demitropoulos signed Bank One's standard automobile lease form covering the lease of a 1994 Chevy Corvette.[FN3] Def's Facts ¶

3. As required by the lease, he paid a $550 refundable security deposit to Team Chevy. *Id.* ¶ 6; Consumer Closed End Vehicle Lease Agreement ("Lease") ¶ 4.b. (attached to Pl's Resp. as Ex. C). The deposit was not to be used as the final lease payment. Pl's Add'l Facts ¶ 3. It was available to adjust Demitropoulos' liability in case of the lease's early termination. Lease ¶ 13.b.

FN3. The same form lease was signed by all the class members. For ease of exposition, we often use "Demitropoulos" to refer to the entire class.

Team Chevy sold the Corvette to Bank One for financing purposes, subtracting $550 from the purchase price to reflect the fact that Demitropoulos had already paid Chevy the security deposit. Def's Facts ¶ 6. In turn, Bank One entered a debit on its general ledger in the amount of the deposit, recognizing that it would have to return the $550 to Demitropoulos at the end of the lease. [FN4] Aff. Kurt Swiecichowski ¶ 3. When the lease terminated, Bank One returned the security deposit to Demitropoulos, without interest. Def's Facts ¶ 9.

FN4. Demitropoulos attacks this statement, contained in the affidavit of Bank One's Vice President in charge of reporting and financial analysis for the Regional Consumer Loan Center, because "no supporting documentation of the general ledger entry" corroborates it. This Court reminds Demitropoulos that the affidavit is sworn testimony, which needs no documentary confirmation in order to be treated as evidence.

The key factual dispute centers on what happened to the class members' security deposits in Bank One's possession. The parties agree that the Bank kept track of all its car lease deposits by entering them in a "Monthly Transaction Journal," which is simply a daily record of the Bank's funds from these deposits. Pl's Add'l Ex. They further concur that Bank One did not put the deposits in interest-bearing accounts. [FN5] Def's Facts ¶ 6; Pl's Resp. ¶ 6. From there, the parties diverge based on dueling affidavits.

FN5. Section 3 of the Illinois Consumer Deposit Security Act of 1987, 815 ILCS 165/3 (1988) permits a lessor requiring lessees to pay deposits under consumer leases either to file a $10,000 surety bond with the Illinois Attorney General in favor of the State of Illinois for the benefit of the lessees, or to place the deposit in a bank account. If the account bears interest (and it need not), the interest goes to the lessee at the end of the lease. Instead of putting the security deposits in a bank account, Bank One filed a surety bond with the Attorney General. Def's Facts ¶ 7.

***977** Plaintiff's expert, John Walsh, who serves as Vice President of a major Chicago bank, offers his opinion on how Bank One probably managed the car lease security deposits. Aff. John Walsh ¶ 2. Pointing out that the affidavit of Bank One's Vice President does not say that the deposit funds were restricted, Walsh states that, "assuming a well-managed banking institution, those funds would have been put to use to either lower the amount of the bank's borrowings or fund the bank's assets." *Id.* ¶ 6. He elaborates:

> By using the funds, the bank would likely have lowered its interest expense or increased its interest income. To not invest available unrestricted funds when the opportunity is present, would not be maximizing shareholder earnings and would likely bring criticism from shareholders and from bank regulators.

Id. Walsh explains that when a bank is short on funds late in the day, it borrows what it needs to manage its daily cash position, often from other banks' excess funds held in balances at the Federal Reserve. *Id.* But a bank operating at a surplus from security deposit funds can rely on them instead of borrowing money, and may even lend money to other banks. *Id.* The result is that the bank effectively earns interest on the security deposits, either relieved of the need to borrow from the Federal Reserve or able to collect interest by lending to other banks. *Id.* Walsh concludes that a "reasonable proxy" for the benefit from the deposits is the average Fed Funds Sold rate or the average interest rate accumulated on earning assets, both calculable from the Bank's quarterly or annual reports. *Id.*

Bank One admits that the class members' car lease security deposits increased the Bank's operating funds. Def. Mot. S.J. at 10. According to Bank One's Vice President, these funds fluctuated daily, as did the Fed's borrowing rate. Aff. Kurt Swiecichowski ¶ 4. He states that the Bank did not rely on increased operating funds to manage its cash position every day during the class period. *Id.* ¶ 5.

What appears to be a factual dispute about whether the deposits earned money is really a legal battle over whether Bank One received interest from the security deposits in a manner contemplated by Article 9 of the UCC. Thus, it is appropriate for summary judgment consideration.

LEGAL STANDARDS

Summary judgment shall be granted "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law." Fed.R.Civ.P. 56(c). To withstand a motion for summary judgment, the non-movant must "make a showing sufficient to establish the existence of [the] element[s] essential to that party's case, and on which that party will bear the burden of proof at trial." *Celotex Corp. v. Catrett,* 477 U.S. 317, 322, 106 S.Ct. 2505, 91 L.Ed.2d 202 (1986).

In considering a motion for summary judgment, the court views all evidence in the light most favorable to the non-moving party and draws all inferences in that party's favor. *Schmidt v. Methodist Hosp.,* 89 F.3d 342, 344 (7th Cir.1996). Summary judgment may be granted if the evidence is merely colorable, or is not significantly probative, *Anderson,* 477 U.S. at 249-50, 106 S.Ct. at 2510-11, or merely raises "some metaphysical doubt as to the material facts." *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.,* 475 U.S. 574, 586, 106 S.Ct. 1348, 1356, 89 L.Ed.2d 538 (1986). If "the record taken as a whole could not lead a rational trier of fact to find for the non-moving party, there is no 'genuine' issue for trial." *Id.* at 587, 106 S.Ct. at 1356. In making its decision, the court's sole function is to determine whether sufficient evidence exists to support a verdict in the non-movant's favor. *Anderson,* 477 U.S. at 255, 106 S.Ct. at 2513-14.

ANALYSIS

Before we address the substance of the parties' (and amicus') arguments, we dispose of a preliminary matter-the validity of the lease form's choice of law provision. We then revisit the UCC's applicability to Demitropoulos' security deposit, interpret the Code's provision governing money received ***978** from collateral, and, finally, apply the Code to the claims before us.

A. *Wisconsin Law Applies*

[1] We are initially confronted with a choice of law issue that we had considered settled by our earlier opinions. Contained in Bank One's automobile lease is a clause providing that Wisconsin law will govern the parties' disputes. In briefing its first motion to dismiss, Bank One vigorously argued in favor of upholding that clause and applying Wisconsin law. Demitropoulos, an Illinois resident, urged the Court to invalidate the choice of law provision and apply Illinois law instead. We enforced the clause, using Wisconsin law to analyze Demitropoulos' state consumer law claims, including those seeking interest on the security deposits. *Demitro-*

poulos v. Bank One Milwaukee, N.A. (Demitropoulos I), 915 F.Supp. 1399, 1413-14 (N.D.Ill.1996); *Demitropoulos II,* 924 F.Supp. at 896-97.

Contrary to its earlier stance, Bank One now asks the Court to void this provision, contending that the UCC forbids enforcing the parties' chosen law. FN6 The Bank relies on Article 2A, the UCC's chapter governing leases, which limits the power of parties to a consumer lease FN7 to choose the law regulating their disputes. Section 2A-106, enacted in both Wisconsin and Illinois, FN8 provides:

FN6. For purposes of this discussion, we assume that the UCC applies. Later in the opinion we demonstrate that this assumption is correct.

FN7. A "Consumer Lease" is one entered into by a lessor regularly engaged in the business of leasing or selling and a lessee who is leasing primarily for a personal, family, or household purpose, and whose total payments do not exceed $25,000. Uniform Commercial Code § 2A-103(e). Demitropoulos' complaint acknowledges that "many" of the class members leased cars from Bank One for personal, family, or household purposes, and that "in many cases," the total contractual obligation was less than $25,000. Am. Compl. ¶ 4.

FN8. Wis. Stat. § 411.106(1); 810 ILCS 5/2A-106.

(1) If the law chosen by the parties to a consumer lease is that of a jurisdiction other than a jurisdiction in which the lessee resides when the lease agreement becomes enforceable or within 30 days thereafter or in which the goods are to be used, the choice is not enforceable.

Bank One points out that the parties have chosen the law of a state "other than a jurisdiction in which the lessee resides" because Demitropoulos and the class members live in Illinois, not Wisconsin. Thus, according to Bank One, the choice of law is unenforceable. This, interestingly, leaves the Bank free to argue the application of Illinois' Consumer Deposit Security Act of 1987, 815 ILCS 165/3, whose provisions purportedly preempt the UCC's more stringent dictates concerning interest payments on security deposits. In other words, because Illinois law suits Bank One's objectives on this issue, it asks the Court to ignore the parties' contract to be governed by Wisconsin law.

[2][3] We decline to overturn our previous choice of law ruling or to apply Illinois law piecemeal to Demitropoulos' security deposit claims. A number of factors weigh against using § 2A-106 to void the parties' chosen law. First, this Code provision was enacted to protect consumer-lessees, not Bank-lessors: § 2A-106's comment warns of the "real danger that a lessor may induce a consumer lessee to agree that the applicable law will be a jurisdiction that has little effective consumer protection." Demitropoulos, the consumer, does not object to the application of Wisconsin law-the party opposing it is the Bank. This Court will not apply a statute to subvert the very reasons for its enactment. Second, Bank One is judicially estopped from taking a position diametrically opposed to its stance position favoring the choice of law provision. Judicial estoppel prevents a party from taking clearly inconsistent legal positions at different stages of litigation in order to take unfair advantage "in a forum designed for suitors seeking justice." *In re Cassidy,* 892 F.2d 637, 641 (7th Cir.1990); *see Continental Illinois Corp. v. Commissioner of Internal Revenue,* 998 F.2d 513, 518 (7th Cir.1993); *Cassidy,* 892 F.2d at 641-42. Just because Bank One's interests have changed does not mean that the law must mold itself accordingly.

Ultimately, however, whether UCC § 2A-106 voids the parties' choice of law clause is a ***979** non-issue because the end result in this case is the same under either Illinois or Wisconsin law. Both states have enacted the relevant portions of the Uniform Commercial Code in identical language. And even if the Illinois Consumer Deposit Security Act operates to alleviate the Illinois UCC's burden on lessors to pay interest on security deposits, this interaction has no legal significance. Bank One is entitled to summary judgment even under the UCC's more demanding interest payment provisions. Consequently, consistent with our prior opinions, we consult Wisconsin law to resolve the questions before US.

B. *The Security Deposits Create a Security Interest Under Wisconsin's Uniform Commercial Code*

In *Demitropoulos II,* we held that Wisconsin's Uniform Commercial Code applies to Demitropoulos' claim for interest on his security deposit. 924 F.Supp. at 896-97. Briefly recapped, our reasoning proceeded along the following lines: Article 9 of Wisconsin's UCC covers "any transaction (regardless of form) which is intended to create a security interest in personal property." Wis. Stat. § 409.102(1)(a). This includes security interests created by a contract (i.e., a lease), such as pledges. *Id.* § 409.102(2). The question before us was whether Bank One's lease form created a security interest in the class members' cash deposits. Undertaking a definitional analysis, we determined that it did. The UCC defines a security interest as "an interest in personal property ... that secures payment or performance of an obligation." *Id.* § 401.201(37)(a). Personal property includes money. *Id.* § 990.01(27). And we found it reasonable to draw the inference that the deposit was designed to secure Demitropoulos' obligations under the lease. 924 F.Supp. at 896-97. Although sparse, case law in this area harmonized with our holding that Bank One had an Article 9 security interest in Demitropoulos' $550 cash deposit. *See Werbosky v. Ford Motor Credit Co.,* 1996 WL 76133, at *1 (S.D.N.Y. Feb. 22, 1996).

Nevertheless, the American Financial Services Association, writing as amicus curiae, contends that our conclusion was off-base. Its brief dwells on a single point: a security deposit paid to a lessor under a personal property lease is not a pledge of money, subject to Article 9. Rather, it creates a debt that the lessor owes the lessee. Such debts are outside the scope of Article 9. Moreover, the AFSA maintains, under "established common law rules" the lessor is not obligated to pay interest on this debt. As a final measure, the AFSA attacks the *Werbosky* case as wrongly decided, urging us to eschew reliance on it because the decision would "change settled law upsetting commercial expectations to no ultimate benefit." AFSA Br. at 13. We address these arguments in turn after expanding on our conclusion that the UCC applies to Demitropoulos' security deposit.

1. *The Code's interpretive and definitional sections encompass the security deposits in this case*

As an initial matter, we point out that Code's own provisions on interpretation call for the UCC to be "liberally construed." Wis. Stat. § 401.102(1). As judges, we must heed this directive. See RAY D. HENSON, SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE § 2-2, pp. 10-11 (2d ed. 1979) ("This command from the enacting legislature is entitled to complete acceptance, recognition and enforcement by every court.... Is there any reason why the Code should not 'be liberally construed and applied to promote its underlying purposes and policies'? There is none. If the legislature commands, the courts must obey."). Consistent with this philosophy, Article 9 itself has a "very broad reach," generally covering any consensual security interest in personal property unless explicitly excluded by § 9-104. BARKLEY CLARK, THE LAW OF SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE ¶ 1.03, at 1-13 (rev. ed.1993); see Wis. Stat. § 409.102(1)(a) & comment 5. Commentators have characterized Article 9's grasp as "octopus"-like and have marveled at its "sweeping breadth." CLARK, ¶ 1.03, at 1-13; 4 JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE § 30-2, at 6 (4th ed.1995). With these standards in mind, we approach the Code's substantive provisions.

***980** [4] Article 9 applies to "security interests created by contract." Wis. Stat. § 409.102. The term "security interest" is defined expansively, as "any interest in personal property or fixtures which secures payment or performance of an obligation." Wis. Stat. § 401.201(37). Demitropoulos' security deposit is a creature of contract, Bank One's standard automobile lease form. And the Wisconsin legislature includes cash within the definition of personal property.[FN9] *See* Wis. Stat. § 990.01(27). The issue is therefore whether the deposit was given to secure payment or performance of an obligation. To that end, we know that the deposit was not to be used as the final lease payment. Pl's Add'l Facts ¶ 3. It was, however, available to adjust Demitropoulos' liability in case of the lease's early termination, that is, to secure his obligation not to end the lease early. *See* Lease ¶ 13.b. ("The charges for early termination will be as follows: ... Your liability under the Lease will be adjusted for any excess mileage charges ..., damages to the Vehicle or other charges provided for in this Lease, and your security deposit."). Bank One has not cited any facts demonstrating that the deposit was not designed to secure an obligation, and, in the absence of contrary evidence, we must take the plaintiff's facts as true. *Flaherty v. Gas Research Inst.*, 31 F.3d 451, 453 (7th Cir.1994). Consequently, based on Article 9's required liberal construction, the broad definition of security interest, the provisions of the lease, and the absence of any facts that would remove this transaction from Article 9, we reaffirm our finding that the lease creates a security interest in Demitropoulos' deposit.[FN10]

FN9. It is important to note that the operative question is whether the lease creates a security interest in Demitropoulos' cash security deposit, not in the car being leased. The latter issue is not relevant here, and involves an entirely different Article 9 analysis.

FN10. The Wisconsin Statutes already assume this conclusion. Section 422.417(2), part of the Wisconsin Consumer Act and entitled "Restrictions on security deposits," states that "[t]his section does not prohibit a security interest in a cash security deposit for a consumer lease of motor vehicles or agricultural equipment." Although Illinois does not have a similar provision, given our Article 9 analysis the result is the same under Illinois' UCC alone.

While scarce, the case law confronting this question supports us. In *Werbosky v. Ford Motor Credit Co.*, the court held that a security deposit paid under an automobile lease created a security interest subject to Article 9's interest payment provisions. 1996 WL 76133, at *1 (S.D.N.Y.1996). Likewise, an equipment lessor was found to have an Article 9 security interest in a cash deposit the lessee paid to secure its performance. *In re Atlanta Times, Inc.*, 259 F.Supp. 820, 827 (N.D.Ga.1966), *aff'd sub nom. Sanders v. National Acceptance Co.*, 383 F.2d 606 (5th Cir.1967). And a judge evaluating a security deposit paid to utility company as a condition of uninterrupted electrical service found that the deposit created a security interest under Article 9. *In re Barr*, 180 B.R. 156, 160 (Bankr.N.D.Tex.1995) (relying on *Atlanta Times* as persuasive authority).

2. *The common-law rule employed in real Property cases is inapplicable to a lease for Personal Property*

The AFSA's primary argument against finding that Bank One took a security interest in Demitropoulos' security deposit is that "most commentators and courts" hold that real property (as opposed to personal property) lease security deposits create a debt, which is outside the reach of the UCC, not a pledge, which Article 9 explicitly embraces. Liberated from the confines of the UCC, the landlord-debtor is spared the burden of paying interest on the tenant's deposit. This "common-law rule," the AFSA contends, is equally germane to security deposits paid under a lease for personal property. According to the AFSA, all security deposits involve contract rights, regardless of whether the underlying lease is for personal or real property. Because courts do not apply the UCC to these contract rights when the lease involves real property, there is no reason to hold differently when the lease covers personal property.

The AFSA is comparing apples to oranges. Any common-law precepts applied to security deposits paid under real property leases are irrelevant because real property transactions ***981** are specifically carved out of Article 9. Section 9-104 spells out in detail what is excluded from the Article's scope. One of the excluded transactions is "the creation or transfer of an interest in or lien on real estate, including a lease or rents thereunder." U.C.C. § 9-104(j) (codified at Wis. Stat. § 409.104(10)). The landlord-tenant cases FN11 that the AFSA relies on for the "common-law rule" that security deposits do not create Article 9 security interests are therefore inapposite-real property lease deposits are encompassed by § 9-104(j)'s exclusion, while the automobile lease deposit in this case is not.

FN11. The cases the AFSA cites for the common-law rule that security deposits create debts that fall outside the UCC and trigger no duty to pay interest all involve leases for real property. *See, e.g., Korens v. R.W. Zukin Corp.*, 212 Cal.App.3d 1054, 261 Cal.Rptr. 137 (1989) (tenants suing landlord to recover interest on security deposits); *Levinson v. Shapiro*, 238 A.D. 158, 263 N.Y.S. 585 (pre-UCC tenant's action against landlord for converting the security deposit), aff'd, 263 N.Y. 91, 188 N.E. 265 (1933); *Matter of State of New York v. Parkchester Apts.*, 61 Misc.2d 1020, 307 N.Y.S.2d 741 (Sup.Ct.1970) (attorney general seeking order requiring landlords to put deposits in interest-bearing accounts and remit interest to tenants); *Donnelly v. Rosoff*, 164 Misc. 384, 298 N.Y.S. 946 (Mun.Ct.1937) (pre-UCC suit to recover security deposit paid under real estate lease); *Goodman v. Schached*, 144 Misc. 905, 260 N.Y.S. 883 (Nassau Cty. Ct.1932) (pre-UCC case in which tenant defended against dispossession with a claim for security deposit conversion); *Handle v. Real Estate-Land Title & Trust Co.*, 316 Pa. 116, 173 A. 313 (1934) (pre-UCC case in which landlord sued bank to recover tenant's security deposit). As is evident, many of these cases pre-date the UCC's enactment in the 1960s, and thus cannot be used to discern its scope.

Although there are no Wisconsin decisions on point, the UCC case law in other jurisdictions explains the crucial distinction between money paid as security under real versus personal property leases. In holding that real property leases and rents are expressly excluded from the UCC, the following cases underscore the point that the UCC was meant to cover only claims under personal property leases. For example, *In re Kavolchyck*, 154 B.R. 793 (Bankr.S.D.Fla.1993), *aff'd*, 164 B.R. 1018 (S.D.Fla.1994), faced the question whether a couple who was assigned rents under a real estate lease had to comply with Article 9's filing requirements to perfect their interest in the rents. Finding the rents outside the scope of Article 9, the court held that "Article 9 of the UCC does not cover the perfection of security interests in real property leases or rents derived therefrom." *Id.* at 797. Characterizing the assignees' right to rents as a "contract right" or as "personal property" did not alter the equation. *Id.* While contract rights and personal property are normally encompassed by Article 9, in this case the rents also constituted "interests in real estate" excluded by § 9-104(j). *Id.* at 797, 799. This exclusion overrode any of the UCC's inclusive provisions.

Likewise, *In re Standard Conveyor Co.*, 773 F.2d 198, 204 (8th Cir.1985), held that money deposited in an escrow account to secure the bankrupt real estate lessee's performance fell outside the scope of

Article 9. The court was asked to determine which of two creditors had priority to the money in the escrow account. As part of this process, the court found that "[a]n Article 9 security interest in the underlying proceeds of a real estate lease-rents-is expressly precluded by U.C.C. § 9-104(j)." *Id.* Other courts concur. *See, e.g., In re Patterson,* 64 B.R. 189, 191-92 (Bankr.N.D.Ill.1986) (money in escrow account designed to serve as advance rental and/or liquidated damages account were "rents from the lease of real estate" excluded from Article 9's coverage).

Finally, *In re Bristol Assocs. Inc.*, 505 F.2d 1056 (3d Cir.1974), the leading decision interpreting UCC § 9-104(j), held that rents under a real estate lease are excluded from Article 9 as "transactions touch[ing] realty." *Id.* at 1060. The landlord in that case assigned to a bank his interest in a real estate lease as collateral for a loan. When the landlord filed for bankruptcy, the bank and the receiver vied for priority in the rents. The receiver argued that because Article 9 expressly covers security interests in personal property and state law classified real estate leases as personal property, the § 9-104(j) exclusion did not apply. *Id.* at 1059-60. Rejecting the receiver's argument, the court found that regardless of whether the lease and its rents constituted personal property,***982** their transfer was nevertheless specifically excluded by § 9-104(j).FN12

FN12. *Bristol* addressed another issue that is only marginally relevant to the facts before us. Commentators have recognized that § 9-104(j)'s exclusion of interests in real estate or rents thereunder is at odds to some extent with one of the chapter's scope provisions, § 9-102(3). *See* CLARK, ¶ 1.08[10][b], at 1-139; 4 WHITE & SUMMERS, § 30-7, at 46. This section states:

(3) The application of this chapter to a security interest in a secured obligation is not affected by the fact that the obligation is itself secured by a transaction or interest to which this chapter does not apply.

The question arises whether this section pulls rents under a real estate lease back into Article 9. *Bristol,* 505 F.2d at 1059. The official comment (which appears in Wisconsin's UCC) clears things up:

Comment 4: An illustration of subsection (3) is as follows: The owner of Blackacre borrows $10,000 from his neighbor, and secures his note by a mortgage on Blackacre. This Article is not applicable to the creation of the real estate mortgage. Nor is it applicable to a sale of the note by the mortgagee, even though the mortgage continues to secure the note. However, when the mortgagee pledges the note to secure his own obligation to X, this Article applies to the security interest thus created, which is a security interest in an instrument even though the instrument is secured by a real estate mortgage.

U.C.C. § 102(3) comment 4, *quoted in Bristol,* 505 F.2d at 1058-59. The court resolved the tension between the two provisions as applied to real estate rents and leases by explaining that the comment "makes explicit that the promissory note itself falls within the scope of Article 9 by virtue of its status as an instrument." *Id.* at 1061. Because "a lease of real property is clearly not an instrument," it could not be analogized to the promissory note example cited in the comment. The court determined that the comment "refute[s] the possibility that Article 9 reaches out to encompass every transaction colorably included under section 9-102." *Id.* Similarly, we find that the security deposits paid under real estate leases, such as those in the AFSA's cited cases, remain outside Article 9 because they cannot be classified as instruments.

These cases defeat the AFSA's argument that common-law rules excepting real estate leases from Article 9 must be extended to personal property leases. First, the decisions hold that "rents" paid under a real estate lease fall outside the scope of Article 9 by virtue of § 9-104(j), not "common-law rules." Whether the rents take the form of an escrow account, as in *Standard and Patterson,* or a tenant's security deposit, as in the AFSA's landlord-tenant cases, the money is paid to secure obligations under a real estate lease. In contrast, Demitropoulos' security deposit was paid under a personal property lease, which § 9-104(j) does not eliminate from Article 9. Second, AFSA's attempts to unify personal and real property leases by identifying them both as contract rights or personal property fails. *Kavolchyck* and *Bristol* render such labels irrelevant. Those cases provide that § 9-104(j) scrutinizes the transaction more closely-even if rents or deposits are themselves contract rights or personal property, their connection with real estate precludes Article 9's application.

[5] The conclusion we draw from the preceding analysis is that money paid under real property leases is distinguishable from money paid pursuant to a personal property lease. These transactions are not both subject to common-law rules; rather, real estate lease deposits are specifically carved out of Article 9 by statute, while personal property lease deposits remain squarely within the Article's scope.

The AFSA's authority is not to the contrary. The two cases cited as extending the "common-law rule" to personal property leases do nothing of the sort. For example, the AFSA quotes a portion of *Mallory Assocs. v. Barving Realty Co.,* 300 N.Y. 297, 90 N.E.2d 468 (1949), another landlord-tenant dispute over a real estate lease deposit. But Mallory merely addressed the applicability of New York's real property law, not the scope of the UCC. In fact, *Mallory* was decided long before the UCC's enactment, and therefore bears not at all on the Code's breadth. Moreover, the decision could not have extended any common-law principle to personal property leases because the only lease before the court involved real estate. The AFSA's second case, *United States v. Samel Refining Corp.,* 461 F.2d 941 (3d Cir.1972), is equally unavailing. The quoted portion, which again examined a security deposit paid under a real, not a personal, property lease, says nothing about the UCC.[FN13] The court merely ***983** stated that "the relationship of a tenant to the landlord with respect to a security deposit is that of creditor and debtor." *Id.* at 943. As explained earlier, how a court characterizes a real estate lease deposit is irrelevant-the UCC views real and personal property lease deposits as different animals.

FN13. In its reply brief, the AFSA concedes that the *Samel* court was dealing with a real property lease, but contends that "[d]espite the fact that real property was involved, the Third Circuit still used Article 9 to analyze the nature of a security deposit." AFSA Reply at 5. We find that characterization misleading. *Samel* never discussed whether the real estate lease deposit created an Article 9 security interest or triggered the UCC's interest payment provisions. Rather, the issue was the coverage of a private security agreement. The agreement was between the tenant, Samel, and a third party, his creditor. It granted the creditor a security interest in all Samel's "contract rights," a term defined by reference to the UCC. 461 F.2d at 942. The court found that Samel's right to the return of his security deposit was a "contract right" in which the creditor had an interest by virtue of the parties' agreement. *Id.* at 943. Notably, this finding prompted a dissent challenging the majority's characterization of the right to a security deposit as a "contract right." *Id.* (Kalodner, J., dissenting). Moreover, *In re Kavolchyck,* 154 B.R. 793, 797, 799 (Bankr.S.D.Fla.1993), explained that classifying something as a "contract right" is not enough to overcome § 9-104(j)'s exclusion of real estate transactions.

3. *Even the common law would subject Demitropoulos' security deposit to the UCC*

[6] Even if we assumed that common-law rules distinguishing debts from pledges were applicable here, it would not change our conclusion that Article 9 applies to this case. To begin with, courts are split on whether real estate lease deposits are debts or pledges. 2 MILTON R. FRIEDMAN, FRIEDMAN ON LEASES § 20.4, at 1166-67 (3d prtg.1990); Comment, *Interest on Security Deposits-Benefit or Burden to Tenant?,* 26 U.C.L.A. L.Rev. 396, 399-400 (1978). The primary difference between debts and pledges is that the landlord classified as a debtor has great discretion to manage the security deposit as he wishes, forcing the tenant to "rely heavily on the landlord's honesty for return of the deposit." *Id.* at 400. While the landlord in a pledgor-pledgee relationship may still commingle the deposit with his own funds, he is prohibited from "permanently disposing of the deposit or in any way jeopardizing the possibility of its eventual return to the tenant." *Id.* at 400-01.

Turning to the facts before us, Demitropoulos' deposit arrangement with Bank One resembles a pledge much more than a debt. First, the lease provides that the deposit is refundable. Demitropoulos need not simply rely on Bank One's charity for its return. In addition, the lease's early termination provisions lay out the specific circumstances in which the Bank is permitted to deplete the deposit. Its consumption is therefore not left to the whims of the Bank. Consequently, we find the AFSA's characterization of the deposit as a debt to be misguided. Even the common law would confer upon the deposit pledge status, bringing it within the UCC. See Wis. Stat. § 409.102(2) ("This chapter applies to security interests created by contract including pledge...."). FN14

FN14. The AFSA's remaining arguments merit only footnote discussion. As a corollary of its contention that Demitropoulos' security deposit creates a debt, AFSA maintains that Bank One had the right to set off its debt against any missed payments. The UCC excludes from Article 9 "any right of setoff." Wis. Stat. § 409.104 (9). But Bank One's contractual right to use the deposit to satisfy Demitropoulos' liability under the lease is not a right of set-off. Section 409.104(9) refers instead to a bank's common-law right, in every jurisdiction, to freeze a demand or time account and use the deposit funds to offset an unpaid loan. CLARK, ¶ 1.08[9], at 1-122. This situation differs from our facts for two reasons. First, Article 9's drafters excluded the right of set-off because it arises by operation of law rather than by consent-Article 9 covers only consensual arrangements. CLARK, ¶ 1.08 [9][c][iii], at 1-27 (Supp. II 1996); HENSON, § 3-2, p. 21. In contrast, any right Bank One has to adjust Demitropoulos' liability using his security deposit is consensual, conferred by the car lease. Second, the deposit account against which a bank exercises a right of set-off must be the property of the depositor, deposited without restriction. CLARK, ¶ 1.08[9][c][v], at 1-28. But Demitropoulos' $550 was deposited with a substantial restriction-he had no access to it until the end of the lease. For these reasons, § 409.104(9)'s right of set-off exclusion is inapplicable here.

Finally, the AFSA urges that following *Werbosky v. Ford Motor Credit Co.'s* holding applying the UCC to automobile lease security deposits would "change settled law upsetting commercial expectations to no ultimate benefit." AFSA Br. at 13. This argument can be dismissed summarily. All the AFSA's professed

> concerns are over the state of real property law. But any common-law rules applied to real estate leases have been left intact by the decision. Werbosky merely confirms the different treatment of personal property leases under the UCC, a distinction apparent upon the UCC's enactment over three decades ago.

***984** Having found that Wisconsin's Commercial Code applies to Demitropoulos' security deposit, we move on to examine what the Code says about paying interest on security deposits.

C. *The UCC Requires Payment of Interest on Security Deposits Only if Any is Actually Earned*

In *Demitropoulos I,* we held that because Bank One's lease form created a security interest in the cash deposits under Wisconsin's Uniform Commercial Code, the Code's provisions governing a secured party's rights and duties in collateral were also applicable. 924 F.Supp. at 896-97. One of those provisions is § 409.207(2)(c):

> (2) Unless otherwise agreed, when collateral is in the secured party's possession:
>
> ...
>
> (c) The secured party may hold as additional security any increase or profits (except money) received from the collateral, but money so received, unless remitted to the debtor, shall be applied in reduction of the secured obligation....

We pointed out that the statute neither imposes an outright obligation to put the collateral, in this case, the security deposit, in an interest-bearing account, nor compels mandatory interest payments. *Id.* at 897. Instead, § 409.207(2)(c) requires only interest *actually earned* ("received") from the collateral to be remitted to the lessee or applied to reduce his obligation. Id. None of the parties contests this interpretation of the statute. [FN15] Accordingly, we must determine whether Bank One did, in fact, earn interest from the deposit in a form contemplated by the UCC. [FN16]

FN15. Bank One argues instead that this provision conflicts with Illinois, Consumer Deposit Security Act of 1987, 815 ILCS 165/3. As noted earlier, the Illinois Act permits a lessor requiring lessees to pay a security deposit in connection with a consumer General, and putting the deposits in bank accounts, which need not produce interest. *Id.* 165/3(a)-(b). If the deposit is $150 or more and the account bears interest, however, the lessor must pay this interest to the lessee. Id. 165/3(b). We need not decide whether the UCC § 9-207(c) conflicts, first, because Wisconsin law applies to the lease. Second, Bank One prevails even under what it contends are the more stringent provisions of the UCC, so it is unnecessary to determine whether the Illinois Act conflicts.

FN16. On January 7, 1997, one of our colleagues in the Northern District of Illinois, Judge Moran, issued an opinion in a case with facts very similar to those before us. *See Wiskup v. Liberty Buick Co.,* No. 95 C 4885, 1996 WL 18896 (N.D.Ill. Jan. 17, 1996). In addressing the plaintiff-lessee's claim for interest on a car lease security deposit under the Uniform Commercial Code, *Wiskup* held that the Illinois Consumer Deposit Security Act, not section 9-207(c) of the UCC, governed the defendant-lessor's security deposit obligations. Slip op. at 30. The court did not decide (because it did not have to) whether the deposit created a security interest under the UCC. Judge Moran did, however, express the opinion that although he found the lessee's UCC argument "strong," it nevertheless encountered "several obstacles." *Id.* at 27. The cited obstacles are that: 1) Illinois courts are silent and few courts nationwide have ruled this way; -and 2) many pre-UCC cases characterize security deposits as debts, not pledges, and only pledges are specifically referenced in the UCC. *Id.* at 28.

> We respectfully disagree that these observations are obstacles. First, the few cases nationwide finding that a security deposit creates a security interest all involve leases for personal property. In contrast, the cases cited in the opinion as holding that a deposit is a debt, not a pledge, are all real estate lease cases. Thus, the *Wiskup* decision seems to be unwittingly grouping the two lines of cases together. Yet, as explained above, real estate lease deposit cases are distinguishable from personal property lease cases because the former are expressly excluded from the Code by § 9-104(j). Moreover, the cases *Wiskup* cites were all strong authority on the Code's scope.
>
> Ultimately, however, *Wiskup* does not bear on our decision because it is based on an interpretation of Illinois, not Wisconsin law. The result in that case is a function of the interaction between the Illinois Consumer Deposit Security Act and the Illinois UCC, an issue we expressly decline to address. And to the extent the case aids Bank One, it is moot because we grant the Bank summary judgment despite our holding that the UCC applies.

D. *Bank One Did Not Earn Interest On the Security Deposits*

[7] Demitropoulos argues that Bank One did earn interest on the security deposit funds, and, as such, "received" from the collateral "money" that must be remitted to the ***985** class members or used to reduce their obligations. Demitropoulos concedes that the Bank did not place the deposits in an interest-bearing account. He focuses instead on the fact that, according to Bank One's "Monthly Transaction Journal," the Bank had nearly $6 million in security deposit funds available for use at some point during the class period. Based on the affidavit of his expert, John Walsh, plaintiff maintains that this increase in operating funds alleviated the Bank's need to borrow from the Federal Reserve and enabled the Bank to collect interest by lending its excess funds to other banks. Demitropoulos speculates that any interest saved from not having to borrow or earned from lending may be "money" that Bank One "received" from the collateral and must pass on to the lessees. But Demitropoulos offers no real evidence in support of this supposition.

We find that § 409.207(2)(c) cannot sustain such a strained reading. Furthermore, even if it could, the record before us does not permit a rational trier of fact to conclude that Bank One saved or made money using the security deposit funds.

[8][9][10] The court's primary job in construing a statute is to determine and advance the legislature's intent. *Ahlgren v. Pierce County,* 198 Wis.2d 576, 543 N.W.2d 812, 813 (1995). The best evidence of legislative intent is the language in the statute. *Town of DePere v. City of DePere,* 184 Wis.2d 278, 516 N.W.2d 1, 2 (Ct.App.1994). We are not, "under the guise of liberal construction," to read into the statute words that do not appear there, *Lang v. Lang,* 161 Wis.2d 210, 467 N.W.2d 772, 777-78 (1991), nor may we "look beyond the plain language of the statute to search for other meanings." *Ahlgren,* 543 N.W.2d at 813. Finally, a statute is not to be interpreted "in derogation of common sense." *State v. Clausen,* 105 Wis.2d 231, 313 N.W.2d 819, 826 (1982); *Town of DePere,* 516 N.W.2d at 2.

The question is whether having use of the security deposits to avoid borrowing or to increase lending on certain days constitutes "money ... received" FN17 from collateral, which Bank One must calculate and divide among the lessees. We answer in the negative. First, if § 409.207(2)(c)' s drafters intended to cover such a specific situation in an area as heavily regulated as banking, they would have made that clear by using language far more precise than "money received from collateral." It is not our prerogative to read words into the statute. Second, Demitropoulos' interpretation defies common sense. If adopted, courts would have license to hold lessors who place security deposits in non-interest-bearing bank accounts liable to lessees for any hypothetical benefits the account might generate, such as an enhanced credit line from the bank. This Court will not, without legislative direction, place on lessors such an onerous burden to discern and calculate every possible benefit, no matter how small or tangential, gained from holding onto a security deposit. The UCC was enacted "to simplify, clarify and modernize the law governing commercial transactions," not complicate and muddle it. Wis. Stat. § 401.102(2)(a); *see also In re Nickerson & Nickerson, Inc.*, 329 F.Supp. 93, 96 (D.Neb.) ("[I]f there is one maxim by which transactions governed by the [UCC] should be construed it is surely that they be construed in the most commercially reasonable manner."), *aff'd*, 452 F.2d 56 (8th Cir.1971); *Farmers Cooperative Elevator Co. v. Union State Bank*, 409 N.W.2d 178, 181 (Iowa 1987) (Article 9 interpretations should be "sensible, workable, practical and logical").

FN17. We note that the meaning of "interest or profits" is not before us. The dispute here is over *money* that Bank One allegedly earned on the deposits, and the statute excludes the subset of money from "interest or profits" that the secured party may hold. See 2 GRANT S. GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY § 42.8, at 1153-54 (1965) ("Money profits may not be held as additional security but must be either remitted to the debtor or applied in reduction of the obligation."). Indeed, Professor Gilmore writes that "[t]he only type of increase, other than money profits, which is likely to present itself is that of the young of animals." *Id.* at 1153.

[11] This legal conclusion alone justifies summary judgment in the Bank's favor. But even if § 409.207 (2)(c) could be read to encompass these "benefits," Demitropoulos has not shown that the Bank in fact received any. To defeat summary judgment, the nonmovant must point to "specific facts," by affidavit ***986** or otherwise, establishing the presence of a genuine issue for trial. Fed.R.Civ.P. 56(e). Even expert affidavits must have this factual basis; naked opinions will not suffice. *Mid-State Fertilizer Co. v. Exchange Nat'l Bank*, 877 F.2d 1333, 1339 (7th Cir.1989) ("[A]ffidavits supporting and opposing motions for summary judgment must do more than present something that will be admissible in evidence. They shall 'set forth facts' and by implication in the case of experts (who are not 'fact witnesses') a process of reasoning beginning from a firm foundation."). Here, summary judgment must be granted because nothing in the plaintiff's evidence points to specific facts showing Bank One used the security deposits to defray its borrowing costs or to increase its lending.

The affidavit of plaintiff's expert, John Walsh, lacks the required "firm foundation"-indeed, it is pure conjecture. Based on Bank One's statement that the security deposits increased the Bank's operating funds, Walsh leaps to the conclusion that the deposits "would have been put to use to either lower the amount of the bank's borrowings or fund the bank's assets." He opines that, as a result, the bank would "likely" have decreased its interest expense or increased its interest income. But no specific facts show that the deposits materially benefitted Bank One in any manner. Walsh's testimony is not based on any admission by Bank One that it relied on the security deposits in some fashion, nor is it the product of personal knowledge about Bank One's operations. His guess as to what Bank One "would have done" in a given situation or how it "likely" benefitted is not good enough to withstand summary judgment because it is rank speculation. What a "major Chicago bank" does on a day-to-day basis with its security deposits is not probative in determining how, if at all, Bank One actually put these deposits to use during the class period. Finally, Walsh's conclusion that Bank One's failure to invest the security deposits "would not be maximizing shareholder earnings and would likely bring criticism from shareholders" is absurd, given that, under plaintiff's theory, any fruits of the investment would go directly to the lessees, not the Bank's shareholders.

[12] Nor does the June 1996 "Monthly Transaction Journal" advance Demitropoulos' case. The journal simply sets forth, on a daily basis, the amount of security deposit funds held at Bank One. In June 1996, the journal reflects that Bank One received a total of about $6,000,000 in automobile lease security deposits. What the journal does not do is show that Bank One used these funds in any manner, much less permit a reasonable inference that Bank One used the deposits to avoid borrowing or increase lending.[FN18]

FN18. We wish briefly to address an unresolved discovery matter. In his Rule 12(N) statement, Demitropoulos dropped a footnote requesting this Court to grant a continuance under Fed.R.Civ.P. 56(f) for more discovery on the issue of where Bank One kept the security deposit. Pl's Resp. ¶ 6 n. 1. According to Demitropoulos, Bank One had "not yet produced any documents demonstrating that the deposit was recorded as a 'general ledger entry.' " *Id.* ¶ 6. The morning before Demitropoulos' brief was due, however, Bank One produced exactly this type of document: a "Monthly Transaction Journal" tracking its car lease security deposits for the month of June 1996. The Court permitted Demitropoulos to file the journal as an "Additional Exhibit in Opposition to Defendant's Motion for Summary Judgment." In several paragraphs preceding the exhibit, Demitropoulos complains that Bank One's discovery responses remain incomplete because the Bank did not produce journals for every month of the class period. He states that, "[i]f necessary, plaintiff will move to compel these documents, and intends to conduct further discovery to ascertain the amount of interest which Bank One actually earned on the deposits." Mot. File Pl. Add'l Ex. ¶ 9. Based on these statements, it appears that the documents Demitropoulos seeks through additional Rule 56(f) discovery are the other Monthly Transaction Journals.

This Court will not permit further discovery in this area for several reasons. First, this Court casts a jaundiced eye upon motions made by footnote. The mandatory procedure for requesting additional discovery under Rule 56(f) is to submit an affidavit describing the materials sought and the reasons they cannot be obtained. *See Stone Container Corp. v. Hartford Steam Boiler Inspection Co.*, 936 F.Supp. 487, 504 n. 19 (N.D.Ill.1996); *Colan v. Prudential-Bache Securities Inc.*, 577 F.Supp. 1074, 1084 (N.D.Ill.1983). Demitropoulos has filed no such affidavit, requiring the Court to guess at what specific documents he is seeking. Second, the time for discovery on this issue is long past. Despite plaintiff's stated intentions to file a motion to compel, none has been forthcoming, either before or during the pendency of this motion. Indeed, the Court questions whether these documents have already been produced.

Most important, though, is the point that the discovery plaintiff seeks is unavailing. It is well-settled that "a plaintiff's entitlement to discovery prior to a ruling on a motion for summary judgment is not unlimited, and may be denied when the record demonstrates that the requested discovery is not likely to produce the facts necessary to defeat the motion." *Colan,* 577 F.Supp. at 1084; *see First Nat'l Bank of Arizona v. Cities Serv. Co.,* 391 U.S. 253, 88 S.Ct. 1575, 20 L.Ed.2d 569 (1968)(court may deny Rule 56(f) discovery when it would amount to a fishing expedition); *Paul Kadair, Inc. v. Sony Corp.,* 694 F.2d 1017, 1029-30 (5th Cir.1983) (court may deny Rule 56(f) request when additional discovery unlikely to produce necessary facts); *Contemporary Mission, Inc. v. United States Postal Serv.,* 648 F.2d 97, 107 (2d Cir.1981) (same). Demitropoulos wants to conduct more discovery "to ascertain the amount of interest which Bank One actually earned on the security deposits," and, to that end, as far as we can tell, desires all Bank One's "Monthly Transaction Journals" during the class period. Mot. File Pl. Add'l Ex. ¶ 9. But the journals give no indication that the deposits earned money. Even plaintiff's theory that the deposits benefitted the Bank by saving it from having to borrow is not in any way supported by the journals. They do not show how much, if any, of the security deposit funds were used to avoid borrowing. Compelling discovery here would truly be sanctioning a fishing expedition. Rule 56(f) may not be used to defeat a summary judgment motion "where the result of a continuance to obtain further information and discovery would be wholly speculative ..." 6 J. MOORE, MOORE'S FEDERAL PRACTICE ¶ 56.24 (2d ed.1982), quoted in *Colan,* 577 F.Supp. at 1084. Demitropoulos' Rule 56(f) request for discovery is therefore denied.

***987** What we know, from the affidavit of Bank One's Vice President, who has first-hand knowledge about the Bank's operations, is that Bank One entered Demitropoulos' deposit amount as a debit on its general ledger. We know the Bank's operating funds fluctuated daily, and that the Bank did not rely on them every day to manage its cash position. But nothing in the record indicates when, if ever, the Bank relied on the security deposits.

Accordingly, we rule that Demitropoulos has failed to set forth specific facts, as required by Rule 56(e), entitling the class to interest on their security deposits. A plaintiff cannot avoid summary judgment merely by raising "some metaphysical doubt as to the material facts." *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.,* 475 U.S. 574, 586, 106 S.Ct. 1348, 1356, 89 L.Ed.2d 538 (1986). Summary judgment on Count II, the restitution claim, is therefore granted.

E. *Disposition of Remaining Claims*

Because Bank One did not earn interest on the security deposits, there was none to disclose. Consequently, Bank One did not violate the federal Consumer Leasing Act by failing to disclose earned interest. Nor did the Bank engage in an unfair or deceptive act under the Wisconsin Consumer Fraud Act by secretly retaining interest on the deposits. Summary judgment is thus granted on Count III (the Wisconsin Consumer Fraud Act claim), and on the portion of Count I's Consumer Leasing Act claim relating to interest on security deposits.

CONCLUSION

For the foregoing reasons, Bank One's motion for summary judgment is hereby granted. We will enter judgment for the Bank on Counts II and III, and on Count I's disclosure-of-interest claim. The rest of Count I remains viable. The parties are ordered to attend a status hearing on February 11, 1997 at 9:15 a.m., at which time a firm litigation schedule, including a trial date, will be set to resolve the remaining issues in this lawsuit.

N.D.Ill.,1997.
Demitropoulos v. Bank One Milwaukee, N.A.
953 F.Supp. 974, 33 UCC Rep.Serv.2d 1205

END OF DOCUMENT

C

United States District Court,
D. Oregon.
Kevin DUNCAN, Plaintiff,
v.
OFFICE DEPOT, Defendant.
Civil No. 96-3015-CO.

July 3, 1997.

Former employee brought breach of employment contract action in Oregon court against employer and employee and employer brought counter claims arising out of employer's overpayment of salary. After employer removed action to federal court, employer moved for summary judgment. The District Court, Cooney, United States Magistrate Judge, held that: (1) employer was not required to provide consideration for modifications of employee's at will employment contract under Oregon law; (2) employee did not show that he agreed to changes in terms of employment due to economic duress under Oregon law; (3) employer was entitled to return of its overpayment of salary to employee; and (4) genuine issue of material fact precluded summary judgment on whether employee was entitled to penalty wages for alleged nonpayment of salary due under Oregon law.

Motion granted in part and denied in part.

West Headnotes

[1] Labor and Employment 231H ⚷40(2)

231H Labor and Employment
231HI In General
231Hk37 Term, Duration, and Termination
231Hk40 Definite or Indefinite Term; Employment At-Will
231Hk40(2) k. Termination; Cause or Reason in General. Most Cited Cases
(Formerly 255k20 Master and Servant)
Without contrary agreement, employment relationship is terminable at will of either party under Oregon law.

[2] Labor and Employment 231H ⚷47

231H Labor and Employment
231HI In General
231Hk47 k. Modification or Rescission of Contract. Most Cited Cases
(Formerly 255k7 Master and Servant)
Under Oregon law, employer may modify employment contract that is terminable at will of either party so long as modification applies only prospectively and employee impliedly accepts such modifications by continuing employment after modification.

[3] Labor and Employment 231H ⚷47

231H Labor and Employment
231HI In General
231Hk47 k. Modification or Rescission of Contract. Most Cited Cases
(Formerly 255k7 Master and Servant)
Modifications of employee's at will employment contract made before employee started work after transfer were prospective in nature, and, thus, employer was not required to provide consideration for modifications under Oregon law, despite employee's arguments that he gave up his job, sold his home in another state, and undertook construction of home in transfer area before changes in terms of contract were imposed.

[4] Labor and Employment 231H ⚷47

231H Labor and Employment
231HI In General
231Hk47 k. Modification or Rescission of Contract. Most Cited Cases
(Formerly 255k7 Master and Servant)
Employer was free to change terms of at will employment prospectively at any time, and, thus, employee could not show that employer's modification of his at-will employment contract was wrongful

under Oregon law, as would support his argument that he agreed to changes in terms of employment due to economic duress.

[5] Contracts 95 ⚷95(1)

95 Contracts
95I Requisites and Validity
95I(E) Validity of Assent
95k95 Duress
95k95(1) k. In General. Most Cited Cases

To establish economic duress as grounds for rescinding contract under Oregon law, plaintiff must prove wrongful acts or threats, financial distress caused by those wrongful acts or threats, and absence of any reasonable alternative to terms presented by defendants.

[6] Labor and Employment 231H ⚷47

231H Labor and Employment
231HI In General
231Hk47 k. Modification or Rescission of Contract. Most Cited Cases
(Formerly 255k7 Master and Servant)

Labor and Employment 231H ⚷844

231H Labor and Employment
231HVIII Adverse Employment Action
231HVIII(A) In General
231Hk841 Good Faith and Fair Dealing; Bad Faith
231Hk844 k. Other Adverse Actions. Most Cited Cases
(Formerly 255k30(1.15) Master and Servant)

Under terms of employee's at will employment contract, employer had right to modify terms and conditions of employment prospectively at any time, and, thus, it was not appropriate to imply duty of good faith and fair dealing under Oregon law regarding employer's modification of employment terms prior to date employee started work.

[7] Labor and Employment 231H ⚷79

231H Labor and Employment
231HIII Rights and Duties of Employers and Employees in General
231Hk79 k. Good Faith and Fair Dealing. Most Cited Cases
(Formerly 255k30(1.15) Master and Servant)

Labor and Employment 231H ⚷843

231H Labor and Employment
231HVIII Adverse Employment Action
231HVIII(A) In General
231Hk841 Good Faith and Fair Dealing; Bad Faith
231Hk843 k. Discharge or Layoff. Most Cited Cases
(Formerly 255k30(1.15) Master and Servant)

In an at-will employment situation, duty of good faith and fair dealing applies to performance and enforcement of terms of employment contract under Oregon law, with exception of employer's right to terminate.

[8] Contracts 95 ⚷168

95 Contracts
95II Construction and Operation
95II(A) General Rules of Construction
95k168 k. Terms Implied as Part of Contract. Most Cited Cases

It is not appropriate to imply duty of good faith and fair dealing if it is inconsistent with provision of contract.

[9] Labor and Employment 231H ⚷228

231H Labor and Employment
231HIV Compensation and Benefits
231HIV(A) In General
231Hk228 k. Recovery of Payment. Most Cited Cases
(Formerly 255k79 Master and Servant)

Under Oregon law, employer did not waive its overpayment of employee's salary for four months under terms of employment contract by failing to immediately object to overpayment, and, thus, employer was entitled to return of overpayment, where on fifth month after overpayment began, employer notified employee of overpayment and its intent to recoup money, and employer filed counterclaim to employee's breach of contract action one month after employee brought action.

[10] Estoppel 156 ⚷52.10(2)

156 Estoppel
156III Equitable Estoppel
156III(A) Nature and Essentials in General
156k52.10 Waiver Distinguished
156k52.10(2) k. Nature and Elements of Waiver. Most Cited Cases

Estoppel 156 ⚷95

156 Estoppel
156III Equitable Estoppel
156III(B) Grounds of Estoppel
156k95 k. Silence. Most Cited Cases

Under Oregon law, "waiver" is intentional relinquishment of known right, and although mere silence can be basis for claim of estoppel when legal duty to speak exists, waiver must be manifested in unequivocal manner.

[11] Federal Civil Procedure 170A ⚷2497.1

170A Federal Civil Procedure
170AXVII Judgment
170AXVII(C) Summary Judgment
170AXVII(C)2 Particular Cases
170Ak2497 Employees and Employment Discrimination, Actions Involving
170Ak2497.1 k. In General. Most Cited Cases

Genuine issue of material fact precluded summary judgment on whether employee was entitled to penalty wages for alleged nonpayment of salary due under Oregon law. ORS 652.140, 652.150; Fed.Rules Civ.Proc.Rule 56(c), 28 U.S.C.A.

[12] Labor and Employment 231H ⚷2187

231H Labor and Employment
231HXIII Wages and Hours
231HXIII(A) In General
231Hk2186 Deduction and Forfeiture
231Hk2187 k. In General. Most Cited Cases
(Formerly 255k79 Master and Servant)

Employer's method of attempting to recoup four month overpayment of salary by deducting portion of overpayment from employee's earned salary after he quit was improper under statute regulating employer's withholding of wages, despite employee's signature on letter stating employer's intent to make deductions. ORS 652.610.

***1172** Lee Werdell, Medford, OR, for Plaintiff.

Douglas J. Richmond, Medford, OR, David S. Bradshaw, D. Gregory Valenza, Tracy S. Smith, San Francisco, CA, for Defendant.

COONEY, United States Magistrate Judge.

Plaintiff Kevin Duncan brought this action for breach of an employment contract in state court. Defendant Office Depot removed the action to federal court. Plaintiff seeks judgment for loss of back wages and benefits and future wages and benefits. Defendant filed a counterclaim for excess salary it claims it inadvertently paid to plaintiff. Plaintiff has filed a counterclaim to defendant's counterclaim for an amount of salary which he claims is due and owing and unpaid. This court has jurisdiction pursuant to 28 U.S.C. § 1332. The parties have executed written consents for entry of final judgment by a magistrate judge. 28 U.S.C. § 636(c). Defendant has filed a motion for summary judgment, or in the alternative, motion for partial summary judgment.

I. *FACTS*

In making the following findings, the court considers the evidence in the light most favorable to plaintiff [FN1]:

FN1. Defendants have filed objections to plaintiff's proposed facts and evidence and a motion to strike. In making its findings of fact, the court has considered the evidence and included the facts proposed by both parties, with the exception of facts which are not supported by the evidence cited, or which state an improper legal conclusion. The court's position is supported by the evidence objected to by defendants and considered by the court even with its inclusion.

Plaintiff became an employee of defendant when defendant acquired his previous employer, Eastman, Inc., in or about September 1993. Both at Eastman and defendant, plaintiff's employment was terminable at will by either party at any time, with or without notice, or good cause. Plaintiff received no employment contract limiting the reasons for termination, or employing him for a fixed period of time.

***1173** In early 1994, plaintiff asked his superior, Frank Martorella, for a transfer from the Southern California market, where he lived and worked, to Medford, Oregon. Although Martorella was hesitant to allow plaintiff to transfer when he requested it, he ultimately agreed to allow plaintiff to transfer to Medford, Oregon. Martorella and plaintiff "did not really have [a salary] battened down." At some point, they "came up with" a monthly salary of about $5,000; however, they did not discuss how long that salary would last. It was understood that the salary would decline over time and he would be on commission. According to plaintiff, Martorella told him that, "We'll kind of work with it as you go...." (K. Duncan Dep. 68, 130.) Plaintiff and Martorella discussed implementation of next day delivery into Medford. According to plaintiff, Matorella told him that he would be implementing next day delivery into the Medford area, and that "it would probably take a couple of months after [plaintiff] got up there to get that implemented." (K. Duncan Dep. At 72-73.) Plaintiff would need the next day delivery capability in order to succeed. Plaintiff states they "kind of had a date," but cannot remember the exact date. (K. Duncan Dep. At 101-02.)

Brad Costello was advised by Frank Martorella that an agreement had been made with plaintiff and that it should be kept. In early 1995, Mr. Costello told Mr. Martorella that he would not honor the agreement that had been made with plaintiff. Mr. Martorella thinks that at the point when the dialogue with Mr. Costello occurred, plaintiff had already dismantled his account base, his house was for sale or had been sold, and he was "midstream in making the move." (Martorella Dep. At 159.)

On March 8, 1995, plaintiff wrote a letter to Kevin Diamond, branch manager of the Portland, Oregon, sales office, stating, "I desperately need your help in finalizing my transfer to the Southern Oregon territory." (Valenza Aff. Ex. C; K. Duncan Dep.. At 101 & Ex. 8.) In a March 30, 1995, memorandum to plaintiff from Rich Hamilton, with copies to Brad Costello, Pete Roberts, and Kevin Diamond, Mr. Hamilton set forth the terms of the transfer. The sales territory was stated as Central and Southern Oregon (Jackson and Lane Counties). The memorandum stated: "I want you to understand that this geographical area is somewhat distant from the Seattle distribution center and the Portland cross-dock. The infrastructure is not present to completely support the Central and Southern Oregon territories.... [A]t this point [during the remainder of this business year and into 1996] perhaps an infrastructure will be in place to continue your aggressive sales efforts." (Valenza Aff. Ex. D; K. Duncan Dep. Ex. 10.) Plaintiff understood that this pertained to the deliveries; he understood that he was going to get next-day deliveries, but that it would take some time after he moved to Southern Oregon. Plaintiff understood it was a change from what he had been told by Mr. Martorella, that defendant was deviating, extending out the deadlines, and making it indefinite. The memorandum stated that plaintiff would earn a salary of $5,200 plus two percent commission for the first four months, and $4,000 plus four percent commission for the second four months. At the end of 1995, plaintiff was to convert to the proposed compensation plan at that time in the Portland branch. Plaintiff's sales goals and objectives were set out in two phases. Kevin Diamond deemed the sales projections given plaintiff unreasonable and not attainable. These goals were later reduced in an April 17, 1995, memorandum from Rich Hamilton to plaintiff. At the end of the March 30th memorandum appears: "If you are in complete agreement with the aforementioned plan, please sign below and we can begin the paperwork for transfer to Location 5126." (Valenza Aff. Ex. D; K. Duncan Dep. Aff. 10.) There is no signature in the space provided for plaintiff's signature in the March 30th memorandum.

Plaintiff responded to the March 30th memorandum in writing on April 6, 1995. Plaintiff asked why the terms and conditions of his transfer were being "substantially changed." (Valenza Aff. Ex. E; K. Duncan Dep. At 140 & Ex. 12.) Plaintiff stated in that letter that his new home was three weeks from completion, and that his house in California had been sold. Plaintiff stated in his letter: "... I must ask you to understand that I have no choice but to reluctantly agree to this new plan, in order to avoid a severe financial situation." (Valenza Aff. Ex. E; K. ***1174** Duncan Dep. At 139, 143 & Ex. 12.) The effective date of plaintiff's transfer was May 15, 1995. Plaintiff transferred to Medford, Oregon, and began working under the modified terms of the agreement. Defendant implemented next day delivery service to Eugene, Oregon, on or about July 3, 1995.

At some point, plaintiff and Kevin Diamond had a conversation regarding the changeover date in salary. Mr. Diamond thought that the changeover should be delayed for some period of time because of the failure to achieve next day delivery into Eugene by the date anticipated, and this was expressed to plaintiff as a factor to be considered in arriving at a recommended changeover date. Mr. Diamond told plaintiff that no action was required of him and that he or someone else would get back to plaintiff after he talked to Mr. Hamilton. Mr. Diamond never got back to plaintiff and he doesn't think anyone else did.

Defendant paid plaintiff $5,200 per month salary for eight months, rather than only the first four months. In a January 3, 1996, letter from senior sales manager Jeff Evans, defendant informed plaintiff that he had not met any of the sales targets and his performance was unacceptable. Mr. Evans told plaintiff that it expected sales in the Eugene area to increase and time spent in areas not fully serviced to decrease. The letter set forth month-by-month sales and GP expectations for January, February, and March 1996. The letter also informed plaintiff that the change to the lower salary was not implemented September 1, 1995, per the compensation agreement and, as a result, plaintiff was overpaid by $4,707.64. Mr. Evans told plaintiff that the repayment would be spread over eight weeks in a deduction of $588.08 per week, beginning on the pay period January 1-6, 1996. The letter closed by stating: "If you have any questions about this, or are unclear about the goals set before you, call me at once. Please sign and date the enclosed copy of this correspondence and bring it with you to your account review meeting next week." In the space for the signature of plaintiff appears, "(sign [sic] under protest)" and plaintiff's signature. (Valenza Aff. Ex. G.)

Plaintiff voluntarily resigned employment with defendant on or about January 18, 1996, without notice, after one $588.08 deduction had been made.

II. *LEGAL STANDARDS*

Pursuant to Rule 56(c) of the Federal Rules of Civil Procedure, a moving party is entitled to summary judgment as a matter of law "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact." Fed.R.Civ.P. 56(c); *Bhan v. NME Hosps.,* *Inc.*, 929 F.2d 1404, 1409 (9th Cir.), *cert, denied,* 502 U.S. 994, 112 S.Ct. 617, 116 L.Ed.2d 639 (1991). The moving party must carry the initial burden of proof. *Celotex Corp. v. Catrett,* 477 U.S. 317, 322-24, 106 S.Ct. 2548, 2552-53, 91 L.Ed.2d 265 (1986). The moving party meets this burden by identifying for the court portions of the record on file which demonstrate the absence of any genuine issue of material fact. *Celotex Corp.*, 477 U.S. at 322-24, 106 S.Ct. at 2552-53; *Bhan,* 929 F.2d at 1409. In assessing whether a party has met its burden, the court must view the evidence in the light most favorable to the non-moving party. *Allen v. City of Los Angeles,* 66 F.3d 1052 (9th Cir.1995). All reasonable doubts must be resolved in the non-movant's favor. *Intel Corp. v. Hartford Accident and Indem. Co.,* 952 F.2d 1551, 1558 (9th Cir.1991).

If the moving party meets its burden with a properly supported motion, the burden then shifts to the opposing party to present specific facts which show there is a genuine issue for trial. Fed.R.Civ.P. 56(e) ; *Intel Corp.,* 952 F.2d at 1558; *Auvil v. CBS "60 Minutes",* 67 F.3d 816 (9th Cir.1995), cert. denied, 517 U.S. 1167, 116 S.Ct. 1567, 134 L.Ed.2d 666 (1996); *see Anderson v. Liberty Lobby, Inc.,* 477 U.S. 242, 250 & n. 4, 106 S.Ct. 2505, 2511 & n. 4, 91 L.Ed.2d 202 (1986). If the moving party presents evidence which, taken by itself, would establish the right to a directed verdict at trial, the motion for summary judgment must be granted, in the absence of any significant probative evidence tending to support the opposing party's theory of the case. *THI-Hawaii-Inc. v. First Commerce Fin. Corp.,* 627 F.2d 991, 993-94 (9th Cir.1980); ***1175** *First Nat'l Bank v. Cities Serv. Co.,* 391 U.S. 253, 290, 88 S.Ct. 1575, 1593, 20 L.Ed.2d 569, *reh'g denied,* 393 U.S. 901, 89 S.Ct. 63, 21 L.Ed.2d 188 (1968). Conclusory allegations, unsupported by factual material, are insufficient to defeat a motion for summary judgment. *Taylor v. List,* 880 F.2d 1040, 1045 (9th Cir.1989). Instead, the opposing party must, by affidavit or as otherwise provided by Rule 56, designate specific facts which show there is a genuine issue for trial. *Leonard v. Clark,* 12 F.3d 885, 888 (9th Cir.1993).

III. *DISCUSSION*

Plaintiff's claim for breach of contract

Defendant argues that, assuming plaintiff's discussions with Frank Martorella constituted a contract, defendant was privileged to unilaterally and prospectively modify the contract; and plaintiff cannot prove the existence of a valid oral contract arising out of the discussions with Frank Martorella because the purported agreement fails for indefiniteness, and the parol evidence rule bars any evidence of an alleged oral promise prior to Rich Hamilton's March 30, 1995, memorandum.

[1][2] Without a contrary agreement, an employment relationship is terminable at the will of either party. *Albrant v. Sterling Furniture Co.,* 85 Or.App. 272, 278, 736 P.2d 201, *review denied,* 304 Or. 55, 742 P.2d 1186 (1987) "It follows that an employer may also modify the employment contract so long as the modification applies only prospectively [and] An employee impliedly accepts such modifications by continuing employment after the modification." *Id.* (citations and footnote omitted); *Fish v. Trans-Box Sys., Inc.,* 140 Or.App. 255, 259, 914 P.2d 1107 (1996) ["The law is well established that an employer may modify an at-will employment relationship unilaterally."]; *Brett v. City of Eugene,* 130 Or.App. 53, 57, 880 P.2d 937 (1994), *review denied,* 320 Or. 507, 888 P.2d 568 (1995); *State ex rel. Roberts v. Public Fin. Co.,* 294 Or. 713, 716, 662 P.2d 330 (1983) ["An employer is free to set the terms and conditions of the work and of the compensation and the employee may accept or reject those conditions."]; *Page v. Thomas Kay Woolen Mill Co.,* 168 Or. 434, 439, 123 P.2d 982 (1942); *see Elliott v. Tektronix,* 102 Or.App. 388, 393, 796 P.2d 361, *review denied,* 311 Or. 13, 803 P.2d 731 (1990)["[A]n at will employer may make unilateral changes in employment terms, notwith-

standing its previous representations, and not be subject to contract liability." (Citing *Albrant,* 85 Or.App. 272, 736 P.2d 201)].

[3] Plaintiff agrees that an employer may prospectively modify the terms and conditions of an at-will employment contract, but contends that the modification at issue here was not prospective. Plaintiff also claims that there was no consideration given to support the modification.

The case of *Stuart v. Tektronix, Inc.,* 83 Or.App. 139, 730 P.2d 619 (1986), *review denied,* 303 Or. 74, 734 P.2d 354 (1987), relied upon by plaintiff is distinguishable. There, plaintiff sought to enforce a promise of a future increase in salary. The court found that an employee who continues employment in reliance on a promise of a future salary increase may hold the employer liable for its breach. Plaintiff there argued that the promise of a salary increase was consideration for his past performance. The court found that any agreement as to a future salary increase was ambiguous and constituted a genuine issue of material fact precluding summary judgment.

The facts of this case are like those in *Fish,* 140 Or.App. at 258-60, 914 P.2d 1107. In *Fish,* plaintiff was told that he would be entitled to benefits including sick pay and health insurance after he had completed a ninety day probationary period. Upon his inquiries after completing his probationary period, he was told that the health benefits packages had not been sent and that the company was attempting to purchase health insurance elsewhere. Plaintiff continued to work for defendant. The court found that, after becoming aware of the unilateral changes in the terms made by his employer-that if benefits would be provided, it would be in the unspecified future-plaintiff accepted the modification by continuing to work.

Plaintiff apparently argues that the modification was not prospective because he gave up his accounts in Southern California, sold ***1176** his house in Southern California, and undertook construction of a new house in Oregon, before the changes in terms were imposed by defendant in the March 30, 1995, memorandum. The court disagrees. At the time the modification was made, plaintiff had not yet transferred to Medford and begun working under the agreement reached with Frank Martorella which included a $5,000 per month salary and implementation of next day delivery in Medford within a couple of months. The situation here is similar to that in *Albrant,* 85 Or.App. at 277-78, 736 P.2d 201. In *Albrant,* plaintiff confirmed her work hours and commission rates with defendant employer and, in reliance on those representations, she quit her job and moved from Klamath Falls to Eugene, Oregon, to work for defendant. When she began work, but before she sold any merchandise, plaintiff was told that the commission rate was lower than represented on certain items, and her work hours were different than represented. The court found that defendant employer was free to modify the employment contract so long as the modification applied only prospectively. The court held that summary judgment was properly granted as to plaintiff's breach of contract claim in which she claimed that defendant could not arbitrarily change the terms of the contract. Here, plaintiff not only impliedly accepted the modified terms contained in the March 30, 1995, memorandum by continuing in defendant's employ and transferring to Medford, Oregon, with full knowledge of the modification, he expressly accepted those terms in his letter of April 6, 1995, albeit reluctantly.

The court further finds that, based on the cases which discuss modification of the terms and conditions by the employer in an at-will employment relationship, no consideration is required for modification of the employment contract. The cases cited by plaintiff involve situations where an employee was induced to enter into a subsequent agreement which contained a restrictive covenant regarding other employment, or modification of a lease agreement.

Plaintiff asserts that, "Assuming arguendo that

Plaintiff has not given consideration or adequate consideration, Plaintiff will rely on *Natkin and Co. v. H.D. Fowler Co.,* 128 Or.App. [311], 876 P.2d 319 (1994)...." (Pa. Opp'n Mem. At 10.) Plaintiff argues that, in reliance on the agreement made with Martorella, he substantially changed his position by giving up his accounts in Southern California, selling his house in Southern California, and undertaking construction of a new house in Oregon and, therefore, promissory estoppel applies to bar enforcement of the modification.

Natkin states that promissory estoppel is a substitute for consideration, and sets forth the elements for recovery on the theory:

A promise is enforceable by reason of promissory estoppel if there is: (1) a promise; (2) which the promisor could reasonably foresee would induce conduct of the kind that occurred; (3) actual reliance on the promise; and (4) a substantial change in position by the party seeking to enforce the promise. The doctrine is applied if "injustice can be avoided only by enforcement of the promise."

128 Or.App. At 314 (citations omitted; quoting Restatement of Contracts § 90 (1932)); *Hill v. Mayers,* 104 Or.App. 629, 631 & n. 2, 802 P.2d 694 (1990), *review denied,* 311 Or. 187, 808 P.2d 91 (1991). As discussed above, consideration is not required to modify an at-will employment contract and, therefore, the doctrine is inapplicable in this case. *See Hill,* 104 Or.App. at 632, 802 P.2d 694. However, even if promissory estoppel would apply to the circumstances presented here, plaintiff could not reasonably rely on the representations made by Frank Martorella after he accepted the terms stated in the March 30, 1995, memorandum, and continued working for defendant. He makes no claim of injury until he began working in Medford and thereafter. *See Fish,* 140 Or.App. at 259, 261, 914 P.2d 1107; *Elliott,* 102 Or.App. at 393, 796 P.2d 361; *Albrant,* 85 Or.App. at 276, 736 P.2d 201.

[4][5] Plaintiff also argues that he agreed to the changes in the terms of employment in Southern Oregon due to economic duress. He argues that he agreed to the modification "because of the wrongful act of Defendant in failing to carry out the Defendant's promises." (Pl. Opp'n Mem. At 11.) To establish economic duress, "Plaintiff must prove (1) wrongful acts or threats, (2) financial distress ***1177** caused by those wrongful acts or threats, and (3) the absence of any reasonable alternative to the terms presented by defendants." *Eulrich v. Snap-On Tools Corp.,* 121 Or.App. 25, 853 P.2d 1350, *review denied,* 317 Or. 583, 859 P.2d 540 (1993), *vacated on other grounds,* 512 U.S. 1231, 114 S.Ct. 2731, 129 L.Ed.2d 854 (1994). Plaintiff cannot prove the first element, that defendants act in changing the terms of the employment contract with plaintiff was wrongful, since an employer is free to change the terms and conditions of employment prospectively at any time. Accordingly, plaintiff's claim of economic duress fails.

[6][7][8] It appears that plaintiff pleads breach of the good faith and fair dealing. Plaintiff alleges that defendant's alleged breach of the employment contract by failing to provide one day delivery at the time he commenced work and thereafter, and by advising plaintiff it would not provide one day delivery in the Medford area and would only provide such service in Eugene also constituted a breach of the duty of good faith and fair dealing. Defendant does not address this claim in its motion for summary judgment. However, plaintiff raises the issue in his opposition to which defendant replies. Because the duty is implied in every contract, and the alleged breach of the duty is the same as the alleged breach of contract, the court will address the issue. In an at will situation, the duty of good faith and fair dealing applies to the performance and enforcement of the contractual terms, with the exception of the right to terminate. *Sheets v. Knight,* 308 Or. 220, 232-34, 779 P.2d 1000 (1989), *abrogated on other grounds,* 321 Or. 532, 901 P.2d 841 (1995); *Elliott,* 102 Or.App. at 396, 796 P.2d 361. However, it is not appropriate to imply the duty of good faith and fair dealing if it is inconsistent with a provision of the contract., 308 Or. at 233, 779

P.2d 1000; *Elliott,* 102 Or.App. at 395, 796 P.2d 361. Here, defendant had a right to modify the terms and conditions of plaintiff's employment with it prospectively at any time. Therefore, it would not be appropriate to apply the duty in this situation. To the extent that plaintiff pleads a claim for breach of the duty of good faith and fair dealing, it should be dismissed.

Parties' counterclaims

[9] In its counterclaim, defendant claims that it inadvertently overpaid plaintiff at the higher salary of $5,200 per month instead of the agreed upon rate of $4,000 per month, for four months, which plaintiff has not repaid. In its motion for summary judgment, defendant argues that plaintiff admits it agreed to pay him $5,200 per month for four months and $4,000 per month for four months, and that it paid him $5,200 for eight months, resulting in an overpayment of § 4,707.64. Defendant further argues that plaintiff acknowledged defendant's intent to recoup the overpayment at the rate of $588.08 per pay period until it was paid off; that one $588.08 deduction was made; and that a balance of $4,119.56 remains. Plaintiff contends that defendant has waived its claim and that defendant is estopped to claim the overpayment. Plaintiff contends that the issue should be submitted to the jury.

[10] "Waiver is an intentional relinquishment of a known right. Although mere silence can be a basis for a claim of estoppel when a legal duty to speak exists, waiver must be manifested in an unequivocal manner." *Hohman v. Bartel,* 128 Or.App. 384, 387, 876 P.2d 347, *review denied,* 320 Or. 110, 881 P.2d 142 (1994) (citations omitted); *South Lake Ctr. Partnership v. Waker Assocs., Inc.,* 129 Or.App. 581, 589-90, 879 P.2d 1342 (1994). Initially, the court notes that plaintiff offers no evidence which supports his assertion that he inquired of Kevin Diamond whether his salary would be reduced on schedule and he was told not to worry about it; or that Mr. Diamond told him that he should be paid at the higher rate for some additional time. The evidence cited by plaintiff indicates that he and Mr. Diamond did have a discussion at some point regarding the changeover date, and that Mr. Diamond expressed to plaintiff his thinking that the failure to achieve next-day delivery in Eugene at the anticipated date was a factor in arriving at a recommended changeover date. The evidence shows that defendant continued to pay plaintiff $5,200 through December 1995, and that defendant notified plaintiff in a letter dated January 3, 1996, of the overpayment and their intent to recoup the money.***1178** The record shows that this action was filed in state court on January 24, 1996, and that defendant filed its counterclaim on March 1, 1996. Even if plaintiff inquired after receiving the higher salary in the second four month phase, defendant's silence until January 1996 could not constitute a waiver of its rights. Defendant took no unequivocal action which would imply any waiver of its right to the overpaid salary; in fact, defendant told plaintiff in early January 1996 its intent to recoup the overpayment. And a delay of one month by defendant in filing its counterclaim after plaintiff commended this action for breach of contract is insufficient to manifest any intention by defendant to give up its rights. Nor does plaintiff offer any evidence which would support an estoppel. There is no evidence that any promise was made to plaintiff that he would receive the higher salary for any amount of time after the time phase II began. Plaintiff shows no evidence that he relied to his detriment on the $5,200 salary checks received. Accordingly, the court finds that defendant's motion as to its counterclaim is granted.

[11] In plaintiff's counterclaim, he alleges that when defendant continued to pay him $5,200, he notified defendant in September 1995, and was assured by his supervisors that "they would notify Plaintiff at such time a [sic] the change would occur and, in the meantime, Plaintiff need not worry about the matter." He further alleges that in retaliation for plaintiff's insistence that defendant keep its promise to support his sales efforts, defendant in January 1996 advised him that he would have to

work in Eugene, Oregon, that no sales effort would be supported in Southern Oregon, and that defendant would take from plaintiff's salary of $4,000 the amounts paid in excess of $4,000 between September 1995 and January 1996; he alleges that $588.08 due and owing to him as salary was not paid to him in his January 27, 1996, paycheck by defendant. Plaintiff seeks penalty wages of $4,000 and attorney's fees pursuant to ORS 652.200. Defendant argues in its motion for summary judgment that it owes plaintiff nothing and that it paid plaintiff more salary than he was entitled to. It asserts that plaintiff is not entitled to ORS 652.150 penalties because plaintiff had not earned any wages that were unpaid at the time of his resignation. Plaintiff contends that his continued employment after being told by defendant not to worry about his pay being dropped supplied consideration for the higher wage. He argues that waiver and estoppel apply equally to his counterclaim. He further argues that defendant's withholding of the $588.08 from his paycheck was an improper setoff against the claim it had against plaintiff.

Plaintiff seeks penalty wages for the alleged nonpayment of salary due and owing to him upon termination of his employment. ORS 652.150 provides in pertinent part:

If an employer willfully fails to pay any wages or compensation of any employee whose employment ceases, as provided in ORS 652.140 ..., than, as a penalty for such nonpayment, the wages or compensation of such employee shall continue from the due date thereof at the same hourly rate for eight hours per day until paid or until action therefore is commenced; provided, that in no case shall such wages or compensation continue for more than 30 days from the due date....

ORS 652.140 provides in pertinent part:
(2) When an employee who does not have a contract for a definite period quits employment, all wages earned and unpaid at the time of quitting become due and payable immediately if the employee has given to the employer not less than 48 hours' notice.... If notice is not given to the employer, the wages shall be due and payable within five days or at the next regularly scheduled payday after the employee has quit, whichever event first occurs.

Defendant asserts that plaintiff is not owed any salary because of the overpayment it made for four months, September through December 1995. It is clear, however, that plaintiff was not paid the salary that he had *earned* relating to the pay period January 1, 1996, to January 6, 1996 (Valenza Aff. Ex. G), *see Schulstad v. Hudson Oil Co.,* 55 Or.App. 323, 326, 637 P.2d 1334 (1981), *review denied,* 292 Or. 825, 648 P.2d 849 (1982), because a $588.08 deduction was made by defendant as a portion of the recoupment of the four month overpayment of salary.

***1179** [12] The court finds that defendant's method of attempting to recoup the overpayment of salary for the months September through December 1995 was improper. Although plaintiff signed (under protest) the January 3, 1996, letter which stated defendant's intent to make the deductions, the court finds that plaintiff's signature was not an agreement to the deductions.

The request for plaintiff's signature makes no reference to the intended deductions, and the paragraph refers only to the goals set for sales in the first part of 1996. Moreover, it appears that defendant could not make the deduction it did, even with a writing by plaintiff. An employer is not allowed to make a deduction from an employee's salary except in the circumstances specified in ORS 652.610,[FN2] or if the agreement is approved by the commissioner pursuant to ORS 652.360.[FN3] *Garvin v. Timber Cutters, Inc.,* 61 Or.App. 497, 500-01, 658 P.2d 1164 (1983); *Kling v. Exxon Corp.,* 74 Or.App. 399, 403, 703 P.2d 1021 (1985); *see Schulstad,* 55 Or.App. at 326-28, 637 P.2d 1334; *Sabin v. Willamette-Western Corp.,* 276 Or. 1083, 1091-92, 557 P.2d 1344 (1976). Even if defendant had a good faith belief that it had a claim or an offset against plaintiff's salary, penalty wages may be imposed for any salary due and unpaid at the time of termination. *Reed v. Curry-Kropp-Cates, Inc.*, 61 Or.App. 520, 525-26 & n. 3, 658 P.2d 531 (1983); *Sabin,* 276 Or. At 1091-92 & n. 5. For the reasons stated, defendant's motion for summary judgment as to plaintiff's counterclaim for penalty wages for unpaid salary is denied.

> FN2. ORS 652.610 provides in pertinent part:
>
> > (3) No employer may withhold, deduct or divert any portion of any employee's wages unless:
> >
> > (a) The employer is required to do so by law;
> >
> > (b) The deductions are authorized in writing by the employee, are for the employee's benefit, and are recorded in the employer's books;
> >
> > (c) The employee has voluntarily signed an authorization for a deduction for any other item, provided that the ultimate recipient of the money withheld is not the employer, and that such deduction is recorded in the employer's books;
> >
> > (d) The deduction is authorized by a collective bargaining agreement to which the employer is a party; or
> >
> > (e) The deduction is made from the payment of wages upon termination of employment and is authorized pursuant to a written agreement between the employee and employer for the repayment of a loan made to the employee by the employer, if all of [certain] specified conditions are met....
>
> FN3. ORS 652.360 provides in pertinent part:
>
> > No employer may by special contract or any other means exempt the employer from any provision of or liability or penalty imposed by ... any statute relating to the payment of wages, except insofar as the commissioner in writing approves a special contract or other arrangement between an employer and one or more of such employer's employees....

IV. *ORDER*

Based on the foregoing, it is ordered that defendant's motion for summary judgment as to plaintiff's claim for breach of contract be granted, that its motion as to its counterclaim for overpaid salary be granted, and that its motion as to plaintiff's counterclaim be denied.

D.Or.,1997.
Duncan v. Office Depot
973 F.Supp. 1171, 137 Lab.Cas. P 58,530

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Only the Westlaw citation is currently available.

UNPUBLISHED OPINION. CHECK COURT RULES BEFORE CITING.

Court of Chancery of Delaware, New Castle County.
EL PASO NATURAL GAS COMPANY, Plaintiff,
v.
AMOCO PRODUCTION COMPANY, Defendant.
Civ. A. No. 12083.

Submitted: Oct. 25, 1994.
Decided: Dec. 16, 1994.

Robert K. Payson, James F. Burnett of Potter Anderson & Corroon, Wilmington, Britton White, Jr. and Arthur R. Formanek, Jr., El Paso, TX, Judy A. Johnson and Thomas R. Kline of Andrews & Kurth L.L.P., Washington, DC, for El Paso Natural Gas Co.

Stephen E. Herrmann of Richards, Layton & Finger, Wilmington, Steven R. Hunsicker and Cheryl J. Walker of Baker & Botts, L.L.P., Washington, DC, Timothy S. Durst of Baker & Botts, L.L.P., Dallas, TX, Rebecca S. McGee, Denver, CO, for Amoco Production Co.

MEMORANDUM OPINION

ALLEN, Chancellor.

***1** The March 29, 1994 memorandum opinion in this action concluded that El Paso Natural Gas Company ("El Paso") had breached similar terms in two contracts that it had entered with Amoco Production Company ("Amoco"). Determination of the amount of compensatory damages to which Amoco is entitled as a result was deferred, however. I now take up that subject, along with related questions of pre-judgment interest and attorneys' fees.

3

As background to these issues, I note that in 1988, Amoco succeeded to the rights of Tenneco, Inc. in the 1984 Gas Gathering Agreement (the "1984 Agreement") with El Paso, which contemplated the transport over El Paso's pipelines of Tenneco/Amoco gas. In 1989 Amoco negotiated an additional Gas Gathering Agreement with El Paso (the "1989 Agreement"). Article V of both the 1984 Agreement and the 1989 Agreement sets out a "most favored rate" provision; those provisions assure Amoco the lowest rate for transportation of its gas that El Paso charges to any person (including affiliates) for services that are "same or similar" to those provided to Amoco. In this suit, Amoco claimed that its most favored rate rights were violated when El Paso provided similar services to El Paso's then affiliate, Meridian Oil Trading, Inc. ("Meridian"), at significantly lower rates than those charged to Amoco. Although El Paso admits that it provided field transportation services to Meridian at lower rates, it insisted that these services were not "same or similar." After four days of trial and two rounds of post trial briefing I concluded that Meridian's "combination backhaul agreement" with El Paso, which was at a lower rate than Amoco's comparable agreement, did contemplate the "same or similar" services as those provided under the 1984 and 1989 Agreements. Accordingly, Article V of both 1984 and 1989 Agreement were found to have been violated.

On the issue of compensatory damages, the parties largely agree to the appropriate calculation (albeit El Paso reserves its trial positions for review on appeal). They disagree, however, on the calculation of damages under the 1984 Agreement for the period from January 1, 1994 to March 31, 1994. Thus on this motion Amoco contends the correct calculation of damages, assuming the facts and law reflected in this court's opinion, would be $15,818,252 plus interest, while El Paso asserts it would be $15,383,286, plus interest. This difference arises from a dispute concerning the effect if any of a post-decision agreement between El Paso and Meridian to amend their gas transportation contract retroactively. *See* pp. 3-6, below.

With respect to pre-judgment interest, the parties appear to agree that the pertinent Texas statute provides the appropriate measure in this case which involves Texas substantive law. *See Stauffer Chemical Co. v. Keysor-Century Corp.*, 541 F.Supp. 234, 238-39 (D.Del.1982). The applicable rate is 6%. *See* pp. 3-4, below.

On the issue of attorneys' fees, Amoco urges that Texas law should apply in accordance with the parties' contractual choice of law provision. Under Texas law, reasonable attorneys' fees are recoverable by the prevailing party in a breach of contract action. El Paso asserts that Delaware deems the issue of recovery of attorneys' fees to be procedural and thus governed by Delaware law, which, it says, does not recognize a right to such an award in a case of this kind. *See* pp. 7-15, below.

***2** For the reasons that follow I conclude that Amoco is entitled to a judgment in the principal amount of $15,818,252 as compensatory damages, which shall bear interest from the date of Amoco's payment of excessive charges until the date of the judgment, at 6% simple interest; plus $649,549.76 as reimbursement of its reasonable attorneys' fees.

I. Compensatory Damages

A. Amoco's Calculation.

Amoco calculates its damages by: (1) determining the lowest rate charged by El Paso for field transportation services during any covered period in the San Juan Basin; (2) multiplying that rate by the volume of Amoco gas transported by El Paso during the period that the most favorable rate was in effect; and (3) subtracting the product from the amount Amoco was charged and paid. Amoco asserts that its compensatory damages, without pre-judgment interest, on this record to be $14,891,695 under the 1984 Agreement and, $926,557 under the 1989 Agreement.

B. Amoco's Calculation of Pre-Judgment Interest.

Amoco asserts (and the parties do not appear to disagree) that Texas law should be applied to determine any right to pre-judgment interest as their contracts are governed by Texas law. In Texas, a pre-judgment rate of interest to be applied in cases of breach of a contract that identifies appropriate measure of damages but does not specify a rate of interest is established by statute. *See* Vernon's Rev. Tex.Civ.Stat.Ann., Art. 5069-1.03 (1987). This statute applies here as both 1984 Agreement and 1989 Agreement identify the appropriate measure of damages but neither specifies a pre-judgment interest rate. In such instances the Texas statute provides that six percent is the applicable rate of interest. The six percent annual simple interest on Amoco's calculation of damages under the 1984 Agreement through March 31, 1994 appears to be agreed to be $2,847,247. The same under the 1989 Agreement appears to be $177,537. I will however ask the parties to attempt to stipulate these calculations once the governing principles are established by this decision.

C. El Paso's Calculation of Compensatory Damages.

El Paso does not contest Amoco's calculation of damages or interest for the period through December 31, 1993. Thus to a large extent the parties agree to the necessary calculations now.

The difference in the parties' calculations arises from the fact that following the issuance of the memorandum opinion, El Paso apparently renegotiated Meridian's (the favored shipper) backhaul contract. That renegotiation is said to have resulted in an *ex post facto* raising of the rates charged by El Paso from $.0275 per MMBtu to $.09 per MMBtu. El Paso insists that although the new agreement was not reached until after January 1, 1994, it is effective retroactively to January 1, 1994. Apparently, having already paid for El Paso's services at the $.0275 rate, Meridian has made an additional payment to reflect the increased rate ($.0275 to $.09) for all volumes gathered since January 1, 1994. Thus, El Paso now seeks that the court calculate the damages for the 1984 Agreement from January 1, 1994 through March 31, 1994 based on the favored shipper having paid the renegotiated rate of $.09 rather than the $.0275 rate that had been paid or incurred at the time of the service. This increase in the rate charged to Meridian if it affects Amoco's entitlement to compensation would decrease its damages (and pre-judgment interest) by $518,132.

D. Rejection of Retroactive Portion of the New El Paso-Meridian Agreement as a Measuring Standard.

***3** At trial A.W. Clark, El Paso's vice president of rates and regulatory affairs, testified that El Paso intended to increase Meridian's gathering rate from $.02 per MMBtu to $.0275 per MMBtu beginning January 1994. On April 28, 1994 El Paso apparently filed a discount report with the Federal Energy Regulatory Commission indicating that Meridian had been charged a rate of $.0275 per MMBtu as reflected in the March 1994 invoices. The revised transportation invoices that El Paso sent to Meridian to charge a $.09 rate retroactively are dated May 16, 1994. Although El Paso does not mention the date of the revised agreement with Meridian, it appears that it must have been executed after the March 29, 1994 memorandum opinion.

In that decision determination of compensatory damages was deferred. Nevertheless, insofar as this court is concerned, that decision settled the rights of each party on the facts then in the record. No motion to re-open the evidence has been granted. El Paso's attempt to take into consideration the effect of its later, retroactive contract amendment, is made through an affidavit, not subject to cross-examination. For this reason alone that amended contract provides no legal basis on this record to modify the calculation of contract damages.

Beyond that is the substantive law point. That is, assuming the record were re-opened and sufficient admissible testimony were admitted to support the finding that the El Paso-Meridian contract had been renegotiated and the rate retroactively changed, would that fact affect the adjudicated, but not liquidated rights of Amoco? Given the state of the record I need not finally determine that question, but I do express my doubt that the amount of damages to which Amoco is entitled could be retroactively altered by unilateral actions of El Paso. To recognize such an effect would encourage conduct that is at best simply strategic and at worst would constitute an attempt to undermine the authority of the court to give effect to its judgments.

In any event, on the record I conclude that, Amoco is entitled to recover the $15,818,252 in compensatory damages for breach of the 1984 and 1989 Agreements, plus pre-judgment interest at 6%.

3

As a part of its relief, Amoco requests that El Paso be enjoined from charging Amoco more than the $.0275 rate until after June 30, 1995 which is the termination date of the 1992 Letter Agreement between El Paso and Meridian providing the rates to be charged. As mentioned El Paso and Meridian have apparently executed a new agreement increasing the gathering rate to $.09 per MMBtu. This issue does not involve retroactivity of a rate change, but the prospective (from the time of the adjudication) effect of one. It is basic law that a contract may be modified by the assent of both parties. Article V of the Agreements only entitles Amoco to a rate *equal* to the lowest rate charged by El Paso for "same or similar" services. It does not limit El Paso's ability to modify its agreements with third parties. Article V does not assure to Amoco, in the future, any particular rate. Thus the injunction sought if granted would be without legal foundation. This form of relief is denied.

II. Attorneys' Fees

*4 While neither the 1984 nor the 1989 Agreements address the question of a possible award of attorneys' fees in litigation brought to enforce those agreements or remedy their breach, Amoco does claim a right, under Texas law, which is expressly adopted as the governing law of these contracts, to such an award. El Paso contends that the matter should be governed by the forum law [FN1] and, under that law, Amoco is not entitled to attorneys' fees as a prevailing party in contract action. *Walsh v. Hotel Corp. of America,* Del.Supr., 231 A.2d 458, 462 (1967); *Maurer v. International Re-Insurance Corp.,* Del.Ch. 95 A.2d 827, 830 (1953).

> FN1. El Paso cites *Whiteside v. New Castle Mutual Ins. Co.,* 595 F.Supp. 1096, 1100 (D.Del.1984) ("Under Delaware conflicts rules, attorneys' fees are considered 'procedural' (in the conflicts sense)."); *Chester v. Assiniboia Corp.,* Del.Supr., 355 A.2d 880 (1976); and *Chrysler Corp. v. Viglino,* Del.Supr., 260 A.2d 160, 161-62 (1969) (holding that statute governing counsel fees in workmen's compensation cases is procedural).

A. Choice of Law.

All courts exhibit a certain rational bias in favor of the law of the forum jurisdiction with which they are familiar. This tendency tends to be efficient, as the forum law is to some extent already known and applying it thus involves little learning costs. The Restatement (Second) of Conflict of Laws, notes that:

> Enormous burdens are avoided when a court applies its own rules, rather than the rules of another state, to issues relating to judicial administration, such as the proper form of action, service of process, pleading, rules of discovery, mode of trial and execution and costs.

See § 122 comment a (1971). This efficiency however does not, as a matter of substantive justice, justify a court in failing to recognize *valid substantive claims of right* created under the laws of a sister-state jurisdiction. Rather matters that are usually treated as governed by local rules, even where foreign law supplies the rule of decision on the substantive claim, are typically collateral to the question of substantive right: pretrial discovery rights, joinder of claims, perhaps evidence, procedures for trial or settlement of class actions, etc. In the language of the decided cases these adjudicative rights are often summarily described as "procedural" rights.

The core analysis of the question whether a forum rule applies in the adjudication of a foreign law claim is not, as sometimes occurs, to try to determine whether an issue is "procedural" [FN2] but, in my opinion, to ask whether the issue is one that constitutes or is vitally bound up with the adjudication of the asserted substantive right. If the issue is not one of substantive right then the forum state may properly apply its own rule.

> FN2. *See, e.g.,* Professor Walter Wheeler Cook's landmark piece, *"Substance" and "Procedure" in the Conflict of Laws,* 42 Yale L.J. 333, 345 (1933).

While this vocabulary is hardly much of an advance over the substance procedure vocabulary, it is helpful in this instance. In many instances involving adjudication of a foreign-law issue attorneys' fees will involve a non-substantive (procedural) issue. For example, where fee shifting is contemplated as a result of bad faith litigation or in common fund class suits; or even where the substantive rule of decision is supplied only because a jurisdiction is determined to have the most significant relationship with the case, the interest of the parties or the foreign state to have foreign law apply to an award of attorneys' fees will be very weak. In such cases the application of forum law to this question could not be seen as failing to accord full faith and credit to the laws of a sister state; nor could it even be seen as disappointing the reasonable expectations of either party. It may thus be said to be "procedural" in this choice of law sense.

***5** But this case involving a selection by the litigants of Texas law as governing law their contractual relationship makes this a very different kind of case. Here the question whether the law of Texas grants to Amoco a right to attorneys' fees under its statute is clearly a substantive claim that cannot simply be ignored by referring to Delaware law as supplying the rule of decision. The Agreements in litigation provided that the contract(s) "shall be governed by the laws of the State of Texas applicable to contracts made and to be performed entirely within that state..." While these contracts did not address attorneys' fees, under conventional understanding their designation of Texas law as governing fills in such gaps. Section 187(1) of the Restatement (Second) of Conflicts, for example, provides:

> The law of the state chosen by the parties to govern their contractual rights and duties will be applied if the particular issue is one which the parties could have resolved by an explicit provision in their agreement directed to that issue.

This principle provides a default rule that tends to give the parties own choice of governing law an appropriately broad reading. I certainly concur in the Restatement's view that in such a case the question of attorneys' fees is a substantive matter of contract, and not a choice of law question. Comment c of the Restatement Section 187 elaborates:

> The rule of this Subsection is a *rule providing for incorporation by reference and is not a rule of choice of law*. The parties, generally speaking, have power to determine the terms of their contractual engagements. They may spell out these terms in the contract. In the alternative, they may incorporate into the contract by reference extrinsic material which may, among other things, be the provisions of some foreign law. In such instances, the forum will apply the applicable provisions of the law of the designated state in order to effectuate the intentions of the parties. So much has never been doubted.

Id. at Comment c (emphasis added).

El Paso's reliance on cited Delaware cases [FN3] for the proposition that determination of attorneys' fees is "procedural" and thus governed by Delaware law is unavailing; none of the cited cases involve the arguable creation of substantive contractual rights by reason of designating as governing the law of a state that included, as Texas arguably does, a statutory right to attorneys' fees.[FN4] The more typical holding-which for example comes up in the federal diversity jurisdiction cases-is that a statutory right to attorneys fees is, like all other statutory entitlements, a matter of substantive right. *See, e.g., Alyeska Pipeline Services Co. v. Wilderness Society,* 421 U.S. 240, 259 n. 31 (1975); *Montgomery Ward & Co. v. Pacific Indemnity Co.,* 557, F.2d 51, 56 (3rd Cir.1977).

> FN3. *Whiteside v. New Castle Mutual Ins. Co.,* 595 F.Supp. 1096, 1100 (D.Del.1984); *Chester v. Assiniboia Corp.,* Del.Supr., 355 A.2d 880 (1976); and *Chrysler Corp. v. Viglino,* Del.Supr., 260 A.2d 160, 161-62 (1969).

> FN4. *Whiteside* involved an action in diversity for collection of counsel fees for prevailing in a dispute over a homeowner's policy pursuant to 18 *Del.C.* § 4102. Its conflicts analysis is based upon the significant relationship test of *Restatement (Second) of Conflict of Laws* § 188(2) which applies only in the absence of effective choice of law by the parties. *See Whiteside,* 595 F.Supp. 1096. Similarly, *Chester* dealt with recovery of attorneys' fees in connection with damages of an insured ship where the policy did not contain a choice of law provision. *See Chester,* Del.Supr., 355 A.2d 880. Lastly, *Chrysler Corp.* merely classifies a workers com-

> pensation fees statute as "procedural" in order to retroactively apply the statute and does not address conflict of laws issues. *See Chrysler Corp.*, Del.Supr., 260 A.2d 160.

Thus I conclude that this court is obligated to adjudicate the substantive claim of right under Texas law which is advanced by Amoco. Therefore, I turn to the question whether attorneys' fees are recoverable for the prevailing party in this breach of contract dispute under Texas law and, if so, in what amount.

B. Amoco's Claim to Attorneys' Fees Under Texas Law.

***6** Amoco seeks the reimbursement of $618,902.06 of fees of the Baker & Botts firm already incurred plus the reimbursement of $5,985.51 in deposition costs, plus $45,000 which constitutes an estimate of attorneys' fees for the forthcoming appeal. It also seeks $30,647 in reimbursable fees of its Delaware counsel, Richards, Layton & Finger. This application does not cover all of the fees Amoco has paid or incurred in this matter but does include at least some 2,773 attorney hours and 838 hours of legal assistants' time. The case was one involving substantial financial claims, litigated intensively and extensively on both sides in a highly professional manner. It involved an expedited schedule that including pretrial motions directed to the merits, discovery and four days of trial. The fees involved are reasonable in the circumstances in my judgment.

Amoco contends that its substantive right to reimbursement of attorneys' fees arises from a Texas statute. Vernon's Rev.Tex.Stat.Ann. § 38.001 (1986). That statute provides in part as follows:

> A person may recover reasonable attorney's fees from an individual or corporation, in addition to the amount of a valid claim and costs, if the claim is for:
>
> ....
>
> (8) an oral or written contract.

While the language of this statute appears to be permissive, the courts of Texas have held that it creates a right in the prevailing party for the award of reasonable attorneys fees. *See Budd v. Gay,* 846 S.W.2d 521 (Tex.App.-Houston 1993); *Caldwell & Hurst v. Myers,* 714 S.W.2d 63 (Tex.App.-Houston 1986, writ ref. n.r.e.) (although trial court has discretion in fixing amount of attorneys' fees, denying attorneys' fees entirely is an abuse of discretion). I accept this interpretation as controlling.

El Paso claims that even if Texas law applies in determining Amoco's claim to attorneys' fees, Amoco is not entitled to all of the fees it seeks. It points out that a substantial amount of attorneys' time was devoted to the litigation of Amoco's rights under Article I of the Agreements that was the subject of the original claims in this court. El Paso won its motion for summary judgment on Article I claims. Only thereafter did Amoco bring claims for breach of contract under the provisions of Article V of the 1984 and 1989 Agreements which were successful. Thus, El Paso asserts that Amoco is not entitled to any legal fees relating to the Article I claims where El Paso was the prevailing party. Moreover, El Paso contends that it is entitled to attorneys' fees for prevailing on the Article I claims. El Paso estimates that the amount of legal fees it deserves offsets Amoco's attorneys' fees in pursuing its successful claims under Article V.

The awarding of attorneys' fees will inevitably involve some judicial judgments concerning, at the least, the reasonableness of the amount of effort and the rates sought to be awarded. As part of this judgment a court may be required to allocate efforts between aspects (or claims) that were not meritorious and those that were. Under Texas law, a party seeking attorneys' fees has a duty to facilitate this exercise of judgment by segregating fees that were incurred in connection with those claims where success was achieved from others. Amoco's application does that to some extent, as it does not include time expended on the pretrial motion on which El Paso prevailed. But generally, a duty to segregate is not imposed "when the attorneys' fees rendered are in connection with claims arising out of the same transaction and are so interrelated that their 'prosecution or defense entails proof or denial of essentially the same facts'." *Stewart Title Guar. Co. v. Sterling,* 822 S.W.2d 1, 11 (Tex.1991). Both Article I and Article V causes of action were dependent on same set of facts as they arise out of the same transaction. Article I and Article V claims were intertwined to the point of being factually inseparable. It should be noted that Amoco does not seek attorneys' fees for those activities related to briefing Article I claims. As Amoco's successful Article V claims are based upon virtually the same transactions and facts as the unsuccessful Article I claims, I find that Amoco is entitled to the entire amount of attorneys' fees it has requested.

***7** El Paso does contend that Amoco's reimbursable attorneys' fees should be offset by the fees El Paso incurred in connection with its successful defense of Article I claims. I do not believe this is correct, however. In order to recover under the Texas attorneys' fees statute, "a party must prevail on a cause of action for which attorneys' fees are recoverable ..." *Rodgers v. RAB Investments, Ltd.,* 816 S.W.2d 543, 551 (Tex.App.-Dallas 1991, no writ). The Texas Supreme Court has held that defendants who prevail in a breach of contract actions are not entitled to attorneys' fees under Section 38.001. *See American Airlines, Inc. v. Swest, Inc.,* 707 S.W.2d 545, 547 (Tex.1986) (without presenting and prevailing on some claim of its own, successful defendants are not entitled to attorneys' fees). Hence, El Paso is not entitled to offset Amoco's attorneys' fees with its own as it did not prevail on any substantive claim for relief in this case. Moreover this litigation involved claimed rights to a most favored shipper rate arising from a single body of facts; that various legal theories or grounds were presented, only some of which were sustained, does not implicate the concern that courts have in awarding costs to parties who prevailed on one of several claims. The only relief sought in Amoco's initial pleading was the relief that it was awarded.

This litigation was intense for the attorneys and required special expertise and experience. In light of the efforts required and time invested, I conclude that under the law of the State of Texas Amoco is entitled to be reimbursed the full amount of its request, $649,549.76.

C. Appellate Attorneys' Fees.

Amoco claims that it is entitled to recovery of attorneys' fees that it may incur in defending an appeal. It estimates the cost of defending an appeal by El Paso would be $52,530. In Texas, trial court has discretion in allowing provisional attorneys' fees in case of appeal. *See, e.g., Rosas v. Bursey,* 724 S.W.2d 402, 411 (Tex.App.-Fort Worth 1986, no writ); *Payne v. Snyder,* 661 S.W.2d 134, 143 (Tex.App.-Amarillo 1983, writ ref'd n.r.e.); *Paulus v. Lawyers Sur. Corp.,* 625 S.W.2d 843, 846 (Tex.App.-Houston [14th Dist.] 1981, writ ref'd n.r.e.). Be that as it may, I decline, in these circumstances, to guess in this way.

Amoco may submit a proposed form of Judgment on notice.

Del.Ch.,1994.
El Paso Natural Gas Co. v. Amoco Production Co.
Not Reported in A.2d, 1994 WL 728816 (Del.Ch.)

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H

United States District Court,
D. South Carolina,
Columbia Division.

ENVIRONMENTAL TECHNOLOGIES COUNCIL, On behalf of itself and its members, Plaintiff,
v.
STATE OF SOUTH CAROLINA; Carroll A. Campbell, Governor; Commissioner, South Carolina Department of Health and Environmental Control; South Carolina Department of Health and Environmental Control; and South Carolina Board of Health and Environmental Control, Defendants,
and
Sierra Club, Energy Research Foundation, Citizens for Clean Air and Water, Environmentalists, Inc., and Citizens Asking for a Safe Environment, Inc. (CASE), Intervenor-Defendants.
Civ. A. No. 3:90-1402.

April 13, 1995.

Trade association for treaters, recyclers, and disposers of hazardous waste brought action against South Carolina, its governor, South Carolina Department of Health and Environmental Control (DHEC), and Commissioner and Board of DHEC to challenge laws restricting in- state treatment and disposal of hazardous waste generated in other states. After the Court of Appeals, 945 F.2d 781, remanded for modification of preliminary injunction, trade association moved for summary judgment and defendants moved for modification of preliminary injunction. The District Court, Perry, J., held that: (1) laws discriminating on their face against in-state disposal of out-of-state hazardous waste required strictest scrutiny under commerce clause; (2) laws discriminating on their face against out-of-state hazardous waste violated commerce clause, absent bona fide distinction between wastes generated out-of-state and in-state, absent lack of nondiscriminatory alternatives; and (3) allegedly neutral provision placing cap on total amount of hazardous waste which could be disposed of in state had to be struck down as part of discriminatory scheme.

Ordered accordingly.

West Headnotes

[1] Administrative Law and Procedure 15A 228.1

15A Administrative Law and Procedure
15AIII Judicial Remedies Prior to or Pending Administrative Proceedings
15Ak228.1 k. Primary Jurisdiction. Most Cited Cases
Primary jurisdiction doctrine applies only to referral of relevant factual, rather than legal, issues to federal agency.

[2] Environmental Law 149E 664

149E Environmental Law
149EXIII Judicial Review or Intervention
149Ek664 k. Primary Jurisdiction. Most Cited Cases
(Formerly 199k25.15(3.2) Health and Environment)
Referral from district court to Environmental Protection Agency (EPA) under primary jurisdiction doctrine was not appropriate for constitutional issues which were within traditional purview of Article III court, and were not issues to which EPA could conceivably lend some degree of expertise. U.S.C.A. Const. Art. 3, § 1 et seq.

[3] Commerce 83 52.10

83 Commerce
83II Application to Particular Subjects and Methods of Regulation
83II(A) In General
83k52.10 k. Environmental Protection Regulations. Most Cited Cases

Environmental Law 149E ⚷406(2)

149E Environmental Law
149EIX Hazardous Waste or Materials
149Ek403 Constitutional Provisions, Statutes, and Ordinances
149Ek406 Validity
149Ek406(2) k. Flow Control Measures. Most Cited Cases

(Formerly 199k25.5(2) Health and Environment)
South Carolina laws discriminating on their face against in-state disposal of out-of-state hazardous waste required strictest scrutiny under commerce clause of any purported legitimate local purpose and of alleged absence of nondiscriminatory alternatives. U.S.C.A. Const. Art. 1, § 8, cl. 3.

[4] Commerce 83 ⚷12

83 Commerce
83I Power to Regulate in General
83k11 Powers Remaining in States, and Limitations Thereon
83k12 k. In General. Most Cited Cases

Whatever state's ultimate purpose, it may not be accomplished by discriminating against articles of commerce coming from outside state unless there is some reason, apart from their origin, to treat them differently. U.S.C.A. Const. Art. 1, § 8, cl. 3.

[5] Commerce 83 ⚷52.10

83 Commerce
83II Application to Particular Subjects and Methods of Regulation
83II(A) In General
83k52.10 k. Environmental Protection Regulations. Most Cited Cases

Environmental Law 149E ⚷406(2)

149E Environmental Law
149EIX Hazardous Waste or Materials
149Ek403 Constitutional Provisions, Statutes, and Ordinances
149Ek406 Validity
149Ek406(2) k. Flow Control Measures. Most Cited Cases

(Formerly 199k25.5(2) Health and Environment)
South Carolina laws discriminating on their face against in-state disposal of hazardous waste generated out-of-state violated Commerce Clause, absent evidence of any bona fide distinction between hazardous wastes generated out-of-state and in-state, and absent evidence of lack of nondiscriminatory alternatives; alternative regulations applicable to all waste treated and disposed of in-state could address state's concerns for protecting health of citizens, preserving existing disposal capacity, and avoiding risks from transportation of hazardous waste. U.S.C.A. Const. Art. 1, § 8, cl. 3; S.C.Code 1976, §§ 44-56-59, 44-56-60(a), 44-56-130, 44-56-205; S.C.Code 1976, R61-99.

[6] Commerce 83 ⚷52.10

83 Commerce
83II Application to Particular Subjects and Methods of Regulation
83II(A) In General
83k52.10 k. Environmental Protection Regulations. Most Cited Cases

Environmental Law 149E ⚷406(2)

149E Environmental Law
149EIX Hazardous Waste or Materials
149Ek403 Constitutional Provisions, Statutes, and Ordinances
149Ek406 Validity
149Ek406(2) k. Flow Control Measures. Most Cited Cases

(Formerly 199k25.5(2) Health and Environment)
Punishing other states for their alleged failure to treat and dispose of their fair share of hazardous waste was not legitimate purpose under commerce clause and could not justify South Carolina laws discriminating on their face against in-state disposal of out-of-state hazardous waste. U.S.C.A. Const. Art. 1, § 8, cl. 3; S.C.Code 1976, §§ 44-56-59, 44-56-60(a), 44-56-130, 44-56-205; S.C.Code 1976, R61-99.

[7] Commerce 83 ⚷12

83 Commerce
83I Power to Regulate in General
83k11 Powers Remaining in States, and Limitations Thereon
83k12 k. In General. Most Cited Cases
General purpose of laws is largely irrelevant to commerce clause analysis if facial or substantial discrimination is involved, and any discrimination must be demonstrably justified by valid factor unrelated to economic protectionism. U.S.C.A. Const. Art. 1, § 8, cl. 3.

[8] Commerce 83 ⚷12

83 Commerce
83I Power to Regulate in General
83k11 Powers Remaining in States, and Limitations Thereon
83k12 k. In General. Most Cited Cases
State cannot seek to achieve presumably legitimate goal by illegitimate means of isolating state from national economy and, thus, even if state demonstrates legitimate purpose for its laws, those laws are impermissible under commerce clause if that purpose is accomplished by discriminating solely on basis of origin. U.S.C.A. Const. Art. 1, § 8, cl. 3.

[9] Commerce 83 ⚷52.10

83 Commerce
83II Application to Particular Subjects and Methods of Regulation
83II(A) In General
83k52.10 k. Environmental Protection Regulations. Most Cited Cases

Environmental Law 149E ⚷406(2)

149E Environmental Law
149EIX Hazardous Waste or Materials
149Ek403 Constitutional Provisions, Statutes, and Ordinances
149Ek406 Validity
149Ek406(2) k. Flow Control Measures. Most Cited Cases
(Formerly 199k25.5(2) Health and Environment)
Unconstitutional purpose of South Carolina laws to discriminate against in-state disposal of out-of-state hazardous waste was demonstrated by provisions voicing concern about limited resources for disposal of hazardous waste, demanding that South Carolina's disposal needs had to be met first, and requiring that disposal facilities in state had to give preference to hazardous waste generators within state. U.S.C.A. Const. Art. 1, § 8, cl. 3; S.C.Code 1976, § 44-56-59(A)(1-3).

[10] Commerce 83 ⚷52.10

83 Commerce
83II Application to Particular Subjects and Methods of Regulation
83II(A) In General
83k52.10 k. Environmental Protection Regulations. Most Cited Cases

Environmental Law 149E ⚷406(2)

149E Environmental Law
149EIX Hazardous Waste or Materials
149Ek403 Constitutional Provisions, Statutes, and Ordinances
149Ek406 Validity
149Ek406(2) k. Flow Control Measures. Most Cited Cases
(Formerly 199k25.5(2) Health and Environment)
Entire South Carolina statute discriminating on its face against in-state disposal of out-of-state hazardous waste had to be struck down for violation of commerce clause, including allegedly neutral provision placing cap on total amount of hazardous waste which could be disposed of in state; district court could not assume that state would have enacted cap without discriminatory provisions reserving substantial portion of total disposal allowed under cap for hazardous waste generated in state. S.C.Code 1976, § 44-56-60(a)(2).

***1028** Stuart H. Newberger, Howard B. Crystal, Crowell and Moring, Washington, DC, Jeter E. Rhodes, Jr., McCutchen, Blanton, Rhodes & Johnson, Columbia, SC (David R. Case, General Counsel, Environmental Technology Council, Washington, DC, of counsel), for Plaintiff.

Charles Malony Condon, Attorney General, Kenneth P. Woodington, Senior Assistant Attorney General, Cameron B. Littlejohn, Jr., Assistant Attorney General, Columbia, SC, for State of South Carolina.

Treva G. Ashworth, Deputy Attorney General, Columbia, SC, for David M. Beasley, Governor of the State of South Carolina.

Carlisle Roberts, Jr., General Counsel, Jacquelyn S. Dickman, Assistant General Counsel, Columbia, SC, for Commissioner, South Carolina Department of Health and Environmental Control; South Carolina Department of Health and Environmental Control; and South Carolina Board of Health and Environmental Control.

Charles F. Lettow, Michael A. Mezzuchi, Cleary, Gottlieb, Steen & Hamilton, Washington, DC, for Defendants.

James S. Chandler, Jr., South Carolina EnvironmentalLaw Project, Pawleys Island, SC, Robert Guild, Columbia, SC, for intervenors Citizens for Clean Air and Water, Citizens Asking for a Safe Environment, Inc., and Environmentalists, Inc.

FINDINGS OF FACT, CONCLUSIONS OF LAW AND ORDER

PERRY, District Judge.

The plaintiff has moved for summary judgment, asserting that there are no genuine issues of material fact and that it is entitled to judgment as a matter of law. Plaintiff seeks a declaration that certain executive orders, statutes and a regulation are invalid under the Interstate Commerce Clause of the United States Constitution.[FN1] Previously, this Court concluded that the plaintiff would probably prevail on the merits and entered a preliminary injunction. *Hazardous Waste Treatment Council v. South Carolina,* 766 F.Supp. 431 (D.S.C.1991).[FN2] That decision was affirmed by the United States Court of Appeals for the Fourth Circuit and remanded for modification of the preliminary injunction. 945 F.2d 781 (4th Cir.1991). Thereafter, the defendants and the intervenors filed motions to modify the preliminary injunction as directed by the Court of Appeals. The plaintiff has filed a motion for summary judgment***1029** pursuant to Rule 56, Federal Rules of Civil Procedure. The Court has now considered the extensive memoranda submitted by the parties, together with the oral arguments and now enters its findings of fact and conclusions of law.

> FN1. "Congress shall have the power.... [t]o regulate commerce with foreign Nations, and among the several States, and with the Indian Tribes." U.S. CONST. art. I, § 8, cl. 3.

> FN2. The plaintiff has now changed its name from "Hazardous Waste Treatment Council" to "Environmental Technologies Council."

I. PRIMARY JURISDICTION

[1] At the September 20, 1994 hearing, this Court denied Defendants' Motion to stay and refer this case to the U.S. Environmental Protection Agency ("EPA") under the primary jurisdiction doctrine. Primary jurisdiction applies only to the referral of relevant *factual,* rather than *legal,* issues to a federal agency. *See Far East Conference v. United States,* 342 U.S. 570, 574, 72 S.Ct. 492, 494, 96 L.Ed. 576 (1952); *Nader v. Allegheny Airlines,* 426 U.S. 290, 304, 96 S.Ct. 1978, 1986, 48 L.Ed.2d 643 (1976). In this case, there are no material facts genuinely in dispute, and thus there are no factual issues requiring resolution by EPA.

[2] Moreover, the constitutional issues raised here are properly within the traditional purview of an Article III court, and are not those to which EPA

could conceivably lend some degree of expertise. *See Environmental Defense Fund v. Wheelabrator Technologies,* 725 F.Supp. 758, 775 (S.D.N.Y.1989), *quoting Board of Educ. of City School Dist. v. Harris,* 622 F.2d 599, 607 (2d Cir.1979), *cert. denied,* 449 U.S. 1124, 101 S.Ct. 940, 67 L.Ed.2d 110 (1981) ("It is well established that the courts need not defer to an agency where the issue involved is a strictly legal one, involving neither the agency's particular expertise nor its fact finding prowess"); *See also Sierra Club v. DOE,* 734 F.Supp. 946, 951 (D.Colo.1990) ("Where, as here, the issue is strictly legal, a court need not defer to a state agency"). In accordance with the mandate of the Fourth Circuit, this Court concludes that referral to EPA is not appropriate. *Hazardous Waste Treatment Council v. South Carolina,* 945 F.2d 781, 794 (4th Cir.1991) ("EPA may change its interpretation of its own regulation; however, we cannot change the commands of the Constitution and Congress") ("HWTC II").

II. MOTION TO MODIFY THE PRELIMINARY INJUNCTION

This Court has considered both Plaintiff's Motion for Summary Judgment and Defendants and Intervenors' Motion to Modify the Preliminary Injunction. Because summary judgment is appropriate, any modification of the preliminary injunction is now moot, and the motion to modify is denied. To the extent the permanent injunction issued herewith differs from the January 20, 1991 preliminary injunction, *see Hazardous Waste Treatment Council v. South Carolina,* 766 F.Supp. 431 (D.S.C.1991) ("HWTC I"), these changes are reflected below.

III. PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT

This case challenges South Carolina's discriminatory efforts to regulate the management of hazardous waste services located in the State.[FN3] At issue are two statutes, two executive orders, and one regulation which constitute an integrated and interconnected discriminatory program.

> FN3. There are three facilities in South Carolina licensed to handle hazardous waste. The largest, located in Pinewood, is a disposal facility operated by Laidlaw Environmental Services of South Carolina, Inc. *See HWRC I,* 766 F.Supp. at 435.

As this Court and the Court of Appeals concluded at the preliminary injunction stage, the State's discriminatory program violates the Commerce Clause. Because there are no material facts in dispute regarding the State's program, summary judgment is appropriate at this stage. *See Philadelphia v. New Jersey,* 437 U.S. 617, 98 S.Ct. 2531, 57 L.Ed.2d 475 (1978); *Chemical Waste Management, Inc. v. Hunt,* 504 U.S. 334, 112 S.Ct. 2009, 119 L.Ed.2d 121 (1992); *Fort Gratiot Sanitary Landfill, Inc. v. Michigan Dep't of Natural Resources,* 504 U.S. 353, 112 S.Ct. 2019, 119 L.Ed.2d 139 (1992); *C & A Carbone, Inc. v. Town of Clarkstown, New York,* 511 U.S. 383, 114 S.Ct. 1677, 128 L.Ed.2d 399 (1994); *Oregon Waste Systems, Inc. v. Dep't of Environmental Quality,* 511 U.S. 93, 114 S.Ct. 1345, 128 L.Ed.2d 13 (1994); ***1030***National Solid Waste Management v. Alabama Dep't of Env't,* 910 F.2d 713 (11th Cir.1990), *cert. denied,* 501 U.S. 1206, 111 S.Ct. 2800, 115 L.Ed.2d 973 (1991).

Initially, the State and Intervenors must come forward with competent evidence demonstrating a genuine issue of material fact for trial. Fed.R.Civ.P. 56(c). *See Anderson v. Liberty Lobby, Inc.,* 477 U.S. 242, 106 S.Ct. 2505, 91 L.Ed.2d 202 (1986); *Celotex Corp. v. Catrett,* 477 U.S. 317, 106 S.Ct. 2548, 91 L.Ed.2d 265 (1986). Defendants have failed to bring forward any evidence relevant to meeting this burden in the context of a case challenging facial discrimination against interstate commerce. *See, e.g., Wyoming v. Oklahoma,* 502 U.S. 437, 112 S.Ct. 789, 117 L.Ed.2d 1 (1992); *Healy v. Beer Inst., Inc.,* 491 U.S. 324, 109 S.Ct. 2491, 105 L.Ed.2d 275 (1989); *City of Philadelphia v. New Jersey,* 437 U.S. 617, 98 S.Ct. 2531, 57 L.Ed.2d

475 (1978).

In particular, none of the eight affidavits the State has provided raises a material fact in issue. The first, from Lewis Bedenbaugh of the Department of Health and Environmental Control ("DHEC"), addresses Superfund clean-up activities in South Carolina. (Exhibit 1, Defendant's Memorandum In Opposition to Motion for Summary Judgment.) The second and third, both by David Wilson of DHEC, address volumes of hazardous waste being treated, stored and disposed of in South Carolina and the permitting process. (Exhibits 2 and 3.) The fourth and fifth, both by John Buchanan of DHEC, address the transportation and record-keeping of hazardous waste in South Carolina, and the State enforcement program for hazardous waste facilities. (Exhibits 4 and 5.) The sixth, seventh, and eighth, all by Robert King of DHEC, address 1) hazardous waste management capacities in various states, 2) South Carolina's EPA authorization to administer its own hazardous waste management program, and 3) South Carolina's efforts to enter a Capacity Assurance Regional Agreement. (Exhibits 6-8.) While some of the attachments to these affidavits do provide breakdowns for in-state and out-of-state waste, none of the affidavits even *purports* to justify South Carolina's discriminatory treatment of out-of-state waste.

