



1 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

I. INTRODUCTION

A. Nature of Contract.

1. Definitions.

a. Contract

1 Witkin Sum. Cal. Law Contracts § 1

[§ 1] Contract

(1) *Civil Code*. The Civil Code defines a contract as "an agreement to do or not to do a certain thing." (C.C. 1549.) Once entered into, a contract gives rise to an obligation or legal duty, enforceable in an action at law. (C.C. 1427, 1428.) (See 1 Corbin (Rev. ed.), §1.1 et seq.; 1 Williston 4th, §1:1 et seq.; 47 *So. Cal. L. Rev.* 691 [extended criticism of traditional definition]; BAJI, No. 10.55 [Contract Defined/Elements]; CACI, No. 302 [Contract Formation--Essential Factual Elements].)

(2) *Uniform Commercial Code*. This Code distinguishes "agreement" from "contract": An "agreement" is the bargain of the parties in fact as determined from their language or by implication from other circumstances (U.C.C. 1201(3)); a "contract" is the total legal obligation resulting from that agreement (U.C.C. 1201(11)).

(3) *Restatement 2d*. "A contract is a promise or a set of promises for the breach of which the law gives a remedy, or the performance of which the law in some way recognizes as a duty." (*Rest.2d, Contracts §1*.) The Comments to this section contain a number of clarifying observations:

(a) The word "contract" is often used with different meanings, e.g., as a synonym for "agreement" or "bargain." It may refer to legally ineffective agreements, or wholly executed transactions; to acts of parties, to a document that evidences them, or to resulting legal relations; and a statute may give still other meanings. Here, the definition in terms of promise excludes executed transactions and obligations imposed by law. (Comment a.)

(b) "Contract" is commonly and quite properly used to refer to the resulting legal obligation. (Comment b.)

(c) A contract may consist of a single promise or a set of promises. To constitute a "set," the promises need not be made simultaneously; it is enough that several promises are regarded by the parties as constituting a single contract, or are so related in subject matter and performance that they may be considered and enforced together. (Comment c.)

(d) "The term contract is generic. As commonly used, and as here defined, it includes varieties described as voidable, unenforceable, formal, informal, express, implied ... unilateral, bilateral." (Comment f.)

(e) The word "binding" or "bound" is used to indicate that (1) the duty arises if the promisor has full capacity, (2)

there is no illegality or fraud, (3) the duty has not been discharged, and (4) there are no other similar facts that would defeat the prima facie duty stated. (Comment g.) (On avoidance in Rest.2d of use of terms "unilateral" and "bilateral," see infra, §6.)

West's Key Number Digest, Contracts k.1

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Civil Code*. See 1 Williston 4th (2007 ed.), §1:1 et seq.(2) *Uniform Commercial Code*. U.C.C 1201 was amended in 2006, and the provisions on "contract" and "agreement" were redesignated U.C.C 1201(b)(12). That subdivision now reads: " 'Contract,' as distinguished from 'agreement,' means the total legal obligation that results from the parties' agreement as determined by this code and as supplemented by any other applicable laws."



2 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

I. INTRODUCTION

A. Nature of Contract.

1. Definitions.

b. Related Terms.

1 Witkin Sum. Cal. Law Contracts § 2

[§ 2] Related Terms.

The Restatement defines a number of related terms used throughout the work.

(1) *Promise, Promisor, Promisee, and Beneficiary.* *Rest.2d, Contracts §2*, deals with the following terms:

"A promise is a manifestation of intention to act or refrain from acting in a specified way, so made as to justify a promisee in understanding that a commitment has been made."

"The person manifesting the intention is the promisor."

"The person to whom the manifestation is addressed is the promisee."

"Where performance will benefit a person other than the promisee, that person is a beneficiary."

Comment b explains the phrase "manifestation of intention": It adopts an external or objective standard, and means "the external expression of intention as distinguished from undisclosed intention."

Comment e observes that words that make performance entirely optional with the "promisor" (commonly referred to as forming "an illusory promise") are not within the present definition of promise.

(2) *Agreement and Bargain.* An agreement is a manifestation of mutual assent on the part of two or more persons. A bargain is a type of agreement, i.e., an agreement to exchange promises or to exchange a promise for a performance or to exchange performances. (*Rest.2d, Contracts §3.*)

"Agreement" in some respects has a wider meaning than contract, bargain, or promise. (Comment a.) "Bargain" has a narrower meaning than agreement in that it includes agreements that are not contracts (e.g., a transaction where the promise is for something that is not consideration, or an illegal transaction). (Comment c.)

(3) *Voidable Contract.* "A voidable contract is one where one or more parties have the power, by a manifestation of election to do so, to avoid the legal relations created by the contract, or by ratification of the contract to extinguish the

power of avoidance." (*Rest.2d, Contracts §7.*) A "void contract" is not a contract at all; it is a "promise" or "agreement" that is void of legal effect. (Comment a.) The propriety of calling a transaction a voidable contract rests primarily on the traditional view that the transaction is valid and has its usual legal consequences until the power of avoidance (often called disaffirmance) is exercised. And where each party can avoid, the term voidable is appropriate if ratification by one party would terminate his or her power of avoidance. (Comment e.)

(4) *Unenforceable Contract.* "An unenforceable contract is one for the breach of which neither the remedy of damages nor the remedy of specific performance is available, but which is recognized in some other way as creating a duty of performance, though there has been no ratification." (*Rest.2d, Contracts §8.*)

(5) *Terms of Promise, Agreement, or Contract.* *Rest.2d, Contracts §5* defines the word "term" as follows:

"A term of a *promise* or *agreement* is that portion of the intention or assent manifested which relates to a particular matter."

"A term of a *contract* is that portion of the legal relations resulting from the promise or set of promises which relates to a particular matter, whether or not the parties manifest an intention to create those relations."

Comment b explains that some contract terms are supplied by law, subject to variation by agreement of the parties. "Such rules are sometimes stated in terms of presumed intention, and they may be thought of as implied terms of an agreement. They often rest, however, on considerations of public policy rather than on manifestation of the intention of the parties."

Statutory contract terms, either optional or required, are not covered in the Restatement. (Comment c.)

SUPPLEMENT: [This section is current through the latest supplement]



3 of 115 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

I. INTRODUCTION

A. Nature of Contract.

2. Elements.

a. In General.

1 *Witkin Sum. Cal. Law Contracts* § 3

[§ 3] In General.

"It is essential to the existence of a contract that there should be: 1. *Parties* capable of contracting; 2. Their *consent*; 3. *A lawful object*; and 4. A sufficient cause or *consideration*." (C.C. 1550; see *Weddington Productions v. Flick* (1998) 60 C.A.4th 793, 811, 71 C.R.2d 265, citing the text [essential element of contract is consent]; 1 Williston 4th, §3:1 et seq.; Cal. Civil Practice, 3 Business Litigation, §24:3; Cal. Transactions Forms, 1 Business Transactions §6:1 et seq.; Cal. Transactions Forms, 2 Business Transactions §8:1 et seq. [Internet and online transactions].)

A *seal* is not required; there is no distinction between sealed and unsealed instruments in California. (C.C. 1629; C.C.P. 1932.) (For rules governing contracts under seal in jurisdictions that have not abolished the distinction, see *Rest.2d, Contracts* §92 et seq.)

SUPPLEMENT: [This section is current through the latest supplement]
See 1 Williston 4th (2007 ed.), §3:1 et seq.



4 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

I. INTRODUCTION

A. Nature of Contract.

2. Elements.

b. Parties.

1 Witkin Sum. Cal. Law Contracts § 4

[§ 4] Parties.

"There must be at least two parties to a contract, a promisor and a promisee, but there may be any greater number." (*Rest.2d, Contracts §9.*) (See *Schaefer v. Williams* (1993) 15 C.A.4th 1243, 1246, 19 C.R.2d 212 [candidate's promise to refrain from defaming other candidates in accordance with Code of Fair Campaign Practices (former Elec.C. 12500 et seq., now *Elec.C. 20400* et seq.) was not enforceable contract; there was a promisor, but no promisee]; 1 Corbin (Rev. ed.), §3.1; 1 Williston 4th, §3.2; 17A Am.Jur.2d (2004 ed.), *Contracts* §31; Cal. Transactions Forms, 1 Business Transactions §6:6 et seq.; BAJI, No. 10.55 [Contract Defined/Elements]; CACI, No. 302 [Contract Formation--Essential Factual Elements].) (On whether person who signs contract, but is not named in body thereof, is party to the contract and liable thereunder, see 94 A.L.R.2d 691; on capacity of parties, see *infra*, §25 et seq.)

"In one sense a person can make a promise to himself, but the law does not provide remedies for breach of such promises." (*Rest.2d, Contracts §9, Comment a.*) However, a contract may be formed in which the same person is one of several persons on one side of a bargain, and either alone or with others a party on the other side. (*Rest.2d, Contracts §11.*) Further, a person may have different capacities (e.g., as executor, trustee, partner, and individual), and if the person purports to make a promise in one capacity to himself or herself in another capacity, there may be legal consequences. (*Rest.2d, Contracts §9, Comment b.*) (See 1 Corbin (Rev. ed.), §3.1; 1 Williston 4th, §3.2.)

A person will be bound by a contract only if that person has "legal capacity to incur at least voidable contractual duties." (*Rest.2d, Contracts §12(1).*)

West's Key Number Digest, Contracts k.11 et seq.

SUPPLEMENT: [This section is current through the latest supplement]

Requirement of at least two parties: See 1 Williston 4th (2007 ed.), §3:2. *Contract involving party acting in different capacities:* See 1 Williston 4th (2007 ed.), §3:2.



5 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

I. INTRODUCTION

A. Nature of Contract.

3. Other Transactions or Relationships Distinguished.

1 Witkin Sum. Cal. Law Contracts § 5

[§ 5] Other Transactions or Relationships Distinguished.

Occasionally, the courts are called upon to distinguish contracts or contractual relationships from other transactions, instruments, or relationships. The principal situations are discussed elsewhere:

- (1) Will. (See 14 *Summary* (10th), *Wills and Probate*, §106.)
- (2) Gift. (See 13 *Summary* (10th), *Personal Property*, §124 et seq.)
- (3) Quasi-contract. (See *infra*, §1013 et seq.)
- (4) Marriage status. (See 11 *Summary* (10th), *Husband and Wife*, §42.)

On the other hand, some transactions or instruments, not in the common forms of contracts, or not entirely the product of free bargaining, nevertheless have a consensual basis and are treated as contracts for various purposes. (See *infra*, §1007 et seq.)

SUPPLEMENT: [This section is current through the latest supplement]



6 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

I. INTRODUCTION

B. Modern Law of Contract.

1. Restatement.

1 Witkin Sum. Cal. Law Contracts § 6

[§ 6] Restatement.

(1) *First and Second Restatement.* The first Restatement of Contracts, in two volumes, was published in 1932, and the California Annotations were published in 1933. (See critical discussions of its provisions in *17 Cal. L. Rev. 441*; *18 Cal. L. Rev. 611*; *21 Cal. L. Rev. 421*.) The Restatement Second, in three volumes, was completed in 1979 and published in 1981. Reporter's Notes give the sources of the black letter rules, leading cases, illustrative statutes, references to treatises of Corbin and Williston and law review articles, and relevant provisions of the Uniform Commercial Code. Volume 3 contains the following Tables: (1) Conversion of section numbers from Official Text to Tentative Drafts and from Tentative Drafts to Official Text. (2) Uniform Commercial Code citations. (3) Statutes cited. (4) Cases cited. (For critical analyses of the approach of the Second Restatement, see *13 Pepperdine L. Rev. 23, 59*.)

The nature of the Second Restatement is described in the Foreword (Vol. 1, p. viii) as follows:

"The Reporters, their Advisers and the Institute approached the text of the first Restatement with the respect and tenderness that are appropriate in dealing with a classic. As the work proceeded, it uncovered relatively little need for major substantive revision, in the sense of changing the positions taken on important issues, although the Uniform Commercial Code inspired a number of significant additions. The opportunities presented for improving the black letter formulations involved primarily the mode of presentation: matters of organization, where changes in the ordering or scope of topics enhanced clarity or reduced redundancy, and matters of drafting, where revision served the interest of compression, simplification, precision or refinement of analysis. No less significant than alterations of this order was the profound shift in style inaugurated by Restatement, Second: the introduction of extensive commentary explaining and expounding the black letter; the publication of Reporter's Notes canvassing the leading authoritative sources; the description and analysis of widespread statutory development."

(2) *Scope of Second Restatement.* The following observations on the scope and limitations on scope are made in the Introduction (p. 1 et seq.).

(a) *Executed transactions*, such as conveyances and corporate charters, may be "contracts" as the term is used in the federal Constitution; and the Uniform Commercial Code uses the term in a similarly broad sense with respect to transfers of personal property. But this Restatement does not attempt to state rules governing transfer of interests in property other than contract rights; the other coverage is in the Restatements of Property, Security and Trusts. (p. 1.)

(b) *Obligations not based on promises*: Where a promise is broken, available remedies may include restitution of benefits conferred or reimbursement of losses suffered in reliance on the promises. Analogous and sometimes overlapping obligations and remedies may arise under rules relating to wrongful conduct or unjust enrichment, and these are covered in the Restatements of Torts and Restitution, even though promises may be involved. Similarly, obligations of a trustee, even though the trustee promises to perform the trust and the particular obligation may be enforceable at law, are covered in the Trusts Restatement 2d. (pp. 1, 2.)

(c) *Particular types of contracts* are not covered, e.g., agreements between principal and agent, partnership agreements, and contracts with a governmental agency as a party. (p. 2.)

(d) *Legislative changes* in the law of contracts are covered only where substantially similar legislative rules are adopted in most states as in the case of the Uniform Commercial Code: "The profound impact of the Code on the law of contracts has sometimes resulted in the statement of rules applicable to contracts generally that are derived by analogy from rules laid down in the Code for contracts for the sale of goods." (p. 2.) (On adoption and scope of Code, see 4 *Summary* (10th), *Sales*, §6 et seq.); for discussions of its effect on traditional contract doctrines, see 1 *U.S.F. L. Rev.* 1.

(e) *Regulatory statutes* involving penal sanctions and administrative remedies are outside the scope of this Restatement; and the word "contract" itself may be defined in a statute or administrative regulation in terms different from those used here. Regulation may affect the usual remedies for breach, but no effort is made to state comprehensively the rules governing statutory obligations imposed regardless of assent. (p. 2.)

(f) Some rules cannot be dispensed with by *private agreement*, e.g., requirements of substance and form for formation of contracts. On the other hand, parties may make their own rules of interpretation. But they cannot by agreement prevent themselves from changing or abandoning the private rules by subsequent agreement or from making future contracts in any way the law permits. To avoid controversy "*unless otherwise agreed*" indicates that a particular rule is subject to variation by agreement; but the absence of such words contains no negative implication, because they are omitted when the context or the form of the rule makes them superfluous. (p. 3.)

West's Key Number Digest, Contracts k.2-

SUPPLEMENT: [This section is current through the latest supplement]



7 of 115 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

I. INTRODUCTION

B. Modern Law of Contract.

2. Texts and Practice Works.

1 Witkin Sum. Cal. Law Contracts § 7

[§ 7] Texts and Practice Works.

The encyclopedic treatment of contracts in volume 17A of American Jurisprudence 2d is cited throughout this chapter, as are the comprehensive treatises of Corbin (which is currently being updated) and Williston, now in its 4th edition. As new revised volumes of Corbin are published, citations to them will appear in the Supplement. Specialized works and articles on particular types of contracts such as sales contracts, commercial paper, security agreements, bailments, and deeds of trust are cited in the chapters in this work dealing with those specific subjects. (See Chapter IV, SALES; Chapter V, NEGOTIABLE INSTRUMENTS; Chapter VI, SECURED TRANSACTIONS IN PERSONAL PROPERTY; Chapter VII, SECURITY TRANSACTIONS IN REAL PROPERTY; Chapter VIII, PERSONAL PROPERTY; Chapter IX, REAL PROPERTY.)

A number of practice works and articles deal with the problems and practice of negotiation, drafting, litigation, and enforcement. (See C.E.B., Practice Under the California Family Code: Dissolution, Legal Separation, Nullity, Chap. 5 et seq.; C.E.B., Marital Settlement and Other Family Law Agreements 2d; C.E.B., Drafting Business Contracts: Principles, Techniques & Forms [hereafter cited as C.E.B., Business Contracts]; C.E.B., Real Property Remedies and Damages 2d; C.E.B., Sales and Mergers of California Businesses; C.E.B., Ground Lease Practice; C.E.B., Construction Contracts and Disputes 3d; C.E.B., Breach of Contract Remedies; C.E.B., Real Property Sales Transactions 3d; Cal. Transactions Forms [California forms for a wide variety of contracts]; Am.Jur. Legal Forms 2d [a multi-volume set of national scope containing an extensive collection of contract forms generally following Am.Jur.2d titles]; 13 Am.Jur.2d (2000 ed.), Building and Construction Contracts; 50 Cal. L. Rev. 619 [labor contract disengagement]; 15 Stanf. L. Rev. 415 [funeral prearrangement contracts]; 15 Stanf. L. Rev. 595 [labor contract--arbitration]; 9 U.C.L.A. L. Rev. 156 [motion picture and television actor's contract]; 9 U.C.L.A. L. Rev. 608 [installment land sales contract]; 87 A.L.R.2d 732 [crop grower's contract with processor]; 90 A.L.R.2d 1142 [cooperative farm products agreement]; 90 A.L.R.2d 1346 [water well-drilling contracts]; on unusual types of contracts, see *infra*, §1007 et seq.; on government contracts, see *infra*, §976 et seq.)

SUPPLEMENT: [This section is current through the latest supplement]

Treatises: Revised volumes 1 and 2 of Williston 4th were published in 2007.

Practice works: See C.E.B., Law of Contracts; C.E.B., Real Property Sales Transactions 4th; C.E.B., Construction Contracts, Defects, and Litigation (replacing C.E.B., Construction Contracts and Disputes 3d).



8 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

I. INTRODUCTION

B. Modern Law of Contract.

3. BAJI Instructions.

1 Witkin Sum. Cal. Law Contracts § 8

[§ 8] BAJI Instructions.

In 1990, a series of basic instructions on Contract Law was added to Part 10 of the 7th Edition of BAJI (California Jury Instructions). With minor changes, these instructions have been included in the 8th and 9th editions of BAJI, which were published in 1994 and 2002. BAJI now appears in semiannual editions (see, e.g., the July 2004 edition). (See 7 *Cal. Proc. (4th), Trial*, §286.)

The INTRODUCTION consists of the following comment and caution:

"The Committee recognizes that in contract litigation many issues should be determined by the Court as a matter of law, either because there is no factual dispute or because of the legal nature of the issue. By providing these instructions, the Committee is not suggesting that any particular instruction, or any part of one, should necessarily be given to the jury."

The list of Instructions (all cited in this chapter at appropriate sections) is as follows:

PART 10--II.

	<i>CONTRACTS (INTRODUCTION)</i>	<i>BAJI No.</i>	<i>Section</i>
A. Nature of Contract			
Contract Defined/Elements	10.55	(§§1, 4, 105)	
Express or Implied Contracts	10.56	(§§102, 103)	
Oral and Written Contracts	10.57	(§116)	
Oral Agreement To Be Reduced			
To Writing	10.58	(§134)	
Third-Party Beneficiary	10.59	(§§688, 700)	

Contract

B. Elements of A Contract

Mutual Consent	10.60	(§116)

Consideration	10.61	(§202 et seq.)

C. Formation of A Contract

Offer	10.65	(§§116, 130, 133, 137, 139, 147)

Uncertainty	10.66	(§§139, 146, 147)

Revocation	10.67	(§§159, 160, 164,)

Acceptance	10.68	(§§185, 187 et seq., 195)

Modification	10.69	(§§183, 964, 967)

D. Implied In Law Contracts

Money Had and Received	10.70	(§1022)

Reasonable Value of Services

(Quantum Meruit)	10.71	(§§1036 et seq., 1042)

E. Interpretation

Interpretation	10.75	(§741)

F. Performance

Conditions Precedent and Subsequent	10.80	(§§776, 777)

Excuse of Condition	10.81	(§§820, 821, 823, 828)

Failure of Consideration	10.82	(§§813, 814)

Discharge By Performance	10.83	(§759)

Tender	10.84	(§§769, 771)

G. Breach of Contract

Breach--Essential Elements	10.85	(§847)

Total/Partial Breach	10.86	(§§847, 852)

Actual and Anticipatory Breach	10.87	(§861 et seq.)

Waiver of Breach	10.88	(§§856, 857)

H. Damages

General Damages/Breach of Contract	10.90	(§871)

General Damages/Loss of Profits	10.91	(§879)

Special Damages/Breach of Contract	10.92	(§871)

Obligation To Pay Money	10.93	(§908)

Only

Measure of Damages--Sale of Land	10.94	(\$899)

Measure of Damages-- -Purchase of Land	10.95	(\$901)

I. Assignments

Assignments--Generally	10.96	(\$707)

Instructions from other Parts of the 9th Edition of BAJI will also be cited as appropriate.

SUPPLEMENT: [This section is current through the latest supplement]

Cross-Reference: 7 *Cal. Proc.* (5th), *Trial*, §273.



9 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

I. INTRODUCTION

B. Modern Law of Contract.

4. CACI Instructions.

1 Witkin Sum. Cal. Law Contracts § 9

[§ 9] CACI Instructions.

In 2003, the Judicial Council of California approved new plain language civil jury instructions, which are set forth in *California Civil Jury Instructions* ("CACI"). The instructions under the "Contracts" heading (all cited in this Supplement in appropriate sections) are as follows:

Title of Inst

	<i>struction</i>	<i>CACI No.</i>	<i>Section</i>
Essential Factual Elements	300	(§847)	
Third-Party Beneficiary	301	(§§688, 689)	
Contract Formation- -Essential Factual Elements	302	(§§1, 4, 7, 105, 202 et seq.)	
Breach of Contract- -Essential Factual Elements	303	(§§847, 852)	
Oral or Written Contract Terms	304	(§134)	
Implied-in-Fact Contract	305	(§§102, 103)	
Unformalized Agreement	306	(§134)	
Contract Formation--Offer	307	(§§116 et seq., 130, 133, 137, 139, 147)	
Contract Formation- -Revocation of Offer	308	(§§159, 160, 164)	
Contract Formation- -Acceptance	309	(§§116, 193 et seq., 217)	
Contract Formation- -Acceptance by Silence	310	(§§116, 183, 185)	

Contract Formation-	311	(§183)
-Rejection of Offer		
Substantial Performance	312	(§759)
Modification	313	(§§747, 964, 967)
Interpretation--Disputed Term	314	(§741)
Interpretation--Meaning of Ordinary Words	315	(§§741, 745)
Interpretation--Meaning of Technical Words	316	(§§741, 745)
Interpretation--Construction of Contract as a Whole	317	(§§741, 746)
Interpretation--Construction by Conduct	318	(§§741, 749)
Interpretation--Reasonable Time	319	(§741)
Interpretation--Construction Against Drafter	320	(§§741, 757)
Existence of Condition Pre- cedent Disputed	321	(§§776, 777)
Occurrence of Agreed Con- dition Precedent	322	(§§776, 777)
Waiver of Condition Preced- ent	323	(§§776, 777, 823)
Anticipatory Breach	324	(§861 et seq.)
Affirmative Defense-	330	(§257)
-Unilateral Mistake of Fact		
Affirmative Defense-	331	(§258)
-Bilateral Mistake		
Affirmative Defense-	332	(§309)
-Duress		
Affirmative Defense-	333	(§314)
-Economic Duress		
Affirmative Defense--Undue Influence	334	(§316)
Affirmative Defense--Fraud	335	(§285)
Affirmative Defense-	336	(§§856, 857)
-Waiver		
Affirmative Defense-	337	(§961)
-Novation		
Introduction to Contract Damages	350	(§871)

Special Damages	351	(§871)	
Loss of Profits--No Profits Earned	352	(§879)	
Loss of Profits--Some Profits Earned	353	(§879)	
Owner's/Lessee's Damages for Breach of Contract to Construct			
	Improvements on Real Property	354	(§909)
Obligation to Pay Money Only	355	(§908)	
Buyer's Damages for Breach of Contract for Sale of Real Prop			
	erty	356	(§899)
Seller's Damages for Breach of Contract to Purchase Real Pro			
	perty	357	(§901)
Mitigation of Damages	358	(§914)	
Present Cash Value of Fu- ture Damages	359	(§869)	
Nominal Damages	360	(§878)	
Plaintiff May Not Recover Duplicate Contract and Tort Damage			
	s	361	(§869)

CACI, Nos. 325-329 and 338-349 are reserved for future use.

SUPPLEMENT: [This section is current through the latest supplement]

CACI instructions under the "Contracts" heading, with additions and revisions subsequent to publication of the text, include the following:

Title of Instruction	CACI No.	Section
Breach of Contract--Introduction	300	(§847)
Third-Party Beneficiary	301	(§§688, 689)
Contract Formation--Essential Factual Elements	302	(§§1, 4, 7, 105, 202 et seq.)
Breach of Contract--Essential Factual Elements	303	(§§847, 852)
Oral or Written Contract Terms	304	(§134)

Implied-in-Fact Contract	305	(§§102, 103)
Unformalized Agreement	306	(§134)
Contract Formation--Offer	307	(§§116 et seq., 130, 133, 137, 139, 147)
Contract Formation--Revocation of Offer	308	(§§159, 160, 164)
Contract Formation--Acceptance	309	(§§116, 193 et seq., 217)
Contract Formation--Acceptance by Silence	310	(§§116, 183, 185)
Contract Formation--Rejection of Offer	311	(§183)
Substantial Performance	312	(§759)
Modification	313	(§§747, 964, 967)
Interpretation--Disputed Term	314	(§741)
Interpretation--Meaning of Ordinary Words	315	(§§741, 745)
Interpretation--Meaning of Technical Words	316	(§§741, 745)
Interpretation--Construction of Contract as a Whole	317	(§§741, 746)
Interpretation--Construction by Conduct	318	(§§741, 749)
Interpretation--Reasonable Time	319	(§741)
Interpretation--Construction Against Drafter	320	(§§741, 757)
Existence of Condition Precedent Disputed	321	(§§776, 777)
Occurrence of Agreed Condition Precedent	322	(§§776, 777)
Waiver of Condition Precedent	323	(§§776, 777, 823)
Anticipatory Breach	324	(§861 et seq.)
Assignment Contested	326	(§712)
Assignment Not Contested	327	(§712)
Affirmative Defense--Unilateral Mistake of Fact	330	(§257)
Affirmative Defense--Bilateral Mistake	331	(§258)
Affirmative Defense--Duress	332	(§309)
Affirmative Defense--Economic Duress	333	(§314)
Affirmative Defense--Undue Influence	334	(§316)
Affirmative Defense--Fraud	335	(§285)
Affirmative Defense--Waiver	336	(§§856, 857)
Affirmative Defense--Novation	337	(§961)
Affirmative Defense--Statute of Limitations	338	(§70)
Introduction to Contract Damages	350	(§871)
Special Damages	351	(§871)
Loss of Profits--No Profits Earned	352	(§879)

Loss of Profits--Some Profits Earned	353	(§879)
Owner's/Lessee's Damages for Breach of Contract to Construct Improvements on Real Property	354	(§909)
Obligation to Pay Money Only	355	(§908)
Buyer's Damages for Breach of Contract for Sale of Real Property	356	(§899)
Seller's Damages for Breach of Contract to Purchase Real Property	357	(§901)
Mitigation of Damages	358	(§914)
Present Cash Value of Future Damages	359	(§869)
Nominal Damages	360	(§878)
Plaintiff May Not Recover Duplicate Contract and Tort Damages	361	(§869)
Common Count: Money Had and Received	370	(4 Cal. Proc. (5th),Pleading, \$ S561)
Common Count: Goods and Services Rendered	371	(4 Cal. Proc. (5th),Pleading, \$ S563)

Correction: Page 67, line 4 of section, "Supplement" should be "Chapter".



10 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

I. INTRODUCTION

B. Modern Law of Contract.

5. New Theories.

1 Witkin Sum. Cal. Law Contracts § 10

[§ 10] New Theories.

The modern law of Contract has produced a number of innovations in theory and doctrine, some of which are embodied in the Uniform Commercial Code and the Second Restatement. The most significant and far-reaching are the related concepts of contracts of adhesion (see *infra*, §323 et seq.) and unconscionability (see *infra*, §330 et seq.).

The important scholarly discussions are fully cited in the Reporter's Notes to sections of the Second Restatement. (See also 74 *Cal. L. Rev.* 1123 [Of Expectations, Incomplete Contracting, and the Bargain Principle]; 77 *Cal. L. Rev.* 1077 [Relationship or Boundary? Handling Successive Contracts]; 95 *Harv. L. Rev.* 741 [The Bargain Principle and Its Limits]; 97 *Harv. L. Rev.* 978 [Efficiency and a Rule of "Free Contract"]; 97 *Harv. L. Rev.* 1222 [review of Farnsworth, Contracts]; 34 *Hastings L. J.* 513 [Reflections on Contract Law and Distributive Justice]; 43 *Hastings L. J.* 1 [Mistake, Frustration, and the Windfall Principle of Contract Remedies]; 29 *Stanf. L. Rev.* 1125 [comment on Gilmore, The Death of Contract]; 33 *Stanf. L. Rev.* 753 [review of Atiyah, The Rise and Fall of Freedom of Contract]; 36 *Stanf. L. Rev.* 1107 [The Responsive Model of Contract Law]; 47 *Stanf. L. Rev.* 211 [The Limits of Cognition and the Limits of Contract]; 22 *U.C.L.A. L. Rev.* 1066 [German law compared]; 30 *U.C.L.A. L. Rev.* 898 [Formal and Comparative Rules Under Common Law and Code]; 34 *U.C.L.A. L. Rev.* 839 [Critical Approaches to Contract Law]; on Restatement 2d, see *supra*, §6.)

SUPPLEMENT: [This section is current through the latest supplement]
See 120 *Harv. L. Rev.* 708 [The Divergence of Contract and Promise].



11 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

I. INTRODUCTION

C. Electronic Transactions.

1. In General.

a. Uniform Act.

1 Witkin Sum. Cal. Law Contracts § 11

[§ 11] Uniform Act.

(1) *In General.* The Uniform Electronic Transactions Act (C.C. 1633.1 et seq.) governs transactions that are conducted electronically. The Act applies to an electronic record or electronic signature created, generated, sent, communicated, received, or stored on or after January 1, 2000. (C.C. 1633.4.) (As to definitions under Act, see *infra*, §13; as to exceptions to Act's applicability, see *infra*, §14.) A transaction subject to the Act is also subject to other substantive law. (C.C. 1633.3(e).)

(2) *Admissibility of Electronic Evidence.* Evidence of a record or signature may not be excluded in any proceeding solely because it is in electronic form. (C.C. 1633.13.)

(3) *Regulation of Electronic Signature by State Agency.* No state agency, board, or commission may require, prohibit, or regulate the use of an electronic signature in a transaction in which the agency, board, or commission is not a party, unless a law other than the Act expressly authorizes the requirement, prohibition, or regulation. (C.C. 1633.17.)

SUPPLEMENT: [This section is current through the latest supplement]
See C.E.B., Law of Contracts §4.59 et seq.



12 of 115 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

I. INTRODUCTION

C. Electronic Transactions.

1. In General.

b. Construction.

1 Witkin Sum. Cal. Law Contracts § 12

[§ 12] Construction.

The Act must be construed and applied according to all of the following:

- (1) To facilitate electronic transactions consistent with other applicable law. (C.C. 1633.6(1).)
- (2) To be consistent with reasonable practices concerning electronic transactions and with the continued expansion of those practices. (C.C. 1633.6(2).)
- (3) To effectuate its general purpose to make uniform the law with respect to the subject of the Act among states enacting it. (C.C. 1633.6(3).)

SUPPLEMENT: [This section is current through the latest supplement]



13 of 115 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

I. INTRODUCTION

C. Electronic Transactions.

1. In General.

c. Definitions.

1 Witkin Sum. Cal. Law Contracts § 13

[§ 13] Definitions.

Under the Uniform Electronic Transactions Act, the following terms are defined:

(1) "Agreement" is the bargain of the parties in fact, as found in their language or inferred from other circumstances and from rules, regulations, and procedures given the effect of agreements under laws otherwise applicable to a particular transaction. (C.C. 1633.2(a).)

(2) "Automated transaction" refers to a transaction conducted or performed, in whole or in part, by electronic means or electronic records, in which the acts or records of one or both parties are not reviewed by an individual in the ordinary course in forming a contract, performing under an existing contract, or fulfilling an obligation required by the transaction. (C.C. 1633.2(b).)

(3) "Computer program" means a set of statements or instructions to be used directly or indirectly in an information processing system in order to bring about a certain result. (C.C. 1633.2(c).)

(4) "Contract" means the total legal obligation resulting from the parties' agreement as affected by this title and other applicable law. (C.C. 1633.2(d).)

(5) "Electronic" refers to relating to technology having electrical, digital, magnetic, wireless, optical, electromagnetic, or similar capabilities. (C.C. 1633.2(e).)

(6) "Electronic agent" means a computer program or an electronic or other automated means used independently to initiate an action or respond to electronic records or performances in whole or in part, without review by an individual. (C.C. 1633.2(f).)

(7) "Electronic record" is a record created, generated, sent, communicated, received, or stored by electronic means. (C.C. 1633.2(g).)

(8) "Electronic signature" means an electronic sound, symbol, or process attached to or logically associated with an electronic record and executed or adopted by a person with the intent to sign the electronic record. (C.C. 1633.2(h).)

(9) "Governmental agency" refers to an executive, legislative, or judicial agency, department, board, commission, authority, institution, or instrumentality of the federal Government or of a state or of a county, municipality, or other political subdivision of a state. (C.C. 1633.2(i).)

(10) "Information" is data, text, images, sounds, codes, computer programs, software, data bases, or the like. (C.C. 1633.2(j).)

(11) "Information processing system" means an electronic system for creating, generating, sending, receiving, storing, displaying, or processing information. (C.C. 1633.2(k).)

(12) "Person" refers to an individual, corporation, business trust, estate, trust, partnership, limited liability company, association, joint venture, governmental agency, public corporation, or any other legal or commercial entity. (C.C. 1633.2(l).)

(13) "Record" means information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form. (C.C. 1633.2(m).)

(14) "Security procedure" is a procedure employed for the purpose of verifying that an electronic signature, record, or performance is that of a specific person or for detecting changes or errors in the information in an electronic record. The term includes a procedure that requires the use of algorithms or other codes, identifying words or numbers, encryption, or callback or other acknowledgment procedures. (C.C. 1633.2(n).)

(15) "Transaction" means an action or set of actions occurring between two or more persons relating to the conduct of business, commercial, or governmental affairs. (C.C. 1633.2(o).)

SUPPLEMENT: [This section is current through the latest supplement]



14 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

I. INTRODUCTION

C. Electronic Transactions.

1. In General.

d. Applicability.

1 Witkin Sum. Cal. Law Contracts § 14

[§ 14] Applicability.

(1) *In General.* Except as otherwise provided, the Act applies to electronic records and electronic signatures relating to a transaction. (C.C. 1633.3(a).)

(2) *Exceptions.* The Act does not apply to transactions subject to the following laws:

(a) A law governing the creation and execution of wills, codicils, or testamentary trusts. (C.C. 1633.3(b)(1).)

(b) U.C.C. 1101 et seq., except U.C.C. 1107, 1206. (C.C. 1633.3(b)(2).)

(c) U.C.C. 3101 et seq., 4101 et seq., 5101 et seq., 8101 et seq., 9101 et seq., 11101 et seq. (C.C. 1633.3(b)(3).)

(d) A law requiring that specifically identifiable text or disclosures in a record or a portion of a record be separately signed, including initialed, from the record. However, this provision does not apply to C.C. 1677, 1678 or *C.C.P. 1298*. (C.C. 1633.3(b)(4).)

In addition, the Act does not apply to specific transactions described in numerous specified statutes. (C.C. 1633.3(c).)

(3) *Effect of Other Laws.* The Act applies to an electronic record or electronic signature otherwise excluded under C.C. 1633.3(b) when used for a transaction subject to a law other than those specified in that provision. (C.C. 1633.3(d).) Further, the exclusion of a transaction from the application of the Act under C.C. 1633.3(b) or (c) may be construed only to exclude the transaction from the application of the Act, but may not be construed to prohibit the transaction from being conducted by electronic means if it may be so conducted under any other applicable law. (C.C. 1633.3(f).)

SUPPLEMENT: [This section is current through the latest supplement]



15 of 115 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

I. INTRODUCTION

C. Electronic Transactions.

1. In General.

e. Attribution of Electronic Record or Signature.

1 Witkin Sum. Cal. Law Contracts § 15

[§ 15] Attribution of Electronic Record or Signature.

(1) *In General.* An electronic record or electronic signature is attributable to a person if it was the act of the person, which may be shown in any manner, including a showing of the efficacy of any security procedure applied to determine the person to which the electronic record or electronic signature was attributable. (C.C. 1633.9(a).)

(2) *Effect of Attributed Record or Signature.* The effect of an electronic record or electronic signature attributed to a person is determined from the context and surrounding circumstances at the time of its creation, execution, or adoption, including the parties' agreement, if any, and otherwise as provided by law. (C.C. 1633.9(b).)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *In General.* See 36 *McGeorge L. Rev.* 697 [disparate impact of electronic signature legislation on indigents].



16 of 115 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

I. INTRODUCTION

C. Electronic Transactions.

1. In General.

f. Change or Error in Electronic Record.

1 Witkin Sum. Cal. Law Contracts § 16

[§ 16] Change or Error in Electronic Record.

If a change or error in an electronic record occurs in a transmission between parties to a transaction, the following rules apply:

(1) If the parties have agreed to use a security procedure to detect changes or errors and one party has conformed to the procedure, but the other party has not, and the nonconforming party would have detected the change or error had that party also conformed, the conforming party may avoid the effect of the changed or erroneous electronic record. (C.C. 1633.10(1).)

(2) An individual in an automated transaction may avoid the effect of an electronic record that resulted from an error made by the individual in dealing with the electronic agent of another person if the electronic agent did not provide an opportunity for the prevention or correction of the error and, at the time the individual learns of the error, all of the following conditions are met:

(a) The individual promptly notifies the other person of the error and that the individual did not intend to be bound by the electronic record received by the other person. (C.C. 1633.10(2)(i).)

(b) The individual takes reasonable steps, including steps that conform to the other person's reasonable instructions, to return to the other person or, if instructed by the other person, to destroy any consideration received as a result of the erroneous electronic record. (C.C. 1633.10(2)(ii).)

(c) The individual has not used or received any benefit or value from any consideration received from the other person. (C.C. 1633.10(2)(iii).)

(3) If neither paragraph (1) nor (2) applies, the change or error has the effect provided by other law, including the law of mistake, and the parties' contract, if any. (C.C. 1633.10(3); on mistake, see *infra*, §256 et seq.)

(4) Paragraphs (2) and (3) may not be varied by agreement. (C.C. 1633.10(4).)

SUPPLEMENT: [This section is current through the latest supplement]



17 of 115 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

I. INTRODUCTION

C. Electronic Transactions.

1. In General.

g. Sending and Receiving Records.

1 Witkin Sum. Cal. Law Contracts § 17

[§ 17] Sending and Receiving Records.

(1) *Method of Sending Records.* Unless the sender and the recipient agree to a different method of sending that is reasonable under the circumstances, an electronic record is sent when the information is addressed properly or otherwise directed properly to the recipient and either (a) enters an information processing system outside the control of the sender or of a person that sent the electronic record on behalf of the sender, or (b) enters a region of an information processing system that is under the control of the recipient. (C.C. 1633.15(a).)

(2) *Method of Receiving Records.* Unless the sender and the recipient agree to a different method of receiving that is reasonable under the circumstances, an electronic record is received when it enters an information processing system that the recipient has designated or uses for the purpose of receiving electronic records or information of the type sent, in a form capable of being processed by that system, and from which the recipient is able to retrieve the electronic record. (C.C. 1633.15(b).) This provision applies even if the place the information processing system is located is different from the place the electronic record is deemed to be received under C.C. 1633.15(d). (C.C. 1633.15(c).)

An electronic record is received under C.C. 1633.15(b) even if no individual is aware of its receipt. (C.C. 1633.15(e).) Receipt of an electronic acknowledgment from an information processing system described in C.C. 1633.15(b) establishes that a record was received but, by itself, does not establish that the content sent corresponds to the content received. (C.C. 1633.15(f).)

(3) *Place Where Records Deemed Sent and Received.* Unless otherwise expressly provided in the electronic record or agreed between the sender and the recipient, an electronic record is deemed to be sent from the sender's place of business and to be received at the recipient's place of business or, if the recipient is an individual acting on his or her own behalf, at the recipient's place of residence. (C.C. 1633.15(d).) For purposes of this provision, the following rules apply:

(a) If the sender or recipient has more than one place of business, the place of business of that person is the place having the closest relationship to the underlying transaction. (C.C. 1633.15(d)(1).)

(b) If the sender or the recipient does not have a place of business, the place of business is the sender's or recipient's

residence. (C.C. 1633.15(d)(2).)

(4) *Effect Where Record Is Not Actually Sent or Received.* If a person is aware that an electronic record purportedly sent under C.C. 1633.15(a), or purportedly received under C.C. 1633.15(b), was not actually sent or received, the legal effect of the sending or receipt is determined by other applicable law. Except to the extent permitted by the other law, this provision may not be varied by agreement. (C.C. 1633.15(g).)

SUPPLEMENT: [This section is current through the latest supplement]



18 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

I. INTRODUCTION

C. Electronic Transactions.

2. Agreement and Legal Effect.

a. Agreement To Transact Electronically.

1 Witkin Sum. Cal. Law Contracts § 18

[§ 18] Agreement To Transact Electronically.

(1) *Electronic Means Not Required.* The Act does not require a record or signature to be created, generated, sent, communicated, received, stored, or otherwise processed or used by electronic means or in electronic form. (C.C. 1633.5(a).)

(2) *Nature and Form of Agreement.* The Act applies only to a transaction that all parties have agreed to conduct electronically, which agreement is determined from the context and surrounding circumstances, including the parties' conduct. Except for a separate and optional agreement whose primary purpose is to authorize a transaction to be conducted electronically, an agreement to conduct a transaction by electronic means may not be contained in a standard form contract that is not an electronic record. An agreement in such a standard form contract may not be conditioned on an agreement to conduct transactions by electronic means. Further, an agreement to conduct a transaction electronically may not be inferred solely from the fact that a party has used electronic means to pay an account or register a purchase or warranty. These provisions may not be varied by agreement. (C.C. 1633.5(b).)

(3) *Agreement Does Not Extend to Other Transactions.* A party that agrees to conduct a transaction electronically may refuse to conduct other transactions by electronic means. If a seller sells goods or services by both electronic and nonelectronic means and a buyer purchases the goods or services by conducting the transaction electronically, the buyer may refuse to conduct further transactions regarding the goods or services by electronic means. These provisions may not be varied by agreement. (C.C. 1633.5(c).)

(4) *Varying Terms of Act by Agreement.* Except as otherwise provided, the effect of any provision in the Act may be varied by agreement. The presence in certain provisions of the Act of the words "unless otherwise agreed," or words of similar import, does not imply that the effect of other provisions may not be varied by agreement. (C.C. 1633.5(d).)

SUPPLEMENT: [This section is current through the latest supplement]



19 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

I. INTRODUCTION

C. Electronic Transactions.

2. Agreement and Legal Effect.

b. Legal Effect or Enforceability of Electronic Record, Signature, or Contract.

1 Witkin Sum. Cal. Law Contracts § 19

[§ 19] Legal Effect or Enforceability of Electronic Record, Signature, or Contract.

The following principles govern the legal effect of conducting transactions electronically:

(1) A record or signature may not be denied legal effect or enforceability solely because it is in electronic form. (C.C. 1633.7(a).)

(2) A contract may not be denied legal effect or enforceability solely because an electronic record was used in its formation. (C.C. 1633.7(b).)

(3) If a law requires a record to be in writing, an electronic record satisfies the law. (C.C. 1633.7(c).)

(4) If a law requires a signature, an electronic signature satisfies the law. (C.C. 1633.7(d).)

SUPPLEMENT: [This section is current through the latest supplement]



20 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

I. INTRODUCTION

C. Electronic Transactions.

2. Agreement and Legal Effect.

c. Automated Transactions.

1 Witkin Sum. Cal. Law Contracts § 20

[§ 20] Automated Transactions.

In an automated transaction, the following rules apply:

(1) A contract may be formed by the interaction of electronic agents of the parties, even if no individual was aware of or reviewed the electronic agents' actions or the resulting terms and agreements. (C.C. 1633.14(a)(1).)

(2) A contract may be formed by the interaction of an electronic agent and an individual, acting on the individual's own behalf or for another person, including by an interaction in which the individual performs actions that the individual is free to refuse to perform and which the individual knows or has reason to know will cause the electronic agent to complete the transaction or performance. (C.C. 1633.14(a)(2).)

The terms of the contract are determined by the substantive law applicable to it. (C.C. 1633.14(b).)

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21 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

I. INTRODUCTION

C. Electronic Transactions.

3. Electronic Satisfaction.

a. Requirement of Writing.

1 Witkin Sum. Cal. Law Contracts § 21

[§ 21] Requirement of Writing.

(1) *In General.* A party to an agreement to conduct a transaction electronically may satisfy a law requiring that information be provided, sent, or delivered by one person to another in writing by providing, sending, or delivering the information in an electronic record capable of retention by the recipient at the time of receipt. An electronic record is not capable of retention by the recipient if the sender or its information processing system inhibits the ability of the recipient to print or store the electronic record. (C.C. 1633.8(a).)

(2) *Requirements of Other Laws.* If a law other than the Act requires a record to be posted or displayed in a certain manner, to be sent, communicated, or transmitted by a specified method, or to contain information that is formatted in a certain manner, all of the following rules apply:

(a) The record must be posted or displayed in the manner specified in the other law. (C.C. 1633.8(b)(1).)

(b) Except as otherwise provided in C.C. 1633.8(d)(2), the record must be sent, communicated, or transmitted by the method specified in the other law. (C.C. 1633.8(b)(2).)

(c) The record must contain the information formatted in the manner specified in the other law. (C.C. 1633.8(b)(3).)

(3) *Inhibition by Sender of Ability To Store or Print Record.* If a sender inhibits the ability of a recipient to store or print an electronic record, the electronic record is not enforceable against the recipient. (C.C. 1633.8(c).)

(4) *Varying Statutory Requirements by Agreement.* These requirements may not be varied by agreement, except as follows:

(a) To the extent a law other than the Act requires information to be provided, sent, or delivered in writing but permits that requirement to be varied by agreement, the requirement under C.C. 1633.8(a) that the information be in the form of an electronic record capable of retention may also be varied by agreement. (C.C. 1633.8(d)(1).)

(b) A requirement under a law other than the Act to send, communicate, or transmit a record by first-class mail may be varied by agreement to the extent permitted by the other law. (C.C. 1633.8(d)(2).)

SUPPLEMENT: [This section is current through the latest supplement]



22 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

I. INTRODUCTION

C. Electronic Transactions.

3. Electronic Satisfaction.

b. Requirement of Notarization and Signature Under Penalty of Perjury.

1 Witkin Sum. Cal. Law Contracts § 22

[§ 22] Requirement of Notarization and Signature Under Penalty of Perjury.

(1) *Notarization.* A law requiring that a signature be notarized is satisfied with respect to an electronic signature if an electronic record includes, in addition to the signature to be notarized, the electronic signature of a notary public together with all other information required to be included in a notarization by other applicable law. (C.C. 1633.11(a).)

(2) *Signature Under Penalty of Perjury.* A law requiring that a statement be signed under penalty of perjury is satisfied with respect to an electronic signature if an electronic record includes, in addition to the signature, all of the information as to which the declaration pertains together with a declaration under penalty of perjury by the person who submits the electronic signature that the information is true and correct. (C.C. 1633.11(b).)

SUPPLEMENT: [This section is current through the latest supplement]



23 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

I. INTRODUCTION

C. Electronic Transactions.

3. Electronic Satisfaction.

c. Requirement To Retain Records.

1 Witkin Sum. Cal. Law Contracts § 23

[§ 23] Requirement To Retain Records.

(1) *In General.* A law requiring that a record be retained is satisfied by retaining an electronic record of the information in the record, provided the electronic record (a) reflects accurately the information set forth in the record at the time it was first generated in its final form as an electronic record or otherwise, and (b) remains accessible for later reference. (C.C. 1633.12(a); see C.C. 1633.12(c) [C.C. 1633.12(a) may be satisfied by using services of another person]; C.C. 1633.12(g) [C.C. 1633.12 does not preclude governmental agency from specifying additional requirements for retention of record subject to agency's jurisdiction].) A requirement to retain a record in accordance with this provision does not apply to information the sole purpose of which is to enable the record to be sent, communicated, or received. (C.C. 1633.12(b).)

(2) *Retention of Record in Original Form.* A law requiring a record to be retained in its original form, or providing consequences if the record is not retained in its original form, is satisfied by an electronic record retained in accordance with C.C. 1633.12(a). (C.C. 1633.12(d).)

(3) *Retention of Check.* A law requiring retention of a check is satisfied by retention of an electronic record of the information on the front and back of the check in accordance with C.C. 1633.12(a). (C.C. 1633.12(e).)

(4) *Retention of Record for Evidentiary Purposes.* A record retained as an electronic record in accordance with C.C. 1633.12(a) satisfies a law requiring retention of a record for evidentiary, audit, or like purposes, unless a law enacted after January 1, 2000, specifically prohibits the use of an electronic record for a specified purpose. (C.C. 1633.12(f).)

SUPPLEMENT: [This section is current through the latest supplement]



24 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

I. INTRODUCTION

C. Electronic Transactions.

4. Notice of Right To Cancel.

1 Witkin Sum. Cal. Law Contracts § 24

[§ 24] Notice of Right To Cancel.

If a law other than the Act requires that a notice of the right to cancel be provided or sent, an electronic record may not substitute for a writing under that other law unless, in addition to satisfying the requirements of that other law and the Act, the notice of cancellation may be returned by electronic means. This provision may not be varied by agreement. (C.C. 1633.16.)

SUPPLEMENT: [This section is current through the latest supplement]



25 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
II. CAPACITY OF PARTIES.
A. General Rule.

1 Witkin Sum. Cal. Law Contracts § 25

[§ 25] General Rule.

The general rule is that all persons are capable of contracting, except minors (see *infra*, §26 et seq.), persons of unsound mind (see *infra*, §50 et seq., and persons deprived of civil rights see *infra*, §58). (C.C. 1556.)

SUPPLEMENT: [This section is current through the latest supplement]
See C.E.B., Law of Contracts §2.1 et seq.



26 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

II. CAPACITY OF PARTIES.

B. Minors.

1. Who Are Minors.

a. Age of Majority: 18 years.

1 Witkin Sum. Cal. Law Contracts § 26

[§ 26] Age of Majority: 18 years.

(1) *Legislative Authority.* The Legislature may fix different times of majority for different purposes. (See *Encinas v. Lowthian Freight Lines* (1945) 69 C.A.2d 156, 160, 158 P.2d 575; and see generally *Rest.2d, Contracts §14*; 7 Corbin (Rev. ed.), §27.21; 5 Williston 4th, §9:1 et seq; 42 *Am.Jur.2d* (2000 ed.), *Infants* §§1 et seq., 45, 46; Cal. Civil Practice, 3 Business Litigation §§24:18 et seq., 24:117, 24:118; Cal. Transactions Forms, 1 Business Transactions §6:7 et seq.; 2 California Affirmative Defenses 2d (2004 ed.), §52:2 et seq.)

(2) *Former Law.* Under California's original law, minors were males under the age of 21 and females under the age of 18. This was subsequently changed to 21 for both males and females, but an exception was made for 18-year-old married persons. (See former C.C. 25.)