[3] The State's failure to raise a factual issue for trial demonstrates, as a matter of law, that the State cannot carry its burden under the Commerce Clause's "strict scrutiny" standard. As the Court of Appeals noted, "[t]he Commerce Clause directly limits the power of the States to discriminate against interstate commerce." *HWTC II,* 945 F.2d at 789, *quoting New Energy Co. of Indiana v. Limbach,* 486 U.S. 269, 273, 108 S.Ct. 1803, 1807, 100 L.Ed.2d 302 (1988) ("New Energy"). A facially discriminatory program such as is at issue here is invalid " 'unless the discrimination is demonstrably justified by a valid factor unrelated to economic protectionism.' " 945 F.2d at 790, *quoting Maine v. Taylor,* 477 U.S. 131, 106 S.Ct. 2440, 91 L.Ed.2d 110 (1986). "Justifying discrimination is difficult to say the least." *HWTC II,* 945 F.2d at 790. Where, as here, each of the challenged laws "do not regulate evenhandedly but discriminate on their face against out-of-state hazardous waste," *id.* at n. 13, there is a "virtually *per se* rule of invalidity...." *New Energy,* 486 U.S. at 278-79, 108 S.Ct. at 1810-11, *quoting Philadelphia v. New Jersey,* 437 U.S. at 624, 98 S.Ct. at 2535. Therefore, " 'the strictest scrutiny of any purported legitimate local purpose and of the absence of nondiscriminatory alternatives' " applies. *Wyoming v. Oklahoma,* 502 U.S. 437, 455, 112 S.Ct. 789, 801, 117 L.Ed.2d 1 (1982), *quoting Hughes v. Oklahoma,* 441 U.S. 322, 337, 99 S.Ct. 1727, 1736, 60 L.Ed.2d 250 (1979).

At the preliminary injunction stage this Court noted that, "[p]laintiff will likely succeed on the merits in their challenge to these actions under the Commerce Clause." *HWTC I,* 766 F.Supp. at 441. The Court also noted that, "[i]t may not be gainsaid that the public interest is best served when unconstitutional laws are enjoined." *Id.* at 442. At this stage, as Defendants have not come forward with any evidence demonstrating a genuine issue of material fact regarding the State's purported "legitimate local purpose" or the "absence of nondiscriminatory alternatives.", summary judgment is appropriate.

A. Undisputed Material Facts

1. South Carolina's Discrimination Program

The program challenged here has five interrelated components, comprised of two executive***1031** orders, two statutes, and one DHEC regulation. Together they compose one overall program designed to provide a system of preferential treatment for hazardous waste generators in-state at the expense of out-of-state generators.

Section 9 of Act No. 196 of 1989, which amends S.C.Code Ann. Section 44-56-130, and Executive Order ("E.O.") No. 89-17, the "blacklisting" provisions, prohibit the introduction into South Carolina of any hazardous waste from generators in particular states-those which, as determined by South Carolina: (1) prohibit treatment, storage or disposal of such waste within their borders, or (2) fail to enter into a regional or interstate agreement with South Carolina regarding the management of such wastes. *See HWTC I.* 766 F.Supp. at 436-37. This statute and order also require the State's treatment and disposal facilities to give preference to hazardous waste generators within the State. Section 5, Act. No. 196; S.C.Code Ann. 44-56-205; E.O. 89-17. The State and Intervenors have essentially abandoned any argument that these two laws pass muster under the Commerce Clause.

Act No. 590 of 1990, amending S.C.Code Ann. Section 44-56-59 and Section 44-56-60(a), and E.O. No. 89-25, the "quota" provisions, put inequitable limits on the amount of hazardous waste that can be disposed of in South Carolina. *See HWTC I,* 766 F.Supp. at 437-48. As proof of its discriminatory purpose, S.C.Code Ann. Section 44-56-59 provides:

(A) The General Assembly finds:

(1) The existing commercial land disposal facility in South Carolina [Pinewood] and available capacity in this State generally are limited resources;

(2) It is essential that the limited waste treatment and disposal capacity of the existing commercial facility [Pinewood] and the State in general be preserved, ready and available to ensure that the needs of South Carolina are met first;

(3) The existing commercial land disposal facility [Pinewood] as well as other hazardous waste treatment and disposal facilities must give preference to hazardous waste generators within the State for treatment and disposal of hazardous materials at licensed facilities in the State;

(4) The General Assembly [Act. No. 196] and the Executive branch [E.O. Nos. 89-17 and 89-25] have mandated restrictions on the importation of out-of-state wastes and on the capacity of existing hazardous waste landfills; and

(5) Reducing the amount of hazardous waste shipped to South Carolina commercial facilities will send a message to all states that South Carolina intends to reduce to the greatest extent possible the amount of hazardous waste treated and disposed of in this State.

(B) Based upon these findings the General Assembly declares that:

* * * * * *

(2) As this State reduces its reliance on landfilling ..., the amount of hazardous waste being shipped into this State for landfilling from locations outside of the State should be reduced and eliminated also.

Accordingly, Section 44-56-60(a)(2) of Act No. 590 subjects Pinewood to a lowered disposal quota of 110,000 tons per year.[FN4] Of that quota, E.O. No. 89-25 sets aside 54,000 tons for hazardous waste "generated in South Carolina." Thus a substantial portion-45 percent of the overall quota-is reserved for South Carolina waste.

FN4. From July 1, 1990 to July 1, 1991, the capacity limit was 120,000 tons. After July 1, 1991, the 110,000 limit was to go into effect, except for this court's preliminary injunction.

Section 44-56-60(a)(3) of Act No. 590 requires that Pinewood reserve *at least* as much capacity for in-state waste as the facility disposed during the previous twelve months. Thus, if more than 54,000 tons is disposed of by South Carolina, that new amount now serves as a floor for the next 12 months. Pinewood may not, however, accept *any more* out-of-state waste than it accepted during the previous twelve months. Thus, if Pinewood accepted less than 56,000 tons from its out-of-state customers over the previous twelve months, that *lower amount* now serves as a new *ceiling* for the next twelve ***1032** months. South Carolina generators of waste thus benefit from preferential treatment contained in Section 44-56-60(a)(3), while out-of-state customers fight for access to the shrinking portion of the lowered 110,000 ton total.

Further, under E.O. No. 89-25 generator-customers located in other states may only utilize up to 35,000 tons of the overall out-of-state quota and not more than 10,000 tons per quarter. E.O. No. 89-25. South Carolina generators, then, are entitled to bring to Pinewood each year over 50% *more* waste than generators from any other one state (54,000 tons as compared with 35,000 tons).

The final element in this discriminatory program is DHEC Regulation 61-99. This regulation contains requirements for the permitting of new or expanded hazardous waste management facilities, including a "demonstration of need" for the new or expanded facility. Plaintiff does not challenge this regulation in its entirety. Instead, Plaintiff only seeks to declare invalid that portion which prohibits an applicant from including out-of-state waste in the demonstration of need: "[f]or the purposes of demonstrating need, Hazardous Waste generated outside the State of South Carolina shall not be included." DHEC Reg. 61-99, III(C). *HWTC I,* 766 F.Supp. at 436.

2. The State Has Failed To Demonstrate That Any Material Facts Are Genuinely In Dispute

Defendants argue that material facts remain in dispute which preclude summary judgment and require a trial. As each of the challenged provisions facially discriminates against interstate commerce, however, the State bears the extraordinarily high burden of demonstrating that (1) there is a legitimate local purpose for the discrimination, *and* (2) there are no non-discriminatory alternatives which could serve this purpose. *Wyoming v. Oklahoma,* 502 U.S. at 455, 112 S.Ct. at 801 (" 'At a minimum such facial discrimination invokes the *strictest scrutiny* of any purported legitimate local purpose and of the absence of nondiscriminatory alternatives' ") (emphasis added), *quoting Hughes,* 441 U.S. at 337, 99 S.Ct. at 1736; *see also Maine v. Taylor,* 477 U.S. 131, 144, 106 S.Ct. 2440, 2450, 91 L.Ed.2d 110 (1986), *quoting Hughes; HWTC II,* 945 F.2d at 790 ("[j]ustifying discrimination is difficult to say the least"). Where, as here, each of the challenged laws "do not regulate evenhandedly but discriminate on their face against out-of-state hazardous waste," *id.* at n. 13, there is a "virtually *per se* rule of invalidity...." *New Energy,* 486 U.S. at 278-79, 108 S.Ct. at 1810-11 *quoting Philadelphia v. New Jersey,* 437 U.S. at 624, 98 S.Ct. at 2535. The burden of overcoming the "virtually *per se* " rule is extraordinarily high, and it has been accomplished only once or twice over the entire history of the Nation.

South Carolina argues that it is entitled to a trial "to exercise its right to adduce evidence in justification of the purpose and basis for its challenged laws." (Memorandum in Opposition at 5). It is the State's position that this Court may not enter summary judgment simply because the Fourth Circuit did not resolve the matter "on the merits" at the preliminary injunction stage. *HWTC II,* 945 F.2d at 789 n. 11.

But this case is no longer at the preliminary injunction stage. In declining, "to decide the case on the merits at the early preliminary injunction stage," *id.,* the Fourth Circuit properly was drawing a distinction between a preliminary injunction motion and a decision on the merits. The present motion is for summary judgment, disposition of which is every bit an adjudication on the merits as a trial.

In particular, at the summary judgment stage, unlike the preliminary injunction stage, it is not sufficient for South Carolina to simply assert an "intention to produce evidence" at some future time. Rather, the time is now for the State to come forward with *actual* evidence to carry its burden under "strict scrutiny" and defeat summary judgment. *See Anderson v. Liberty Lobby, Inc.*, 477 U.S. at 256, 106 S.Ct. at 2514 (" Rule 56(e) itself provides that a party opposing a properly supported motion for summary judgment may not rest upon mere allegation or denials of his pleading, but must set forth specific facts showing that there is a genuine issue for trial"). This is particularly true where, as here, it must submit enough evidence***1033** to overcome the heavy burden of the virtual *per se* rule of invalidity. *See generally Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp.*, 475 U.S. 574, 106 S.Ct. 1348, 89 L.Ed.2d 538 (1986); *Celotex Corp. v. Catrett*, 477 U.S. at 322, 323, 106 S.Ct. at 2552, ("[t]he moving party is 'entitled to a judgment as a matter of law' because the nonmoving party has failed to make a sufficient showing on an essential element of her case with respect to which she has the burden of proof").

Thus the State is obligated to demonstrate that there is a material fact genuinely in dispute. Mere incantations will not suffice at this stage of the litigation. Nonetheless incantations are all the State has provided on the essential issue: why discrimination against interstate commerce is necessary to achieve the State's allegedly legitimate purposes. In particular, South Carolina purports to list in its Memorandum in Opposition to Motion for Summary Judgment "factual matters" that "must be addressed." (Memorandum in Opposition at 9.) All of the factual issues listed in the Memorandum in Opposition and in the State's Statement of Material Facts, however, either (1) are undisputed at this stage (*i.e.*, the State's presumably legitimate purpose, which Plaintiff concedes for purposes of this motion only); (2) are irrelevant to the constitutional issues at hand; or (3) raise questions of law rather than questions of fact.

[4][5] Assuming arguendo that the State possesses legitimate local purposes for placing certain restrictions on hazardous waste, in order to prevail the State must demonstrate that those goals cannot be achieved without facially violating the commerce clause: "[W]hatever [a state's] ultimate purpose, it may not be accomplished by discriminating against articles of commerce coming from outside the State *unless there is some reason, apart from their origin, to treat them differently.*" *Philadelphia v. New Jersey*, 437 U.S. at 627, 98 S.Ct. at 2537 (emphasis added); *see also Wyoming v. Oklahoma*, 502 U.S. at 454, 112 S.Ct. at 800 (discriminatory laws "will be struck down unless the discrimination is demonstrably justified by a valid factor unrelated to economic protectionism") (citations omitted). The fatal flaw in South Carolina's program is that the State has failed even to suggest that it has some basis-other than state of origin-for discriminating against out-of-state waste. In fact, that is the reason for the discrimination. Thus, the State cannot justify such unconstitutional activity under any set of alleged facts.

Certainly Defendants' Statement of Material Facts does contain certain incantations regarding alternatives-"The South Carolina laws reflect the unavailability of neutral alternatives to achieving the State's legitimate purposes in the pertinent circumstances" (Statement of Material Facts at 2); "The failure of [EPA] and other States to license new or additional commercial land disposal capacity has severely restricted the availability of neutral alternatives for achieving the State's legitimate purposes" (*Id.* at 3). Nowhere in the record, however, is there evidence to support the assertion that neutral alternatives are not available.

Indeed, nowhere in the record has South Carolina argued that hazardous waste from out-of-state is *any different* from hazardous waste generated instate. As noted by this Court and the Fourth Circuit at the preliminary injunction stage, there is no difference: "[h]azardous wastes generated out-of-state pose no more threat to human health and the environment than hazardous waste generated in South Carolina." *HWTC I*, 766 F.Supp. at 441-42, *quoted in HWTC II*, 945 F.2d at 788. In the absence of a *bona fide* distinction, any effort to discriminate against out-of-state waste solely because it is from out-of-state customers must fail. *See Philadelphia* *v. New Jersey,* 437 U.S. at 629, 98 S.Ct. at 2538 (because "there is no basis to distinguish out-of-state waste from domestic waste ... [the state's] legislative effort is clearly impermissible under the Commerce Clause ...").

The State has not presented any evidence to show the absence of nondiscriminatory alternatives. Although South Carolina has not precisely articulated its purposes, there appear to be several alleged concerns, all of which can be satisfied through nondiscriminatory means.

First, South Carolina mentions its concern for the "health, safety and welfare of its ***1034** citizens." However, as this Court expressly found (and the Fourth Circuit affirmed), "[h]azardous wastes generated out-of-state pose no more threat to human health and the environment than hazardous wastes generated in South Carolina." *HWTC I,* 766 F.Supp. at 441-42, *quoted in HWTC II,* 945 F.2d at 788. Accordingly, to the extent the State deems the existing comprehensive federal and State regulatory regimes insufficient to protect public health and safety, the State's interest can be served by *nondiscriminatory* hazardous waste management regulations that are applicable to *all* waste treated and disposed of within South Carolina. *See Philadelphia v. New Jersey,* 437 U.S. at 629, 98 S.Ct. at 2538; *accord New Energy,* 486 U.S. at 279, 108 S.Ct. at 1810.

Second, South Carolina also is concerned with preserving existing disposal capacity. As the Fourth Circuit held, however, it is impermissible for a state to "accord its own inhabitants a preferred right of access over consumers in other States to natural resources located within its borders." *Philadelphia v. New Jersey,* 437 U.S. at 627, 98 S.Ct. at 2537; *accord New England Power Co. v. New Hampshire,* 455 U.S. 331, 338, 102 S.Ct. 1096, 1099, 71 L.Ed.2d 188 (1982), *cited in HWTC II,* 945 F.2d at 792 ("South Carolina has little inherent right to use capacity located within its borders solely for waste generated within its borders"). The Commerce Clause thus bars any attempt to "conserve" hazardous waste capacity through discriminatory laws. If South Carolina is truly interested in preserving its in-state capacity, that interest would be served by the *bona fide* evenhanded regulations that apply equally to in-state and out-of-state waste generators. *See HWTC II,* 945 F.2d at 792 ("South Carolina may preserve the capacity by limiting total disposal and treatment within the state without reference to whether in-state or out-of-state waste is actually involved") (Footnote omitted). Moreover, the Supreme Court recently rejected the argument that protectionist and discriminatory measures are necessary "as landfill space diminishes and environmental cleanup costs escalate...." *Carbone,* 511 U.S. at ----, 114 S.Ct. at 1683. As the Court held in *Carbone,* there has never been a showing "that the unobstructed flow of interstate commerce itself is unable to solve the local problems" which face all landfills around the country. *Id.*

Third, South Carolina makes mention of vague "transportation risks," again without distinguishing between wastes generated in-state and those generated out-of-state. There is no evidence that any of the challenged South Carolina laws even address this purported concern. However, even if South Carolina were interested in seeking to minimize the risks associated with transportation of hazardous waste, there would be several nondiscriminatory methods of addressing that interest. For example, South Carolina could increase the stringency of its regulations on an evenhanded basis, effectively addressing the State's putative transportation concerns by not exempting South Carolina waste or waste that is imported through South Carolina. With alternatives available to it, South Carolina cannot force *only* interstate commerce to bear the burden of its purported concerns.

[6] Finally, it appears to be South Carolina's perception that certain other state's are not bearing their "fair share" of hazardous waste treatment and disposal. It thus has tried to influence the public policy of *other* states to compel them to take action. Suffice it to say that punishing other states is not a legitimate purpose under the Commerce Clause.

See HWTC II, 945 F.2d at 791 (South Carolina does not have the authority "to punish certain hazardous waste generators merely because they reside in states that South Carolina concludes have not fulfilled obligations under CERCLA § 104(c)(9)"). Only Congress has the responsibility and power under the Constitution to impose national policy on individual states. Indeed, for South Carolina to try to impose its will on its neighbors is nothing more than one state making economic warfare on another of its sister states.

As for its purportedly legitimate local purpose, South Carolina asserts a range of general justifications. (See Statement of Material Facts ("South Carolina has legitimate purposes in protecting the health, safety and ***1035** welfare of its citizens"); ("South Carolina has a legitimate public purpose in taking actions to reduce reliance upon land disposal of hazardous waste"); ("South Carolina has a legitimate public purpose in taking measures to minimize the transportation of hazardous waste in the State"); ("South Carolina has a legitimate public purpose in taking measures to minimize the disposal of hazardous waste in the State"); ("South Carolina has a legitimate public purpose in carefully regulating the siting of new disposal facilities")).

[7][8] South Carolina's emphasis on this "purpose," however, misses the point entirely. The general purpose of such laws are largely irrelevant when facial or substantial discrimination is involved. *See Philadelphia v. New Jersey,* 437 U.S. at 626, 98 S.Ct. at 2536 ("[t]his dispute about ultimate legislative purpose need not be resolved, because its resolution would not be relevant to the constitutional issue to be decided in this case"). Thus, it is "the discrimination [that must be] demonstrably justified by a valid factor unrelated to economic protectionism." *New Energy,* 486 U.S. at 274, 108 S.Ct. at 1807 (citation omitted). Every time the State grants a preference to in-state waste-by allowing that waste to be disposed in the State, or setting differential quotas, or barring consideration of out-of-state market needs and customers in determining whether a facility may be built or expanded-it is engaged in a form of protectionism the Constitution forbids by granting benefits to its citizens and businesses while denying them to those of other states. A state cannot seek to achieve a "presumably legitimate goal" by " 'the illegitimate means of isolating the State from the national economy.' " *Wyoming v. Oklahoma,* 502 U.S. at 455, 112 S.Ct. at 801, *quoting Philadelphia v. New Jersey,* 437 U.S. at 627, 98 S.Ct. at 2537. In other words, even if a state demonstrates a legitimate *purpose* for its laws, those laws are impermissible if that purpose is accomplished by discriminating *solely* on the basis of origin. Thus, the Supreme Court in *Philadelphia v. New Jersey* found the State's salutary motives irrelevant, stating:

> [I]t does not matter whether the ultimate aim of [the law] is to reduce the waste disposal costs of [the State's] residents or to save remaining open lands from pollution, for we assume [the State] has every right to protect its residents' pocketbooks as well as their environment.... But whatever [the State's] ultimate purpose, it may not be accomplished by discriminating against articles of commerce coming from outside the State unless there is some reason, apart from their origin, to treat them differently.

437 U.S. at 626-27, 98 S.Ct. at 2536-37.

[9] In addition, while it is evident from the alternatives South Carolina chose not to pursue that there are indeed nondiscriminatory alternatives, a close look at the program South Carolina *did* put into place reveals that the actual purpose of the program was to discriminate. In Act No. 590, Section 44-56-59(A)(1) reflects the State's clear and unmistakable efforts to discriminate by voicing concern about "limited resources" for disposal of hazardous waste. The next provision references South Carolina's demand that "the needs of South Carolina are met first" and that disposal facilities in the State must "give preference to hazardous waste generators within the State." *Id.* at (A)(2), (3). In addition, the two executive orders contain "whereas" clauses

rife with indicia of the State's true purpose.

B. *Conclusions of Law*

South Carolina is not the only state that has recently discriminated against the interstate waste services market. *See Philadelphia v. New Jersey,* 437 U.S. 617, 98 S.Ct. 2531, 57 L.Ed.2d 475 (1978); *Chemical Waste Management, Inc. v. Hunt,* 504 U.S. 334, 112 S.Ct. 2009, 119 L.Ed.2d 121 (1992); *Fort Gratiot Sanitary Landfill, Inc. v. Michigan Dep't of Natural Resources,* 504 U.S. 353, 112 S.Ct. 2019, 119 L.Ed.2d 139 (1992); *C & A Carbone, Inc. v. Town of Clarkstown, New York,* 511 U.S. 383, 114 S.Ct. 1677, 128 L.Ed.2d 399 (1994); *Oregon Waste Systems, Inc. v. Dep't of Environmental Quality,* 511 U.S. 93, 114 S.Ct. 1345, 128 L.Ed.2d 13 (1994). *National Solid Waste Management v. Alabama Dep't of Env't,* 910 F.2d 713 (11th Cir.1990), *cert. denied,* 501 U.S. 1206, 111 S.Ct. 2800, 115 L.Ed.2d 973 (1991). As ***1036** the Fourth Circuit explained, these attempts to discriminate must fail:

> Perhaps most importantly, the effect of every state designing particular limits and bars for out-of-state waste could be catastrophic. Indeed, such treatment of hazardous waste-in essence, ensured nontreatment of some hazardous waste-might destroy not only the theoretical principle of a national economic union, but contains the real potential to destroy land, if not also persons, within the union.

HWTC II, 945 F.2d at 792 (citation omitted).

If South Carolina were entitled to enforce this program, *every state* could act similarly. The result would be states making economic war on other states in connection with the policies those states choose to pursue for hazardous waste treatment and disposal:

> The practical effect of the [discriminatory] statute must be evaluated not only by considering the consequences of the statute itself, but also considering how the challenged statute may interact with the legitimate regulatory regimes of other states and what effect would arise if not one, but many or every state enacted similar legislation.

Healy v. The Beer Institute, 491 U.S. at 336, 109 S.Ct. at 2499.

Thus, the constituent parts of South Carolina's program are unconstitutional, because they discriminate against out-of-state interests. Further, because those parts work together to compose an overall discriminatory program the entire program is unconstitutional.

Defendant's essentially agree that the blacklisting laws are invalid. They impose an embargo on *any* waste from generators in certain states. This is exactly the sort of discrimination the commerce clause prohibits:

> South Carolina's Act. No. 196 seems to punish certain hazardous waste generators merely because they reside in states that South Carolina concludes have not fulfilled obligations under CERCLA 104(c)(9). But South Carolina does not appear to have been empowered to place penalties on businesses in such states.... And it seems unlikely that South Carolina can penalize its own citizens by prohibiting them from participating in interstate commerce with other states' citizens simply because that state has not met its obligations under CERCLA 104(c)(9). The Commerce Clause protects those "engaged in interstate commerce."

HWTC II, 945 F.2d at 791-2 (other citations omitted). Thus, Section 9 of Act No. 196, amending S.C.Code Ann.Section 44-56-130, must be enjoined. In addition, Section 5 of Act No. 196, which requires that preference be given to in-state generators, must also be enjoined. S.C.Code Ann. 44-56-205.

Similarly, all of the operative language of Executive Order No. 89-17 must be permanently enjoined.

These provisions mirror Act No. 196 in blacklisting hazardous waste from certain other states and granting a preference for in-state waste.[FN5]

FN5. Plaintiff does not object to the Court's refraining from permanently enjoining the "whereas" sections of E.O. 89-25 and E.O. 89-17, as these do not contain any operative language. Therefore, although these sections do indicate that the operative sections were designed in toto to discriminate, this Court need not enjoin them *per se*.

[10] The quota laws are also invalid. They systematically discriminate against out-of-state businesses by allowing in-state generators to dispose of significantly more hazardous waste than out-of-state generators. Act No. 590 is thus invalid in its entirety. Defendants assert that the so-called "neutral cap" on disposal in Act No. 590 (S.C.Code Ann. 44-56-60(a)(2)) can be "divorced" from the rest of the State's discriminatory program even if the other discriminatory provisions were invalid. Defendants cite the Fourth Circuit's *dictum* that, with regard to the preliminary injunction, "South Carolina may preserve the capacity by limiting total disposal and treatment within the state *without reference* to whether in-state or out-of-state waste is actually involved." *HWTC II,* 945 F.2d at 792. As shown above, however, the so-called neutral cap on disposal is set forth in a statute which expressly references discrimination, both in the statute itself and in its references to the blacklisting statute ***1037** and executive order. *See* Act No. 590, Section 1, amending S.C.Code Ann. 44-56-59, at (A)(4). On that basis, this cap provision cannot be upheld in accord with the Fourth Circuit's mandate. Moreover, the Supreme Court recently held that a discriminatory program cannot be parsed into its otherwise valid but constituent parts. *West Lynn Creamery, Inc. v. Healy,* 512 U.S. 186, 114 S.Ct. 2205, 129 L.Ed.2d 157 (1994). In *West Lynn,* Massachusetts sought to protect state dairy farming from interstate competition. To accomplish this objective, Massachusetts constructed a "two-part pricing order" program consisting of a cash/credit subsidy for state farmers and an "even-handed" tax on all dairy producers selling in the state, regardless of the producer's domicile. Analyzed separately, each of the Massachusetts provisions would likely have survived Constitutional challenge, a point the Supreme Court made clear. *Id.* at ----, 114 S.Ct. at 2214. Operating together as they did, however, the Court concluded the State had created an overall discriminatory program that could not withstand Commerce Clause scrutiny:

> [Massachusetts] errs in assuming that the constitutionality of the pricing order follows logically from the constitutionality of its component parts. By conjoining a tax and a subsidy, Massachusetts has created a program more dangerous to interstate commerce than either part alone. Nondiscriminatory measures, like the evenhanded tax at issue here, are generally upheld, in spite of any adverse effects on interstate commerce, in part because *"[t]he existence of major in state interests adversely affected ... is a powerful safeguard against legislative abuse...."* However, when a nondiscriminatory tax is coupled with a subsidy to one of the groups hurt by the tax, *a state's political processes can no longer be relied upon* to prevent legislative abuse, because one of the in-state interests which would otherwise lobby against the tax *has been mollified by the subsidy.*

* * * * * *

> Respondent's argument would require us to analyze separately two parts of an integrated regulation, but we cannot divorce the premium payments from the use to which the payments are put. It is the entire program-not just the contributions to the fund or the distributions from that fund-*that simultaneously burdens interstate commerce and discriminates in favor of local producers.* The choice of constitutional means-nondiscriminatory tax and local subsidy-cannot guarantee the constitutionality of the program as

a whole.

Id. at ---- - ----, 114 S.Ct. at 2214-2215 (citations and footnote omitted). Thus, in *West Lynn Creamery,* the Court struck down all components of the State's discriminatory program, including the so-called neutral tax at issue there.

Similarly, Act No. 590 is invalid in its entirety, including the so-called neutral caps on disposal. Under *West Lynn Creamery,* it is not appropriate to assume that the South Carolina legislature would have enacted the (reduced) 110,000 ton cap in Section 44-56-60(a)(2) *without* the other discriminatory provisions, which reserve substantial disposal capacity for South Carolina generated waste (i.e., 54,000 tons, or 50% more than any other state). The disposal cap was not enacted in a vacuum. To the contrary, in-state generators are *not* adversely effected by the quotas because they received a further benefit at the expense of out-of-state generators. Thus in-state generators could not and did not serve as a "powerful safeguard against legislative abuse." *Id.*

Finally, Section III(C) of DHEC Regulation 61-99 must be declared invalid and permanently enjoined. It is certainly within DHEC's authority to make certain restrictions with respect to the permitting of new and expanded hazardous waste facilities under RCRA. It is simply beyond the agency's authority, however, to create discriminatory restrictions which consider "in-state needs" only to the exclusion of the needs of *all* the customers who bring waste into South Carolina. It is difficult to conceive of a more obvious effort to hoard the economic resources of a state and to isolate that state from interstate commerce. The Fourth Circuit itself acknowledged the unconstitutionality of this provision, remanding not on the merits of its invalidity, but only on the "balance***1038** of hardships" for the issuance of a preliminary injunction. The Fourth Circuit noted that Plaintiff "appears to have a substantial argument that Regulation 61-99 is unconstitutional," *HWTC II,* 945 F.2d at 788, because it:

> ... appears to be an attempt to *block South Carolina from the nationwide problem. On its face. Regulation 61-99 appears not to regulate evenhandedly.* It permits South Carolina to refuse to allow new construction if all of its waste can be disposed of by exportation. The "practical effect," *Healy,* 491 U.S. at 332, 109 S.Ct. at 2497, *of the regulation may be to favor in-state interests over out-of-state interests.*

HWTC II, 945 F.2d at 791 n. 14 (emphasis added).

South Carolina has a range of administrative, legislative and cooperative remedies available to ameliorate its concerns regarding how other states are dealing with hazardous waste issues. *See generally South Carolina v. Reilly Admin. of EPA,* No. 91-3090 (D.D.C. filed Nov. 25, 1991) (complaint that Court prevent EPA "from releasing or earmarking federal hazardous waste cleanup funds under CERCLA to states such as North Carolina whose failure to meet certain statutory conditions renders them ineligible for the funds"). However, South Carolina cannot solve its perceived problem through a program which violates the Commerce Clause.

IV. CONCLUSION

For the foregoing reasons, it is hereby ORDERED:

1. Sections 5 and 9 of Act No. 196 of 1989, amending S.C.Code Ann. Section 44-56-205 and Section 44-56-130, are declared invalid and are permanently enjoined;

2. Executive Order No. 89-17, from the words "Now therefore" onward is declared invalid and is permanently enjoined;

3. Act No. 590 of 1990, amending S.C.Code Ann. Section 44-56-59 and S.C.Code Ann. Section 44-56-60 is declared invalid and is permanently enjoined;

4. Executive Order No. 89-25, from the words

"Now therefore" onward is declared invalid and is permanently enjoined; and

5. South Carolina Department of Health and Environmental Control Regulation 61-99(III)(C) is declared invalid and is permanently enjoined.

IT IS SO ORDERED.

D.S.C.,1995.
Environmental Technologies Council v. State of S.C.
901 F.Supp. 1026

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H

Court of Appeals of Texas,
Houston (1st Dist.).
FAIRMONT SUPPLY COMPANY, Appellant,
v.
HOOKS INDUSTRIAL, INC., Appellee.
Hooks Industrial, Inc., Appellant,
v.
Fairmont Supply Company, Appellee.
No. 01-03-01129-CV.

Aug. 4, 2005.
Rehearing Overruled Sept. 2, 2005.

Background: Supplier brought action for breach of contract and negligent misrepresentation against distributor. The 157th District Court, Harris County, Randall W. Wilson, J., awarded $1,200,000 in lost profit damages on breach of contract claim, but denied supplier's claim for attorney fees. Distributor appealed, and supplier cross-appealed.

Holdings: The Court of Appeals, Laura Carter Higley, J., held that:
(1) any error in admission of testimony of supplier's damages expert with respect to lost profits damages was harmless, and
(2) Pennsylvania law governed issue of whether supplier was entitled to attorney fees.

Affirmed.

West Headnotes

[1] Appeal and Error 30 ⚷1051(1)

30 Appeal and Error
30XVI Review
30XVI(J) Harmless Error
30XVI(J)10 Admission of Evidence
30k1051 Facts Otherwise Established
30k1051(1) k. By other evidence in general. Most Cited Cases

Any error in admission of testimony of plaintiff supplier's damages expert with respect to calculation of lost profits damages in action for breach of contract did not probably cause rendition of improper judgment and was harmless, where other testimony admitted without objection supported jury's award of $1,200,000 in lost profits; specifically, alternate values were admitted, without objection, for variables in lost-profit formula with which defendant distributor took exception as such variables were calculated by plaintiff's expert.

[2] Appeal and Error 30 ⚷1051.1(1)

30 Appeal and Error
30XVI Review
30XVI(J) Harmless Error
30XVI(J)10 Admission of Evidence
30k1051.1 Same or Similar Evidence Otherwise Admitted
30k1051.1(1) k. In general. Most Cited Cases

Error in admitting evidence is generally harmless if the contested evidence is merely cumulative of properly admitted evidence.

[3] Appeal and Error 30 ⚷1050.1(1)

30 Appeal and Error
30XVI Review
30XVI(J) Harmless Error
30XVI(J)10 Admission of Evidence
30k1050 Prejudicial Effect in General
30k1050.1 Evidence in General
30k1050.1(1) k. In general. Most Cited Cases

On a challenge to a trial court's evidentiary ruling, a reviewing court examines the entire record to determine whether the judgment is controlled by the evidence that should have been excluded.

[4] Appeal and Error 30 ⚷893(1)

30 Appeal and Error
30XVI Review

30XVI(F) Trial De Novo
30k892 Trial De Novo
30k893 Cases Triable in Appellate Court
30k893(1) k. In general. Most Cited Cases

Costs 102 ⚷208

102 Costs
102IX Taxation
102k208 k. Duties and proceedings of taxing officer. Most Cited Cases
Question of whether law of Pennsylvania or Texas applied in determining prevailing party's entitlement to attorney fees in action for breach of contract was question of law, and trial court's decision to apply Pennsylvania law was subject to de novo review on appeal.

[5] Contracts 95 ⚷206

95 Contracts
95II Construction and Operation
95II(C) Subject-Matter
95k206 k. Legal remedies and proceedings. Most Cited Cases
Not all claims in a case are necessarily governed by a choice-of-law provision that expressly governs only contractual matters.

[6] Contracts 95 ⚷206

95 Contracts
95II Construction and Operation
95II(C) Subject-Matter
95k206 k. Legal remedies and proceedings. Most Cited Cases
Pennsylvania law governed issue of whether supplier was entitled to attorney fees in its breach of contract action against distributor, as provided in choice-of-law provision of parties' contract, absent any indication that parties intended for Texas law to apply to such issue, where attorney fee claim arose directly from breach of contract containing choice-of-law provision, rather than from tortious conduct or other independent source of liability, choice-of-law provision expressly governed issues of contractual performance, and parties could have contractually allocated attorney fees but chose not to do so.

[7] Appeal and Error 30 ⚷226(2)

30 Appeal and Error
30V Presentation and Reservation in Lower Court of Grounds of Review
30V(B) Objections and Motions, and Rulings Thereon
30k226 Costs
30k226(2) k. Fees. Most Cited Cases
Prevailing plaintiff in breach of contract action waived appellate consideration of its contention that state's statutory scheme allowing successful breach of contract plaintiff to recover attorney fees was fundamental policy of Texas and that Texas had materially greater interest in award of attorney fees than did Pennsylvania, and that Texas law, rather than Pennsylvania law as provided in contract at issue, should apply to issue of entitlement to attorney fees,by failing to raise such argument before trial court. Rules App.Proc., Rule 33.1(a).
***531** Craig H. Clendenin, The Ballard Law Firm, Houston, TX, for Appellant.

George Diaz-Arrastia, Ruth Ellen Shapiro, Andrew C. Schirrmeister, III, Schirrmeister Diaz-Arrastia, Houston, TX, for Appellee.

Panel consists of Chief Justice RADACK and Justices HIGLEY and BLAND.

OPINION

LAURA CARTER HIGLEY, Justice.

In this breach of contract case, the trial court awarded Hooks Industrial, Inc. ("Hooks") $1,200,000 in lost profit-damages against Fairmont Supply Company ("Fairmont"), but denied Hooks's attorney's fees claim. Both Fairmont and Hooks appeal; each raise one issue. Fairmont complains that the trial court abused its discretion in admitting the opinion testimony of Hooks's damages expert, regarding the calculation of lost-profit damages. Hooks contends that the trial court erred in concluding that Pennsylvania law governs its claim for attorney's fees.

We affirm.

Background

Hooks and Fairmont entered into a "Strategic Distribution and Alliance Agreement" ("Alliance Agreement") by which Fairmont agreed to "use Hooks as their [sic] exclusive supplier" for all of the products defined in the contract. The Alliance Agreement remained in effect for 27 months. Hooks later discovered that Fairmont had purchased approximately $62 million worth of products from other suppliers that Fairmont was contractually required to purchase from Hooks.

Hooks sued Fairmont for breach of contract, negligent misrepresentation, and fraud, seeking to recover its lost profits for the products that Fairmont had failed to purchase as required under the Alliance Agreement. In support of its lost-profit claim, Hooks offered the opinion of its damages expert, Jeffrey Compton. Fairmont filed a pre-trial motion to exclude the expert opinion of Compton, which the trial court denied.

The jury found in Hooks's favor on its breach of contract and negligent misrepresentation claims. Hooks elected to have judgment entered on the $1,200,000 in lost-profit damages awarded by the jury for breach of contract.

The parties agreed that the trial court would decide, post-verdict, whether Hooks could recover its attorney's fees related to its breach of contract claim. The determinative issue was whether Texas law or Pennsylvania law governed. Based on a choice-of-law provision found in the Alliance Agreement, the trial court concluded that Pennsylvania law controlled whether Hooks was entitled to recover its attorney's fees. It is undisputed that Pennsylvania law generally does not allow an award of attorney's fees for breach of a contract, absent an agreement by the parties that such fees are recoverable. Fairmont and Hooks had not agreed that attorney's fees were recoverable in the event of a breach of contract. Accordingly, the trial court denied Hooks's attorney's fees request.

Lost-Profit Award

In its sole issue, Fairmont complains that the trial court erred in admitting the opinion testimony of Compton, Hooks's damages expert. Excluding Compton's challenged testimony, Fairmont contends that no competent evidence supports the lost-profit award.

***532** [1] No dispute exists as to the appropriate formula used to determine lost profits in this case. At trial, Compton testified that lost profits are calculated by multiplying expected sales by gross profit margin, subtracting incremental expenses, and applying a discount rate. Fairmont's damages expert agreed that this was the appropriate formula to calculate lost profits. Fairmont, however, takes issue with the method that Compton used to calculate the following three formula variables: Hooks's expected sales, gross profit margin, and incremental expenses. The calculation method used by Compton to ascertain these three formula variables is termed the "yardstick approach" by the parties. Utilizing this approach, Compton projected Hooks's lost profits to be $1,684,199. In its motion to exclude, Fairmont challenged Compton's opinion testimony relating to his calculation of these formula variables based on the yardstick approach.

Compton testified that the yardstick approach is employed to calculate lost profits by analyzing the sales and profits of comparable businesses. Fairmont generally does not dispute the yardstick approach as an accounting method; rather, it argues that its application is not appropriate to determine lost profits in this case. Fairmont also takes issue with Compton's determination that a comparable business to Hooks, with regard to performance of the Alliance Agreement, would be a "manufacturer's agent." And Fairmont disputes the reliability of a survey conducted by an association of manufacturer's agents used by Compton to determine the formula variables. Specifically, Fairmont challenges the reliability of Compton's use of data from the survey to extrapolate the figures for Hooks's expected sales, gross profit margin, and incremental expenses, which Compton then used to calculate Hooks's lost profits.

[2][3] Regardless of whether the trial court erred in admitting Compton's challenged testimony, we conclude that such error was harmless. We will not reverse a trial court for an erroneous evidentiary ruling unless the error probably caused the rendition of an improper judgment. *See* TEX.R.APP. P. 44.1; *see also Gee v. Liberty Mut. Fire Ins. Co.,* 765 S.W.2d 394, 396 (Tex.1989). Error in admitting evidence is generally harmless if the contested evidence is merely cumulative of properly admitted evidence. *See Mancorp, Inc. v. Culpepper,* 802 S.W.2d 226, 230 (Tex.1990). We examine the entire record to determine whether the judgment is controlled by the evidence that should have been excluded. *Id.*

Hooks points out that, in addition to Compton's testimony regarding the yardstick method of valuation, other unobjected-to testimony was admitted that supports the jury's lost profits award. Specifically, alternate values were admitted, without objection, for the variables in the lost-profit formula.

Evidence was admitted, establishing that John Valentine, Hooks's president, had also determined the projected lost sales due to Fairmont's breach and the profitability of the Alliance Agreement had it been performed.[FN1] In particular, Hooks presented testimony, without objection, regarding Valentine's independent determination of Hooks's expected sales and profit margin. Valentine testified that Hooks would have made $28,070,000 in sales had Fairmont performed the Alliance Agreement.***533** Although it made no objection to this portion of Valentine's testimony before or during trial, on appeal, Fairmont contends that Valentine's expected-sales figure is unreliable because it is not based on "objective, facts, figures, or data." Despite Fairmont's contention, the record reveals that Valentine testified about the source and method that he used for determining the expected sales figure. According to Valentine, he reviewed Fairmont's sales data for the period of the contract's 27-month term. The sales data information was contained in Fairmont's "flat files," which Fairmont produced during discovery. On direct examination, Valentine gave detailed testimony about his review and analysis of Fairmont's flat files. In addition, six separate exhibits containing summaries of information found in Fairmont's flat files were admitted at trial and used to support Valentine's testimony on this point.

> FN1. We note that "while expert opinion evidence *may* be offered to prove up the amount of lost profits, in the absence of highly technical issues, the cases do not *require* an expert's opinion to support an award of lost profits." *Southwestern Bell Media, Inc. v. Lyles,* 825 S.W.2d 488, 499 (Tex.App.-Houston [1st Dist.] 1992, writ denied).

Without objection, Valentine also testified that, had Fairmont performed under the Alliance Agreement, Hooks's profit margin would have been 27.5 percent. Valentine explained that this profit margin was indicated by (1) pricing reviews that Hooks had performed for Fairmont during the term of the contract, (2) the few actual purchases that Fairmont had made under the Alliance Agreement, and (3) quotations that Hooks had given to Fairmont for products, which Fairmont never purchased. Valentine testified that 27.5 percent was also Hooks's historic profit margin.

Compton testified that he had determined that

Hooks's "overhead" or incremental expenses historically had been 16 percent. Compton acknowledged that this was a lesser amount than he had determined using the yardstick approach.[FN2] Fairmont made no objection to Compton's testimony on this point in the trial court and does not challenge it on appeal. Compton also testified, without objection, that the applicable discount rate was 33 percent. Fairmont's financial expert testified that he believed the appropriate discount rate was 36 percent.

FN2. Compton testified that Hooks's incremental expenses were 30 percent using the yardstick method.

From the unobjected-to evidence presented at trial, the jury could have assigned the following values to the variables in the lost-profit formula: (1) $28,070,000 for expected sales, (2) 27.5 percent for profit margin, (3) 16 percent for incremental expenses, and (4) 33 or 36 percent for the discount rate. Assuming the jury made the lost profit calculation applying these values, the jury's $1,200,000 award is within the range of the evidence.

After reviewing the record, and without deciding whether the trial court erred in admitting Compton's objected-to testimony, we conclude sufficient evidence is found in the record to render any error harmless. Compton's testimony was cumulative of other evidence admitted without objection, supporting the jury's damages award. Fairmont has failed to show that Compton's challenged testimony probably caused the rendition of an improper judgment. Thus, we hold that the trial court's ruling, even if erroneous, did not amount to harmful error. *See VingCard A.S. v. Merrimac Hospitality Sys., Inc.,* 59 S.W.3d 847, 859 (Tex.App.-Fort Worth 2001, pet. denied) (holding that error in admission of manufacturer's expert's testimony regarding loss of projected future sales was harmless because it was merely cumulative to testimony of manufacturer's president).

We overrule Fairmont's sole issue.

***534 Attorney's Fees**

[4] In its sole issue, Hooks challenges the trial court's denial of its request for attorney's fees. The trial court's ruling was based on its conclusion of law that "the issue of attorneys' fees in this case is governed by Pennsylvania law, and under Pennsylvania law, Hooks is not entitled to recover attorney's fees...." Hooks does not dispute that, under Pennsylvania law, it would not be entitled to attorney's fees for successfully prosecuting its breach of contract claim; rather, Hooks contends that the trial court erred in ruling that Pennsylvania law governs this issue. Hooks asserts that Texas law applies and that, under Texas Civil Practice and Remedies Code ("CPRC") section 38.001(8), it is entitled to attorney's fees. *See* TEX. CIV. PRAC. & REM.CODE ANN. § 38.001(8) (Vernon 1997) (allowing recovery of attorney's fees "in addition to the amount of a valid claim" for breach of contract). Fairmont responds that the trial court properly applied Pennsylvania law pursuant to a choice-of-law provision in the Alliance Agreement. Because it is a question of law, we review the trial court's decision to apply Pennsylvania law to the attorney's fees issue de novo. *See Compaq Computer Corp. v. Lapray,* 135 S.W.3d 657, 672 (Tex.2004).

The choice-of-law provision found in paragraph 21 of the Alliance Agreement reads as follows:

21. *CONTROLLING LAW*

The validity, construction and performance of this Agreement shall be determined in accordance with the internal laws of the Commonwealth of Pennsylvania applicable to agreements to be performed within that State.

Hooks characterizes the choice-of-law provision as a "narrow" one that does not encompass the issue of attorney's fees. In this regard, Hooks asserts as follows:

[The choice of law provision] does not provide broadly that Pennsylvania law governs all issues relating to or arising from the Agreement. Instead, it provides only that Pennsylvania law applies to certain limited issues: whether the Agreement was validly formed, how it should be interpreted or construed, and whether it has been properly performed or breached. The recovery of attorney's fees relates to the types of remedies available for a breach of the Agreement and to the amount of Hooks' recovery for breach. These issues are not subject to the ... choice of law provision.

[5] In support of its position that the choice-of-law provision does not encompass the attorney's fees issue, Hooks advances the conflicts-of-law principle known as "depecage"-a process of applying the laws of different states to discrete issues within the same case. *See* Willis L.M. Reese, *Depecage: A Common Phenomenon in Choice of Law,* 73 COLUM. L.REV.. 58, 73-75 (1973). We do not dispute the validity of depecage, only the appropriateness of its application to the attorney's fees issue in this case. To be sure, the following cases cited by Hooks support its position that not all claims in a case are necessarily governed by a choice-of-law provision that expressly governs only contractual matters: *Stier v. Reading & Bates Corp.,* 992 S.W.2d 423, 433 (Tex.1999) (concluding that Texas choice-of-law clause in employment agreement did not encompass tort claims for personal injury arising out of employment); *Covert Chevrolet-Oldsmobile, Inc. v. Gen. Motors Corp.,* No. 05-00-01170-CV, 2001 WL 950274, at *2-3 (Tex.App.-Dallas Aug.21, 2001, no pet.) (not designated for publication) (holding that Virginia choice-of-law clause did not apply to indemnification claims when such claims were based on Texas statutes and Texas common law and were not based on indemnification***535** provision found in contract containing choice-of-law provision); *Benchmark Elecs., Inc. v. J.M. Huber Corp.,* 343 F.3d 719, 726-27 (5th Cir.2003) (holding that, when agreement's choice-of-law provision stated that "[the] Agreement shall be governed by, and construed in accordance with, the internal laws of the State of New York," agreement would be construed under New York law, but that plaintiff's tort claims would be governed by Texas law).

[6] Unlike the claims in the cases cited by Hooks, the attorney's fees claim here arises directly from a breach of the contract containing the choice-of-law provision. In contrast, the claims in the cases relied on by Hooks, to which the choice-of-law provisions were held not to apply, were independent causes of action and were derived from separate sources of liability, such as tort law.[FN3]

FN3. In its reply brief, Hooks cites to federal cases that apply Pennsylvania law and similarly hold that claims arising from tortious conduct are not governed by the law chosen by the parties to govern the parties' contractual duties and obligations. *See Coram Healthcare Corp. v. Aetna U.S. Healthcare, Inc.,* 94 F.Supp.2d 589, 593, 596 (E.D.Pa.1999); *Stone Street Servs., Inc. v. Daniels,* No. CIV. A. 00-1904, 2000 WL 1909373, at *4 (E.D.Pa. Dec.29, 2000) . Hooks also cites *Composiflex, Inc. v. Advanced Cardiovascular Systems, Inc.,* a case in which the court held that a contractual choice of law applied to tort claims between the parties because the parties agreed that the chosen law would govern "all matters, including but not limited to, matters of validity, construction, effect, or performance." 795 F.Supp. 151, 157 (W.D.Pa.1992).

In *Stier,* the plaintiff, a Jones Act seaman, contended that his personal-injury claims were governed by the substantive laws of Texas, rather than federal maritime law. 992 S.W.2d at 433. In this regard, Stier relied on his employment agreement's choice-of-law provision, which read that the contract "shall be interpreted and enforced in accordance with the laws of the State of Texas." *Id.* The *Stier* court concluded that the choice-of-law provision did not purport to encompass tort claims and did not entitle Stier to assert his tort claims pursuant to the substantive laws of Texas. *Id.* Citing the language of the choice-of-law provision, the *Stier* court reasoned that Stier's "claims do not rise or fall on the 'interpret[ation] and enforce [ment]' of any contractual provision." *Id.* We find the reasoning of *Stier* to be instructive.

Here, the choice-of-law provision in the Alliance Agreement expressly governs issues of contractual performance. And it is undisputed that the liability for Fairmont's contractual non-performance was governed by Pennsylvania law. Undeniably, Hooks could not assert an attorney's fees claim but for its claim against Fairmont for non-performance of the Alliance Agreement. Distinct from the subject claims in the cases that it cites, Hooks's attorney's fees claim is not an independent cause of action; rather, Hooks asserts such claim as a right derived from its successful prosecution of its breach of contract cause of action. Thus, unlike the tort claims in *Stier,* Hooks's attorney's fees claim *does* "rise or fall" on Fairmont's performance, or non-performance, of the Alliance Agreement.[FN4] *See id.* That is, the award of ***536** attorney's fees is inextricably intertwined with the substantive issue of contractual liability-an issue that is undisputably governed by the choice-of-law provision.

FN4. Hooks cites to no authority in which a court has held that a choice-of-law provision does not encompass the recovery of attorney's fees for breach of contract when the choice-of-law provision expressly governs the contractual rights and duties of the parties. *Cf. Katz v. Berisford Int'l PLC,* No. 96 Civ. 8695(JGK), 2000 WL 959721, at *8 (S.D.N.Y. July 10, 2000) (concluding that law of jurisdiction named in contract's choice-of-law provision applied to attorney's fees issue even though contract did not expressly address attorney's fees issue). Although contextually different, we note that Fifth Circuit authority inferentially supports the conclusion that the choice-of-law provision encompasses attorney's fees. *See Exxon Corp. v. Burglin,* 4 F.3d 1294, 1302 (5th Cir.1993) (relying on *Kucel v. Walter E. Heller & Co.,* 813 F.2d 67, 73 (5th Cir.1987) for proposition that choice-of-law clause governs both interpretation of contract and award of attorney's fees); *Hooper v. F.D.I.C.,* 785 F.2d 1228, 1231 (5th Cir.1986) ("Attorney's fees arising out of contract on account of the failure of the maker to perform it, are incidental to it, and arise from the express agreement of the parties and are as much a part of the controversy, or matter in dispute, as the debt itself.").

Such conclusion is reinforced by the realization that the parties in this case could have contractually allocated attorney's fees, if they had so chosen. Though Pennsylvania law does not statutorily allow the recovery of attorney's fees in breach of contract cases, it does permit parties to contractually allocate attorney's fees. *See Fidelity-Philadelphia Trust Co. v. Philadelphia Transp. Co.,* 404 Pa. 541, 548, 173 A.2d 109, 113 (Pa.1961) (stating that attorney's fees are recoverable "when clearly agreed to by the parties"). Here, a contractual provision governing attorney's fees is conspicuously absent. Having chosen Pennsylvania law to govern substantive issues of liability arising from non-performance of the contract, the parties' implicit decision not to address the issue of attorney's fees indicates their expectation that Pennsylvania law would likewise apply to that issue. No indication exists that the parties intended to have Texas law apply to an isolated issue arising from the breach of the contract, such as attorney's fees. In contrast, every indication exists that the parties shaped their conduct in light of Pennsylvania law.

We conclude that attorney's fees are part of the substantive contractual issues, encompassed within the Alliance Agreement, that are governed by the law of the jurisdiction chosen by the parties: Pennsylvania.[FN5] *See Rapp Collins Worldwide, Inc. v. Mohr,* 982 S.W.2d 478, 487-88

(Tex.App.-Dallas 1998, no pet.) (concluding that New York law applied to issues of attorney's fees when contract provided that New York law applied to substantive issues); *Boyd Rosene & Assocs., Inc. v. Kansas Mun. Gas Agency,* 174 F.3d 1115, 1127-28 (10th Cir.1999) (concluding that issue of attorney's fees was substantive issue controlled by law of jurisdiction designated in contract's choice-of-law provision, even though contract did not expressly address attorney's fees issue); *Katz v. Berisford Int'l PLC,* No. 96 Civ. 8695(JGK), 2000 WL 959721, at *8 (S.D.N.Y. July 10, 2000) (concluding that law of jurisdiction named in contract's choice-of-law provision applied to attorney's fees issue even though contract did not expressly address attorney's fees issue); *Atchison Casting Corp. v. Dofasco, Inc.,* No. 93-2447-JWL, 1995 WL 655183, at *8-9 (D.Kan. Oct.24, 1995) (holding that attorney's fees are substantive in nature because contract, though silent on attorney's*537 fees, provided for Canadian law to govern, tending to show that parties had shaped their conduct in light of Canadian law); *El Paso Natural Gas Co. v. Amoco Prod. Co.,* Civ. A. No. 12083, 1994 WL 728816, at *5 (Del.Ch. Dec.16, 1994) (concluding that parties made award of attorney's fees substantive contractual right by designating Texas law as governing, even though contract did not address attorney's fees).

FN5. In support of its assertion that "Courts have awarded attorney's fees pursuant to Texas statute even though another jurisdiction's law governed the substantive rights of the parties," Hooks cites the following cases: *Lipschutz v. Gordon Jewelry Corp.,* 373 F.Supp. 375, 385, 389-93 (S.D.Tex.1974); *Pennwell Corp. v. Ken Assocs., Inc.,* 123 S.W.3d 756, 763-64 (Tex.App.-Houston [14th Dist.] 2003, pet. denied); *Grace v. Allen,* 407 S.W.2d 321, 325 (Tex.Civ.App.-Dallas 1966, writ ref'd n.r.e.); and *Nolen v. Rig-Time, Inc.,* 392 S.W.2d 754, 757-58 (Tex.Civ.App.-Corpus Christi 1965, writ ref'd n.r.e.). Importantly, in these cases, the parties had not made a contractual choice of law. Thus, we find the authority relied on by Hooks to be inapposite.

[7] We hold that the trial court properly determined that Pennsylvania law governed the issue of attorney's fees in this case.[FN6] We overrule Hooks's sole issue.[FN7]

FN6. Hooks further contends that *Duncan v. Cessna Aircraft Co.,* 665 S.W.2d 414 (Tex.1984), requires the application of Texas law because Texas has the "most significant relationship" with the Alliance Agreement. In *Duncan,* the court adopted the "most significant contacts" method for resolving conflicts of law in all cases "except those contract cases in which the parties have agreed to a valid choice of law clause." *Id.* at 421. Because we have concluded that the choice-of-law clause applies to the issue of attorney's fees, we need not engage in the "most significant contacts" analysis.

FN7. In its appellate brief, Hooks also contends that Texas law applies to the attorney's fees issue because the state's statutory scheme, which allows a successful breach of contract plaintiff to recover attorney's fees, is a "fundamental policy" of Texas and because Texas has a "materially greater interest in the award of attorney's fees" than does Pennsylvania. Despite Hooks's contention, we do not find in the appellate record where Hooks presented such argument to the trial court; thus, it is waived. *See* TEX.R.APP. P. 33.1(a). In any event, in addressing a similar "fundamental public policy argument," the Fifth Circuit Court of Appeals concluded, "While Texas law allows attorney's fees to be awarded in breach of contract claims, they are not required by public policy. Texas courts frequently deny attorney's fees if prohibited by the state law designated by contractual choice-of-law provisions." *Smith v. EMC*, 393 F.3d 590, 597 (5th Cir.2004) (internal citation omitted). Moreover, Hooks's contention is undermined by Texas case law in which the courts have acknowledged that parties are free to adopt a more liberal (or more strict) standard for recovery of attorney's fees in their contract than is statutorily provided and that the appellate court is bound by such choice. *Wayne v. A.V.A. Vending, Inc.*, 52 S.W.3d 412, 417-18 (Tex.App.-Corpus Christi 2001, pet. denied); *One Call Sys., Inc. v. Houston Lighting & Power*, 936 S.W.2d 673, 676 (Tex.App.-Houston [14th Dist.] 1996, writ denied).

Conclusion

We affirm the judgment of the trial court.

Tex.App.-Houston [1 Dist.],2005.
Fairmont Supply Co. v. Hooks Indus., Inc.
177 S.W.3d 529

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H

Court of Appeal, Second District, Division 6, California.

FLIR SYSTEMS, INC., et al., Plaintiffs and Appellants,

v.

William PARRISH et al., Defendants and Respondents.

No. B209964.

June 15, 2009.

Review Denied Sept. 23, 2009.

Background: Employer brought action against former employees for misappropriation of trade secrets, seeking injunction. The Superior Court, Santa Barbara County, No. B8154145,James W. Brown, J., entered judgment for former employees after court trial, awarding attorney fees and costs. Employer appealed.

Holdings: The Court of Appeal, Yegan, P.J., held that:

(1) misappropriation claim was objectively specious;

(2) employer acted with subjective bad faith in bringing or maintaining the action;

(3) employee's act of bringing files home was not a threatened misappropriation of trade secrets;

(4) employee's statements that two of employer's patent applications were not valid was not a threatened misappropriation of trade secrets;

(5) trial court's earlier rulings for employer did not preclude bad faith sanctions;

(6) finding in trial court's tentative statement of decision did not preclude bad faith sanctions; and

(7) declining to hold post-trial hearing to address issue of bad faith was proper.

Affirmed.

West Headnotes

[1] Costs 102 ⚷194.44

102 Costs

102VIII Attorney Fees

102k194.44 k. Bad Faith or Meritless Litigation. Most Cited Cases

Statute authorizing award of reasonable attorney fees and costs when a claim of trade secret misappropriation is made in bad faith authorizes the trial court to award attorney fees as a deterrent to specious trade secret claims. West's Ann.Cal.Civ.Code § 3426.4.

[2] Costs 102 ⚷2

102 Costs

102I Nature, Grounds, and Extent of Right in General

102k1 Nature and Grounds of Right

102k2 k. In General. Most Cited Cases

Costs 102 ⚷194.44

102 Costs

102VIII Attorney Fees

102k194.44 k. Bad Faith or Meritless Litigation. Most Cited Cases

Because the award is a sanction, a trial court has broad discretion in awarding fees under statute authorizing award of reasonable attorney fees and costs when a claim of trade secret misappropriation is made in bad faith. West's Ann.Cal.Civ.Code § 3426.4.

[3] Appeal and Error 30 ⚷984(5)

30 Appeal and Error

30XVI Review

30XVI(H) Discretion of Lower Court

30k984 Costs and Allowances

30k984(5) k. Attorney Fees. Most Cited Cases

Appeal and Error 30 ⚷1024.1

30 Appeal and Error

30XVI Review

30XVI(I) Questions of Fact, Verdicts, and Findings
30XVI(I)6 Questions of Fact on Motions or Other Interlocutory or Special Proceedings
30k1024.1 k. In General. Most Cited Cases
On appeal from an order awarding attorney fees and costs based on a claim of trade secret misappropriation made in bad faith, the appellant has an uphill battle, and must overcome both the "sufficiency of evidence" rule and the "abuse of discretion" rule. West's Ann.Cal.Civ.Code § 3426.4.

[4] Costs 102 ⚷194.44

102 Costs
102VIII Attorney Fees
102k194.44 k. Bad Faith or Meritless Litigation. Most Cited Cases
"Objective speciousness," as required for bad faith in a claim of trade secret misappropriation supporting an award of reasonable attorney fees and costs, exists where the action superficially appears to have merit but there is a complete lack of evidence to support the claim. West's Ann.Cal.Civ.Code § 3426.4.

[5] Antitrust and Trade Regulation 29T ⚷438

29T Antitrust and Trade Regulation
29TIV Trade Secrets and Proprietary Information
29TIV(B) Actions
29Tk438 k. Costs and Attorney Fees. Most Cited Cases
Trial court's finding that employer's trade secret misappropriation claim against former employees was objectively specious, in awarding attorney fees and costs, was supported by substantial evidence, including chief executive officer's (CEO) testimony that the lawsuit was filed because employer could not "tolerate a direct competitive threat" from the former employees, and employer's failure to prove its complaint's allegations that employees misappropriated secrets, that employees stated an intention to misappropriate trade secrets, and that employees caused employer to suffer actual damage. West's Ann.Cal.Civ.Code § 3426.4.
See Cal. Civil Practice (Thomson Reuters 2009) Business Litigation, §§ 66:2, 66:19; Cal. Transactions Forms, Business Transactions, § 9:43 (Thomson Reuters 2009); Chin et al., Cal. Practice Guide: Employment Litigation (The Rutter Group 2009) ¶ 14:216 (CAEMPL Ch. 14-C); 13 Witkin, Summary of Cal. Law (10th ed. 2005) Equity, § 91.

[6] Antitrust and Trade Regulation 29T ⚷438

29T Antitrust and Trade Regulation
29TIV Trade Secrets and Proprietary Information
29TIV(B) Actions
29Tk438 k. Costs and Attorney Fees. Most Cited Cases
Statute authorizing award of reasonable attorney fees and costs when a claim of trade secret misappropriation is made in bad faith requires objective speciousness of the plaintiff's claim, as opposed to frivolousness. West's Ann.Cal.Civ.Code § 3426.4; West's Ann.Cal.C.C.P. § 128.5.

[7] Antitrust and Trade Regulation 29T ⚷414

29T Antitrust and Trade Regulation
29TIV Trade Secrets and Proprietary Information
29TIV(A) In General
29Tk414 k. Elements of Misappropriation. Most Cited Cases
The doctrine of inevitable disclosure, which would allow a plaintiff to prove a claim of trade secret misappropriation by demonstrating that the defendant's new employment will inevitably lead him to rely on the plaintiff's trade secrets, is not the law in California. West's Ann.Cal.Bus. & Prof.Code § 16600.

[8] Injunction 212 ⚷56

212 Injunction
212II Subjects of Protection and Relief
212II(B) Matters Relating to Property
212k56 k. Disclosure or Use of Trade

Secrets. Most Cited Cases
Speculation that a departing employee may misappropriate and use a trade secret in a startup business will not support an injunction. West's Ann.Cal.Civ.Code § 3426.2.

[9] Antitrust and Trade Regulation 29T ⚿414

29T Antitrust and Trade Regulation
29TIV Trade Secrets and Proprietary Information
29TIV(A) In General
29Tk414 k. Elements of Misappropriation. Most Cited Cases
A misappropriation of trade secrets plaintiff must show an actual use or an actual threat. West's Ann.Cal.Civ.Code § 3426.2.

[10] Antitrust and Trade Regulation 29T ⚿438

29T Antitrust and Trade Regulation
29TIV Trade Secrets and Proprietary Information
29TIV(B) Actions
29Tk438 k. Costs and Attorney Fees. Most Cited Cases
Subjective bad faith, as required for bad faith in a claim of trade secret misappropriation supporting an award of reasonable attorney fees and costs, may be inferred by evidence that the plaintiff intended to cause unnecessary delay, filed the action to harass the defendant, or harbored an improper motive. West's Ann.Cal.Civ.Code § 3426.4.

[11] Antitrust and Trade Regulation 29T ⚿438

29T Antitrust and Trade Regulation
29TIV Trade Secrets and Proprietary Information
29TIV(B) Actions
29Tk438 k. Costs and Attorney Fees. Most Cited Cases
The timing of a trade secret misappropriation action may raise an inference of bad faith supporting a sanctions award of reasonable attorney fees and costs. West's Ann.Cal.Civ.Code § 3426.4.

[12] Antitrust and Trade Regulation 29T ⚿438

29T Antitrust and Trade Regulation
29TIV Trade Secrets and Proprietary Information
29TIV(B) Actions
29Tk438 k. Costs and Attorney Fees. Most Cited Cases
Trial court's finding that employer acted with subjective bad faith in bringing or maintaining a misappropriation of trade secrets action against former employees, in awarding attorney fees and costs to employees, was supported by substantial evidence, including contradictory testimony of employer's executives who did not want to take responsibility for initiating and maintaining the action, employer's failure to seek an order compelling employees to return anything in requesting a permanent injunction, employer's failure to identify what trade secrets would be subject to permanent injunction, and employer's settlement demands which were inflammatory and contrary to public policy. West's Ann.Cal.Civ.Code § 3426.4.

[13] Antitrust and Trade Regulation 29T ⚿420

29T Antitrust and Trade Regulation
29TIV Trade Secrets and Proprietary Information
29TIV(A) In General
29Tk420 k. Particular Cases, in General. Most Cited Cases

Injunction 212 ⚿56

212 Injunction
212II Subjects of Protection and Relief
212II(B) Matters Relating to Property
212k56 k. Disclosure or Use of Trade Secrets. Most Cited Cases
Employee's act of copying employer's commodity

code database onto a hard drive was not a "threatened misappropriation" of trade secrets subject to injunction under California Uniform Trade Secrets Act, even though employee later stopped working for employer and planned to start a competing business, where employee notified employer that he had copied the files in an attempt to work on them at home and that he later destroyed the hard drive; employee did not threaten to misuse trade secrets, by words or conduct. West's Ann.Cal.Civ.Code § 3426.2.

[14] Antitrust and Trade Regulation 29T ⚷ 413

29T Antitrust and Trade Regulation
29TIV Trade Secrets and Proprietary Information
29TIV(A) In General
29Tk413 k. What Are "Trade Secrets" or Other Protected Proprietary Information, in General. Most Cited Cases
A "threatened misappropriation" of trade secrets, as would support injunction under California Uniform Trade Secrets Act, means a threat by a defendant to misuse trade secrets, manifested by words or conduct, where the evidence indicates imminent misuse. West's Ann.Cal.Civ.Code § 3426.2.

[15] Injunction 212 ⚷56

212 Injunction
212II Subjects of Protection and Relief
212II(B) Matters Relating to Property
212k56 k. Disclosure or Use of Trade Secrets. Most Cited Cases
Mere possession of trade secrets by a departing employee is not enough for an injunction under California Uniform Trade Secrets Act. West's Ann.Cal.Civ.Code § 3426.2.

[16] Injunction 212 ⚷56

212 Injunction
212II Subjects of Protection and Relief
212II(B) Matters Relating to Property
212k56 k. Disclosure or Use of Trade Secrets. Most Cited Cases
Under California Uniform Trade Secrets Act, a trade secret will not be protected by the extraordinary remedy of an injunction on mere suspicion or apprehension of injury; there must be a substantial threat of impending injury before an injunction will issue. West's Ann.Cal.Civ.Code § 3426.2.

[17] Injunction 212 ⚷56

212 Injunction
212II Subjects of Protection and Relief
212II(B) Matters Relating to Property
212k56 k. Disclosure or Use of Trade Secrets. Most Cited Cases
Provision of California Uniform Trade Secrets Act stating that affirmative acts to protect a trade secret may be compelled by court order authorizes mandatory, not prohibitory injunctions. West's Ann.Cal.Civ.Code § 3426.2(c).

[18] Injunction 212 ⚷56

212 Injunction
212II Subjects of Protection and Relief
212II(B) Matters Relating to Property
212k56 k. Disclosure or Use of Trade Secrets. Most Cited Cases
Provision of California Uniform Trade Secrets Act stating that affirmative acts to protect a trade secret may be compelled by court order does not authorize an order enjoining a remote threat or misuse or disclosure, since such an order is prohibitory and does not necessarily compel affirmative acts. West's Ann.Cal.Civ.Code § 3426.2(c).

[19] Antitrust and Trade Regulation 29T ⚷ 420

29T Antitrust and Trade Regulation
29TIV Trade Secrets and Proprietary Information
29TIV(A) In General
29Tk420 k. Particular Cases, in General. Most Cited Cases

Injunction 212 ⚷56

212 Injunction
212II Subjects of Protection and Relief
212II(B) Matters Relating to Property
212k56 k. Disclosure or Use of Trade Secrets. Most Cited Cases

Trial court acted within its discretion in finding that former employee's statements that two of employer's patent applications based on a process employee had worked on were not valid was not a threatened misappropriation of trade secrets subject to injunction under California Uniform Trade Secrets Act, where employer's Chief Intellectual Property Officer opined that the United States Patent & Trademark Office could go either way on the validity of the applications, and where employer's officers and managers stated that the former employee was trustworthy and that an inventor's disagreement about a patent application did not signal a plot to steal trade secrets. West's Ann.Cal.Civ.Code § 3426.2.

[20] Injunction 212 ⚷189

212 Injunction
212V Permanent Injunction and Other Relief
212k189 k. Nature and Scope of Relief. Most Cited Cases

Employer's proposed injunction against former employees under California Uniform Trade Secrets Act, barring employees from developing certain products for a 12 month period even if employees did not use employer's technology or trade secrets, would be an unlawful restraint on trade. West's Ann.Cal.Civ.Code § 3426.2; West's Ann.Cal.Bus. & Prof.Code § 16600.

[21] Compromise and Settlement 89 ⚷9

89 Compromise and Settlement
89I In General
89k7 Validity
89k9 k. Legality of Consideration. Most Cited Cases

A condition in employer's proposed settlement of a misappropriation of trade secrets action against former employees, barring employees from working with certain third party foundries, was an unlawful trade restraint. West's Ann.Cal.Bus. & Prof.Code § 16600; West's Ann.Cal.Civ.Code § 3426 et seq.

[22] Compromise and Settlement 89 ⚷9

89 Compromise and Settlement
89I In General
89k7 Validity
89k9 k. Legality of Consideration. Most Cited Cases

A condition in employer's proposed settlement of a misappropriation of trade secrets action against former employees, barring the former employees from hiring employer's other employees, violated public policy. West's Ann.Cal.Bus. & Prof.Code § 16600; West's Ann.Cal.Civ.Code § 3426 et seq.

[23] Compromise and Settlement 89 ⚷9

89 Compromise and Settlement
89I In General
89k7 Validity
89k9 k. Legality of Consideration. Most Cited Cases

A condition in employer's proposed settlement of a misappropriation of trade secrets action against former employees, barring the former employees from challenging employer's patent applications, violated public policy. 37 C.F.R. § 1.56; West's Ann.Cal.Civ.Code § 3426 et seq.

[24] Antitrust and Trade Regulation 29T ⚷438

29T Antitrust and Trade Regulation
29TIV Trade Secrets and Proprietary Information
29TIV(B) Actions
29Tk438 k. Costs and Attorney Fees. Most Cited Cases

A trial court may consider a party's dilatory tactics and bad faith settlement demands in maintaining the action, in awarding attorney fees and costs for bad faith in bringing or maintaining a misappropriation of trade secrets action. West's Ann.Cal.Civ.Code § 3426.4.

[25] Costs 102 ⚷194.44

102 Costs
102VIII Attorney Fees
102k194.44 k. Bad Faith or Meritless Litigation. Most Cited Cases

Malicious Prosecution 249 ⚷77

249 Malicious Prosecution
249V Actions
249k77 k. Costs. Most Cited Cases
In certain tort actions, such as malicious prosecution, the denial of summary judgment normally precludes the trial court from finding that the lawsuit was frivolous.

[26] Judgment 228 ⚷190

228 Judgment
228V On Motion or Summary Proceeding
228k190 k. Construction and Operation. Most Cited Cases
Trial court's denial of a motion for summary judgment, a motion in limine, and two nonsuit motions did not preclude trial court from awarding attorney fees and costs to former employees for employer's bad faith in bringing or maintaining misappropriation of trade secrets action, where employer opposed summary judgment motion with expert declarations suggesting there was a scientific methodology to predict the likelihood of trade secret misuse, but at trial employer's experts admitted there was no valid scientific methodology to predict trade secret misuse and agreed that no trade secrets were misappropriated. West's Ann.Cal.Civ.Code § 3426.4.

[27] Antitrust and Trade Regulation 29T ⚷438

29T Antitrust and Trade Regulation
29TIV Trade Secrets and Proprietary Information
29TIV(B) Actions
29Tk438 k. Costs and Attorney Fees. Most Cited Cases
Under the California Uniform Trade Secret Act, sanctions may be awarded for the bad faith filing or maintenance of a groundless action. West's Ann.Cal.Civ.Code § 3426.4.

[28] Antitrust and Trade Regulation 29T ⚷438

29T Antitrust and Trade Regulation
29TIV Trade Secrets and Proprietary Information
29TIV(B) Actions
29Tk438 k. Costs and Attorney Fees. Most Cited Cases
Under the California Uniform Trade Secret Act, a trade secrets claim brought in good faith could warrant an award of attorney fees if the claim is pursued beyond a point where the plaintiff no longer believes the case has merit. West's Ann.Cal.Civ.Code § 3426.4.

[29] Antitrust and Trade Regulation 29T ⚷438

29T Antitrust and Trade Regulation
29TIV Trade Secrets and Proprietary Information
29TIV(B) Actions
29Tk438 k. Costs and Attorney Fees. Most Cited Cases
For purposes of an award of attorney fees and costs for bad faith in bringing or maintaining a misappropriation of trade secrets action, bad faith may be inferred where the specific shortcomings of the case are identified by opposing counsel, and the decision is made to go forward despite the inability to respond to the arguments raised. West's Ann.Cal.Civ.Code § 3426.4.

[30] Judges 227 ⚷24

227 Judges
227III Rights, Powers, Duties, and Liabilities
227k24 k. Judicial Powers and Functions in General. Most Cited Cases
A finding in trial court's tentative statement of decision, that former employees did not prevail on an unclean hands defense in employer's misappropriation of trade secrets action against former employees, did not preclude trial court from awarding attorney fees and costs to employees for employer's bad faith in bringing or maintaining the action, since the tentative statement of decision was not binding on the trial court, and the doctrine of unclean hands did not relate to the filing or maintenance of the action. West's Ann.Cal.Civ.Code § 3426.4; Cal.Rules of Court, Rule 3.1590(b).

[31] Appeal and Error 30 ⚷717

30 Appeal and Error
30X Record
30X(N) Matters Not Apparent of Record
30k717 k. Opinion of Lower Court. Most Cited Cases
A tentative decision cannot be relied on to impeach the judgment on appeal. Cal.Rules of Court, Rule 3.1590(b).

[32] Equity 150 ⚷65(1)

150 Equity
150I Jurisdiction, Principles, and Maxims
150I(C) Principles and Maxims of Equity
150k65 He Who Comes Into Equity Must Come with Clean Hands
150k65(1) k. In General. Most Cited Cases
The doctrine of unclean hands relates to misconduct occurring before the lawsuit was filed, not the bad faith filing or maintenance of an action.

[33] Antitrust and Trade Regulation 29T ⚷427

29T Antitrust and Trade Regulation
29TIV Trade Secrets and Proprietary Information
29TIV(B) Actions
29Tk427 k. Defenses in General. Most Cited Cases

Equity 150 ⚷65(1)

150 Equity
150I Jurisdiction, Principles, and Maxims
150I(C) Principles and Maxims of Equity
150k65 He Who Comes Into Equity Must Come with Clean Hands
150k65(1) k. In General. Most Cited Cases
The doctrine of unclean hands does not apply to an action for unfair competition. West's Ann.Cal.Bus. & Prof.Code § 17200 et seq.

[34] Antitrust and Trade Regulation 29T ⚷438

29T Antitrust and Trade Regulation
29TIV Trade Secrets and Proprietary Information
29TIV(B) Actions
29Tk438 k. Costs and Attorney Fees. Most Cited Cases

Constitutional Law 92 ⚷4018

92 Constitutional Law
92XXVII Due Process
92XXVII(E) Civil Actions and Proceedings
92k4017 Costs and Fees
92k4018 k. In General. Most Cited Cases

Costs 102 ⚷208

102 Costs
102IX Taxation
102k208 k. Duties and Proceedings of Taxing Officer. Most Cited Cases
Trial court acted within its discretion in declining to hold a post-trial hearing to address the issue of bad faith, before awarding attorney fees and costs to employees for employer's bad faith in bringing or

maintaining misappropriation of trade secrets action, where trial court did not exclude evidence before ruling on question of bad faith, trial court had already found objective speciousness and subjective bad faith and calendared the matter to determine reasonable attorney fees, and employer did not object to the briefing schedule or make an offer of proof that it had new evidence; employer had no due process right to retry the issue of bad faith. U.S.C.A. Const.Amend. 14; West's Ann.Cal.Civ.Code § 3426.4.

[35] Antitrust and Trade Regulation 29T 438

29T Antitrust and Trade Regulation
29TIV Trade Secrets and Proprietary Information
29TIV(B) Actions
29Tk438 k. Costs and Attorney Fees. Most Cited Cases

Costs 102 2

102 Costs
102I Nature, Grounds, and Extent of Right in General
102k1 Nature and Grounds of Right
102k2 k. In General. Most Cited Cases

Costs 102 208

102 Costs
102IX Taxation
102k208 k. Duties and Proceedings of Taxing Officer. Most Cited Cases
Employer was not denied a meaningful opportunity to address sanctions, before trial court awarded attorney fees and costs to former employees for employer's bad faith in bringing or maintaining misappropriation of trade secrets action, where sanctions were discussed a few days after the action was filed, in the answer to the complaint, in opening statement, in closing statement, and in the post-trial briefs, and the trial court asked counsel to brief sanctions on the next-to-last day of trial. West's Ann.Cal.Civ.Code § 3426.4.

****311** Latham & Watkins; Daniel Scott Schecter, Charles Courtenay, Los Angeles, and Svetlana M. Berman, San Francisco; Bickel Brewer; William A. Brewer III and James S. Renard, Dallas, TX, for Appellants.

Wilson, Sonsini, Goodrich & Rosati; James A. DiBoise and Charles Tait Graves, San Francisco, for Respondents.

****312** YEGAN, P.J.

***1273** Appellants FLIR Systems, Inc. (FLIR) and Indigo Systems Corporation (Indigo) appeal from a judgment and post-judgment order awarding respondents William Parrish and Timothy Fitzgibbons $1,641,216.78 attorney fees and costs in a trade secret action. (Civ.Code, § 3426 et seq.) FN1 ***1274** THE TRIAL COURT FOUND THAT THE ACTION WAS FILED AND maintained in bad faith within the meaning of section 3426.4 of the California Uniform Trade Secrets Act. We affirm.

> FN1. Unless otherwise stated, all statutory references are to the Civil Code. The California Uniform Trade Secrets Act states: " 'Trade secret' means information, including a formula, pattern, compilation, program, device, method, technique, or process, that: [¶] (1) Derives independent economic value, actual or potential, from not being generally known to the public or to other persons who can obtain economic value from its disclosure or use; and [¶] (2) Is the subject of efforts that are reasonable under the circumstances to maintain its secrecy." (§ 3426.1, subd. (d).)

Facts

Indigo manufactures and sells microbolometers. A microbolometer is a device used in connection with infrared cameras, night vision, and thermal imaging. A significant portion of Indigo's technology was created by respondent William Parrish. FLIR manufactures and sells infrared cameras, night vision, and thermal imaging systems that use microbolometers. In 2004, FLIR purchased Indigo for approximately $185 million, acquiring Indigo's patents, technology, and intellectual property. Parish and Fitzgibbons were shareholders and officers of Indigo before the company was sold. After the sale, they continued working at Indigo.

In 2005, respondents decided to start a new company to mass produce bolometers and gave notice that they would quit Indigo on or about January 6, 2006. The new company was based on a business plan (Thermicon) developed by Fitzgibbons in 1998 and 1999 when he was self-employed.

Before leaving Indigo, respondents discussed allowing appellants to participate in Thermicon. Respondents proposed outsourcing bolometer production to a third party. The production startup time would be quick, assuming respondents could acquire technology licenses and intellectual property from a third party. Respondents offered FLIR a non-controlling interest in Thermicon. FLIR rejected the offer and wished respondents success in the new endeavor.

In early 2006, respondents entered into negotiations with Raytheon Company to acquire licensing, technology, and manufacturing facilities for Thermicon. Respondents assured appellants they would not misappropriate Indigo's trade secrets and that the new company would use an intellectual property filter similar to the one used at Indigo to prevent the misuse of trade secrets.

Fearful that the new business would undermine FLIR's market, appellants sued for injunctive relief and damages on June 15, 2006. The action was premised on the theory that respondents could not mass produce low-cost microbolometers based on the Thermicon time line without misappropriating trade secrets.

Upon learning of the lawsuit, Raytheon Company terminated business discussions with respondents. On August 15, 2006, respondents advised appellants that they were not going forward with the new business.

**1275 The Permanent Injunction Trial*

Appellants dismissed the damage causes of action and proceeded to trial for a permanent****313** injunction to enjoin respondents from: (1) making use of appellants' trade secrets in the design, manufacture, and high-volume production of uncooled Vanadium Oxide microbolometers; (2) selling uncooled Vanadium Oxide microbolometers in commercial markets less than 12 months after respondents entered into a license with Raytheon Company or any other third party to purchase intellectual property; or (3) using, disclosing or misappropriating the contents of an Indigo commodity code database that Parrish attempted to download while an employee at Indigo.

After eight days of testimony, the trial court found no misappropriation or threatened misappropriation of trade secrets. It was uncontroverted that respondents received no funding for Thermicon, did not start a new business, had no employees or customers, did not lease a facility or develop technology, and did not design, produce, sell, or offer to sell infrared products.

In a 25-page well-reasoned statement of decision, the trial court found that the action was brought in bad faith based on a theory of "inevitable disclosure," a doctrine not recognized by California courts because it contravenes a strong public policy of employee mobility that permits ex-employees to start new entrepreneurial endeavors. (See *Continental Car-Na-Var v. Moseley* (1944) 24 Cal.2d 104, 110, 148 P.2d 9; *Whyte v. Schlage Lock Co.* (2002) 101 Cal.App.4th 1443, 1462, 125 Cal.Rptr.2d 277.) Appellants were ordered to pay $1,352,000 attorney fees and $289,216.78 costs. (§ 3426.4.)

Section 3426.4 Fees: Trial Rules, and Appellate

Rules

[1][2] Section 3426.4 of the California Uniform Trade Secrets Act provides: "If a claim of misappropriation is made in bad faith, ... the [trial] court may award reasonable attorney's fees and costs to the prevailing party." Although the Legislature has not defined "bad faith," our courts have developed a two-prong standard: (1) objective speciousness of the claim, and (2) subjective bad faith in bringing or maintaining the action, i.e., for an improper purpose. (*Gemini Aluminum Corp. v. California Custom Shapes, Inc.* (2002) 95 Cal.App.4th 1249, 1262, 116 Cal.Rptr.2d 358 (*Gemini*).) Section 3426.4 authorizes the trial court to award attorney fees as a deterrent to specious trade secret claims. (*Id.,* at p. 1261, 116 Cal.Rptr.2d 358.) Because the award is a sanction, a trial court has broad discretion in awarding fees. (*Id.,* at p. 1262, 116 Cal.Rptr.2d 358.)

[3] On appeal from such an order, the appellant has an "uphill battle" and must overcome both the "sufficiency of evidence" rule and the "abuse of discretion" rule. We need not repeat these well-settled rules. (See ***1276***Estate of Gilkison* (1998) 65 Cal.App.4th 1443, 1448-1450, 77 Cal.Rptr.2d 463.) As we shall explain, appellant does not appear to appreciate the trial court's fact-finding power and its discretionary power to award attorney fees and costs to curtail a bad faith claim of trade secret misappropriation. We do not retry cases on appeal and we do not substitute our discretion for that of the trial court.

Objectively Specious

[4] Appellant argues that the first prong, i.e. objective speciousness, was not satisfied. Objective speciousness exists where the action superficially appears to have merit but there is a complete lack of evidence to support the claim. (*Gemini, supra,* 95 Cal.App.4th at p. 1261, 116 Cal.Rptr.2d 358; *CRST Van Expedited, Inc. v. Werner Enterprises* (9th Cir.2007) 479 F.3d 1099, 1112.)

****314** The trial court found that the action was objectively specious because appellants suffered no economic harm and there was no misappropriation or threatened misappropriation of trade secrets. It also found that respondents did not misappropriate the idea of outsourcing bolometer production to a third party and that the Thermicon business plan, which included a business forecast chart, did not misappropriate confidential information from appellants.

[5] Objective speciousness was established by evidence that appellants had an anticompetitive motive in filing the lawsuit. When asked why the action was filed, FLIR CEO Earl Lewis testified that "we can't tolerate a direct competitive threat by Bill [Parrish] and Tim [Fitzgibbons]." Lewis had no evidence of wrongdoing but was bothered that respondents planned to compete with FLIR in the future.

[6] Appellants argue that attorney fees may not be awarded unless the action is "frivolous," an objective standard used to impose Code of Civil Procedure section 128.5 sanctions. But the word "frivolous" does not appear in section 3426.4. "[S]ection 3426.4 requires objective speciousness of the plaintiff's claim, as opposed to frivolousness...." (*Gemini, supra,* 95 Cal.App.4th at p. 1262, 116 Cal.Rptr.2d 358.)

The evidence here supports the finding that appellants filed a specious action as a preemptive strike and for an anticompetitive purpose. The complaint alleges that appellants suffered "actual damages" and that respondents willfully and maliciously converted appellants' trade secrets "with the deliberate intent to injure [appellants'] business...." FN2 The evidence, ***1277** however, showed no "actual damages," misappropriation, or threatened misappropriation of trade secrets, and no threat of imminent harm.

FN2. The complaint alleges that Fitzgibbons, at a July 2004 board presentation to partner with FLIR, "effectively claimed

> ownership of FLIR's trade secrets" and "stated his intentions to proceed with a competing business based on such ideas, plans and information...." The complaint states that appellants were concerned about respondents' "brazen plan to use FLIR's confidential trade secrets" and that respondents willfully and deliberately breached non-compete agreements and proprietary agreements. None of these allegations were proven.

[7] The trial court ruled that the action was based on the doctrine of "inevitable disclosure" and violated public policy favoring employee mobility. (Bus. & Prof.Code § 16600; *Metro Traffic Control, Inc. v. Shadow Traffic Network* (1994) 22 Cal.App.4th 853, 859, 27 Cal.Rptr.2d 573; *Bayer Corp. v. Roche Molecular Systems, Inc.* (N.D.Cal.1999) 72 F.Supp.2d 1111, 1119-1120.) FN3 The doctrine of inevitable disclosure is not the law in California. (*Whyte v. Schlage Lock Co., supra,* 101 Cal.App.4th at p. 1447, 125 Cal.Rptr.2d 277 [inevitable disclosure injunction not permitted].) Sixty years ago our Supreme Court in *Continental Car-Na-Var Corp. v. Moseley, supra,* 24 Cal.2d at page 110, 148 P.2d 9, stated: "A former employee has ****315** the right to engage in a competitive business for himself and to enter into competition with his former employer, even for the business of those who had formerly been the customers of his former employer, provided such competition is fairly and legally conducted. [Citation.]"

> FN3. "Under the doctrine of inevitable disclosure, 'a plaintiff may prove a claim of trade secret misappropriation by demonstrating that defendant's new employment will inevitably lead him to rely on the plaintiff's trade secrets.' (*PepsiCo, Inc. v. Redmond* (7th Cir.1995) 54 F.3d 1262, 1269 (*PepsiCo*).) The inevitable disclosure doctrine results in an injunction prohibiting employment, not just use of trade secrets. The doctrine's justification is that unless the employee has 'an uncanny ability to compartmentalize information' the employee will necessarily rely-consciously or subconsciously-upon knowledge of the former employer's trade secrets in performing his or her new job duties. (Citation.)" (*Whyte v. Schlage Lock Co., supra,* 101 Cal.App.4th at pp. 1458-1459, 125 Cal.Rptr.2d 277.)

[8][9] Appellants admitted that respondents had the right leave to Indigo but claimed that respondents would misappropriate trade secrets if they started a new company. But speculation that a departing employee may misappropriate and use a trade secret in a startup business will not support an injunction. (*Continental Car-Na-Var v. Moseley, supra,* 24 Cal.2d at pp. 107-108, 148 P.2d 9 [injunction may not issue based on employer's speculation]; *GlobeSpan, Inc. v. O'Neill* (C.D.Cal.2001) 151 F.Supp.2d 1229, 1235 [same].) "A trade secrets plaintiff must show an actual use or an actual threat." (*Bayer Corp. v. Roche Molecular Systems, Inc., supra,* 72 F.Supp.2d at p. 1120.)

Missing here is evidence of misappropriation, threatened misappropriation, imminent harm, or on-going wrongdoing. William Sundermeier, president of a FLIR division, voted with FLIR CEO Lewis to file the lawsuit but had no ***1278** personal knowledge that respondents had committed a wrongful act. At trial, Sundermeier could not say why the lawsuit was still on-going a year and a half later.

Subjective Bad Faith

[10][11] Subjective bad faith may be inferred by evidence that appellants intended to cause unnecessary delay, filed the action to harass respondents, or harbored an improper motive. (*Gemini, supra,* 95 Cal.App.4th at p. 1263, 116 Cal.Rptr.2d 358.) The timing of the action may raise an inference of bad faith. (*Id.,* at pp. 1263-1264, 116 Cal.Rptr.2d 358.) Similar inferences may be made where the plaintiff proceeds to trial after the action's fatal shortcom-

ings are revealed by opposing counsel. (*Id.*, at p. 1264, 116 Cal.Rptr.2d 358.)

[12] Appellants suspected that trade secrets would be misappropriated and claim that a reasonable suspicion is evidence of good faith.[FN4] The trial court did not credit this theory, instead finding that appellants' reasons for bringing and maintaining the action were "inevitable disclosure" arguments. "In reviewing the facts which led the trial court to impose sanctions, we must accept the version thereof which supports the trial court's determination, and must indulge in the inferences which favor its findings. [Citations.]' [Citation.]" (*Gemini, supra,* 95 Cal.App.4th at pp. 1262-1263, 116 Cal.Rptr.2d 358.)

FN4. The statement of decision states that respondents, by their words or conduct, did not threaten imminent misuse of appellant's trade secrets or threaten immediate harm, "although the conduct of both of them raised a reasonable suspicion that they might misuse [appellants'] trade secrets." Appellants argue that "reasonable suspicion" bars a finding of subjective bad faith. The trial court correctly ruled that "reasonable suspicion" was not enough and that appellants were suing on an inevitable disclosure theory to prevent respondents from competing with FLIR.

Hard Drive Download

[13] Appellants contend there was a threatened misappropriation of trade secrets because Parrish downloaded technological data onto a portable hard drive before leaving Indigo. The information was stored on Indigo's computer network in a commodity code database for employee access.

Working on a project at Indigo, Parrish was frustrated about the slow computer network and copied the database to work ****316** at home. Parrish tried to use the hard drive but discovered that the database hyperlinks were broken and the data was not readable. Parrish left the hard drive at home and destroyed it in the spring of 2006 before the lawsuit was filed.

Parrish told Jim Woolaway, FLIR's Chief Intellectual Property Officer, about the download several months after the lawsuit was filed. Woolaway reported ***1279** the incident to his superiors. Thomas Surran, an Indigo executive, thereafter attempted to download the database on a hard drive and confirmed the hyperlinks did not work.

The hard drive download was not a consideration in bringing the action because appellants first learned of it after the complaint was filed. The trial court found that the download was not a threatened misappropriation because there was no evidence that the contents of the hard drive, "if such contents existed, were improperly accessed, used, or copied before the drive was destroyed."

[14] Appellants claim that the hard drive download is a "threatened" misappropriation under the California Uniform Trade Secrets Act. This is a restatement of the inevitable disclosure doctrine which is not the law in California. (*Whyte v. Schlage Lock Co., supra,* 101 Cal.App.4th at pp. 1463-1464, 125 Cal.Rptr.2d 277; Trade Secrets Practice in California (Cont.Ed.Bar 2d ed.2008) § 12.13, p. 486.) The trial court, in construing section 3426.2, properly found that a "threatened misappropriation" means a threat by a defendant to misuse trade secrets, manifested by words or conduct, where the evidence indicates imminent misuse. (See e.g., *Central Valley General Hosp. v. Smith* (2008) 162 Cal.App.4th 501, 527, 75 Cal.Rptr.3d 771 [imminent threat of misuse based on defendant's possession of trade secrets and prior misuse].)

Under appellants' construction of the law, an employer could bring a trade secret action after an employee downloads a company document and deletes the document from his or her laptop computer at home. A similar action could be brought where company messages are left on the employee's email or phone answering machine and deleted after the employee changes jobs.

[15][16] The California Uniform Trade Secrets Act requires an "[a]ctual or threatened misappropriation ...." (§ 3426.2, subd. (a).) Mere possession of trade secrets by a departing employee is not enough for an injunction. (*Central Valley General Hosp. v. Smith, supra,* 162 Cal.App.4th at pp. 528-529, 75 Cal.Rptr.3d 771; Trade Secrets Practice in California, *supra,* § 12.13, pp. 484-485.) " 'A trade secret will not be protected by the extraordinary remedy of an injunction on mere suspicion or apprehension of injury. There must be a substantial threat of impending injury before an injunction will issue....' [Citations.]" (*Del Monte Fresh Produce Co. v. Dole Food Co., Inc.* (S.D.Fla.2001) 148 F.Supp.2d 1326, 1328 [discussing California and Florida law].)

[17][18] Where the trade secrets plaintiff seeks a permanent injunction, section 3426.2, subdivision (c) "authorizes only injunctions that compel 'affirmative acts.' " It authorizes mandatory, not prohibitory injunctions, i.e., "mandatory injunctions requiring that a misappropriator return the fruits of misappropriation to an aggrieved person ... [Citation.] An order enjoining a remote threat or misuse or disclosure is prohibitory and does not necessarily compel affirmative acts. Thus such an injunction is not authorized by subdivision (c) of section 3426.2." ***1280**(*Central Valley General Hospital v. Smith, supra,* 162 Cal.App.4th at p. 530, 75 Cal.Rptr.3d 771; see Trade ****317** Secrets Practice in Calif., *supra,* § 12.13, p. 485.)

Although the complaint was for a permanent injunction, appellants did not seek an order compelling respondents to return anything. The hard drive was destroyed prior to trial. Respondents could not return anything because no trade secrets were misappropriated. "All that is alleged, at bottom, is that defendants could misuse plaintiff's secrets, and plaintiffs fear they will. That is not enough." (*Teradyne, Inc. v. Clear Communications Corp.* (N.D.Ill.1989) 707 F.Supp. 353, 357.)

Subjective bad faith was established by the contradictory testimony of appellants' executives who did not want to take responsibility for initiating and maintaining the action. Appellants' managers and employees testified that respondents were trustworthy, would not do anything wrong, and should have been allowed to start a new company.

Patent Applications

[19] Appellants argue that Parrish's objections to two Indigo patent applications created a reasonable suspicion that he would misappropriate trade secrets. Parrish held 25 patents and was the inventor of 11 or 12 patents while employed at Indigo.

After quitting Indigo, Parrish learned that appellants were submitting patent applications on a packaging and manufacturing process that he had worked on. Parrish told Woolaway, FLIR's Chief Intellectual Property Officer, that the patent applications were not valid. At trial, appellants claimed that Parrish's objection to the patent applications caused them to believe that trade secrets might be misappropriated.

Woolaway, who authored the patent applications, stated that the United States Patent & Trademark Office could go either way on the validity of the applications. Woolaway was concerned about Parrish's remarks but did not believe Parish would steal or misuse appellants' intellectual property. This testimony was echoed by appellants' officers and managers who stated that respondents were trustworthy and that an inventor's disagreement about a patent application did not signal a plot to steal trade secrets. The trial court ***1281** reasonably concluded that Parrish's objections to the patent applications was not a threatened misappropriation of a trade secret.

Trade Secret Experts

The trial court factually found that appellants maintained the action in bad faith with expert testimony that lacked a scientific basis and failed to address the possibility that respondents could lawfully acquire technology from Raytheon Company. Appellants claimed that respondents' plan to work with Raytheon Company was a contrivance and that Raytheon did not have the technology for mass-producing microbolometers. The trial court found that respondents' testimony, the testimony of a Raytheon official, and the Raytheon negotiation documents were credible and unrebutted. It concluded that the "contrivance" argument was asserted in bad faith to bolster a groundless action.

[20] Subjective bad faith was also established by appellants' failure to identify what trade secrets would be subject to the permanent injunction. Appellants' experts testified that appellants had a mix of trade secrets and non-secret information and that no list was prepared to identify the trade secrets. The trial court found that the proposed injunction was overbroad, did not give notice as to what was forbidden, and would harm respondents' reputation in the business community. (See e.g., ****318***MAI Systems Corp. v. Peak Computer, Inc.* (9th Cir.1993) 991 F.2d 511, 522-523 [permanent injunction failed to identify trade secrets with reasonable specificity]; *Advanced Modular Sputtering, Inc. v. Superior Court* (2005) 132 Cal.App.4th 826, 836, 33 Cal.Rptr.3d 901 [more particularity required in describing trade secrets in highly specialized technical field]; Trade Secrets Practice in California, *supra,* § 12.8, p. 476.) Among other things, the proposed injunction barred respondents from developing certain products for a 12 month period even if respondents did not use appellants' technology or trade secrets. It was an unlawful restraint on trade (Bus. & Prof.Code, § 16600) and strong evidence of subjective bad faith.

Bad Faith Settlement Tactics

The trial court further found that appellants maintained the action in bad faith by imposing unnecessary settlement conditions. In a July 14, 2005 settlement letter, respondents described their plan to acquire technology from a third party, restated that they would not misappropriate appellants' trade secrets, attached copies of Fitzgibbons' Thermicon business plan, and agreed to have a third party monitor and review the technology that respondents would develop. Appellants responded with the demand for $75,000, a non-competition agreement, an agreement that respondents would not hire appellants' employees, or challenge Indigo patent applications.

[21][22][23] ***1282** Woolaway, FLIR's Chief Intellectual Property Officer, was privy to the settlement discussions and testified that the $75,000 demand was "inflammatory." The trial court found that the other settlement terms were not related to the trade secret action and were made for an anticompetitive purpose. The condition that respondents not work with certain third party foundries was an unlawful trade restraint. (Bus. & Prof.Code, § 16600.) The condition that respondents not hire appellants' employees violated public policy (*ibid.*) as did the demand that Parrish not communicate relevant information to the federal government about the patent applications. (See 37 C.F.R. § 1.56; *Honeywell Intern., Inc. v. Universal Avionics Systems* (Fed.Cir.2007) 488 F.3d 982, 999 [applicants for patents have duty to prosecute patent applications with candor, good faith, and honesty].)

[24] A trial court, in awarding sanctions, may consider a party's dilatory tactics and bad faith settlement demands in maintaining the action. (§ 3426.4; *Gemini, supra,* 95 Cal.App.4th at p. 1263, 116 Cal.Rptr.2d 358; see e.g., *In re Marriage of Norton* (1988) 206 Cal.App.3d 53, 58-60, 253 Cal.Rptr. 354.) Here the settlement terms were inflammatory, violated public policy, and were made in bad faith.

Pre-Trial Motions

[25][26] Appellants argue that the trial court was estopped from finding bad faith because the court denied a motion for summary judgment, a motion in limine, and two nonsuit motions. In certain tort

actions, such as malicious prosecution, the denial of summary judgment normally precludes the trial court from finding that the lawsuit was frivolous. (See *Zamos v. Stroud* (2004) 32 Cal.4th 958, 973, fn. 10, 12 Cal.Rptr.3d 54, 87 P.3d 802.) "We say 'normally' rather than 'conclusively' because there may be situations where denial of summary judgment should not irrefutably establish probable cause. For example, if denial of summary judgment was induced by materially false facts submitted in opposition, equating denial with probable cause might be wrong. Summary judgment might have been granted but for the false evidence." ****319**(*Roberts v. Sentry Life Insurance* (1999) 76 Cal.App.4th 375, 384, 90 Cal.Rptr.2d 408.)

Appellants opposed the summary judgment motion with expert declarations suggesting there was a scientific methodology to predict the likelihood of trade secret misuse. The trial court found that respondents made a compelling argument for summary judgment but "the concepts involved in this action are highly technical." Erring on the side of caution, the trial court denied the summary judgment motion to see what would develop.

At trial, appellants' experts admitted there was no valid scientific methodology to predict trade secret misuse and agreed that no trade secrets were misappropriated. Both experts failed to address the possibility that respondents might lawfully acquire Raytheon's internal technology for the startup ***1283** business. One expert, Daniel Murphy, assumed that respondents would not innovate at the new company and incorrectly assumed that respondents planned to manufacture and sell bolometers in one year.

The trial court, in awarding sanctions, ruled: "The denial of the motion [for summary judgment] was not a ruling on whether [appellants] initiated or maintained the lawsuit in bad faith." The court denied the motion because it had not heard all the evidence or considered witness credibility.

Appellants cite no California authority that the denial of a summary judgment motion in a trade secret case precludes the trial court from finding, after it has heard all the evidence, that the action was brought or maintained in bad faith. (See *Waller v. TJD, Inc.* (1993) 12 Cal.App.4th 830, 836, 16 Cal.Rptr.2d 38 [order denying summary judgment is not a basis to reverse a judgment entered after trial on the merits]; Weil & Brown, Cal. Practice Guide, Civil Procedure Before Trial (The Rutter Group 2008) ¶ 10:364, p. 10-129.) If the rule was otherwise, a trade secrets plaintiff could file sham declarations to successfully oppose a summary judgment motion and immunize itself from sanctions.

[27][28][29] Under the California Uniform Trade Secret Act, sanctions may be awarded for the bad faith filing *or* maintenance of a groundless action. (*Gemini, supra,* 95 Cal.App.4th at pp. 1261-1262, 116 Cal.Rptr.2d 358.) A trade secrets claim could be brought in good faith but warrant attorney fees were the claim is pursued beyond a point where the plaintiff no longer believes the case has merit. (See *Yield Dynamics, Inc. v. TEA Systems Corp.* (2007) 154 Cal.App.4th 547, 579, fn. 20, 66 Cal.Rptr.3d 1 [discussed but not decided].) " 'Bad faith may be inferred where the specific shortcomings of the case are identified by opposing counsel, and the decision is made to go forward despite the inability to respond to the arguments raised.' [Citation.]" (*Gemini, supra,* 95 Cal.App.4th at p. 1264, 116 Cal.Rptr.2d 358.) The trial court reasonably inferred that appellants knew there was no misappropriation or threatened misappropriation of trade secrets before the summary judgment motion was argued.

In *Gemini,* the Court of Appeal rejected the argument that lack of bad faith was established by the denial of a nonsuit motion. (*Gemini, supra,* 95 Cal.App.4th at p. 1264, fn. 6, 116 Cal.Rptr.2d 358.) The same principle applies here. At trial, appellants' experts conceded there was no accepted scientific methodology for predicting the misuse of trade secrets and made false assumptions that respondents would not innovate new technology or acquire technology from a third party. The trial court found that appellants used expert testimony to "unreasonably discount[ ] ways in which Defendants could ****320** have proceeded with the new company lawfully." The award for sanctions was proper. It is well settled that "[n]o one can take advantage of his own wrong." (§ 3517.)

[30][31][32][33] ***1284** Appellants assert that the tentative statement of decision includes a finding that respondents did not prevail on an unclean hands defense, thus precluding the trial court from finding the action was brought in bad faith. The argument fails for several reasons. First, a tentative statement of decision is not binding on the trial court and can be modified or changed as the judge sees fit before entry of judgment. (Cal. Rules of Court, rule 3.1590(b); *Horning v. Shilberg* (2005) 130 Cal.App.4th 197, 203, 29 Cal.Rptr.3d 717.) A tentative decision cannot be relied on to impeach the judgment on appeal. (*In re Marriage of Ditto* (1988) 206 Cal.App.3d 643, 646-647, 253 Cal.Rptr. 770.) Second, the doctrine of unclean hands relates to misconduct occurring before the lawsuit was filed, not the bad faith filing or maintenance of an action. (See e.g., *Smoketree-Lake Murray, Ltd. v. Mills Concrete Construction Co.* (1991) 234 Cal.App.3d 1724, 1743-1744, 286 Cal.Rptr. 435.) Moreover, the doctrine of unclean hands does not apply to an action for unfair competition, alleged here as an alternative theory for injunctive relief. (See *Cortez v. Purolator Air Filtration Products Co.* (2000) 23 Cal.4th 163, 179-180, 96 Cal.Rptr.2d 518, 999 P.2d 706.) "Courts have long held that the equitable defense of unclean hands is not a defense to an unfair trade or business practices claim based on violation of a statute." (*Ticconi v. Blue Shield* (2008) 160 Cal.App.4th 528, 543, 72 Cal.Rptr.3d 888.)

Post-Trial Bad Faith Hearing

[34] Appellants contend that the trial court erred in not conducting a post-trial hearing to address the issue of bad faith. In *Yield Dynamics, Inc. v. TEA Systems Corp., supra,* 154 Cal.App.4th 547, 66 Cal.Rptr.3d 1, the trial court excluded evidence, proffered after trial, that the trade secrets action was filed in good faith. The Court of Appeal held that it was error because "[t]he subjective element of bad faith ... might be proved or refuted by evidence that would have been wholly irrelevant at trial." (*Id.*, at p. 579, 66 Cal.Rptr.3d 1.)

Unlike *Yield Dynamics Inc. v. TEA Systems Corp., supra,* here the trial court did not exclude evidence before ruling on the question of bad faith. Appellants' request for a post-trial hearing was denied because the court had received voluminous briefing and had already found objective and subjective bad faith. Appellants did not object to the briefing schedule or make an offer of proof that they had new evidence.

[35] The assertion that appellants were denied a meaningful opportunity to address sanctions is equally without merit. Sanctions were discussed a few days after the action was filed, in the answer to the complaint, in opening ***1285** statement, in closing statement, and in the post-trial briefs. On the next-to-last day of trial, the trial court asked counsel to brief sanctions and the inevitable disclosure doctrine which was "the heart of the case." Appellants' post-trial brief devoted 10 pages to sanctions and stated: " Throughout trial, Defendants consistently claimed that they would prove that Plaintiffs brought this action in bad faith."

A fair reading of the 25 page judgment and statement of decision with citations to the pleadings, to discovery, to the settlement discussions, to the pretrial motions, and to the trial evidence obviated any need for a further hearing. The complaint states that appellants were entitled to a ****321** permanent injunction and punitive damages yet FLIR's CEO, Earl Lewis, had no evidence that respondents had engaged in wrongdoing.

Lewis's testimony is remarkable and clearly shows that the action was brought for an anti-competitive purpose. Lewis did not "think it would be good, healthy for them [respondents] to go and directly compete with us." Lewis stated that FLIR "couldn't tolerate a direct competitive threat by [respondents] because it would fly in the face of everything that we spent 200 million dollars to buy." Lewis's statements were corroborated by FLIR Senior Vice President Tony Trunzo who testified that respondents' "vision for the industry will take place someday" but FLIR "wanted that competition to take place as far out in the future as possible."

The trial court reasonably concluded that further briefing or post-trial testimony on the question of bad faith would be repetitive and unnecessary. It had already found objective speciousness and subjective bad faith and calendared the matter to determine reasonable attorney fees.[FN5] Appellants did not file a motion for new trial and had no due process right to retry the issue of bad faith.

> FN5. Respondents moved for $2,399,650.55 attorney fees and were awarded $1,352,000 fees plus $289,216.78 costs. The order granting fees and costs recites the following bad faith findings which were previously made in the statement of decision: "Plaintiffs initiated and continued to pursue this action against Defendants in bad faith and primarily for the anticompetitive motive of preventing Defendants from attempting to create a new business in competition with Plaintiffs.... Plaintiffs engaged in subjective and objective bad faith.... Plaintiffs' suspicions regarding Defendants were not sufficient to justify the filing of the lawsuit on June 15, 2006, or the maintenance of the lawsuit through trial in December 2007.... Plaintiffs initiated and maintained the lawsuit in bad faith in that Plaintiffs proceeded on a legal theory that Defendants would misuse trade secret[s] in the future, and that 'inevitable disclosure' type of theory is not supported by California law.... The Court finds that plaintiffs' theory for initiating the lawsuit, as described in Mr. Lewis's testimony is not consistent with California law ... [and] Plaintiffs continued the lawsuit in bad faith [after] Defendants notified Plaintiffs of problems in Plaintiffs' case...."

**1286 Conclusion*

Appellants' remaining arguments merit no further discussion.

The judgment and order awarding respondents $1,641.216.78 attorney fees and costs are affirmed. (§ 3426.4.) Respondents are awarded costs and attorney fees on appeal, in an amount to be determined by the trial court on noticed motion. (*Gemini, supra,* 95 Cal.App.4th at pp. 1264-1265, 116 Cal.Rptr.2d 358.)

We concur: COFFEE and PERREN, JJ.
Cal.App. 2 Dist.,2009.
FLIR Systems, Inc. v. Parrish
174 Cal.App.4th 1270, 95 Cal.Rptr.3d 307, 29 IER Cases 441, 09 Cal. Daily Op. Serv. 7448, 2009 Daily Journal D.A.R. 8599

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H

Appeals Court of Massachusetts,
Hampshire.

FRANK D. WAYNE ASSOCIATES, INC.
v.
Paul A. LUSSIER.
Argued April 19, 1983.
Decided Sept. 16, 1983.
Further Appellate Review Denied Nov. 2, 1983.

Real estate agency brought action against real estate salesman seeking to enforce covenant not to compete. The Superior Court, Hampshire County, entered judgment confirming a master's report which awarded $50,000 in damages to agency, and salesman appealed. The Appeals Court held that: (1) master's finding that agency suffered a very substantial decrease in income following breach of covenant, and that salesman earned substantial real estate commissions while engaged in that competition with agency during period of covenant was not too speculative to provide basis for damage award; (2) agency's earnings record and salesman's income were admissible as evidence of extent of damages caused by breach; and (3) limited injunction issued by trial court at preliminary stage of proceeding did not preclude an award of damages.

Affirmed.

West Headnotes

[1] Appeal and Error 30 713(1)

30 Appeal and Error
30X Record
30X(N) Matters Not Apparent of Record
30k713 Matters Improperly Included
30k713(1) k. In General. Most Cited Cases

Although several hundred pages of transcript of hearings before a master, as well as exhibits introduced in those proceedings, were reproduced in defendant's record appendix, Appeals Court would decline to look at material, since order of reference provided that evidence was not to be reported, and there was no indication in record that judge subsequently ordered evidence to be reported.

[2] Appeal and Error 30 713(1)

30 Appeal and Error
30X Record
30X(N) Matters Not Apparent of Record
30k713 Matters Improperly Included
30k713(1) k. In General. Most Cited Cases

Filing of transcript by agreement of parties with clerk of trial court did not change status of transcript in absence of change in order of reference providing that transcript was not to be reported on appeal.

[3] Appeal and Error 30 713(1)

30 Appeal and Error
30X Record
30X(N) Matters Not Apparent of Record
30k713 Matters Improperly Included
30k713(1) k. In General. Most Cited Cases

Allowance by trial judge of defendant's motion to include transcript in record on appeal did not enhance its status, in absence of change in order of reference providing that transcript was not to be reported on appeal.

[4] Appeal and Error 30 848(1)

30 Appeal and Error
30XVI Review
30XVI(A) Scope, Standards, and Extent, in General
30k844 Review Dependent on Mode of Trial in Lower Court
30k848 Trial by Referee
30k848(1) k. In General. Most Cited Cases

Order of reference providing that evidence attending master's report was not to be reported, provided "facts final," and thus under applicable rule of civil procedure only questions of law arising upon the report would be considered. Rules Civ.Proc., Rule 53(e)(4), 43A M.G.L.A.

[5] Damages 115 ⚷190

115 Damages
115IX Evidence
115k183 Weight and Sufficiency
115k190 k. Loss of Profits. Most Cited Cases

Although task of quantifying consequences of violating a noncompetition clause is a particularly difficult and elusive one, damages are not precluded; as in other cases where lost profits have to be valued, mathematical accuracy of proof is not required, and estimates are in order.

[6] Damages 115 ⚷190

115 Damages
115IX Evidence
115k183 Weight and Sufficiency
115k190 k. Loss of Profits. Most Cited Cases

Master's finding in action for breach of covenant not to compete that real estate agency suffered a very substantial decrease in income following termination of agreement by real estate salesman, and that salesman did in fact earn substantial real estate commissions while engaged in direct competition with agency during period of the covenant not to compete within the territorial limits specified in the agreement was not too speculative to provide a basis for damage award in action by agency to enforce covenant.

[7] Damages 115 ⚷176

115 Damages
115IX Evidence
115k164 Admissibility
115k176 k. Loss of Profits. Most Cited Cases

In an action for breach of a covenant not to compete, plaintiff's earnings record, while not conclusive, is admissible as evidence of extent of damages caused by the breach; similarly, defendant's income is also relevant.

[8] Injunction 212 ⚷197

212 Injunction
212V Permanent Injunction and Other Relief
212k197 k. Recovery of Damages in Addition to Injunction. Most Cited Cases

Plaintiff in action for breach of a covenant not to compete, having obtained injunctive relief, could also recover damages, as injunction was not issued until few months after breach and hence damages could be awarded for period before injunction went into effect.

[9] Injunction 212 ⚷138.39

212 Injunction
212IV Preliminary and Interlocutory Injunctions
212IV(A) Grounds and Proceedings to Procure
212IV(A)3 Subjects of Relief
212k138.36 Contracts
212k138.39 k. Noncompetition Covenants or Agreements. Most Cited Cases
(Formerly 212k136(2))

Limited injunction ordered by trial judge at preliminary stage of proceedings in action seeking to enforce covenant not to compete was appropriate, since judge's assessment of parties' lawful rights in preliminary proceedings might not have corresponded to final judgment, and purpose of preliminary injunction was not to award full relief but to seek to minimize harm that final relief could not redress.

[10] Injunction 212 ⚷197

212 Injunction
212V Permanent Injunction and Other Relief
212k197 k. Recovery of Damages in Addition to Injunction. Most Cited Cases

Injunction in action seeking to enforce covenant not to compete did not preclude an award of damages, since contractual restraint was found to be lawful, and injunctive relief given was narrower than restraint to which plaintiff was entitled under the contract.

****110 *989** James Coyne King, Boston, for defendant.

Judith Kundl, Northampton, for plaintiff.

Before BROWN, ROSE and DREBEN, JJ.

***986** RESCRIPT.

The defendant appeals from a judgment confirming a master's report which awarded $50,000 in damages (less an offset in an agreed amount ***987** for commissions earned by the defendant) for breach of a covenant not to compete. We affirm.

[1][2][3][4] 1. Although several hundred pages of the transcript of the hearings before the master, as well as the exhibits introduced in those proceedings, have been reproduced in the record appendix, we decline to look at this material. The order of reference provided that the evidence was not to be reported, and there is no indication in the record that the judge subsequently ordered the evidence to be reported. See *Shelburne Shirt Co. v. Singer,* 322 Mass. 262, 265, 76 N.E.2d 762 (1948). "[E]vidence which a master neither reports nor is ordered to report is not part of the record on appeal." *Lynch v. Planning Bd. of Groton,* 4 Mass.App.Ct. 781, 341 N.E.2d 925 (1976). See *Robbins v. Robbins,* 16 Mass.App.Ct. 576, 577 n. 1, 453 N.E.2d 1058 (1983).[FN1] Not having followed the steps set forth in *Miller v. Winshall,* 9 Mass.App.Ct. 312, 314-317, 400 N.E.2d 1306 (1980), the defendant may not now claim that a subsidiary or ultimate ****111** finding of the master is not supported by the evidence. The order of reference provided "facts final." Thus under Mass.R.Civ.P. 53(e)(4), 365 Mass. 820 (1974), as in effect prior to the 1982 amendment, "only questions of law arising upon the report shall thereafter be considered."

FN1. The filing of the transcript by agreement of the parties with the clerk of the trial court does not change its status in the absence of a change in the order of reference. See *Glynn v. Gloucester,* 9 Mass.App.Ct. 454, 458-459 n. 6, 401 N.E.2d 886 (1980). Similarly, the allowance by the trial judge of the defendant's motion to include the transcript in the record on appeal does not enhance its status. See *Peabody Constr. Co. v. First Fed. Parking Corp.,* 3 Mass.App.Ct. 768, 330 N.E.2d 497 (1975).

2. The master found that the plaintiff and the defendant entered into an agreement on August 25, 1973, under which the defendant became a real estate salesman for the plaintiff. The agreement contained a clause prohibiting the defendant after termination from using any information gained from the plaintiff's files and also prevented him from conducting a competing business for a period of two years in the communities of Southampton, Easthampton, Westhampton, Huntington, Northampton, Holyoke and Westfield. The defendant terminated the arrangement and, contrary to the agreement, directly competed with the plaintiff within the prohibited geographic area.

The thrust of the defendant's argument is directed to the following findings of the master as to the plaintiff's damages.

"[15](i) It is found that Plaintiff has been damaged by the Defendant's breach of his Agreement. It is found that Plaintiff suffered a very substantial decrease in income following termination of the Agreement by Defendant although it cannot be found as a matter of certainty that all of the loss or decrease is attributable directly to the Defendant's termination of the Agreement (e.g., did the decrease result from less effort on the part of the employees or less effort on the part of Wayne or a general decrease in real estate activity, or a direct competition of the Defendant). It is found that Defendant did in fact earn substantial real estate commissions ***988** while engaged in direct competition with Plaintiff during the period of the Covenant not to Compete within the territorial limits specified in the Agreement, although it cannot be said with certainty that all of such income would have gone to the Plaintiff or Wayne if it did not go to the Defendant (e.g., some or many of the customers might have dealt with an entirely different real estate agency).

"[15](j) On the evidence, I find that the Plaintiff has been damaged by loss of business and goodwill due to the actions of the Defendant in engaging directly in competition with the Plaintiff in violation of the Agreement in the amount of $50,000.00."

[5][6] Relying on *Lufkin's Real Estate, Inc. v. Aseph,* 349 Mass. 343, 346, 208 N.E.2d 209 (1965), and *Snelling & Snelling of Mass., Inc. v. Wall,* 345 Mass. 634, 635, 189 N.E.2d 231 (1963), the defendant argues that a more solid foundation in fact is needed to recover damages for breach of a covenant not to compete than for breaches of other contracts and that the statements in par. 15(i) show that the award made is too speculative. The cases cited do not impose such a rule, and there is no requirement that such a degree of proof be shown. See generally 11 Williston, Contracts § 1406 (3d ed. 1968). It is true that "the task of quantifying the consequences of violating a non-competition clause is a particularly difficult and elusive one," *Kroeger v. Stop & Shop Cos.,* 13 Mass.App.Ct. 310, 322, 432 N.E.2d 566 (1982), and, for this reason, injunctive relief is often given. Damages are not, however, precluded. As in other cases where lost profits have to be valued, see, e.g., *Matsushita Elec. Corp. of America v. Sonus Corp.,* 362 Mass. 246, 264, 284 N.E.2d 880 (1972), mathematical accuracy of proof is not required, and estimates are in order. *Smith v. Brown,* 164 Mass. 584, 586, 42 N.E. 101 (1895). On the record before us, see part 1, *supra,* we have no basis for saying that the statements in par. 15(i) of the master's report in themselves show that the award was improper. See *National Merchandising Corp. v. Leyden,* 370 Mass. 425, 431 n. 10, 348 N.E.2d 771 (1976).

[7] 3. The master's report specifically preserved for review the defendant's claim that evidence of the plaintiff's revenues should not have been admitted in evidence. There was no error. The plaintiff's "earnings record, while not conclusive, is admissible as evidence of the extent of damages caused by the breach." ****112***Rombola v. Cosindas,* 351 Mass. 382, 386, 220 N.E.2d 919 (1966), and cases cited. *Matsushita Elec. Corp. of America,* 362 Mass. at 264, 284 N.E.2d 880. Similarly, the defendant's income was relevant. See *National Merchandising Corp. v. Leyden,* 370 Mass. at 431, 348 N.E.2d 771. See generally 11 Williston, Contracts § 1406.

[8] 4. The defendant argues that the plaintiff, having obtained injunctive relief, may not also recover damages. The injunction, however, was not issued until a few months after the breach and hence damages may be awarded for the period before the injunction went into effect. In addition, the injunction was considerably more limited than the non-competition clause of the agreement. The defendant was only enjoined from selling to persons who "had either listed, purchased, or sold real estate" through the plaintiff and was not otherwise restrained from making sales in the prohibited territories.[FN2]

> FN2. The defendant stresses a statement in the master's report that "there was no evidence that the Defendant competed with the Plaintiff in violation of the Agreement during the period of time the injunction was in effect." The context of that statement indicates that the master meant that the defendant did not violate that portion of the covenant which prohibited the use by the defendant of information gained from the plaintiff's files; he did not mean that the defendant did not sell in the geographic area prohibited by the agreement during the period of the injunction.

[9] It was wholly appropriate for the judge to issue

a limited injunction at the preliminary stage of the proceedings. Since his "assessment of the parties' lawful rights" at that time might not correspond to the final judgment, the purpose of the preliminary injunction was not to award full relief but rather to "seek to minimize the harm that final relief can not redress." *Packaging Indus. Group, Inc. v. Cheney,* 380 Mass. 609, 616, 405 N.E.2d 106 (1980). Only after a full hearing could the measure of relief to which the plaintiff was entitled be properly determined.