(3) *New Age of Majority.* Since 1971, minors are all persons under 18 years of age. The period of minority is calculated from the first minute of the day of birth to the same minute of the corresponding day completing the period of minority. (*Family C. 6500*; *People v. Dudley* (1942) 53 C.A.2d 181, 185, 127 P.2d 569; 17 *So. Cal. L. Rev.* 71; for a discussion of the 1971 and 1972 legislation, see 4 *Pacific L. J.* 318, 677.) Most of the states have similarly lowered the age to 18. (See *Rest.2d, Contracts §14*, and Comment a.)

(4) *Effect of Change on Existing Law and Rights.* *Family C. 6502* provides as follows:

(a) "The use of or reference to the words 'age of majority,' 'age of minority,' 'adult,' 'minor,' or words of similar intent in any instrument, order, transfer, or governmental communication made in this state" before March 4, 1972, is deemed a reference to persons older or younger than 21; any such use or reference on or after March 4, 1972, is deemed a reference to persons older or younger than 18.

(b) A court order, will, trust, contract, transfer, or instrument that was in existence on March 4, 1972, may be amended to refer to the new 18-year-old age of majority, provided: (1) It is subject to amendment by law; (2) amendment is allowable or not prohibited by the terms thereof; and (3) it is otherwise subject to the laws of California. (See 75 *A.L.R.3d* 228 [effect of change in age of majority on preexisting status or rights].)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Legislative Authority.* See C.E.B., Law of Contracts §2.2 et seq.; 2 California Affirmative Defenses §52:2 et seq.



27 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

II. CAPACITY OF PARTIES.

B. Minors.

1. Who Are Minors.

b. Misrepresentation of Age.

1 Witkin Sum. Cal. Law Contracts § 27

[§ 27] Misrepresentation of Age.

It has been held in California that no estoppel arises against the minor by reason of his or her misrepresentation of age. Thus, (1) the invalidity or voidability of the minor's contract (*infra*, §28 et seq.) depends on the fact of minority, and (2) the representation that the minor was over the period of minority did not impose on him or her the requirement of restoration of consideration formerly existing under C.C. 35. (On repeal of C.C. 35, see *infra*, §31). (See *Lee v. Hibernia Savings & Loan Soc.* (1918) 177 C. 656, 660, 171 P. 677; *Williams v. Leon T. Shettler Co.* (1929) 98 C.A. 282, 283, 276 P. 1065.)

The authorities elsewhere are conflicting. (See 5 Williston 4th, §§9:22, 9:23; 42 *Am.Jur.2d* (2000 ed.), *Infants* §110; 29 *A.L.R.3d* 1270 [misrepresentation as to age as estopping minor from disaffirming voidable transaction]; for argument that minor's misrepresentation of age and the reasonableness of the other party's reliance thereon should be considered, see *Rest.2d, Contracts* §14, Reporter's Note to Comment c.)

SUPPLEMENT: [This section is current through the latest supplement]



28 of 115 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

II. CAPACITY OF PARTIES.

B. Minors.

2. Void Contracts.

a. Delegation of Power.

1 Witkin Sum. Cal. Law Contracts § 28

[§ 28] Delegation of Power.

Under the Family Code, a minor is absolutely prohibited from giving a delegation of power. (*Family C. 6701(a)*; see Cal. Transactions Forms, 1 Business Transactions §6:8.) In *Hakes Inv. Co. v. Lyons* (1913) 166 C. 557, 560, 137 P. 911, the court declared that it was the obvious intention of the Legislature to lay down the rule that "an infant could not execute contracts through an agent having only a delegated authority executed by the infant." (See *Morgan v. Morgan* (1963) 220 C.A.2d 665, 674, 34 C.R. 82; 2 Cal. L. Rev. 211.)

The former section on which *Family C. 6701(a)* is based (C.C. 33) was construed to apply only to a *voluntary* delegation by the minor, and not to liabilities created by statute. Hence, *Veh.C. 17451*, providing for implied appointment of a state officer as agent for service of process in an automobile tort action, may be validly applied to minors. (*Silver Swan Liquor Corp. v. Adams* (1941) 43 C.A.2d Supp. 851, 852, 110 P.2d 1097.) Similarly, *Veh.C. 17150* validly imposes liability on the minor owner of an automobile for negligence of another driving with the minor's permission. (*Ridley v. Young* (1944) 64 C.A.2d 503, 513, 149 P.2d 76; see 18 So. Cal. L. Rev. 75.)

West's Key Number Digest, Contracts k.12; Infants k.5

SUPPLEMENT: [This section is current through the latest supplement]



29 of 115 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

II. CAPACITY OF PARTIES.

B. Minors.

2. Void Contracts.

b. Contract Relating to Real Property.

1 Witkin Sum. Cal. Law Contracts § 29

[§ 29] Contract Relating to Real Property.

Family C. 6701 also makes absolutely void any contract by a minor "relating to *real property or any interest therein*." (*Family C. 6701(b)*.) The effect of this section is that such contracts or a deed of real property is void from the beginning and *need not be disaffirmed*. (*Hakes Inv. Co. v. Lyons* (1913) 166 C. 557, 560, 137 P. 911; *Lee v. Hibernia Savings & Loan Soc.* (1918) 177 C. 656, 659, 171 P. 677; *Sparks v. Sparks* (1950) 101 C.A.2d 129, 137, 225 P.2d 238; see *Burnand v. Irigoyen* (1947) 30 C.2d 861, 864, 186 P.2d 417, stating the general rule but holding it inapplicable; 3 U.C.L.A. L. Rev. 475 [oil lease].)

An unusual application of the rule and policy of this statute was made in *Niel v. Barton* (1952) 108 C.A.2d 781, 239 P.2d 912. Plaintiff, at the request of A, furnished materials to improve the land of defendant B, a minor (whose age did not appear but was apparently assumed to be under 18). B failed to file or post the required notice of nonresponsibility within 10 days. In this action to subject B to the materialman's lien (see C.C. 3129), recovery was denied on the following reasoning: (a) The minor could not convey or mortgage his land, and the Legislature cannot be presumed to have intended to allow him to encumber it indirectly by a contract for its improvement that would lead to a mechanic's lien. (108 C.A.2d 782.) (b) If the minor cannot become liable on such an express contract, he should not be held liable as a noncontracting owner under a statute based on the principle of estoppel; minors are generally not considered subject to the estoppel doctrine. (108 C.A.2d 783; on inapplicability of estoppel, see *supra*, §27.)

West's Key Number Digest, Infants k.23

SUPPLEMENT: [This section is current through the latest supplement]



30 of 115 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

II. CAPACITY OF PARTIES.

B. Minors.

2. Void Contracts.

c. Other Void Contracts.

1 Witkin Sum. Cal. Law Contracts § 30

[§ 30] Other Void Contracts.

A third and final type of contract made void by *Family C. 6701* is a contract of a minor "relating to any *personal property not in the immediate possession or control of the minor*," e.g., the minor's wages before they are paid to him or her. (*Family C. 6701(c)*; see *Morgan v. Morgan* (1963) 220 C.A.2d 665, 675, 34 C.R. 82, citing the text.) Also, under *Veh.C. 15500*, a minor who does not have a *valid* driver's license may not purchase or lease a vehicle subject to registration. (See also *Veh.C. 15501* [cannot purchase or lease by use of false or fraudulent license].)

SUPPLEMENT: [This section is current through the latest supplement]



31 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

II. CAPACITY OF PARTIES.

B. Minors.

3. Voidable Contracts.

a. Disaffirmance.

1. Statutory Right and Methods.

1 Witkin Sum. Cal. Law Contracts § 31

[§ 31] Statutory Right and Methods.

(1) *Statutory Right.* The general rule is that a minor may make a contract in the same manner as an adult. (*Family C. 6700.*) Despite this rule, some contracts of a minor are void (see *supra*, §28 et seq.), and others are subject to the provision on validity of marriage (*Family C. 300, 11 Summary* (10th), *Husband and Wife*, §42 et seq.). Most, however, are voidable and "may be disaffirmed *by the minor* before majority or within a reasonable time afterwards or, in case of the minor's death within that period, *by the minor's heirs or personal representative.*" (*Family C. 6710.*) (See *People v. Mortera* (1993) 14 C.A.4th 861, 864, 17 C.R.2d 782 [former C.C. 35 (now *Family C. 6710*) applies only to civil contracts; hence, it did not authorize minor to disaffirm guilty plea entered in criminal case as part of plea bargain]; 1 Corbin (Rev. ed.), §1.6; 7 Corbin (Rev. ed.), §27.4; 5 Williston 4th, §9:5 et seq.; 42 Am.Jur.2d (2000 ed.), *Infants* §82 et seq.; Cal. Transactions Forms, 1 Business Transactions §6:9; on binding contracts that cannot be disaffirmed, see *infra*, §34 et seq.)

The policy behind this provision has been stated as follows: "The law shields minors from their lack of judgment and experience and under certain conditions vests in them the right to disaffirm their contracts. Although in many instances such disaffirmance may be a hardship upon those who deal with an infant, the right to avoid his contracts is conferred by law upon a minor 'for his protection against his own improvidence and the designs of others.' It is the policy of the law to protect a minor against himself and his indiscretions and immaturity as well as against the machinations of other people and to discourage adults from contracting with an infant. Any loss occasioned by the disaffirmance of a minor's contract might have been avoided by declining to enter into the contract." (*Niemann v. Deverich* (1950) 98 C.A.2d 787, 793, 221 P.2d 178.)

(2) *Methods of Disaffirmance.* The disaffirmance may be made by any *act or declaration* disclosing an unequivocal intent to repudiate the contract's binding force and effect. (*Spencer v. Collins* (1909) 156 C. 298, 303, 104 P. 320.) Hence, express notice to the other party is unnecessary; the filing of an action is sufficient. (*Abdullah v. Abdullah* (1920) 50 C.A. 115, 119, 194 P. 511; *Pereira v. Toscano* (1927) 84 C.A. 526, 531, 258 P. 429; *Celli v. Sports Car Club of America* (1972) 29 C.A.3d 511, 517, 105 C.R. 904.)

However, *disaffirmance must be complete*: The minor cannot disaffirm only the irksome part of a contract and

enforce the beneficial part. (*Holland v. Universal Underwriters Ins. Co. (1969) 270 C.A.2d 417, 421, 75 C.R. 669* [automobile insurance; attempt to affirm policy but disaffirm the written endorsement deleting uninsured motorist coverage].)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Statutory Right*.

See *Berg v. Taylor (2007) 148 C.A.4th 809, 818, 56 C.R.3d 140* [minor television actor was entitled to disaffirm contract with personal manager obligating minor to pay commissions, even though his mother signed agreement; minor was principal of contract rather than third-party beneficiary of contract between mother and manager, and contract was not for necessities of life for minor or his family].

Family C. 300 was subdivided in 2006. The provision discussed in the text is now in *Family C. 300(a)*.



32 of 115 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

II. CAPACITY OF PARTIES.

B. Minors.

3. Voidable Contracts.

a. Disaffirmance.

2. No Need To Restore Consideration.

1 *Witkin Sum. Cal. Law Contracts* § 32

[§ 32] No Need To Restore Consideration.

Rescission requires restoration of consideration (see *infra*, §930 et seq.). Whether restoration is required after *disaffirmance* may depend on whether the consideration is in the minor's possession at the time of disaffirmance. (See *Rest.2d, Contracts* §14, Comment c ["If the consideration received by the infant has been dissipated by him, the other party is without remedy unless the infant ratifies the contract after coming of age or is under some non-contractual obligation"]; 1 Corbin (Rev. ed.), §1.6; 7 Corbin (Rev. ed.), §27.6; 5 Williston 4th, §9:16; 19 *Hastings L. J.* 1199.)

Under former California law, the crucial factor was the minor's age, because, prior to 1971, former C.C. 35 expressly required restoration by minors *over* 18. On the basis of this provision, restoration was held to be a necessity for minors over 18 (see *Freitas v. Cordeiro* (1932) 122 C.A. 319, 323, 9 P.2d 882) but, by implication, not for minors under 18 (see *Tracy v. Gaudin* (1930) 104 C.A. 158, 160, 285 P. 720). (See 19 *Hastings L. J.* 1199 [criticizing this interpretation of former C.C. 35 and suggesting that purpose of former over-18 provision was simply to create condition precedent to disaffirmance by older minors, rather than to give possessory rights to younger minors].)

In 1971, in conformity with the new definition of minors as all persons under 18 (see *supra*, §26), the special provision on minors over 18 was deleted from former C.C. 35, leaving the statute with no requirement of restoration. This requirement of restoration was likewise omitted from *Family C. 6710*, which replaced former C.C. 35 in 1992 (see *supra*, §31).

West's Key Number Digest, Infants k.31(2)

SUPPLEMENT: [This section is current through the latest supplement]



33 of 115 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

II. CAPACITY OF PARTIES.

B. Minors.

3. Voidable Contracts.

b. No Recovery From Bona Fide Purchase

1 Witkin Sum. Cal. Law Contracts § 33

[§ 33] No Recovery From Bona Fide Purchase

Former C.C. 35a brought one aspect of minors' contracts into harmony with the Uniform Sales Act (former C.C. 1744), and this policy was continued in the Family Code (see *Family C. 6713*). If the minor sells goods to a buyer, the minor may of course disaffirm and recover them. But if before such disaffirmance, the first buyer transfers them to another purchaser who takes them for value and without notice of the voidable title of the first buyer, *the minor cannot recover the goods from the innocent purchaser.* (*Family C. 6713*; see *16 A.L.R.2d 1420* [right of minor to disaffirm sale of personalty and recover it from bona fide purchaser]; 5 Williston 4th, §9:11.)

The Sales Act was superseded by the Uniform Commercial Code, which states the same rules in broader terms: "A person with voidable title has power to transfer a good title to a good faith purchaser for value." (U.C.C. 2403(1); see 4 *Summary* (10th), *Sales*, §232.)

SUPPLEMENT: [This section is current through the latest supplement]



34 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

II. CAPACITY OF PARTIES.

B. Minors.

4. Binding Contracts.

a. Contracts Authorized by Statute.

1. Contract for Necessaries.

1 Witkin Sum. Cal. Law Contracts § 34

[§ 34] Contract for Necessaries.

A contract, otherwise valid, entered into during minority, may not be disaffirmed on the ground of minority either during the actual minority of the contracting minor, or at any time thereafter, if all of the following requirements are satisfied: (1) the contract is to pay the reasonable value of things necessary for the support of the minor or the minor's family; (2) these things have been actually furnished to the minor or to the minor's family; (3) the contract is entered into by the minor when not under the care of a parent or guardian able to provide for the minor or his or her family. (*Family C. 6712.*) (See *Aubel v. Sosso* (1925) 72 C.A. 57, 60, 236 P. 319 [if minor is living with his or her parents, and they are able to take care of the minor, his or her contract for necessities is voidable]; 7 Corbin (Rev. ed.), §27.7; 5 Williston 4th, §9:18 et seq.; 42 *Am.Jur.2d* (2000 ed.), *Infants* §64 et seq.; 6 *Hastings L. J.* 112 [automobile as necessities]; 41 *A.L.R.3d* 1075 [employment agency services as necessities]; 56 *A.L.R.3d* 1335 [automobile or motorcycle as necessities].)

In *Burnand v. Irigoyen* (1947) 30 C.2d 861, 186 P.2d 417, a girl of 17 contracted to purchase a home in which she and her parents subsequently lived. Although the original contract was concededly void, her claim after reaching majority, for recovery of prior payments, was rejected, apparently on two grounds that are not clearly distinguished: (1) There was an *implied contract* for the reasonable value of necessities--lodging--furnished a minor whose parents were unable to provide it for her; and (2) even if such a contract was subject to disaffirmance, payments made after reaching majority estopped the minor from asserting its invalidity. (30 C.2d 867.) (See dissent, questioning the factual basis of the opinion.)

The Uniform Sales Act provided that a minor was required to pay a reasonable price for necessities, defined to mean "goods suitable to the condition in life of such infant ... and to his actual requirements at the time of delivery." The Uniform Commercial Code, superseding the Act, has no provisions relating to the liability of minors for necessities. However, the Code expressly preserves general non-Code law relating to capacity of parties. (U.C.C. 1103.) (On use of prior statute in areas not covered by the Code, see 1 Anderson 3d (2003 Rev. ed.) §1-103:5.)

SUPPLEMENT: [This section is current through the latest supplement]
See 1 Lawrence's Anderson 3d (2003 ed.), §1-103:5.



35 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

II. CAPACITY OF PARTIES.

B. Minors.

4. Binding Contracts.

a. Contracts Authorized by Statute.

2. Contract for Attorneys' Fees.

1 Witkin Sum. Cal. Law Contracts § 35

[§ 35] Contract for Attorneys' Fees.

"A contract for attorney's fees for services in litigation, made by or on behalf of a minor, is void unless the contract is approved, on petition by an interested person, by the court in which the litigation is pending or by the court having jurisdiction of the guardianship estate of the minor. If the contract is not approved and a judgment is recovered by or on behalf of the minor, the attorney's fees chargeable against the minor shall be fixed by the court rendering the judgment." (*Family C. 6602.*)

Despite the negative phrasing of this section, it would appear that the contract is binding and not subject to disaffirmance when approved by the court. And, although the contract is void if not approved, the attorney may nevertheless recover in quasi-contract for the reasonable value of his or her services, which are considered necessities. (*Leonard v. Alexander (1942) 50 C.A.2d 385, 387, 122 P.2d 984.*) (See *13 A.L.R.3d 1251* [minor's liability for attorney's services rendered under contract with minor].)

SUPPLEMENT: [This section is current through the latest supplement]



36 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

II. CAPACITY OF PARTIES.

B. Minors.

4. Binding Contracts.

a. Contracts Authorized by Statute.

3. Contracts of Creative Artist, Entertainer, or Athlete.

aa. Scope of Statute.

1 Witkin Sum. Cal. Law Contracts § 36

[§ 36] Scope of Statute.

An unemancipated minor's contract, otherwise valid, to render artistic or creative services or services in professional sports, or to secure certain properties for use in the entertainment field, is binding on court approval (see *supra*, §37). (*Family C. 6750(a)(1)-(a)(3)*, 6751; see *Lab.C. 1700.37* [contract between minor and talent agency binding if approved by superior court]; *B. & P.C. 18702* [16-year-old may be licensed as amateur and may participate in amateur contest or match]; *Morgan v. Morgan* (1963) 220 C.A.2d 665, 672, 34 C.R. 82; 19 J. Juvenile Law 376 [regulation of minors' entertainment contracts]; 31 *McGeorge L. Rev.* 201 [Saving Shirley Temple: An Attempt To Secure Financial Futures for Child Performers].) The contract must have been entered into on or after January 1, 2000. (*Family C. 6750(a)*.)

The provision on artistic and creative services applies to a contract under which a minor "is employed or agrees to render artistic or creative services, either directly or through a third party, including, but not limited to, a personal services corporation (loan-out company) or through an existing agency." (*Family C. 6750(a)(1)*.) Artistic and creative services are defined as including, but not limited to, "services as an actor, actress, dancer, musician, comedian, singer, stunt-person, voice-over artist, or other performer or entertainer, or as a songwriter, musical producer or arranger, writer, director, producer, production executive, choreographer, composer, conductor, or designer." (*Family C. 6750(a)(1)*.)

The provision on acquiring certain properties covers contracts under which the minor agrees "to purchase, or otherwise secure, sell, lease, license, or otherwise dispose of literary, musical, or dramatic properties, or use of a person's likeness, voice recording, performance, or story of or incidents in his or her life, either tangible or intangible, or any rights therein." The contract is "for use in motion pictures, television, the production of sound recordings in any format now known or hereafter devised, the legitimate or living stage, or otherwise in the entertainment field." (*Family C. 6750(a)(2)*.)

The provision on services in professional sports applies to both players and participants. (*Family C. 6750(a)(3)*.) (As to minor's employer, see *Family C. 6750(b)*; as to minor's gross earnings, see *Family C. 6750(c)*.)

In *Warner Bros. Pictures v. Brodel* (1948) 31 C.2d 766, 192 P.2d 949, former C.C. 36 (now Family C. 6750, 6751) was held applicable to a contract containing *options to extend* the period of employment, so that the original term and the optional extensions were equally binding. While the case was pending, the former statute was amended to make express provision to the same effect: The court's approval "shall extend to the whole of the contract or agreement," including "any optional or conditional provisions contained therein for extension, prolongation or termination of the term thereof." (21 So. Cal. L. Rev. 34; on same provision in Family C. 6751(c), see supra, §37.) In stressing the policy reasons for its decision, the court pointed out that the employer's option provision encourages the development of new talent, for the employer may object to making large initial investments without some protection. Thus, the opinion declares: "The court may consider whether the terms of the contract are reasonable in the light of the then financial and educational interests of the minor as well as the proper development of his talents and his chances for success in the profession. This discretion ... would be rendered ineffectual to serve the best interests of the minor if it were not applicable to such option provisions." (31 C.2d 775.)

West's Key Number Digest, Infants k.47

SUPPLEMENT: [This section is current through the latest supplement]

See 27 J. Juvenile Law 47 [contracting with minors in entertainment industry]; 27 J. Juvenile Law 69 [protecting earnings of child performers].



37 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

II. CAPACITY OF PARTIES.

B. Minors.

4. Binding Contracts.

a. Contracts Authorized by Statute.

3. Contracts of Creative Artist, Entertainer, or Athlete.

bb. Court Approval.

1 Witkin Sum. Cal. Law Contracts § 37

[§ 37] Court Approval.

(1) *In General.* A contract, otherwise valid, of a type described in *Family C. 6750* (see *supra*, §36), entered into during minority, cannot be disaffirmed on that ground either during the minority of the person entering into the contract, or at any time thereafter, *if the contract has been approved by the superior court* in any county in which the minor resides or is employed or in which any party to the contract has its principal office in California for the transaction of business. (*Family C. 6751(a).*)

(2) *Scope of Approval.* The court's approval extends to the whole of the contract and all of its terms and provisions, including, but not limited to, any optional or conditional provisions for extension, prolongation, or termination of the term of the contract. (*Family C. 6751(c).*)

(3) *Procedure.* Court approval may be given on petition of any party to the contract, after such reasonable notice to all other parties to the contract as is fixed by the court, with opportunity to the other parties to appear and be heard. (*Family C. 6751(b).*)

(4) *Funds To Be Set Aside.* In the order of approval, the court must require that 15% of the minor's gross earnings under the contract be set aside by the minor's employer in trust, in an account or other savings plan, and preserved for the benefit of the minor. The court may also require that more than 15% of the minor's gross earnings be set aside in trust and preserved for the benefit of the minor. (*Family C. 6752(b)(1).*) The court must require that at least one parent or legal guardian, as the case may be, entitled to the physical custody, care, and control of the minor at the time the order is issued be appointed as trustee of the funds ordered to be set aside in trust, unless the court determines that appointment of a different individual or entity as trustee is required in the best interest of the minor. (*Family C. 6752(b)(2)*; on duties of trustee, see *Family C. 6753.*)

SUPPLEMENT: [This section is current through the latest supplement]



38 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

II. CAPACITY OF PARTIES.

B. Minors.

4. Binding Contracts.

a. Contracts Authorized by Statute.

4. Contracts for Medical or Dental Care.

aa. Nature of Statutes.

1 Witkin Sum. Cal. Law Contracts § 38

[§ 38] Nature of Statutes.

The Legislature, by a "consistent series of enactments," has freed "particular classes of minors from the necessity of obtaining parental consent" for various hospital, medical, and dental services. (*Ballard v. Anderson (1971) 4 C.3d 873, 882, 95 C.R. 1, 484 P.2d 1345.*) Thus, it is provided by statute that not only may certain minors consent to medical or dental services without needing to obtain the consent of a parent or guardian (*Family C. 6920*), but that this consent is *not subject to disaffirmance because of minority (Family C. 6921)*. A major effect of this legislation is to relieve hospitals and the medical profession from potential tort liability for lack of parental consent. (See *23 Hastings L. J. 1499; 53 A.L.R.4th 1249* [minor's liability for medical, dental, or hospital services]; *5 Summary (10th), Torts*, §389 et seq.) The categories of minors who can give binding consent are covered in subsequent sections.(See *infra*, §39 et seq.)

SUPPLEMENT: [This section is current through the latest supplement]



39 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

II. CAPACITY OF PARTIES.

B. Minors.

4. Binding Contracts.

a. Contracts Authorized by Statute.

4. Contracts for Medical or Dental Care.

bb. Unwed Pregnant Minors.

1 Witkin Sum. Cal. Law Contracts § 39

[§ 39] Unwed Pregnant Minors.

In *Ballard v. Anderson* (1971) 4 C.3d 873, 95 C.R.1, 484 P.2d 1345, the court held that under former C.C. 34.5, a minor could obtain a *therapeutic* abortion without parental consent, but had to have the requisite understanding and maturity. (4 C.3d 878, 883.) *Family C.* 6925, while recognizing that a minor may consent to medical care related to the *prevention or treatment of pregnancy* adds that it does not authorize a minor either "[t]o be sterilized without the consent of the minor's parent or guardian" or "[t]o receive an abortion without the consent of a parent or guardian other than as provided in *Section 123450 of the Health and Safety Code*" (requiring that the minor secure parental authorization or judicial authorization). However, the Supreme Court in 1997 declared these restrictions on a minor's right to obtain an abortion to be an unconstitutional violation of the right to privacy (Cal. Const., Art. I, §1). (See *American Academy of Pediatrics v. Lungren* (1997) 16 C.4th 307, 314, 66 C.R.2d 210, 940 P.2d 797, 7 Summary (10th), *Constitutional Law*, §579.) In 2002, the Reproductive Privacy Act was adopted (see *Health & Saf.C. 123460 et seq.*), providing generally that "a woman" has the right to obtain an abortion prior to viability of the fetus or when necessary to protect her life or health. (See *Michaelis v. Schori* (1993) 20 C.A.4th 133, 136, 24 C.R.2d 380 [under former C.C. 34.5, unemancipated minor may not disaffirm arbitration provision enacted under C.C.P. 1295 (see *infra*, §328) as part of contract for hospital, medical, or surgical care related to pregnancy].)

West's Key Number Digest, Infants k.46

SUPPLEMENT: [This section is current through the latest supplement]



40 of 115 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

II. CAPACITY OF PARTIES.

B. Minors.

4. Binding Contracts.

a. Contracts Authorized by Statute.

4. Contracts for Medical or Dental Care.

cc. Married Minors.

1 Witkin Sum. Cal. Law Contracts § 40

[§ 40] Married Minors.

Any lawfully married minor, male or female, regardless of age, may give binding consent to the furnishing to him or her of *hospital, medical, and surgical care*; and, for this purpose, a subsequent judgment of dissolution of marriage does not deprive the minor of adult status. (*Family C. 7002(a), 7050(e)(1).*)

SUPPLEMENT: [This section is current through the latest supplement]



41 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

II. CAPACITY OF PARTIES.

B. Minors.

4. Binding Contracts.

a. Contracts Authorized by Statute.

4. Contracts for Medical or Dental Care.

dd. Minors in Military Service.

1 Witkin Sum. Cal. Law Contracts § 41

[§ 41] Minors in Military Service.

Any minor, male or female, regardless of age, *on active duty* with any of the armed services of the United States, may give binding consent for hospital, medical and surgical care furnished to him or her. (*Family C. 7002(b), 7050(e)(1).*) (See 10 *Summary* (10th), *Parent and Child*., §§299, 301.)

SUPPLEMENT: [This section is current through the latest supplement]



42 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

II. CAPACITY OF PARTIES.

B. Minors.

4. Binding Contracts.

a. Contracts Authorized by Statute.

4. Contracts for Medical or Dental Care.

ee. Minors Exposed to Communicable isease.

1 Witkin Sum. Cal. Law Contracts § 42

[§ 42] Minors Exposed to Communicable isease.

A minor, 12 or older, who may have come into contact with an infectious, contagious, or communicable disease may give binding consent to medical care related to the diagnosis or treatment of the disease, if the disease or condition is one that is required by a legally adopted law or regulation to be reported to the local health officer, or is a related sexually transmitted disease as may be determined by the State Director of Health Services. (Family C. 9026(a).) The minor's parents or guardian are not liable for payment for medical care so provided. (Family C. 9026(b).)

West's Key Number Digest, Infants k.46

SUPPLEMENT: [This section is current through the latest supplement]



43 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

II. CAPACITY OF PARTIES.

B. Minors.

4. Binding Contracts.

a. Contracts Authorized by Statute.

4. Contracts for Medical or Dental Care.

ff. Minor Raped or Sexually Assaulted.

1 Witkin Sum. Cal. Law Contracts § 43

[§ 43] Minor Raped or Sexually Assaulted.

(1) *Minor of 12 or Over Raped.* A minor, 12 years of age or older, who is alleged to have been raped "may consent to medical care related to the diagnosis or treatment of the condition and the collection of medical evidence with regard to the alleged rape." (*Family C. 6927.*)

(2) *Any Minor Sexually Assaulted.* Similarly, *any* minor alleged to have been sexually assaulted (defined as including, but not limited to, conduct coming within P.C. 261, 286, or 288a) may consent to medical care related to the diagnosis and treatment of the condition and to the collection of medical evidence with regard to the alleged assault. (*Family C. 6928(a), (b).*)

The professional person providing the medical treatment must attempt to contact the minor's parent or guardian and note in the minor's treatment record the date and time of the attempt and whether it was successful or unsuccessful. This subdivision does not apply if the professional person reasonably believes that the minor's parent or guardian committed the sexual assault. (*Family C. 6928(b).*)

SUPPLEMENT: [This section is current through the latest supplement]



44 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law

II. CAPACITY OF PARTIES.

B. Minors.

4. Binding Contracts.

a. Contracts Authorized by Statute.

4. Contracts for Medical or Dental Care.

gg. Minor With Drug or Alcohol Problem.

1 Witkin Sum. Cal. Law Contracts § 44

[§ 44] Minor With Drug or Alcohol Problem.

(1) *Binding Consent.* A minor, 12 years of age or older, may consent to medical care and counseling relating to the diagnosis and treatment of a drug- or alcohol-related problem. (*Family C. 6929(b).*) The terms "counseling," "drug or alcohol," "LAAM," and "professional person" are defined (*Family C. 6929(a)*), and the minor is expressly prohibited from receiving *methadone treatment* without the consent of his or her parent, parents, or legal guardian (*Family C. 6929(e)*). *Family C. 6929* further provides that it is the legislative intent to respect the right of a parent or legal guardian to seek medical care and counseling for a drug- or alcohol-related problem of a minor when the minor does not consent to the care and counseling, and nothing in the statute is to be construed to restrict or eliminate this right. (*Family C. 6929(f).*)

(2) *Involvement of Parent or Guardian.* The treatment plan must include the involvement of the minor's parent or guardian, if appropriate, as determined by the professional person or treatment facility treating the minor. The professional person providing the care or counseling must state in the treatment record whether and when he or she attempted to contact the minor's parent or guardian, and whether the attempt was successful, or the reason why, in the opinion of the professional, it would not be appropriate to contact the parent or guardian. (*Family C. 6929(c).*)

(3) *Liability of Parent or Guardian.* The minor's parents or guardian are not liable for payment for any care provided to a minor, except that if the parent or guardian participates in a counseling program, he or she is liable for the cost of these services. (*Family C. 6929(d).*)

SUPPLEMENT: [This section is current through the latest supplement]



45 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

II. CAPACITY OF PARTIES.

B. Minors.

4. Binding Contracts.

a. Contracts Authorized by Statute.

4. Contracts for Medical or Dental Care.

hh. Minor Needing Mental Health Treatment.

1 Witkin Sum. Cal. Law Contracts § 45

[§ 45] Minor Needing Mental Health Treatment.

A minor, 12 or older, may consent to mental health treatment or counseling on an outpatient basis, or to residential shelter services, if (1) the minor, in the opinion of the attending professional person, is mature enough to participate intelligently in the outpatient treatment or residential shelter services, and (2) the minor presents a danger of serious physical or mental harm to self or to others without this treatment or service, or is the alleged victim of incest or child abuse. (*Family C. 6924(b)*; for definitions of "counseling services," "professional person," and "residential shelter services," see *Family C. 6924(a)*.) However, a minor is not authorized to receive convulsive therapy or psychosurgery as defined in *Welf.C. 5325(f)*, (g), or psychotropic drugs without the consent of the minor's parent or guardian. (*Family C. 6924(f)*.)

A professional person offering residential shelter services to a minor, whether as an individual or as a representative of a qualifying entity, must make his or her best efforts to notify the parent or guardian regarding the provision of services. (*Family C. 6924(c)*.) Similarly, the mental health treatment or counseling of a minor must include involvement of the minor's parent or guardian unless, in the opinion of the treating professional person, the involvement would be inappropriate. Accordingly, the professional person must state in the client record whether and when he or she attempted to contact the minor's parent or guardian, and whether the attempt was successful or unsuccessful, or the reason why, in the professional's opinion, it would be inappropriate to contact the minor's parent or guardian. (*Family C. 6924(d)*; on liability of participating parents and guardians, see *Family C. 6924(e)*.)

The persons rendering the mental health treatment or counseling services to consenting minors under *Family C. 6924* are included within the general definition of "psychotherapist." (See *Ev.C. 1010, 2 Cal. Evidence (4th), Witnesses, §215*.)

West's Key Number Digest, Infants k.46

SUPPLEMENT: [This section is current through the latest supplement]



46 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

II. CAPACITY OF PARTIES.

B. Minors.

4. Binding Contracts.

a. Contracts Authorized by Statute.

4. Contracts for Medical or Dental Care.

ii. Minor of 15 Living Apart.

1 Witkin Sum. Cal. Law Contracts § 46

[§ 46] Minor of 15 Living Apart.

A minor, 15 or older, may consent to the furnishing of medical or dental care if (1) the minor is living separate and apart from the minor's parents or guardian, whether with or without the consent of a parent or guardian and regardless of the duration of the separate residence, and (2) the minor is managing his or her own financial affairs, regardless of the source of the minor's income. (*Family C. 6922(a)*; see *Carter v. Cangello (1980) 105 C.A.3d 348, 350, 164 C.R. 361* [duration of minor's separate residence, whether it is with or without parental consent, and source of his or her income are matters that do not affect minor's status; construing former C.C. 34.6]; 10 Santa Clara Lawyer 334; on definitions of "dental care" and "medical care," see *Family C. 6901* and *6902*, respectively.)

A physician and surgeon or dentist may, with or without the consent of the minor, advise the minor's parent or guardian of the treatment given or needed, if the physician or dentist has reason to know, on the basis of information given by the minor, the whereabouts of the parent or guardian. (*Family C. 6922(c)*; see 10 Santa Clara L. Rev. 343.) In any event, the minor's parents or guardian are not liable for the medical or dental care provided. (*Family C. 6922(b)*.)

SUPPLEMENT: [This section is current through the latest supplement]



47 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

II. CAPACITY OF PARTIES.

B. Minors.

4. Binding Contracts.

a. Contracts Authorized by Statute.

5. Miscellaneous Contracts.

1 Witkin Sum. Cal. Law Contracts § 47

[§ 47] Miscellaneous Contracts.

Family C. 6711 contains a general catch-all provision, making an obligation, otherwise valid, binding on the minor if "entered into by the minor under the *express authority or direction of a statute*." In addition to the examples set forth in preceding sections (*supra*, §34 et seq.), the following are important:

(a) A minor who is a public officer "shall have the rights and liabilities of an adult, both civil and criminal, with regard to his official duties." (*Govt.C. 275.2.*)

(b) A minor who is "a candidate for nomination or election to public office" has the rights and liabilities of an adult "with regard to his activities as a candidate." (*Govt.C. 275.2.*)

(c) A minor's relinquishment of his or her child to an adoption agency is not subject to revocation. (*Family C. 8700(b).*)

(d) A minor's consent to the adoption of his child is not subject to revocation. (*Family C. 8814(d).*)

(e) Minors over the age of 16 may validly contract for life or disability insurance, or annuities, except where personal liability for assessment may result. (*Ins.C. 10112.*)

(f) A veteran who is under 21 may contract with the Department of Veterans Affairs with respect to the purchase of a farm or home. (*Mil. & Vet.C. 986.10.*)

The United States Supreme Court has held that the enlistment of a minor in the armed forces of the United States is binding. (See *United States v. Williams* (1937) 302 U.S. 46, 58 S.Ct. 81, 82, 82 L.Ed. 39, 42.) And §2 of the Model Minor Student Capacity to Borrow Act (9B U.L.A. (Master Ed.), p. 1) makes a written obligation signed by a minor of 16 or over as consideration for an educational loan enforceable as if the minor were an adult, if an educational institution has given written certification of the minor's enrollment to the person making the loan.

SUPPLEMENT: [This section is current through the latest supplement]



48 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

II. CAPACITY OF PARTIES.

B. Minors.

4. Binding Contracts.

a. Contracts Authorized by Statute.

6. Emancipated Minors.

1 Witkin Sum. Cal. Law Contracts § 48

[§ 48] Emancipated Minors.

The 1978 Legislature adopted the Emancipation of Minors Act (former C.C. 60 et seq.) to clarify and restate the law on emancipation and the rights and powers of emancipated minors. (See *10 Pacific L. J.* 522, *15 Pacific L. J.* 453; *12 U.C. Davis L. Rev.* 283.) Since then, the Act has been repealed and reenacted as a division of the Family Code (see *Family C. 7000* et seq., *10 Summary* (10th), *Parent and Child*, §299 et seq.).

An emancipated minor is any person under 18 who (1) has entered into a valid marriage, whether or not it was terminated by dissolution; (2) is on active duty in the armed forces; or (3) has received a declaration of emancipation by satisfying the following conditions: being at least 14; willingly and with consent, living separate from parents or guardian; managing his or her own financial affairs, as evidenced by a declaration of income and expenses; and deriving no income from criminal activity. (*Family C. 7002, 7120*; see *10 Summary* (10th), *Parent and Child*, §299.)

The acts that an emancipated minor can do to the same degree as an adult include, but are not limited to, the following: (1) consent to medical, dental, or psychiatric care, without parental consent, knowledge, or liability (*Family C. 7050(e)(1)*); (2) enter into a binding contract (*Family C. 7050(e)(2)*), including an insurance contract (*Family C. 7051*); (3) enter into a transaction involving an interest in real or personal property (*Family C. 7050(e)(3)*), including the conveyance or release of contingent or expectant interests and the consent to transfers, encumbrances, or gifts of marital property (*Family C. 7050(e)(8)*); and (4) compromise or otherwise adjust a claim, action, or proceeding (*Family C. 7050(e)(5)*). (See *10 Summary* (10th), *Parent and Child*, §301.)

SUPPLEMENT: [This section is current through the latest supplement]



49 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

II. CAPACITY OF PARTIES.

B. Minors.

4. Binding Contracts.

b. Parent's Agreement To Arbitrate.

1 Witkin Sum. Cal. Law Contracts § 49

[§ 49] Parent's Agreement To Arbitrate.

(1) *In General.* Under three circumstances, a party can bind another person to a medical arbitration agreement without that person's consent: An agent can bind a principal. Spouses can bind each other. A parent can bind a *minor* child. (*Buckner v. Tamarin* (2002) 98 C.A.4th 140, 142, 119 C.R.2d 489 [adult children not bound].)

(2) *Child Already Born at Time of Agreement.* In *Doyle v. Giuliani* (1965) 62 C.2d 606, 43 C.R. 697, 401 P.2d 1, the court sustained the authority of a parent to bind his or her child to arbitrate claims under a medical care contract. The contract was made by the father with defendant medical group; plaintiff minor was an express third-party beneficiary (see *infra*, §685 et seq.). A claim for malpractice was made by plaintiff, and, pursuant to the arbitration provision of the contract, arbitration was had. Before the decision, however, plaintiff filed a malpractice action. *Held*, judgment confirming the arbitration award in favor of defendant affirmed.

(a) Former C.C. 35 (now *Family C. 6710*), giving a minor the right to disaffirm a contract, is not applicable to a contract between adults, of which the child is a third-party beneficiary. (62 C.2d 609.)

(b) *C.C.P. 1287.6*, providing that an unconfirmed arbitration award has the same effect as a written contract, was intended to strengthen arbitration awards, not to give minors an opportunity to disaffirm. (62 C.2d 609.)

(c) Former C.C. 42 (now *Family C. 6601*) authorizes a minor to enforce his or her rights by a civil action "or other legal proceedings," and does not except arbitration proceedings. If minors were free to disaffirm arbitration awards, they would be effectively denied the benefits of arbitration, for few adults would agree to submit their claims. (62 C.2d 609.)

(d) Thus, there is no statutory bar to enforcement of the contract to arbitrate. And the power of a parent to bind his or her child to arbitrate a dispute under a group medical service contract is "implicit" in the parent's duty to provide care for a child, for, unless he or she can so contract, medical benefits will be denied the child. (62 C.2d 610.)

(e) The arbitration provision does not unreasonably restrict minors' rights; it merely specifies a forum for settlement of disputes, with full judicial review, and invests parents and guardians with considerably less power than the statute authorizing them to compromise minors' claims (former Prob.C. 1431, now *Prob.C. 3500*). (62 C.2d 610.)

(3) *Child Conceived, but Unborn, at Time of Agreement.* *Doyle v. Giuliucci, supra*, was followed in *Wilson v. Kaiser Foundation Hosp.* (1983) 141 C.A.3d 891, 190 C.R. 649, where the parent's agreement was held binding on her unborn child. Mrs. W had medical coverage under defendant's Health Plan, which automatically enrolled a newborn child as a member. Plaintiff, Mrs. W's child, was born with prenatal and postnatal injuries allegedly caused by negligence of defendants, and a complaint was filed for personal injuries. Defendant invoked the arbitration clause of the Health Plan agreement. Plaintiff conceded that he became a member of the Plan on his birth, and that postnatal injuries had to be submitted to arbitration; but he argued that prior to birth he was not a person and could not be bound by the agreement, hence prenatal injuries could be the basis of a tort action. *Held*, the clause was binding as to both causes of action. Plaintiff's mother sought obstetric care from defendants under the Plan, thereby electing to obtain medical service for both herself and her unborn child; and she had the authority to contract on his behalf and to bind him to arbitration. (141 C.A.3d 898, 899.)

(4) *Child Neither Conceived nor Born at Time of Agreement.* In *Pietrelli v. Peacock* (1993) 13 C.A.4th 943, 16 C.R.2d 688, plaintiff's mother, who was not pregnant at the time, signed an arbitration agreement covering, in part, controversies arising between defendant physician and "persons, born or unborn, on behalf of whom I have the power to contract." In his later malpractice action alleging negligence in the care he received from defendant at or around the time of his birth, plaintiff argued that his mother had no power to bind him to arbitration because, being neither born nor conceived at the time, he did not exist as a legal entity at the time the agreement was executed. *Held*, the agreement was binding on plaintiff.

(a) It is settled that nonsignatories may be bound by arbitration agreements executed on their behalf. (13 C.A.4th 947, citing *Keller Const. Co. v. Kashani* (1990) 220 C.A.3d 222, 269 C.R. 259, 6 Cal. Proc. (4th), *Proceedings Without Trial*, §499.) In addition, in other contexts the law recognizes the ability of a party to act on behalf of persons who have not yet come into existence. For example, a testamentary bequest to a class of persons applies to all persons answering the class description at the time the devise is to take effect, regardless of whether they were born before or after the testator's death. And a guardian ad litem may be appointed to represent the interests of persons who are designated as beneficiaries under the terms of a written instrument, but are not ascertained or are not yet in being. (13 C.A.4th 947.)

(b) Here, the arbitration agreement bound "persons unborn" whom plaintiff's mother had authority to bind, and at the moment of his conception, plaintiff became such a person. As in *Wilson v. Kaiser Foundation Hosp.*, *supra*, by electing to receive obstetric services provided for under the agreement, defendant's mother impliedly agreed to arbitration for her unborn child, an election that became binding on plaintiff at birth. (13 C.A.4th 948.)

West's Key Number Digest, Infants k.47

SUPPLEMENT: [This section is current through the latest supplement]

(4) *Child Neither Conceived nor Born at Time of Agreement.*

Keller Const. Co. case:

Cross-Reference: 6 Cal. Proc. (5th), *Proceedings Without Trial*, §533.



50 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
II. CAPACITY OF PARTIES.
C. Persons of Unsound Mind.
1. In General.

1 Witkin Sum. Cal. Law Contracts § 50

[§ 50] In General.

The contracts of a person wholly without understanding or whose insanity has been judicially determined are *void* and need not be rescinded. Those of a person of unsound mind but not wholly without understanding are *voidable* and are binding unless rescinded. (C.C. 38, 39, 40; see *infra*, §52 et seq.); and see generally *Smalley v. Baker* (1968) 262 C.A.2d 824, 832, 69 C.R. 521, *infra*, §57; 7 Corbin (Rev. ed.), §27.10; 5 Williston 4th, §10:1 et seq.; 41 *Am.Jur.2d* (1996 ed.), *Mentally Impaired Persons* §§1 et seq., 155 et seq.; 62 Proof of Facts 3d 197 [proof of incompetence]; 13 Santa Clara Lawyer 537; 27 *Santa Clara L. Rev.* 787; 39 *So. Cal. L. Rev.* 211; Cal. Civil Practice, 3 Business Litigation, §§24:23 et seq., 24:119 et seq.; Cal. Transactions Forms, 1 Business Transactions §6:11; 2 California Affirmative Defenses 2d (2004 ed.), §52:21 et seq.

The Restatement (§15) treats the contracts as voidable. (See Comments a and b, and Reporter's Note, discussing various approaches to the subject.)

The statute rendering void contracts executed by persons wholly without understanding (C.C. 38) is intended for the protection of the incompetent, and cannot be invoked by the other party to the contract. This is declared to be the rule even though the incompetent is wholly insane, and the contract void. (See *San Francisco Credit Clearing House v. MacDonald* (1912) 18 C.A. 212, 215, 122 P. 964.) It is immaterial whether the other party knew of the incompetence. (*Neale v. Sterling* (1931) 117 C.A. 507, 509, 4 P.2d 250.)

A voidable contract may ordinarily be ratified where the conditions of ratification are met; but it is generally held that a contract that is wholly void cannot be ratified, and that there can be no estoppel to deny its validity. (*Dool v. First Nat. Bank* (1930) 209 C. 717, 719, 290 P. 15.) The *Dool* court was of the opinion that the incompetent was not, at the time of contracting, "wholly without understanding." (209 C. 719.) Nevertheless, it was held that, even if he was, his subsequent acts following restoration to capacity could give rise to an estoppel, on the same theory that a minor, after reaching majority, might be estopped to plead minority as against a contract originally void. (209 C. 725.)

Even though the contracts of a person wholly without understanding are void, such a person is liable for the reasonable value of things furnished that are necessary for the support of the person or his or her family. (C.C. 38.)

West's Key Number Digest, Contracts k.12; Mental Health k.372.1

SUPPLEMENT: [This section is current through the latest supplement]

See 53 *Am.Jur.2d* (2006 ed.), *Mentally Impaired Persons* §§1 et seq., 145 et seq.; C.E.B., Law of Contracts §2.24 et seq.; 2 California Affirmative Defenses §52:21 et seq. *Correction:* Page 95, line 7 of section, "41 *Am.Jur.2d*" should be "53 *Am.Jur.2d*".



51 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
II. CAPACITY OF PARTIES.
C. Persons of Unsound Mind.
2. Capacity To Contract.

1 Witkin Sum. Cal. Law Contracts § 51

[§ 51] Capacity To Contract.

The 1995 Legislature enacted a comprehensive statute governing legal capacity, encompassing the capacity to contract, execute wills and trusts, and consent to medical treatment. The new provisions, *Prob.C. 810* et seq., are known as the Due Process in Competence Determinations Act. (Stats. 1995, Chap. 842, §12.) (See 27 *Pacific L. J.* 471; 14 *Summary* (10th), *Wills and Probate*, §8 et seq.)

(1) *Legislative Findings.* The Legislature made the following findings:

(a) "For purposes of this part, there shall exist a rebuttable presumption affecting the burden of proof that all persons have the capacity to make decisions and to be responsible for their acts or decisions." (*Prob.C. 810(a)*.)

(b) "A person who has a mental or physical disorder may still be capable of contracting, conveying, marrying, making medical decisions, executing wills or trusts, and performing other actions." (*Prob.C. 810(b)*.)

(c) "A judicial determination that a person is totally without understanding, or is of unsound mind, or suffers from one or more mental deficits so substantial that, under the circumstances, the person should be deemed to lack the legal capacity to perform a specific act, should be based on evidence of a deficit in one or more of the person's mental functions rather than on a diagnosis of a person's mental or physical disorder." (*Prob.C. 810(c)*); on adjudication of insanity, see *infra*, §53.)

(2) *Conditions for Legal Capacity.* Generally, a person lacks the capacity to make a decision unless the person has the ability to communicate the decision, verbally or by other means, and to understand and appreciate all the following:

(a) "The rights, duties, and responsibilities created by or affected by the decision." (*Prob.C. 812(a)*.)

(b) "The probable consequences for the decisionmaker and, where appropriate, the persons affected by the decision." (*Prob.C. 812(b)*.)

(c) "The significant risks, benefits, and reasonable alternatives involved in the decision." (*Prob.C. 812(c)*.)

(3) *Evidence of Deficit in Mental Function.* "A determination that a person is of unsound mind or lacks the capacity

to make a decision or do a certain act" must be supported by evidence of a deficit in at least one of four specified mental functions, and evidence of a correlation between the deficit and the decision or acts in question. (*Prob.C. 811(a)*; for discussion of mental functions, see 14 *Summary* (10th), *Wills and Probate*, §9; on adjudication of insanity, see *infra*, §53.)

West's Key Number Digest, Mental Health k.374

SUPPLEMENT: [This section is current through the latest supplement]



52 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

II. CAPACITY OF PARTIES.

C. Persons of Unsound Mind.

3. Void Contracts.

a. Insanity Without Adjudication.

1 *Witkin Sum. Cal. Law Contracts* § 52

[§ 52] Insanity Without Adjudication.

Complete insanity may be proved *as a fact*, under C.C. 38, dealing with persons "entirely without understanding." That phrase means a want of capacity to understand the particular act or transaction in dispute. (*Jacks v. Estee* (1903) 139 C. 507, 511, 73 P. 247; *Ripperdan v. Weldy* (1906) 149 C. 667, 674, 87 P. 276; see generally 13 Santa Clara Lawyer 537; 39 So. Cal. L. Rev. 211.)

In the absence of an adjudication of insanity (see *infra*, §53), the following matters may be admissible as evidence of contractual incapacity:

(1) *Hospitalization under court order*. (See *Guardianship of Carniglia* (1934) 139 C.A. 629, 631, 34 P.2d 752 [judicial commitment admissible, but not conclusive].)

(2) *Mental illness or deficiency*. The evidence must show that it in fact deprived the party of capacity to understand the particular contract in dispute. (See *Holman v. Stockton Savings & Loan Bank* (1942) 49 C.A.2d 500, 508, 122 P.2d 120 [incapacity not proved merely by evidence of senile dementia].)

(3) *Irrational conduct*. (See *Hughes v. Grandy* (1947) 78 C.A.2d 555, 564, 177 P.2d 939 [in determining mental condition of grantor at time of execution of deed, conduct of grantor both before and after execution may be considered]; *Stratton v. Grant* (1956) 139 C.A.2d 814, 817, 294 P.2d 500; 1 Cal. Evidence (4th), *Circumstantial Evidence*, §125.)

(4) *Opinions of experts or of laymen*. (See *Hughes v. Grandy*, *supra*, 78 C.A.2d 567 [opinions of intimate acquaintances admissible]; *Mills v. Kopf* (1963) 216 C.A.2d 780, 784, 31 C.R. 80 [opinion of psychiatrist admissible, but not conclusive]; 1 Cal. Evidence (4th), *Opinion Evidence*, §§7, 56, 87.)

The burden of proof of insanity rests on the party alleging insanity. (Ev.C. 522; *Albertson v. Schmidt* (1932) 128 C.A. 344, 346, 17 P.2d 158; see 1 Cal. Evidence (4th), *Burden of Proof and Presumptions*, §16.)

SUPPLEMENT: [This section is current through the latest supplement]



53 of 115 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

II. CAPACITY OF PARTIES.

C. Persons of Unsound Mind.

3. Void Contracts.

b. Adjudication of Insanity.