[10] On this record, see part 1, *supra,* the defendant may not argue that the evidence shows that the clause was unreasonable. There is nothing in the master's report (or for that matter in the defendant's assertions) suggesting error in the master's conclusion that the two year period was not too long, and that the territorial scope of the covenant was not broader than the plaintiff's legitimate business interests. Since the contractual restraint was found to be lawful, and since the injunctive relief given was narrower than the restraint to which the plaintiff was entitled under the contract, the injunction did not preclude an award of damages. See *Foss v. Roby,* 195 Mass. 292, 298, 81 N.E. 199 (1907); *Brandt v. Olympic Constr., Inc.,* 16 Mass.App.Ct. 913, 916, 449 N.E.2d 1231 (1983).

5. No error appears on the face of the master's report in his finding that the plaintiff did not break the contract.

Judgment affirmed.

Mass.App.,1983.
Frank D. Wayne Associates, Inc. v. Lussier
16 Mass.App.Ct. 986, 454 N.E.2d 109

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United States Court of Appeals,
Tenth Circuit.
Anthony HEUSER and Nona Heuser, Plaintiffs-Appellants,
v.
Frank KEPHART; Farmington Utility System; Jack McQuitty, Code Compliance Officer; Stephen Hrzich, City Electrical Inspector, City of Farmington; James Cheverie, Roger Lasater, San Juan County Board of County Commissioners, Defendants-Appellees.
No. 98-2233.

June 30, 2000.

Customers of city electrical utility brought § 1983 action against county and city officials alleging constitutional violations in connection with denial of electrical services. The United States District Court for the District of New Mexico, Martha Vasquez, J., dismissed action pursuant to putative settlement agreement. Customers appealed. The Court of Appeals, Holloway, Circuit Judge, held that putative agreement settling action, stating that officials' counsel would recommend that officials pay certain amount to settle action, set forth illusory promise.

Reversed and remanded.

Ebel, Circuit Judge, dissented and filed opinion.

West Headnotes

[1] Federal Courts 170B ⚷813

170B Federal Courts
170BVIII Courts of Appeals
170BVIII(K) Scope, Standards, and Extent
170BVIII(K)4 Discretion of Lower Court
170Bk813 k. Allowance of Remedy and Matters of Procedure in General. Most Cited Cases

A district judge's approval of a settlement agreement is reviewed for an abuse of discretion.

[2] Compromise and Settlement 89 ⚷3

89 Compromise and Settlement
89I In General
89k1 Nature and Requisites
89k3 k. Subject-Matter. Most Cited Cases

Compromise and Settlement 89 ⚷6(1)

89 Compromise and Settlement
89I In General
89k1 Nature and Requisites
89k6 Consideration
89k6(1) k. Necessity and Sufficiency in General. Most Cited Cases

Under federal or New Mexico law, putative agreement settling electrical customers' action alleging constitutional violations by county and city officials in connection with denial of electrical service, stating that officials' counsel would recommend that officials pay certain amount to settle action, but indicating that settlement had to be approved by city and county authorities, set forth illusory promise, and thus was legally insufficient as consideration for customers' promises; officials had unfettered discretion to accept or reject settlement, attorneys promised only to do that which they were separately entitled to do, and, because counsel were officials' agents, their recommendation was not consideration flowing from third party. Restatement (Second) of Contracts §§ 71(4), 77.

[3] Contracts 95 ⚷10(1)

95 Contracts
95I Requisites and Validity
95I(A) Nature and Essentials in General
95k10 Mutuality of Obligation
95k10(1) k. In General. Most Cited Cases

Under federal and New Mexico law, a promise by a party in the alternative is not consideration except under limited circumstances.

[4] Contracts 95 ⚷10(1)

95 Contracts
95I Requisites and Validity
95I(A) Nature and Essentials in General
95k10 Mutuality of Obligation
95k10(1) k. In General. Most Cited Cases

Under federal and New Mexico law, a promise or apparent promise is not consideration if by its terms the promisor or purported promisor reserves a choice of alternative performances unless: (1) each of the alternative performances would have been consideration if it alone had been bargained for, or (2) one of the alternative performances would have been consideration and there is or appears to the parties to be a substantial possibility that before the promisor exercises his or her choice events may eliminate the alternatives which would not have been consideration. Restatement (Second) of Contracts § 77.

[5] Contracts 95 ⚷10(1)

95 Contracts
95I Requisites and Validity
95I(A) Nature and Essentials in General
95k10 Mutuality of Obligation
95k10(1) k. In General. Most Cited Cases

Under federal and New Mexico law, where a party has an unfettered choice of alternatives, and one alternative would not have been consideration if separately bargained for, the promise in the alternative is not consideration. Restatement (Second) of Contracts § 77.

[6] Contracts 95 ⚷10(1)

95 Contracts
95I Requisites and Validity
95I(A) Nature and Essentials in General
95k10 Mutuality of Obligation
95k10(1) k. In General. Most Cited Cases

Under New Mexico law, a valid contract must possess mutuality of obligation, and mutuality means both sides must provide consideration.

[7] Contracts 95 ⚷10(1)

95 Contracts
95I Requisites and Validity
95I(A) Nature and Essentials in General
95k10 Mutuality of Obligation
95k10(1) k. In General. Most Cited Cases

Under New Mexico law, a contract which leaves it entirely optional with one of the parties to perform is not founded on mutual promises and thus is not valid.

***1187** Debra D. Poulin, Santa Fe, New Mexico, (Richard Rosenstock, Santa Fe, New Mexico and Jeffrey J. Buckels, Albuquerque, New Mexico on the briefs) for the plaintiffs-appellants.

David G. Reynolds (Wayne E. Bingham with him on the brief), Crider, Bingham & Hurst, P.C., Albuquerque, New Mexico, for the defendants-appellees Hrzich, McQuitty and City of Farmington Utility System.

Robert C. Armijo (Gregory W. MacKenzie with him on the brief), Civerolo, Gralow & Hill, Albuquerque, New Mexico, for defendants-appellees Kephart, Cheverie, Lasater and San Juan County Board of County Commissioners.

Before EBEL, HOLLOWAY and KELLY, Circuit Judges.

HOLLOWAY, Circuit Judge.

Plaintiffs/appellants Anthony and Nona Heuser (plaintiffs) bring this timely appeal from a judgment of the district court dismissing, pursuant to a putative settlement agreement, a suit they brought under 42 U.S.C. § 1983. The Section 1983 action alleged constitutional violations by state, county and city officials in denying electrical services to plaintiffs, *inter alia.* Contending that no enforceable settlement agreement had been reached, the plaintiffs opposed the dismissal below and now ask this court to reverse the judgment of dismissal.

I

A

Because the issues in this appeal are limited to those involving the enforceability of the putative settlement agreement of April 15, 1998, the "Outline of Agreement," we need only provide a brief general sketch of the underlying dispute. Except for findings of the district court noted below, we summarize only the plaintiffs' allegations.

Plaintiffs apparently live near to but not within the city limits of Farmington, New Mexico and before the present controversy, received their electrical service from the Farmington Utility System. Defendant Kephart, a building inspector for the county, allegedly entered plaintiffs' property without a warrant in 1991. As a result of what he saw then, he brought a criminal charge of constructing a building without a permit. Eventually plaintiffs were acquitted of that charge. While that criminal case was pending, however, a search warrant was obtained for some of the outbuildings on plaintiffs' property, and the warrant was executed on March 11, 1992. The actions of some of the defendants in obtaining and executing this search warrant are central events alleged by plaintiffs in the instant case.

The district judge found that the following facts were undisputed.[FN1] Kephart was ***1188** not properly certified as a building inspector. None of the officers who assisted Kephart in presentation of the search warrant application demonstrated their credentials to conduct an administrative inspection. The allegations in the search warrant application were limited to violations of county ordinances regarding proper set back and/or fire separations, failure to obtain building permits, and the existence of five or more structures "that appear to be fire hazards to adjacent buildings and property lines." Aplt.App. 63, 65-66.

FN1. These findings occurred in a rather unusual procedure. Some or all of the defendants had filed a motion for summary judgment raising the defense of qualified immunity. When that motion was denied, the defendants commenced an interlocutory appeal. Plaintiffs then moved the district court to certify that the appeal was frivolous, arguing that the appellate court did not have jurisdiction of the appeal under the doctrine of *Johnson v. Jones,* 515 U.S. 304, 115 S.Ct. 2151, 132 L.Ed.2d 238 (1995). The district court granted the plaintiffs' motion, thus determining that proceedings could continue in the district court during the pendency of the interlocutory appeal. *See Stewart v. Donges,* 915 F.2d 572, 574-79 (10th Cir.1990).

The district judge further found that no allegations of electrical or plumbing code violations were made in the affidavit and Kephart was neither qualified nor authorized to conduct electrical or plumbing inspections. Kephart asked defendant Hrzich to investigate the electrical wiring of the plaintiffs' buildings in spite of the lack of allegations of violations of electrical codes in the search warrant affidavit. No allegations of criminal activity were made in the search warrant affidavit. The district judge found that in the affidavit defendant Deputy Sheriff Cheverie "falsely accused Plaintiffs of committing crimes in violation of a county ordinance and misinformed the magistrate who issued the criminal search warrant that Plaintiffs' refusal to allow Kephart right of entry on their property without a warrant in itself violated the building code." The search warrant authorized a search only by Kephart, but other inspectors or law enforcement officers (ten of them according to plaintiffs' allegations) joined him in executing the warrant. While executing the warrant, two of the defendants entered the plaintiffs' residence, which was expressly excluded from the search warrant. *Id.*

About two months after execution of the search warrant, plaintiffs filed a tort claim with the county. On June 10, 1992, within a week of plaintiffs' filing of the claim, two of the defendants cut off plaintiffs' electrical service. Service was restored on April 2, 1993, but on May 26, 1993, it was again terminated by some of the defendants. Service was then not restored for about five years, under circumstances discussed below. Altogether, the plaintiffs were without electric service from the City for almost six years, relying on electricity from their own generator during that time.

B

About three years after the March 1992 execution of the search warrant, plaintiffs commenced the present Section 1983 action. Plaintiffs, who originally were proceeding *pro se,* sued the Governor and the Attorney General of New Mexico; the City Council of Farmington and the Farmington Utility System (the City); the Board of Commissioners of the County of San Juan (the County); and various county and city officials. Plaintiffs invoked 42 U.S.C. § 1983, *inter alia,* alleging that the defendants had violated plaintiffs' constitutional rights. The district court thus had jurisdiction under 28 U.S.C. §§ 1331 and 1343. The state officials were dismissed during the progress of the case and are not parties to this appeal.

C

On April 15, 1998, about three years after the action had been commenced, a settlement conference was conducted with a court-appointed mediator. At the conference there was agreement on the basic contours of a settlement, which the mediator summarized in a hand written document styled "Outline of Agreement" and which was signed by plaintiffs, their attorney, and attorneys for the Cityand for San ***1189** Juan County. Aplt.App. 106-109. (The attorney for the City also was representing the city employees and officials; similarly the attorneys for the County were also representing the county employees and officials.)

We quote the most pertinent provisions of the Outline:[FN2]

> FN2. We have a typed "transcript" of the Outline provided by plaintiffs and appended to their brief. Defendants have not contested the accuracy of plaintiffs' typed version of the original hand-written document.

1. Counsel for the County and City Defendants agree that they will recommend to their respective clients that said clients jointly pay the total sum of $237,500 in full and complete settlement of all claims in this above-referenced action filed or that could have been filed including attorneys fees and costs.

2. Plaintiffs agree that if said sum of $237,500 is jointly offered as indicated above by the County & City Defendants that they will accept said offer, if it also includes the terms set out below.

3. Farmington Utility System agrees that if a full and complete settlement is reached, they will promptly restore electrical service to the Heuser's [sic] property ... and the Heusers will be reinstated as regular customers without need of an inspection, subject to the Heusers[ ] signing a Hold Harmless Agreement.

4. The Heusers agree to sign a full and complete standard release in a form satisfactory to Defendants which Release shall contain language that Defendants do not admit liability.

Aplt.App. 107-108.

As made clear in an affidavit of counsel later submitted to the district court, the attorney representing the City at the mediation session did not have authority to commit the City to any settlement, which required the approval of the City Council. FN3 Before that body could meet and approve the proposal, plaintiffs communicated their dissatisfaction with it and indicated that they would not accept the payment called for therein. Upon receiving notice that the settlement was being rejected by the plaintiffs, the district judge *sua sponte* scheduled a hearing to determine whether plaintiffs' electricity could be safely restored immediately. Aplt.App. 70-71. Before the day of the scheduled hearing, the service was restored.

FN3. The New Mexico Supreme Court has noted that it " 'is fundamental that an attorney does not by reason of his employment have authority to compromise his client's cause of action absent an emergency requiring prompt action.' " *See Augustus v. John Williams & Assoc., Inc.*, 92 N.M. 437, 589 P.2d 1028, 1030 (1979) (quoting *Hayes v. Eagle-Picher Industries, Inc.*, 513 F.2d 892, 893 (10th Cir.1975)).

The defendants moved for enforcement of the purported settlement agreement, which the district court granted over plaintiffs' objection. The court entered judgment based on that order, dismissing plaintiffs' action as settled. Plaintiffs then filed a motion under Fed.R.Civ.P. 59(e) asking the court to vacate the order enforcing the settlement. The judge denied that motion, again holding that the Outline constituted an enforceable agreement, and plaintiffs commenced this appeal.

II

In the first of the two orders upholding the settlement agreement, the district judge ruled that the language of the Outline was unambiguous so that there was no need for extrinsic evidence as to the meaning of its terms. The judge found no merit in plaintiffs' contention that the terms of the Outline were not sufficiently definite for creation of a binding contract, and she found that the parties intended to form a final enforceable agreement, as opposed to merely documenting the progress of their negotiations. Her findings stated:

> Since the City Defendants are self insured, the City Council had to give final formal approval of the settlement amounts. Affidavit of Robin D. Strother.***1190** Accordingly, the parties agreed that "Counsel for the County and City Defendants will recommend to their respective clients that said clients jointly pay the total sum of $237,500 in full and complete settlement of all claims in the action filed or that could have been filed including attorneys fees and costs."

Aplt.App. at 76.

The condition of approval of the settlement amount by the City Council was a condition precedent to enforcement of the contract, the district court ruled, but not a condition to formation of the contract. Accordingly, the City had a reasonable time to perform the condition. The judge also rejected the plaintiffs' allegation that they had signed the Outline under duress. The judge opined that the real reason for the plaintiffs' resistance was the belated belief that they were not receiving enough money for their claims and that the court could not relieve the parties of their commitments.

On plaintiffs' motion to amend the judgment, which argued that there was no consideration for their promise to accept the deal if offered, the district judge specifically held that the consideration was sufficient:

> There was a bilateral contract here: *in return for Defendants' agents' promise to recommend that the City pay the negotiated amount, Plaintiffs promised not to back out on the deal that Defendants' attorneys had negotiated* (at great expense to the Defendants) before Defendants could act on that recommendation. New Mexico follows Section 71 of the Restatement (Second) of Con-

> tracts (1979). Under that Section, "[t]o constitute consideration, a performance or a return promise must be bargained for.".... The Court finds that the parties bargained for the exchange of promises and that the cessation of litigation was the goal of the bargaining process. .... *Defendants, through their agents, provided adequate consideration for Plaintiffs' promise to accept the monetary settlement if it was offered.* Settlement negotiations between individuals and public entities would be meaningless if Courts allowed individuals to undo days of negotiation (with their underlying expense) by simply changing their minds before the entity can take formal action to complete the bargain.

Aplt.App. 92-93 (emphasis added).

III

[1] We review a district judge's approval of a settlement agreement for an abuse of discretion. *See United States v. Hardage,* 982 F.2d 1491, 1495 (10th Cir.1993). We have held that the enforcement and interpretation of settlement agreements in Title VII cases are governed by federal common law because such settlements are "inextricably linked" to the underlying law of Title VII. *Snider v. Circle K Corp.,* 923 F.2d 1404, 1407 (10th Cir.1991) ("Federal common law governs the enforcement and interpretation of such agreements because 'the right of the litigants and the operative legal policies derive from a federal source.' *Fulgence v. J. Ray McDermott & Co.,* 662 F.2d 1207, 1209 (5th Cir.1981) ."). Our later opinion in *Morris v. City of Hobart,* 39 F.3d 1105, 1112 (10th Cir.1994), addressed the issue whether federal or state law governs the interpretation of such settlement agreements in the context of subject matter jurisdiction and said that the "cause of action [for breach of contract arising out of private settlement of a Title VII claim] is a subject traditionally relegated to state law." FN4 Here the district judge said that " 'Construction of a settlement agreement generally is governed by state law.' " Memorandum Opinion and Order, Appellants' App. at 78 (quoting ***1191***Brockman v. Sweetwater County School Dist. No. 1,* 25 F.3d 1055, 1994 WL 170795 (10th Cir.), *cert. denied,* 513 U.S. 951, 115 S.Ct. 368, 130 L.Ed.2d 320 (1994)).

> FN4. The divergence of views of other courts on the applicability of federal or state law is noted in 19 Charles A. Wright, Arthur R. Miller & Edward H. Cooper, *Federal Practice & Procedure: Jurisdiction 2d* § 4541 at p. 394 n. 132 (2d ed.1996) (collecting cases).

In the instant appeal, the parties do not present a controversy over which law governs. In fact the briefs for all the parties say that state law governs interpretation of the settlement contract. Appellants' Brief at 20 n. 6; Response Brief of Appellees Frank Kephart *et al.* at 21; Response Brief of Appellees McQuitty *et al.* at 18. Moreover we feel that the applicable principles of contract law are not different in federal and New Mexico law. Accordingly, we turn to the parties' arguments which we will consider under basic contract rules.

[2] Plaintiffs first argue that the defendants' alleged promise was illusory and thus legally insufficient as consideration for plaintiffs' promises. Therefore, plaintiffs contend, the district court erred in holding that the Outline constituted a legally enforceable contract. We agree. It was apparent from paragraphs 1 and 3 of the Outline's numbered provisions that the $237,500 settlement had to be submitted to, and be given approval by, the City and County authorities. Aplt.App. at 108.

Thus, there was no legally sufficient consideration for the plaintiffs' promise to accept the contemplated settlement offer. The district judge found that the consideration, which she also found had been specifically bargained for, was the attorneys' promise to recommend the terms of the proposed settlement to their clients. The court's ruling notes that the attorneys were acting as agents. Section 147 of the Restatement (Second) of Agency provides: "Unless otherwise agreed, a disclosed or partially disclosed principal is a party to a contract, if not negotiable or sealed, made by his agent within his authority." *See also id.* § 292 & comment *a.* Here, the language of the Outline makes it clear that the parties "otherwise agreed" that the defendants as principals were not parties to the "agreement" but were to be given a recommendation to offer a specific amount of money, plus other consideration, to the plaintiffs if they chose to do so.

[3][4] Under the terms of the Outline, the defendants were not obligated to extend the offer to plaintiffs, and the Outline noted the operative procedure "if said sum of $237,500 is jointly offered ... by the County and City Defendants ..." Outline of Agreement, paragraph 2, Aplt.App. at 107. The defendants were completely free to choose between two alternatives-they could accept the attorneys' recommendation and extend the offer, or they could reject the recommendation. Obviously, if the defendants were to choose the second alternative, plaintiffs would have received nothing in exchange for their agreement. It is well settled that a promise by a party in the alternative is not consideration except under limited circumstances:

> A promise or apparent promise is not consideration if by its terms the promisor or purported promisor reserves a choice of alternative performances unless
>
> (a) each of the alternative performances would have been consideration if it alone had been bargained for; or
>
> (b) one of the alternative performances would have been consideration and there is or appears to the parties to be a substantial possibility that before the promisor exercises his choice events may eliminate the alternatives which would not have been consideration.

Restatement (Second) of Contracts § 77 (1981).

[5] Where, as here, a party "has an unfettered choice of alternatives, and one alternative would not have been consideration if separately bargained for, the promise in the alternative is not consideration." *Id., comment b.* In circumstances very similar to those presented here, it has been held that an apparent promise subject to the "unfettered discretion" of a municipality's governing body to accept or reject is "a classic example of an illusory promise." ***1192** *Mastaw v. Naiukow,* 105 Mich.App. 25, 306 N.W.2d 378, 380 (1981) ("Since the Detroit Common Council had unfettered discretion to accept or reject the settlement, its options were in no way limited by the supposed settlement."). Similarly in the instant case the defendants made no binding promise but had the unfettered discretion to accept or reject the proposed terms. Hence this is a clear example of an illusory promise.

[6][7] New Mexico cases have applied this principle, holding that where the purported promise to perform actually leaves it to the discretion of the promisor, the alleged promise is illusory and not consideration as a matter of law. *See Board of Education v. James Hamilton Construction Co.,* 119 N.M. 415, 891 P.2d 556, 561 (App.1994), *cert. denied,* 119 N.M. 354, 890 P.2d 807 (1995); *Acme Cigarette Services, Inc. v. Gallegos,* 91 N.M. 577, 577 P.2d 885, 889 (App.1978). As the court explained in *Hamilton Construction:* "A valid contract must possess mutuality of obligation. Mutuality means both sides must provide consideration. It is also elementary that a contract, which leaves it entirely optional with one of the parties to perform, is not founded on mutual promises." 891 P.2d at 561 (internal citations and quotation marks omitted).

The purported contract in *Hamilton Construction* was for the purchase of real property, but the written agreement provided forty days for the buyer to complete its due diligence work "and to review and approve or reject all matters pertaining to this transaction." *Id.* at 558. The escrow arrangements provided that buyer "may" deposit funds with the escrow agent. The New Mexico court held that there was no contract: "[B]ecause Buyer's promise to perform under the Agreement and [escrow] Instructions was entirely at its discretion, any consideration contained in such a promise would be illusory." *Id.* at 561. Because the purported contract in the instant case likewise left it entirely to the discretion of the defendants whether to accept or reject the proposed terms, we hold that the district court erred in concluding that the parties had entered into a binding contract.

In *Joseph E. Montoya and Associates v. State of New Mexico,* 103 N.M. 224, 704 P.2d 1100 (1985), another ruling similar to that of the Michigan Court in *Mastaw,* 306 N.W.2d at 380, was made. The New Mexico Supreme Court there held:

> Even without consideration of New Mexico law requiring DFA approval of state agency contracts, a contract never came into being under traditional contract principles. Part of the bargain between HSD and Montoya was that the proposed contract would not become effective unless and until DFA approval was obtained ... Because this condition precedent was not satisfied, no contract came into being.

704 P.2d at 1102.

Defendants contend that there was consideration for the plaintiffs' promise to accept the designated sum because the attorneys were bound by their promise to recommend the settlement. Defendants correctly point out that the district judge ruled that this was the promise for which the plaintiffs had specifically bargained, as our quotation *supra* from her order shows. We conclude nevertheless that the Outline is unenforceable, even if we assume that the district judge was correct in her ruling that the plaintiffs specifically bargained for only the attorneys' promise to recommend the settlement to their clients (as opposed to bargaining for the anticipated offer of money and restoration of electrical services from the defendants under the terms of the Outline). The attorneys' promise is not consideration because the attorneys promised only to do that which they were as counsel separately entitled to do-make a recommendation to the City and County. We assume that the attorneys promised to recommend the settlement to their clients because, in the exercise of their independent judgment and adhering to their ethical obligation of loyalty to their clients, the attorneys had ***1193** concluded that it was in their clients' best interests to approve the settlement.

The dissent argues that the recommendation from the attorneys, contemplated in the Outline of Agreement, serves as consideration flowing from a third party supporting the settlement agreement as performance given "by some other person." *See Restatement (Second) Contracts* § 71(4). This contention is premised on a misconception of the City and County counsel as a third party. The misconception runs counter to the parties' and the attorneys' treatment of such counsel not as third parties, but as *agents* of the City and County. The district judge found that "Defendants, through their agents, provided adequate consideration ...". Aplt.App. at 93. In their brief before us, the County defendants recognize that their counsel were acting as their *agents.* Response Brief of Appellees Kephart, et al. at 27 ("Plaintiffs bargained for the Defendants' agents['] promise that they would recommend the settlement to their clients"). The Response Brief of Appellees McQuitty, et al. at 24 and 25, implicitly recognizes their counsel as their agents (the offer had been "accepted by the Appellees, through counsel ..."). Thus the recommendations of counsel to accept the settlement must be treated as coming from the City's and County's agents, and cannot serve as third party performance given "by some other person." *Restatement (Second) Contracts* § 71(4).[FN5]

FN5. Moreover the wording of the Outline of Agreement refutes the dissent's suggestion that the agreement contained "no such language" as that in *Montoya v. State of New Mexico,* 704 P.2d at 1101, showing that the agreement in *Montoya* was not to be effective until a given date or approval by a state Department. To the contrary, the Outline of Agreement in the instant case clearly conditioned the duty of the plaintiffs to accept the settlement, saying " *if said sum of $237,500 is jointly offered as indicated above* ... they [plaintiffs] will accept said offer." Aplt.App. at 108.

In sum, the attorneys' promise is not sufficient as a matter of law to serve as consideration *from the defendants* to support this purported contract because the defendants simply made no enforceable promise. Because we have determined that there was no consideration given to the plaintiffs to make their promise enforceable at law, we need not reach other issues raised by the plaintiffs.

IV

The judgment of the district court is **reversed** and the case is remanded for further proceedings.

EBEL, Circuit Judge, dissenting

I disagree with the majority's conclusion that the settlement outline fails for lack of consideration. In my view, the promise of the City and County attorneys to recommend ratification of the settlement constitutes sufficient third-party consideration to support an agreement. I therefore respectfully dissent.

The cases relied upon by the majority are not persuasive under the facts presented by this case. First, the majority notes that the New Mexico Supreme Court has held that, absent emergency circumstances or preauthorization, an attorney may not " 'compromise his client's cause of action.' " *Augustus v. John Williams & Assocs., Inc.*, 92 N.M. 437, 589 P.2d 1028, 1030 (1979) (quoting *Hayes v. Eagle-Picher Indus., Inc.*, 513 F.2d 892, 893 (10th Cir.1975)); *see* Majority Opinion at n. 3. The *Augustus* case, however, does not describe the situation we are presently addressing. In the case at bar, the lawyers merely supplied valid third-party consideration in the form of a promise to recommend the settlement to their clients.[FN1] They did not, ***1194** as the *Augustus* case prohibits, affirmatively bind the City or County or otherwise compromise their interests. Rather, they made a promise that induced the Heusers to agree to the settlement.

FN1. The majority opinion dismisses the possibility that the attorneys supplied third-party consideration because, the opinion states, the parties have chosen to characterize the attorneys as agents of the City and County. However, even assuming that the attorneys did not act both as agents for the City and County and as third parties, the majority's point is misguided. If acting as agents, then the attorneys' promise affirmatively to recommend the settlement is direct consideration flowing from the promisee. The fact remains that the Heusers bargained for this affirmative act by the attorneys, and it was a meaningful restraint on the attorneys' freedom which constitutes adequate consideration, regardless of whether it is viewed as third-party consideration or party consideration.

The majority also cites cases for the proposition that "where the purported promise to perform actually leaves it to the discretion of the promisor, the alleged promise is illusory and not consideration as a matter of law." Majority Opinion at 13 (citing *Board of Educ. v. Hamilton Constr. Co.*, 119 N.M. 415, 891 P.2d 556, 561 (App.1994); *Acme Cigarette Servs., Inc. v. Gallegos*, 91 N.M. 577, 577 P.2d 885, 889 (App.1978)).[FN2] This discussion likewise overlooks the presence of third-party consideration in the present case. Although the City retained the option of either approving or rejecting the proposed settlement, the attorneys obligation to recommend the settlement was firm and definite.

FN2. I also note that the majority's reliance on *Joseph E. Montoya & Assocs. v. State of New Mexico*, 103 N.M. 224, 704 P.2d 1100 (1985) is misplaced because that case is plainly distinguishable from the present

> facts. The alleged agreement in *Montoya* contained a explicit provision stating that the agreement was not to become effective until "January 1, 1983, or upon approval by the Department of Finance and Administration, whichever is later." *Id.* at 1102. The outline at issue in the case at bar contains no such language, and that case did not involve third-party consideration as is the case here.

I would conclude that the attorneys promise to recommend the settlement was sufficient consideration supporting the settlement agreement. It is well-settled that consideration may flow from a third-party. *See* Restatement (Second) of Contracts § 71(4) ("The performance or return promise may be given to the promisor or to some other person. *It may be given by the promisee or by some other person.*") (emphasis added); 2 Corbin on Contracts § 5.11 (1995 Rev. Ed.) ("[I]n this country it is indisputable that the consideration need not move from the promisee.").

The majority seeks to dismiss the value of the attorneys' promise as consideration "because the attorneys promised to do that which they were as counsel separately entitled to do-make a recommendation to the City and County." Majority Opinion at 15. The majority then explicitly "assume[s] that the attorneys promised to recommend the settlement to their clients because, in the exercise of their independent judgment and adhering to their ethical obligation of loyalty to their clients, the attorneys had concluded that it was in their clients' best interests to approve the settlement." *Id.* This reasoning is misguided. The attorneys had an ethical and professional obligation to *present* the settlement to their clients, but they were under no duty to *affirmatively recommend* it. Furthermore, the assumption that the attorneys must have concluded that it was in their clients' best interest to accept the settlement is unfounded. The attorneys may very well have concluded that this was the best settlement offer that they could negotiate with the Heusers, but that it was perhaps still too generous. Whatever tension might exist between the lawyers' promise to recommend the settlement and their professional obligation not to advise a client to accept an undesirable settlement does not alter the fact that the attorneys are not obligated to affirmatively recommend every settlement offer presented to their clients.

Here the Heusers obtained a clear commitment from the City's and County's attorneys to recommend the settlement for adoption. That commitment was an obvious benefit to the Heusers, as it would greatly facilitate the likelihood that the City and County would approve the settlement. It was similarly a detriment to the attorneys, who thereby diminished their ***1195** own options. Whatever implication this may have had as between the City and County and its attorneys is of no consequence to the Heusers. From the Heusers' perspective, the commitment by the City's and County's attorneys was clear and valuable consideration, and in my opinion, it supports the settlement agreement.

Thus, I would find that the attorneys' promise represented valid third-party consideration supporting the agreement. I respectfully dissent.

C.A.10 (N.M.),2000.
Heuser v. Kephart
215 F.3d 1186, 2000 CJ C.A.R. 4049

END OF DOCUMENT

I

United States Bankruptcy Court,
N.D. Georgia,
Newnan Division.
In the Matter of The NEW POWER COMPANY, a/k/a EMW Marketing Corp., a/k/a Columbia Energy Services, New Power Holdings, Inc., a/k/a EMW Energy Services Corp., a/k/a TNPC, Inc., TNPC Holdings, Inc., a/k/a EMW Holdings Corp., Debtors.
Nos. 02-10835-WHD to 02-10837-WHD.

July 16, 2004.

Background: Chapter 11 debtors objected to application filed by creditor for allowance of attorney fees and costs as administrative expense or, in alternative, as general unsecured claim.

Holdings: The Bankruptcy Court, W. Homer Drake, Jr., J., held that:
(1) while transaction processing services provider, in furnishing data and invoices utilized by debtors in settling dispute with third party creditor, may have provided some assistance to debtor, services provider failed to demonstrate that such assistance rose to level of "substantial contribution" to case, as required to support administrative expense claim;
(2) creditor's claim for attorney fees payable under its prepetition service agreement that debtor never assumed postpetition did not arise out of postpetition transaction between creditor and trustee or debtor-in-possession, and was not payable on administrative priority basis as "actual and necessary" cost of preserving estate;
(3) unsecured creditors may assert general unsecured claim for postpetition attorney fees to which they have contractual or statutory right; and
(4) unsecured creditor that succeeded in establishing its $3.4 million claim against Chapter 11 estate was entitled, pursuant to California statute allowing award of "costs" to prevailing parties, to general unsecured claim for filing fee in amount of $190.

So ordered.

West Headnotes

[1] Bankruptcy 51 2877

51 Bankruptcy
51VII Claims
51VII(C) Administrative Claims
51k2877 k. Professional Services; Attorney Fees. Most Cited Cases

Bankruptcy 51 2926

51 Bankruptcy
51VII Claims
51VII(E) Determination
51k2925 Evidence
51k2926 k. Presumptions and Burden of Proof. Most Cited Cases
Creditor seeking reimbursement, as administrative expense, of legal fees and costs that it allegedly incurred in "making a substantial contribution" in Chapter 11 case, bears burden of proving that such expenses resulted in significant and tangible benefit to estate; simple fact that expenses were incurred, without proof of concrete benefit to estate, is insufficient. Bankr.Code, 11 U.S.C.A. § 503(b)(3)(D).

[2] Bankruptcy 51 2877

51 Bankruptcy
51VII Claims
51VII(C) Administrative Claims
51k2877 k. Professional Services; Attorney Fees. Most Cited Cases
Bankruptcy court will not allow reimbursement, as administrative expense, of legal fees and costs that creditor allegedly incurred in "making a substantial contribution" in Chapter 11 case, if it concludes that creditor's participation in case was, as a whole, detrimental to estate, or caused adverse impact on estate. Bankr.Code, 11 U.S.C.A. § 503(b)(3)(D).

[3] Bankruptcy 51 ⚷2877

51 Bankruptcy
51VII Claims
51VII(C) Administrative Claims
51k2877 k. Professional Services; Attorney Fees. Most Cited Cases

No matter how extensively creditor has participated in Chapter 11 case, bankruptcy court is unlikely to find a substantial contribution by creditor to case, as ground for allowing creditor to recover its legal fees and costs as administrative expense, where creditor's participation has retarded or interrupted debtor's reorganization. Bankr.Code, 11 U.S.C.A. § 503(b)(3)(D).

[4] Bankruptcy 51 ⚷2871

51 Bankruptcy
51VII Claims
51VII(C) Administrative Claims
51k2871 k. Administrative Expenses in General. Most Cited Cases

Fact that creditor performed services, or incurred expenses, primarily to benefit its own interest, rather than bankruptcy estate or its creditors, is largely irrelevant to whether creditor has made "substantial contribution" to case, within meaning of administrative expense provision; however, where creditor acts primarily for its own benefit, evidence may show that creditor's participation resulted in primary benefit to creditor and only an incidental benefit to estate, of kind insufficient to constitute a "substantial contribution." Bankr.Code, 11 U.S.C.A. § 503(b)(3)(D).

[5] Bankruptcy 51 ⚷2877

51 Bankruptcy
51VII Claims
51VII(C) Administrative Claims
51k2877 k. Professional Services; Attorney Fees. Most Cited Cases

Bankruptcy 51 ⚷2927

51 Bankruptcy
51VII Claims
51VII(E) Determination
51k2925 Evidence
51k2927 k. Weight and Sufficiency. Most Cited Cases

While transaction processing services provider, in furnishing data and invoices utilized by Chapter 11 debtors in settling dispute with third party creditor, may have provided some assistance to debtor, services provider failed to demonstrate that such assistance rose to level of "substantial contribution" to case, as required to support services provider's claim for roughly $100,000 in legal fees as administrative expense; services provider failed to show that any benefit that it provided was not already being provided by debtor's own employees/consultants. Bankr.Code, 11 U.S.C.A. § 503(b)(3)(D).

[6] Bankruptcy 51 ⚷2877

51 Bankruptcy
51VII Claims
51VII(C) Administrative Claims
51k2877 k. Professional Services; Attorney Fees. Most Cited Cases

Bankruptcy 51 ⚷2927

51 Bankruptcy
51VII Claims
51VII(E) Determination
51k2925 Evidence
51k2927 k. Weight and Sufficiency. Most Cited Cases

Even assuming that transaction processing services provider, in furnishing data and invoices used by Chapter 11 debtors in settling dispute with third party creditor, may have made a "substantial contribution" to case, services provider failed to prove that the roughly $100,000 in attorney fees that it incurred, the bulk of which related to investigating means by which it could gain leverage with debtors and with creditors' committee, were "actually and necessarily" incurred in making this contribution; as required to be reimbursable as administrative expense. Bankr.Code, 11 U.S.C.A. § 503(b)(3)(D).

[7] Bankruptcy 51 2871

51 Bankruptcy
51VII Claims
51VII(C) Administrative Claims
51k2871 k. Administrative Expenses in General. Most Cited Cases

On request for reimbursement as administrative expense of costs that creditor allegedly incurred in making "substantial contribution" to case, bankruptcy court must distinguish between expenses incurred in making substantial contribution to case and expenses lacking that causal connection, with the latter being noncompensable. Bankr.Code, 11 U.S.C.A. § 503(b)(3)(D).

[8] Bankruptcy 51 2877

51 Bankruptcy
51VII Claims
51VII(C) Administrative Claims
51k2877 k. Professional Services; Attorney Fees. Most Cited Cases

Creditor's claim for attorney fees payable under its prepetition service agreement that Chapter 11 debtor never assumed postpetition did not arise out of postpetition transaction between creditor and trustee or debtor-in-possession, and was not payable on administrative priority basis as "actual and necessary" cost of preserving estate, even though fees were incurred postpetition. Bankr.Code, 11 U.S.C.A. § 503(b)(1)(A).

[9] Bankruptcy 51 2182.1

51 Bankruptcy
51II Courts; Proceedings in General
51II(C) Costs and Fees
51k2182 Grounds and Circumstances
51k2182.1 k. In General. Most Cited Cases

Bankruptcy 51 2828.1

51 Bankruptcy
51VII Claims
51VII(A) In General
51k2828 Contingent or Unliquidated Claims
51k2828.1 k. In General. Most Cited Cases

Unsecured creditors may assert general unsecured claim for postpetition attorney fees to which they have contractual or statutory right, and mere fact that such attorney fees are unmatured on petition date is not basis for disallowing claim.

[10] Bankruptcy 51 2828.1

51 Bankruptcy
51VII Claims
51VII(A) In General
51k2828 Contingent or Unliquidated Claims
51k2828.1 k. In General. Most Cited Cases

Fact that claim is contingent or unmatured is not ground for disallowing claim, unless claim is for unmatured interest.

[11] Bankruptcy 51 2182.1

51 Bankruptcy
51II Courts; Proceedings in General
51II(C) Costs and Fees
51k2182 Grounds and Circumstances
51k2182.1 k. In General. Most Cited Cases

Mere fact that, in order to recover postpetition legal fees on a preferred basis as addition to its secured claim, creditor must be oversecured was no ground for disallowing unsecured claim filed by creditor for postpetition attorney fees to which it was allegedly entitled under its contract with debtor. Bankr.Code, 11 U.S.C.A. § 506(b).

[12] Bankruptcy 51 2182.1

51 Bankruptcy
51II Courts; Proceedings in General
51II(C) Costs and Fees
51k2182 Grounds and Circumstances
51k2182.1 k. In General. Most Cited

Cases
Even assuming that unsecured creditors could not generally seek payment of their postpetition attorney fees upon unsecured basis, this prohibition would not apply in case filed by solvent debtor.

[13] Bankruptcy 51 ⚿2182.1

51 Bankruptcy
51II Courts; Proceedings in General
51II(C) Costs and Fees
51k2182 Grounds and Circumstances
51k2182.1 k. In General. Most Cited Cases
General indemnification provision in prepetition service agreement between Chapter 11 debtor and transaction processing services provider did not contain language evidencing any intent between parties to shift payment of attorney fees which provider incurred in litigation with debtor to establish its claim, and did not provide basis for general unsecured claim by provider to recover its attorney fees.

[14] Bankruptcy 51 ⚿2183

51 Bankruptcy
51II Courts; Proceedings in General
51II(C) Costs and Fees
51k2182 Grounds and Circumstances
51k2183 k. Prevailing Party. Most Cited Cases
Under Georgia choice-of-law rules, bankruptcy court, in determining whether service provider had a statutory right to recover postpetition attorney fees for successfully establishing its $3.4 million contract-based claim in bankruptcy, would apply statutory law of state which parties had specified would govern their contract, i.e., California, pursuant to which provider's right to recover prevailing party costs was limited solely to "costs," and did not include attorney fees. West's Ann.Cal.C.C.P. § 1032.

[15] Action 13 ⚿17

13 Action
13II Nature and Form
13k17 k. What Law Governs. Most Cited Cases

Action 13 ⚿66

13 Action
13IV Commencement, Prosecution, and Termination
13k66 k. Course of Procedure in General. Most Cited Cases
First step in conflicts-of-law analysis is to determine whether issue is procedural or substantive; if substantive, then court will examine substantive law of the forum state, including its choice of law rules, to ascertain the applicable substantive law.

[16] Federal Courts 170B ⚿415

170B Federal Courts
170BVI State Laws as Rules of Decision
170BVI(C) Application to Particular Matters
170Bk415 k. Damages, Interest, Costs and Fees. Most Cited Cases
Statutes allowing for recovery of attorney fees are "substantive law," for purposes of *Erie* rule that federal court must apply substantive law of state in which it sits.

[17] Bankruptcy 51 ⚿2183

51 Bankruptcy
51II Courts; Proceedings in General
51II(C) Costs and Fees
51k2182 Grounds and Circumstances
51k2183 k. Prevailing Party. Most Cited Cases
Creditor that, although it succeeded in establishing claim against Chapter 11 estate for only $3.4 million of the $6.6 million originally claimed, had sufficient success to be regarded as "prevailing party," within meaning of California statute providing for recovery of costs. West's Ann.Cal.C.C.P. § 1032.

[18] Bankruptcy 51 ⚿2183

51 Bankruptcy
51II Courts; Proceedings in General
51II(C) Costs and Fees
51k2182 Grounds and Circumstances
51k2183 k. Prevailing Party. Most Cited Cases
Unsecured creditor that succeeded in establishing its $3.4 million claim against Chapter 11 estate was entitled, pursuant to California statute allowing award of "costs" to prevailing parties, to claim for filing fee in amount of $190, but not to amounts expended for facsimiles, computer-assisted legal research, photocopies, postage, telephone calls, or the like. West's Ann.Cal.C.C.P. § 1032.
***499** Robert J. Mottern, Weizenecker, Rose, Mottern & Fisher, P.C., Atlanta, GA, Craig H. Averch, White & Case, LLP, Los Angeles, CA, for Automated Power Exchange.

Richard W. Havel, Sidley, Austin, Brown, & Wood LLP, Los Angeles, CA, Paul K. Ferdinands, King & Spalding, Atlanta, GA, Geoffrey T. Raicht, Sidley, Austin, Brown & Wood LLP, New York, NY, for Debtors.

ORDER

W. HOMER DRAKE, JR., Bankruptcy Judge.

Before the Court is the Application of Automated Power Exchange (hereinafter "APX") for Payment of Attorneys' Fees and Expenses. An objection to the Application has been filed by New Power Company (hereinafter "New Power"), New Power Holdings, Inc., and TNPC Holdings, Inc. (collectively referred to herein as the "Debtors"). This matter constitutes a core proceeding over which this Court has subject matter jurisdiction. *See* 28 U.S.C §§ 157(b)(2)(B); 1334.

BACKGROUND

On June 11, 2002, the Debtors filed voluntary petitions under Chapter 11 of the Bankruptcy Code. These cases were administratively consolidated on June 12, 2002, and an Official Committee of Unsecured Creditors (hereinafter the "Committee") was appointed for New Power on June 18, 2002.

New Power is the operating entity through which the Debtors provided gas and electric service to customers in various states, including Georgia, Texas, Ohio, and Pennsylvania. Throughout the case, the Debtors have continued to operate as debtors-in-possession and have worked toward the liquidation of the Debtors' assets. The asset sales, the bulk of which were concluded prior to the end of July 2002, produced funds sufficient to pay all creditors in full, with interest.

APX is an independent transaction processing service provider for wholesale electric power markets. APX and New Power were parties to a Master Service and Participation Agreement (hereinafter the "MSPA"). New Power did not assume the MSPA. Accordingly, pursuant to the Debtors' Second Amended Plan, the MSPA was deemed rejected as of the Effective Date of the Plan, which was March 11, 2003.

Under the MSPA, APX provided scheduling services to New Power in connection with New Power's servicing of Texas customers. The Texas market is managed and administered by the Electric Reliability Council of Texas (hereinafter "ERCOT"). Pursuant to the MSPA, APX acted as New Power's Qualified Scheduling Entity. New Power provided data regarding its power needs to APX, which APX in turn submitted to ERCOT. ERCOT generated several successive statements regarding New Power's use of energy and ***500** provided weekly settlement invoices to APX. APX remitted the amounts due to ERCOT on behalf of New Power and subsequently billed New Power for these amounts by way of a monthly invoice. The MSPA also obligated New Power to pay APX certain fees for its services.

APX contends that, following the filing of the Debtors' bankruptcy petitions, New Power asked

APX to continue to act as its scheduling coordinator throughout the time period in which New Power would be winding down its operations in Texas. At that time, New Power anticipated that its retail customers would be transferred to another service provider. This transition process was completed at the end of September 2002.

At the time of the filing of the bankruptcy petitions, APX asserted a pre-petition claim for $2,199,565.98. APX also contends that New Power defaulted upon its post-petition obligations under the MSPA, resulting in a $1,199,090.17 administrative expense claim. APX filed one proof of claim (# 912) for the pre-petition and post-petition amounts that APX had already remitted to ERCOT on New Power's behalf and a separate proof of claim for $1,914,017.80, which represented: 1) amounts arising from a demand by ERCOT that APX increase the amounts posted in its Margin Account; 2) additional, estimated post-petition ERCOT charges; and 3) estimated legal fees.

On March 24, 2003, the Debtors objected to the APX proof of claim, asserting that the amounts billed by ERCOT were inaccurate, and asked the Court to adjourn a hearing on the claim objection until after the ERCOT Resettlement Process had been completed. The Court set this objection for a hearing on April 25, 2003. On March 28, 2003, APX filed: 1) a motion to compel payment of the undisputed portion of its claim, or, in the alternative, to convert the Debtors' bankruptcy cases to Chapter 7; 2) a motion for relief from the automatic stay to allow APX to setoff the cash collateral against amounts owed to APX; and 3) a response to the Debtors' objection to its claim. On April 22, 2003, the Debtors, APX, and the Committee met to discuss a resolution of APX's claims. On April 25, 2003, the Court approved a stipulation between APX and the Debtors. Pursuant to the stipulation, the automatic stay was lifted to allow APX to set off up to $1,535,704.99 against cash collateral, and the hearing on the Debtors' claim objection was adjourned. Additionally, APX's motion to compel or, in the alternative, convert the Debtors' cases, was deemed withdrawn without prejudice.

On June 25, 2003, at the direction of and on behalf of New Power, APX requested a formal Alternative Dispute Resolution, pursuant to Part 20 of the ERCOT protocols, in order to resolve New Power's billing dispute with ERCOT. [FN1] On August 6, 2003, the parties entered a Stipulation and Consent Order, under which New Power agreed to advance to APX 90% of the ERCOT charges actually paid by APX on New Power's behalf, valid and unpaid APX fees, and post-petition interest as provided for under the Debtors' Plan. The parties also agreed to a procedure for resolving additional disputes over future ERCOT charges. Subsequently, New Power paid APX $3.4 million in full satisfaction of its claim.

> FN1. New Power agreed to indemnify APX for any damages or losses incurred in connection with the ADR, including reasonable attorneys' fees and expenses. Accordingly, this application does not seek payment of fees incurred in connection with the ADR.

APX employed the law firms of White & Case LLP and Weizenecker, Rose, Mottern, and Fisher to represent it throughout ***501** the Debtors' bankruptcy proceedings. APX seeks reimbursement from the Debtors' estates for $93,692.70 in legal fees and $4,068.47 in expenses incurred in connection with the Debtors' cases. APX asserts that these fees are properly payable by the Debtors' estates as either an administrative expense claim or as part of the unsecured claim of APX. The Debtors have objected to the payment of the fees in any manner.

CONCLUSIONS OF LAW

A. *Payment of Attorneys' Fees Pursuant to Section 503(b)(3)(D)*

[1][2][3] APX first contends that it is entitled to

have its legal fees and expenses reimbursed by the Debtors' estates because it made a substantial contribution to the bankruptcy cases. As the Debtors have noted, as a general rule, each party to a litigation must pay its own fees and expenses. However, in the bankruptcy context, if a creditor or other party makes a substantial contribution to a bankruptcy case, the Code provides for payment of the party's expenses as an administrative expense by the estate. *See* 11 U.S.C. 503(b)(3)(D); *Matter of D'Lites of America, Inc.,* 108 B.R. 352 (Bankr.N.D.Ga.1989) (Drake, J.). The party seeking payment of an administrative expense claim under § 503(b)(3)(D) bears the burden of proving that the "expenses resulted in a significant and tangible benefit to the estate." *D'Lites,* 108 B.R. at 356. The simple fact that the expenses were incurred, without proof of a "concrete benefit to the estate," is insufficient to satisfy this burden. *Id.* The Court will not allow the payment of expenses if it concludes that the claimant's participation in the case "as a whole was detrimental to the estate," or "caused an adverse impact on the estate rather than a 'substantial contribution' as required by § 503(b)(3)(D)." *Id.* For example, notwithstanding a finding of extensive involvement in a case, the Court is unlikely to find a substantial contribution when the movant's participation has retarded or interrupted the debtor's reorganization. *See In re DP Partnership,* 106 F.3d 667, 672 (5th Cir.1997); *In re Communications Management & Information, Inc.,* 172 B.R. 136, 141 (Bankr.N.D.Ga.1994) (Murphy, J.); *see also In re Big Rivers Elec. Corp.,* 233 B.R. 739 (W.D.Ky.1998) (denying application for payment of expenses after finding that, although some of the applicant's activities may have benefitted the estate, any benefit was outweighed by the costs associated with the applicant's attempts to interrupt and delay the bankruptcy proceedings).

[4] The Court recognizes that "the motive of the petitioner should not be a factor in determining whether a substantial contribution has been made in the bankruptcy proceeding." *In re Celotex Corp.,* 227 F.3d 1336, 1339 (11th Cir.2000). The fact that the movant performed services or incurred expenses primarily to benefit its own interest rather than that of the estate or the creditors at large is irrelevant to the question of whether the movant has made a substantial contribution to the case. Nonetheless, when a creditor acts primarily for its own benefit, the evidence may show that the movant's participation resulted in a primary benefit to the creditor and only an incidental benefit to the estate. In such a case, the contribution made is not "substantial" within the meaning of the statute. *In re Kidron, Inc.,* 278 B.R. 626 (Bankr.M.D.Fla.2002).

[5] In this case, APX argues that it made a substantial contribution to the Debtors' bankruptcy estates by helping New Power to resolve its issues with ERCOT without having to resort to costly and time-consuming litigation. APX contends ***502** that it voluntarily educated the Debtors and the Committee about ERCOT and its complex settlement procedures and assisted the Debtors through the "protracted ERCOT settlement process." Specifically, APX submits that: 1) it used its marketing clearing account to shield New Power from the effects of an increased ERCOT margin call for three months; 2) it made a special trip to New York City to educate the Committee about the nature of the ERCOT resettlement process; 3) it assisted the Debtors' financial experts in recovering their "root ERCOT data" from the prior year and showed them how the data correlated to existing data; and 4) provided New Power with weekly invoices to allow the Debtors to track on-going, changing exposure, caused by ERCOT's decision to resettle the charges for the year 2002. Absent these services, APX contends, the Debtors would have had to engage in "costly and risky" litigation that could have derailed the progression of the Debtors' bankruptcy cases. Finally, APX asserts that only APX had the requisite expertise and contractual relationship with ERCOT to provide these services to the estates.

The Debtors object to the payment of fees incurred by APX on the basis that APX has failed to satisfy its burden of proving that it made a substantial contribution to these bankruptcy cases. First, the Debtors take issue with the contention that APX educated the Debtors and the Committee with regard to ERCOT and its resettlement procedures. The Debtors would instead characterize the meeting in New York as a settlement conference, at which APX made a presentation to the Committee in support of the merits of its claim. Second, the Debtors dispute APX's contention that it voluntarily provided the Debtors with invoices to track the Debtors' liabilities to ERCOT, as APX was obligated under the MSPA to provide the Debtors with any information transmitted by ERCOT. Further, the Debtors insist that the provision of these invoices did not result in a significant benefit to the estate because it was the Debtors' employees who were responsible for reviewing the information. Third, the Debtors deny that APX's use of its marketing clearing account to shield the Debtors from certain charges actually benefitted the estates. The Debtors contend that these charges would have been disputed charges that the Debtors could not have been paid any earlier.

The relatively swift resolution of the Debtors' dispute with ERCOT would appear to have benefitted the estates. The Court is not in a position to estimate with any certainty the amount saved by the Debtors in terms of time or money. Although it seems clear that APX participated in the process of the resettlement of the Debtors' liabilities to ERCOT by providing certain data and invoices, the Debtors and the Committee also played substantial roles in this process. The Court has insufficient evidence in the record to find that APX's involvement was crucial to the end result. Additionally, on the record before it, the Court cannot conclude that the Debtors would have incurred almost $100,000 in dealing with ERCOT had it not been for the assistance provided by APX.

Having reviewed the time entries submitted by APX along with its Application, the Court agrees with the Debtors that APX's purpose in attending the April 22nd meeting was to reach a resolution of its claim. Imparting information regarding ERCOT to the Committee would appear to have been a by-product of this meeting, and the Court cannot rely upon this to justify the payment of $100,000 of fees by the estate. Similarly, the totality of the circumstances would suggest that APX's focus throughout the case was to protect ***503** itself from any exposure to ERCOT. The bulk of the time entries indicate that APX spent most of its attorney time investigating ways to negotiate and settle its claims and strategies by which it could gain leverage with the Debtors and the Committee. The Court recognizes that APX's motivation should not be a bar to a finding that its actions resulted in a substantial contribution to the Debtors' cases. However, APX's motivation does tend to support the conclusion that any assistance that APX may have rendered to the Debtors in dealing with ERCOT was merely incidental. APX seems to be suggesting that it should be entitled to have its attorney's fees paid because it agreed to continue acting as the Debtors' QSE during the post-petition period. However, vendors and other service providers often agree to do business with debtors during the post-petition period without such a benefit. In short, there is simply insufficient evidence in the record to support APX's contention that its efforts, including the presentation made by APX to the Debtors and the Committee, provided a benefit to the estate that was not already being provided by the Debtors' own employees or consultants.

[6][7] Even if the Court were to find that the provision of data and invoices to the Debtors conferred a substantial benefit upon the estates, none of the time entries contain any references that suggest that any of the attorney time for which APX seeks reimbursement was spent in this regard. Accordingly, the Court could not conclude that the fees incurred by APX were actually and necessarily incurred in making this contribution, within the meaning of § 503(b)(3)(D). "This provision requires the bankruptcy judge to .... distinguish between expenses incurred in making a substantial contribution to the case and expenses lacking that causal connection, the latter being noncompensable." *In re DP Part-*

nership, 106 F.3d 667, 673 (5th Cir.1997).

B. *Payment of Attorneys' Fees as an Administrative Expense Pursuant to Section 503(b)(1)(A)*

[8] APX next argues that its post-petition fees should be paid as an administrative expense claim, pursuant to § 503(b)(1)(A). APX contends that the Debtors encouraged APX to continue to provide services under the MSPA during the post-petition period and should, therefore, be liable for payment of any attorneys' fees APX incurred as a result of its post-petition performance of its obligations under the MSPA. APX relies upon *In re New York Trap Rock Corp.,* 137 B.R. 568 (Bankr.S.D.N.Y.1992) for the proposition that attorneys' fees may be awarded to creditors in cases in which the "creditor's right to attorney's fees and costs incurred during the pendency of the case is based upon a pre-petition agreement" and "the attorney's fees are incurred as a result of some post-petition action by the debtor under the agreement that induced the creditor to provide goods or services to the debtor post-petition." The Debtors contend that *New York Trap Rock* is distinguishable from this case because, in *New York Trap Rock,* the debtor had assumed the pre-petition agreement at issue, and, in this case, the Debtors have rejected the MSPA. The Court agrees with the Debtors, as it does not interpret *New York Trap Rock* as broadly as APX.

In *New York Trap Rock,* the debtor operated a cement plant. *New York Trap Rock,* 137 B.R. at 571. The debtor had entered a pre-petition agreement with a contractor to modernize the debtor's plant. The agreement provided that the contractor would subcontract out certain aspects of the project, but would not pay any of the subcontractors without the debtor's ***504** prior written approval. The agreement also obligated the debtor to indemnify the contractor for "any loss, damages, fines or penalties, or any cancellation fees" suffered by the contractor due to nonpayment of the subcontractors. *Id.* On behalf of the debtor, the contractor entered a subcontract for structural and mechanical work at the plant. Post-petition, the debtor moved to assume the subcontract and to cure the defaults thereunder. Although the debtor was not originally a party to the subcontract, the bankruptcy court authorized the debtor to cure the arrearage and assume the subcontract. The cure was to be made in installment payments, as opposed to a lump sum payment. However, the debtor failed to make the cure payments, and the subcontractor filed suit against the contractor to collect the arrearage under the subcontract. *Id.* In response, the contractor requested that the debtor seek authority to assume the pre-petition construction contract and reimburse the contractor for legal fees and expenses incurred in defending against the subcontractor's suit. *Id.* at 572. The debtor did not move for authority to assume the pre-petition contract. *Id.*

The contractor moved for allowance of an administrative expense claim for reimbursement of its attorneys' fees. The court explained that the issue in the case was whether the debtor's pre-petition obligation to indemnify the contractor for its expenses "triggered a post-petition administrative expense claim in favor of [the contractor] because of the debtor's post-petition conduct." *Id.* The court stated that "[t]o qualify as an administrative expense, the claim must satisfy section 503(b)(1)(A), which accords administrative expense status for 'the actual, necessary costs and expenses of preserving the estate ... for services rendered after the commencement of the case.' " *Id.* (citing 11 U.S.C. §§ 503(b)(1)(A)). The court also noted that expenses will generally be entitled to priority treatment if "the right to payment arose from a post-petition transaction with the debtor estate rather than from a prepetition transaction with the debtor, and the conduct giving rise to the payment was beneficial to the estate of the debtor." *Id.* The court then applied a two-prong test to determine whether the expenses were entitled to payment in accordance with § 503(b)(1)(A): "(1) the claim must arise out of a post-petition transaction between the creditor and the trustee or debtor in possession and (2) the claim is allowable only to the extent the consideration supporting the claimant's right to payment was both supplied to and beneficial to the post-petition estate in the operation of the business." *Id.*

In applying the test, the court reasoned that the pre-petition contract between the debtor and contractor obligated the debtor to indemnify the contractor for losses, but the "fact that post-petition defaults by the debtor on the assumed [subcontract] may have triggered the debtor's prepetition obligation to indemnify [the contractor] for losses or damages does not mean that [the contractor's] contingent claim for indemnification was elevated and transformed into a post-petition administrative claim." *Id.* Although the court recognized that a pre-petition indemnification agreement could give rise to a contingent claim, the court concluded that the claim could not be considered to have arisen from a post-petition transaction with the debtor. *Id.* at 573 (citing *In re Hemingway Transport, Inc.*, 954 F.2d 1 (1st Cir.1992) for the proposition that a "prepetition lease containing an indemnification agreement with respect to attorney's fees does not give rise to a post-petition administrative expense claim merely because the lessor incurred post-petition legal expenses as a result of the debtor's post-petition use of the premises"). Further, the court stated that to ***505** establish entitlement to administrative expense status, the contractor must establish that "the post-petition debtor in possession induced the claimant to incur the post-petition expenses or perform the post-petition services for which an administrative expense priority is claimed." *Id.* Because the debtor had not assumed the pre-petition contract, which contained the indemnity provision, the court concluded that the pre-petition contract, "without additional post-petition conduct by the debtor," could not form the basis for granting administrative expense priority to the contractor's claim for legal fees and expenses. *Id.*

Had the court ended its analysis at this point, the contractor would have failed the first prong of the test in that the contractor would not have established that its entitlement to payment of its legal fees arose from a post-petition transaction with the debtor. However, the court went on to explain that the fact that the debtor had assumed the subcontract and "chose to assume responsibility for continuing the construction work as a benefit to the estate and its creditors," distinguished that case from those cases in which the pre-petition agreement to indemnify was not assumed. Because the debtor assumed the subcontract, the debtor was now responsible for payment of all of the contractor's obligations under the subcontract. *Id.* Additionally, the court concluded that, under Texas agency law, the debtor was obligated to indemnify the contractor for any amounts that it actually paid towards a liability that arose from a transaction performed on the debtor's behalf. *Id.* at 574. "When the debtor assumed the [subcontract] for the benefit of the estate, such post-petition assumption also incorporated the implied obligation of a principal to indemnify its agent for obligations incurred by the agent in furtherance of the assumed contract." *Id.* Therefore, the obligation to indemnify was also entitled to administrative expense priority under § 503(b)(1)(A). *Id.* The court further explained that:

> [I]t was the post-petition debtor in possession that induced [the subcontractor] to perform the services under the [subcontract] which also gave rise to [the contractor's] expenses for which indemnification as an administrative expense are sought. The post-petition inducement of [the subcontractor's] services and [the contractor's] expenses were fueled by the debtor's assumption of the [subcontract], which is crucial to [the contractor's] claim for administrative priority. To determine the existence of the implied indemnity obligation under the assumed contract which gave rise to the inducement, reference must be had to the applicable state law, which in this case is Texas law. A principal's implied obligation under Texas law to indemnify its agent for expenses incurred in furtherance of the agency relationship was incorporated into the [subcontract] which the debtor assumed, thereby entitling [the contractor]

> to seek indemnification from the debtor as an administrative expense priority. The debtor could have protected itself from elevating [the contractor's] expenses to administrative priority status by simply not assuming the [subcontract] that [the contractor] entered into with [the subcontractor]. If the debtor wished to keep [the contractor] out of the post-petition picture with respect to the original [subcontract], it need only have entered into a new contract directly with [the subcontractor]. In such event, the new post-petition contract with the [subcontractor] would not have incorporated the prepetition claim and post-petition expenses associated with the [subcontract].

Id.

The reasoning and holding of *New York Trap Rock* do not support APX's claim. ***506** The result of *New York Trap Rock* was dependent upon the fact that the debtor assumed the pre-petition subcontract. This assumption allowed the court to find the existence of a post-petition transaction that benefitted the bankruptcy estate. Had the court not found that the assumed subcontract contained an implied obligation to indemnify the contractor, the court could not have found that the contractor's right to the payment of fees arose from a post-petition transaction. This was important to the resolution of the claim because the only other basis for the debtor's obligation to pay those fees was contained within the pre-petition contract, which the debtor had not assumed.

In this case, the Debtors did not assume the MSPA, and it was deemed rejected. The MSPA is the only basis under which the Debtors are even arguably obligated to pay APX's attorneys' fees. Assuming that the Debtors had an obligation under the MSPA to reimburse APX for attorneys' fees, that obligation would have been a pre-petition obligation, and, as noted by the court in *New York Trap Rock,* the fact that the fees were incurred during the post-petition period does not elevate that obligation to the status of an administrative expense. APX can point to no post-petition transaction between the Debtors and APX that would entitle APX to payment of its attorneys' fees. Accordingly, APX cannot meet the test applied by the court in *New York Trap Rock* and is not entitled to payment of its attorneys' fees as administrative expense.

C. *Collection of Post-Petition Fees and Expenses as Part of the Unsecured Claim*

Finally, APX argues that it is entitled to collect its reasonable attorneys' fees and expenses as part of its unsecured claim because it would have been entitled to recover these fees under the MSPA had the Debtors' bankruptcy case not intervened. In response, the Debtors argue that, unlike an oversecured creditor, an unsecured creditor is not entitled to the payment of post-petition attorneys' fees. Alternatively, the Debtors argue that, even if the Court were to determine that an unsecured creditor can collect post-petition fees and expenses as part of its unsecured claim, APX has no contractual or statutory right to do so.

1. *Whether Unsecured Creditors Are Barred from Collecting Attorneys' Fees*

[9] A split of authority exists as to whether an unsecured creditor is entitled to payment of post-petition attorneys' fees as part of its unsecured claim. A majority of courts have held that, unlike a secured creditor, an unsecured creditor is not entitled to collect post-petition attorneys' fees or collection costs, notwithstanding the existence of a contractual or statutory right to do so. *See In re Hedged-Investments Associates, Inc.,* 293 B.R. 523 (D.Colo.2003); *In re Loewen Group Intern., Inc.,* 274 B.R. 427 (Bankr.D.Del.2002); *In re Sakowitz, Inc.,* 110 B.R. 268 (Bankr.S.D.Tex.1989). As noted by the court in *In re Pride Companies, L.P.,* 285 B.R. 366 (Bankr.N.D.Tex.2002), the majority generally relies upon four arguments to support this proposition.

The first is the legal maxim of "*expressio unius est exclusio alterius,* meaning the expression of one is the exclusion of another." *In re Pride Companies, LP,* 285 B.R. 366 (Bankr.N.D.Tex.2002). Section 506(b) provides that oversecured creditors may collect attorneys' fees and costs as part of the secured claim. 11 U.S.C. § 506(b). The majority of courts have concluded that, if Congress intended for unsecured creditors to receive post-petition***507** attorneys' fees, it would have said so as explicitly as it authorized oversecured creditors to collect such fees in § 506(b). Second, as the Debtors suggest, some courts have concluded that the United States Supreme Court's decision in *United Savings Association of Texas v. Timbers of Inwood Forest Assocs. Ltd.,* 484 U.S. 365, 108 S.Ct. 626, 98 L.Ed.2d 740 (1988), supports a finding that unsecured creditors are not entitled to collect attorneys' fees from the bankruptcy estate. *See In re Loewen Group Intern., Inc.,* 274 B.R. 427 (Bankr.D.Del.2002). The court in *In re Loewen Group* noted that, "in *Timbers,* the Supreme Court concluded that because § 506(b) 'permits post-petition interest to be paid only out of the security cushion, the undersecured creditor, who has no such cushion, falls within the general rule disallowing post-petition interest.' " The *Loewen Group* court reasoned that this "rationale applies equally to claims for post-petition fees and costs." *Id.* Third, the majority decisions often point to § 502(b), which provides that the bankruptcy court "shall determine the amount of [a] claim as of the date of the filing of the petition," as support for the proposition that attorneys' fees incurred after the filing of the bankruptcy case may not be added to the creditor's unsecured claim. 11 U.S.C. § 502(b). Finally, the majority decisions rely upon the policy argument that payment of post-petition attorneys' fees to only those unsecured creditors with a contractual or statutory right to fees would be contrary to the bankruptcy system's "primary purpose" of bringing about "an equitable distribution of the bankrupt's estate among creditors holding just demands." *In re Pride Companies,* 285 B.R. at 373 (citing *In re Sakowitz, Inc.,* 110 B.R. 268, 271 (Bankr.S.D.Tex.1989)).

A significant minority of courts have held that nothing in the Code prevents an unsecured creditor from asserting an unsecured claim for post-petition attorneys' fees to which the creditor has a contractual or statutory right. *See In re United Merchants & Mfrs., Inc.,* 674 F.2d 134 (2d Cir.1982); *In re Byrd,* 192 B.R. 917, 919 (Bankr.E.D.Tenn.1996); *Matter of 268 Ltd.,* 789 F.2d 674 (9th Cir.1986). Having considered the various arguments on this issue, the Court finds the reasoning of the minority more persuasive.

[10] Sections 501 and 502 govern the allowance of claims filed against the bankruptcy estate. Section § 101(5)(A) broadly defines "claim" as a "right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured." 11 U.S.C. § 101(5)(A). Pursuant to § 502, when a proof of claim is filed, the claim will be deemed allowed unless a party in interest objects. *See* 11 U.S.C. § 502(a). In the face of an objection, the bankruptcy court must allow the claim unless one of nine specific exceptions applies. *Id.* § 502(b). The exception most often applicable provides that a claim shall be disallowed to the extent that "such claim is unenforceable against the debtor and property of the debtor, under any agreement or applicable law for a reason other than because such claim is contingent or unmatured." *Id.* § 502(b)(1). Accordingly, the fact that a claim is contingent or unmatured is not grounds to disallow a claim unless that claim is for unmatured interest. *See* 11 U.S.C. § 502(b)(2); *see also In re Hemingway Transport, Inc.,* 954 F.2d 1, 8 (1st Cir.1992) ("The difficulty or impossibility of estimation no longer constitutes a legitimate basis for disallowing any prepetition right to payment as a 'claim' against the estate."). The Court finds nothing within § 502 that would require the disallowance of an unmatured claim for attorneys' fees.

***508** Although § 502 directs the bankruptcy court to "determine the amount of such claim as of the date of the filing of the petition" and to allow the claim in such amount, § 502(c) provides that the court shall estimate for purposes of allowance of claims "any contingent or unliquidated claim, the fixing or liquidation of which, as the case may be, would unduly delay the administration of the case." 11 U.S.C. § 502(c)(1). When a creditor's right to payment for fees exists pre-petition, the right to payment constitutes a "claim," within the meaning of § 101(5)(A), albeit an unliquidated, unmatured claim that may be estimated for purposes of allowance, if necessary, pursuant to § 502(c). So long as the right to collect the fees existed pre-petition, the fact that the fees were actually incurred during the post-petition period is not relevant to the determination of whether the creditor has an allowable pre-petition claim for the fees. *See In re Hemingway Transport, Inc.,* 954 F.2d 1 (1st Cir.1992) ("As most courts now recognize, the term 'claim' is broad enough to encompass an unliquidated, contingent right to payment under a prepetition indemnification agreement executed by the debtor, even though the triggering contingency does not occur until *after* the filing of the petition under the Bankruptcy Code."). Therefore, the Court does not agree with the reasoning of the majority decisions that § 502(b)'s requirement that the amount of the claim be determined as of the filing of the petition bars a claim for post-petition fees.

[11] As to the majority's reasoning that § 506(b) prohibits the collection of post-petition attorneys' fees by undersecured creditors, this Court has previously considered this argument without actually deciding the issue. In *In re Homestead Partners, Ltd.,* 200 B.R. 274 (Bankr.N.D.Ga.1996) (Drake, J.), a secured creditor exercised its rights, pursuant to O.C.G.A. § 13-1-11, to collect a flat percentage of attorneys' fees upon the debtor's default. The debtor objected to the addition of the statutory attorneys' fees to the creditor's proof of claim because the creditor was not fully secured. The Court recognized that "post-petition fees and interest may be recovered as part of a secured claim if, and only if, that claim is oversecured." *Id.* at 276-77 (citing *United States v. Ron Pair Enterprises, Inc.,* 489 U.S. 235, 109 S.Ct. 1026, 103 L.Ed.2d 290 (1989)). However, the Court also noted that "section 506(b) provides little guidance on ... whether creditors not capable of recovering post-petition fees or interest as a section 506(b) secured claim still may have them paid as a general unsecured claim." *Id.* at 277 (citing *In re United Merchants & Mfrs., Inc.,* 674 F.2d 134, 138 (2d Cir.1982)). For guidance as to the allowance of an unsecured claim, the Court turned to § 502. The Court noted that § 502(b)(2) provides that the bankruptcy court must disallow claims for unmatured interest. *Homestead Partners,* 200 B.R. at 277. However, the Court found none of the § 502(b) exceptions to be applicable to attorneys' fees and stated that "[o]ne, therefore, reasonably could conclude that statutory percentage-based claims for post-petition fees, such as those arising under O.C.G.A. § 13-11-1, may be presented via an unsecured claim, notwithstanding section 506(b)." *Id.* The Court noted that the use of the word "shall" within § 502 "would appear to demand that no such exception be inferred and that the pursuit of post-petition fees be permitted on an unsecured basis." *Id.* The Court assumed, *arguendo,* that the attorneys' fees could be allowed as part of the undersecured creditor's unsecured claim, but did not need to specifically determine the issue because the Court concluded that the steps taken to prefect the creditor's right ***509** to collect the fees constituted an avoidable preferential transfer. *Id.*

The Court's earlier analysis in *Homestead Partners* is consistent with the Eleventh Circuit Court of Appeals' recent decision in *In re Welzel,* 275 F.3d 1308 (11th Cir.2001). In *Welzel,* an oversecured creditor sought payment of attorneys' fees pursuant to § 506(b). The bankruptcy court found a portion of the fees to be unreasonable, and therefore, not payable as a secured claim under § 506(b). The debtor argued that the claim should be disallowed in its entirety, but the creditor sought payment of the fees as an unsecured claim. In analyzing the issue, the court interpreted § 506 as a provision that merely determines which claims should be entitled to receive the preferential treatment accorded secured claims, and construed § 502 as the provision that determines whether a claim should be allowed or disallowed. *Id.* at 1317-18. The court concluded that the failure of the claim for attorney's fees to meet the reasonableness test of § 506(b) did not require the court to disallow the claim. It merely prevented the creditor from seeking payment of the fees from its collateral, ahead of the unsecured creditors. Accordingly, the court held that the bankruptcy court should have bifurcated the claim for statutory attorneys' fees into secured and unsecured portions. *Id.*

In its analysis of the issue in *Welzel,* the court employed the same reasoning used by this Court in *Homestead Partners.* The court recognized that the determination of whether the attorneys' fees are an allowable claim must be made with reference to § 502 and that the "entire claim to fees is allowable under § 502 as long as the exceptions in subsection (b) do not apply." *Id.* The court concluded that, because none of the § 502(b) exceptions applied, the creditor's "claim for its contractual attorney's fees passes muster under § 502." This is consistent with this Court's assumption in *Homestead Partners* that § 506(b) does not preclude undersecured creditors from collecting contractually set attorneys' fees as an unsecured claim. Although § 506(b) allows preferential treatment to claims for attorneys' fees asserted by oversecured creditors, it does not necessarily follow that similar claims of unsecured creditors are not entitled to payment with less favorable treatment. *See also Blair v. Bank One, N.A.,* 307 B.R. 906 (N.D.Ill.2004).

In further support of its conclusion that fees not entitled to secured status are still entitled to be paid as unsecured claims, the court explained that reading § 506(b) to disallow claims of secured creditors for attorneys' fees that are found to be unreasonable would "turn a basic principle of bankruptcy law on its head." *Welzel,* 275 F.3d at 1319. The court reasoned that

> "[u]nsecured creditors would be privileged over oversecured creditors ... in the area of contractually set attorney's fees. Not subject to § 506(b), unsecured creditors who desired to collect unreasonable contractual fees would have an allowed claim under § 502, while as oversecured creditors would have such fees disallowed entirely under § 506(b). This outcome would create an absurd result-unsecured creditors would be in a more protected position than a group of secured creditors."

Id. This statement indicates that the *Welzel* court assumed that an unsecured creditor with a contractual claim for attorneys' fees would be entitled to payment of such fees as an unsecured claim. *See Blair v. Bank. One, N.A.,* 307 B.R. 906 (N.D.Ill.2004) ("[E]very federal circuit court of appeals that has done so has held that such fees do not fall into any of the exception categories. *Id.; see, e.g.,* ***510***In re Welzel,* 275 F.3d 1308, 1318 (11th Cir.2001) ...."). Otherwise, if § 506(b) is a bar to the collection of contractually set attorneys' fees by unsecured creditors, the Eleventh Circuit's concern about preferring unsecured creditors over oversecured creditors would be misplaced.

[12] Finally, unlike the majority of courts, this Court is not persuaded that the Supreme Court's decision in *Timbers* requires a finding that undersecured or unsecured creditors cannot assert an unsecured claim for post-petition attorneys' fees. In *Timbers,* the Court stated that, pursuant to § 506(b), secured creditors could be paid post-petition interest only out of the "security cushion." *Timbers,* 484 U.S. at 372-73, 108 S.Ct. 626. Consequently, only oversecured creditors are entitled to a claim for post-petition interest. *Id.* Some courts have concluded that the same rationale applies to a claim for attorneys' fees because attorneys' fees are also included within § 506(b). However, in concluding that undersecured creditors are not entitled to post-petition interest, the Court reasoned that an "undersecured creditor, who has no such [security] cushion, falls within the general rule disallowing postpetition interest." *Id.* As noted above, there is no exception within § 502(b) which would prevent the collection of attorneys' fees by a creditor who

has a valid nonbankruptcy right to do so. The Court did not consider the issue of whether this same undersecured creditor, with a contractual right to attorneys' fees, could have filed an unsecured claim for those fees. It is this Court's position that the Supreme Court would analyze that issue just as the Eleventh Circuit Court of Appeals has in *Welzel* and would conclude that § 506(b) does not dispose of the question. Neither § 506(b) nor the *Timbers* decision bar unsecured creditors' from asserting a contractual or statutory claim for attorneys' fees as an unsecured claim.[FN2]

FN2. Even if the Court concluded that unsecured creditors may not generally seek payment of attorneys' fees as an unsecured claim, the Court would adopt, as APX urges, an exception for solvent debtors. *See In re Continental Airlines, Inc.,* 110 B.R. 276 (Bankr.S.D.Tex.1989) (holding that allowing a solvent debtor to retain estate funds without paying attorneys' fees, to which the unsecured creditor would otherwise have been legally entitled outside of bankruptcy, would be unjust); *see also In re Carter,* 220 B.R. 411 (Bankr.D.N.M.1998).

2. *Whether APX Has a Right to Payment of its Attorneys' Fees and Costs*

That being said, in order to allow APX to collect attorneys' fees and costs as part of its unsecured claim, the Court must find that APX has either a contractual or statutory right to collect such fees. APX contends that it is entitled to fees either pursuant to the terms of the MSPA or applicable state law.

[13] As to the MSPA, APX turns to the indemnification provision of the MSPA, which provides as follows:

> To the fullest extent permitted by law, [the Debtor] shall indemnify and hold harmless APX, its Affiliates, agents, officers and employees from any and all claims and expenses incurred by them to the extent caused wholly or in part by any act or omission by [New Power], its Affiliates, agents, officers or employees, except to the extent such claim is caused by the negligence or willful misconduct of APX. [New Power's] obligation to indemnify under this Section shall survive termination of the [MSPA], and shall not be limited in any way by amount or type of damages.

MSPA, Section 13.1. APX argues that the terms of the indemnification provision are ***511** broad enough to include reimbursement of all costs incurred by APX in enforcing its rights under the MSPA, including attorneys' fees and expenses.

The Debtors do not agree that the MSPA's indemnification provision permits reimbursement of attorneys' fees, and take issue with the fact that the MSPA does not expressly state that attorneys' fees are recoverable. By way of comparison, the Debtors note that the later indemnification agreement, which the parties executed prior to APX's efforts to resolve the dispute with ERCOT, specifically states that the Debtors will indemnify APX for all losses, damages, costs, and expenses "(including reasonable attorneys' fees and expenses)." Indemnity Agreement, ¶ 4. The Debtors submit that APX clearly knew how to bargain for an indemnification provision that specifically provides for reimbursement of attorneys' fees, but did not do so in the MSPA. Further, the Debtors contend that, under California law, which is applicable to the MSPA,[FN3] attorneys' fees should not be reimbursed unless the parties explicitly provide for them.

FN3. Section 8.3 of the MSPA provides that the "MSPA shall be governed by, and interpreted in accordance with, the laws of the State of *California,* excluding any choice of law rule that directs the application of the laws of another jurisdiction, irrespective of the places of execution or of the order in which signatures of the parties are affixed or of the place of performance." MSPA, § 8.3 (emphasis in original). The parties appear to agree that California law is applicable to the Court's interpretation of the MSPA.

The Debtors rely upon *Continental Heller Corp. v. Amtech Mech. Servs., Inc.*, 53 Cal.App.4th 500, 61 Cal.Rptr.2d 668 (1997), for the proposition that attorneys' fees must be expressly provided for within the agreement. In *Continental Heller Corp.*, the court stated that:

> Indemnity agreements are construed under the same rules which govern the interpretation of other contracts. Accordingly, the contract must be interpreted so as to give effect to the mutual intention of the parties. (Civ.Code, § 1636.) The intention of the parties is to be ascertained from the "clear and explicit" language of the contract. (Civ.Code, §§ 1638-1639.) And, unless given some special meaning by the parties, the words of a contract are to be understood in their "ordinary and popular sense." (Civ.Code, § 1644.) "In interpreting an express indemnity agreement, the courts look first to the words of the contract to determine the intended scope of the indemnity agreement." (*Smoketree-Lake Murray, Ltd. v. Mills Concrete Construction Co.* (1991) 234 Cal.App.3d 1724, 1737[, 286 Cal.Rptr. 435]).

Continental Heller Corp., 61 Cal.Rptr.2d at 670.

In *Continental Heller Corp.*, a general contractor and subcontractor entered an agreement under which the subcontractor was to perform certain work. The agreement contained an indemnification provision. As a result of the subcontractor's actions, the general contractor settled certain claims for damages asserted against it. The general contractor later brought a claim against the subcontractor for payment of the settlement amount, plus the costs and fees incurred in both defending against the claims and bringing the indemnification action. The issue before the court was whether the general contractor was entitled to recover the attorneys' fees incurred in the indemnification action, or whether the indemnification provision allowed only recovery of the attorneys' fees incurred to defend against the original claims that arose from the subcontractor's actions. *Id.*, 61 Cal.Rptr.2d at 672. After noting that the language of the indemnification agreement controlled, the court ***512** found that the indemnification agreement contained two specific provisions dealing with the recovery of losses, including attorneys' fees. The first provision required indemnification "from all loss, damage, etc., 'including attorney's fees' which 'arises out of or is in any way connected with the performance of work under' " the contract. *Id.* at 673. The court agreed with the subcontractor that, if this had been the only provision within the agreement regarding the recovery of fees, the general contractor would not have been "entitled to attorney fees incurred in prosecuting this action for breach of the indemnity agreement." However, the second provision required indemnification from "any and all loss, damage, costs, expenses and attorney's fees suffered or incurred *on account of any breach of the aforesaid obligations and covenants, and any other provision or covenant.*' " *Id.* (emphasis in original). The court concluded that the language of the second provision clearly referred to attorneys' fees incurred in any action for a "breach of any provision of the contract including, but not limited to, breach of the indemnity provisions." *Id.*

Like the court in *Continental Heller*, a significant number of courts have distinguished general indemnification provisions from more specific provisions that clearly address the reimbursement of fees incurred during litigation between the parties. These courts have determined that the broad language of standard indemnification provisions, although arguably broad enough to encompass attorneys' fees as losses or damages, do not contain specific language to support a finding that the parties intended to include payment of attorneys' fees arising from litigation between the contracting parties. *See Building Maintenance Service Co. v. AIL Systems, Inc.*, 55 Cal.App.4th 1014, 64 Cal.Rptr.2d 353 (1997) (rejecting the argument that an indemnification was "broad enough to constitute an attorney's fee provision ... because it provides for the recovery of costs, including attorney's fees, for 'any claim arising for any reason or cause whatsoever' and which is 'related in any way to this Order' " and finding that the provision contained no language that indicated that the "contracting parties intended to address claims made against each other"); *Otis Elevator Co. v. Toda Construction,* 27 Cal.App.4th 559, 32 Cal.Rptr.2d 404, 406-07 (1994) ("Further, '[a] provision including attorney fees as an item of loss in an indemnity clause is not a provision for attorney fees in an action to enforce the contract.' "); *.92 Madison Ave., LLC v. Mulberry Thai Silks, Inc.,* 2003 WL 22203742 (S.D.N.Y. Sept.22, 2003) ("California case law has consistently rejected arguments that would read indemnity provisions as contractual agreements to permit fee shifting in litigation between the contracting parties"; "When California courts have decided to read indemnification clauses as ... applying to fees arising from litigation between the contracting parties themselves, they require additional language making that intention explicit."); *Zurich Ins. Co. v. Killer Music, Inc.,* 998 F.2d 674 (9th Cir.1993) (under California law, insurer was liable to pay attorneys' fees incurred as a result of its failure to defend insured, but was not liable to reimburse insured for attorneys' fees incurred in action to enforce the indemnity provision).

Having reviewed the indemnification language within the MSPA, the Court concludes that the provision is a standard indemnification provision that does not include language evidencing any intent between the parties to shift the payment of fees incurred by APX during litigation with the Debtors to establish APX's claim. APX has pointed to no other provision ***513** within the MSPA that would require the Debtors to reimburse APX for attorneys' fees incurred during an action against the Debtors for a breach of the MSPA. Accordingly, under California law, the MSPA does not require the Debtors to reimburse APX for those fees.

[14] The Court also agrees with the Debtors that APX's claim for fees is not supported by statute. APX argues that Texas law applies to the issue of whether APX is statutorily entitled to attorneys' fees as the prevailing party in a contract dispute. Specifically, APX contends that Section 38.001 of the Texas Civil Practice and Remedies Code (hereinafter "Section 38.001") entitles APX to payment of its attorneys' fees. Pursuant to Section 38.001, a "person may recover reasonable attorney's fees from an individual or corporation, in addition to the amount of a valid claim and costs, if the claim is for ... an oral or written contract." TEX. CIV. PRAC. & REM. CODE ANN. § 38.001. If Texas law is applicable, and the Court determines that APX asserted a valid claim and met the procedural requirements imposed by Section 38.001, APX would be entitled to an award of reasonable attorneys' fees.

The Debtors argue that California law, rather than Texas law, controls this issue. Unlike Texas law, California law has no statutory provision similar to Section 38.001. Section 1021 of the California Code of Civil Procedure provides that "[e]xcept as attorney's fees are specifically provided for by statute, the measure and mode of compensation of attorneys and counselors at law is left to the agreement, express or implied, of the parties." CALIF. CODE OF CIV. P. § 1021. Section 1032 also provides for a recovery of "costs" by a prevailing party. *Id.* § 1032. However, the term "costs" includes attorneys' fees only where attorneys' fees are authorized by either contract, statute, or other law. *See Id.* § 1033.5. "[R]ecoverable litigation costs do include attorney fees, but only when the party entitled to costs has a legal basis, independent of the cost statutes and grounded in an agreement, statute, or other law, upon which to claim recovery of attorney fees." *Santisas v. Goodin,* 17 Cal.4th 599, 71 Cal.Rptr.2d 830, 951 P.2d 399 (1998). In this case, APX has not presented any other statutory authority that would support a claim for attorneys' fees under which the Court could consider the fees to be "costs" within the meaning of Section 1032. Further, as discussed above, the MSPA does not provide APX with a contractual right to collect fees. Finally, the Court has been presented with no argument to support a finding that APX is otherwise entitled to fees under any other law. Therefore, if California law is applicable, the Court must find that APX is not entitled to recover its attorneys' fees.

[15][16] Because the application of California law, as opposed to Texas law, could lead to a different result, the Court must resolve the conflict of law issue. The first step in the conflicts of law analysis is to determine whether the issue is procedural or substantive for purposes of *Erie Railroad Co. v. Tompkins,* 304 U.S. 64, 58 S.Ct. 817, 82 L.Ed. 1188 (1938). "If the Court determines that the matter is substantive, it will examine the substantive law of the forum state, which includes its choice of law rules, to ascertain the applicable substantive law." *Pinkerton & Laws, Inc. v. Royal Ins. Co. of America,* 227 F.Supp.2d 1348, 1357 (N.D.Ga.2002) (citing *Klaxon Co. v. Stentor Elec. Mfg. Co.,* 313 U.S. 487, 496, 61 S.Ct. 1020, 85 L.Ed. 1477;) *see also McMahan v. Toto,* 256 F.3d 1120 (11th Cir.2001); *In re Bagley,* 6 B.R. 387 (Bankr.N.D.Ga.1980) ***514** (Drake, J.).[FN4] "It is clear that statutes allowing for recovery of attorney's fees are substantive for *Erie* purposes." *Pinkerton & Laws, Inc.,* 227 F.Supp.2d at 1357. As to the interpretation of the contract itself, a Georgia court would apply the law of the state designated by the parties. *Kellogg v. Food Service Supplies, Inc.,* 246 Ga.App. 695, 541 S.E.2d 683, 684 n. 5 (2000) ("In the absence of contrary public policy, our courts normally will enforce a contractual choice of law provision, as the parties by contract may stipulate that the laws of another jurisdiction will govern the transaction."). Accordingly, if APX had filed suit against the Debtors in Georgia to recover the amounts due under the MSPA, the Georgia court would have applied the substantive law of California to interpret the contract. The Court is persuaded that, if a Georgia court were to conclude that, under California law, APX was entitled to prevail on its contract claim, a Georgia court would also apply California law to determine whether APX is entitled to a statutory award of attorneys' fees. *See Pinkerton & Laws, Inc.,* 227 F.Supp.2d at 1357 (holding that, because attorneys' fees statutes are substantive for *Erie* purposes, a Georgia court would not apply Georgia's bad-faith litigation attorneys' fee statute "if the laws of some other state should be applied to the issues" in the case). This conclusion is consistent with that adopted by other courts. *See, e.g., El Paso Natural Gas Co. v. Amoco Production Co.,* 1994 WL 728816, *5 (Del.Ch. Dec.16, 1994) (holding that Texas law applied to the issue of whether the prevailing party in a contract dispute was entitled to attorneys' fees because the contract at issue provided for Texas law to apply); *Tensar Environmental Systems, Inc. v. GSE Lining Technology, Inc.,* 1999 WL 649624, *6 (Tex.App. Aug.26, 1999) (holding that, when the contract contains no choice of law provision, and the claimant has not sufficiently explained why another state's law should control, the court will refer to the same state's law used to determine the substantive issues).

FN4. The Court recognizes that, under binding precedent from the United States Supreme Court and the Fifth Circuit Court of Appeals, bankruptcy courts may not always be bound to apply the conflicts principles of the forum state. *See Vanston Bondholders Protective Committee v. Green,* 329 U.S. 156, 67 S.Ct. 237, 91 L.Ed. 162 (1946); *Matter of Crist,* 632 F.2d 1226, 1229 (5th Cir.1980) ("When disposition of a federal question requires reference to state law, federal courts are not bound by the forum state's choice of law rules, but are free to apply the law considered relevant to the pending controversy."). However, in this particular case, the Court finds it appropriate to apply the choice of law principles of the forum state, as the issue involved is one that could have been raised by APX outside of bankruptcy

> had the Debtors' bankruptcy case not intervened. Additionally, following its decision in *Crist,* the Fifth Circuit Court of Appeals stated that the court had "taken care to avoid resolving" the question of whether bankruptcy courts are bound to apply the conflicts rules of the forum state. *Woods-Tucker Leasing Corp. of Ga. v. Hutcheson-Ingram Development Co.,* 642 F.2d 744, 748 (5th Cir.1981). Even in that later case, the court left open the possibility that, even if a bankruptcy court is not bound to apply the conflicts rules of the forum state, it may choose to do so when "the issue presents a question that is 'independent of bankruptcy and precedes it,' ... and that should be resolved in a manner that is not inconsistent with the resolution that would have occurred had the bankruptcy proceeding not intervened." *Id.* at 748 n. 8. The Court believes that these claims would fall within those parameters and that using the choice of law principles of the forum state is appropriate in this case.

The only argument that APX has made as to why Texas law should control this issue is that APX was merely acting as a middle man between the Debtors and ERCOT, and, therefore, the real dispute was between the Debtors and ERCOT. Accordingly, since the contract between ERCOT***515** and APX provides for Texas law to apply, APX contends that the Court should look to Texas law to resolve the question of whether payment of APX's attorneys' fees can be shifted from APX to the Debtors. However, the only dispute brought before this Court was a dispute between APX and the Debtors. APX filed a proof of claim based upon the amounts due and owing APX by the Debtors under the MSPA, not under the terms of the contract between APX and ERCOT. The Court is at a loss to understand why a choice of law provision that was bargained for and agreed to by ERCOT and APX should now be employed to saddle the Debtors with a liability that they never intended to undertake. The Debtors and APX bargained for and agreed that California law would govern the interpretation of the MSPA, and this Court respects that choice of law provision. For the same reasons that the Court would respect the parties' choice of law when interpreting the contract, the Court will apply the same law to resolve the issue of whether APX has a statutory claim for attorneys' fees.

[17] As discussed above, under California law, APX is not entitled to reimbursement for its attorneys' fees. However, it appears that APX may be entitled to recover its costs, pursuant to Section 1032. As noted above, California law allows for the recovery of costs by a prevailing party. A " '[p]revailing party' includes the party with a net monetary recovery, a defendant in whose favor a dismissal is entered, a defendant where neither plaintiff nor defendant obtains any relief, and a defendant as against those plaintiffs who do not recover any relief against that defendant." CALIF. CODE OF CIV. P. § 1032(a)(4). In this case, APX recovered $3.4 million as a result of filing its various proofs of claim against the Debtors. The Debtors have argued that, because APX originally asserted total claims of $6.6 million, APX cannot be considered a prevailing party. APX counters that the original $6.6 million was based upon amounts that APX estimated to be due to ERCOT on the Debtors' behalf, and that the actual amount owed was in fact the $3.4 million, which APX successfully recovered. Although APX did not recover the full amount of the $6.6 million claims originally filed, the Court finds that the recovery of $3.4 million is a sufficient recovery to support a finding that APX is a prevailing party within the meaning of Section 1032. *See Scott Co. of California v. Blount, Inc.,* 20 Cal.4th 1103, 86 Cal.Rptr.2d 614, 979 P.2d 974 (1999) (holding that the trial court did not abuse its discretion by finding that the plaintiff was a prevailing party despite the fact that the plaintiff originally sought $2 million in damages, but recovered only $440,000).

[18] Pursuant to Section 1033.5, "costs" allowable

under Section 1032 include "filing, motion, and jury fees"; "[j]uror food and lodging"; "transcribing necessary depositions" and "travel expenses to attend depositions"; costs for "[s]ervice of process by a public officer, registered process server, or other means"; "[e]xpenses of attachment including keeper's fees"; "[p]remiums on necessary surety bonds"; "[o]rdinary witness fees; [f]ees of expert witnesses ordered by the court"; "[t]ranscripts of court proceedings ordered by the court"; "[c]ourt reporters fees as established by statute"; and "[m]odels and blowups of exhibits and photocopies of exhibits may be allowed if they were reasonably helpful to aid the trier of fact." CALIF. CODE OF CIV. P. § 1033.5(a). Specifically not allowed as costs are investigation expenses of preparing for trial, postage, telephone, and photocopying costs, except as ***516** necessary for preparing exhibits. *Id.* § 1033.5(b).

In its application, APX has sought recovery of expenses incurred in the amount of $4,068.47, which includes amounts expended for facsimiles, computer-assisted legal research, photocopies, postage, telephone calls, word processing, travel expenses, taxis, conference expenses, courier services and express mail, and filing fees of $190. There is no evidence within the record to suggest that any of the travel expenses were incurred in connection with attendance of a deposition. Other than the filing fees, which are an item that is specifically included within the definition of costs provided by Section 1033.5, none of these expenses appear to be allowable. Therefore, the Court will award APX an unsecured claim of $190 as reimbursement for its filing fees.

CONCLUSION

Having carefully considered the matter, the Court finds that the Application of Automated Power Exchange for Payment of Attorneys' Fees and Expenses should be, and hereby is, **DENIED** in part and **GRANTED** in part. Automated Power Exchange shall be entitled to payment of $190.00 as an allowed unsecured claim against the Debtors' bankruptcy estates.

IT IS SO ORDERED.

Bkrtcy.N.D.Ga.,2004.
In re New Power Co.
313 B.R. 496, 43 Bankr.Ct.Dec. 132

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Only the Westlaw citation is currently available.

United States District Court, S.D. New York.
Shimon Y. KATZ, et al., Plaintiffs,
v.
BERISFORD INTERNATIONAL PLC, Defendant.
No. 96 Civ. 8695(JGK).

July 10, 2000.

OPINION AND ORDER

KOELTL, J.

***1** In this diversity action, the plaintiffs, Shimon Y. Katz ("Katz"), Bomar Resources Holdings, Inc. ("BRHI"), and Bomar Resources Inc. ("Bomar Resources"), alleged that the defendant, Berisford International PLC ("Berisford"), breached the terms of a contract that provided for indemnity. The underlying facts and the contentions of the parties are set forth in the Court's prior decision, *Katz v. Berisford,* No. 96 Civ. 8695, 1998 WL 684481 (S .D.N.Y. Sept. 30, 1998), familiarity with which is assumed.

The action was tried to a jury. At the end of the plaintiffs' case, the defendant moved for judgment as a matter of law pursuant to Rule 50(a)(1) of the Federal Rules of Civil Procedure. The Court reserved decision pending completion of the evidence. The Court continued to reserve after the evidence was complete, and the case was sent to the jury. The jury rejected the claims of Mr. Katz and Bomar Resources, but returned a verdict in favor of BRHI, finding the defendant liable to BRHI in the amount of $1,800,024.80 plus 50% of certain future costs, expenses and damages. With respect to the verdict in favor of BRHI, the defendant timely renewed its motion for judgment as a matter of law pursuant to Rule 50(b) of the Federal Rules of Civil Procedure. The defendant has explicitly not moved for a new trial pursuant to Rule 59 of the Federal Rules of Civil Procedure.

I.

The standards for granting a Rule 50 motion are well established. In ruling on a motion for judgment as a matter of law, the district court must deny the motion "unless, viewed in the light most favorable to the nonmoving party, 'the evidence is such that, without weighing the credibility of the witnesses or otherwise considering the weight of the evidence, there can be but one conclusion as to the verdict that reasonable [persons] could have reached." ' *Cruz v. Local Union Number 3 of the International Brotherhood of Electrical Workers,* 34 F.3d 1148, 1154-55 (2d Cir.1994) (quoting *Simblest v. Maynard,* 427 F.2d 1, 4 (2d Cir.1970)). "In other words, there must be either an utter lack of evidence supporting the verdict, so that the jury's findings could only have resulted from pure guesswork, or the evidence must be 'so overwhelming that reasonable and fair-minded persons could only have reached the opposite result." ' *Doctor's Associates, Inc. v. Weible,* 92 F.3d 108, 112 (2d Cir.1996) (quoting *Baskin v. Hawley,* 807 F.2d 1120, 1129 (2d Cir.1986)).

II.

A.

The defendant moves for judgment as a matter of law on several grounds. First, the defendant asserts that it was impossible for the jury rationally to conclude that the indemnity rights under which BRHI recovered, contained in Clause 10 of the so-called U.S. Agreement, had been validly assigned to BRHI. The defendant argues that the indemnity rights contained in Clause 10 were not validly assigned because they were not assignable. The defendant relies on the fact that Clause 10, unlike certain other provisions of the U.S. Agreement, did not expressly permit assignment, and on the testimony of Patrick O'Connor that the parties did not intend for the rights under Clause 10 to be assignable. *See* Def. Mem., at 5-7; *Katz v. Berisford Int'l PLC,* No. 96 Civ. 8695, Trial Transcript ("Tr."), at 531.

***2** Under English law, which the parties agree governs the U.S. Agreement, the issue of whether the right to indemnification was assignable is resolved by determining whether the parties to the agreement intended that the right to indemnification be assignable. The parties' intent is an objective fact that is generally to be found by looking at the words of the written contract taken as a whole. *See* 1 *Chitty on Contracts* §§ 12-039, 12-040, 12-053, 12-060 (27th ed.1994) (hereinafter *"Chitty"*). The jury was instructed on the law to be applied to determine whether the indemnity was assignable and whether it had actually been assigned. The defendant does not contend that the instructions were in any way improper, and there was ample evidence to support the jury's verdict.

Here, the U.S. Agreement was received into evidence, *see* PX 3, and the jury had the opportunity to review its contents. There is nothing in the agreement that expressly prevented the assignment of the indemnity rights contained in Clause 10. Moreover, Clause 4 explicitly permitted the assignment of the representations and warranties listed in the Fourth Schedule to the U.S. Agreement, including the representation and warranty that "[t]here are no actions, suits, claims or legal, administrative or arbitration proceedings or investigations ... pending or threatened against or involving the Company which, in the aggregate, could have a material adverse effect upon the condition, business prospects or financial affairs of the Company and the Subsidiaries (considered as a whole)." PX 3, at 62. It would be reasonable for this representation and warranty to be guaranteed by an indemnification provision in the event it proved false. On this basis alone, inasmuch as the indemnity rights contained in Clause 10 specifically concerned "litigation and/or arbitration proceedings brought against the Company," the jury could rationally have concluded, in light of the expressly assignable representation and warranty contained in Clause 4, that the parties intended the indemnity rights under Clause 10 to be assignable.

The rationality of such a conclusion is also supported by evidence extrinsic to the U.S. Agreement. Evidence introduced at trial supported a conclusion that Berisford continued to pay under the indemnity contained in Clause 10 even after it learned that BRHI had acquired Bomar Resources from its original purchaser, Bomar Holdings, Inc. ("Bomar Holdings"). *See, e.g.,* PX 27; PX 38; Tr. 59-60, 62-63, 91-92, 112-15, 235, 477-85. Moreover, evidence was introduced at trial from which it could reasonably be inferred that Patrice Klein ("Klein"), a signatory to the U.S. Agreement, believed the indemnity rights to be assignable. *See* PX 26, at 1-2; PX 30, ¶ 1(a); PX 31, ¶ 2(e). Finally, the jury was entitled to disbelieve the arguably self-interested testimony of Mr. O'Connor, a Berisford executive. Therefore, the jury's conclusion that the parties intended the rights contained in Clause 10 to be assignable is neither unreasonable nor devoid of evidentiary support.

B.

***3** Berisford next contends that as a matter of law BRHI may not enforce the indemnity rights under Clause 10, even if those rights were assignable, because Bomar Holdings, BRHI's predecessor-in-interest, materially breached the U.S. Agreement, thereby terminating Berisford's obligations under the agreement. In particular, Berisford asserts that Bomar Holdings contravened Clause 20 of the U.S. Agreement by paying a $3 million dividend and by winding up its affairs without, as required by the Eleventh Schedule, first obtaining Berisford's written consent while Berisford was owed money due under the U.K. Agreement, one of three agreements to which the Eleventh Schedule expressly refers. *See* Def. Mem., at 7-11; PX 3, at

105.

BRHI does not dispute the fact that Bomar Holdings failed to obtain Berisford's written consent to the payment of the dividend by Bomar Holdings and to the subsequent liquidation of Bomar Holdings despite being required to do so under Clause 20 and the Eleventh Schedule of the U.S. Agreement. BRHI contends, however, that the jury could reasonably conclude that the failure to obtain such consent was not a material breach of the agreement. Materiality is a question of fact to be determined by the jury, and the defendant does not dispute that the jury was properly instructed on the meaning of materiality.

A rational jury could determine that no material breach had occurred. The amount still owed to Berisford at the time that the dividend was paid and at the time that Bomar Holdings was liquidated was £150,000, or 3% of the £ 5,000,000 Total Consideration that was to be paid Berisford. *See* PX 3, at 82; PX 4, at 22; PX 5, at 115; DX E, at 3; Tr. 537-40. The apparent purpose of Clause 20 and the Eleventh Schedule was to preserve the assets of Bomar Holdings to ensure that Berisford would receive the money that it was due. The evidence showed that Berisford did in fact receive the money owed it. *See* DX E, at 3. There was no evidence that Berisford suffered any harm as a result of Bomar Holdings' failure to obtain its written consent or that it was ever at risk that any material protion of the purchase price would not be paid. Under these circumstances, it cannot be said that the only reasonable conclusion allowed by the evidence is that a material breach had occurred. [FN1]

FN1. Berisford argues that the U.S. Agreement established a $75,000 materiality threshold, and that therefore it was necessarily a material breach when the plaintiffs failed to obtain Berisford's written consent to the payment of the dividend and to the liquidation of Bomar Resources when £150,000 (or roughly $227,000 at the current exchange rate) of the total consideration remained outstanding. *See* Def. Mem., at 9; PX 3, at 84. This argument is, however, unavailing. Materiality is a question of fact for the jury to decide, and the defendant does not dispute the correctness of the jury instructions. Thus, the $75,000 threshold was not binding on the jury, which was, as the finder of fact, free to determine whether a given breach was material in light of all the circumstances. Moreover, the $75,000 threshold was the threshold set for the *seller's* representations and warranties. It did not apply to the alleged breaches of the purchaser's obligations under the Eleventh Schedule and was thus not directly relevant to the issue of the materiality of an alleged breach of that Schedule.

Moreover, the jury was entitled to credit Mr. Katz's testimony that in December 1989 he informed Berisford, although perhaps only orally, of his intent to restructure Bomar Holdings. *See* PX 26; PX 51; Tr. 59, 69-70, 235. There is no dispute that Berisford continued to pay under the indemnity after December 1989. *See, e.g .,* PX 37-39, PX 42, PX 44; Tr. 59-60, 63, 91-92, 118-21, 131, 136-40, 477-78. Thus, even if the failure to comply with Clause 20 were a material breach, the jury could rationally conclude that such a breach had been waived by Berisford. *See Chitty* §§ 24-002, 24-003, 24-005. Berisford does not dispute that the jury was correctly instructed on the principle of waiver.

C.

*4 Berisford argues that BRHI may not recover with respect to the so-called Sierre Rutile Limited ("SRL") matters because the expenses and liabilities for which BRHI would be indemnified are the result of fraud that was committed by Mr. Katz. Under English law, an indemnity against the expenses and liabilities that result from the deliberate commission of a crime or fraud generally may not be enforced by the wrongdoer, either directly or indirectly. *See Askey v. Golden Wine Co. Ltd.,* [1948] 2 All E.R. 35, 38H; *Chitty* § 16-146; 20 *Halsbury's Laws of England* § 359 (4th ed. reissued 1993). Because Mr. Katz is the sole shareholder of BRHI, *see* Tr. 174, recovery by BRHI ultimately redounds to Mr. Katz's benefit. Thus, BRHI may not recover for the SRL matters if Mr. Katz were guilty of the wrongdoing that gave rise to the expenses and liabilities associated with the SRL matters.

To support its contention that Mr. Katz had committed the wrongdoing that gave rise to the expenses and liabilities associated with the SRL matters, Berisford relies primarily upon an arbitration award, subsequently confirmed by Judge Keenan, that found Bomar Resources had committed fraud and racketeering. *See Sierra Rutile Ltd. v. Bomar Resources, Inc.,* No. 90 Civ. 0835 (S.D.N.Y. Aug. 25, 1992); *Sierra Rutile Ltd. v. BRINC Ltd.,* No. 13-199-0098-90 (A.A.A. March 27, 1992); Def. Mem., at 12-15. However, Mr. Katz was not a party to the arbitration and the arbitration award was not binding upon him. Moreover, there is evidence in the record from which the jury could rationally conclude that the wrongdoing that gave rise to the SRL expenses and liabilities was committed by Michael Lobel, a former associate of Mr. Katz, rather than by Mr. Katz. [FN2] *See* DX C, at 13-15; Tr. 49, 51-53, 197-99, 222, 325-26, 655-56, 671. In any event, the jury was entitled to credit Mr. Katz's sworn denials of wrongdoing and conclude that the defendants had failed to prove that he was guilty of fraudulent conduct. Thus, it cannot be said that the evidence was so overwhelming that reasonable and fair-minded persons could only have concluded that Mr. Katz committed the wrongdoing that gave rise to the SRL expense and liability.

> FN2. Although Mr. Lobel did not appear as a witness, portions of testimony that he gave at a deposition were read into the record at trial. *See* Tr. 667-96. The jury was entitled to question Mr. Lobel's credibility given his repeated failure to recall relevant details.

D.

The jury awarded BRHI fifty percent of any future costs, expenses and damages arising from the so-called Brazilian Friendship litigation. Berisford argues that BRHI may not recover with respect to the Brazilian Friendship litigation because the costs, expenses and liabilities for which BRHI would be indemnified are the result of an intentional tort committed by Mr. Katz. Under English law, an indemnity against the expenses and liabilities that result from the commission of an intentional tort may not be enforced, either directly or indirectly, by the person who commited the tort. *See Chitty* § 16-148; G.H. Treitel, *The Law of Contract* 383-84 (8th ed.1991). Because Mr. Katz is the sole shareholder of BRHI, *see* Tr. 174, recovery by BRHI ultimately benefits Mr. Katz. Thus, BRHI may not recover for the Brazilian Friendship litigation if it were proven that Mr. Katz had committed the tortious interference with contract that gave rise to the Brazilian Friendship litigation.

***5** During the course of the Brazilian Friendship litigation, Bomar Resources was found liable at trial for tortious interference with contract. *See International Minerals & Resources v. Pappas,* 96 F.3d 586 (2d Cir.1996). [FN3] Without citation to the record, Berisford asserts that the evidence adduced in this trial "establishes that Katz and no one else at Bomar Resources committed the intentional wrongful acts that led to the *Brazilian Friendship* action." Def. Mem., at 17. There is, however, no merit to this assertion. First, the Court of Appeals decision makes clear that the liability of Bomar Resources for tortious interference with contract rested on a theory of vicarious liability for the actions of Richard Jaross, not those of Mr. Katz. *See International Minerals & Resources,* 96 F.3d at 594 (quoting trial court's jury instruction that "[p]laintiffs claim that Bomar's interference with the contract was through its agent Jaross"). Second, Mr. Katz, who testified that he was not intimately involved with the Brazilian Friendship matter, categorically denied any wrongdoing in connection therewith. *See* Tr. 57, 61-62. Thus, there is ample evidence in the record from which the jury could rationally conclude that the costs, expenses and damages arising from the Brazilian Friendship litigation were not the result of an intentional tort committed by Mr. Katz.

FN3. The Court of Appeals affirmed Bomar Resources' liability, but remanded for retrial as to the liability of certain other defendants and as to the amount of damages. In a separate trial held after the conclusion of this trial, Bomar Resources was held liable in the amount of $19.5 million in compensatory damages and $5 million in punitive damages. *See International Minerals & Resources v. Pappas,* No. 87 Civ. 3988, Verdict Form, at 4 (S.D.N.Y. Sept. 15, 1999), attached as Ex. 2 to Affidavit of Howard R. Hawkins, dated October 1, 1999. The parties advised this Court at argument on the current motion that those amounts were substantially reduced by the trial court and that the judgment is now on appeal.

Berisford contends that BRHI cannot recover any damages for the Brazilian Friendship litigation because the public policy of New York would prevent such recovery. It is undisputed that English law is the substantive law that governs the U.S. Agreement. Berisford contends, however, that New York public policy bars indemnification for liability arising from an intentional tort, and that therefore, because New York provides the forum for this action, BRHI may not be indemnified for any liability relating to the Brazilian Friendship litigation inasmuch as that liability arises from tortious interference with contract, an intentional tort. BRHI has agreed that it will not seek indemnification for any punitive damages arising from the Brazilian Friendship litigation. *See Katz v. Berisford,* No. 96 Civ. 8695, Hearing, at 26 (S.D.N.Y. May 26, 2000). To the extent that this argument is directed against indemnification for punitive damages, the argument is moot. Berisford, however, argues that under New York public policy BRHI may not be indemnified for any liability arising from an intentional tort, regardless of whether that liability is for punitive or compensatory damages. Berisford misconstrues New York law. New York public policy does not under all circumstances preclude indemnification for compensatory damages awarded in connection with an intentional tort. In *Zurich Ins. Co. v. Shearson Lehman Hutton, Inc.,* 642 N.E.2d 1065 (N.Y.1994), the plaintiff, who had issued an insurance policy to the defendant, sought a declaration that it was under no duty to indemnify the defendant, who had been found liable for slander, an intentional tort, in two out-of-state actions. The New York Court of Appeals held that the plaintiff was obligated to indemnify the defendant to the extent that the defendant's liabilities, although denominated "punitive damages" under the applicable foreign law, might have been considered compensatory damages under New York law. Thus, New York public policy does not automatically preclude indemnification for compensatory damages arising from an intentional tort. *See id.,* at 1068 ("[O]nly when the damage award is of a 'punitive nature' is indemnification precluded by New York policy. On the record before us, it appears that the damages awarded ... also had a compensatory purpose and plaintiff must indemnify its insured for them."). BRHI may therefore be indemnified for liabilities arising from the Brazilian Friendship litigation to the extent that those liabilities represent compensatory damages.

E.

***6** Berisford next argues that BRHI may not enforce the indemnity, which would benefit Mr. Katz as BRHI's sole shareholder, because it was obtained, if at all, through Mr. Katz's theft and fraud. *See* Def. Mem., at 18. It is a principle of English law that no person can obtain or enforce, directly or indirectly, any rights resulting to him from his own crime or fraud. *See Chitty* § 16-142. Thus, if the right to indemnity was obtained by Mr. Katz's theft or fraud, BRHI would indeed be barred from recovering under the indemnity. According to Berisford, "[t]he record at trial establishes that plaintiff Katz acquired Bomar Resources and Bomar Holdings," the original holder of the indemnity, "through the theft of Bomar Resources assets that he and his partner Michael Lobel wrongfully siphoned out of Bomar and kept entirely off the books of Bomar Resources." Def. Mem., at 18.

There is, however, evidence in the record that would allow the jury rationally to conclude that Mr. Katz had not used theft and fraud to acquire Bomar Resources and Bomar Holdings. Mr. Katz testified that various Berisford executives as well as Mr. Klein, the previous owner of Bomar Resources and Bomar Holdings, were aware of the rebate scheme that accounted for more than half of the allegedly siphoned funds. Mr. Katz, who generally denied siphoning funds from Bomar Resources and specifically denied that he had forged an invoice as part of the alleged siphoning effort, further testified that others besides himself directed the transfer of Bomar Resources funds to various foreign accounts. Finally, Mr. Katz testified that the financing of his acquisition of Bomar Resources and Bomar Holdings was handled by his lawyers and that he was not involved in the details. *See* Tr. 43-44, 46, 52-54, 66-69, 180-81, 194, 196, 199-200, 204-15, 219-20, 27273, 325-27. This testimony, which the jury was entitled to credit, is evidence from which the jury could rationally conclude that the indemnity had not been acquired through theft or fraud by Mr. Katz.

F.

Berisford argues that even if the indemnity were properly assigned and not acquired by theft or fraud BRHI is not entitled to indemnification for costs associated with the Dale action and the Hyosung arbitration because BRHI breached Clause 10(b) of the U.S. Agreement, which required that Berisford be kept fully informed of all material developments in any legal proceedings involving Bomar Resources. BRHI does not dispute that it breached Clause 10(b) with respect to the Dale action and Hyosung arbitration. BRHI argues, however, that the jury was entitled to conclude that the breach was not material. Given that Berisford offered no evidence that it was in any way harmed by the breach, that the litigation was conducted in a less than optimal way, or that Berisford would have done anything differently had it been advised of any developments, it cannot be said that the only conclusion a reasonable person would have reached is that a material breach had in fact occurred.

*7 Berisford also contends that prior to trial it had already paid $109,000 of the approximately $142,000 for which BRHI seeks indemnification in connection with the Hyosung arbitration. *See* PX 75; Tr. 522. The plaintiff concedes that the jury award should be reduced by $109,000 and agrees to accept an award of $33,000 in damages for the Hyosung matter. *See Katz v. Berisford,* No. 96 Civ. 8695, Hearing, at 23-24 (S.D.N.Y. May 26, 2000).

G.

The U.S. Agreement provides that it "shall be governed by and construed in accordance with English law." PX 3, ¶ 18(A), at 22. In contrast to the "American Rule," under which each party to a litigation bears its own costs, *see generally Aleyska Pipeline Service Co. v. The Wilderness Society,* 421 U.S. 240, 247-62 (1975), under the "English Rule," the prevailing party may recover at least some of its costs, including attorneys' fees, from the losing party. *See generally Bensen v. American Ultramar Ltd.,* No. 92 Civ. 4420, 1997 WL 317343, at *7-9 (S.D.N.Y. June 12, 1997). Here, the jury awarded BRHI the very modest amount of $36,626.10 in damages arising from the current action.

Berisford does not dispute the reasonableness of the costs awarded but maintains that BRHI is not entitled to recover the costs of this action. The U.S. Agreement is silent as to the issue of attorney's fees arising from the enforcement of the agreement.

Berisford argues that, in the absence of a contractual provision expressly allowing the recovery of attorneys' fees, the American Rule should be applied as the procedural law of the forum in which this action was brought.

In a diversity action such as this, a federal court follows federal procedure but applies the substantive law of the state in which it sits. *See Erie R.R. Co. v. Tompkins,* 304 U.S. 64, 78 (1938). For purposes of *Erie* analysis, attorneys' fees are considered substantive and are therefore controlled by state law in diversity cases. *See Bensen,* 1997 WL 317343, at * 13; *Whiteside v. New Castle Mut. Ins. Co.,* 595 F.Supp. 1096, 1100 (D.Del.1984); *see also Alyeska,* 421 U.S. at 259 n. 31. Thus, the dispositive question is whether BRHI is entitled to recover attorneys' fees under New York law.

New York follows the American rule and does not allow the prevailing party to recover its attorneys' fees unless there is a specific statutory or contractual right to such fees. *See A.G. Ship Maintenance Corp. v. Lezak,* 503 N.E.2d 681, 683 (N.Y.1986) (per curiam) ("Under the general rule, attorneys' fees and disbursements are incidents of litigation and the prevailing party may not collect them from the loser unless an award is authorized by agreement between the parties or by statute or court rule."). The contract at issue in this case, however, is governed by English law and English law allows the recovery of attorneys' fees. There is, therefore, a conflict between New York law and English law. When resolving a conflict of laws in a diversity action such as this, a federal court must apply the choice-of-law principles of the forum state, in this case New York. *Klaxon Co. v. Stentor Elec. Mfg. Co., Inc.,* 313 U.S. 487, 496-97 (1941).

***8** The U.S. Agreement contains a choice-of-law clause which provides that the agreement shall be governed by the laws of England. *See* PX 3, ¶ 18(A), at 22. Where the parties to a contract have expressly agreed that the laws of a particular jurisdiction will govern that contract, New York courts will generally honor the parties' choice of law so long as the selected jurisdiction has significant contacts to the transaction. *See International Minerals & Resources,* 96 F.3d at 592 ("New York law is unambiguous in the area of express choice of law provisions in a contract. Absent fraud or violation of public policy, contractual selection of governing law is generally determinative so long as the State selected has sufficient contacts with the transaction.") (internal quotations and alterations omitted); *see also Bank Itec N.V. v. J. Henry Schroder Bank & Trust Co.,* 612 F.Supp. 134, 140-41 (S.D.N.Y.1985); *Freedman v. Chemical Const. Corp.,* 372 N .E.2d 12, 15 n. * (N.Y.1977); 19A N.Y.Jur.2d Conflict of Laws § 33 (1999). Here, there is no allegation that the U.S. Agreement is either contrary to New York public policy or a result of fraud. Moreover, there can be no question that there are sufficient contacts between England and the transaction governed by the U.S. Agreement: the transaction involved a sale of assets by an English company; the contract was drafted by English solicitors; and, the deal was closed in London. Under these circumstances, a New York court would honor the U.S. Agreement's choice-of-law provision.

While it is true that the U.S. Agreement does not specifically address the issue of attorney's fees, by agreeing that English law would govern the U.S. Agreement, "[i]t is as though the law of [England] were incorporated into the agreement by reference." *Freedman,* 372 N.E.2d at 15 n.. * English law allows the recovery of attorneys' fees by the prevailing party. Inasmuch as the parties to the U.S. Agreement incorporated English law into their agreement, the parties' agreement provides for the recovery of attorneys' fees. Although the American rule is the default rule under New York law, New York law does allow contracting parties to provide for the recovery of attorneys' fees if they so choose. *See A.G. Ship Maintenance Corp. v. Lezak,* 503 N.E.2d at 683. Given that the parties to the U.S. Agreement could have expressly provided for the recovery of attorneys' fees under New York law, the parties' choice of English law should be interpreted as encompassing the English rule that the prevailing party may recover its attorneys' fees. *See* Restatement (Second) of Conflict of Laws § 187(1) (1971) ("The law of the state chosen by the parties to govern their contractual rights and duties will be applied if the particular issue is one which the parties could have resolved by an explicit provision in their agreement directed to that issue."); *see also Boyd Rosene & Assocs., Inc. v. Kansas Municipal Gas Agency,* 174 F.3d 1115, 1126-28 (10th Cir.1999) (applying law of jurisdiction designated in contract's choice-of-law clause to attorneys' fees issue despite fact that contract did not expressly address attorneys' fees issue); *El Paso Natural Gas Co. v. Amoco Production Co.,* Civ. A. No. 12083, 1994 WL 728816, at *4-5 (Del. Ch. Dec. 16, 1994) (same).

***9** This conclusion, that BRHI is entitled to recover attorneys' fees under New York choice-of-law analysis, is consistent with the few reported cases that have reached the issue. *See Csaky v. Meyer,* No. 94 Civ. 8117, 1995 WL 494574 (S.D.N.Y. Aug. 18, 1995) (applying English rule in contract action where contract governed by English law under New York choice-of-law principles); *cf. J. Barbour & Sons, Ltd. v. Taftco, Inc.,* Civ. A. No. 87-2609, 1989 WL 49518 (E.D.Pa. May 8, 1989) (applying English rule in contract action where contract, although silent as to attorneys' fees, contained choice-of-law clause designating English law as governing law and forum state honors parties' choice of law).

Bensen, 1997 WL 317343, which is in any event not controlling, does not dictate a contrary result. In *Bensen,* the party seeking attorneys' fees had prevailed on a statutory counterclaim under the English Companies Act. *See id.,* at *6. Here, by contrast, BRHI prevailed on a contract claim. The *Bensen* court distinguished both *Csaky* and *J. Barbour,* noting that they were "decided pursuant to contracts involving English law" and were therefore "entirely different" from *Bensen. Bensen,* 1997 WL 317343, at *10. Insofar as the verdict in this case was returned on a contract claim brought under English law, this case is more like *Csaky* and *J. Barbour* than *Bensen.* Moreover, here, in contrast to *Bensen,* the application of the English rule "would be wholly [ ] consistent with the parties' justified expectations." *Id.,* at *9. Not only did the U.S. Agreement contain a choice-of-law clause that designated English law as the law to govern the agreement, but both the Complaint and the Joint Pretrial Order put Berisford on notice that the plaintiffs were seeking attorneys' fees. *See* Amended Complaint ¶ 35; Amended Joint Pretrial Order, at 17.[FN4]

FN4. *Bensen* expressly relied upon Judge Friendly's choice-of-law analysis in *Conte v. Flota Mercante Del Estado,* 277 F.2d 664, 672 (2d Cir.1960). *See Bensen,* 1997 WL 317343, at *13-14. That analysis, however, was in the context of an admiralty torts case, not a contracts case, and Judge Friendly therefore did not have occasion to consider the appropriate choice-of-law analysis to be applied under New York law to the issue of attorneys' fees in the face of a contractual choice-of-law clause. New York applies different choice-of-law principles in contract cases than in tort cases, particularly where the contract at issue contains a choice-of-law provision. *See Lazard Freres & Co. v. Protective Life Ins. Co.,* 108 F.3d 1531, 1539 n. 5 (2nd Cir.1997); *Robins v. Max Mara, U.S.A., Inc.,* 923 F.Supp. 460, 465 (S.D.N.Y.1996) ; *see also* 19A N.Y.Jur.2d Conflict of Laws § 2 (1999) ("In a conflict of laws situation, a court must determine at the outset whether the problem brought before it for a solution relates to torts, contracts, property, or some other field, or to a matter of substance or procedure, in order to refer to the appropriate law."). Here, the relevant choice-of-law analysis is the New York choice-of-law analysis which is appropriate to contracts cases.

Because New York law would honor the choice-of-law provision contained in the U. S. Agreement, *see International Minerals & Resources,* 96 F.3d at 592, and because that provision has the effect of incorporating English law by reference, *see Freedman,* 372 N.E.2d at 15 n., BRHI is, in accordance with the English rule and New York choice-of-law principles, entitled to recover attorneys' fees.

H.

Finally, Berisford argues that there was insufficient evidence from which the jury could reasonably conclude that the SRL matters were included within the Clause 10 indemnity as amended by Addendum No. 1 in April 1989. This assertion is without merit. Clause 3(C) of Addendum No. 1 limited the scope of the indemnity to matters listed in an attached Schedule. The Schedule contains, among other things, a reference to "an ongoing dispute between Bomar Resources and Nord Resources." Memorandum for William P. Karon, dated September 6, 1988, attached as part of Schedule to Addendum No. 1 (PX 6). It was this dispute that matured into the SRL arbitration and litigation. While it is true that the dispute had not yet ripened into formal arbitration and litigation as of the signing of Addendum No. 1, the jury could reasonably conclude that the reference to the dispute contained in the Schedule attached to Addendum No. 1 brought the SRL matters within the scope of the indemnity.

***10** Moreover, Clause 4 of Addendum No. 1 provided that "[n]othing in this Agreement shall affect the liability under the agreement of ... [Berisford] ... in respect of any costs, claims, expenses, liabilities whatsoever that may arise due to any action, omission or activity in each case of an illegal or fraudulent nature in relation to or affecting [Bomar Resources] ... prior to 31st July 1988." Addendum No. 1, PX 6, at 3. Mr. O'Connor testified that he knew of no allegations of fraud against Bomar Resources other than those alleged in the SRL arbitration and litigation. *See* Tr. 411-12. Given the unambiguous language of Clause 4, the testimony of Mr. O'Connor, and the reference to the dispute with Nord contained in the Schedule, the jury could reasonably conclude on the basis of the evidence before it that the parties intended for the indemnity to cover the SRL matters.

While BRHI could not recover under the indemnity if it had been proven that Mr. Katz, BRHI's sole shareholder, had committed the fraud alleged in the SRL matters, there is, as discussed above, an evidentiary basis upon which the jury could reasonably find that the fraud was not committed by Mr. Katz. Under these circumstances BRHI is not barred from indemnification for Bomar Resources' liabilities in the SRL matters. While a person who commits fraud may not be indemnified against liabilities arising from such fraud, nothing prevents an innocent party from being indemnified against the liabilities arising from the fraud of another.

CONCLUSION

For all of the foregoing reasons,[FN5] the defendant's motion is denied except insofar as BRHI agrees to accept an award of $33,000 in damages for the Hyosung arbitration and agrees not to seek indemnification for punitive damages arising from the Brazilian Friendship litigation.

FN5. The Court has considered all of the arguments raised by the parties and any argument not expressly addressed above is either moot or without merit.

BRHI is directed to submit a proposed Judgment by July 14, 2000 together with any supporting memorandum of law and detailed calculations for any requested pre-judgment interest. The defendant may submit any counter proposal and supporting materials by July 21, 2000.

SO ORDERED.

S.D.N.Y.,2000.
Katz v. Berisford Intern. PLC
Not Reported in F.Supp.2d, 2000 WL 959721

(S.D.N.Y.)

END OF DOCUMENT

C

District of Columbia Court of Appeals.
William L. KAUFFMAN, Appellant,
v.
INTERNATIONAL BROTHERHOOD OF TEAMSTERS, Appellee.
No. 06-CV-1198.

Argued May 16, 2008.
Decided June 12, 2008.

Background: At-will employee brought action against his employer for breach of a contract to provide him with a monthly housing allowance. The Superior Court, Maurice A. Ross, J., granted summary judgment in favor of employer. Employee appealed.

Holdings: The Court of Appeals, Farrell, J., held that:
(1) employee impliedly agreed to employer's elimination of his monthly housing allowance by continuing his employment for three more years after the change took effect with his knowledge, and
(2) trial court's earlier denial of employer's motion for summary judgment did not, under law of the case doctrine, prevent trial court from later granting employer's renewed motion for summary judgment.

Affirmed.

West Headnotes

[1] Labor and Employment 231H 36

231H Labor and Employment
231HI In General
231Hk31 Contracts
231Hk36 k. Implied Contracts. Most Cited Cases
At-will employee impliedly agreed to employer's elimination of his monthly housing allowance by continuing his employment for three more years after the change took effect with his knowledge, though employee claimed that he challenged the termination of the housing allowance throughout the three-year period.

[2] Labor and Employment 231H 40(2)

231H Labor and Employment
231HI In General
231Hk37 Term, Duration, and Termination
231Hk40 Definite or Indefinite Term; Employment At-Will
231Hk40(2) k. Termination; Cause or Reason in General. Most Cited Cases
An at-will employment relationship is terminable by either party at any time.

[3] Labor and Employment 231H 34(2)

231H Labor and Employment
231HI In General
231Hk31 Contracts
231Hk34 Formation; Requisites and Validity
231Hk34(2) k. Particular Cases. Most Cited Cases
Unlike employment contracts for a fixed duration, neither party to at-will employment is bound to continue performance, and thus future performance by each party amounts to valid consideration for a change in terms.

[4] Labor and Employment 231H 36

231H Labor and Employment
231HI In General
231Hk31 Contracts
231Hk36 k. Implied Contracts. Most Cited Cases
After at least a brief period of time in which to evaluate his options, an at-will employee is deemed as a matter of law to have accepted a known change in employment terms by continuing in the job.

[5] Labor and Employment 231H 47

231H Labor and Employment
231HI In General
231Hk47 k. Modification or Rescission of Contract. Most Cited Cases
Absent a modification of employment terms during the employment, an employee upon termination is entitled to monetary compensation for benefits accrued under those terms.

[6] Estoppel 156 ⚷85

156 Estoppel
156III Equitable Estoppel
156III(B) Grounds of Estoppel
156k82 Representations
156k85 k. Future Events; Promissory Estoppel. Most Cited Cases
At-will employee who sued his employer for breach of contract to provide him with a monthly housing allowance could not enforce employer's promise to pay the allowance under a promissory estoppel theory; employee's promissory estoppel claim merely restated his breach of contract claim in other dress, employee cited no promise on which he relied to his detriment other than the same term that employer was free to modify with his consent, which consent was implied from employee's continuing to work for employer at an at-will employee, and employee offered no reason why rejection of his breach of contract claim resulted in an injustice.

[7] Estoppel 156 ⚷85

156 Estoppel
156III Equitable Estoppel
156III(B) Grounds of Estoppel
156k82 Representations
156k85 k. Future Events; Promissory Estoppel. Most Cited Cases
For promissory estoppel to lie, there must be evidence of a promise, the promise must reasonably induce reliance upon it, and the promise must be relied upon to the detriment of the promisee.

[8] Estoppel 156 ⚷85

156 Estoppel
156III Equitable Estoppel
156III(B) Grounds of Estoppel
156k82 Representations
156k85 k. Future Events; Promissory Estoppel. Most Cited Cases
The theory of promissory estoppel may be invoked only when injustice otherwise would not be avoidable.

[9] Courts 106 ⚷99(3)

106 Courts
106II Establishment, Organization, and Procedure
106II(G) Rules of Decision
106k99 Previous Decisions in Same Case as Law of the Case
106k99(3) k. Jurisdiction, Dismissal, Nonsuit, and Summary Judgment, Rulings Relating To. Most Cited Cases
Trial court's earlier denial of employer's motion for summary judgment, in at-will employee's action for breach of contract to provide him with a monthly housing allowance, did not, under the law of the case doctrine, prevent trial court from later granting employer's renewed motion for summary judgment, where employee's employment status was a material issue of fact in dispute at the time of the first motion, and employer renewed its motion only after the issue of employee's employment status was resolved in a related federal action.
***45** Richard L. Thompson, II, La Plata, MD, for appellant.

William R. Wilder, Washington, DC, for appellee.

Before WASHINGTON, Chief Judge, and FARRELL and GLICKMAN, Associate Judges.

FARRELL, Associate Judge:

Kauffman sued his employer, International Brotherhood of Teamsters (hereafter IBT), in Superior Court for breach of an agreement to provide him with a monthly housing allowance. IBT had paid Kauffman the allowance starting in 1993, but in April 1996 discontinued it, prompting this suit. IBT defended by arguing in part that, as an at-will employee, Kauffman had impliedly agreed to elimination of the housing allowance by remaining an employee of IBT for years (namely, three) after the change took effect with his knowledge. The trial court, implicitly relying on our decision in *National Rifle Ass'n v. Ailes,* 428 A.2d 816 (D.C.1981), granted summary judgment to IBT. We affirm.

***46 I.**

Beginning in 1992, Kauffman took a leave of absence from his job with United Parcel Service in New Jersey to become an International Representative for IBT. IBT did not specify a period of time during which Kauffman would be employed by IBT, and his leave from UPS was to be active "as long as [he] wanted." [FN1] IBT's constitution provided that the General President could remove an International Representative "when he deems it for the best interests of the International Union." In 1993, Mario Perrucci, an IBT representative, asked Kauffman to relocate to Washington, D.C. Perrucci agreed that IBT would compensate Kauffman to offset the higher cost of living in Washington. Specifically, IBT offered to reimburse his housing expenses, and Kauffman accepted this offer as a condition of his agreement to relocate. Kauffman maintained his home in New Jersey as his permanent residence and obtained an apartment in Washington. IBT reimbursed him for his housing expenses in Washington until late 1994.

FN1. Although Kauffman alleged in his complaint that his appointment was "[i]n accordance with the collective bargaining agreement between UPS and [IBT]," Kauffman produced no evidence of these agreements.

On December 15, 1994, IBT changed its policy somewhat and decided to pay Kauffman a monthly housing allowance of one thousand dollars, which would be included in the last paycheck of each month to cover expenses for the following month. In 1994, Kauffman still owned his home in New Jersey, but spent all of his time in Washington because of his assignment and because he and his wife had divorced. On July 29, 1995, Kauffman requested that IBT change his permanent address to a residence in Arlington, Virginia.

Around April 9, 1996, Kauffman received a memorandum from Howard Edwards, Director of Human Resources for IBT, notifying him that he "no longer qualif [ied]" for the housing allowance because he had relocated his permanent residence to the Washington, D.C. area (*i.e.,* he would no longer be forced to maintain two residences), and that the allowance would be discontinued effective April 1.[FN2] The memorandum instructed him to contact Edwards if he had questions. Kauffman requested to meet with Aaron Belk, who was "party to the discussion and the agreement," but never obtained a meeting. Kauffman spoke to Edwards, who "reemphasized what the memo said." Kauffman also raised the issue in a meeting with a director and the office staff and sent memoranda. He understood, nevertheless, that IBT was no longer going to pay the housing allowance. IBT never changed its position and did not pay the allowance after April 1996. Kauffman sued in Superior Court on March 29, 1999, and IBT terminated his employment the next day.[FN3]

FN2. Since the allowance for April would have been paid on March 31, 1996, it would not be affected by the April 1 effective date. Kauffman conceded at oral argument that the change had only prospective effect.

FN3. After Kauffman filed his suit, IBT moved unsuccessfully for judgment on the pleadings, *see* Super. Ct. Civ. R. 12(c), then moved for summary judgment at the close of discovery. The trial court denied the motion and subsequently granted the parties' joint motion to stay further proceedings pending the outcome of a suit Kauffman had filed meanwhile in federal court. See note 4, *infra.* After that suit was resolved, IBT successfully renewed its motion for summary judgment in Superior Court, giving rise to this appeal.

II.

[1][2] Kauffman does not challenge his discharge as an employee by IBT in 1999. ***47** He does not, that is, dispute the fact that he was an "at-will" employee of IBT, a relationship "terminable ... by either party at any time." *Nickens v. Labor Agency of Metro. Washington,* 600 A.2d 813, 816 (D.C.1991).[FN4] Kauffman sued IBT instead on the theory that his at-will status did not bar him from suing his employer for breach of a "subsidiary agreement" (Br. for App. at 14), namely, IBT's promise to pay him a housing allowance for the duration of his employment in Washington. Kauffman argues that IBT's action in terminating this allowance in April 1996 was a "unilateral change" of this agreement for which "there was [no] consideration" (*id.* at 12), and thus was a breach of contract. We agree with the trial court that settled law, beginning with our decision in *National Rifle Ass'n v. Ailes, supra,* refutes this claim.

FN4. *See, e.g.,* Br. for App. at 11 ("Analysis of the instant case ... is not altered when one adds the fact of Appellant's at will status."). Kauffman's at-will status was, in any event, established conclusively in the related suit he brought in federal district court, *see Kauffman v. International Bhd. of Teamsters, AFL-CIO,* Civ. Act. No. 01-1104 (D.D.C.) (Order of May 24, 2005), a decision he did not appeal. *See, e.g., Smith v. Jenkins,* 562 A.2d 610, 617 (D.C.1989) (collateral estoppel or issue preclusion barred relitigation of an issue previously decided by a court of competent jurisdiction); *Williams v. Mount Jezreel Baptist Church,* 589 A.2d 901, 906 (D.C.1991) (*res judicata* or claim preclusion barred relitigation in Superior Court of claim decided in federal district court and not challenged by direct appeal).

In *Ailes* a number of employees who had been discharged as part of a reduction-in-force sued to recover monetary compensation for unused leave they had accrued in excess of a 225-hour limit that NRA had imposed by a policy change made during their employment. On the employer's appeal from an adverse jury verdict, this court agreed with the plaintiffs that, "as a general rule, an employee who accrues but does not take ... paid leave is entitled to monetary compensation for that leave upon discharge ... absent an agreement to the contrary." *Ailes,* 428 A.2d at 820. We held, however, that "once an employee learns about a new [employer] policy limiting compensation for unused leave upon termination, but elects to stay on the job and accept compensation, that decision is sufficient to imply an agreement to continue working subject to the new limitation." *Id.* at 822. This "implicit[ ]" or imputed agreement to a change, we said, required proof that the employee's "knowledge of the change was complete enough" to support an inference that his "decision to remain on the job was premised on acceptance of the new policy," *id.,* and further required proof that he had been given "at least a brief period of time" to "remain on the job without prejudice"-*i.e.,* without having "impl[iedly] acquiesce[d]" in the change-while considering whether to accept the change or leave the employment. *Id.* at 822, 823. Applying these standards to the facts at hand, we sustained the jury's finding as to certain of the employees that there was an inadequate basis "for imputing [to them] a belief that the [225-hour policy] limit applied to them," *id.* at 824, but as to others, whose awareness of the change and its application to them was undisputed, we held that they "must be said as a matter of law to have agreed to that limitation." *Id.* at 825.

Ailes did not expressly confine itself to agreement by at-will employees, though we think that is its clear implication.[FN5] So ***48** viewed, the principle *Ailes* established for this jurisdiction is in keeping with the rule adopted by most courts considering the issue that an employer may prospectively modify the terms of at-will employment and that the employee's continued service amounts to acceptance of the modification. *See Cotter v. Desert Palace, Inc.,* 880 F.2d 1142, 1145 (9th Cir.1989); *Martin v. Airborne Express,* 16 F.Supp.2d 623, 632 (E.D.N.C.1996); *Martin v. Golden Corral Corp.,* 601 So.2d 1316, 1317 (Fla.Dist.Ct.App.1992); *Moody v. Bogue,* 310 N.W.2d 655, 660-61 (Iowa Ct.App.1981); *Stieber v. Journal Publ'g Co.,* 120 N.M. 270, 901 P.2d 201, 204 (Ct.App.1995); *Albrant v. Sterling Furniture Co.,* 85 Or.App. 272, 736 P.2d 201, 203 (1987); *In re Dillard Dep't Stores, Inc.,* 198 S.W.3d 778, 780 (Tex.2006); *Hathaway v. General Mills, Inc.,* 711 S.W.2d 227, 229 (Tex.1986); *see also* Thomas G. Fischer, *Sufficiency of Notice of Modification in Terms of Compensation of At-Will Employee Who Continues Performance to Bind Employee,* 69 A.L.R.4th 1145, 1147 (1989). These courts hold that the ability to terminate the employment relationship at will necessarily includes the ability to alter its terms, and that permitting such modification avoids the undesirable result of encouraging employers to fire employees who do not expressly agree to new terms. *See, e.g., Cotter,* 880 F.2d at 1145; *Stieber,* 901 P.2d at 204.

> FN5. In *Dahl v. Brunswick Corp.,* 277 Md. 471, 356 A.2d 221 (1976), for example, on which *Ailes* relied, the court noted that whatever rights the affected employees had were not derived from "written employment contracts [or] a collective bargaining agreement" but rather from written policy standards of the employer governing matters such as severance and vacation pay. *Id.* at 223.

[3] Contrary to Kauffman's argument, contract modifications in this context are not unilateral and without consideration. Rather, unlike employment contracts for a fixed duration, neither party to at-will employment is bound to continue performance, and thus courts properly view future performance by each as valid consideration for the change in terms. *See Curtis 1000, Inc. v. Suess,* 24 F.3d 941, 947 (7th Cir.1994) ("In the case of employment at will ... continued employment for a substantial period is good consideration for the [new] covenant."); *Schoppert v. CCTC Int'l, Inc.,* 972 F.Supp. 444, 447-48 (N.D.Ill.1997); *Martin v. Airborne Express,* 16 F.Supp.2d at 632; *DiGiacinto v. Ameriko-Omserv Corp.,* 59 Cal.App.4th 629, 69 Cal.Rptr.2d 300, 305 (1997). As the court observed in *Curtis 1000, Inc., supra,* a contrary view "refus[ing] to regard continued employment as consideration" for a change imposed during the employment would only induce employers to fire employees "and rehire them the following day" under the changed term of employment. 24 F.3d at 947. This body of law, as we have seen, is consistent with and reinforces our own analysis in *Ailes, supra.*

[4] In his deposition, Kauffman admitted that he knew IBT would no longer pay the housing allowance beginning in 1996, and yet he continued the employment for three more years-by any measure "a reasonable period during which" to consider his "personal alternatives," *i.e.,* "whether to resign ... or to remain with [IBT]." *Ailes,* 428 A.2d at 823, 825. His argument that he "attempted to challenge the termination" throughout this period (Br. for App. at 11) is unavailing. The agreement or acquiescence *Ailes* found in similar circumstances is "impl[ied]" or "impute[d]," 428 A.2d at 822, 824; it does not depend on willing acceptance. As we explained in *Ailes,* after "at least a brief period of time" in which "to evaluate his ... options," the at-will employee is "deemed as a matter of law" to have accepted a known change by continuing in the job. *Id.* at 822, 823, 826. *See also DiGiacinto,* 69 Cal.Rptr.2d at 305 ("Presumably, under [the majority] approach, it would not be legally relevant if the employee also had complained, objected, or expressed disagreement."); *Moody,* 310 N.W.2d at

660-61 (at-will employee's "decision to continue work, knowing the newly proposed terms, results in the employee's***49** acceptance as a matter of law"); *Geary v. Telular Corp.*, 341 Ill.App.3d 694, 275 Ill.Dec. 648, 793 N.E.2d 128, 130, 133 (2003) (same result despite fact that employee had "verbally objected to the change"); *Schoppert*, 972 F.Supp. at 448-49 (finding agreement to change that both parties understood was "a done deal" where the employee kept working for two years while accepting compensation under its new terms).[FN6]

FN6. Of course, if the employer's notice of change required the employee's acceptance by signature, *see Schoppert*, 972 F.Supp. at 449, or evidence suggested the parties could still negotiate the terms of the change, *see Knowlton v. Viktron Ltd. P'ship*, 994 F.Supp. 128, 132 (E.D.N.Y.1998), the employee could not be deemed to have accepted it merely by continuing to work. In the words of *Ailes*, his "knowledge of the change" in those circumstances would not be "complete enough" to support the inference that his "decision to remain on the job was premised on acceptance of the new policy." 428 A.2d at 822. Here, IBT's discontinuance of the allowance was not conditional on Kauffman's express acceptance, and despite his objections IBT never changed its position or suggested that the matter was open to negotiation.

[5] Kauffman cites decisions recognizing the right of at-will employees to sue for breach of a subsidiary agreement, say, to pay accrued commissions or bonuses. *See, e.g., Smith v. Chase Group, Inc.*, 354 F.3d 801 (8th Cir.2004); *Terrell v. Uniscribe Prof'l Servs., Inc.*, 348 F.Supp.2d 890 (N.D.Ohio 2004). Those decisions, however, do not deal with the situation here and in *Ailes*-as well as in the other cases we have cited-because none involved a change in terms of employment of an at-will employee who continues in the job with knowledge of the modification. As we recognized in *Ailes*, absent a modification of employment terms during the employment, an employee upon termination is entitled to monetary compensation for benefits accrued under those terms. *See* 428 A.2d at 820. It is worth noting, moreover, that IBT's modification operated only prospectively and did not seek to recoup any "accrued" housing payments to Kauffman.

[6][7][8] As an alternative to his breach of contract claim, Kauffman invokes the doctrine of promissory estoppel, but to the extent he explains its application here at all,[FN7] it appears merely to restate his breach of contract claim in other dress. Kauffman cites no promise on which he relied to his detriment other than the same term IBT was free to modify with his consent-a consent implied from his continuing to work for IBT as an at-will employee. (He does not claim, for example, that IBT induced him to move to Washington *permanently*, such that he incurred costs he could not meet through his salary and his savings in no longer having to keep a second, New Jersey home.) Kauffman, in short, offers no reason why rejection of his breach of contract claim under the principles we have discussed results in an "injustice." *Bender, supra* note 7.

FN7. For promissory estoppel to lie, "there must be evidence of a promise, the promise must reasonably induce reliance upon it, and the promise must be relied upon to the detriment of the promisee." *Simard v. Resolution Trust Corp.*, 639 A.2d 540, 552 (D.C.1994). Further, the theory may be invoked only when "injustice otherwise [would] not [be] avoidable." *Bender v. Design Store Corp.*, 404 A.2d 194, 196 (D.C.1979). Kauffman's complaint did not mention promissory estoppel, and although he more than once stated in his trial court papers that he would move to amend the complaint to add that count, he did not do so. Nevertheless, the theory was mentioned in the parties' motions for, and oppositions to, summary judgment, and we address it briefly here.

[9] Finally, we reject Kauffman's argument that the law of the case doctrine prevented the trial judge from granting IBT's motion for summary judgment. More than once this court has cited the ***50** principle that "we cannot be expected to reverse a correct decision by one [trial] judge simply because we find it contrary to a prior ruling by another [trial] judge in the same case, *i.e.,* contrary to the law of the case." *Williams v. Paul,* 945 A.2d 607, 611 n. 4 (D.C.2008) (alteration in original) (quoting *Guilford Transp. Indus., Inc. v. Wilner,* 760 A.2d 580, 593 (D.C.2000)); *but see Kritsidimas v. Sheskin,* 411 A.2d 370, 371-72 (D.C.1980). In any event, Kauffman's reliance on the earlier denial of summary judgment, see note 3, *supra,* is unavailing because at the time of the first motion his employment status with IBT-at-will or something more-was a material issue of fact in dispute. Once that issue was resolved in the federal action, see note 4, *supra,* IBT was free to renew its motion for summary judgment citing that material change in the record. *See Williams v. Mount Jezreel Baptist Church, supra* note 4, 589 A.2d at 907; *Gordon v. Raven Systems & Research, Inc.,* 462 A.2d 10, 13 (D.C.1983).

Accordingly, the judgment of the Superior Court is

Affirmed.

D.C.,2008.
Kauffman v. International Brotherhood of Teamsters
950 A.2d 44

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C

United States Court of Appeals,
Fifth Circuit.
Richard KUCEL, Plaintiff-Appellee Cross-Appellant,
v.
WALTER E. HELLER & CO., Defendant-Appellant Cross-Appellee.
Richard KUCEL, Plaintiff-Appellee,
v.
WALTER E. HELLER & CO., Defendant,
Appeal of Wendell S. LOOMIS, Appellant.
Nos. 85-2822, 85-2831.

March 30, 1987.

Borrower brought action against lender for money had and received to recover alleged overpayment of loan. The United States District Court for the Southern District of Texas, John B. Singleton, Jr., Chief Judge, awarded borrower $41,778.50 for overpayment of loan, attorney fees, and interest. Appeal and cross appeal were taken. The Court of Appeals, Patrick E. Higginbotham, Circuit Judge, held that: (1) parties lacked necessary accord to prevent suit for money had and received; (2) provision of Uniform Commercial Code stating that unless otherwise specified provision for interest means interest at judgment rate in place of payment was inapplicable; (3) lender did not have right to assess service charge for prepayment of note; (4) district court clearly erred in determining amount of overpayment and in not allowing lender to retain interest accrued after last monthly payment; and (5) borrower could not recover attorney fees.

Affirmed in part, reversed in part, vacated in part and remanded.

West Headnotes

[1] Accord and Satisfaction 8 ⚷4

8 Accord and Satisfaction
8k4 k. Form of Agreement of Accord. Most Cited Cases
Accord and satisfaction is a contract and therefore requires meeting of minds, or agreement.

[2] Accord and Satisfaction 8 ⚷20

8 Accord and Satisfaction
8k20 k. Validity. Most Cited Cases
Even when agreement exists, accord is not binding if party enters it under fraud, compulsion or mistake of fact.

[3] Accord and Satisfaction 8 ⚷26(3)

8 Accord and Satisfaction
8k26 Evidence
8k26(3) k. Sufficiency. Most Cited Cases
Parties lacked necessary accord to prevent borrower's suit against lender for overpayment of loan, where lender released lien after borrower paid note, but did not release borrower from any obligations or liabilities occurring before release, and both borrower and his attorney understood that final accounting on note and payment remained open when lien was released.

[4] Interest 219 ⚷35

219 Interest
219II Rate
219k32 Stipulations as to Rate
219k35 k. Statement as to Rate in Contract. Most Cited Cases
Precomputed note specified interest, even though not specifying interest separately from principal, where it was not necessary to look beyond face of note to ascertain sum of principal and interest owing each month, and total principal and interest to be paid; thus, Uniform Commercial Code provision stating that unless otherwise specified in note, interest means interest at judgment rate at place of payment was inapplicable. U.C.C. §§ 3-118(d), 3-118 comment; Ill.S.H.A. ch. 26, ¶ 3-118; V.T.C.A., Bus. & C. § 3.118(4).

[5] Interest 219 ⚷36(1)

219 Interest

219II Rate
219k32 Stipulations as to Rate
219k36 Construction and Operation
219k36(1) k. In General. Most Cited Cases
Consideration of documents that were executed with promissory note, including chattel mortgage and security agreement, aircraft bill of sale, and statement of account, to determine principal amount of loan in order to determine annual interest rate to be paid, was proper. U.C.C. §§ 3-119(a), 3-119 comment.

[6] Bills and Notes 56 ⚿429

56 Bills and Notes
56X Payment and Discharge
56k428 Mode and Sufficiency of Payment
56k429 k. In General. Most Cited Cases
Lender, which did not disclose to borrower before accepting prepayment that lender was assessing service charge, could not assess borrower service charge for prepayment of note.

[7] Federal Courts 170B ⚿859

170B Federal Courts
170BVIII Courts of Appeals
170BVIII(K) Scope, Standards, and Extent
170BVIII(K)5 Questions of Fact, Verdicts and Findings
170Bk855 Particular Actions and Proceedings, Verdicts and Findings
170Bk859 k. Contract Cases in General. Most Cited Cases
District court clearly erred in determining amount of overpayment on note and in not allowing lender to retain interest accrued after last monthly payment, where calculations of district court conflicted with undisputed facts.

[8] Evidence 157 ⚿574

157 Evidence
157XII Opinion Evidence
157XII(F) Effect of Opinion Evidence
157k574 k. Conflict with Other Evidence. Most Cited Cases
Expert's testimony on overpayment of note could not form basis of district court's damage award, where undisputed facts and expert's assumed amounts could not be reconciled.

[9] Costs 102 ⚿194.32

102 Costs
102VIII Attorney Fees
102k194.24 Particular Actions or Proceedings
102k194.32 k. Contracts. Most Cited Cases
(Formerly 102k173(1))
Although borrower's claim was for money had and received, claim was sufficiently founded on contract that Texas would likely award fees, where resolution of claim depended entirely on interpretation of promissory note. V.T.C.A., Civil Practice & Remedies Code § 38.001(8); Vernon's Ann.Texas Civ.St. art. 2226 (Repealed).

[10] Federal Civil Procedure 170A ⚿2737.14

170A Federal Civil Procedure
170AXIX Fees and Costs
170Ak2737 Attorneys' Fees
170Ak2737.14 k. Miscellaneous Matters. Most Cited Cases
(Formerly 170Ak2737)
Award of attorney fees is part of substantive right of suit.

[11] Federal Courts 170B ⚿415

170B Federal Courts
170BVI State Laws as Rules of Decision
170BVI(C) Application to Particular Matters
170Bk415 k. Damages, Interest, Costs and Fees. Most Cited Cases
Award of attorney fees in diversity case depends on law of state whose rules govern substantive claims.

[12] Bills and Notes 56 ⚿117

56 Bills and Notes
56II Construction and Operation
56k117 k. What Law Governs. Most Cited Cases
Choice-of-law provision of promissory note governed

both interpretation of contract and action for money had and received under note, which were inextricably intertwined.

[13] Costs 102 ⚷194.32

102 Costs
102VIII Attorney Fees
102k194.24 Particular Actions or Proceedings
102k194.32 k. Contracts. Most Cited Cases
(Formerly 102k172)

Under Illinois law, lender could not recover attorney fees in action for money had and received based on overpayment of loan.

[14] Federal Courts 170B ⚷612.1

170B Federal Courts
170BVIII Courts of Appeals
170BVIII(D) Presentation and Reservation in Lower Court of Grounds of Review
170BVIII(D)1 Issues and Questions in Lower Court
170Bk612 Nature or Subject-Matter of Issues or Questions
170Bk612.1 k. In General. Most Cited Cases
(Formerly 170Bk612)

Under federal pleading requirements, party need not plead applicability of law to preserve choice-of-law question.

[15] Evidence 157 ⚷35

157 Evidence
157I Judicial Notice
157k35 k. Laws of Other States. Most Cited Cases

Party need not prove in federal court content of state law or show that it differs from law of another state, for federal courts are required to take judicial notice of content of laws of every state in union.

[16] Evidence 157 ⚷51

157 Evidence
157I Judicial Notice
157k51 k. Mode of Ascertaining Facts Required to Be Noticed; Motions and Notice of Reliance. Most Cited Cases

Party has obligation to call applicability of another state's law to court's attention in time to be properly considered.

[17] Evidence 157 ⚷51

157 Evidence
157I Judicial Notice
157k51 k. Mode of Ascertaining Facts Required to Be Noticed; Motions and Notice of Reliance. Most Cited Cases

Lender properly raised choice-of-law issue in borrower's action for money had and received due to alleged overpayment of promissory note, where lender raised choice-of-law issue in motion to dismiss, and again indicated to court that Texas law did not apply in its amended motion to dismiss, and both motions were pending when joint pretrial order was filed.

[18] Federal Civil Procedure 170A ⚷2774(1)

170A Federal Civil Procedure
170AXX Sanctions
170AXX(B) Grounds for Imposition
170Ak2767 Unwarranted, Groundless or Frivolous Papers or Claims
170Ak2774 Motions and Opposition Thereto
170Ak2774(1) k. In General. Most Cited Cases
(Formerly 45k24)

Federal Courts 170B ⚷817

170B Federal Courts
170BVIII Courts of Appeals
170BVIII(K) Scope, Standards, and Extent
170BVIII(K)4 Discretion of Lower Court
170Bk817 k. Parties; Pleading. Most Cited Cases

If attorney signs motion in violation of federal civil rule requiring good faith pleading, court may impose appropriate sanction, which may be reversed only for abuse of discretion. Fed.Rules Civ.Proc.Rule 11, 28 U.S.C.A.

[19] Federal Civil Procedure 170A ⚷2774(1)

170A Federal Civil Procedure
170AXX Sanctions
170AXX(B) Grounds for Imposition
170Ak2767 Unwarranted, Groundless or Frivolous Papers or Claims
170Ak2774 Motions and Opposition Thereto
170Ak2774(1) k. In General. Most Cited Cases
(Formerly 45k24)

Imposition of sanctions on attorney for signing motion for reconsideration of award of attorney fees would be reversed; motion for reconsideration was not meritless, as evidenced by reversal of attorney fees award on appeal. Fed.Rules Civ.Proc.Rule 11, 28 U.S.C.A.

***68** Michael M. Wilson, Wendall S. Loomis, Richard Frankel, Houston, Tex., for Walter E. Heller & Co.

Morton L. Susman, Robert D. Daniel, Houston, Tex., for Richard Kucel.

Wendall S. Loomis, Houston, Tex., pro se.

Appeals from the United States District Court for the Southern District of Texas.

Before VAN GRAAFEILAND FN*, HIGGINBOTHAM, and JONES, Circuit Judges.

FN* Circuit Judge of the Second Circuit, sitting by designation.

***69** PATRICK E. HIGGINBOTHAM, Circuit Judge:

Walter E. Heller & Co. appeals the district court's judgment awarding Richard J. Kucel $41,778.50 for Kucel's overpayment of a loan, and awarding interest and attorney's fees. Kucel cross-appeals the district court's failure to apply Uniform Commercial Code § 3-118(d) to determine the interest rate of the promissory note and to award an additional $287,070.40 in overpaid interest. Wendell S. Loomis, Heller's attorney, appeals the district court's imposition of sanctions against Loomis for his motion to reconsider the award of attorney's fees. We affirm the district court's determination that Heller must return Kucel's overpayments and that U.C.C. § 3-118(d) does not apply, but reverse on the actual amount of damages, award of attorney's fees, and the sanction.

I

A

Chandler Airlease Corporation sold a Lear jet to Lucey Products Company on February 28, 1978. Lucey executed a promissory note for $1,712,496.96, payable in 96 installments of $17,838.51 each. The note states that "interest, precomputed to the due dates, is included in the foregoing installments." The note does not state the principal amount borrowed, but the district court determined the principal to be $1,082,678.24 from documents executed with the promissory note. The note also does not state an annual percentage rate, but the rate is readily calculated to be 12.7198% based on the note's face value, principal, and payment period. The note was executed in Chicago, Illinois, and contains a provision designating the laws of the State of Illinois as the governing law. The first payment on the note was made at the time of execution.

Lucey sold the airplane to Richard J. Kucel, a Texas resident, who assumed the note. Later, Chandler was merged into Walter E. Heller & Co., a Delaware corporation with its principal place of business in Illinois. Thus Kucel and Heller stand in the same legal positions as the original borrower and lender, respectively.

After 62 payments were made on the note, Kucel encountered financial difficulties and ceased payments. Kucel found a purchaser for the airplane and asked Heller to release its lien on the airplane in exchange for prepayment of the note. Heller said that $615,717.12 was owing, an amount Kucel disputed. Determining that it had improperly included some taxes in the figure, Heller reduced the amount to $540,799.35. Kucel stated that he did not believe the revised figure was accurate and requested an accounting. Nevertheless, in order not to lose the purchaser, Kucel paid the amount in May 1983 before receiving the accounting. Heller released the lien, but did not release Kucel and Lucey from any obligation or liability occurring before the date of the release.

On May 18, 1983, two days after the sale, Kucel sent Heller a written demand for a loan payment history and calculation of the prepayment amount. On June 28, Kucel threatened suit, and on August 3, Kucel filed suit against Heller in federal district court, asserting diversity jurisdiction under 28 U.S.C. § 1332.

B

Kucel sought damages on several theories: money had and received, duress, coercion, fraud, conversion, and violations of the Texas Deceptive Trade Practices Act, Tex.Bus. & Comm.Code §§ 17.41-.63. Kucel also sought exemplary damages and attorney's fees. Heller denied Kucel's claims and argued that the prepayment constituted accord and satisfaction of all claims involving the note.

The district court, after a bench trial, awarded Kucel damages under his claim for money had and received, but denied Kucel's other claims. The court awarded $42,892.40 as the difference between what Kucel paid and what he owed, and reduced that award by $1,114.90 in late fees that Kucel owed Heller. The court also awarded prejudgment interest under Illinois law and postjudgment interest under federal law.

***70** On January 15, 1985, about two weeks after trial, Kucel submitted an application for a hearing on and entry of award of attorney's fees under Tex.Rev.Civ.Stat. art. 2226 (current version at Tex.Civ.Prac. & Rem.Code § 38.001(8)). The court awarded Kucel the fees under art. 2226 on April 23, 1985, and held a hearing on the amount of fees on August 29, 1985. Three days after the hearing, Heller filed a motion for reconsideration on the grounds that Illinois law applied and that Illinois law did not allow attorney's fees in actions for money had and received. The district court denied Heller's motion and imposed a $500 sanction on Wendell Loomis, Heller's attorney.

Heller appeals the failure of the district court to find accord and satisfaction. Kucel cross-appeals the failure of the district court to apply the Illinois judgment rate of interest to the note in order to award him another $287,070.40. Heller also appeals the amount of damages and award of attorney's fees. Loomis appeals the sanction. We treat the claims in that order.

II

Heller argues that Kucel's payment of $540,799.35 on May 16, 1983, constituted an accord and satisfaction of all claims and therefore prevents Kucel from recovering any overpayment.

[1][2] An accord and satisfaction is "a contract under which an obligee promises to accept a stated performance in satisfaction of the obligor's existing duty." Restatement (Second) of Contracts § 281 (1981). Because accord and satisfaction is a contract, it requires a meeting of the minds, or an agreement. *See Flowers v. Diamond Shamrock Corp.*, 693 F.2d 1146, 1151-52 (5th Cir.1982) (applying Texas law); *Sears, Sucsy & Co. v. Insurance Co.*, 392 F.Supp. 398, 404 (N.D.Ill.1974) (applying Illinois law). Even when agreement exists, the accord is not binding if a party enters it under fraud, compulsion or mistake of fact. *See Groves v. Farmers State Bank*, 368 Ill. 35, 12 N.E.2d 618 (1937); *Spring Branch Bank v. Mengden*, 628 S.W.2d 130, 134 (Tex.Civ.App.-Houston 1981, writ ref'd n.r.e.).

[3] The district court held that Kucel and Heller never agreed, expressly or implicitly, that the payment constituted satisfaction of all claims. The evidence established that, although Heller released the lien on the airplane after Kucel paid the note, Heller specifically did not release Kucel or Lucey from any obligations or liabilities occurring before the release. Also, both Kucel and his attorney testified that they understood that a final accounting on the note and payment remained open when

Heller released the lien. Their demand letter two days later confirms that belief. In light of this evidence, the district court did not clearly err in holding that the parties lacked the necessary accord to prevent this suit. FN1

FN1. The evidence also supports the district court's conclusion that Kucel paid under a mistake of fact, although we need not discuss that issue because accord and satisfaction fails for lack of accord in any event.

III

Kucel argues on cross-appeal that the district court erred in failing to set the interest rate of the note at the 9% judgment rate in Illinois. Under Kucel's theory, the district court should have determined that the note did not provide for interest, applied the Illinois judgment rate of interest to a principal of $1,082,678.24 to create a new amortization schedule for the loan, then awarded Kucel $287,070.40 as the difference in what Kucel would have paid with interest at 9% and what he paid with interest at 12.71%.

The Uniform Commercial Code § 3-118(d) provides:

> Unless otherwise specified a provision for interest means interest at the judgment rate at the place of payment from the date of the instrument....

This provision is equally applicable in Texas, *see* Tex.Bus. & Comm.Code § 3.118(4), and in Illinois, *see* Ill.Rev.Stat. ch. 26, § 3-118. The purpose of U.C.C. § 3-118(d) is to avoid parol evidence about the amount ***71** of interest the parties intended when the note does not specify. *See* U.C.C. § 3-118 comment 1.

[4] The promissory note states, "interest, precomputed to the due dates, is included in the foregoing installments." Although the note does not state on its face an annual percentage rate, the note clearly provides a fixed amount of interest. One need not look beyond the face of the note to ascertain the sum of principal and interest owing each month, or $17,838.51, and the total principal and interest to be paid, or $1,712,496.96. Although the "precomputed note" does not specify interest separately from principal, it nevertheless specifies interest, and U.C.C. § 3-118(d) does not apply.

[5] The district court also relied on U.C.C. § 3-119(a), which provides:

> As between the obligor and his immediate obligee or any transferee the terms of an instrument may be modified or affected by any other written agreement executed as a part of the same transaction....

This provision merely applies the "ordinary rule [of contracts] that writings executed as part of the same transaction are to be read together as a single agreement." U.C.C. § 3-119 comment 3. The district court examined several documents that were executed with the note, including the chattel mortgage and security agreement, aircraft bill of sale, and statement of account, to determine that the principal amount of the loan was $1,082,678.24. From that figure and the information in the note, the annual interest rate was calculated to be 12.7198%. Although reference to these additional documents under U.C.C. § 3-119(a) was not necessary to hold that the note specified interest, it was not improper. FN2 The district court properly held that the judgment rate of interest did not apply to the note.

FN2. Ironically, Kucel argues against the court's considering these additional documents to determine whether the note specifies an interest rate, but asks us to apply the 9% judgment rate to $1,082,678.24-a figure Kucel can obtain only by referring to the additional documents also. If the note did not provide for interest and if the district court could not consider the additional documents, the judgment rate would be applied to the face value of the note, or $1,712,496.96, and Kucel would have vastly underpaid Heller.

IV

Heller argues that the district court clearly erred in calculating the amount of damages. Specifically, Heller asserts that the district court should have allowed Heller's service charge for prepayment, that the district court miscalculated the amount of overpayment, and that the district court failed to allow Heller interest between the last monthly payment and the prepayment. Kucel argues that the amount of damages was supported by expert testimony and thus was not clearly erroneous.

A

[6] The district court did not err in deciding that Heller could not assess Kucel a service charge for prepayment of the note. The note and other documents do not provide for prepayment, nor do they mention a service charge. Also, Heller did not disclose to Kucel before accepting prepayment that it was assessing a service charge. Accepting *arguendo* Heller's argument that the common law does not allow prepayment without the lender's consent, *see Marsh v. Stover,* 281 Ill.App. 590 (1935), *rev'd on other grounds,* 363 Ill. 490, 2 N.E.2d 559 (1936), it does not follow that a lender may make payment of a service charge the condition for prepayment without disclosing that condition to the borrower. Heller did not communicate to Kucel that prepayment was conditioned on the service charge. Thus, the service charge was properly denied.

B

[7] The district court clearly erred in determining the amount of overpayment and in not allowing Heller to retain interest accrued after the last monthly payment, for its calculations conflict with undisputed facts.

***72** The district court held that 62 payments were made on the note, leaving 34 installments unpaid when Kucel negotiated to prepay the note. The district court also held that the amortization schedule labeled "Plaintiff's Exhibit 22," which Heller sent Kucel on September 16, 1981, and which is in the Appendix of this opinion, was the correct amortization table for the note. Finally, the court held that the first payment on the note was made when the note was executed, and that the payment was reflected on the amortization table as a lower initial balance for 2/28/78. Based on these undisputed findings, the proper award to Kucel is $7,132.99, not $42,893.40 as the district court determined.

To explain the correct amount of damages, we must explain the amortization table in the Appendix. We have added the left-hand or "Payment No." column for convenience. The next column ("Date") lists the payment dates, beginning with the first payment when the note was executed.[FN3] The third column ("Principal") lists the principal remaining *after payment on that date.* Thus, to determine the principal owing after payment on, for example, 3/28/83, one must look in the "Principal" column for 3/28/83, and not at the next line down. The remaining columns list the interest recovered, principal recovered, and amount of payment due, respectively.

FN3. The actual payment dates were the first day of the month immediately following the date listed on the amortization table. We use the dates listed on the amortization table for convenience.

The district court held that 62 payments had been made. Counting 2/28/78 as the date of the first payment, the 62d payment was due on 3/28/83. The principal remaining after that payment was $524,329.06. Kucel thus overpaid the note by $540,799.35 less $524,329.06, or $16,470.29. Interest accrued on the unpaid principal from its due date until the prepayment on May 16, 1983. Thus Kucel owed Heller 45 days of interest, or $8,222.40.[FN4] Finally, Kucel owed Heller $1,114.90 in late fees, as the district court found. The proper award to Kucel should therefore be:

Amount Paid	$540,799.35	
Principal after 62d Payment	524,329.06	
Unadjusted difference	$ 16,470.29	$16,470.29

Adjustments to difference:			
Late Charges Owing	$ 1,114.90		
Interest owing	8,222.40		
Amount Kucel owed Heller	$ 9,337.30	($ 9,337.30)	
Amount Kucel overpaid Heller		$ 7,132.99	

FN4. Calculated as follows:

$$\$524{,}329.06 \times \frac{45}{365} \times .127198$$

The 45 represents the 45 days between April 1, 1983, when the 62d payment was due, and the prepayment on May 16, 1983.

We remand for the district court to enter judgment for Kucel in the amount of $7,132.99.[FN5]

FN5. We can but guess exactly how the district court misread the amortization table to determine that the difference in payment and principal outstanding was $42,893.40. The court may have miscounted and thought that the payment due 5/28/83 was payment 62 instead of payment 64. More likely, it counted down the right-hand or "Payment" column, forgot to count 2/28/78 as the first payment because no payment was listed in the right-hand column, then determined that 4/28/83 was the 62d payment. The court then looked to the next line (5/28/83) to determine the outstanding principal. In either scenario, the court clearly erred.

Because the court used the principal amount from the payment dated 5/28/83, it assumed that no interest was due for the prepayment made on 5/16/83. This too was error since the 62d payment was due April 1, 1983 (3/28/83 on the schedule), 45 days before the prepayment was made.

Finally, we do not believe this approach constitutes a new theory on appeal and that Heller waived it. We view the error as purely mechanical in the judgment itself and not the trial-an error we can readily cure based on undisputed evidence in the record.

C

[8] Kucel argues that the court's decision on damages was not plain error because it was based on an expert witness's testimony. We disagree. The expert admitted he did not know how many payments had been made, then assumed the principal listed under 5/28/83 was correct for discussion. He also testified the actual figures would vary depending on the actual number of payments made. The undisputed facts and the expert's assumed amounts cannot be reconciled. Therefore, it is clear ***73** error to rely on the expert's testimony as the basis of the district court's award.

V

[9] Texas permits the recovery of "reasonable attorney's fees" if a claim is founded on "an oral or written contract." Tex.Rev.Civ.Stat. art. 2226 (current version at Tex.Civ.Prac. & Rem.Code § 38.001(8)). Although Kucel's claim was for money had and received, the resolution of that claim depended entirely on the interpretation of the promissory note. Thus, his claim was sufficiently founded on contract that Texas courts would likely award fees under art. 2226. *See Exxon Corp. v. Bell,* 695 S.W.2d 788, 791 (Tex.App.-Texarkana 1985, no writ) (award of fees in conversion action founded on contract interpretation). In contrast, Illinois does not permit recovery of attorney's fees in suits on a note or

other contract. *See Community Consolidated School District v. Meneley Construction Co.*, 86 Ill.App.3d 1101, 42 Ill.Dec. 571, 409 N.E.2d 66 (1980) (no statutory basis for recovery of fees in contract claim).

Heller argues that Kucel was not entitled to attorney's fees because Illinois law controls the award of fees. Kucel responds that the law of the forum state governs the award of attorney's fees and thus Texas law applies. Kucel argues that, in any event, Heller waived its claim that Illinois law governs the question.[FN6]

> FN6. Because the elements of a claim for money had and received are the same under Texas and Illinois law, resolution of the choice-of-law question affects only the award of fees.

A

[10][11] The award of attorney's fees is part of the substantive right of a suit. *Missouri State Insurance Co. v. Jones,* 290 U.S. 199, 202, 54 S.Ct. 133, 133, 78 L.Ed. 267 (1933). Thus, the award of attorney's fees in a diversity case depends on the law of the state whose rules govern the substantive claims. *See Prudential Insurance Co. v. Carlson,* 126 F.2d 607, 611 (10th Cir.1942). In this case, then, Texas law may control the award of fees, not because Texas is the forum state, but only if Texas law governs the other substantive rights.

To determine which state's substantive laws control this case, we must follow the choice-of-law principles of the forum state, Texas. *See Klaxon Co. v. Stentor Electric Manufacturing Co.*, 313 U.S. 487, 61 S.Ct. 1020, 85 L.Ed. 1477 (1941). Texas recently changed its choice-of-law rules to adopt a "significant relationship" test, stating,

> [I]n all choice of law cases, except those contract cases in which the parties have agreed to a valid choice of law clause, the law of the state with the most significant relationship to the particular substantive issue will be applied to resolve that issue.

Duncan v. Cessna Aircraft Co., 665 S.W.2d 414, 421 (Tex.1984). For cases involving contracts with choice-of-law clauses, the rule remains that if the parties agree that the contract will be governed by the laws of a particular state, then that intention prevails. *See Austin Building Co. v. National Union Fire Insurance Co.*, 432 S.W.2d 697, 701 (Tex.1968).

[12][13] Kucel and Heller agreed in the promissory note that "this Note and the obligations provided for hereunder shall be governed by the laws of the State of Illinois." No one disputes the validity of this choice-of-law provision. The district court applied Illinois law to construe the note and to award prejudgment interest, but apparently viewed the action for money had and received as arising under Texas law and therefore awarded attorney's fees. We see a contradiction in saying on the one hand that the action for money had and received is inextricably intertwined with the interpretation of the contract in order to award fees under Texas law, but on the other in saying the action and the interpretation of the note are not intertwined in order to avoid the choice-of-law provision. The proper position, we hold, is that the choice-of-law provision governs both the interpretation of the contract and the action for money had and received, which are inextricably intertwined. Thus, Illinois law *74 controls and Kucel may not recover attorney's fees.

B

In order to escape the dilemma posed by the contradictory characterizations in the choice-of-law and attorney's fees arguments, Kucel argues that Heller waived its right to assert that Illinois law governed the award of fees.

[14][15][16] Under federal pleading requirements, Heller need not plead the applicability of Illinois law to preserve a choice-of-law question. *Lumbermen's Mutual Casualty Co. v. Norris Grain Co.*, 343 F.2d 670, 685 (8th Cir.1965); 5 C. Wright & A. Miller, Federal Practice & Procedure § 1253 (1969). Nor must Heller prove in federal court the content of Illinois law or show that it differs from Texas law, for federal courts are required to take judicial notice of the content of the laws of every state in the Union. *Lamar v. Micou,* 114 U.S. 218,

223, 5 S.Ct. 857, 859, 29 L.Ed. 94 (1885). Nevertheless, Heller does have an obligation to call the applicability of another state's law to the court's attention in time to be properly considered. *Prudential Insurance*, 126 F.2d at 611.

[17] In addition to the notice provided by the choice-of-law provision in the promissory note, Heller raised the choice-of-law issue in its motion to dismiss, filed November 22, 1983. Heller again indicated to the court that Texas law did not apply in its amended motion to dismiss, filed July 27, 1984. Both motions were pending when the joint pretrial order was filed November 30, 1984. The joint pretrial order does not preclude consideration of choice-of-law questions because it stated that the motions to dismiss were outstanding and itself contained no agreement about the applicability of either Texas or Illinois law. Consequently, Heller satisfied its obligation to raise the choice-of-law issue before the court. The issue was not waived.[FN7]

> FN7. Nor do we believe Heller waived the issue by not raising it again until the motion for reconsideration of attorney's fees. Having once properly notified the court of the issue, it satisfied its duty.

VI

[18] Fed.R.Civ.P. 11 provides that every pleading or motion be signed and that the signature certify that the attorney

> has read the pleading, motion, or other paper; that to the best of his knowledge, information, and belief formed after reasonable inquiry it is well grounded in fact and is warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law, and that it is not interposed for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation.

If an attorney signs a motion in violation of the rule, the court may impose "an appropriate sanction." The sanction may be reversed only for "abuse of discretion." *Southern Leasing Partners, Ltd. v. McMullan*, 801 F.2d 783, 787-88 (5th Cir.1986).

[19] The district court imposed sanctions on Loomis for signing the motion for reconsideration of the award of attorney's fees. The district court denied the motion because it held that Heller had waived the applicability of Illinois law to attorney's fees and because Heller failed to prove Illinois law at trial. In light of the unpersuasiveness of the motion and what the district court viewed as its paucity of authority, the district court believed the motion to be frivolous and awarded sanctions.

We have in this opinion ruled that Heller did not waive the applicability of Illinois law to attorney's fees. We have also explained that, unlike state practice, a party need not prove the law of a state in federal court. Thus, the motion for reconsideration was not meritless. The arguments the district court thought barren of authority and frivolous have persuaded us on appeal. We therefore reverse the award of sanctions.

VII

In sum, we affirm the district court's determination that Heller is liable to Kucel ***75** for money had and received. We also affirm on cross-appeal the district court's determination that U.C.C. § 3-118(d) does not apply to the promissory note. However, we vacate the award of damages and remand for the district court to enter an award in favor of Kucel in the amount of $7,132.99, with prejudgment interest on that amount at the rate of 12.7198% per annum from May 16, 1983, until September 16, 1985, and postjudgment interest at the rate of 7.91% per annum from September 16, 1985, until the date of payment. We also reverse the award of attorney's fees to Kucel and reverse the imposition of a sanction on Wendell Loomis. The judgment of the district court is AFFIRMED in part, REVERSED in part, VACATED in part, and REMANDED.

APPENDIX

PLAINTIFF'S EXHIBIT 22

LUCEY PRODUCTS

AMORTIZATION SCHEDULE-RULE OF 78's

(Payment No.)	Date	Principal	Interest (12.719828%)	Principal Recovery	Payment
(1)	2/28/78	$1,064,839.81			
(2)	3/28/78	$1,060,122.52	$13,121.22	$4,717.29	$17,838.51
(3)	4/28/78	$1,055,267.12	$12,983.10	$4,855.41	$17,838.51
(4)	5/28/78	$1,050,273.59	$12,844.99	$4,993.52	$17,838.51
(5)	6/28/78	$1,045,141.95	$12,706.87	$5,131.64	$17,838.51
(6)	7/28/78	$1,039,872.19	$12,568.75	$5,269.76	$17,838.51
(7)	8/28/78	$1,034,464.31	$12,430.63	$5,407.88	$17,838.51
(8)	9/28/78	$1,028,918.31	$12,292.51	$5,546.00	$17,838.51
(9)	10/28/78	$1,023,234.20	$12,154.39	$5,684.12	$17,838.51
(10)	11/28/78	$1,017,411.96	$12,016.28	$5,822.23	$17,838.51
(11)	12/28/78	$1,011,451.61	$11,878.16	$5,960.35	$17,838.51
(12)	1/28/79	$1,005,353.14	$11,740.04	$6,098.47	$17,838.51
(13)	2/28/79	$999,116.55	$11,601.92	$6,236.59	$17,838.51
(14)	3/28/79	$992,741.85	$11,463.80	$6,374.71	$17,838.51
(15)	4/28/79	$986,229.02	$11,325.69	$6,512.82	$17,838.51
(16)	5/28/79	$979,578.08	$11,187.57	$6,650.94	$17,838.51
(17)	6/28/79	$972,789.02	$11,049.45	$6,789.06	$17,838.51
(18)	7/28/79	$965,861.84	$10,911.33	$6,927.18	$17,838.51
(19)	8/28/79	$958,796.55	$10,773.21	$7,065.30	$17,838.51
(20)	9/28/79	$951,593.13	$10,635.10	$7,203.41	$17,838.51
(21)	10/28/79	$944,251.60	$10,496.98	$7,341.53	$17,838.51
(22)	11/28/79	$936,771.95	$10,358.86	$7,479.65	$17,838.51
(23)	12/28/79	$929,154.18	$10,220.74	$7,617.77	$17,838.51
(24)	1/28/80	$921,398.29	$10,082.62	$7,755.89	$17,838.51
(25)	2/28/80	$913,504.29	$9,944.50	$7,894.01	$17,838.51
(26)	3/28/80	$905,472.16	$9,806.39	$8,032.12	$17,838.51
(27)	4/28/80	$897,301.92	$9,668.27	$8,170.24	$17,838.51

(28)	5/28/80	$888,993.56	$9,530.15	$8,308.36	$17,838.51
(29)	6/28/80	$880,547.09	$9,392.03	$8,446.48	$17,838.51
(30)	7/28/80	$871,962.49	$9,253.91	$8,584.60	$17,838.51
(31)	8/28/80	$863,239.78	$9,115.80	$8,722.71	$17,838.51
(32)	9/28/80	$854,378.94	$8,977.68	$8,860.83	$17,838.51
(33)	10/28/80	$845,379.99	$8,839.56	$8,998.95	$17,838.51
(34)	11/28/80	$836,242.93	$8,701.44	$9,137.07	$17,838.51
(35)	12/28/80	$826,967.74	$8,563.32	$9,275.19	$17,838.51
(36)	1/28/81	$817,554.44	$8,425.21	$9,413.30	$17,838.51
(37)	2/28/81	$808,003.01	$8,287.09	$9,551.42	$17,838.51
(38)	3/28/81	$798,313.47	$8,148.97	$9,689.54	$17,838.51
(39)	4/28/81	$788,485.81	$8,010.85	$9,827.66	$17,838.51
(40)	5/28/81	$778,520.04	$7,872.73	$9,965.78	$17,838.51
(41)	6/28/81	$768,416.14	$7,734.61	$10,103.90	$17,838.51
(42)	7/28/81	$758,174.13	$7,596.50	$10,242.01	$17,838.51
(43)	8/28/81	$747,794.00	$7,458.38	$10,380.13	$17,838.51
(44)	9/28/81	$737,275.75	$7,320.26	$10,518.25	$17,838.51
(45)	10/28/81	$726,619.38	$7,182.14	$10,656.37	$17,838.51
(46)	11/28/81	$715,824.89	$7,044.02	$10,794.49	$17,838.51
(47)	12/28/81	$704,892.29	$6,905.91	$10,932.60	$17,838.51
(48)	1/28/82	$693.821.57	$6,767.79	$11,070.72	$17,838.51
(49)	2/28/82	$682,612.73	$6,629.67	$11,208.84	$17,838.51
(50)	3/28/82	$671,265.77	$6,491.55	$11,346.96	$17,838.51
(51)	4/28/82	$659,780.69	$6,353.43	$11,485.08	$17,838.51
(52)	5/28/82	$648,157.50	$6,215.32	$11,623.19	$17,838.51
(53)	6/28/82	$636,396.19	$6,077.20	$11,761.31	$17,838.51
(54)	7/28/82	$624,496.76	$5,939.08	$11,899.43	$17,838.51
(55)	8/28/82	$612,459.21	$5,800.96	$12,037.55	$17,838.51
(56)	9/28/82	$600,283.54	$5,662.84	$12,175.67	$17,838.51
(57)	10/28/82	$587,969.75	$5,524.72	$12,313.79	$17,838.51
(58)	11/28/82	$575,517.85	$5,386.61	$12,451.90	$17,838.51
(59)	12/28/82	$562,927.83	$5,248.49	$12,590.02	$17,838.51
(60)	1/28/83	$550,199.69	$5,110.37	$12,728.14	$17,838.51
(61)	2/28/83	$537,333.43	$4,972.25	$12,866.26	$17,838.51
(62)	3/28/83	$524,329.06	$4,834.13	$13,004.38	$17,838.51
(63)	4/28/83	$511,186.56	$4,696.02	$13,142.49	$17,838.51
(64)	5/28/83	$497,905.95	$4,557.90	$13,280.61	$17,838.51

(65)	6/28/83	$484,487.22	$4,419.78	$13,418.73	$17,838.51
(66)	7/28/83	$470,930.37	$4,281.66	$13,556.85	$17,838.51
(67)	8/28/83	$457,235.41	$4,143.54	$13,694.97	$17,838.51
(68)	9/28/83	$443,402.32	$4,005.43	$13,833.08	$17,838.51
(69)	10/28/83	$429,431.12	$3,867.31	$13,971.20	$17,838.51
(70)	11/28/83	$415,321.80	$3,729.19	$14,109.32	$17,838.51
(71)	12/28/83	$401,074.36	$3,591.07	$14,247.44	$17,838.51
(72)	1/28/84	$386,688.80	$3,452.95	$14,385.56	$17,838.51
(73)	2/28/84	$372,165.13	$3,314.83	$14,523.68	$17,838.51
(74)	3/28/84	$357,503.33	$3,176.72	$14,661.79	$17,838.51
(75)	4/28/84	$342,703.42	$3,038.60	$14,799.91	$17,838.51
(76)	5/28/84	$327,765.39	$2,900.48	$14,938.03	$17,838.51
(77)	6/28/84	$312,689.25	$2,762.36	$15,076.15	$17,838.51
(78)	7/28/84	$297,474.98	$2,624.24	$15,214.27	$17,838.51
(79)	8/28/84	$282,122.60	$2,486.13	$15,352.38	$17,838.51
(80)	9/28/84	$266,632.10	$2,348.01	$15,490.50	$17,838.51
(81)	10/28/84	$251,003.48	$2,209.89	$15,628.62	$17,838.51
(82)	11/28/84	$235,236.74	$2,071.77	$15,766.74	$17,838.51
(83)	12/28/84	$219,331.88	$1,933.65	$15,904.86	$17,838.51
(84)	1/28/85	$203,288.91	$1,795.54	$16,042.97	$17,838.51
(85)	2/28/85	$187,107.81	$1,657.42	$16,181.09	$17,838.51
(86)	3/28/85	$170,788.60	$1,519.30	$16,319.21	$17,838.51
(87)	4/28/85	$154,331.27	$1,381.18	$16,457.33	$17,838.51
(88)	5/28/85	$137,735.83	$1,243.06	$16,595.45	$17,838.51
(89)	6/28/85	$121,002.26	$1,104.94	$16,733.57	$17,838.51
(90)	7/28/85	$104,130.58	$966.84	$16,871.68	$17,838.51
(91)	8/28/85	$87,120.78	$828.71	$17,009.80	$17,838.51
(92)	9/28/85	$69,972.86	$690.59	$17,147.92	$17,838.51
(93)	10/28/85	$52,686.82	$552.47	$17,286.04	$17,838.51
(94)	11/28/85	$35,262.67	$414.35	$17,424.16	$17,838.51
(95)	12/28/85	$17,700.39	$276.24	$17,562.27	$17,838.51
(96)	1/28/86	$.00	$138.12	$17,700.39	$17,838.51

C.A.5 (Tex.),1987.
Kucel v. Walter E. Heller & Co.
813 F.2d 67, 3 UCC Rep.Serv.2d 1416

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United States District Court,
S.D. New York.
Louis Vuitton MALLETIER, Plaintiff,
v.
DOONEY & BOURKE, INC., Defendant.
No. 04 Civ. 2990(SAS).

May 30, 2008.

Background: Handbag manufacturer brought action against competitor alleging trademark infringement, false designation and unfair competition in violation of Lanham Act and New York law and trademark dilution in violation of Federal Trademark Dilution Act and New York law. Defendant moved for summary judgment.

Holdings: The District Court, Shira A. Scheindlin, J., held that:
(1) similarity of marks was unlikely to confuse ordinary consumers;
(2) there was no actual confusion between products;
(3) competitor did not act in bad faith in using allegedly infringing multi-colored monogram on handbag;
(4) monogram mark used on handbags was sufficiently famous for dilution claims;
(5) competitor's use of multi-colored monogram on handbags did not actually dilute mark of handbag manufacturer in violation of Lanham Act; and
(6) competitor's use of multi-colored monogram on handbags did not dilute mark of handbag manufacturer under New York law.

Motion granted.

West Headnotes

[1] Trademarks 382T ⚷1084

382T Trademarks
382TIII Similarity Between Marks; Likelihood of Confusion
382Tk1083 Nature of Confusion
382Tk1084 k. In general. Most Cited Cases

Trademarks 382T ⚷1112

382T Trademarks
382TIII Similarity Between Marks; Likelihood of Confusion
382Tk1112 k. Persons confused; circumstances of sale. Most Cited Cases
Where there is a claim of consumer confusion as to the association of a product or service with another person's trademark, the central inquiry is whether it is likely that an appreciable number of ordinarily prudent purchasers will be misled as to the source or sponsorship of the product or service in question. Lanham Act, §§ 32(1), 43(a)(1)(A), 15 U.S.C.A. §§ 1114(1), 1125(a)(1)(A).

[2] Trademarks 382T ⚷1084

382T Trademarks
382TIII Similarity Between Marks; Likelihood of Confusion
382Tk1083 Nature of Confusion
382Tk1084 k. In general. Most Cited Cases

Trademarks 382T ⚷1421

382T Trademarks
382TVIII Violations of Rights
382TVIII(A) In General
382Tk1418 Practices or Conduct Prohibited in General; Elements
382Tk1421 k. Infringement. Most Cited Cases
A claim of trademark infringement, whether brought under section of Lanham Act governing claims of infringement of a registered trademark or section governing infringement of an unregistered trademark, is analyzed under the familiar two-prong test for infringement; the test looks first to whether the plaintiff's mark is entitled to protection, and

second to whether defendant's use of the mark is likely to cause consumers confusion as to the origin or sponsorship of the defendant's goods. Lanham Act, §§ 32(1), 43(a)(1)(A), 15 U.S.C.A. §§ 1114(1), 1125(a)(1)(A).

[3] Trademarks 382T ⚷1081

382T Trademarks
382TIII Similarity Between Marks; Likelihood of Confusion
382Tk1081 k. Factors considered in general. Most Cited Cases
In order to determine whether a defendant's use of a mark is likely to cause consumer confusion, courts typically engage in a weighing analysis using eight factors, which are: (1) the strength of plaintiff's mark, (2) the similarity of plaintiff's and defendant's marks, (3) the proximity of the products, (4) the likelihood that plaintiff will "bridge the gap," (5) actual confusion between products, (6) defendant's good or bad faith in adopting the mark, (7) the quality of defendant's product, and (8) the sophistication of the buyers. Lanham Act, §§ 32(1), 43(a)(1)(A), 15 U.S.C.A. §§ 1114(1), 1125(a)(1)(A).

[4] Trademarks 382T ⚷1081

382T Trademarks
382TIII Similarity Between Marks; Likelihood of Confusion
382Tk1081 k. Factors considered in general. Most Cited Cases
When engaging in analysis to determine whether defendant's use of a mark is likely to cause confusion, for trademark infringement purposes, no single factor is dispositive, nor is a court limited to consideration of only some factors; each factor must be evaluated in the context of how it bears on the ultimate question of likelihood of confusion as to the source of the product. Lanham Act, §§ 32(1), 43(a)(1)(A), 15 U.S.C.A. §§ 1114(1), 1125(a)(1)(A).

[5] Trademarks 382T ⚷1459

382T Trademarks
382TVIII Violations of Rights
382TVIII(B) Dilution
382Tk1458 Nature and Elements in General
382Tk1459 k. In general. Most Cited Cases
To prevail under the Federal Trademark Dilution Act (FTDA), a mark's owner must show that: (1) the senior mark is famous, and (2) distinctive, (3) the junior use is a commercial use in commerce, (4) it begins after the senior mark has become famous, and (5) causes dilution of the distinctive quality of the senior mark. Lanham Act, § 43(c)(1), 15 U.S.C.A. § 1125(c)(1).

[6] Trademarks 382T ⚷1468

382T Trademarks
382TVIII Violations of Rights
382TVIII(B) Dilution
382Tk1468 k. Marks protected; strength or fame. Most Cited Cases
Because a famous mark can be protected under the Federal Trademark Dilution Act (FTDA) without a showing of confusion, the standard for fame and distinctiveness required to obtain anti-dilution protection is more rigorous than that required to seek infringement protection. Lanham Act, § 43(c)(1), 15 U.S.C.A. § 1125(c)(1).

[7] Trademarks 382T ⚷1468

382T Trademarks
382TVIII Violations of Rights
382TVIII(B) Dilution
382Tk1468 k. Marks protected; strength or fame. Most Cited Cases
It is not enough for a trademark holder to show that the mark has acquired secondary meaning to prevail on a trademark dilution claim under the Federal Trademark Dilution Act (FTDA); rather, the plaintiff must demonstrate that the mark is inherently distinctive. Lanham Act, § 43(c)(1), 15 U.S.C.A. § 1125(c)(1).

[8] Trademarks 382T ⚷1468

382T Trademarks
382TVIII Violations of Rights
382TVIII(B) Dilution
382Tk1468 k. Marks protected; strength or fame. Most Cited Cases

A plaintiff alleging trademark dilution in violation of Federal Trademark Dilution Act (FTDA) must show that the senior mark possesses both a significant degree of inherent distinctiveness and a high degree of acquired distinctiveness. Lanham Act, § 43(c)(1), 15 U.S.C.A. § 1125(c)(1).

[9] Trademarks 382T ⚷1468

382T Trademarks
382TVIII Violations of Rights
382TVIII(B) Dilution
382Tk1468 k. Marks protected; strength or fame. Most Cited Cases

In general, the degree of fame required for a mark to have trademark protection under the Federal Trademark Dilution Act (FTDA) must exist in the general marketplace, not in a niche market; thus, fame limited to a particular channel of trade, segment of industry or service, or geographic region is not sufficient to meet that standard. Lanham Act, § 43(c)(1), 15 U.S.C.A. § 1125(c)(1).

[10] Trademarks 382T ⚷1421

382T Trademarks
382TVIII Violations of Rights
382TVIII(A) In General
382Tk1418 Practices or Conduct Prohibited in General; Elements
382Tk1421 k. Infringement. Most Cited Cases

The elements necessary to prevail on common law causes of action for trademark infringement under New York law mirror the Lanham Act claims. Lanham Act, §§ 32(1), 43(a)(1)(A), 15 U.S.C.A. §§ 1114(1), 1125(a)(1)(A).

[11] Antitrust and Trade Regulation 29T ⚷18

29T Antitrust and Trade Regulation
29TII Unfair Competition
29TII(A) In General
29Tk15 Practices Prohibited or Required in General; Elements
29Tk18 k. Intent. Most Cited Cases

A claim of unfair competition under New York law requires evidence of defendant's bad faith.

[12] Trademarks 382T ⚷1459

382T Trademarks
382TVIII Violations of Rights
382TVIII(B) Dilution
382Tk1458 Nature and Elements in General
382Tk1459 k. In general. Most Cited Cases

To prevail on a trademark dilution claim under New York law, first, the plaintiff's trademark must be distinctive and second, the plaintiff must show a likelihood of dilution. N.Y.McKinney's General Business Law § 360-1.

[13] Trademarks 382T ⚷1468

382T Trademarks
382TVIII Violations of Rights
382TVIII(B) Dilution
382Tk1468 k. Marks protected; strength or fame. Most Cited Cases

New York law accords protection against dilution to marks that are distinctive as a result of acquired secondary meaning as well as to those that are inherently distinctive. N.Y.McKinney's General Business Law § 360-1.

[14] Trademarks 382T ⚷1463

382T Trademarks
382TVIII Violations of Rights
382TVIII(B) Dilution
382Tk1462 Reduction of Mark's Capacity to Identify; Blurring
382Tk1463 k. In general. Most Cited Cases

Trademarks 382T ⚷1466

382T Trademarks
382TVIII Violations of Rights
382TVIII(B) Dilution
382Tk1465 Creation of Unfavorable Associations; Tarnishment
382Tk1466 k. In general. Most Cited Cases
Trademark dilution under New York law can involve blurring or tarnishment. N.Y.McKinney's General Business Law § 360-1.

[15] Trademarks 382T ⚷1463

382T Trademarks
382TVIII Violations of Rights
382TVIII(B) Dilution
382Tk1462 Reduction of Mark's Capacity to Identify; Blurring
382Tk1463 k. In general. Most Cited Cases
To determine the likelihood of blurring, for purposes of trademark dilution under New York law, courts look to six factors, including: (i) the similarity of the marks, (ii) the similarity of the products covered, (iii) the sophistication of the consumers, (iv) the existence of predatory intent, (v) the renown of the senior mark, (vi) the renown of the junior mark. N.Y.McKinney's General Business Law § 360-1.

[16] Injunction 212 ⚷158

212 Injunction
212IV Preliminary and Interlocutory Injunctions
212IV(A) Grounds and Proceedings to Procure
212IV(A)4 Proceedings
212k156 Order on Application
212k158 k. Operation and effect. Most Cited Cases
The Court's findings of fact and conclusions of law made on a motion for preliminary injunction are not binding on the Court when deciding a motion for summary judgment; the parties are held to different standards of proof in preliminary injunction hearings than in motions for summary judgment and because findings of fact at the preliminary injunction stage are not as fully fleshed out as at the summary judgment stage.

[17] Trademarks 382T ⚷1098

382T Trademarks
382TIII Similarity Between Marks; Likelihood of Confusion
382Tk1093 Relationship Between Marks
382Tk1098 k. Appearance, sound, and meaning. Most Cited Cases
Similarity of multi-colored, monogrammed marks used by handbag manufacturer and its competitor was unlikely to confuse ordinary consumers, as required for manufacturer's trademark infringement claim against competitor under Lanham Act and New York law; manufacturer's monogram was significantly larger than competitor's and manufacturer's mark unmistakably included three geometric shapes that were evenly interspersed across design while competitor's mark did not include shapes, each monogram or shape that comprised manufacturer's mark bore a single color, while competitor's monogram bore different colors, color scheme on competitor's handbags created softer, unfocused effect, while manufacturer's handbags presented crisp, bold, individual colors that appeared more as collection of distinct colors. Lanham Act, § 43(a)(1)(A), 15 U.S.C.A. § 1125(a)(1)(A).

[18] Trademarks 382T ⚷1097

382T Trademarks
382TIII Similarity Between Marks; Likelihood of Confusion
382Tk1093 Relationship Between Marks
382Tk1097 k. Examination and comparison; construction as entirety. Most Cited Cases
In considering similarity of marks for purposes of trademark infringement claim under Lanham Act, courts must assess whether the overall impression created by the marks at issue in relation to the context in which they are found is likely to confuse

prospective customers. Lanham Act, §§ 32(1), 43(a)(1)(A), 15 U.S.C.A. §§ 1114(1), 1125(a)(1)(A).

[19] Trademarks 382T ⚿1088

382T Trademarks
382TIII Similarity Between Marks; Likelihood of Confusion
382Tk1083 Nature of Confusion
382Tk1088 k. "Initial interest" confusion. Most Cited Cases
"Initial interest confusion" for purposes of trademark infringement under Lanham Act is defined as confusion that creates initial customer interest, even though no actual sale is finally completed as a result of the confusion. Lanham Act, § 43(a)(1)(A), 15 U.S.C.A. § 1125(a)(1)(A).

[20] Trademarks 382T ⚿1087

382T Trademarks
382TIII Similarity Between Marks; Likelihood of Confusion
382Tk1083 Nature of Confusion
382Tk1087 k. Time of confusion. Most Cited Cases
Post-sale confusion, for purposes of trademark infringement under Lanham Act, can occur when a manufacturer of knockoff goods offers consumers a cheap knockoff copy of the original manufacturer's more expensive product, thus allowing a buyer to acquire the prestige of owning what appears to be the more expensive product. Lanham Act, §§ 32(1), 43(a)(1)(A), 15 U.S.C.A. §§ 1114(1), 1125(a)(1)(A).

[21] Federal Civil Procedure 170A ⚿2493

170A Federal Civil Procedure
170AXVII Judgment
170AXVII(C) Summary Judgment
170AXVII(C)2 Particular Cases
170Ak2493 k. Copyright, trademark, and unfair competition cases. Most Cited Cases
In order to prove actual confusion on summary judgment in a trademark infringement action, a plaintiff must put forth more than a single anecdote of confusion over the entire course of competition because de minimis evidence is insufficient to raise a triable issue. Lanham Act, § 43(a)(1)(A), 15 U.S.C.A. § 1125(a)(1)(A).

[22] Trademarks 382T ⚿1086

382T Trademarks
382TIII Similarity Between Marks; Likelihood of Confusion
382Tk1083 Nature of Confusion
382Tk1086 k. Actual confusion. Most Cited Cases
Consumers were generally aware that two multicolored and monogrammed handbag designs came from different, unaffiliated sources, which they were able to distinguish and identify by name, and thus there was no actual confusion between the products, as required for handbag manufacturer's trademark infringement action against competitor under Lanham Act and New York law. Lanham Act, § 43(a)(1)(A), 15 U.S.C.A. § 1125(a)(1)(A).

[23] Trademarks 382T ⚿1111

382T Trademarks
382TIII Similarity Between Marks; Likelihood of Confusion
382Tk1111 k. Intent; knowledge of confusion or similarity. Most Cited Cases
Competitor did not act in bad faith in using allegedly infringing multi-colored monogram on handbag, as required for handbag manufacturer's trademark infringement claims against competitor under Lanham Act and New York law, absent evidence that competitor acted to deceive customers into believing that its products were related to handbag manufacturer. Lanham Act, § 43(a)(1)(A), 15 U.S.C.A. § 1125(a)(1)(A).

[24] Trademarks 382T ⚿1112

382T Trademarks
382TIII Similarity Between Marks; Likelihood

of Confusion

382Tk1112 k. Persons confused; circumstances of sale. Most Cited Cases

Consumers of handbags sold by handbag manufacturer and competitor were sophisticated and discerning, and unlikely to be confused about brands, as would support finding of lack of likelihood of confusion, for purposes of handbag manufacturer's trademark infringement action against competitor under Lanham Act and New York law. Lanham Act, § 43(a)(1)(A), 15 U.S.C.A. § 1125(a)(1)(A).

[25] Trademarks 382T ⚷1112

382T Trademarks
382TIII Similarity Between Marks; Likelihood of Confusion
382Tk1112 k. Persons confused; circumstances of sale. Most Cited Cases

If the goods are expensive, the reasonably prudent buyer does not buy casually, but only after careful consideration; thus, for trademark infringement purposes, confusion of expensive goods is less likely than where the goods are cheap and bought casually. Lanham Act, § 43(a)(1)(A), 15 U.S.C.A. § 1125(a)(1)(A).

[26] Trademarks 382T ⚷1468

382T Trademarks
382TVIII Violations of Rights
382TVIII(B) Dilution
382Tk1468 k. Marks protected; strength or fame. Most Cited Cases

Monogram mark used on handbags was sufficiently famous, for purposes of handbag manufacturer's trademark dilution claims against competitor under Lanham Act; manufacturer engaged in widespread advertising, publicity, promotion and sales of products bearing mark, and enjoyed deluge of unsolicited media coverage and attention following release of product bearing multi-colored, monogrammed mark. Lanham Act, § 43(c)(1), 15 U.S.C.A. § 1125(c)(1).

[27] Trademarks 382T ⚷1463

382T Trademarks
382TVIII Violations of Rights
382TVIII(B) Dilution
382Tk1462 Reduction of Mark's Capacity to Identify; Blurring
382Tk1463 k. In general. Most Cited Cases

Mental association of junior mark with famous mark is not sufficient to establish actionable dilution under Lanham Act, because it does not necessarily reduce the capacity of the famous mark to identify the goods of its owner, the statutory requirement for dilution under the Federal Trademark Dilution Act (FTDA). Lanham Act, § 43(c)(1), 15 U.S.C.A. § 1125(c)(1).

[28] Trademarks 382T ⚷1463

382T Trademarks
382TVIII Violations of Rights
382TVIII(B) Dilution
382Tk1462 Reduction of Mark's Capacity to Identify; Blurring
382Tk1463 k. In general. Most Cited Cases

Blurring is not a necessary consequence of mental association for purposes of trademark dilution under Lanham Act. Lanham Act, § 43(c)(1), 15 U.S.C.A. § 1125(c)(1).

[29] Trademarks 382T ⚷1464

382T Trademarks
382TVIII Violations of Rights
382TVIII(B) Dilution
382Tk1462 Reduction of Mark's Capacity to Identify; Blurring
382Tk1464 k. Particular cases. Most Cited Cases

Competitor's use of multi-colored monogram on handbags did not actually dilute mark of handbag manufacturer, as would support manufacturer's trademark dilution claim against competitor under Lanham Act, although number of consumers mentally associated products, absent of evidence of any lessening of capacity of manufacturer's mark to identify and distinguish the goods or services offered by manufacturer. Lanham Act, § 43(c)(1), 15 U.S.C.A. § 1125(c)(1).

[30] Trademarks 382T ⚿1461

382T Trademarks
382TVIII Violations of Rights
382TVIII(B) Dilution
382Tk1461 k. Nature and extent of harm; similarity, competition, and confusion. Most Cited Cases

Trademarks 382T ⚿1473

382T Trademarks
382TVIII Violations of Rights
382TVIII(B) Dilution
382Tk1473 k. Knowledge, intent, and motives; bad faith. Most Cited Cases
Competitor's use of multi-colored monogram on handbags did not dilute mark of handbag manufacturer, as would support manufacturer's trademark dilution claim against competitor under New York law, although number of consumers mentally associated products and competitor may have attempted to benefit from association with senior mark; marks were not similar even when viewed in market conditions and considering similarity from initial interest or post-sale perspective, and there was no evidence demonstrating lack of sophistication of consumers. N.Y.McKinney's General Business Law § 360-l.
***372** Steven Kimelman, Esq., Michael A. Grow, Esq., Alison Arden Besunder, Esq., Arent Fox LLP, Theodore C. Max, Esq., Sheppard Mullin Richter & Hampton LLP, New York, NY, for Plaintiff.

Douglas D. Broadwater, Esq., Roger G. Brooks, Esq., Darin P. McAtee, Esq., Cravath, Swaine & Moore LLP, New York, NY, Thomas J. McAndrew , Esq., Thomas J. McAndrew & Associates, Providence, RI, for Defendant.

OPINION AND ORDER

SHIRA A. SCHEINDLIN, District Judge.

I. INTRODUCTION

This action has pitted two prominent handbag manufacturers against each other and mired them in seemingly endless and often contentious litigation for nearly four years. Plaintiff Louis Vuitton Malletier ("Louis Vuitton") claims that defendant Dooney & Bourke, Inc. ("Dooney & Bourke" or "Dooney") violated federal and state law by introducing and selling handbags bearing designs that infringe upon and dilute Louis Vuitton's trademark rights. Following the conclusion of extensive fact and expert discovery, Dooney & Bourke now seeks to end the case by moving for summary judgment on all of Louis Vuitton's claims. For the reasons that follow, defendant's motion is granted in its entirety.

***373 II. BACKGROUND**

A. Facts[FN1]

FN1. For a thorough discussion of the factual background, see *Louis Vuitton Malletier v. Dooney & Bourke, Inc. (Vuitton I),* 340 F.Supp.2d 415, 419-28 (S.D.N.Y.2004), *vacated in part,* 454 F.3d 108 (2d Cir.2006) (*Vuitton II*). The facts in this section are not in dispute, and are drawn from Defendant's Local Rule 56.1 Statement ("Def.56.1"), Plaintiff's Local Rule 56.1 Counterstatement of Material Facts ("Pl. Counter 56.1"), and Defendant's Amended Response to Certain Responses in Plaintiff's Local Rule 56.1 Counterstatement ("Def. Response 56.1"). The Court notes that defendant's Local Rule 56.1 Statement is shamefully long, totaling almost three hundred facts-many of which are legal conclusions and non-binding findings of fact from the preliminary injunction stage. Similarly, plaintiff's counter-statement is comprised of needlessly long responses to those purported facts, and denials based on painfully thin distinctions. Indeed, the immature posturing that both parties have exhibited throughout this litigation is evident even in their Local Rule 56.1 statements.

1. The Parties

Louis Vuitton designs, manufactures, imports, and sells fine apparel, handbags, luggage, and fashion accessories.[FN2] It maintains its principal place of business in Paris, France and employs more than ten thousand people both directly and through its subsidiaries and affiliates.[FN3]

FN2. *See* Def. 56.1 ¶ 6.

FN3. *See id.* ¶ 7.

Dooney & Bourke designs, manufacturers and sells quality handbags and fashion accessories.[FN4] It was founded in 1975, and maintains its principal place of business in Connecticut.[FN5] Peter Dooney serves as the company's president and chief designer, and he bears final authority over all of the Dooney & Bourke product designs.[FN6]

FN4. *See id.* ¶ 2.

FN5. *See id.* ¶¶ 1-2.

FN6. *See id.* ¶ 3.

2. The Handbag Designs

At its Fall 2003 fashion show held on October 7, 2002, Louis Vuitton introduced handbags bearing a new design.[FN7] This design consisted of Louis Vuitton's original, registered Toile Monogram trademark-*i.e.,* entwined "LV" initials with a curved diamond with a four-point star inset, its negative, and a circle with a four-leafed flower inset [FN8]-newly set in thirty-three colors (the "Murakami colors") [FN9] arranged on a white or black background (collectively, the "Monogram Multicolore mark").[FN10] Both the "L" and the "V" in a single "LV" monogram bear the same Murakami color.[FN11] Although the letters comprising each monogram are the same color, the colors vary from monogram to monogram.[FN12] Additionally, both of the letters in a single monogram face in the same direction, as well as all of the "LV" monograms on any given side of a handbag.[FN13] To the extent that zippers appear on the exterior of a handbag from the Monogram Multicolore line, those zippers are uncolored.[FN14]

FN7. *See id.* ¶ 11.

FN8. *See id.* ¶¶ 8-10.

FN9. These colors include red, orange, yellow, green, blue, violet, pink, black, white, brown, and gray. *See id.* ¶ 96.

FN10. *See id.* ¶¶ 12-13. *See also* Def. Response 56.1 ¶ 11.

FN11. *See, e.g.,* Four Views of One Handbag Bearing Monogram Multicolore Mark, Ex. L to Declaration of Charles A. LeGrand ("LeGrand Deck"), plaintiff's co-counsel, at L-12.

FN12. *See, e.g., id.*

FN13. *See, e.g., id.*

FN14. *See* Def. 56.1 ¶ 116.

***374** Louis Vuitton's new design, which is not registered with the U.S. Patent and Trademark Office, was the product of a collaboration between its designers and the Japanese artist Takashi Murakami.[FN15] Soon after the introduction of handbags bearing the Monogram Multicolore mark in October 2002, fashionista customers began contacting Louis Vuitton to pre-order the handbags.[FN16] Due to the great amount of interest generated by the Monogram Multicolore mark, Louis Vuitton decided to make the line of handbag and accessories bearing the mark a permanent addition to its collection.[FN17] By March 2003, handbags bearing the Monogram Multicolore mark with the white background began arriving in Louis Vuitton's retail stores.[FN18] Handbags with the black background were distributed for retail sale in July 2003.[FN19] Due to the handbags' popularity, there were waiting lists for certain products at times during 2003 and 2004.[FN20]

FN15. *See id.* ¶¶ 12, 17.

FN16. *See id.* ¶ 21.

FN17. *See* Pl. Counter 56.1 ¶ 15.

FN18. *See* Def. 56.1 ¶ 21.

FN19. *See id.*

FN20. *See id.* ¶ 275.

The price range for handbags and fashion accessories bearing the Monogram Multicolore mark range from less than one hundred and fifty dollars for a simple mirror case to thousands of dollars for certain handbags.[FN21] As of late 2006, products bearing the Monogram Multicolore mark have sold over 186,600 units in the United States,[FN22] resulting in total sales as of November 2006 of almost $145 million.[FN23]

FN21. *See, e.g.,* Photographs and Prices of Sample Louis Vuitton Monogram Multicolore Products, Ex. J to LeGrand Decl., at J-01.

FN22. *See* Def. 56.1 ¶¶ 45, 71.

FN23. *See id.* ¶ 73.

Dooney & Bourke has sold a line of products, including handbags, known as the "Signature Collection" since 2001.[FN24] This line features a repeated pattern of an interlocking "DB" monogram alternating forwards and backwards across the surface of the product.[FN25] The "DB" monogram is a registered trademark.[FN26]

FN24. *See id.* ¶ 23.

FN25. *See id.* ¶ 24.

FN26. *See id.* ¶ 26. *See also* Trademark Reg. No. 2,771,012, Ex. O to Declaration of Jessica L. Selb, defendant's counsel, in Support of Dooney & Bourke's Motion for Summary Judgment ("Selb Decl."), at 0-1.

In 2003, D & B introduced its "It Bag" line of handbags, small leather goods, and accessories.[FN27] The "It Bag" line bears a design featuring the "DB" monogram that appears in the "Signature Collection" but set in nine colors on a white background, and the "DB" monogram printed in seven colors on a black background.[FN28] The individual "D" and "B" in a single "DB" monogram bear colors different from each other and both letters face in the same direction.[FN29] Each monogram faces in an opposite direction from the monogram immediately beside it. Additionally, the "DB" monograms alternate between a "DB" facing to the right side with the "D" on top and the interlocked "B" on the bottom, and ***375** a "DB" facing to the left side (*i.e.,* the mirror image of a standard "D" and "B") with the "B" on top and the interlocked "D" on the bottom.[FN30]

FN27. *See* Def. 56.1 ¶ 34.

FN28. *See id.* ¶¶ 29, 97.

FN29. *See, e.g.,* Swatch of Dooney & Bourke Monogram on White Background ("Dooney Swatch"), Ex. C to LeGrand Deck, at C-10. *See also* Photograph of Dooney & Bourke Round Backpack, Ex. J to Selb Deck, at J-13. For photographs of examples of Louis Vuitton and Dooney & Bourke handbags bearing the marks at issue, see *Vuitton I,* 340 F.Supp.2d at 422-23 .

FN30. *See, e.g.,* Dooney Swatch.

The "It Bag" line does not feature any additional graphics or shapes other than the colored monograms on a white or black background.FN31 To the extent that zippers appear on the exterior of an "It Bag" product, those zippers are multicolored.FN32 The "It Bag" line of products also features a pink enameled heart with the words "Dooney & Bourke" written in gold script and hanging from certain handbags.FN33

FN31. *See, e.g., id.*

FN32. *See* Def. 56.1 ¶ 115. *See also* Def. Response 56.1 ¶ 115.

FN33. *See* Def. 56.1 ¶ 106. *See also* Photographs and Prices of Sample Dooney & Bourke "It Bag" Products ("Defendant's Sample of Dooney & Bourke Products"), Ex. K to Selb Deck, at K-1, K-5-K-9.

Products featuring the colored monogram on a white background began to be sold in retail stores in July 2003, and those with the black background were sold beginning in October 2003.FN34 The "It Bag" line of products range in price from less than fifty dollars to hundreds of dollars, and in general, are less expensive than Louis Vuitton products of similar size and shape.FN35

FN34. *See* Def. 56.1 ¶¶ 30-31.

FN35. *See, e.g.,* Defendant's Sample of Dooney & Bourke Products at K-1. *Accord* Photographs and Prices of Sample Dooney & Bourke "It Bag" Products, Ex. J to LeGrand Deck, at J-08.

As of late 2006, more than 1.76 million products from the "It Bag" line have been sold in the United States.FN36 The sales figures for those products have exceeded $100 million.FN37

FN36. *See* Def. 56.1 ¶ 70.

FN37. *See id.* ¶ 72.

B. Procedural Background

Louis Vuitton filed its complaint on April 19, 2004, alleging trademark infringement under section 32 of the Lanham Act, unfair competition and false designation of origin under section 43(a) of the Lanham Act, and trademark dilution under the Federal Trademark Dilution Act of 1996 (the "FTDA").FN38 Additionally, Louis Vuitton brought claims for trademark infringement and unfair competition under New York state law, and trademark dilution and injury to business reputation under section 360-l of New York's General Business Law.

FN38. *See* Complaint ¶ 1.

By motion dated April 30, 2004, Louis Vuitton moved to preliminarily enjoin Dooney & Bourke from infringing upon and diluting its trademark rights pending the final determination of the instant action. Following a seven-day hearing, the Court denied Louis Vuitton's motion in its entirety. By Opinion and Order dated August 27, 2004 (the "August 27, 2004 Opinion"), I denied injunctive relief on the trademark infringement claim because, despite the validity of the Monogram Multicolore mark, Louis Vuitton failed to demonstrate a likelihood of confusion "among consumers as to the source, authorization, or affiliation of Dooney & Bourke's handbags." FN39 I denied injunctive relief on the federal dilution claim where Louis Vuitton had demonstrated the fame and inherent distinctiveness of its mark, but had failed to adequately demonstrate that it was likely to prove actual dilution.FN40 Louis Vuitton appealed to the Second Circuit, ***376** and discovery proceeded while the appeal was pending.

FN39. *Vuitton I,* 340 F.Supp.2d at 447.

FN40. *See id.* at 448-52.

The Second Circuit affirmed in part and vacated and remanded in part. With respect to the trademark infringement claim, it agreed with this Court that the Monogram Multicolore mark is both inherently distinctive and holds secondary meaning.FN41 However, in assessing likelihood of confusion, the

Second Circuit held that this Court's utilization of a side-by-side comparison to determine the similarity of the marks at issue was improper in light of the Circuit's decision in an unrelated case, *Louis Vuitton Malletier v. Burlington Coat Factory Warehouse Corp.*[FN42] Although the Circuit found no clear error otherwise with respect to the Court's analysis of the trademark infringement claim, it vacated and remanded for a reassessment of that claim. [FN43] The Second Circuit affirmed this Court on the federal dilution claim, holding that Louis Vuitton had failed to offer any evidence of actual dilution.[FN44]

FN41. *See Vuitton II,* 454 F.3d at 116.

FN42. 426 F.3d 532 (2d Cir.2005). Notably, the Second Circuit acknowledged that the decision was issued over a year after the August 27, 2004 Opinion and could not have been anticipated by this Court. *See Vuitton II,* 454 F.3d at 112.

FN43. Specifically, the Second Circuit instructed the Court to "consider the precise trademark claimed by the plaintiff and whether, under market conditions and when viewed sequentially, Vuitton can prove likelihood of confusion between its Multicolore mark and the pattern of Dooney & Bourke's It-Bag." *Vuitton II,* 454 F.3d at 119-20. For similar reasons, the Second Circuit also vacated and remanded the portions of the August 27, 2004 Opinion that addressed Louis Vuitton's trademark infringement, unfair competition, and dilution claims under New York law. *See id.* at 119.

FN44. *See id.* at 118-19.

By Opinion and Order dated April 27, 2007, I held that in order for Louis Vuitton to recover Dooney & Bourke's profits should it prevail on its federal trademark infringement claim, it must prove that Dooney & Bourke's infringing conduct was willfully deceitful.[FN45] In the absence of such a showing, Louis Vuitton would only be entitled to recover the amount of its own damages. [FN46] Moreover, I held that Louis Vuitton's federal dilution claim, to the extent it seeks damages, continues to be governed by the standard set forth in the FTDA rather than its replacement-the Trademark Dilution Revision Act of 2006 (the "TDRA"). As a result, Louis Vuitton cannot recover monetary damages absent a showing of actual dilution.[FN47]

FN45. *See Louis Vuitton Malletier v. Dooney & Bourke, Inc. ("Vuitton III"),* 500 F.Supp.2d 276, 280-82 (S.D.N.Y.2007).

FN46. *See id.* at 282 ("Unless Louis Vuitton has developed new proof of Dooney & Bourke's willful deceit, the only monetary remedy to which Louis Vuitton will be entitled, with respect to its infringement claim, are damages-not Dooney & Bourke's profits.").

FN47. *See id.* at 282-83. By Memorandum Opinion and Order dated May 22, 2007,1 denied Louis Vuitton's motion for reconsideration and modification of *Vuitton III. See Louis Vuitton Malletier v. Dooney & Bourke, Inc.,* 500 F.Supp.2d 276 (S.D.N.Y.2007).

Following the close of extensive fact and expert discovery, both parties moved in limine to exclude certain expert testimony and reports under Federal Rules of Evidence 403 and 702, and *Daubert v. Merrell Dow Pharmaceuticals, Inc.*[FN48] and its progeny. In light of the volume of submissions on those motions, the Court appointed special masters with the parties' consent pursuant to Federal Rule of Civil Procedure 53(a)(1)(A) and (a)(1)(C) and by Order dated May 18, 2007. The special masters ***377** issued a Report & Recommendation (the "R & R") and the parties objected to the Court's adoption of various portions of the R & R. By Opinion and Order dated December 13, 2007, I adopted the

R & R subject to certain very limited modifications.[FN49] Dooney & Bourke then filed the instant motion for summary judgment.

FN48. 509 U.S. 579, 113 S.Ct. 2786, 125 L.Ed.2d 469(1993).

FN49. *See Louis Vuitton Malletier v. Dooney & Bourke, Inc. ("Vuitton IV")*, 525 F.Supp.2d 558 (S.D.N.Y.2007).

III. APPLICABLE LAW

A. Summary Judgment

Summary judgment is appropriate "if the pleadings, the discovery and disclosure materials on file, and any affidavits show that there is no genuine issue as to any material fact and that the movant is entitled to judgment as a matter of law."[FN50] An issue of fact is genuine " 'if the evidence is such that a reasonable jury could return a verdict for the nonmoving party.' "[FN51] A fact is material when it " 'might affect the outcome of the suit under the governing law.' "[FN52] "It is the movant's burden to show that no genuine factual dispute exists."[FN53]

FN50. Fed.R.Civ.P. 56(c).

FN51. *Higazy v. Templeton,* 505 F.3d 161, 169 (2d Cir.2007) (quoting *Anderson v. Liberty Lobby, Inc.,* 477 U.S. 242, 248, 106 S.Ct. 2505, 91 L.Ed.2d 202 (1986)).

FN52. *McCarthy v. Dun & Bradstreet Corp.,* 482 F.3d 184, 202 (2d Cir.2007) (citing *Jeffreys v. City of New York,* 426 F.3d 549, 553 (2d Cir.2005)).

FN53. *Vermont Teddy Bear Co. v. 1-800 Beargram Co.,* 373 F.3d 241, 244 (2d Cir.2004) (citing *Adickes v. S.H. Kress & Co.,* 398 U.S. 144, 157, 90 S.Ct. 1598, 26 L.Ed.2d 142 (1970)).

In turn, to defeat a motion for summary judgment, the non-moving party must raise a genuine issue of material fact. To do so, it must do more than show that there is " 'some metaphysical doubt as to the material facts,' "[FN54] and it " 'may not rely on conclusory allegations or unsubstantiated speculation.' "[FN55] However, " 'all that is required [from a non-moving party] is that sufficient evidence supporting the claimed factual dispute be shown to require a jury or judge to resolve the parties' differing versions of the truth at trial.' "[FN56]

FN54. *Higazy,* 505 F.3d at 169 (quoting *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.,* 475 U.S. 574, 586, 106 S.Ct. 1348, 89 L.Ed.2d 538 (1986)).

FN55. *Jeffreys,* 426 F.3d at 554 (quoting *Fujitsu Ltd. v. Federal Express Corp.,* 247 F.3d 423, 428 (2d Cir.2001)).

FN56. *McClellan v. Smith,* 439 F.3d 137, 144 (2d Cir.2006) (quoting *First Nat'l Bank of Ariz. v. Cities Serv. Co.,* 391 U.S. 253, 288-89, 88 S.Ct. 1575, 20 L.Ed.2d 569 (1968)).

In determining whether a genuine issue of material fact exists, the court must construe the evidence in the light most favorable to the non-moving party and draw all justifiable inferences in that party's favor.[FN57] However, "[i]t is a settled rule that '[c]redibility assessments, choices between conflicting versions of the events, and the weighing of evidence are matters for the jury, not for the court on a motion for summary judgment.' "[FN58] Summary judgment is therefore inappropriate " 'if there is any evidence in the record that could reasonably support a jury's verdict for the non-moving party.' "[FN59]

FN57. *See Allstate Ins. Co. v. Hamilton Beach/Proctor Silex, Inc.,* 473 F.3d 450, 456 (2d Cir.2007) (citing *Stern v. Trustees of Columbia Univ.,* 131 F.3d 305, 312 (2d Cir.1997)).

FN58. *McClellan,* 439 F.3d at 144 (quoting

Fischl v. Armitage, 128 F.3d 50, 55 (2d Cir.1997)). *Accord Anderson,* 477 U.S. at 249, 106 S.Ct. 2505.

FN59. *American Home Assurance Co. v. Hapag Lloyd Container Linie, GmbH,* 446 F.3d 313, 315 (2d Cir.2006) (quoting *Marvel Characters, Inc. v. Simon,* 310 F.3d 280, 286 (2d Cir.2002)).

***378 B. Trademark Infringement Under the Lanham Act**

Section 32(1) of the Lanham Act governs claims for infringement of a registered trademark, prohibiting the use in commerce of "any reproduction, counterfeit, copy, or colorable imitation of a registered mark in connection with the sale, offering for sale, distribution, or advertising of any goods or services on or in connection with which such use is likely to cause confusion, or to cause mistake, or to deceive." FN60

FN60. 15 U.S.C. § 1114(1).

[1] Section 43(a) of the Act FN61 governs claims for infringement of an unregistered trademark and also acts as "a broad federal unfair competition provision." FN62 Accordingly, "[w]here there is a claim of consumer confusion [as] to the association of a product or service with another person's trademark, the central inquiry is whether it is likely that 'an appreciable number of ordinarily prudent purchasers' will be misled as to the source or sponsorship of the product or service in question." FN63

FN61. *See* 15 U.S.C. § 1125(a)(1)(A).

FN62. *Chambers v. Time Warner, Inc.,* 282 F.3d 147, 155 (2d Cir.2002). Specifically, section 43(a) prohibits the use in commerce of "any word, term, name, symbol, or device, or any combination thereof, or any false designation of origin, false or misleading description of fact, or false or misleading representation of fact, which ... is likely to cause confusion, or to cause mistake, or to deceive as to the affiliation, connection, or association of such person with another person, or as to the origin, sponsorship, or approval of his or her goods, services, or commercial activities by another person." 15 U.S.C. § 1125(a)(1)(A).

FN63. *Chambers,* 282 F.3d at 155 (quoting *EMI Catalogue P'ship v. Hill, Holliday, Connors, Cosmopulos Inc.,* 228 F.3d 56, 61-62 (2d Cir.2000)).

[2] "A claim of trademark infringement, whether brought under [section 32(1) or 43(a) of the Act], is analyzed under the familiar two-prong test .... The test looks first to whether the plaintiff's mark is entitled to protection, and second to whether defendant's use of the mark is likely to cause consumers confusion as to the origin or sponsorship of the defendant's goods." FN64 A certificate of registration of plaintiff s trademark on the principal register is prima facie evidence that plaintiff's mark satisfies the first prong of the test. FN65

FN64. *Virgin Enters. Ltd. v. Nawab,* 335 F.3d 141, 146 (2d Cir.2003) (citing *Gruner + Jahr USA Publ'g v. Meredith Corp.,* 991 F.2d 1072 (2d Cir.1993) and *Time, Inc. v. Petersen Publ'g Co. L.L.C,* 173 F.3d 113, 117 (2d Cir.1999)). *Accord Vuitton II,* 454 F.3d at 115.

FN65. *See* 15 U.S.C. § 1057(b) ("A certificate of registration of a mark upon the principal register provided by this chapter shall be prima facie evidence of the validity of the registered mark and of the registration of the mark, of the registrant's ownership of the mark, and of the registrant's exclusive right to use the registered mark in commerce ....").

[3][4] In order to determine whether a defendant's use of a mark is likely to cause consumer confu-

sion, courts in the Second Circuit typically engage in a weighing analysis using the eight *Polaroid* factors set out by Judge Henry Friendly, which are: (1) the strength of plaintiff s mark; (2) the similarity of plaintiffs and defendant's marks; (3) the proximity of the products; (4) the likelihood that plaintiff will "bridge the gap;" (5) actual confusion between products; (6) defendant's good or bad faith in adopting the mark; (7) the quality of defendant's product; and (8) the sophistication of the buyers. [FN66] However, "[n]o single factor is dispositive, nor is a court limited to consideration of only these factors." [FN67] "Further, 'each factor must be evaluated in the context of how it bears on the ultimate question of likelihood of confusion***379** as to the source of the product.' " [FN68] The Second Circuit has also noted that "the court may in some circumstances grant summary judgment even without considering all of the *Polaroid* factors." [FN69]

FN66. *See Polaroid Corp. v. Polarad Elecs. Corp.,* 287 F.2d 492, 495 (2d Cir.1961).

FN67. *Brennan's, Inc. v. Brennan's Restaurant, L.L.C.,* 360 F.3d 125, 130 (2d Cir.2004) (citing *Polaroid,* 287 F.2d at 495).

FN68. *Id.* (quoting *Lois Sportswear, U.S.A., Inc. v. Levi Strauss & Co.,* 799 F.2d 867, 872 (2d Cir.1986)).

FN69. *Playtex Prods., Inc. v. Georgia-Pacific Corp.,* 390 F.3d 158, 167 (2d Cir.2004) (citation omitted).

"The likelihood-of-confusion inquiry turns on whether 'numerous ordinary prudent purchasers are likely to be misled or confused as to the source of the product in question because of the entrance in the marketplace of defendant's mark.' " [FN70] "To support a finding of infringement, there must be a 'probability of confusion, not a mere possibility.' " [FN71] "This standard does not change on summary judgment." [FN72]

FN70. *Id.* at 161 (quoting *Cadbury Beverages, Inc. v. Cott Corp.,* 73 F.3d 474, 477-78 (2d Cir.1996)).

FN71. *Id.* (quoting *Nora Beverages, Inc. v. Perrier Group of Am., Inc.,* 269 F.3d 114, 121 (2d Cir.2001)).

FN72. *Id.*

"If a factual inference must be drawn to arrive at a particular finding on a *Polaroid* factor, and if a reasonable trier of fact could reach a different conclusion, the district court may not properly resolve that issue on summary judgment." [FN73] As such, summary judgment should only be granted "where the undisputed evidence would lead only to one conclusion as to whether confusion is likely." [FN74]

FN73. *Cadbury Beverages,* 73 F.3d at 478.

FN74. *Id.*

C. Trademark Dilution Under the Lanham Act

Under the FTDA, "the owner of a famous trademark [can] seek 'an injunction against another person's commercial use in commerce of a mark or trade name, if such use begins after the mark has become famous and causes dilution of the distinctive quality of the mark.' " [FN75] Whereas an action for trademark infringement "serves the interests of consumers, as well as sellers, in having trademarks function as source-identifiers," a dilution claim exists "*solely* for the benefit of sellers. Its purpose is to protect the owners of famous marks from the kind of dilution that is permitted by the trademark laws when a junior user uses the same mark in a non-confusing way in an unrelated area of commerce." [FN76] Dilution ordinarily applies where the parties do not operate in competitive or closely related product lines, but the FTDA "on its face is capable of application to competitive situations." [FN77]

FN75. *New York Stock Exch., Inc. v. New*

York, New York Hotel, LLC, 293 F.3d 550, 557 (2d Cir.2002) (quoting 15 U.S.C. § 1125(c)(1)). The FTDA provides, in relevant part, that: "The owner of a famous mark shall be entitled ... to an injunction against another person's commercial use ... of a mark or trade name, if such use begins after the mark has become famous and causes dilution of the distinctive quality of the mark ...."

FN76. *TCPIP Holding Co. v. Haar Commc'ns,* 244 F.3d 88, 95 (2d Cir.2001) (emphasis added). *See also id.* ("The [FTDA] offers no benefit to the consumer public-only to the owner.").

FN77. J. Thomas McCarthy, 4 *McCarthy on Trademarks and Unfair Competition* § 24:72 (4th ed.2008). McCarthy opines that ("[i]t is difficult to understand why an anti-dilution law is invoked when the parties operate in competitive or closely related product or service lines. The legal theory of anti dilution was conceived to protect strong marks against a diluting use by a junior users in a product or service line far removed from that in which the famous mark appears. Thus, using the anti-dilution law when the parties are competitors in the same market sounds a dissonant and false note. Why the need to invoke the 'super weapon' of anti-dilution law to resolve what appears to be a garden variety infringement case."). *But see Nabisco, Inc. v. PF Brands, Inc.,* 191 F.3d 208, 219 (2d Cir.1999) ("While the antidilution statutes aim at a different harm than the infringement statute ... we see no reason why dilution cannot occur ... where the products are competing."), *abrogated on other grounds, Moseley v. V Secret Catalogue, Inc.,* 537 U.S. 418, 433, 123 S.Ct. 1115, 155 L.Ed.2d 1 (2003).

***380** [5][6][7] To prevail under the FTDA, a mark's owner must show that: "(1) the senior mark [is] famous; [and] (2) distinctive; (3) the junior use [is] a commercial use in commerce; (4) it [ ] begin[s] after the senior mark has become famous; and (5)[ ] cause[s] dilution of the distinctive quality of the senior mark." FN78 Because a famous mark can be protected under the FTDA *without* a showing of confusion, "the standard for fame and distinctiveness required to obtain anti-dilution protection is more rigorous than that required to seek infringement protection." FN79 It is not enough for a trademark holder to show that the mark has acquired secondary meaning. Rather, the plaintiff must demonstrate that the mark is *inherently distinctive* to prevail under the FTDA. FN80

FN78. *Nabisco,* 191 F.3d at 215.

FN79. *Empresa Cubana del Tabaco v. Culbro Corp.,* No. 97 Civ. 8399, 2004 WL 602295, at *33 (S.D.N.Y. Mar. 26, 2004) (quotation marks and citation omitted).

FN80. *See New York Stock Exch.,* 293 F.3d at 556-57.

[8][9] A "plaintiff must show that the senior mark possesses both a significant degree of *inherent* distinctiveness and ... a high degree of ... *acquired* distinctiveness." FN81 In general, the " 'degree of fame required for protection under the FTDA must exist in the general marketplace, not in a niche market. Thus, fame limited to a particular channel of trade, segment of industry or service, or geographic region is not sufficient to meet that standard.' " FN82

FN81. *Savin Corp. v. Savin Group,* 391 F.3d 439, 449 (2d Cir.2004) (quotation marks omitted) (emphasis in original).

FN82. *Id.* at 450 n. 6 (quoting *Christopher D. Smithers Found., Inc. v. St. Luke's-Roosevelt Hosp. Ctr.,* 00 Civ. 5502, 2003 WL 115234, at *5-6 (S.D.N.Y. Jan.13, 2003)).

A plaintiff must next demonstrate the existence of *actual* dilution, although it need not prove actual loss of sales or profits.[FN83] The Supreme Court has explained:

FN83. The Supreme Court [in *Moseley*] in essence made it more difficult for dilution claims to succeed because plaintiffs face a much higher hurdle of demonstrating actual dilution, but the Court was silent as to the manner in which courts must evaluate plaintiffs' success in overcoming that hurdle. This silence could imply that a test designed to measure likelihood of dilution may not be appropriate to evaluate actual dilution, but we are left without firm guidance on the issue.

AutoZone, Inc. v. Tandy Corp., 373 F.3d 786, 804 (6th Cir.2004).

[W]here the marks at issue are not identical, the mere fact that consumers mentally associate the junior user's mark with a famous mark is not sufficient to establish actionable dilution .... [S]uch mental association will not necessarily reduce the capacity of the famous mark to identify the goods of its owner ....[FN84]

FN84. *Moseley,* 537 U.S. at 433, 123 S.Ct. 1115.

In 2006, Congress enacted the TDRA, which replaced the FTDA in its entirety.[FN85] Under the TDRA, a trademark owner must still demonstrate that its mark is famous or "widely recognized by the general consuming public of the United States as a designation of source of the goods or services of the mark's owner."[FN86] While ***381** the TDRA reconfigured the factors used by courts to evaluate fame, the "Second Circuit's requirement that 'the senior mark [must] be truly famous before a court will afford the owner of the mark the vast protections of the FTDA' remains unchanged ...."[FN87]

FN85. *See* Pub.L. No. 109-312, 120 Stat. 1730 (2006).

FN86. 15 U.S.C. § 1125(c)(2)(A).

FN87. *Dan-Foam A/S v. Brand Named Beds, LLC,* 500 F.Supp.2d 296, 307 n. 90 (S.D.N.Y.2007) (quoting *Savin Corp.,* 391 F.3d at 449).

The TDRA also provides the owner of a famous mark with injunctive relief.[FN88] In addition to injunctive relief, the TDRA permits the recovery of monetary damages on a federal dilution claim where the owner of a famous mark establishes a likelihood of dilution.[FN89] The TDRA thus relaxed the burden of proof required to obtain monetary relief since the FTDA had required the owner to establish actual dilution. This relaxed standard, however, applies only if the mark "that is likely to cause dilution ... was first used in commerce by the person against whom the injunction is sought *after October 6, 2006* ...."[FN90]

FN88. 15 U.S.C. § 1125(c)(5) ("[T]he owner of a famous mark shall be entitled to injunctive relief as set forth in section 1116 of this title."). Section 1116 empowers courts to "grant injunctions, according to the principles of equity and upon such terms as the court may deem reasonable, to prevent the violation of any right of the registrant of a mark registered in the Patent and Trademark Office or to prevent a violation under subsection (a), (c), or (d) of section 1125 of this title." *Id.* § 1116.

FN89. *See id.* § 1125(c)(5).

FN90. *Id.* (emphasis added). *Accord Dan-Foam A/S,* 500 F.Supp.2d at 308 ("Because the TDRA's relaxed likelihood of dilution standard applies only to pre-October 6, 2006 claims seeking prospective relief, actual dilution ... still applies when a pre-October 6, 2006 claimant seeks monetary relief").

D. State Law Claims

1. Trademark Infringement and Unfair Competition

[10][11] "The elements necessary to prevail on common law causes of action for trademark infringement 'mirror the Lanham Act claims.' " FN91 A claim of unfair competition under New York law also requires evidence of defendant's bad faith. FN92

FN91. *Vuitton I,* 340 F.Supp.2d at 436 (quoting *TCPIP Holding Co. v. Haar Commc'ns,* No. 99 Civ. 1825, 2004 WL 1620950, at *6 n. 5 (S.D.N.Y. July 19, 2004)). *Accord Cartier Int'l B.V. v. Ben-Menachem,* No. 06 Civ. 3917, 2008 WL 64005, at *13 (S.D.N.Y. Jan.3, 2008) ("The same acts that constitute trademark counterfeiting and unfair competition under federal laws give rise to [p]laintiffs' claims of common law trademark infringement and unfair competition, as well as unfair competition under New York law.").

FN92. *See Vuitton I,* 340 F.Supp.2d at 436.

2. Trademark Dilution Under Section 360-1 of the New York General Business Law

[12] Under New York General Business law, a "[l]ikelihood of ... dilution of the distinctive quality of a mark or trade name shall be a ground for injunctive relief ... notwithstanding the absence of competition between the parties or the absence of confusion as to the source of goods or services." FN93 To prevail on a claim under section 360-1 of the New York General Business Law, *first,* the plaintiff's trademark must be distinctive and *second,* the plaintiff must show a likelihood of dilution. FN94

FN93. N.Y. Gen. Bus. Law § 360-1.

FN94. *See Vuitton I,* 340 F.Supp.2d at 436.

***382** [13][14][15] With respect to the first element, "[d]istinctiveness for dilution purposes often has been equated with the strength of a mark for infringement purposes." FN95 "New York law accords protection against dilution to marks that are distinctive as a result of acquired secondary meaning as well as to those that are inherently distinctive." FN96 Dilution under the second element can involve blurring or tarnishment. FN97 " 'To determine the likelihood of blurring, [courts look] to six factors, including: (i) the similarity of the marks; (ii) the similarity of the products covered; (iii) the sophistication of the consumers; (iv) the existence of predatory intent; (v) the renown of the senior mark; (vi) the renown of the junior mark.' " FN98

FN95. *Mead Data Cent., Inc. v. Toyota Motor Sales, U.S.A., Inc.,* 875 F.2d 1026, 1030 (2d Cir.1989) (citations omitted).

FN96. *New York Stock Exch.,* 293 F.3d at 557 (citation omitted).

FN97. *See id.* (citation omitted).

FN98. *Vuitton I,* 340 F.Supp.2d at 437 (quoting *New York Stock Exch.,* 293 F.3d at 558).

IV. DISCUSSION

As an initial matter, the parties dispute whether the findings of fact and conclusions of law reached by the Court at the preliminary injunction stage are relevant to the resolution of the instant motion. Louis Vuitton contends that Dooney & Bourke's references in its Local Rule 56.1 statement to those findings and conclusions are improper because the standard governing summary judgment is distinguishable from the standard on a motion to preliminarily enjoin activity.

[16] Louis Vuitton is correct that the Court's findings of fact and conclusions of law made on a motion for preliminary injunction are not binding on the Court when deciding a motion for summary judgment. This is because the "parties are held to different standards of proof in preliminary injunction hearings than in motions for summary judgment and because findings of fact at the preliminary injunction stage are not as fully fleshed out as at the summary judgment stage ...." FN99

FN99. *DeSmeth v. Samsung Am.*, No. 92 Civ. 3710, 1998 WL 315469, at *2 (S.D.N.Y. June 16, 1998).

Although Dooney & Bourke is correct that the Court may consider those findings and conclusions on a summary judgment motion, FN100 its proffer of statements made in the August 27, 2004 Opinion as undisputed facts is not helpful. FN101 Even if Louis Vuitton does not dispute that those statements were once made, the Court must still conduct an independent inquiry based on the record, as it currently stands, to determine whether judgment can be granted as a matter of law.

FN100. *See Lanvin, Inc. v. Colonia, Inc.*, 776 F.Supp. 125, 127 (S.D.N.Y.1991) (stating that "[i]n determining a motion for summary judgment, we may consider the Court's findings of fact and conclusions of law in a prior motion for preliminary injunction. However, those earlier findings are not binding ....").

FN101. *See, e.g.*, Def. 56.1 ¶ 130 ("[T]here is absolutely no proof that Dooney & Bourke attempted to deceive consumers. *Vuitton [I]*, 340 F.Supp.2d at 447, *aff'd, Vuitton [II]*, 454 F.3d at 118."). The Court is obviously aware of its own findings in 2004. Dooney & Bourke's citation to those findings in its Local Rule 56.1 statement was a waste of time, paper, and this Court's limited resources.

A. Trademark Infringement Under the Lanham Act

After nearly four years of litigation, the parties continue to dispute the exact contours of the Monogram Multicolore mark. Specifically, in its Counterstatement of Material Facts pursuant to Local Rule ***383** 56.1, Louis Vuitton now claims that the Monogram Multicolore mark consists of "elements of the original Toile Monogram [t]rademark ... thirty-three colors arranged and displayed with regularly spaced intervals in horizontal and diagonal rows, in a repeating fashion, on a white [ ] or a black background [ ]." FN102 This definition marginally expands the scope of the Monogram Multicolore mark, as originally defined. However, because Louis Vuitton has consistently defined the Monogram Multicolore mark, up until now, as the Toile Monogram trademark in the thirtythree Murakami colors set against the white or black background, FN103 I continue to use that definition here.