1. In General.

1 Witkin Sum. Cal. Law Contracts § 53

[§ 53] In General.

There may be an adjudication of insanity in a proceeding brought for that purpose. C.C. 40(a) provides: [A]fter his or her incapacity has been judicially determined a person of unsound mind can make no conveyance or other contract, nor delegate any power or waive any right, until his or her restoration to capacity.

As the court said in *Hellman Commercial Trust & Savings Bank v. Alden* (1929) 206 C. 592, 604, 275 P. 794: "[H]e thereby becomes incapable of making a valid contract, and it is deemed to be void, not because he is unable, unassisted, to properly care for his property, or lacked understanding of the nature and effect of the particular transaction, but because the decree of incompetence is *notice* to the world of his incapacity to make a valid contract." (See *Gibson v. Westoby* (1953) 115 C.A.2d 273, 275, 251 P.2d 1003 [deed executed by incompetent under guardianship void, conveys no title even to bona fide purchaser]; *Rest.2d, Contracts §13*.)

The judicial determination of insanity mentioned in C.C. 40(a) means a determination in a proceeding such as guardianship, not a summary proceeding under Welf.C. 6250 et seq. at which a person may be judicially committed. (*Carroll v. Carroll* (1940) 16 C.2d 761, 766, 108 P.2d 420; see discussion, *In re Zanetti* (1949) 34 C.2d 136, 143, 208 P.2d 657.) However, incompetent adults are now placed under *conservatorship*, not guardianship. (See *infra*, §54.)

A certificate showing that such a person has been *discharged as cured* from an insane asylum establishes a *presumption* of legal capacity from the time of discharge. (C.C. 40(a); see *Shaw v. Feehan* (1929) 207 C. 561, 568, 279 P. 658.)

West's Key Number Digest, Mental Health k.374

SUPPLEMENT: [This section is current through the latest supplement]



54 of 115 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

II. CAPACITY OF PARTIES.

C. Persons of Unsound Mind.

3. Void Contracts.

b. Adjudication of Insanity.

2. Conservatee.

1 *Witkin Sum. Cal. Law Contracts* § 54

[§ 54] Conservatee.

The Probate Code now provides for conservatorship for incompetent adults, instead of guardianship. (See *Prob.C. 1800 et seq.*; 14 *Summary* (10th), *Wills and Probate*, §932.) The distinction between conservatorship and guardianship was emphasized in the following case holding that a conservatee has a limited power to contract.

In *Board of Regents v. Davis* (1975) 14 C.3d 33, 120 C.R. 407, 533 P.2d 1047, a petition for conservatorship was filed in August 1967, alleging that Davis was over 80 and unable properly to care for his property, an estate worth \$ 1.8 million. A temporary conservator was appointed. On January 6, 1968, Davis pledged \$ 150,000 for construction of a stadium at a fund-raising dinner conducted on behalf of his alma mater. Plaintiff Board of Regents, being unaware of his conservatorship, publicized the pledge to solicit matching contributions. Letters of conservatorship were issued on January 15, 1968, and on September 10, 1968, the conservators petitioned for instructions to rescind the pledge. Davis died on September 12, 1968, before a hearing could be had. Plaintiff filed a probate claim for the amount of the pledge, which defendant executor rejected. Plaintiff then brought this action on the claim, and the trial judge gave judgment on the pleadings in favor of defendant. *Held*, reversed.

(a) *Conservatee who is not incompetent.* The conservatorship proceeding seeks to avoid the stigma of the label "incompetent," and also to provide management for the affairs of a person who is neither insane nor incompetent, but is otherwise in need of direction. (14 C.3d 38; see 14 *Summary* (10th), *Wills and Probate*, §932.) It is possible to adjudicate a conservatee incompetent, and therefore without capacity to contract, by alleging and proving that he is a person "for whom a guardian could be appointed." (14 C.3d 38, footnote 6.) Here, however, the petition did not allege, nor did the court find, that Davis was either insane or incompetent. (14 C.3d 36.) Hence, the holding in *Hellman Commercial Trust & Savings Bank v. Alden* (1929) 206 C. 592, 604, 275 P. 794, *supra*, §53, that a finding of incompetence serves notice of a person's incapacity under C.C. 40, is not controlling here. (14 C.3d 40.)

(b) *Power to incur debts.* The Probate Code provides that the conservator is to pay debts incurred by the conservatee for necessities, and also other debts if they appear to be such as a reasonably prudent person might incur. (See *Prob.C. 2430*, formerly *Prob.C. 1858*.) This section recognizes a limited power to contract. (14 C.3d 41.)

(c) *Lanterman-Petris-Short Act*. Welf.C. 5357, dealing with conservatorships for mentally disordered persons and chronic alcoholics (see 3 *Cal. Proc.* (4th), *Actions*, §46 et seq.), provides that the report must recommend for or against imposition of disabilities on the conservatee, including a disability restricting the right to enter into contracts. This also is a recognition of a right to contract, which may be restricted only by explicit judicial declaration. (14 *C.3d* 43.)

(d) *No practical difficulties*. The fact that two persons comanage property does not mean that the property becomes unmanageable; the conservator will more likely play the part of supervisor rather than comanager. (14 *C.3d* 43.) And, since transfer of property and incurrence of contracts remain subject to review by the probate court, the conservatee retains the protection of the conservatorship. (14 *C.3d* 43.)

Place v. Trent (1972) 27 *C.A.3d* 526, 532, 103 *C.R.* 841, holding a conservatee incapable of making a valid contract, was disapproved. (14 *C.3d* 43.) (See 64 *Cal. L. Rev.* 636; for the affirmance of the judgment for plaintiff at the trial, see *Board of Regents v. Davis* (1977) 74 *C.A.3d* 862, 870, 141 *C.R.* 670 ["There is certainly no evidence decedent did not understand the nature and purpose of the pledge as a charitable gift"].)

In 1979, *Prob.C.* 1872 was amended to specify that "the appointment of a conservator ... is an adjudication that the conservatee lacks the legal capacity to enter into ... any transaction that binds ... the conservatorship estate." (*Prob.C.* 1872(b).) Similar language was added to C.C. 40: "The establishment of a conservatorship ... is a judicial determination of the incapacity of the conservatee for the purposes of this section." In *O'Brien v. Dudenhoeffer* (1993) 16 *C.A.4th* 327, 19 *C.R.2d* 826, 14 *Summary* (10th), *Wills and Probate*, §954, involving a gift of real property by a conservatee under a temporary conservatorship, the court held that *Board of Regents v. Davis*, supra, had been superseded by these amendments and that the temporary conservatorship was thus an adjudication that the conservatee lacked legal capacity to give away real property. (16 *C.A.4th* 331.)

SUPPLEMENT: [This section is current through the latest supplement]
Lanterman-Petris-Short Act:

Cross-Reference: 3 *Cal. Proc.* (5th), *Actions*, §97 et seq.



55 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
II. CAPACITY OF PARTIES.
C. Persons of Unsound Mind.
4. Voidable Contracts.

1 Witkin Sum. Cal. Law Contracts § 55

[§ 55] Voidable Contracts.

"A conveyance or other contract of a person of unsound mind, but not entirely without understanding, made before the incapacity of the person has been judicially determined, is subject to rescission." (C.C. 39(a).) The test of this unsoundness is whether the party was mentally competent to deal with the subject involved with a full understanding of his or her rights, and whether the party understood the nature, purpose, and effect of the contract. One may be incompetent to some extent, and yet have sufficient mentality to comprehend the nature and effect of a particular transaction, and therefore to execute a valid contract. (*Hellman Commercial Trust & Savings Bank v. Alden* (1929) 206 C. 592, 604, 275 P. 794; *Burgess v. Security-First Nat. Bank of Los Angeles* (1941) 44 C.A.2d 808, 816, 113 P.2d 298; see 7 Corbin (Rev. ed.), §27.12.)

There is a rebuttable presumption affecting the burden of proof that a person is of unsound mind if the person is substantially unable to manage his or her own financial resources or resist fraud or undue influence, and substantial inability may not be proved solely by isolated incidents of negligence or improvidence. (C.C. 40(b).)

Rescission of the voidable contract requires restoration of what was received, in accordance with the usual rule. (*Burgess v. Security-First Nat. Bank*, *supra*, 44 C.A.2d 818; *Mills v. Kopf* (1963) 216 C.A.2d 780, 783, 31 C.R. 80; see *infra*, §941.)

West's Key Number Digest, Mental Health k.389

SUPPLEMENT: [This section is current through the latest supplement]



56 of 115 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

II. CAPACITY OF PARTIES.

C. Persons of Unsound Mind.

5. Intoxication or Other Temporary Condition.

a. Intoxication.

1 Witkin Sum. Cal. Law Contracts § 56

[§ 56] Intoxication.

Intoxication that reaches such a stage that the party is incapable of contracting intelligently may be a defense against the enforcement of the contract. (See *Swan v. Talbot* (1907) 152 C. 142, 146, 94 P. 238; 7 Corbin (Rev. ed.), §27.14; 5 Williston 4th, §10:10 et seq.; 41 *Am.Jur.2d* (1996 ed.), *Mentally Impaired Persons* §159 et seq.)

Rest.2d, Contracts §16, reads as follows:

"A person incurs only voidable contractual duties by entering into a transaction if the *other party* has reason to know that by reason of intoxication

(a) he is unable to understand in a reasonable manner the nature and consequences of the transaction, or

(b) he is unable to act in a reasonable manner in relation to the transaction."

Comment a states: "Compulsive alcoholism may be a form of mental illness; and when a guardian is appointed for the property of a habitual drunkard, his transactions are treated like those of a person under guardianship by reason of mental illness." However, voluntary intoxication has been thought less excusable than mental illness. "Hence a contract made by an intoxicated person is enforceable by the other party even though entirely executory, unless the other person has reason to know that the intoxicated person lacks capacity. Elements of overreaching or other unfair advantage may be relevant on the issues of competency, of the other party's reason to know, and of the appropriate remedy."

Comment b states that the standard is the same as in mental illness cases: "If the intoxication is so extreme as to prevent any manifestation of assent, there is no contract. Otherwise the other party is affected only by intoxication of which he has reason to know. A contract made by a person who is so drunk he does not know what he is doing is voidable if the other party has reason to know of the intoxication. Where there is some understanding of the transaction despite intoxication, avoidance depends on a showing that the other party induced the drunkenness or that the consideration was inadequate or that the transaction departed from the normal pattern of similar transactions; if the particular transaction in its result is one which a reasonably competent person might have made, it cannot be avoided even though entirely executory."

SUPPLEMENT: [This section is current through the latest supplement]

See 53 *Am.Jur.2d* (2006 ed.), *Mentally Impaired Persons* §149 et seq. *Correction:* Page 101, line 4 of section, "41 *Am.Jur.2d*" should be "53 *Am.Jur.2d*".



57 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

II. CAPACITY OF PARTIES.

C. Persons of Unsound Mind.

5. Intoxication or Other Temporary Condition.

b. Manic Depressive Psychosis.

1 Witkin Sum. Cal. Law Contracts § 57

[§ 57] Manic Depressive Psychosis.

"[T]he manic depressive has alternating moods of euphoria and depression, and ... during the euphoric cycle or the excited phase of the illness the imprudent tendencies of the manic may motivate him to enter into ill-advised contracts." (*Smalley v. Baker* (1968) 262 C.A.2d 824, 833, 69 C.R. 521.)

A New York case decided in 1963 allowed rescission of a contract executed during the manic phase of this psychosis. The theory was that the traditional test of understanding (C.C. 39, *supra*, §55) developed prior to recognition of the manic-depressive psychosis as a distinct form of mental illness, and that it is now appropriate to broaden the test to include motivation: If, but for the mental illness, the contract would not have been entered into, it is voidable. (See discussion, *Smalley v. Baker, supra*, 262 C.A.2d 824; 39 So. Cal. L. Rev. 220.)

In *Smalley v. Baker, supra*, the court rejected this extension. Although the manic suffers from impaired judgment, he understands the transaction; and the California cases follow the statutory language, which excludes the motivational test. (262 C.A.2d 834.) The failure of the Legislature to act may, indeed, be a considered policy determination: The motivational test might be used not only by the manic but by the other contracting party as a means of avoiding a bad bargain. (262 C.A.2d 835.)

Nevertheless, the court pointed to another means of escape for the manic: The psychosis is clearly a "weakness of mind," as that term is used in the undue influence statute (C.C. 1575, *infra*, §316); hence, on a showing of unfairness or overreaching by the other contracting party with knowledge of the facts, rescission would be appropriate. (262 C.A.2d 834, 836.)

SUPPLEMENT: [This section is current through the latest supplement]



58 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
II. CAPACITY OF PARTIES.
D. Persons Deprived of Civil Rights.

1 Witkin Sum. Cal. Law Contracts § 58

[§ 58] Persons Deprived of Civil Rights.

(1) *Former Law: Incapacity To Contract.* Under C.C. 1556, "persons deprived of civil rights" lack capacity to contract. (See *supra*, §25.) And former P.C. 2600 suspended civil rights on a sentence of imprisonment in a state prison for any term, with the general result that no right to contract remained. (For criticisms of the concept of "civil death," see *Grasso v. McDonough Power Equipment* (1968) 264 C.A.2d 597, 602, 70 C.R. 458; 50 Harv. L. Rev. 973; 15 Santa Clara Lawyer 427; 26 So. Cal. L. Rev. 425.) However, the then Adult Authority could restore the civil rights of a paroled prisoner, including the right to contract. (See *Hall v. Hall* (1950) 98 C.A.2d 209, 213, 219 P.2d 808; 26 So. Cal. L. Rev. 430, 432.)

(2) *Statutory Revision.* Former P.C. 2600 et seq. have been repealed, and new P.C. 2600 and 2601 enacted.

(a) P.C. 2600 states that "[a] person sentenced to imprisonment in a state prison may during that period of confinement be deprived of such rights, and only such rights, as is reasonably related to legitimate penological interests." (See 7 *Pacific L. J.* 390; Cal. Transactions Forms, 1 Business Transactions §6:12; 2 California Affirmative Defenses 2d (2004 ed.), §52:35.)

(b) P.C. 2601 enumerates specific rights retained by prisoners. These include the right (1) to "inherit, own, sell, or convey real or personal property, including all written and artistic material produced or created by the person during the period of imprisonment," provided that the Department of Corrections may, to the extent authorized in P.C. 2600, "restrict or prohibit sales or conveyances that are made for business purposes" (P.C. 2601(a)); and (2) subject to certain exceptions, "[t]o purchase, receive, and read any and all newspapers, periodicals, and books accepted for distribution by the United States Post Office" (P.C. 2601(c)(1).)

All proceeds from the preparation for the purpose of sale, the sale of the rights to, or the sale of materials that are based on the story of a felony for which a convicted felon was convicted are subject to an involuntary trust for 5 years. (C.C. 2225(b); see 14 *Summary* (10th), *Trusts*, §321; 3 *Cal. Crim. Law* (3d), *Punishment*, §67.)

West's Key Number Digest, Contracts k.12

SUPPLEMENT: [This section is current through the latest supplement]

(2) *Statutory Revision.* See 2 California Affirmative Defenses §52:35.



59 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

III. CONFLICT OF LAWS.

A. In General.

1. Nature of Conflicts Rules.

1 Witkin Sum. Cal. Law Contracts § 59

[§ 59] Nature of Conflicts Rules.

The various states have separate and differing systems of law; but "events and transactions occur, and issues arise," that relate to two or more of these legal systems or states. (*Rest.2d, Conflict of Laws §1.*) Special rules have developed in each state to handle cases involving foreign elements "in a manner designed to promote the smooth functioning of the international and interstate systems and to do justice to the parties." (*Rest.2d, Conflict of Laws §1, Comment c.*) These rules constitute the subject matter of Conflict of Laws. (See *Rest.2d, Conflict of Laws §2*; and see generally Leflar 4th, §1 et seq.; Scoles & Hay 3d, §1.1 et seq.; *16 Am.Jur.2d (1998 ed.), Conflict of Laws §1* et seq.; *88 Harv. L. Rev. 347* [advocating adoption of special substantive rules to accommodate sometimes conflicting goals in choice of law, in order to apply most apt law and avoid forum shopping]; *97 Harv. L. Rev. 1984* [review of Hancock's "functional analysis" approach]; *73 Cal. L. Rev. 525* [same]; *34 San Diego L. Rev. 1263, 1381* [choice-of-law issues regarding contracts made on World Wide Web].)

Matters falling within the scope of a state's Conflict of Laws rules include: (1) judicial jurisdiction and competence (see *2 Cal. Proc. (4th), Jurisdiction, §1* et seq.); (2) foreign judgments (see *7 Cal. Proc. (4th), Judgment, §296* et seq.); and (3) choice of law (see *3 Cal. Proc. (4th), Actions, §92* et seq.; *infra, §64* et seq.). (See *Rest.2d, Conflict of Laws §2, Comment a.*) Conflict of Laws rules, especially the rules of choice of law, are largely decisional and are, therefore, "as open to reexamination as any other common law rules." (*Rest.2d, Conflict of Laws §5*; cf. *44 So. Cal. L. Rev. 340* [legislative choice of law: European examples].)

Occasionally, a case that might have involved a question of conflict of laws is disposed of on the ground that the law is the same in both states (see *Hamilton v. Abadjian (1947) 30 C.2d 49, 51, 179 P.2d 804*; *Fruns v. Albertsworth (1945) 71 C.A.2d 318, 320, 162 P.2d 666*; *Robert McMullan & Son v. United States Fidelity & Guaranty Co. (1980) 103 C.A.3d 198, 202, 162 C.R. 720*; *International Service Ins. Co. v. Gonzales (1987) 194 C.A.3d 110, 116, 239 C.R. 341*; *Gitano Group v. Kemper Group (1994) 26 C.A.4th 49, 57, 31 C.R.2d 271*), or by assumption of both parties that the California law applies (see *Glickman v. Collins (1975) 13 C.3d 852, 857, footnote 1, 120 C.R. 76, 533 P.2d 204, infra, §626*; *Wells v. Wells (1946) 74 C.A.2d 449, 453, 169 P.2d 23*), or by applying the law of a particular jurisdiction pursuant to a contract provision for the governing law (see *infra, §§66* et seq.). (For discussion of "false conflict" concept, see Leflar 4th §92; *55 Cal. L. Rev. 74*; *7 Cal. Western L. Rev. 408.*)

West's Key Number Digest, Courts k.513

SUPPLEMENT: [This section is current through the latest supplement]

See McDougal, American Conflicts Law 5th §1 et seq. *Matters within scope of state's conflict of laws rules:*

(1) *Judicial jurisdiction and competence:*

Cross-Reference: 2 Cal. Proc. (5th), *Jurisdiction*, §1 et seq.

(2) *Foreign judgments:*

Cross-Reference: 7 Cal. Proc. (5th), *Judgment*, §353 et seq.

(3) *Choice of law:*

Cross-Reference: 3 Cal. Proc. (5th), *Actions*, §42 et seq.



60 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

III. CONFLICT OF LAWS.

A. In General.

2. Earlier Strict Rules.

1 Witkin Sum. Cal. Law Contracts § 60

[§ 60] Earlier Strict Rules.

In accordance with the theory of Beale, the first Restatement of Conflict of Laws was a formulation of black letter rules designating some single important factor in a transaction (e.g., the place of contracting or the place of harmful impact); and rights and obligations vested in accordance with the law of the place (state) thus designated. This approach was designed to bring a measure of uniformity and predictability into an area of law formerly characterized by confusion and uncertainty.

The approach of Beale and the first Restatement was criticized by many legal writers as being mechanical, conceptualistic, and dogmatic, and as ignoring important values, considerations of policy, and practical exigencies. (See Rest.2d, Conflict of Laws, p. VII [describing first Restatement as "a closed set of rules derived from vested-rights analysis"]; for other criticisms of the conventional Restatement doctrines, see *13 Stanf. L. Rev.* 719; and see *49 Cal. L. Rev.* 962; *51 Cal. L. Rev.* 461; *54 Cal. L. Rev.* 1584 [choice-of-law rules]; *54 Cal. L. Rev.* 1599 [interstate and international problems]; *16 Hastings L. J.* 21 [survey of past and contemporary theory]; *16 Hastings L. J.* 636 [review of Currie's Selected Essays]; *4 San Diego L. Rev.* 45 [international trade problems]; *16 Stanf. L. Rev.* 234 [reviews of Ehrenzweig's text]; *17 Stanf. L. Rev.* 750 [Oregon's adoption of Currie's governmental interest approach]; *12 U.C.L.A. L. Rev.* 29 [critical examination of Ehrenzweig theories]; *21 U.C.L.A. L. Rev.* 719 [Horowitz, Choice of Law in California--A Restatement]; *21 U.C.L.A. L. Rev.* 781 [Ehrenzweig, Choice of Law in California--A "Prestatement"].)

SUPPLEMENT: [This section is current through the latest supplement]



61 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
III. CONFLICT OF LAWS.
A. In General.
3. Approach of Restatement 2d.

1 Witkin Sum. Cal. Law Contracts § 61

[§ 61] Approach of Restatement 2d.

Criticism of Beale and the first Restatement (see *supra*, §60) led to abandonment of the earlier strict rules and to an entirely new approach. Following the modern view of progressive courts, the Second Restatement formulates a "most significant relationship" (or "center of gravity" or "dominant contacts") rule. In the absence of an effective choice of law by the parties, rights and obligations are to be determined by the law of the state that, with respect to the particular issue, has the most significant relationship to the transaction and the parties. (See *Rest.2d, Conflict of Laws*, p. VII; *Leflar 4th*, §90; *Scoles & Hay 3d*, §2.14 et seq.; 7 *Golden Gate L. Rev.* 469.) (On "characterization" of legal issues and concepts, see *Rest.2d, Conflict of Laws* §7 [conflicts concepts determined in accordance with law of forum; other legal concepts determined in accordance with law that governs issue involved]; 15 *U.C.L.A. L. Rev.* 818; *Leflar 4th*, §§87, 88; *Scoles & Hay 3d*, §2.1 et seq.; 16 *Am.Jur.2d* (1998 ed.), *Conflict of Laws* §§3, 4.)

If there is no statutory directive of the forum, the factors relevant in the choice of the applicable rule of law include "(a) the needs of the interstate and international systems, (b) the relevant policies of the forum, (c) the relevant policies of other interested states and the relative interests of those states in the determination of the particular issue, (d) the protection of justified expectations, (e) the basic policies underlying the particular field of law, (f) certainty, predictability and uniformity of result, and (g) ease in the determination and application of the law to be applied." (*Rest.2d, Conflict of Laws* §6.) The relevant factors often point in different directions, and the ultimate choice of law represents an accommodation of conflicting values. (*Rest.2d, Conflict of Laws* §6, Comment c; see *Leflar 4th*, §99 et seq.)

In the usual case, reference to the law of another state will be to the substantive law of that state, exclusive of the other state's conflicts law. (*Rest.2d, Conflict of Laws* §8(1).) However, where uniformity of result is desirable, the reference will be to the entire law, including the conflicts law, of the other state. (*Rest.2d, Conflict of Laws* §8(2).) (On *renvoi* doctrine (where law of other forum is applied, whole law is applied) generally, see *Leflar 4th*, §7; *Scoles & Hay 3d*, §§3.13, 3.14; 16 *Am.Jur.2d* (1998 ed.), *Conflict of Laws* §5; 15 *U.C.L.A. L. Rev.* 828.)

SUPPLEMENT: [This section is current through the latest supplement]
See McDougal, *American Conflicts Law* 5th §84.



62 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

III. CONFLICT OF LAWS.

A. In General.

4. California Follows Restatement 2d.

1 Witkin Sum. Cal. Law Contracts § 62

[§ 62] California Follows Restatement 2d.

The analysis of conflicts law in the present text follows that of the Second Restatement for these reasons: (1) California usually follows the Restatement in every substantive field; (2) in the 1969 Jurisdiction and Process Act (see 2 *Cal. Proc.* (4th), *Jurisdiction*, §§7, 8), California adopted the Restatement view; (3) recent California cases indicate an abandonment of the doctrinal system of Beale and the first Restatement in favor of the modern, flexible approach of the Restatement 2d "significant relationship" rule. (See *Gamer v. DuPont Glore Forgan* (1976) 65 *C.A.3d* 280, 287, 135 *C.R.* 230, *infra*, §69; *Henderson v. Superior Court* (1978) 77 *C.A.3d* 583, 593, 142 *C.R.* 478.)

Thus, in *Travelers Ins. Co. v. Work. Comp. App. Bd.* (1967) 68 *C.2d* 7, 64 *C.R.* 440, 434 *P.2d* 992, 2 *Summary* (10th), *Workers' Compensation*, §112, the court said: "California has rejected the traditional mechanical solutions to choice-of-law problems and adopted foreign law only when it is appropriate in light of the significant interests in the particular case. The significance of extra-state elements varies directly with the nature of the forum's interest in a given case." (68 *C.2d* 11.) (See *Bernkrant v. Fowler* (1961) 55 *C.2d* 588, 594, 12 *C.R.* 266, 360 *P.2d* 906, *infra*, §83; *Ury v. Jewelers Acceptance Corp.* (1964) 227 *C.A.2d* 11, 16, 20, 38 *C.R.* 376, *infra*, §69; *Buskuhl v. Family Life Ins. Co.* (1969) 271 *C.A.2d* 514, 521, 76 *C.R.* 602, *infra*, §86 ["Whether the validity of the particular contractual provisions is to be tested by Washington or California law must be based not upon the mechanical rules but upon the relative interests of the litigants and the involved states"]; *Mencor Enterprises v. Hets Equities Corp.* (1987) 190 *C.A.3d* 432, 436, 235 *C.R.* 464, quoting the text; 35 *Hastings L. J.* 747 [Chief Justice Traynor and Choice of Law Theory].)

West's Key Number Digest, Courts k.513

SUPPLEMENT: [This section is current through the latest supplement]
Jurisdiction and Process Act:

Cross-Reference: 2 *Cal. Proc.* (5th), *Jurisdiction*, §§8, 9.



63 of 115 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

III. CONFLICT OF LAWS.

A. In General.

5. Governmental Interest Approach.

1 *Witkin Sum. Cal. Law Contracts* § 63

[§ 63] Governmental Interest Approach.

(1) *Adoption of Approach.* In *Dixon Mobile Homes v. Walters* (1975) 48 C.A.3d 964, 122 C.R. 202, the court, citing tort conflict of laws cases (*Reich v. Purcell* (1967) 67 C.2d 551, 63 C.R. 31, 432 P.2d 727, 5 Summary (10th), Torts, §191; *Hurtado v. Superior Court* (1974) 11 C.3d 574, 114 C.R. 106, 522 P.2d 666, 5 Summary (10th), Torts, §200; *Kasel v. Remington Arms Co.* (1972) 24 C.A.3d 711, 101 C.R. 314, 5 Summary (10th), Torts, §198), described the California "methodology" as the "governmental interest" approach. Defendant W, a California resident, purchased a mobilehome from plaintiff Nevada dealer, which was delivered to defendant's California property. In plaintiff's action to recover possession and obtain a deficiency judgment, defendant set up violation of the California Rees-Levering Act (see 4 Summary (10th), Sales, §239 et seq.), and sought rescission, damages, and attorneys' fees. *Held*, the California Act was properly applied by the trial judge.

(a) California, the forum, had a strong interest in applying its law: It was the residence of the buyer; the buyer initiated his payments here; the seller installed the home here; the loan was secured by California property; and all acts relating to breach (attempted repossession and collection) occurred in *California*. (48 C.A.3d 973.)

(b) Nevada had no interest in having its law applied. The practices of plaintiff are regulated by statutes in both states; and, although the California statute is broader and gives the buyer a better recovery, the contract involved did not meet the requirements of either *Nevada or California law*. (48 C.A.3d 973.) (See *Robert McMullan & Son v. United States Fidelity & Guaranty Co.* (1980) 103 C.A.3d 198, 204, 162 C.R. 720 [restating *Dixon* analysis and following governmental interest approach]; 25 U.C.L.A. L. Rev. 181 [Governmental Interest Approach: Analysis and Reformulation].)

In *Stonewall Surplus Lines Ins. Co. v. Johnson Controls* (1993) 14 C.A.4th 637, 17 C.R.2d 713, *infra*, §63, the court, after recognizing that California follows a methodology characterized as the "governmental interest" approach, described that approach as follows:

"With the governmental interest approach, 'relevant contacts' stressed by the Restatement Second of Conflict of Laws are not disregarded, but are examined in connection with the analysis of the interest of the involved state in the issues, the character of the contract and the relevant purposes of the contract law under consideration. ... The forum must consider all the foreign and domestic elements and interests involved in the case to determine the applicable rule."

(14 C.A.4th 645; see *Janzen v. Work. Comp. App. Bd.* (1997) 61 C.A.4th 109, 115, footnote 3, 71 C.R.2d 260 [quoting *Stonewall*].)

(2) *Governmental Interest Approach Applicable Only Where Two States Have Legitimate Interest.* Under the governmental interest analysis, when one of two states related to a case has a legitimate interest in the application of its law and policy and the other has none, there is no real problem and the law of the interested state should be applied. Thus, the court must examine the laws of the states involved, and the underlying policies, before assessing whether either or both states have an interest in applying their policy to the case. Only if each of the states involved has a legitimate but conflicting interest in applying its own law is there a true conflicts case. (*In re Title U.S.A. Ins. Corp.* (1995) 36 C.A.4th 363, 372, 42 C.R.2d 498 [voidable preference statute of California law, not Texas law, was applicable, because there was no conflict in policies behind each state's law and Texas had no conflicting legitimate interest in seeing its preference statute applied in California].)

SUPPLEMENT: [This section is current through the latest supplement]



64 of 115 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

III. CONFLICT OF LAWS.

B. Validity and Effect of Contract.

1. In General.

a. Importance of Contacts.

1 Witkin Sum. Cal. Law Contracts § 64

[§ 64] Importance of Contacts.

Under the first Restatement, validity of a contract was governed by the law of the place of contracting, matters of performance were governed by the law of the place of performance, and the parties could not choose the applicable law. (See *Rest.2d, Conflict of Laws*, p. 558.)

This distinction between matters of validity and matters of performance was abandoned in the Second Restatement. In the absence of an effective choice of law by the parties, all issues involving contracts are governed by the local law of the state that, with respect to the particular issue, has the most significant relationship to the transaction and the parties. (*Rest.2d, Conflict of Laws* §§186, 188(1); see Leflar 4th, §149; Scoles & Hay 3d, §18.8 et seq.; *infra*, §74 et seq.) As indicated by the foregoing, the parties, within certain limits, have power to choose the applicable law. (*Rest.2d, Conflict of Laws* §187; see *infra*, §§66 et seq.) Moreover, the Second Restatement does not lay down rules applicable to the entire field of contracts; it states special rules for particular kinds of contracts and for particular issues. (See *Rest.2d, Conflict of Laws* §186, Comment a; *infra*, §§81 et seq., 97 et seq.)

In determining the state of most significant relationship, the following contacts are important: (1) the place of contracting (see *infra*, §74); (2) the place of negotiation of the contract (see *infra*, §75); (3) the place of performance (see *infra*, §76); (4) the location of the subject matter of the contract (see *infra*, §77); and (5) the domicile, residence, nationality, place of incorporation, and places of business of the parties (see *infra*, §78). (*Rest.2d, Conflict of Laws* §188(2).) These contacts must be evaluated according to their relative importance with respect to each particular issue. (*Rest.2d, Conflict of Laws* §188(2).)

SUPPLEMENT: [This section is current through the latest supplement]

Most significant relationship test: See McDougal, *American Conflicts Law* 5th §138.



65 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

III. CONFLICT OF LAWS.

B. Validity and Effect of Contract.

1. In General.

b. Rule of Validation.

1 Witkin Sum. Cal. Law Contracts § 65

[§ 65] Rule of Validation.

The basic policy in the field of contracts is protection of the justified expectations of the parties. Parties will generally enter into a contract with the expectation that the provisions of the contract will be binding on them. These expectations "should not be disappointed by application of the local law rule of a state which would strike down the contract or a provision thereof unless the value of protecting the expectations of the parties is substantially outweighed in the particular case by the interest of the state with the invalidating rule in having this rule applied." (*Rest.2d, Conflict of Laws §188(1)*, Comment b; on this "rule of validation," see Leflar 4th, §148.)

West's Key Number Digest, Courts k.513

SUPPLEMENT: [This section is current through the latest supplement]
See McDougal, *American Conflicts Law* 5th §136.



66 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

III. CONFLICT OF LAWS.

B. Validity and Effect of Contract.

2. Law Chosen by Parties.

a. Modern View.

1. In General.

1 Witkin Sum. Cal. Law Contracts § 66

[§ 66] In General.

It has been urged by writers, with some support in the authorities, that the parties should have a considerable amount of freedom to make their own choice of law, in good faith, to govern the contract. (See generally Leflar 4th, §147; Scoles & Hay 3d, §18.16 et seq.; 15 Corbin (Rev. ed.), §83.9; 16 *Am.Jur.2d* (1998 ed.), *Conflict of Laws* §89 et seq.; 8 Cal. Western L. Rev. 324; 50 *Harv. L. Rev.* 1160; 62 *Harv. L. Rev.* 647; 69 *Harv. L. Rev.* 563; 23 *Loyola L.A. L. Rev.* 1337 [proposal for method of drafting commercial lending agreements with choice-of-law provisions]; 12 *So. Cal. L. Rev.* 345; 6 *U.C.L.A. L. Rev.* 55; 21 *U.C.L.A. L. Rev.* 719 [Horowitz, Choice of Law in California--A Restatement]; 21 *U.C.L.A. L. Rev.* 781 [Ehrenzweig, Choice of Law in California--A "Prestatement"]; 51 *U.C.L.A. L. Rev.* 593 [choice-of-law provisions in noncompete agreements]; 53 *A.L.R.3d* 1095 [choice-of-law provision in group insurance policy]; 16 *A.L.R.4th* 967 [stipulation in contract that contract is to be governed by law of state that is neither place of making nor performance].) In addition, a choice-of-law provision can be enforced by or against a nonsignatory to the contract. (See *Bugna v. Fike* (2000) 80 *C.A.4th* 229, 233, 95 *C.R.2d* 161 [in action by doctors alleging that defendants fraudulently induced doctors to enter into contracts with physician management company, defendants could enforce forum selection clauses in contracts even though they were nonsignatories, where they were closely related to contractual relationship between doctors and management company and were key transaction participants]; *Net2Phone v. Superior Court* (2003) 109 *C.A.4th* 583, 589, 135 *C.R.2d* 149 [forum selection clause in contract between telecommunication company and its customers could be enforced against nonparty public interest group, where group sued in representative capacity and thus asserted rights of those who were parties; distinguishing *Bancomer, S.A. v. Superior Court* (1996) 44 *C.A.4th* 1450, 52 *C.R.2d* 435, *infra*, this section.]) However, there is also authority to the contrary. (See *Bancomer, S.A. v. Superior Court*, *supra*, 44 *C.A.4th* 1458 [bank that was nonsignatory to agreement between developer and purchasers of leasehold interests in property, although designated to establish trust through which interests would be purchased, was not intended beneficiary of transaction and could not enforce forum selection clause against purchasers in their fraud action against it]; *Berclain America Latina v. Baan Co.* (1999) 74 *C.A.4th* 401, 405, 87 *C.R.2d* 745 [defendant corporation did not have standing to assert forum selection clause in agreement signed by subsidiary prior to being purchased by corporation, where corporation was neither signatory to contract nor third-party beneficiary and was not so closely related to subsidiary as to be entitled to assert clause].)

West's Key Number Digest, Courts k.513

SUPPLEMENT: [This section is current through the latest supplement]

See *Aral v. Earthlink* (2005) 134 C.A.4th 544, 561, 36 C.R.3d 229 [forum selection clause in Internet service contract providing all actions would be brought in Georgia was unenforceable, as applied to class action claims that consumers were charged for service they could not access for 4 to 5 weeks; to expect customers to travel to Georgia to obtain redress on individual claims of \$ 40 or \$ 50 on a case-by-case basis was unreasonable]; *Discover Bank v. Superior Court* (2005) 134 C.A.4th 886, 891, 36 C.R.3d 456 [in credit card holder's class action against issuer, agreement calling for application of Delaware law was valid, where although California law on class action waiver arguably differed from law of Delaware, it was unnecessary to resolve issue, because Delaware, as home of sole defendant, had greater interest than California, and holder was asserting claims on behalf of every state's consumers, not just California's]; *Klussman v. Cross Country Bank* (2005) 134 C.A.4th 1283, 1293, 36 C.R.3d 728 [because Delaware law permitting waivers of classwide arbitration conflicted with fundamental California policy, choice-of-law provision choosing Delaware law was invalid; distinguishing *Discover Bank v. Superior Court*]; *Olinick v. BMG Entertainment* (2006) 138 C.A.4th 1286, 1289, 42 C.R.3d 268 [choice of law provision in employment agreement calling for disputes to be resolved under New York law applied not only to contract actions, but also to terminated employee's causes of action for statutory age discrimination under California Fair Employment and Housing Act and common law wrongful discharge in violation of public policy]; McDougal, *American Conflicts Law* 5th §134. *Choice-of-law provision enforced by or against nonsignatory*: See *ABF Capital Corp. v. Berglass* (2005) 130 C.A.4th 825, 834, 30 C.R.3d 588 [provision enforced against third-party beneficiary].



67 of 115 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

III. CONFLICT OF LAWS.

B. Validity and Effect of Contract.

2. Law Chosen by Parties.

a. Modern View.

2. Commercial Code and Restatement 2d.

1 Witkin Sum. Cal. Law Contracts § 67

[§ 67] Commercial Code and Restatement 2d.

The Uniform Commercial Code adopts the rule governing choice of law in the following language: With certain exceptions, "when a transaction bears a *reasonable relation* to this state and also to another state or nation the parties may agree that the law either of this state or of such other state or nation shall govern their rights and duties." (U.C.C. 1105(1).)

The Second Restatement declares that the intent of the parties, express or implied, is to be given effect as to any issues that the parties could have determined by explicit agreement. This is a rule providing for incorporation by reference, and is not one of choice of law. Examples of issues that the parties could have determined in their contract include questions of construction, conditions, sufficiency of performance, and excuse for nonperformance. (*Rest.2d, Conflict of Laws §187(1)*, Comments a, c.) The rule is the same as to issues that the parties could not have determined by explicit agreement (e.g., questions involving capacity, formalities, and substantial validity), unless (1) the chosen state has no *substantial relationship* to the parties or the transaction; or (2) application of the chosen law would be contrary to a fundamental policy of the state of otherwise applicable law, and this state "has a materially greater interest than the chosen state in the determination of the particular issue." (*Rest.2d, Conflict of Laws §187(2)*, Comments d, e, f, g.) In the absence of a contrary indication of intention, the reference is to the "local law," excluding the conflicts rules, of the chosen state. (*Rest.2d, Conflict of Laws §187(3)*, Comment h.)

The view expressed in these sources has been approved in California cases. (See *Boole v. Union Marine Ins. Co.* (1921) 52 C.A. 207, 209, 198 P. 416; *People v. Globe & Rutgers Fire Ins. Co.* (1950) 96 C.A.2d 571, 575, 216 P.2d 64; *Ury v. Jewelers Acceptance Corp.* (1964) 227 C.A.2d 11, 38 C.R. 376, *infra* §69; *Frame v. Merrill Lynch* (1971) 20 C.A.3d 668, 673, 97 C.R. 811 [agreement for application of New York law cannot be allowed to defeat "strong public policy" of California]; *Gamer v. DuPont Glore Forgan* (1976) 65 C.A.3d 280, 286, 135 C.R. 230, *infra*, §69; *Bos Material Handling v. Crown Controls Corp.* (1982) 137 C.A.3d 99, 108, 186 C.R. 740, citing the text; *Lu v. Dryclean-U.S.A. of Calif.* (1992) 11 C.A.4th 1490, 1493, 14 C.R.2d 906 [plaintiff seeking to defeat forum selection clause has heavy burden and must demonstrate that enforcement would be unreasonable under circumstances of case]; 23 *Loyola L.A. L. Rev.* 1337 [review of California cases and discussion of choice of law in commercial lending agreements].)

The Second Restatement (§187, Comment b) makes an exception where the choice-of-law provision was obtained by fraud or invalidating cause. However, where the choice-of-law clause was included without any invalidating cause, the fact that the substantive contract terms were induced by fraud would not render the choice-of-law clause ineffectual. (*Seidman & Seidman v. Wolfson* (1975) 50 C.A.3d 826, 831, 123 C.R. 873; *infra*, §71.)

SUPPLEMENT: [This section is current through the latest supplement]

See 40 *Loyola L.A. L. Rev.* 1 [contracting out of U.C.C.].

U.C.C. 1105 was repealed in 2006. The choice of law provision is now in U.C.C. 1301(a). *Chosen law contrary to fundamental policy of state:* See *ABF Capital Corp. v. Grove Properties Co.* (2005) 126 C.A.4th 204, 214, 23 C.R.3d 803 [California statute mandating reciprocity of contractual attorneys' fees provisions governed contract, despite unilateral attorneys' fees provision in contract and choice-of-law provision stating that New York law would govern, and fact that New York law did not preclude unilateral provision]; *Klussman v. Cross Country Bank* (2005) 134 C.A.4th 1283, 1293, 36 C.R.3d 728 [choice-of-law provision choosing Delaware law was invalid; Delaware law permitting waivers of classwide arbitration conflicted with fundamental California policy].



68 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

III. CONFLICT OF LAWS.

B. Validity and Effect of Contract.

2. Law Chosen by Parties.

a. Modern View.

3. Distinction: Contracts Involving Transaction of \$ 250,000 or Over.

1 Witkin Sum. Cal. Law Contracts § 68

[§ 68] Distinction: Contracts Involving Transaction of \$ 250,000 or Over.

A special rule exists for contracts involving a transaction of at least \$ 250,000, including a transaction otherwise covered by U.C.C. 1105(1), *supra*, §67: the parties may agree that California law will govern their rights and duties, in whole or in part, *regardless of whether the contract bears a reasonable relation to this state*. The statute applies to contracts entered into before or after its effective date and is fully retroactive. However, it does not apply to contracts for labor or personal services, or to those relating to a transaction primarily for personal, family, or household purposes. Nor does it apply to the extent provided to the contrary in U.C.C. 1105(2) (see 13 *Summary* (10th), *Personal Property*, §111). (C.C. 1646.5.)

SUPPLEMENT: [This section is current through the latest supplement]

As amended in 2006, C.C. 1646.5 refers to U.C.C. 1301(a) and (c), respectively, rather than to U.C.C. 1105(1) and (2).



69 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

III. CONFLICT OF LAWS.

B. Validity and Effect of Contract.

2. Law Chosen by Parties.

b. Illustrations.

1. Usury.

1 Witkin Sum. Cal. Law Contracts § 69

[§ 69] Usury.

In *Ury v. Jewelers Acceptance Corp.* (1964) 227 C.A.2d 11, 38 C.R. 376, plaintiff, a retail jeweler, sought financing of his accounts receivable with defendant JAC, a New York lending institution. The lender required incorporation of its customers in order to make the New York Usury Law inapplicable, and plaintiff incorporated. The contract was then made in the form of a proposal by plaintiff to be accepted by defendant in New York, and it recited that it should be "governed by and construed" by New York law. It provided for interest aggregating 20.3% per month, illegal in California and generally illegal in New York, but legal in this case because the usury defense in New York is not available to a corporation borrower. In plaintiff's action for rescission and penalties, the contract was held valid.

(a) The transaction involved the lending of money repayable in New York. The place of payment is the place of performance of a lending agreement, and the validity of a lending bargain is generally determined by the law of the place of performance. (227 C.A.2d 16, 18.)

(b) Another significant factor is the agreement of the parties. Although the particular provision ("governed by and construed") is not as broad as some, it eliminated any idea that the parties intended the California Usury Law to apply, for the presumption is that they intended a valid contract. (227 C.A.2d 17, citing *Bernkrant v. Fowler* (1961) 55 C.2d 588, 594, 12 C.R. 266, 360 P.2d 906, *infra*, §83.) But "[w]e need not decide, and we do not, that this provision in the contract would cause New York law to apply if the transaction had no substantial connection with New York." (227 C.A.2d 18.)

(c) The exception denying enforcement on public policy grounds does not apply here: (1) Although the agreement was by a borrower on a standardized form, this did not make it a "contract of adhesion" (see *infra*, §323), for plaintiff was represented by counsel and the agreement was made after extensive negotiation. (227 C.A.2d 19.) (2) California, which exempts many types of lenders from the usury law, has no overriding public policy on this subject. (227 C.A.2d 19.) (3) The interest rate was not unconscionable, for personal property brokers like plaintiff legally charge a greater rate, and here plaintiff sold his goods to customers on a 100% markup with a 10% interest charge. (227 C.A.2d 21.) (See 55 Cal. L. Rev. 230.)

In *Gamer v. DuPont Glore Forgan* (1976) 65 C.A.3d 280, 135 C.R. 230, plaintiff signed a margin agreement with defendant stockbroker, under which the broker was authorized to charge interest at *varying* rates. Prior to the 1973 statute authorizing licensing of stockbrokers under the Personal Property Broker's Act (see 9 *Summary* (10th), *Corporations*, §435), and thereby permitting interest charges in excess of the constitutional 10% maximum (former Fin.C. 22451, now Fin.C. 22303, *infra*, §462 et seq.), defendant charged plaintiff with interest ranging from 9 1/2 to 12 1/4%. The rate of 12% was illegal under California law, but the margin agreement provided that the rights and liabilities of the parties should be governed by New York law, which permitted that rate. In plaintiff's action to recover allegedly usurious interest, the trial judge gave summary judgment for defendant. *Held*, affirmed.

(a) The Second Restatement supports choice-of-law provisions where the law of the state chosen has a substantial relationship to the parties and would not be contrary to a fundamental policy of the forum. (*Rest.2d, Conflict of Laws* §187(1)(2).) And the validity of a contract will be sustained against a charge of usury if the rate is permissible in a state to which the contract has a substantial relationship (*Rest.2d, Conflict of Laws* §203). (65 C.A.3d 288.)

(b) Plaintiff signed the margin agreement in California, and gave orders and made payments in defendant's California offices. But defendant's principal place of business was in New York; it bought and sold stocks, borrowed and repaid money, and settled for shares bought on margin in New York. Hence, New York was the place where the contract was to be performed, and New York law would normally govern its validity. (65 C.A.3d 289, 290.)

(c) Although California has a strong public policy against usury, "[i]t has no strong public policy against a particular rate of interest so long as the charging of that rate is permitted by law to the specific lender." (65 C.A.3d 287.)

In *Mencor Enterprises v. Hets Equities Corp.* (1987) 190 C.A.3d 432, 235 C.R. 464, plaintiff, a California corporation, borrowed \$ 140,000 from defendant lender, a Colorado corporation. The note, which called for 44% interest (valid under Colorado law but usurious under California law), was executed and funded in Colorado, and specified that the law of Colorado should apply. After defaulting in some payments, plaintiff filed a complaint in California seeking treble interest. The trial judge sustained defendant's demurrer, holding that as a matter of law, the 44% rate did not entitle the borrower to sue under the California usury law. *Held*, reversed.

(a) Under the analysis in *Rest.2d, Conflict of Laws* §§187 and 203, "whether the Colorado 44% interest rate notes will be validated by a California court to defeat a claim of usury depends on the relationship of Colorado to the parties and the contract. ... This is a factual issue not reached by the general demurrer to the pleadings here." (190 C.A.3d 439.)

(b) In *Gamer v. DuPont Glore Forgan*, *supra*, and *Ury v. Jewelers Acceptance Corp.*, *supra*, the usury defense was rejected where the specified New York law made the interest legal. However: "*Ury* and *Gamer* did not consider applicability of chosen law in the factual vacuum of a demurrer to a complaint. Evidence before the trial judge and findings on that evidence before the courts of appeal supported inquiry into the domiciliary status of the parties, the relationship of the state of the chosen law to the parties and the contract, the public policy of the forum state, and the other factors we have noted." (190 C.A.3d 440.)

(c) "Our analysis of choice-of-law concepts leads to an inevitable conclusion. The specific incorporation of Colorado's 44 percent interest rate, which is usurious under California law, into the contract of the parties here does not as a matter of law validate the contract and immunize the parties to it from the rights and the penalties imposed by California law on parties to usurious transactions. ... [T]he parties' choice of Colorado law will be permitted in a California forum only upon the examination of the reasonable relationship of the contract to Colorado, the substantial contacts of the parties with Colorado and consideration of California's fundamental policy with respect to usury. These are issues of fact requiring evidentiary hearings." (190 C.A.3d 440.)

SUPPLEMENT: [This section is current through the latest supplement]



70 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

III. CONFLICT OF LAWS.

B. Validity and Effect of Contract.

2. Law Chosen by Parties.

b. Illustrations.

2. Statute of Limitations.

1 Witkin Sum. Cal. Law Contracts § 70

[§ 70] Statute of Limitations.

In *Hambrecht & Quist Venture Partners v. American Med. Int.* (1995) 38 C.A.4th 1532, 46 C.R.2d 33, plaintiffs, two corporations, a general partnership, and seven limited partnerships, sued defendant, a Delaware corporation with its principal place of business in California, for breach of contract arising out of plaintiffs' purchase of stock in a leveraged buyout. A choice-of-law provision in the agreement between the parties stated that it "shall be governed by and construed in accordance with the laws of the State of Delaware." Defendant demurred on the ground that the action was barred by Delaware's 3-year statute of limitations for breach of contract, and the trial judge sustained the demurrer. *Held*, affirmed.

(a) *Scope of choice-of-law provision.* As used in the choice-of-law provision, the "laws" of Delaware included that state's statutes of limitations.

(1) Both technical and popular meanings of "laws" refer to a jurisdiction's statutory law, which includes statutes of limitations. Also, as used in C.C. 1646 (see *infra*, §90), the "law" includes the statutes of limitations of the jurisdiction where the contract was made or to be performed. *Rest.2d, Conflict of Laws §187(3)* provides that "[i]n the absence of a contrary indication of intention, the reference is to the local law of the [chosen] state," and *Rest.2d, Conflict of Laws §4(1)* defines "local law" to mean the chosen state's "body of standards, principles, and rules, exclusive of its rules of Conflict of Laws, which the courts of that state apply in the decision of controversies brought before them." This undoubtedly includes the state's statutes of limitations. (38 C.A.4th 1540, citing the text.)

(2) Although statutes of limitations may be viewed as procedural instead of substantive in some contexts, the choice-of-law provision here did not make a distinction along those lines. It simply incorporated the "laws" of Delaware without using adjectives or other qualifiers. Moreover, even if the clause could be read to exclude Delaware procedural law, it does not follow that the statutes of limitations would be excluded. (38 C.A.4th 1542.)

(3) Under the applicable "governmental interest" approach to conflict of laws issues (see *supra*, §63), the statute of limitations is treated in the same manner as any other issue, and California courts do not automatically apply California's statutes of limitations in every case. Where a jurisdiction does not follow the traditional approach of

applying its own statutes of limitations to all claims within its courts, a standard choice-of-law provision should be construed to incorporate the chosen state's statutes of limitations. (38 C.A.4th 1543.)

(b) *Enforceability of choice-of-law provision.* The choice-of-law provision was enforceable under the test established pursuant to *Rest.2d, Conflict of Laws §187* (see *supra*, §67).

(1) Corporate parties to a contract have a "substantial relationship" with the chosen state if one or more of them is incorporated there; it is not necessary that each of the parties have an enduring or permanent connection to that state. Here, the fact that two of the three parties to the agreement were incorporated in Delaware established a substantial relationship between the contracting parties and Delaware. Also, a party's place of incorporation meets the alternative "reasonable basis" test. (38 C.A.4th 1545.)

(2) No fundamental state policy prohibits applying a foreign jurisdiction's statutes of limitations to claims brought in California courts. In the absence of a choice-of-law provision, California's conflict of laws principles recognize that it may be appropriate to apply a foreign state's statute of limitations instead of *California's*. (38 C.A.4th 1548.) (See *Hughes Electronics Corp. v. Citibank Delaware* (2004) 120 C.A.4th 251, 259, 15 C.R.3d 244 [choice-of-law provision between California customer and New York bank that New York law applied, incorporated all New York laws, including New York's borrowing statute, which required action to be timely under both states' law; thus, California's shorter statute of limitations applied to customer's California action on check].)