FN102. *See, e.g.*, Pl. Counter 56.1 ¶ 18. *See also* Def. Response 56.1 ¶ 11 ("The cited evidence does not demonstrate that the [Monogram] Multicolore mark is 'colors arranged and displayed with regularly spaced intervals' in 'horizontal rows in a repeating fashion,' as LV now states ....").

FN103. *See, e.g.*, *Vuitton II*, 454 F.3d at 115 ("Vuitton claims a new trademark, currently unregistered, consisting of a design plus color, that is, the traditional Vuitton Toile pattern design-entwined LV initials with the three already described motifs-displayed in the 33 Murakami colors and printed on a white or black background.").

The first prong of the test for trademark infringement requires that the Monogram Multicolore mark be entitled to protection. The Second Circuit has previously held that the mark is protectable under section 43(a) of the Lanham Act because it is inherently distinctive, and it has acquired secondary meaning.[FN104] Despite Louis Vuitton's assertion that "a genuine issue of fact exists on this important [ ] factor,"[FN105] nowhere does Dooney & Bourke actually dispute that the Monogram Multicolore mark is a valid mark entitled to protection. In the absence of any dispute on this prong, and because it is well-established based on ample evidence that the mark is inherently distinctive, and has acquired secondary meaning, there is no genuine issue of material fact on this prong.

FN104. *See id.* at 116.

FN105. Plaintiff Louis Vuitton Malletier's Memorandum of Law in Opposition to Defendant Dooney & Bourke, Inc.'s Motion for Summary Judgment ("Pl.Opp.") at 13.

The outcome of plaintiff's trademark infringement claim thus turns on the likelihood-of-confusion inquiry. I focus primarily on the *Polaroid* factors for which the parties dispute whether genuine issues of material fact remain.[FN106] The crux of Dooney & Bourke's motion for summary judgment on the trademark infringement claim is that Louis Vuitton has failed to put forth evidence demonstrating likelihood of confusion despite the fact that the allegedly infringing "It Bags" have been sold for four years.[FN107] According to Dooney & Bourke, "confusion has never occurred in the real world despite colossal sales of both products,"[FN108] and therefore there is ***384** no genuine issue of material fact as to whether consumers are likely to be confused. Louis Vuitton contends that because a reasonable juror could find that the design featured on Dooney & Bourke's "It Bags" is likely to cause confusion, summary judgment is precluded.[FN109]

FN106. It is "incumbent upon the district judge to engage in a deliberate review of each factor, and, if a factor is inapplicable to a case, to explain why." *Natural Organics, Inc. v. Nutraceutical Corp.*, 426 F.3d 576, 579 (2d Cir.2005) (quotation marks omitted). The parties agree that the fourth *Polaroid* factor of "the likelihood that plaintiff will bridge the gap" is not an issue here and need not be considered. *See* Pl. Opp. at 14 n. 5; Dooney & Bourke's Memorandum of Law in Support of its Motion for Summary Judgment ("Def.Mem.") at 13 n. 11. Dooney & Bourke contends that even if the remaining two *Polaroid* factors-"the strength of plaintiff's mark" and "the proximity of the products"-weigh in Louis Vuitton's favor, "the outcome of the *Polaroid* analysis on likelihood of confusion must still favor" Dooney & Bourke. Def. Mem. at 13 n. 11. Because there is no genuine issue of material fact as to either factor, both *Polaroid* factors weigh in Louis Vuitton's favor.

FN107. Def. Mem. at 3-13.

FN108. Dooney & Bourke's Reply Memorandum of Law in Further Support of its Motion for Summary Judgment at 1.

FN109. *See* Pl. Opp. at 13.

1. The Second *Polaroid* Factor: Similarity Between Plaintiffs and Defendant's Marks

[17][18][19][20] In considering similarity, courts must assess whether the "overall impression" created by the marks at issue in relation to the "context in which they are found" is likely to confuse prospective customers.[FN110] Because the Second Circuit has made clear that "market conditions must be examined closely to see whether the differences between the marks are 'likely to be memorable enough to dispel confusion on serial viewing,' "[FN111] the Court has carefully considered all of the evidence in the record with this guidance in mind. Based on that review, I hold that plaintiff has offered no proof that the similarity in the marks is likely to confuse ordinary consumers, whether it is at the point of initial interest, point-of-sale, or post-

sale, and the differences between the marks are "likely to be memorable enough to dispel confusion" even under market conditions. FN112

FN110. *Gruner + Jahr,* 991 F.2d at 1079.

FN111. *Vuitton II,* 454 F.3d at 118 (quoting *Burlington Coat Factory,* 426 F.3d at 538).

FN112. *Id.* (quotation marks omitted). Louis Vuitton appears to claim only initial interest and post-sale confusion. Initial interest confusion is defined as "confusion that creates initial customer interest, even though no actual sale is finally completed as a result of the confusion." "[E]ven if the marks are almost identical, initial interest confusion is not assumed and must be proven by the evidence." 4 McCarthy § 23:6. Post-sale confusion "can occur when a manufacturer of knockoff goods offers consumers a cheap knockoff copy of the original manufacturer's more expensive product, thus allowing a buyer to acquire the prestige of owning what appears to be the more expensive product." *Hermes Int'l v. Lederer de Paris Fifth Ave., Inc.,* 219 F.3d 104, 108 (2d Cir.2000).

As I have previously observed, there are obvious similarities between the products bearing the marks at issue. Most notably, both the Louis Vuitton and Dooney & Bourke handbags feature multicolored monograms set against a white or black background. In market as well as social settings, consumers would likely view the handbags sequentially or serially rather than simultaneously, from a distance rather than at close-range, and subject to varying lighting conditions. Considering real-world conditions "is merely an application of the general rule that the job of a decision-maker is not to make a personal evaluation of the marks as shown on exhibits side-by-side in a brief or displayed in blown-up reproductions conveniently placed next to each other on easels in a courtroom." FN113

FN113. 4 McCarthy § 23:58. *Accord Burlington Coat Factory,* 426 F.3d at 539.

Even when viewed in market and social settings, from afar, and at different times, there are a number of key, discernible dissimilarities that preclude a finding that consumers would consider the marks confusingly similar. *First,* Louis Vuitton's Monogram Multicolore mark consists of its well-recognized, strong, and inherently distinctive Toile Monogram mark. Dooney & Bourke's "It Bags" prominently feature the "DB" registered trademark. Although the background color may be the same-either white or black-the monograms and their positioning on that background distinguish the products even when viewed "in public from a distance, in a store window, from across a room, from a passing ***385** car, [ ] while walking in the street," FN114 in an advertisement, or hanging off of a woman's shoulder, by way of examples.

FN114. Declaration of Heather Vandenberghe, Vice President of Marketing and Communications for Louis Vuitton North America ("Vandenberghe Decl."), in Opposition to Dooney's Motion for Summary Judgment, ¶ 9.

The "LV" in the Monogram Multicolore mark is significantly larger in font size than Dooney & Bourke's "DB," and plaintiff's mark unmistakably includes three geometric shapes that are evenly interspersed across the design. In fact, the geometric shapes themselves constitute a significant portion of the design. Even when viewed in marketplace conditions, it is plainly discernible that the Monogram Multicolore mark is a combination of letters *and* shapes. In contrast, the design on Dooney & Bourke's "It Bags" is solely comprised of the "DB" monogram, without any other shapes whatsoever.

Second, the undisputed evidence shows that each monogram or shape that comprises the Louis Vuitton's Monogram Multicolore mark bears a single color. For example, both the "L" and the "V" that comprise a single "LV" monogram on a handbag are the same color. In contrast, the "D" and the "B" comprising a single "DB" monogram on a handbag bear different colors. The impressions created by the handbags' differing presentations of color are distinct as well as distinguishable. The color scheme on the Dooney & Bourke handbags creates a softer, unfocused effect, while the Monogram Multicolore mark presents crisp, bold, individual colors that appear more as a collection of distinct colors.

In light of the key dissimilarities between the marks at issue and the existence of defendant's prominent and registered trademark on the products bearing the allegedly infringing mark, the differences are "likely to be memorable enough to dispel confusion on serial viewing." FN115 As a result, this factor favors defendant.

FN115. *Burlington Coat Factory,* 426 F.3d at 538.

2. The Fifth *Polaroid* Factor: Actual Confusion Between the Products

Louis Vuitton asserts that two genuine issues of material fact on this *Polaroid* factor remain in dispute: *first,* "[w]hether consumers have been confused by Dooney's marks, including as to whether products bearing them are Louis Vuitton products;" and *second,* "[w]hether the decline in Louis Vuitton's U.S. sales of products under its Monogram Multicolore [m]arks, versus the upward trend in the rest of the world where Dooney does not sell products, was the result of Dooney's use of multicolored monogram marks ... that confused and diverted customers ...." FN116 Louis Vuitton further contends that because it has obtained evidence of actual confusion since the Court's finding at the preliminary injunction stage this factor weighs in favor of defendant.

FN116. Plaintiff Louis Vuitton's Statement of Material Facts Precluding Summary Judgment ¶¶ 320-321.

[21] Dooney & Bourke argues that Louis Vuitton has still failed to produce any evidence that even a single consumer was actually confused about source or sponsorship of the "It Bags" during the past four years and instead continues to rely on previously-rejected evidence. It is well-established that Louis Vuitton need not show actual confusion in order to prevail on its claim, but " '[t]here can be no more positive or substantial proof of the likelihood of confusion than proof of actual confusion.' " FN117 In order to prove actual ***386** confusion, however, Louis Vuitton must put forth more than a " 'single anecdote [ ] of confusion over the entire course of competition' " because de minimis evidence is insufficient to raise a triable issue. FN118

FN117. *Savin Corp.,* 391 F.3d at 459 (quoting *World Carpets, Inc. v. Dick Littrell's New World Carpets,* 438 F.2d 482, 489 (5th Cir.1971)).

FN118. *Id.* (quoting *Nora Beverages,* 269 F.3d at 124) (finding that evidence of a single incident where "someone who had previously sold an exhibit to [d]efendants mistakenly concluded that one of [p]laintiff's executives was associated with [defendants]" constituted de minimis evidence of actual confusion, and weighing that factor in defendants' favor).

[22] The evidence submitted both in support of and in opposition to the instant motion fails to raise a genuine issue of material fact as to actual confusion. The Second Circuit has made clear that "[i]f consumers have been exposed to two allegedly similar trademarks in the marketplace for an adequate period of time and no actual confusion is detected ... that can be a powerful indication that the junior trademark does not cause a meaningful likelihood of confusion." FN119 It is undisputed that Louis Vuitton has sought evidence of consumer confusion generated by the sale of Dooney & Bourke's "It Bags" from 2003 through at least 2007. FN120 Despite these efforts, Louis Vuitton continues to point to what amounts to de minimis evidence of confu-

sion-whether initial, reverse, or post-sale-particularly considering the number of years these products have been on the market and the volume of sales they have generated.[FN121] Indeed, at her November 2006 deposition, Louis Vuitton's director of intellectual property, Nathalie Moulle-Berteaux, testified that she had no recollection of any new incidents or examples of consumer confusion since the preliminary injunction hearing in 2004.[FN122]

FN119. *Nabisco,* 191 F.3d at 228. *See* 4 McCarthy § 23:18 ("Weight is given to a failure to prove instances of actual confusion only in instances where the relevant products have coexisted in the market for a long period of time. However, as the duration of non-confusing co-existence stretches into years, the force of the inference strengthens.") (quotation marks omitted).

FN120. *See* Def. 56.¶ 146.

FN121. Louis Vuitton's products bearing the Monogram Multicolore mark have now been on the market for more than four and a half years and, as of November 2006, have generated total sales of almost $145 million. *See id.* ¶ 73.

FN122. *See id.* ¶ 50.

A very generous reading of the declarations submitted by Louis Vuitton's sales associates and the email evidence reveals, at most, a de minimis number of instances of what might be considered actual consumer confusion. Rather, the vast majority of the evidence on actual confusion submitted by Louis Vuitton solely suggests that Dooney & Bourke's "It Bag" design may "call to mind" the Monogram Multicolore mark, or vice versa. As an example of actual confusion, Louis Vuitton's sales associate asserts that "in or about May 2005, a group of young girls were in the [Louis Vuitton] store ... [o]ne ... carried a multicolor Dooney & Bourke bag and while holding her bag close to the Louis Vuitton multicolor display said ..., 'Look, my bag looks almost identical to the Louis Vuitton!' "[FN123] "[W]hile the junior user's mark may call to mind the senior user's famous mark, this alone is not sufficient ***387** for a likelihood of confusion."[FN124] Indeed, the " 'very fact of calling to mind may indicate that the mind is distinguishing rather than being confused by the two marks.' "[FN125]

FN123. *See* Declaration of Danika Quinones, retail sales associate for Louis Vuitton, Ex. K to Selb Decl., ¶ 4. *See also* Declaration of Annabelle Huynh, retail sales associate for Louis Vuitton, Ex. K to Selb Decl., ¶ 4 ("In or about the last two months, I assisted a female customer who was with another female customer and showed them a Louis Vuitton 'Eliza' bag. The women said they did not like it because it looked just like the multicolor Dooney & Bourke bag one of the women was carrying. The women said that Louis Vuitton copied Dooney & Bourke.").

FN124. 4 McCarthy § 23:9 (citation omitted). *Compare Burlington Coat Factory,* 426 F.3d at 538 n. 3 ("Even if a consumer can differentiate between two products, the question is whether, and to what degree, the look of the junior user's product calls to mind the senior user's product") *with Vuitton IV,* 525 F.Supp.2d at 593-94 (noting that in *Burlington Coat Factory,* Louis Vuitton claimed trade dress infringement in addition to trademark infringement, and the "calls to mind" language from that opinion refers to the "look" or trade dress of a product, which the parties agree is not at issue in the instant case).

FN125. 4 McCarthy § 23:9 (quoting *Application of Ferrero,* 479 F.2d 1395, 1397 (C.C.P.A.1973)).

Here, Louis Vuitton's evidence actually demonstrates that despite the fact that one source's bag may remind some consumers of the bags of another source, consumers are generally aware that the two multi-colored and monogrammed designs come from different, unaffiliated sources which they were able to distinguish and identify by name. The fact that some consumers believed that Louis Vuitton copied Dooney & Bourke's design weighs in defendant's favor because it tends to show that consumers are not misled as to the source, sponsorship, or affiliation of Dooney & Bourke's products with Louis Vuitton. Indeed, they recognize that their products are distinct and originate from independent and unaffiliated sources.[FN126]

FN126. *See id.* § 24:69 ("Traditional trademark infringement involves mistakenly connecting similar marks with the same source or an affiliate source. Similar marks: one source.").

Even the testimony of Louis Vuitton's director of intellectual property suggests that Louis Vuitton's infringement claim is not necessarily premised on a likelihood of confusion between its products and those of defendant, but rather Louis Vuitton's distaste at being associated with the "It Bags."[FN127] The evidence, however, fails to demonstrate that this "association," which Louis Vuitton disdains, amounts to consumer confusion as to the sponsorship, affiliation, or connection between the marks at issue. Moreover, the extremely scant number of instances on which Louis Vuitton relies as evidence of consumer confusion as to sponsorship or affiliation constitutes de mimimis evidence that is insufficient to raise a triable issue of material fact.[FN128]

FN127. *See* 11/15/06 Deposition of Nathalie Moulle-Berteaux, plaintiff's director of intellectual property, Ex. C to Selb Deck, at 101:5-8, 101:24-102:2 (Defendant's counsel: "So you think [Louis Vuitton] has good grounds to claim of [sic] infringement if people simply think of Louis Vuitton but don't believe these [*i.e.*, Dooney & Bourke "It Bags"] are Louis Vuitton bags; correct?" [Objections omitted] Witness: "Okay. What I am saying is making association with [-] it is whether or not they are likely to be confused.").

FN128. *See Louis Vuitton Malletier v. Burlington Coat Factory*, 217 Fed.Appx. 1, 2 (2d Cir.2007) ("In applying the *Polaroid* factors during resolution of the parties' claims at a trial on the merits, the [ ][c]ourt should consider not only the potential for consumer confusion as to the *source* of the marks in question, but [ ] also ... the potential for confusion as to the sponsorship, affiliation, connection, or identification of those marks.") (quotation marks omitted) (emphasis in original).

Because so little of Louis Vuitton's evidence indicates any confusion as to source, sponsorship, or affiliation between the products of plaintiff and defendant, no reasonable juror could find that actual confusion exists. This factor, therefore, weighs in defendant's favor.[FN129]

FN129. *See, e.g., Atlantic Richfield Co. v. Arco Globus Int'l Co.*, No. 95 Civ. 6361, 1997 WL 607488, at *8 (S.D.N.Y. May 29, 1997) (dismissing plaintiff's complaint and directing entry of judgment in favor of defendants where, inter alia, plaintiff failed to show any meaningful instances of actual confusion in support of this *Polaroid* factor, and stating that "isolated instances of confusion, especially by unidentified individuals after the commencement of litigation, is insufficient to establish a likelihood of confusion").

*388 3. The Sixth *Polaroid* Factor: Defendant's Good or Bad Faith in Adopting the Mark

[23] The crux of Dooney & Bourke's argument here is that because this Court has previously found no

proof of willful deceit in Dooney's adoption of its mark and because Louis Vuitton has failed to produce any probative evidence since then, this factor continues to weigh in defendant's favor. Louis Vuitton argues that genuine issues of material fact exist with respect to this factor, including, inter alia, "whether [Peter] Dooney preselected the infringing marks and used the 'It Team' as a smokescreen to deceive the public," and "whether Dooney created false waiting lists to confuse the public into associating its bags with those sold under the Monogram Multicolore [m]arks ...." FN130

FN130. Pl. Opp. at 19.

In support of its opposition, Louis Vuitton has also submitted the report of its expert, Dr. Richard A. Holub, on the overlapping use of colors in the marks at issue, and for the limited purpose of proving defendant's intent to copy. Dr. Holub testified that six of the seven colors used by Dooney & Bourke on its black bags and seven of the nine colors used on the white bags are "very similar" to the corresponding colors on Louis Vuitton's bags. FN131 He further testified that this overlap in colors is striking-and Louis Vuitton argues that this speaks to Dooney's intent-because Dooney could have chosen from thousands of distinct colors for its monogram design. FN132

FN131. Declaration of Richard A. Holub ¶ 13.

FN132. *See id.* ¶ 17.

The Second Circuit has suggested that evidence on this *Polaroid* factor is insufficient when it solely demonstrates that a defendant was aware of a plaintiff's marks before proceeding to use its own modified version. FN133 Where there is "no evidence that the [defendant] acted in bad faith in any sense relevant to the Lanham Act, that is, by deceiving customers into believing that its products [ ] were related to" the plaintiff, this factor favors defendant. FN134 While the evidence proffered by Louis Vuitton on this factor is not necessarily convincing, a jury could conclude that the discrepancies, however minor, in testimony regarding the genesis of the "It Bags" coupled with the expert testimony on the proximity between Dooney's color palette and the Murakami colors suggest that Peter Dooney was aware of the Monogram Multicolore mark and may have imitated or been inspired by certain "design features" or the look of products bearing the mark. FN135 However, there continues to be no proof that Dooney & Bourke acted in bad faith or attempted to deceive consumers in any way relevant to the Lanham Act.

FN133. *See New York Stock Exch.,* 293 F.3d at 556 n. 1.

FN134. *Id.*

FN135. Pl. Opp. at 20.

4. The Seventh *Polaroid* Factor: The Quality of Defendant's Product

According to Dooney & Bourke, there is no serious dispute that both parties' products are generally considered to be of high quality and regard. FN136 The Second Circuit has observed, however, that a "marked difference in quality ... actually tends to reduce the likelihood of confusion ... because buyers will be less likely to assume ***389** that the senior user whose product is high-quality will have produced the lesser-quality products of the junior user." FN137 Louis Vuitton does not allege that Dooney & Bourke's products are inferior, nor is there any evidence in the record substantiating the high or low quality of defendant's products relative to those of plaintiff. As a result, this factor is neutral as a matter of law.

FN136. *See* Def. Mem. at 12-13.

FN137. *Savin Corp.,* 391 F.3d at 461.

5. The Eighth *Polaroid* Factor: The Sophistication of the Buyers

[24][25] Dooney & Bourke contends that consumers who purchase its handbags and those of Louis Vuitton are sophisticated about brand identity. Therefore, according to Dooney & Bourke, this factor weighs in its favor because discerning consumers are less likely to be confused about source, sponsorship, or affiliation. "If the goods are expensive, the reasonably prudent buyer does not buy casually, but only after careful consideration. Thus, confusion is less likely than where the goods are cheap and bought casually." [FN138]

> FN138. 4 McCarthy § 23:96 (citation omitted).

Louis Vuitton argues that "the significance of this factor depends on the circumstances and the nature of the confusion at issue" because the sophistication of direct purchasers has no effect on post-sale confusion. [FN139] Moreover, according to Louis Vuitton, Dooney & Bourke's "It Bags" were targeted at consumers who are teenagers and are presumptively not sophisticated.

> FN139. Pl. Opp. at 22-23 (citing *T. Anthony, Ltd. v. Louis Vuitton Malletier,* 30 U.S.P.Q.2d 1214, 1218 (S.D.N.Y.1993)).

It cannot be reasonably disputed that consumers of products offered by both Louis Vuitton and Dooney & Bourke are sophisticated and discerning. Moreover, while Louis Vuitton's handbags are, on average, more costly than those sold by Dooney & Bourke, the evidence shows that there is an overlap among consumers of both brands. [FN140]

> FN140. *See, e.g.,* 1/27/04 Email to Dooney & Bourke, Ex. K to LeGrand Deck, at K-02 ("I was going to buy a Dooney [&] Bourke "It" style bag with the proceeds of my handbags but instead I will purchase a Coach or a Louis Vuitton."). *Accord* 9/9/06 Email from "Mark and Paula" to Dooney & Bourke, Ex. K to LeGrand Deck, at K-10 ("Even though this is an old style and I have several other Dooney/Coach/Burberry and Louis Vuitton purses[,] this is one of my favorites and I would like to get it done as soon as possible.").

This factor slightly favors Dooney & Bourke. On the one hand, consumers of quality, expensive handbags-made by Louis Vuitton, Dooney & Bourke, and other high-end brands-tend to be sophisticated, hyper fashion-conscious, and are not likely to be easily confused regardless of their youth. On the other hand, Louis Vuitton alleges, inter alia, post-sale confusion and the sophistication of direct purchasers does not necessarily bear on those who might be confused in the post-sale context. [FN141]

> FN141. However, most cases finding actionable post-sale confusion involve a defendant's counterfeit or "knock-off" copies of the plaintiff's product. *See, e.g., Cartier v. Symbolix, Inc.,* 386 F.Supp.2d 354 (S.D.N.Y.2005).

6. Balancing the *Polaroid* Factors and Other Considerations

For the reasons set forth above, the majority of the *Polaroid* factors weigh in Dooney & Bourke's favor, leading the Court to conclude that defendant has demonstrated that there is no genuine issue of material fact on the likelihood of confusion among consumers as to the source, affiliation, or sponsorship of the handbags at issue. [FN142] Summary judgment on a trademark infringement claim is appropriate where the *Polaroid* analysis reveals that ***390** "undisputed evidence would lead to only one conclusion." [FN143] Although Louis Vuitton's mark is strong and there is a proximity between the products, no one factor is determinative and the *Polaroid* factors cannot be balanced according to a mathematical formula. Rather, considering all of the evidence and evaluating the *Polaroid* factors, a reasonable jury could only conclude that Dooney & Bourke's mark is not likely to cause confusion with Louis Vuitton's Monogram Multicolore mark. Accordingly, defendant's motion for summary judgment on plaintiff's trademark infringement claim is granted.

FN142. *See, e.g., Savin Corp.,* 391 F.3d at 462 (affirming grant of summary judgment in favor of defendant on trademark infringement claim where the balance of the *Polaroid* factors weighed in defendant's favor even though one of the factors favored plaintiff); *Playtex,* 390 F.3d at 166-67 (affirming grant of summary judgment in favor of defendant on trademark infringement claim where the court held that, on balance, the *Polaroid* factors favored defendant); *SLY Magazine, LLC v. Weider Publ'ns L.L.C.,* 529 F.Supp.2d 425, 442 (S.D.N.Y.2007) (granting defendants summary judgment on trademark infringement claim where all *Polaroid* factors weighed in defendants' favor and the court therefore concluded that there was no genuine issue of material fact as to the likelihood of consumer confusion); *Verilux, Inc. v. Hahn,* No. 3:05 Civ. 254, 2007 WL 2318819, at *9 (D.Conn. Aug. 10, 2007) (granting defendants summary judgment on trademark infringement claim because plaintiff had failed to "raise a genuine issue of material fact as to whether there exists a likelihood of confusion between the source of defendants' and its products" where two *Polaroid* factors supported plaintiff's claim but the balance of the factors did not).

FN143. *The Sports Auth., Inc. v. Prime Hospitality Corp.,* 89 F.3d 955, 960 (2d Cir.1996).

B. Trademark Dilution Under the Lanham Act FN144

FN144. As set forth above, the FTDA governs Louis Vuitton's federal dilution claim insofar as it seeks monetary damages, and the TDRA governs its claim for injunctive relief. *See supra* Part II.B.

In contrast to trademark infringement, a cause of action for trademark dilution seeks to prevent the "diminution of the strength of the famous mark [ ] even though no confusion as to source, sponsorship, affiliation or connection has occurred." FN145 As a result, "[d]ilution by blurring is not just another name for the injury to a trademark caused by confusion and mistake ... [it] is a name for a kind of erosion of the strength of a mark that could occur in the *absence* of consumer confusion." FN146 "[D]ilution presupposes no mental confusion over affiliation or connection, but rather a state of mind that recognizes independent sources and affiliation." FN147

FN145. 4 McCarthy § 24:69.

FN146. *Id.* "The dilution theory grants protection to a strong, well recognized mark *even in the absence of a likelihood of confusion,* if defendant's use is such as to be likely to diminish or dilute the strong identification value of the plaintiff's mark ...." *Id.* § 24:72 (emphasis added). Here, Louis Vuitton claims dilution by blurring under the Lanham Act. *See, e.g.,* Pl. Opp. at 8.

FN147. 4 McCarthy § 24:72.

The Second Circuit has made clear that a "plaintiff cannot prevail on a state or federal dilution claim unless the marks at issue are 'very' or 'substantially similar.' " FN148 Here, as previously discussed, because fundamental differences distinguish the marks at issue, they are not sufficiently similar to sustain a dilution claim. FN149 Notwithstanding this holding, I ***391** assess the other elements of Louis Vuitton's federal dilution claim.

FN148. *Playtex,* 390 F.3d at 167 (quoting *Federal Express Corp. v. Fed. Espresso, Inc.,* 201 F.3d 168, 176 (2d Cir.2000)).

FN149. *Compare id.* (affirming district court's grant of defendant's motion for summary judgment on dilution claim where the marks at issue-"Wet Ones" versus "Quilted Northern Moist-Ones"-were not sufficiently similar to sustain the claim) *with adidas Am., Inc. v. Payless Shoesource, Inc.*, 546 F.Supp.2d 1029, 1062-63 (D.Or.2008) (holding that a reasonable juror could find plaintiff's three-stripe mark and defendant's four-stripe design to be sufficiently close and in fact, nearly identical). *See Playtex Prods., Inc. v. Georgia-Pacific Inc.*, No. 02 Civ. 7848, 2003 WL 21939706, at *8 (S.D.N.Y. Aug. 12, 2003) ("Because I concluded above that the dissimilarity [between plaintiff's mark and defendant's mark] was a major reason that there was no likelihood of consumer confusion [with respect to the trademark infringement claim], it follows that the marks are not sufficiently similar to support a claim for dilution under either the federal or state statute."), *aff'd*, 390 F.3d 158 (2d Cir.2004).

1. Famousness of Mark

[26] Dooney & Bourke contends that Louis Vuitton's Monogram Multicolore mark was not sufficiently famous-*i.e.*, "widely recognized by the general consuming public ... as a designation of source of the goods or services of the mark's owner" [FN150] -prior to defendant's introduction of the "It Bags" in July 2003. Citing Louis Vuitton's targeted advertising and its limited sales as of July 2003, Dooney & Bourke argues that the Monogram Multicolore mark had not attained the requisite level of fame to sustain a dilution claim as a matter of law.

FN150. 15 U.S.C. § 1125(c)(1).

According to Louis Vuitton, this argument creates a genuine issue of material fact with respect to the Monogram Multicolore mark's fame as of July 2003. I disagree. Despite Louis Vuitton's apparent willingness to have this issue resolved by the fact-finder, there is no genuine issue of material fact. Louis Vuitton's own evidence demonstrates the distinctive quality and great degree of recognition enjoyed by the Monogram Multicolore mark, even by July 2003, and even outside of the fashionista world. For example, according to Louis Vuitton North America's Vice President of Marketing and Communications, the company engaged in "widespread advertising, publicity, promotion and sales of products bearing the Monogram Multicolore [m]ark[ ]," and enjoyed a deluge of unsolicited media coverage and attention.[FN151]

FN151. Vandenberghe Deck ¶ 29. *See id.* ¶¶ 16-18. *See also id.* ¶ 29 (stating that the publication *Women's Wear Daily* ranked Louis Vuitton as the ninth most recognized accessory brand in the United States in its *June 2003* listing, and "attributed the success in consumer recognition in part to the Louis Vuitton handbags bearing the Monogram Multicolore [m]arks") (emphasis added).

Moreover, notwithstanding Dooney & Bourke's contention that Louis Vuitton's "limited advertising did not have [ ] geographic or demographic reach," [FN152] Louis Vuitton spent more money on advertising products bearing the Monogram Multicolore mark in 2003 than during any other year since their launch.[FN153] The evidence adequately demonstrates that, far beyond a narrow, niche market, the Monogram Multicolore mark achieved a high level of fame in the broad fashion market by early to mid-2003. Therefore, even under the high standard of fame required to sustain a dilution claim, the Monogram Multicolore mark meets that standard as a matter of law.

FN152. Def. Mem. at 20.

FN153. *See* Vandenberghe Decl. ¶ 27.

2. Evidence of Actual Dilution

[27][28] Louis Vuitton must establish actual dilution in order to recover monetary damages on its dilution claim. However, its anecdotal evidence on actual dilution continues to be insufficient as a matter of law. At most, Louis Vuitton's ***392** evidence demonstrates that "consumers mentally associate the junior user's mark with a famous mark." FN154 But, as the Supreme Court has made clear, "such mental association is not sufficient to establish actionable dilution" because it does not necessarily "reduce the capacity of the famous mark to identify the goods of its owner, the statutory requirement for dilution under the FTDA." FN155 Indeed, "[b]lurring is not a necessary consequence of mental association." FN156

FN154. *Moseley,* 537 U.S. at 433, 123 S.Ct. 1115.

FN155. *Id.*

FN156. *Id.* at 434, 123 S.Ct. 1115.

[29] The record establishes that a number of consumers mentally associated Louis Vuitton's products bearing the Monogram Multicolore mark with Dooney & Bourke's "It Bags," and vice versa. However, similar to the Supreme Court's observation in *Moseley,* "[t]here is a complete absence of evidence of any lessening of the capacity" of the Monogram Multicolore mark "to identify and distinguish the goods or services" offered by Louis Vuitton. FN157 In fact, the evidence demonstrates that, rather than eroding the strength of Louis Vuitton's mark, some consumers that made the mental association between the marks at issue directed any "offense" they might have felt from the association towards defendant rather than plaintiff. FN158 While some of the evidence shows that certain consumers preferred the "It Bags" for various reasons, it does not sufficiently raise any genuine issues of fact as to the impact of the "It Bags" on the strength of the Monogram Multicolore mark. FN159 As Louis Vuitton's own witness affirmed, Louis Vuitton's reputation and standing in the handbag industry has only increased since 2002, despite the introduction and success of the "It Bags" in the market. FN160

FN157. *Moseley,* 537 U.S. at 434, 123 S.Ct. 1115.

FN158. *See, e.g.,* Pl. Counter 56.1 ¶ 175 ("A Dooney employee directed to collect comments from customers in the ordinary course of business wrote that several customers were turned off to the Dooney It Bags because they thought that it [sic] looked like a Louis Vuitton 'knock-off.' "). *See also Moseley,* 537 U.S. at 434, 123 S.Ct. 1115 (stating that an individual who saw an advertisement for defendant's store, which bore the allegedly diluting mark as its name, was offended by it but his offense was directed at the defendant and his opinion of plaintiff was not altered).

FN159. *See, e.g.,* Pl. Counter 56.1 ¶ 175.

FN160. *See, e.g.,* 7/7/01 Deposition of Nathalie Moulle-Berteaux, Ex. B to Selb Deck, at 38:5-25 (Defendant's counsel: "Has Louis Vuitton's goodwill, reputation and standing in the handbag industry grown throughout the period since 2002?" Moulle-Berteaux: "I do think so, yes."). Additionally, for the reasons set forth in *Vuitton IV* with respect to plaintiff's now-excluded expert Mr. Weston Anson, the substantively similar "evidence" now put forth by plaintiff's witness Guillaume Cardon, Financial Control Manager for Louis Vuitton, fails to raise a genuine issue of material fact because it is "simply not probative of dilution under the substantive law." *Vuitton IV,* 525 F.Supp.2d at 662-64 (noting that plaintiff has made no effort to "connect a loss of sales in the United States to a loss of reputation on the part of Louis Vuitton and [it] cites no case law to support the proposition that a plaintiff's loss of sales coincident with a defendant's achieving 'critical mass' in the marketplace necessarily implies a loss of reputation" or an erosion of the strength of plaintiff's mark).

C. State Law Claims

1. Trademark Infringement and Unfair Competition

For the reasons set forth above in Part IV.A, no reasonable juror could conclude that there is a likelihood of confusion between the marks at issue for purposes of the Lanham Act. Accordingly, Louis Vuitton's***393** claim under New York law fails as a matter of law for those same reasons.

2. Trademark Dilution

[30] There is no genuine issue of material fact that Louis Vuitton's Monogram Multicolore mark is distinctive. Under the six-factor framework for assessing likelihood of dilution by blurring under New York law, no reasonable jury could conclude that Louis Vuitton's Monogram Multicolore mark has been diluted. *First,* for the reasons stated above, the marks are not similar even when viewed in market conditions and considering similarity from an initial interest or post-sale perspective.[FN161] Similar to the dilution claim brought under the Lanham Act, I continue to assess the state law dilution claim notwithstanding the holding that the marks are not similar as a matter of law.[FN162]

FN161. Because "[o]ne of the factors to be considered for determining likelihood of dilution is also a factor in likelihood of confusion analysis for trademark claims under the Lanham Act"-*i.e.,* similarity of the marks-the Court assesses this factor "in a similar fashion as [it has done] under the Lanham Act." *Vuitton II,* 454 F.3d at 119.

FN162. *See Savin Corp.,* 391 F.3d at 455 ("A prerequisite to a finding of dilution is that the marks are substantially similar.") (quotation marks omitted).

Second, as set forth earlier, Louis Vuitton and Dooney & Bourke overlap in their consumer bases, and there is no evidence demonstrating any lack of sophistication of the consumers that comprise those bases. Instead, the evidence shows that these consumers are discerning and knowledgeable with respect to the handbag market.

Third, there is some evidence that might suggest that Dooney & Bourke "adopted its mark hoping to benefit commercially from association with the senior mark."[FN163] However, this evidence is de minimis and this factor is not dispositive but is just one of the factors for courts to weigh when assessing likelihood of blurring.

FN163. *Mead Data Cent.,* 875 F.2d at 1037 (citations omitted).

Fourth, while the similarity of the products covered-*i.e.,* handbags and accessories-and the renown of the senior mark favor Louis Vuitton, the Court must balance all of the factors.[FN164] Balancing those factors, it is clear that, given the dissimilarities between the marks, the general sophistication of the consumers, and the de minimis nature of the proffered evidence on predatory intent, there is no genuine issue of material fact that remains to be resolved by the fact-finder. Because there is no diminution of the capacity of Louis Vuitton's mark to serve as a unique identifier of its source, Dooney & Bourke is granted summary judgment on the state law dilution claim as well.

FN164. As I previously stated in *Vuitton I,* the renown of defendant's mark is largely irrelevant to the analysis here. "Ordinarily, renown of the junior user's mark weighs in the senior user's favor, under the theory that the junior mark might overwhelm the senior mark. But where, as here, the marks are not substantially similar, let alone identical, the concept of a junior user makes little sense and lacks relevance to the issue of dilution by blurring." *Vuitton I*, 340 F.Supp.2d at 453 n. 210.

V. CONCLUSION

For the reasons set forth above, defendant's motion for summary judgment is granted in its entirety. The Clerk of the Court is directed to close the motion [document no. 269] and this case.

SO ORDERED

S.D.N.Y.,2008.
Malletier v. Dooney & Bourke, Inc.
561 F.Supp.2d 368, 91 U.S.P.Q.2d 1347

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Only the Westlaw citation is currently available.

United States District Court,
E.D. Pennsylvania.
Lynne MAROTTA
v.
TOLL BROTHERS, INC.
Civil Action No. 09-2328.

March 3, 2010.

Ayesha Krishman Hamilton, Hamilton Law Firm, PC, Lansdale, PA, for Lynne Marotta.

Therese Gillespie, Joseph J. Centeno, Obermayer Rebmann Maxwell & Hippel LLP, Philadelphia, PA, for Toll Brothers, Inc.

MEMORANDUM

McLAUGHLIN, District Judge.

***1** The plaintiff, Lynne Marotta, brought suit against her former employer, Toll Bros., Inc. ("Toll"),[FN1] alleging six counts of employment discrimination under federal and state statutes. The defendant moves to compel arbitration and dismiss the plaintiff's amended complaint or, alternatively, to dismiss the plaintiff's claim of marital status discrimination and stay the proceedings pending arbitration. Because the Court finds that the plaintiff signed a valid and enforceable arbitration agreement, the Court will compel arbitration and stay the proceedings pending final binding arbitration.

> FN1. In her complaint and amended complaint, the plaintiff named "Toll Brothers, Inc." as the defendant. The defendant clarifies that its correct identification is "Toll Bros., Inc." The Court will use the defendant's clarification for purposes of identification.

I. *Background*

The plaintiff began her employment with Toll in October, 1987.[FN2] In 1996, she obtained a bachelor's degree in management with a minor in accounting, and in 2001, she was promoted from project administrator to project manager. Aff. of Lynne Marotta ("Marotta Aff.") ¶ 7; Compl. ¶¶ 18-19.

> FN2. The facts are taken from the plaintiff's complaint, her affidavit submitted with her memorandum in opposition to the defendant's motion, and the various documents submitted with the defendant's motion: a declaration from a vice president at Toll, the plaintiff's right to sue letter and charges of discrimination filed with the EEOC, the signed arbitration agreement between the parties, and a letter from Toll's counsel to the plaintiff's counsel. As such, the Court will apply the summary judgment standard to this action and consider the evidence in the light most favorable to the non-moving party. *See Anderson v. Liberty Lobby, Inc.,* 477 U.S. 242, 256, 106 S.Ct. 2505, 91 L.Ed.2d 202 (1986); *Nationwide Ins. Co. v. Patterson,* 953 F.2d 44, 45 n. 1 (3d Cir.1991).

Sometime in November or December of 2001, Toll communicated to its employees that the employees would be asked to sign an arbitration agreement related to their employment with Toll. The Human Resources department ("HR") at Toll contacted the plaintiff in early February because it had not yet received the plaintiff's signed agreement. Decl. of Michele Wolfe, Vice President of Human Resources at Toll ("Wolfe Decl.") ¶ 4, Ex. D to Def.'s M.; Marotta Aff. ¶¶ 6, 13.

According to the plaintiff, Toll representatives, including HR staff, told the plaintiff that if she did not sign the agreement, she would lose her job. The defendant disputes that it told its employees that they would lose their jobs upon not signing the agreement. Toll points to a memorandum circulated to Division Vice Presidents, which noted that employees who do not wish to sign the arbitration agreement should state as such on the agreement itself and return it to HR. Toll also states that one employee under the same supervisor as the plaintiff refused to sign the agreement and remained employed at Toll until her resignation on May 14, 2004. Marotta Aff. ¶ 18; Memorandum Mar. 14, 2002, Ex. 1 to Wolfe Decl.; Wolfe Decl. 13.

The plaintiff submitted her signed arbitration agreement to HR on February 21, 2002, after making changes to its text. According to the plaintiff, HR told her that the agreement could not be altered in any way and that the plaintiff had to "take it or leave it." On March 19, 2002, the plaintiff signed a clean copy of the agreement and returned it to HR. Marotta Decl. ¶¶ 27, 29, 30; Arbitration Agreement ("Agreement"), Ex. A to Def.'s M.

The arbitration agreement notes that the plaintiff and Toll "intend[ ] to be legally bound" by the terms of the agreement. It states that "[a]ll disputes ... arising out of or in connection with [the plaintiff's] employment or its termination, including but not limited to those concerning workplace discrimination, shall exclusively be submitted to and determined by final and binding arbitration." By entering into the agreement, the plaintiff is "waiving [her] right to have a court resolve any disputes or claims [she] may have regarding [her] employment, including any dispute or claims ... arising from federal, state and local statutes prohibiting employment discrimination, including sexual harassment." Agreement ¶¶ 1, 2.

***2** The agreement explains that a single arbitrator from the American Arbitration Association will decide the dispute in accordance with the association's rules. The arbitrator must write the decision "and set forth the findings and conclusions upon which the decision is based." His or her decision will be "final and binding ... but may be set aside or modified by a reviewing court solely on the grounds that the Arbitrator made a material error of law, or in accordance with the Federal Arbitration Act." *Id.* ¶¶ 1-2; 6.

Toll "will bear the costs of the filing fee and the Arbitrator's fee." The arbitrator has discretion to "award all or some of the Employee's or Company's attorneys' fees and costs, in addition to any such awards required by law." Further, "If any provision of [the] Agreement is construed by a court of competent jurisdiction or Arbitrator to be invalid or unenforceable, the remainder of [the] Agreement shall not be affected and the remaining provisions will be given full force and effect without regard to the unenforceable provisions." *Id.* ¶¶ 7, 9.

By signing the agreement, the plaintiff acknowledged that she received three days of additional paid vacation, and that she read, understood, and agreed to all of the provisions of the agreement. *Id.* ¶ 8.

The plaintiff was fired from her job on Friday, June 6, 2008. Her husband, who also worked at Toll, was fired on Monday, June 9, 2008. Marotta Aff. ¶¶ 38, 39.

The plaintiff brought suit on May 21, 2009, and on July 8, 2009, the defendant moved to dismiss the complaint. The plaintiff amended her complaint on July 28, 2009, and the Court denied as moot and without prejudice the defendant's motion to dismiss. In her amended complaint, the plaintiff brought six claims of discrimination: failure to promote, retaliation, and discriminatory termination under Title VII; violations of the Equal Pay Act; and violations of New Jersey's Law Against Discrimination for marital status and gender discrimination.

On August 17, 2009, the defendant filed the instant motion to compel arbitration and to dismiss the amended complaint. The defendant argues that the Court should either compel arbitration and dismiss the amended complaint in its entirety with prejudice, or, alternatively, dismiss the plaintiff's claim of marital status discrimination and stay the proceedings pending final binding arbitration. It argues that the agreement is valid, the plaintiff's claims fall under the scope of the agreement, and there are no principles of contract law that would render the agreement unenforceable. The defendant also seeks costs and attorneys' fees for its preparation, filing, and service of its motion, arguing that the plaintiff's complaint is frivolous in view of the parties' arbitration agreement.

The plaintiff argues in her opposition that the agreement is unenforceable because the plaintiff was threatened with losing her job if she did not sign the arbitration agreement. She argues that the agreement therefore lacked consideration, was executed under economic duress, was illusory, was not signed knowingly and willfully by the plaintiff, and is procedurally and substantively unconscionable and against public policy. She further disputes the dismissal of her marital status claim, and she denies that her lawsuit is frivolous.

II. *Analysis*

***3** Under the Federal Arbitration Act ("FAA"), 9 U.S.C. § 4, any party "aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement" may seek an order to compel arbitration. If a court orders the parties to compulsory arbitration, the court may stay the proceedings pending the arbitration, or, if all of the claims involved are arbitrable, dismiss the action. *Seus v. Nuveen & Co.,* 146 F.3d 175, 179 (3d Cir.1998).

A motion to compel arbitration is treated as a motion to dismiss for failure to state a claim upon which relief can be granted. *Palcko v. Airborne Express, Inc.,* 372 F.3d 588, 597 (3d Cir.2004). In deciding a motion to compel arbitration, a court may consider the pleadings, documents of uncontested validity, and affidavits submitted by the parties, and decide the matter under a summary judgment standard. *Nationwide Ins. Co. v. Patterson,* 953 F.2d 44, 45 n. 1 (3d Cir.1991). Summary judgment is appropriate if there is no genuine issue as to any material fact and judgment is appropriate as a matter of law. Fed.R.Civ.P. 56(c).

A. *Formation of the Arbitration Agreement*

Before compelling arbitration, a court must ensure that: (1) the parties entered into a valid arbitration agreement, and (2) the specific dispute falls within the substantive scope of the agreement. *Pritzker v. Merrill Lynch, Pierce, Fenner & Smith,* 7 F.3d 1110, 1114 (3d Cir.1993). With respect to the second prong of the Court's inquiry, the parties do not dispute that the subject matter of the plaintiff's claims falls within the scope of the agreement. Pl.'s Opp. 5. The Court agrees: the agreement states that "all disputes ... including but not limited to those concerning workplace discrimination" shall be submitted to binding arbitration, and all of the plaintiff's claims allege employment discrimination. *See* Agreement ¶ 1; Compl.

The Court also finds that the arbitration agreement contains the requirements for a valid agreement. Courts look to the relevant state law of contracts to determine whether a valid arbitration agreement exists. *Homa v. Am. Express Co.,* 558 F.3d 225, 229 (3d Cir.2009). Under both Pennsylvania law and New Jersey law,[FN3] a valid contract exists when: (1) the parties manifest an intention to be bound by the agreement, (2) the terms of the agreement are sufficiently definite, and (3) the agreement is supported by consideration. *See Atacs Corp. v. Trans World Commc'n,* 155 F.3d 659, 666 (3d Cir.1998) (Pennsylvania); *Creek Ranch, Inc. v. N.J. Tpk. Auth.,* 75 N.J. 421, 383 A.2d 110, 115 (N.J.1978) (New Jersey).

FN3. When applying state law contract principles to arbitration agreements, courts look to the laws of the involved state or territory. *Gay v. Creditinform,* 511 F.3d 369, 388 (3d Cir.2007). The plaintiff's complaint notes that Toll is registered to

> do business in both Pennsylvania and New Jersey, and Toll required the plaintiff to work in both states. Compl. ¶¶ 119-20. The defendant argues that the Court need not resolve a choice-oflaw issue because it will prevail under either state's law. The plaintiff does not address the choice of law issue, but she cites primarily to Pennsylvania law in her opposition brief. The Court will not address the choice-of-law issue and will decide this motion pursuant to both Pennsylvania and New Jersey law.

The agreement states that the parties intend to be legally bound by the agreement and that the parties "have read and understand all of the provisions of this arbitration agreement and ... agree to all of the provisions set forth." The terms of the agreement are sufficiently definite because the agreement directs that all employment-related claims, including federal and state statutory discrimination claims, are subject to arbitration before a single arbitrator. Agreement ¶¶ 1, 3. The agreement also outlines the procedures governing the arbitration. *Id.* at ¶¶ 3-7.

*4 The plaintiff does not dispute that the parties intended to be bound by the agreement or that the terms of the agreement are sufficiently clear. She does, however, challenge whether the agreement is supported by valid consideration. She argues that her continued employment cannot constitute consideration for the agreement because employment contracts entered into after a job start date require separate consideration from that of the existing employment relationship.

The Court finds that the arbitration agreement is supported by adequate consideration, even without an evaluation of the plaintiff's argument, because the agreement contains several forms of consideration.[FN4] Consideration confers a benefit on the promisor or a detriment on the promisee, and must be an act, forbearance or promise in exchange for the original promise. *Channel Home Ctrs. v. Grossman,* 795 F.2d 291, 299 (3d Cir.1986). The Court of Appeals for the Third Circuit has held that an arbitration agreement in the employment context contains adequate consideration when both parties to the contract agree to be legally bound by it. *Blair v. Scott Specialty Gases,* 283 F.3d 595, 603-04 (3d Cir.2002). Here, both the plaintiff and defendant agreed to be legally bound by the arbitration agreement for all disputes arising out of the plaintiff's employment. Agreement ¶ 1.[FN5]

> FN4. Although the Court takes no view on the plaintiff's argument with respect to her continued employment as consideration, it notes that courts consistently find continued employment to be adequate consideration for arbitration agreements. *See e.g., Grant v. Phila. Eagles, L.L.C.,* No. 09-1222, 2009 U.S. Dist. LEXIS 53075, 2009 WL 1845231 at *15-16 (E.D. Pa. June 24, 2009); *Kanoff v. Better Life Renting Corp.,* No. 03-2326, 2008 U.S. Dist. LEXIS 10994, 2008 WL 442145 at *5 (D.N.J. Feb. 14, 2008); *Hamilton v. Travelers Prop. & Cas. Corp.,* No 01-11, 2001 U.S. Dist. LEXIS 6123, 2001 WL 503387 at *7 (E.D.Pa. May 11, 2001).

> FN5. To the extent that the plaintiff claims that Toll's promise to arbitrate its disputes against the plaintiff cannot amount to consideration because "circumstances under which an employer would desire a public jury trial are scarce," the Court rejects this argument. *See* Pl.'s Opp. 11. The Court of Appeals for the Third Circuit has held that consideration in the form of a mutual obligation to arbitrate applies directly to arbitration agreements between an employer and employee and to claims involving employment discrimination. *Blair,* 283 F.3d at 603.

Further, consideration found to be a "very slight advantage to one party or a trifling inconvenience to the other" is adequate consideration for a contract. *Oscar v. Simeonidis,* 352 N.J.Super. 476, 800 A.2d

271, 276 (N.J.Super.Ct.2002); *Wilson v. Viking Corp.,* 134 Pa.Super. 153, 3 A.2d 180, 184 (Pa.Super.Ct.1938). Here, the agreement states that the plaintiff acknowledged receipt of three additional days of paid vacation in consideration for her agreement to arbitrate her claims, constituting sufficient consideration. *See* Agreement ¶ 8. Although the plaintiff states in her affidavit that she told Toll she did not want the additional vacation days, she does not appear to dispute that she received them. *See* Marotta Aff. ¶ 19. [FN6]

> FN6. The plaintiff also argues that a promise of continued employment as consideration is illusory because the plaintiff was an at-will employee. Because the Court finds that the arbitration agreement is supported by adequate consideration irrespective of the plaintiff's continued employment, the Court will not address the plaintiff's position.

B. *Defenses to Enforcement*

The plaintiff argues that the arbitration agreement between the parties is unenforceable because Toll threatened the plaintiff with the loss of her job if she did not sign the agreement. The plaintiff argues that this constitutes economic duress and procedural and substantive unconscionability, and that it is contrary to public policy. The plaintiff also argues that she did not knowingly and willfully waive her right to a jury trial. Although courts may not enforce arbitration agreements if such agreements are revokable based on a generally applicable principle of contract law, such as fraud, duress, or mistake, *Seus,* 146 F.3d at 183-84, the Court finds that no such principle applies, and the agreement is enforceable.

First, the plaintiff has not demonstrated that she was subject to economic duress when signing the arbitration agreement. Under Pennsylvania law, economic duress exists "whenever one person, by the unlawful act of another, is induced to enter into contractual relations under such circumstances as to indicate that he has been deprived of the exercise of free will." *Harsco Corp. v. Zlotnicki,* 779 F.2d 906, 911 (3d Cir.1985). Both New Jersey and Pennsylvania courts find that duress is present only if the defendant causes the plaintiff's financial distress. *Id.* (Pennsylvania); *Cont'l Bank of Pa. v. Barclay Riding Acad.,* 93 N.J. 153, 459 A.2d 1163, 1176 (N.J.1983) (New Jersey). A plaintiff's fear of the loss of her job is insufficient to amount to economic duress when "the situation that caused [her] to fear the loss of [her] job-the need to support [her family]-was of [her] own making," and not that of the defendant. *Harsco Corp.,* 779 F.2d at 911.

*5 Here, the plaintiff has not presented evidence to demonstrate that she was deprived of free will or that the defendant caused her economic situation. The plaintiff had several months, from November or December 2001 until March 19, 2002, to consider the arbitration agreement before she signed it. In her affidavit, she explains that she reviewed and discussed the agreement with others. Marotta Aff. ¶¶ 16, 18, 2, 27. She presents no evidence beyond the fact that both she and her husband worked for Toll to demonstrate that Toll caused the plaintiff's economic situation. The Court of Appeals for the Third Circuit has already rejected economic duress premised on a plaintiff's fear of the loss of her job upon not signing an employment agreement. *Harsco Corp.,* 779 F.2d at 911.

Second, the plaintiff has not demonstrated that the arbitration agreement is unconscionable. A plaintiff must establish both procedural and substantive unconscionability for a Court to render a contract unenforceable. *Harris v. Green Tree Fin. Corp.,* 183 F.3d 173, 181 (3d Cir.1999) (Pennsylvania); *Sitogum Holdings, Inc. v. Ropes,* 352 N.J.Super. 555, 800 A.2d 915, (N.J.Super.Ct.2002) (New Jersey). Procedural unconscionability relates to the process by which the parties reached the agreement, and substantive unconscionability relates to whether the arbitration provision unreasonably favors the party asserting it. *Zimmer v. Cooperneff Advisors, Inc.,* 523 F.3d 224, 228 (3d Cir.2008).

The plaintiff contends that the agreement is unconscionable because it was a contract of adhesion, such that the plaintiff could not negotiate the terms and was forced to "take it or leave it." She argues that the agreement is substantively unconscionable because Toll benefits from arbitrating all claims and Toll had superior bargaining power.

Although the plaintiff may have been unable to alter the terms of the agreement, the Court finds that the contract is not unconscionable because it does not unreasonably favor Toll. Inequality in bargaining power is itself insufficient for finding an arbitration agreement unenforceable in the employment context. *Gilmer v. Interstate/Johnson Lane Corp.,* 500 U.S. 20, 33, 111 S.Ct. 1647, 114 L.Ed.2d 26 (1991). Whether an arbitration agreement constitutes an unenforceable contract is a fact-intensive inquiry. *See Martindale v. Sandvik, Inc.,* 173 N.J. 76, 800 A.2d 872, 880 (N.J.2002); *Huegel v. Mifflin Constr. Co.,* 796 A.2d 350, 357 (Pa.Super.Ct.2002).

Here, the terms of the agreement do not favor Toll as evident by their neutrality. Both Toll and the plaintiff consented to arbitrating all claims, demonstrating that neither party is unreasonably favored.[FN7] Under the terms of the agreement, Toll must pay the costs of the arbitration, and the arbitrator may award attorney's fees and costs to either Toll or the plaintiff, depending on the outcome of the arbitration.[FN8] The agreement provides that an arbitrator from the American Arbitration Association will decide the disputes, and the arbitrator must abide by the association's rules. The arbitrator must set forth the findings and conclusions upon which the decision is based, and a court may set aside the arbitrator's decision upon a material error of law, or in accordance with the FAA.

FN7. The plaintiff argues that the agreement disproportionately favors Toll because Toll could never have claims against the plaintiff, such that it has effectively not waived any right to a jury trial. She also argues that Toll benefits from a non-jury adjudication because Toll will be shielded from the public embarrassment of a trial. The Court finds these arguments uncompelling. The plaintiff cites no authority for her assertions, and her arguments contravene the strong federal policy in favor of arbitration, which explicitly extends to the employment context. *See Kirleis v. Dickie, McCamey & Chilcote, P.C.,* 560 F.3d 156, 160 (3d Cir.2009); *Seus,* 146 F.3d at 182-83.

FN8. The plaintiff argues that this provision of the agreement is unconscionable because it may deter plaintiffs from bringing claims for fear of being arbitrarily charged with the defendant's fees. Pl .'s Opp. 18-19. The Court declines to address this argument. A court may judicially determine whether the parties have submitted a dispute to arbitration, but, "in other circumstances, resolution by the arbitrator remains the presumptive rule." *Gay,* 511 F.3d at 387. Because the agreement contains a severability clause, the possible unconscionability of this fee-shifting provision will not render the arbitration agreement itself unenforceable, and the arbitrator may thus resolve this issue for the parties. For these same reasons, the Court will decline to resolve the defendant's motion to dismiss the plaintiff's claim of marital status discrimination and will leave this determination for the arbitrator. *Id.*

***6** Third, with respect to the plaintiff's argument that she did not knowingly and willfully waive her right to a jury trial, this argument fails. The Court of Appeals for the Third Circuit has explicitly rejected a heightened "knowingly and willfully" standard for arbitration agreements, holding that only a generally applicable principle of contract law, such as fraud or duress, may make an arbitration agreement unenforceable. *Seus,* 146 F.3d at

183-84 (rejecting "knowing and voluntary" standard used to evaluate waiver of substantive claims to evaluate enforcement of arbitration agreements).

Fourth, the Court finds that strong public policy favors enforcement of the arbitration agreement, rather than renders it unenforceable. *Kirleis v. Dickie, McCamey & Chilcote, P.C.*, 560 F.3d 156, 160 (3d Cir.2009). The plaintiff's public policy argument is further undercut because she premises it solely on the assertion that Toll compelled its employees to agree to arbitration or risk the loss of their jobs. The fact that courts routinely find compulsory arbitration clauses enforceable in employment contexts demonstrates that such agreements are not contrary to public policy. *See, e.g., Zimmer,* 523 F.3d 224; *Seus,* 146 F.3d 175; *Blair,* 283 F.3d 595; *Grant v. Philadelphia Eagles, L.L.C.*, No 09-1222, 2009 U.S. Dist. LEXIS 53075, 2009 WL 1845231 (E.D.Pa.2009).

C. *Attorneys' Fees*

In its motion, the defendant argues that it is entitled to attorneys' fees and costs because the plaintiff brought suit in district court rather than before an arbitrator. It states that the agreement is enforceable, and the plaintiff's failure to voluntarily dismiss this action after counsel for Toll alerted the plaintiff's counsel of the arbitration agreement makes this lawsuit frivolous. *See EEOC v. L.B. Foster Co.,* 123 F.3d 746, 751 (3d Cir.1997) ("A district court may in its discretion award attorney's fees to a prevailing defendant in a Title VII case upon a finding that the plaintiff's action was frivolous, unreasonable, or without foundation, even though not brought in subjective bad faith.").

The Court will not award attorneys' fees to the defendant because it finds that the plaintiff's lawsuit is not frivolous. Although arbitration is the proper adjudication for the plaintiff's claims, courts have a role in the "gateway" decision as to whether a matter should be arbitrated. *Gay v. Creditinform,* 511 F.3d 369, 387 (3d Cir.2007). The plaintiff raised arguments based on general principles of contract law, such as duress and unconscionability, that could have rendered the arbitration agreement unenforceable. *See Seus,* 146 F.3d at 183-84.

III. *Conclusion*

For the reasons herein stated, the defendant's motion is granted to the extent that the Court will stay this matter and compel arbitration.

An appropriate order shall issue separately.

ORDER

AND NOW, this 3rd day of March, 2010, upon consideration of the defendant's Motion to Compel Arbitration and Dismiss the Amended Complaint (Docket No. 15), the plaintiff's opposition, and the defendant's reply thereto, and for the reasons stated in a memorandum of law bearing today's date, IT IS HEREBY ORDERED that the defendant's motion is GRANTED IN PART AND DENIED IN PART as follows:

*7 1. The defendant's motion is granted to the extent that the plaintiff shall submit her claims to arbitration pursuant to the parties' arbitration agreement if she wishes to pursue her claims against the defendant.

2. The defendant's motion is denied to the extent that it seeks dismissal of the plaintiff's marital status discrimination claim (Count V of the amended complaint).

3. The defendant's motion is denied with respect to its request for attorneys' fees.

4. This matter is stayed pending final resolution of the parties' arbitration, and the Clerk of Court shall place this matter in civil suspense.

E.D.Pa.,2010.
Marotta v. Toll Bros., Inc.
Slip Copy, 2010 WL 744174 (E.D.Pa.)

END OF DOCUMENT

C
NOTE: THIS OPINION WILL NOT APPEAR IN A PRINTED VOLUME. THE DISPOSITION WILL APPEAR IN A REPORTER TABLE.

Court of Appeals of North Carolina.
MSC INDUSTRIAL DIRECT CO., INC., Plaintiff,
v.
James Gregory STEELE, Defendant.
No. COA08-418.

Aug. 18, 2009.

West KeySummary
Contracts 95 ⚷65.5

95 Contracts
95I Requisites and Validity
95I(D) Consideration
95k65.5 k. Covenants Not to Compete. Most Cited Cases

Labor and Employment 231H ⚷305

231H Labor and Employment
231HV Intellectual Property Rights and Duties
231Hk304 Trade Secrets or Confidential Information
231Hk305 k. In General. Most Cited Cases

A grant of restricted shares to employee was not proper consideration for a confidentiality, non-solicitation, and non-competition agreement. The grant of the shares was made more than thirty days before the agreement was entered. Employee had no rights to the shares when they were granted but merely an expectation of rights in the future. Also, the employer reserved all rights to terminate employee at any time without cause. Any value in the grant of shares was illusory.

***1** Appeal by plaintiff from an order entered 30 January 2008 by Judge W. David Lee in Union County Superior Court. Heard in the Court of Appeals 22 October 2008.

Jackson Lewis, LLP, by Paul H. Derrick, for plaintiff-appellant.

Black Ruth Grossman & Cain, P.A., by Aimee E. Cain and Lucas T. Baker, for defendant-appellee.

JACKSON, Judge.

MSC Industrial Direct Co., Inc. ("plaintiff") appeals the 30 January 2008 denial of a preliminary injunction and dissolution of a temporary restraining order. For the reasons stated below, we affirm.

Plaintiff, a direct marketer of industrial products, hired James Gregory Steele ("defendant") on 17 October 1994 as an Outside Sales Associate. He was promoted to the position of Senior Account Executive in 1999. On 19 August 2005, defendant signed an Associate Confidentiality, Non-Solicitation and Non-Competition Agreement in connection with his having been given the use of a company car.

On 19 February 2006, defendant signed a second Associate Confidentiality, Non-Solicitation and Non-Competition Agreement ("the Agreement") which, pursuant to its terms, superceded "any and all prior agreements or understandings" between the parties. The Agreement stated that defendant signed it in exchange for (1) restricted shares of plaintiff's stock, (2) his continued employment, (3) his compensation, and (4) plaintiff's entrustment to him of confidential information related to its business. Plaintiff terminated defendant's employment on 11 May 2007 for alleged violations of the Agreement. In August 2007, defendant began working for Hagemeyer North America, one of plaintiff's competitors.

On 10 October 2007, plaintiff filed a complaint in Union County Superior Court seeking a temporary restraining order ("TRO") and preliminary injunction, enjoining and restraining defendant from engaging in allegedly restricted activity. Also on that date, plaintiff filed a motion seeking the same relief. An order granting a TRO in favor of plaintiff was filed 11 October 2007. Defendant's deposition was taken on the morning of 21 December 2007, and a Consent Temporary Restraining Order was filed later that afternoon. Plaintiff's motion for a preliminary injunction was heard 14 January 2008. The trial court denied the motion and dissolved the TRO. Plaintiff appeals.

As a preliminary matter, we must determine if this appeal has been brought prematurely. "A preliminary injunction is interlocutory in nature and therefore not immediately appealable unless it deprives the appellant of a substantial right that he would lose absent immediate review." *Redlee/SCS Inc. v. Pieper,* 153 N.C.App. 421, 423, 571 S.E.2d 8, 11 (2002) (citing *Wade S. Dunbar Ins. Agency, Inc. v. Barber,* 147 N.C.App. 463, 466, 556 S.E.2d 331, 334 (2001)).

In *QSP, Inc. v. Hair,* 152 N.C.App. 174, 566 S.E.2d 851 (2002), this Court noted that "[i]n cases involving an alleged breach of a non-competition agreement and an agreement prohibiting disclosure of confidential information, North Carolina appellate courts have routinely reviewed interlocutory court orders both granting and denying preliminary injunctions holding that substantial rights have been affected." *Id.* at 175, 566 S.E.2d at 852. *QSP* went on to hold that the denial of a preliminary injunction "(1) prohibiting defendant from using or disclosing QSP's confidential information and trade secrets and (2) prohibiting defendant from soliciting for one year the same customers defendant solicited while working for QSP" would deprive the plaintiff of a substantial right absent a review prior to a final determination. *Id.* at 176, 566 S.E.2d at 852. As plaintiff in the case *sub judice* sought a similar preliminary injunction, which was denied, the appeal is appropriate for our review at this time.

***2** We first address defendant's contention that the issue is moot because the period covered by the Agreement has passed. We disagree.

"Whenever, during the course of litigation it develops that ... the questions originally in controversy between the parties are no longer at issue, the case should be dismissed, for courts will not entertain or proceed with a cause merely to determine abstract propositions of law." *In re Peoples,* 296 N.C. 109, 147, 250 S.E.2d 890, 912 (1978) (citations omitted), *cert. denied,* 442 U.S. 929, 99 S.Ct. 2859, 61 L.Ed.2d 297 (1979).

Pursuant to the terms of the Agreement, if valid, defendant is prohibited from (1) using or disclosing confidential information for so long as the information generally is not known to the public, (2) competing with plaintiff while employed there and for one year after the termination of his employment, and (3) soliciting its customers while employed there and for one year after the termination of his employment. However, in the event it is determined that defendant violated the Agreement, the duration of the second and third restrictions would be extended for an amount of time equal to the period during which such violations occurred.

Clearly, with respect to the first restriction, the restrictive period could extend indefinitely. With respect to the second and third restrictions, because defendant was terminated on 11 May 2007, with no other facts appearing, the applicable period would expire 10 May 2008, which has passed. However, it is alleged that defendant violated the Agreement. Therefore, pursuant to the Agreement the restricted period would extend for an amount of time equal to the period during which the violations occurred, if such violations are found to have occurred.

A TRO was ordered on 11 October 2007 and was to "remain in full force and effect until such time as this [c]ourt specifically orders otherwise[.]" The 11 October order also set a hearing on plaintiff's motion for 17 October 2007. It appears from defendant's deposition testimony that a hearing was held on that date and that the TRO remained in effect from that point in time. However, there is no direct evidence in the record with respect to a hearing on 17 October 2007 or at any other time prior to the deposition. The 21 December 2007 consent order does not purport to extend an existing TRO. It orders that a TRO "issue immediately" and that plaintiff post bond. This implies that an existing TRO was not in effect at that time. In any event, a TRO finally was dissolved on 14 January 2008, by order filed 30 January 2008.

With the exception of the three-month period during which a TRO was in place, defendant is alleged to have been in violation of the terms of the Agreement. As of the date of this opinion, if a court were to determine that defendant was, in fact, in violation of the Agreement, his business activities would be restricted by the Agreement's terms for a period of time equal to at least an additional twenty-four months beyond the one-year post-separation period, or at least 10 May 2010 which has not passed yet. Because the question originally in controversy between the parties-whether defendant's activities are restricted, and if so, for how long-has not been resolved, the issue is not moot.

*3 Therefore, we consider the merits of the appeal. Plaintiff argues that the trial court erred in failing to grant a preliminary injunction because it demonstrated a substantial likelihood of success on the merits. We disagree.

The scope of appellate review of a trial court's grant or denial of a preliminary injunction is essentially *de novo* because the appellate court "is not bound by the [trial court's] findings [of fact], but may review and weigh the evidence and find facts for itself." *A.E.P. Industries v. McClure,* 308 N.C. 393, 402, 302 S.E.2d 754, 760 (1983) (citations omitted).

> In considering the propriety of a preliminary injunction, this Court does not determine whether a confidentiality, no-solicitation, and non-competition agreement is in fact enforceable, but reviews the evidence and determines (1) whether plaintiff has met its burden of showing a likelihood of success on the merits and (2) whether plaintiff is likely to sustain irreparable loss unless the injunction is issued.

QSP, 152 N.C.App. at 176, 566 S.E.2d at 853 (citing *A.E.P. Industries,* 308 N.C. at 401, 302 S.E.2d at 759). However, "[w]here a preliminary injunction is sought to enforce a non[-]competition clause in an employment contract, [the Supreme] Court has held that the employment agreement itself must be valid and enforceable in order for the employer to be able to show the requisite likelihood of success on the merits." *Triangle Leasing Co. v. McMahon,* 327 N.C. 224, 227-28, 393 S.E.2d 854, 857 (1990) (citing *A.E.P. Industries,* 308 N.C. 393, 302 S.E.2d 754).

Although both parties discussed in their briefs the issue of choice of law-the Agreement called for New York law to apply-plaintiff did not assign error to the trial court's determination that North Carolina law governs the enforceability of the Agreement. "[T]he scope of review on appeal is confined to a consideration of those assignments of error set out in the record on appeal[.]" N.C. R.App. P. 10(a) (2007). Because no assignment of error addresses choice of law, the issue is not within the scope of our review. Therefore, we apply the same law the trial court did-North Carolina law.

"Under North Carolina law, covenants not to compete are valid and enforceable if: '(1) in writing; (2) made part of a contract of employment; (3) based on valuable consideration; (4) reasonable both as to time and territory; and (5) not against public policy.' " *Calhoun v. WHA Med. Clinic, PLLC,* 178 N.C.App. 585, 597, 632 S.E.2d 563, 571 (2006) (quoting *QSP,* 152 N.C.App. at 176, 566 S.E.2d at 852), *disc. rev. denied,* 361 N.C. 350, 644 S.E.2d 5 (2007). Defendant contends that plaintiff was not likely to succeed on the merits because the Agreement was unenforceable due to a lack of valuable consideration.

As stated above, there were four bases for defendant's agreeing to be bound by the Agreement's restrictive covenants. First, defendant received eighty-five "MSC Restricted Shares effective January 10, 2006, with a price of $42.86" ("the Grant") as stated consideration for entering into the Agreement. Pursuant to *Kinesis Adver., Inc. v. Hill,* 187 N.C.App. 1, 652 S.E.2d 284 (2007), *disc. rev. denied, appeal dismissed,* 362 N.C. 177, 658 S .E.2d 485 (2008), uncertificated shares of stock are valuable consideration to support a non-compete agreement entered during the course of an existing employment relationship. *Id.* at 11-12, 652 S.E.2d at 292-93. In *Kinesis,* upon our review of summary judgment, this Court determined that there was a genuine issue of material fact as to whether the shares actually had been issued. *Id.* at 13, 652 S.E.2d at 293. That is not the issue before us in the instant case. Although uncertificated shares of stock can be valuable consideration, here, the evidence of record makes clear that the stock at issue was not.

*4 On 19 February 2006, defendant signed the Agreement as well as a Restricted Stock Award ("the Award") pursuant to plaintiff's 2005 Omnibus Equity Plan ("the Plan"). Pursuant to the Award, the terms and conditions of the Grant were controlled in all respects by the Award, the Agreement, and the Plan. The Award, signed 19 February 2006, states that the "Award Date" is 10 January 2006. The Grant was transferred into an account in defendant's name on 10 January 2006-more than thirty days *before* either the Award or the Agreement was signed.

Pursuant to the Award, fifty percent of the shares would vest on 10 January 2009, seventy-five percent would vest on 10 January 2010, and the remaining shares would vest on 10 January 2011. If defendant's employment ended due to death, disability, or retirement, any unvested shares would become vested. If his employment terminated by any other means-involuntary discharge for cause, involuntary discharge without cause, or resignation-any unvested shares were to be redelivered to plaintiff. Until they vested, defendant had no right to vote the shares, no right to receive dividends, and no right of alienation.

The Award stated that it was not an employment contract. It conferred no right to continued employment and did not interfere with plaintiff's right to discharge defendant. It further stated that the Plan was discretionary on plaintiff's part and participation was voluntary on defendant's part. The Award was not to be considered as a part of defendant's salary.

Keeping in mind the terms of the Award, we see no valuable consideration for the Agreement. The Grant was made more than thirty days *before* defendant entered into the Agreement. At the time the Grant was given, defendant had no rights to the shares, merely an expectation of rights in the future. Pursuant to the terms of the Award, plaintiff retained the right to discharge defendant at any time without cause, including the right to discharge him only moments after signing the Award and the Agreement. Any value in the Grant was illusory. This Court has held that a non-compete agreement may be set aside for lack of consideration when the stated consideration is illusory. *Milner Airco, Inc. v. Morris,* 111 N.C.App. 866, 870, 433 S.E.2d 811, 814 (1993). In *Milner,* as in the case *sub judice,* the agreement recited consideration but did not actually bind the employer to any promise. *Id.*

Having determined that the stock does not constitute valid consideration, we consider the promise of continued employment and defendant's compensation as stated consideration for entering into the Agreement. Defendant had been employed by plaintiff for over ten years when he signed the Agreement. When the employer-employee relationship exists already without a restrictive covenant, any new agreement not to compete must be in the nature of a new contract based upon new consideration. *Engineering Associates v. Pankow,* 268 N.C. 137, 139, 150 S.E.2d 56, 58 (1966); *Kadis v. Britt,* 224 N.C. 154, 163, 29 S.E.2d 543, 548 (1944).

*5 "[C]ontinued employment is insufficient consideration to support a covenant not to compete where the employee receives 'no change in compensation, commission, duties, nature of employment or other consideration in exchange for signing the agreement[.]' " *Howard v. Oakwood Homes Corp.*, 134 N.C.App. 116, 121, 516 S.E.2d 879, 882 (quoting *Cox v. Dine-A-Mate, Inc.*, 129 N.C.App. 773, 776, 501 S.E.2d 353, 356, *disc. rev. denied,* 349 N.C. 355, 525 S.E.2d 449 (1998)), *disc. rev. denied,* 350 N.C. 832, 539 S.E.2d 288 (1999), *cert. denied,* 528 U.S. 1155, 120 S.Ct. 1161, 145 L.Ed.2d 1072 (2000). However, continued employment for a specified period of time constitutes consideration to support a non-compete agreement when an employment relationship already exists. *See Amdar, Inc. v. Satterwhite,* 37 N.C.App. 410, 414, 246 S.E.2d 165, 167 (new contract of employment bound the employer for an additional year), *disc. rev. denied,* 295 N.C. 645, 248 S.E.2d 249 (1978).

Here, there was no change in defendant's "compensation, commission, duties, or nature of employment" which could be consideration for the restrictive covenants. Further, as determined above, the Grant is not "other consideration" for the restrictive covenants. Plaintiff was not bound to employ defendant for any specified period of time, remaining free to terminate the relationship with or without cause at any time. Accordingly, defendant's continued employment and associated salary does not constitute valid consideration to support the Agreement.

Finally, the Agreement stated that plaintiff entrusted defendant with confidential information relating to its business as consideration. However, it appears clear that such information had been entrusted to defendant for a number of years prior to the signing of the Agreement. There was no new information entrusted to defendant, therefore, this does not constitute valid consideration.

Because pursuant to North Carolina law no valuable consideration was given in exchange for defendant's entering into the Agreement, the Agreement was not enforceable. Therefore, plaintiff was not likely to succeed on the merits and the trial court did not err in denying a preliminary injunction and dissolving the TRO.

Affirmed.

Judges STEELMAN and STROUD concur.
Report per Rule 30(e).

N.C.App.,2009.
MSC Indus. Direct Co., Inc. v. Steele
682 S.E.2d 248, 2009 WL 2501762 (N.C.App.)

END OF DOCUMENT

N

Court of Special Appeals of Maryland.
Howard J. NEEDLE, et al.
v.
WHITE, MINDEL, CLARKE AND HILL, et al.
462 Sept. Term 1989

Jan. 31, 1990.

Employee who was acquitted on embezzlement charge sued her former employer for malicious prosecution and intentional infliction of emotional distress. The Circuit Court, Baltimore County, Dana M. Levitz, J., entered judgment for employer, and imposed sanctions against employee and her attorneys. Employee and attorneys appealed. The Court of Special Appeals, James S. Getty, Judge of the Court of Special Appeals (retired), specially assigned, held that employee and her attorneys did not bring and pursue the action in bad faith and without substantial justification.

Reversed.

West Headnotes

[1] Attorney and Client 45 24

45 Attorney and Client
451 The Office of Attorney
45I(B) Privileges, Disabilities, and Liabilities
45k24 k. Liability for Costs; Sanctions. Most Cited Cases
Attorneys had substantial justification for instituting malicious prosecution and intentional infliction of emotional distress action against client's former employer in regard to employer's accusing client of embezzlement, of which charge employee was acquitted, and action was not maintained in bad faith; thus, imposition of sanctions against attorneys was improper. Md.Rule 1-341.

[2] Costs 102 2

102 Costs
102I Nature, Grounds, and Extent of Right in General
102k1 Nature and Grounds of Right
102k2 k. In General. Most Cited Cases
As matter of law, reasonable basis for believing that case will generate factual issue for fact finder at trial provides substantial justification for initiating or defending action, thus precluding sanctions under rule which provides for sanctions against party who maintains action in bad faith or without substantial justification. Md.Rule 1-341.

[3] Costs 102 2

102 Costs
102I Nature, Grounds, and Extent of Right in General
102k1 Nature and Grounds of Right
102k2 k. In General. Most Cited Cases
Court erred in imposing sanctions against plaintiff for bringing and pursuing action in bad faith and without substantial justification; court decided three times that evidence was sufficient that granting of defendant's motions for summary judgment may have been error. Md.Rule 1-341.

[4] Costs 102 2

102 Costs
102I Nature, Grounds, and Extent of Right in General
102k1 Nature and Grounds of Right
102k2 k. In General. Most Cited Cases
It may well be abuse of discretion to impose substantial monetary sanction on litigant without first determining financial ability of litigant to pay amount assessed. Md.Rule 1-341.

[5] Constitutional Law 92 4019

92 Constitutional Law
92XXVII Due Process
92XXVII(E) Civil Actions and Proceedings
92k4017 Costs and Fees

92k4019 k. Fees. Most Cited Cases
(Formerly 92k317(1))

Costs 102 ⚷2

102 Costs
102I Nature, Grounds, and Extent of Right in General
102k1 Nature and Grounds of Right
102k2 k. In General. Most Cited Cases
Constitutional due process is applicable to assessment of attorney fees for litigation misconduct; fair notice and opportunity for hearing on record should be provided. U.S.C.A. Const.Amend. 14.
****856 *464** Melvin J. Sykes, Baltimore, for appellants, Howard J. Needle and Sarah C. King.

Gregory A. Cross (Susan K. Gauvey and Venable, Baetjer and Howard, on the brief), Baltimore, for appellant, Carolyn J. Gerst (Susan Goering, Baltimore, of counsel.)

J. Norris Byrnes (Albert J. Mezzanotte, Jr., Tricia D. O'Neill and Whiteford, Taylor ****857** & Preston, on the brief), Towson, for appellees.

Argued before MOYLAN and CATHELL, JJ., and JAMES S. GETTY, Judge of the Court of Special Appeals (retired), Specially Assigned.

JAMES S. GETTY, Judge Specially Assigned.

This case involves two appeals in one record from the imposition of sanctions, pursuant to Md.Rule 1-341, by the Circuit Court for Baltimore County. The appellants herein are Carolyn Gerst, the plaintiff in the underlying lawsuit, ***465** and her attorneys, Howard J. Needle and Sarah C. King. The court ordered that Gerst pay the sum of $121,369.14 and that Needle and King pay the sum of $21,748.00 to the law firm of White, Mindel, Clarke and Hill, Samuel D. Hill, and John F. Foley, the defendants in the trial court and appellees herein.

The record establishes that Gerst began working for the appellees in 1970 as a bookkeeper. In March, 1983, she was discharged, according to appellees, because a replacement bookkeeper could do a better job. That her termination was amicable is evidenced by the fact that she received four weeks severance pay, a farewell luncheon, and several letters of recommendation from members of the law firm.

Following Gerst's departure, the appellees discovered that withdrawals in 1982 and the first quarter of 1983 from their escrow savings account totaling approximately $203,000.00 had not been deposited into the escrow checking account. During the same period $170,000.00 in fees received was deposited in the escrow savings account rather than in the appellees' operating account.

The appellees maintained an employee fidelity policy with the Insurance Company of North America in the amount of $100,000.00. Appellees directed John Foley, a member of the firm, to file a claim for reimbursement. The proof of loss contained an affidavit that the loss resulted from dishonest or fraudulent acts by Gerst.

A condition of recovery under the policy required the appellees to file a complaint with the local police. Appellees filed proof of loss with the insurer and a report to the police on the same day. The full $100,000.00 was eventually remitted to appellees. Detective Henry Wysham testified that he was assigned to investigate the alleged theft, but he could not determine what happened to the money, because he was instructed by an Assistant State's Attorney not to interview Gerst.

Gerst, meanwhile, was charged with embezzlement and she was represented at trial by an assigned public defender. ***466** The principal witnesses testifying on behalf of the State were John Foley and Samuel Hill, both of whom were partners in the law firm. Hill testified that he set up the escrow savings account so that withdrawals were to be by internal paper transfer but never by cash. He denied authorizing cash withdrawals or receiving cash from

Gerst, who alleged she withdrew cash from the escrow account at Hill's direction and turned the money over to him.

At the conclusion of the three-day jury trial, Gerst was acquitted. Thereafter, Gerst retained Needle and King, who reviewed the transcript of the criminal trial, interviewed several of the jurors who heard the case, and interviewed Detective Wysham as well as employees of First American Bank where the escrow account was maintained. Gerst paid an initial counsel fee of $9,500.00 with additional fees being contingent upon the outcome of the case.

The court trial focused on Gerst's claims for malicious prosecution and intentional infliction of emotional distress. The trial was preceded by an extensive hearing on appellees' motion for summary judgment which included memoranda by both litigants, numerous exhibits and excerpts of testimony from the criminal trial. Appellees contended that probable cause existed for accusing Gerst of the crime of embezzlement and that appellees' conduct was not so outrageous as to justify an action for intentional infliction of emotional distress. In appellees' view, Gerst's civil action was nothing short of retaliation for the ****858** criminal charges. Gerst, conversely, advanced the argument that the criminal charges were motivated solely by appellees' efforts to collect on its employee fidelity insurance policy. The trial court denied the pre-trial motion as to malicious prosecution and intentional infliction of emotional distress and granted it as to four other allegations.

The trial proceeded with Gerst reiterating her previous testimony that all transfers of funds were by written authorization of a partner in the law firm and that all cash withdrawals were returned to Hill. A former employee of ***467** First American Bank testified that withdrawals could be by check or cash during the period in question. Hill and Foley contradicted Gerst's testimony regarding cash withdrawals and receipt of cash from her.

At the close of Gerst's case, appellees again moved for judgment which the court denied. The court pointed out that the appellees could be liable "if there was evidence, considered in the light most favorable to appellants, that some member of the law firm made a report to the Baltimore County Police knowing that the report was recklessly made with a high probability that emotional distress would result" and, the court added, "in fact, emotional distress has resulted, given the testimony of Dr. Bills, who said, you know, how terrible it's been on Miss Gerst, if that's believed."

Appellees' case included further attacks on Gerst's credibility by presenting evidence that she cashed checks that were to be used to maintain the appellees' postage meter and kept the cash; that she sought to purchase a house that required a $30,000.00 down payment; that she spent large sums of money purchasing lottery tickets; that her lifestyle was inconsistent with her earned income of $265.00 weekly; and that she had fraudulently received unemployment compensation benefits.

The issues in this case were whether the appellees instituted a criminal proceeding against Gerst without probable cause for a purpose other than bringing an offender to justice, and whether the appellant suffered emotional distress therefrom. The appellees' defense was twofold: that it did not act maliciously or recklessly in reporting the theft, and that the evidence amassed through pre-trial discovery clearly established that Gerst stole the money.

Appellees' introduction of evidence discovered after Gerst's acquittal in the criminal case was objected to by Gerst's counsel, who maintained that probable cause in making the accusation of theft should be restricted to the known facts as of the time the accusation was made. The ***468** court overruled the objection and admitted the later discovered evidence.

The appellees renewed their motion for judgment at the conclusion of all of the evidence; the court reserved ruling and submitted the case to the jury on issues. The jury decided that appellees had a reasonable belief that Gerst took the money, and that appellees did not report the matter to the police with ill will or with a reckless disregard for the truth. Interestingly, issue 3, submitted over objection by Gerst, asked whether Gerst stole money from appellees. The jury decided that she did not. The jury found that Gerst suffered from emotional distress, that it was not severe, and that a causal connection existed between the filing of the police report and Gerst's emotional distress. Based upon the responses by the jury, judgment was entered for the appellees.

The jury verdict was returned on Friday, September 16, 1988. The court, *sua sponte,* scheduled a sanctions hearing for the following Thursday, stating:

> I am scheduling a hearing on Thursday, September 22nd at 3:30 p.m. on the issue of Rule 1-341, bad faith and unjustified proceedings. At that time I would appreciate Mr. White or Mr. Byrnes providing me with lists of all expense, attorney's fees incurred since the filing of this action. All right. That concludes the case.

As we shall see, rather than concluding the case, the court's action merely set the stage for phase two of the battle.

****859** On December 16, 1988,[FN1] the court filed a 21-page Memorandum Opinion and Order imposing the monetary sanctions which are the subject of this appeal. The court made post-trial findings of fact which we shall summarize as follows:

FN1. The appellants Gerst, Needle and King, requested a postponement to establish the specifics of the charges facing them and to seek separate counsel. The request was denied and the hearing proceeded as scheduled with Needle and King representing Gerst and themselves.

***469** The court found as a fact that when John Foley made the police report on behalf of the law firm it "was not done with ill will or hostility or lack of good faith or reckless disregard for the truth." Referring to the disputed testimony over Gerst's spending habits, the trial court found as a fact that "after having had the opportunity to see and hear the witnesses, that the plaintiff spent approximately $1,000 to $1,500 per week in cash during the 1982 through March of 1983 period despite the fact that she had a cash income of only $275.00 per week."

Addressing the issue of emotional distress, the court said: "The facts clearly and convincingly established that the plaintiff never suffered from any disabling emotional distress. Nevertheless, the court finds that the plaintiff's attorney did have good reason to believe that the plaintiff had emotional problems as early as November of 1985."

Concluding its fact finding, the court opined:

> "After reading the extensive pleadings ... and ... documentation which takes up four file folders, listening to every witness over the eight days that the trial took and again reviewing the 58 exhibits introduced ... the court is clearly convinced that this suit was brought by the plaintiff because of her ill will and hostility toward White, Mindel, Clark & Hill, Samuel Hill and John Foley. Further, that she felt that she had nothing to lose by bringing this suit but believed that if she were successful she could reap a windfall from the defendants. This court finds as a fact that this suit was brought and continued in bad faith and without substantial justification. The plaintiff knew that this action was frivolous. In addition, this court is clearly convinced that at the very latest, when the case was called for trial on September 6, 1988, the plaintiff's attorneys knew that there was no evidence to support the plaintiff's allegations. Further, they knew or reasonably should have known that there was no justification in continuing this litigation and causing the defendants to incur additional defense costs.

***470** Aside from "hindsight," which we address later, some of the court's findings adopt the version of a particular witness or witnesses over the testimony of others, or its findings are contrary to the responses of the jury on the issues, or it adopts a conclusion where more than one inference is presented by the testimony.[FN2]

> FN2. We note that the court allegedly talked to the jury off the record after the case ended. Appellants obtained affidavits of several jurors relating to the testimony of various witnesses who participated in the trial. Arguably, the role of the jury ought to end with its verdict. Satellite litigation is a matter that the court and counsel should resolve without seeking the thought processes of the trier of fact.

The appellants raise a number of issues including denial of due process in scheduling the sanctions hearing; whether the standard of reviews in Rule 1-341 cases ought to include an independent review by the appellate court; and whether the sanctions imposed amount to an abuse of discretion. We shall limit our review to the single issue:

Is the trial court's decision clearly erroneous?

Rule 1-341 Bad Faith-Unjustified Proceeding

> In any civil action, if the court finds that the conduct of a party in maintaining or defending any proceeding was in bad faith or without substantial justification the court may require the offending party or the attorney advising the conduct or both of them to pay to the adverse party the costs of the proceeding and the ****860** reasonable attorney's fees incurred by the adverse party in opposing it.

The objective of the Rule is to fine-tune the judicial process by eliminating the abuses arising from the tendency of a few litigants and their counsel initiating or continuing litigation that is clearly without merit. The inherent danger in the process is that over zealous pursuit of the objective may result in what the Court, in *Eastway Construction Corp. v. City of New York,* 762 F.2d 243, 254 (2nd Cir.1985) , described as "stifling the enthusiasm or chilling the creativity that is the very lifeblood of the law."

***471** Although Rule 1-341 was adopted in 1984, our appellate courts have addressed the rule in at least six cases in 1988 alone. *Watson v. Watson,* 73 Md.App. 483, 534 A.2d 1365; *Legal Aid v. Farmer,* 74 Md.App. 707, 539 A.2d 1173; *Legal Aid v. Bishop's Garth,* 75 Md.App. 214, 540 A.2d 1175; *Allnutt v. Comptroller of the Treasury,* 77 Md.App. 424, 550 A.2d 728; *Yamaner v. Orkin,* 313 Md. 508, 545 A.2d 1345: *Newman v. Reilly,* 314 Md. 364, 550 A.2d 959.

Sanctions imposed upon litigants and counsel pursuant to Rule 1-341 were upheld in two of the above cases and reversed in four. In *Watson,* sanctions were upheld where fraud was clearly established. Likewise, in *Allnutt,* sanctions were imposed where the attack on the validity of state personal income tax laws lacked substantial justification in view of a plethora of cases rejecting the same argument. Sanctions imposed were reversed on appeal in: *Farmer,* where a $900.00 attorney fee was imposed against attorneys for taking a "frivolous appeal" from a District Court order favoring a landlord in a landlord-tenant dispute; *Bishop's Garth,* where the trial judge assessed a counsel fee of $9,691.00 after concluding that "it became clear during the trial that the defendant's case (an evicted tenant) was totally without merit"; *Yamaner,* where the court granted a $300.00 fee against a party filing a second motion for summary judgment; and *Newman,* where sanctions of $21,165.05 were approved by the trial court which held that a plaintiff lacked substantial justification to pursue in court a malpractice claim where the plaintiff admittedly had no expert witnesses to testify as to his condition when he was involuntarily committed for treatment of a mental disorder.

The cases make clear that the principle we stated in *Dent v. Simmons,* 61 Md.App. 122, 124, 485 A.2d 270 (1985) (Alpert, J.), is to be zealously guarded.

That principle confirms that:

> [F]ree access to the courts is an important and valuable aspect of an effective system of jurisprudence, and a party possessing a *colorable* claim must be allowed to ***472** assert it without fear of suffering a penalty more severe than that typically imposed on defeated parties.

In *Newman, supra,* the Court of Appeals (Rodowsky, J.), citing both *Yamaner* and *Farmer, supra,* reiterated that Rule 1-341 is not intended to penalize a party and/or counsel for asserting a colorable claim or defense. *Ibid.* 314 Md. at 380, 550 A.2d 959.

Needle and King

[1] The trial court held that as of the start of the trial Needle and King knew that there was no evidence to support Gerst's allegations and, therefore, there was no justification in continuing the litigation. At the outset of the case Needle and King knew the following:

> a. That a direct conflict existed between Gerst and her accusers as to whether cash withdrawals were permitted and, if so, whether their client or a member of the firm took the money.
>
> b. That a representative of the bank would dispute the law firm's allegation that cash withdrawals were prohibited.
>
> c. That Gerst was acquitted of the crime of embezzlement.
>
> d. That if Gerst did not take the money, some other person in the law firm must have done so and, under that scenario, the named defendant and the law firm were chargeable with falsely accusing Gerst with the theft.
>
> e. That the law firm filed its police report and claim for reimbursement on its ****861** employee dishonesty policy on the same day and that the policy did not cover members of the firm.
>
> f. That its research of the law restricted evidence of probable cause in initiating the charges of theft to the facts known by the law firm at the time the accusations were made.
>
> g. That Gerst had paid a substantial retainer in order that her case be presented in court.

***473** The appellants herein, Needle and King, testified at the sanctions hearing that they believed Gerst's protestations of innocence to be "sincere" and "consistent." A subjective belief in one's client, standing alone, should not be a bar to the imposition of sanctions. Where that belief is supported by articulated facts supporting the subjective opinion, however, the rule is otherwise. The federal courts, in order to reduce satellite litigation, have adopted an objective standard holding that sanctions shall be imposed when it appears that a competent attorney could not form the requisite reasonable belief as to the validity of what is asserted at trial. *See Eastway Construction Corp. v. City of New York,* 762 F.2d 243 (2nd Cir.1985). Counsel's justification for initiating or continuing a suit, moreover, does not and was never intended by Rule 1-341 to require an attorney to pass judgment on the credibility of his client under the threat of a monetary sanction in the event that either a jury or judge arrives at a different conclusion as to credibility. Substantial justification is established where the legal position taken by counsel is "fairly debatable." *Newman v. Reilly, supra. See also* ABA Section of Litigation, *Sanctions* (2d Ed.1988) stating:

> monetary sanctions against an attorney should not turn on whether a court or jury later believes that the client lacks credibility; Comment to Rule 3.1 of the Rules of Professional Conduct (action by lawyer does not lack substantial justification even if lawyer "believes that the client's position ultimately will not prevail").

We hold that by either an articulated subjective belief or by a more rigorous objective standard, Needle and King could not reasonably be held to have proceeded without substantial justification on September 6, 1988.

The trial court also charged Needle and King with bad faith in proceeding to trial. The Supreme Court has characterized "bad faith" as actions that are maintained "vexatiously, wantonly or for oppressive reasons." *Roadway Express, Inc. v. Piper,* 447 U.S. 752, 100 S.Ct. 2455, 65 L.Ed.2d 488 (1980), cited in *Watson v. Watson, supra.* ***474** Although Maryland appellate courts have not, to our knowledge, defined "bad faith" under Rule 1-341, the few cases addressing the issue indicate that only egregious behavior will support such a holding. *See Watson, supra* (fraud); and *Miller v. Miller,* 70 Md.App. 1, 519 A.2d 1298 (1987) (obstructive and dilatory tactics bordering on contemptuous conduct).

We hold that where the underlying action presents a colorable claim, as it does here, Rule 1-341 sanctions are improper. We concede that a trial court has inherent power to impose sanctions for continuing an action vexatiously, wantonly, or for oppressive reasons. Such action, however, requires clear evidence that the action is entirely without color and taken for other improper purposes amounting to bad faith. On the facts of this case and the inferences deducible therefrom, bad faith is not clearly established.

Gerst

The trial court charged Gerst with proceeding without justification and in bad faith, making no distinction between her actions and those of her counsel. Whether substantial justification is established for initiating or continuing a lawsuit involves an analysis of the adequacy of legal arguments, theories of recovery, evidentiary considerations, and other decisions requiring the expertise of trained professionals. Judicial review in this area, therefore, is more appropriately addressed to the actions of attorneys than to their clients. Gerst could not reasonably be expected to understand and evaluate her chances of proving the necessary elements of malicious****862** prosecution and intentional infliction of emotional distress.

The test of substantial justification under Rule 1-341 is that the legal position asserted be "fairly debatable"; that is an attorney's call. To the extent that the trial court ascribed any legal deficiencies in that call to Gerst, it erred.

Clearly, the trial court's primary basis for sanctioning Gerst was for what the court perceived as bad faith in initiating and pursuing her claims. The court concluded:

> ***475** This suit was brought ... because of her ill will and hostility toward White, Mindel, Clark & Hill, Samuel Hill and John Foley ... she had nothing to lose ... but believed that if she were successful she could reap a windfall from the defendants.

The court concluded that Gerst did not prove either lack of probable cause or improper motive in support of her malicious prosecution count, and did not prove intentionally reckless and outrageous conduct as would support intentional infliction of emotional distress.

Gerst established that she had been criminally prosecuted and that the appellees initiated the complaint. She proved that the criminal proceeding terminated in her favor. As to the absence of probable cause for the prosecution, there was evidence from which the jury could conclude that at the time the police report was made the only evidence pointing to Gerst was that she was the bookkeeper charged with the responsibility of maintaining the three accounts. Finally, there was evidence, if believed, that the law firm's purpose in naming Gerst as the prime suspect was to recover on the fidelity bond which was payable only if the loss was attributable to an employee. Thus, the elements of malicious prosecution were, *prima facie* raised; whether the trier of fact accepted or rejected Gerst's claim on these facts is not the issue.

The same reasoning applies to the claim for emotional distress. Gerst testified to her condition, and her psychologist described her physical and psychological reaction to the criminal proceeding. More importantly, the trial court denied appellees' motion for judgment on the emotional distress issue; the jury concluded that Gerst suffered emotionally and that her emotional distress was caused by the appellees' actions. Whether that distress was severe and whether the appellee acted "with deliberate disregard of a high degree of probability that emotional distress would result," and whether such action was "extreme and outrageous" were for the jury to determine.

*476 The Law and the Court

The controlling principles in Rule 1-341 cases were enunciated in *Legal Aid Bureau v. Bishop's Garth Associates Limited Partnership,* 75 Md.App. 214, 540 A.2d 1175 (1988), in an opinion by Chief Judge Gilbert. At issue in that case was a sanction order against counsel imposed by the trial court. The balance of credibility weighed heavily against Legal Aid's clients. Following a two-day trial the jury deliberated only 27 minutes before returning its verdict for Bishop's Garth. The jury foreman later indicated that the jury decided the case within 5 minutes but did not return to the courtroom for an additional 22 minutes "out of embarrassment for the defense."

There was evidence that Legal Aid's counsel informed Bishop's Garth that "we intend to seek a trial in this matter (eviction of a tenant). And that's going to be very expensive for you, just in attorney's fees alone. And you also know that we can drag this thing out for some time." *Id.* at 219, 540 A.2d 1175. Following the trial, Bishop's Garth filed a Motion for Attorney's Fees. The trial judge heard evidence on the motion for two days and ordered Legal Aid to pay attorney's fees totaling $9,691.00 to Bishop's Garth.

In his Memorandum Opinion and Order the trial judge said, "I had the opportunity to evaluate the Plaintiff's and Defendant's cases. It became clear during the trial that the Defendant's case was totally without merit." *Id.* at 222, 540 A.2d 1175. We reversed. Lack of substantial justification, ****863** we said, may not be determined from the vantage point of judicial hindsight.

[2] Trial counsel's role, we emphasized, is that of an advocate, not trier of fact or judge. It follows, therefore, that as a matter of law, a reasonable basis for believing that a case will generate a factual issue for the fact-finder at trial provides substantial justification for initiating or defending an action. *Bishop's Garth* is a specific application of the general principle that one need only assert a ***477** colorable claim or defense to escape Rule 1-341 sanctions. *See Dent v. Simmons, supra.*

[3] The Comment to Rule 3.1 of the Maryland Lawyers Rules of Professional Conduct, cited in *Bishop's Garth,* states in part:

> The filing of an action or defense or similar action taken for a client is not frivolous merely because the facts have not first been fully substantiated or because the lawyer expects to develop vital evidence only by discovery. Such action is not frivolous even though the lawyer believes that the client's position ultimately will not prevail. The action is frivolous, however, if the client desires to have the action taken primarily for the purpose of maliciously injuring a person or if the lawyer is unable either to make a good faith argument on the merits of the action taken or to support the action taken by a good faith argument for an extension, modification or reversal of existing law.

75 Md.App. at 221-22, 540 A.2d 1175.

The best evidence that Gerst had a *colorable* claim, and that the issues of bad faith and substantial justification in pursuing her claim were "fairly debatable," is patent in that the jury found that she suffered emotional distress occasioned by the appellees' actions and that she did not steal any money from the appellees. As we said earlier, the fact that her emotional distress was determined to be "not severe" is beside the point.

The federal courts, like the appellate courts in Maryland, have taken a cautious approach to claims for sanctions grounded upon issues of credibility. In *Oliveri v. Thompson,* 803 F.2d 1265, 1271 (2d Cir.1986), sanctions were imposed against counsel for "instituting and continuing the prosecution of meritless claims after it became apparent they were without a factual or legal basis." The claimant was seeking damages for malicious prosecution and use of excessive force in his arrest. Before trial, claimant's counsel knew that the police had a taped conversation in which ***478** the claimant discussed setting up a drug sale and that a photograph taken shortly after his arrest showed no evidence of the facial injuries he allegedly sustained when arrested. In reversing the sanctions against counsel, the court concluded that the strength of the evidence against the claimant did not preclude submitting the case to a jury. The Court said;

> In imposing Rule 11 sanctions,[FN3] the court is to avoid hindsight and resolve all doubts in favor of the signer.... Heavily coloring the district court's decision ... we suspect, was its conclusion that he was "unworthy of belief and his testimony was incredible." ... It goes too far, however, to impose monetary sanctions on an attorney on the ground that his testimony was not worthy of belief....

FN3. F.R.C.P. Rule 11 requires counsel to certify that the pleading, motion, or other paper filed is well grounded in fact and is warranted by existing law or a good faith argument for the modification, extension or reversal of existing law and is not interposed for any improper purpose.

Id. at 1275.

The cock did not begin to crow in this case possibly because the appellees were not thrice denied.[FN4] The court denied appellees' motion for judgment twice and reserved its ruling the third time. After the verdict was harkened, the court, exercising its perceived power to engage in judicial hindsight, stated that it should never have permitted the case to continue and *sua sponte* embarked on the sanctions phase of the trial. That the result of the sanctions ****864** hearing was predictable is evidenced by the fact that the appellees, who had not requested sanctions at the time, were advised to prepare a list of their expenses for presentation at the sanctions hearing.

FN4. *John* 18:15-27.

The trial court paid little, if any, heed to the fact that two separate jury panels concluded that Gerst did not steal the money missing from the appellees' accounts. Instead, the ***479** court concluded that appellant spent from $1,000 to $1,500 per week in cash during 1983 and the early part of 1983 despite evidence to the contrary, and that transfer of funds from the appellees' escrow savings account was to be accomplished as paper transactions with no funds ever leaving the bank, which was disputed by neutral bank witnesses. The court's conclusion that Gerst had nothing to lose, moreover, is refuted by the testimony that she had paid $9,500.00 to her attorneys in advance of trial. These findings, "after having the opportunity to see and hear the witnesses," are classic examples of judicial hindsight proscribed by *Bishop's Garth.*

Whether this case went forward, or ended before it started, was the trial judge's call. The appellees' thorough and well documented argument in support of their pretrial motion for summary judgment was denied by the court. *That* ruling forced the case to trial. The denial of the motion, furthermore, establishes that the court recognized that there were disputed questions of fact presented by the pleadings that precluded the court from granting appellees' motion as a matter of law. Having recognized Gerst's right to proceed, the court cannot thereafter decide that the case was *brought* and *pursued* in bad faith and without substantial justification. Clearly, sanctions may arise during the course of a trial warranting the imposition of sanctions at the conclusion thereof irrespective of whether the one sanctioned is a winner or loser. Dilatory tactics, for example, or abusive conduct, or disregard of rulings by the court could result in some form of sanctioning, but there is no allegation of misconduct alleged herein.

Although the court ultimately concluded that Gerst did not prove her case, we cannot overlook the fact that the court decided three times that the evidence was sufficient that the granting of a motion for summary judgment may have been error. If the evidence was sufficiently debatable to deny the motions throughout the trial, it was sufficient to justify Gerst in bringing and continuing the case. We hold, ***480** therefore, that the trial court's imposition of sanctions was clearly erroneous.

It is unnecessary that we consider the appellants' claims of denial of due process in the scheduling of the sanctions hearing. For the court's guidance in future Rule 1-341 cases, we suggest:

[4] 1. It may well be an abuse of discretion to impose a substantial monetary sanction on a litigant without first determining the financial ability of the litigant to pay the amount assessed. *See In Re Ruben,* 825 F.2d 977 (6th Cir.1987) (litigant assessed $36,159.21 for attorney fees and cost); *Oliveri v. Thompson, supra.*

[5] 2. Constitutional due process is applicable to the assessment of attorney's fees for litigation misconduct. Fair notice and an opportunity for a hearing on the record should be provided. *See Talley v. Talley,* 317 Md. 428, 564 A.2d 777 (1989), and cases cited therein. An inherent problem arises in a sanction hearing addressed to both a claimant and counsel where, as here, they are not separately represented. A conflict of interest is foreseeable where both client and counsel may be pitted against each other in defending against Rule 1-341 sanctions. At a minimum, a trial court should set forth the specific underlying charges of bad faith and lack of substantial justification and allow a reasonable time to each party charged to prepare a defense and obtain separate counsel.

This case concluded on a Friday and the sanctions hearing was set for the following Thursday. Eliminating the two-day weekend and a religious holiday, the appellants had two days in which to prepare a joint defense. Considering the extensive litigation and the very substantial expenses generated therefrom, we think the trial court's refusal to allow additional time to prepare a response was an abuse of discretion.

****865** This case is yet another example of the ever increasing request for sanctions at the close of civil trials. The judicial process is as much abused by wholesale requests for sanctions***481** hearings as it is by conducting judicial proceedings in bad faith or without substantial justification. Rule 1-341 was not designed to provide another bite of the apple and sanctions cannot rest upon the individual perturbations of trial judges.

In *Oliveri v. Thompson, supra,* the court recognized the need for caution in sanction hearings when it observed that courts should be sensitive to the impact of sanctions on attorneys. They can be economically punishing as well as professionally harmful. Beyond that, unjustified sanction orders chill legitimate advocacy and erode the confidence of otherwise competent and ethical counsel. Appellate reversal, moreover, cannot erase the lingering doubts of legitimacy that sanction proceedings generate.

Unfortunately, a highly respectable law firm has been exposed to some degree of taint notwithstanding that it successfully defended the charges it faced. Equally unfortunate are Needle and King, who have ultimately prevailed with regard to sanctions imposed, but suffered from the allegations made. In short, there are no winners, which underscores the necessity that counsel seek sanctions only where a claim is clearly meritless and trial judges accept the premise that Rule 1-341 "is an extraordinary remedy intended to reach only intentional misconduct." *Talley v. Talley, supra,* at 438, 564 A.2d 777. As the Supreme Court made clear in *Christiansburg Garment Co. v. E.E.O.C.,* 434 U.S. 412, 421-22, 98 S.Ct. 694, 700-01, 54 L.Ed.2d 648 (1978), a trial court should:

> ... resist the understandable temptation to engage in *post hoc* reasoning by concluding that, because a plaintiff did not ultimately prevail, his action must have been unreasonable or without foundation. This kind of hindsight logic could discourage all but the most airtight claims, for seldom can a prospective plaintiff be sure of ultimate success. No matter how honest one's belief that he has been the victim of discrimination, no matter how meritorious one's claim may appear at the outset, the course of litigation is rarely predictable....

***482** JUDGMENT REVERSED.

COSTS TO BE PAID BY APPELLEES.

Md.App.,1990.
Needle v. White, Mindel, Clarke and Hill
81 Md.App. 463, 568 A.2d 856

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United States Court of Appeals,
Tenth Circuit.
OKLAHOMA FIXTURE COMPANY, an Oklahoma corporation, Plaintiff-Appellant/Cross-Appellee,
v.
ASK COMPUTER SYSTEMS, INC., a California corporation, Defendant-Appellee/Cross-Appellant.
Nos. 93-5199, 93-5200.

Jan. 13, 1995.

Buyer brought action against seller for breach of computer software sales agreement. After jury returned verdict for seller, the United States District Court for the Northern District of Oklahoma, James O. Ellison, Chief Judge, awarded seller attorney fees, and buyer appealed. The Court of Appeals, Logan, Circuit Judge, held that attorney fees were recoverable under sales agreement in accordance with California law.

Affirmed and remanded.

West Headnotes

Costs 102 ⚷194.32

102 Costs
102VIII Attorney Fees
102k194.24 Particular Actions or Proceedings
102k194.32 k. Contracts. Most Cited Cases

Pursuant to California contractual attorney fee statute, provision of computer software sales agreement granting seller recovery of "all reasonable collection costs," if it became necessary for seller to initiate legal proceedings to collect money due from buyer, amounted to unilateral attorney fee provision that enabled seller to recover fees incurred in defending contract as well as collecting upon it. West's Ann.Cal.Civ.Code § 1717.

David W. Wulfers (Charles D. Harrison, also of Houston and Klein, Tulsa, OK, with him on the briefs), for plaintiff-appellant/cross-appellee Oklahoma Fixture Co.

Richard B. Noulles of Gable and Gotwals, Tulsa, OK, for defendant-appellee/cross-appellant ASK Computer Systems, Inc.

Before TACHA, FAIRCHILD FN* and LOGAN, Circuit Judges.

FN* The Honorable Thomas E. Fairchild, Senior United States Circuit Judge, United States Court of Appeals for the Seventh Circuit, sitting by designation.

LOGAN, Circuit Judge.

The only issue in this appeal is a victorious defendant's entitlement to attorney's fees in a breach of contract, breach of warranty action, tried in Oklahoma but specifying that California law applies "in all respects." Appellant's App. 103 ¶ 14c.

Plaintiff Oklahoma Fixture Company (Oklahoma Fixture) filed this diversity suit in Oklahoma against ASK Computer Systems, Inc. (ASK), seeking damages for breach of a contract for sale of computer software and breach of warranty. Both sides stipulated that under the choice of law provision in the contract California law would control the contract and breach of warranty claims. Interestingly, both parties' pleadings sought attorney's fees. After the jury returned a defendant's verdict for ASK, Oklahoma Fixture objected to allowing ASK attorney's fees. Following our holding in *Bill's Coal Co., Inc. v. Board of Public Utilities,* 887 F.2d 242 (10th Cir.1989), that entitlement to attorney's fees in a diversity action is governed by the same state law that governs the substantive issues, the district court applied California law and determined that, reading the parties' contract in light of California Civil Code § 1717, ASK was entitled to recover $319,123.75 in attorney's fees.

The parties' contract provided that "[s]hould it be necessary for ASK to initiate legal proceedings to collect monies due from Buyer, ASK is entitled to recover all reasonable collection costs." Appellant's App. 103 ¶ 4f. There is no doubt that Oklahoma law would permit the attorney's fees. *See* Okla.Stat. tit. 12, §§ 936, 939. Oklahoma Fixture urges that we apply California law, and asserts that neither the contract nor California Civil Code § 1717 permits the attorney's fees award. Defendant ASK argues to the contrary, and, alternatively, asks us to revisit our holding in *Bill's Coal.* We need not reconsider that ruling, however,[FN1] because we ***381** conclude that the contract and § 1717 of the California Civil Code support the attorney's fee award made to ASK by the district court. Thus, the award was authorized, no matter which state law applies.

> FN1. ASK contends that *Bill's Coal Co., Inc. v. Board of Public Utilities,* 887 F.2d 242 (10th Cir.1989), was incorrectly decided, and that the district court should have looked to Oklahoma conflicts law in determining which state's law applied to the attorney's fees issue. In *Bill's Coal,* we stated that:
>
> > Sellers contend that the Oklahoma district court, sitting in diversity, erroneously applied Missouri law on the issue of attorney's fees. They argue that the trial court should have applied Oklahoma's attorney fee statute because attorney's fees are purely procedural and the law of the forum (Oklahoma) governs. However, the law in this circuit governing attorney's fees is clear. In *Matter of King Resources Co.,* 651 F.2d 1349, 1353 (10th Cir.) [*cert. denied,* 454 U.S. 881 [102 S.Ct. 370, 70 L.Ed.2d 195] (1981)], we held that "[t]hus in diversity cases generally, and certainly in this circuit, attorney fees are determined by state law and are substantive for diversity purposes." The substantive law of this case is Missouri law. Therefore, the trial court properly applied Missouri law in determining whether attorney's fees were proper. We affirm the trial court's denial of attorney fees under Missouri law.
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> 887 F.2d at 246 (footnotes omitted).
>
> *Bill's Coal* did not cite *Klaxon Co. v. Stentor Electric Mfg. Co.,* 313 U.S. 487, 61 S.Ct. 1020, 85 L.Ed. 1477 (1941), in which a Delaware federal court sitting in diversity adjudicated a dispute over a New York contract. The jury awarded plaintiff monetary damages but the issue remained whether New York or Delaware law governed prejudgment interest. The *Klaxon* Court held that in diversity cases such a decision should be made by referring to the conflicts rules of the state in which the federal district court was sitting, in that case, Delaware. Basically, *Klaxon* recognized that, even after federal courts have answered the *Erie* question of *whether* state law should govern a particular substantive issue, a question arises regarding *which* state's law to apply. *Bill's Coal* merely found that, because under *Erie R.R. v. Tompkins,* 304 U.S. 64, 58 S.Ct. 817, 82 L.Ed. 1188 (1938), the availability of attorney's fees is a substantive question, the state law that had controlled the other substantive portions of the case would control. ASK's argument is that *Bill's Coal* should have determined whether under Oklahoma conflicts law, the attorney's fees issue was procedural or substantive.
>
> This panel is bound by the earlier panel decision, of course, and if the panel were

inclined to change the analysis in *Bill's Coal,* its predecessor and successor cases, we would have to ask for in banc review. Because we here determine that ASK is entitled to attorney's fees under either California or Oklahoma law, we do not consider that argument.

Section 1717 provides in pertinent part:

(a) In any action on a contract, where the contract *specifically provides that attorney's fees and costs,* which are incurred to enforce that contract, shall be awarded either to one of the parties or to the prevailing party, then the party who is determined to be the party prevailing on the contract, whether he or she is the party specified in the contract or not, shall be entitled to reasonable attorney's fees in addition to other costs.

Where a contract provides for attorney's fees, as set forth above, *that provision shall be construed as applying to the entire contract,* unless each party was represented by counsel in the negotiation and execution of the contract, and the fact of that representation is specified in the contract.

Reasonable attorney's fees shall be fixed by the court, and shall be an element of the costs of suit.

(Emphasis added). As noted, the parties' contract provided that "[s]hould it be necessary for ASK to initiate legal proceedings to collect monies due from Buyer, ASK is entitled to recover all reasonable collection costs." Appellant's App. 103 ¶ 4f. The district court found that "reasonable collection costs" included attorney's fees. Then, although the provision on its face applies only to ASK's efforts to collect monies owed on the contract, the district court determined that under § 1717 the collection costs provision applied to the entire contract and entitled ASK to attorney's fees for defending the contract action. We review de novo the district court's interpretation and application of § 1717. *See Hoyt v. Robson Cos., Inc.,* 11 F.3d 983, 984 (10th Cir.1993).

Oklahoma Fixture asserts that the contract with ASK did not "specifically provide" for an award of "attorney's fees," as required by § 1717, and therefore ASK was not entitled to attorney's fees. Oklahoma Fixture points out that the district court relied on ***382** cases in which the contracts specifically referenced "attorney's fees." *See, e.g., United States ex rel. Reed v. Callahan,* 884 F.2d 1180, 1186 (9th Cir.1989), *cert. denied,* 493 U.S. 1094, 110 S.Ct. 1167, 107 L.Ed.2d 1069 (1990); *see also Reynolds Metals Co. v. Alperson,* 25 Cal.3d 124, 158 Cal.Rptr. 1, 2, 599 P.2d 83, 84 (1979) (note specifically provided for recovery of collection costs, "including attorney fees"). Oklahoma Fixture, however, cites no cases involving a contract with a provision for "reasonable collection costs," but supports its argument by citing cases in which there was no contractual provision either for collection costs or attorney's fees. *See Myers Bldg. Indus. v. Interface Technology, Inc.,* 13 Cal.App.4th 949, 17 Cal.Rptr.2d 242, 258 (2d Dist.1993) (trial court's award of attorney's fees under § 1717 reversed because no contractual provision for award of attorney's fees), *modified on denial of reh'g; Pilcher v. Wheeler,* 2 Cal.App.4th 352, 3 Cal.Rptr.2d 533 (2d Dist.1992) (§ 1717 not applicable in action for breach of limited partnership where partnership agreement did not contain attorney's fees provision).

Because no California case directly addresses whether a contract calling for reimbursement of "reasonable collection costs" if legal proceedings are necessary meets § 1717's requirement that the contract "specifically provide [ ] [for] attorney's fees and costs," we must determine for ourselves how California courts would answer this question.

Following California principles of interpretation, in construing a statute we first look to the language of the statute. "If a statute's language is clear, then the Legislature is presumed to have meant what it said, and the plain meaning of the language governs." *Kizer v. Hanna,* 48 Cal.3d 1, 255 Cal.Rptr. 412, 415, 767 P.2d 679, 682 (1989). Likewise, if contract language is "clear and explicit, it governs." *La Jolla Beach & Tennis Club, Inc. v. Industrial Indemnity Co.,* 9 Cal.4th 27, 36 Cal.Rptr.2d 100, 105, 884 P.2d 1048, 1053 (1994). If statutory or contract language is ambiguous, then a court may resolve the ambiguity using standard rules of construction.

We believe that the contract provision at issue here constituted a unilateral attorney's fees provision within the meaning of § 1717. The contract language "all reasonable collection costs" is a broad term, and a common sense reading includes attorney's fees. *See McClain v. Continental Supply Co.,* 66 Okla. 225, 168 P. 815, 817 (1917) (agreement in promissory note to pay costs of collection provides for reasonable attorney's fee in suit on note). This is especially so when, as here, the situation that gives rise to the right to recover "reasonable collection costs" is where it is "necessary for ASK to initiate *legal proceedings.* " Appellant's App. 103 ¶ 4f (emphasis added). Taken together with the reasonable collection costs language, the "legal proceedings" language can only mean that attorney's fees are to be included under this provision. And under § 1717, any provision for attorney's fees "shall be construed as applying to the entire contract," Cal.Civ.Code § 1717, which means, as the district court held, fees incurred in defending a contract as well as collecting upon it.

This construction and application of the statute is supported by several California court decisions construing § 1717 in a reasonably broad manner. *See, e.g., Real Property Servs. Corp. v. City of Pasadena,* 25 Cal.App.4th 375, 30 Cal.Rptr.2d 536 (2d Dist.1994) (third party plaintiff beneficiary of contract entitled to attorney's fees); *Milman v. Shukhat,* 22 Cal.App.4th 538, 27 Cal.Rptr.2d 526 (1st Dist.1994) (although relief sought by respondents was declaratory, court awarded attorney's fees, citing fundamental purpose of § 1717); *California Teachers Ass'n v. Governing Board of Simi Valley Unified School Dist.,* 161 Cal.App.3d 393, 207 Cal.Rptr. 659 (2d Dist.1984) (citing § 1717 in holding that an indemnity clause to hold the district harmless entitled it to attorney's fees), *rejected by Brock v. Kaiser Found. Hosps.,* 10 Cal.App.4th 1790, 13 Cal.Rptr.2d 678 (3d Dist.1992); [FN2] ***383** *T.E.D. Bearing Co. v. Walter E. Heller & Co.,* 38 Cal.App.3d 59, 112 Cal.Rptr. 910 (2d Dist.1974) (awarding fees to prevailing party although that party also benefitted by the unilateral attorney's fees provision).

FN2. ASK relies on *California Teachers Ass'n* for its assertion that "a contract need not contain [the precise words 'attorney's fees'] to authorize the recovery of attorneys' fees under section 1717." Combined Answer Brief and Opening Brief of Appellee/Cross-Appellant ASK Computer Systems, Inc. at 13. Oklahoma Fixture argues that *California Teachers* was overturned by *Myers Building Indus. v. Interface Technology, Inc.,* 13 Cal.App.4th 949, 17 Cal.Rptr.2d 242 (2d Dist.1993), which held that a third-party contractual indemnity provision was not made reciprocal and applicable to the entire contract by § 1717. ASK counters that *Myers* only addressed third party indemnity provisions, and did not overrule *California Teachers.* We note that in *California Teachers* the indemnitee was awarded attorney's fees, whereas in *Myers* it was the indemnitor that sought attorney's fees. The *Myers* court stated that "[t]he provisions of Civil Code section 1717 were never intended to inflict upon the indemnitee the obligation to indemnify his indemnitor in similar circumstances." *Myers,* 13 Cal.App.4th 949, 17 Cal.Rptr.2d at 256. In any event, neither *California Teachers Ass'n* nor *Myers* is controlling here.

We also are persuaded by the intent apparent in § 1717's statement that a provision for attorney's fees for any part of the contract applies to the entire contract. *See Milman v. Shukhat,* 22 Cal.App.4th 538, 27 Cal.Rptr.2d 526 (1st Dist.1994) (citing

Reynolds Metals Co. v. Alperson, 25 Cal.3d 124, 158 Cal.Rptr. 1, 599 P.2d 83 (1979)). Although it might appear equitable to hold ASK, as the author of the contract, to a higher standard than the other party, § 1717 does not allow that result. *See T.E.D. Bearing Co.,* 38 Cal.App.3d 59, 112 Cal.Rptr. at 913.

For the reasons stated, we hold that the district court correctly found ASK to be entitled to attorney's fees under § 1717. Because we affirm the district court's determination, ASK is also entitled to attorney's fees on appeal. *See Leaf v. Phil Rauch, Inc.,* 47 Cal.App.3d 371, 120 Cal.Rptr. 749, 753-54 (2d Dist.1975).[FN3] The district court is in a better position than this court to evaluate the reasonableness of the attorney's fee request. We AFFIRM the award of attorney's fees and REMAND for a determination of a reasonable attorney's fee for defending this appeal.

> FN3. Oklahoma Fixture opposes ASK's motion for attorney's fees on appeal, arguing that they should have been requested in the initial briefs. Contrary to the policy of the Ninth Circuit, in this circuit a request for attorney's fees on appeal is not required in the initial briefs. *See Hoyt v. Robson Companies, Inc.,* 11 F.3d 983, 985 (10th Cir.1993); *cf. United States v. City and County of San Francisco,* 990 F.2d 1160, 1161 (9th Cir.1993) (Ninth Circuit rules provide that court will not consider request for appellate attorney's fees unless opening brief indicates such fees will be sought). There is also pending ASK's motion to be excused from the filing fee for its second cross-appeal filed after the district court disposed of Oklahoma Fixture's Fed.R.Civ.P. 59(e) motion. The motion is not contested, and we grant it.

C.A.10 (Okl.),1995.
Oklahoma Fixture Co. v. Ask Computer Systems, Inc.
45 F.3d 380

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Only the Westlaw citation is currently available.

United States District Court, E.D. Louisiana.
OMNITECH INTERNATIONAL, INC.
v.
The CLOROX COMPANY.
Civ. A. No. 90-2929.

Aug. 19, 1992.

REPORT AND RECOMMENDATION

AFRICK, United States Magistrate Judge.

*1 On February 25, 1992, judgment was entered in favor of plaintiff, Omnitech International, Inc. (Omnitech), and against defendant, The Clorox Company (Clorox), in the sum of 3.5 million dollars with interest, plus attorney's fees and costs. Judgment was also entered in favor of Clorox against Omnitech in the sum of $782,480.00 plus accrued fees in the amount of $4,117.97, interest and attorney's fees. On February 25, 1992, the district judge referred the issue of attorney's fees to the magistrate judge for a report and recommendation.

After reviewing submissions, including memoranda, affidavits and billing statements from the parties, the magistrate judge finds that an evidentiary hearing is unnecessary.[FN1] For reasons articulated below, the magistrate judge finds that Clorox's request for attorney's fees is limited by Georgia Code Ann. § 13-1-11 (West 1982), such that Clorox should be awarded attorney's fees in an amount which equals 15% of the first $500.00 in principal and interest and 10% of the amount in excess of $500.00 of principal and interest owing on the promissory note at issue. Georgia Code Ann. § 13-1-11 (West 1982). With respect to plaintiff's request for attorney's fees, the magistrate judge finds that Omnitech's request for attorney's fees is governed by Louisiana law and that under Louisiana law, $361,653.46 would constitute a reasonable fee in this case.

BACKGROUND

On August 13, 1990, Omnitech filed suit against Clorox, asserting claims for breach of contract, misappropriation of trade secrets, unfair competition, wrongful taking and breach of fiduciary duty. Clorox counterclaimed to assert claims for Omnitech's default on a promissory note, breach of contract and negligent or intentional misrepresentation and unfair trade practices. On February 10, 1992, a jury trial commenced. The only issue reaching the jury was Omnitech's unfair trade practices claim, for which the jury rendered a 3.5 million dollar verdict in favor of Omnitech. The district judge granted a directed verdict in favor of Clorox on the promissory note. All other claims, including Clorox's claims for breach of contract, negligent or intentional misrepresentation, and unfair trade practices, were dismissed on a directed verdict.

ANALYSIS

Clorox's claim for attorney's fees

In this case, Clorox prevailed on a promissory note which contained the language "the rights and obligations of the parties hereunder, shall be governed by and construed in accordance with the laws of the State of Georgia." The note, which is silent with regard to the amount of recoverable attorney's fees, also states that "[i]n the event the indebtedness evidenced hereby is collected by or through an attorney, the holder shall be entitled to recover reasonable attorney's fees and all other costs and expenses of collection." Clorox urges that according to the note, it is entitled to all attorney's fees incurred in defending Omnitech's suit against Clorox as well as "all other costs and expenses of collection." Citing no authority, Clorox asserts that Georgia law, specifically Georgia Code Ann. § 13-1-11 (West 1982), should not limit the amount of attorney's fees to a mathematical computation.[FN2] Clorox's argument is not supported by the Fifth Circuit or by the Eleventh Circuit construing Georgia law.

***2** In *Kucel v. Walter E. Heller & Co.,* 813 F.2d 67, 73 (5th Cir.1987), the court considered the question of attorney's fees in connection with a promissory note. In *Kucel,* the forum court was a Texas district court and the promissory note at issue contained language similar to that which is contained in the note before the court, except that the parties agreed to Illinois law. *Id. at 73.* The court noted:

For cases involving contracts with choice-of-law clauses, the rule remains that if the parties agree that the contract will be governed by the laws of a particular state, then that intention prevails.

Id. at 73. The *Kucel* case also stands for the proposition that the law which governs the substantive claims of the note also govern a claim for attorney's fees.
The award of attorney's fees is part of the substantive right of a suit. Thus, the award of attorney's fees in a diversity case depends on the law of the state whose rules govern the substantive claims.

Kucel, 813 F.2d at 73 (citations omitted).[FN3]

Thus, *Kucel* instructs that we should use the choice-of-law agreed upon by the parties, that is, Georgia law, to decide the amount of attorney's fees awardable to Clorox. Georgia Code Ann. § 13-1-11(a)(2) (West 1982) states that "reasonable attorneys' fees" in the absence of specificity:

shall be construed to mean 15 percent of the first $500.00 of principal and interest owing on such note or other evidence of indebtedness and 10 percent of the amount of principal and interest thereon in excess of $500.00.

In *Pacific Mutual Life Ins. v. Wise,* 878 F.2d 1398 (11th Cir.1989),[FN4] the Eleventh Circuit affirmed the mathematical application of § 13-1-11(a)(2) and stated:

... Georgia law is clear that a provision for reasonable attorney's fees in a note or other evidence of indebtedness must contain a specific percent or the amount will be calculated using the percentages of § 13-1-11....

As long as the [note] falls within the purview of [Georgia Code] § 13-1-11, the amount of attorney's fees to which [defendant] is entitled is purely a matter of mathematical calculation.

Pacific Mutual, 878 F.2d at 1399-1400 (citations omitted). The court further stated:
[W]e have no choice but to follow the statutory dictates of the statute. As we stated in *United States v. Allen,* 699 F.2d 1117, 1123 (11th Cir.1983):

We concede that the attorney's modest efforts hardly justify such a large award. This, however, is not the issue on appeal. The validity of the law is not challenged. We are concerned merely with its application. Georgia law allows the assessment of such disproportionate fees if the formal statutory requirements are met.[FN5]

Thus, the amount of attorney's fees to which [defendant] is entitled derives purely from a mechanical application of the statute, and we remand the case to the district court with instructions to enter an attorney's fees award in favor of [defendant] in the amount anticipated by § 13-1-11.

***3** *Pacific Mutual,* 878 F.2d at 1400.

Further support for the conclusion that Clorox is entitled to only that amount described in Georgia Code Ann. § 13-1-11 (West 1982) comes from *Eways v. Georgia R.R. Bank,* 806 F.2d 991 (11th Cir.1986), wherein a bank attempted to justify the district court's award of litigation expenses in excess of that allowed by Georgia Code Ann. § 13-1-11 (West 1982). Rejecting the district court's award in excess of the formula set forth in Georgia Code Ann. § 13-1-11 (West 1982), the court stated:

The amount that can be awarded under the [note] is limited by [Georgia Code §] 13-1-11(a)(2). Under sec. 13-1-11(a)(2), an obligation for attorney's fees in a note or other evidence of indebtedness, where such an obligation does not specify that the attorney's fees will equal a certain percent of the principal and interest, is only enforceable up to 15% of the first $500.00 of principal and interest, and 10% of the principal and interest in excess of $500.00....

Any award for litigation expenses-attorney's fees, expenses and overhead-in excess of [the 13-1-11(a)(2) amount] must therefore be justified, if at all, under the bad faith and stubborn litigiousness statute (i.e., section 13-6-11).[FN6,FN7]

Id. at 993.

In *LaRoche Industries Inc. v. AIG Risk Management, Inc.*, 959 F.2d 189, 192 (11th Cir.1992) (citations omitted) (emphasis added), the Eleventh Circuit stated:

The rule in Georgia with respect to attorney's fees and litigation cost provides that these awards are generally not allowed. In order to fall within an exception to this rule, one must plead *and* prove that the opposing party acted in bad faith in the underlying transaction, was stubbornly litigious, or caused unnecessary trouble and expense in the ensuing litigation.

In this case, Clorox cannot satisfy the requirements of Georgia Code Ann. § 13-6-11 (West 1982). Although Clorox alleged bad faith on Omnitech's part, Clorox could not prove that Omnitech acted in bad faith. Clorox's claims for bad faith were rejected by the district court when it granted a directed verdict. Additionally, Clorox did not specifically allege nor did it prove that Omnitech was stubbornly litigious or caused unnecessary trouble and expense in the litigation. The court notes that Omnitech received a 3.5 million dollar judgment in its favor. Accordingly, Clorox is not entitled to fees under Georgia Code Ann. § 13-6-11 (West 1982).

Clorox also argues that it is entitled to attorney's fees for defending against Omnitech's complaint. Even if Clorox could satisfy the requirements of Georgia Code Ann. § 13-6-11 (West 1982), Clorox would not recover the costs associated with defending against the complaint. *Eways,* 806 F.2d at 993.

Accordingly, this court finds that Clorox's award for attorney's fees is limited by Georgia Code Ann. § 13-1-11 (West 1982), such that Clorox should be awarded attorney's fees in an amount which equals 15% of the first $500.00 in principal and interest and 10% of the amount in excess of $500.00 of principal and interest. Georgia Code Ann. § 13-1-11 (West 1982).

Omnitech's claim for attorney's fees

*4 Initially, Omnitech argues that the court should use its contingency fee (25% of the amount recovered) as a base figure and that if the contingency fee is used, the amount awarded should be increased to 33 1/3 % of the amount awarded. Alternatively, Omnitech argues if the court employs a lodestar approach (reasonable hours multiplied by a reasonable rate[FN8]), several factors, as enunciated in *Johnson v. Georgia Highway Express, Inc.* 488 F.2d 714, 717-719 (5th Cir.1974) and *Leenerts Farms, Inc. v. Rogers,* 421 So.2d 216, 219 (La.1982), favor an upward adjustment of the lodestar. Clorox argues that however computed, Omnitech's claim for attorney's fees should be decreased because Omnitech did not prevail on all claims and that time devoted to only the unfair trade practices claim should be given.

In this case, Omnitech's claim for attorney's fees arises under La.Rev.Stat.Ann. 51:1409A (West 1987); hence, Louisiana law will determine the reasonableness of counsel's fee.[FN9,FN10] This court could find no case, Louisiana or federal, which apportioned attorney fees in case involving a successful unfair trade practices claim and related unsuccessful claims. Nevertheless, this court finds guidance in several federal cases.

In *Norris v. Hartmarx Specialty Stores, Inc.*, 913 F.2d 253, 257 (5th Cir.1990), the court noted that plaintiff should recover for "time spent on her successful claim as well as for time spent on other issues and claims if that time contributed to her ultimate success in the case." *Id.* In a RICO case, the Fifth Circuit noted that "[w]here time spent on unsuccessful issues is difficult to segregate, no reduction of fees is required." *Abell v. Potomac Inc. Co. of Illinois,* 946 F.2d 1160, 1169 (5th Cir.1991), *cert. denied, Fryar v. Abell,* 112 S.Ct. 1944, 118 L.Ed.2d 549 (1992).

In this case, plaintiff obtained an excellent result and as in *Norris,* plaintiff's claims are difficult, if not impossible, to segregate in terms of attorney's fees and counsel's efforts. According to Omnitech's complaint, Clorox misappropriated certain trade secrets and proprietary information belonging to Omnitech, the manufacturer and distributor of "Dr. X," an insecticide which Clorox considered purchasing. Omnitech claimed that the misappropriation occurred when Clorox opted to purchase a competitor's insecticide over Omnitech's Dr. X. Omnitech's claims for breach of contract, misappropriation of trade secrets, unfair competition, wrongful taking and breach of fiduciary duty, were intertwined factually and legally.

Under the Louisiana statute, a trade practice is "unfair when it offends established public policy and when the practice is unethical, oppressive, unscrupulous, or substantially injurious to consumers and consumers include business competitors." *Roustabouts, Inc. v. Hamer,* 447 So.2d 543, 548 (La.App. 1st Cir.1984). *See also Grace-Cajun Oil Co. No. Two v. Damson Oil Corp.,* 897 F.2d 1364, 1367 (5th Cir.1990) and *Tufts v. Amoco Production Co.,* 1991 WL 61483 (E.D.La. April 15, 1991) (J. Sear, presiding), *aff'd,* 948 F.2d 1286 (5th Cir.1991) (Table). Under this broad rubric, attorney's time spent on any of the failed claims was time which was potentially spent in furtherance of the successful unfair trade practices claim.

*5 Notwithstanding the inability to apportion time between the successful claim and the unsuccessful claims, the court must review the attorney's fee request for reasonableness. The existence of a contingency fee contract does not abrogate this court's duty to review the fee for reasonableness.

In determining and fixing necessary and reasonable attorneys' fees, the court must adhere to the Code of Professional Responsibility which prohibits a fee in excess of a reasonable fee, and requires the court to disregard any provisions of an attorney-client contract that would produce an excessive, unearned or incommensurate fee.

Moody v. Arabie, 498 So.2d 1081, 1083 (La.1986). *See also State, Dept. of Transp. and Development v. Williamson,* 597 So.2d 439, 443 n. 10 (La.1992); *Central Progressive Bank v. Bradley,* 502 So.2d 1017, 1017 (La.1987) (wherein the Louisiana Supreme Court stated that the prohibition against a lawyer accepting a clearly excessive fee "cannot be abrogated by a law fixing the amount of attorney fees as a percentage of the amount to be collected.").

In *City of Baton Rouge v. Stauffer Chemical Co.,* 500 So.2d 397, 400-01 (La.1987), the Louisiana Supreme Court, *citing Leenerts Farms,* 421 So.2d 216, stated:

Louisiana courts have not hesitated to apply the guidelines of Disciplinary Rule 2-106 [FN11] in their review and control of attorney fees established by contract between the parties. ... Thus, despite such a provision fixing attorney fees in the parties' contract-the law between the parties-courts may inquire as to the reasonableness of the attorney fee as part of their prevailing, inherent authority to regulate the practice of law.

In a case involving plaintiffs entitled to attorney's fees under federal and Louisiana law, the Fifth Circuit stated:

We take note that "[t]here is a 'strong presumption' that the lodestar figure ... represents a 'reasonable' attorney's fee," *D'Emanuele v. Montgomery Ward & Co., Inc.,* 904 F.2d 1379, 1384 (9th Cir.1990), and that "upward adjustments of the lodestar are appropriate only in certain 'rare' and 'exceptional' cases." *Alberti v. Klevenhagen,* 896 F.2d 927, 930 (5th Cir.1990).

R.M. Perez & Associates, Inc., 960 F.2d at 542. In *Fourchon Docks, Inc., v. Milchem,* 849 F.2d 1561, 1568 (5th Cir.1988), the Fifth Circuit upheld the district court's calculation of the final fee which calculation consisted of multiplying attorney hours by a reasonable hourly rate. Further, it is not mandatory that the court consider all eight factors. *Id.* at 1568.[FN12]

The court finds that a reasonable attorney fee in this case can be achieved by multiplying Omnitech's attorney hours by the hourly rate. Omnitech's counsel submitted affidavits and an itemized statement of services. On June 10, 1992, defense counsel entered into a joint stipulation as to the reasonableness of the rates of plaintiff's counsel.[FN13] Plaintiff's attorney also submitted affidavits as to their experience.[FN14] Employing the stipulated rates, plaintiff's counsel urges that the lodestar amount results in a total of $335,839.00 in attorney fees.[FN15,FN16] Defense counsel offers no specific objection to various entries, except to argue that the fees should be apportioned between the successful claim and the unsuccessful claims, a task which, for reasons previously articulated, is not possible.

***6** The court notes that this matter was vigorously litigated for approximately seventeen months with intensive discovery and with countless conferences with the magistrate judge and the district judge. According to the joint stipulation, Clorox had the benefit of at least 19 attorneys. On the other hand, Omnitech, for the majority of the litigation, relied upon the services of three attorneys. In this case, Amato, Dendy and Neeb expended approximately 2,289.95 hours, a substantial amount of time which reasonably limited the amount of time they had to devote to other matters. Efforts of plaintiff's counsel resulted in a 3.5 million dollar jury verdict in favor of their client, a result which this court finds to be an excellent result. While plaintiff, citing *Roustabouts,* 447 So.2d 543,[FN17] argues that a 25% contingency fee would be owed pursuant to its arrangement with counsel, and while defendant suggests a far lower figure would be appropriate, this court finds that use of the "lodestar" formula amounts to a reasonable attorney's fee.

Considering the foregoing, the magistrate judge finds that Omnitech's request for attorney's fees is governed by Louisiana law and that under Louisiana law, $361,653.46 [FN18] would constitute a reasonable fee in this case.

RECOMMENDATION

Accordingly, the magistrate judge finds that Clorox's award for attorney's fees is limited by Georgia Code Ann. § 13-1-11 (West 1982) and recommends that Clorox be awarded attorney's fees in an amount which equals 15% of the first $500.00 in principal and interest and 10% of the amount in excess of $500.00 of principal and interest owing on the promissory note. Georgia Code Ann. § 13-1-11 (West 1982). With respect to plaintiff's request for attorney's fees, the magistrate judge finds that Omnitech's request for attorney's fees is governed by Louisiana law and recommends that under Louisiana law, $361,653.46 would constitute a reasonable fee in this case.

Failure to file written objections to the report and recommendation within ten (10) days from the date of its service shall bar an aggrieved party from attacking the factual findings on appeal. *Nettles v. Wainwright,* 677 F.2d 404 (5th Cir.1982).

FN1. *Gulf Union Industries, Inc. v. Formation Security, Inc.,* 842 F.2d 762, 767-68 (5th Cir.1988). *See also Alizadeh v. Safeway Stores, Inc.,* 910 F.2d 234, 236 (5th Cir.1990).

FN2. Clorox argues that *Ray v. Pease,* 25 S.E. 360 (Ga.1895) supports its notion that it should be allowed to recover fees incurred in defending Omnitech's suit. The *Ray* court allowed a noteholder to collect attorney's fees in connection with a suit on the note and a related injunction proceeding. This court notes that the *Ray* case was decided long before the enactment of Georgia Code § 13-1-11. Additionally, for reasons to be explained, subsequent federal cases in the Eleventh Circuit lead this court to conclude that the § 13-1-11 computation should be the only source of attorney's fees for Clorox.

FN3. In *Kucel,* the Fifth Circuit rejected the district court's application of Illinois law to construe the note and the application of Texas law to award attorney's fees for the collection of the note. *Kucel,* 813 F.2d at 73. The court held that Illinois law controlled both the interpretation of the note and the award of attorney's fees. *Id.* at 73-74.

FN4. In *Pacific Mutual,* the Eleventh Circuit agreed with the district court that Georgia Code Ann. § 13-1-11 (West 1982) resulted in defendant receiving grossly excessive fees. *Id.* at 1400. However, the Eleventh Circuit remanded the issue of attorney's fees, ordering the district court to compute the attorney's fees in accordance with the percentages fixed by Georgia Code Ann. § 13-1-11 (West 1982). *Id.* at 1400.

FN5. On page 5 of the plaintiff's opposition memorandum, plaintiff admits that Clorox is entitled to recover its statutory attorney's fees pursuant to the Georgia Code.

FN6. This statute, which Clorox does not mention, reads:

> The expenses of litigation generally shall not be allowed as a part of the damages; but where the plaintiff has specially pleaded and has made prayer therefor and where the defendant has acted in bad faith, has been stubbornly litigious, or has caused the plaintiff unnecessary trouble and expense, the jury may allow them.
>
> Georgia Code Ann. § 13-6-11 (West 1982).

FN7. Clorox cites *Towers Charter & Marine Corp. v. Cadillac Ins. Co.,* 894 F.2d 516 (2d Cir.1990) in support of its contention that it should get attorney's fees for defending plaintiff's entire suit. *Towers* is distinguishable. First, that court was not construing Georgia law. Second, the *Towers* plaintiff did not prevail on any of its claims against the defendant. Here, Omnitech prevailed on an important claim, the unfair trade practices claim.

FN8. *R.M. Perez & Associates, Inc. v. Welch,* 960 F.2d 534, 542 (5th Cir.1992).

FN9. In *Gulf Union Industries, Inc.,* 842 F.2d at 767, the Fifth Circuit noted it is "to follow the state-law fee-setting requirements in cases involving state substantive law."

FN10. La.Rev.Stat.Ann. 51:1409A (West 1987) states in pertinent part:

> ... In the event that damages are awarded under this Section, the court shall award to the person bringing such action reasonable attorney's fees and costs.

FN11. According to *City of Baton Rouge,* 500 So.2d 397, 400 (La.1987) (emphasis in original), Disciplinary Rule 2-106 provides in pertinent part:

> (a) a lawyer should not *enter into an agreement for, charge, or collect* an illegal or *clearly excessive fee.*
>
> (b) a fee is clearly excessive when, after a review of the facts, a lawyer of ordinary prudence would be left with a definite and firm conviction that the fee is in excess of a reasonable fee. Factors to be considered as guides in determining the reasonableness of the fee include the following:
>
> (1) the time and labor required, the novelty and difficulty of the questions involved, and the skill requisite to perform the legal services properly;
>
> (2) the likelihood, if apparent to the client, that the acceptance of the particular employment would preclude other employment by the lawyer;

(3) the fee customarily charged in the locality for similar legal services;

(4) the amount involved and the results obtained;

(5) the time limitations imposed by the client or by the circumstances;

(6) the nature and the length of time of professional relationship with the client;

(7) the experience, reputation and ability of the lawyer or lawyers performing the service; and

(8) whether the fee is fixed or contingent.

These factors are now found in Rule 1.5(a) of the Rules of Professional Conduct (West 1988) and are similar to those factors listed in *Johnson v. Georgia Highway Express, Inc.*, 488 F.2d 714, 717-19 (5th Cir.1974).

FN12. For a generalized discussion of the factors, see *Drury v. Fawer*, 590 So.2d 808, 812-13 (La.App. 4th Cir.1991), *writ denied*, 592 So.2d 1304 (1992).

FN13. The joint stipulation states that plaintiff and defendant consider the following rates to be reasonable for plaintiff's counsel:

Jacob J. Amato, Jr.	$ 190.00 per hour
D. Michael Dendy	130.00 "
Anne LaCour Neeb	120.00 "

The parties also stipulated to the reasonableness of the rates of Clorox's counsel. Those rates ranged from $215.00 per hour to $85.00 per hour. The stipulation is in itself evidence of the fee customarily charged in the locality for similar services.

FN14. Affidavits provided by plaintiff's counsel state that Jacob Amato has been practicing law since 1970, that C. Michael Dendy has been practicing since 1979, and that Anne Neeb has been practicing since 1982. All three attorneys attest that their practices primarily involve civil litigation including commercial or business disputes.

FN15. Exhibit 2 of Jacob Amato's affidavit states:

ATTORNEY	*HOURS EXPENDED*	*RATE*	*TOTAL*
Jacob J. Amato, Jr.	775.20	190.00	$147,288.00
D. Michael Dendy	637.85	130.00	82,920.00
Anne L. Neeb	876.90	120.00	105,228.00
Law Clerks	23.00	17.50	402.50
			$335,839.00

The actual total is $335,838.50.

FN16. Omnitech also wants to recover $25,814.96 in attorney's fees incurred by prior counsel. During an August 18, 1992, telephone conference, counsel for Clorox urged the same objection to these fees as that lodged against the fees claimed by Omnitech's current counsel.

FN17. In *Roustabouts*, the plaintiff was awarded $133,333.00 in damages in addition to attorney's fees under La.Rev.Stat.Ann. § 51:1409A (West 1987). *Roustabouts*, 447 So.2d at 545. Defendant argued that the attorney's fee award was not reasonable because it was excessive. *Id.* at 550. The state appellate court stated that while 25% was "on the high end of the scale," the award was justified considering the factors enumerated in Disciplinary Rule 2-106 and because "[g]iven the nature of this litigation, we are not left with the definite and firm conviction that the 25% fee was in excess of reasonableness." *Id.* at 550-51.

FN18. This total is the sum of the "lodestar" fees of Omnitech's current counsel and the fees of Omnitech's former counsel.

E.D.La.,1992.
Omintech Intern., Inc. v. Clorox Co.
Not Reported in F.Supp., 1992 WL 211490 (E.D.La.)

END OF DOCUMENT

Court of Special Appeals of Maryland.
OPTIC GRAPHICS, INC.
v.
Ross AGEE, et al.
No. 1356, Sept. Term, 1990.

June 27, 1991.

Former employer brought suit against former employee, employee's business partner, and his business, alleging misappropriation of trade secrets consisting of marketing strategy and pricing information and breach of confidentiality agreement by using and disclosing trade secrets. The Circuit Court, Baltimore City, Hilary D. Caplan, J., rejected employer's claims and assessed attorney fees and expenses for employer's continuance of suit after date on which employer's president learned by faxed letter that someone had allegedly forged employee's signature on confidentiality agreement. Employer appealed and employee and his partner cross-appealed. The Court of Special Appeals, Alpert, J., held that: (1) evidence supported conclusions that pricing information and marketing strategy of vinyl loose-leaf binder manufacturer were not "trade secrets" entitled to protection under the Maryland version of the Uniform Trade Secrets Act; (2) employer had reason to believe it had colorable trade secrets misappropriation claim when it initiated and continued suit against employee; but (3) case would be remanded for determination of when employer's bad faith began and for award of sanctions for bad faith with respect to breach of contract claim if such fees and expenses were separable.

Affirmed in part; vacated in part; and remanded.

West Headnotes

[1] Antitrust and Trade Regulation 29T ⚷413

29T Antitrust and Trade Regulation
29TIV Trade Secrets and Proprietary Information
29TIV(A) In General
29Tk413 k. What Are "Trade Secrets" or Other Protected Proprietary Information, in General. Most Cited Cases
(Formerly 382k984 Trade Regulation, 379k10(5))
To extent that Restatement of Torts presents narrower view of trade secret than definition contained in Maryland Uniform Trade Secrets Act, Act preempts the Restatement definition. Code, Commercial Law, § 11-1201(e)(1, 2).

[2] Antitrust and Trade Regulation 29T ⚷413

29T Antitrust and Trade Regulation
29TIV Trade Secrets and Proprietary Information
29TIV(A) In General
29Tk413 k. What Are "Trade Secrets" or Other Protected Proprietary Information, in General. Most Cited Cases
(Formerly 382k984 Trade Regulation, 379k10(5))
Although not all of the Restatement of Torts' factors are required to find trade secret, under the Maryland Uniform Trade Secrets Act, Restatement's factors still provide helpful guidance to determine whether information in given case constitutes trade secrets within definition of Act. Code, Commercial Law, § 11-1201(e)(1, 2).

[3] Antitrust and Trade Regulation 29T ⚷420

29T Antitrust and Trade Regulation
29TIV Trade Secrets and Proprietary Information
29TIV(A) In General
29Tk420 k. Particular Cases, in General. Most Cited Cases
(Formerly 382k990 Trade Regulation, 379k10(5))
Pricing information and marketing strategy are pro-

tectible as "trade secret."

[4] Antitrust and Trade Regulation 29T ⚷413

29T Antitrust and Trade Regulation
29TIV Trade Secrets and Proprietary Information
29TIV(A) In General
29Tk413 k. What Are "Trade Secrets" or Other Protected Proprietary Information, in General. Most Cited Cases
(Formerly 382k984 Trade Regulation, 379k10(5))
For information to be "trade secret" under the Maryland Uniform Trade Secrets Act, information must hold independent economic value because it is not generally known to or readily ascertainable by others who stand to benefit economically if they use or disclose it, and information must be the subject of reasonable efforts to maintain its secrecy. Code, Commercial Law, § 11-1201(e)(1, 2).

[5] Antitrust and Trade Regulation 29T ⚷432

29T Antitrust and Trade Regulation
29TIV Trade Secrets and Proprietary Information
29TIV(B) Actions
29Tk429 Evidence
29Tk432 k. Weight and Sufficiency of Evidence. Most Cited Cases
(Formerly 382k1002 Trade Regulation, 379k27)
Evidence supported conclusion that pricing information regarding vinyl loose-leaf binder manufacturing operation was not "trade secret" for purposes of the Maryland Uniform Trade Secrets Act; pricing information was found not to be of economic value as being composed of so many variables that it was generally subject to change and specific to the particular manufacturer, and manufacturer's efforts to safeguard and keep secret the information were found to fall short of what the Act required. Code, Commercial Law, § 11-1201(e)(1, 2).

[6] Antitrust and Trade Regulation 29T ⚷432

29T Antitrust and Trade Regulation
29TIV Trade Secrets and Proprietary Information
29TIV(B) Actions
29Tk429 Evidence
29Tk432 k. Weight and Sufficiency of Evidence. Most Cited Cases
(Formerly 382k1002 Trade Regulation, 379k27)
Evidence supported conclusion that manufacturer's marketing strategy for vinyl loose-leaf binders was not "trade secret" for purposes of the Maryland Uniform Trade Secrets Act; marketing strategy was found to be composed of information readily available from marketplace by inquiry of prospective purchasers, and pricing information was found not to permit underbidding of the existing manufacturer as it was specific to that manufacturer. Code, Commercial Law, § 11-1201(e)(1, 2).

[7] Costs 102 ⚷2

102 Costs
102I Nature, Grounds, and Extent of Right in General
102k1 Nature and Grounds of Right
102k2 k. In General. Most Cited Cases
In resolving whether sanctions could be imposed for maintaining suit in bad faith or without substantial justification, under Maryland Uniform Trade Secrets Act provision for award of attorney fees if claim of misappropriation is made in bad faith or under rule providing for award of attorney fees if party maintained proceeding in bad faith, only egregious behavior will support imposition of attorney fees, and although sanctions are improper if underlying action presents colorable claim, court has inherent power to impose sanctions for continuing action vexatiously, wantonly, or for oppressive reasons. Code, Commercial Law, § 11-1204; Md.Rule 1-341.

[8] Appeal and Error 30 ⚷984(5)

30 Appeal and Error
30XVI Review
30XVI(H) Discretion of Lower Court

30k984 Costs and Allowances
30k984(5) k. Attorney Fees. Most Cited Cases

Court of Special Appeals' standard of review for award of attorney fees under Maryland Uniform Trade Secrets Act provision or under rule providing for award against party who maintained proceeding in bad faith is the same. Code, Commercial Law, § 11-1204; Md.Rule 1-341.

[9] Appeal and Error 30 ⚿1178(6)

30 Appeal and Error
30XVII Determination and Disposition of Cause
30XVII(D) Reversal
30k1178 Ordering New Trial, and Directing Further Proceedings in Lower Court
30k1178(6) k. Ordering New Trial of Certain Issues Only. Most Cited Cases

Former employer's suit alleging former employee misappropriated trade secrets and breached his confidentiality agreement by using and disclosing trade secrets would be remanded for trial court to determine when during prosecution of suit bad faith began, for purposes of awarding attorney fees, but only with respect to breach of contract claim, as bad faith was not clearly established with respect to prosecution of trade secrets claim. Code, Commercial Law, § 11-1204; Md.Rule 1-341.

[10] Antitrust and Trade Regulation 29T ⚿425

29T Antitrust and Trade Regulation
29TIV Trade Secrets and Proprietary Information
29TIV(A) In General
29Tk425 k. Injury or Harm from Use of Information. Most Cited Cases
(Formerly 382k981 Trade Regulation, 379k24)

Party may initiate suit alleging misappropriation of trade secrets before damages actually accrue. Code, Commercial Law, § 11-1202(a).

[11] Costs 102 ⚿194.44

102 Costs
102VIII Attorney Fees
102k194.44 k. Bad Faith or Meritless Litigation. Most Cited Cases

Former employer had reason to believe it had colorable claim when it initiated suit against former employee alleging misappropriation of trade secrets consisting of marketing strategy and pricing information, so any award of attorney fees against employer based on bad faith in prosecuting trade secrets theory of litigation was abuse of discretion. Code, Commercial Law, § 11-1204.

[12] Attorney and Client 45 ⚿24

45 Attorney and Client
45I The Office of Attorney
45I(B) Privileges, Disabilities, and Liabilities
45k24 k. Liability for Costs; Sanctions. Most Cited Cases

Costs 102 ⚿2

102 Costs
102I Nature, Grounds, and Extent of Right in General
102k1 Nature and Grounds of Right
102k2 k. In General. Most Cited Cases

Neither Uniform Trade Secrets Act provision for award of attorney fees nor rule providing for award of fees against party who maintained proceeding in bad faith were intended to penalize party and/or counsel for asserting colorable claim or defense. Code, Commercial Law, § 11-1204; Md.Rule 1-341.

[13] Costs 102 ⚿194.44

102 Costs
102VIII Attorney Fees
102k194.44 k. Bad Faith or Meritless Litigation. Most Cited Cases

Even after former employer learned of alleged forgery of employee's signature on confidentiality agreement, employer had colorable claim against employee under misappropriation of trade secrets theory, so continued prosecution of trade secrets theory of litigation did not warrant award of attorney fees against employer, as bad faith was not clearly established. Code, Commercial Law, § 11-1204; Md.Rule 1-341.

[14] Costs 102 ⚷2

102 Costs
102I Nature, Grounds, and Extent of Right in General
102k1 Nature and Grounds of Right
102k2 k. In General. Most Cited Cases

If fees and expenses generated by defense of colorable trade secrets claim could be separated from fees and expenses generated by defense of breach of contract claim based on confidentiality agreement on which employee's purported signature was allegedly forgery, sanctions could appropriately be imposed for bad faith with respect to former employer's breach of contract claim. Code, Commercial Law, § 11-1204; Md.Rule 1-341.

****580*774** John A. Scaldara (Stephen P. Kauffman and Wendy A. Kronmiller, on the brief), Baltimore, for appellant.

Stanley B. Rohd and Kathleen McDermott (Weinberg and Green, on the brief), Baltimore, for appellees.

Argued before ALPERT, BLOOM and ROSALYN B. BELL, JJ.

ALPERT, Judge.

In this case we are asked to decide (1) whether internal operating information (internal business facts) consisting of marketing strategy and pricing information are trade secrets under Maryland's Uniform Trade Secrets Act (the Act), and (2) under what circumstances a trial court appropriately may impose sanctions under section 11-1204 of the Act and Maryland Rule 1-341 for bad faith in conducting litigation.

FACTS AND PROCEEDINGS

Optic Graphics, Inc. (appellant) is a Maryland corporation located in Glen Burnie, Maryland, which engages in the graphic arts business. Optic primarily operated as a printing company from its inception in the early 1900's until about 1980, when it began to manufacture vinyl looseleaf binders.

The company is a family business that currently is run by the founder's grandson, David Kinlein. Kinlein, a thirty-six-year-old business graduate, is the company's president and chief executive officer. His mother, Carolyn Wilder, is the personnel director. The company employs about 375 ***775** people. In 1989, its gross revenues approached 27 million dollars.

In July 1987, Optic hired Ross Agee (appellee) to work as an estimator for its printing department. Optic had solicited Agee in April 1987 while he still was employed by Sheridan Press. Sheridan terminated Agee in June 1987, after a reorganization. Seeking employment, Agee contacted a number of printing companies. Three, including Optic, extended him offers of employment. Of these, Optic was the only ****581** company that manufactured vinyl looseleaf binders.

On or about July 27, 1987, Agee began work with Optic as an estimator in its printing department. When the company reorganized its corporate structure in January 1988, it gave Agee responsibility for all of Optic's estimating functions, *i.e.*, both the printing and looseleaf binder divisions. Agee estimated the cost of materials and labor required to complete those jobs on which Optic planned to submit a bid. The method by which he did so "consisted of matching job specifications to a plan to produce a product in terms of production standards [FN1] and budgeted hourly rates." [FN2] To perform this function, Optic necessarily had to give Agee access to certain information that the company considered to be confidential: pricing, material cost, mark-ups, profit margins, machine cost rates, production rates, and marketing strategies.

FN1. A production standard is a company's range of operating speeds for different equipment in units of output. Record at 70.

FN2. A budgeted hourly rate is the theoretical cost for a company to run its equipment on an hourly basis. Record at 69.

Agee had a long-time friend, Michael Zanella (appellee), whom he had met when they both were employees at Port City Press, another graphic arts company engaged primarily in printing. The two had discussed starting their own printing business on and off for a number of years. In 1980, Bindagraphics Corporation-one of Optic's competitors ***776** -hired Zanella to work in its vinyl looseleaf manufacturing business where he remained until his resignation in December 1989. When Sheridan terminated Agee in June 1987, he and Zanella resumed their informal discussions about starting a business. They contacted a business broker that year and asked the broker to be on the lookout for a small printing company.

Early in 1988, Agee and Zanella learned that Specialties Binder, a looseleaf bindery business, was for sale. They held a number of informal discussions with the owner, a Mr. Ridgeway, but failed to reach an agreement for the purchase of the business. In December 1988, Ridgeway informed them that he had sold the business to a Canadian printing company. The pair lost their momentum until they again contacted Ridgeway in the spring of 1989. Ridgeway indicated that although he had completed the sale, he had retained the vinyl division and its equipment, and wanted to resume negotiations.

In June 1989, Agee and Zanella agreed to purchase the vinyl looseleaf binder manufacturing business. The pair then formed "A to Z Enterprises, Inc." [FN3] (appellee), a Maryland corporation, to conduct the business. The corporation apparently had neither assets nor customers at that time.

FN3. Agee and Zanella later changed their company's name to "A to Z Looseleaf, Inc." They used "Enterprises" in the original name because they believed that their respective employers would fire them if the employers learned of their business plans. Agee's employer, David Kinlein, testified that not only would he have fired Agee had he learned of Agee's plans, but also that he never would have hired Agee to begin with had he known that Agee had notions of running his own business.

From June through August 1989, Agee and Zanella researched and prepared a formal business plan to secure financing for the business. Agee and Zanella continued to work for their respective employers through December 1989, working on their new business venture at night and on the weekends.

***777** Early in 1989, Optic developed a formal marketing plan for its future growth; Agee received a copy of the plan, and had this information available when he and Zanella prepared their financing proposal that summer. In its complaint, Optic alleged, *inter alia,* that Agee and Zanella had incorporated a portion of its marketing strategy into A to Z's financing proposal.[FN4] It ****582** further alleged that the two then disclosed this marketing strategy, as well as other confidential information, to various third parties without Optic's knowledge or consent.[FN5]

FN4. Specifically, Optic complained in its brief that the financing proposal stated that Optic " 'neglects certain segments of [A to Z's] defined market.' " While Optic will " 'perform miracles for its major customers [naming specific Optic customers] upon whose large volume and moderate profit levels Optic will base its future growth, other segments of the market, most noticeably those targeted by A to Z Looseleaf, Inc. in the Baltimore-Washington area, have been neglected in many ways.' "

Optic also complained that Agee and Zanella "boasted" in the financial proposals that they currently held influential positions at A to Z's competitors, Optic and Bindagraphics. That information was included in the proposal's "resume" section, which told prospective lenders the background of A to Z's chief operating officers.

FN5. The parties to whom Agee and Zanella purportedly disclosed this information are as follows: A to Z's attorneys and accountant, the employees of prospective lenders, including the Baltimore Economic Development Company (BEDCO), Provident Bank, Maryland National Bank, and the Small Business Administration (SBA).

In October 1989, Agee and Zanella tentatively secured financing through a Small Business Administration (SBA) loan; settlement was scheduled for early February 1990. Agee tendered his resignation to Optic's treasurer, John Strauss, on December 26, 1989, informing Strauss that he was going into his own business with Zanella. At that time, A to Z Looseleaf, Inc. was not yet operational. The company had no assets, contracts, customers, or prospective customers. Neither Agee nor Zanella had contacted any vendors.

On January 24, 1990, Optic filed suit against Agee, Zanella, and A to Z Looseleaf, Inc., asking for damages and *ex *778 parte* injunctive relief.[FN6] In its complaint, Optic alleged that Agee and Zanella had misappropriated Optic's trade secrets, that Optic as a result had sustained damages, the nature and extent of which were not yet known, and that Agee had breached his confidentiality agreement with Optic when he used and disclosed Optic's trade secrets. Optic attached and incorporated into its complaint a faxed copy of the "Confidentiality Agreement" that Agee allegedly executed in July 1987.[FN7] The suit effectively impeded Agee's and Zanella's plans to move forward with their business.[FN8]

FN6. Apparently, Optic's treasurer, John Strauss, indicated to Agee and Zanella that Optic initiated the suit solely in response to a rumor that a former Optic competitor-Jerry Nocar-was financing A to Z in violation of a noncompetition agreement that Nocar had with Optic. Optic did not name Nocar as a defendant or mention the rumor in its complaint.

FN7. When Optic hired Agee, he executed several employment-related documents that Optic maintained in his personnel file in the regular course of business. The confidentiality agreement purportedly was one of them.

FN8. Agee and Zanella had to disclose the suit to their potential lenders, which essentially foreclosed the possibility of any financing. The SBA indefinitely postponed settlement on the loan pending the suit's resolution. Agee and Zanella were unable to purchase equipment, execute a lease, or occupy A to Z's intended business premises. The two used personal funds to lease space at their seller's facility and, at the time of trial, had begun to manufacture their product.

Agee and Zanella waived the hearing, scheduled for February 2, 1990, on Optic's request for an *ex parte* injunction. The parties held four meetings in late January and early February to discuss settlement. These negotiations ultimately failed. At the final meeting, Agee returned to Optic a number of confidential documents that included pricing information for one of Optic's largest customers, raw material costs, and information about the machines that it used in its manufacturing process.[FN9]

FN9. Optic contends that Agee did not have permission to retain this material and that the information returned directly related to the market which A to Z targeted in its financing proposal, *i.e.*, that segment of the market in which Optic hoped for business but would allocate only a few of its sales resources.

> Agee, on the other hand, contends that he had these materials to develop estimates when he worked at home on evenings and weekends. Optic's treasurer, John Strauss, admitted that he knew that Agee worked at home and would have needed these materials. In fact, Agee testified that at the time he resigned, Strauss had asked him to continue his estimating work for a short time.

***779** On February 13, 1990, Agee and Zanella filed a motion to dismiss the complaint. The circuit court scheduled the matter for trial on March 16, 1990. At his deposition on March 6, 1990, Agee for the first time questioned whether the signature on the photocopied confidentiality agreement in ****583** the personnel file that Optic produced was his. Agee had requested the opportunity to view the original document about one month prior to his deposition. Optic's personnel director, Carolyn Wilder, allegedly sent the original to 20 South Charles Street, Agee's counsel's former address. No one ever found the letter. On March 8, 1990, Agee and Zanella retained a handwriting expert, Gary Girton of the Maryland State Crime Laboratory, to examine the documents, *i.e.,* the photocopy and the faxed copy. He concluded that the signature on the documents was an imitation forgery.[FN10]

FN10. An "imitation forgery" is a forged signature that someone has imitated from a model signature. Record at 173.

On March 9, 1990, Agee and Zanella withdrew their motion to dismiss and answered Optic's complaint. On March 13, 1990, by faxed letter dated March 12, 1990, Agee's counsel advised Optic's counsel that Girton would testify that the signature was an "imitation forgery," and provided opposing counsel with the expert's written report and conclusions. On March 14, 1990, Agee amended his answer to include a negative defense, in which he denied that he had signed the "Confidentiality Agreement."

Optic's counsel attempted to settle the case on March 14, 1990. Optic's terms included a dismissal with prejudice and a mutual release. Agee and Zanella agreed to execute the ***780** releases if Optic paid them $150,000. Optic declined to do so. On the day of trial, Agee and Zanella reduced their demand to a dismissal with prejudice, but reserved the right to request sanctions. Optic rejected the offer and proceeded to a trial on the merits. After a two and one-half day trial, the trial court rejected Optic's claims for injunctive relief and damages and found in favor of Agee, Zanella, and A to Z Looseleaf, Inc.

On March 26, 1990, the trial court entered final judgment, which reserved the right of Agee and Zanella to request attorneys' fees and costs. On March 30, 1990, the pair applied for attorneys' fees and costs pursuant to Maryland Rule 1-341 and section 11-1204 of Maryland's Uniform Trade Secrets Act, asserting that Optic had pursued the suit in bad faith. Optic moved the court to alter or amend its ruling that there was no misappropriation of trade secrets.

The circuit court held a hearing on Optic's motion to alter or amend the judgment and on the motion of Agee and Zanella for sanctions. The court denied Optic's motion to alter or amend.

After hearing argument on the motion for sanctions, the trial court assessed attorney's fees and expenses for Optic's continuance of its action after March 13, 1990-the date that Optic's president learned by faxed letter dated March 12, 1990 that someone had forged Agee's signature on the confidentiality agreement. It is not clear, however, whether the court also found that Optic had *initiated* the action in bad faith. *See* discussion *infra* in part II of this opinion.

The court ordered Optic to pay Agee's and Zanella's attorneys' fees and costs of $25,000. Both sides had stipulated to this figure as representing all of their legal fees and expenses from March 14, 1990 through April 30, 1990. The court entered final judgment on May 21, 1990.

Optic filed an appeal from that judgment. At the same time, Agee and Zanella filed a cross-appeal from the trial ***781** court's refusal to award sanctions from January 24, 1990, the date the action commenced.

On appeal, Optic asks us whether:

> I. The trial court erred when it found that Optic had failed to establish the existence and misappropriation of trade secrets.
>
> II. The trial court erred when it imposed sanctions against Optic.

On cross-appeal, Agee and Zanella ask us whether:

> III. The trial court erred when it refused to award sanctions from the date that Optic commenced its action.

****584** I.

Optic contends that appellees misappropriated its trade secrets. Specifically, Optic asserts that the information which Agee retained-pricing information, raw material costs, and marketing strategy-constitutes trade secrets protected by the State's Uniform Trade Secrets Act. Optic also contends that Agee misappropriated this information when he wrongfully retained it and subsequently disclosed it to Zanella and to potential lenders without Optic's knowledge or consent.

We begin by noting the conspicuous absence of an enforceable covenant to restrict competition. Recently we observed that Court of Appeals held

> absent an enforceable covenant restricting competition, an employee may make arrangements to compete with his former employer before termination of his services, but he may not solicit customers or directly compete while still employed. The right to prepare to compete is limited only where the employee 'has committed some fraudulent, unfair or wrongful act' in the course of his preparation. Moreover, an employee is not required 'in all cases [to] tell his employer of his future plans to become a competitor.' Once the employment relationship is terminated, the employee may solicit his former employer's ***782** business absent an enforceable covenant restricting competition, misuse of trade secrets, or misuse of confidential information.

Dworkin v. Blumenthal, 77 Md.App. 774, 779, 551 A.2d 947 (1989) (citations omitted).

[1] Courts for the most part have adopted one of two views as to what constitutes a trade secret. FN11 *See* Annotation, *What Is "Trade Secret" So As To Render Actionable Under State Law Its Use or Disclosure By Former Employee,* 59 A.L.R. 4th 641, 652 (1988). One view is found in the Restatement of Torts, *see Restatement of Torts* § 757 (1939); the other is found in the Uniform Trade Secrets Act, *see* Unif. Trade Secrets Act, 14 U.L.A. 433 (1985). The Court of Appeals adopted the *Restatement* definition of "trade secret" in *Space Aero Products Co., Inc. v. R.E. Darling Co., Inc.,* 238 Md. 93, 110, 208 A.2d 74, *cert. denied,* 382 U.S. 843, 86 S.Ct. 77, 15 L.Ed.2d 83 (1965).

> FN11. Both views are attempts to provide a uniform guideline for determining protectable trade secret status and they contain similar provisions; for instance, under both views, the secrets must be information, must be valuable, must be generally unknown, and must be the subject of reasonable security measures designed to maintain confidentiality.
>
> Annotation, *What Is "Trade Secret" So As To Render Actionable Under State Law Its Use Or Disclosure By Former Employee,* 59 A.L.R.4th 641, 652 (1988)
>
> .

Under the *Restatement* view,

> '[a] trade secret may consist of any formula, pattern, device or compilation of information which is used in one's business, and which gives him an opportunity to obtain an advantage over competitors who do not know or use it. It may be a formula for a chemical compound, a process of manufacturing, treating, or preserving materials, a pattern for a machine or other device, or a list of customers.'

Id., at 105, 208 A.2d 74 (quoting Restatement of Torts § 757 comment b (1939)); *see also Note, Maryland Uniform ***783** Trade Secrets Act,* 49 Md.L.Rev. 1056, 1060 (1990) [hereinafter Note].

The court also adopted the *Restatement's* list of factors to be used in determining whether particular information qualifies as a trade secret:

> '(1) the extent to which the information is known outside of his business; (2) the extent to which it is known by employees and others involved in his business; (3) the extent of measures taken by him to guard the secrecy of the information; (4) the value of the information to him and to his competitors; (5) the amount of effort or money expended by him in developing the information; (6) the ease or difficulty with which the information could be properly acquired or duplicated by others.'

Id. at 110, 208 A.2d 74 (quoting *Restatement of Torts* § 757 comment b (1939)); *see also* Note, *supra,* at 1060-61.

****585** On July 1, 1989, Maryland adopted the Uniform Trade Secrets Act (the Act).[FN12] *See* Act of July 1, 1989, ch. 598, 1989 Md. Laws 3642; *see also* Md.Com.Law Code Ann. § 11-1201 to -1209 (1990). To the extent that the *Restatement* presents a narrower view, the Act pre-empts that definition. *See* Note, *supra,* at 1061 n. 36 & 1061-66.

> FN12. The purpose of the Act is "to codify and clarify the existing common law of trade secrets, and to minimize substantive differences among the adopting states by expressly requiring uniform construction." Note, *Maryland Uniform Trade Secrets Act,* 49 Md.L.Rev. 1056 (1990) [hereinafter Note]; *see also* Unif. Trade Secrets Act, 14 U.L.A. 434 commissioners' prefatory note (1990).

[2] Maryland's Uniform Trade Secrets Act defines "trade secret" as follows:

> 'Trade Secret' means information, including a formula, pattern, compilation, program, device, method, technique or process, that:
>
> (1) Derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons ***784** who can obtain economic value from its disclosure or use; and
>
> (2) Is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.

Md.Com. Law Code Ann. § 11-1201(e)(1) & (2) (1990). This definition clearly "is based on the *Restatement* comment...."[FN13] Note, *supra,* at 1061. Although all of the Restatement's factors no longer are required to find a trade secret, those factors still provide helpful guidance to determine whether the information in a given case constitutes "trade secrets" within the definition of the statute. *See Minuteman, Inc. v. Alexander*, 147 Wis.2d 842, 434 N.W.2d 773, 777 (1989).

> FN13. There is "at least one substantive difference [between the two] that significantly broadens the scope of trade secrets law [under the Act]." Note, *supra* note 11, at 1061.
>
> The common law required that the purported trade secret be 'used in [one's] business,' and provide 'an advantage over competitors who do not know or use it.' Under the Act, this business re-

> quirement is absent and it is unnecessary to show that one gains value from the competitors' lack of knowledge.
>
> *Id.* (quoting *Restatement of Torts* § 757 comment b (1939)).

There are two types of trade secrets: technological developments and internal operating information. *See* 2 R. Callman, *The Law of Unfair Competition, Trademarks, and Monopolies* § 14.06, at 35 (4th ed. 1982 & Supp.1991). Technological developments are "independent of any connection with a particular company." *Id.* Internal operating information (internal business facts) "relat[es] to a particular business organization." *Id.* At issue in this case are internal business facts peculiar to Optic and whether these are "trade secrets" within the meaning of the Act.

In determining whether the information constituted "trade secrets," the trial court relied on the Restatement factors enumerated *supra.* As to the pricing information, the court made the following findings:

> The extent to which the information is known outside of the business; some of that might be known, some of it might not be.
>
> ***785** The extent to which it is known by employees; some employees know, some don't.
>
> The extent to which measures are taken to guard the secrecy; the plaintiffs certainly have fallen very short of that in many ways, because they didn't get these things [the Confidentiality Agreement] signed by the key employees that they should have, and the ones that they had, at least the most important one in this case[,] was lost.[ ]
>
> The value of the information to him or his competitors. That is always subject-that cannot be an objective test. It is sort of always a subjective test.
>
> Amount of effort or money expended in developing the information; that comes through the years. That probably costs a lot of money, and the test has been met by the plaintiffs, but that will continue to cost money, because things do change.
>
> [ ] The ease or difficulty with which the information could be promptly acquired or duplicated by others. I don't ****586** think it could ever be duplicated by others in this particular shop.
>
> The question, I think, is whether or not this information is of such importance it is meaningful to the defendants, and I cannot say that it indeed is meaningful to the defendants, because it is, number one, subject to change; number two, subject to the market; number three, subject to machinery, cost of living increases and employees running machinery. There are so many variables, it is hard to say whether this will be in place one day, one year, or one century.
>
> The court believes that the pricing information is not a trade secret.

With respect to the marketing strategy, the court said

> I can see where the plaintiffs might believe that that is a trade secret, but it is nothing more than a strategy, which if one goes into the marketplace, you could find that salespeople call on you or not by simply going to people who are purchasers and saying did Optics call you, ***786** did A to Z call you, or did anybody call you. So the information is available, and it's always subject to change[.] Also, because with the profitability that Optics has encountered, some twenty-three million back in 1988, maybe twenty-seven million in '89, their objectives are different, and obviously from what the evidence has produced, the objectives of the defendants in this case, A to Z, are different.
>
> Whether or not that information is used or could be used is certainly not before this court. All I can tell you is that Mr. Agee has said I will

not use that information, and how one determines whether or not he uses it as an impossible question that this court nor any other court can answer. Nor maybe a psychiatrist or psychologist could answer, because one would have to look into the mind of Mr. Agee and figure the intent out from a pricing number that he gives to his future purchasers.

.... The marketing numbers are variable also, and I don't think that they could be ascertained to be a trade secret. I find from the evidence that there are no trade secrets.

The court concluded by making additional comments about the evidence.

Number One, there is no use of this information. Even if it were found to have been a trade secret, there is no use to the detriment of the plaintiff at this time shown by the evidence.

There is no evidence that there is a violation of a contract which was allegedly signed by Mr. Agee, but which the court has to find was not signed by Mr. Agee. There is no original and no evidence that it was ever signed by Mr. Agee. In fact, it is emphatically denied. So there is no signature on that other than someone who, apparently at Optics, whoever that might be, signed that.

There is no evidence of use or misuse. There is no evidence of damages to the plaintiffs at this time.

***787** The court has found that even if these items are trade secrets, they're peculiar to the plaintiff, and that is who can use these to the best advantage.

Maryland Rule 8-131(c) delineates the scope of our review in this case. *See Operations Research, Inc. v. Davidson & Talbird, Inc.*, 241 Md. 550, 556, 217 A.2d 375 (1966); *Space Aero Products Company, Inc. v. R.E. Darling Co., Inc.*, 238 Md. 93, 106, 208 A.2d 74 (1965). The rule provides that

[w]hen an action has been tried without a jury, the appellate court will review the case on both the law and the evidence. It will not set aside the judgment of the trial court on the evidence unless clearly erroneous, and will give due regard to the opportunity of the trial court to judge the credibility of the witnesses. Md.R. 8-131(c).

[3][4] Pricing information and marketing strategy are protectable as "trade secrets." *See, e.g., S.I. Handling Systems, Inc. v. Heisley*, 753 F.2d 1244, 1260 (3d Cir.1985) (pricing information); *Air Products & Chemicals, Inc. v. Johnson*, 296 Pa.Super. 405, 442 A.2d 1114, 1122 (1982) (marketing strategy). As noted *supra*, there are two requirements for a court to ****587** find that information is a "trade secret" under the Act: the information must (1) hold "independent economic value" because it is not "generally known" to or readily ascertainable by others who stand to benefit economically if they use or disclose it, and (2) be the subject of reasonable efforts to maintain its secrecy.

[5] In this case, the trial court concluded from the testimony presented at trial that the pricing information was *not* a trade secret because it would not be "meaningful" to appellees. The court determined that the pricing information would not be "meaningful" because it was (1) subject to change, (2) subject to market forces, (3) subject to the type of machinery used, and so forth. In short, the pricing information was composed of so many variables that it was generally subject to change and specific to Optic. Thus, the court was unable to find that appellees could "obtain economic value from its disclosure or use" as required***788** by the Act. The court further found that Optic's efforts to safeguard and keep secret the information fell short of what the statute required. We cannot say that the trial court's findings of fact in this regard were clearly erroneous.

[6] The trial court then concluded that the marketing strategy was not a trade secret because it, too, was subject to change and because the court found that the information was readily available from the

marketplace. That is, appellees could obtain the same information simply by talking with prospective purchasers. The court further found that the two companies (Optic and A to Z) would have substantially different market objectives because of their difference in size. We note as well that the marketing strategy was of value to appellees only if they could use Optic's pricing information to underbid the company in the "neglected" segment of its market, and we already have determined that they could not because the pricing information was specific to Optic. As before, we cannot say that the court's findings were clearly erroneous. Because the information at issue was not a "trade secret" within the meaning of the Act, it follows that there was no "misappropriation."

II.

Optic contends that the trial court erred in imposing sanctions against Optic, pursuant to Maryland's Uniform Trade Secret Act and Rule 1-341, for maintaining its action in bad faith or without substantial justification.

Maryland's Uniform Trade Secrets Act provides, *inter alia,* that a

> court may award reasonable attorney's fees to the prevailing party if:
>
> (1) A claim of misappropriation is made in bad faith;
>
> (2) A motion to terminate an injunction is made or resisted in bad faith; or
>
> ***789** (3) Willful and malicious misappropriation exists.

Md.Com. Law Code Ann. § 11-1204 (1990).

The purpose of this provision is to "discourage conduct that abuses legal and business process." Letter from William T. Fuyer, III, Professor, University of Baltimore School of Law, to Maryland House Judiciary Committee, February 24, 1989.

Maryland Rule 1-341 provides that

> [i]n any civil action, if the court finds that the conduct of any party in maintaining or defending any proceeding was in *bad faith* or *without substantial justification* the court may require the offending party or the attorney advising the conduct or both of them to pay the adverse party the costs of the proceeding and the reasonable expenses, including reasonable attorney's fees, incurred by the adverse party in opposing it.

(emphasis added).

[7] In *Needle v. White,* 81 Md.App. 463, 473-74, 568 A.2d 856 (1990), we said that "[t]he Supreme Court has characterized 'bad faith' as actions that are maintained 'vexatiously, wantonly or for oppressive reasons.' Although Maryland appellate courts have not, to our knowledge, defined 'bad faith' under rule 1-341, the few cases addressing the issue indicate that only egregious behavior will support such a holding." *Id.* (citations omitted). Although****588** sanctions are improper if "the underlying action presents a colorable claim, ... a trial court has inherent power to impose sanctions for *continuing* an action vexatiously, wantonly, or for oppressive reasons. Such action, however, requires clear evidence that the action is entirely without color and taken for other improper purposes amounting to bad faith." *Id.* (emphasis added). Thus, "[t]he bad-faith exception for the award of attorney's fees is not restricted to cases where the action is filed in bad faith ... [but] may be found ... in the conduct of the litigation." *Roadway Express, Inc. v. Piper,* 447 U.S. 752, 766, 100 S.Ct. 2455, 2464, 65 L.Ed.2d 488 (1980).

[8][9] ***790** The above holds true whether we are addressing a claim of bad faith under Rule 1-341 or under section 11-1204. Likewise, our standard of review is the same for both.

In *Johnson v. Baker,* 84 Md.App. 521, 528-29, 581

A.2d 48 (1990), we said that

> [a] court must make an evidentiary finding of 'bad faith' or 'lack of substantial justification' before it imposes Rule 1-341 sanctions. The existence of bad faith or lack of substantial justification is a question of fact subject to a 'clearly erroneous' standard of review. Upon a finding of bad faith or lack of substantial justification, the court must decide whether to award attorney's fees and costs. On appeal, the appellate court reviews the propriety of the sanction imposed under an abuse of discretion standard and will not disturb the sanction unless the lower court abused its discretion.

At the sanctions hearing, the court made the following findings:

> I have to make a finding under this case that there is bad faith or lack of substantial justification in order to proceed to the next area. So I so find. Finding that, basically I'm going to adopt the Defendant's memorandums because I think they speak very adequately and on point to the conduct here that is bought by the Court.
>
> I really believe that the document, forged document is very, very important; that there was an attempt, and more importantly, not only was it forged but it was an attempt to copy another signature that was known to be an exemplar of the Defendant. I think there is clear evidence that the action that was taken here is entirely without any color and taken for improper purposes. An action is frivolous if it is taken for the purpose of maliciously injuring a person.
>
> There is no question in this case what this did to the Defendants was put them on hold, number one, stopped the infancy of this corporation in its heels because they ***791** couldn't even get financing without the suit being prohibited.
>
> So the Court finds for all those reasons, plus those that are named more specifically in the Defendant's briefs and memorandum, that there is bad faith and I so find.
>
> The next issue is that of the amount of damages. Mr. Rohd, I'm inclined in this case, because of the nature of the case, to tell you that the bad faith in my mind, if it exists, you may argue that it exists at the beginning of the filing of this suit. That may be your argument.[ ]
>
> I'm going to reject that and find that the bad faith in this case begins when there is a finding by the expert in this case that there was a forged document.
>
> I can't say that Mr. Kinline [sic] knew or should have known that that document was forged until he was given that evidence. Once that was presented to him and he chose not to do anything with it or chose not to go out and have it examined, then his bad faith I think is shown very clearly at that particular time.
>
> So any damages which are alleged to have taken place will go from the date of March 13th and forward. That is the Court's finding.

Although initially it is unclear from the record extract whether the trial court made a finding of bad faith or lack of substantial justification, the court's later comment clarifies its finding: "That's what the intent****589** is now that the Court has found bad faith. That was the first threshold finding."

Because the trial court, in reaching this holding, adopted appellee's memoranda-presumably the trial memorandum and the application for sanctions-it is unclear precisely *when* the court below found the bad faith began. Optic alleged in its complaint that appellees had *actually* misappropriated its trade secrets and that Optic had *actually* suffered damage as a result. Kinlein later testified that he had no actual knowledge that appellees had misappropriated or misused trade secrets, and that he instituted suit " 'to ***792** create a level playing field for future competition.' " From this, appellees alleged, and the court apparently agreed, that Optic had no basis at all for its suit. Optic then purportedly fabricated a theory of industrial espionage to justify the false allegations in its complaint. That is, it abandoned allegations that it had suffered from appellee's actual misappropriation of its trade secrets and presented instead a theory that Agee had "engaged in industrial espionage" and "in unlawful preparatory efforts to compete." From this, it seems as though the court was finding that Optic had *initiated* the suit in bad faith.

On the other hand, the trial court expressly found that "the bad faith in this case begins when there is a finding by the expert in this case that there was a forged document" and that "any damages which are alleged to have taken place will go from the date of March 13th and forward." That is, the court's express finding is that the bad faith commenced when Optic learned of the forged document.[FN14]

FN14. On March 13, 1990, by faxed letter dated March 12, 1990, Optic learned that an expert would testify that the signature on the confidentiality agreement was an imitation forgery. Thus, the court assessed attorney's fees and expenses beginning on March 13, 1990.

Because of the apparent conflict as to *when* the bad faith actually commenced, we shall vacate the award of attorney's fees and expenses, and remand in order that the trial court may, with greater clarity, determine precisely when the bad faith began. For reasons stated *infra,* however, that determination shall apply only to the breach of contract claim.

A. *Initiation of the Lawsuit*

Prior to initiating the suit, Kinlein knew that:

1. Agee left Optic to begin a competing vinyl looseleaf binder business.

2. Agee's partner in the business, Zanella, was the former manager of Bindagraphics, a vinyl looseleaf binder business in direct competition with Optic.

***793** 3. Agee's position as an estimator at Optic required him to have "total knowledge of [Optic's] entire cost system and pricing system."

4. Agee conceivably could use this information to "predict" Optic's prices.

5. Agee and Zanella formed A to Z Enterprises in June 1989, six months before they resigned from their respective companies.

6. Agee continued to attend Optic's business meetings, at which employees discussed confidential information such as pricing, during these six months.

7. Agee did not inform Optic of his plans to open a vinyl binder business until he resigned in December 1989.

8. Optic had a confidentiality policy and required its employees to sign a confidentiality agreement.

[10][11] We already have noted that pricing information and marketing strategies are protectable trade secrets. Further, both the statute and the case law make clear that a party may initiate an action *before* damages actually accrue. *See* Md.Com. Law Code Ann. § 11-1202(a) ("Actual or *threatened* misappropriation may be enjoined.") (1990) (emphasis added); *see also Air Products and Chemicals, Inc. v. Johnson,* 296 Pa.Super. 405, 442 A.2d 1114, 1120-25 (1982). From these facts, we think that Optic had reason to believe that it had a colorable claim when it initiated its suit against appellees.

[12] We have said before that " 'free access to the courts is an important and valuable aspect of an effective system of ****590** jurisprudence, and a party possessing a *colorable* claim must be allowed to assert it without fear of suffering a penalty more

severe than that typically imposed on defeated parties.' " *Dent v. Simmons*. 61 Md.App. 122, 124, 485 A.2d 270 (1985) (citation omitted). Neither rule 1-341 nor section 11-1204 were intended to penalize a party and/or counsel for asserting a colorable claim or defense. *See Needle v. White*, 81 Md.App. 463, 472, 568 A.2d 856 (1990).

***794** In this case, the trial court placed great weight on Agee's credibility. It was entitled to do so [under Rule 8-131], and to find in appellee's favor as a result, but that was an insufficient basis on which to impose sanctions for bad faith.

In *Bohle v. Thompson*, 78 Md.App. 614, 554 A.2d 818 (1989), we said:

> To prevent placing a chill on a person's right to resort to the judicial system for legal redress, a trial court's finding under Rule 1-341 must transcend a determination of who the prevailing party will be. A person has a right to 'lose' within the judicial system without incurring the added imposition of paying the other side's attorney's fees.

Id. at 639, 554 A.2d 818.

We hold that the trial court was clearly erroneous to the extent it found that Optic acted in bad faith by initiating suit on a trade secrets theory. We further hold that the lower court abused its discretion if it imposed sanctions on this basis.

B. *Continuation of the Lawsuit After March 13*

[13] The trial court also based its finding of bad faith on the existence of the forged confidentiality agreement and particularly on Optic's continuance of the action even after it learned of the forgery on March 13. We agree that the deliberate use of a falsified document is a serious misuse of the judicial process. Notwithstanding Optic's circumstantial evidence suggesting the existence of a confidentiality agreement, we hold that the trial court was not clearly erroneous in finding bad faith on this basis.

The breach of contract claim and the misappropriation of trade secrets claim were severable, however. That is, the claims stood separate and apart from each other and the knowledge that the confidentiality agreement was forged, *i.e.*, did not validly exist, did not necessarily destroy the action for misappropriation of trade secrets. Consequently, we believe that Optic still had a colorable claim under a ***795** misappropriation of trade secrets theory even after the parties learned of the forgery.

Although the trial court had the power to impose sanctions for "continuing an action vexatiously, wantonly, or for oppressive reasons," there had to be "clear evidence that the action [was] entirely without color and taken for other improper purposes amounting to bad faith" for it to do so. *Needle*, 81 Md.App. at 474, 568 A.2d 856. On the facts of this case and the inferences deducible therefrom, we do not think that bad faith clearly was established with respect to the trade secrets claim.

[14] If counsel can separate the fees and expenses generated by the defense of the trade secrets claim from those generated by the defense of the breach of contract claim, then we think that the trial court appropriately may impose sanctions for bad faith with respect to the breach of contract claim.

We reverse the trial court's imposition of attorney's fees and expenses based on the trade secrets claim, but remand for the court to determine when the bad faith began, *i.e.*, whether it began when Optic initiated suit or when Optic continued the action after March 13, 1990-the date it learned of the forged document, assuming that counsel can determine those fees and expenses attributable to the breach of contract claim.

III.

Because of our determination in part II, we do not address appellee's contention that the court erred when it refused to impose sanctions from the date that Optic commenced its action.

****591** JUDGMENT FOR APPELLEES/CROSS-APPELLANTS ON THE MERITS AFFIRMED; JUDGMENT FOR ATTORNEY'S FEES VACATED; CASE REMANDED FOR FURTHER PROCEEDINGS CONSISTENT WITH THIS OPINION; COSTS TO BE PAID 3/4 BY APPELLANT/CROSS-APPELLEE; 1/4 BY APPELLEES/CROSS-APPELLANTS.

Md.App.,1991.
Optic Graphics, Inc. v. Agee
87 Md.App. 770, 591 A.2d 578

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United States District Court,
W.D. Washington,
at Seattle.
PRECISION AIRMOTIVE CORPORATION, a Washington corporation, Plaintiff,
v.
Donald J. RIVERA, individually and his marital community composed thereof, et al., Defendants.
No. 02-CV-01946-R.

July 10, 2003.

Manufacturer of fuel injection systems sued predecessor's former employee and his new company for, inter alia, trade secret misappropriation. On defendants' motion for summary judgment, the District Court, Rothstein, J., held that: (1) suit was time-barred; (2) continuance was not warranted; and (3) attorney fee award was not warranted.

Motion granted in part and denied in part.

West Headnotes

[1] Judgment 228 ⚷185(2)

228 Judgment
228V On Motion or Summary Proceeding
228k182 Motion or Other Application
228k185 Evidence in General
228k185(2) k. Presumptions and Burden of Proof. Most Cited Cases
Under Washington law, where defendant moves for summary judgment on basis of affirmative defense such as appropriate statute of limitations, defendant bears initial burden of proving absence of issue of material fact as to that defense.

[2] Limitation of Actions 241 ⚷195(3)

241 Limitation of Actions
241V Pleading, Evidence, Trial, and Review
241k194 Evidence
241k195 Presumptions and Burden of Proof
241k195(3) k. Burden of Proof in General. Most Cited Cases
Under Washington law, where plaintiff invokes discovery rule to counter statute of limitations defense, burden is on that plaintiff to show that facts constituting cause of action were not discovered or could not have been discovered by due diligence within limitations period.

[3] Limitation of Actions 241 ⚷95(7)

241 Limitation of Actions
241II Computation of Period of Limitation
241II(F) Ignorance, Mistake, Trust, Fraud, and Concealment or Discovery of Cause of Action
241k95 Ignorance of Cause of Action
241k95(7) k. Injuries to Property. Most Cited Cases
Under Washington law, fuel injection system manufacturer knew or should have known of former employee's alleged trade secret misappropriation, for limitations purposes, by date it acquired and disassembled injector manufactured by former employee's new company, even if it was not, at that time, looking for misappropriation. West's RCWA 19.108.060.

[4] Federal Civil Procedure 170A ⚷2539

170A Federal Civil Procedure
170AXVII Judgment
170AXVII(C) Summary Judgment
170AXVII(C)3 Proceedings
170Ak2536 Affidavits
170Ak2539 k. Sufficiency of Showing. Most Cited Cases
Affidavit offered by trade secret misappropriation plaintiff in opposition to defendant's motion for summary judgment would not be considered where not based on personal knowledge. Fed.Rules Civ.Proc.Rule 56(e), 28 U.S.C.A.

[5] Federal Civil Procedure 170A ⚷2553

170A Federal Civil Procedure
170AXVII Judgment
170AXVII(C) Summary Judgment
170AXVII(C)3 Proceedings
170Ak2547 Hearing and Determination
170Ak2553 k. Time for Consideration of Motion. Most Cited Cases

Continuance of summary judgment motion was not justified where all information and knowledge was already in non-movant's possession. Fed.Rules Civ.Proc.Rule 56(f), 28 U.S.C.A.

[6] Costs 102 ⚷194.44

102 Costs
102VIII Attorney Fees
102k194.44 k. Bad Faith or Meritless Litigation. Most Cited Cases

Under Washington law, prevailing trade secret misappropriation defendant was not entitled to recover attorney fees, though suit had been brought well after statute of limitations had run, absent evidence that defendant had alerted plaintiff to limitations issue prior to seeking summary judgment or that plaintiff had otherwise acted in bad faith. West's RCWA 19.108.040, 19.108.060.

***1152** Ramsey M. Al-Salam, Perkins Coie, Seattle, WA, for Precision Airmotive Corporation.

Ada Ko, Paul Douglas Swanson, Lane Powell Spears Lubersky, Seattle, WA, for Precision Airmotive Corporation.

Paul F. McQuade, Greenberg Traurig LLP, McLean, VA, Peter McNaughton Vial, McNaul, Ebel, Nawrot, Helgren & Vance, Seattle, WA, for Airflow Performance Inc., Donald J. Rivera.

ORDER GRANTING IN PART AND DENYING IN PART DEFENDANTS' MOTION FOR SUMMARY JUDGMENT

ROTHSTEIN, District Judge.

THIS MATTER comes before the court on Defendants' motion to dismiss. Having reviewed the pleadings filed in support of and in opposition to this motion, the court finds and rules as follows:

I. BACKGROUND

From 1977 to 1983, Defendant Donald Rivera worked for the Fuel Controls Group of Bendix Corp. developing fuel injection systems. In 1983 Bendix was acquired by Allied Signal, Inc. On his departure in 1984, Rivera began his own business, Airflow Performance Inc., which develops, manufactures, and sells fuel control systems. A year later, Airflow began to produce and sell its series of "FM" fuel controls.

In 1988, Plaintiff Precision Airmotive Corporation ("PAC") bought an entire line of fuel injection systems and their derivatives from Allied Signal, Inc. This purchase included the RSA-5DD1 fuel injection system and design. In PAC's first amended complaint, PAC alleges that Rivera and Airflow incorporate the RSA-5DD1 technology in their FM-series devices. PAC asserts claims for misappropriation of trade secrets, breach of contract,[FN1] and unfair competition. Defendants respond that regardless of the merits of these claims, PAC's claims are all barred by the appropriate statutes of limitation. PAC's reply is that the limitations periods did not accrue until 2001, when it alleges it first discovered the bases for its claims.

FN1. The breach is based on an alleged confidentiality and nondisclosure agreement between Rivera and Bendix/Allied Signal.

II. DISCUSSION

A. *Motion to dismiss*

1. Summary judgment standard

Summary judgment is appropriate when "the pleadings ... show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law." Fed.R.Civ.P. 56(c); *Celotex Corp. v. Catrett,* 477 U.S. 317, 322, 106 S.Ct. 2548, 91 L.Ed.2d 265 (1986). As PAC has alleged only state law claims in this diversity action, state law determines the untimeliness of those claims. ***1153***Guaranty Trust Co. v. York,* 326 U.S. 99, 108-11, 65 S.Ct. 1464, 89 L.Ed. 2079 (1945).

[1][2] Under Washington law, where a defendant moves for summary judgment on the basis of an affirmative defense such as the appropriate statute of limitations, the defendant bears the initial burden of proving the absence of an issue of material fact as to that defense. *Haslund v. City of Seattle,* 86 Wash.2d 607, 621, 547 P.2d 1221 (1976). Where, however, a plaintiff invokes the discovery rule to counter the statute of limitations defense,[FN2] the burden is also on that plaintiff to show that facts constituting the cause of action were not discovered *or could not have been discovered* by due diligence within the limitations period. *G.W. Constr. Corp. v. Prof'l Serv., Indus., Inc.,* 70 Wash.App. 360, 367, 853 P.2d 484 (1993); *accord Giraud v. Quincy Farm and Chem.,* 102 Wash.App. 443, 449-50, 6 P.3d 104 (2000) ("To invoke the discovery rule, the plaintiff must show that he or she could not have discovered the relevant facts earlier.").

> FN2. Under the discovery rule, a cause of action accrues only when the claimant knew or should have known the essential elements of the cause of action. *Allen v. State,* 118 Wash.2d 753, 758, 826 P.2d 200 (1992).

Because the gravamen of all of PAC's claims is the alleged misappropriation of the RSA-5DD1 technology, the relevant inquiry into the statute of limitations defense is to determine when PAC knew or should have known of that misappropriation. Though statute of limitations questions often involve questions of fact, *Green v. A.P.C.,* 136 Wash.2d 87, 100, 960 P.2d 912 (1998), such "factual questions may be decided as a matter of summary judgment if reasonable minds can reach but one conclusion on them." *Allen v. State,* 118 Wash.2d 753, 760, 826 P.2d 200 (1992).

2. Application of the discovery rule

[3] In the present case, there is undisputed evidence that PAC had in its possession an FM-200 device manufactured by Defendants as early as 1993. Jenson Decl. ¶ 5; Ex. C, Coleen Rivera Decl. (May 22, 2003). That unit was disassembled no later than 1994 "to determine and analyze its configuration and inner workings." Jenson Decl. ¶ 5 (Jan. 30, 2003). That model does not differ in any material respect from Airflow's current models. Coleen Rivera Decl. ¶ 8 (May 22, 2003). Consequently, PAC had in its possession all that was necessary for it to discover any alleged misappropriation as early as 1994. *See Chasteen v. UNISIA JECS Corp.,* 216 F.3d 1212, 1219 (10th Cir.2000) (purchase and inspection of product gives "further reason" to find that plaintiff "either knew or should have discovered the alleged misappropriation"). Furthermore, PAC was well aware of Donald Rivara's prior employment and work at Bendix, Suppl. Jenson Decl. ¶ 3. As the Fifth Circuit stated in *Seatrax, Inc. v. Sonbeck Int'l, Inc.,* 200 F.3d 358, 366 (5th Cir.2000), "[s]uspicions should abound when a competitor markets a product similar to that previously developed by a former employer after one of the former employer's employees begins work for the competitor."

[4] PAC attempts to dispute these facts through Scott Grafenauer's declaration. Grafenauer, PAC's current general manager, declares that it was not PAC's intention to investigate the unit purchased from Airflow in 1993 to determine whether it incorporated the RSA-5DD1 technology, and that in fact, PAC was not even focused on that technology at the time. Grafenauer Decl. ¶¶ 3-5. Grafenauer, however, did not join PAC until 1998. His declaration, therefore, cannot be based on personal knowledge. *See* Fed.R.Civ.P. 56(e) ("Supporting and op-

posing affidavits shall be made on personal knowledge."). The ***1154** court concludes that PAC fails to raise any dispute of fact as to whether it knew or should have known of any alleged misappropriation as early as 1994.

Furthermore, PAC presents no evidence as to why it could not have discovered the infringement within the limitations period. *Giraud,* 102 Wash.App. at 449-50, 6 P.3d 104. PAC merely submits a statement by its current general manager that the organization simply was not looking for any misappropriation during the limitations period. That statement, even if it were based on personal knowledge, is insufficient especially when PAC had the accused product in its possession. *See Chasteen,* 216 F.3d at 1219. PAC fails to provide any other explanation for why it could not have discovered the misappropriation within the limitations period. Accordingly, the court finds that reasonable minds could not differ in finding that through due diligence, PAC should have known of any alleged misappropriation in 1994.[FN3] Consequently, the limitations period for even the claim with the longest limitations period (six years for breach of contract, *see* RCW 4.16.040(1)) ran before PAC filed suit in 2002.[FN4]

FN3. There is even some evidence that the date on which the limitations period began to accrue is earlier than 1994 as knowledge and acquiescence on the part of PAC's predecessors regarding Rivera's alleged use the RSA-5DD1 technology is imputed to PAC. *Precision Moulding & Frame, Inc. v. Simpson Door Co.,* 77 Wash.App. 20, 27-28, 888 P.2d 1239 (1995). In the present case, Bendix "actually took steps to communicate ... how the [RS and RSA fuel control devices] were built and how they functioned. [Bendix] even published and sold detailed manuals showing the component parts of these long-used devices that any member of the public was free to purchase." Kirwin Decl. ¶ 7. Consequently, it is questionable whether the RSA-5DD1 technology is even a trade secret, let alone, whether PAC's predecessors acquiesced in the appropriation of the technology by Rivera.

Furthermore, to the extent that PAC moves to strike the Kirwin declaration as being based on hearsay and speculation, that motion is denied at least as to paragraph 7 on which the court relies.

FN4. The limitations period for misappropriation is three years. RCW 19.108.060. The period for unfair competition is four years. RCW 19.86.120.

B. *Rule 56(f) continuance*

PAC contends that the present motion should be continued under Federal Rule of Civil Procedure 56(f) in order to allow it more time to conduct discovery. Under FRCP 56(f), a court can grant a continuance "[s]hould it appear from the affidavits of a party opposing the motion that the party cannot for reasons stated present by affidavit facts essential to justify the party's opposition." Fed.R.Civ.P. 56(f).

[5] According to PAC's attorney, "Precision should at least be allowed to conduct further discovery and develop a complete record on the issues raised by defendants' motion." Fisher Decl. ¶ 3. Here, all the issues raised by Defendants relate to PAC's and its predecessors' state of knowledge-whether PAC and/or its predecessors knew or should have known of the alleged misappropriation. A continuance is not justified when all the information and knowledge is already in Plaintiff's possession. Moreover, a continuance is not justified to establish whether Defendants' products have changed over time in light of undisputed testimony by Airflow's Vice President that the current models of the accused products are in all material respects the same as the original models. Coleen Rivera Decl. ¶ 8 (May 22, 2003). Accordingly, the request for a continuance is denied.

C. *Attorneys' fees*

[6] Defendants request their attorneys' fees under RCW 19.108.040, which provides***1155** that "[i]f a claim of misappropriation is made in bad faith ... the court may award reasonable attorney's fees to the prevailing party." Defendants cite to *Alamar Biosciences Inc. v. Difco Labs. Inc.*, 40 U.S.P.Q.2d 1437, 1444, 1996 WL 648286 (E.D.Cal.1996), for the proposition that fees should be awarded where a plaintiff files a claim for misappropriation suit well after the statute of limitations has run. In *Alamar,* "all the facts which made [plaintiff's] action frivolous were known to [plaintiff] at the time the complaint was filed.... [as the] statute of limitations bar was explained in detail in letters from [defendant's] counsel to [plaintiff's]." *Id.*

In the present case, there is no evidence of any exchange between the parties regarding the statute of limitation issues aside from the present briefing. Consequently, it cannot be said that PAC was fully aware that its suit was essentially frivolous. Given that there is no other evidence of bad faith on PAC's behalf, the court finds that an award of fees in the case is not appropriate. *Ed Nowogroski Ins., Inc. v. Rucker,* 88 Wash.App. 350, 360, 944 P.2d 1093 (1997) (court has discretion to not award fees).

III. CONCLUSION

For the foregoing reasons, Defendants' motion for summary judgment [docket no. 35] is GRANTED in part and DENIED in part. Plaintiff's claims are dismissed with prejudice.

W.D.Wash.,2003.
Precision Airmotive Corp. v. Rivera
288 F.Supp.2d 1151

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Supreme Court of Nebraska.
Lawrence PRIBIL, Appellant,
v.
Barton and Sandra KOINZAN, husband and wife, et al., Appellees.
No. S-01-251.

July 3, 2003.

Corn and soybean farmer brought action against cattle farmer, owner of land on which cattle were kept, and manager of land, seeking damages for losses which were caused after cattle escaped onto corn and soybean fields and destroyed crops. The District Court, Holt County, William B. Cassel, J., entered partial summary judgment for farmer holding that defendants were jointly and severally liable for damages, and subsequently entered judgment on jury verdict, which awarded corn and soybean farmer $34,920.60 in damages. Corn and soybean farmer appealed. The Court of Appeals, 11 Neb.App. 199, 647 N.W.2d 110, affirmed. Corn and soybean farmer petitioned for further review. Granting further review, the Supreme Court, Gerrard, J., held that: (1) crop and soybean farmer was entitled to jury instruction requiring proof of damages by greater weight of evidence, rather than instruction requiring evidence to establish amount of damage with reasonable certainty, and (2) incorrect jury instruction prejudiced crop and soybean farmer sufficiently to require reversal.

Reversed and remanded with directions.

West Headnotes

[1] Appeal and Error 30 ⚷842(1)

30 Appeal and Error
30XVI Review
30XVI(A) Scope, Standards, and Extent, in General
30k838 Questions Considered
30k842 Review Dependent on Whether Questions Are of Law or of Fact
30k842(1) k. In General. Most Cited Cases

For appellate purposes, whether a jury instruction given by a trial court is correct is a question of law.

[2] Appeal and Error 30 ⚷842(1)

30 Appeal and Error
30XVI Review
30XVI(A) Scope, Standards, and Extent, in General
30k838 Questions Considered
30k842 Review Dependent on Whether Questions Are of Law or of Fact
30k842(1) k. In General. Most Cited Cases

When reviewing questions of law, an appellate court has an obligation to resolve the questions independently of the conclusion reached by the trial court.

[3] Trial 388 ⚷251(1)

388 Trial
388VII Instructions to Jury
388VII(D) Applicability to Pleadings and Evidence
388k249 Application of Instructions to Case
388k251 Pleadings and Issues
388k251(1) k. In General. Most Cited Cases

Trial 388 ⚷252(1)

388 Trial
388VII Instructions to Jury
388VII(D) Applicability to Pleadings and Evidence
388k249 Application of Instructions to Case
388k252 Facts and Evidence
388k252(1) k. In General. Most

Cited Cases

Trial 388 ⚿295(1)

388 Trial
388VII Instructions to Jury
388VII(G) Construction and Operation
388k295 Construction and Effect of Charge as a Whole
388k295(1) k. In General. Most Cited Cases

In reviewing a claim of prejudice from instructions given or refused, an appellate court must read the instructions together, and if, taken as a whole, they correctly state the law, are not misleading, and adequately cover the issues supported by the pleadings and evidence, there is no prejudicial error.

[4] Damages 115 ⚿6

115 Damages
115I Nature and Grounds in General
115k6 k. Certainty as to Amount or Extent of Damage. Most Cited Cases

Damages 115 ⚿184

115 Damages
115IX Evidence
115k183 Weight and Sufficiency
115k184 k. In General. Most Cited Cases

A plaintiff's evidence of damages may not be speculative or conjectural and must provide a reasonably certain basis for calculating damages; the general rule is that uncertainty as to the fact of whether damages were sustained at all is fatal to recovery, but uncertainty as to the amount is not if the evidence furnishes a reasonably certain factual basis for computation of the probable loss.

[5] Damages 115 ⚿184

115 Damages
115IX Evidence
115k183 Weight and Sufficiency
115k184 k. In General. Most Cited Cases

A plaintiff's burden of offering evidence sufficient to prove damages cannot be sustained by evidence which is speculative and conjectural, but proof of damages to a mathematical certainty is not required; the proof is sufficient if the evidence is such as to allow the trier of fact to estimate actual damages with a reasonable degree of certainty and exactness.

[6] Damages 115 ⚿208(1)

115 Damages
115X Proceedings for Assessment
115k208 Questions for Jury
115k208(1) k. In General. Most Cited Cases

The initial question of law for the trial court when presented with plaintiff's proof of damages is whether the evidence of damages provides a basis for determining damages with reasonable certainty, i.e., the evidence of damages is not speculative or conjectural; if the evidence does provide such a basis, the issue of damages can be submitted to the jury.

[7] Damages 115 ⚿184

115 Damages
115IX Evidence
115k183 Weight and Sufficiency
115k184 k. In General. Most Cited Cases

When presented with plaintiff's proof of damages, the jury is not charged with the duty of determining whether the evidence of damages is reasonably certain; rather, the jury is instructed that the plaintiff must prove the nature and extent of damages by the greater weight of the evidence.

[8] Damages 115 ⚿216(7)

115 Damages
115X Proceedings for Assessment
115k209 Instructions
115k216 Measure of Damages for Injuries to the Person
115k216(7) k. Future Pain and Suffering. Most Cited Cases

Damages 115 ⚷216(8)

115 Damages
115X Proceedings for Assessment
115k209 Instructions
115k216 Measure of Damages for Injuries to the Person
115k216(8) k. Loss of Earnings, Services, or Consortium, and Impairment of Earning Capacity. Most Cited Cases

When a plaintiff seeks prospective damages, such as recovery for future pain and suffering or loss of earning capacity, the jury is to be instructed, when the evidence warrants, that the damages must be proved with "reasonable certainty," and the jury is to award such damages only where the evidence shows that the future earnings or pain and suffering for which recovery is sought are "reasonably certain" to occur.

[9] Damages 115 ⚷26

115 Damages
115III Grounds and Subjects of Compensatory Damages
115III(A) Direct or Remote, Contingent, or Prospective Consequences or Losses
115III(A)1 In General
115k25 Prospective and Anticipated Consequences
115k26 k. In General. Most Cited Cases

When a plaintiff seeks prospective damages, the contingent nature of the damages claimed inherently requires consideration of future events that can only be reasonably predicted, but not conclusively proved, at the time of trial.

[10] Damages 115 ⚷112

115 Damages
115VI Measure of Damages
115VI(B) Injuries to Property
115k107 Injuries to Real Property
115k112 k. Growing Crops, Grass, Shrubbery, or Trees. Most Cited Cases

In crop damage cases, the measure of damages for the destruction of an unmatured growing crop is the value the crop would have had if it had matured, minus any savings to the plaintiff in the costs of producing, harvesting, and transporting the crop to market; damages based upon the value of an unmatured crop are analogous to profits lost and are governed by the same rule precluding recovery in cases of either uncertainty or remoteness.

[11] Damages 115 ⚷112

115 Damages
115VI Measure of Damages
115VI(B) Injuries to Property
115k107 Injuries to Real Property
115k112 k. Growing Crops, Grass, Shrubbery, or Trees. Most Cited Cases

In crop damage cases, the measure of damages for the destruction of a mature crop is the difference between the value of the mature crop if there had been no injury and the value of the actual crop harvested, less the necessary costs of harvesting and transporting the crop to market; thus, when a mature crop is destroyed, damages may be proved by showing the market value of the crop, less the necessary costs of finishing, harvesting, and transporting the crop to market.

[12] Damages 115 ⚷217

115 Damages
115X Proceedings for Assessment
115k209 Instructions
115k217 k. Measure of Damages for Injuries to Property. Most Cited Cases

Corn and soybean farmer, in his suit against defendants seeking damages for losses which were caused after cattle escaped and destroyed crops, was entitled to jury instruction requiring proof of nature and extent of his damages by greater weight of evidence, not instruction requiring damages to be proved with reasonable certainty, since farmer sought compensation for damages inflicted on his mature crops; damages sought were not based on any future contingency, because crops were mature at time of destruction, and damages were fully incurred at time of trial.

[13] Appeal and Error 30 ⚷1064.1(7)

30 Appeal and Error
30XVI Review
30XVI(J) Harmless Error
30XVI(J)18 Instructions
30k1064 Prejudicial Effect
30k1064.1 In General
30k1064.1(2) Particular Cases
30k1064.1(7) k. Damages and Amount of Recovery. Most Cited Cases

In his suit against defendants seeking damages for losses which were caused after cattle escaped and destroyed his crops, crop and soybean farmer was sufficiently prejudiced by jury instruction requiring damages to be proved with reasonable certainty, rather than proper jury instruction, requiring proof of damages by greater weight of evidence, and thus reversal was necessary; jury was given two separate, and not entirely consistent, instructions on what farmer was required to prove in order to recover same measure of damages, and potential for confusion created by instruction established sufficient prejudice.

[14] Appeal and Error 30 ⚷1032(3)

30 Appeal and Error
30XVI Review
30XVI(J) Harmless Error
30XVI(J)1 In General
30k1032 Burden to Show Prejudice from Error
30k1032(3) k. Instructions. Most Cited Cases

In an appeal based on a claim of an erroneous jury instruction, the appellant has the burden to show that the questioned instruction was prejudicial or otherwise adversely affected a substantial right of the appellant.

[15] Trial 388 ⚷242

388 Trial
388VII Instructions to Jury
388VII(C) Form, Requisites, and Sufficiency
388k242 k. Confused or Misleading Instructions. Most Cited Cases

Trial 388 ⚷243

388 Trial
388VII Instructions to Jury
388VII(C) Form, Requisites, and Sufficiency
388k243 k. Inconsistent or Contradictory Instructions. Most Cited Cases

A party's right to a fair trial may be substantially impaired by jury instructions that contain inconsistencies or confuse or mislead the jury.

[16] Trial 388 ⚷243

388 Trial
388VII Instructions to Jury
388VII(C) Form, Requisites, and Sufficiency
388k243 k. Inconsistent or Contradictory Instructions. Most Cited Cases

Conflicting instructions are erroneous unless it appears that the jury was not misled.

[17] Trial 388 ⚷205

388 Trial
388VII Instructions to Jury
388VII(B) Necessity and Subject-Matter
388k205 k. Presumptions and Burden of Proof. Most Cited Cases

A jury instruction that misstates the burden of proof has a tendency to mislead the jury and is erroneous.

[18] Courts 106 ⚷92

106 Courts
106II Establishment, Organization, and Procedure
106II(G) Rules of Decision
106k88 Previous Decisions as Controlling or as Precedents
106k92 k. Dicta. Most Cited Cases

A case is not authority for any point not necessary to be passed on to decide the case or not specifically raised as an issue addressed by the court.

***569 Syllabus by the Court*

*222 1. **Jury Instructions: Judgments: Appeal and Error.** Whether a jury instruction given by a trial court is correct is a question of law. When reviewing questions of law, an appellate court has an obligation to resolve the questions independently of the conclusion reached by the trial court.

2. **Jury Instructions: Appeal and Error.** In reviewing a claim of prejudice from instructions given or refused, an appellate court must read the instructions together, and if, taken as a whole, they correctly state the law, are not misleading, and adequately cover the issues supported by the pleadings and evidence, there is no prejudicial error.

3. **Damages: Evidence: Proof.** A plaintiff's evidence of damages may not be speculative or conjectural and must provide a reasonably certain basis for calculating damages. The general rule is that uncertainty as to the fact of whether damages were sustained at all is fatal to recovery, but uncertainty as to the amount is not if the evidence furnishes a reasonably certain factual basis for computation of the probable loss.

4. **Damages: Evidence: Proof.** A plaintiff's burden of offering evidence sufficient to prove damages cannot be sustained by evidence which is speculative and conjectural, but proof of damages to a mathematical certainty is not required; the proof is sufficient if the evidence is such as to allow the trier of fact to estimate actual damages with a reasonable degree of certainty and exactness.

5. **Jury Instructions: Damages: Evidence: Proof.** When a plaintiff seeks prospective damages, such as recovery for future pain and suffering or loss of earning capacity, the jury is to be instructed, when the evidence warrants, that the damages must be proved with "reasonable certainty," and the jury is to award such damages only where the evidence shows that the future earnings or pain and suffering for which recovery is sought are "reasonably certain" to occur.

6. **Crops: Damages.** The measure of damages for the destruction of an unmatured growing crop is the value the crop would have had if it had matured, minus any savings to the plaintiff in the costs of producing, harvesting, and transporting the crop to market. Damages based upon the value of an unmatured crop are analogous to profits lost and are governed by the same rule precluding recovery in cases of either uncertainty or remoteness.

****570** 7. **Crops: Damages**. The measure of damages for the destruction of a mature crop is the difference between the value of the mature crop if there had been no injury and the value of the actual crop harvested, less the necessary costs of harvesting and transporting the crop to market.

8. **Jury Instructions: Proof: Appeal and Error.** In an appeal based on a claim of an erroneous jury instruction, the appellant has the burden to show that the questioned instruction was prejudicial or otherwise adversely affected a substantial right of the appellant.

9. **Jury Instructions: Trial.** A party's right to a fair trial may be substantially impaired by jury instructions that contain inconsistencies or confuse or mislead the jury.

***223** 10. **Jury Instructions: Appeal and Error.** Conflicting instructions are erroneous unless it appears that the jury was not misled.

11. **Jury Instructions: Proof: Appeal and Error.** A jury instruction that misstates the burden of proof has a tendency to mislead the jury and is erroneous.

12. **Appeal and Error.** A case is not authority for any point not necessary to be passed on to decide the case or not specifically raised as an issue addressed by the court.
George H. Moyer, Jr., of Moyer, Moyer, Egley, Fullner & Warnemunde, Madison, for appellant.

David J. Partsch and Thomas H. DeLay, of Jewell, Collins, DeLay & Gray, Norfolk, for appellees Barton and Sandra Koinzan.

Kathleen Koenig Rockey, of Copple & Rockey, P.C., Norfolk, for appellees Terry Held and Genevieve Shaw.

HENDRY, C.J., WRIGHT, CONNOLLY, GERRARD, STEPHAN, McCORMACK, and MILLER-LERMAN, JJ.

GERRARD, J.

BACKGROUND

Lawrence Pribil sued Barton and Sandra Koinzan, Terry Held, and Genevieve Shaw (collectively the defendants) for damages that the Koinzans' cattle inflicted on Pribil's mature corn and soybean crops on several quarter sections of irrigated land. The Koinzans' cattle escaped from Shaw's land and went onto Pribil's neighboring fields. A summary judgment on the issue of liability was granted, and liability is not disputed in this appeal. In Pribil's operative petition, he sought $164,079.42 in damages, but the jury returned a verdict for $34,920.60. Pribil appealed, and the Nebraska Court of Appeals affirmed the judgment of the district court. See *Pribil v. Koinzan,* 11 Neb.App. 199, 647 N.W.2d 110 (2002) . Pribil petitioned for further review, which we granted.

ASSIGNMENT OF ERROR

Pribil's three assignments of error on further review combine to advance one claim: The Court of Appeals erred in its analysis ***224** of the district court's jury instruction No. 8C, which dealt with damages.

STANDARD OF REVIEW

[1][2] Whether a jury instruction given by a trial court is correct is a question of law. When reviewing questions of law, an appellate court has an obligation to resolve the questions independently of the conclusion reached by the trial court. *Jay v. Moog Automotive,* 264 Neb. 875, 652 N.W.2d 872 (2002).

****571** ANALYSIS

The factual details of the case are set forth in the opinion of the Court of Appeals, and most of the facts need not be repeated here, except those that give context to the issue on further review. Pribil is a 70-year-old farmer with many years' experience growing corn and soybeans on irrigated land southwest of O'Neill, Nebraska. The land is irrigated by center-pivot irrigation systems. These systems work by pivoting a suspended pipe with sprinklers on it around the center of a quarter section, which is usually 160 acres. Thus, each system irrigates only about 130 acres of each quarter section. The irrigated portion of each quarter section is commonly called a circle. In 1996, Pribil raised corn and soybeans on 13 circles. The cattle trespassed upon only five circles that were adjacent to Shaw's land and to each other. It is undisputed that between September 23 or 25 and the end of October, cattle for which the defendants were legally responsible escaped and got into and damaged or destroyed the corn and soybeans on these five circles.

Pribil computed his lost yield to be 26,311 bushels of corn and 2,153 bushels of soybeans on the five circles. Although there was testimony that some of the corn had been damaged and replanted in May 1996, prior to the damage inflicted by the Koinzans' cattle, the evidence indicated that the replanted corn had "caught up" with the remaining corn by September 25 and was fully mature at that time. Pribil testified that the beans were ready to harvest and that he had stopped watering the corn and was waiting for it to dry prior to harvest. In short, the record establishes beyond reasonable dispute that the corn and beans were mature crops by the time they were damaged by the Koinzans' cattle.

***225** The sole issue presented by Pribil's petition for further review concerns the instructions given to the jury with respect to the measure of damages and Pribil's burden of proof. Jury instruction No. 8C, given over objection, provided that "[t]he evidence must establish the amount of any item of damage with reasonable certainty or that item of damage cannot be recovered." Pribil argues that this instruction is in conflict with the standard jury instruction regarding damages, instantiated in this case by instruction No. 6A(3), which provides that "[b]efore [Pribil] can recover against the defendants on [Pribil's] claim, [Pribil] must prove, by the greater weight of the evidence, the nature and extent of the damage to the corn and soybean crops." See NJI2d Civ. 2.12A. Pribil contends, in essence, that "reasonable certainty" is a different burden of proof for plaintiffs' damages than "the greater weight of the evidence."

The Court of Appeals rejected Pribil's argument. The Court of Appeals stated:

> We believe that *Worth v. Schillereff,* 233 Neb. 628, 447 N.W.2d 480 (1989), is the case which controls the issue presented by instruction No. 8C. *Worth* was a suit for personal injuries sustained in an automobile accident. The plaintiff sought special and general damages, including future damages.... The court instructed the jury that future damages must be " 'reasonably certain.' " *Id.* at 630, 447 N.W.2d at 482. The plaintiff appealed, arguing that the trial court erred in so instructing the jury " 'when the standard which has been recognized in this state since 1981 is "reasonably probable".' " *Id.* at 630, 447 N.W.2d at 483. The plaintiff in *Worth* argued essentially the same point as Pribil argues in this case.
>
> In addition, in holding that an instruction almost identical to the one given by ****572** the trial court in this case in instruction No. 8C was not error, the *Worth* court stated: "This court has said that 'reasonable certainty' and 'reasonable probability' are one and the same thing." 233 Neb. at 633, 447 N.W.2d at 484, citing *Lane v. State Farm Mut. Automobile Ins. Co.,* 209 Neb. 396, 308 N.W.2d 503 (1981). With this statement and holding by the Nebraska Supreme Court, we conclude there is nothing further to discuss. We believe the *Worth* court ***226** clearly held that "reasonable certainty" and "reasonable probability" mean the same thing and that it is not error for a trial court to instruct that damages must be proved by the plaintiff with reasonable certainty, notwithstanding that the plaintiff's burden of proof is by the greater weight of evidence.

Pribil v. Koinzan, 11 Neb.App. 199, 213-14, 647 N.W.2d 110, 121 (2002).

Pribil argues that the Court of Appeals missed the point and that *Worth v. Schillereff,* 233 Neb. 628, 447 N.W.2d 480 (1989), is distinguishable because it dealt with prospective damages. See, e.g., NJI2d Civ. 4.01. Pribil's contention is that instructing the jury that damages must be proved with "reasonable certainty" is proper only when the damages at issue are future or contingent damages and the issue is whether or not certain contingencies are likely to come to pass in the future. Pribil argues that there are no future contingencies to consider once a crop is mature; the measure of damages for the destruction of a mature crop is the difference between the value of the crop if there had been no injury and the value of the actual crop harvested. Pribil contends that under these circumstances, "the greater weight of the evidence" is the only burden of proof on which the jury should be instructed.

[3] In reviewing a claim of prejudice from instructions given or refused, an appellate court must read the instructions together, and if, taken as a whole, they correctly state the law, are not misleading, and adequately cover the issues supported by the pleadings and evidence, there is no prejudicial error. See *Nauenburg v. Lewis,* 265 Neb. 89, 655 N.W.2d 19 (2003). We conclude that instruction No. 8C was not a correct statement of the law, given the evidence that Pribil's crops were mature at the time of the damage or destruction, and that the judgments of the Court of Appeals and the district court must

be reversed.

[4][5] We have often stated that a plaintiff's evidence of damages may not be speculative or conjectural and must provide a reasonably certain basis for calculating damages. The general rule is that uncertainty as to the fact of whether damages were sustained at all is fatal to recovery, but uncertainty as to the amount is not if the evidence furnishes a reasonably certain factual basis ***227** for computation of the probable loss. *Sack Bros. v. Tri-Valley Co-op.,* 260 Neb. 312, 616 N.W.2d 786 (2000). A plaintiff's burden of offering evidence sufficient to prove damages cannot be sustained by evidence which is speculative and conjectural, but proof of damages to a mathematical certainty is not required; the proof is sufficient if the evidence is such as to allow the trier of fact to estimate actual damages with a reasonable degree of certainty and exactness. See *III Lounge, Inc. v. Gaines,* 227 Neb. 585, 419 N.W.2d 143 (1988).

We have consistently framed the question whether the evidence of damages is "reasonably certain" as a question of law, and not as a matter to be decided by the trier of fact. See, e.g., *Sack Bros., supra; O'Connor v. Kaufman,* 260 Neb. 219, 616 N.W.2d 301 (2000); *Gagne v. Severa,* 259 Neb. 884, 612 N.W.2d 500 (2000); ****573***Phipps v. Skyview Farms,* 259 Neb. 492, 610 N.W.2d 723 (2000); *Union Ins. Co. v. Land and Sky, Inc.,* 253 Neb. 184, 568 N.W.2d 908 (1997); *World Radio Labs. v. Coopers & Lybrand,* 251 Neb. 261, 557 N.W.2d 1 (1996); *Evergreen Farms v. First Nat. Bank & Trust,* 250 Neb. 860, 553 N.W.2d 728 (1996); *McWhirt v. Heavey,* 250 Neb. 536, 550 N.W.2d 327 (1996); *Bristol v. Rasmussen,* 249 Neb. 854, 547 N.W.2d 120 (1996); *Lone Cedar Ranches v. Jandebeur,* 246 Neb. 769, 523 N.W.2d 364 (1994); *Bakody Homes & Dev. v. City of Omaha,* 246 Neb. 1, 516 N.W.2d 244 (1994); *Buell, Winter, Mousel & Assoc. v. Olmsted & Perry,* 227 Neb. 770, 420 N.W.2d 280 (1988); *III Lounge, Inc., supra; Shadow Isle, Inc. v. Granada Feeding Co.,* 226 Neb. 325, 411 N.W.2d 331 (1987); *Sesostris Temple Golden Dunes v. Schuman,* 226 Neb. 7, 409 N.W.2d 298 (1987); *Lis v. Moser Well Drilling & Serv.,* 221 Neb. 349, 377 N.W.2d 98 (1985); *Peterson v. North American Plant Breeders,* 218 Neb. 258, 354 N.W.2d 625 (1984); *Knoell Constr. Co., Inc. v. Hanson,* 209 Neb. 461, 308 N.W.2d 356 (1981); *Hein v. M & N Feed Yards, Inc.,* 205 Neb. 691, 289 N.W.2d 756 (1980); *Tyler v. Olson Bros. Mfg. Co., Inc.,* 201 Neb. 79, 266 N.W.2d 216 (1978); *Shotkoski v. Standard Chemical Manuf. Co.,* 195 Neb. 22, 237 N.W.2d 92 (1975); *Midlands Transp. Co. v. Apple Lines, Inc.,* 188 Neb. 435, 197 N.W.2d 646 (1972); *Frank H. Gibson, Inc. v. Omaha Coffee Co.,* 179 Neb. 169, 137 N.W.2d 701 (1965); *State v. Dillon,* 175 Neb. 350, 121 N.W.2d 798 (1963); ***228***Wischmann v. Raikes,* 168 Neb. 728, 97 N.W.2d 551 (1959); *Patrick v. City of Bellevue,* 164 Neb. 196, 82 N.W.2d 274 (1957); *Selig v. Wunderlich Contracting Co.,* 160 Neb. 215, 69 N.W.2d 861 (1955); *Ricenbaw v. Kraus,* 157 Neb. 723, 61 N.W.2d 350 (1953); *Faught v. Dawson County Irrigation Co.,* 146 Neb. 274, 19 N.W.2d 358 (1945); *Snyder v. Platte Valley Public Power and Irrigation District,* 144 Neb. 308, 13 N.W.2d 160 (1944); *James Poultry Co. v. City of Nebraska City,* 136 Neb. 456, 286 N.W. 337 (1939); *Meister v. Krotter,* 134 Neb. 293, 278 N.W. 483 (1938); *Gledhill v. State,* 123 Neb. 726, 243 N.W. 909 (1932); *Gilbert v. Rothe,* 106 Neb. 549, 184 N.W. 119 (1921); *Wade v. Belmont Irrigating Canal & Water Power Co.,* 87 Neb. 732, 128 N.W. 514 (1910).

[6][7] In other words, the initial question of law for the trial court is whether the evidence of damages provides a basis for determining damages with reasonable certainty, i.e., the evidence of damages is not speculative or conjectural. If the evidence does provide such a basis, the issue of damages can be submitted to the jury. The jury, however, is not charged with the duty of determining whether the evidence of damages is reasonably certain; rather, the jury is instructed that the plaintiff must prove the nature and extent of damages by the greater weight of the evidence. See, e.g., NJI2d Civ. 2.12A.

[8] The one context in which we have held that the jury is to be instructed that damages must be proved with "reasonable certainty" is when the plaintiff seeks prospective damages, such as recovery for future pain and suffering or loss of earning capacity, and the evidence warrants such an instruction. In those cases, we have held that the jury is to award such damages only where the evidence shows that the future earnings or pain and suffering for which recovery is sought are "reasonably certain" to occur. See, e.g., *Snyder v. EMCASCO Ins. Co.,* 259 Neb. 621, 611 N.W.2d 409 (2000); *Worth v. Schillereff,* 233 Neb. 628, 447 N.W.2d 480 (1989); *Uryasz v. Archbishop Bergan Mercy Hosp.,* 230 Neb. 323, 431 N.W.2d 617 (1988); *Steinauer v. Sarpy County,* 217 Neb. 830, 353 N.W.2d 715 (1984); ****574***Bassinger v. Agnew,* 206 Neb. 1, 290 N.W.2d 793 (1980); *LeMieux v. Sanderson,* 180 Neb. 311, 142 N.W.2d 557 (1966); *Schwab v. Allou Corp.,* 177 Neb. 342, 128 N.W.2d 835 (1964); *Bresley v. O'Connor Inc.,* 163 Neb. 565, 80 N.W.2d 711 (1957); ***229***Remmenga v. Selk,* 152 Neb. 625, 42 N.W.2d 186 (1950); *Jensen v. Omaha & C.B. Street R. Co.,* 127 Neb. 599, 256 N.W. 65 (1934); *Schwarting v. Ogram,* 123 Neb. 76, 242 N.W. 273 (1932); *Garrison v. Everett,* 112 Neb. 230, 199 N.W. 30 (1924); *Morfeld v. Weidner,* 99 Neb. 49, 154 N.W. 860 (1915); *Bower v. Chicago & N.W.R. Co.,* 96 Neb. 419, 148 N.W. 145 (1914); *Svetkovic v. Union P.R. Co.,* 95 Neb. 369, 145 N.W. 990 (1914); *Johnson v. Johnson,* 81 Neb. 60, 115 N.W. 323 (1908); *Nixon v. Omaha & C.B. Street R. Co.,* 79 Neb. 550, 113 N.W. 117 (1907); *City of South Omaha v. Sutliffe,* 72 Neb. 746, 101 N.W. 997 (1904); *Chicago, R.I. & P.R.C. v. McDowell,* 66 Neb. 170, 92 N.W. 121 (1902); *Omaha & R.V.R. Co. v. Brady,* 39 Neb. 27, 57 N.W. 767 (1894). See, also, *Dorsey v. Yost,* 151 Neb. 66, 69, 36 N.W.2d 574, 576 (1949) (recovery of damages to mother for wrongful death of daughter limited to monetary benefits that would with " 'reasonable certainty' " have resulted to mother from continued life of daughter), *overruled on other grounds, Reiser v. Coburn,* 255 Neb. 655, 587 N.W.2d 336 (1998).

[9] When the plaintiff seeks prospective damages, the contingent nature of the damages claimed inherently requires consideration of future events that can only be reasonably predicted, but not conclusively proved, at the time of trial. In such instances, the jury should be instructed, when the evidence warrants, that the plaintiff may recover damages for injuries "reasonably certain" to be incurred in the future. See, e.g., NJI2d Civ. 4.01.

[10] Applying these principles to crop damage cases, we note that the measure of damages for the destruction of an *unmatured* growing crop is the value the crop would have had if it had matured, minus any savings to the plaintiff in the costs of producing, harvesting, and transporting the crop to market. *Bristol v. Rasmussen,* 249 Neb. 854, 547 N.W.2d 120 (1996). See, *Romshek v. Osantowski,* 237 Neb. 426, 466 N.W.2d 482 (1991); *Pulliam v. Miller,* 108 Neb. 442, 187 N.W. 925 (1922). We have explained that damages based upon the value of an unmatured crop are analogous to profits lost and are governed by the same rule precluding recovery in cases of either uncertainty or remoteness. *Bristol, supra; Romshek, supra.* As a result, this court has listed several factors that may assist the trier of fact in determining the value of an unmatured crop at the time of its injury or ***230** destruction, including the nature of the land; the type of crop planted; the kind of season, whether wet or dry; the yield of crops growing in such a season; the average yield of crops on neighboring land; the development of the crop at the time of destruction; the yield of a similar crop not injured; the market value of the crop as injured; the market value of the probable crop without injury; the time of the injury; the expense that would have been incurred if the crop had not been injured; the circumstances which surrounded the crop which may have resulted in the crop's not maturing; and other circumstances illustrated by the evidence tending to establish such value. See *id.* Proof on these factors assists a trier of fact to determine with some reasonable degree of certainty the value of a crop had it fully matured.

[11] On the other hand, we long ago established that the measure of damages for the destruction of a *mature* crop is the difference between the value of the mature crop if there had been no injury and the value of the actual crop harvested, less the ****575** necessary costs of harvesting and transporting the crop to market. Thus, when a mature crop is destroyed, damages may be proved by showing the market value of the crop, less the necessary costs of finishing, harvesting, and transporting the crop to market. See, *id.; Kula v. Prososki,* 228 Neb. 692, 424 N.W.2d 117 (1988); *Pulliam, supra.* This is so because proving the value of a destroyed mature crop, while not subject to absolute mathematical certainty, does not suffer from the same type of uncertainty or remoteness as proving the value of a crop damaged prior to maturity. The measure of damages of a mature crop is not analogous to profits lost-the trier of fact need not be concerned with the crop's rate of growth, the weather, or other factors which might have contributed to or detracted from the crop's maturation during the course of a growing season. Those types of uncertainty are absent; the crop is mature at the time of the damage.

[12] In this case, Pribil sought compensation for the damages inflicted on his *mature* corn and soybean crops. The damages sought by Pribil were not based on any future contingency; the crops were mature at the time of the destruction, and the damages were fully incurred at the time of trial. Consequently, the Court of Appeals erred in relying on *Worth v. Schillereff,* 233 Neb. 628, 447 N.W.2d 480 (1989), a prospective damages case, as a basis ***231** for affirming the judgment in the instant case. Instead, because Pribil sought only present damages to fully mature crops, the appropriate instruction on Pribil's burden of proof on the issue of damages was instruction No. 6A(3): that Pribil was required to prove the nature and extent of his damages by the greater weight of the evidence. The district court erred in giving instruction No. 8C, which was not a correct statement of the law under these circumstances and had the practical effect of unintentionally elevating Pribil's burden of proof or, at a minimum, confusing the jury on the required quantum of proof.

[13][14][15][16][17] In an appeal based on a claim of an erroneous jury instruction, the appellant has the burden to show that the questioned instruction was prejudicial or otherwise adversely affected a substantial right of the appellant. *Nauenburg v. Lewis,* 265 Neb. 89, 655 N.W.2d 19 (2003). Here, the jury was given two separate, and not entirely consistent, instructions on what Pribil was required to prove in order to recover the same measure of damages. A party's right to a fair trial may be substantially impaired by jury instructions that contain inconsistencies or confuse or mislead the jury. *Tapp v. Blackmore Ranch,* 254 Neb. 40, 575 N.W.2d 341 (1998). Conflicting instructions are erroneous unless it appears that the jury was not misled. *Dolberg v. Paltani,* 250 Neb. 297, 549 N.W.2d 635 (1996). A jury instruction that misstates the burden of proof has a tendency to mislead the jury and is erroneous. *David v. DeLeon,* 250 Neb. 109, 547 N.W.2d 726 (1996). In this case, we conclude that the potential for confusion created by instruction No. 8C establishes sufficient prejudice to require reversal of the district court's judgment on the issue of damages.

[18] We note, for the sake of completeness, that three opinions of this court discuss jury instructions in which the jury was informed that the plaintiffs, seeking past and present damages, were nonetheless required to establish damages with "reasonable certainty." See, *Colvin v. Powell & Co., Inc.,* 163 Neb. 112, 77 N.W.2d 900 (1956); *Hopper v. Elkhorn Valley Drainage District,* 108 Neb. 550, 188 N.W. 239 (1922); *Russell v. Horn, Brannen & Forsyth Mfg. Co.,* 41 Neb. 567, 59 N.W. 901 (1894). In those cases, however,****576** the defendants had appealed from verdicts and judgments entered in favor of the plaintiffs. Whether ***232** the "reasonable certainty" language of the instructions was correct was neither presented to nor decided by this court. See *id.* A case is not authority for any point not necessary to be passed on to decide the case or not

specifically raised as an issue addressed by the court. *Mach v. County of Douglas,* 259 Neb. 787, 612 N.W.2d 237 (2000).

CONCLUSION

The Court of Appeals erred in affirming the judgment of the district court with respect to the issue of damages, because the district court's instruction that Pribil's evidence must establish the amount of damages with "reasonable certainty" was not warranted by the evidence in this case and was prejudicial to Pribil. Pribil did not seek further review of the other determinations of the Court of Appeals, so those issues are not before us and, on remand, stand as decided. See *US Ecology v. Boyd Cty. Bd. of Equal.,* 256 Neb. 7, 588 N.W.2d 575 (1999). The judgment of the Court of Appeals is reversed, and the cause is remanded to the Court of Appeals with directions to reverse the judgment of the district court and remand the cause to the district court for a new trial on the issue of damages.

REVERSED AND REMANDED WITH DIRECTIONS.

Neb.,2003.
Pribil v. Koinzan
266 Neb. 222, 665 N.W.2d 567

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REYNOLDS METALS COMPANY, Plaintiff and Appellant,
v.
NORMAN O. ALPERSON et al., Defendants and Respondents
L.A. No. 31045.

Supreme Court of California
August 31, 1979.

SUMMARY

Plaintiff brought an action against two shareholders and directors of two bankrupt corporations, seeking to hold them liable for the debts owed plaintiff by the corporations, claiming defendants were "alter egos" of the companies. One count was based on two unpaid promissory notes executed by one corporation with the other as endorser, which provided for recovery of collection cost, including attorney fees limited to 15 percent of the principal amount. Defendants had not signed the promissory notes. Two other causes of action were on common counts. The trial court rejected the alter ego theory and absolved defendants from personal liability for the obligations of the corporations. In addition, the trial court granted defendants 100 percent of their legal fees incurred in attachment proceedings, 75 percent of their fees incurred from the commencement of the lawsuit until certain tort causes of action were dismissed, and 100 percent of their remaining fees. (Superior Court of Los Angeles County, No. C61852, August J. Goebel, Judge.)

The Supreme Court reversed for redetermination of attorney fees. The court held that Civ. Code, § 1717 , enacted to establish mutuality of remedy where contractual provision makes recovery of attorney fees available for only one party, is to be interpreted to further provide a reciprocal remedy for a nonsignatory defendant, sued on a contract as if he were a party to it, when a plaintiff would clearly be entitled to attorney fees should he prevail in enforcing the contractual obligation against defendant. Accordingly, the court held that, since defendants would have been liable for attorney fees pursuant to the fees provision in the promissory note had plaintiff prevailed, they could recover attorney fees pursuant to Civ. Code, § 1717, now that they had prevailed. The court further held that, because the promissory notes contained a provision limiting attorney fees to 15 percent of the amount of the notes, recovery of fees under Civ. Code, § 1717, must be similarly limited, and the trial court erred in failing to observe that limitation. (Opinion by Clark, J., expressing the unanimous view of the court.)

HEADNOTES

Classified to California Digest of Official Reports

(1) Costs § 7--Amount and Items Allowable--Attorney Fees.
Unless authorized by either statute or agreement, attorney fees ordinarily are not recoverable as costs.

(2) Damages § 11--Compensatory Damages--Attorney Fees--Contractual Provision--Mutuality--Nonsignatory.
Civ. Code, § 1717, enacted to establish mutuality of remedy where contractual provision makes recovery of attorney fees available for only one party and to prevent oppressive use of one-sided attorney fee provisions, is to be interpreted to further provide a reciprocal remedy for a nonsignatory defendant, sued on a contract as if he were a party to it, when a plaintiff would clearly be entitled to attorney fees should he prevail in enforcing the contractual obligation against defendant. Accordingly, in an action against two defendants on promissory notes executed by bankrupt corporations in which defendants were shareholders and directors, with defendants' liability predicated on an alter ego theory, even though defendants had not signed the notes, they were entitled to attorney fees where the notes

provided for recovery of collection costs, including attorney fees. Because defendants would have been liable for attorney fees pursuant to the fees provision had plaintiff prevailed, they could recover attorney fees pursuant to the statute when they prevailed. (Disapproving *Arnold* v. *Browne* (1972) 27 Cal.App.3d 386, 398-399 [103 Cal.Rptr. 775] and *Sain v. Silvestre* (1978) 78 Cal.App.3d 461, 476 [144 Cal.Rptr. 478], insofar as they are inconsistent.)
[See **Cal.Jur.3d,** Costs, § 64; **Am.Jur.2d,** Costs, § 79.]
(3) Damages § 11--Compensatory Damages--Attorney Fees--Contractual Provision.
Where a cause of action based on a contract providing for attorney fees is joined with other causes of action beyond the contract, the prevailing party may recover attorney fees under Civ. Code, § 1717, only as they relate to the contract action. A litigant may not increase his recovery of attorney fees by joining a cause of action in which attorney fees are not recoverable to one in which an award is proper. Accordingly, attorney fees incurred solely by defendants for defending causes of action not related to an action on promissory notes providing for recovery of attorney fees were not recoverable.