SUPPLEMENT: [This section is current through the latest supplement]

See *ABF Capital Corp. v. Berglass* (2005) 130 C.A.4th 825, 834, 836, 30 C.R.3d 588 [under choice of law provision in royal- ties contract providing that agreement was "governed by and construed under the laws of the State of New York," New York statute of limitations applied to action for breach of contract; provision's language denoted New York's entire body of statutory law, including statutes of limitations]; CACI, No. 338 [Affirmative Defense--Statute of Limitations].



71 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

III. CONFLICT OF LAWS.

B. Validity and Effect of Contract.

2. Law Chosen by Parties.

b. Illustrations.

3. Breach of Duties Under Contract.

1 Witkin Sum. Cal. Law Contracts § 71

[§ 71] Breach of Duties Under Contract.

In *Nedlloyd Lines B.V. v. Superior Court* (1992) 3 C.4th 459, 11 C.R.2d 330, 834 P.2d 1148, plaintiff Seawinds was a shipping company incorporated in Hong Kong, but with its principal place of business in Redwood City, California. Defendants Nedlloyd were interrelated shipping companies incorporated in the Netherlands, with their principal place of business in Rotterdam. Nedlloyd and other parties entered into a "Shareholders' Agreement" with Seawinds to purchase shares of Seawinds' stock. The agreement contained the following choice-of-law and forum selection provision: "This agreement shall be governed by and construed in accordance with Hong Kong law and each party hereby irrevocably submits to the non-exclusive jurisdiction and service of process of the Hong Kong courts."

Seawinds sued Nedlloyd, pleading causes of action for breach of contract, breach of the implied covenant of good faith and fair dealing, and breach of fiduciary duty. Nedlloyd demurred, contending that Hong Kong law should apply. The trial judge determined that California law applied, and overruled the demurrer. The Court of Appeal affirmed. *Held*, judgment of the Court of Appeal reversed; the choice-of-law provision was enforceable and Hong Kong law applied.

(a) *The proper test.*

(1) "We have not previously considered the enforceability of a contractual choice-of-law provision. We have, however, addressed the closely related issue of the enforceability of a contractual choice-of-*forum* provision, and we have made clear that, 'No satisfying reason of public policy has been suggested why enforcement should be denied a forum selection clause appearing in a contract entered into freely and voluntarily by parties who have negotiated at arm's length.' " (3 C.4th 464, quoting *Smith, Valentino & Smith v. Superior Court* (1976) 17 C.3d 491, 131 C.R. 374, 551 P.2d 1206, 2 Cal. Proc. (4th), *Jurisdiction*, §347.) The court in *Smith* observed that choice-of-law provisions are usually respected by California courts, and this result is consistent with the modern approach of *Rest. 2d, Conflict of Laws* §187. (3 C.4th 464.)

"We reaffirm this approach. In determining the enforceability of arm's length contractual choice-of-law provisions, California courts shall apply the principles set forth in Restatement section 187, which reflects a strong policy favoring enforcement of such provisions." (3 C.4th 464; see footnote 2, pointing out that contracts subject to the Uniform

Commercial Code are governed by its choice-of-law provision stating a "reasonable relation" test, which appears to be similar to the Restatement "substantial relationship" test.)

(2) "Briefly restated, the proper approach under Restatement section 187, subdivision (2) is for the court first to determine either: (a) whether the chosen state has a substantial relationship to the parties or their transaction, or (b) whether there is any other reasonable basis for the parties' choice of law. If, however, either test is met, the court must next determine whether the chosen state's law is contrary to a *fundamental* policy of California. If there is no such conflict, the court shall enforce the parties' choice of law. If, however, there is a fundamental conflict with California law, the court must then determine whether California has a 'materially greater interest than the chosen state in the determination of the particular issue ... ' If California has a materially greater interest than the chosen state, the choice of law shall not be enforced, for the obvious reason that in such circumstance we will decline to enforce a law contrary to this state's fundamental policy." (3 C.4th 466; see footnote 6, observing that there may be instances in which the chosen state has a materially greater interest than does California, and enforcement of its law may be appropriate despite California's policy to the contrary.)

(b) *Application of test: implied covenant.*

(1) Hong Kong has a "substantial relationship to the parties." Seawinds is incorporated under its laws and has a registered office there; and two Hong Kong corporations are parties. (3 C.4th 467.)

(2) No fundamental policy of California requires application of state law to the claims based on the implied covenant of good faith and fair dealing. "Seawinds directs us to no authority exalting the *implied* covenant of good faith and fair dealing over the *express* covenant of these parties that Hong Kong law is to govern their agreement." (3 C.4th 468.)

(c) *Application of test: fiduciary duty.* Seawinds' contention that the fiduciary duty claim is independent of the shareholders' agreement and therefore outside the intended scope of the clause is untenable. "We seriously doubt that any rational business-person, attempting to provide by contract for an efficient and business-like resolution of possible future disputes, would intend that the laws of multiple jurisdictions would apply to a single controversy having its origin in a single, contract-based relationship." (3 C.4th 469.) Hence, "we hold a valid choice-of-law clause, which provides that a specified body of law 'governs' the 'agreement' between the parties, encompasses all causes of action arising from or related to that agreement, regardless of how they are characterized, including tortious breaches of duties emanating from the agreement or the legal relationships it creates." (3 C.4th 470.)

Three justices dissented, primarily on the ground that the choice-of-law clause should not have been applied to related *noncontractual* causes of action. (See *Washington Mut. Bank, FA v. Superior Court* (2001) 24 C.4th 906, 915, 103 C.R.2d 320, 15 P.3d 1071 [class action; *Nedlloyd* analysis followed]; 20 *Pepperdine L. Rev.* 1602.)

SUPPLEMENT: [This section is current through the latest supplement]

See *Expansion Pointe Properties Ltd. Partnership v. Procopio, Cory, Hargreaves & Savitch, LLP* (2007) 152 C.A.4th 42, 60, 61 C.R.3d 166 [choice of law clause, choosing California Law, in retainer agreement between defendant law firm and plaintiff client, allegedly resident of Arizona, was enforceable in plaintiff's legal malpractice action against defendant, precluding recovery of Punitive damages plaintiff allegedly lost in underlying litigation; defendant's principal place of business was in California, defendant was governed by laws of California, plaintiff's only employee resided in California, and Arizona's interest was not materially greater than California's]; *Brack v. Omni Loan Co., Ltd* (2008) 164 C.A.4th 1312, 1328, 80 C.R.3d 275 [choice-of-law provision in contract between Nevada lender and nonresident military borrowers stationed in California, which provided that Nevada law governed contract, was unenforceable in California; California's interest in enforcing its consumer protection laws regulating finance lending was greater than Nevada's general interest in enforcing contracts made by its citizens]. *Smith, Valentino & Smith case:*

Cross-Reference: 2 Cal. Proc. (5th), *Jurisdiction*, §355.



72 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

III. CONFLICT OF LAWS.

B. Validity and Effect of Contract.

2. Law Chosen by Parties.

b. Illustrations.

4. Deficiency Judgment.

1 Witkin Sum. Cal. Law Contracts § 72

[§ 72] Deficiency Judgment.

In *Guardian Savings & Loan Assn. v. MD Associates* (1998) 64 C.A.4th 309, 75 C.R.2d 151, a Texas savings and loan association brought a foreclosure action against an individual and several business entities, all Texas domiciliaries, which had been involved in a complex secured transaction relating to California real property. The parties' agreement contained a choice-of-law provision adopting Texas law, and the trial court ruled that it was enforceable. *Held*, affirmed.

Texas law exposed defendants to a deficiency judgment contrary to California's anti-deficiency statute (*C.C.P. 580b*; 4 *Summary* (10th), *Security Transactions in Real Property*, §187), which reflects a fundamental public policy of the state. Nevertheless, the policies underlying the statute have limited application to this case: (a) the transaction does not involve the sale of a home, which would implicate the strong policies reflected in the 1963 amendment of the statute; (b) the policy of equitable risk allocation does not apply to a transaction negotiated between sophisticated Texas domiciliaries; and (c) the objective of the statute--to prevent the aggravation of a downturn in market prices--becomes more problematic when both parties are domiciliaries of another state. At the same time, the interest of Texas in assuring the justified expectations of the parties to an agreement has maximum force where the agreement is negotiated between domiciliaries of that state. Thus, under the circumstances, California's interest in enforcement of the policies underlying *C.C.P. 580b* was not materially greater than Texas' policy of assuring the justified expectations of the parties. (64 C.A.4th 315.) (On enforceability of agreement where fundamental policy of forum state would be seriously compromised, see *infra*, §73.)

SUPPLEMENT: [This section is current through the latest supplement]



73 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

III. CONFLICT OF LAWS.

B. Validity and Effect of Contract.

2. Law Chosen by Parties.

b. Illustrations.

5. Unfair Competition or Restraint of Trade.

1 *Witkin Sum. Cal. Law Contracts* § 73

[§ 73] Unfair Competition or Restraint of Trade.

In *Application Group v. Hunter Group* (1998) 61 C.A.4th 881, 72 C.R.2d 73, plaintiff, a California corporation, recruited and hired a consultant who was a Maryland resident and an employee of defendant Maryland corporation and who had a covenant not to compete in her employment contract with defendant. Although the contract provided that it was to be governed by Maryland law, plaintiff sought a declaration that California law, specifically B. & P.C. 16600 (restraint of trade; see *infra*, §579) and B. & P.C. 17200 (unfair competition; see 13 *Summary* (10th), *Equity*, §105), and not Maryland law, applied to the covenant. The trial court ruled that California law applied and that the covenant was illegal under the two statutes. *Held*, affirmed.

(a) Although *Nedlloyd Lines B.V. v. Superior Court* (1992) 3 C.4th 459, 11 C.R.2d 330, 834 P.2d 1148, *supra*, §71, outlined the analytical approach to cases involving contractual choice-of-law provisions, pursuant to *Rest.2d, Conflict of Laws* §187, it did not decide how the Restatement principles would apply to cases in which the interests of the chosen state clash with a "fundamental policy" of California, because it found that no such "fundamental policy" was implicated in that case. One of the difficulties in these cases is that the "materially greater interest" test of the Restatement overlaps with the "governmental interest" and "comparative impairment" analyses that must be conducted in California to determine which state would be the state of the applicable law in the absence of an effective choice of law by the parties. No case has discussed the relationship between and among these tests. However, a federal court, in examining the respective "governmental interests" of the chosen and forum states, has taken the approach that a court can decline to enforce the parties' contractual choice-of-law provision only if the interests of the forum state are "materially greater" than those of the chosen state, *and* the forum state's interests would be more seriously impaired by enforcement of the parties' contractual choice-of-law provision than would the interests of the chosen state by application of the law of the forum state. (61 C.A.4th 897.)

(b) Here, there is no dispute that the chosen state has a "substantial relationship" to the parties and the transaction, and there is no dispute that there is a "reasonable basis" for the contractual choice-of-law provision. The parties also agree that both California and Maryland are "potentially concerned" states with diametrically opposed laws regarding the enforceability of the covenant not to compete. Further, each state purports to have significant interests in having its law applied. (61 C.A.4th 899.) "Thus, the real issues for decision are whether Maryland's law is contrary to a

fundamental policy of California and, if so, which state has a 'materially greater interest' in the determination of the issue and which state's interests would be more seriously impaired if its policy were subordinated to the policy of the other state." (61 C.A.4th 900.)

(c) *B. & P.C. 16600* reflects a strong public policy of the state. California courts have consistently declared the statute to be an expression of public policy to ensure that all citizens retain the right to pursue any lawful employment and enterprise of their choice. The statute is based on a policy that an employee's interests in mobility and betterment are deemed paramount to employers' competitive business interests, where there has been no illegal act accompanying an employment change. It follows that California has a strong interest in protecting the freedom of movement of persons whom California-based employers (such as plaintiff) wish to employ to provide services in California, regardless of the person's state of residence or precise degree of involvement in California projects, and there is no reason why these employees' interests should not be deemed paramount to the competitive business interests of out-of-state as well as in-state employers. (61 C.A.4th 900.)

(d) Further, to the extent it is invoked by a California *employer* to protect itself from "unfair competition," *B. & P.C. 16600* (as implemented through *B. & P.C. 17200* and *17204*) is all the more important as a statement of California public policy that ensures that California employers will be able to compete effectively for the most talented, skilled employees in their industries, wherever they may reside. (61 C.A.4th 901.)

(e) Although defendant claims that Maryland has an equally strong public policy favoring the use and enforcement of noncompetition covenants, insofar as they serve the interests of Maryland employers in preventing recruitment of employees who provide "unique services," and the misuse of trade secrets, routes, or lists of clients, or solicitation of customers, there is nothing to support a finding that failure to enforce defendant's noncompetition covenant would significantly impair any of the asserted interests. (61 C.A.4th 901.) "We are, therefore, convinced that California has a materially greater interest than does Maryland in the application of its law to the parties' dispute, and that California's interests would be more seriously impaired if its policy were subordinated to the policy of Maryland." (61 C.A.4th 902.)

(f) Defendant also argues that Maryland law should apply on the basis of the "relevant contacts" of the parties with the two states. While the "relevant contacts" test, as set forth in *Rest.2d, Conflict of Laws §188(2)* (see *supra*, §64), might support the application of Maryland law to the employment contract itself, it does not support that conclusion with respect to the covenant not to compete. Although the covenant was negotiated and signed in Maryland, which is both the employee's and defendant's state of residence, Maryland was not the exclusive place of business of either of them and was not necessarily the place where the covenant was to be "performed." Also, because the contracting parties were well aware that the purpose of the covenant was to prevent defendant's competitors, especially those in California, from recruiting and hiring its consultants, they were or should have been alerted to the possibility that California law could come into play in the course of their relationship. Further, plaintiff is a California employer against whom defendant repeatedly threatened and attempted to "enforce" the relevant "contract"--one to which plaintiff is not even a party. Finally, defendant itself has significant "contacts" with California, where it maintains an office and conducts business in direct competition with plaintiff. (61 C.A.4th 903.)

SUPPLEMENT: [This section is current through the latest supplement]



74 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

III. CONFLICT OF LAWS.

B. Validity and Effect of Contract.

3. Where No Choice Made.

a. Place of Contracting.

1. Significance of Factor.

1 Witkin Sum. Cal. Law Contracts § 74

[§ 74] Significance of Factor.

The place of contracting, standing alone, may be relatively insignificant; but it is usually one of several contacts. For this reason, validity of a contract will ordinarily be determined by the local law of the state of contracting. (*Rest.2d, Conflict of Laws §188(2)(a)*, Comment e.) (For older cases following the traditional rule that the law of the place of making governs validity, see *Fenton v. Edwards & Johnson* (1899) 126 C. 43, 46, 58 P. 320 [contract valid where made is valid everywhere]; *Mercantile Acceptance Co. v. Frank* (1928) 203 C. 483, 485, 265 P. 190 [same]; *Hutchinson v. Hutchinson* (1941) 48 C.A.2d 12, 21, 119 P.2d 214 [mere difference in law is no reason for refusing to enforce contract valid in state where made]; see also Leflar 4th, §145; 16 *Am.Jur.2d* (1998 ed.), *Conflict of Laws* §94 et seq.)

SUPPLEMENT: [This section is current through the latest supplement]
See McDougal, *American Conflicts Law* 5th §132.



75 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

III. CONFLICT OF LAWS.

B. Validity and Effect of Contract.

3. Where No Choice Made.

a. Place of Contracting.

2. What Constitutes Place of Contracting.

1 *Witkin Sum. Cal. Law Contracts* § 75

[§ 75] What Constitutes Place of Contracting.

(1) *Place Where Last Act Done.* The place of contracting is the place where the last act is done that is necessary to give a contract binding effect, under the forum's rules of offer and acceptance, "assuming, hypothetically, that the local law of the state where the act occurred rendered the contract binding." (*Rest.2d, Conflict of Laws* §188(2)(a), Comment e.) (See *Michelin Tire Co. of Calif. v. Coleman & Bentel Co.* (1919) 179 C. 598, 604, 178 P. 507; *Reynolds Elec. & Engineering Co. v. Work. Comp. App. Bd.* (1966) 65 C.2d 429, 433, 55 C.R. 248, 421 P.2d 96, 2 *Summary* (10th), *Workers' Compensation*, §112; *Hardy v. Musicraft Records* (1949) 93 C.A.2d 698, 701, 209 P.2d 839 [offer sent from New York to California, acceptance mailed here; held made in California]; *Leven v. Legarra* (1951) 103 C.A.2d 319, 320, 229 P.2d 383; *Commercial Cas. Ins. Co. of Newark, New Jersey v. Industrial Acc. Com.* (1952) 110 C.A.2d 83, 90, 242 P.2d 13 [place where formal contract signed]; *Leflar* 4th, §145; 16 *Am.Jur.2d* (1998 ed.), *Conflict of Laws* §§97, 98; 50 *Harv. L. Rev.* 1160; 13 *So. Cal. L. Rev.* 247; for similar test in *venue* and *attachment* cases, see 3 *Cal. Proc.* (4th), *Actions*, §755; 6 *Cal. Proc.* (4th), *Provisional Remedies*, §58.)

If a contract is entered into orally by *telephone*, under the foregoing test the place of making is the place where the acceptor speaks. (See *Travelers Ins. Co. v. Work. Comp. App. Bd.* (1967) 68 C.2d 7, 14, 64 C.R. 440, 434 P.2d 992, 2 *Summary* (10th), *Workers' Compensation*, §112; *Ward Mfg. Co. v. Miley* (1955) 131 C.A.2d 603, 610, 281 P.2d 343 [venue case]; *Wilson v. Scannavino* (1958) 159 C.A.2d 369, 371, 324 P.2d 350 [same]; *Ledbetter Erection Corp. v. Work. Comp. App. Bd.* (1984) 156 C.A.3d 1097, 1105, 203 C.R. 396; *Janzen v. Work. Comp. App. Bd.* (1997) 61 C.A.4th 109, 114, 71 C.R.2d 260.)

In *Skaggs-Stone v. LaBatt* (1960) 182 C.A.2d 142, 5 C.R. 882, a venue case, defendant signed a guaranty of payment of the account of A to plaintiff for any merchandise furnished by plaintiff to A. Held, the contract was not completed when defendant guarantor signed the written guaranty and placed it in the mail. An ordinary contract is completed by such a deposit of the acceptance, but "suretyship contracts differ in that the creditor must accept the surety's guarantee, either by acting upon it and extending credit, or by communicating his acceptance to the surety. ... Logically there doesn't seem to be any way in which a creditor could extend credit in reliance upon a guarantee until such time as he had knowledge of the guarantor's undertaking." Hence, the contract was entered into in the county of plaintiff's principal office, to which the guaranty was sent. (182 C.A.2d 143.)

(2) *Place of Negotiation Distinguished.* The place where the parties negotiate and agree on the terms of their contract is not necessarily the place of contracting; but the place of negotiation may itself be a significant contact. (*Rest.2d, Conflict of Laws §188(2)(b)*, Comment e.)

West's Key Number Digest, Courts k.513

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Place Where Last Act Done.* See McDougal, *American Conflicts Law* 5th §132.

Test in venue and attachment cases:

Cross-References: 3 *Cal. Proc.* (5th), *Actions*, §837; 6 *Cal. Proc.* (5th), *Provisional Remedies*, §58.



76 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witkin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law

III. CONFLICT OF LAWS.

B. Validity and Effect of Contract.

3. Where No Choice Made.

b. Place of Performance.

1 *Witkin Sum. Cal. Law Contracts* § 76

[§ 76] Place of Performance.

The state where performance is to occur has an obvious interest in the nature of the performance and in the party who is to perform. Hence, the law of the place of performance may be applied to govern any contractual issue if both parties are to perform in the state. (*Rest. 2d, Conflict of Laws* §188(2)(c), Comment e; see Leflar 4th, §146; Scoles & Hay 3d, §18.7; *16 Am.Jur.2d* (1998 ed.), *Conflict of Laws* §100; 29 *San Diego L. Rev.* 175 [The Applicability of Japanese Labor and Employment Laws to Americans Working in Japan].)

This is particularly true if both parties are domiciled in the state where performance is to take place (*Rest.2d, Conflict of Laws* §188(2)(c), Comment e), or if the place of performance of a contract and the place of negotiation (see *supra*, §75) are in the same state. (*Rest.2d, Conflict of Laws* §188(3), Comment f.) (For application of law of place of performance to questions relating to details of performance, see *infra*, §92; for application of this law to questions of legality, see *infra*, §86.)

SUPPLEMENT: [This section is current through the latest supplement]
See McDougal, *American Conflicts Law* 5th §133.



77 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law

III. CONFLICT OF LAWS.

B. Validity and Effect of Contract.

3. Where No Choice Made.

c. Location of Subject Matter.

1 Witkin Sum. Cal. Law Contracts § 77

[§ 77] Location of Subject Matter.

The situs of the subject matter of a contract is an important contact "when the contract deals with a specific physical thing, such as land or a chattel, or affords protection against a localized risk, such as the dishonesty of an employee in a fixed place of employment." (*Rest.2d, Conflict of Laws §188(2)(d)*, Comment e.) The state where the res or the risk is located has a legitimate interest in transactions affecting the res or the risk; and, when the res or the risk is the principal subject of the contract, it can often be assumed that the parties intended their contract to be governed by the local law of such state. (*Rest.2d, Conflict of Laws §188(2)(d)*, Comment e.)

SUPPLEMENT: [This section is current through the latest supplement]



78 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law

III. CONFLICT OF LAWS.

B. Validity and Effect of Contract.

3. Where No Choice Made.

d. Domicile and Related Factors.

1 Witkin Sum. Cal. Law Contracts § 78

[§ 78] Domicile and Related Factors.

Domicile, residence, nationality, place of incorporation, and place of business of the parties may each be a significant contact with respect to a particular issue. (*Rest.2d, Conflict of Laws §188(2)(e)*, Comment e; on concept of domicile, see 2 *Cal. Proc.* (4th), *Jurisdiction*, §129.) Thus, the capacity of a party to contract will usually be upheld if the party has this capacity under the local law of the state of his or her domicile. (*Rest.2d, Conflict of Laws §198(2)*; see *infra*, §81.)

Domicile gains enhanced significance if combined with other contacts. If both parties to the contract have domiciles in the same state, or if the state of domicile of one of the parties is the same as the place of contracting or of performance, the law of that state may be held determinative of most issues. (*Rest.2d., Conflict of Laws §188(2)(e)*, Comment e.)

West's Key Number Digest, Courts k.513

SUPPLEMENT: [This section is current through the latest supplement]

Cross-Reference: 2 *Cal. Proc.* (5th), *Jurisdiction*, §127.



79 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
III. CONFLICT OF LAWS.
B. Validity and Effect of Contract.
4. Public Policy Exception.

1 *Witkin Sum. Cal. Law Contracts* § 79

[§ 79] Public Policy Exception.

The forum will not enforce a contract that is valid in accordance with an otherwise applicable foreign law if enforcement of the contract is deemed to be opposed to some important consideration of public policy. (See *Hall v. Superior Court* (1983) 150 C.A.3d 411, 417, 197 C.R. 757, 2 Cal. Proc. (4th), *Jurisdiction*, §349; *Kashani v. Tsann Kuen China Enterprise Co., Ltd.* (2004) 118 C.A.4th 531, 540, 13 C.R.3d 174 [because California law includes federal law, latter is relevant in determining public policy of California]; *Leflar* 4th, §45; *Scoles & Hay* 3d, §§18.4, 18.9.; 16 *Am.Jur.2d* (1998 ed.) *Conflict of Laws* §23 et seq.; 81 *Harv. L. Rev.* 1864; 1 *San Diego L. Rev.* 122 [gambling transaction]; 15 *U.C.L.A. L. Rev.* 833; on public policy objections to enforcement of contracts made in foreign countries, see 71 *A.L.R.3d* 178 [gambling transaction]; on application with respect to contracts involving choice-of-law provision, see *supra*, §69 et seq.)

In *Weisz v. Weisz* (1971) 19 C.A.3d 676, 681, 97 C.R. 18, a Massachusetts agreement, purporting to limit the power of any court to modify or revoke provisions for support and maintenance, was held to contravene California policy as expressed in the language of the then controlling statute. Under the present statutes (*Family C. 3591 and 3651, 11 Summary* (10th), *Husband and Wife*, §356 et seq.), an agreement for support may be made nonmodifiable, and consequently an out-of-state agreement valid under that state's law is no longer contrary to California policy. (*Knodel v. Knodel* (1975) 14 C.3d 752, 766, 122 C.R. 521, 537 P.2d 353.)

SUPPLEMENT: [This section is current through the latest supplement]
See McDougal, *American Conflicts Law* 5th §44.

Hall case:

Cross-Reference: 2 Cal. Proc. (5th), *Jurisdiction*, §358.



80 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law

III. CONFLICT OF LAWS.

B. Validity and Effect of Contract.

5. Where Applicable Law Not Ascertainable.

1 Witkin Sum. Cal. Law Contracts § 80

[§ 80] Where Applicable Law Not Ascertainable.

In *Ferrell v. Southern Nevada Off-Road Enthusiasts, Ltd.* (1983) 147 C.A.3d 309, 195 C.R. 90, plaintiff, participating in a dune buggy race in Nevada, was injured when his vehicle collided with that of a spectator at a place maintained by defendant without barriers or supervision. Defendant relied on a written release of liability signed by plaintiff as a condition of entering the race, and contended that Nevada law applied because the release was made in Nevada and the accident occurred there. *Held*, California law applied, and the release, lacking explicit language, was ineffective (see *infra*, §673). No Nevada case in point (on race car driver releases) was found; and where the law of another state applies but cannot be determined, the court may apply California law (*Ev.C. 311, 1 Cal. Evidence (4th), Judicial Notice, §29.*) "Since we cannot determine the law of Nevada as to agreements purporting to exculpate a party from its liability for the results of its future negligence or other tortious conduct, we deem that the ends of justice are best served by applying the law of California in that area as it appears to be in accord with the weight of authority of the United States on this subject." (147 C.A.3d 314.)

SUPPLEMENT: [This section is current through the latest supplement]



81 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

III. CONFLICT OF LAWS.

B. Validity and Effect of Contract.

6. Particular Issues.

a. Capacity To Contract.

1 *Witkin Sum. Cal. Law Contracts* § 81

[§ 81] Capacity To Contract.

In the absence of an effective choice of law by the parties (see *supra*, §44 et seq.), capacity to contract is normally determined by the law of the state that has the most significant relationship with the contract. (*Rest.2d, Conflict of Laws* §198(1); see *Flittner v. Equitable Life Assn. Soc. of United States* (1916) 30 C.A. 209, 215, 157 P. 630 [applying law of place where the contract was made]; *Deason v. Jones* (1935) 7 C.A.2d 482, 484, 45 P.2d 1025; 16 Am.Jur.2d (1998 ed.), *Conflict of Laws* §111.)

However, pursuant to the strong policy favoring validity (see *supra*, §65), the contract may be enforced if the party has capacity under the local law of the state of his or her domicile. Another state's law should not be applied to invalidate the contract unless that state has an "equally great, or greater, interest in the person involved" than the state of domicile. (*Rest.2d, Conflict of Laws* §198(2), Comment b.)

West's Key Number Digest, Courts k.513

SUPPLEMENT: [This section is current through the latest supplement]



82 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

III. CONFLICT OF LAWS.

B. Validity and Effect of Contract.

6. Particular Issues.

b. Formalities of Execution.

1. In General.

1 Witkin Sum. Cal. Law Contracts § 82

[§ 82] In General.

In the absence of an effective choice of law by the parties (see *supra*, §66 et seq.), the law of the state having the most significant relationship to a contract generally governs its formal validity. (*Rest.2d, Conflict of Laws §199(1)*; see Leflar 4th, §148; Scoles & Hay 3d, §18.38; *16 Am.Jur.2d (1998 ed.)*, *Conflict of Laws §§112, 113*.) Matters of formal validity include questions of whether a contract must be in writing (see *infra*, §83), and, if so, whether the writing must be signed by the parties to be charged, executed before witnesses, acknowledged before a public official, or executed under seal. (*Rest.2d, Conflict of Laws §199*, Comment b.)

Thus, the parol evidence rule, now universally regarded as a doctrine of substantive law rather than a rule of evidence, should be applied according to the law of the state of most significant relationship. (*Rest.2d, Conflict of Laws §140*; see *Crumley v. Walter M. Ballard Corp. (1950) 100 C.A.2d 698, 702, 224 P.2d 455* [rule of substantive law; law of place of making applied]; Leflar 4th, §125; Scoles & Hay §18.38; 3 *Cal. Proc. (4th), Actions*, §97.)

In accordance with the choice-of-law policy favoring protection of the justified expectations of the parties, a contract that meets the requirements with respect to formalities of the state where the contract is executed is usually upheld. (*Rest.2d, Conflict of Laws §199(2)*.) But a contract that satisfies the formalities requirements of that state may nevertheless be held invalid by application of the local law of another state, if such other state is the state of most significant relationship, and "the place of execution is fortuitous and bears no real relationship to the transaction and the parties." (*Rest.2d, Conflict of Laws §199*, Comment c.)

SUPPLEMENT: [This section is current through the latest supplement]
See McDougal, *American Conflicts Law* 5th §136.

Parol evidence rule:

Cross-Reference: 3 *Cal. Proc. (5th), Actions*, §47.



83 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

III. CONFLICT OF LAWS.

B. Validity and Effect of Contract.

6. Particular Issues.

b. Formalities of Execution.

2. Statute of Frauds.

1 Witkin Sum. Cal. Law Contracts § 83

[§ 83] Statute of Frauds.

The statute of frauds has sometimes been regarded as procedural only, and governed by the law of the forum. The better view, however, characterizes it as substantive. (See *Rest.2d, Conflict of Laws §141*, Comment b; *Leflar 4th*, §125; *Scoles & Hay 3d*, §18.38; *50 Harv. L. Rev. 1162*; *67 Harv. L. Rev. 179*; *47 A.L.R.3d 137* [statute of frauds and conflict of laws]; *3 Cal. Proc. (4th), Actions*, §98; but see critical discussion, *43 Cal. L. Rev. 295*.)

Accordingly, questions relating to the statute of frauds should be determined by the law of the state with the most significant relationship to the contract, unless the parties have made an effective choice of law. (*Rest.2d, Conflict of Laws §§141*, 199(1).) The forum should not refuse to apply a foreign statute of frauds either because some of its local law effects may be deemed procedural or remedial for other purposes, or because of requirements of local public policy. (*Rest.2d, Conflict of Laws §141*, Comments d, e.)

Where the contacts are more or less evenly divided between two states, and a contract is valid and enforceable in one but unenforceable in the other, the justified expectations of the parties (see *supra*, §65) call for application of the statute of frauds that upholds the contract, particularly if the laws differ only in matters of detail. (*Rest.2d, Conflict of Laws §141*, Comment g.)

The modern approach, avoiding rigid characterization and weighing the interests involved, was taken in *Bernkrant v. Fowler (1961) 55 C.2d 588, 12 C.R. 266, 360 P.2d 906*. Plaintiffs, residents of Nevada, owed Granrud \$ 24,000 on a note secured by Nevada property. Granrud, needing funds, orally stated to plaintiffs, in Nevada, that if plaintiffs would refinance and pay a substantial part of this indebtedness, he would provide by will that any debt remaining at his death would be cancelled. Plaintiffs refinanced, paid \$ 13,114.20, and gave him a new note and deed of trust for \$ 9,227, on which they paid installments until his death. Granrud died a resident of California, and his will made no provision for cancellation of the final balance of \$ 6,425. In this action by plaintiffs against his executrix to cancel the note and deed of trust, the trial judge held that the oral contract was unenforceable, although he made no finding on Granrud's domicile at the time of contracting. *Held*, reversed.

(a) The contract was invalid in California but valid in Nevada. An oral contract not to be performed during the

promisor's lifetime is within the California statute of frauds (see *infra*, §371), but not within the general Nevada provision on oral transfers of land; hence, if Nevada law applied, the contract was enforceable. (55 C.2d 593, 594.) Even though California has a sufficient interest in protecting local estates to justify legislation making the California statute of frauds applicable to a contract even though the contract has substantial contacts with another state, it has not enacted such legislation; hence, general principles of conflict of laws apply. (55 C.2d 594.)

(b) If Granrud was domiciled in Nevada at the time of making, and merely moved to California thereafter, there would be no good reason for applying the California statute. Plaintiffs were Nevada residents, and the contract was made and performed in Nevada. "The basic policy of upholding the expectations of the parties by enforcing contracts valid under the only law apparently applicable would preclude an interpretation of our statute of frauds that would make it apply to and thus invalidate the contract because Granrud moved to California and died here. ... Just as parties to local transactions cannot be expected to take cognizance of the law of other jurisdictions, they cannot be expected to anticipate a change in the local statute of frauds. Protection of rights growing out of valid contracts precludes interpreting the general language of the statute of frauds to destroy such rights whether the possible applicability of the statute arises from the movement of one or more of the parties across state lines or subsequent enactment of the statute." (55 C.2d 594, 595.)

(c) If Granrud was domiciled in California at the time of making (a distinct possibility given that he had a California bank account), the result should nevertheless be the same. "Nevada has a substantial interest in the contract and in protecting the rights of its residents who are parties thereto, and its policy is that the contract is valid and enforceable. California's policy is also to enforce lawful contracts. ... It is true that if Granrud was domiciled here at the time the contract was made, plaintiffs may have been alerted to the possibility that the California statute of frauds might apply. Since California, however, would have no interest in applying its own statute of frauds unless Granrud remained here until his death, plaintiffs were not bound to know that California's statute might ultimately be invoked against them. Unless they could rely on their own law, they would have to look to the laws of all of the jurisdictions to which Granrud might move regardless of where he was domiciled when the contract was made." (55 C.2d 595, 596.) (See 49 Cal. L. Rev. 962; 53 Cal. L. Rev. 64; 16 Hastings L. J. 644.)

SUPPLEMENT: [This section is current through the latest supplement]
See McDougal, American Conflicts Law 5th §132.

Procedural or substantive:

Cross-Reference: 3 Cal. Proc. (5th), Actions, §48.



84 of 115 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

III. CONFLICT OF LAWS.

B. Validity and Effect of Contract.

6. Particular Issues.

c. Essential Validity and Invalidating Factors.

1 Witkin Sum. Cal. Law Contracts § 84

[§ 84] Essential Validity and Invalidating Factors.

In the absence of an effective choice of law by the parties, the essential or substantial validity of a contract, in respects other than capacity and formalities, is determined by reference to the law of the state having the most significant relationship to the contract. (*Rest.2d, Conflict of Laws* §§200, 201; see Scoles & Hay 3d, §18.11.) Issues relating to necessary parties, contract beneficiaries, offer and acceptance, and consideration are within the scope of this rule, as are issues of misrepresentation, duress, undue influence, mistake, illegality (see *infra*, §85 et seq.), and usury (see *infra*, §88). (*Rest.2d, Conflict of Laws* §200, Comment b.)

The justified expectations of the parties (see *supra*, §65) will be invoked to sustain the validity of a contract "whenever this can be done by application of the local law of a state having a substantial relationship to the transaction and the parties, provided that in so doing the interests of a state with a materially greater interest are not seriously infringed." (*Rest.2d, Conflict of Laws* §200, Comment c.)

However, the justified expectations of the parties have less weight when the issue is the effect of misrepresentation, duress, undue influence, or mistake. In this situation, expectations are likely to be defeated regardless of whether the contract is upheld; and rules governing misrepresentation, duress, undue influence, and mistake often represent strongly held state policies. Thus, when these issues are raised, a court will be reluctant to subordinate the policy of the nonvalidating state having the dominant interest in the issue to be decided. (*Rest.2d, Conflict of Laws* §201, Comment d.)

SUPPLEMENT: [This section is current through the latest supplement]



85 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

III. CONFLICT OF LAWS.

B. Validity and Effect of Contract.

6. Particular Issues.

d. Illegality.

1. Traditional Rule.

aa. Place of Contracting.

1 *Witkin Sum. Cal. Law Contracts* § 85

[§ 85] Place of Contracting.

The conventional, and probably the majority, rule determines legality by the law of the place of making, at least in the absence of compelling reasons to apply the law of the place of performance. (See *Hutchinson v. Hutchinson* (1941) 48 C.A.2d 12, 18, 119 P.2d 214; 8 Williston 4th, §19:3 et seq.; 50 *Harv. L. Rev.* 1163; 54 A.L.R.2d 1053 [attorneys' fee provision valid in state of execution or performance, but invalid under law of forum]; 67 A.L.R.2d 694 [Sunday contracts]; 70 A.L.R.2d 1292 [covenant not to compete]; 81 A.L.R.2d 1128 [contract to adopt]; 87 A.L.R.2d 1306 [contract to support illegitimate child].)

Where no place of performance was specified, a contract made in California was held governed by California law. (*Wheeling v. Financial Indem. Co.* (1962) 201 C.A.2d 36, 40, 19 C.R. 879 [automobile liability insurance with exclusion invalid in California].)

SUPPLEMENT: [This section is current through the latest supplement]



86 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

III. CONFLICT OF LAWS.

B. Validity and Effect of Contract.

6. Particular Issues.

d. Illegality.

1. Traditional Rule.

bb. Place of Performance.

1 Witkin Sum. Cal. Law Contracts § 86

[§ 86] Place of Performance.

The place of making may be casually chosen, and the parties who contemplate performance in a different place may be thinking in terms of the law of the latter. For this and other reasons, some courts have applied the law of the place of performance in testing the contract for legality.

In *Cochran v. Ellsworth* (1954) 126 C.A.2d 429, 272 P.2d 904, defendant vendor, in Arizona, listed Arizona land for sale, and authorized plaintiff broker in California to act. Plaintiff found a California buyer and an escrow was opened in California. But the written brokerage contract was executed in Arizona and was invalid there, because plaintiff had no Arizona license. *Held*, nevertheless, California law governed and the agreement was valid. The court said:

"There are some cogent reasons for not paying blind obeisance to the authority of the place of contracting in this day when ease of transportation and communication virtually erase state boundaries as commercial limitations. The *lex loci contractus* rule is not universally recognized and has been criticized in that it frequently elevates fortuitous and insignificant circumstances to crucial importance in establishing the controlling law." (126 C.A.2d 436.)

"In the instant case we have a contract for personal services, most of which the parties well knew had already been performed in California, and the balance of which they contemplated to be performed in California. In this situation the bare physical act of signing the written instrument was a fortuitous, fleeting and relatively insignificant circumstance in the total contractual relationship between the parties. It should not be elevated to paramount importance, particularly when to do so will serve only the purpose of rendering invalid an otherwise legal agreement." (126 C.A.2d 438.)

An equally sophisticated view was taken in *Estate of Grace* (1948) 88 C.A.2d 956, 200 P.2d 189. Mrs. Grace, a resident of Texas, joined with her husband in a statement of "adoption" of E, declaring that E was henceforth their heir and "our child, and a member of our family, with all the rights and privileges as if born to us." They came to California where E married and died, with R, her daughter, surviving. Later Mrs. Grace died. R's claim as her heir by reason of the Texas *adoption* was rejected on the ground that the Texas law did not then give the adopted party the actual status of an

adopted child. However, the court held that (1) the quoted statement, going beyond the scope of the Texas law, was an *offer* by the adopting parents to the child to give it such status; (2) although a contract of this type would be void under Texas law, the *acceptance* of the offer and the *consideration*--consisting of the child's living with the parents--took place partly in California, where the contract was legal; and (3) in any event, though the agreement did not so state, it would necessarily be performed where the parents took the child, and its legality could be upheld in California as the place of *performance*.

The court's quotation from C.J.S. seems a candid statement of the ground of the decision: "Irrespective of the general rule that the law of the place of the making governs the validity of a contract, the courts, in their effort to protect and promote the welfare of the child, have given effect to a contract to adopt, where it has been fully performed on the part of the child, although it was invalid under the laws where it was made." (88 C.A.2d 963.)

A contract for the sale of a building in which a legal gambling enterprise was operated in Nevada, though made in California, was held enforceable under the general rule that the law of the place of performance governs; and, in view of the several types of gambling permitted in California, enforcement did not violate any public policy of this state. (*Nevcal Enterprises v. Cal-Neva Lodge* (1961) 194 C.A.2d 177, 178, 14 C.R. 805.)

In *Buskuhl v. Family Life Ins. Co.* (1969) 271 C.A.2d 514, 76 C.R. 602, a life insurance agent's contract was made in Washington, but was to be performed in California. The question involved was the validity of a clause cutting off the right to future commissions after termination of the employment and certain acts injurious to the former employer. *Held*, the issues of forfeiture and restraint of trade were governed by California law. The interest of California, the state of performance, outweighed that of the state in which nothing happened but the signing of the agreement. (271 C.A.2d 521.)

In a number of cases involving violations of the California Corporate Securities Act by executory contracts to issue stock without a permit, it was held that there may be a legal *performance* of such a contract by delivery and payment, where the contract specifies another state as the place of performance. (See *Robbins v. Pacific Eastern Corp.* (1937) 8 C.2d 241, 277, 65 P.2d 42; *Jones v. Re-Mine Oil Co.* (1941) 47 C.A.2d 832, 837, 119 P.2d 219; *Oakley v. Rosen* (1946) 76 C.A.2d 310, 314, 173 P.2d 55; *B.C. Turf & Country Club v. Daugherty* (1949) 94 C.A.2d 320, 329, 210 P.2d 760; 26 Cal. L. Rev. 265; 31 Cal. L. Rev. 95.) However, in a number of other cases involving this same Act, a transaction's contact with California was held to be so substantial that the application of the Act was required. (See *Hardy v. Musicraft Records* (1949) 93 C.A.2d 698, 703, 209 P.2d 839 [holding *Robbins* case inapplicable where, although offer to sell shares came from New York, acceptance, delivery of shares, and payment therefor took place in California]; *Leven v. Legarra* (1951) 103 C.A.2d 319, 320, 229 P.2d 383 [essential acts took place here despite attempted mailing of certificates in Nevada]; *Western Air Lines v. Sobieski* (1961) 191 C.A.2d 399, 406, 12 C.R. 719 [distinguishing *Robbins* and *B.C. Turf*, *supra*, and holding California Corporate Securities Act applicable].)

SUPPLEMENT: [This section is current through the latest supplement]



87 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

III. CONFLICT OF LAWS.

B. Validity and Effect of Contract.

6. Particular Issues.

d. Illegality.

2. Restatement Rules.

1 Witkin Sum. Cal. Law Contracts § 87

[§ 87] Restatement Rules.

The Second Restatement takes the position that the courts should look to the local law of the state where an act related to the contract was, or is to be, done. If illegality is found to exist, questions concerning the *effect* of such illegality upon the rights of the parties under the contract should be determined, in the absence of an effective choice of law by the parties, by the law of the state having the most significant relationship to the contract. (*Rest.2d, Conflict of Laws §202(1)*, Comment c.)

In selecting the appropriate law a court should give less weight to the principle protecting the justified expectations of the parties than to the principle "which seeks the effectuation of the relevant policies of the state with the dominant interest in the issue to be determined." (*Rest.2d, Conflict of Laws §202(1)*, Comment e.) Thus, if performance is illegal in the place of performance, the contract will usually be denied enforcement. (*Rest.2d, Conflict of Laws §202(2)*.)

SUPPLEMENT: [This section is current through the latest supplement]



88 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

III. CONFLICT OF LAWS.

B. Validity and Effect of Contract.

6. Particular Issues.

d. Illegality.

3. Usury.

1 Witkin Sum. Cal. Law Contracts § 88

[§ 88] Usury.

A special rule of validation is declared in the Second Restatement for cases involving usury: "The validity of a contract will be sustained against the charge of usury if it provides for a rate of interest that is permissible in a state to which the contract has a substantial relationship and is not greatly in excess of the rate permitted by the general usury law of the state of the otherwise applicable law under the rule of §188." (*Rest.2d, Conflict of Laws §203*; see *Leflar 4th, §152*; *Scoles & Hay 3d, §§18.5, 18.28*; *55 Cal. L. Rev. 123*; *77 Harv. L. Rev. 754.*)

The law of the state chosen by the parties will not be given effect if such state has no "substantial relationship" to the contract. (*Rest.2d, Conflict of Laws §203, Comment e*; see *supra, §69.*) However, if a contract is usurious under the general usury laws of all states that have a "substantial relationship" to the contract, the forum should apply the statute of the state that imposes the lightest penalty for usury. (*Rest.2d, Conflict of Laws §203, Comment d.*)

This concept of "substantial relationship" is distinct from that of "most significant relationship." A contract may have a "substantial relationship" to two or more states; whereas, on a particular issue, only one state can be the state of "most significant relationship." (*Rest.2d, Conflict of Laws §203, Comment c.*) A state must have a "normal and natural relationship to the contract and the parties" to be a state of "substantial relationship." Contacts such as the domicile of an individual borrower or lender, the principal place of business of a corporate borrower or lender, or the place where the loan was negotiated, made, or to be repaid, will generally make a state one of "substantial relationship." (*Rest.2d, Conflict of Laws §203, Comment c.*)

The rule of validation (see *supra, §65*) was applied in *Ury v. Jewelers Acceptance Corp. (1964) 227 C.A.2d 11, 16, 38 C.R. 376, supra, §69*, upholding a contract made and performed in New York. (See *Gamer v. DuPont Glore Forgan (1976) 65 C.A.3d 280, 288, 135 C.R. 230, supra, §69.*) However, in *Rochester Capitol Leasing Corp. v. K & L Litho Corp. (1970) 13 C.A.3d 697, 91 C.R. 827*, the court, without referring to the rule of validation or the Restatement, applied California's invalidating law rather than the validating law of a state having a "substantial relationship" to the transaction.

Plaintiff was a leasing corporation, apparently domiciled and having its principal place of business in New York.

Defendant was a printing corporation, apparently domiciled and having its principal place of business in California. Pursuant to written agreements, defendant transferred title to certain printing presses and equipment to plaintiff and, concurrently, plaintiff leased the property back to defendant. The total monthly lease payments required from defendant amounted to a sum equal to the original advance (referred to as purchase price) made by plaintiff to defendant, plus interest for the term of the advance or loans at the rate of 11.5%. The agreements also provided that filing of an involuntary petition in bankruptcy against the lessee would constitute a breach; such a petition was filed against the successor-lessee, and plaintiff proceeded to sell the property at public auction. Plaintiff then brought this action to recover damages for breach of the lease agreements, and the trial court denied recovery. *Held*, affirmed. The lease-back agreements merely disguised transactions that were in substance loans secured by chattels, and the trial court correctly applied the California usury law to the agreements.

(a) Under California law the transactions were usurious and, while plaintiff could recover its principal, it could claim no interest. (13 C.A.3d 703.)

(b) New York, apparently the domicile and principal place of business of the lender and the place where the monthly lease payments were to be made, was a state having a "substantial relationship" to the *Rochester* transactions; and the rate of interest provided by the *Rochester* agreements (11.5%) was not "greatly in excess of" the rate permitted by California. (See *infra*, §456.) Hence, if the Restatement rule were followed, the transactions could have been sustained. (13 C.A.3d 702.)

(c) California, however, had the following contacts: (1) place of execution of agreements; (2) situs of the personal property that formed the security for all the transactions; (3) place where the act that effectuated the agreements (disbursement of original advance through an escrow) was completely performed; (4) place where all acts by the lender to enforce its rights of repossession and to recover due balances were exercised; and (e) apparently the domicile and principal place of business of the borrower. (13 C.A.3d 702.)

Thus, California was clearly the state of "most significant relationship" to the transactions and the parties, and its law was held to govern despite the special rule for usury enunciated in §203 of the Restatement (see *supra*). (13 C.A.3d 703.) (See 9 U.S.F. L. Rev. 441.)

West's Key Number Digest, Courts k.513

SUPPLEMENT: [This section is current through the latest supplement]
See McDougal, *American Conflicts Law* 5th §140.



89 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

III. CONFLICT OF LAWS.

B. Validity and Effect of Contract.

6. Particular Issues.

d. Illegality.

4. Intentional Violation of Foreign Law.

1 Witkin Sum. Cal. Law Contracts § 89

[§ 89] Intentional Violation of Foreign Law.

In *Wong v. Tenneco* (1985) 39 C.3d 126, 216 C.R. 412, 702 P.2d 570, plaintiff, a United States citizen and California resident, moved his extensive farm operations to Mexico. Since Mexican law and policy prohibited foreign ownership and control of farming land, he engaged Mexican citizens to lease land and perform the farming operation in their own names. The equipment and money were furnished by him, and the produce was shipped under his name and label. He borrowed money from defendant corporation to finance this operation, and when his situation reached a financial crisis, defendant yielded to demands of the Mexican growers that it sever its relationship with plaintiff and remit sales proceeds to the growers. Shortly afterwards, the operations ceased, and plaintiff sued in California for damages on various causes of action, including breach of contract and interference with advantageous business relations. The trial judge ruled that plaintiff was barred from recovery because the entire transaction was illegal. *Held*, affirmed.

(a) Under the doctrine of comity, a contract made with the intention of violating the laws of another country, though not otherwise obnoxious to the law of the forum, will be treated as against the public policy of the forum and hence not enforceable in the forum. (39 C.3d 135.)

(b) The exception to the comity doctrine precludes application of a foreign state's law where to do so would violate California's public policy. This exception is invoked not when the law is simply contrary to California public policy, but only where it is so offensive as to be prejudicial to recognized standards of morality and to the general interests of California citizens. (39 C.3d 135, quoting *Knodel v. Knodel* (1975) 14 C.3d 752, 766, 122 C.R. 521, 537 P.2d 353, *supra*, §79.) California public policy is not offended by application of Mexican law: Questions relating to control of real property are determined by the law of the situs, and the protectionist sentiment of the Mexican law does not adversely affect the general interests of *Californians*. (39 C.3d 136.)

(c) This is not a "true" conflict of laws case requiring analysis of the respective interests of the states involved. The governmental interest analysis applies only where two states have different laws governing the issue (see *supra*, §63). Here, only one state has a legitimate interest in the application of its law. California normally has an interest in compensation where a party breaches a contract entered into in California; but principles of equity and comity take precedence: "[T]he only California interest implicated is our public policy against enforcement of a contract dependent

upon violation of the laws of another sovereign." (39 C.3d 137, footnote 13.)

A lengthy dissent argues that the operations were not illegal under Mexican law; that any possible illegal transaction had been consummated; and that if Mexican law prohibits land ownership or holding by noncitizens, it is contrary to California policy and California law should prevail. (39 C.3d 138, 145.) (See 74 Cal. L. Rev. 1447, 1469.)

In *Crockford's Club Ltd. v. Si-Ahmed* (1988) 203 C.A.3d 1402, 250 C.R. 728, an English judgment based on bad checks passed at a legal English casino was held enforceable in California. "In view of the expanded acceptance of gambling in this state as manifested by the introduction of the California lottery and other innovations ... , it cannot seriously be maintained that enforcement of said judgment 'is so antagonistic to California public policy interests as to preclude the extension of comity in the present case.' " (203 C.A.3d 1406, quoting *Wong v. Tenneco*, *supra*; see *Metropolitan Creditors Service of Sacramento v. Sadri* (1993) 15 C.A.4th 1821, 19 C.R.2d 646, *infra*, §426, disagreeing with *Crockford's Club*; *Kelly v. First Astri Corp.* (1999) 72 C.A.4th 462, 488, 84 C.R.2d 810, *infra*, §1028, declining to follow *Crockford's Club*.)

SUPPLEMENT: [This section is current through the latest supplement]



90 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

III. CONFLICT OF LAWS.

B. Validity and Effect of Contract.

6. Particular Issues.

e. Interpretation and Construction.

1. California Cases and Statutes.

1 Witkin Sum. Cal. Law Contracts § 90

[§ 90] California Cases and Statutes.