(4) Damages § 11--Compensatory Damages--Attorney Fees--Apportionment.
Attorney fees need not be apportioned when incurred for representation on an issue common to both a cause of action in which fees are proper and one in which they are not allowed. Accordingly, all expenses incurred by defendants with respect to an issue that was common to both an action on a promissory note providing for attorney fees and a cause of action not so providing, qualified for an award of attorney fees.

(5) Damages § 11--Compensatory Damages--Attorney Fees--Contractual Provision--Mutuality--Amount.
Because promissory notes contained provisions limiting attorney fees to 15 percent of the amount of the notes, recovery of fees by defendants who prevailed in an action on the notes under Civ. Code, § 1717, establishing a reciprocal right to attorney fees, were limited to the same 15 percent of the face amount of the notes.

COUNSEL

Adams, Duque & Hazeltine, James L. Nolan and Margaret Levy for Plaintiff and Appellant.

Kranitz, Sarrow, Imerman & Sacks, Jerome H. Sarrow, Goodstein, Copes & Field, Donald A. Dewar and H. Walter Croskey for Defendants and Respondents.

CLARK, J.

Plaintiff appeals from judgment awarding defendants $80,500 attorney's fees. We reverse. ***127**

Defendants, shareholders and directors of Titanium Metallurgical, Inc. (TMI), owned and operated a subsidiary, Turner Metals Supply, Inc. (Turner). Plaintiff supplied aluminum goods and products to Turner pursuant to a general line consignment agreement executed in 1971. TMI signed the agreement as guarantor of Turner's payments. The agreement contained no provision for recovery of attorney's fees in the event of breach.

In January 1973, Turner, with TMI as indorser, executed and delivered two promissory notes in the aggregate principal amount of $60,794.12. The notes provided for recovery of collection costs, including attorney's fees limited to 15 percent of the principal amount of the notes, in the event of default.

In 1973, Turner and TMI became insolvent and bankruptcy proceedings commenced. Plaintiff, having extended credit of $823,231.48 to Turner, filed a creditor's claim in the proceedings. Plaintiff also brought this suit seeking to hold defendants personally liable for the debts owed plaintiff by Turner and TMI, claiming defendants were "alter egos" of the two bankrupt companies. Trial proceeded on three causes of action, two on common count and the third upon the two unpaid promissory notes.

After lengthy trial, the court rejected the "alter ego" theory advanced by plaintiff, absolving defendants from personal liability for the obligations of Turner and TMI. In addition, the trial court granted defendants $80,500 in attorney's fees. [FN1]

FN1 Defendant Alperson sought to recover $39,445 in attorney's fees and was awarded $38,500. Defendant Blivas sought $51, 597.50 and was awarded $42,000.

The court awarded defendants 100 percent of their legal fees incurred in attachment proceedings, 75 percent of their fees incurred from the commencement of the lawsuit until certain tort causes of action were dismissed, and 100 percent of their remaining fees.

I. Availability of Attorney's Fees

(1) Unless authorized by either statute or agreement, attorney's fees ordinarily are not recoverable as costs. (Code Civ. Proc., § 1021; *D'Amico v. Board of Medical Examiners* (1974) 11 Cal.3d 1, 24-27 [112 Cal.Rptr. 786, 520 P.2d 10]; *Freeman v. Goldberg* (1961) 55 Cal.2d 622, 625 [***128**12 Cal.Rptr. 668, 361 P.2d 244]; *Young v. Redman* (1976) 55 Cal.App.3d 827, 834-835 [128 Cal.Rptr. 86].)

Civil Code section 1717 provides in part: "*In any action on a contract*, where such contract specifically provides that attorney's fees and costs, which are incurred to enforce the provisions of such contract, shall be awarded to one of the *parties, the prevailing party, whether he is the party specified in the contract or not*, shall be entitled to reasonable attorney's fees in addition to costs and necessary disbursements." [FN2] (Italics added.)

FN2 Section 1717 also provides: "Attorney's fees provided for by this section shall not be subject to waiver by the parties to any contract which is entered into after the effective date of this section. Any provision in any such contract which provides for waiver of attorney's fees is void. [¶] As used in this section 'prevailing party' means the party in whose favor final judgment is rendered."

The language of the statute is unclear as to whether it shall be applied to litigants who like defendants have not signed the contract. The section refers to "any action on a contract" thus including any action where it is alleged that a person is liable on a contract, whether or not the court concludes he is a party to that contract. Nevertheless the terms "parties" and "party" are ambiguous. It is unclear whether the Legislature used the terms to refer to signatories or to litigants.

(2) Section 1717 was enacted to establish mutuality of remedy where contractual provision makes recovery of attorney's fees available for only one party (*International Industries v. Olen* (1978) 21 Cal.3d 218, 223 [145 Cal.Rptr. 691, 577 P.2d 1031]; *System Inv. Corp. v. Union Bank* (1971) 21 Cal.App.3d 137, 163 [98 Cal.Rptr. 735]; Review of Selected 1968 Code Legislation (Cont.Ed.Bar) pp. 35-36), and to prevent oppressive use of one-sided attorney's fees provisions. (*Coast Bank* v. *Holmes* (1971) 19 Cal.App.3d 581, 596-597 [97 Cal.Rptr. 30].)

Its purposes require section 1717 be interpreted to further provide a reciprocal remedy for a nonsignatory defendant, sued on a contract as if he were a party to it, when a plaintiff would clearly be entitled to attorney's fees should he prevail in enforcing the contractual obligation against the defendant.

Attorney's fees were awarded pursuant to section 1717 to a person found not to be a signatory to a contract in *Babcock v. Omansky* (1973) 31 Cal.App.3d 625, 633-634 [107 Cal.Rptr. 512]. The defendant prevailed following the plaintiff's allegation she was liable as a coventurer or partner with another defendant who had executed a promissory note ***129** providing for attorney's fees. Concluding that the nonsigning defendant was entitled to attorney's fees, the court reasoned the language of section 1717 was sufficiently broad to include persons who had not signed the contract but were sued on the note and found not to be parties to it. (See *Pas v. Hill* (1978) 87 Cal.App.3d 521, 533-536 [151 Cal.Rptr. 98]; *Canal-Randolph Anaheim, Inc. v. Wilkoski* (1978) 78 Cal.App.3d 477, 486, fn. 2 [144 Cal.Rptr. 474]; *Schlocker v. Schlocker* (1976) 62 Cal.App.3d 921, 923 [133 Cal.Rptr. 485]; *Boliver* v. *Surety Co.* (1977) 72 Cal.App.3d Supp. 22, 29 [140 Cal.Rptr. 259].)

Arnold v. Browne (1972) 27 Cal.App.3d 386, 398-399 [103 Cal.Rptr. 775] and *Sain v. Silvestre*, (1978) 78 Cal.App.3d 461, 476 [144 Cal.Rptr. 478] are disapproved insofar as they are inconsistent with our holding here.

Had plaintiff prevailed on its cause of action claiming defendants were in fact the alter egos of the corporation. (*Kohn v. Kohn* (1950) 95 Cal.App.2d 708, 718 [214 P.2d 71]),defendants would have been liable on the notes. Since they would have been liable for attorney's fees pursuant to the fees provision had plaintiff prevailed, they may recover attorney's fees pursuant to section 1717 now that they have prevailed.

II. The Amount

(3) Where a cause of action based on the contract providing for attorney's fees is joined with other causes of action beyond the contract, the prevailing party may recover attorney's fees under section 1717 only as they relate to the contract action. (*McKenze* v. *Kaiser-Aetna* (1976) 55 Cal.App.3d 84, 88-90 [127 Cal.Rptr. 275]; see *Schlocker v. Schlocker, supra*, 62 Cal.App.3d 921, 923.) Describing the attorney's fees provision, section 1717 specifically refers to fees "incurred to enforce the provisions of [the] contract." A litigant may not increase his recovery of attorney's fees by joining a cause of action in which attorney's fees are not recoverable to one in which an award is proper. In this case, the two promissory notes contained contract provisions for attorney's fees, but no such provision existed in the general line consignment agreement. Accordingly, attorney's fees incurred solely for defending causes of action based on the latter agreement and defending against the tort causes of action are not recoverable.

Conversely, plaintiff's joinder of causes of action should not dilute its right to attorney's fees. (4) Attorney's fees need not be apportioned when incurred for representation on an issue common to both a cause of ***130** action in which fees are proper and one in which they are not allowed. All expenses incurred with respect to the alter ego issue - common to both the note and the general line consignment agreement - qualify for award.

(5) Because the promissory notes contained provision limiting attorney's fees to 15 percent of the amount of the notes ($60,794.12) recovery of fees under section 1717 must be similarly limited. As we have seen, the section establishes a reciprocal right to attorney's fees, and the statutory right should be no greater than the contractual right. The statute refers to "reasonable attorney's fees," and reasonable falls within the fundamental principle of reciprocity.

The trial court erred in failing to observe the 15 percent limitation.

The judgment is reversed for redetermination of attorney's fees.

Bird, C. J., Tobriner, J., Mosk, J., Richardson, J., Manuel, J., and Newman, J., concurred. ***131**

Cal.
Reynolds Metals Co. v. Alperson
25 Cal.3d 124, 599 P.2d 83, 158 Cal.Rptr. 1

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Only the Westlaw citation is currently available.

United States District Court,
E.D. Pennsylvania.
Thomas SCHIRMER and Marc Smith, Plaintiffs,
v.
PRINCIPAL LIFE INSURANCE CO., et al., Defendants.
Civil Action No. 08-cv-2406.

Oct. 29, 2008.

West KeySummary
Federal Civil Procedure 170A ⚷675.1

170A Federal Civil Procedure
170AVII Pleadings and Motions
170AVII(B) Complaint
170AVII(B)1 In General
170Ak675 Alternate, Hypothetical and Inconsistent Claims
170Ak675.1 k. In General. Most Cited Cases

Federal Civil Procedure 170A ⚷1828

170A Federal Civil Procedure
170AXI Dismissal
170AXI(B) Involuntary Dismissal
170AXI(B)5 Proceedings
170Ak1827 Determination
170Ak1828 k. Time of Determination; Reserving Decision. Most Cited Cases

Federal Civil Procedure 170A ⚷2497.1

170A Federal Civil Procedure
170AXVII Judgment
170AXVII(C) Summary Judgment
170AXVII(C)2 Particular Cases
170Ak2497 Employees and Employment Discrimination, Actions Involving
170Ak2497.1 k. In General. Most Cited Cases

Genuine issue of material fact as to whether employees' claims against employer were subject to ERISA precluded summary judgment in suit alleging failure to pay certain compensation, marketing reimbursements, deferred compensation, and stock options. Employees also filed state law claims in the event that the claims were not subject to ERISA. Dismissing employees' state law claims at such an early stage of litigation would be premature. Allowing employees to plead state claims in the alternative permitted them to maintain a cause of action if the facts ultimately indicated that any of the plans were not subject to ERISA. Employee Retirement Income Security Act of 1974, § 514(a), 29 U.S.C.A. § 1144(a).

Fred Warren Jacoby, Julie Beth Negovan, Cozen & O'Connor, Philadelphia, PA, for Plaintiffs.

Andrew J. Soven, Reed Smith, LLP, Thomas J. McGarrigle, Philadelphia, PA, for Defendants.

MEMORANDUM AND ORDER

JOYNER, District Judge.

***1** Presently before the Court is Defendants' Motion to Dismiss Counts I, II, III, VI, VIII, IX, and X of Plaintiffs' Amended Complaint pursuant to Rule 12(b)(6), Plaintiffs' Response thereto, and Defendants' Reply. For the reasons set forth below, the Defendants' Motion to Dismiss is granted in part and denied in part.

I. BACKGROUND

Plaintiffs Marc Smith ("Smith") and Thomas Schirmer ("Schirmer") are in the business of selling financial services and products to businesses and individuals as well as managing, directing, and overseeing the same.[FN1] Defendants are three related companies-Principal Life Insurance Company

("PLIC"), Principal Financial Group ("PFG"), and Princor Financial Services Corporation ("Princor"). FN2 From 2002 until earlier this year, Smith and Schirmer worked for Defendants as Co-Managing Directors in the Philadelphia area and as representatives of their dealer/broker-Princor. Prior to joining Defendants, Plaintiffs had successful careers working for a different nationwide provider of financial services. This suit arises out of alleged misrepresentations made by Defendants to entice Plaintiffs into working for Defendants and subsequent breaches of various contracts and agreements by Defendants, as well as alleged tortious behavior on the part of the Defendants prior to and during the employment relationship.

FN1. The facts are presented in the light most favorable to the Plaintiffs. *Phillips v. County of Allegheny,* 515 F.3d 224, 233 (3d Cir.2008).

FN2. Princor is a subsidiary of Principal Services Trust Company, which is a subsidiary of PLIC. Although not stated in the complaint, Principal Services Trust Company is a member company of PFG.

In January of 2002, Defendants began engaging in an effort to solicit Plaintiffs away from their positions at Provident Mutual Life Insurance Company ("Provident") and its subsidiary, 1717 Capital Management Company ("1717"). Plaintiffs repeatedly made it known to Defendants that they would not leave Provident and 1717 if doing so would negatively impact their income and earning potential. It therefore became a necessary term and condition of employment that Plaintiffs' compensation would equal or exceed their salaries prior to joining Defendants. Letters outlining Schirmer's expectations for compensation and Defendants' offer of compensation were eventually exchanged and, in reliance on Defendants' offer, Schirmer began his affiliation with the Defendants as a Management Consultant on June 24, 2002. In reliance on Defendants' commitment to provide the same terms and conditions to Smith, Smith joined PLIC as a Management Consultant in the Fall of 2002.

Smith and Schirmer shortly thereafter became Co-Managers in Philadelphia and in October, 2002, both signed Co-Manager Agreements with PLIC. Smith and Schirmer also entered into Agent Contracts with PLIC that provided for commissions to be paid to Smith and Schirmer and contracts with Princor to act as Registered Representatives on behalf of Princor. Under the various agreements, Smith and Schirmer were also entitled to receive benefits under the 401k Plan and Senior Executive Retire Plan ("SERP"), additional payment under Principal Life Insurance Company's Deferred Compensation Plan, stock options, and reimbursement for marketing expenses.

***2** Within the first year of employment, Plaintiffs began battling with Defendants to obtain the compensation to which they were entitled and to have Defendants make good on their obligations and agreements. Over the years, Plaintiffs and Defendants continually disagreed on what was owed to Plaintiffs and on how certain factors that determined how commissions and remuneration were to be calculated. These battles culminated with Schirmer retiring from the company on December 31, 2007 and Smith resigning on May 26, 2008.

Immediately preceding Smith's resignation, Plaintiffs filed the instant action alleging, *inter alia,* that Defendants have failed to comply with the terms of the various contracts and with the additional agreements made between the parties. They assert that despite repeated demands Defendants have failed to pay certain compensation, marketing reimbursements, deferred compensation and stock options. In addition, Schirmer alleges that Defendants have intentionally manipulated circumstances to reduce the value and amount of his compensation and other remuneration, causing him to suffer substantial losses and damages. He also alleges that Defendants misrepresented to him the effect of his retirement on his stock options and then unilaterally cashed out his stock options without turning over the proceeds. Smith additionally alleges that PLIC coerced him to sign a Restricted Stock Agreement that improperly converted his previously contracted for bonuses into Restricted Stock Units and that this agreement was signed under duress and without consideration. Smith further alleges that he was forced to resign as a result of circumstances occurring over the weekend of May 23, 2008, when Defendants restricted access to offices and files and locked Smith and his team out of the office, making him unable to conduct his business.

Plaintiffs complaint includes ten separate counts, some of which are pled in the alternative. Defendants have moved to dismiss seven of the ten counts.

II. STANDARD OF REVIEW

Pursuant to Federal Rule of Civil Procedure 12(b)(6), in response to a pleading, a Defendant may file a motion asserting that the Plaintiff's complaint "[fails] to state a claim upon which relief can be granted." In analyzing a Rule 12(b)(6) motion to dismiss, we "accept all factual allegations as true, construe the complaint in the light most favorable to the plaintiff, and determine whether, under any reasonable reading of the complaint, the plaintiff may be entitled to relief." *Phillips v. County of Allegheny,* 515 F.3d 224, 233 (3d Cir.2008) (citations omitted). "To survive a motion to dismiss, a civil plaintiff must allege facts that 'raise a right to relief above the speculative level ....' " *Id.* at 232 (quoting *Bell Atl. Corp. v. Twombley,* 550 U.S. 544, ----, 127 S.Ct. 1955, 1965, 167 L.Ed.2d 929 (2007)). In other words, the plaintiff must provide "enough facts to raise a reasonable expectation that discovery will reveal evidence of the necessary element[s]" of a particular cause of action. *Id.* at 234. This "requires more than labels and conclusions, and a formulaic recitation of the elements of a cause of action will not do." *Twombley,* 127 S.Ct. at 1964-65. In ruling on a Rule 12(b)(6) motion to dismiss, the court may consider documents "integral to or explicitly relied upon in the complaint." *In re Rockefeller Sec. Lit.,* 184 F.3d 280, 287 (3d Cir.1999).

III. DISCUSSION

A. Count I-ERISA Violations

***3** "Except in limited circumstances ... a federal court will not entertain an ERISA claim unless the plaintiff has exhausted the remedies available under the plan." *Harrow v. Prudential Ins. Co. of Am.,* 279 F.3d 244, 249 (3d Cir.2002) (quoting *Weldon v. Kraft, Inc.,* 896 F.2d 793, 800 (3d Cir.1990)). Thus, an ERISA claim "is subject to dismissal if it does not plead or otherwise deal with the issue of exhaustion." *Balmat v. CertainTeed Corp.,* 2004 WL 2861873, at *3 (E.D.Pa. Dec.9, 2004) (quoting *Campbell v. Prudential Ins. Co. of Am.,* 2002 WL 462085, at *2 (E.D.Pa. Mar.25, 2002)). However, exhausting administrative remedies is excused if it would be futile to do so. *Harrow,* 279 F.3d at 249. A party claiming this exception must make a "clear and positive showing that further attempts to seek redress under the plan would be futile." *Balmat,* 2004 WL 2861873 at *3.

Plaintiffs' Complaint does not plead that they exhausted the claim and appeals procedures set forth by each Plan in question. The Complaint does state, however, that "Schirmer and Smith fulfilled all of their obligations and conditions under the various plans," and Plaintiffs argue that this statement is sufficient to plead exhaustion. We disagree. We reiterate that, under *Twombley* and its progeny, a "formulaic recitation" of the legal requirements for a cause of action will not survive a motion to dismiss. 127 S.Ct. at 1964-65. Plaintiffs' bare-bones assertion of "compliance" with unidentified "obligations" is nothing more than a mere recitation of the exhaustion requirement under ERISA, and it therefore cannot survive Defendants' Motion to Dismiss. However, we will give Plaintiffs leave to amend their Complaint in order to properly plead facts pertaining to their exhaustion of each Plan's claim and appeals processes (or their failure to do so). *See Campbell,* 2002 WL 462085, at *2 (allowing ERISA plaintiff to amend complaint to properly plead exhaustion, should it be applicable).

B. Count II-Common Law Claims under Deferred Compensation Plan, 401K and SERP

ERISA preempts "any and all State laws insofar ... as they relate to any employee benefit plan" to which ERISA applies. *See* 29 U.S.C.A. § 1144(a) (1998 & Supp.2008). "[T]he express preemption provisions of ERISA are deliberately expansive, and designed to 'establish pension plan regulation as exclusively a federal concern.' " *Pilot Life Ins. Co. v. Dedeaux,* 481 U.S. 41, 45, 107 S.Ct. 1549, 95 L.Ed.2d 39 (1987) (quoting *Alessi v. Raybestos-Manhattan, Inc.,* 451 U.S. 504, 523, 101 S.Ct. 1895, 68 L.Ed.2d 402 (1981)). A plaintiff's state law claims pled in the alternative will nonetheless survive a motion to dismiss where there is doubt whether a plan is subject to ERISA, regardless that they will be preempted if ERISA ultimately does apply. *See Coleman v. Standard Life Ins. Co.,* 288 F.Supp.2d 1116, 1121 (E.D.Cal.2003) (denying motion to dismiss state claims before determining whether ERISA applied). Both the ERISA claims and the state claims, however, would not be able to survive the summary judgment stage. *Nicolaysen v. BP Amoco Chemical Co.,* 2002 WL 1060587, at *5 (E.D.Pa. May 23, 2002).

***4** Plaintiffs have pled common law claims in the alternative in the event that the Deferred Compensation Plan, 401k Plan, or SERP Plan is not subject to enforcement under ERISA. Defendants move to dismiss these claims as entirely preempted by ERISA. They argue that any state law claim related to Plan-managed assets or Plan benefits clearly relates to a benefits plan and that here there is no doubt the Plans are employee benefits plans covered by ERISA. Plaintiffs respond that they are entitled to plead in the alternative because there has been no legal determination that the Plans are subject to ERISA and dismissing the state law claims at this early stage in the litigation would severely prejudice them if it were later determined that some or all of their claims were not subject to ERISA. Defendants in reply urge us to determine at this point whether the plans are subject to ERISA.

Dismissing Plaintiffs' state law claims at this early stage of the litigation would be premature. Allowing the Plaintiffs' to plead state claims in the alternative permits them to maintain a cause of action if the facts ultimately bear out that any of the plans-for whatever unlikely reason-are not subject to ERISA. *See Nicolaysen,* 2002 WL 1060587, at *5. Although, as Defendants point out, Plaintiffs have averred in their complaint that the Plans are governed by ERISA and hence subject to its enforcement provisions, Plaintiffs are permitted by the Federal Rules of Civil Procedure to plead alternative claims regardless of their consistency. *See* Fed.R.Civ.P. 8(d). Whether the Plans are subject to ERISA can be determined during the summary judgment stage of the proceedings. Defendants Motion to Dismiss Count II is denied.

C. Count III-Request for Accounting

Under Pennsylvania law,

> An equitable accounting is improper where no fiduciary relationship exists between the parties, no fraud or misrepresentation is alleged, the accounts are not mutual or complicated, *or* the plaintiff possesses an adequate remedy at law.

Rock v. Pyle, 720 A.2d 137, 142 (Pa.Super.1998). Thus, an equitable accounting is proper where there is no adequate remedy at law and there is also a fiduciary relationship between the parties, alleged fraud or misrepresentation, or mutual and complicated accounts. *Greencort Condominium Ass'n v. Greencort Partners,* 2005 WL 2562909, *7 (Pa.Com.Pl. Oct.4, 2005); *Koch v. First Union Corp.,* 2002 WL 372939, * 12 (Pa.Com.Pl. Jan.10, 2002); *see also Poeta v. Jaffe,* 2001 WL 1113012, *4 (Pa.Com.Pl. May 30, 2001) (dismissing equitable accounting claim where accounts were mutual and complicated but there was an adequate remedy at law). "Equitable jurisdiction for an accounting does not exist merely because the plaintiff desires information that he could obtain through discovery." *Buczek v. First Nat'l Bank of Mifflintown,* 366

Pa.Super. 551, 531 A.2d 1122, 1124 (Pa.Super.1987).

ERISA also includes disclosure and reporting provisions. *See* 29 U.S.C. § 1025(a) (1998 & Supp.2008). Under ERISA, the administrator of a defined benefit plan must, *inter alia,* provide a pension benefit statement to a plan participant or beneficiary upon request. *Id.* § 1025(a)(1)(B); *Barrowclough v. Kidder, Peabody & Co.,* 752 F.2d 923, 933 (3d Cir.1985), *overruled in part by Pritzker v. Merrill Lynch, Pierce, Fenner & Smith, Inc.,* 7 F.3d 1110, 1112 (3d Cir.1993).

***5** Plaintiffs' Complaint does not specify whether an accounting is sought under Pennsylvania law or under ERISA. Their complaint, however, fails to plead facts sufficient to defeat a motion to dismiss under either. Although Plaintiffs' aver in their response that the accounts are mutual and complicated, they have failed entirely to plead an inadequate remedy at law. Plaintiffs have stated only that they are "entitled to an accounting from Defendants" and that Defendants are solely in possession of the necessary information Plaintiffs seek. Moreover, Plaintiffs are demanding money damages for alleged breach of contract and violations under ERISA. It appears, therefore, that an adequate remedy at law exists and that the information sought can be obtained through ordinary discovery. *See Poeta,* 2001 WL 1113012, *4 (finding an adequate remedy at law where the claim was for money damages based on breach of contract). Thus, there is no need for an equitable accounting.

The Plaintiffs' response also makes reference to the requirement under ERISA to provide an accounting upon request and asserts that Defendant PLIC, as Administrator of the Deferred Compensation and SERP Plans, failed to comply with this law. A conclusory allegation that a Defendant "failed to comply" with section 1025(a) is nothing more than a mere recitation of the disclosure requirements under ERISA, and, as such, cannot survive Defendants' Motion to Dismiss. *See Twombley,* 127 S.Ct. at 1964-65. Plaintiffs have failed in their pleadings to aver any facts relating to a request for, or subsequent denial of, an accounting under ERISA. Plaintiffs have merely stated that they are entitled to an accounting and that the Defendants are solely in possession of information necessary to the Plaintiffs. Defendants' motion to dismiss Count III is, therefore, granted.

D. Count VIII-Unjust Enrichment

As previously stated, pursuant to Rule 8, Plaintiffs may plead multiple claims in the alternative regardless of consistency. Fed.R.Civ.P. 8(d). Federal courts specifically allow plaintiffs to plead a contract claim and an unjust enrichment claim in the alternative, regardless that the plaintiff will ultimately be able to recover under only one theory. *See, e.g., Cornell Co. v. Borough of New Morgan,* 512 F.Supp.2d 238, 265 (E.D.Pa.2007); *U.S. v. Kensington Hosp.,* 760 F.Supp. 1120, 1132 (E.D.Pa.1991). Plaintiffs here have properly pled an unjust enrichment claim in the alternative. Defendant's motion to dismiss Count VIII is denied.

E. Counts VI, IX and X-Rescission of the 2007 and 2008 Restricted Stock Agreements (Smith), Fraud (Smith & Schirmer), and Negligent Misrepresentation (Schirmer)

When engaging in a conflict-of-law analysis, Federal District Courts apply the conflict-of-law rules of the forum state to determine which state's substaNtive law applies. *Klaxon Co. v. Stentor Electric Manufacturing Co.,* 313 U.S. 487, 486 (1941); *Garcia v. Plaza Oldsmobile,* 421 F.3d 216, 219 (3d Cir.2005). Pennsylvania's choice-of-law analysis involves a hybrid approach that " 'combines the approaches of both Restatement [(Second) of Conflict of Laws] (contacts establishing significant relationships) and 'interest analysis' (qualitative appraisal of the relevant States' policies with respect to the controversy).' " *Garcia,* 421 F.3d at 219 (quoting *Melville v. American Home Assurance Co.,* 584 F.2d 1306, 1311 (3d Cir.1978). Under

Pennsylvania's choice-of-law analysis, the Court must first determine whether there is a true conflict between the alleged competing bodies of law. *Hammersmith v. Tig Insurance Co.,* 480 F.3d 220, 230 (3d Cir.2007); *Garcia,* 421 F.3d at 220. There is a true conflict if, after engaging in an analysis of the policies underlying the laws of the interested states, the governmental interests of each jurisdiction would be impaired by applying the other jurisdiction's law. *Hammersmith,* 480 F.3d at 230; *Garcia,* 421 F.3d at 220. Where a true conflict exists, the Court must then " 'weigh the contacts on a qualitative scale according to their relation to the policies and interests underlying the [particular] issue' " to determine which state has a greater interest in the application of its law. *Hammersmith,* 480 F.3d at 231 (quoting *Shields v. Consolidated Rail Corp.,* 810 F.2d 397, 400 (3d Cir.1987). "Because choice of law analysis is issue specific, different states' laws may apply to different issues in a single case." *Berg Chilling Systems v. Hull Corp.,* 435 F.3d 455, 462 (3d Cir.2006).

***6** Smith has pled in the alternative to his breach of contract claim that the 2007 and 2008 Restricted Stock Agreements should be rescinded for lack of consideration or because the agreement was signed under duress. The Defendants move to dismiss this claim, arguing that Smith has not pled sufficiently extraordinary facts or the particular circumstances regarding the alleged duress to support rescission of a contract and that Smith's continued employment constituted sufficient consideration for the Agreements. Smith and Schirmer have also both pled Fraud claims and Schirmer has in addition pled a Negligent Misrepresentation claim. Defendants move to dismiss these claims as precluded by the gist of the action doctrine and the economic loss doctrine.

The Plaintiffs and Defendants are in disagreement over which state's law controls in each of these claims. Defendants argue that Pennsylvania law applies [FN3] whereas Plaintiffs assert that Iowa law is controlling. This Court finds that granting Defendants' Motion to Dismiss in regard to these counts at this time would be premature. Pennsylvania's choice-of-law analysis involves a fact-intensive inquiry that can be more properly addressed at the summary judgment stage of the proceedings once the record has been more fully developed through discovery. *See Kilpatrick v. Sheet Metal Workers Int'l Ass'n Local Union No. 19,* 1996 WL 635691, *4 (E.D.Pa. Oct.30, 1006) (citing *Lejeune v. Bliss-Salem, Inc.,* 85 F.3d 1069 (3d Cir.1996). Defendant's Motion to Dismiss Counts VI, IX, and X is, therefore, denied.

FN3. In regard to Count VI (Rescission), Defendants in their reply brief also allude to the possibility that Delaware law may control.

ORDER

AND NOW, this 29th day of October, 2008, upon consideration of Defendants' Motion to Dismiss (Doc. No. 9) and responses thereto (Doc. Nos.11, 13), it is hereby ORDERED that the Motion is GRANTED IN PART and DENIED IN PART. Count I (ERISA Violations) of Plaintiffs' Complaint is hereby dismissed with leave to amend. Count III (Request for an Accounting) of Plaintiffs' Complaint is hereby dismissed. Defendants' motion in regard to the remaining counts is denied.

E.D.Pa.,2008.
Schirmer v. Principal Life Ins. Co.
Not Reported in F.Supp.2d, 2008 WL 4787568 (E.D.Pa.)

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Supreme Court of South Carolina.
Sherry H. SIMPSON, Respondent,
v.
MSA OF MYRTLE BEACH, INC. d/b/a Addy's Harbor Dodge, Daimler Chrysler Services NA, LLC, and CrossCheck, Inc., Defendants,
of whom MSA of Myrtle Beach, Inc. d/b/a Addy's Harbor Dodge, is the Appellant.
No. 26293.

Heard Nov. 1, 2006.
Decided March 26, 2007.
Rehearing Denied May 23, 2007.

Background: Customer brought action against automobile dealership alleging that the dealership violated the South Carolina Unfair Trade Practices Act and the South Carolina Manufacturers, Distributors, and Dealers Act by misrepresenting the trade-in value of her vehicle, artificially increasing the purchase price on new vehicle, and failing to provide all rebates promised. Dealership moved to stay the action and to compel arbitration. The Circuit Court, Horry County, B. Hicks Harwell, Jr., J., ordered mediation, then subsequently denied dealership's motion. Dealership appealed, and the Court of Appeals certified the case to the Supreme Court.

Holdings: The Supreme Court, Toal, C.J., held that:
(1) the Circuit Court was the proper forum to decide the enforceability of the arbitration clause;
(2) customer lacked meaningful choice in agreeing to arbitration clause;
(3) limitations on statutory remedies imposed by arbitration clause were unconscionable and unenforceable;
(4) provision of arbitration clause that excepted from arbitration certain claims dealership might pursue against customer was unconscionable and unenforceable; and
(5) the unconscionable provisions in arbitration clause were not severable.

Affirmed.

West Headnotes

[1] Alternative Dispute Resolution 25T 213(5)

25T Alternative Dispute Resolution
25TII Arbitration
25TII(D) Performance, Breach, Enforcement, and Contest
25Tk204 Remedies and Proceedings for Enforcement in General
25Tk213 Review
25Tk213(5) k. Scope and Standards of Review. Most Cited Cases
Arbitrability determinations are subject to de novo review, but a circuit court's factual findings will not be reversed on appeal if any evidence reasonably supports the findings.

[2] Alternative Dispute Resolution 25T 199

25T Alternative Dispute Resolution
25TII Arbitration
25TII(D) Performance, Breach, Enforcement, and Contest
25Tk197 Matters to Be Determined by Court
25Tk199 k. Existence and Validity of Agreement. Most Cited Cases
The circuit court, rather than an arbitrator, was the proper forum to decide the enforceability of the arbitration clause in automobile trade-in and sales contract between customer and automobile dealership, which contract was governed by the South Carolina Uniform Arbitration Act (UAA), even though the contract specifically stated that arbitration applied to issues involving the "validity and scope" of the contract; the customer challenged the arbitration clause on grounds of unconscionability, bringing into question whether an arbitration agreement even existed in the first place. Code 1976, §

15-48-20(a).

[3] Alternative Dispute Resolution 25T ⚷114

25T Alternative Dispute Resolution
25TII Arbitration
25TII(A) Nature and Form of Proceeding
25Tk114 k. Constitutional and Statutory Provisions and Rules of Court. Most Cited Cases
The Federal Arbitration Act (FAA) codifies federal policy on arbitration and arbitration agreements. 9 U.S.C.A. § 1 et seq.

[4] Alternative Dispute Resolution 25T ⚷116

25T Alternative Dispute Resolution
25TII Arbitration
25TII(A) Nature and Form of Proceeding
25Tk116 k. What Law Governs. Most Cited Cases

Commerce 83 ⚷80.5

83 Commerce
83II Application to Particular Subjects and Methods of Regulation
83II(I) Civil Remedies
83k80.5 k. Arbitration. Most Cited Cases

Federal Courts 170B ⚷403

170B Federal Courts
170BVI State Laws as Rules of Decision
170BVI(C) Application to Particular Matters
170Bk403 k. Arbitration. Most Cited Cases
Unless the parties have contracted otherwise, the Federal Arbitration Act (FAA) applies in federal and state courts to any arbitration agreement regarding a transaction that involves interstate commerce, regardless of whether the parties contemplated an interstate transaction. 9 U.S.C.A. § 1 et seq.

[5] Alternative Dispute Resolution 25T ⚷116

25T Alternative Dispute Resolution
25TII Arbitration
25TII(A) Nature and Form of Proceeding
25Tk116 k. What Law Governs. Most Cited Cases
Even in cases where the Federal Arbitration Act (FAA) otherwise applies, general contract principles of state law apply in a court's evaluation of the enforceability of an arbitration clause. 9 U.S.C.A. § 1 et seq.

[6] Alternative Dispute Resolution 25T ⚷199

25T Alternative Dispute Resolution
25TII Arbitration
25TII(D) Performance, Breach, Enforcement, and Contest
25Tk197 Matters to Be Determined by Court
25Tk199 k. Existence and Validity of Agreement. Most Cited Cases
Rulings that a trial court should determine the threshold validity of an arbitration agreement under the South Carolina Uniform Arbitration Act (UAA) are based on the contractual nature of arbitration agreements. Code 1976, § 15-48-20(a).

[7] Alternative Dispute Resolution 25T ⚷210

25T Alternative Dispute Resolution
25TII Arbitration
25TII(D) Performance, Breach, Enforcement, and Contest
25Tk204 Remedies and Proceedings for Enforcement in General
25Tk210 k. Evidence. Most Cited Cases
There is a strong presumption in favor of the validity of arbitration agreements because both state and federal policy favor arbitration of disputes.

[8] Alternative Dispute Resolution 25T ⚷139

25T Alternative Dispute Resolution
25TII Arbitration
25TII(B) Agreements to Arbitrate
25Tk136 Construction

25Tk139 k. Construction in Favor of Arbitration. Most Cited Cases
Unless a court can say with positive assurance that the arbitration clause is not susceptible to an interpretation that covers the dispute, arbitration should generally be ordered.

[9] Alternative Dispute Resolution 25T ⚿112

25T Alternative Dispute Resolution
25TII Arbitration
25TII(A) Nature and Form of Proceeding
25Tk112 k. Contractual or Consensual Basis. Most Cited Cases

Alternative Dispute Resolution 25T ⚿134(3)

25T Alternative Dispute Resolution
25TII Arbitration
25TII(B) Agreements to Arbitrate
25Tk131 Requisites and Validity
25Tk134 Validity
25Tk134(3) k. Validity of Assent. Most Cited Cases

Alternative Dispute Resolution 25T ⚿134(6)

25T Alternative Dispute Resolution
25TII Arbitration
25TII(B) Agreements to Arbitrate
25Tk131 Requisites and Validity
25Tk134 Validity
25Tk134(6) k. Unconscionability. Most Cited Cases
Arbitration is a matter of contract law and is available only when the parties involved contractually agreed to arbitrate, and a party may seek revocation of the contract under such grounds as exist at law or in equity, including fraud, duress, and unconscionability. Code 1976, § 15-48-10(a).

[10] Alternative Dispute Resolution 25T ⚿137

25T Alternative Dispute Resolution
25TII Arbitration
25TII(B) Agreements to Arbitrate
25Tk136 Construction
25Tk137 k. In General. Most Cited Cases
General contract principles of state law apply in a court's evaluation of the enforceability of an arbitration clause.

[11] Alternative Dispute Resolution 25T ⚿134(6)

25T Alternative Dispute Resolution
25TII Arbitration
25TII(B) Agreements to Arbitrate
25Tk131 Requisites and Validity
25Tk134 Validity
25Tk134(6) k. Unconscionability. Most Cited Cases
"Unconscionability," as pertains to a contractual arbitration clause, is defined as the absence of meaningful choice on the part of one party due to one-sided contract provisions, together with terms that are so oppressive that no reasonable person would make them and no fair and honest person would accept them.

[12] Contracts 95 ⚿1

95 Contracts
95I Requisites and Validity
95I(A) Nature and Essentials in General
95k1 k. Nature and Grounds of Contractual Obligation. Most Cited Cases
For purposes of determining whether a contract is unconscionable, the absence of meaningful choice on the part of one party generally speaks to the fundamental fairness of the bargaining process in the contract at issue.

[13] Contracts 95 ⚿1

95 Contracts
95I Requisites and Validity
95I(A) Nature and Essentials in General
95k1 k. Nature and Grounds of Contractual Obligation. Most Cited Cases
In determining whether a contract was tainted by an absence of meaningful choice so as to render it un-

conscionable, courts should take into account: (1) the nature of the injuries suffered by the plaintiff; (2) whether the plaintiff is a substantial business concern; (3) the relative disparity in the parties' bargaining power; (4) the parties' relative sophistication; (5) whether there is an element of surprise in the inclusion of the challenged clause; and (6) the conspicuousness of the clause.

[14] Alternative Dispute Resolution 25T 🔑 134(6)

25T Alternative Dispute Resolution
25TII Arbitration
25TII(B) Agreements to Arbitrate
25Tk131 Requisites and Validity
25Tk134 Validity
25Tk134(6) k. Unconscionability. Most Cited Cases

Customer lacked meaningful choice in agreeing to an arbitration clause contained in automobile trade-in and sales contract formed with automobile dealership, as could justify a finding that the clause was unconscionable; the contract was a "take it or leave it" adhesion contract the contract, the contract was for the purchase of customer's primary vehicle, customer did not possess business sophistication, the contract was hastily presented for customer's signature, and the arbitration clause was inconspicuous in light of its consequences.

[15] Contracts 95 🔑1

95 Contracts
95I Requisites and Validity
95I(A) Nature and Essentials in General
95k1 k. Nature and Grounds of Contractual Obligation. Most Cited Cases

An "adhesion contract" is a standard form contract offered on a take-it-or-leave-it basis with terms that are not negotiable.

[16] Contracts 95 🔑1

95 Contracts
95I Requisites and Validity
95I(A) Nature and Essentials in General
95k1 k. Nature and Grounds of Contractual Obligation. Most Cited Cases

"Adhesion contracts" are not per se unconscionable, but the finding of an adhesion contract may mark the beginning point of an unconscionability analysis.

[17] Alternative Dispute Resolution 25T 🔑 134(6)

25T Alternative Dispute Resolution
25TII Arbitration
25TII(B) Agreements to Arbitrate
25Tk131 Requisites and Validity
25Tk134 Validity
25Tk134(6) k. Unconscionability. Most Cited Cases

Limitations on statutory remedies imposed by arbitration clause in automobile sales contract between customer and automobile dealership, which provided that an arbitrator was not authorized to award punitive, exemplary, double, or treble damages as to disputes arising under the contract, were oppressive and one-sided and violated statutory law and public policy, and thus, were unconscionable and unenforceable; customer asserted claims that dealership violated the South Carolina Uniform Trade Practices Act (SCUPTA) and the South Carolina Regulation of Manufacturers, Distributors, and Dealers Act (Dealers Act), which required courts to impose awards of either double or treble damages for violations. Code 1976, §§ 39-5-140(a), 56-15-110(1), 56-15-130.

[18] Alternative Dispute Resolution 25T 🔑 134(6)

25T Alternative Dispute Resolution
25TII Arbitration
25TII(B) Agreements to Arbitrate
25Tk131 Requisites and Validity
25Tk134 Validity
25Tk134(6) k. Unconscionability. Most Cited Cases

Provision of arbitration clause in sales contract between customer and automobile dealership that excepted from arbitration certain claims which dealership might opt to pursue against customer, and which further stipulated that any judicial proceeding brought by dealership pursuant to the exception would not be stayed pending the outcome of arbitration, was oppressive and one-sided, and, in combination with customer's lack of meaningful choice as to the arbitration clause, was unconscionable and thus unenforceable; the provision allowed dealership to bring a judicial proceeding that completely disregarded any pending claims from customer requiring arbitration.

[19] Alternative Dispute Resolution 25T ⚷121

25T Alternative Dispute Resolution
25TII Arbitration
25TII(A) Nature and Form of Proceeding
25Tk118 Matters Which May Be Subject to Arbitration Under Law
25Tk121 k. Statutory Rights and Obligations. Most Cited Cases

Antitrust and Trade Regulation 29T ⚷206

29T Antitrust and Trade Regulation
29TIII Statutory Unfair Trade Practices and Consumer Protection
29TIII(C) Particular Subjects and Regulations
29Tk204 Warranties and Service Contracts
29Tk206 k. Motor Vehicles; "Lemon" Laws. Most Cited Cases

Customer was not precluded from attacking arbitration clause in sales contract with automobile dealership as a violation of the Magnuson-Moss Warranty Act (MMWA), even though customer's underlying claims against dealership alleged no violation of the MMWA, and therefore, the inclusion of the MMWA in the scope of the arbitration clause was unenforceable as a matter of public policy, where the arbitration clause applied to "any and all disputes" including "automobile warranty" and "any consumer protection statute." Magnuson-Moss Warranty-Federal Trade Commission Improvement Act, § 101 et seq., 15 U.S.C.A. § 2301 et seq.; 16 C.F.R. § 703.5(j).

[20] Contracts 95 ⚷103

95 Contracts
95I Requisites and Validity
95I(F) Legality of Object and of Consideration
95k103 k. Contravention of Law in General. Most Cited Cases

Contracts 95 ⚷105

95 Contracts
95I Requisites and Validity
95I(F) Legality of Object and of Consideration
95k104 Violation of Statute
95k105 k. In General. Most Cited Cases

Contracts 95 ⚷108(1)

95 Contracts
95I Requisites and Validity
95I(F) Legality of Object and of Consideration
95k108 Public Policy in General
95k108(1) k. In General. Most Cited Cases

The Court of Appeals will not enforce a contract which is violative of public policy, statutory law, or provisions of the constitution.

[21] Alternative Dispute Resolution 25T ⚷140

25T Alternative Dispute Resolution
25TII Arbitration
25TII(B) Agreements to Arbitrate
25Tk140 k. Severability. Most Cited Cases

Unconscionable provisions in arbitration clause in the adhesion contract between customer and automobile dealership were not severable, but rather, the entire clause was wholly unconscionable and unenforceable based on the cumulative effect of multiple oppressive and one-sided provisions; severing only the offending provisions would not achieve the intent of the parties, but would effectively "rewrite" the contract, and two of the offending provisions were grossly unconscionable such that public policy was best served by invalidating the entire clause.

[22] Alternative Dispute Resolution 25T ⚷211

25T Alternative Dispute Resolution
25TII Arbitration
25TII(D) Performance, Breach, Enforcement, and Contest
25Tk204 Remedies and Proceedings for Enforcement in General
25Tk211 k. Trial or Hearing. Most Cited Cases

Trial court's consideration of parties' memoranda on the unconscionability of an arbitration clause in sales contract between customer and automobile dealership, which consideration was conducted without a hearing, did not deprive dealership of a reasonable opportunity to present evidence as to the commercial setting, purpose, and effect of the arbitration clause, as statutorily required upon a claim of a contract's unconscionability, where the dealership had four months between customer's motion alleging unconscionability and the time dealership filed a response. Code 1976, § 36-2-302(2).

****665** Joseph Gregory Studemeyer, of Columbia, for Appellant.

Lawrence Sidney Connor, IV, of Kelaher, Connell & Connor, of Surfside Beach, for Respondent.

Chief Justice TOAL:

***19** This case arises out of an arbitration clause in an automobile trade-in contract between an automobile dealership and a customer. The automobile dealership filed a motion for protective order and/or to stay and to compel arbitration in response to the customer's civil action. The trial court denied the dealership's motion on the grounds ****666** that the arbitration clause was unconscionable. This appeal followed.

FACTUAL/PROCEDURAL BACKGROUND

Appellant MSA of Myrtle Beach, Inc d/b/a Addy's Harbor Dodge ("Addy"), a car dealership, and Respondent Sherry H. Simpson ("Simpson") entered into a contract whereby Simpson traded in her 2001 Toyota 4Runner for a new 2004 Dodge Caravan. Directly above the signature line on the first page of the contract, the signee was instructed in bold to "SEE ADDITIONAL TERMS AND CONDITIONS ON OPPOSITE PAGE." The additional terms and conditions contained an arbitration clause stating the following:

> 10. *ARBITRATION* Any and all disputes, claims or controversies between Dealer and Customer or between any ***20** officers, directors, agents, employees, or assignees of Dealer and Customer arising out of or relating to: (a) automobile warranty, workmanship, or repair; (b) the terms or enforceability of the sale, lease, or financing of any vehicle; (c) any claim of breach of contract, misrepresentation, conversion, fraud, or unfair and deceptive trade practices against Dealer or any officers, directors, agents, employees, or assignees of Dealer; (d) any and all claims under any consumer protection statute; and (e) the validity and scope of this contract, shall be settled by binding arbitration in accordance with the Commercial Arbitration Rules of the American Arbitration Association. The parties expressly waive all rights to trial by jury on such claims. Provided, however, that nothing in this contract shall require Dealer to submit to arbitration any claims by Dealer against customer for claim and delivery, repossession, injunctive relief, or monies owed by customer in connection with the purchase or lease of any vehicle and any claims by Dealer for these remedies shall not be stayed pending the outcome of arbitration. The filing fees for arbitration shall be paid by the party ini-

tiating arbitration. The arbitrator may allocate the other arbitration fees as he/she deems appropriate. In addition to any discovery permitted by the Commercial Arbitration rules, any party may take one disposition [sic] of an opposing party. The parties agree to exchange all exhibits to be used in arbitration 7 days before arbitration. The arbitrator shall determine the controversy in accordance with the terms of this contract between the parties and shall not consider any parole evidence which purports to alter, modify, vary, add to, or contradict such contract. The arbitrator shall give effect to all applicable statutes of limitation. Any arbitration under this agreement shall take place in Horry County, South Carolina and Customer agrees that the courts of Horry County, South Carolina shall have exclusive jurisdiction over enforcement of this contract and any award made by any arbitrator pursuant to this contract. In no event shall the arbitrator be authorized to award punitive, exemplary, double, or treble damages (or any other damages which are punitive in nature or effect) against either party. Unless otherwise agreed in writing, no claims ***21** against Dealer shall be consolidated with other claims in the nature of a class action.

Six months later, Simpson filed a complaint in the Horry County court of common pleas alleging Addy violated the South Carolina Unfair Trade Practices Act and the South Carolina Manufacturers, Distributors, and Dealers Act by misrepresenting the trade-in value of the vehicle, artificially increasing the purchase price, and failing to provide all rebates promised. Simpson sought damages consistent with the maximum statutory remedies permitted for violations of these statutes.

Addy's answer denied Simpson's allegations and asserted that the contract between the parties contained an arbitration clause such that the matter should be stayed and that Simpson's only remedy was to file for arbitration. Addy contemporaneously filed a motion for protective order and/or to stay and compel arbitration. Thereafter, Simpson filed a memorandum in opposition to Addy's motion alleging that the arbitration clause was unconscionable and unenforceable.

At the motion hearing, the trial court ordered the parties to attempt mediation. After the parties notified the trial court that mediation failed, the trial court issued an order denying Addy's motion on the grounds ****667** that the arbitration clause was unconscionable. Addy filed this appeal.

The case was certified to this Court from the court of appeals pursuant to Rule 204(b), SCACR, and Addy raises the following issues for review:

I. Did the lower court err in ruling that the arbitration clause was unenforceable without first submitting the issue of enforceability to arbitration?

II. Did the lower court err in denying Addy's motion to stay the civil litigation pending arbitration?

III. Did the lower court err in failing to provide Addy a reasonable opportunity to present evidence as to the commercial setting, purpose, and effect of the arbitration clause in order to aid the court in making a determination on unconscionability?

*22 STANDARD OF REVIEW

[1] Arbitrability determinations are subject to *de novo* review. *Wellman, Inc. v. Square D Co.,* 366 S.C. 61, 67, 620 S.E.2d 86, 89 (Ct.App.2005). Nevertheless, a circuit court's factual findings will not be reversed on appeal if any evidence reasonably supports the findings. *Thornton v. Trident Med. Ctr., L.L.C.,* 357 S.C. 91, 94, 592 S.E.2d 50, 51 (Ct.App.2003).

LAW/ANALYSIS

I. The appropriate forum for determining the validity of the arbitration clause.

[2] As a preliminary matter, Addy contends that the trial court erred in ruling on the arbitration clause's enforceability rather than first submitting that issue of enforceability to arbitration. We disagree.

[3][4][5] The South Carolina Uniform Arbitration Act (UAA) generally provides that where one party denies the existence of an arbitration agreement raised by an opposing party, a court must immediately determine whether the agreement exists in the first place. S.C.Code Ann. § 15-48-20(a)(2005). If no agreement is found to exist, the court must deny any application to arbitrate.[FN1] *Id.*

FN1. The Federal Arbitration Act (FAA), 9 U.S.C.A. § 1 *et. seq.* (1999) codifies federal policy on arbitration and arbitration agreements. Unless the parties have contracted otherwise, the FAA applies in federal and state courts to any arbitration agreement regarding a transaction that involves interstate commerce, regardless of whether the parties contemplated an interstate transaction. *Munoz v. Green Tree Fin. Corp.*, 343 S.C. 531, 538, 542 S.E.2d 360, 363 (2001). Although the vehicle trade-in contract at issue in the instant case involves interstate commerce, the contract contains a choice of law provision designating South Carolina law as governing law. Therefore, the UAA governs where, as here, the validity of the choice of law provision is not in issue. Additionally, FAA pre-emption of the UAA is not an issue in this case because the state laws applicable to this case do not operate to completely invalidate the parties' agreement to arbitrate. *See Zabinski v. Bright Acres Assocs.,* 346 S.C. 580, 592, 553 S.E.2d 110, 116 (2001).

This distinction is insignificant in the instant case because the UAA and FAA provisions that apply to the issues are nearly identical. *See* S.C.Code Ann. § 15-48-10(a) (2005) and 9 U.S.C.A. § 2 (1999). Therefore, the analysis under state law is ultimately the same as the analysis under federal law. Moreover, even in cases where the FAA otherwise applies, general contract principles of state law apply in a court's evaluation of the enforceability of an arbitration clause. *Munoz,* 343 S.C. at 539, 542 S.E.2d at 364.

***23** [6] Our precedents in this area echo the UAA's policy that the trial court should determine the threshold validity of the arbitration agreement. *See Zabinski,* 346 S.C. at 596, 553 S.E.2d at 118 ("The question of the arbitrability of a claim is an issue for judicial determination, unless the parties provide otherwise."); *Hous. Auth. of the City of Columbia v. Cornerstone Hous., LLC,* 356 S.C. 328, 334, 588 S.E.2d 617, 620 (Ct.App.2003) ("The initial inquiry to be made by the trial court is whether an arbitration agreement exists between the parties."). Such rulings are based on the contractual nature of arbitration agreements. *See Towles v. United Healthcare Corp.,* 338 S.C. 29, 37, 524 S.E.2d 839, 843-44 (Ct.App.1999) ("Arbitration is available only when the parties involved contractually agreed to arbitrate.").

This proposition finds support in other jurisprudence. The United States Supreme Court has noted that, in limited circumstances, a court should assume that the parties****668** intended the court to decide certain arbitration issues in the absence of "clear and unmistakable" evidence to the contrary. *Green Tree Fin. Corp. v. Bazzle,* 539 U.S. 444, 452, 123 S.Ct. 2402, 156 L.Ed.2d 414 (2003) (quoting *AT & T Techs., Inc. v. Commc'ns Workers of America,* 475 U.S. 643, 649, 106 S.Ct. 1415, 89 L.Ed.2d 648 (1986)). These limited circumstances typically involve certain "gateway matters," such as whether the parties have a valid arbitration agreement at all, or whether an arbitration clause applies to a certain type of controversy. *Id.* Thus, the prevailing authority supports the notion that courts may have at least a limited role where an arbitration clause otherwise applies.

In this case, the trial court was the proper forum for determining the enforceability of the arbitration clause in the contract between Simpson and Addy. Although the clause specifically stated that arbitration applied to issues involving "the validity and scope of this contract," Simpson challenged the validity of the arbitration provision on grounds of unconscionability, bringing into question whether an arbitration agreement even existed in the first place. Under the UAA, ***24** the question of this clause's validity was for the court to decide. *See* S.C.Code Ann. § 15-48-20(a) (2005).

Furthermore, because Simpson has challenged the validity of the entire arbitration clause on grounds of unconscionability, there can be no "clear and unmistakable" evidence that the parties actually agreed to arbitrate the gateway matter of the arbitration clause's validity. Accordingly, the trial court did not err in ruling on the issue of validity instead of submitting the issue itself to arbitration.

II. Denial of Addy's motion for protective order and/or to stay and compel arbitration.

Addy argues that the trial court erred in denying Addy's motion for protective order and/or to stay and compel arbitration. We disagree.

[7][8] There is a strong presumption in favor of the validity of arbitration agreements because both state and federal policy favor arbitration of disputes. *Towles,* 338 S.C. at 34, 524 S.E.2d at 842. The South Carolina Uniform Arbitration Act (UAA) provides that in any contract evidencing a transaction involving commerce, a written provision to settle by arbitration shall be valid, irrevocable, and enforceable. S.C.Code Ann. § 15-48-10(a) (2005). Unless a court can say with positive assurance that the arbitration clause is not susceptible to an interpretation that covers the dispute, arbitration should generally be ordered. *Zabinski,* 346 S.C. at 597, 553 S.E.2d at 118.

[9] Despite these clear rules, arbitration is a matter of contract law and is available only when the parties involved contractually agreed to arbitrate. *Towles,* 338 S.C. at 37, 524 S.E.2d at 843-44. Accordingly, a party may seek revocation of the contract under "such grounds as exist at law or in equity," including fraud, duress, and unconscionability. S.C.Code Ann. § 15-48-10(a). Arbitration will be denied if a court determines no agreement to arbitrate existed. S.C.Code Ann. § 15-48-20(a).

[10][11] General contract principles of state law apply in a court's evaluation of the enforceability of an arbitration clause. *Munoz,* 343 S.C. at 539, 542 S.E.2d at 364. In South Carolina, ***25** unconscionability is defined as the absence of meaningful choice on the part of one party due to one-sided contract provisions, together with terms that are so oppressive that no reasonable person would make them and no fair and honest person would accept them. *Carolina Care Plan, Inc. v. United HealthCare Servs., Inc.,* 361 S.C. 544, 554, 606 S.E.2d 752, 757 (2004). If a court as a matter of law finds any clause of a contract to have been unconscionable at the time it was made, the court may refuse to enforce the unconscionable clause, or so limit its application so as to avoid any unconscionable result. S.C.Code Ann. § 36-2-302(1) (2003).

In analyzing claims of unconscionability in the context of arbitration agreements, the Fourth Circuit has instructed courts to focus generally on whether the arbitration clause is geared towards achieving an unbiased decision by a neutral decision-maker. *See* ****669***Hooters of Am., Inc. v. Phillips,* 173 F.3d 933, 938 (4th Cir.1999). It is under this general rubric that we determine whether a contract provision is unconscionable due to both an absence of meaningful choice and oppressive, one-sided terms.

A. Absence of meaningful choice

Addy argues that the facts do not show that Simpson had no meaningful choice in agreeing to arbitrate. We disagree.

[12][13] Absence of meaningful choice on the part of one party generally speaks to the fundamental fairness of the bargaining process in the contract at issue. *See Carlson v. General Motors Corp.,* 883 F.2d 287, 295 (4th Cir.1989). In determining whether a contract was "tainted by an absence of meaningful choice," *id.* at 295, courts should take into account the nature of the injuries suffered by the plaintiff; whether the plaintiff is a substantial business concern; the relative disparity in the parties' bargaining power; the parties' relative sophistication; whether there is an element of surprise in the inclusion of the challenged clause; and the conspicuousness of the clause. *Id.* at 293. *See also Holler v. Holler,* 364 S.C. 256, 269, 612 S.E.2d 469, 476 (Ct.App.2005) ("A determination whether a contract is unconscionable depends upon all the facts and circumstances of a particular case." (quoting 17A AM.JUR.2D *Contracts* § 279 (2004))).

***26** There are many cases in this jurisdiction and others involving the enforceability of arbitration clauses in adhesion contracts between commercial entities and consumers. Each transaction is analyzed on its own particular facts in conjunction with the federal and/or state policies favoring arbitration. We begin our inquiry with a focus on the decisions of courts in Ohio, which have heard numerous cases in the very recent past specifically addressing issues of unconscionability of arbitration clauses embedded in adhesion contracts between automobile retailers and consumers. *See Long v. N. Ill. Classic Auto Brokers,* 2006 WL 3783507 (Ohio Ct.App. 9th Dist.2006); *Felix v. Ganley Chevrolet, Inc.,* 2006 WL 2507469 (Ohio Ct.App. 8th Dist.2006), *Eagle v. Fred Martin Motor Co.,* 157 Ohio App.3d 150, 809 N.E.2d 1161 (9th Dist.2004) ; *Battle v. Bill Swad Chevrolet, Inc.,* 140 Ohio App.3d 185, 746 N.E.2d 1167 (10th Dist.2000).

The Ohio courts characterize automobiles as a "necessity" and factor this characterization into a determination of whether a consumer had a "meaningful choice" in negotiating the arbitration agreement. *See, e.g., Eagle,* 809 N.E.2d at 1175; *Cf. Henningsen v. Bloomfield Motors, Inc.,* 32 N.J. 358, 161 A.2d 69, 85 (1960) (invalidating auto manufacturer's standard-form disclaimers of implied warranties because such disclaimers frustrated consumer protection legislation given that in modern times, "automobiles are a common and necessary adjunct of daily life"). In this same context, the Ohio courts have adhered to the idea that sales agreements between consumers and retailers "are subject to considerable skepticism upon review, due to the disparity in bargaining positions of the parties." *Eagle,* 809 N.E.2d at 1179. Under the Ohio courts' rationale, "the presumption in favor of arbitration clauses is substantially weaker when there are strong indications that the contract at issue is an adhesion contract, and the arbitration clause itself appears to be adhesive in nature. In this situation there arises considerable doubt that any true agreement ever existed to submit disputes to arbitration." *Williams v. Aetna Fin. Co.,* 83 Ohio St.3d 464, 700 N.E.2d 859, 866 (1998).

[14][15][16] Turning to the instant case, we first note that under general principles of state contract law, an adhesion contract is a standard form contract offered on a "take-it-or-***27** leave-it" basis with terms that are not negotiable. *Munoz v. Green Tree Fin. Corp.,* 343 S.C. 531, 541, 542 S.E.2d 360, 365 (2001). Neither party disputes that the contract entered into by Simpson and Addy was an adhesion contract as such contracts are standard in the automobile retail industry. Adhesion contracts, however, are not per se unconscionable. Therefore, finding an adhesion contract is merely the beginning point of the analysis. *Lackey v. Green Tree Fin. Corp.,* 330 S.C. 388, 395, 498 S.E.2d 898, 902 (Ct.App.1998).

****670** We agree with the rationale of the Ohio courts and proceed to analyze this contract between a consumer and automobile retailer with "considerable skepticism." Under this approach, we first observe that the contract between Simpson and Addy involved a vehicle intended for use as

Simpson's primary transportation, which is critically important in modern day society. Applying the factors considered by the Fourth Circuit in analyzing arbitration clauses, we also acknowledge Simpson's claim that she did not possess the business judgment necessary to make her aware of the implications of the arbitration agreement, and that she did not have a lawyer present to provide any assistance in the matter. *But see Munoz,* 343 S.C. 531, 542 S.E.2d 360 (failing to factor in the weaker party's status as a consumer in analyzing an unconscionability claim in an arbitration agreement between a consumer and a lender). Similarly, we note Simpson's allegation that the contract was "hastily" presented for her signature.

Moreover, regardless of the general legal presumptions that a party to a contract has read and understood the contract's terms,[FN2] we also find it necessary to consider the otherwise inconspicuous nature of the arbitration clause in light of its consequences. The loss of the right to a jury trial is an obvious result of arbitration. However, this particular arbitration clause also required Simpson to forego certain remedies that were otherwise required by statute.[FN3] While certain ***28** phrases within other provisions of the additional terms and conditions were printed in all capital letters,[FN4] the arbitration clause in its entirety was written in the standard small print, and embedded in paragraph ten (10) of sixteen (16) total paragraphs included on the page. Although this Court acknowledges that parties are always free to contract away their rights, we cannot, under the circumstances, ignore the inconspicuous nature of a provision, which was drafted by the superior party, and which functioned to contract away certain significant rights and remedies otherwise available to Simpson by law. Furthermore, and contrary to Addy's argument, the present transaction may be distinguished from that in *Carolina Care Plan, Inc. v. United HealthCare Services, Inc.,* 361 S.C. 544, 606 S.E.2d 752 (2004), where both parties were sophisticated business interests in an arms-length negotiation.

FN2. *See Munoz,* 343 S.C. at 541, 542 S.E.2d at 365 ("[A] person who can read is bound to read an agreement before signing it."); *Towles,* 338 S.C. at 39, 524 S.E.2d at 845 ("[T]he law does not impose a duty to explain a document's contents to an individual when the individual can learn the contents simply from reading the document.").

FN3. Specifically, the arbitration clause prohibited an arbitrator from awarding double or treble damages.

FN4. This included phrases in the "Disclaimer of Warranties" provision and the "Used Vehicle Disclosure." We note that S.C.Code Ann. § 36-2-316 (2003) requires disclaimers of implied warranties to be "conspicuous."

Accordingly, we find that when considered as a whole and in the context of an adhesion contract for a vehicle trade-in, the circumstances reveal that Simpson had no meaningful choice in agreeing to arbitrate claims with Addy.

B. Oppressive and one-sided terms

1. Limitation on statutory remedies in an arbitration clause

[17] Addy contends that the arbitration clause's limitation on statutory remedies was not oppressive and one-sided. We disagree.

The arbitration clause in Simpson's contract with Addy provides that "[i]n no event shall the arbitrator be authorized to award punitive, exemplary, double, or treble damages (or any other damages which are punitive in nature or effect) against either party." Simpson's underlying complaint filed in civil court alleged, among other things, that Addy violated the South Carolina Uniform Trade Practices Act (SCUPTA) and the South Carolina Regulation of Manufacturers, Distributors, and Dealers Act (Dealers Act). The SCUPTA requires a ***29** court to award treble damages for violations of the statute.[FN5] Similarly, the Dealers Act requires a court to ****671** award double damages for violations of the statute.[FN6]

FN5. *See* S.C.Code Ann. § 39-5-140(a) (1976) (providing that a "court *shall* award three times the actual damages sustained and may provide such other relief as it deems necessary or proper" [emphasis added]).

FN6. *See* S.C.Code Ann. § 56-15-110(1) (2006) (providing that an individual "*shall* recover double the actual damages by him sustained" [emphasis added]).

In arguing that this provision was not oppressive and one-sided, Addy relies on *Carolina Care Plan.* In that case, this Court held that the issue of whether an arbitration clause prohibiting an arbitrator from awarding "punitive damages" violated the public policy of the SCUTPA was not ripe for review. 361 S.C. 544, 606 S.E.2d 752. The Court explained that "an arbitrator may or may not choose to award treble damages in accordance with the SCUTPA, depending upon whether an arbitrator finds the SCUPTA was violated and whether the arbitrator finds that statutory treble damages are punitive or compensatory damages." *Id.* at 557, 606 S.E.2d at 759 (discussing *PacifiCare Health Systems v. Book,* 538 U.S. 401, 123 S.Ct. 1531, 155 L.Ed.2d 578 (2003) (holding it was premature to conclude that meaningful relief for the plaintiff under RICO was unavailable in arbitration because the arbitrator may conclude that a restriction on "punitive damages" in an arbitration clause did not preclude the authorization of treble damages under RICO)).

Addy's comparison falls short. In fact, the present case requires the *Carolina Care Plan* analysis to be taken one step further because the arbitration clause at issue here goes beyond banning "punitive" damages generally and specifically prohibits an arbitrator from awarding statutorily required treble or double damages. Therefore, an arbitrator's ultimate classification of an award as "compensatory" or "punitive" is no longer relevant in an analysis of whether this particular clause is unconscionable: under this arbitration clause, treble and double damages-whether classified as compensatory or punitive-are prohibited outright.

The general rule is that courts will not enforce a contract which is violative of public policy, statutory law, or provisions ***30** of the Constitution. *Carolina Care Plan,* 361 S.C. at 555, 606 S.E.2d at 758. In our opinion, this rule has two applications in the present case. First, this arbitration clause violates statutory law because it prevents Simpson from receiving the mandatory statutory remedies to which she may be entitled in her underlying SCUTPA and Dealers Act claims. Second, unconditionally permitting the weaker party to waive these statutory remedies pursuant to an adhesion contract runs contrary to the underlying statutes' very purposes of punishing acts that adversely affect the public interest.[FN7] Therefore, under the general rule, this provision in the arbitration clause is unenforceable.

FN7. This Court has previously recognized the strong public policy notions behind the enactment of the SCUPTA and the Dealers Act. *See deBondt v. Carlton Motorcars, Inc.,* 342 S.C. 254, 263, 536 S.E.2d 399, 404 (Ct.App.2000) ("It is a violation of the Dealers Act for any manufacturer or motor vehicle dealer 'to engage in any action which is arbitrary, in bad faith, or unconscionable and which causes damage to any of the parties or to the public.' " (citing S.C.Code Ann. § 56-15-40(1) (1991))); *Young v. Century Lincoln-Mercury, Inc.,* 302 S.C. 320, 326, 396 S.E.2d 105, 108 (Ct.App.1989) (defining an unfair trade practice as a practice which is "offensive

> to public policy or which is immoral, unethical, or oppressive"), *aff'd in part, rev'd in part, on other grounds,* 309 S.C. 263, 422 S.E.2d 103 (1992) (per curiam). The Dealers Act also specifically provides that "any contract or part thereof or practice thereunder in violation of any provision of this chapter shall be deemed against public policy and shall be void and unenforceable." S.C.Code Ann. § 56-15-130 (2006).

Accordingly, we find the provision prohibiting double and treble damages to be oppressive, one-sided, and not geared toward achieving an unbiased decision by a neutral decision-maker. In conjunction with Simpson's lack of meaningful choice in agreeing to arbitrate, this provision is an unconscionable waiver of statutory rights, and therefore, unenforceable.

2. Dealer's remedies not stayed pending outcome of arbitration

[18] Addy argues that the arbitration clause's provision reserving certain judicial remedies to the dealer and authorizing the award of the dealer's remedies even if the consumer's arbitration proceedings have not concluded is not oppressive and one-sided. We disagree.

****672 *31** While stating that "all disputes, claims or controversies between Dealer and Customer" are to be settled in binding arbitration, the arbitration clause notes several exceptions. Specifically, the clause provides:

> Nothing in this contract shall require the Dealer to submit to arbitration any claims by Dealer against Customer for claim and delivery, repossession, injunctive relief, or monies owed by Consumer in connection with the purchase or lease of any vehicle and *any claims by Dealer for these remedies shall not be stayed pending the outcome of arbitration.* [emphasis added].

Our courts have held that lack of mutuality of remedy in an arbitration agreement, on its own, does not make the arbitration agreement unconscionable. *See Munoz,* 343 S.C. at 542, 542 S.E.2d at 365 (holding that an arbitration agreement between a consumer and a lender was not unconscionable where it allowed the lender to seek foreclosure while requiring the consumer to arbitrate any counterclaim in the foreclosure action); *Lackey v. Green Tree Financial Corp.,* 330 S.C. at 402, 498 S.E.2d at 905 (same). The primary basis for this conclusion in *Munoz* and *Lackey* was that requiring one party to seek a remedy through arbitration rather than the judicial system did not deprive that party of a remedy altogether. *See Munoz,* 343 S.C. at 542, 542 S.E.2d at 365. The *Lackey* court additionally explained that the judicial remedies which the lender in that case had reserved for itself (*i.e.* replevin and foreclosure actions) provided specific procedures for protecting the collateral and the parties during the pendency of the arbitration proceedings. *Lackey,* 330 S.C. at 401, 498 S.E.2d at 905. Because these protections related to both parties and were facilitated by enforcement procedures specified by law, the court of appeals concluded that, regardless of the lack of mutuality of remedy, the arbitration clause bore "a reasonable relationship to the business risks" inherent in secured transactions. *Id.*

However, the essence of Simpson's unconscionablity claim is not the general lack of mutuality of remedy, but rather the arbitration agreement's express stipulation that the dealer may bring a judicial proceeding that completely disregards any pending consumer claims that require arbitration. The clauses at issue in *Munoz* and *Lackey* contained no such ***32** directives. To this effect, we can easily envision a scenario in which a dealer's claim and delivery action is initiated in court, completed, and the vehicle sold prior to an arbitrator's determination of the consumer's rights in the same vehicle. As the arbitration agreement between Simpson and Addy is written, the dealer collects on a judgment awarded in a judicial proceeding regardless of any protections for the collateral afforded by law.

Addy's suggestion that there are procedural motions FN8 available to the consumer which offset any potentially inconsistent effects of this provision, in our opinion, shows an informal acknowledgement on the part of Addy that such a provision on its face is indeed one-sided. These procedural mechanisms only act to place an additional burden on the consumer to ensure that the vehicle in controversy is not disposed of in a court proceeding initiated by the dealer before the adjudication of the consumer's claims in arbitration.

> FN8. Specifically, Addy suggests that a motion for protective order or a motion to stay pending arbitration.

We continue to abide by our previous holdings in *Munoz* and *Lackey* that lack of mutuality of remedy will not invalidate an arbitration agreement. However, we find that the provision in the arbitration clause dictating that the dealer's judicial remedies supersede the consumer's arbitral remedies is one-sided and oppressive and does not promote a neutral and unbiased arbitral forum. Accordingly, in light of Simpson's lack of meaningful choice in agreeing to arbitrate, the provision is unconscionable and unenforceable.

3. Limitation on bringing warranty claims in a judicial forum

[19] Addy argues that Simpson may not attack the arbitration clause on the grounds that it violates the Magnuson-Moss Warranty Act (MMWA), **673 15 U.S.C.A § 2301 *et seq.* (1997), because Simpson's underlying claims alleged no violation of the MMWA. We disagree.

The arbitration clause in the contract between Simpson and Addy states that it applies to "any and all disputes" including "automobile warranty" and "any consumer protection statute" *33 -all of which implicate the MMWA. The provision further specifies that such matters are to be resolved only by " binding arbitration."

Rules promulgated by the Federal Trade Commission (FTC) state that informal dispute resolution procedures set forth in *written* warranties under the MMWA are not to be legally binding on any person. 16 C.F.R. § 703.5(j) (2006). *See also Richardson v. Palm Harbor Homes, Inc.,* 254 F.3d 1321 (11th Cir.2001). Moreover, the MMWA has been interpreted to supersede the FAA with respect to consumer claims for breach of written warranty. *See Boyd v. Homes of Legend, Inc.,* 981 F.Supp. 1423, 1437-38 (M.D.Ala.1997). Therefore, the federal government has made it clear that parties may not agree to arbitrate an MMWA claim as the arbitration clause between Simpson and Addy attempted to do here.

[20] This Court will not enforce a contract which is violative of public policy, statutory law, or provisions of the Constitution. *Carolina Care Plan,* 361 S.C. at 555, 606 S.E.2d at 758. The fact that Simpson did not bring a claim under the MMWA is irrelevant to our conclusion that the inclusion of the MMWA in the scope of the arbitration clause is unenforceable as a matter of public policy. Accordingly, we hold that this provision of the arbitration clause is an unconscionable and unenforceable violation of public policy.

C. Severability

In the alternative to its argument that the arbitration clause is not unconscionable, Addy suggests that any provision found by this Court to be unconscionable may be severed from the clause and arbitration allowed to otherwise proceed. In fact, it seems as though the "Additional Terms and Conditions" section of the contract anticipated just such a scenario. Paragraph fifteen (15) articulates a severability clause providing that:

> In the event any provision of this contract shall be held invalid, illegal, or unenforceable, the validity, legality, and *34 enforceability of the remaining provisions shall not be affected or impaired thereby.

We disagree.

In consideration of the federal and state policies favoring arbitration agreements, severability clauses have been used to remove the unenforceable provisions in an arbitration clause while saving the parties' overall agreement to arbitrate. *See Healthcomp Evaluation Servs. Corp. v. O'Donnell,* 817 So.2d 1095, 1098 (Fla.Ct.App.2d Dist.2002) (holding that an arbitration clause was divisible and therefore a severability provision acted to remove the unenforceable provision from the arbitration clause without affecting the intent of the parties); *Primerica Fin. Servs. v. Wise,* 217 Ga.App. 36, 456 S.E.2d 631, 635 (1995) (upholding the trial court's application of a severability clause to an arbitration agreement "in light of the liberal federal policy favoring arbitration agreements and the parties' intentions in entering into those agreements"). Additionally, legislation permits this Court to "refuse to enforce" any unconscionable clause in a contract or to "limit its application so as to avoid an unconscionable result." S.C.Code Ann. § 36-2-302(1) (2003).

At the same time, courts have acknowledged that severability is not always an appropriate remedy for an unconscionable provision in an arbitration clause. Although, "a critical consideration in assessing severability is giving effect to the intent of the contracting parties," the D.C. Circuit recently cautioned, "If illegality pervades the arbitration agreement such that only a disintegrated fragment would remain after hacking away the unenforceable parts, the judicial effort begins to look more like rewriting the contract than fulfilling the intent of the parties." *Booker v. Robert Half Intn'l Inc.,* 413 F.3d 77, 84-85 (D.C.Cir.2005) (citations omitted). Similarly, the general principle in this State is that it is not the function of the court to rewrite contracts for parties. ****674***Lewis v. Premium Inv. Corp.,* 351 S.C. 167, 171, 568 S.E.2d 361, 363 (2002).

[21] In this case, we find the arbitration clause in the adhesion contract between Simpson and Addy wholly unconscionable and unenforceable based on the cumulative effect of a number of oppressive and one-sided provisions contained within the entire clause. While this Court does not ignore ***35** South Carolina's policy favoring arbitration, we hold that the intent of the parties is best achieved by severing the arbitration clause in its entirety rather than "rewriting" the contract by severing multiple unenforceable provisions.[FN9]

FN9. We acknowledge that in light of the state and federal policies favoring arbitration, many courts view severing the offending provision and otherwise proceeding with arbitration to be the preferred remedy for an unconscionable provision in an arbitration clause. However, we find the present case is distinguishable from those cases prescribing severability such that the invalidation of the arbitration clause in its entirety is the more appropriate remedy.

First, the arbitration clause in the contract between Simpson and Addy contained a total of three unconscionable provisions while arbitration clauses examined by courts prescribing severability generally contained only one offending provision. *See Kristian v. Comcast Corp.,* 446 F.3d 25 (1st Cir.2006) (severing a provision in an arbitration clause that prohibited the award of treble damages); *Safranek v. Copart, Inc.,* 379 F.Supp.2d 927 (D.Ill.2005) (severing a provision in an arbitration clause that violated Title VII by requiring each party to bear its own attorney's fees and costs); *Ex parte Celtic Life Ins. Co.,* 834 So.2d 766 (Ala.2002) (severing a provision in an arbitration clause that was void as a violation of public policy by prohibiting the award of punitive damages); *Healthcomp Evaluation Servs. Corp.,* 817 So.2d 1095 (severing a provision in an arbitration clause that violated state law by not permitting the parties to appeal or review an arbitration award). *But see*

> *Primerica Fin. Servs. v. Wise,* 217 Ga.App. 36, 456 S.E.2d 631 (severing two provisions governing the eligibility of arbitrators and the judicial review of an arbitration). Second, two of the provisions in this case were found unconscionable because the provisions contravened state and federal consumer protection law. The sheer magnitude of unconscionability present in a provision that prevents a party from vindicating the party's statutory rights, along with the fact that such a grossly unconscionable provision occurred not once, but *twice,* requires that we give significant consideration to a remedy in this situation that best serves the interests of public policy. *See Graham Oil Co. v. ARCO Prods. Co.,* 43 F.3d 1244, 1249 (9th Cir.1994) (noting that severance of illegal provisions is inappropriate when the entire arbitration clause represents an "integrated scheme to contravene public policy" (citations omitted)).
>
> Accordingly, while this Court generally would encourage severability of an unconscionable provision, we do not view the arbitration agreement between Simpson and Addy to be a proper candidate for the application of this remedy. *See Ingle v. Circuit City Stores, Inc.,* 328 F.3d 1165, 1180 (9th Cir.2003); (finding arbitration agreement wholly unenforceable because of an "insidious pattern" of unconscionable provisions, and therefore "any earnest attempt to ameliorate the unconscionable aspects of [the] arbitration agreement would require [the] court to assume the role of contract author rather than interpreter"); *In re Cotton Yarn Antitrust Litig.,* 406 F.Supp.2d 585, 604 (M.D.N.C.2005) ("[W]here, as here, multiple provisions of the arbitration clauses are inconsistent with Plaintiffs' ability to effectively vindicate their statutory rights ..., the Court finds that the better course of action in this case is to excise the arbitration clauses altogether.").

***36** Additionally, we note that there is no specific set of factual circumstances establishing the line which must be crossed when evaluating an arbitration clause for unconscionability. Therefore, in holding today that the arbitration clause in the vehicle trade-in contract between Addy and Simpson is unconscionable due to a multitude of one-sided terms, we do not overrule our decision in *Munoz* where we held that an adhesion contract between a consumer and a lender was not unconscionable because it lacked mutuality of remedy. Instead, we emphasize the importance of a case-by-case analysis in order to address the unique circumstances inherent in the various types of consumer transactions.

Accordingly, we affirm the trial court's denial of the motion to compel arbitration.

III. Presentation of evidence to determine unconscionability

[22] Addy argues that the trial court erred in failing to provide Addy a reasonable opportunity to present evidence as to the commercial setting, purpose, and effect of the arbitration clause in order to aid the court in making a determination on unconscionability. We disagree.

S.C.Code Ann. § 36-2-302(2) (2003) provides:

> ****675** When it is claimed or appears to the court that the contract or any clause thereof may be unconscionable the parties shall be afforded a reasonable opportunity to present evidence as to its commercial setting, purpose and effect to aid the court in making the determination.

Simpson filed her memorandum in opposition to Addy's motion alleging the unconscionability of the arbitration clause on March 16. After a motion hearing that same day, the trial court ordered mediation. When mediation failed, the court ordered Addy to submit a memorandum in support of its motion, which it did on July 13. The court considered the arguments in both memoranda before issuing its order on August 12.

***37** In our opinion, the four months that passed between Simpson's memorandum and Addy's response was a "reasonable opportunity" for Addy to consider Simpson's arguments and respond with respect to the commercial setting, purpose, and effect of the arbitration clause. Accordingly, the trial court's consideration of the parties' memoranda without a hearing did not deny Addy a reasonable opportunity to present its evidence in order to aid the court's determination.

CONCLUSION

For the foregoing reasons, we find the arbitration clause between Simpson and Addy unconscionable and unenforceable in its entirety. Accordingly, we affirm the trial court's denial of Addy's motion to stay litigation pending arbitration.

MOORE, WALLER, BURNETT and PLEICONES, JJ., concur.
S.C.,2007.
Simpson v. MSA of Myrtle Beach, Inc.
373 S.C. 14, 644 S.E.2d 663, 62 UCC Rep.Serv.2d 217

END OF DOCUMENT

H

United States District Court,
D. South Carolina,
Charleston Division.
Kevin SMITH, a/k/a Bar-None Royal Blackness # 164920 Plaintiff,
v.
Jon OZMINT, Director of the South Carolina Department of Corrections, et. al., Defendants.
No. Civ.A. 04-1819.

March 31, 2006.

Background: State prison inmate sought temporary restraining order (TRO), barring enforcement of prison grooming standards requiring that his hair be cut, which he claimed was violation of his Rastafarian religious principles.

Holdings: The District Court, Duffy, J., held that:
(1) balance of harms did not favor issuance of TRO, and
(2) inmate failed to show less restrictive way of advancing prison's compelling interest in safety, sanitation and security.

Motion denied.

West Headnotes

[1] Civil Rights 78 ⚷1457(5)

78 Civil Rights
78III Federal Remedies in General
78k1449 Injunction
78k1457 Preliminary Injunction
78k1457(5) k. Criminal Law Enforcement; Prisons. Most Cited Cases
Prison inmate whose Rastafarian religion forbid cutting of hair failed to satisfy requirement that balance of harms favored him rather than prison, needed to obtain preliminary injunction barring cutting of his hair, under Religious Land Use and Institutionalized Persons Act (RLUIPA); grooming policy, adopted to further prison safety, sanitation and security, outweighed harm to inmate's religious practices. Religious Land Use and Institutionalized Persons Act of 2000, § 3(A)(1, 2), 42 U.S.C.A. 2000cc-1(a)(1, 2).

[2] Civil Rights 78 ⚷1457(5)

78 Civil Rights
78III Federal Remedies in General
78k1449 Injunction
78k1457 Preliminary Injunction
78k1457(5) k. Criminal Law Enforcement; Prisons. Most Cited Cases
Prison inmate failed to show there were less restrictive means to advance prison's compelling objectives, of maintaining safety, sanitation and security, than cutting of his hair, which would not involve violation of his Rastafarian religious principles, precluding grant of temporary restraining order barring haircutting. U.S.C.A. Const.Amend. 1; Religious Land Use and Institutionalized Persons Act of 2000, § 3(a)(1), (a)(2)(b), 42 U.S.C.A. § 2000cc-1(a)(1), (a)(2)(b).
***502** Kevin Smith, Columbia, SC, pro se.

Matthew B. Rosbrugh, William Henry Davidson, II, Davidson, Morrison and Lindemann, Columbia, SC, Sheally Venus Poe, Allen Kopet and Associates, Vinton Devane Lide, Vinton D. Lide and Associates, Lexington, SC, for Defendants.

*503 OPINION

DUFFY, District Judge.

This matter is before the court upon Kevin Smith, aka Bar None Royal Blackness's ("Plaintiff" or "Blackness") Motion for a temporary restraining order ("TRO") and/or preliminary injunction. Plaintiff is seeking an order from the court preventing the South Carolina Department of Corrections ("SCDC") from forcibly cutting his hair. Plaintiff alleges that, because hair-cutting is contrary to the tenants of Rastafarianism, such cutting of his hair is in violation of the Religious Land Use and Institutionalized Persons Act ("RLUIPA"). The record contains a report and recommendation of the Magistrate ("the R & R"), which was made in accordance with 28 U.S.C. § 636(b)(1)(B). A party may object, in writing, to a report and recommendation within ten days after being served with a copy of that report. 28 U.S.C. § 636(b)(1). Plaintiff has timely filed objections to the R & R, which recommended the denial of Plaintiff's requests for temporary restraining orders.

I. *BACKGROUND*

The current SCDC Policy regarding "Inmate Grooming Standards" (the "Policy") requires all male inmates' hair be "neatly cut (not to exceed one inch in length) and must remain above the shirt collar and above the ear (not touching the ear). Braids, plaits, Afros, blow-outs, Mohawks, etching of designs or patterns, or other extreme styles are not allowed." (See SCDC Policy No. OP-22.13, 1.1) The Policy requires that all inmates, regardless of religious objections, be in compliance with this standard. Inmates who refuse to comply with the inmate grooming standards "may be given forced haircuts or shaves." [FN1] (SCDC Policy No. OP-22.13, 3.3.)

> FN1. Prior to 2004, the SCDC's "Inmate Grooming Standards" allowed an exception for inmates claiming a religious objection from the general requirement that inmates have short hair and no beards. Under the old Policy, an inmate who refused to have his hair cut was allowed to keep his hair long, but was placed in custody level ML5, a higher security classification which permitted corrections officers to guard them more closely and thereby reduce the potential security and health problems caused by long hair. Director Jon Ozmint issued a memorandum changing this policy to the current Policy effective May 1, 2004.

Plaintiff, an inmate with the SCDC proceeding pro se, instituted this action by Complaint filed June 23, 2004. Plaintiff is a practicing member of the Rastafarian faith which, among other things, prohibits the cutting of hair. Plaintiff alleges that when he refused to comply with the SCDC grooming policy, he "is then sprayed with Cs gas directly in the face, then beaten and shackled by the forced cell movement team usually consisting of six or more prison guards, dragged across the floor to the barber shop to then be further assaulted by another SCDC inmate who is allowed per SCDC staff to participate in enforcing the SCDC grooming policy by shaving the Plaintiff's head with sharp clippers while covered with hazardous chemical agents [Cs gas]." (Pl. Mot. at 2.) Plaintiff has now filed a motion for TRO and/or preliminary injunction (Court Document No. 127), seeking an order from this court preventing the SCDC from forcibly cutting his hair and enjoining SCDC from allowing fellow inmates to cut his hair. [FN2]

> FN2. Plaintiff's claim that fellow inmates participate in forcing his compliance with the Policy was not addressed either by Defendants in their brief, or by the magistrate in the R & R.

II. *STANDARD OF REVIEW*

A. The R & R

The magistrate judge makes only a recommendation to this court. The recommendation***504** has no presumptive weight, and the responsibility to make a final determination remains with the court. *See Mathews v. Weber,* 423 U.S. 261, 96 S.Ct. 549, 46 L.Ed.2d 483 (1976). This court is charged with conducting a *de novo* review of any portion of the Magistrate Judge's R & R to which a specific objection is registered, and may accept, reject, or modify, in whole or in part, the recommendations contained in that R & R. 28 U.S.C. § 636(b)(1).

B. Religious Land Use and Institutionalized Persons Act [RLUIPA]

Plaintiff asserts as a cause of action violation of § 3 of RLUIPA in his original complaint. Section 3 of RLUIPA provides, in relevant part, that "[n]o government shall impose a substantial burden on the religious exercise of a person residing in or confined to an institution ... even if the burden results from a rule of general applicability," unless the government establishes that the burden furthers "a compelling government interest," and does so by "the least restrictive means." 42 U.S.C. § 2000cc-1(a)(1)-(2). RLUIPA defines "religious exercise" to include "any exercise of religion, whether or not compelled by, or central to, a system of religious belief." § 2000cc-5(7)(A). "A person may assert a violation of [RLUIPA] as a claim or defense in a judicial proceeding and obtain appropriate relief against a government." § 2000cc-2(a).

The Supreme Court recently upheld RLUIPA against a challenge under the Establishment Clause. *Cutter v. Wilkinson,* 544 U.S. 709, 125 S.Ct. 2113, 161 L.Ed.2d 1020 (2005). In *Cutter,* the Court found that RLUIPA's institutionalized-persons provision was compatible with the Court's Establishment Clause jurisprudence and concluded that RLUIPA "alleviates exceptional government-created burdens on private religious exercise." *Id.* at 2121. In upholding the act, the Court recognized RLUIPA "[a]s the latest of long-running congressional efforts to accord religious exercise heightened protection from government-imposed burdens," *id.* at 2117, and that Congress sought to provide inmates a mechanism to seek redress against the " 'frivolous or arbitrary' barriers [that] impeded institutionalized persons' religious exercise," *id.* at 2119; *see also id.* at 2115 (noting that RLUIPA's purpose is to "protect[ ] institutionalized persons who are unable freely to attend to their religious needs and are therefore dependent on the government's permission and accommodation of their religion"). Congress did this by replacing the "legitimate penological interest" standard articulated in *Turner v. Safley,* 482 U.S. 78, 89, 107 S.Ct. 2254, 96 L.Ed.2d 64 (1987), with the "compelling governmental interest" and "least restrictive means" tests codified at 42 U.S.C. § 2000cc-1(a). *See also Cutter,* 125 S.Ct. at 2119.

III. ***ANALYSIS***

In order to issue a preliminary injunction under Rule 65(b), this court must consider the following four factors: (1) the likelihood of irreparable harm to the plaintiff if the court denies the preliminary injunction; (2) the likelihood of harm to the defendants if the injunction is granted; (3) the likelihood that the plaintiff will succeed on the merits of his underlying claim; and (4) the public interest. *Blackwelder Furniture Co. v. Seilig Manuf. Co.,* 550 F.2d 189, 196 (4th Cir.1977). In the R & R, the magistrate found that (1) while Plaintiff will be irreparably harmed to the extent that continuing haircuts violate his sincerely held religious beliefs, (2) the harm to Defendants if they were not able to enforce the Policy outweighs the Plaintiff's possible harm; and, in any event, (3) Plaintiff is unlikely to succeed on the merits of his RLUIPA claim. Accordingly, the magistrate recommended denial of Plaintiff's motion for injunctive relief.

***505** Plaintiff argues that the magistrate erred both in finding that the harm to Defendants if the injunction were granted outweighs any harm suffered by the Plaintiff if it is denied and in finding that he has failed to show a sufficient likelihood of success on the merits of his claim to entitle him to the granting of a TRO. Further, Plaintiff objects that the R & R failed to address his request for a TRO and/or preliminary injunction "regarding an order to prohibit inmate participation in enforcing the SCDC grooming policy by participating in the forced grooming of the Plaintiff." The court considers each of Plaintiff's objections.

(1) The balancing of the potential harms to the parties should the injunctive relief be granted/denied.

[1] The magistrate, citing *Hines v. South Carolina Department of Corrections,* 148 F.3d 353, 358 (4th Cir.1998), found that the Policy causes the Plaintiff irreparable harm to the extent it violates Plaintiff's sincerely held religious beliefs. However, the magistrate further found that the "harm to Defendants if the injunction is granted outweighs any harm suffered by the Plaintiff." In so finding, the magistrate relied upon the affidavit of Robert Ward, the Department's Director of Division Operations. Ward sets forth numerous examples showing the importance of maintaining the Department's grooming Policy in order to maintain safety, sanitation, and security of the prison.

Plaintiff objects that his harm, which includes not only the violation of his religious beliefs but also the injuries he suffers from the use of force in ensuring his compliance with the Policy, far outweighs any harm which may come to Defendants from temporarily enjoining the enforcement of the Policy. Plaintiff reiterates that, according to his Rastafarian faith, the cutting of his hair distances him from God. He also describes the physical harm he suffers, including being sprayed in the face with CS gas while in shackles, then beaten and forcibly restrained while being shaved.

Plaintiff's claim is not frivolous and his harms are irreparable and substantial; however, in light of the special considerations that are involved in setting policy within a prison, the court is persuaded that the risk of harm to security and discipline within that environment arguably outweighs the restriction on this one aspect of an individual inmate's practice of his religion. *Morrison v. Garraghty,* 239 F.3d 648, 654 (4th Cir.2001) ("[I]t has long been recognized that, within the prison environment, courts grapple with yet another set of special considerations-those dictated by the needs and problems inherent in a penitentiary."). Accordingly, the court finds that the magistrate did not err in recommending that the balance of harms weighs in favor of Defendants.

(2) The likelihood Plaintiff will succeed on the merits of his underlying claim.

[2] Where there is no imbalance of hardship in a plaintiff's favor, plaintiff must make a "strong or substantial showing of likelihood of success on the merits." *Direx Israel, Ltd. v. Breakthrough Medical Corp.,* 952 F.2d 802, 818 (4th Cir.1991). The magistrate found that Plaintiff failed to make such a strong showing. Plaintiff objects that he has made such a showing.

Under RLUIPA, Plaintiff Blackness bears the initial burden of going forward with evidence to demonstrate a prima facie claim that SCDC's grooming policy, the physical enforcement of the policy by the guards and the punitive sanctions imposed designed to coerce him to comply with that policy constitute a substantial burden on the exercise of his religious beliefs. *See* 42 U.S.C. § 2000cc-2(b). If Blackness establishes the prima facie existence of such a substantial burden, on which he bears the ***506** burden of persuasion, the SCDC shall bear the burden of persuasion to prove that any substantial burden on Blackness's exercise of his religious beliefs is *both* "in furtherance of a compelling governmental interest" *and* the "least restrictive means of furthering that compelling governmental interest." 42 U.S.C. § 2000cc-1(a); § 2000cc-2(b). By its terms, RLUIPA is to be construed broadly in favor of protecting an inmate's right to exercise his religious beliefs. 42 U.S.C. § 2000cc-3(g) ("This chapter shall be construed in favor of a broad protection of religious exercise, to the maximum extent permitted by the terms of this chapter and the Constitution.").

1. Substantial Burden

The Nazarite Vow,[FN3] which forbids the cutting of hair, is part of the Rastafarian faith. Defendants do not contest the sincerity of Plaintiff's Rastafarian beliefs. The magistrate correctly found that a policy which requires hair to be cut, and ensures compliance by force, imposes a substantial burden to one of the Rastafarian faith.[FN4]

FN3. The Nazarite Vow, from Numbers 6:1-21 (King James Version) reads in relevant part as follows:

> And the LORD spake unto Moses, saying, Speak unto the children of Israel, and say unto them, *When either man or woman shall separate themselves to vow a vow of a Nazarite, to separate themselves unto the LORD:* He shall separate himself from wine and strong drink, and shall drink no vinegar of wine, or vinegar of strong drink, neither shall he drink any liquor of grapes, nor eat moist grapes, or dried. All the days of his separation shall he eat nothing that is made of the vine tree, from the kernels even to the husk. *All the days of the vow of his separation there shall no razor come upon his head: until the days be fulfilled, in the which he separateth himself unto the LORD, he shall be holy, and shall let the locks of the hair of his head grow.*

FN4. Defendants argue that the burden placed on Plaintiff is not "substantial" because he is allowed to practice other aspects of Rastafarianism and the prohibition on cutting of hair is not central to Plaintiffs beliefs. The magistrate rightly does not consider this argument. It is clear that RLUIPA bars inquiry into whether a particular belief or practice is "central" to a prisoner's religion, see 42 U.S.C. § 2000cc-5(7)(A). Accordingly, once it is established that a prohibition of cutting hair is a part of the Rastafarian faith, Defendants may not attack the relative importance of that tenet to the religion. *Cutter,* 125 S.Ct. at 2124 n. 13. The Act does not, however, preclude inquiry into the sincerity of a prisoner's professed religiosity. Cf. *Gillette v. United States,* 401 U.S. 437, 457, 91 S.Ct. 828, 28 L.Ed.2d 168 (1971) (" '[T]he "truth" of a belief is not open to question'; rather, the question is whether the objector's beliefs are 'truly held.' " (quoting *United States v. Seeger,* 380 U.S. 163, 185, 85 S.Ct. 850, 13 L.Ed.2d 733 (1965))).

2. Compelling State Interest

Because SCDC's grooming policy imposes a substantial burden on Blackness's religious exercise, SCDC must establish that the policy serves a compelling government interest. To this end, Defendants present the affidavit of Robert Ward, who states that long hair poses increased risks to security, as an inmate can more easily hide contraband in long hair and can more easily alter his appearance should he escape. Ward also states that short hair is more hygienic than long hair and is more easily searched. The Fourth Circuit has already recognized that prison grooming Policies requiring short hair serve the compelling state interests of security, safety, and sanitation. *Hines,* 148 F.3d at 358.[FN5] Accordingly,***507** the court finds that the magistrate correctly recommended that Defendants successfully showed that the Policy serves a compelling state interest.

FN5. Both the magistrate and Defendants rely heavily upon the Fourth Circuit's holding in *Hines;* however, the court notes that the Policy upheld in *Hines* was the older SCDC policy which allowed non-complying inmates to be placed in segregation rather than have their hair cut. *Hines,* 148 F.3d at 356 ("No prisoners are forcibly shaved or shorn. Instead, those inmates who refuse to comply with the Grooming Policy are reclassified to a more restrictive security level and moved to a higher security cell."). Further, because the claims in *Hines* were brought under the Constitution, *Hines* was analyzed under a less stringent standard than the "compelling state interest" and "least restrictive means" test of RLUIPA. Accordingly, the court only relies upon *Hines* to stand for the assertion that grooming policies do serve a compelling state interest.

3. Least Restrictive Means

Because it is clear that forced haircuts are a substantial burden on the free exercise of some religions and that prison policies requiring short hair do serve a compelling state interest, the only issue the court must decide is whether a policy which offers no exceptions for religious beliefs can be the least restrictive means. Most Circuits to have addressed this issue have held that prison grooming policies which, like the SCDC Policy, recognize no religious exceptions and allow the forced cutting of hair, can be the least restrictive option. *See Brunskill v. Boyd,* 141 Fed.Appx. 771 (11th Cir. May 10, 2005) (Florida Department of Corrections's hair length policy which required the forced cutting of hair was the least restrictive means in furthering compelling governmental interests in the security, health, and safety of inmates and staff, and, thus, did not violate the Religious Land Use and Institutionalized Persons Act (RLUIPA)); *Hoevenaar v. Lazaroff,* 422 F.3d 366 (6th Cir.2005) (remanding district court's holding that Ohio prison regulation restricting hair length without exception and allowing forced cutting of hair violated RLUIPA for failing to give proper deference to expertise and experience of prison officials who testified that the policy was the least restrictive means available); *Diaz v. Collins,* 114 F.3d 69 (5th Cir.1997) (Texas regulation requiring short hair was the "least restrictive means" under RFRA); *Hamilton v. Schriro,* 74 F.3d 1545 (8th Cir.1996) (prison hair length regulation was least restrictive means of maintaining prison's interest in safety and security). ***But see,*** *Williams v. Snyder,* 150 Fed.Appx. 549, 551-52 (7th Cir. Sept.26, 2005) (noting that "contrary to his assertions," plaintiff had not been required to cut his hair but "was also given the option of taking down his hair for a security inspection"); *Warsoldier v. Woodford,* 418 F.3d 989 (9th Cir.2005) (grooming policy of California Department of Corrections requiring male inmates to maintain hair no longer than three inches imposed substantial burden on Native American inmate's religious practice within meaning of RLUIPA *notwithstanding that he was not physically forced to cut his hair,* where he was subjected to punishments including confinement to his cell and reclassification into less desirable workgroup).

Within the Fourth Circuit, however, it has not been established that a grooming policy which offers no alternative to short hair can be the least restrictive workable policy. In fact, prior to the enactment of RLUIPA, the Fourth Circuit upheld the District Court for the Eastern District of Virginia's finding that a policy of forced haircuts regardless of religious objections violates the First Amendment. *Gallahan v. Hollyfield,* 516 F.Supp. 1004 (E.D.Va.1981), *aff'd,* 670 F.2d 1345 (4th Cir.1982). In that case, Plaintiff Gallahan, a Native American inmate whose religious beliefs proscribed the cutting of hair, brought a civil action under 42 U.S.C. § 1983, claiming that a Virginia prison grooming policy violated his constitutional right to free exercise of his religious beliefs. 670 F.2d at 1346. In 1980, a Virginia prison regulation, Division of Institutional Services Guideline ("guideline") 864, required all inmates***508** to keep their hair trimmed so that it did not extend below the top of the collar. *Id.* When Gallahan entered a Virginia prison, officials compelled him to cut his hair so that it complied with guideline 864, and Gallahan thereafter filed suit. *Id.* The district court found that Gallahan had a sincere religious belief requiring him to wear his hair long and that as applied in Gallahan's case, the grooming policy violated the First Amendment; therefore, the court enjoined the defendants and their successors from cutting plaintiff's hair. *Id.*

The Fourth Circuit affirmed, holding that "[p]rison regulations which affect a prisoner's right to worship must be reasonably and substantially justified by considerations of prison discipline and order and further must be in a form substantially warranted by the requirements of prison safety and order." 670 F.2d at 1346. The court noted that the defendants' asserted reasons for the grooming policy were "either overly broad or lacking in substance." *Id.* In support of their motion for summary judgment, defendants had not offered any empirical data demonstrating the compelling interests the state had in enforcement of the grooming policy, although they later asserted that such data was available. *Gallahan,* 516 F.Supp. at 1007 (order on motion to reconsider). Defendants also offered no evidence that there were no less restrictive alternatives to the regulation. *Id.*

The *Gallahan* case reflects the Fourth Circuit's efforts to protect the religious rights of inmates under the strict scrutiny test of *Sherbert v. Verner,* 374 U.S. 398, 403, 83 S.Ct. 1790, 10 L.Ed.2d 965 (1963), while at the same time recognizing the expertise and needs of professional prison officials in addressing difficult issues of prison administration, such as security and order. *Gallahan,* 670 F.2d at 1346, citing *Sweet v. South Carolina Dept. of Corr.,* 529 F.2d 854, 863 (4th Cir.1975); *Brown v. Peyton,* 437 F.2d 1228, 1231 (1971); *Abernathy v. Cunningham,* 393 F.2d 775 (4th Cir.1968). *See also Pell v. Procunier,* 417 U.S. 817, 827, 94 S.Ct. 2800, 41 L.Ed.2d 495 (1974) (mandating court deference to expert judgment of prison officials in matters of prison administration unless substantial evidence in the record indicates their response is exaggerated). Although the constitutional test applied in the 1982 *Gallahan* case was abrogated by subsequent Supreme Court cases that eliminated strict scrutiny for First Amendment claims in the prison context, *Hines v. South Carolina Dept. of Corr.,* 148 F.3d 353, 358 (4th Cir.1998), citing *Employment Division, Dep't of Human Resources v. Smith,* 494 U.S. 872, 876-79, 110 S.Ct. 1595, 108 L.Ed.2d 876 (1990) (formulating a "generally applicable regulation" test); *O'Lone v. Estate of Shabazz,* 482 U.S. 342, 349, 107 S.Ct. 2400, 96 L.Ed.2d 282 (1987) (formulating a "reasonably related to legitimate penological interests" test), RLUIPA returns the strict scrutiny test to prison litigation. Thus, *Gallahan* and related cases are instructive for district courts in the Fourth Circuit when applying the strict scrutiny test of RLUIPA while also deferring as required to the expertise of prison officials. *See Cutter v. Wilkinson,* 544 U.S. 709, 125 S.Ct. 2113, 2123, 161 L.Ed.2d 1020 (2005) (noting that courts applying RLUIPA must give "due deference to the experience and expertise of prison and jail administrators in establishing necessary regulations and procedures to maintain good order, security and discipline, consistent with consideration of costs and limited resources") (citations to congressional records omitted).

Recently, under the RLUIPA strict scrutiny test, the Western District of Virginia, applying the *Gallahan* rationale, found that a grooming policy requiring short hair and penalizing inmates for non-compliance was the least restrictive means ***509** available; however, that court relied heavily upon the fact that an inmate could *choose* to be placed in segregation rather that comply with the grooming policy. *Ragland v. Angelone,* 420 F.Supp.2d 507 (W.D.Va.2006) ("Ragland was not forced to cut his hair or beard. He continues to practice this aspect of his religious beliefs. This fact alone weighs heavily in favor of finding that the restrictions are proper."); *see also DeBlasio v. Johnson,* 128 F.Supp.2d 315 (E.D.Va.2000) (citing inmate for disciplinary violations and assigning him to segregation for refusing to comply with grooming policy does not violate constitutional rights).

Considering the Fourth Circuit's holding in *Gallahan* and the rulings in the more recent cases from Virginia, the court finds that it is far from clear that the SCDC Policy will be found to be the least restrictive means available. Nonetheless, the court agrees with the magistrate that Plaintiff does not make the strong showing of likelihood of success necessary to justify a preliminary injunction. As both *Gallahan* and *Cutter* make clear, courts must defer appropriately to the expertise of prison officials in matters of prison administration even when reviewing a prison regulation under the RLUIPA strict scrutiny standard. *Cutter,* 125 S.Ct. at 2123; *Ragland,* 420 F.Supp.2d 507, 519-20. Ward, a Director of Division Operations at SCDC, explained in an affidavit that the current Policy is the least restrictive available. Ward claims that the former policy allowing inmates to be segregated rather than comply with the Policy had become unworkable due to budgetary and space constraints.

While the court finds troubling the fact that SCDC operated successfully for many years under a grooming policy which allowed for exceptions, the court must defer to the prison official's testimony that the old policy has become cumbersome and impossible. Further, the court recognizes that the fact that one prison operates safely while under a less restrictive regulation is no evidence that another prison could so operate. *Ragland,* 420 F.Supp.2d at 519-20 ("To accept the logic of this argument the court would have to conclude that the least restrictive means necessary to serve the interests of one jurisdiction's prison system is the only lawful means to serve the same interests of another jurisdiction's system though they may be entirely different in terms of their history, inmate population, structure and funding.") Given the deference courts are required to show to opinions of experienced prison officials, Plaintiff cannot show a substantial likelihood of success to support the extreme remedy of a TRO.

(3) Plaintiff's claim that he was forcibly groomed of *by other inmates.*

The magistrate did not address Plaintiff's claim that fellow inmates, rather than SCDC employees, performed the haircuts on Plaintiff. If inmates are involved in forcing Plaintiff's compliance with the Policy, it is in express violation of SCDC Policies No. 29 providing that all "services such as ... barber ... will be provided by SCDC employees" and No. OP-22.14, "Inmate Disciplinary System," which forbids inmates from "exerting any authority over another inmate, to include (h) enforcing any SCDC or institutional or other governmental agency rule or regulation." According to SCDC's own policies, an inmate so exerting authority over another inmate is deemed to have committed a Level 3 Offense. In addition to being a violation of SCDC internal policies, Plaintiff contends that the practice of allowing inmates to participate in grooming him violates his Eighth Amendment right to be free from cruel and unusual punishment. Plaintiff therefore objects that the magistrate erred ***510** in failing to consider this claim for TRO and/or preliminary injunction.

Plaintiff offers no corroborating evidence to support his claim that SCDC officers allow fellow inmates to participate in forcibly grooming him. He submits no affidavits of prisoners who witnessed an inmate grooming Plaintiff, [FN6] nor has any Defendant admitted to allowing such inmate participation. [FN7] Generally, bald assertions and unsupported self-serving statements do not prevent dismissal of a complaint under Rule 12(b)(6). *Young v. City of Mount Ranier,* 238 F.3d 567 (4th Cir.2001). Accordingly, because his entire § 1983 claim is dependant on his own unsupported assertion, the court finds that Plaintiff has not made a sufficient showing of likelihood of success on the merits of this claim to support the granting of a TRO.[FN8] Therefore, to the extent the magistrate erred in failing to address this portion of Plaintiff's motion, such error was harmless.

FN6. Plaintiff does submit the affidavits of several fellow inmates who saw officers using force against him to ensure his compliance with the Policy; however, none of these inmates claims to have witnessed a fellow inmate participating in the use of force.

FN7. Plaintiff submits the Admissions of Defendant L. Bessinger, who admitted that "under no circumstances will any S.C.D.C. inmate enforce any S.C.D.C. or institutional or other governmental agency rules or regulations."

FN8. Should more evidence supporting Plaintiff's version of the facts come to light, the court does not rule out the possibility that Plaintiff may have a viable § 1983 claim for violation of his Eighth Amendment rights. The Eighth Amendment prohibits punishments which, although not physically barbarous, involve unnecessary and wanton infliction of pain; among unnecessary and wanton inflictions of pain are those that are totally without penological justification. *Rhodes v. Chapman,* 452 U.S. 337, 101 S.Ct. 2392, 69 L.Ed.2d 59 (1981). Certainly, allowing *fellow inmates,* rather than corrections officers, to forcibly shave him can serve no legitimate penological interest and may very well constitute "cruel and unusual punishment."

IV. *CONCLUSION*

For the reasons set forth above, the court adopts the R & R's recommended disposition and denies Plaintiff's motion for preliminary injunction. The court notes that this decision does not constitute the final decision on the merits of Plaintiff's claims; rather, it finds that he has failed to overcome the high burden necessary for preliminary relief.

It is therefore **ORDERED** that Plaintiff Blackness' Motion for Temporary Restraining Order and/or Preliminary Injunction is hereby **DENIED.**
AND IT IS SO ORDERED.

D.S.C.,2006.
Smith v. Ozmint
444 F.Supp.2d 502

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SUPER 7 MOTEL ASSOCIATES, Plaintiff and Appellant,
v.
KENNETH K. WANG, Defendant and Respondent.
No. D015647.

Court of Appeal, Fourth District, Division 1, California.
June 10, 1993.

SUMMARY

A buyer of real property sued the seller and its broker for fraud, seeking rescission or, alternatively, compensatory damages. The buyer recovered damages against the seller, but the broker's defense was successful, and the trial court granted his claim for attorney fees under the fee provision of the contract of sale. (Superior Court of San Diego County, No. N43620, Douglas R. Woodworth, Judge. FN*)

The Court of Appeal reversed the order granting attorney fees to the broker. The court held that as a nonparty to the contract of sale, the broker was not entitled to invoke the contractual attorney fee clause, even if he could be considered a third party beneficiary of the contract. The court also held that the broker could not prevail on the theory that the buyer was estopped from denying his right to fees after suing him as if he were a contracting party. He could only recover as a nonparty if he could have been liable for attorney fees on the contract, and, while he could have been held jointly and severally liable for consequential damages on the rescission claim, that liability would have been premised not on the contract but on fraud, and would have been ancillary to the contractual claim against the vendor.

FN* Retired judge of the San Diego Superior Court sitting under assignment by the Chairperson of the Judicial Council.(Opinion by Froehlich, J., with Kremer, P. J., and Todd, J., concurring.)

HEADNOTES

Classified to California Digest of Official Reports

(1) Costs § 25--Attorney Fees--Contract Provisions--General Principles.
Ordinarily attorney fees can only be awarded when the lawsuit (1) involves a claim covered by a contractual attorney fee clause, and (2) is between the parties to that contract. The first issue involves interpreting the parties' contract, and requires the court to examine the language of the contractual clause to determine whether the nature of the claims asserted by plaintiff fall within the intended scope of the attorney fee clause. The second issue also requires examination of the operative contract to determine if the parties to the lawsuit were also parties to the attorney fee clause covering the disputed claims. In some cases, however, the issue of whether the claim is between contracting parties also involves the reciprocity principles embodied in Civ. Code, § 1717, because under some circumstances a nonsignatory to the contract will be deemed entitled to the benefits of the attorney fee clause.

(2) Appellate Review § 145--Scope of Review--Function of Appellate Court-- Contract Interpretation.
Interpretation of a contract is a question of law and, in the absence of conflicting parol evidence, is subject to de novo analysis by the appellate court, which independently construes the contract to determine its scope and intent.

(3a, 3b) Costs § 27--Attorney Fees--Contract Provisions--Broker's Status as Party to Buy-sell Contract.
In an action by a buyer of real property alleging fraud by the seller and its broker, the trial court erroneously awarded the broker attorney fees under the attorney fee clause in the buy-sell contract, since the broker was not a party to that contract. Al-

though he was mentioned in the contract as the broker, he had no contractual obligations to either party or interest in the sale of the property. The lawsuit did not arise from the broker's commission agreement, the only agreement to which he was a signatory. If he were considered a party to the buy-sell contract, the attorney fee clause in the commission agreement would be redundant, because commission disputes would fall within the more general attorney fee clause in the buy-sell contract. Even if the broker was a third party beneficiary to the buy-sell contract, a third party beneficiary has only the right to collect the benefits the contracting parties agreed to confer on the third party; because the third party does not participate in reaching the agreement, he or she is not included in a clause providing for attorney fees.

(4) Contracts § 23--Interpretation--Giving Effect to Every Part.
A contract must be interpreted as a whole, with each clause aiding the interpretation in the attempt to give purpose to every part, and the interpretation should, where possible, give effect to every part so that no clause is redundant.

(5) Real Estate Sales § 41--Operation of Contract--Broker's Status as Third Party Beneficiary.
Where a buy-sell agreement specifically contains a promise to pay the broker, third party beneficiary rules are applicable. Without such a promise, however, the mere fact that a seller will use the proceeds to pay the broker does not make the broker a third party beneficiary.

(6a, 6b) Costs § 27--Attorney Fees--Contract Provisions--Recovery, Under Buy- sell Agreement, by Broker Unsuccessfully Sued for Rescission.
In an action by a buyer of real property alleging fraud by the seller and its broker, in which the broker's defense was successful, the trial court erroneously awarded the broker attorney fees under the attorney fee clause in the buy-sell contract, even though the broker was named as a defendant in causes of action seeking rescission. The broker, a nonsignatory to the contract, could not recover on the theory that the buyer was estopped from denying his right to fees after suing him as if he were a contracting party. He could only recover if he could have been liable for attorney fees on the contract. The claim against him, however, was not "on the contract," and the buyer neither sought nor could have obtained rescission against him. Although a broker is a proper party defendant to a claim seeking rescission for fraud, and can be held jointly and severally liable for consequential damages, this liability is not premised on the contract but on fraud, and is ancillary to the contractual claim against the vendor. Since a tort claim for damages carries no award of attorney fees, the broker could not not recover his fees under Civ. Code, § 1717.
[See 7 **Witkin,** Cal. Procedure (3d ed. 1985) Judgment, § 150.]

(7) Costs § 25--Attorney Fees--Contract Provisions--Action for Fraud--Where Rescission Is Sought.
An action for fraud seeking damages sounds in tort, and is not "on a contract" for purposes of an attorney fee award under Civ. Code, § 1717, even though the underlying transaction in which the fraud occurred involved a contract containing an attorney fee clause. However, a claim seeking rescission based on fraud does sound in contract and permits an award of fees.
[Attorney fees as recoverable in fraud action, note, 44 **A.L.R.4th** 776.]

COUNSEL

Jones, Hatfield, Penfield, Barden & Finegold and Thomas E. Polakiewicz for Plaintiff and Appellant.

Testa & Grady and James A. Testa for Defendant and Respondent. ***544**

FROEHLICH, J.

The trial court awarded attorney fees to defendant Kenneth K. Wang (Wang) following his successful defense of the fraud complaint filed by Super 7 Motel Associates (appellant). Appellant claims the attorney fee award was improper. We agree.

1. *Facts*

Appellant sued numerous parties in connection with its purchase of certain property. Appellant's complaint alleged the seller (Westland Motel Associates) had engaged in fraud by failing to disclose certain information about the property. Appellant alleged that Wang, the real estate broker for seller, engaged in the same fraud. Appellant's lawsuit sought rescission or, alternatively, fraud damages.

Though appellant recovered damages against seller, Wang was acquitted of liability. Wang subsequently requested his attorney fees and costs. He claimed fees under paragraph 14 of the "Real Estate Purchase Contract and Receipt for Deposit," the document containing the terms of appellant's offer to purchase the property from seller. Paragraph 14 stated: "In any action or proceeding arising out of this agreement, the prevailing party shall be entitled to reasonable attorney's fees and costs."

The document contained a separate section titled "Acceptance," which stated in part: "The undersigned Seller accepts and agrees to sell the property on the above terms and conditions. Seller has employed [Wang] as Broker and agrees to pay for services the sum of $100,000 [payable on certain conditions] .... In any action between Broker and Seller arising out of this agreement, the prevailing party shall be entitled to reasonable attorney's fees and costs."

Following the "Acceptance" section was a line for seller's signature, and a space reading, "Broker[] agree[s] to the foregoing," followed by a line for broker's signature.

2. *Attorney Fees Are Recoverable Only If There Is a Contract Between the Parties Containing an Attorney Fee Clause*

Our analysis begins with a recognition of certain fundamental principles. (1) Ordinarily attorney fees can only be awarded when the lawsuit (1) involves a claim covered by a contractual attorney fee clause (*Meininger v. Larwin-Northern California, Inc.* (1976) 63 Cal.App.3d 82, 84 ***545** [135 Cal.Rptr. 1]) and (2) is between the parties to that contract (*Canal-Randolph Anaheim, Inc. v. Wilkoski* (1978) 78 Cal.App.3d 477, 485 [144 Cal.Rptr. 474]). The first issue (the claims issue) essentially involves interpreting the parties' contract, and requires the court to examine the language of the contractual clause to determine whether the nature of the claims asserted by plaintiff fall within the intended scope of the attorney fee clause. (*Xuereb v. Marcus & Millichap, Inc.* (1992) 3 Cal.App.4th 1338, 1342-1344 [5 Cal.Rptr.2d 154].)

The second issue (the parties issue) also requires that we examine the operative contract to determine if the parties to the lawsuit were also parties to the attorney fee clause covering the disputed claims. In some cases, however, the parties issue also involves the reciprocity principles embodied in Civil Code section 1717, because under some circumstances a nonsignatory to the contract will be *deemed* entitled to the benefits of the attorney fee clause. (See discussion, *post,* at pt. 4.A.)

With these general principles in mind, we next evaluate the award of attorney fees here.

3. *Not Having Been a Party to the Contract, Wang Is Not Entitled to Attorney Fees*

The dispositive issue is whether Wang and appellant were parties to the contract containing the attorney fee clause. The relevant attorney fee clause, found at paragraph 14, is part of the purchase contract between appellant and seller, which contract specifies the obligations of each. (2)**(See fn. 1.)** We have examined the contract and conclude Wang was not a party thereto. FN1 (3a) Although Wang was mentioned in the contract as the broker, FN2 he had no contractual obligations or interest in the sale of the property. He was neither obliged nor able to convey title or otherwise satisfy the seller's obligations; he was not obliged to satisfy any of the buyer's obligations; and he had no contractual duty under the purchase contract to assist either party in discharging obligations under the contract.

FN1 Because interpretation of a contract is a question of law and, on this record, is subject to de novo analysis (*Winet v. Price* (1992) 4 Cal.App.4th 1159, 1165-1166 [6 Cal.Rptr.2d 554]), we independently construe the contract to determine its scope and intent.

FN2 The only mention of broker in the buy-sell portion of the contract is in paragraph 11. However, that provision merely contains buyer's and seller's consents to broker's reporting the financial details of the sale to members of broker's multiple listing service.

Wang raises two theories under which he claims to be a "party" to the buy-sell contract. First, as a factual matter, he claims he was a party because he was required to sign the document. However, this claim overlooks the ***546** fact that the document is in two parts: the first part is the buy- sell agreement, to which Wang was a stranger; the second part is the broker's commission agreement, to which he was a contracting party. Wang's signature, found in the portion of the document addressing broker's commission, signifies his assent to the terms of that aspect of the document. (Accord, *Weber v. Dobyns* (1961) 193 Cal.App.2d 402 [14 Cal.Rptr. 103].) The lawsuit here did not arise from the broker's commission agreement, the only agreement to which Wang was a signatory.

(4) Our conclusion that Wang was not a party to the buy-sell agreement is confirmed by construing the document according to certain rules of interpretation: A contract must be interpreted as a whole, with each clause aiding the interpretation in the attempt to give purpose to every part, and the interpretation should, where possible, give effect to every part so that no clause is redundant. (*Lawrence Block Co. v. Palston* (1954) 123 Cal.App.2d 300, 310 [266 P.2d 856].) (3b) Under Wang's interpretation *the attorney fee clause in the commission agreement would become redundant and unnecessary* because were Wang a party to the buy-sell agreement, commission disputes arising from the buy-sell contract would fall within the more general attorney fee clause contained in paragraph 14. FN3

FN3 Other language in the buy-sell contract supports our conclusion that paragraph 14's reference to "party" was intended to refer only to buyer and seller. First, the contract as a whole is focused on buyer and seller, with only a single inconsequential mention of broker. Second, the other contractual references to "parties" clearly focus on the buyer and seller: paragraph 13 discusses arbitrating any disputes "the parties" might have over buyer's deposit (a matter of no concern to broker); and paragraph 15 provides that any modifications or extensions of the contract must be in a writing signed by "the parties"; however, the parties (i.e., buyer and seller) certainly could modify their agreement without broker's signature. These clauses demonstrate broker is not a "party" within the contemplation of the buy-sell contract.

Wang alternatively argues he was a party to the contract as a matter of law because his entitlement to a broker's commission made him a third party beneficiary of the sale. This theory has two defects. First, even assuming a buy-sell contract automatically confers "third party beneficiary" status on the broker, Wang cites no authority suggesting a third party beneficiary has any right other than to collect the benefits the contracting parties agreed to confer on him. Indeed, the basic premise underlying attorney fee clauses, i.e., a party is not liable for attorney fees unless he agrees to the clause, is inconsistent with Wang's theory, because a third party beneficiary does not participate in reaching the agreement. Wang's theory would have the third party beneficiary bound by an agreement to which he did not consent.

A second and more fundamental flaw in Wang's argument is that this particular buy-sell agreement does not confer "third party beneficiary" status ***547** on Wang. In *Weber v. Dobyns, supra,* 193 Cal.App.2d 402, the court analyzed a document substantively identical to the document here, and concluded the broker was not a third party beneficiary of the buy-sell contract. In *Weber,* as here, the first part of a document contained the buyer's offer but no promise of payment to broker, yet the "acceptance" part of the document (signed by seller) contained the commission agreement. The *Weber* court concluded the document represented two distinct contracts: one between seller and buyer (the buy-sell contract) and one between seller and broker (the commission contract). Broker's rights derived from the latter agreement, and because the buy-sell contract contained no promise to pay broker, he was not a third party beneficiary of the buy-sell portion of the document. (*Id.* at pp. 406-408.)

(5)**(See fn. 4.)** Wang cites numerous cases loosely describing the broker as a third party beneficiary of a buy- sell agreement; however, close examination of those cases shows they are either factually or legally inapposite. [FN4] In *Donnellan v. Rocks* (1972) 22 Cal.App.3d 925 [99 Cal.Rptr. 692], for instance, the broker was originally hired by the buyer, but the buy-sell agreement stated seller would pay the commission. When buyer reneged on the purchase, broker sued the buyer. Although the *Donnellan* court loosely used third party beneficiary language, it held the buyer's liability rested on an entirely distinct basis: Buyer, by hiring broker, impliedly promised to purchase the property if procured on acceptable terms, and therefore buyer could be *liable for breaching that implied promise.* Thus buyer's liability was premised on his direct contractual relationship, not on third party beneficiary rules.

> FN4 Several cases are factually dissimilar. Two of the cases cited by Wang (*Calhoun v. Downs* (1931) 211 Cal. 766 [297 P. 548] and *Lane v. Davis* (1959) 172 Cal.App.2d 302 [342 P.2d 267]), for example, involved buy-sell agreements which specifically contained a promise to pay the broker; under such circumstances "third party beneficiary" rules are applicable. Without such a promise, however, the mere fact that a seller will use the proceeds to pay the broker does not make the broker a third party beneficiary.

We conclude that Wang was not a party to the contract, either factually or as a matter of third party beneficiary law, and hence cannot invoke the attorney fee clause.

4. *Wang Is Not Entitled to Attorney Fees Merely Because Appellant Named Wang as a Defendant in Its Causes of Action Seeking Rescission*

(6a) Wang finally urges he is entitled to collect his fees because appellant named Wang, along with others, as a defendant in its causes of action seeking rescission. This fact gives rise to two related contentions. First, Wang argues that a plaintiff who sues the nonsignatory as if he were a party ***548** to the contract is estopped from denying the nonsignatory's right to fees. Second, Wang argues he could have been liable for a rescission judgment, which rescission is an action on the contract, and hence reciprocity requires he be accorded the benefits of the contractual clause.

A. *Estoppel Does Not Apply*

Several cases hold that a plaintiff, having sued a nonsignatory on the contract as if the nonsignatory were a contracting party, becomes liable for fees when the nonsignatory prevails. Wang argues these cases premised their rulings on estoppel principles, i.e., the plaintiff, having sued the nonsignatory as if the nonsignatory were a party to the contract, is estopped from objecting to the fee award. However, the underlying rationale of those cases does not aid

Wang. Those cases involved lawsuits in which the plaintiff's claim, if successful, would have established the defendant was *in fact liable* on the contract even though the defendant was nominally a nonsignatory. In *Reynolds Metals Co. v. Alperson* (1979) 25 Cal.3d 124 [158 Cal.Rptr. 1, 599 P.2d 83], for example, the plaintiff brought suit to collect a note signed by the corporation, suing individual defendants on an alter ego theory. The *Reynolds* court recognized that the individual defendants, though nonsignatories to the note, would have been liable for attorney fees had plaintiff prevailed in establishing alter ego liability. Accordingly, the demands of reciprocity under Civil Code section 1717 required that such section be "interpreted to further provide a reciprocal remedy for a nonsignatory defendant, sued on a contract as if he were a party to it, when a plaintiff would clearly be entitled to attorney's fees should he prevail in enforcing the contractual obligation against the defendant." (*Reynolds, supra,* at p. 128.)

Thus, contrary to Wang's contention, *Reynolds* and similar cases [FN5] do not rely on estoppel. While *Manier v. Anaheim Business Center Co., supra,* 161 Cal.App.3d 503 and *Pas v. Hill* (1978) 87 Cal.App.3d 521 [151 Cal.Rptr. 98] suggested estoppel was the basis for the nonsignatory's right to fees, the court in *Leach v. Home Savings & Loan Assn.* (1986) 185 Cal.App.3d 1295 [230 Cal.Rptr. 553] convincingly explained these cases should be disregarded. First, *Manier* relied on *Pas,* but *Pas* was subject to extensive ***549** criticism and ultimately was overruled by the *Pas* court itself. More importantly, *Leach* explained that "estoppel" is inconsistent with the *Reynolds* requirement that the nonsignatory show the plaintiff would *actually* have been entitled to fees. (185 Cal.App.3d at pp. 1306-1307.)

> FN5 Thus, in *Babcock v. Omansky* (1973) 31 Cal.App.3d 625 [107 Cal.Rptr. 512], the prevailing nonsignatory had been sued on the allegation she was the partner or co-adventurer on the contract, and the court held she was entitled to fees because she would have been exposed to contractual liability had "co- adventurer" liability been shown. In the other cases cited by Wang, attorney fees were awarded based on a similar rationale: the plaintiff would have been entitled to collect the fees had he prevailed, and hence reciprocity demands the prevailing defendant be accorded the same right. (See, e.g., *Manier v. Anaheim Business Center Co.* (1984) 161 Cal.App.3d 503, 505-507 [207 Cal.Rptr. 508] [defendant, having established contract was unenforceable, was awarded fees because plaintiff would have been entitled to fees had he shown contract was enforceable]; *Care Constr., Inc. v. Century Convalescent Centers, Inc.* (1976) 54 Cal.App.3d 701 [126 Cal.Rptr. 761] [same].)

Since the crucial issue here is not merely estoppel, but is whether Wang could actually have been held liable for fees on the contract, we must examine Wang's related contention that he could have been liable for attorney fees as part of the rescission judgment.

B. *Wang's Liability Was Premised in Tort Rather Than Contract*

(7) We preliminarily note that an action for fraud seeking damages sounds in tort, and is not "on a contract" for purposes of an attorney fee award, even though the underlying transaction in which the fraud occurred involved a contract containing an attorney fee clause. (*Stout v. Turney* (1978) 22 Cal.3d 718, 730 [150 Cal.Rptr. 637, 586 P.2d 1228].) However, where the plaintiff's claim instead seeks rescission based on fraud, the courts have concluded such claim does sound in contract and permits the award of fees. (*Hastings v. Matlock* (1985) 171 Cal.App.3d 826, 841 [217 Cal.Rptr. 856] [action to rescind purchase agreement is an action to enforce the agreement].)

(6b) Wang claims that because appellant sued him for rescission and he could have been held jointly and severally liable for the rescission judgment, and because the action was "on the contract," fees should be awarded. However, appellant's claim against Wang was not "on the contract," and appellant neither sought nor could have obtained rescission of the contract *against Wang*. The contractual aspects of a complaint seeking rescission of the contract and restitution of the benefits presuppose that plaintiff and defendant occupy the relationship of vendor and vendee. (*Leavens v. Sharp* (1944) 66 Cal.App.2d 425, 429 [152 P.2d 460].) In *Leavens,* buyer obtained rescission based on fraud, with a judgment representing a portion of the purchase price against the broker. The *Leavens* court reviewed numerous cases which consistently held a defrauded buyer could obtain either rescission of the contract against the seller (with a judgment for return of the purchase price) or a judgment in fraud for damages against the broker, but a buyer could not obtain a rescission judgment against a nonvendor of the property. (*Id.* at pp. 428-430.)

It is true, as Wang points out, that a broker is a proper party defendant to a fraud claim seeking rescission, and that the broker can be held jointly and severally liable for the consequential damage award in that action. (*Snelson* ***550** *v. Ondulando Highlands Corp.* (1970) 5 Cal.App.3d 243 [84 Cal.Rptr. 800].) However, such liability is not premised on the contract. As the *Snelson* court explained, the 1961 amendments to the California Civil Code permitted a defrauded buyer to obtain both a rescission judgment (against the seller) and a judgment for consequential damages (jointly and severally against the broker and seller) in the same lawsuit. The *Snelson* court recognized, however, that the statutory changes were designed to allow a buyer to obtain consequential damages *in addition* to the rights accorded a rescinding party (e.g., restitution). The court stated: "It would appear not improper to hold all of the guilty defendants (who would be liable in an action for damages) jointly and severally liable on these [consequential] damages *as an ancillary remedy* to the principal remedy of rescission restoring plaintiffs to their status quo ante." (*Id.* at p. 254, italics added.) Thus, *Snelson* held the broker's liability in a rescission claim is a claim ancillary to the contractual claim against the vendor, and is premised in tort (i.e., fraud) rather than contract.

We thus conclude the broker's liability in a rescission claim springs from his own fraud, not from a contract to which he was not a party. Since a tort claim for damages carries no award of attorney fees (*Stout v. Turney, supra,* 22 Cal.3d at p. 730), Wang would not have been liable to appellant for fees, and hence Wang may not recover his fees under Civil Code section 1717.

Disposition

The order is reversed. Wang shall bear costs on appeal.

Kremer, P. J., and Todd, J., concurred.
Respondent's petition for review by the Supreme Court was denied September 2, 1993. ***551**

Cal.App.4.Dist.
Super 7 Motel Associates v. Wang
16 Cal.App.4th 541, 20 Cal.Rptr.2d 193

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United States District Court,
S.D. Florida.
David TOMASINI, Plaintiff,
v.
MOUNT SINAI MEDICAL CENTER OF FLORIDA, INC., a Florida corporation, d/b/a Mount Sinai Medical Center, Defendant.
No. 02-22044-CIV.

Feb. 20, 2004.

Background: Former chief medical officer sued hospital for breach of contract under Florida law, seeking severance pay and other accrued and earned benefits. Hospital counterclaimed, alleging fraud in the inducement. Former chief medical officer moved for summary judgment.

Holdings: The District Court, Altonaga, J., held that:
(1) hospital's later discovery that former chief medical officer had committed alleged acts constituting moral turpitude did not relieve hospital of its obligation to pay severance;
(2) hospital provided no evidence that former chief medical officer had lied regarding circumstances of his departure from his prior employment; and
(3) fact questions precluded summary judgment on hospital's claim for money had and received.

Motion granted in part.

West Headnotes

[1] Health 198H ⚷263

198H Health
198HI Regulation in General
198HI(C) Institutions and Facilities
198Hk259 Officers and Employees
198Hk263 k. Compensation and Benefits. Most Cited Cases
Hospital's later discovery that former chief medical officer, who was asked to resign due to change in hospital administration, had committed alleged acts constituting moral turpitude did not relieve hospital of its obligation to pay him 18 months of base pay plus 30% of his base pay as severance pursuant to contract providing for severance pay unless chief medical officer was asked to resign for cause, defined to include moral turpitude; hospital could have reserved right to investigate chief medical officer following termination, to ascertain whether during his tenure he had committed any acts constituting moral turpitude, and to deny severance benefits on basis of such after-acquired evidence, but did not.

[2] Labor and Employment 231H ⚷855

231H Labor and Employment
231HVIII Adverse Employment Action
231HVIII(B) Actions
231Hk855 k. Defenses in General. Most Cited Cases

Labor and Employment 231H ⚷876

231H Labor and Employment
231HVIII Adverse Employment Action
231HVIII(B) Actions
231Hk875 Judgment and Relief
231Hk876 k. In General. Most Cited Cases
After-acquired evidence doctrine shields employer from liability or limits available relief where, after termination, employer learns for first time about employee wrongdoing that would have caused employer to discharge employee.

[3] Labor and Employment 231H ⚷198

231H Labor and Employment
231HIV Compensation and Benefits
231HIV(A) In General
231Hk198 k. Additional Compensation in General. Most Cited Cases
(Formerly 255k72 Master and Servant)

Annual leave credits are wages under Florida law, and constitute compensation for services performed.

[4] Fraud 184 ⚷58(2)

184 Fraud
184II Actions
184II(D) Evidence
184k58 Weight and Sufficiency
184k58(2) k. Falsity of Representations and Knowledge Thereof. Most Cited Cases
Hospital provided no evidence that former chief medical officer had lied regarding circumstances of his departure from his prior employment to recruiter hired by hospital to help fill chief medical officer position, as required to support claim for fraud in the inducement under Florida law.

[5] Contracts 95 ⚷94(1)

95 Contracts
95I Requisites and Validity
95I(E) Validity of Assent
95k94 Fraud and Misrepresentation
95k94(1) k. In General. Most Cited Cases

Fraud 184 ⚷3

184 Fraud
184I Deception Constituting Fraud, and Liability Therefor
184k2 Elements of Actual Fraud
184k3 k. In General. Most Cited Cases
To prevail on claim for fraud in the inducement under Florida law, plaintiff must show: (1) misrepresentation of material fact, (2) knowledge by person making statement that representation is false, (3) intent by person making statement that representation would induce another to rely and act on it, and (4) that plaintiff suffered injury in justifiable reliance on representation.

[6] Fraud 184 ⚷23

184 Fraud
184I Deception Constituting Fraud, and Liability Therefor
184k19 Reliance on Representations and Inducement to Act
184k23 k. Relations and Means of Knowledge of Parties. Most Cited Cases
Hospital's claimed reliance on former chief medical officer's alleged misrepresentations of circumstances of his departure from his prior employment to recruiter hired by hospital to help fill chief medical officer position, in making decision to hire chief medical officer, was not justified, as required to support claim for fraud in the inducement under Florida law; hospital had advised recruiter that it wanted to perform its own reference calls, and chief medical officer was not hired until after hospital's search committee had conducted its own interviews of all candidates.

[7] Federal Civil Procedure 170A ⚷2497.1

170A Federal Civil Procedure
170AXVII Judgment
170AXVII(C) Summary Judgment
170AXVII(C)2 Particular Cases
170Ak2497 Employees and Employment Discrimination, Actions Involving
170Ak2497.1 k. In General. Most Cited Cases
Genuine issue of material fact as to whether hospital was entitled to return of second bonus paid to chief medical officer for given year precluded summary judgment on hospital's claim for money had and received under Florida law.
***1253** Neil F. McGuinness, Frank Howard Henry, Bennett Aiello Henry & McGuinness, Miami, FL, for David Tomasini, M.D., plaintiff.

Richard L. Lapidus, Miami, FL, for Mount Sinai Medical Center of Florida, Inc., a Florida corporation dba Mount Sinai Medical Center, defendant.

ORDER ON PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT

ALTONAGA, District Judge.

THIS CAUSE came before the Court on Plaintiff, David Tomasini, M.D.'s (hereinafter "Dr. Tomasini") Motion for Summary Judgment on Counts I & II of the Complaint and on MSMC's Affirmative Defenses and Counterclaims (**D.E.67**). The undersigned has carefully reviewed the parties' memoranda, statements of undisputed and disputed facts, applicable law, and the record.

I. *FACTUAL BACKGROUND*

In late December of 1998, Defendant, Mount Sinai Medical Center (hereinafter "Mount Sinai"), executed a contract with the executive search firm of Heidrick & Struggles ("H & S") to assist it in the search for a chief medical officer ("CMO"). By early 1999, a job specification had been finalized by both the Mount Sinai search committee and H & S, and a lengthy search process for the CMO began. A Mount Sinai search committee and Mount Sinai physicians interviewed prospective candidates, and at the conclusion of the process, Dr. Tomasini was selected.

As part of the selection process, H & S prepared a brochure that Dr. Tomasini did not see or approve, containing information about him that had been provided to H & S by Dr. Tomasini as a result of an interview by H & S recruiter, Chris Clark. According to Mount Sinai, it made its decision to hire the doctor based on the H & S brochure.[FN1] The brochure stated that "under no circumstances should the evaluation contained herein be transmitted to the candidate." During the interview, Clark did not ask Dr. Tomasini whether he had been terminated in the past. Indeed, Mount Sinai had not instructed Clark to focus on whether any of the candidates, including Dr. Tomasini, had been previously terminated from prior employers. With respect to his notes of the interview, Clark stated that "[t]hey're a combination of my notes of what he was telling me and my paraphrasing and impression of what he was telling me."

FN1. Mount Sinai had also told Clark that it would perform its own "reference calls."

After his selection, Dr. Tomasini negotiated an employment agreement with Mount Sinai dated May 6, 1999. On May 20, 1999, after having entered into the employment agreement with Mount Sinai, Dr. Tomasini completed a Mount Sinai application ***1254** form. In explaining why he had been "discharged or asked to resign" from Community Hospital, his previous employer, Dr. Tomasini wrote as the reason: "Change in Administration." Dr. Tomasini began working for Mount Sinai on or about June 7, 1999.

Bruce M. Perry, at that time Mount Sinai's Chief Executive Officer, amended Dr. Tomasini's employment agreement on October 13, 2000. It is undisputed that Perry had the authority to enter into the amendment and was not required to obtain approval for the amendment from the Mount Sinai Board of Trustees or anyone else. Although Mount Sinai has certainly indicated that "[a]n issue of fact exists as to whether the 'amendment' was ... authorized or is binding on the Hospital," no factual issue has been presented[FN2] by way of citations to the record, to rebut the evidence presented by Dr. Tomasini that Mr. Perry had the full and unrestricted authority to set compensation and enter into the amendment. The agreement was amended as follows:

FN2. The "factual issue" presented by Mount Sinai is stated as follows:

> The Amendment ... was intended not to simplify forms of administration, but simply to get more money out of Mount Sinai Hospital for Dr. Tomasini, ... Bruce Perry has testified that the 30% increase in severance was to be in lieu of life insurance and health benefits after severance. He admitted that David Tomasini did not have a right before the Amendment... to either health insurance or life insurance after severance.... He

> then testified that it might be in lieu of vacation benefits after severance .... He admitted, once you are fired, you don't get vacation. An issue of fact exists as to whether the "amendment" was supported by consideration, was authorized or is binding on the Hospital.
>
> (Def.'s Statement of Material Facts at 1-2).

The following paragraph contained in your letter of Agreement dated May 6, 1999 is being changed from:

• In the event you are asked to resign other than for cause, defined as conviction of a felony, moral turpitude or gross neglect of duties, you would be entitled to eighteen months of base salary as severance.

to:

• In the event you are asked to resign other than for cause, defined as conviction of a felony, moral turpitude or gross neglect of duties, you will be entitled to eighteen [sic] of base pay, paid monthly, plus 30% of base pay paid in one lump sum in lieu of benefits.

The lump sum payment was to be calculated based on eighteen months of base pay. According to Mount Sinai, "the sole effect [of the amendment] was to give Dr. Tomasini not only the 18 months base pay as severance, but 30 percent of that amount in addition as a lump sum." (*See* Countercl. II ¶ 18).

During his tenure at Mount Sinai, Dr. Tomasini received two performance-based bonuses, one on August 24, 2000 and one on February 5, 2001. He remained employed at Mount Sinai for approximately two years and five months, and until October 8, 2001, he reported to Perry. After Perry was terminated, Dr. Tomasini, too, was terminated by Perry's replacement, Steven Sonenreich. Other members of the management team were also later discharged.

At the time of Dr. Tomasini's termination, Mount Sinai was unaware of any grounds that would support a resignation for "moral turpitude or gross neglect of duties." FN3 The Plaintiff has also identified ten "key" witnesses who have testified they are not aware of any act or omission ***1255** of Dr. Tomasini that would constitute "gross neglect of duties" or "moral turpitude." Nonetheless, Mount Sinai maintains that,

> FN3. The parties concede that the ground of "conviction of a felony," as contained in the amendment to the employment agreement, is not at issue here.

> [a]lthough the corporate officer who terminated Plaintiff's employment was unaware at the time or [sic] the facts constituting "moral turpitude," Dr. Tomasini in fact, took monies to which he was not entitled from the Defendant, and received, without authority of the Board of Trustees or the Compensation Committee, an amendment to his Contract of Employment, for which there was no justification.

(*See* Def.'s Resp. to Pl.'s Req. for Admis. ¶ 2). Also,

> [t]he Defendant's Officer who made the decision to terminate Dr. Tomasini was, in fact, unaware of the facts constituting "gross neglect of duties." The Defendant corporation, however, was aware of these facts since the knowledge was possessed by a person who held that office prior to the officer who fired Dr. Tomasini.

(*See* Def.'s Resp. to Pl.'s Req. for Admis. ¶ 4). Dr. Tomasini did accept payment of a $41,625 bonus in February 2001 that Mount Sinai maintains he was not entitled to because it overlaps with a bonus he had earlier received in August of 2000. At the time he terminated Dr. Tomasini, Sonenreich was unaware that the bonus in question had been paid.

As it pertains to Dr. Tomasini's vacation, sick and holiday pay, his agreement with Mount Sinai provides: "You will be entitled to up to four weeks of paid vacation time per annum and other standard holiday and sick pay benefits." (May 6, 1999 Letter of Agreement). By the time he was terminated by Mount Sinai, Dr. Tomasini had accrued 173 hours of earned time off. At termination, an executive is entitled to be paid his earned time off.

Although the Vice President of Human Resources for Mount Sinai drafted a severance agreement for Dr. Tomasini that included amounts for salary, base pay, earned time off and deferred compensation, that agreement was not made final and Dr. Tomasini did not receive severance pay or other accrued and earned benefits. Dr. Tomasini therefore filed suit for breach of contract seeking to recover in Count I: 18 months of salary, for a total of $468,000; 173.6 hours of earned (but unpaid) vacation time, for a total of $26,040; and attorney's fees and costs. In Count II, he seeks the recovery of a lump sum payment of 30% of his base salary for eighteen months, as provided for in the October 13, 2000 amendment to the employment agreement, for a total of $140,400, as well as attorney's fees and costs. By Order dated January 2, 2004, summary judgment was denied as to Count III, pertaining to Dr. Tomasini's claim for supplemental retirement benefits. Count IV of the Complaint was earlier dismissed on October 27, 2003 pursuant to the parties' stipulation.

Mount Sinai, in Count I of its Counterclaim, alleges fraud in the inducement. It maintains it hired Dr. Tomasini in reliance upon misrepresentations contained in the H & S brochure, misrepresentations that the doctor allegedly made to the H & S recruiter. In Count II, incorrectly [FN4] labeled "Gross Neglect of Duties," Mount Sinai alleges that Dr. Tomasini, without authority, enriched himself by amending his employment agreement and converting funds of Mount Sinai (by accepting a duplicate bonus). These issues are also raised as affirmative defenses. Mount Sinai has ***1256** raised as "issues of fact" that need to be tried the following:

FN4. Mount Sinai now concedes the label it gave to Count II was "improvident," and that the cause of action it meant to allege is for money had and received or contract implied in fact. (*See* Def.'s Resp. to Order Requiring Further Briefing by Def.)

A. Whether during his tenure, as Executive Vice President of Mount Sinai Hospital, David Tomasini took $41,625 from the Hospital that he was not entitled to.

B. Whether anyone, who was aware that David Tomasini had received an annual bonus in the summer of 2000, authorized an additional annual bonus to be paid to him in February of 2001.

C. Whether a Senior Vice President of a charitable corporation commits gross neglect of duties, or an act condemned as moral turpitude by unlawfully taking $41,625 of the institutions [sic] money.

D. Whether anyone authorized the Addendum to the Contract increasing the severance for the Plaintiff.

E. Whether the Addendum to the Contract increasing the severance was supported by any consideration whatsoever.

F. Whether Dr. Tomasini deliberately lied to the search firm that recruited him regarding the termination of his employment at his prior job and when the Hospital knew or should have known of the lie.

(Def.'s Statement of Material Facts at 3-4).

II. *LEGAL ANALYSIS*

A. *Summary Judgment Standard*

Under Rule 56(c), Fed.R.Civ.P., a motion for summary judgment "shall be rendered forthwith if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law." The Supreme Court explained the movant's burden in *Celotex Corp. v. Catrett,* 477 U.S. 317, 106 S.Ct. 2548, 91 L.Ed.2d 265 (1986), as follows:

> In our view, the plain language of Rule 56(c) mandates the entry of summary judgment, after adequate time for discovery and upon motion, against a party who fails to make a showing sufficient to establish the existence of an element essential to that party's case, and on which that party will bear the burden of proof at trial.

Id. at 322, 106 S.Ct. 2548. The Court further stated that "Rule 56(c) therefore requires a non-moving party to go beyond the pleadings and by [its] own affidavits or by the 'depositions, answers to interrogatories, and admissions on file' designate 'specific facts showing that there is a genuine issue for trial.' " *Id.* at 324, 106 S.Ct. 2548.

Under this standard, the mere existence of "*some* alleged factual dispute between the parties will not defeat an otherwise properly supported motion for summary judgment, the requirement is that there be no *genuine* issue of *material* fact." *Anderson v. Liberty Lobby, Inc.,* 477 U.S. 242, 247-48, 106 S.Ct. 2505, 91 L.Ed.2d 202 (1986)(emphasis in original); *see also Matsushita Elec. Indus. Co. v. Zenith Radio Corp.,* 475 U.S. 574, 106 S.Ct. 1348, 89 L.Ed.2d 538 (1986). An issue is only "material" if it is a legal element of the claim under the applicable substantive law which might affect the outcome of the case. *Anderson,* 477 U.S. at 248, 106 S.Ct. 2505; *Allen v. Tyson Foods,* 121 F.3d 642, 646 (11th Cir.1997). An issue is "genuine" if the record taken as a whole could lead a rational trier of fact to find for the non-moving party. *Allen,* 121 F.3d at 646. Thus, while all of the evidence and the factual inferences drawn therefrom must be viewed in the light most favorable to the non-moving party, ***1257***Celotex,* 477 U.S. at 322-23, 106 S.Ct. 2548; *Allen,* 121 F.3d at 646, the non-moving party has a duty to present affirmative evidence to defeat a properly supported motion for summary judgment. *Anderson,* 477 U.S. at 252, 106 S.Ct. 2505. A mere "scintilla" of evidence in favor of the non-moving party, or evidence that is "merely colorable" or "not significantly probative," is not enough. *Id.; see also Mayfield v. Patterson Pump Co.,* 101 F.3d 1371, 1376 (11th Cir.1996) (conclusory allegations and conjecture cannot be the basis for denying summary judgment).

B. ***Counts I and II of the Complaint***

1. As to the Claim for Severance Benefits in Counts I and II of the Complaint, After-Acquired Evidence of Plaintiff's "Misconduct" Does Not Present a Triable Issue

[1] The parties concede that Dr. Tomasini was not asked to resign "for cause," which is defined by the parties' amended contract [FN5] as "a felony, moral turpitude or gross neglect of duties." Because there is no question regarding whether or not Dr. Tomasini committed a felony, the issue presented is if Mount Sinai's later discovery that Dr. Tomasini committed acts that constitute moral turpitude or gross neglect of duties would relieve Mount Sinai of its obligation to pay him eighteen months of base pay plus 30% of his base pay as severance. This is an issue of law for the court to resolve. The additional question presented in the summary judgment papers is whether on the factual record, the acts complained of come within the purview of moral turpitude or gross neglect of duties. This latter question is a mixed one of law and fact, which the undersigned does not reach in light of the conclusion reached on the first issue.

> FN5. Mount Sinai's argument that the amendment is not supported by consideration, and is therefore unenforceable, is raised for the first time in the summary judgment papers. This position is wholly lacking in merit as Florida law does not require there to be additional consideration for an amendment to an employment

agreement. Continued employment constitutes sufficient consideration. *See, e.g., South Miami v. Dembinsky,* 423 So.2d 988, 990 (Fla. 3d DCA 1982); *Coastal Unilube, Inc. v. Smith,* 598 So.2d 200 (Fla. 4th DCA 1992).

[2] The late discovery (during the litigation) by Mount Sinai of acts by Dr. Tomasini that it now seeks to use as a bar to the doctor's recovery of severance benefits, is tantamount to application of the after-acquired evidence doctrine. The after-acquired evidence doctrine "shields an employer from liability or limits available relief where, after a termination, the employer learns for the first time about employee wrongdoing that would have caused the employer to discharge the employee." *Schiavello v. Delmarva Sys. Corp.,* 61 F.Supp.2d 110, 113 (D.Del.1999) (quoting *Crawford Rehab. Services Inc. v. Weissman,* 938 P.2d 540, 547 (Colo.1997)). The parties concede that there is no Florida case addressing the use of the after-acquired evidence doctrine in the context of a wrongful discharge action that does not raise allegations of the deprivation of constitutional rights. Admittedly, in the context of a Title VII and Equal Pay Act claim, the Eleventh Circuit has followed and interpreted the Supreme Court decision of *McKennon v. Nashville Banner Publishing Co.,* 513 U.S. 352, 115 S.Ct. 879, 130 L.Ed.2d 852 (1995), to provide that the after-acquired evidence rule "applies to cases in which the after-acquired evidence concerns the employee's misrepresentations in a job application or resume, as well as cases in which the after-acquired evidence relates to employee wrongdoing during employment." *Wallace v. Dunn Construction Co. Inc.,* 62 F.3d 374, 379 (11th Cir.1995) (finding also that party relying***1258** on doctrine must prove that immediate discharge would have followed disclosure of employee's wrongdoing). But as to its application as a defense to a wrongful discharge or denial of severance benefits, outside the *McKennon* context, no Florida court has spoken in a published decision.[FN6]

FN6. The undersigned notes that it is Mount Sinai which seeks to use the after-acquired doctrine as a shield, and yet Mount Sinai cannot identify any Florida decisional or statutory law which supports such a defense.

Thus, as with any other breach of contract case, the undersigned is left with the task of construing the parties' contract and applying its unambiguous terms to the dispute presented. The applicable language is clear: "[i]n the event you are asked to resign other than for cause, ... you will be entitled to eighteen [months] of base pay, paid monthly, plus 30% of base pay paid in one lump sum...." Dr. Tomasini was precisely asked to resign other than for cause.

In a case from which applicable legal principles can be derived, *Barakat v. Broward County Housing Authority,* 771 So.2d 1193 (Fla. 4th DCA 2000), a county housing authority employee who had been terminated for cause sued to recover severance pay, and his case was dismissed. The employee was employed pursuant to a Broward County Housing Resolution, which provided that if he, Barakat, "should be terminated, then he will be given severance pay...." *Id.* at 1194. As a result of a conviction for filing false tax returns, Barakat could not continue with his employment and was terminated without severance pay. In reversing the trial court, who had implied "reasonableness" into the parties' contract, it was noted:

> [I]t is a well settled principle of contract law that where the terms of a contract are unambiguous, the parties' intent must be determined from within the four corners of the document. In the absence of ambiguity, the language itself is the best evidence of the parties' intent and its plain meaning controls. Contracts are to be construed in accordance with the plain meaning of the words contained therein.....If terminated, Barakat was entitled to severance pay in the amount due, as if his contract had run its full length.

It is never the role of a trial court to rewrite a contract to make it more reasonable for one of the parties or to relieve a party from what turns out to be a bad bargain.... Had the BCHA wanted to provide for severance pay only when Barakat was terminated without cause, it could have made that a requirement in the Resolution.

Id. at 1194-95 (citations omitted).

Similarly here, had Mount Sinai wanted to reserve to itself the right to investigate the doctor following a termination, to ascertain whether during his tenure he had committed any acts constituting moral turpitude or gross neglect of duties, and to deny severance benefits on the basis of such after-acquired evidence, Mount Sinai, as the drafter of the amendment, could have done so. It did not, and cannot now avail itself of information gathered during the course of litigation to deny severance benefits to one who was not terminated, at the time, for cause. Thus, Dr. Tomasini is entitled to summary judgment on his claim for severance pay as well as his claim for the 30% lump sum amount.

2. On Count I of the Complaint, Plaintiff is Entitled to Payment of "Earned Time Off"

[3] Mount Sinai has presented no issues of material fact or argument addressing Dr. Tomasini's request for 173.6 hours of "Earned Time Off". As Dr. Tomasini has correctly pointed out, "the payment of accrued leave time is an independent contractual right that the claimant and the ***1259** employer have agreed to as a *condition* of the claimant's employment." *Marion Corr. Inst. v. Kriegel,* 522 So.2d 45, 47 (Fla. 5th DCA 1988). Annual leave credits are wages and constitute compensation for services performed. *Strasser v. City of Jacksonville,* 655 So.2d 234, 236 (Fla. 1st DCA 1995). Therefore Dr. Tomasini is entitled to summary judgment on this claim of Count I.

C. *Counts I and II of the Counterclaim and the Affirmative Defenses*

1. There is no Issue of Fact as to Count I of the Counterclaim and the Affirmative Defense for Fraud in the Inducement

[4] In Count I of the Counterclaim, for fraudulent inducement,[FN7] Mount Sinai alleges that Dr. Tomasini retained H & S to prepare a brochure for himself that was submitted to Mount Sinai with Plaintiff's resume. The H & S brochure allegedly contained material misstatements as a result of information provided to H & S by Dr. Tomasini. Furthermore, Mount Sinai maintains it relied upon these misrepresentations to its detriment when it made its hiring decision on May 9, 1999. As a result, Mount Sinai seeks damages consisting of the "finding fee" that it paid to H & S for having hired Dr. Tomasini.

FN7. In its opposition memorandum, Mount Sinai focuses on a newly asserted "resume fraud" defense that is not alleged in its Affirmative Defenses or Counterclaim. Mount Sinai maintains that Dr. Tomasini committed "resume fraud" when he allegedly told Clark that he voluntarily left his employment, and therefore such fraud operates as a complete defense to the action for breach of an employment contract. Assuming that defense were even properly before the Court, as noted *infra,* Mount Sinai has failed to provide any evidence that Dr. Tomasini misrepresented to the recruiter that he voluntarily left Community Hospital.

Dr. Tomasini argues that the fraudulent inducement claim is barred by applicable limitations period, the Florida economic loss rule, and/or fails to state a legal claim. Because the Court finds that Mount Sinai cannot establish the elements of its fraudulent inducement claim, the statute of limitations and the economic loss rule arguments are not addressed.

[5] To prevail on its claim for fraud in the inducement, Mount Sinai must show: "(1) a misrepresentation of a material fact; (2) knowledge by the per-

son making the statement that the representation is false; (3) intent by the person making the statement that the representation would induce another to rely and act on it; and (4) that the plaintiff suffered injury in justifiable reliance on the representation." *Susan Fixel, Inc. v. Rosenthal & Rosenthal, Inc.*, 842 So.2d 204, 209 (Fla. 3d DCA 2003). All four elements must be shown.[FN8] Turning to the first element, Mount Sinai insists an issue of fact exists as to whether Dr. Tomasini lied to Clark so that the recruiter in turn could lie to Mount Sinai regarding the circumstances of the doctor's departure from his prior employment. Nonetheless, Mount Sinai fails to cite to any evidence supporting its position that Dr. Tomasini "lied" to the H & S recruiter.[FN9]

> FN8. Not all four are examined here, since the absence of evidence supporting any one element is fatal to the claim.

> FN9. Contrary to the allegations contained within the Counterclaim, H & S was retained by Mount Sinai and not Dr. Tomasini. H & S acted on behalf of Mount Sinai when it obtained information from the candidates for the CMO position.

Plaintiff admitted in his deposition as well as on Mount Sinai's application form that he had been discharged by Community Hospital, his previous employer.[FN10] ***1260** While the statements in the brochure suggest that he voluntarily left his former employer, contrary to Plaintiff's own admissions, there is no evidence that Dr. Tomasini provided such misleading information to the recruiter who prepared the brochure. Indeed, the portions of Clark's deposition that are a part of the record do not suggest that Dr. Tomasini misrepresented any information.

> FN10. **After** Dr. Tomasini was hired, he completed a form application on May 20, 1999. Although admittedly he checked off indicating he had been "discharged or asked to resign," Dr. Tomasini provided a reason ("change in administration") that may have been more benign than what had actually transpired. Nonetheless, Defendant does not suggest the "fraud" lies in such incomplete disclosure; rather, that the fraud inheres in the information purportedly given by the doctor to H & S.

In its opposition memorandum, Mount Sinai claims that the recruiter had been told by Dr. Tomasini that the doctor had "voluntarily left" his former employment. A review of the cited deposition transcript reveals that Clark did not make such a statement. Clark took notes of what Dr. Tomasini told him and paraphrased and wrote his impressions of what he was being told. Moreover, Clark stated that Mount Sinai did not instruct him to inquire of any of the candidates whether they had been terminated by their prior employers. Mount Sinai's attempt to hold Dr. Tomasini liable for statements made by its own agent, H & S, in a brochure that the Plaintiff did not see or have an opportunity to correct, is simply too attenuated based on the record before the Court.[FN11]

> FN11. It is the non-moving party's burden to present evidence to preclude the entry of summary judgment. While Defendant has raised the issue of whether Plaintiff lied to the recruiter in its Statement of Facts, the Court is not required to "scour the record to determine whether there exists a genuine issue of material fact to preclude summary judgment." *L.S. Heath & Son, Inc. v. AT & T Info. Sys. Inc.*, 9 F.3d 561, 567 (7th Cir.1993); *see also Skotak v. Tenneco Resins, Inc.*, 953 F.2d 909, 916 n. 7 (5th Cir.1992); *Lawrence v. Wal-Mart Stores, Inc.*, 236 F.Supp.2d 1314, 1322 (M.D.Fla.2002). Mount Sinai was required to "identify specific evidence in the record, and to articulate the 'precise manner' in which that evidence supported [its] claim." *Forsyth v. Barr*, 19 F.3d 1527, 1537 (5th Cir.1994) (quoting *Topalian v. Ehrman*, 954 F.2d 1125, 1131 (5th Cir.1992)). To

> the contrary here, Defendant's only reference to the record on this issue proved to be wholly inaccurate.

[6] Turning to the fourth element required for a fraudulent inducement claim, reliance on the brochure cannot be considered justifiable in light of Mount Sinai's own participation in the selection process for the CMO position. Mount Sinai advised H & S that it wanted to perform its own reference calls. Furthermore, Tomasini was not hired until after Mount Sinai's search committee had conducted its own interviews of all the candidates. Thus, the claimed reliance on the brochure is not supported by the record. As Mount Sinai fails to establish justifiable reliance on the alleged misstatements contained in the brochure, for this additional reason it cannot sustain a claim for fraud in the inducement. *See Hillcrest Pac. Corp. v. Yamamura,* 727 So.2d 1053, 1057 (Fla. 4th DCA 1999) (stating there can be no actionable fraud without justifiable reliance).

Accordingly, summary judgment on Count I of the Counterclaim and the defense of fraudulent inducement is appropriate.

2. Factual Issues Exist as to Count II of the Counterclaim, for Money Had and Received

[7] In response to the undersigned's January 22, 2004 Order requiring Mount Sinai to supply the Court with "a memorandum of law containing citations to applicable authorities that support Count II of the Counterclaim," Mount Sinai conceded there was no cause of action for "Gross Neglect of Duties," and that Count II of its Counterclaim should more properly be considered to state a claim for money ***1261** had and received or contract implied in fact. *Watson Clinic, LLP v. Verzosa,* 816 So.2d 832 (Fla. 2d DCA 2002), a case cited by Mount Sinai in its additional briefing, concerns a somewhat factually analogous case, and references that Florida recognizes actions for recoupment. *Id.* at 834 (citing *First State Bank of Fort Meade v. Singletary,* 124 Fla. 770, 169 So. 407 (1936)). In *Watson* the overpaid doctor maintained the medical clinic was estopped from seeking return of salary payments made to him because he had previously advised the clinic of the accounting error, and had been told it was correct. In reversing the trial court, the Second District Court of Appeal found that the facts had not established an estoppel, and that judgment for the clinic should be entered. *Id.* at 835.

Dr. Tomasini received a $67,500 bonus on August 24, 2000, covering his first year of employment. His yearly performance was to be reviewed again during the next evaluation, on June 7, 2001. Nonetheless, on February 5, 2001, Dr. Tomasini accepted another bonus of $83,250. When he received it, he knew it was an error, but he maintains Bruce Perry told him the Compensation Committee had approved it. Bruce Perry does not recall having made that representation.

Thus, material issues of fact exist regarding whether or not Mount Sinai is entitled to a return of the second bonus paid to Dr. Tomasini.

For the foregoing reasons, it is

ORDERED AND ADJUDGED that Plaintiff's Motion (**D.E.67**) is **GRANTED IN PART**. Summary Judgment is entered in favor of Plaintiff as to Counts I and II of the Complaint, and Count I of Defendant's Counterclaim and the Affirmative Defense of Fraudulent Inducement. Plaintiff's Motion is DENIED with respect to Count II of Defendant's Counterclaim.

S.D.Fla.,2004.
Tomasini v. Mount Sinai Medical Center of Florida, Inc.
315 F.Supp.2d 1252

END OF DOCUMENT

W

Court of Appeals of North Carolina.
WILMAR, INCORPORATED
v.
Leo Vander LILES.
WILMAR, INCORPORATED
v.
O. T. POLK, Jr.
No. 7126SC620.

Dec. 15, 1971.
Certiorari Denied by Supreme Court Jan. 28, 1972.

Action by employer against former employees to enforce covenant not to compete contained in employment contracts entered into between employer and employees. The Superior Court, Mecklenburg County, Frank W. Snepp, Jr., J., entered an interlocutory order restraining employees from further competition with employer, and former employees appealed. The Court of Appeals, Britt, J., held that where covenants not to compete were included in employment contracts which provided for initiation of a profit sharing plan allegedly for benefit of employees, but which was subject to amendment by employer, and which in fact was amended by employer to reduce, and for a period of two years eliminate, contributions to the plan, and employment contracts were not entered into at time employees were employed by employer and terms and conditions of employees' existing employment were not altered in any other manner, restrictive covenant not to compete was not an ancillary contract, but rather was a naked contract not to compete not protected as to enforceability by exceptions afforded ancillary contracts in restraint of trade permissible in connection with sale of a going business, a contract of employment, or a lease.

Reversed.

West Headnotes

[1] Equity 150 ⚷43

150 Equity
150I Jurisdiction, Principles, and Maxims
150I(B) Remedy at Law and Multiplicity of Suits
150k43 k. Existence of Remedy at Law and Effect in General. Most Cited Cases
While under present system the same court grants legal as well as equitable relief, this does not allow a party the option to demand either at his will; equitable relief will be granted only when legal relief is inadequate, and party must bring himself within rule by alleging and establishing facts which will warrant the equitable remedy.

[2] Contracts 95 ⚷65.5

95 Contracts
95I Requisites and Validity
95I(D) Consideration
95k65.5 k. Covenants Not to Compete. Most Cited Cases
(Formerly 95k65(2))
When employment preexists execution of employment contracts, there must be some additional consideration to employee to support his covenant not to compete.

[3] Contracts 95 ⚷116(2)

95 Contracts
95I Requisites and Validity
95I(F) Legality of Object and of Consideration
95k115 Restraint of Trade or Competition in Trade
95k116 In General
95k116(2) k. Restriction Necessary for Protection. Most Cited Cases
(Formerly 95k16(2))
To be enforceable, a covenant not to compete must protect some substantial interest of the employer.

[4] Contracts 95 ⚷116(1)

95 Contracts

95I Requisites and Validity
95I(F) Legality of Object and of Consideration
95k115 Restraint of Trade or Competition in Trade
95k116 In General
95k116(1) k. In General. Most Cited Cases
(Formerly 95k16(1))

Where covenants not to compete were included in employment contracts which provided for initiation of a profit sharing plan allegedly for benefit of employees, but which plan was subject to amendment by employer, and which in fact was amended by employer to reduce, and for a period of two years eliminate, contributions to the plan, and employment contracts were not entered into at time of employment and terms and conditions of employees' existing employment were not altered in any other manner, restrictive covenant not to compete was not an ancillary contract, but rather was a naked contract not to compete not protected as to enforceability by exceptions afforded ancillary contracts in restraint of trade.

***72 **279** Plaintiff instituted these two actions against defendants, former employees of plaintiff, to enforce covenants not to compete contained in employment contracts entered into between plaintiff and defendants. By agreement the cases were consolidated for hearing in the superior court and for determination in this court.

The facts pertinent to the issue raised on appeal are substantially free from dispute.

Defendants were both employed by plaintiff as salesman of its products, janitorial and automotive chemicals and supplies. They were paid on a commission basis and were assigned to sell in certain non-exclusive territories in North Carolina and Virginia. Defendant Liles became an employee of plaintiff in 1957, and defendant Polk in April 1963. Neither of defendants was asked to enter into any written agreement with plaintiff at the time they became employees. Both defendants continued to work for plaintiff without written contracts until November of 1963. On 6 November 1963 in the case of Liles, and on 7 November 1963 in the case of Polk, written employment contracts were executed with plaintiff. The contracts were similar except for the territories to be covered by defendants. Each of the contracts contained a covenant by defendants not to compete, either directly or indirectly, with plaintiff during the term of their employment or for a period of one year thereafter. The covenant was limited to the territory in which defendants worked while employed by plaintiff. The stated consideration by plaintiff for the new contracts was the initiation of a profit sharing plan for defendants and other employees to begin as of 1 December 1963. Plaintiff also agreed to reimburse the defendants for one-half of their gasoline bill for any quarter in which ***73** their gross sales exceeded $9,000.00; this provision could be terminated by plaintiff at its option. There was no other change in the employment conditions or compensation of defendants.

Plaintiff instituted the profit sharing plan as agreed upon in the contracts. The plan was subject to amendment by plaintiff, but plaintiff could not disturb any contributions already made to the fund. The right to amend was exercised by plaintiff on several occasions. By two of these amendments, plaintiff reduced the minimum amount which it would contribute to the plan. Under these reductions, no contributions were made between 30 November 1967 and 30 April 1969.

Defendants continued to work for plaintiff until 1971. On 12 February 1971 defendant Polk voluntarily terminated his employment with plaintiff and on 15 February 1971 defendant Liles voluntatily terminated his employment with plaintiff.

Upon termination of their employment with plaintiff, defendants accepted positions with Palmetto Chemical Company of Cheraw, South Carolina. Palmetto was a direct competitor of plaintiff. Defendants were employed as salesman by Palmetto and serviced substantially the same territories and customers they had previously serviced for the plaintiff. As a result of their competition, plaintiff suffered a substantial decline in its sales in those areas serviced by defendants. Further pertinent facts are set forth in the opinion.

****280** On 10 March 1971, plaintiff brought these actions seeking to enforce the covenants not to compete contained in defendants' contracts. Pursuant to appropriate notice, plaintiff moved for temporary injunctions against defendants. Following a hearing the superior court made appropriate findings of fact and entered an interlocutory order restraining defendants from further competition with plaintiff.

From this order defendants appealed.
Grier, Parker, Poe, Thompson, Bernstein, Gage & Preston, by Mark R. Bernstein, Sydnor Thompson and W. Samuel Woodard, Charlotte, for plaintiff appellee.

McElwee & Hall, by John E. Hall, and W. G. Mitchell, North Wilkesboro, for defendant appellants.

***74** BRITT, Judge.

Did the trial court err in entering the temporary injunction appealed from? We hold that it did.

[1] By seeking to have defendants enjoined from certain acts, plaintiff asks the court to exercise its equitable jurisdiction. While under our present system the same court grants legal as well as equitable relief, this does not allow a party the option to demand either at his will; equitable relief will be granted only when legal relief is inadequate, and the party must bring himself within the rule by alleging and establishing facts which will warrant the equitable remedy. McIntosh, N.C. Practice and Procedure, 2d Ed., Sec. 2191.

Although the Supreme Court of North Carolina and this court have considered numerous cases involving anticompetitive covenants, our search fails to reveal any case in which either court addressed itself to a determination of whether the contract before it was, in fact, a naked contract not to compete or an ancillary contract in restraint of trade and whether a restrictive covenant not ancillary to a principal contract of employment, sale, or lease is enforceable.

In 54 Am.Jur.2d, Monopolies, Sec. 514, p. 961, it is said:

'As a general rule, an anticompetitive covenant is unenforceable unless it is ancillary or incidental to a lawful contract, even though it is supported by a consideration. A restrictive provision which might be upheld if it were incidental to some principal contract cannot be enforced if it appears to be the main purpose of the contract, and not subordinate thereto.'

In Purchasing Associates, Inc. v. Weitz, 13 N.Y.2d 267, 246 N.Y.S.2d 600, 196 N.E.2d 245 (1963) the New York Court of Appeals said:

'At one time, a covenant not to compete, basically an agreement in restraint of trade, was regarded with high disfavor by the courts and denounced as being 'against the benefit of the commonwealth'. (Citations) It later became evident, however, that there were situations in which it was not only desirable but essential that such covenants not to compete be enforced.

'Where, for instance, there is a sale of a business, involving as it does the transfer of its goodwill as a going ***75** concern, the courts will enforce an incidental covenant by the seller not to compete with the buyer after the sale. (Citations) * * * The sole limitation on the enforcibility (sic) of such a restrictive covenant is that the restraint imposed be 'reasonable,' that is, not more extensive, in terms of time and space, than is reasonably necessary to the buyer for the protection of his legitimate interest in the enjoyment of the asset bought. (Citations)

'Also enforcible (sic) is a covenant given by an employee that he will not compete with his employer when he quits his employ, and the general limitation of 'reasonableness', to which we have just ****281** referred, applies equally to such a covenant. (Citations) However, since in the case of such a covenant the element of good will, or its transfer, is not involved and since there are powerful considerations of public policy which militate against sanctioning the loss of a man's livelihood, the courts have generally displayed a much stricter attitude with respect to covenants of this type. (Citations)'

In Little Rock Towel & Linen Supply Co. v. Independent Linen Serv. Co., 237 Ark. 877, 377 S.W.2d 34 (1964) we find:

'A naked contract not to compete with another is against public policy. Shapard pard v. Lesser, 127 Ark. 590, 193 S.W. 262, 3 A.L.R. 247. Such an agreement is permissible, however, either in connection with the sale of a going business or, as here, in connection with a contract of employment. Yet even in those instances the restraint is unreasonable and void if it is greater than is required for the protection of the promisee or if it imposes an undue hardship upon the person who is restricted. Rest., Contracts, s 515, which we quoted with approval in Marshall v. Irby, 203 Ark. 795, 158 S.W.2d 693. Owing to the possibility that a person may be deprived of his livelihood the courts are less disposed to uphold restraints in contracts of employment than to uphold them in contracts of sale. Williston, Contracts (Rev.Ed.), s 1643; Banks, Covenants Not to Compete, 7 Ark.L.Rev. 35.'

In Super Maid Cook-Ware Corporation v.Hamil, 50 F.2d 830 (1931), the 5th Circuit Court of Appeals said:

***76** 'Appellant by its prayer for injunctive relief prima facie puts itself in the position of seeking, by contract, to deprive appellees of the right to earn their livelihood. Equity places upon it the burden of showing that the contract was fair, the restrictive covenants reasonable, and that they have a real relation to, and are really necessary for, the protection of appellant in the business to which the covenants are an incident. For, fundamentally, in and of themselves these covenants are in restraint of trade, and unenforceable. It is a settled principle of law that no man may, per se, contract with another that that other will not follow a calling by which he may make his livelihood. It is only when they are incidental to some contract which is reasonable in its purpose and its terms, and it is necessary to the protection of the rights of the employer under such contract, that the validity of restrictive covenants will be recognized and enforced, and then only when they are themselves reasonable, no public interests are involved, and the restriction is limited to the very point of the necessity of protecting contract rights, to which the covenant is incidental. In short, it is never the covenant itself, but the covenant in relation to the facts of the situation or contract to which it is incidental, which may be valid.

'Further, it is well settled that, while a court of equity will in proper cases issue its writ of injunction to enforce covenants of this kind, it will not do so unless the whole matter appears equitable; that is, unless it rests upon a contract which is fair in its terms, involves no imposition nor injustice, and the private interests of the employer in the subject-matter of the contract to which the restrictive covenant is incidental, requires in good faith for its protection the enforcement of the covenant. Hepworth Mfg. Co. v. Ryott (1920) 1 Ch. 1, 9 A.L.R. 1484; Samuel Stores v. Abrams, 9 A.L.R. 1450, note; Taylor Iron & Steel Co. v. Nichols, 73 N.J.Eq. 684, 69 A. 186, 24 L.R.A., N.S., 933, 133 Am.St.Rep. 753; Kinney v. Scarbrough Co., 138 Ga. 77, 74 S.E. 772, 40 L.R.A.,N.S., 473; Herbert Morris, Ltd. v. Saxelby, 1 App.Cas. 688; Clark Paper & Mfg. Co. v. Stenacher, 236 N.Y. 312, 140 N.E. 708, 29 A.L.R. 1325; Club Aluminum Co. v. Young, 263 Mass. 223, 160 N.E. 804; ****282** Mentor Co. v. Brock, 147 Minn. 407, 180 N.W. 553, 20 A.L.R. 857; Southern Properties v. Carpenter (Tex.Civ.App.) 21 S.W.2d 372, 373.'

***77** The case of Orkin Exterminating Co. v. Jones, et al., 258 N.C. 179, 128 S.E.2d 139 (1962), involved covenants not to compete set forth in original contracts of employment. Our Supreme Court held that courts of equity will enforce such a covenant not to compete if it is: (1) in writing, (2) entered into at the time and as part of the employment contract, (3) based on valuable consideration, (4) reasonable as to time and territory, (5) fair to the parties and (6) not against public policy.

Contracts in restraint of trade or commerce are condemned by statutes in North Carolina. G.S. 75-1 provides in pertinent part as follows: 'Every contract, combination in the form of trust or otherwise, or conspiracy in restraint of trade or comerce in the State of North Carolina is hereby declared to be illegal. . . .' G.S. 75-2 provides: 'Any act, contract, combination in the form of trust, or conspiracy in restraint of trade or commerce which violates the principles of the common law is hereby declared to be in violation of s 75-1.' G.S. 75-4 provides: 'No contract or agreement hereafter made, limiting the rights of any person to do business anywhere in the State of North Carolina shall be enforceable unless such agreement is in writing duly signed by the party who agrees not to enter into any such business within such territory: Provided, nothing herein shall be construed to legalize any contract or agreement not to enter into business in the State of North Carolina, or at any point in the State of North Carolina, which contract is now illegal, or which contract is made illegal by any other section of this chapter.' These statutes were enacted by the 1913 General Assembly.

[2] In the case before us the covenants not to compete were included in contracts of employment entered into by the defendants after defendant Liles had been in plaintiff's employment for six years and defendant Polk for six months. When the employment preexists the execution of the contracts, there must be some additional consideration to the employee to support his covenant not to compete. Greene Co. v. Kelley, 261 N.C. 166, 134 S.E.2d 166 (1964).

The principles stated above must be applied as we turn to an examination of the facts in this case. As mentioned before, the contracts before us were not entered into at the time defendants were employed by plaintiff. Each contract provided for the initiation of a profit sharing plan allegedly for the benefit***78** of defendants (and other employees) and for the reimbursement of one-half of defendants' gasoline bills for any quarter in which their gross sales exceeded $9,000. In return defendants executed the covenants not to compete with plaintiff. The terms and conditions of defendants' existing employment were not altered in any other manner. Plaintiff's promise to reimburse defendants for their gasoline bills could be terminated at plaintiff's option and it is not contended that such a promise would be valid consideration to support defendants' covenants. The profit sharing plan instituted pursuant to defendants' contracts provided that plaintiff could, at any time, amend the plan so long as such amendment did not divert the corpus of the trust to a purpose other than for the benefit of members of the plan. Under this provision plaintiff did in fact alter the plan to reduce its contributions to the trust fund. These reductions had the effect of eliminating, for a period of two years, any contributions by plaintiff. Under the plan if an employee under written contract with plaintiff terminated his employment, he would not be entitled to his vested interest until three years from the date of termination. It was further provided that if the former employee competed with plaintiff during this period, he would forfeit his vested interest and it would revert to the accounts of all other participants in the plan in proportion to ****283** their share of allocable contributions for that year. It is noted that the forfeiture provision extends two years beyond the period covered by defendants' covenants not to compete. Contribution to an employee's account was based on the ratio of the employee's compensation to the total compensation of all participants in the plan. Other relevant circumstances include the fact that Mr. Jules Buxbaum is the president and sole shareholder of plaintiff corporation. As such he was paid the highest salary of any employee and therefore he was the greatest beneficiary of the profit sharing plan.

An analysis of the profit sharing plan leaves little doubt as to whether it was a consideration for defendants' covenants. The plan was drawn up by plaintiff; it was subject to amendment by plaintiff; it was amended by plaintiff to reduce, and for a period of two years eliminate, contributions to the plan; it imposed a three-year limitation on competition by former employees and the greatest benefit of the plan accrued to plaintiff's president and owner, Jules Buxbaum. We find this consideration to be illusory as to defendants. 'A consideration ***79** cannot be constituted out of something that is given and taken in the same breath-. . . .' Kadis v. Britt, 224 N.C. 154, 163, 29 S.E.2d 543, 548 (1944).

Somewhat analogous to the facts in this case is the following statement by the court in Super Maid Cook-Ware Corporation v. Hamil, Supra: 'Without guaranteeing to the defendants one day's regular work, without the obligation of the appellant to employ them or pay them anything, upon a seductive promise of the disclosure of the information upon which they may hope to build a profitable line of sales, the appellees are induced to sign a paper which, while it has the general appearance of a contract, but keeps the promise to the ear while it breaks it to the hope. Such a contract, wanting in mutuality, presenting no equitable considerations, a court of equity will not enforce. (Citations)'

[3] To be enforceable, a covenant not to compete must protect some substantial interest of the employer. We are not convinced from the evidence in this case that defendants had access to any trade secrets. Defendants were already employees of plaintiff at the time the contracts were executed. They had acquired a knowledge of plaintiff's business methods, customer list and territories prior to the execution of the contracts. The plaintiff had failed to protect his interest at the time the defendants came into his employment. By the contracts plaintiff was merely attempting to close the barn door after the horse was out.

[4] The inescapable conclusion then is that in actuality the restrictive covenant not to compete here sought to be enforced is not an ancillary contract at all. It is the main purpose of the contract and not a subordinate feature. It becomes and is, therefore, a naked contract not to compete not protected as to enforceability by the exceptions afforded ancillary contracts in restraint of trade permissible in connection with the sale of a going business, a contract of employment, or a lease.

For the reasons stated the order appealed from is

Reversed.

MORRIS and PARKER, JJ., concur.
N.C.App. 1971.
Wilmar, Inc. v. Liles
13 N.C.App. 71, 185 S.E.2d 278, 51 A.L.R.3d 816, 1972 Trade Cases P 73,870

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United States District Court,
E.D. Pennsylvania.
Philip YOUTIE
v.
MACY'S RETAIL HOLDING, INC., and Macy's, Inc.
Civil Action No. 07-3182.

June 5, 2009.

Background: Employee brought action against his former employer and its parent company for breach of contract, alleging his employment agreement was improperly assigned. Defendants asserted counterclaims for breach of employment agreement, misappropriation of trade secrets and/or confidential and proprietary information, breach of fiduciary duty and duty of loyalty, tortious interference with business and employment relations, unjust enrichment, and unfair competition, alleging employee improperly disclosed information regarding the cost a manufacturer charged to a division of employer to manufacturer its dress designs. Parties moved for summary judgment.

Holdings: The District Court, O'Neill, J., held that:
(1) employee consented to assignment of employment contract;
(2) genuine issue of material fact as to whether information disclosed by employee constituted a trade secret precluded summary judgment on issue of whether claims against employee for breach of fiduciary duty and duty of loyalty, unjust enrichment, and unfair competition, based on disclosure of the same information, were preempted by the Pennsylvania Uniform Trade Secrets Act (PUTSA);
(3) information disclosed by employee was confidential information within meaning of employment agreement;
(4) defendants were entitled to damages in the amount of the portion of the employee's salary that could be attributed to the time he spent obtaining the confidential information; but
(5) there was no evidence that employee's introduction of a vice president of a division of employer to an alleged competitor caused any damages to defendants, as required to support claims against employee for breach of contract, breach of fiduciary duty and duty of loyalty, and tortious interference with business and employment relations based on this introduction.

Plaintiff's motion granted in part and denied in part; defendants' motion granted in part and denied in part.

West Headnotes

[1] Assignments 38 ⚷58

38 Assignments
38II Mode and Sufficiency of Assignment
38k58 k. Consent of Debtor. Most Cited Cases

Labor and Employment 231H ⚷35

231H Labor and Employment
231HI In General
231Hk31 Contracts
231Hk35 k. Construction and Operation in General. Most Cited Cases

Under Missouri law, employee consented to the assignment of his employment contract to another company by entering agreement which provided that employer was entitled to assign the contract to a subsidiary of employer, even if the company was actually a subsidiary of the employer's parent company, where the agreement specifically defined the company as a division of the employer.

[2] Contracts 95 ⚷326

95 Contracts
95VI Actions for Breach
95k326 k. Grounds of Action. Most Cited Cases

To recover for a breach of contract claim under Missouri law, plaintiff must establish: (1) the existence of an enforceable contract between the parties to the action; (2) mutual obligations arising under its terms; (3) the party being sued failed to perform obligations imposed by the contract; and (4) the party seeking recovery was thereby damaged.

[3] Contracts 95 ⚷129(1)

95 Contracts
95I Requisites and Validity
95I(F) Legality of Object and of Consideration
95k129 Obstructing or Perverting Administration of Justice
95k129(1) k. Agreements Relating to Actions and Other Proceedings in General. Most Cited Cases

Under Pennsylvania's choice of law analysis, Pennsylvania courts generally honor the intent of the contracting parties and enforce choice of law provisions executed by them.

[4] Contracts 95 ⚷129(1)

95 Contracts
95I Requisites and Validity
95I(F) Legality of Object and of Consideration
95k129 Obstructing or Perverting Administration of Justice
95k129(1) k. Agreements Relating to Actions and Other Proceedings in General. Most Cited Cases

Under Pennsylvania law, a choice of law provision stands unless: (1) 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 (2) 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 would be the state of the applicable law in the absence of an effective choice of law by the parties.

[5] Federal Courts 170B ⚷409.1

170B Federal Courts
170BVI State Laws as Rules of Decision
170BVI(C) Application to Particular Matters
170Bk409 Conflict of Laws
170Bk409.1 k. In General. Most Cited Cases

Where federal jurisdiction is based on diversity of citizenship, the court must apply the choice of law rules of the forum state.

[6] Assignments 38 ⚷19

38 Assignments
38I Property, Estates, and Rights Assignable
38k17 Executory Contracts
38k19 k. Personal Nature. Most Cited Cases

Assignments 38 ⚷58

38 Assignments
38II Mode and Sufficiency of Assignment
38k58 k. Consent of Debtor. Most Cited Cases

As a general rule, a contract for personal services cannot be assigned without the consent of the employee under Missouri law; however, a mere change in the form in which a business is owned or conducted should not work to prohibit assignment.

[7] Assignments 38 ⚷19

38 Assignments
38I Property, Estates, and Rights Assignable
38k17 Executory Contracts
38k19 k. Personal Nature. Most Cited Cases

Whether there is a change in partnership personnel or structure, the incorporation of a previously unincorporated business, the dissolution of a corporation or a change in corporate structure, if there is no material change in the contract obligations and duties of the employee, there is no reason for the transfer of the rights from one entity or form to another to work an assignment putatively prohibited by the rule under Missouri law against assignment of personal service contracts.

[8] Federal Civil Procedure 170A ⚷2497.1

170A Federal Civil Procedure
170AXVII Judgment
170AXVII(C) Summary Judgment
170AXVII(C)2 Particular Cases
170Ak2497 Employees and Employment Discrimination, Actions Involving
170Ak2497.1 k. In General. Most Cited Cases

Genuine issue of material fact as to whether information disclosed by former employee, regarding the cost a manufacturer charged to a division of employer to manufacturer its dress designs, constituted a trade secret precluded summary judgment on issue of whether employer's claims against employee for breach of fiduciary duty and duty of loyalty, unjust enrichment, and unfair competition, based on disclosure of the same information, were preempted by the Pennsylvania Uniform Trade Secrets Act (PUTSA). 12 Pa.C.S.A. § 5308.

[9] Antitrust and Trade Regulation 29T ⚷415

29T Antitrust and Trade Regulation
29TIV Trade Secrets and Proprietary Information
29TIV(A) In General
29Tk415 k. What Law Governs. Most Cited Cases

District court would apply Pennsylvania law to employer's claims against former employee for misappropriation of trade secrets and/or confidential and proprietary information, unjust enrichment, and unfair competition; Pennsylvania was the forum state, parties addressed issue of whether claims were preempted by the Pennsylvania Uniform Trade Secrets Act (PUTSA) without objection to application of Pennsylvania law, only other state that had interest in case was Missouri, as employment contract between parties was governed by Missouri law, and there was no conflict with Missouri law because Missouri had also adopted the Uniform Trade Secrets Act. 12 Pa.C.S.A. § 5301 et seq.

[10] Action 13 ⚷17

13 Action
13II Nature and Form
13k17 k. What Law Governs. Most Cited Cases

Because choice of law analysis is issue-specific, different states' laws may apply to different issues in a single case, a principle known as "depecage."

[11] Action 13 ⚷17

13 Action
13II Nature and Form
13k17 k. What Law Governs. Most Cited Cases

Pennsylvania's choice of law analysis requires that the court determine whether a false conflict exists, and, if no false conflict exists, that it determine which state has the greater interest in the application of its law.

[12] Action 13 ⚷17

13 Action
13II Nature and Form
13k17 k. What Law Governs. Most Cited Cases

Under Pennsylvania's choice of law analysis, a false conflict exists where the application of either state's law renders the same result, or where only one jurisdiction's governmental interests would be impaired by the application of the other jurisdiction's law.

[13] Antitrust and Trade Regulation 29T ⚷413

29T Antitrust and Trade Regulation
29TIV Trade Secrets and Proprietary Information
29TIV(A) In General
29Tk413 k. What Are "Trade Secrets" or Other Protected Proprietary Information, in General. Most Cited Cases

Under Pennsylvania law, some factors to be considered in determining whether given information is a trade secret are: (1) the extent to which the information is known outside of the owner's business; (2) the extent to which it is known by employees and others involved in the owner's business; (3) the extent of measures taken by the owner to guard the secrecy of the information; (4) the value of the information to the owner and to his competitors; (5) the amount of effort or money expended by the owner in developing the information; and (6) the ease or difficulty with which the information could be properly acquired or duplicated by others. 12 Pa.C.S.A. § 5302.

[14] Labor and Employment 231H ⚷306

231H Labor and Employment
231HV Intellectual Property Rights and Duties
231Hk304 Trade Secrets or Confidential Information
231Hk306 k. What Are Trade Secrets or Confidential Information of Employer. Most Cited Cases

Under Missouri law, information disclosed by former employee regarding the cost a manufacturer charged to a division of employer to manufacture its dress designs was confidential information within meaning of employment contract prohibiting the employee from disclosing confidential information at any time and defining confidential information as any non-public information pertaining to employer's business, even if manufacturers could provide third parties with the costs of their materials; information at issue was not merely the cost manufacturers charged for their materials, but was specific to the division's products.

[15] Labor and Employment 231H ⚷324

231H Labor and Employment
231HV Intellectual Property Rights and Duties
231Hk313 Actions
231Hk324 k. Damages and Amount of Recovery. Most Cited Cases

Under Missouri law, employee's breach of contract by requesting and disclosing confidential data regarding manufacturing costs entitled his former employer to damages in the amount of the portion of the employee's salary that could be attributed to the time he spent obtaining the data, rather than to reimbursement for the entire cost of the business trip during which employee requested the data, where trip was part of employee's regular duties, and there was no evidence that the request for the data was the entire purpose of the trip.

[16] Labor and Employment 231H ⚷111

231H Labor and Employment
231HIII Rights and Duties of Employers and Employees in General
231Hk109 Employee's Duties
231Hk111 k. Fiduciary Duty. Most Cited Cases

Labor and Employment 231H ⚷909

231H Labor and Employment
231HIX Interference with the Employment Relationship
231Hk907 Enticing Employee to Leave Employment
231Hk909 k. Competitors. Most Cited Cases

Torts 379 ⚷241

379 Torts
379III Tortious Interference
379III(B) Business or Contractual Relations
379III(B)2 Particular Cases
379k241 k. Business Relations or Economic Advantage, in General. Most Cited Cases

There was no evidence that employee's introduction of a vice president of a division of employer to an alleged competitor of employer caused any damage to employer, as required to support employer's claims against employee for breach of contract, breach of fiduciary duty and duty of loyalty, and tortious interference with business and employment relations under Pennsylvania law.

***513** Alan B. Epstein, Nancy Beth Abrams, Spector Gadon & Rosen, PC, Philadelphia, PA, for Philip Youtie.

***514** *MEMORANDUM*

O'NEILL, District Judge.

On August 3, 2007, plaintiff Philip Youtie filed a complaint against defendant Macy's Inc. (Macy's), [FN1] and on March 26, 2009, filed an amended complaint against defendants Macy's and Macy's Retail Holdings, Inc. (Macy's Retail), [FN2] alleging a breach of plaintiff's employment agreement and violations of the Pennsylvania Wage Payment and Collection Law (WPCL), 43 P.S. § 260.1 et seq. Defendants filed an answer, affirmative defenses and counterclaims on December 17, 2007, alleging that plaintiff breached his employment agreement, misappropriated trade secrets and/or confidential and proprietary information, breached his fiduciary duty and duty of loyalty, engaged in tortious interference with business and employment relations, was unjustly enriched and engaged in unfair competition. Defendants request a hearing on damages. Defendants seek declaratory relief regarding whether Macy's Retail lawfully assigned plaintiff's employment agreement on January 31, 2007 to David's Bridal, Inc. and injunctive and monetary relief. Presently before me are defendants' motions for summary judgment on plaintiff's claims, plaintiff's response and cross-motion for summary judgment on defendants' counterclaims, [FN3] defendants' reply thereto, plaintiff's reply in support of his cross-motion for summary judgment and defendants' sur-reply thereto, and defendants' motion for partial summary judgment with respect to its counterclaims of breach of contract, breach of fiduciary duty and duty of loyalty and misappropriation of confidential and proprietary information, plaintiff's response and defendants' reply thereto.

> FN1. Defendants have had various corporate names during the periods relevant to this litigation. Macy's was The May Department Stores Company, May DE at the time it acquired David's Bridal's shares and the agreement was signed with plaintiff. It was later referred to as Federated Department Stores, Inc. and then became Macy's, Inc. For this reason, regardless of its name at the time of the incident discussed, I will refer to this defendant as Macy's.

> FN2. Defendant Macy's Retail was The May Department Stores Company, May N.Y. at the time it signed the agreement with plaintiff. It was later referred to as Federated Retail Holding, Inc. and then became Macy's Retail Holdings, Inc. For this reason, regardless of its name at the time of the incident discussed, I will refer to this defendant as Macy's Retail.

> FN3. Plaintiff moved for summary judgment on counts I through VIII of defendants' counterclaims. For defendants' count VIII for injunctive relief, plaintiff merely states in a footnote in his cross-motion for summary judgment that injunctive relief is "clearly unwarranted as [plaintiff has] not engaged in any improper conduct." Defendants did not respond to plaintiff's motion for summary judgment on count VIII. Because the briefing is insufficient by both parties to determine the merits of a request for injunctive relief, I will deny plaintiff's motion for summary judgment on count VIII without prejudice until briefing with legal analysis is provided. Parties may simultaneously brief this issue within 15 days from the date of the attached Order.

BACKGROUND

On August 1, 2000, Macy's acquired all of the publicly-held shares of David's Bridal, Inc. David's Bridal is a corporation and a clothier specializing in bridal gowns and other formal wear and accessories. Plaintiff had purchased David's Bridal in 1972, expanded the operations, partnered with Steven Erlbaum beginning in 1989 or 1990 and with Erlbaum made a public offering of David's Bridal's stock in 1999. After Macy's acquired David's Bridal, plaintiff entered into a contract of employment with a division of Macy's, Macy's Retail, on or about October 1, 2001. In accordance with the terms of the agreement, Youtie ***515** served as the Executive Vice-President, Product Development and Sourcing of the David's Bridal division of Macy's Retail. On November 17, 2006, an affiliate of Leonard Green & Partners signed an agreement with Macy's to acquire David's Bridal and consummated the sale and transfer of stock of David's Bridal to the Leonard Green affiliate on January 31, 2007. As part of the transaction, Macy's subsidiary Macy's Retail assigned its employment agreement with plaintiff to David's Bridal. The agreement provided in relevant part:

> **11. Successors and Assigns.** This Agreement will inure to the benefit of, and will be binding upon, May, its successors and assigns; provided, however, that, because this is an agreement for the personal services [sic], you cannot assign any of your obligations under this Agreement to anyone else. May may assign its obligations under this Agreement to a May subsidiary; any assignment, however, will not relieve May of any of its obligations hereunder except to the extent that they are actually discharged by the subsidiary. Whenever this Agreement refers to May, that reference includes any of May subsidiaries or divisions in existence at any time during which this Agreement governs the conduct of you and May.

Plaintiff alleges that, at the time his employment agreement was assigned to David's Bridal he was not aware of, let alone did he consent to, the purported assignment. Plaintiff argues that he was therefore no longer an employee of Macy's Retail and, as a result of the termination of his employment, was entitled to the severance obligations set forth in Paragraph 4(c) and (f) of the agreement.

Defendants contest plaintiff's claims and his entitlement to severance. Additionally, defendants argue that plaintiff's conduct during his employment created their causes of action against him.

Defendants claim that, in late 2006, plaintiff asked Linda Shaps-Shanin, Vice President and General Merchandising Manager of David's Bridal, for "first cost" data involving the costs incurred by the company to manufacture its bridal dresses and gowns. It is further alleged that, despite being denied access to this information, plaintiff renewed his request for such information to Shaps-Shanin and her assistant Sharon Zuk in January 2007 but was again denied. Plaintiff denies that he asked Shaps-Shanin or Zuk for the "first cost" data. However, plaintiff admits that he obtained "first cost" data on the dresses in David's Bridal's Spring 2007 catalogue from Lydia Chow, an employee of Fillberg LTD, David's Bridal's Hong Kong marketing representation, during a business trip to Hong Kong in January 2007 with other David's Bridal employees. Plaintiff does not dispute that the "first cost" data at issue is the cost the manufacturer charged David's Bridal to manufacture the designs David's Bridal provided the manufacturer for its Spring 2007 catalogue. Additionally, plaintiff admitted in his affidavit that he "asked for the cost data because [ ] Erlbaum ... was interested in what David's Bridal paid various manufacturers for the dresses they manufactured." Plaintiff further admits that he gave a copy of the cost sheet to Erlbaum but believes that plaintiff provided it to Erlbaum after plaintiff recovered from the surgical procedure he underwent after his January trip to Hong Kong.

Plaintiff also admits that he and his former partner Erlbaum had general discussions about Erlbaum returning to the bridal business. However, he states that no specifics were discussed and that neither had plans to enter into a business in competition with David's Bridal. In his deposition on June 4, 2008, plaintiff testified that, during the period in which he was still employed by David's Bridal, he ***516** and Erlbaum discussed starting a business in "direct competition" with David's Bridal but that no specifics were discussed. However, in his December 2008 affidavit, plaintiff claimed that the potential business discussed was "a wholesale dress manufacturing business in an off-shore location" that "would not compete in any way with David's Bridal."

Plaintiff admits that he introduced Shaps-Shanin to Erlbaum on January 29, 2007 but claims that he did so at her request. He also admits that, after this meeting, he asked Shaps-Shanin for a copy of her employment agreement but claims that she refused to give it to him. Although Shaps-Shanin asserted that Erlbaum "attempted to convince [her] to join [him] in a competing bridal business," plaintiff argues that it is uncontroverted that Erlbaum never established any type of business and that Shaps-Shanin never left David's Bridal's employ. Defendants dispute that Shaps-Shanin in any way instigated her introduction to Erlbaum.

Section 6(a) of the Employment Agreement prohibited plaintiff "at any time, directly or indirectly, [from] us[ing] or disclos[ing] any of May's [aka Macy's Retails'] Confidential Information except as authorized and within the scope of [his] employment with May [aka Macy's Retail.]" Section 6(d) defines Confidential Information as:

> any non-public information pertaining to May's business. Confidential information includes information disclosed by May to you, and information developed or learned by you during the course of or as a result of your employment with May, which you also agree is May's property .... Confidential information includes, without limitation, information and documents concerning May's processes, suppliers (including May's terms, conditions and other business arrangements with suppliers); supplier and customer lists; advertising and marketing plans and strategies; profit margins; seasonal plans, goals objectives and projections; compilations, anaylses and projections regarding May's divisions, stores, product segments, product lines, suppliers, sales and expenses; files; trade secrets and patent applications (prior to their being public); salary, staffing and employment information (including information about performance of other executives); and "know-how," techniques or any technical information not of a published nature relating, for example, how May conducts its business.

The agreement also contained a non-compete clause for conflicts of interest constraining plaintiff with the following language:

> 5. Avoiding Conflict of Interest. (a) At all times while you are employed by May and for one year after your employment terminates, you will not directly or indirectly:
>
> (i) own, manage, operate, finance, join, control, advise, consult, render services to, have an interest or future interest in or participate in the ownership, management, operation, financing or control of, or be employed by or connected in any manner with any Competing Business;
>
> (ii) solicit for employment, hire or offer employment to, or otherwise aid or assist (by disclosing information about employees or otherwise) any person or entity other than David's Bridal, May or another May subsidiarty in soliciting for employment, hiring or offering employment to, any employee of David's Bridal, May or another May subsidiary; or
>
> (iii) take any action which is intended to harm David's Bridal or May or either of their reputations, or that David's Bridal or May reasonably concludes ***517** could harm David's Bridal or May or their reputations or lead to unwanted or unfavorable publicity for David's Bridal or May.

David's Bridal terminated plaintiff's employment as Executive Vice President on February 27, 2007 based upon his allegedly competitive and disloyal conduct.

STANDARD OF REVIEW

Rule 56(c) of the Federal Rules of Civil Procedure provides, in relevant part, that summary judgment is proper "if the pleadings, the discovery and disclosure materials on file, and any affidavits show that there is no genuine issue as to any material fact and that the movant is entitled to judgment as a matter of law." Fed.R.Civ.P. 56(c). An issue of material fact is genuine if "the evidence is such that a reasonable jury could return a verdict for the nonmoving party." *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 255, 106 S.Ct. 2505, 91 L.Ed.2d 202 (1986). Summary judgment will be granted "against a party who fails to make a showing sufficient to establish the existence of an element essential to that party's case, and on which that party will bear the burden of proof at trial." *Celotex Corp. v. Catrett*, 477 U.S. 317, 322, 106 S.Ct. 2548, 91 L.Ed.2d 265 (1986).

The party moving for summary judgment has the burden of demonstrating that there are no genuine issues of material fact. *Id.* at 322-23, 106 S.Ct. 2548. If the moving party sustains the burden, the nonmoving party must set forth facts demonstrating the existence of a genuine issue for trial. *See Anderson*, 477 U.S. at 255, 106 S.Ct. 2505. Rule 56(e) provides that when a properly supported motion for summary judgment is made, "an adverse party may not rest upon the mere allegations or denials of the adverse party's pleading, but the adverse party's response, by affidavits or as otherwise provided in this rule, must set forth specific facts showing that there is a genuine issue for trial." Fed.R.Civ.P. 56(e). The adverse party therefore must raise "more than a mere scintilla of evidence in its favor" in order to overcome a summary judgment motion, and cannot survive by relying on unsupported assertions, conclusory allegations, or mere suspicions. *Williams v. Borough of W. Chester*, 891 F.2d 458, 460 (3d Cir.1989). However, the "existence of disputed issues of material fact should be ascertained by resolving 'all inferences, doubts and issues of credibility against' " the moving party. *Ely v. Hall's Motor Transit Co.*, 590 F.2d 62, 66 (3d Cir.1978), *quoting Smith v. Pittsburgh Gage & Supply Co.*, 464 F.2d 870, 874 (3d Cir.1972).

DISCUSSION

Plaintiff claims that defendants breached the employment agreement by improperly and illegally assigning his employment contract to David's Bridal which resulted in a termination without cause and his entitlement to severance payments. Because defendants did not make such payments, plaintiff alleges defendants violated the WPCL. Defendants' counterclaims of breach of contract, misappropriation of trade secrets and/or confidential and proprietary information, breach of fiduciary duty and duty of loyalty, tortious interference with business and employment relations, unjust enrichment and unfair competition rest on two alleged actions by plaintiff: plaintiff's disclosure of "first cost" data to Erlbaum and plaintiff's introduction of David's Bridal employee Shaps-Shanin to Erlbaum.

I. *Plaintiff's Claims*

[1] Plaintiff filed claims for breach of contract and violations of the WPCL. Plaintiff argues that his employment contract with Macy's Retail was one for personal services and that it was thus improper ***518** and illegal to assign it to David's Bridal without his prior consent. Therefore, plaintiff argues that there was a breach of contract because this assignment was, in effect, a termination from Macy's Retail and that he is entitled to severance benefits under the contract for his termination without cause The parties do not dispute that defendants' failure to make the alleged required severance payments and the resulting alleged violations of the WPCL are contingent on whether defendants' assignment of plaintiff's contract to David's Bridal was proper. If the assignment was proper, then there is no breach of contract and accordingly no termination without cause to trigger the severance entitlement and defendants' violations of the WP-

CL.

Defendants dispute that the assignment was improper. They claim that the agreement permitted the assignment and, moreover, that the law allows such an assignment in situations involving sale of stock or merger.

[2][3][4][5] To recover for his breach of contract claim under Missouri law,[FN4] plaintiff must establish the following elements: "(1) the existence of an enforceable contract between the parties to the action; (2) mutual obligations arising under its terms; (3) the party being sued failed to perform obligations imposed by the contract; and (4) the party seeking recovery was thereby damaged." *Jackson v. Williams, Robinson, White & Rigler, P.C.*, 230 S.W.3d 345, 348 (Mo.Ct.App.2007).

> FN4. The contract at issue has a choice of law provision which states that Missouri law governs regarding "any questions or other matters arising under th[e] Agreement." Where, as here, federal jurisdiction is based on diversity of citizenship, I must apply the choice of law rules of the forum state, here Pennsylvania. *St. Paul Fire & Marine Ins. Co. v. Lewis,* 935 F.2d 1428, 1431 n. 3 (3d Cir.1991) *citing Klaxon Co. v. Stentor Elec. Mfg. Co.*, 313 U.S. 487, 496, 61 S.Ct. 1020, 85 L.Ed. 1477 (1941). Under Pennsylvania's choice of law analysis, "Pennsylvania courts generally honor the intent of the contracting parties and enforce choice of law provisions executed by them." *Kruzits v. Okuma Mach. Tool, Inc.*, 40 F.3d 52, 55 (3d Cir.1994) *citing Smith v. Commonwealth Nat'l Bank,* 384 Pa.Super. 65, 557 A.2d 775, 777 (1989). The choice of law provision stands "unless: (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." *Berg Chilling Sys.*, 435 F.3d at 463-64, *citing* Restatement (Second) of Conflicts of Law § 187(2). Thus, because neither party disputes that Missouri law applies to the breach of contract claim and counterclaim and because none of the above concerns are present, I will apply Missouri law to the breach of contract claims at issue.

The parties do not dispute that an agreement and mutual obligations existed between plaintiff and Macy's Retail. The parties dispute only whether defendants failed to perform a contractual obligation. Deciding this issue requires determining whether the assignment was proper.

[6][7] The employment contract at issue in this case is one for personal services, which, as a general rule, cannot be assigned without the consent of the employee. *Alexander & Alexander, Inc. v. Koelz,* 722 S.W.2d 311, 312-13 (Mo.Ct.App.1986), *citing Alldredge v. Twenty-Five Thirty-Two Broad. Corp.*, 509 S.W.2d 744, 749 (Mo.Ct.App.1974). However, a mere change in the form in which a business is owned or conducted should not work to prohibit assignment. *Id.* at 313. Whether there is a change in partnership personnel or structure, the incorporation of a previously unincorporated business, the dissolution of a corporation or a change in corporate***519** structure, "if there is no material change in the contract obligations and duties of the employee, there is no reason for the transfer of the rights from one entity or form to another to work an assignment putatively prohibited by the rule against assignment of personal service contracts." *Id.*, internal citations omitted.

The employment agreement between plaintiff and Macy's Retail expressly addressed assignability as follows:

> **11. Successors and Assigns.** This Agreement will inure to the benefit of, and will be binding upon, May, its successors and assigns; .... May may assign its obligations under this Agreement to a May subsidiary; .... Whenever this Agreement refers to May, that reference includes any of May subsidiaries or divisions in existence at any time during which this Agreement governs the conduct of you and May.

Plaintiff points out that the agreement defines May as "The May Department Stores Company" and that defendants do not dispute that this is May NY, aka Macy's Retail, not the parent company of May DE, aka Macy's. Plaintiff argues that Macy's Retail and David's Bridal are both subsidiaries of Macy's and therefore the provision permitting Macy's Retail to assign its obligations under the agreement to a Macy's Retail subsidiary cannot apply to David's Bridal. However, regardless of the subsidiary structure that existed between Macy's Retail and David's Bridal, language in the agreement specifically refers to David's Bridal as a division of Macy's Retail. The first time that David's Bridal is mentioned, in the first paragraph in the first section of the agreement entitled "Employment," the agreement refers to plaintiff's employment as Executive Vice President "of the David's Bridal division of May," aka Macy's Retail.[FN5] When signing the agreement, plaintiff consented to a possible assignment to David's Bridal as it was defined as a division of Macy's Retail. Thus, plaintiff consented to the assignment of his contract to David's Bridal. Moreover, plaintiff admits that his duties remained the same; the sole change was that David's Bridal was obligated to him for his performance of the duties and not Macy's Retail. Defendants' motion for summary judgment on plaintiff's breach of contract claim and WPCL claims against defendants will be granted because plaintiff's claims are based solely on the assignment being improper.[FN6] Accordingly, plaintiff's*520 motion for summary judgment on all of his claims will be denied.

FN5. Plaintiff's statement of facts in response to defendants' motion for summary judgment and his cross motion for summary judgment state that plaintiff was the Executive Vice-President of the David's Bridal division of May DE, aka Macy's. The agreement does not include "DE" after May and, based on the plaintiff's own arguments, "May" refers to May NY, aka Macy's Retail in the agreement, not May DE, aka Macy's. Plaintiff cannot argue for different meanings of the term "May" in different locations of the agreement to benefit him accordingly. *See e.g., Thompson v. Potter,* 2006 WL 783395, at *11 (S.D.Ohio Mar. 27, 2006), holding that "the plaintiff cannot expect to present two conflicting arguments and have the Court interpret both sets of facts to his advantage."

FN6. Because I will find that the agreement expressly permitted assignment, I need not consider whether the law permits assignment in this circumstance regardless of consent. However, I note that during the sale and transfer of stock of David's Bridal to a Leonard Green Partners, LLC affiliate, plaintiff's agreement remained with David's Bridal and that plaintiff admitted that no material change occurred in his contract obligations or duties. I also note that after the assignment plaintiff performed the same duties for David's Bridal without objection until his termination.

> Moreover, I note that it appears that the language stating that "the Agreement will inure to the benefit of, and will be binding upon, May, its successors and assigns ..." also supports the proposition that plaintiff consented to have his contract assigned. Missouri courts have previously held that virtually identical language stating that "[t]his Agreement shall be binding on and inure to the be-

> nefit of the parties and their respective heirs, successors, assigns and legal representatives" is sufficient to render an agreement involving personal services assignable. *Orthotic & Prosthetic Lab, Inc. v. Pott,* 851 S.W.2d 633, 639 (Mo.Ct.App.1993), see *also Schnucks Twenty-Five, Inc. v. Bettendorf,* 595 S.W.2d 279, 287 (Mo.Ct.App.1979).

II. *Defendant's Counterclaims*

Defendants seek summary judgment on their counterclaims for breach of contract, breach of fiduciary duty and duty of loyalty and misappropriation of trade secrets and/or confidential and proprietary information. Plaintiff seeks summary judgment on these counterclaims and on defendants' counterclaims for tortious interference with business and employment relations, unjust enrichment, unfair competition and defendants' request for injunctive relief. Defendants' counterclaims are based on plaintiff's request and disclosure of "first cost" data to Erlbaum and plaintiff's introduction of Shaps-Shanin to Erlbaum.

A. Disclosure of "First Cost" Data to Erlbaum

Defendants assert the following counterclaims arising out of plaintiff's request for and disclosure of the "first cost" data to Erlbaum: breach of contract; misappropriation of trade secrets and/or confidential and proprietary information; breach of fiduciary duty and duty of loyalty; unjust enrichment; and unfair competition. Plaintiff argues that defendants' counterclaims for misappropriation of trade secrets and/or confidential and proprietary information, unjust enrichment and unfair competition are preempted by the Pennsylvania Uniform Trade Secrets Act (PUTSA), 12 Pa. Cons.Stat. Ann. § 5301, et seq. (2004). Plaintiff also argues that defendants cannot establish any damages to support any of their counterclaims involving the "first cost" data. Even if defendants could establish damages, plaintiff argues that defendants have not satisfied the other elements of these counterclaims.

1. PUTSA's Alleged Premption

[8][9][10][11][12] Plaintiff argues that defendants' counterclaims for misappropriation of trade secrets and/or confidential and proprietary information, unjust enrichment and unfair competition are preempted by the PUTSA.[FN7] The relevant section of the ***521** PUTSA provides as follows:

> FN7. The choice of law provision in the agreement between Macy's Retail and plaintiff only applied to claims arising under the agreement. Thus, I must address choice of law for the counterclaims not arising under the agreement, including the analysis of whether the PUTSA preempts the counterclaims at issue. Where, as here, federal jurisdiction is based on diversity of citizenship, I must apply the choice of law rules of the forum state, here Pennsylvania. *St. Paul Fire & Marine Ins. Co. v. Lewis,* 935 F.2d 1428, 1431 n. 3 (3d Cir.1991) *citing Klaxon Co. v. Stentor Elec. Mfg. Co.,* 313 U.S. 487, 496, 61 S.Ct. 1020, 85 L.Ed. 1477 (1941). "Because choice of law analysis is issue-specific, different states' laws may apply to different issues in a single case, a principle known as depecage." *Berg Chilling Sys., Inc. v. Hull Corp.,* 435 F.3d 455, 462 (3d Cir.2006); *Taylor v. Mooney Aircraft Corp.,* 265 Fed.Appx. 87, 91 n. 4 (3d Cir.2008), recognizing prediction that a Pennsylvania court would apply different state laws in the same case because *Griffith v. United Air Lines, Inc.,* 416 Pa. 1, 203 A.2d 796, 805 (1964), suggests that each issue must receive a separate choice of law analysis.
>
> Pennsylvania's choice of law analysis requires that I determine whether a false conflict exists, and, if no false conflict exists, that I determine which state has

the greater interest in the application of its law. *LeJeune v. Bliss-Salem, Inc.*, 85 F.3d 1069, 1071 (3d Cir.1996), *citing Cipolla v. Shaposka*, 439 Pa. 563, 267 A.2d 854, 855-56 (1970). A false conflict exists where the application of either state's law renders the same result, *Coram Healthcare Corp. v. Aetna U.S. Healthcare, Inc.*, 94 F.Supp.2d 589, 594 (E.D.Pa.1999), or where "only one jurisdiction's governmental interests would be impaired by the application of the other jurisdiction's law," *LeJeune*, 85 F.3d at 1071.

Neither parties' briefs contain a discussion of choice of law beyond a mere mention that they agreed that Missouri law applies to the contract claims. The parties address the preemption issue under the PUTSA without objection to the application of Pennsylvania law. The only other state with a purported interest in this case is Missouri. Like Pennsylvania, Missouri has adopted the Uniform Trade Secrets Act, Mo. Ann. Stat. § 417.450 et seq. Thus, no differences exist between the laws of these two states to affect the outcome of whether the counterclaims at issue are preempted and a false conflict exists. There being no conflict, I will apply the forum states' law, i.e. the PUTSA. *Scirex Corp. v. Federal Ins. Co.*, 313 F.3d 841, 847 n. 1 (3d Cir.2002); *Drexel Univ. v. Santa Fe Sci. and Tech., Inc.*, 2005 WL 5973213, at *1 (E.D.Pa. Apr. 26, 2005).

(a) General rule.-Except as provided in subsection (b), this chapter displaces conflicting tort, restitutionary and other law of this Commonwealth providing civil remedies for misappropriation of a trade secret.

(b) Exceptions.-This chapter does not affect:

(1) contractual remedies, whether or not based upon misappropriation of a trade secret;

(2) other civil remedies that are not based upon misappropriation of a trade secret; or

(3) criminal remedies, whether or not based upon misappropriation of a trade secret.

12 Pa.C.S.A. § 5308. The dominant view of courts in states that have also adopted the Uniform Trade Secrets Act of 1985 is that preemption exists to the extent that defendants' counterclaims are based on the same conduct that is said to constitute a misappropriation of trade secrets. *See e.g., Motorola, Inc. v. Lemko Corp.*, 609 F.Supp.2d 760, 771 (N.D.Ill.2009); *Hecny Trans., Inc. v. Chu*, 430 F.3d 402, 404-05 (7th Cir.2005); *Penalty Kick Mgmt. Ltd. v. Coca Cola Co.*, 318 F.3d 1284, 1296-98 (11th Cir.2003); *Savor, Inc. v. FMR Corp.*, 812 A.2d 894 (Del.2002).

Defendants' counterclaims for misappropriation of trade secrets and/or confidential and proprietary information, breach of fiduciary duty and duty of loyalty, unjust enrichment and unfair competition involve plaintiff's conduct of requesting and disclosing "first cost" data to Erlbaum.[FN8] These claims each refer to the same "first cost" data and are wholly based on the same conduct as the conduct that comprises a misappropriation of trade secrets claim. The "first cost" data is the sole information at issue in this case and it is either a trade secret or something less.[FN9] Thus, these counterclaims are preempted only if the "first cost" data at issue constitutes a misappropriation of a trade secret. *See e.g., T.D.I. Intern., Inc. v. Golf Preservations, Inc.*, 2008 WL 294531, at *5 (E.D.Ky. Jan. 31, 2008), stating that breach of *fiduciary duty* claim is preempted by Kentucky Uniform Trade Secrets Act if premised upon the alleged disclosure of trade secrets; *Weiss v. Fiber Optic Designs, Inc.*, 2007 WL 3342605, at *1 (E.D.Pa. Nov. 9, 2007), stating that claims of breach of *duty of loyalty* and *unfair competition* would be preempted to the extent they are based on misappropriation of trade secrets but delaying a finding on ***522** preemption until it could be determined whether the conduct constituted a misappropriation of a trade secret; *Penalty Kick Mgmt. Ltd. v. Coca Cola Co.,* 318 F.3d 1284, 1296-98 (11th Cir.2003), agreeing with the district court's finding that breach of confidential relationship and duty of good faith and *unjust enrichment* claims are preempted by the Georgia Trade Secrets Act because these claims are based on the same facts that comprise the trade secret claim. (All emphases added).

> FN8. As discussed above, some of these same counterclaims involve plaintiff's introduction of Shaps-Shanin to Erlbaum and this will be discussed below as they are separate claims.

> FN9. Information need not rise to the level of a trade secret in order to qualify for protection under other theories. *See Brett Senior & Associates, P.C. v. Fitzgerald,* 2007 WL 2043377, at *8 (E.D.Pa. July 13, 2007). The parties should consider this question in future briefs.

[13] The PUTSA creates a statutory cause of action for injunctive relief, compensatory damages and exemplary damages for the actual loss caused by misappropriation of trade secrets and the unjust enrichment caused by such misappropriation. 12 Pa.C.S.A. §§ 5303-4. "Misappropriation" is defined to include:

> (1) acquisition of a trade secret of another by a person who knows or has reason to know that the trade secret was acquired by improper means; or
>
> (2) disclosure or use of a trade secret of another without express or implied consent by a person who:
>
> (i) used improper means to acquire knowledge of the trade secret;
>
> (ii) at the time of disclosure or use, knew or had reason to know that his knowledge of the trade secret was:
>
> (A) derived from or through a person who had utilized improper means to acquire it;
>
> (B) acquired under circumstances giving rise to a duty to maintain its secrecy or limit its use; or
>
> (C) derived from or through a person who owed a duty to the person seeking relief to maintain its secrecy or limit its use; or
>
> (iii) before a material change of his position, knew or had reason to know that it was a trade secret and that knowledge of it had been acquired by accident or mistake.

12 Pa.C.S.A. § 5302. A trade secret under the PUTSA is defined as:

> Information, including a formula, drawing, pattern, compilation including a costumer list, program, device, method, technique or process that:
>
> (1) Derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use.
>
> (2) Is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.

PUTSA, 12 Pa.C.S.A. § 5302. Some factors to be considered in determining whether given information is a trade secret are: (1) the extent to which the information is known outside of the owner's business; (2) the extent to which it is known by employees and others involved in the owner's business; (3) the extent of measures taken by the owner to guard the secrecy of the information; (4) the value of the information to the owner and to his competitors; (5) the amount of effort or money expended by the owner in developing the information; and (6) the ease or difficulty with which the information could be properly acquired or duplicated by others. *SI Handling Sys., Inc. v. Heisley,* 753 F.2d 1244, 1255-56 (3d Cir.1985), *citing* Restatement of Torts

§ 757 comment b (1939); *Amerisourcebergen Drug Corp. v. Am. Associated Druggists, Inc.*, 2008 WL 248933, at *18-19 (E.D.Pa. Jan. 29, 2008); *Iron Age Corp. v. Dvorak*, 880 A.2d 657, 663 (Pa.Super.Ct.2005).[FN10]

> FN10. The PUTSA displaced Pennsylvania's common law tort for misappropriation of trade secrets, but there is no indication that the statute effected a substantive shift in the definition of "trade secret." The common-law definition, like the statutory one, provided for protection for a formula, pattern, device, or compilation of information and required that the information be kept secret and provide a competitive value to the owner. *Pestco, Inc. v. Associated Prod., Inc.*, 880 A.2d 700, 706 (Pa.Super.Ct.2005). The conclusion that the PUTSA did not substantially alter the definition of "trade secret" is supported by post-PUTSA cases that rely on common law in determining whether certain information rises to the level of a trade secret. *See, e.g., Parsons v. Pa. Higher Educ. Assistance Agency,* 910 A.2d 177, 185-86 (Pa.Commw.Ct.2006); *Select Med. Corp. v. Hardaway,* 2006 WL 859741, at *8 (E.D.Pa.2006); *Brubaker Kitchens, Inc. v. Brown,* 2006 WL 1193223, at *1-2 (E.D.Pa.2006).

***523** However, neither party has properly briefed whether this information qualifies as a trade secret. Plaintiff argues that the PUTSA preempts defendants' counterclaims but states, without sufficient legal analysis, that the information does not qualify as a trade secret to satisfy the PUTSA because it was readily available to anyone who asked for it. These arguments are contradictory; plaintiff cannot have it both ways. *See Callaway Golf Co. v. Dunlop Slazenger Group Am., Inc.*, 295 F.Supp.2d 430, 437 (D.Del.2003), stating that arguing that information does not constitute a trade secret and also that other claims are preempted by the Trade Secret Act is contradictory. Defendants did not respond with legal analysis on whether the "first cost" data constitutes a trade secret; instead they merely requested leave to file an amended counterclaim complaint if I find such information to be a trade secret. As this information may qualify as a trade secret, I will not find that the data satisfies lesser standards than those required for a trade secret merely because the issue has not been properly briefed. For this reason, I cannot find that defendants' counterclaims of misappropriation of trade secrets and/or confidential and proprietary information, breach of fiduciary duty and duty of loyalty, unjust enrichment and unfair competition are preempted at this time because defendants may still be able to recover under such theories in the event that the "first cost" data does not constitute a misappropriation of a trade secret under the PUTSA. *Cenveo Corp. v. Slater,* 2007 WL 527720, at *3 (E.D.Pa. Feb. 12, 2007), stating "that the cases holding that the Trade Secrets Act does not preempt common law tort claims when it has yet to be determined whether the information at issue constitutes a trade secret take the better approach." Thus, plaintiff's motion for summary judgment on these claims and defendants' motion for summary judgment on their misappropriation of trade secrets and/or confidential and proprietary information claim and breach of fiduciary duty and duty of loyalty claims will be denied without prejudice. Defendants will be permitted to file an amended counterclaim adding a claim under the PUTSA within 15 days from date. Plaintiff and defendants will be permitted to simultaneously file motions for summary judgment on these claims within 15 days from date briefing whether the information qualifies as a trade secret, the merits of a claim under the PUTSA if the information is a trade secret, the merits of the other claims if it does not with the relevant choice of law analysis, and the appropriate relief available. The parties are requested to provide authority to support their arguments to allow me to properly determine the status of the information or if factual issues exist regarding its status. *See Amerisourcebergen Drug Corp.*, 2008 WL 248933, at *26, finding that whether the "information can qualify as trade secrets is dependant upon the resolution of disputed questions of fact."

2. Breach of Contract Claim

Defendants allege that plaintiff breached his contract [FN11] with defendants by violating ***524** a confidentiality restriction in a restrictive covenant provision of the agreement when he provided Erlbaum with confidential information regarding "first cost" data. Plaintiff argues that defendants have not established that he engaged in any activity that breached his employment agreement because they failed to show that the information allegedly misappropriated was confidential and proprietary information or that it was disclosed to anyone outside of defendants' company while plaintiff was still employed with defendant.

> FN11. Defendants' counterclaim for breach of contract for plaintiff's request and disclosure of the "first cost" data to Erlbaum is specifically excluded from the preemption by subsection (b)(1) of the PUTSA. *See* 12 Pa.C.S.A. § 5308(b)(1), making an exception for contractual remedies.

To recover for its breach of contract claim under Missouri law, [FN12] defendant must establish the following elements: "(1) the existence of an enforceable contract between the parties to the action; (2) mutual obligations arising under its terms; (3) the party being sued failed to perform obligations imposed by the contract; and (4) the party seeking recovery was thereby damaged." *Jackson v. Williams, Robinson, White & Rigler, P.C.*, 230 S.W.3d 345, 348 (Mo.Ct.App.2007).

> FN12. As discussed above, under the agreement Missouri law applies to the contract claims in this case.

Plaintiff does not contest that a valid, enforceable contract giving rise to mutual obligations existed between himself and Macy's Retail or that his employment agreement obligated him not to disclose "Confidential Information" as defined in that agreement. However, plaintiff claims that defendants have not established the third element, that he failed to perform his contractual obligations, because defendants have failed to produce any evidence that the information plaintiff disclosed was "Confidential Information" as defined in the agreement. Plaintiff does not contest that he disclosed such information and, in fact, admits that he did. Plaintiff also argues that defendants fail to satisfy the fourth element for the breach of the confidentiality provision because they present no evidence that they suffered any damages as a result of the alleged conduct. Defendants argue that they are entitled to summary judgment on their counterclaim for breach of contract because plaintiff admits that he disclosed "first cost" data to Erlbaum and such information was confidential.

[14] First, I will consider whether the information was confidential. The confidentiality provision in Section 6 states that plaintiff is prohibited "at any time, directly or indirectly, [from] us[ing] or disclos[ing] any of May's [aka Macy's Retails'] Confidential Information except as authorized and within the scope of [his] employment with May [aka Macy's Retail]". Section 6(d) defines Confidential Information as:

> any non-public information pertaining to May's business. Confidential information includes information disclosed by May to you, and information developed or learned by you during the course of or as a result of your employment with May, which you also agree is May's property.... Confidential information includes, without limitation, information and documents concerning May's processes, suppliers (including May's terms, conditions and other business arrangements with suppliers); supplier and customer lists; advertising and marketing plans and strategies; profit margins; seasonal plans, goals objectives and projections; compilations, anaylses and projections regarding May's divi-

sions, stores, product segments, product lines, suppliers, sales and expenses; files; trade secrets and patent applications (prior to their being public); salary, staffing and employment information (including information about performance***525** of other executives); and "know-how," techniques or any technical information not of a published nature relating, for example, how May conducts its business.

As the agreement specifically defines what constitutes confidential information, I will consider only whether the information satisfies the provision's definition.

Plaintiff argues that, based on his experience, factories in Asia are under no obligation to keep the prices that they charge to their various customers confidential and that such information is well known and readily available to anyone seeking to do business with the various manufacturers from which David's Bridal buys dresses.[FN13] I find this statement to be self-serving and without any factual or legal support. Moreover, it fails to recognize the provision's definition which does not depend on plaintiff's experience.

> FN13. Plaintiff specifically testified in his deposition that:
>
> > The orient has no secrets. Everyone in the orient knows everyone's business. So what you're saying, I'm sure that everyone who wanted to know could easily find out. The factories that David's used were not David's sole factories, they were factories that many people worked in .... As I explained to you before, there is no secrets in the orient. They [referring to any third party] could easily find that [referring to the cost of manufacturing of any specific David's Bridal gown.] They have the picture. They could find out within an hour ... Within five minutes, if they were in the factory.

Plaintiff also argues that the information at issue is public and, therefore, not confidential because confidential information under the agreement is defined as "any non-public information pertaining to May's business." Plaintiff cites *SI Handling Systems, Inc. v. Heisley,* 753 F.2d 1244 (3d Cir.1985) for the proposition that the price of materials are readily available from a third-party supplier. *Id.* at 1257. Plaintiff argues that this case supports that the cost of a company's product is not confidential information when readily available directly from the manufacturer. However, *SI Handling Systems* addresses other products involved in the case and found that another product's price was confidential when the manufacturer was given exact specifications for the product and the product was manufactured exclusively for that customer. *Id.* Plaintiff does not provide evidence to the contrary or even refute that the "first cost" data was a list of the manufacturing costs of the gowns and accessories in David's Bridal's Spring 2007 Bridal Catalog (approximately 140 items) manufactured by the factories to the design specifications of David's Bridal exclusively for David's Bridal. The information at issue was not merely the costs that the factory charges for its materials that go into their customer's products; the information was specific for David's Bridal's products. Although plaintiff may accurately argue that factories could provide third parties with the costs of the factories' materials, plaintiff provides no support for his contention that factories are permitted to provide the costs of David's Bridal's specific final products. Though individuals could request the cost of the material used in David's Bridal gowns for their own designs, this is distinguishable from individuals being told the factories' costs to manufacturer David's Bridal's designs. *See id.* Thus, the information satisfies the requirement under the agreement that confidential information be "non-public information pertaining to [Macy's Retail's] business."

Additionally, the agreement specifically states that confidential information "includes, without limitation, information and documents concerning

[Macy's Retail's] ... suppliers (including [Macy's Retail's] terms, conditions and other business arrangements with suppliers)." Plaintiff fails to provide any evidence that this provision***526** does not cover the information at issue which concerns an aspect of the business arrangements with one of their factory suppliers. Because plaintiff fails to provide any such evidence or any evidence or law to refute the nonpublic nature of the information, the information qualifies as confidential information under the agreement. [FN14]

> FN14. Because defendants have sufficiently provided evidence that the information at issue was confidential information under the agreement, I will not address any arguments suggesting that plaintiff's behavior with regard to his request of the information may also support that such information is confidential, the significance of the alleged confidentiality agreements David's Bridal had with the factories or plaintiff's argument that these agreements do not cover the information at issue. I note that as plaintiff refers to these agreements as alleged confidentiality agreements defendants may find it necessary to offer such agreements for in-camera review as support for their other claims when filing the additional brief requested.

Moreover, plaintiff's arguments that he disclosed the "first cost" data to Erlbaum only after his employment with defendants ended is irrelevant to determining a breach of this provision. The confidentiality provision specifically states that plaintiff will not disclose the confidential information "at any time" without limiting it to his time of employment or even to a year thereafter as the conflict of interest provision provides. Additionally, plaintiff's argument that Erlbaum was not and is still not in a competing business with David's Bridal and that the alleged wholesale business that Erlbaum discussed with plaintiff would not actually compete with defendants is irrelevant to a finding a breach of this provision. [FN15] The provision does not provide any language limiting a breach to those situations where the confidential information is disclosed to someone who is competing or planning to compete with defendants' business. Plaintiff disclosed the information to someone outside of defendants' company; whether the individual established a competing legal entity at any time is irrelevant. *See Orthovita, Inc. v. Erbe,* 2008 WL 423446, at *9 (E.D.Pa. Feb. 14, 2008). Thus, this information was confidential and, as plaintiff admits he disclosed it to Erlbaum, defendants have established that plaintiff failed to perform his obligation under the confidentiality provision.

> FN15. As I find these arguments irrelevant, I will not address defendants' argument that plaintiff makes contradictory statements in his deposition and affidavit regarding his discussions with Erlbaum.

[15] Because defendants satisfied the third element, I will address whether defendants satisfy the damage element of this claim. Defendants claim that their damages were incurred when plaintiff engaged in "disloyal conduct while on trips to Houston, Europe, and Asia at the company's expense as part of his plan to obtain and provide David's Bridal's confidential first cost data information to competitor or potential competitor Erlbaum." Plaintiff argues that the only conduct alleged to have occurred during any of plaintiff's travels was his request for "first cost" data from Chow during his business trip to Hong Kong. Although defendants include Houston and London in their list of business trips, they do not provide any evidence of or even specifically discuss in their briefing any additional conduct that would lead to damages during these trips. Plaintiff also alleges that defendants fail to allege any damages as a result of plaintiff's disclosure of the "first cost" data to Erlbaum. Plaintiff also alleges that no damages exist because he disclosed the information to Erlbaum only after his employment ended with defendants.

As plaintiff admits that he requested the "first cost" data from Chow while on a ***527** business trip in Hong Kong and provided it to Erlbaum and I find such information satisfies the confidentiality provision's prohibition to disclose, the costs associated with this inappropriate use of his time should be reimbursed to defendants. Because the damages sustained consist of the value of this use of time which occurred while employed by defendants, plaintiff's argument that he disclosed the information after his employment with defendants ended is irrelevant. Defendants, however, have failed to provide any evidence that this request was the entire purpose of plaintiff's trip to Hong Kong; therefore, reimbursement of the trip as a whole would be improper. Additionally, defendants have provided no evidence that his trip to Hong Kong was not part of his regular duties for David's Bridal, particularly as defendants do not dispute that other David's Bridal employees not accused of any wrongdoing were also on the trip. Therefore, plaintiff does not forfeit his salary for these duties and need not reimburse defendants for the entire expense of the trip. *See Fidelity Fund, Inc. v. Di Santo,* 347 Pa.Super. 112, 500 A.2d 431, 440 (1985). He loses only the portion of his salary that can be attributed to the time he spent obtaining the "first cost" data. *Id.* Defendants also fail to show any further damages from plaintiff requesting and disclosing the "first cost" data to Erlbaum [FN16] or any law that the mere disclosure results in damages.[FN17] Thus, defendants' motion for summary judgment on their breach of contract claim for this conduct will be granted and plaintiff's motion for summary judgment for this claim will be denied. A hearing on damages will be limited to determining the damages incurred during the business trip to Hong Kong when plaintiff requested the information.

FN16. Defendants cite *Dozor Agency, Inc. v. Rosenberg,* 218 A.2d 583 (Pa.1966) for the proposition that it is entitled to recoup its costs of investigating plaintiff's conduct. *Id.* at 585-86. However, this case involved a discussion of out-of-pocket expenses for salaries for the time employees spent reinstating former policies and protecting other policies affected by defendant's actions. *Id.* The case does not discuss entitlement to recoup costs incurred by defendants to investigate plaintiff's conduct. Defendants provide no other case law to support the reimbursement of such costs.

FN17. Even if defendants had provided law to support that mere disclosure creates damages, plaintiff claims that the disclosure did not occur until February when he was no longer employed by defendants and was instead employed by David's Bridal.

B. Introduction of Shaps-Shanin to Erlbaum

[16] Defendants argue the following counterclaims for plaintiff's introduction of Shaps-Shanin to Erlbaum: breach of contract, breach of fiduciary duty and duty of loyalty and tortious interference with business and employment relations. Plaintiff claims that defendants fail to demonstrate any damages as a result of this conduct. Additionally, even if damages existed, plaintiff argues that the fact that he admittedly introduced Shaps-Shanin to Erlbaum or that he provided her name to Erlbaum cannot be a solicitation of a David's Bridal employee in violation of his employment agreement's conflict of interest provision or a breach of any duty because he introduced Shaps-Shanin to Erlbaum at Shaps-Shanin's request and there were never any concrete discussions or plans for a business, let alone a competing business, to solicit Shaps-Shanin to join.

Each of these counterclaims requires that defendants prove damages. *See e.g., Jackson,* 230 S.W.3d at 348, breach of contract claim requires damages; *Baker v. Family Credit Counseling Corp.,* 440 F.Supp.2d 392, 414-15 (E.D.Pa.2006), ***528** breach of fiduciary duty claim requires a suffered injury harm; *McDermott v. Party City Corp.,* 11 F.Supp.2d 612, 626 n. 18 (E.D.Pa.1998), breach of duty of loyalty requires a suffered injury; *Rossi v. Schlarbaum,* 600 F.Supp.2d 650, 659

(E.D.Pa.2009), tortious interference with business and employment relations claims require actual damages.[FN18] Based on plaintiff's arguments, I will first address whether defendants have satisfied the damage element of these claims.

FN18. As discussed above, under the agreement Missouri law applies to the breach of contract counterclaim. With regard to the other counterclaims based on plaintiff's introduction of Shaps-Shanin to Erlbaum, neither parties' briefs contain a discussion of choice of law nor is there a dispute regarding which law to use and, indeed, both parties use Missouri and Pennsylvania law interchangeably in their briefings for some of these counterclaims. Like Pennsylvania, Missouri law for defendants' counterclaims of breach of fiduciary duty and duty of loyalty and tortious interference with business and employment relations requires damages. *See e.g., Icard Stored Value Solutions, L.L.C. v. West Suburban Bank,* 2008 WL 619236, at *3 (E.D.Mo. Mar. 3, 2008), *citing Preferred Physicians Mut. Mgmt. Group v. Preferred Physicians Mut. Risk Retention,* 918 S.W.2d 805, 810 (Mo.Ct.App.1996), breach of fiduciary duty claim requires damage; *Pony Computer, Inc. v. Equus Computer Sys. of Mo., Inc.,* 162 F.3d 991, 999 (8th Cir.1998), *citing Peterson v. Continental Boiler Works, Inc.,* 783 S.W.2d 896, 904-05 (Mo.1990), a breach of the duty of loyalty is treated as breach of a fiduciary duty which requires damages; *Nitro Distributing, Inc. v. Alitcor, Inc.,* 565 F.3d 417, 427-28 (8th Cir.2009), *citing Nazeri v. Mo. Valley Coll.,* 860 S.W.2d 303, 316 (Mo.1993), tortious interference claims require damages. Because these counterclaims can be decided on the damage element alone, and the laws of the interested states do not differ materially on this element, no conflict exists and I will apply Pennsylvania law. *Scirex Corp.,* 313 F.3d at 847 n. 1; *Drexel Univ.,* 2005 WL 5973213, at *1; *Vital State Canada, Ltd. v. DreamPak, LLC,* 303 F.Supp.2d 516, 521 (D.N.J.2003), finding that no conflict for choice of law analysis is needed when only one element was necessary to decide the case and the laws of the interested states did not differ materially on this element.

Defendants have not established any damages associated with plaintiff's introduction of Shaps-Shanin to Erlbaum, with his providing her name to Erlbaum at Erlbaum's request that plaintiff tell him "the names of people that were good that were employees of David's" or with his request for Shaps-Shanin's employment contract to satisfy these counterclaims. Defendants do not provide any evidence of damages they incurred based on plaintiff's introduction of Shaps-Shanin to Erlbaum. No evidence exists that Shaps-Shanin left defendants' employment as a result of such introduction or that she left at all. Defendants provide no allegations of such damages, let alone evidence of such and fail to provide any law that the mere introduction results in damages. As discussed above, the only evidence of damages defendants provide for any of their counterclaims involves expenses incurred by David's Bridal when plaintiff requested the "first cost" data in Hong Kong. Thus, plaintiff's motion for summary judgment on defendants' breach of contract, breach of fiduciary duty and duty of loyalty and tortious interference with business and employment relations claims for plaintiff's introduction of Shaps-Shanin to Erlbaum will be granted because defendants fail to provide any evidence of damages for these counterclaims. Accordingly, defendants' motion for summary judgment on their counterclaims for breach of contract and breach of fiduciary duty and duty of loyalty for this conduct will be denied.

An appropriate Order follows.

ORDER

AND NOW, this 5th day of June 2009, upon consideration of defendants' Macy's ***529** Inc. and Macy's Retail Holdings, Inc. motions for summary judgment on plaintiff Philip Youtie's claims (No. 33), plaintiff's response and cross-motion for summary judgment (No. 40), defendants' reply, plaintiff's reply in support of his cross-motion for summary judgment on his claims and defendants' sur-reply thereto, and defendants' motion for partial summary judgment (No. 43) on some of its counterclaims, plaintiff's response and defendants' reply thereto and for the reasons set forth in the accompanying memorandum of law, it is ORDERED that:

1. Defendants' motion for summary judgment on plaintiff's claims of breach of contract and violations of the Pennsylvania Wage Payment and Collection Law, 43 P.S. § 260.1 et seq. is GRANTED. Accordingly, plaintiff's motion for summary judgment on these claims is DENIED. Pursuant to Rule 54(b) and finding that there is no just reason for delay, judgment is entered in favor of defendants Macy's Inc. and Macy's Retail Holdings, Inc. and against plaintiff Philip Youtie on plaintiff's claims against defendants.

2. Plaintiff's motion for summary judgment on defendants' counterclaims of misappropriation of trade secrets and/or confidential and proprietary information, breach of fiduciary duty and duty of loyalty, unjust enrichment and unfair competition with regards to plaintiff's request and disclosure of "first cost" data is DENIED without prejudice. Defendants' motion for summary judgment on their counterclaims of misappropriation of trade secrets and/or confidential and proprietary information and breach of fiduciary duty and duty of loyalty with respect to plaintiff's request and disclosure of "first cost" data is DENIED without prejudice. Defendants may file an amended counterclaim complaint adding a claim under the Pennsylvania Uniform Trade Secrets Act (PUTSA), 12 Pa. Cons.Stat. Ann. § 5301, et seq. (2004) within 15 days of the date of this order. Plaintiff and defendants may submit simultaneous motions for summary judgment on these claims within 15 days of the date of this Order to brief whether the "first cost" data qualifies as a trade secret, the merits of a claim under the PUTSA, the merits of the alternative claims with the relevant choice of law analysis and the appropriate relief available.

3. Defendants' motion for summary judgment on their breach of contract claim for plaintiff's request and disclosure of "first cost" data is **GRANTED.** Accordingly, plaintiff's motion for summary judgment on this claim is DENIED. A hearing will be scheduled to determine damages.

4. Plaintiff's motion for summary judgment on defendants' breach of contract, breach of fiduciary duty and duty of loyalty and tortious interference with business and employment relations with respect to plaintiff's introduction of David's Bridal employee Linda Shaps-Shanin to Steven Erlbaum is GRANTED. Accordingly, defendants' motion for summary judgment on their counterclaims of breach of contract, and breach of fiduciary duty and duty of loyalty with respect to plaintiff's introduction of Shaps-Shanin to Erlbaum is DENIED.

5. Plaintiff's motion for summary judgment on defendants' request for injunctive relief is DENIED without prejudice. Plaintiff and defendants may submit simultaneous motions regarding the request for injunctive relief within 15 days of the date of this Order.

E.D.Pa.,2009.
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