C.C. 1646 provides that "[a] contract is to be interpreted according to the law and usage of the place where it is to be performed; or, if it does not indicate a place of performance, according to the law and usage of the place where it is made." (See *Sullivan v. Shannon* (1938) 25 C.A.2d 422, 425, 77 P.2d 498 [law of New York, where contract was made and to be performed, controlling on question of construction of acceleration clause]; *Covely v. C.A.B. Const. Co.* (1952) 110 C.A.2d 30, 33, 242 P.2d 87 [usage of place of performance]; *Sharpe v. Arabian Amer. Oil Co.* (1952) 111 C.A.2d 99, 105, 244 P.2d 83 [recognizing performance rule, but holding that plaintiff failed to show that alleged custom existed at place of performance].) (Cf. *C.C.P.* 1857 ["The language of a writing is to be interpreted according to the meaning it bears in the place of its execution, unless the parties have reference to a different place"]; see 12 *So. Cal. L. Rev.* 338, 342 [in regard to contracts, the more specific provisions of C.C. 1646 should be deemed controlling].)

However, the court may give effect to the intent of the parties in seeking the governing law. (See *Eaton v. Thieme* (1936) 15 C.A.2d 458, 465, 59 P.2d 638; *Blair v. New York Life Ins. Co.* (1940) 40 C.A.2d 494, 499, 104 P.2d 1075; 72 *Harv. L. Rev.* 1164; 12 *So. Cal. L. Rev.* 342; on special rule for contracts involving transaction of at least \$ 250,000, see *supra*, §68.)

SUPPLEMENT: [This section is current through the latest supplement]

In *Frontier Oil Corp. v. RLI Ins. Co.* (2007) 153 C.A.4th 1436, 63 C.R.3d 816, plaintiff oil corporation and defendant insurer entered into a general liability insurance policy in Texas that stated that defendant had a duty to defend any suit seeking to recover covered damages. The policy specified that it did not apply to damage caused by pollution, but also contained an endorsement stating that this pollution exclusion did not apply here. However, the endorsement did not mention a duty to defend. When third parties instituted the underlying personal injury actions alleging that pollution from plaintiff's oil drilling operations in California caused personal injury, plaintiff demanded that defendant provide a defense. When defendant refused, plaintiff instituted the present action for declaratory relief and breach of contract, the primary issue being whether, as a matter of contractual interpretation, defendant had agreed to defend pollution claims. The trial court, after holding that C.C. 1646 was the appropriate choice of law rule for determining whether Texas or California law applied to questions of contractual interpretation, held that Texas law applied and that, under Texas law,

defendant had no duty to defend. Plaintiff appealed from the summary judgment entered for defendant. *Held*, reversed.

(a) C.C. 1646, by its express terms, prescribes a choice of law rule concerning the interpretation of contracts. It states that a contract is to be *interpreted* according to the law and usage of the place where it is to be performed, if the contract indicates a place of performance, and that, if the contract does not indicate a place of performance, it is to be interpreted according to the law and usage of the place where it was made. This provision means that a contract must be interpreted according to the law of the place where it is to be performed if the contract *contemplates* performance in a particular place; the contract need not *expressly specify* a place of performance. Plaintiff is correct. C.C. 1646 was intended to give effect to the parties' presumed intention that the law of the place where a contract is to be performed should govern its interpretation, and the parties' intention as to the place of performance can often be gleaned from the nature of the contract and the surrounding circumstances, even if the contract does not expressly specify a place of performance. Moreover, the statute's use of the word "indicate," in lieu of a more restrictive word such as "specify" or "state," suggests that the Legislature intended a less restrictive meaning. (153 C.A.4th 1449, 1450.)

(b) The most prevalent modern choice of law rule in California is the governmental interest analysis. It has replaced former common law choice of law rules, and is sometimes labeled California's modern choice of law rule. Accordingly, the issue has arisen whether the governmental interest analysis has supplanted C.C. 1646 as to the law governing the interpretation of contracts. It has not. C.C. 1646 "determines the law governing the interpretation of a contract, notwithstanding the application of the governmental interest analysis to other choice-of-law issues. The California Supreme Court has never applied the governmental interest analysis to determine the law governing the interpretation of a contract and has never stated or suggested that Section 1646 does not determine the law governing the interpretation of a contract. Broad statements declaring the governmental interest analysis California's choice-of-law rule and rejecting traditional choice-of-law rules should be viewed in light of the particular choice-of-law issues that were before the court in those cases." (153 C.A.4th 1459.)

(c) The intended place of performance of a liability insurance policy is the place of the insured risk. If, as here, the insured risk involves operations at one or more fixed locations, a third-party complaint against the insured arising out of those operations typically is brought in the jurisdiction where those operations are located. Thus, the insurer performs its obligation to defend in the jurisdiction where the suit is prosecuted. Here, three endorsements clearly demonstrated that the parties intended that the policy provide coverage for the plaintiff's oil and gas operations in *Beverly Hills, California*. (153 C.A.4th 1461.) "Accordingly, we conclude that the parties anticipated that a suit arising from those operations in Beverly Hills could be prosecuted in California and that RLI would be obligated to provide a defense in California if the claims were potentially covered under the policy." (153 C.A.4th 1461.)



91 of 115 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

III. CONFLICT OF LAWS.

B. Validity and Effect of Contract.

6. Particular Issues.

e. Interpretation and Construction.

2. Restatement Rules.

1 Witkin Sum. Cal. Law Contracts § 91

[§ 91] Restatement Rules.

(1) *In General.* The Second Conflict of Laws Restatement distinguishes between "construction" and "interpretation." The court first seeks to ascertain the meaning intended by the parties. (*Rest.2d, Conflict of Laws §204, Comment a.*) In this process, called "interpretation," the court considers "the ordinary meaning of the words, the context in which they appear in the instrument, and any other evidence which casts light on the parties' intentions, including an intention, if any, to give a word the meaning given it in the local law of another state." (*Rest.2d, Conflict of Laws §204, Comment a.*) When the intended meaning cannot be satisfactorily ascertained by interpretation, the appropriate rule of construction will be invoked:

(a) If the parties have designated the law of a particular state, the court will apply that law, even though the state has no relationship to the contract. (*Rest.2d, Conflict of Laws §204(a), Comment b.*) The court may also give effect to the parties' intention that the contract be construed in accordance with the rules or usages of unofficial organizations. (*Rest.2d, Conflict of Laws §204(a), Comment b, Illustration and Reporter's Note.*)

(b) If no law has been designated, the court will construe the contract in accordance with the local law of the state having the most significant relationship to the contract. (*Rest.2d, Conflict of Laws §204(b), Comment c; see Leflar 4th, §151; Scoles & Hay 3d, §18.3; 60 A.L.R.2d 467 [conflict of laws as to usage and custom, with respect to interpretation or performance].*)

(c) In the absence of satisfactory evidence of the parties' actual intention, the rules of construction of the place of performance will be given effect to determine the meaning of words relating to details of performance. (*Rest.2d, Conflict of Laws §204, Comment c; see supra, §90.*)

On rare occasions (e.g., in "standard form" insurance policies), the state of applicable law may require that contractual provisions be given a particular legal effect irrespective of the intentions of the parties. In this situation, the court will neither interpret nor construe the provisions, but will give them the arbitrary meaning required by the applicable law. (*Rest.2d, Conflict of Laws §204, Comment d and Reporter's Note.*)

(2) *Nature and Extent of Contractual Obligations.* The parties to a contract can expressly determine the nature and extent of contractual obligations. When they do not, such issues are determined in accordance with the law of the state having the most substantial relationship to the contract. (*Rest.2d, Conflict of Laws* §205, Comments b, c.) This rule applies to questions involving rights of third-party beneficiaries, application and effect of integration (parol evidence rule), sufficiency of performance, excuse for nonperformance, and breach of contract. (*Rest.2d, Conflict of Laws* §205, Comments d, e, f, g.)

West's Key Number Digest, Courts k.513

SUPPLEMENT: [This section is current through the latest supplement]

(1) *In General.*

(b) *Construction according to law of state with most significant relationship:* See McDougal, American Conflicts Law 5th §138.



92 of 115 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

III. CONFLICT OF LAWS.

B. Validity and Effect of Contract.

6. Particular Issues.

f. Performance.

1 Witkin Sum. Cal. Law Contracts § 92

[§ 92] Performance.

The local law of the place of performance governs issues relating to *details* of performance of a contract such as time, place, manner, and method of performance. (*Rest.2d, Conflict of Laws §206*, and Comments.) But matters that substantially affect the nature and extent of *contractual obligations*, such as sufficiency of performance and excuse for nonperformance, are governed by the law of the state of most significant relationship. (See *Rest.2d, Conflict of Laws §205*, supra, §91; Leflar 4th, §146; Scoles & Hay 3d, §18.39; *16 Am.Jur.2d (1998 ed.)*, *Conflict of Laws §114* et seq.) (On questions relating to termination, breach, rescission, or repudiation as "matters of performance" for purposes of determining applicable law, see *16 Am.Jur.2d (1998 ed.)*, *Conflict of Laws §§122, 123*; *50 A.L.R.2d 254* [law governing determination whether facts and circumstances operate to terminate, breach, rescind, or repudiate contract].)

Although it may be difficult to determine whether a particular issue affects substantial rights or merely concerns details of performance (see *50 Harv. L. Rev. 1164*), the problem is simplified by the fact that the state of performance is frequently also the state of most significant relationship. (*Rest.2d, Conflict of Laws §206*, Comment b.)

SUPPLEMENT: [This section is current through the latest supplement]

Matters substantially affecting contractual obligations: See McDougal, American Conflicts Law 5th §133.



93 of 115 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

III. CONFLICT OF LAWS.

B. Validity and Effect of Contract.

6. Particular Issues.

g. Recovery for Breach.

1 Witkin Sum. Cal. Law Contracts § 93

[§ 93] Recovery for Breach.

In the absence of an effective choice of law by the parties, the measure of recovery for a breach of contract is determined by the local law of the state having the most significant relationship to the contract. (*Rest.2d, Conflict of Laws* §207; see Leflar 4th, §§126, 149; Scoles & Hay 3d, §18.39; *50 A.L.R.2d* 227 [elements and measure of damages recoverable for breach]; 3 *Cal. Proc.* (4th), *Actions*, §§99, 100.) A state that is the place of performance and also the place of negotiating a contract will generally be the state having the most significant relationship to the contract. (*Rest.2d, Conflict of Laws* §§188(3), 207, Comment c; see *Bracker v. American Nat. Food* (1955) 133 *C.A.2d* 338, 344, 284 *P.2d* 163 [measure of damages governed by law of Missouri, place of performance and place where contract was negotiated and executed].)

Questions concerning the validity of a provision for liquidated damages (*infra*, §503 et seq.) and questions concerning the recovery of interest (*infra*, §888 et seq.) are within the scope of this rule. (*Rest.2d, Conflict of Laws* §207, Comments d, e.)

SUPPLEMENT: [This section is current through the latest supplement]
See McDougal, *American Conflicts Law* 5th §§115, 138.

Cross-Reference: 3 *Cal. Proc.* (5th), *Actions*, §§49, 50.



94 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
III. CONFLICT OF LAWS.
C. Assignment.
1. In General.

1 Witkin Sum. Cal. Law Contracts § 94

[§ 94] In General.

(1) *Assignability*. The law of the state with the most significant relationship to the *issue of assignability* determines whether, and under what conditions, a contractual right not embodied in a document can be assigned. (*Rest.2d, Conflict of Laws* §208.)

(2) *Performance*. Payment or other performance by the obligor, following assignment, discharges the obligor if this payment or other performance would have such effect under either: (a) the law governing the original contract, or (b) the law governing the assignment, provided the contractual right is assignable. (*Rest.2d, Conflict of Laws* §210; on assignments generally, see *infra*, §707 et seq.) The obligor can, without liability, refuse performance to an assignor or assignee who is not entitled thereto under the law governing the assignment. (*Rest.2d, Conflict of Laws* §210, Comment d.)

(3) *Priorities Between Assignees*. (a) When all of the assignments are governed either by the same law or by different laws embodying the same rule, questions of priority are determined by the law governing the assignment. (*Rest.2d, Conflict of Laws* §211(1).) (b) When the assignments are governed by the law of different states with different rules, questions of priority are determined by the law governing the assignability of the contractual right; or, in the case of accounts receivable of a business enterprise, "by the local law of the state where the books evidencing the accounts are kept." (*Rest.2d, Conflict of Laws* §211(2).)

West's Key Number Digest, Courts k.513

SUPPLEMENT: [This section is current through the latest supplement]



95 of 115 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law
III. CONFLICT OF LAWS.

C. Assignment.

2. Assignment as Between Assignee and Assignor.

1 Witkin Sum. Cal. Law Contracts § 95

[§ 95] Assignment as Between Assignee and Assignor.

Assuming that a contractual right is assignable (see *supra*, §94), the next question is whether the actual assignment is valid, a question that is separate from that of assignability. (*Rest. 2d, Conflict of Laws* §209, Comment a.) Paralleling the issue of assignability, the rule is that the validity of an assignment of a contractual right not embodied in a document and the rights created thereby as between the assignor and the assignee are determined by the law of the state with the most significant relationship *to the assignment*. (*Rest.2d, Conflict of Laws* §209; see Leflar 4th, §185; Scoles & Hay 3d, §18.37; 6 *Am.Jur.2d* (1999 ed.), *Assignments* §§11, 12, 19, 80; 50 *Harv. L. Rev.* 1163; 97 *A.L.R.2d* 1399 [law governing assignment of life insurance policy]; 1 *A.L.R.3d* 927 [law governing assignment of wages or salary].) In some cases, the domicile of a party other than the assignee or the assignor may be the controlling factor in determining which law applies. (See *Smith v. Harris* (1954) 127 *C.A.2d* 311, 314, 273 *P.2d* 835 [law of place where debtor of the assignor was domiciled applied in order to validate assignment of account receivable as against attachment of account by creditor of assignor].)

In *Kracht v. Perrin, Gartland & Doyle* (1990) 219 *C.A.3d* 1019, 268 *C.R.* 637, *infra*, §729, plaintiff filed an action against defendant Oregon attorneys based on an assigned malpractice claim. The claim had been involuntarily assigned to plaintiff, under *C.C.P.* 708.510 (8 *Cal. Proc.* (4th), *Enforcement of Judgment*, §297), by H, an Oregon resident against whom plaintiff had recovered a judgment in California after H's responses to discovery prepared by defendants were found deficient. Plaintiff sought to avoid California's proscription against assignment of malpractice claims (*infra*, §729) by arguing that Oregon law, purportedly permitting assignment of these claims, was applicable because Oregon was the domicile of the owner of the claim, H. *Held*, even if Oregon permits the assignability of malpractice claims, California law still governs on whether the assignment itself is valid or enforceable in California.

(a) California law is applicable because California has the most significant relationship to the assignment. (219 *C.A.3d* 1027, citing the text.) "The assignment was effected in California, upon motion by a California resident, by an order of a California court; and the assignee and assignor (at least to the extent Hogue was subjected to the court's jurisdiction in connection with the order) were in California at the time of the assignment. Moreover, the assignment was effected in order to assist in the collection of an underlying California court judgment. Finally, using a 'governmental interest' analysis ... , Oregon has little interest in having its law applied to determine the validity of an assignment which was both effected by and is being litigated in California courts, while California's interest in having its law applied (in light of the public policies implicated by such an assignment) is significant." (219 *C.A.3d* 1027.)

(b) Even if Oregon law were applicable, and the assignment were valid thereunder, California courts would not enforce it, because assignment of malpractice claims have been held to violate important California policy considerations. (219 C.A.3d 1027.)

Questions involving capacity of the assignor, formalities, substantial validity of the assignment, the nature of the interests transferred, and the existence and nature of any warranties, are determined by the law governing the assignment. (*Rest.2d, Conflict of Laws* §209, Comment a.) The state where the assignment took place is generally found to be the state of most significant relationship to the assignment, particularly if both the assignor and assignee were in that state at the time the assignment was made. (*Rest.2d, Conflict of Laws* §209, Comment c.)

SUPPLEMENT: [This section is current through the latest supplement]

See McDougal, *American Conflicts Law* 5th §173; 6 *Am.Jur.2d* (2008 ed.), *Assignments* §§9, 10, 17.

C.C.P. 708.510:

Cross-Reference: 8 *Cal. Proc.* (5th), *Enforcement of Judgment*, §305.



96 of 115 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law
III. CONFLICT OF LAWS.
D. Discharge.

1 Witkin Sum. Cal. Law Contracts § 96

[§ 96] Discharge.

(1) A contract is discharged by a *subsequent act* of one or both of the parties, irrespective of the intention of the parties to discharge the contract, if the act has this effect under the law of the state that, with respect to the issue, has the most significant relationship to the transaction and the parties. (*Rest.2d, Conflict of Laws §212(1)*; see *Grayhill Drilling Co. v. Superior Oil Co.* (1952) 39 C.2d 751, 754, 249 P.2d 21 [contract made and to be performed in Oklahoma, and acts relied upon to establish an accord and satisfaction took place in that state; Oklahoma law determinative on issue of discharge]; 50 A.L.R.2d 254 [law governing whether facts operate to terminate, rescind, or repudiate].) Thus, a debt will be discharged by a creditor's release of a coobligor or by the creditor's acceptance of the debtor's promissory note, "even though the creditor did not intend to discharge the debt and even though the creditor's act would not have this effect under the local law of the state where the act was done." (*Rest.2d, Conflict of Laws §212(1)*, Comment b.)

(2) A contract is discharged by a *subsequent agreement* of the parties, which is intended to result in such a discharge, if the agreement has this effect under the law of the state having the most significant relationship to the agreement, with respect to the issue of discharge. (*Rest.2d, Conflict of Laws §212(2)*, Comment c.)

(3) The obligations of one party to a contract are discharged by a subsequent *unilateral act*, such as a release, by the other party, provided: (a) the other party intends his or her act to result in a discharge; and (2) the unilateral act has this effect under the law of the state that governs the act (ordinarily, the state where the act was done) if that state bears a reasonable relation to the transaction and the parties. (*Rest.2d, Conflict of Laws §212(3)*, Comment d.)

(4) These rules also govern questions relating to the release of a surety. (*Rest.2d, Conflict of Laws §213*.)

SUPPLEMENT: [This section is current through the latest supplement]



97 of 115 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law
III. CONFLICT OF LAWS.
E. Particular Contracts.
1. Contracts Involving Land.

1 Witkin Sum. Cal. Law Contracts § 97

[§ 97] Contracts Involving Land.

(1) *Contract To Convey*. In the absence of an effective choice of law by the parties, the validity of a contract for the transfer of an interest in land and the rights created thereby are determined by the law of the state where the land is situated unless, with respect to a particular issue, another state has a more significant relationship to the transaction and the parties. (*Rest.2d, Conflict of Laws §189*; see Leflar 4th, §170; Scoles & Hay 3d, §18.23; *16 Am.Jur.2d (1998 ed.)*, *Conflict of Laws §30* et seq.; *15 A.L.R.2d 1199* [law governing validity and construction of, and rights and obligations arising under, a lease of real property].) (For choice-of-law rules relating to the *conveyance* of an interest in land, see *11 Summary (10th)*, *Real Property*, §§5, 6.) Furthermore, if a contract, though invalid under the *lex situs*, is valid under the law of another state with a close relation to the transaction and the parties, the policy of protecting the justified expectations of the parties (see *supra*, §65) will often lead the forum to apply the validating law of the other state. (See *Rest.2d, Conflict of Laws §189*, Comments c, d.)

(2) *Contractual Provisions in Conveyance*. The same rules apply to contractual duties imposed upon the parties by a deed of conveyance of an interest in land. (*Rest.2d, Conflict of Laws §190*; see Leflar 4th, §170; Scoles & Hay 3d, §18.23.)

In determining the state of applicable law, the most important single contact is the *situs* of the land. (*Rest.2d, Conflict of Laws §190*, Comments a, c, d.) Hence, the *lex situs* is often applied to determine questions relating to covenants of title such as covenants of seisin, right to convey, and against encumbrances, covenants imposing some obligation on the grantor relating to the transferred land, and contractual duties imposed on the grantee, such as assumption of a mortgage. (*Rest.2d, Conflict of Laws*, Comments c, d.)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Contract To Convey*. See McDougal, *American Conflicts Law* 5th §158.



98 of 115 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law
III. CONFLICT OF LAWS.
E. Particular Contracts.
2. Contracts Involving Chattels.

1 Witkin Sum. Cal. Law Contracts § 98

[§ 98] Contracts Involving Chattels.

(1) *State of Delivery.* In the absence of an effective choice of law by the parties, the validity of a contract for the sale of an interest in a chattel and the rights created thereby are determined by the law of the state where the seller is to deliver the chattel unless, in regard to a particular issue, another state has a more significant relationship to the transaction and the parties. (*Rest.2d, Conflict of Laws §191*; Scoles & Hay 3d, §§18.24, 18.25.) (For choice-of-law rules relating to the conveyance of an interest in a chattel, as distinguished from the contract for the sale of such an interest, see 13 *Summary* (10th), *Personal Property*, §112.) However, the forum may apply the law of another state if a continued relationship between the parties contemplated by the contract is centered in that state, or if the contract, invalid under the law of the state of delivery, is valid under the law of a state with a close relation to the transaction and the parties. (*Rest.2d, Conflict of Laws §191*, Comment f.)

(2) *What Is Place of Delivery?* The place of delivery is the place where the seller "completes his performance with reference to the physical delivery" of the chattel. (*Rest.2d, Conflict of Laws §191*, Comment d.) This is usually where the parties deal with each other, and ordinarily will be the place where the seller is domiciled or does business. (*Rest.2d, Conflict of Laws §191*, Comment d.) If, however, the seller sends the chattel to the buyer "f.o.b.," the place of delivery will ordinarily be the place where the seller is to deliver the goods to the carrier. (*Rest.2d, Conflict of Laws §191*, Comment d.)

West's Key Number Digest, Courts k.513

SUPPLEMENT: [This section is current through the latest supplement]



99 of 115 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law
III. CONFLICT OF LAWS.
E. Particular Contracts.
3. Other Contracts.

1 Witkin Sum. Cal. Law Contracts § 99

[§ 99] Other Contracts.

In the absence of an effective choice of law by the parties, the validity of particular kinds of contracts and the rights created thereby are usually determined as follows:

(1) *Suretyship*: "by the law governing the principal obligation which the contract of suretyship was intended to secure." (*Rest.2d, Conflict of Laws §194.*) (On law governing written guaranty, see *72 A.L.R.3d 1180*; on suretyship generally, see *infra*, §1002 et seq.)

(2) *Repayment of money lent*: "by the local law of the state where the contract requires that repayment be made." (*Rest.2d, Conflict of Laws §195.*) (On issue of usury, see *supra*, §88.)

(3) *Rendition of services*: "by the local law of the state where the contract requires that the services, or a major portion of the services, be rendered." (*Rest.2d, Conflict of Laws §196.*)

(4) *Transportation*: "by the local law of the state from which the passenger departs or the goods are dispatched." (*Rest.2d, Conflict of Laws §197.*)

(5) *Arbitration agreement*: by the law of the state having the most significant relationship to the arbitration agreement and the parties. (*Rest.2d, Conflict of Laws §218*; see *Leflar 4th, §155.*) (For rules relating to methods of enforcement of arbitration agreements and enforcement of foreign arbitration awards, see *Rest.2d, Conflict of Laws §219, 220.*)

However, if, with respect to a particular issue, some other state has a more significant relationship to the transaction and the parties than the state otherwise indicated, the local law of the other state should be applied. (*Rest.2d, Conflict of Laws §§194, 195, 196, 197.*) (For the rules governing negotiable instruments, see *4 Summary (10th), Negotiable Instruments, §§6, 7.*)

SUPPLEMENT: [This section is current through the latest supplement]

(5) *Arbitration agreement*: See McDougal, *American Conflicts Law* 5th §143.



100 of 115 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law
III. CONFLICT OF LAWS.
F. Restitution.

1 Witkin Sum. Cal. Law Contracts § 100

[§ 100] Restitution.

In actions for restitution (i.e., claims, based neither on contract nor on tort, to recover for unjust enrichment; see *infra*, §91 et seq.), the governing law is that of the state that, in regard to a particular issue, has the most significant relationship to the occurrence and the parties. (*Rest.2d, Conflict of Laws §221(1)*, Comments a, b, c; cf. *Leflar 4th*, §156.)

Contacts that are important in determining the state of most significant relationship are listed in the Restatement (*Rest.2d, Conflict of Laws §221(2)*, Comment d) as follows:

"(a) the place where a relationship between the parties was centered, provided that the receipt of enrichment was substantially related to the relationship,

(b) the place where the benefit or enrichment was received,

(c) the place where the act conferring the benefit or enrichment was done,

(d) the domicile, residence, nationality, place of incorporation and place of business of the parties, and

(e) the place where a physical thing, such as land or a chattel, which was substantially related to the enrichment, was situated at the time of the enrichment."

West's Key Number Digest, Courts k.513-

SUPPLEMENT: [This section is current through the latest supplement]
See McDougal, *American Conflicts Law* 5th §144.



101 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
IV. CATEGORIES OF CONTRACT
A. Executory and Executed.

1 Witkin Sum. Cal. Law Contracts § 101

[§ 101] Executory and Executed.

"An executed contract is one, the object of which is fully performed. All others are executory." (C.C. 1661; see 1 Williston 4th, §1:19; *17A Am.Jur.2d* (2004 ed.), *Contracts* §5; Cal. Transactions Forms, 1 Business Transactions §6:3.) This distinction becomes important in several situations:

(1) Consideration. (See *Julian v. Gold* (1931) 214 C. 74, 76, 3 P.2d 1009, *infra*, §243.)

(2) Statute of frauds. (See *James v. Hall* (1928) 88 C.A. 528, 533, 264 P. 516; *infra*, §401.)

(3) Illegality. (See *National Stone Tile Corp. v. Voorheis* (1928) 93 C.A. 738, 743, 270 P. 286.)

(4) Modification of written contract by executed oral agreement. (See *Pearsall v. Henry* (1908) 153 C. 314, 325, 95 P. 154, 159; *Klein Norton Co. v. Cohen* (1930) 107 C.A. 325, 330, 290 P. 613; *Harvey v. DeGarmo* (1933) 129 C.A. 487, 493, 18 P.2d 971; *infra*, §968.)

West's Key Number Digest, Contracts k.6

SUPPLEMENT: [This section is current through the latest supplement]
See 1 Williston 4th (2007 ed.), §1:19.



102 of 115 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law
IV. CATEGORIES OF CONTRACT
B. Express, Implied, and Quasi-Contracts.
1. Express and Implied in Fact Contracts.

1 Witkin Sum. Cal. Law Contracts § 102

[§ 102] Express and Implied in Fact Contracts.

"An express contract is one, the terms of which are stated in words." (C.C. 1620.) "An implied contract is one, the existence and terms of which are manifested by conduct." (C.C. 1621.) (See *Rest.2d, Contracts §4* ["A promise may be stated in words either oral or written, or may be inferred wholly or partly from conduct"]; 1 Corbin (Rev. ed.), §1.19; 1 Williston 4th, §1.5; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §12 et seq.; Cal. Civil Practice, 3 Business Litigation, §24:4; Cal. Transactions Forms, 1 Business Transactions §6:2; BAJI, No. 10.56 [Express or Implied Contracts]; CACI, No. 305 [Implied-in-Fact Contract].) (On distinguishable quasi-contract, see *infra*, §103.)

The distinction between express and implied in fact contracts relates only to the *manifestation of assent*; both types are based upon the expressed or apparent intention of the parties. "The true implied contract, then, consists of obligations arising from a mutual agreement and intent to promise where the agreement and promise have not been expressed in words." (*Silva v. Providence Hosp. of Oakland* (1939) 14 C.2d 762, 773, 97 P.2d 798; see *Desny v. Wilder* (1956) 46 C.2d 715, 734, 299 P.2d 257; *Youngman v. Nevada Irr. Dist.* (1969) 70 C.2d 240, 246, 74 C.R. 398, 449 P.2d 462; *Pasadena v. Los Angeles* (1953) 118 C.A.2d 497, 499, 258 P.2d 28 [contract implied in fact "is consensual in nature"]; *Zint v. Topp Industries* (1960) 184 C.A.2d 240, 243, 7 C.R. 302, citing the text [action for reasonable value of services]; *Spinelli v. Tallcott* (1969) 272 C.A.2d 589, 595, 77 C.R. 481 [services of type usually charged for, and performed with defendant's knowledge]; *Arcade County Water Dist. v. Arcade Fire Dist.* (1970) 6 C.A.3d 232, 237, 85 C.R. 737; *Pennsylvania Sec. Life Ins. v. Rising* (1976) 62 C.A.3d 302, 308, 133 C.R. 59; *Division of Labor Law Enforcement v. Transpacific Trans. Co.* (1977) 69 C.A.3d 268, 275, 137 C.R. 855 [no implied contract found]; *McGough v. University of San Francisco* (1989) 214 C.A.3d 1577, 1584, 263 C.R. 404, quoting the text; *Bell v. Superior Court* (1989) 215 C.A.3d 1103, 1109, 263 C.R. 787; *Varni Bros. Corp. v. Wine World* (1995) 35 C.A.4th 880, 888, 889, 41 C.R.2d 740, quoting the text; *Maglica v. Maglica* (1998) 66 C.A.4th 442, 456, 78 C.R.2d 101, citing the text; *Binder v. Aetna Life Ins. Co.* (1999) 75 C.A.4th 832, 850, 89 C.R.2d 540, quoting the text; *Gunther-Wahl Productions v. Mattel* (2002) 104 C.A.4th 27, 35, 128 C.R.2d 50 [by instructing that plaintiff had to have "clearly conditioned" disclosure of idea for TV series on defendant's agreement to pay for it if defendant used idea, court led jury to believe, contrary to law of implied in fact contracts, that express promise of compensation was required].) (On implied in fact contract arising from nonmarital relationship, see *Marvin v. Marvin* (1976) 18 C.3d 660, 134 C.R. 815, 557 P.2d 106, 11 Summary (10th), *Community Property*, §271.)

In *Arcade County Water Dist. v. Arcade Fire Dist.*, *supra*, water companies, predecessors of plaintiff water

districts, supplied water to defendant fire districts pursuant to a compromise agreement, under which defendant paid 75 cents per month per hydrant but did not admit any liability. Plaintiff districts continued to supply the water at the same rate until a study showed that the actual cost was \$ 4. Thereupon, the districts adopted ordinances setting the rate at \$ 4 and billed defendants accordingly. Defendants continued to take the water, but notified plaintiffs that they would not pay the new charge and also stopped paying the old charge. In a trial of the issue of liability, the lower court gave judgment for defendants. *Held*, reversed; defendants were liable for a reasonable charge, to be determined on a trial of the issue.

(a) If a buyer says he or she will take goods in a shop not at the price asked but at its fair value, the shop owner may hold the buyer liable not simply in tort (conversion) but "as a buyer for the stated price." (6 C.A.3d 236, footnote 3.)

(b) Here, defendants in effect said they declined to pay the rate charged, but their actions in taking the water could be considered an implied acceptance. (6 C.A.3d 237.) Also, the past dealings of the parties, i.e., defendants taking the service but rejecting the new rate, "indicate an implied agreement to pay not the demanded price but a reasonable price." (6 C.A.3d 238, citing Corbin.)

West's Key Number Digest, Contracts k.3, 27

SUPPLEMENT: [This section is current through the latest supplement]

See *Kashmiri v. Regents of Univ. of Calif.* (2007) 156 C.A.4th 809, 827, 67 C.R.3d 635 [there was no formal agreement between students and state university so as to create express contract, but implied contract was created by students' conduct when they accepted university's offer of enrollment]; 1 Williston 4th (2007 ed.), §1:5.



103 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
IV. CATEGORIES OF CONTRACT
B. Express, Implied, and Quasi-Contracts.
2. Quasi-Contract and Implied in Fact Contract Distinguished.

1 Witkin Sum. Cal. Law Contracts § 103

[§ 103] Quasi-Contract and Implied in Fact Contract Distinguished.

Implied contracts, more accurately called *contracts implied in fact*, should be distinguished from *contracts implied in law, or quasi-contracts*. (See *Desny v. Wilder* (1956) 46 C.2d 715, 737, 299 P.2d 257; *Taggart v. Shepherd* (1932) 122 C.A. 755, 757, 10 P.2d 808; *Santa Clara v. Robbiano* (1960) 180 C.A.2d 845, 848, 5 C.R. 19; *Arcade County Water Dist. v. Arcade Fire Dist.* (1970) 6 C.A.3d 232, 236, 85 C.R. 737, *supra*, §102; 1 Corbin (Rev. ed.) §1.20; 1 Williston 4th, §1.6; Cal. Civil Practice, 3 Business Litigation, §34:1 et seq.; Cal. Transactions Forms, 1 Business Transactions §6:2; BAJI, No. 10.56 [Express or Implied Contracts]; CACI, No. 305 [Implied-in-Fact Contract]; on right to restitution or quasi-contractual recovery, see *infra*, §1013 et seq.)

"Quasi-contracts have often been called implied contracts or contracts implied in law; but, unlike true contracts, quasi-contracts are not based on the apparent intention of the parties to undertake the performances in question, nor are they promises. They are obligations created by law for reasons of justice." (*Rest.2d, Contracts §4, Comment b.*)

This distinction is the basis of several important decisions in the field of literary plagiarism. The plaintiff submits an *idea* that, unlike a complete literary work, is not a protectible property interest, i.e., is not a subject of exclusive ownership. (See 13 *Summary* (10th), *Personal Property*, §§69, 70.) The use of the idea by the defendant is not unjust enrichment and will not support recovery in quasi-contract. But the disclosure of the idea may be the conferring of a benefit on the promisor, so as to constitute consideration for either an express promise or contract implied in fact. (See *Weitzenkorn v. Lesser* (1953) 40 C.2d 778, 792, 256 P.2d 947; *Desny v. Wilder*, *supra*, 46 C.2d 738; *Thompson v. California Brewing Co.* (1957) 150 C.A.2d 469, 473, 310 P.2d 436; *Chandler v. Roach* (1957) 156 C.A.2d 435, 440, 219 P.2d 776; 27 *So. Cal. L. Rev.* 133, 298.)

"There cannot be a valid express contract and an implied contract, each embracing the same subject matter, existing at the same time. ... The reason for the rule is simply that where the parties have freely, fairly, and voluntarily bargained for certain benefits in exchange for undertaking certain obligations, it would be inequitable to imply a different liability and to withdraw from one party benefits for which he has bargained and to which he is entitled." (*Wal-Noon Corp. v. Hill* (1975) 45 C.A.3d 605, 613, 119 C.R. 646; see *Hedging Concepts v. First Alliance Mortg. Co.* (1996) 41 C.A.4th 1410, 1419, 49 C.R.2d 191 [finding that parties formed actual contract conditioning plaintiff's right to payment on procurement of certain financial transaction precluded implied-in-law duty of defendant to pay money to plaintiff, where plaintiff failed to procure transaction but only provided list of companies doing that business; quoting *Wal-Noon*

Corp. v. Hill , supra.)

SUPPLEMENT: [This section is current through the latest supplement]
See 1 Williston 4th (2007 ed.), §1:6.



104 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
 IV. CATEGORIES OF CONTRACT
 B. Express, Implied, and Quasi-Contracts.
 3. Statutory Obligations.

1 Witkin Sum. Cal. Law Contracts § 104

[§ 104] Statutory Obligations.

In interpreting statutes dealing with claims "arising upon contract" to cover quasi-contractual obligations, the term "quasi-contract" is sometimes applied to statutory obligations that cannot be accurately classified as strictly contractual or tortious. (See *People v. Zegras* (1946) 29 C.2d 67, 68, 69, 172 P.2d 883 [venue: classification held unnecessary where act expressly provided for enforcement of statutory liability in same manner as contractual obligation]; *Hays v. Bank of America* (1945) 71 C.A.2d 301, 306, 162 P.2d 679 [probate: employee's claim against estate of decedent employer, for overtime wages due under federal Fair Labor Standards Act, held quasi-contractual]; *Smith v. Minnesota Mut. Life Ins. Co.* (1948) 86 C.A.2d 581, 590, 195 P.2d 457 [survival: cause of action based upon failure of insurance company to act upon application for insurance characterized as founded upon "implied or quasi" contract and survived applicant's death].) (See 3 *Cal. Proc.* (4th), *Actions*, §138.)

Govt.C. 53150, 53151, and 53152 provide respectively that a person who, while operating a vehicle, boat, or civil aircraft under the influence of alcohol or drugs, negligently or intentionally causes "any incident resulting in an appropriate emergency response" by a public agency is liable for the expense of that response. *Govt.C. 53154* provides that the charge for this expense "constitutes a debt of that person and is collectible by the public agency incurring those costs in the same manner as in the case of an obligation under a contract, expressed or implied, except that liability ... shall not be insurable."

West's Key Number Digest, Contracts k.2-

SUPPLEMENT: [This section is current through the latest supplement]

Reimbursement of public agency for costs incurred in emergency response to incident resulting from operation of vehicle, boat, or aircraft under influence of alcohol or drugs: California Highway Patrol v. Superior Court (2006) 135 C.A.4th 488, 502, 38 C.R.3d 16, held that emergency response costs recoverable under *Govt.C. 53150 et seq.* included law enforcement expenses, such as salary costs incurred in ensuring public safety at scene, investigating incident, and, if appropriate, arresting and detaining operator. There is no statutory distinction between public safety functions and law enforcement functions, so long as they directly arise from the agency's response to the incident. (135 C.A.4th 502.)

Statutory obligations not classifiable as contractual:

Cross-Reference: 3 Cal. Proc. (5th), Actions, §143.



105 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
IV. CATEGORIES OF CONTRACT
C. Unilateral and Bilateral Contracts.
1. Nature and Presumptions.

1 Witkin Sum. Cal. Law Contracts § 105

[§ 105] Nature and Presumptions.

A unilateral contract is one in which a promise is given in exchange for some act, forbearance or thing; there is only one promisor. A bilateral contract is one in which there are mutual promises, a promise being given in consideration of another promise. (See *Davis v. Jacoby* (1934) 1 C.2d 370, 378, 34 P.2d 1026; *Chicago Bridge & Iron Co. v. Industrial Acc. Com.* (1964) 226 C.A.2d 309, 318, 38 C.R. 57, citing the text; 1 Corbin (Rev. ed.), §1.23; 1 Williston 4th, §1:17; 17A Am.Jur.2d (2004 ed.), *Contracts* §7 et seq.; Cal. Transactions Forms, 1 Business Transactions §6:4; 26 U.C. *Davis L. Rev.* 1 [Reassessing Unilateral Contracts: The Role of Offer, Acceptance and Promise].)

The Reporter's Note to Comment f of *Rest.2d, Contracts* §1 criticizes the distinction on the following grounds:

The First Restatement defined unilateral and bilateral contracts. This definition "has not been carried forward because of doubt as to the utility of the distinction, often treated as fundamental, between the two types."

"Moreover, as to bargains, the distinction tends to suggest, erroneously, that the obligation to repay a loan is somehow different if the actual delivery of the money was preceded by an advance commitment from the obligation resulting from a simultaneous loan and commitment. It also causes confusion in cases where performance is complete on one side except for an incidental or collateral promise, as where an offer to buy goods is accepted by shipment and a warranty is implied. Finally, the effect of the distinction has been to exaggerate the importance of the type of bargain in which one party begins performance without making any commitment, as in the classic classroom case of the promise to pay a reward for climbing a flagpole."

"The principal value of the distinction has been the emphasis it has given to the fact that a promise is often binding on the promisor even though the promisee is not bound by any promise. This value is retained in §25 on option contracts. But the terms unilateral and bilateral are generally avoided in this Restatement."

SUPPLEMENT: [This section is current through the latest supplement]
See 1 Williston 4th (2007 ed.), §1:17.



106 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
IV. CATEGORIES OF CONTRACT
C. Unilateral and Bilateral Contracts.
2. Presumption of Bilateral Contract.

1 Witkin Sum. Cal. Law Contracts § 106

[§ 106] Presumption of Bilateral Contract.

Most contracts are bilateral. And there is a general rule of interpretation, sometimes stated in the form of a presumption, in favor of a bilateral contract, which immediately and fully protects both parties. (See *Davis v. Jacoby* (1934) 1 C.2d 370, 380, 34 P.2d 1026; *Bandoni v. Walston* (1947) 79 C.A.2d 178, 183, 179 P.2d 365; 1 Corbin (Rev. ed.), §3.8; 1 Williston 4th, §4:11.)

Thus, in *Davis v. Jacoby*, *supra*, plaintiff wife's uncle wrote to plaintiffs in Canada, asking them to come to California and look after him and his wife. The letter stated: "So if you can come, Caro (plaintiff wife) will inherit everything. ... Will you let me hear from you as soon as possible." (1 C.2d 374.) Plaintiffs answered that they would come and commenced preparations. While so engaged, the uncle died, and plaintiffs came and took care of the aunt until her death. However, instead of leaving the property to plaintiff wife, the uncle's will left the property to defendants, who contended that the uncle's letter was only an offer to enter into a unilateral contract (which was revoked by death before performance) and that plaintiffs' letter of acceptance was thus ineffective. (1 C.2d 375.) *Held*, there is a presumption in favor of bilateral contracts, which, taken together with the uncle's request for a reply and the letter of acceptance, justified the conclusion that a bilateral contract was made, which plaintiffs could enforce against the devisees and legatees. (1 C.2d 374, 380.) (See 23 Cal. L. Rev. 213; 8 So. Cal. L. Rev. 152.)

This presumption was recognized in the First Contracts Restatement, but the Second Restatement replaced it with a different formulation: "In case of doubt an offer is interpreted as inviting the offeree to accept either by promising to perform what the offer requests or by rendering the performance, as the offeree chooses." (*Rest.2d, Contracts* §32.)

SUPPLEMENT: [This section is current through the latest supplement]
See 1 Williston 4th (2007 ed.), §4:14.



107 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
IV. CATEGORIES OF CONTRACT
C. Unilateral and Bilateral Contracts.
3. Illustrations of Unilateral Contracts.

1 Witkin Sum. Cal. Law Contracts § 107

[§ 107] Illustrations of Unilateral Contracts.

The following are common illustrations of unilateral contracts:

- (1) A bilateral contract that has become unilateral by full performance on one side. (See *infra*, §§370, 867, 868.)
- (2) An option to purchase. In its inception, it is a unilateral contract, although if exercised it gives rise to a bilateral contract between buyer and seller. (*Chrisman v. Southern Calif. Edison Co. (1927) 83 C.A. 249, 255, 256 P. 618; Newberger v. Rifkind (1972) 28 C.A.3d 1070, 1075, 104 C.R. 663; infra*, §§171, 172.)
- (3) A contract unilateral in its inception and remaining unilateral until acceptance or revocation. (See, e.g., *infra*, §§166, 208 et seq.)
- (4) A general listing with a real estate broker. (*Baumgartner v. Meek (1954) 126 C.A.2d 505, 508, 272 P.2d 552* ["Basically, a brokerage listing is an offer of a unilateral contract, the act requested being the procuring by the broker of a purchaser ready, able and willing to buy upon the terms stated in the offer"]; *Tetrick v. Sloan (1959) 170 C.A.2d 540, 546, 339 P.2d 613; Richardson v. Rose (1961) 197 C.A.2d 318, 322, 17 C.R. 84; 8 U.C.L.A. L. Rev. 153.*)
- (5) A promissory note or check. Although a *check* is in form an *order*, it "imports" a promise to pay, i.e., the drawer impliedly promises to pay the holder. (See *Roff v. Crenshaw (1945) 69 C.A.2d 536, 539, 159 P.2d 661; Gambord Meat Co. v. Corbari (1952) 109 C.A.2d 161, 162, 240 P.2d 342.*)

There are, however, no fixed categories of unilateral contracts. (See *Anchor Cas. Co. v. Surety Bond Savings & Loan Assn. (1962) 204 C.A.2d 175, 182, 22 C.R. 278* [execution of bond in exchange for conditional promise to disburse sum of money]; on breach of unilateral contract as theory of subpurchaser's cause of action against manufacturer, see *8 U.C.L.A. L. Rev. 267*; and see *infra*, §§182, 198, 199, 208 et seq.)

Where the offeror tenders money, property, or services in exchange for the offeree's promise to pay for them, the result is a "reverse unilateral contract"; i.e., the offeror offers performance without making a promise, and the offeree accepts by making the required promise. (*Rest.2d, Contracts §55, Comment a*; see *68 So. Cal. L. Rev. 1239* [shrinkwrap license, i.e., paper enclosed in software package and stating that by opening package, recipient agrees to certain license terms, as reverse unilateral contract].)

SUPPLEMENT: [This section is current through the latest supplement]



108 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
IV. CATEGORIES OF CONTRACT

- D. Joint and Several Contracts.
 - 1. Joint and Several Obligations.
 - a. Nature and Distinctions.
 - 1. In General.

1 Witkin Sum. Cal. Law Contracts § 108

[§ 108] In General.

An obligation imposed on several persons may be (1) joint, (2) joint and several, or (3) several. (C.C. 1430; see *Rest.2d, Contracts* §§288, 289, and Introductory Note, p. 401; Corbin §923 et seq.; 12 Williston 4th, §36:1 et seq.; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §418 et seq.; 5A *Am.Jur. Legal Forms 2d* (2004 ed.), §68:17 et seq.) Which type exists under a particular contract depends upon the intention of the parties, and, where the intention is clear, no statutory presumption applies. (*Farmers' Exchange Bank v. Morse* (1900) 129 C. 239, 242, 61 P. 1088; *Carpenter v. Elmer R. Sly Co.* (1930) 109 C.A. 539, 545, 293 P. 162.)

Where the intention is not clear, the presumptions are as follows:

(1) An obligation imposed upon a number of persons is presumed to be *joint*, with certain exceptions. (C.C. 1431; see *infra*, §109.)

(2) An obligation is presumed to be *joint and several* where the promise is in the singular but executed by several, or where all the parties receive some benefit. (See *infra*, §109.)

(3) A *several* obligation only arises where words of severance disclose this intention. (See *infra*, §110.)

Under some facts, one obligor may have the primary obligation and the other obligor only a secondary obligation. In that case, the secondary obligor may be characterized as a guarantor whose duty to pay only commences if the primary obligor defaults. Thus, if the primary obligor makes full payment, the secondary obligor is exonerated. (See *Quality Wash Group V, Ltd. v. Hallak* (1996) 50 C.A.4th 1687, 1699, 58 C.R.2d 592.)

West's Key Number Digest, Insurance k.105

SUPPLEMENT: [This section is current through the latest supplement]
See 9 Corbin (Rev. ed.), §52.1 et seq.



109 of 115 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law
IV. CATEGORIES OF CONTRACT

- D. Joint and Several Contracts.
 - 1. Joint and Several Obligations.
 - a. Nature and Distinctions.
 - 2. Joint and Several Obligation.

1 Witkin Sum. Cal. Law Contracts § 109

[§ 109] Joint and Several Obligation.

The exceptions, under which the obligation is presumed to be *joint and several*, are:

(1) Where all the parties *receive some benefit from the consideration*, whether past or present. (C.C. 1659; see *Gummer v. Mairs* (1903) 140 C. 535, 537, 74 P. 26; *Shelton v. Michael* (1916) 31 C.A. 328, 330, 160 P. 578; *Webb v. Casassa* (1927) 82 C.A. 307, 312, 255 P. 541; *Keppelman v. Heikes* (1952) 111 C.A.2d 475, 481, 245 P.2d 54; *Kaneko v. Okuda* (1961) 195 C.A.2d 217, 225, 15 C.R. 792.)

(2) Where the promise is made in the singular number, but is executed by each of the parties (so that each says in effect, "I agree"). (C.C. 1660; see *Webb v. Casassa*, *supra*.)

In practice, most obligations of several persons appear to be joint and several. In *Dewing v. Chow* (1933) 129 C.A. 441, 445, 19 P.2d 12, the court said: "[D]espite the apparent general character of section 1431, a joint contractual liability is quite an unusual creature under the law. The section is robbed of much of its apparent import by the language of section 1659. Another despoiler of its effect is section 1660." (See *Dabney v. Dabney* (1935) 9 C.A.2d 665, 674, 51 P.2d 108; *Garthofner v. Edmonds* (1946) 74 C.A.2d 15, 18, 167 P.2d 789 [joint and several obligation results where married woman joins with husband in promise to pay debt for money lent to them].)

SUPPLEMENT: [This section is current through the latest supplement]



110 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
IV. CATEGORIES OF CONTRACT

- D. Joint and Several Contracts.
 - 1. Joint and Several Obligations.
 - a. Nature and Distinctions.
 - 3. Several Obligation.

1 Witkin Sum. Cal. Law Contracts § 110

[§ 110] Several Obligation.

An example of a purely several obligation is a contract signed by a number of persons, each agreeing to pay a particular sum set opposite his or her name. There is clearly no joint or joint and several liability; the document is, in practical effect, equivalent to a series of individual contracts. (*George Herz & Co. v. Solt* (1937) 23 C.A.2d 178, 180, 72 P.2d 251; see *Douglas v. Bergere* (1949) 94 C.A.2d 267, 271, 210 P.2d 727 [presumption of joint and several obligation declared by C.C. 1659 is rebuttable; promises held to be several].)

West's Key Number Digest, Contracts k.183

SUPPLEMENT: [This section is current through the latest supplement]



111 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
IV. CATEGORIES OF CONTRACT

- D. Joint and Several Contracts.
 - 1. Joint and Several Obligations.
 - b. Performance and Discharge.

1 Witkin Sum. Cal. Law Contracts § 111

[§ 111] Performance and Discharge.

(1) *Performance*. Performance by one joint, or joint and several promisor, extinguishes the liability of the others to the promisee. (C.C. 1474; see *Harris v. King* (1931) 113 C.A. 357, 362, 298 P. 100.)

(2) *Release*. A release of one of two or more joint debtors does not extinguish the obligations of any of the others, unless they are mere guarantors; nor does it affect their right to contribution from him or her, *except as provided in C.C.P. 877* (see 5 *Summary* (10th), *Torts*, §71 et seq.). (C.C. 1543; see *Brown v. Pacific Coast Agency* (1921) 53 C.A. 788, 791, 200 P. 977; *Bank of America v. Duer* (1941) 47 C.A.2d 100, 102, 117 P.2d 405 [one of two joint judgment debtors]; *Oil Tool Exchange v. Schuh* (1944) 67 C.A.2d 288, 295, 153 P.2d 976 [one of two joint guarantors]; 12 Williston 4th, §36:18 et seq.; on coobligor's contribution status generally, see *infra*, §113.) The statutory exception regarding contribution applies to a good faith release, given before verdict or judgment. Under these circumstances, a release discharges "the party to whom it is given from all liability for any contribution to any other parties." (C.C.P. 877(b).) However, this exception does not apply to coobligors who expressly agreed in writing to an apportionment of liability among themselves, or to a release given on a debt where the contract was made prior to January 1, 1988. (C.C.P. 877(c), (d).)

If the joint debtors are *principal and guarantor*, release of the principal will discharge the guarantor (or surety) under general rules of suretyship. (C.C. 1543; *Oil Tool Exchange v. Schuh*, *supra*; on suretyship contracts, see *infra*, §1002 et seq.)

(3) *Settlement*. C.C.P. 877.6 (see 5 *Summary* (10th), *Torts*, §83 et seq.) provides that a determination by the court that a settlement was made in good faith "shall bar any other joint tortfeasor or *co-obligor* from any further claims against the settling tortfeasor or *co-obligor* for equitable comparative contribution, or partial or comparative indemnity, based on comparative negligence or comparative fault." (C.C.P. 877.6(c); on comparative negligence and right to comparative partial indemnity, see 6 *Summary* (10th), *Torts*, §1327 et seq.) (See 24 Southwestern U. L. Rev. 1157 [Settlement of Complex Environmental Insurance Coverage Cases Under the California Code of Civil Procedure].)

(4) *Death*. The death of one joint obligor does not release the others. (*Forbes v. Board of Missions of Methodist Episcopal Church, South* (1941) 17 C.2d 332, 338, 110 P.2d 3.)

SUPPLEMENT: [This section is current through the latest supplement]



112 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
IV. CATEGORIES OF CONTRACT

D. Joint and Several Contracts.
1. Joint and Several Obligations.
c. Action and Judgment.

1 Witkin Sum. Cal. Law Contracts § 112

[§ 112] Action and Judgment.

(1) *Action: Joinder of Parties.* Under the common law rule originally stated in the California Codes, if the obligation was joint, the plaintiff had to join all the obligors. (See *Farmers' Exchange Bank v. Morse* (1900) 129 C. 239, 243, 61 P. 1088; *Hansen v. Burford* (1931) 212 C. 100, 108, 297 P. 908; *Merchants' Nat. Bank of Los Angeles v. Clark-Parker Co.* (1932) 215 C. 296, 299, 9 P.2d 826; 12 Williston 4th, §36:29 et seq.) On the other hand, if it was joint and several, the obligee could sue any one of the obligors without joining the rest. (See *Gummer v. Mairs* (1903) 140 C. 535, 537, 74 P. 26; *Moreing v. Weber* (1906) 3 C.A. 14, 22, 84 P. 220; *Webb v. Casassa* (1927) 82 C.A. 307, 312, 255 P. 541.)

The requirement of compulsory joinder was eliminated in 1971. (See 4 *Cal. Proc.* (4th), *Pleading*, §179 et seq.)

(2) *Judgment.* The general rule makes a judgment against any joint obligor effective to discharge the others. But in California, the creditor is entitled to join the joint debtors, and, though unable to serve all, may take judgment against those served and later enforce it against the others in a summary proceeding. (*C.C.P.* 410.70, 578, 579, 989, 990; see *Merchants' Nat. Bank v. Clark-Parker Co.*, supra; 12 Williston 4th, §36:34 et seq.; 7 *Cal. Proc.* (4th), *Judgment*, §40; 8 *Cal. Proc.* (4th), *Enforcement of Judgment*, §389 et seq.)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Action: Joinder of Parties.*

Elimination of compulsory joinder:

Cross-Reference: 4 *Cal. Proc.* (5th), *Pleading*, §198 et seq.

(2) *Judgment.*

Cross-References: 7 *Cal. Proc.* (5th), *Judgment*, §40; 8 *Cal. Proc.* (5th), *Enforcement of Judgment*, §398 et seq.



113 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
IV. CATEGORIES OF CONTRACT

D. Joint and Several Contracts.

1. Joint and Several Obligations.

d. Contribution.

1 Witkin Sum. Cal. Law Contracts § 113

[§ 113] Contribution.

"[A] party to a joint, or joint and several obligation, who satisfies *more* than his share of the claim against all, may require a proportionate contribution from all the parties joined with him. (C.C. 1432; see *C.C.P. 882(a)*; *Hurlbut v. Quigley* (1919) 180 C. 265, 271, 180 P. 613; *Rest., Restitution §81* et seq.; 29 *Cal. L. Rev.* 65; on exception where party has given good faith release, see *supra*, §1042.) However, even after making full payment, a principal obligor on a note does not have the right to seek contribution against a coobligor who is only *secondarily liable* on the note. (See *Quality Wash Group V, Ltd. v. Hallak* (1996) 50 C.A.4th 1687, 1699, 58 C.R.2d 592, *supra*, §108.)

"If the judgment is based upon an obligation of one judgment debtor *as surety* for another and the surety satisfies the judgment or *any part* thereof, whether voluntarily or through enforcement procedures, the surety may compel repayment from the principal." (*C.C.P. 882(b)*.) However, it has been declared that a *cosurety* has no right of contribution until he or she has *fully paid* the principal obligation. (*Jackson v. Lacy* (1940) 37 C.A.2d 551, 559, 100 P.2d 313; see criticism, 29 *Cal. L. Rev.* 65.)

West's Key Number Digest, Contracts k.181.1

SUPPLEMENT: [This section is current through the latest supplement]



114 of 115 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law
IV. CATEGORIES OF CONTRACT
D. Joint and Several Contracts.
2. Joint and Several Rights.

1 Witkin Sum. Cal. Law Contracts § 114

[§ 114] Joint and Several Rights.

There may also be joint, several, or joint and several *rights*, where there are a number of promisees or creditors. (C.C. 1430; see *Rest.2d, Contracts* §297 et seq.; Corbin §939 et seq.; 12 Williston 4th, §§36:7, 36:8, 36:10.) The presumption is that a right is *joint*, and this presumption can be overcome only by *express words* to the contrary. (C.C. 1431.)

Performance or tender of performance to any joint promisee is sufficient. (C.C. 1475, 1488; see *Hoover v. Wolfe* (1914) 167 C. 337, 342, 139 P. 794; *Rest.2d, Contracts* §299; 24 So. Cal. L. Rev. 306.) In *Cober v. Connolly* (1942) 20 C.2d 741, 128 P.2d 519, one joint creditor authorized the debtor to furnish goods and services to him alone, in part payment. *Held*, this discharge pro tanto was good against the other joint creditors. (20 C.2d 744.)

SUPPLEMENT: [This section is current through the latest supplement]
See 9 Corbin (Rev. ed.), §52.14 et seq.



115 of 115 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
IV. CATEGORIES OF CONTRACT
E. Judgment as Contract.

1 Witkin Sum. Cal. Law Contracts § 115

[§ 115] Judgment as Contract.

Although a judgment arises by operation of law and not by voluntary agreement, the California courts have held that, for certain purposes, a judgment is included within the meaning of the term "contract." (See *London Guarantee & Acc. Co., Ltd. v. Industrial Acc. Com.* (1919) 181 C. 460, 465, 184 P. 864 [interlocutory decree of divorce described as contract determining rights of parties]; *Miller v. Murphy* (1921) 186 C. 344, 347, 199 P. 525 [statute referring to cause of action "arising upon contract"]; *Becker v. Becker* (1950) 36 C.2d 324, 326, 223 P.2d 479 [same]; 3 Cal. Proc. (4th), Actions, §136; for a discussion of conflicting views on this point, see 24 So. Cal. L. Rev. 484.)

In *Colvig v. RKO General* (1965) 232 C.A.2d 56, 42 C.R. 473, a judgment confirmed an arbitration award recognizing plaintiff's right to continued employment as a staff radio announcer. *Held*, the judgment was a proper basis for a contract action for damages for breach of its terms. (232 C.A.2d 65.) (On unconfirmed award, see *infra*, §1011.)

SUPPLEMENT: [This section is current through the latest supplement]
Cross-Reference: 3 Cal. Proc. (5th), Actions, §141.



1 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law V. FORMATION: MUTUAL CONSENT A. Objective Theory. 1. In General.

1 Witkin Sum. Cal. Law Contracts § 116

[§ 116] In General.

Every contract requires consenting parties. (See C.C. 1550, 1565.) However, there need not be a subjective meeting of the minds; in the absence of fraud, mistake, etc. (see *infra*, §256 et seq.), the outward *manifestation* or *expression* of consent is controlling. In other words, mutual consent is gathered from the reasonable meaning of the words and acts of the parties, and not from their unexpressed intentions or understanding. "By the modern law of contract, the mere state of mind of the parties--with reference to the 'meeting of the minds'--is not the essential object of inquiry, the terms of the promise-act being determinable by an *external* and not by an internal standard ... or by what distinguished writers have termed the *objective* rather than the *subjective test*." (*Zurich General Acc. & Liab. Assur. Co., Ltd. v. Industrial Acc. Com.* (1933) 132 C.A. 101, 104, 22 P.2d 572.)

This fundamental rule is constantly restated by courts and commentators. (See *Brant v. California Dairies* (1935) 4 C.2d 128, 133, 48 P.2d 13; *King v. Stanley* (1948) 32 C.2d 584, 591, 197 P.2d 321; *Horacek v. Smith* (1948) 33 C.2d 186, 193, 199 P.2d 929 [undisclosed intentions do not establish terms of contract]; *Donovan v. RRL Corp.* (2001) 26 C.4th 261, 270, 109 C.R.2d 807, 27 P.3d 702, *infra*, §264 [it was error to base trial court's conclusion that advertisement did not constitute offer solely on that court's factual determination that low price in advertisement was result of good faith mistake, because under objective theory of mutual assent, mistake was relevant in determining whether there was a contract, not an offer]; *Lande v. Southern Calif. Freight Lines* (1948) 85 C.A.2d 416, 420, 193 P.2d 144 ["A contract or agreement in legal contemplation is neither written nor oral, but oral or written evidence may be received to establish the terms of the contract or agreement between the parties"]; *Leo F. Piazza Paving Co. v. Bebek & Brkich* (1956) 141 C.A.2d 226, 230, 296 P.2d 368; *H.S. Crocker Co. v. McFaddin* (1957) 148 C.A.2d 639, 643, 307 P.2d 429, 4 Summary (10th), Sales, §46; *Crow v. P.E.G. Const. Co.* (1957) 156 C.A.2d 271, 277, 319 P.2d 47; *Houghton v. Kerr Glass Mfg. Corp.* (1968) 261 C.A.2d 530, 537, 68 C.R. 43; *Larsen v. Johannes* (1970) 7 C.A.3d 491, 501, 503, 86 C.R. 744; *Meyer v. Benko* (1976) 55 C.A.3d 937, 942, 127 C.R. 846, citing the text ["Deposit Receipt and Agreement of Sale" of real property]; *Estate of Wilson* (1976) 64 C.A.3d 786, 802, 134 C.R. 749, citing the text; *Blumenfeld v. R.H. Macy & Co.* (1979) 92 C.A.3d 38, 46, 154 C.R. 652, citing the text; *Merced County Sheriff's Employees' Assn. v. Merced* (1987) 188 C.A.3d 662, 672, 233 C.R. 519, citing the text; *Weddington Productions v. Flick* (1998) 60 C.A.4th 793, 811, 71 C.R.2d 265, quoting the text; *Binder v. Aetna Life Ins. Co.* (1999) 75 C.A.4th 832, 851, 89 C.R.2d 540, quoting the text; *Money Store Inv. Corp. v. Southern Calif. Bank* (2002) 98 C.A.4th 722, 728, 120 C.R.2d 58; *Rest.2d, Contracts* §17; 1 Corbin (Rev. ed.), §§1.9, 4.12, 4.13; 1 Williston 4th, §§4:1, 4:2; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §§30, 31; Cal.

Transactions Forms, 1 Business Transactions Forms §6:20; 17 *Cal. L. Rev.* 441; 74 *Cal. L. Rev.* 189; 44 *Hastings L. J.* 621 [precontractual bargaining]; 34 *San Diego L. Rev.* 1263, 1328 [contract formation on Internet]; 39 *San Diego L. Rev.* 1363 [same]; 25 *Thomas Jefferson L. Rev.* 1 [same]; 24 *So. Cal. L. Rev.* 490; BAJI, No. 10.57 [Oral and Written Contracts]; BAJI, No. 10.60 [[Mutual Consent]; CACI, No. 309 [Contract Formation--Acceptance], CACI, No. 310 [Contract Formation--Acceptance by Silence].)

West's Key Number Digest, Contracts k.10(1)

SUPPLEMENT: [This section is current through the latest supplement]

See *Lachtman v. Regents of Univ. of Calif.* (2007) 158 *C.A.4th* 187, 208, 70 *C.R.3d* 147 [genuine issues of material fact existed as to whether state university student's diversity fellowship created contractual relationship with university, and, if so, whether such contract was fully performed, precluding summary judgment on student's claims that university breached such contract and breached implied covenant of good faith and fair dealing with regard to fellowship]; *Rodriguez v. Bank of the West* (2008) 162 *C.A.4th* 454, 460, 75 *C.R.3d* 543 [lawyer was not "customer" of, and thus had no contractual relationship with, banks where lawyer's office manager opened accounts in lawyer's name; banks owed no duty of care to lawyer, even if office manager forged lawyer's name on signature card, where lawyer did not consent to creation of accounts and did not know of accounts' existence until after office manager stole client funds from accounts]; 1 *Williston 4th* (2007 ed.), §§4:1, 4:2; C.E.B., *Law of Contracts* §3.2 et seq.



2 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law V. FORMATION: MUTUAL CONSENT A. Objective Theory. 2. How Consent Manifested.

1 Witkin Sum. Cal. Law Contracts § 117

[§ 117] How Consent Manifested.

The manifestation of mutual consent is usually accomplished through the medium of an *offer* (infra, §125 et seq.) communicated to the offeree and an *acceptance* (infra, §180 et seq.) communicated to the offeror. (See *American Bldg. Maintenance Co. v. Indemnity Ins. Co. of North America* (1932) 214 C. 608, 615, 7 P.2d 305; *Moorpark v. Moorpark Unified School Dist.* (1991) 54 C.3d 921, 930, 1 C.R.2d 896, 819 P.2d 854, citing the text; *Patterson v. Clifford F. Reid* (1933) 132 C.A. 454, 456, 23 P.2d 35; *Rest.2d, Contracts* §§22(1), 23, 24; 1 Corbin (Rev. ed.), §1.11; 1 Williston 4th, §§4:3 et seq., 4:13 et seq.; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §§45, 46; Cal. Civil Practice, 3 Business Litigation, §24:34 et seq.; Cal. Transactions Forms, 1 Business Transactions §6:13 et seq.; 83 *Cal. L. Rev.* 547 [application of doctrine of offer and acceptance as dependent on effect of transaction on distribution of wealth between parties]; 48 *Stanf. L. Rev.* 481 [contract formation as based on efficient reliance by one party on conduct of other party]; BAJI, No. 10.65 [Offer]; CACI, No. 307 [Contract Formation--Offer].)

A manifestation may be made "even though neither offer nor acceptance can be identified and even though the moment of formation cannot be determined." (*Rest.2d, Contracts* §22(2); see *Bundsen v. Work. Comp. App. Bd.* (1983) 147 C.A.3d 106, 110, 195 C.R. 10, 2 *Summary* (10th), *Workers' Compensation*, §113, quoting Restatement and citing the text.) Furthermore, the manifestation may be partly written and partly oral statements or acts; e.g., a written offer and an oral acceptance or acceptance by conduct. (See *Griffith v. Buckman* (1947) 81 C.A.2d 454, 458, 184 P.2d 179; *Estate of Grace* (1948) 88 C.A.2d 956, 962, 200 P.2d 189.) *Rest.2d, Contracts* §19, emphasizes the point that consent may be manifested by conduct as well as words:

(1) The manifestation may be made wholly or partly by written or spoken words or by other acts or by failure to act.

(2) The conduct of a party is not effective as a manifestation of consent unless the party intends to engage in the conduct and knows or has reason to know that the other party may infer consent from the conduct.

(3) The conduct of a party may manifest consent even though the party does not in fact consent. In such cases, a resulting contract may be voidable because of fraud, duress, mistake, or other invalidating cause.

Thus, a "letter of intent," containing the necessary elements of a contract, can constitute a binding contract,

depending on the expectations of the parties; and these expectations may be inferred from the conduct of the parties and surrounding circumstances. (*California Food Service Corp. v. Great Amer. Ins. Co.* (1982) 130 C.A.3d 892, 897, 182 C.R. 67.) (See 1 Corbin (Rev. ed.), §1.11.)

West's Key Number Digest, Contracts k.18

SUPPLEMENT: [This section is current through the latest supplement]
See 1 Williston 4th (2007 ed.), §§4:3 et seq., 4:16 et seq.



3 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT

A. Objective Theory.
3. Negligence in Signing or Accepting Instrument.

1 Witkin Sum. Cal. Law Contracts § 118

[§ 118] Negligence in Signing or Accepting Instrument.

Ordinarily, one who accepts or signs an instrument, which on its face is a contract, is deemed to consent to all its terms, and cannot escape liability on the ground that he or she has not read it. If the person cannot read, he or she should have it read or explained. (*Greve v. Taft Realty Co. (1929) 101 C.A. 343, 351, 281 P. 641; Security First Nat. Trust & Savings Bank v. Loftus (1933) 129 C.A. 650, 654, 19 P.2d 297; Randas v. YMCA of Metropolitan Los Angeles (1993) 17 C.A.4th 158, 163, 21 C.R.2d 245*, quoting the text; see 7 Corbin (Rev. ed.), §28.38; 1 Williston 4th, §4:16; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §210.) Fraud, or a confidential relationship giving rise to an affirmative duty of disclosure, are obvious exceptions to this rule. (See *infra*, §§282, 301, 318.) (On right of insured requesting special coverage to rely on company's promise to provide that coverage even though policy as written differs, see 2 *Summary* (10th), *Insurance*, §28; on principle of disclosure in contract law generally, see 91 *Cal. L. Rev.* 1645.)

SUPPLEMENT: [This section is current through the latest supplement]
See 1 Williston 4th (2007 ed.), §4:19.



4 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT

A. Objective Theory.

4. Ignorance of Contractual Nature or Terms of Instrument.

a. Contractual Terms Apparent to Reasonable Person.

1. General Rule.

1 Witkin Sum. Cal. Law Contracts § 119

[§ 119] General Rule.

If a writing appears on its face to be an offer or proposed contract, and it is delivered by one party to another, the receipt thereof may constitute a manifestation of acceptance. The acceptor will be bound by all of its terms, though ignorant of the fact that it is an agreement or, knowing it is an agreement, ignorant of some or all of its terms. (See *Constantian v. Mercedes-Benz Co.* (1936) 5 C.2d 631, 634, 55 P.2d 841; *Cunningham v. International Com. Y.M.C.A.* (1921) 51 C.A. 487, 490, 197 P. 140; *Larrus v. First Nat. Bank of San Mateo County* (1954) 122 C.A.2d 884, 889, 266 P.2d 143; *Rest.2d, Contracts §211*; *infra*, §120.)

SUPPLEMENT: [This section is current through the latest supplement]



5 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT

A. Objective Theory.

4. Ignorance of Contractual Nature or Terms of Instrument.

a. Contractual Terms Apparent to Reasonable Person.

2. Illustrations.

1 Witkin Sum. Cal. Law Contracts § 120

[§ 120] Illustrations.

(1) *Baggage or Claim Check*. A baggage or other claim check that appears to be a contract and not a mere identification tag is binding. (*Cunningham v. International Com. Y.M.C.A. (1921) 51 C.A. 487, 490, 197 P. 140*; see *Rest.2d, Contracts §211*; 5 *Stanf. L. Rev. 418*; but see *infra*, §123.)

(2) *Railroad Ticket*. A ticket may contain contractual terms binding if brought to the notice of the passenger. (See *C.C. 2176*; *Ames v. Southern Pac. Co. (1904) 141 C. 728, 731, 75 P. 310*; 18 *Cal. L. Rev. 441*.)

(3) *Bill of Lading*. A bill of lading is both a receipt for goods and a contract for their carriage. (*Pioneer Fruit Co. v. Southern Pac. Co. (1920) 47 C.A. 44, 46, 190 P. 50*; see 4 *Summary (10th), Sales, §138*.)

(4) *Bank Signature Card*. Although it has been held that the mere acceptance of a bank passbook does not bring this rule into operation (*Los Angeles Inv. Co. v. Home Savings Bank of Los Angeles (1919) 180 C. 601, 614, 182 P. 293*, *infra*, §122), the signing of a signature card is a consent to contractual terms. In *Larrus v. First Nat. Bank of San Mateo County (1954) 122 C.A.2d 884, 889, 266 P.2d 143*, the court said: "Here the clause is clearly printed in the only sentence on the face of the signature card. The card was not printed in such a manner that it tended to conceal the fact that it was an express acceptance of the bank's rules and regulations. Plaintiffs, who had the cards overnight at their home, had the opportunity to read the short text just above the spaces for their signatures and to ask for the rules and regulations it referred to if they did not wish to subject themselves to them in ignorance of their contents. Having signed and returned the cards without doing so they are bound." (See also *Perdue v. Crocker Nat. Bank (1985) 38 C.3d 913, 922, 216 C.R. 345, 702 P.2d 503*, *infra*, §339.) (On signature card as a contract of adhesion, see *Perdue, supra*, 38 *C.3d* 924, 928, *infra*, §339.)

(5) *Delivery Sheets and Similar Writings*. Frequently, printed *conditions* or disclaimers are contained in delivery sheets, order blanks, billheads, or letters, which are not specially referred to nor called to the attention of the other party. Where the test is met, they may be held part of a contract of sale. (See *Marin Storage & Trucking v. Benco Contracting & Engineering (2001) 89 C.A.4th 1042, 1049, 107 C.R.2d 645* [form entitled "Work Authorization and Contract," which stated that it was contract and that it included all terms on reverse side, was contract satisfying mutual assent

requirement, considering long work-history between parties].)

Thus, in *Constantian v. Mercedes-Benz Co.* (1936) 5 C.2d 631, 55 P.2d 841, defendant received personal property as lessee. The "delivery sheet" contained a printed term at the bottom: "Renters responsible for loss or damage of goods while in their possession." This statement was never called to the attention of defendant's agents, but the document was signed by its agent. *Held*, the statement was part of the contract of bailment, because the sheet was brief, a duplicate was retained, and the condition was plainly printed. (5 C.2d 634.) (See *George v. Bekins Van & Storage Co.* (1949) 33 C.2d 834, 848, 205 P.2d 1037; *Page v. Ace Van & Storage Co.* (1948) 87 C.A.2d 294, 297, 196 P.2d 816 [plaintiff bailor bound by limitation of liability in warehouse receipt where terms plain, instrument signed by her, and copy given her]; 13 Summary (10th), *Personal Property*, §§175, 176.)

In *Nelkin v. Marvin Hime & Co.* (1964) 228 C.A.2d 744, 39 C.R. 701, plaintiff wholesaler sent \$ 25,000 worth of jewelry on consignment to defendant retail jeweler. The memorandum accompanying delivery recited that defendant would be responsible for the value if the property were damaged, lost, stolen or destroyed, regardless of fault. Defendant, though not signing, accepted the memorandum without objection. The goods were stolen without defendant's negligence. At the trial, defendant showed that the parties disregarded some of the terms of the memorandum, e.g., the 10-day inspection period limitation. The trial judge concluded that the memorandum was only a receipt, not a contract modifying the ordinary bailment rule. *Held*, reversed. It contained contractual terms, and acceptance without objection resulted in a contract. The contractual terms could not be challenged by parol evidence, except to show that the parties did not intend the document to be a contract at all (see 2 Cal. Evidence (4th), *Documentary Evidence*, §102), and evidence of nonobservance of some terms did not prove that other terms were to have no efficacy. (228 C.A.2d 748.)

SUPPLEMENT: [This section is current through the latest supplement]

(5) *Delivery Sheets and Similar Writings.* See *Rodriguez v. American Technologies* (2006) 136 C.A.4th 1110, 1124, 39 C.R.3d 437 [arbitration clause in agreement entitled "WORK PROPOSAL AND AUTHORIZATION" was conspicuous, where underlying agreement looked like contract, above signature lines was paragraph indicating that some terms were on reverse side, and arbitration clause on reverse side was labeled with heading "ARBITRATION" in bold capital letters].



6 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT

A. Objective Theory.

4. Ignorance of Contractual Nature or Terms of Instrument.

b. Contractual Terms Not Apparent.

1. Test.

1 Witkin Sum. Cal. Law Contracts § 121

[§ 121] Test.

If the writing does not reasonably appear to be a contract, and its contractual terms are not called to the attention of the person who receives it, that person is not bound. (See *Los Angeles Inv. Co. v. Home Savings Bank of Los Angeles* (1919) 180 C. 601, 614, 182 P. 293, *infra*, §122; *Steven v. Fidelity & Cas. Co. of New York* (1962) 58 C.2d 862, 881, 27 C.R. 172, 377 P.2d 284, quoting the text; *India Paint & Lacquer Co. v. United Steel Products Corp.* (1954) 123 C.A.2d 597, 608, 267 P.2d 408; *Klein v. Asgrow Seed Co.* (1966) 246 C.A.2d 87, 97, 54 C.R. 609, 4 Summary (10th), Sales, §94; *California State Auto. Assn. Inter-Ins. Bureau v. Barrett Garages* (1967) 257 C.A.2d 71, 79, 64 C.R. 699 [claim check for automobile parked by attendant; attention not called to contractual provisions]; *Rest.2d, Contracts §211*; 7 Corbin (Rev. ed.), §28.38; 2 Williston 4th, §6:59; 17A Am.Jur.2d (2004 ed.), *Contracts §209*.)

West's Key Number Digest, Contracts k.10(1)

SUPPLEMENT: [This section is current through the latest supplement]

See 2 Williston 4th (2007 ed.), §6:60; 39 U.C. Davis L. Rev. 1545 [contractual consent to installation of spyware as unenforceable].



7 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT

A. Objective Theory.

4. Ignorance of Contractual Nature or Terms of Instrument.

b. Contractual Terms Not Apparent.

2. Illustrations.

1 *Witkin Sum. Cal. Law Contracts* § 122

[§ 122] Illustrations.

(1) *Bank Passbook*. A passbook is ordinarily not a contract but a mere receipt, and the presence of contractual terms would not be noticed by a depositor. In *Los Angeles Inv. Co. v. Home Savings Bank of Los Angeles* (1919) 180 C. 601, 182 P. 293, the passbook contained a special agreement changing the liability of defendant bank with respect to forged or altered checks and endorsements, but it was not signed by plaintiff depositor, and there was no evidence that these special terms had been brought to the attention of any of plaintiff's responsible officials. *Held*, the provision was a "trap for the unwary," and unenforceable. (180 C. 614.) (See *Frankini v. Bank of America* (1936) 12 C.A.2d 298, 305, 55 P.2d 232; *Frankini v. Bank of America* (1939) 31 C.A.2d 666, 675, 88 P.2d 790; 25 Cal. L. Rev. 711, 715; 4 *Summary* (10th), *Negotiable Instruments*, §87.)

(2) *Delivery Sheets and Similar Writings*. Where the contractual terms of a delivery sheet are not obvious, they may be denied enforcement. (See *Wilson v. Crown Transfer & Storage Co.* (1927) 201 C. 701, 711, 258 P. 596; *May Hosiery Mills v. G.C.Hall & Son* (1926) 77 C.A. 291, 294, 246 P. 332; *McQueen v. Tyler* (1943) 61 C.A.2d 263, 267, 142 P.2d 466 [trucking company's "freight bill," with fine print provision limiting liability; document signed by plaintiff, but provision not called to his attention]; *Windsor Mills v. Collins & Aikman Corp.* (1972) 25 C.A.3d 987, 993, 101 C.R. 347, citing the text ["acknowledgment of order" form, with inconspicuous fine print provision requiring arbitration; buyer had not been advised of provision and had no actual knowledge of it before receiving seller's demand for arbitration].)

Thus, in *Scott's Valley Fruit Exchange v. Growers Refrigeration Co.* (1947) 81 C.A.2d 437, 184 P.2d 183, defendant warehouseman was sued for negligent storage of plaintiff's fruit. He offered evidence that with each load received from plaintiff he gave a "hand receipt" which recited the date, lot number and quantity, and contained the printed statement: "Customer in accepting this receipt agrees to rules of our standard warehouse receipt and is bound thereby." The "standard" warehouse receipt contained various special limitations of liability. *Held*, plaintiff was not bound by the terms of the extrinsic document, for no copy of it had ever been furnished and its terms were not known to plaintiff nor called to his attention by defendant. (81 C.A.2d 449.) (See 5 *Stanf. L. Rev.* 423.)

Even if the delivery sheet is given the more pretentious designation of "invoice," the test remains the same, for an

"invoice" is a mere statement of the transaction and not a contract. Thus, in *India Paint & Lacquer Co. v. United Steel Products Corp.* (1954) 123 C.A.2d 597, 267 P.2d 408, plaintiff seller delivered defective paint to defendant buyer. The informal and incomplete duplicate "invoices" left with the goods contained a disclaimer of warranty in fine print at the bottom; the formal typewritten "invoice" sent later, complete with all details of the sale, contained no such disclaimer. *Held*, the disclaimer was not binding. The first invoice was merely a "bill of parcels" or receipt for delivery; its lack of contractual character showed on its face, particularly in view of the completeness and formality of the later invoice. (123 C.A.2d 606, 607.) And here the fine print was so located as easily to escape attention, and there was no evidence that the buyer's attention had ever been called to it. (123 C.A.2d 610.)

(3) *Money Order*. Purchasers of money orders may not be subjected to hidden service charges. (See *Cory v. Golden State Bank* (1979) 95 C.A.3d 360, 366, 157 C.R. 538 [service charge provision in small print on customer's copy; copy was not received until after purchase, and the provision was not normally brought to customer's attention thereafter].)

SUPPLEMENT: [This section is current through the latest supplement]



8 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT

A. Objective Theory.

4. Ignorance of Contractual Nature or Terms of Instrument.

c. Statutory Requirements.

1. In General.

1 Witkin Sum. Cal. Law Contracts § 123

[§ 123] In General.

(1) *Motor Vehicle Parking and Storage*. A regulation of the practice of imposing unsuspected contractual limitations of liability, although limited to motor vehicle parking and storage, is established by C.C. 1630. Such a printed bailment contract is not binding unless:

(a) "This contract limits our liability--read it" is printed at the top in capital letters of 10-point type or larger.

(b) All the provisions "are printed legibly" in 8-point type or larger.

(c) A copy of the contract "printed in large type, in an area at least 17 by 22 inches," is *posted* in a conspicuous place at each entrance of the parking lot. (See *California State Auto. Assn. Inter-Ins. Bureau v. Barrett Garages* (1967) 257 C.A.2d 71, 80, 64 C.R. 699 [sign posted 100-150 feet from place where motorists turned cars over to attendants, not compliance].)

The statute further authorizes the enactment of city ordinances on this subject "that are not less restrictive."

(2) *Retail Credit or Installment Sales*. Similar requirements are established by the Unruh Act for any retail credit or installment sale. (See 4 *Summary* (10th), *Sales*, §272.)

(3) *Subordination Agreement*. Similar requirements also exist for real property security instruments containing a subordination clause. (See 4 *Summary* (10th), *Security Transactions in Real Property*, §§51, 54.)

(4) *Sale of Motor Vehicles*. The Automobile Sales Finance Act (C.C. 2981 et seq.) regulates the type size for the basic provisions and required warnings. (See 4 *Summary* (10th), *Sales*, §241 et seq.)

(5) *Health Studio Services*. Notice of the buyer's right to cancel the contract must be printed near the signature line in at least 10-point boldface type. (C.C. 1812.85(b)(1); see 4 *Summary* (10th), *Sales*, §362.)

(6) *Home Solicitation*. A similar right to cancel notice, printed in the language used in the contract, is required for

home solicitation contracts. (C.C. 1689.7; see 4 *Summary* (10th), *Sales*, §329 et seq.)

SUPPLEMENT: [This section is current through the latest supplement]



9 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT

A. Objective Theory.

4. Ignorance of Contractual Nature or Terms of Instrument.

c. Statutory Requirements.

2. Of Translation.

1 Witkin Sum. Cal. Law Contracts § 124

[§ 124] Of Translation.

A special problem arises where a person enters into a disadvantageous written contract because he or she is unable to read English. (See *11 San Diego L. Rev.* 415.) This problem has been resolved for those literate in specified languages by C.C. 1632. (See *6 Pacific L. J.* 163; *7 Pacific L. J.* 276.) Hence, tradesmen or businessmen negotiating, orally or in writing, primarily in Spanish, Chinese, Tagalog, Vietnamese, and Korean must furnish, prior to execution, a translation of the contract or agreement in the language in which it was negotiated. (C.C. 1632(b).)

(1) *What Constitutes "Contract."* The term "contract" or "agreement" refers to the document creating the rights and obligations of the parties, as well as to any subsequent document making substantial changes in such rights and obligations. (C.C. 1632(g).)

(2) *Contracts Covered.* The statute covers the following: (a) retail installment sales contracts under C.C. 1801 et seq., automobile conditional sales contracts under C.C. 2981 et seq., and automobile leasing contracts under C.C. 2985.7 et seq.; (b) loans or extensions of credit that are unsecured or secured other than by real property and which are to be used primarily for personal, family or household purposes; (c) leases and other tenancy contracts for longer than 1 month on dwellings, apartments, or mobilehomes; (d) loans or extensions of credit for personal, family, or household purposes if subject to *B. & P.C. 10240* et seq. (real property loans), *Fin.C. 18000* et seq. (Industrial Loan Law), or *Fin.C. 22000* et seq. (California Finance Lenders Law); (e) legal services contracts with attorneys containing a statement of fees or charges. (C.C. 1632(b); see *Reyes v. Superior Court (1981) 118 C.A.3d 159, 162, 173 C.R. 267* [notice of repossession and deficiency under C.C. 2983.2, as document substantially affecting borrower's rights under loan contract, is subject to C.C. 1632].)

If, prior to the execution of the contract or agreement, a *supervised financial organization* (for definition, see C.C. 1632(e)(2)) provides a translation in one of the aforementioned languages of the disclosures required by (a) Regulation M or Regulation Z (see C.C. 1632(e)(1)), and, if applicable, (b) *Fin.C. 18000* et seq. (industrial loan companies) or *Fin.C. 22000* et seq. (finance lenders), it is deemed to be in compliance with the requirements of C.C. 1632(b), *supra*, with regard to the original contract or agreement. (C.C. 1632(e).)

(3) *Contracts Not Covered.* The statute does not apply to the following: (a) Subsequent documents authorized or contemplated by the original contract, such as periodic statements, sales slips or invoices representing purchases made pursuant to credit card agreements, retail installment contracts, add-on sales, or refinancing transactions; (b) home improvement contracts as defined in B. & P.C. 7151.2 and 7159, if part of an otherwise covered contract; (c) plans, specifications, descriptions and collateral taken pursuant to a contract for the installation of goods by a licensed contractor, if the installation contract is otherwise part of a covered contract; (d) matters ordinarily incorporated by reference in covered tenancy contracts, such as governing rules and regulations and inventories of furnishings. (C.C. 1632(g).)

(4) *Posted Notice of Right to Translation.* At the time and place where a contract or agreement described in C.C.1632(b)(1) or (b)(2) is executed, a notice in any of the languages specified above in which the contract or agreement was negotiated must be conspicuously displayed, telling the other party of his or her right to a translation. However, if business is done at more than one location, the requirements of C.C. 1632 apply only to the location at which the language in which the contract or agreement was negotiated is used. (C.C. 1632(f).)

(5) *Notice to Lessee or Tenant.* Notice in any of the statutorily specified languages in which a lease, sublease, or rental contract or agreement is negotiated must be provided to the lessee or tenant at the time and place of execution. (C.C. 1632(d).)

(6) *Statute Inapplicable Where Party Has Interpreter.* C.C. 1632 does not apply where the other party negotiates the terms of the contract, lease, or other obligation through his or her own interpreter, i.e., a person, not a minor, who is fluent in one of the specified languages and not furnished by the tradesman or businessman. (C.C. 1632(h).)

(7) *Translation Admissible in Evidence.* "The terms of the contract or agreement which is executed in the English language shall determine the rights and obligations of the parties. However, the translation of the contract or the disclosures required by subdivision (e) in any of the languages specified in subdivision (b) in which the contract or agreement was negotiated shall be admissible in evidence only to show that no contract was entered into because of a substantial difference in the material terms and conditions of the contract and the translation." (C.C. 1632(j).)

(8) *Effect of Failure To Comply With Statute.* The aggrieved party may rescind the contract for failure to comply with the provisions of the statute. If the rescinded contract is for a consumer credit sale or consumer lease that has been assigned, the consumer must make restitution to and have restitution made by the assignor and give notice of the rescission to the assignee. The assignor must then promptly repurchase the contract from the assignee. (C.C. 1632(k).)

(9) *Elements That Need Not Be Translated.* A translation may retain the following elements of the executed English-language contract or agreement without translation: names and titles of individuals and other persons, addresses, brand names, trade names, trademarks, registered service marks, full or abbreviated designations of the make and model of goods or services, alphanumeric codes, numerals, dollar amounts expressed in numerals, dates, and individual words or expressions having no generally accepted non-English translation. (C.C. 1632(i).)

(10) *Execution of Translation.* It is permissible, but not required, that the translation be signed. (C.C. 1632(i).)

SUPPLEMENT: [This section is current through the latest supplement]

(2) *Contracts Covered.* C.C. 1632(b) was amended in 2006 to include reverse mortgages among the contracts covered, and in 2008 to include foreclosure consulting contracts.



10 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT

B. Offer.

1. In General.

a. Nature and Effect.

1 Witkin Sum. Cal. Law Contracts § 125

[§ 125] Nature and Effect.

"An offer is the manifestation of willingness to enter into a bargain, so made as to justify another person in understanding that his assent to that bargain is invited and will conclude it." (Rest.2d, §24.) This definition makes it clear that the offeree may create a contract without further action by the offeror.

"An offer may propose the formation of a single contract by a single acceptance or the formation of a number of contracts by successive acceptances from time to time." (Rest.2d, Contracts §31; on continuing guaranty, see infra, §199.)

West's Key Number Digest, Contracts k.18

SUPPLEMENT: [This section is current through the latest supplement]
See C.E.B., Law of Contracts §4.1 et seq.



11 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT

B. Offer.

1. In General.

b. Distinction: Warning or Demand.

1 Witkin Sum. Cal. Law Contracts § 126

[§ 126] Distinction: Warning or Demand.

A warning or demand is not an offer. In *Wright v. Sonoma* (1909) 156 C. 475, 105 P. 409, there was a dispute between plaintiff and defendant as to the ownership of land upon which a well was situated. Plaintiff notified defendant that no water was to be taken from the well, and that he would demand \$ 50 per day for every day on which water was removed in violation of this notice. Defendant continued to take water, and the courts ultimately decided that the ownership of the land was wholly in the plaintiff. *Held*, there was no contract to take water at \$ 50 per day. The notice forbidding the taking was not an offer, but a notice of claim for damages, and the taking of the water could not be construed as an acceptance of a proposal, since it was against the will of the plaintiff. (156 C. 477.) (See 2 *Cal. L. Rev.* 178.)

Similarly, in *Sherman v. Associated Tel. Co.* (1950) 100 C.A.2d 806, 224 P.2d 846, defendant's telephone wires encroached on plaintiff's land. Plaintiff notified defendant that he would charge \$ 25 per day for each day they remained. Recovery was denied; plaintiff was entitled only to the reasonable value of the use of the property, which he had failed to prove. (100 C.A.2d 807.)

The same result has been reached in such cases on the theory that silence in the face of the demand is not an acceptance. (See *Sorg v. Fred Weisz & Associates* (1971) 14 C.A.3d 78, 81, 91 C.R. 918.)

SUPPLEMENT: [This section is current through the latest supplement]



12 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT
B. Offer.

2. Offer Not Contemplating Legal Relations.
a. Jest or Social Engagement.

1 Witkin Sum. Cal. Law Contracts § 127

[§ 127] Jest or Social Engagement.

Proposals obviously made in jest, invitations to purely social engagements, or remarks made in the course of family discussions, which a reasonable person would not be justified in treating as offers to enter into contracts, do not, upon acceptance, give rise to binding agreements. (See *Fowler v. Security-First Nat. Bank of Los Angeles* (1956) 146 C.A.2d 37, 47, 303 P.2d 565; 1 Corbin (Rev. ed.), §2.13; 1 Williston 4th, §3:5.)

In applying the test, it is necessary to consider the circumstances under which the manifestations occur. "[T]he same interchange of words may or may not be a binding contract depending upon the circumstances under which the words are uttered, the tone of voice used, to whom they are addressed. If words are spoken under circumstances where it is obvious that neither party would be entitled to believe that the other intended a contract to result, there is no contract." (*Fowler v. Security-First Nat. Bank*, *supra*, 146 C.A.2d 47 [testator's expressions to his wife concerning manner in which property would be left by will held not to constitute a contract]; see also *infra*, §§128, 129.)

Rest.2d, Contracts §18, Comment c makes a similar observation with respect to words spoken in jest: "In some cases the setting makes it clear that there is no contract, as where a business transaction is simulated on a stage during a dramatic performance. In other cases, there may be doubt as to whether there is a joke, or one of the parties may take the joke seriously. If one party is deceived and has no reason to know of the joke the law takes the joker at his word. Even if the deceived party had reason to know of the joke, there may be a claim for fraud or unjust enrichment by virtue of the promise made."

Rest.2d, Contracts §21, Comment c deals with the effect of social engagements and domestic arrangements: "In some situations the normal understanding is that no legal obligation arises, and some unusual manifestation of intention is necessary to create a contract. Traditional examples are social engagements and agreements within a family group. See §189-191. Where the family relation is not close, valuable services rendered in the home may make binding an express or implied promise to pay for the services; but even in such cases it would often be understood that there is no legal obligation while the agreement is entirely executory on both sides."

West's Key Number Digest, Contracts k.15

SUPPLEMENT: [This section is current through the latest supplement]
See 1 Williston 4th (2007 ed.), §3:5.



13 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT
B. Offer.

2. Offer Not Contemplating Legal Relations.
b. Statement of Moral Obligation.

1 Witkin Sum. Cal. Law Contracts § 128

[§ 128] Statement of Moral Obligation.

If the parties expressly stipulate that the agreement is not to create a *legal obligation*, this will be given effect. Thus, in *Smith v. MacDonald* (1918) 37 C.A. 503, 174 P. 80, there was a written instrument under which defendant acknowledged his indebtedness to plaintiff, but it also contained a provision that it should be void if suit were brought to enforce it. *Held*, there was no legal obligation. (37 C.A. 505.) (See *Scott v. Lee* (1962) 208 C.A.2d 12, 15, 24 C.R. 824 [language of association bylaws and rules held to state, as between members, merely a moral obligation and not a business agreement]; 37 Harv. L. Rev. 154; 49 Harv. L. Rev. 148.)

A moral obligation only was found under unusual facts in *San Diego v. Vilorio* (1969) 276 C.A.2d 350, 80 C.R. 869. Defendant, a farmer, was asked by the father-in-law of A, a Mexican, to sign an affidavit sponsoring his admission to the United States. Defendant did so, and A was admitted and worked for defendant and others. Subsequently A became ill and was treated in the county hospital as an indigent, pursuant to Welf.C. 17000. Then plaintiff county sued defendant on his guarantee of support in the affidavit. *Held*, judgment for plaintiff reversed; there was no contract between defendant and the government.

(a) The sponsor's affidavit, under federal regulations, is merely evidence on which the consular officer makes a determination of whether the immigrant is likely to become a public charge. Its probative value is greater where, as here, the sponsor is a stranger; but the legislative history and case law indicate that the affidavit does not create a legal claim for support. (276 C.A.2d 356.)

(b) The county relied on the statements in the affidavit that the affiant is "ready and willing to support" the alien, and "I guarantee that he will not become a public charge." The trial judge, accepting that theory, found that defendant had executed a contract of continuing guarantee. But this is unsound: (1) The affidavit contained no other contractual language, did not recite or disclose a consideration, and included much noncontractual material. (2) The alien himself was not a party to it. (3) A guarantor contracts to answer for the debt of another, and where the principal is not liable the purported guarantor is not. Here A, an indigent, was not liable for the medical care beyond his ability to pay. (276 C.A.2d 357.)

The Restatement (§21) states that "Neither real nor apparent intention that a promise be legally binding is essential

to the formation of a contract, but a manifestation of intention that a promise shall not affect legal relations may prevent the formation of a contract." Comment b explains: "Parties to what would otherwise be a bargain and a contract sometimes agree that their legal relations are not to be affected. This may mean that no bargain has been reached, or that a particular manifestation of intention is not a promise; it may reserve a power to revoke or terminate under certain circumstances. But where one party has fully performed, the term may be unenforceable as a penalty or forfeiture; in other cases it may be unenforceable as against public policy (limiting recourse to courts) or as unconscionably limiting remedies for breach of contract."

SUPPLEMENT: [This section is current through the latest supplement]



14 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT
B. Offer.
2. Offer Not Contemplating Legal Relations.
c. Sham Instrument.

1 Witkin Sum. Cal. Law Contracts § 129

[§ 129] Sham Instrument.

A purported contract may be a sham to be used in dealings with third parties and not intended to bind the ostensibly contracting parties. (*P. A. Smith Co. v. Muller* (1927) 201 C. 219, 224, 256 P. 411 [oral understanding that sham contract was to be used solely to enable plaintiff to secure certain material from manufacturers]; on the use of parol evidence to show that purported contract was not intended to be effective, see 2 *Cal. Evidence* (4th), *Documentary Evidence*, §62.) (Cf. *Rest.2d, Contracts §18*, Comment c ["Where the parties to a sham transaction intend to deceive third parties, considerations of public policy may sometimes preclude a defense of sham".])

SUPPLEMENT: [This section is current through the latest supplement]



15 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law V. FORMATION: MUTUAL CONSENT B. Offer.

3. Preliminary Negotiations and External Conditions Precedent. a. Call for, or Attempt To Induce, Offer. 1. Invitation To Make Offer.

1 Witkin Sum. Cal. Law Contracts § 130

[§ 130] Invitation To Make Offer.

(1) *In General.* Sometimes a party suggests the terms of a possible contract, by advertisement, letter, or catalogue, without making a definite proposal. The result is a mere invitation to others to make offers. (See *Hanley v. Marsh & McLennan-J.B.F. Davis & Son, Ltd.* (1941) 46 C.A.2d 787, 795, 117 P.2d 69 [prospective purchaser of insurance who requests proposals from a broker is merely making a call for offers]; *Loneragan v. Scolnick* (1954) 129 C.A.2d 179, 182, 276 P.2d 8; *Richards v. Flower* (1961) 193 C.A.2d 233, 236, 14 C.R. 228; *Sinai Memorial Chapel v. Dudler* (1991) 231 C.A.3d 190, 198, 282 C.R. 263 [cemetery's advertisement promising "reverence for customs and observances in strict accord with family wishes" held too general to create contract permitting monuments containing portraits, contrary to cemetery's policy]; *Brown v. California State Lottery Com.* (1991) 232 C.A.3d 1335, 1339, footnote 1, 284 C.R. 108 [state's solicitations concerning purchase of lottery tickets were mere invitations to wager, not offers to enter into unilateral contracts]; *Rest.2d, Contracts* §26; 1 Corbin (Rev. ed.), §2.4; 1 Williston 4th, §4:7; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §50; 44 *Hastings L. J.* 621 [potential liability arising from precontractual bargaining]; BAJI, No. 10.65; cf. 43 *A.L.R.3d* 1102 [advertisement addressed to public relating to sale or purchase of goods at specified price as offer].)

The Restatement (§26) states the rule as follows:

"A manifestation of willingness to enter into a bargain is not an offer if the person to whom it is addressed knows or has reason to know that the person making it does not intend to conclude a bargain until he has made a further manifestation of assent."

In *Richards v. Flower*, *supra*, plaintiffs wrote defendant a letter on January 15 stating that they would like to buy his lot without dealing through a realtor, and "If you are interested, please advise us by return mail the cash price you would expect to receive." Defendant answered by letter on January 19, stating that "As long as your offer would be in cash I see no reason why we could not deal directly" and that "I expect to receive \$ 4,500.00 for this property." This letter closed with the words "Please let me know what you decide." Plaintiffs on January 25 wired defendant: "Have agreed to buy your lot on your terms will handle transactions through local title company who will contact you." Defendant on February 5 agreed to sell to another, and plaintiffs sued for specific performance. *Held*, judgment for defendant affirmed.

(a) Defendant's condition that plaintiff's offer be made "in cash" was an indication that he was not making an offer but anticipated an offer from plaintiffs. (193 C.A.2d 236.)

(b) Defendant's reference to price was an answer to an inquiry, and constituted only a quotation, not an offer. (193 C.A.2d 236.)

(c) The phrase "let me know what you decide" has no established legal significance, and could mean that the owner wanted to know whether the buyer intended to make an offer or wished to discontinue negotiations. (193 C.A.2d 238.)

In *Moorpark v. Moorpark Unified School Dist.* (1991) 54 C.3d 921, 1 C.R.2d 896, 819 P.2d 854, the issue was whether the Naylor Act, governing the disposal of certain kinds of surplus school property, supplanted the common law of contracts pertaining to offers. *Held*, the common law applied. Hence, the notice sent by defendant school district to various public agencies, stating that it "proposes to offer for sale, lease or exchange all or a portion of the [site] at fair market value," was not an offer. It was "a mere invitation, sent to 13 public agencies with the hope one or more of them would express interest in the property." (54 C.3d 930, citing the text.) (See 19 *Pepperdine L. Rev.* 1580 [Moorpark].)

(2) *Counteroffer*. In *Carver v. Teitsworth* (1991) 1 C.A.4th 845, 2 C.R.2d 446, *infra*, §292, T listed real estate for sale at \$ 795,000 and received two full-price offers. He responded by delivering to the prospective buyers identical forms published by the California Association of Realtors and entitled "Counter Offer." These forms provided that the seller accepted the previous offers on the conditions that the sale price was to be determined by sealed bids at a price not less than \$ 795,000 and that the terms would not be renegotiated. *Held*, the "Counter Offer" was a binding offer to sell, instead of a mere invitation to bid.

(a) If a seller who solicits sealed bids manifests an intent to be bound by the highest bid, his solicitation constitutes an offer. (1 C.A.4th 851.) Here, that intent was manifested by the title and content of the forms, as well as by the testimony of both T and his broker that they intended the forms to create a binding agreement with the highest bidder. (1 C.A.4th 852.)

(b) A provision in the forms reserving to the seller the right to continue to offer the property for sale did not make them an invitation to bid; the provision was merely an explicit reminder of the common law rule that an offer or counteroffer may be revoked at any time prior to its acceptance. (1 C.A.4th 852, citing the text, §164.)

West's Key Number Digest, Contracts k.17

SUPPLEMENT: [This section is current through the latest supplement]

(1) *In General*. See 1 Williston 4th (2007 ed.), §4:10; 58 *Hastings L.J.* 61 [advertisement as offer].



16 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT
B. Offer.

3. Preliminary Negotiations and External Conditions Precedent.
 - a. Call for, or Attempt To Induce, Offer.
 2. Solicitation by Auctioneer.

1 Witkin Sum. Cal. Law Contracts § 131

[§ 131] Solicitation by Auctioneer.

An auctioneer normally solicits or calls for offers, and the bidders are the offerors. This offer is revocable, i.e., no sale is complete until the fall of the auctioneer's hammer. The auctioneer may withdraw the goods unless the auction is announced to be *without reserve*. (U.C.C. 2328; see *Estate of Lynch* (1923) 62 C.A. 687, 690, 217 P. 807; *Lim v. The TV Corp. Int.* (2002) 99 C.A.4th 684, 689, 121 C.R.2d 333, citing the text [Internet auction; website posting of domain name was offer to register name to highest bidder, and accordingly offer was accepted by plaintiff's submission of highest bid]; 1 Corbin (Rev. ed.), §2.3; 1 Williston 4th, §§4:9, 4:10; 7 *Am.Jur.2d* (1997 ed.), *Auctions and Auctioneers* §20 et seq.; on sale by auction generally, see 4 *Summary* (4th), *Sales*, §123.)

Rest.2d, Contracts §28 states the rules that govern unless different rules are made known by publication or announcement:

"(1) At an auction, unless a contrary intention is manifested,"

"(a) the auctioneer invites offers from successive bidders which he may accept or reject;"

"(b) when goods are put up without reserve, the auctioneer makes an offer to sell at any price bid by the highest bidder, and after the auctioneer calls for bids the goods cannot be withdrawn unless no bid is made within a reasonable time;"

"(c) whether or not the auction is without reserve, a *bidder* may withdraw his bid until the auctioneer's announcement of completion of the sale, but a bidder's retraction does not revive any previous bid."

"(2) Unless a contrary intention is manifested, bids at an auction embody terms made known by advertisement, posting or other publication of which bidders are or should be aware, as modified by any announcement made by the auctioneer when the goods are put up."

SUPPLEMENT: [This section is current through the latest supplement]

See 1 Williston 4th (2007 ed.), §§4:12, 4:13; 7 *Am.Jur.2d* (2007 ed.), *Auctions and Auctioneers* §20 et seq.



17 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT
B. Offer.

3. Preliminary Negotiations and External Conditions Precedent.
 - a. Call for, or Attempt To Induce, Offer.
 3. Quotation or Estimate.

1 Witkin Sum. Cal. Law Contracts § 132

[§ 132] Quotation or Estimate.

(1) *Quotation*. Such language as "we can quote you" is ordinarily understood as merely a statement of terms and not an offer. (See *Piazza Paving Co. v. Bebek & Brkich* (1956) 141 C.A.2d 226, 230, 296 P.2d 368 [defendant subcontractors quoted figures on pipe laying and excavation, on which plaintiff general contractor relied; held not a firm offer]; *Rest.2d, Contracts* §26, Comment c; 1 Corbin (Rev. ed.), §2.5.)

But a quotation may be sufficiently specific and promissory to constitute an offer. (See *Rest.2d, Contracts* §26, Comment c ["relevant factors include the terms of any previous inquiry, the completeness of the terms of the suggested bargain, and the number of persons to whom a communication is addressed"].)

Thus, it may add the statement that the quotation is for "immediate wire acceptance." (See discussion, *Gibson v. De La Salle Institute* (1944) 66 C.A.2d 609, 624, 152 P.2d 774.) In the *Gibson* case, the same view was taken of the following telegram: "Find it necessary to ask for following prices ... wire today if interested and samples and sales contract will go forward."

(2) *Estimate*. In *Parker v. Meneley* (1951) 106 C.A.2d 391, 235 P.2d 101, a writing was headed "Estimate on Parker Pump. Co. Equipment." Although the word "estimate" often does not suggest a binding proposal, it was held an offer here because (a) the word was a heading, not part of the operative clauses; (b) the body commenced with the words "We propose to furnish to" the other party; (c) the instrument also contained the printed statement that "The signature herein is an authorization to install such equipment as described in the above estimate." (106 C.A.2d 398.)

SUPPLEMENT: [This section is current through the latest supplement]



18 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT
B. Offer.

3. Preliminary Negotiations and External Conditions Precedent.
b. Formal Writing Contemplated.

1 Witkin Sum. Cal. Law Contracts § 133

[§ 133] Formal Writing Contemplated.

(1) *In General.* Parties may engage in preliminary negotiations, oral or written, in order to reach an agreement. These negotiations ordinarily result in a binding contract when all of the terms are definitely understood, even though the parties intended that a formal writing embodying these terms was to be executed later. (*Gavina v. Smith* (1944) 25 C.2d 501, 504, 154 P.2d 681; *King v. Stanley* (1948) 32 C.2d 584, 591, 197 P.2d 321; *Conner v. Plank* (1914) 25 C.A. 516, 518, 144 P. 295; *Nolte v. Southern Calif. Home Bldg. Co.* (1938) 28 C.A.2d 532, 534, 82 P.2d 946; *Clarke v. Fiedler* (1941) 44 C.A.2d 838, 846, 113 P.2d 275; *Laughlin v. Haberfelde* (1946) 72 C.A.2d 780, 785, 165 P.2d 544; *Cappelmann v. Young* (1946) 73 C.A.2d 49, 53, 165 P.2d 950; *Johnston v. Twentieth Century-Fox Film Corp.* (1947) 82 C.A.2d 796, 821, 187 P.2d 474; *Columbia Pictures Corp. v. DeToth* (1948) 87 C.A.2d 620, 629, 197 P.2d 580; *Skirball v. RKO Radio Pictures* (1955) 134 C.A.2d 843, 861, 286 P.2d 954; *Johnston, Baker & Palmer v. Record Machine & Tool Co.* (1960) 183 C.A.2d 200, 206, 6 C.R. 847 [rule applied to oral stipulation not reduced to writing]; *Schwartz v. Shapiro* (1964) 229 C.A.2d 238, 247, 40 C.R. 189, quoting the text; *Stephan v. Maloof* (1969) 274 C.A.2d 843, 848, 79 C.R. 461, quoting the text; *Pacific Grove-Asilomar Operating Corp. v. Monterey* (1974) 43 C.A.3d 675, 686, 117 C.A. 874, quoting the text.) (See *Rest.2d, Contracts* §27; 1 Corbin (Rev. ed.), §2.9; 1 Williston 4th, §4:8; 17 *Am.Jur.2d* (2004 ed.), *Contracts* §33.) (On application to insurance binders, see 2 *Summary* (10th), *Insurance*, §37 et seq.; on terms incomplete or writing required, see *infra*, §134.)

(2) *Settlement.* In *Harris v. Rudin, Richman & Appel* (1999) 74 C.A.4th 299, 87 C.R.2d 822, after plaintiff sued defendant law firm and individual attorneys for malpractice, he brought an action for breach of contract to enforce a settlement offer made by defendants' counsel. The offer was in the form of a letter to plaintiff's counsel, which purported to contain the essential terms of a settlement and stated that defendants' counsel would prepare the initial draft of the settlement documents. The letter was signed by two of the four individual defendants under a signature block noting "[a]ccepted and agreed." *Held*, grant of demurrer for defendants reversed.

This case is far different from *Beck v. American Health Group Int.* (1989) 211 C.A.3d 1555, 260 C.R. 237, *infra*, §134, where the writing itself was expressly denominated as an outline of a "future agreement." Also, in *Beck*, plaintiff's complaint merely relied on the language of the letter and did not attempt to plead facts alleging the plaintiff's interpretation of the letter. Here, plaintiff alleges that he and defendants engaged in several communications, "both written and telephonic," which "culminated in a settlement agreement." The terms of the purported settlement

agreement are set forth in the complaint and are alleged to have been reduced to writing in the letter attached to the complaint and incorporated by reference. At a minimum, plaintiff's complaint alleges facts evidencing an oral agreement. Whether the parties intended their communications to be a binding settlement agreement or an agreement to further negotiate after a formal draft was prepared is a factual question not properly the subject of a demurrer. (74 C.A.4th 308, 309.)

West's Key Number Digest, Contracts k.18

SUPPLEMENT: [This section is current through the latest supplement]

(1) *In General.* See 1 Williston 4th (2007 ed.), §4:11.



19 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT
B. Offer.

3. Preliminary Negotiations and External Conditions Precedent.
c. Terms Incomplete or Writing Required.

1 Witkin Sum. Cal. Law Contracts § 134

[§ 134] Terms Incomplete or Writing Required.

Where any of the terms are left for future determination and it is understood that the agreement is not to be deemed complete until they are settled, or where it is understood that the agreement is incomplete until reduced to writing and signed by the parties, no contract results until this is done. (*Spinney v. Downing* (1895) 108 C. 666, 668, 41 P. 797; *Wolfsen v. Hathaway* (1948) 32 C.2d 632, 641, 198 P.2d 1 [preliminary negotiations with agent, but rejected by principal]; *Howard v. Burrow* (1926) 77 C.A. 4, 8, 245 P. 808; *Toms v. Hellman* (1931) 115 C.A. 74, 83, 1 P.2d 31; *Patterson v. Clifford F. Reid* (1933) 132 C.A. 454, 456, 23 P.2d 35 [plaintiff signed contract to purchase land while description, amount, and terms of payment were still blank, with understanding that no contract was to be effective until she gave approval]; *Dexter v. Ankiewicz* (1938) 26 C.A.2d 326, 333, 79 P.2d 400; *Kerr Glass Mfg. Corp. v. Elizabeth Arden Sales Corp.* (1943) 61 C.A.2d 55, 56, 141 P.2d 938 [purported agreement, part of lease, to make future agreement subject to approval by both parties]; *Palo & Dodini v. Oakland* (1947) 79 C.A.2d 739, 741, 180 P.2d 764 [written agreement held to be a statutory condition precedent to formation of binding contract]; *Central Contra Costa Sanitary Dist. v. National Surety Corp.* (1952) 112 C.A.2d 61, 65, 246 P.2d 150, *infra*, §838 [written agreement with performance bond held condition precedent to binding public works contract]; *Sam Finman v. Rokuz Holding Corp.* (1955) 130 C.A.2d 758, 761, 279 P.2d 982; *American Aeronautics Corp. v. Grand Cen. Aircraft Co.* (1957) 155 C.A.2d 69, 80, 317 P.2d 694; *Apablaza v. Merritt & Co.* (1959) 176 C.A.2d 719, 729, 1 C.R. 500; *Peterson Dev. Co. v. Torrey Pines Bank* (1991) 233 C.A.3d 103, 115, 284 C.R. 367 [letter of commitment for permanent financing held unenforceable, where it was uncertain as to potential borrower and specified neither loan amount nor repayment terms]; *Khajavi v. Feather River Anesthesia Med. Group* (2000) 84 C.A.4th 32, 59, 100 C.R.2d 627, 3 *Summary* (10th), *Agency and Employment*, §254 [oral contract that did not provide for attorneys' fees could not be basis for recovery of fees despite parties' intent to reduce contract to writing that would include express attorneys' fees clause]; *Rest.2d, Contracts* §31; see 1 *Corbin* (Rev. ed.), §2.9; 1 *Williston* 4th, §4:8; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §32; BAJI, No. 10.58 [Oral Agreement To Be Reduced to Writing]; CACI, No. 304 [Oral or Written Contract Terms], CACI, No. 306 [Unformalized Agreement].)

In *Store Properties v. Neal* (1945) 72 C.A.2d 112, 164 P.2d 38, an action was brought for specific performance of a preliminary agreement to lease land for 99 years. The main opinion, by one justice, states that the agreement was not binding because the details were not agreed upon (72 C.A.2d 115), but the other two opinions rely solely on the narrow

point that the agreement was too uncertain for *specific performance* (see 13 *Summary* (10th), *Equity*, §42). (72 C.A.2d 119.) There would appear to be sound reasons why a preliminary agreement is not intended to be binding where a contract involves a 99-year lease, permanent improvements, and the financial responsibility of a lessee for such a long period of time. However, in *Cappellmann v. Young* (1946) 73 C.A.2d 49, 53, 165 P.2d 950, an action for damages, the court interpreted the *Store Properties* case as holding merely that the agreement was not certain enough for specific performance.

In *Beck v. American Health Group Int.* (1989) 211 C.A.3d 1555, 260 C.R. 237, a letter from defendant hospital corporation to plaintiff doctor contained the following: "It is a pleasure to draft the outline of our future agreement." The letter then outlined the terms, and asked plaintiff to sign it "if this is a general understanding of the agreement," in order that the hospital may "forward it to Corporate Counsel for the drafting of a contract." The letter concluded: "When we have a draft, we will discuss it, and hopefully shall have a completed contract and operating unit in the very near future." (211 C.A.3d 1562.)

The court said: "Taken in their ordinary sense, the words of the letter manifest an intention of the parties that no binding contract would come into being until the terms of the letter were embodied in a formal contract to be drafted by corporate counsel. Assignment of the drafting to an attorney evidences an expectation that the terms set forth in the letter were subject to his approval. ... That plaintiff may have intended or believed a binding contract came into existence upon his signing the letter is immaterial in the face of its language which plainly indicated otherwise." (211 C.A.3d 1563.)

The Restatement (§27, Comment c) lists some of the circumstances that may show that a contract has been concluded or that the agreements were preliminary negotiations: "the extent to which express agreement has been reached on all the terms to be included, whether the contract is of a type usually put in writing, whether it needs a formal writing for its full expression, whether it has few or many details, whether the amount involved is large or small, whether it is a common or unusual contract, whether a standard form of contract is widely used in similar transactions, and whether either party takes any action in preparation for performance during the negotiations."

SUPPLEMENT: [This section is current through the latest supplement]

See 1 Williston 4th (2007 ed.), §4:11; 120 *Harv. L. Rev.* 662 [precontractual liability and preliminary agreements].



20 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT
B. Offer.

3. Preliminary Negotiations and External Conditions Precedent.
d. Approval of Others Contemplated or Required.

1 Witkin Sum. Cal. Law Contracts § 135

[§ 135] Approval of Others Contemplated or Required.

The same problem of intention (see *supra*, §133) is involved where the terms are agreed upon and reduced to writing, but *signatures* of several persons are contemplated.

The importance of all signatures *not* being contemplated was seen in *Winter v. Kitto* (1929) 100 C.A. 302, 279 P. 1024, where the vendor agreed to sell property to two brothers and the contract named both as purchasers. However, the contract was signed by the vendor and only one brother. The latter went into possession and paid part of the purchase price. *Held*, the contract was binding on him. There was no evidence of an understanding that the contract was to be deemed incomplete until signed by all parties, and here the party signing received the consideration for which he had bargained. (100 C.A. 306.) (See *John v. Marshall* (1951) 103 C.A.2d 172, 180, 229 P.2d 367; *Angell v. Rowlands* (1978) 85 C.A.3d 536, 541, 542, 149 C.R. 574 [land purchase contract signed by purchaser husband and vendor husband, without signatures of wives; early cases compared, *Winter v. Kitto* followed, and *Macaroni*, *infra*, this section, distinguished]; 1 Corbin (Rev. ed.), §2.10; 15 A.L.R.4th 760 [real estate contract contingent on approval by attorney for either party].)

But if the evidence shows that the signatures of other parties were required as one of the conditions of the completed agreement, it is incomplete and not binding upon those who sign until the others sign. (*Anthony Macaroni Co. v. Nunziato* (1935) 5 C.A.2d 588, 589, 43 P.2d 315; *Helperin v. Guzzardi* (1951) 108 C.A.2d 125, 128, 238 P.2d 141; *Nakatsukasa v. Wade* (1954) 128 C.A.2d 86, 91, 274 P.2d 918; cf. *Sparks v. Mauk* (1915) 170 C. 122, 123, 148 P. 926 [where both parties acceded to terms and partly performed, defendant held estopped to object that plaintiff had not signed].)

SUPPLEMENT: [This section is current through the latest supplement]



21 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT

B. Offer.

3. Preliminary Negotiations and External Conditions Precedent.

e. Other Conditions Precedent.

1 Witkin Sum. Cal. Law Contracts § 136

[§ 136] Other Conditions Precedent.

Even where the contract is complete and signed, it may be shown that the parties orally agreed that it should not become binding until the happening of some event. This event is an "external condition precedent" to its effectiveness. (*Paratore v. Scharetg* (1942) 53 C.A.2d 710, 713, 128 P.2d 560 [building contract, conditioned upon obtaining sufficient loan]; *Unger v. Hall* (1943) 61 C.A.2d 535, 537, 143 P.2d 497; *Bravo v. Sharkey* (1950) 97 C.A.2d 883, 886, 218 P.2d 785 [agreement to make lease conditioned upon preparation and approval of plans for remodeling]; *Spade v. Cossett* (1952) 110 C.A.2d 782, 784, 243 P.2d 799 [joint tenant-wife's agreement to pay real estate commission conditioned upon husband cotenant's agreeing to sale]; *Hartford Acc. & Indem. Co. v. McCullough* (1965) 235 C.A.2d 195, 203, 44 C.R. 915 [insurance policy]; *Corbin* §628; 12 Williston 4th, §6:14; 17A Am.Jur.2d (2004 ed.), *Contracts* §38.)

An external condition precedent may be shown by parol evidence. (See *Haines v. Bechdolt* (1965) 231 C.A.2d 659, 661, 42 C.R. 53 [written contract between plaintiff architect and defendant owner, but collateral oral agreement requiring plaintiff to assist in financing and providing for payment only from funds to be obtained therefrom; condition not performed, written contract never took effect]; *Clyde Bldg. Assn. v. Walsh* (1967) 248 C.A.2d 513, 515, 56 C.R. 617, citing the text [building contract, conditioned upon construction loan]; 2 Cal. Evidence (4th), *Documentary Evidence*, §104.)

West's Key Number Digest, Contracts k.221

SUPPLEMENT: [This section is current through the latest supplement]



22 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT

B. Offer.

4. Certainty of Offer.

a. In General.

1. Requirement of Certainty.

1 Witkin Sum. Cal. Law Contracts § 137

[§ 137] Requirement of Certainty.

An offer must be sufficiently definite, or must call for such definite terms in the acceptance, that the performance promised is reasonably certain. (*Weddington Productions v. Flick* (1998) 60 C.A.4th 793, 811, 71 C.R.2d 265, quoting the text; *Holmes v. Lerner* (1999) 74 C.A.4th 442, 457, 88 C.R.2d 130 [terms of contract are reasonably certain if they provide basis for determining existence of breach and for giving appropriate remedy]; *Rest.2d, Contracts* §33; see 1 Corbin (Rev. ed.), §4.1; 1 Williston 4th, §4:18 et seq.; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §181; Cal. Transactions Forms, 1 Business Transactions §6.14; 10 *So. Cal. L. Rev.* 504; *infra*, §§138, 139, 140 et seq.; BAJI, No. 10.65 [Offer]; CACI, No. 307 [Contract Formation--Offer].)

The Restatement (§33) sets forth the rule and test as follows:

"(1) Even though a manifestation of intention is intended to be understood as an offer, it cannot be accepted so as to form a contract unless the terms of the contract are reasonably certain."

"(2) The terms of a contract are reasonably certain if they provide a basis for determining the existence of a breach and for giving an appropriate remedy."

"(3) The fact that one or more terms of a proposed bargain are left open or uncertain may show that a manifestation of intention is not intended to be understood as an offer or as an acceptance."

A party cannot give validity to a void contract of this type by waiving the benefits of the uncertain provision; this would be an ineffectual attempt to unilaterally create a new contract. (*Magna Dev. Co. v. Reed* (1964) 228 C.A.2d 230, 243, 39 C.R. 284; *White Point Co. v. Harrington* (1968) 268 C.A.2d 458, 469, 73 C.R. 885.)

West's Key Number Digest, Contracts k.143(2)

SUPPLEMENT: [This section is current through the latest supplement]

See 1 Williston 4th (2007 ed.), §4:21 et seq.



23 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law V. FORMATION: MUTUAL CONSENT

B. Offer.

4. Certainty of Offer.

a. In General.

2. Promises Held Uncertain.

1 Witkin Sum. Cal. Law Contracts § 138

[§ 138] Promises Held Uncertain.

Many cases illustrate the rule requiring certainty. (See *Van Slyke v. Broadway Ins. Co.* (1897) 115 C. 644, 646, 47 P. 689, 928 [agent hired for "a contingent commission" of 5%; instrument was silent as to contingency and method of computing the amount]; *Jules Levy & Bro. v. A. Mautz & Co.* (1911) 16 C.A. 666, 669, 117 P. 936; *Charles Brown & Sons v. White Lunch Co.* (1928) 92 C.A. 457, 461, 268 P. 490; *K.C. Working Chemical Co. v. Eureka-Sec. Fire & Marine Ins. Co. of Cincinnati, Ohio* (1947) 82 C.A.2d 120, 130, 185 P.2d 832 [uncertainty in purported oral insurance contract]; *Dickey v. Pattison* (1949) 92 C.A.2d 659, 662, 207 P.2d 1081 [purported agreement to sell land, no price specified]; *Goehring v. Stockton Morris Plan Co.* (1949) 93 C.A.2d 417, 420, 209 P.2d 41; *Gould v. Callan* (1954) 127 C.A.2d 1, 4, 273 P.2d 93; *Putnam v. Cameron* (1954) 129 C.A.2d 89, 95, 276 P.2d 102; *Ferrara v. Silver* (1956) 138 C.A.2d 616, 619, 292 P.2d 251; *Apablaza v. Merritt & Co.* (1959) 176 C.A.2d 719, 723, 1 C.R. 500; *Yucca Water Co. v. Anderson* (1960) 177 C.A.2d 253, 256, 2 C.R. 162 [agreement for installation of water system, insufficient identification of "tract or tracts" to be covered]; *Ganiats Const. v. Hesse* (1960) 180 C.A.2d 377, 384, 4 C.R. 706 [option to purchase land, described as "next contiguous 30 acres"]; *Magna Dev. Co. v. Reed* (1964) 228 C.A.2d 230, 242, 39 C.R. 284 [contract of sale of land, fatally uncertain subordination clause]; *Brooks v. Allard* (1966) 244 C.A.2d 283, 284, 53 C.R. 82 [agreement to sell timber land adequately described, but "Excepting therefrom that portion ... to be surveyed and retained by the family," with no key to its location or size]; *White Point Co. v. Harrington* (1968) 268 C.A.2d 458, 465, 73 C.R. 885 [release clause in escrow instructions for sale of land]; *Goldberg v. Santa Clara* (1971) 21 C.A.3d 857, 861, 98 C.R. 862, 1 Cal. Proc. (4th), Attorneys, §178 [attorney's contract calling for additional compensation contingent on "savings to the City of such magnitude" as would justify it; no objective standard and fatally uncertain]; *Weddington Productions v. Flick* (1998) 60 C.A.4th 793, 813, 815, 71 C.R.2d 265, citing the text [missing material terms in settlement agreement].)

In *Brudvig v. Renner* (1959) 172 C.A.2d 522, 342 P.2d 276, a real estate salesman drew a contract of sale of land by defendant owner to plaintiff buyer, describing property as "2-acres more or less, with New Home, located at 4053 Branciforte Drive, Santa Cruz, California; legally known as Dr. J. H. Renner property." *Held*, decree of specific performance reversed. The description would have been sufficient if it had covered all of defendant's land at that location, or all the property known as 4053 Branciforte Drive. But defendant, who had owned 18 acres, had previously

sold 15 and retained about 3, irregularly shaped; and there were many possible means of carving out 2 acres. Plaintiff's suggestion that he had the right to select any 2 acres was rejected because the contract contained no such right. (172 C.A.2d 523.)

The court pointed out, however, that the denial of specific performance did not preclude recovery of damages for breach, under the rule that less certainty is required for damages than for specific performance. (172 C.A.2d 524.) (Cf. *Ganiats Const. v. Hesse, supra*, where the court held that damages could not be recovered because the contract failed to meet the requirements of a memorandum to satisfy the statute of frauds.)

In *Western Homes v. Herbert Ketell* (1965) 236 C.A.2d 142, 45 C.R. 856, defendant S owned unimproved real property. He made a contract with K for its development, which contained a paragraph reading: "Management: Parties contemplate that Western Homes ... shall handle leasing, rental collection, and management of the entire project." Plaintiff B, sole owner of Western Homes, sued for declaratory relief, alleging that defendants denied his management rights. *Held*, judgment on K's demurrer affirmed. The word "contemplate" normally implies an expectation rather than a promise. However, it can be given the meaning of "agreed" if coupled with other terms, where the elements contemplated are sufficiently certain. But here nothing was said about the amount of compensation, the periods of payment, the duration of the employment, or the relationship--employee or independent contractor. (236 C.A.2d 145.)

In *Ladas v. California State Auto. Assn.* (1993) 19 C.A.4th 761, 23 C.R.2d 810, plaintiff insurance sales representatives claimed that defendant insurer (CSAA) breached its promise to consider parity with other insurance companies in setting compensation rates. *Held*, the promise was too uncertain to be enforceable. Distinguishing statements not to terminate employment without just cause, which may justify the imposition of an implied-in-fact term to that effect in the employment agreement, the court said:

"An amorphous promise to 'consider' what employees at other companies are earning cannot rise to the level of a contractual duty. Appellants were paid according to a precise unit value system detailed in the comp plan. By what standard would a court or a jury determine that the company failed to meet its obligation to 'consider' commissions earned by competitors? What would be the relevant market on which such a duty would be predicated? CSAA's four major competitors? All insurers in the state? Eighty companies nationwide? How would 'damages' be calculated? By totaling up all yearly commissions earned by other agents, averaging them and subtracting the difference? By coming up with an 'industry standard' factor and increasing CSAA's unit value ratio by that factor? The nature of the obligation asserted provides no rational method for determining breach or computing damages." (19 C.A.4th 771.)

SUPPLEMENT: [This section is current through the latest supplement]

See *Terry v. Conlan* (2005) 131 C.A.4th 1445, 1455, 33 C.R.3d 603 [parties' failure to agree on means of performing purported settlement regarding competing trust instruments prevented formation of enforceable contract]; *Lindsay v. Lewandowski* (2006) 139 C.A.4th 1618, 1622, 43 C.R.3d 846 [settlement agreement was unenforceable, because parties never agreed on procedure to resolve payment dispute still in controversy; settlement agreement originally provided for binding mediation, but "mediation" was crossed out and "arbitration" was inserted, indicating that parties did not consider binding mediation to be equivalent of arbitration]; *Bustamante v. Intuit* (2006) 141 C.A.4th 199, 209, 45 C.R.3d 692 [proposal by entrepreneur to software company to form and launch software company was not enforceable against company after it withdrew because of entrepreneur's failure to obtain promised financing, where parties never agreed on form and amount of entrepreneur's compensation, nature of his management role, amount of company's royalty, and equity percentages held by parties and outside investors]. *Goldberg case*:

Cross-Reference: 1 Cal. Proc. (5th), Attorneys, §154.



24 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT

B. Offer.

4. Certainty of Offer.

a. In General.

3. Promises Held Certain.

1 Witkin Sum. Cal. Law Contracts § 139

[§ 139] Promises Held Certain.

Although a contract might be unclear in some respects, numerous courts have held that a contract of this type was, nevertheless, sufficiently certain to be enforced, or at least to withstand a motion for summary judgment. (See, e.g., *Ersa Grae Corp. v. Fluor Corp.* (1991) 1 C.A.4th 613, 623, 2 C.R.2d 288 [contract to transfer real property held sufficiently certain even though some provisions were to be the subject of later documentation]; *Carver v. Teitsworth* (1991) 1 C.A.4th 845, 853, 2 C.R.2d 446, *infra*, §292 [bid agreeing to pay \$ 1,000 more than any other bid provided objective method for determining price, and hence was not uncertain]; *Byrne v. Laura* (1997) 52 C.A.4th 1054, 1065, 60 C.R.2d 908 [although decedent's promise to support unmarried cohabitant for rest of her life did not specify amount of support, conflicting evidence as to its interpretation made improper summary adjudication that promise was too uncertain to enforce]; *Alexander v. Codemasters Group Ltd.* (2002) 104 C.A.4th 129, 148, 127 C.R.2d 145 [option agreement without conditions for vesting is not so uncertain as to be unenforceable]; BAJI, No. 10.65 [Offer]; CACI, No. 307 [Contract Formation--Offer].)

The Restatement (§34) deals with choice of terms and performance or reliance, and the effect this has on certainty, as follows:

"(1) The terms of a contract may be reasonably certain even though the contract empowers one or both parties to make a selection of terms in the course of performance."

"(2) Part performance under an agreement may remove uncertainty and establish that a contract enforceable as a bargain has been formed."

"(3) Action in reliance on an agreement may make a contractual remedy appropriate even though uncertainty is not removed."

Comment b points out that, if one party is given *unlimited* choice, the party may not be a promisor and the contract may fail for want of consideration; but this difficulty may be avoided where the choice is *limited*, and discretionary power may be exercised in good faith and in accordance with fair dealing.

An offer may also be given precision by usage of trade or course of dealing between the parties; terms may be supplied by factual or legal implication; and uncertainty as to incidental or collateral matters is seldom fatal. (*Rest.2d, Contracts* §33, Comment a; see *infra*, §146.)

West's Key Number Digest, Contracts k.159

SUPPLEMENT: [This section is current through the latest supplement]



25 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT

B. Offer.

4. Certainty of Offer.

b. Reasonable Interpretation of Nontechnical Language.

1. Rule of Liberal Construction.

1 Witkin Sum. Cal. Law Contracts § 140

[§ 140] Rule of Liberal Construction.

To determine that a contract is sufficiently certain to be enforced, the court will liberally interpret laymen's agreements or nontechnical language. "In considering expressions of agreement, the court must not hold the parties to some impossible, or ideal, or unusual standard. It must take language as it is and people as they are. All agreements have some degree of indefiniteness and some degree of uncertainty. ... The court must not be overly fearful of error; it must not be pedantic or meticulous in interpretation of expressions. ... If the parties have concluded a transaction in which it appears that they intend to make a contract, the court shall not frustrate their intention, if it is possible to reach a fair and just result, even though this requires a choice among conflicting meanings and the filling of some gaps that the parties have left." (*Rivers v. Beadle* (1960) 183 C.A.2d 691, 695, 7 C.R. 170, quoting Corbin; see *McIllmoil v. Frawley Motor Co.* (1923) 190 C. 546, 549, 213 P. 971 ["The law does not favor but leans against the destruction of contracts because of uncertainty; and it will, if feasible, so construe agreements as to carry into effect the reasonable intentions of the parties if that can be ascertained"]; *Masterson v. Sine* (1968) 68 C.2d 222, 224, 65 C.R. 545, 436 P.2d 561 [trial judge properly refused to frustrate clear intention by "an overly meticulous insistence on completeness and clarity of written expression"]; *Haggerty v. Warner* (1953) 115 C.A.2d 468, 472, 252 P.2d 373; *Bettancourt v. Gilroy Theatre Co.* (1953) 120 C.A.2d 364, 367, 261 P.2d 351; *Schomaker v. Osborne* (1967) 250 C.A.2d 887, 893, 58 C.R. 827; 1 Corbin (Rev. ed.), §4.1; 1 Williston 4th, §4:18; 17A Am.Jur.2d (2004 ed.), Contracts §181 et seq.)

A fiduciary relationship may cause the court to apply the certainty requirement with great liberality; e.g., where one member of a joint venture attempts to take over the assets, and when sued contends that there is no binding contract and the plaintiff is only entitled to quasi-contractual recovery of money advanced. (See *Boyd v. Bevilacqua* (1966) 247 C.A.2d 272, 288, 55 C.R. 610 [joint venture for land acquisition and development; held sufficiently certain despite fact that plans were not yet made].)

SUPPLEMENT: [This section is current through the latest supplement]
See 1 Williston 4th (2007 ed.), §4:21.



26 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT

B. Offer.

4. Certainty of Offer.

b. Reasonable Interpretation of Nontechnical Language.

2. Illustrations.

aa. Nature and Quality of Performance.

1 Witkin Sum. Cal. Law Contracts § 141

[§ 141] Nature and Quality of Performance.

In *Bettancourt v. Gilroy Theatre Co.* (1953) 120 C.A.2d 364, 261 P.2d 351, defendant buyers agreed to purchase land and "erect a First class Theatre" thereon. Several competent witnesses testified to the basic requirements of such a theatre. The court, exhaustively reviewing the case law on contracts to build structures, concluded that the challenged words were sufficiently definite, at least in an action for damages. (120 C.A.2d 368.) (Cf. *Ellis v. Klaff* (1950) 96 C.A.2d 471, 478, 216 P.2d 15, *infra*, §349.)

West's Key Number Digest, Contracts k.159

SUPPLEMENT: [This section is current through the latest supplement]



27 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT

B. Offer.

4. Certainty of Offer.

b. Reasonable Interpretation of Nontechnical Language.

2. Illustrations.

bb. Consideration or Price.

1 Witkin Sum. Cal. Law Contracts § 142

[§ 142] Consideration or Price.

In *Haggerty v. Warner* (1953) 115 C.A.2d 468, 252 P.2d 373, defendants employed plaintiff to promote the sale of a mechanism called a "unit." They agreed to pay 5% "of all our *billings* on sales of units." *Held*, plaintiff was entitled to recover for breach; "billings" was a term sufficiently understood in the commercial world. (115 C.A.2d 473.)

The price of goods in a contract of sale is of course an essential term, and uncertainty in this element may render the contract unenforceable. (See *infra*, §153.) But the complete absence of any mention of the price is not necessarily fatal: The contract may be interpreted to mean the market price or a reasonable price. (See 1 Corbin (Rev. ed.), §4.3; 1 Williston 4th, §4:22; 17A Am.Jur.2d (2004 ed.), *Contracts* §198; 2 A.L.R.3d 701 [definiteness of price in option contract].)

The Uniform Commercial Code liberalized the law by introducing, for the sale of goods, the concept of "open price term": "The parties if they so intend can conclude a contract for sale even though the price is not settled." (U.C.C. 2305; see 4 *Summary* (10th), *Sales*, §47.)

A similar approach has been taken in contracts for the sale of real property. "Fair market value," "reasonable value," or "current market value" are sufficiently certain price terms to support specific performance of an option to purchase. (*Goodwest Rubber Corp. v. Munoz* (1985) 170 C.A.3d 919, 921, 216 C.R. 604 [lease provision with option to buy at "fair market value"].)

SUPPLEMENT: [This section is current through the latest supplement]
See 1 Williston 4th (2007 ed.), §4:25.



28 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT

B. Offer.

4. Certainty of Offer.

b. Reasonable Interpretation of Nontechnical Language.

2. Illustrations.

cc. Duration of Contract.

1 Witkin Sum. Cal. Law Contracts § 143

[§ 143] Duration of Contract.

(1) *Duration Subject to Condition.* In *Sultiff v. Seidenberg Stiefel & Co.* (1901) 132 C. 63, 64 P. 131, 469, plaintiff agreed to assist defendants "to make a success" of their line of goods as long as they found a "ready sale" on the coast. It appeared that defendants were cigar manufacturers in New York, and desired to introduce their goods in California. *Held*, the contract was sufficiently definite. (132 C. 65.) (See *Great Western Distillery Products v. John A. Wathen Distillery Co.* (1937) 10 C.2d 442, 447, 74 P.2d 745 [agreement to sell goods exclusively to plaintiff "as long as the plaintiff purchases and continues to purchase" exclusively from defendant]; *Long Beach Drug Co. v. United Drug Co.* (1939) 13 C.2d 158, 165, 88 P.2d 698 [exclusive sales agreement, so long as agent "shall perform the terms of this agreement"]; *Noble v. Reid-Avery Co.* (1928) 89 C.A. 75, 78, 264 P. 341 [exclusive right to sell as long as agent "able to give faithful service and a business management to the trade and produce the trade that was warranted in the territory allotted"]; *Zee Med. Distributor Assn. v. Zee Med.* (2000) 80 C.A.4th 1, 7, 94 C.R.2d 829 [plain, unambiguous provision in distribution agreements that contract "shall continue" until grounds arise for termination was valid, express contractual term of duration, making agreements terminable only for cause; following *Great Western Distillery Products v. Wathen Distillery Co.*, *supra*]; 20 California Lawyer 62 (October 2000) [When Is a Contract Over; *Zee Med.*].)

(2) *No Reference to Duration.* Lack of a provision for duration does not make the agreement fatally uncertain. (a) If the nature of the contract and surrounding circumstances afford a reasonable basis for implying the term, this can be done. (b) If not, the court will usually imply a reasonable time, after which the contract is terminable at will by either party on reasonable notice. (*Consolidated Theatres v. Theatrical Stage Employees Union* (1968) 69 C.2d 713, 725, 730, 73 C.R. 213, 447 P.2d 325, citing the text [ascertainable term implied, time expired, hence no subsisting contract at time of litigation]; see *International Aerial Tramway Corp. v. Konrad Doppelmayer & Sohn* (1969) 70 C.2d 400, 408, 74 C.R. 908, 450 P.2d 284 [allegation that defendant prematurely repudiated without notice sufficient to raise issue of implying term or reasonable time]; *Ravel v. Hubbard* (1952) 112 C.A.2d 255, 259, 246 P.2d 88 [contract not void for failure to specify definite termination point; though terminable at will, damages awarded for breach prior to termination]; *Haggerty v. Warner* (1953) 115 C.A.2d 468, 473, 252 P.2d 373 [matter of construction, may be implied from nature of

contract or surrounding circumstances]; *Zimco Restaurants v. Bartenders & Culinary Workers Union Local 340, AFL-CIO* (1958) 165 C.A.2d 235, 240, 331 P.2d 789 [contract that appears to contemplate continuing performance for indefinite time is terminable at will by either party]; *Aronowicz v. Nalley's* (1972) 30 C.A.3d 27, 51, 106 C.R. 424 [court will imply reasonable term making contract terminable on reasonable notice]; *Varni Bros. Corp. v. Wine World* (1995) 35 C.A.4th 880, 890, 41 C.R.2d 740 [distribution contracts, lacking agreement that distributing arrangements would last for fixed term of years, were of indefinite duration, and thus terminable at will]; 1 Corbin (Rev. ed.), §4.2; 1 Williston 4th, §4:19 et seq.; 17A Am.Jur.2d (2004 ed.), Contracts §191; 19 A.L.R.3d 196 [distributorship contract without express provision for termination]; 3 Summary (10th), Agency and Employment, §206 [employment contract for unspecified term].)

West's Key Number Digest, Contracts k.176(10)

SUPPLEMENT: [This section is current through the latest supplement]

(2) *No Reference to Duration.* See *Unterberger v. Red Bull North America* (2008) 162 C.A.4th 414, 420, 75 C.R.3d 368 [following *Varni Bros. Corp. v. Wine World* (1995) 35 C.A.4th 880, 41 C.R.2d 740, text, p. 183, and affirming nonsuit on distributor's breach of contract claim; evidence that employee of beverage manufacturer rhetorically asked distributor why manufacturer would terminate anybody who is doing such good job was not sufficient to create fact issue as to whether distributor and manufacturer agreed that manufacturer could not terminate their distribution arrangement without good cause]; 1 Williston 4th (2007 ed.), §4:22 et seq.



29 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT
B. Offer.

4. Certainty of Offer.

b. Reasonable Interpretation of Nontechnical Language.

3. Inquiry into Purpose of Contract.

1 Witkin Sum. Cal. Law Contracts § 144

[§ 144] Inquiry into Purpose of Contract.

In *Rivers v. Beadle* (1960) 183 C.A.2d 691, 7 C.R. 170, defendant owners made a written contract with plaintiff licensed real estate broker. She agreed to obtain three specific lots without commission, and they agreed to build on each "a speculative home" for immediate sale and to give her the exclusive right to sell each on 3% commission for 1 year from date of completion. No houses were constructed, but plaintiff sued for her commissions. *Held*, the contract was enforceable, and plaintiff was entitled to 3% on the houses, which would have sold for \$ 20,000.

The court pointed out that the principal element of alleged uncertainty--"speculative home"--had a definite meaning to the parties. And the evidence showed that the term was well known in real estate circles, as meaning a home built with the expectation of selling it at a profit, and of the type and price of homes being then generally built and sold in the area. (183 C.A.2d 697.) The opinion concludes: "In determining the sufficiency of the subject matter of the contract, the purpose of the contract must be borne in mind. Its basic purpose was to enable the real estate broker to obtain a commission on the sale of three houses, to make up for the waiver of a commission then due for the purchase by defendants of the lots. While the description might be considered too vague were this a contract of purchase of a house or houses, it is not too vague for the purpose intended. The type, materials and price (within the norm or standard above mentioned) was left to the discretion of defendants, but they were to build the houses and the broker was to be permitted to sell them on commission." (183 C.A.2d 698.) (See *Kerner v. Hughes Tool Co.* (1976) 56 C.A.3d 924, 933, 128 C.R. 839; *S. Jon Kreedman & Co. v. Meyers Bros. Parking-Western Corp.* (1976) 58 C.A.3d 173, 180, 130 C.R. 41, *infra*, §152 ["We emphasize that this case involves an agreement to build a parking structure, not a palace"]; *Sanders Const. Co. v. San Joaquin First Fed. Savings & Loan Assn.* (1982) 136 C.A.3d 387, 394, 186 C.R. 218 [following *Kreedman*].)

SUPPLEMENT: [This section is current through the latest supplement]



30 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT
B. Offer.

4. Certainty of Offer.

b. Reasonable Interpretation of Nontechnical Language.

4. Uncertainty Cured by Performance.

1 Witkin Sum. Cal. Law Contracts § 145

[§ 145] Uncertainty Cured by Performance.

In *Bohman v. Berg* (1960) 54 C.2d 787, 8 C.R. 441, 356 P.2d 185, defendant purchased a Greyhound bus and engaged plaintiff, a custom auto body builder, to convert it into a "land yacht." After numerous conferences, a detailed agreement was made specifying items of material and labor and charges, with a total cost not to exceed \$ 25,000. Defendant paid this sum and \$ 6,820.05 for extras, but refused to pay additional charges for work specified in the contract. In this action, the trial judge held the contract too indefinite to enforce, and gave judgment for plaintiff for a total of \$ 46,004.75 as the reasonable value of the work, leaving \$ 14,184.70 to be paid. *Held*, reversed.

(a) Defendant, arguing that the trial court erred in holding that the agreement was too indefinite and uncertain to constitute a contract, contended that he was required to pay no more than the \$ 25,000 contract price (he did contest paying the reasonable value of the additions). This argument is meritorious. Plaintiff understood what he was expected to do, and the performance was completed. Cases where specific performance or damages for failure to perform are sought are distinguishable; here, even though some uncertainty may have been present at the inception, *subsequent performance cured the defect*. "When one party performs under the contract and the other party accepts his performance without objection it is assumed that this was the performance contemplated by the agreement." (54 C.2d 795, citing many authorities, including the text, *infra*, §749.)

(b) The trial judge thought that the contract was uncertain because the work proposed was novel and some details were left to experimentation and future consideration. This theory is unsound: "[T]he protection of a binding contract is not afforded merely to common and ordinary projects." Both parties knew that their venture was unusual, it was entirely reasonable to protect themselves by binding agreements, and plaintiff accepted the risk that the experimental nature of the project might result in unexpected cost. (54 C.2d 797.) (For other examples of cure by practical construction, see *Fisher v. Parsons* (1963) 213 C.A.2d 829, 836, 29 C.R. 210; *Carruth v. Madera* (1965) 233 C.A.2d 688, 696, 43 C.R. 855, citing the text [invoking analogy of 1-year provision of statute of frauds, overcome by full performance]; 1 Corbin (Rev. ed.), §4.7; 1 Williston 4th, §4:29; 17A Am.Jur.2d (2004 ed.), *Contracts* §188.)

SUPPLEMENT: [This section is current through the latest supplement]
See 1 Williston 4th (2007 ed.), §4:32.



31 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT

B. Offer.

4. Certainty of Offer.

c. Matters Left to Future Agreement.

1. Minor or Nonessential Detail.

1 Witkin Sum. Cal. Law Contracts § 146

[§ 146] Minor or Nonessential Detail.

It is well settled that an agreement definite in its essential elements is not rendered unenforceable by reason of uncertainty in some minor, nonessential detail. Hence, it is common practice to provide that the unessential details are to be left to further agreement of the parties. (See *Hylton Flour Mills v. Bowen* (1933) 128 C.A. 711, 714, 18 P.2d 689 [election of buyer to select quality or brand of flour]; *Wilson v. Wilson* (1950) 96 C.A.2d 589, 594, 216 P.2d 104; *Riley v. Riley* (1953) 121 C.A.2d 303, 306, 263 P.2d 47; *Ontario Downs v. Lauppe* (1961) 192 C.A.2d 697, 703, 13 C.R. 782; *Rest.2d, Contracts* §33, Comment a; 1 Williston 4th, §4:28; on sale of goods, see U.C.C. 2204 [one or more terms left open], U.C.C. 2311 [particulars of performance to be specified].)

In *Los Angeles v. Superior Court (Los Angeles Dodgers)* (1959) 51 C.2d 423, 333 P.2d 745, plaintiff city contracted to transfer land to the Brooklyn National League Baseball Club in consideration of obligations such as erection of a stadium and procurement of the Dodgers' franchise. The instrument left for future agreement the exact location and size of the city's reserved oil drilling site and details concerning recreational facilities. *Held*, these uncertainties did not invalidate the agreement. "The enforceability of a contract containing a promise to agree depends upon the relative importance and the severability of the matter left to the future; it is a question of degree and may be settled by determining whether the indefinite promise is so essential to the bargain that inability to enforce that promise strictly according to its terms would make unfair the enforcement of the remainder of the agreement. ... Where the matters left for future agreement are unessential, each party will be forced to accept a reasonable determination of the unsettled point or if possible the unsettled point may be left unperformed and the remainder of the contract be enforced." (51 C.2d 433.)

West's Key Number Digest, Contracts k.25

SUPPLEMENT: [This section is current through the latest supplement]
See 1 Williston 4th (2007 ed.), §4:31.



32 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT

B. Offer.

4. Certainty of Offer.

c. Matters Left to Future Agreement.

2. Essential Element Reserved: No Contract.

aa. General Rule.

1 Witkin Sum. Cal. Law Contracts § 147

[§ 147] General Rule.

A contract that leaves an essential element for future agreement of the parties is usually held fatally uncertain and unenforceable. As the court said in *Ablett v. Clauson* (1954) 43 C.2d 280, 284, 272 P.2d 753, quoting Williston: "Although a promise may be sufficiently definite when it contains an option given to the promisor or promisee, yet if an essential element is reserved for the future agreement of both parties, the promise can give rise to no legal obligation until such future agreement. Since either party by the terms of the promise may refuse to agree to anything to which the other party will agree, it is impossible for the law to affix any obligation to such a promise." (See *Moore v. White* (1950) 98 C.A.2d 510, 511, 220 P.2d 918; *Salomon v. Cooper* (1950) 98 C.A.2d 521, 522, 220 P.2d 774; *Hiller v. King* (1951) 105 C.A.2d 181, 190, 232 P.2d 905; *Burgess v. Rodom* (1953) 121 C.A.2d 71, 73, 262 P.2d 335; *Roberts v. Adams* (1958) 164 C.A.2d 312, 315, 330 P.2d 900; *Louis Lesser Enterprises, Ltd. v. Roeder* (1962) 209 C.A.2d 401, 408, 25 C.R. 917; *Robinson & Wilson v. Stone* (1973) 35 C.A.3d 396, 409, 110 C.R. 675 [provision for building contractors to complete undersigned areas in future]; *Rest.2d, Contracts* §33, Comment e; 1 Corbin (Rev. ed.), §2.8; 1 Williston 4th, §4:26; 41 *San Diego L. Rev.* 1099 ["rolling contracts," in which agreement is formed or modified when last terms are presented for assent]; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §36; BAJI, No. 10.65 [Offer]; CACI, No. 307 [Contract Formation--Offer]; but see *infra*, §152)

A peculiar use of this terminology appears in *Autry v. Republic Productions* (1947) 30 C.2d 144, 180 P.2d 888. Plaintiff, a motion picture actor, was subject to military service during the period of his contract with defendant producer. A modification was executed, providing that if he should be drafted or should volunteer "the parties hereto will agree upon their mutual rights and obligations hereunder in view of such military service." Plaintiff enlisted, and defendant contended that the war service merely constituted temporary impossibility of performance, suspending his obligations until he returned, but requiring him to perform them thereafter. (See *infra*, §840.) *Held*, although the type of language used in the clause would not create an enforceable contract, it did operate to keep their existing contract in force, despite plaintiff's military service; hence, the period ran and plaintiff's obligations were discharged by "performance in legal contemplation," though he made no pictures during that time. (30 C.2d 151.)

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See 1 Williston 4th (2007 ed.), §4:29.



33 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT

B. Offer.

4. Certainty of Offer.

c. Matters Left to Future Agreement.

2. Essential Element Reserved: No Contract.

bb. Distinction: Contract To Negotiate Agreement.

1 Witkin Sum. Cal. Law Contracts § 148

[§ 148] Distinction: Contract To Negotiate Agreement.

Copeland v. Baskin Robbins U.S.A. (2002) 96 C.A.4th 1251, 117 C.R.2d 875, addressed the following question, which was unsettled in California: "[M]ay a party sue for breach of a *contract to negotiate an agreement* or is such a 'contract' merely an unenforceable '*agreement to agree*'?" Plaintiff contracted to purchase defendant's ice cream manufacturing plant, contingent on defendant's agreeing to purchase the ice cream manufactured there. This ice cream purchase contingency, known as a "co-packing" agreement, was an indispensable part of the underlying contract to purchase the plant. After several months of negotiation, the contract took the form of plaintiff's agreeing to purchase the manufacturing assets and sublease the plant property, and defendant's agreeing to purchase a specific amount of ice cream over a 3-year period. Defendant then sent plaintiff a letter confirming this arrangement and stating that it was subject to a separate co-packing agreement yet to be agreed upon. Details remaining to be settled were the price of the ice cream, the flavors, quality standards and controls, the party bearing the loss from spoilage, and trademark protection. When defendant later broke off negotiations to enter into the co-packing agreement, plaintiff sued for breach of contract and claimed as damages the profits lost from the failure to negotiate that contract. On the ground that the aforementioned confirming letter was merely an unenforceable agreement to agree, the trial court granted summary judgment for defendant. *Held*, affirmed, but on a different ground.

(a) *Contract to negotiate agreement.*

(1) Plaintiff had three options: (a) proceed with the contract for the purchase and lease of the plant assets; (b) claim that the confirming letter constituted an enforceable co-packing agreement; or (c) contend that the confirming letter was a contract to negotiate the remaining terms of the co-packing agreement. Plaintiff choose the third option. (*96 C.A.4th 1255.*)

(2) In principle, there is no reason why the parties could not enter into an enforceable contract to negotiate the terms of a co-packing agreement. A contract is but an agreement to do or not to do a certain thing, and parties are thus free to contract to do anything that is not illegal or immoral. Conducting negotiations to buy and sell ice cream is neither. (*96 C.A.4th 1257.*)

(3) Contracts to negotiate are distinguishable from unenforceable agreements to agree. For example, if, despite their good faith efforts, the parties fail to agree on the issues remaining to be settled, a contract to negotiate is nevertheless deemed performed. In other words, a party will be liable only if the failure to agree on the remaining terms results from a breach of that party's obligation to negotiate in good faith. (96 C.A.4th 1257.) On the other hand, an agreement to agree is unenforceable, because, by the very terms of the promise, either party may refuse to agree on anything to which the other party will agree. (96 C.A.4th 1257, footnote 10, citing *Avalon Products v. Lentini* (1950) 98 C.A.2d 177, 219 P.2d 485, *infra*, §152; on requirement of *present* willingness to enter into a bargain, see *supra*, §125.)

(4) Moreover, the focus is different. Thus, an agreement to negotiate a contract is not concerned with the enforceability of the agreement to negotiate, whereas with an agreement to agree, the focus is on the enforceability of the underlying contract. (96 C.A.4th 1257.)

(5) Most jurisdictions that have considered this question have concluded that a cause of action exists for breach of a contract to negotiate the terms of an agreement. (96 C.A.4th 1259, citing a federal case.)

(6) Defendant argued that enforcing a contract to negotiate an agreement would be to inject a covenant of good faith and fair dealing into the *negotiation* process and thereby increase the pressure on the parties to bring the negotiations to a hasty, even if unsatisfactory, conclusion, rather than risk being found to have acted in bad faith. This argument is without merit. "Allowing a party to sue for breach of a contract to negotiate an agreement would not inject a covenant of good faith and fair dealing into the negotiation process in violation of the parties' intent. When two parties, under no compulsion to do so, engage in negotiations to form or modify a contract neither party has any obligation to continue negotiating nor to negotiate in good faith. Only when the parties are under a contractual compulsion to negotiate does the covenant of good faith and fair dealing attach, as it does in every contract. In the latter situation the implied covenant of good faith and fair dealing has the salutary effect of creating a disincentive for acting in bad faith in contract negotiations." (96 C.A.4th 1260.)

(7) Defendant also argued that any precontractual wrongdoing can be adequately remedied by existing causes of action for unjust enrichment, promissory fraud, and promissory estoppel. These contentions are likewise unpersuasive: (a) Recovery for *unjust enrichment* in the context of contract negotiations is usually based on ideas disclosed or services rendered during the negotiation process. Here, however, the negotiations were about the sale of goods. (b) A cause of action for *promissory fraud* is based on a promise made without any intention of performing it. However, the defendant may have intended to negotiate in good faith, but may have changed his or her mind when a more attractive alternative presented itself. (c) A cause of action for *promissory estoppel* might lie if the defendant made a clear promise to negotiate in good faith, and the plaintiff reasonably relied on this promise in incurring expenditures. Such a cause of action would be based on the implied promise to negotiate in good faith. "If these propositions are correct, then promissory estoppel is just a different rubric for determining the enforceability of a contract to negotiate an agreement." (96 C.A.4th 1261.)

(8) Contracts today are not made by discrete offers, counteroffers, and acceptances. Rather, they are the result of a gradual process involving face-to-face meetings, telephone calls, e-mails, and input by many persons other than the original parties. These contracts are not only time-consuming but costly, and the parties should have some assurance that their investments in time and money will not be destroyed by the other party's foot-dragging or change of heart. (96 C.A.4th 1262.)

(b) *Damages.*

(1) Damages for breach of a contract to negotiate an agreement are measured by the injury the plaintiff suffered in relying on the defendant to negotiate in good faith. This measure encompasses the plaintiff's out-of-pocket costs in conducting the negotiations and may include lost opportunity expenses. However, the plaintiff cannot recover for *lost profits*, because there is no way of knowing what the ultimate terms of the agreement would have been, or even if there would have been an agreement. (96 C.A.4th 1262.)

(2) Here, the only damages that plaintiff seeks in his complaint are derived from what he would have received if the underlying contract had been consummated. Moreover, the complaint disavowed reliance damages. Similarly, in response to defendant's interrogatories, plaintiff stated that his damages were lost profits from the ice cream deals. In short, the complaint and the answer to interrogatories constitute a sufficient showing that plaintiff does not possess, and cannot obtain, needed evidence to establish the required reliance damages. Therefore, defendant is entitled to summary judgment. (96 C.A.4th 1263.)

SUPPLEMENT: [This section is current through the latest supplement]



34 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT

B. Offer.

4. Certainty of Offer.

c. Matters Left to Future Agreement.

2. Essential Element Reserved: No Contract.

cc. Terms of Renewal Lease.

1 Witkin Sum. Cal. Law Contracts § 149

[§ 149] Terms of Renewal Lease.

A typical uncertain provision is one giving a lessee an option to renew a lease at its expiration, "upon terms to be then agreed upon." Unless exceptional circumstances exist, e.g., where the only term requiring future agreement is the amount of rental (see *infra*, §152), the option is unenforceable. (*Ablett v. Clauson* (1954) 43 C.2d 280, 286, 272 P.2d 753, *supra*, §147 [questioning extended rule suggested in *Chaney v. Schneider* (1949) 92 C.A.2d 88, 206 P.2d 669, *infra*, §152]; see *Myers v. Gager* (1959) 175 C.A.2d 314, 323, 346 P.2d 251 [following *Ablett* case]; *Etco Corp. v. Hauer* (1984) 161 C.A.3d 1154, 1161, 208 C.R. 118, 12 Summary (10th), *Real Property*, §529 [renewal provision calling for rent to be determined by mutual agreement at time of renewal held unenforceable for lack of ascertainable standard; distinguishing *Chaney v. Schneider*; 43 Cal. L. Rev. 706.]

West's Key Number Digest, Contracts k.25

SUPPLEMENT: [This section is current through the latest supplement]



35 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT
B. Offer.
4. Certainty of Offer.
c. Matters Left to Future Agreement.
2. Essential Element Reserved: No Contract.
dd. Price of Stock.

1 Witkin Sum. Cal. Law Contracts § 150

[§ 150] Price of Stock.

In *Citizens Util. Co. v. Wheeler* (1957) 156 C.A.2d 423, 319 P.2d 763, a lengthy memorandum of agreement provided for the sale of the stock of a water company by defendants to plaintiff for a base price of \$ 2.8 million, which was subject to adjustment by a complicated process in the event of rate increases or decreases ordered by the Public Utilities Commission. After months of negotiation, the parties failed to agree on the final terms of the purchase. *Held*, the trial judge's conclusion that the contract was fatally uncertain in its provisions for ascertainment of the price was justified. Answering the argument that a "reasonable price" could be determined (see 4 *Summary* (10th), *Sales*, §47), the court said: "The proposed sale was of all the stock of a water company involving somewhat unique problems of valuation. There was no established market price; there was no prior course of dealings between the parties; and the record discloses no established practice in the industry by which the price could be fixed. The parties clearly attempted to provide an exclusive method by which price was to be ascertained. ... The magnitude of the risk to the parties by the attempt to substitute a reasonable price ... is apparent from the mere statement of the following facts: the original asking price was \$ 3,000,000; the original offer to buy was \$ 2,300,000; and the fair market value is alleged to be \$ 7,200,000." (156 C.A.2d 433.)

SUPPLEMENT: [This section is current through the latest supplement]



36 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT

B. Offer.

4. Certainty of Offer.

c. Matters Left to Future Agreement.

2. Essential Element Reserved: No Contract.

ee. Manner of Payment.

1 Witkin Sum. Cal. Law Contracts § 151

[§ 151] Manner of Payment.

In *Avalon Products v. Lentini* (1950) 98 C.A.2d 177, 219 P.2d 485, defendant's agreement to buy ice cream freezer equipment contained the provision: "Method of payment to be agreed upon before delivery." *Held*, the contract was void. If it had been *wholly silent* as to payment, it could have been construed as requiring cash on delivery. But the clause in question, by specifically stating that the method of payment was yet to be arrived at, clearly indicated a failure to agree on an essential term. (98 C.A.2d 180.) (See *Burgess v. Rodom* (1953) 121 C.A.2d 71, 73, 262 P.2d 335; *Roberts v. Adams* (1958) 164 C.A.2d 312, 315, 330 P.2d 900; *Alaimo v. Tsunoda* (1963) 215 C.A.2d 94, 96, 29 C.R. 806 [listing with plaintiff real estate broker, defendant seller reserving right to determine sale price of land]; 68 A.L.R.2d 1221 [terms of payment for property].)

SUPPLEMENT: [This section is current through the latest supplement]



37 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT
B. Offer.

4. Certainty of Offer.

c. Matters Left to Future Agreement.

3. Essential Element Reserved: Contract Enforced.

aa. Terms of Lease.

1 Witkin Sum. Cal. Law Contracts § 152

[§ 152] Terms of Lease.

In *Chaney v. Schneider* (1949) 92 C.A.2d 88, 206 P.2d 669, upholding a provision for renewal of a lease on terms and rentals "to be mutually agreed upon," the court, after observing that "the rules as to uncertainty in interpreting contracts are developing along with changing conditions in business and human affairs," quoted from Williston as follows: "[S]ome courts, recognizing the practical business utility of such clauses in a lease, treat them as sufficiently definite by interpreting them as meaning a reasonable rental under the circumstances in case the parties cannot agree. A similar development is taking place with respect to sales of goods at prices to be later agreed upon in jurisdictions unhampered by the statutory requisite of the memorandum under the Statute of Frauds." (92 C.A.2d 90.) (See *California Lettuce Growers v. Union Sugar Co.* (1955) 45 C.2d 474, 483, 289 P.2d 785, *infra*, §153; *Forde v. Vernbro Corp.* (1963) 218 C.A.2d 405, 409, 32 C.R. 577, *infra*, §153; 1 Williston 4th, §4:26; 43 Cal. L. Rev. 706; 61 Harv. L. Rev. 372; 24 So. Cal. L. Rev. 91; 58 A.L.R.3d 500 [validity of renewal provision requiring amount of rent to be fixed by future agreement].) In *Ablett v. Clauson* (1954) 43 C.2d 280, 272 P.2d 753, *supra*, §147, the court apparently confined *Chaney, supra*, to situations where *rental* alone is to be fixed, not where all the provisions of a new lease are to be determined without ascertainable standards. (43 C.2d 286; see *Etco Corp. v. Hauer* (1984) 161 C.A.3d 1154, 1161, 208 C.R. 118, 12 Summary (10th), *Real Property*, §529 [renewal provision leaving rent to be determined in future is enforceable only if lease contains ascertainable standard for such determination; distinguishing *Chaney*].)

In *Kreedman & Co. v. Meyers Bros. Parking-Western Corp.* (1976) 58 C.A.3d 173, 130 C.R. 41, the lessor and lessee signed a 30-page standard commercial lease, under which the lessor agreed to proceed diligently with the construction of a parking garage "in accordance with certain plans, drawings and specifications ... which have been signed by the parties and are incorporated in and made a part of this Lease." No such plans, etc., were ever prepared. *Held*, nevertheless, the agreement was sufficiently certain to support a judgment for damages in favor of the lessee when the lessor failed to perform. (a) The agreement involved a structure for cars, not people, and cases involving residences and commercial buildings are of limited applicability. (58 C.A.3d 180.) (b) Cases involving specific performance are likewise not controlling, for an agreement not certain enough for an equitable decree may be the basis of an action for damages. (58 C.A.3d 180; see 13 Summary (10th), *Equity*, §42.) (c) The lessor's promise was based on

requirements known to him, and the agreement provided a list of details defining the structure. (58 C.A.3d 182.) (See *Sanders Const. Co. v. San Joaquin First Fed. Savings & Loan Assn.* (1982) 136 C.A.3d 387, 394, 186 C.R. 218 [following *Kreedman*].)

West's Key Number Digest, Contracts k.25

SUPPLEMENT: [This section is current through the latest supplement]

See 1 Williston 4th (2007 ed.), §4:29. *Correction:* Page 192, line 6, "*Kreedman & Co. v. Meyers Bros. Parking-Western Corp.*" should be "*S. Jon Kreedman & Co. v. Meyers Bros. Parking-Western Corp.*"



38 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT
B. Offer.
4. Certainty of Offer.
c. Matters Left to Future Agreement.
3. Essential Element Reserved: Contract Enforced.
bb. Price of Goods or Stock.

1 Witkin Sum. Cal. Law Contracts § 153

[§ 153] Price of Goods or Stock.

(1) *Sale of Goods*. A provision in a contract of sale that the price of goods is to be subsequently ascertained by agreement of the parties was formerly considered a fatal defect. (*Jules Levy & Bro. v. A. Mautz & Co. (1911) 16 C.A. 666, 669, 117 P. 936; Stone Drill Corp. v. Stooddy Co. (1935) 4 C.A.2d 367, 369, 40 P.2d 945; see 1 Williston 4th, §4:26.*) However, the mere *failure to state the price* was not necessarily fatal; the contract was enforceable if the price could be objectively determined in some manner. Thus, in *California Lettuce Growers v. Union Sugar Co. (1955) 45 C.2d 474, 289 P.2d 785*, there was a usage of trade, known to both parties, that the price of sugar beets to be bought from plaintiff seller was to be determined by the net return from sugar sold by defendant processor during the current crop year. *Held*, this net return formula was sufficiently definite to satisfy the requirement of certainty. (*45 C.2d 483.*) (See *49 A.L.R.2d 508* [validity of sales contract as affected by provision giving buyer power to fix price].)

The Uniform Commercial Code liberalizes the rule by providing that if the parties intend an agreement for the sale of goods to be binding, the agreement will be enforceable even though the price term is left open. If no price is thereafter fixed, the price to be paid will be "a reasonable price at the time for delivery." (U.C.C. 2305, *supra*, §142); see *4 Summary (10th), Sales, §47.*

(2) *Sale of Corporate Stock*. In *Forde v. Vernbro Corp. (1963) 218 C.A.2d 405, 32 C.R. 577*, the contract was for sale of corporate stock, at "the amount of the fair evaluation as agreed by the attorneys." *Held*, citing the text, this was enforceable; there was a sufficient standard for determination by the court in the event the attorneys failed to agree. (*218 C.A.2d 409.*)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Sale of Goods*. See 1 Williston 4th (2007 ed.), §4:29.



39 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT
B. Offer.

4. Certainty of Offer.

c. Matters Left to Future Agreement.

3. Essential Element Reserved: Contract Enforced.

cc. Promise To Reach Agreement on Placement of Former Employees.

1 Witkin Sum. Cal. Law Contracts § 154

[§ 154] Promise To Reach Agreement on Placement of Former Employees.

In *Herman v. Los Angeles* (2002) 98 C.A.4th 484, 119 C.R.2d 691, a transportation authority abolished its police force, and contracted with defendant county to provide it with police services through the county sheriff. As to those former transportation authority officers who did not pass the sheriff's review process, the contract provided that the parties "shall meet and reach mutual agreement on the placement of such personnel." Plaintiff, a former transportation authority officer fitting this description, sought mandamus enforcing this provision, but his petition was denied partly on the ground that the contract was void for leaving an essential element unsettled. *Held*, reversed.

(a) Generally, where any of the essential elements of a promise are reserved for the future agreement of both parties, no legal obligation arises until this future agreement is reached (see *supra*, §147). This rule might have been applicable had the parties done nothing more than reserve for future agreement the question of what to do with former transportation authority officers who did not pass the sheriff's review process and therefore were not given jobs as deputy sheriffs. However, the parties made provision for this contingency by providing that they would meet and reach mutual agreement on the placement of these officers in some other employment. Moreover, the parties provided that if they could not reach an agreement on this matter, it would be submitted to mediation. "There is nothing unlawful or even unusual about contracting parties agreeing to cross certain bridges when they are reached." (98 C.A.4th 488.)

(b) Here, the parties could not have made their contract more definite, because at the time that it was drafted they had no way of knowing which former transportation authority officers would fail the sheriff's screening process and what jobs might be available and appropriate for these people. (98 C.A.4th 488.)

SUPPLEMENT: [This section is current through the latest supplement]



40 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT

B. Offer.

4. Certainty of Offer.

c. Matters Left to Future Agreement.

4. Changes in Building Contract.

1 Witkin Sum. Cal. Law Contracts § 155

[§ 155] Changes in Building Contract.

In *Coleman Engineering Co. v. North Amer. Aviation* (1966) 65 C.2d 396, 55 C.R. 1, 420 P.2d 713, a loose contractual engagement led to the pronouncement of a new doctrine by a divided court (5-2). Defendant, manufacturing the "Hound Dog Missile" for the Armed Forces, invited bids for trailers to carry it, and plaintiff was the successful bidder. An essential element of the contract was the description that established the "CG" (center of gravity) of the payload. This was never clearly stated in any of the writings that together constituted the contract. Plaintiff's engineers, reasonably interpreting the specifications as locating the CG at the rail top of the trailer, discovered later that it would be 35 inches higher, and it caused extra expense to plaintiff.

The contract contained a provision under which defendant reserved the right to make "changes," in which event "an equitable adjustment in price and time of performance mutually satisfactory to buyer and seller" would be made. Plaintiff refused to continue further performance without determination of the increase in price, and defendant made other arrangements. Plaintiff was awarded judgment for damages, consisting of the expense incurred in performing until termination. *Held*, affirmed.

(a) The general rule rendering a contract fatally uncertain where an essential element is reserved cannot fairly be applied to change orders in a building contract that lack a formula for price determination. At the time of contracting, it is impossible to tell whether a change order will be substantial or not. "Accordingly, where a provision for changes contains an agreement to agree in the future as to price, the contract is not invalid from the outset, and the validity of the provision for changes depends upon subsequent events." (65 C.2d 406.)

(b) If the subsequent change is minor in nature, the contractor must perform and, if necessary, seek a later judicial determination of price. If, however, a major change is made, the contractor need only negotiate for the "mutually satisfactory" price in good faith; when negotiations fail, he or she need not continue performance. (65 C.2d 406.)

(c) The trial judge here properly concluded that the change was major, and that plaintiff was justified in stopping performance in the absence of an agreement as to price. (65 C.2d 407.)

An extremely persuasive dissenting opinion argues that the contractual negotiations never gave rise to a binding contract because of the failure to agree on the specifications, time of performance, and price--particularly the essential element of the CG. This being so, the change clause never came into operation, and plaintiff's remedy was in quasi-contract, for performance in good faith under an unenforceable agreement. (65 C.2d 410.)

The view taken by the dissent made it necessary to answer the old question whether a plaintiff may have restitution from a defendant not benefited, for here defendant procured the entire performance elsewhere and plaintiff's partial performance was of no value to it. The dissenting justice, citing some scholarly sources, declared that "benefit conferred" is a fiction; the basis of recovery is the moral obligation to the plaintiff who renders requested services--beneficial or not. (65 C.2d 418.) (See supra, §§1018, 1019; for comments on the *Coleman* case, see 55 Cal. L. Rev. 1114; 19 Hastings L. J. 1259.) (See *Denver D. Darling v. Controlled Environments Const.* (2001) 89 C.A.4th 1221, 1237, 108 C.R.2d 213, citing the text, [using custom and usage in building industry to determine required flatness of dock floor, i.e., floor had to meet industry standards and be suitable for building owner's use].)

SUPPLEMENT: [This section is current through the latest supplement]



41 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT

B. Offer.

5. Termination of Offer.

a. In General.

1 Witkin Sum. Cal. Law Contracts § 156

[§ 156] In General.

An offer gives the offeree a continuing power to create a contract by acceptance of the offer *before the power has been terminated*. (*Rest.2d, Contracts §§35, 36.*)

The power may be terminated by lapse of either a prescribed or a reasonable time (see *infra*, §157); death or incapacity of the offeror or offeree (see *infra*, §158); revocation by the offeror (see *infra*, §159 et seq.); rejection or counteroffer by the offeree (see *infra*, §163); or nonoccurrence of any condition of acceptance under the terms of the offer (see *Rest.2d, Contracts §36(2)* and Comment b). (See 1 Williston 4th, §5:1 et seq.)

West's Key Number Digest, Contracts k.20

SUPPLEMENT: [This section is current through the latest supplement]
See 1 Williston 4th (2007 ed.), §5:1 et seq.



42 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT
B. Offer.
5. Termination of Offer.
b. Lapse of Prescribed or Reasonable Time.

1 Witkin Sum. Cal. Law Contracts § 157

[§ 157] Lapse of Prescribed or Reasonable Time.

(1) *Lapse of Prescribed Time.* An offeree's power of acceptance is terminated if he or she fails to accept within the prescribed period. (C.C. 1587(2); see *Rest.2d, Contracts §41(1)*; 1 Corbin (Rev. ed.), §2.14; 1 Williston 4th, §§5:5, 5:6; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §§58, 79.)

(2) *Lapse of Reasonable Time.* If the offer does not specify a particular time for acceptance, the offeree's power is terminated if he or she fails to accept within a reasonable time. (C.C. 1587(2); see *Rest.2d, Contracts §41(1)*; 1 Corbin (Rev. ed.), §2.16; 1 Williston 4th, §5:7; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §§58, 79.)

(3) *What Constitutes Reasonable Time.* "Reasonable time" is a question of fact, dependent on the circumstances existing when the offer and attempted acceptance are made; such circumstances include the nature of the proposed contract, the purposes of the parties, the course of dealing, and relevant usages of trade. (See *Bandy v. Westover* (1927) 200 C. 222, 230, 252 P. 593; *Forbes v. Board of Missions of Methodist Episcopal Church, South* (1941) 17 C.2d 332, 339, 110 P.2d 3; *Coats & Williamson v. Moran & Co.* (1924) 67 C.A. 46, 50, 227 P. 213 [market for hay fluctuating, acceptance after 2 weeks said to be too late]; *Rest.2d, Contracts §41(2)*, and Comment b; §41(3) [offer sent by mail is seasonably accepted by acceptance mailed before midnight on day offer was received]; §41, Comment d [in direct negotiations, face to face or over telephone, time ordinarily does not extend beyond end of conversation]; §41, Comment f [in speculative transactions where there is rapid fluctuation in value, reasonable time is brief]; 1 Corbin (Rev. ed.), §2.16; 1 Williston 4th, §5:7; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §58.)

(4) *Effect of Delay in Communication of Offer.* If a mailed offer specifies 10 days after its receipt for acceptance, and is greatly delayed in delivery, has the offeree the full 10-day period after receipt within which to accept? The better view is that if the postmark or other evidence makes it apparent that there was undue delay, the offeree cannot take advantage of it, but must accept within the time that would have been available had the letter arrived in the normal time. (See *Rest.2d, Contracts §49*; 1 Corbin (Rev. ed.), §2.17; 1 Williston 4th, §5:21; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §77.)

The Restatement section is more comprehensive:

"If communication of an offer to the offeree is delayed, the period within which a contract can be created by acceptance is not thereby extended if the offeree knows or has reason to know of the delay, though it is due to the fault of the offeror; but if the delay is due to the fault of the offeror or to the means of transmission adopted by him, and the offeree neither knows nor has reason to know that there has been delay, a contract can be created by acceptance within the period which would have been permissible if the offer had been dispatched at the time that its arrival seems to indicate." (*Rest. 2d, Contracts §49.*)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Lapse of Prescribed Time.* See 1 Williston 4th (2007 ed.), §§5:5, 5:6.

(2) *Lapse of Reasonable Time.* See 1 Williston 4th (2007 ed.), §5:7.(3) *What Constitutes Reasonable Time.* See 1 Williston 4th (2007 ed.), §5:7.

(4) *Effect of Delay in Communication of Offer.* See 1 Williston 4th (2007 ed.), §5:21.



43 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT
B. Offer.
5. Termination of Offer.
c. Death or Incapacity of Offeror or Offeree.

1 Witkin Sum. Cal. Law Contracts § 158

[§ 158] Death or Incapacity of Offeror or Offeree.

(1) *Offeror*. Death or incapacity of the offeror terminates the power of acceptance even though the offeree has no knowledge or notice of it. The theory is that, at the time of acceptance, there is no offeror capable of contracting. (C.C. 1587(4); *Shaw v. King* (1923) 63 C.A. 18, 24, 218 P. 50; *Board of Home Missions & Church Extension of Methodist Episcopal Church v. Manley* (1933) 129 C.A. 541, 543, 19 P.2d 21; *Fritz v. Thompson* (1954) 125 C.A.2d 858, 863, 271 P.2d 205; see *Rest.2d, Contracts §48*; 1 Corbin (Rev. ed.), §2.34; 1 Williston 4th, §§5:19, 5:20; 17A Am.Jur.2d (2004 ed.), *Contracts §63*.)

The Restatement describes the rule as a relic of the obsolete requirement of a "meeting of minds," out of harmony with the modern objective theory (see *supra*, §116). However, some inroads have been made by statutes and decisions on bank deposits and collections, and on powers of attorney given by servicemen; also, persons under a disability often have power to enter into voidable contracts. (*Rest.2d, Contracts §48*, Comments a, b.)

(2) *Offeree*. Death of the offeree also terminates the offer, but for a different reason: Only the person to whom the offer was made can accept it. Consequently, upon his or her death, neither the offeree's executor nor any other person may accept on his or her behalf. (See *Estate of Watts* (1984) 162 C.A.3d 1160, 1164, 208 C.R. 846, quoting the text; *Rest.2d, Contracts §48*; 1 Corbin (Rev. ed.), §2.34; 1 Williston 4th, §§5:19, 5:20; 17A Am.Jur.2d (2004 ed.), *Contracts §63*.)

Death of a party to a *completed contract* must be distinguished: The obligations may survive. (See *infra*, §838.)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Offeror*. See 1 Williston 4th (2007 ed.), §§5:19, 5:20.

(2) *Offeree*. See 1 Williston 4th (2007 ed.), §§5:19, 5:20.



44 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT

B. Offer.

5. Termination of Offer.

d. Revocation by Offeror.

1. In General.

1 Witkin Sum. Cal. Law Contracts § 159

[§ 159] In General.

An offer is revoked by notice of revocation communicated by the offeror to the offeree before the latter's acceptance has been communicated to the offeror. (C.C. 1587(1); *Willson v. Niagara Duplicator Co. (1948)* 88 C.A.2d 63, 76, 198 P.2d 362; *Bellasi v. Shackelford (1962)* 201 C.A.2d 265, 267, 19 C.R. 925; *CPI Builders v. Impco Technologies (2001)* 94 C.A.4th 1167, 1172, 114 C.R.2d 851 [offeror's agent communicated offer to offeree, and offeree's counsel accepted, not knowing that previously offeror had communicated notice of revocation to her agent; because this communication did not satisfy C.C. 1587(1), revocation was ineffective, and contract was formed]; *Rest.2d, Contracts §42*; 1 Corbin (Rev. ed.), §2.19; 1 Williston 4th, §5:9; *17A Am.Jur.2d (2004 ed.)*, *Contracts §59*; BAJI, No. 10.67 [Revocation]; CACI, No. 308 [Contract Formation--Revocation of Offer].)

West's Key Number Digest, Contracts k.19

SUPPLEMENT: [This section is current through the latest supplement]
See 1 Williston 4th (2007 ed.), §5:8.



45 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT

B. Offer.

5. Termination of Offer.

d. Revocation by Offeror.

2. When Revocation Becomes Effective.

1 Witkin Sum. Cal. Law Contracts § 160

[§ 160] When Revocation Becomes Effective.

(1) *In General.* Section 42 of the Restatement states that the power of acceptance is terminated when the offeree "receives" from the offeror a manifestation of intention not to enter into the proposed contract, and section 68 defines "received" for the purpose of revocation, rejection, or acceptance as follows: "A written revocation, rejection, or acceptance is received when the writing comes into the possession of the person addressed, or of some person authorized by him to receive it for him, or when it is deposited in some place which he has authorized as the place for this or similar communications to be deposited for him." (See 1 Corbin (Rev. ed.), §2.19; 1 Williston 4th, §5:9; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §60; BAJI, No. 10.67 [Revocation]; CACI, No. 308 [Contract Formation--Revocation of Offer].)

The California statute appears to be contrary to the general rule set forth in the Restatement. C.C. 1587(1) provides that revocation is effected by the communication of notice of revocation by the offeror to the offeree, in the manner prescribed by C.C. 1581 and C.C. 1583. The cited statutes deal with communication of *acceptance*, which requires only placement "in the course of transmission." (See *infra*, §187 et seq.) Hence, if this section is literally applied, a notice of revocation posted *before* the posting of acceptance, even though it reaches the offeree *after* acceptance, prevents formation of a contract.

(2) *Agent Not Equivalent of Telegraph or Mail.* In *Ersa Grae Corp. v. Fluor Corp.* (1991) 1 C.A.4th 613, 2 C.R.2d 288, defendant raised the novel argument that the revocation of its counteroffer to plaintiff was effective at the time its *own agent* received notice thereof, because the agent, being the human and legal equivalent of a telegraph office or mailbox, was a reasonable and usual *mode* for the communication of offers, acceptances, and revocations within the meaning of C.C. 1582 and 1587. Defendant further contended that the revocation was effective regardless of whether its agent was also plaintiff's agent or whether the agent actually communicated the revocation to plaintiff.

Rejecting this argument, the court said: "Fluor offers no authority to support this rather astonishing proposition nor does it attempt to explain how notice to one's own agent who is not also the agent of the offeree and who does not communicate the notice to its intended recipient could ever suffice. We know of no such authority and therefore summarily refuse to adopt a rule which, by its own terms, is patently absurd. In any event, 'mode' of communication

refers to the medium used, not the messenger." (1 *C.A.4th* 623.)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *In General*. See 1 Williston 4th (2007 ed.), §5:9.



46 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT

B. Offer.

5. Termination of Offer.

d. Revocation by Offeror.

3. Indirect Revocation: "Reliable Information."

1 Witkin Sum. Cal. Law Contracts § 161

[§ 161] Indirect Revocation: "Reliable Information."

Ordinarily, the revocation must be *directly* communicated to the offeree. But the Restatement, following the rule of *Dickinson v. Dodds* (1876) 2 Ch.D. 463, recognizes a form of indirect communication, i.e., where the offeror takes definite action inconsistent with the offer, and the offeree "acquires reliable information to that effect." (*Rest.2d, Contracts §43*; see 1 Corbin (Rev. ed.), §2.20; 1 Williston 4th, §5:10.) The rule is applied most frequently to offers for the sale of an interest in land: when the offeror sells or contracts to sell to another, creating a probable inability to perform, the initial offer is revoked upon the original offeree's learning of the sale to the other person. (*Rest.2d, Contracts §43*, Comment b.)

The rule does not apply, however, where the offeror takes no action or takes equivocal action; e.g., where he or she merely negotiates with a third person, or makes a binding contract with a third person expressly subject to the rights of the offeree. (*Rest.2d, Contracts §43*, Comment d.)

West's Key Number Digest, Contracts k.19

SUPPLEMENT: [This section is current through the latest supplement]
See 1 Williston 4th (2007 ed.), §5:10.



47 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT

- B. Offer.
- 5. Termination of Offer.
- d. Revocation by Offeror.
- 4. General Offer to Public.

1 Witkin Sum. Cal. Law Contracts § 162

[§ 162] General Offer to Public.

If an offer has been communicated to an offeree, a change in its terms, like a revocation, must be communicated in order to be effective. The normal and reasonable communication of such change would be in the manner in which the original offer was communicated. But in *Long v. Chronicle Publishing Co. (1924) 68 C.A. 171, 228 P. 873*, a newspaper announced a subscription contest, with prizes, and set forth certain conditions, reserving the right to amend them. A change in the conditions was made, and published in a subsequent issue of the paper. Plaintiff, who had entered the contest, did not see the latter notice. The court held that she was not bound by it. (68 C.A. 176.) The decision, however, proceeds in part upon the theory of waiver of the rule by the defendant company. (See concurring opinion, 68 C.A. 185.)

SUPPLEMENT: [This section is current through the latest supplement]



48 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT
B. Offer.

5. Termination of Offer.
e. Rejection or Counteroffer by Offeree.

1 Witkin Sum. Cal. Law Contracts § 163

[§ 163] Rejection or Counteroffer by Offeree.

(1) *Rejection.* An offeree's power of acceptance is terminated by his or her rejection of the offer. (*Beverly Way Associates v. Barham* (1990) 226 C.A.3d 49, 55, 276 C.R. 240, *infra*, §790; see *Rest.2d, Contracts* §38(1); 1 Corbin (Rev. ed.), §3.41; 1 Williston 4th, §5:3; Cal. Transactions Forms, 1 Business Transactions §6:16.) However, if the offeree states that he or she rejects the offer for the present but will reconsider it at a future time, the offeree "manifests an intention to take it under further advisement," and there is no rejection. (*Rest.2d, Contracts* §38(2), and Comment b.)

(2) *Counteroffer.* A counteroffer proposing a substituted bargain has the same effect as a rejection in terminating the offeree's power of acceptance, unless the offeror or offeree has manifested a contrary intention. (*Rest.2d, Contracts* §39; see 1 Corbin (Rev. ed.), §3.36; 1 Williston 4th, §5:3.) (On qualified or conditional acceptance as counteroffer, see *infra*, §185.)

(3) *Time When Rejection or Counteroffer Takes Effect.* The Restatement (§40) states the following rules:

(a) A rejection or counteroffer by mail or telegram does not terminate the power of acceptance until received by the offeror. (See 1 Corbin (Rev. ed.), §§3.36, 3.41; 1 Williston 4th, §5:4.)

(b) A rejection or counteroffer may be superseded by an acceptance; but a letter or telegram of acceptance started after the rejection or counteroffer is ineffective unless received by the offeror before he receives the rejection or counteroffer. The reason is that the offeror will probably rely on the rejection or counteroffer if it arrives first; therefore, to protect the offeror, the offeree in this situation is deprived of the benefit of the rule that an acceptance takes effect on dispatch (*infra*, §191). (*Rest.2d, Contracts* §40, Comment b.)

West's Key Number Digest, Contracts k.21

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Rejection.* See 1 Williston 4th (2007 ed.), §5:3; 102 Proof of Facts 3d 313 [acts constituting rejection of offer].(2)

Counteroffer. See 1 Williston 4th (2007 ed.), §5:3.

(3) *Time When Rejection or Counteroffer Takes Effect.* See 1 Williston 4th (2007 ed.), §5:4.



49 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law V. FORMATION: MUTUAL CONSENT

B. Offer.

6. Revocability.

a. Offeror's Right To Revoke.

1. General Rule of Revocability.

1 Witkin Sum. Cal. Law Contracts § 164

[§ 164] General Rule of Revocability.

The offeror may revoke the offer at any time before the communication of acceptance. (C.C. 1586; *Rest.2d, Contracts* §42; see *T.M. Cobb Co. v. Superior Court* (1984) 36 C.3d 273, 278, 204 C.R. 143, 682 P.2d 338, 6 Cal. Proc. (4th), *Proceedings Without Trial*, §83.)

This right to revoke exists even though the offeror has stated that the offer is to continue for a specified period. (*Thomas v. Birch* (1918) 178 C. 483, 489, 173 P. 1102; *Bullock v. McKeon* (1930) 104 C.A. 72, 78, 285 P. 392; see 1 Corbin (Rev. ed.), §2.18; 1 Williston 4th, §5:8 et seq.; 17A Am.Jur.2d (2004 ed.), *Contracts* §58 et seq.; Cal. Transactions Forms, 1 Business Transactions §6:15; BAJI, No. 10.67 [Revocation]; CACI, No. 308 [Contract Formation--Revocation of Offer].) And an oral revocation is effective in the face of a stipulation that the offer is not to be revoked except *in writing*. (*Bellasi v. Shackelford* (1962) 201 C.A.2d 265, 267, 19 C.R. 925.) The basis for the offeror's right to revoke is the absence of consideration for the offer. (*Prather v. Vasquez* (1958) 162 C.A.2d 198, 204, 327 P.2d 963 [option is revocable where no consideration has been given to keep option open]; on irrevocable options, see §168.)

"An offeror's power of revocation is not limited by the deposit of money or other property to be forfeited in the event of revocation, but the deposit may be forfeited to the extent that it is not a penalty." (*Rest.2d, Contracts* §44.)

West's Key Number Digest, Contracts k.19

SUPPLEMENT: [This section is current through the latest supplement]

See *Brown v. Labow* (2007) 157 C.A.4th 795, 816, 69 C.R.3d 417 [written statutory compromise offer under C.C.P. 998 could be orally revoked prior to its acceptance]; 1 Williston 4th (2007 ed.), §5:8 et seq.

T.M. Cobb Co. case:

Cross-Reference: 6 Cal. Proc. (5th), *Proceedings Without Trial*, §92.



50 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT

B. Offer.

6. Revocability.

a. Offeror's Right To Revoke.

2. Exceptions.

1 Witkin Sum. Cal. Law Contracts § 165

[§ 165] Exceptions.

There are a number of exceptions to the offeror's right to revoke:

(1) An *option*, where consideration is given for an *agreement* to keep the offer open. (See *infra*, §168.)

(2) A *unilateral contract*, after part performance by the offeree. (See *infra*, §166.)

(3) A *subcontractor's bid*, relied on by the general contractor in making his or her own bid. (See *infra*, §250.)

(4) An offer made *irrevocable by statute*. Thus, the Subdivision Map Act (*Govt.C. 66410 et seq., 66477.2(a)*) provides that if at the time the final map is approved any streets are rejected, the offer of dedication will remain open, and that, at a later date, the governing body may rescind its action and accept the offer of dedication. (See *Stump v. Cornell Const. Co. (1946) 29 C.2d 448, 451, 175 P.2d 510, 12 Summary (10th), Real Property, §246* [acceptance effective 3 years after original rejection of offer of dedication].)

Statutes, city charters, or other regulations frequently make a bid for a government contract irrevocable. (See *M.F. Kemper Const. Co. v. Los Angeles (1951) 37 C.2d 696, 699, 700, 235 P.2d 7; 66 Harv. L. Rev. 1312.*)

(5) A "*firm offer*" to buy or sell goods. The Uniform Commercial Code provides that a merchant's written and signed offer to buy or sell goods, which gives assurance that it will be held open, may be irrevocable for a stated time or reasonable time (neither exceeding 3 months), without consideration. (U.C.C. 2205; see *4 Summary (10th), Sales, §35.*)

SUPPLEMENT: [This section is current through the latest supplement]



51 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT

B. Offer.

6. Revocability.

b. Offer of Unilateral Contract.

1. Rule and Theories.

1 Witkin Sum. Cal. Law Contracts § 166

[§ 166] Rule and Theories.

(1) *In General.* In a unilateral contract, performance of the act or acts or forbearances contracted for ordinarily constitutes the acceptance. (See *supra*, §105, and *infra*, §198; on acceptance generally, see *infra*, §180 et seq.). Accordingly, because there can be no acceptance until performance is fully completed, it would seem to follow that the offeror may revoke his or her offer at any time prior to completion. The injustice of such a result where the offeree has *partially performed* has been the subject of much discussion, and the courts of most jurisdictions will protect the offeree in some way.

The following are among the theories that have been suggested: (1) That part performance should make the offer irrevocable, unless a power of revocation has been expressly reserved; (2) that the offeror should be estopped to revoke where efforts have been expended and obligations incurred by the offeree; (3) that, upon part performance or tender of performance by the offeree, the offeror is bound by a contract when performance is commenced, but the offeror's duty of performance is conditional upon full performance or tender thereof by the offeree within the prescribed period, or if none, within a reasonable time; (4) that the offeree may recover in quasi-contract for the reasonable value of the performance up to the time of revocation. (See generally *Los Angeles Traction Co. v. Wilshire* (1902) 135 C. 654, 658, 67 P. 1086, *infra*, §167; *California v. Agostini* (1956) 139 C.A.2d 909, 914, 294 P.2d 769 [tender prevents revocation; Restatement followed]; *Edgar Rice Burroughs v. Commodore Productions & Artists* (1959) 167 C.A.2d 463, 468, 334 P.2d 922; 1 Corbin (Rev. ed.), §§2.29 et seq., 3.9; 1 Williston 4th, §4:5; 17A Am.Jur.2d (2004 ed.), Contracts §62; 1 *Hastings L. J.* 141.)

(2) *Restatement Position.* The Restatement (§45) follows the contract theory of part performance or tender:

"(1) Where an offer invites an offeree to accept by rendering a performance and does not invite a promissory acceptance, an option contract is created when the offeree tenders or begins the invited performance or tenders a beginning of it."

"(2) The offeror's duty of performance under any option contract so created is conditional on completion or tender of the invited performance in accordance with the terms of the offer."

Comment f points out that what is begun or tendered must be part of the actual performance invited in order to preclude revocation; but *preparations* to perform may constitute justifiable reliance sufficient to make the offeror's promise binding under the promissory estoppel theory of §87(2) (*infra*, §169).

(3) *Real Estate Brokers*. The doctrine as to revocability has been invoked in connection with general authorizations given to real estate brokers, but the following distinction is made: A *nonexclusive* authority of unspecified duration ("general listing") may be revoked by the owner-principal, in good faith, at any time, despite the broker's efforts to obtain a purchaser (see *Heffernan v. Merrill Estate Co. (1946) 77 C.A.2d 106, 114, 174 P.2d 710*; Rest.2d, Agency §453), but an *exclusive* authority to sell during a specified period may be treated as an irrevocable offer under the theory of Restatement, §45 (see *Baumgartner v. Meek (1954) 126 C.A.2d 505, 509, 272 P.2d 552*).

SUPPLEMENT: [This section is current through the latest supplement]

(1) *In General*. See 1 Williston 4th (2007 ed.), §4:8.



52 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT

B. Offer.

6. Revocability.

b. Offer of Unilateral Contract.

2. Is the Offeree Bound?

1 Witkin Sum. Cal. Law Contracts § 167

[§ 167] Is the Offeree Bound?

The leading California case holding the offer irrevocable, *Los Angeles Traction Co. v. Wilshire* (1902) 135 C. 654, 67 P. 1086, made the peculiar statement that upon part performance *the contract takes on a bilateral character*. Defendant had offered to pay a certain sum upon the completion of a street railway to a certain point. Plaintiff secured a franchise and built a part of the road, but before completion defendant attempted to revoke. *Held*, he could not revoke. "The contract at the date of its making was unilateral, a mere offer that, if subsequently accepted and acted upon by the other party to it, would ripen into a binding, enforceable obligation. When the respondent purchased and paid upwards of fifteen hundred dollars for a franchise, it had acted upon the contract; and it would be manifestly unjust thereafter to permit the offer that had been made to be withdrawn. The promised consideration had then been partly performed, and the contract had taken on a bilateral character." (135 C. 658.) The theory of this decision has been greatly criticized, and, although ambiguous, it would seem to imply that not only can the offeror no longer revoke, but that the offeree is also bound to complete his or her performance, even though the offeree has made no promise to do so. Such a doctrine seems impossible to justify. (See *Wilck v. Herbert* (1947) 78 C.A.2d 392, 407, 178 P.2d 25 [dictum restating bilateral contract theory]; 1 Corbin (Rev. ed.), §2.29; 1 Williston 4th, §§5:13, 5:14; 10 Cal. L. Rev. 80; 17 Cal. L. Rev. 153; 1 Hastings L. J. 143; cf. *Bank of America v. Lane Mortg. Co.* (1937) 18 C.A.2d 431, 440, 63 P.2d 1189 [citing *Wilshire* case, but facts showed full performance].) A more reasonable method of reaching this result is to *construe* the contract as bilateral rather than unilateral. (See *supra*, §106; 1 Hastings L. J. 143.)

The Restatement theory is that part performance or tender creates an option contract (see *supra*, §166). Thereafter, in accordance with the usual irrevocable option rules, the offeror cannot revoke his or her offer, but the offeree is not bound to complete performance. This involves no injustice to the offeror, because, although the offeror alone is bound, his or her duty of performance is conditional on completion of the offeree's performance. (*Rest.2d, Contracts* §45, and Comment e; see *Aronowicz v. Nalley's* (1972) 30 C.A.3d 27, 43, 106 C.R. 424, *infra*, §689 [jury could find that unilateral contract was formed under this theory].)

West's Key Number Digest, Contracts k.59

SUPPLEMENT: [This section is current through the latest supplement]

See 1 Williston 4th (2007 ed.), §§5:13, 5:14.



53 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT

B. Offer.

7. Option.

a. Nature of Option.

1 Witkin Sum. Cal. Law Contracts § 168

[§ 168] Nature of Option.

(1) *Contract To Keep Offer Open*. An option is a *contract*, made for consideration, to keep an offer open for a prescribed period. Generally, it is irrevocable, but if consideration is not given, the option is revocable at any time. (*Kelley v. Rouse* (1961) 188 C.A.2d 92, 96, 10 C.R. 235, citing the text; *Torlai v. Lee* (1969) 270 C.A.2d 854, 858, 76 C.R. 239; *Landberg v. Landberg* (1972) 24 C.A.3d 742, 751, 101 C.R. 335, citing the text; *Lowe v. Massachusetts Mut. Life Ins. Co.* (1976) 54 C.A.3d 718, 725, 127 C.R. 23; *C. Robert Nattress & Associates v. CIDCO* (1986) 184 C.A.3d 55, 66, 229 C.R. 33; see *Rest.2d, Contracts* §§25, 37; 3 Corbin (Rev. ed.), §11.1 et seq.; 1 Williston 4th, §§4:24, 4:25, 5:15 et seq.; 17A Am.Jur.2d (2004 ed.), *Contracts* §§26, 53 et seq.; Cal. Transactions Forms, 1 Business Transactions §6:17; 5A Am.Jur. Legal Forms 2d (2004 ed.), §68:30; 47 Cal. L. Rev. 85 [arguing that option, like "firm offer," should require no consideration]; *supra*, §164; on revocability generally, see *supra*, §164 et seq.)

The Restatement points out that the word "option" is often used for any continuing offer even though revocable, or to refer to any power to make a choice; hence, to avoid ambiguity, the phrase "option contract" is used. And the promise to keep the offer open may be made not only in the main offer itself, but also separately in a collateral offer. (*Rest.2d, Contracts* §25, Comment a.)

(2) *Dual Nature*. The option is both an *irrevocable offer* that, on acceptance, becomes a bilateral contract, and a *unilateral contract* that binds the optionor on the optionee's performance of a condition precedent (exercise of the option). Stated differently, from the viewpoint of the optionor, an option is a binding contract subject to the performance of a condition precedent by the optionee. From the optionee's viewpoint, an option is an irrevocable offer that he or she can convert into a binding bilateral contract by acceptance of the offer. Which aspect is emphasized depends on which party's duties are under consideration. From the point of view of the duty of the optionor, the duty to keep the option open is binding on the making of the option contract. The optionee, however, has no duty until, and unless, he or she accepts the optionor's irrevocable offer. (See *Palo Alto Town & Country Village v. BBTC Co.* (1974) 11 C.3d 494, 502, 113 C.R. 705, 521 P.2d 1097, *infra*, §177.)

West's Key Number Digest, Contracts k.59

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Contract To Keep Offer Open*. See 1 Williston 4th (2007 ed.), §§4:27, 4:28; 5:15 et seq.



54 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT

B. Offer.

7. Option.

b. Requisites of Option.

1 Witkin Sum. Cal. Law Contracts § 169

[§ 169] Requisites of Option.

(1) *Writing and Consideration.* The offer is binding if it "is in writing and signed by the offeror, recites a purported consideration for the making of the offer, and proposes an exchange on fair terms within a reasonable time." (*Rest.2d, Contracts §87(1)(a)*; see 2 Corbin (Rev. ed.), §5.17.)

The consideration may be nominal; e.g., \$ 1 paid or promised. (*Rest.2d, Contracts §87, Comment b*; see *infra*, §205.) And the giving and recital of nominal consideration performs only a formal function: Hence, the option contract is not invalidated by proof that the recited consideration was not given. (*Rest.2d, Contracts §87, Comment c.*)

However, Corbin argues that parol evidence should be admissible to contradict a recital of nominal consideration (2 Corbin (Rev. ed.), §5.17), and California, while not specifically addressing the problem of nominal consideration, does permit the use of parol evidence to establish a lack or failure of consideration (2 *Cal. Evidence (4th)*, *Documentary Evidence*, §99).

(2) *Offer Made Irrevocable by Statute.* Some offers are made irrevocable by special statutes; e.g., goods not up at auction without reserve (U.C.C. 2328(3)), 4 *Summary* (10th), *Sales*, §123, government contracts on competitive bidding (*Pub.Contr.C. 10169*), a firm offer on goods by a merchant (U.C.C. 2205, *supra*, §165).

(3) *Promissory Estoppel.* An offer that the offeror should reasonably expect to induce action or forbearance of a substantial character on the part of the offeree before acceptance and that does induce this action or forbearance is binding as an option contract to the extent necessary to avoid injustice. (*Rest.2d, Contracts §87(2)*; see *Drennan v. Star Paving Co. (1958) 51 C.2d 409, 413, 333 P.2d 757, infra*, §250.)

SUPPLEMENT: [This section is current through the latest supplement]



55 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT

B. Offer.

7. Option.

c. Rejection, Counteroffer, and Death or Incapacity.

1 Witkin Sum. Cal. Law Contracts § 170

[§ 170] Rejection, Counteroffer, and Death or Incapacity.

The Restatement takes the position that, because the option contract is a promise that limits the promisor's power to revoke the offer, the optionee's power of acceptance is not terminated by rejection or counteroffer, or by death or incapacity of the offeror, unless the requirements are met for the *discharge of a contractual duty*. (*Rest.2d, Contracts §37.*)

The California view is unsettled: On the one hand, one court has stated: "[W]hen an offer under an option contract has been rejected, the party rejecting cannot subsequently, at his option, accept the rejected offer and thus convert the same to an agreement by acceptance." (*Landberg v. Landberg* (1972) 24 C.A.3d 742, 757, 101 C.R. 335; see *Beverly Way Associates v. Barham* (1990) 226 C.A.3d 49, 55, 276 C.R. 240, *infra*, §790 [citing *Landberg* in support of analogous holding that buyer's disapproval of condition precedent terminated bilateral contract].) On the other hand, it has been held: "[U]nlike a conditional or qualified acceptance in the formation stage of a contract, purported exercise of an option which is qualified or made conditional, does not in and of itself terminate the option if there yet remains time during the term of the option in which the unauthorized qualification or condition may be removed and the option exercised absolutely." (*C. Robert Nattress & Associates v. CIDCO* (1986) 184 C.A.3d 55, 67, 229 C.R. 33; for criticism of *Landberg* and discussion of other cases supporting view that qualified acceptance does not terminate option, see 1 Miller & Starr 3d, §1:50.)

West's Key Number Digest, Contracts k.59

SUPPLEMENT: [This section is current through the latest supplement]



56 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT

- B. Offer.
- 7. Option.
- d. Kinds of Options.
- 1. Purchase Option.
- aa. In General.

1 Witkin Sum. Cal. Law Contracts § 171

[§ 171] In General.

The typical option gives a right to purchase property under stated terms, and the acceptance of the offer by the optionee (offeree) is an election to be bound with the optionor (offeror) by the contemplated contract of sale. Upon making this election in strict compliance with the terms of the option, the optionee is entitled to *specific performance*. "It is a unilateral agreement. The optionor offers to sell the subject property at a specified price or upon specified terms and agrees, in view of the payment received, that he will hold the offer open for the fixed time. Upon the lapse of that time, the matter is completely ended and the offer is withdrawn. If the offer be accepted upon the terms and in the time specified, then a bilateral contract arises which may become the subject of a suit to compel specific performance, if performance by either party thereafter be refused." (*Auslen v. Johnson* (1953) 118 C.A.2d 319, 321, 257 P.2d 664 [option lapsed]; see *Copple v. Aigeltinger* (1914) 167 C. 706, 709, 140 P. 1073; *Denbo v. Senness* (1953) 120 C.A.2d 863, 864, 262 P.2d 31 [agreement set out in full; judgment for specific performance affirmed]; *Maxfield v. Burt* (1953) 121 C.A.2d 102, 105, 262 P.2d 580 [provisions summarized; no specific performance where optionee in default]; *Caras v. Parker* (1957) 149 C.A.2d 621, 625, 309 P.2d 104 [specific performance granted]; *Newberger v. Rifkind* (1972) 28 C.A.3d 1070, 104 C.R. 663, *infra*, §208; *Chow v. Levi Strauss & Co.* (1975) 49 C.A.3d 315, 324, 122 C.R. 816, citing the text [unilateral contract, hence does not require mutuality of obligation]; *Pellandini v. Valadao* (2003) 113 C.A.4th 1315, 1319, 7 C.R.3d 413 [P's right of first refusal to purchase property owned by V and W as tenants in common was not triggered when W gave V deed of her interest; contract indicated that right of first refusal was triggered only when sale encompassed entire property and was to third person].) (See generally 77 *Am.Jur.2d* (1997 ed.), *Vendor and Purchaser* §33 et seq.; C.E.B., 1 *Real Property Sales Transactions* 3d, Chap. 7 [use of options in real estate transactions]; 72 *A.L.R.2d* 1127 [provision for giving notice of exercise of option]; 2 *A.L.R.3d* 701 [definiteness of price]; 34 *A.L.R.4th* 1217 [effect on option of optionor's receipt of offer for larger tract that includes optioned property].) (On option to purchase as property right compensable in eminent domain, see *San Diego v. Miller* (1975) 13 C.3d 684, 119 C.R. 491, 532 P.2d 139, 8 *Summary* (10th), *Constitutional Law*, §1138; on lessee's option to purchase, see 12 *Summary* (10th), *Real Property*, §533 et seq.)

If the optionor repudiates, the court has the power to grant relief by way of extension of time, or by giving the

optionor the election to pay damages. (*Bertero v. National General Corp.* (1967) 254 C.A.2d 126, 147, 62 C.R. 714.)

SUPPLEMENT: [This section is current through the latest supplement]

See *Hartzheim v. Valley Land & Cattle Co.* (2007) 153 C.A.4th 383, 389, 62 C.R.3d 815 [lessee's right of first refusal to purchase property owned by lessor family-owned partnership was not triggered when lessor transferred property to partners' grandchildren without giving lessee opportunity to purchase it, because conveyance was not made pursuant to bona fide offer from third party; transfer was not marked by arms' length dealing, but was made for legitimate tax and estate planning reasons]; *Bill Signs Trucking, LLC v. Signs Family Ltd. Partnership* (2007) 157 C.A.4th 1515, 1524, 69 C.R.3d 589 [in commercial lease's preemptive purchase right provision allowing tenant right of first refusal if landlord received acceptable offer from "any person," term "any person" referred only to third persons; thus, provision was not triggered by transfer between partners in family limited partnership that owned property; relying on *Pellandini v. Valadao* (2003) 113 C.A.4th 1315, 7 C.R.3d 413, text, p. 207]; C.E.B., 2 Real Property Sales Transactions 4th, Chap. 8 [use of options in real estate transactions]; 94 Proof of Facts 3d 387 [optionor's right to retain payment as consideration for unexercised option to purchase realty]; 77 Am.Jur.2d (2006 ed.), *Vendor and Purchaser* §27 et seq.



57 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT

B. Offer.

7. Option.

d. Kinds of Options.

1. Purchase Option.

bb. Right Relates Back.

1 *Witkin Sum. Cal. Law Contracts* § 172

[§ 172] Right Relates Back.

The right in the optionee to acquire the property, when the election is made, relates back to the time of the giving of the option, and cuts off intervening rights acquired *with knowledge* of its existence. (*Seeburg v. El Royale Corp.* (1942) 54 C.A.2d 1, 4, 128 P.2d 362; *Anthony v. Enzler* (1976) 61 C.A.3d 872, 877, 132 C.R. 553, citing the text; see *Dawson v. Goff* (1954) 43 C.2d 310, 316, 273 P.2d 1.) It thus follows that an intervening bona fide purchaser *without notice* prevails over the optionee. (*Utley v. Smith* (1955) 134 C.A.2d 448, 451, 285 P.2d 986.)

In *Smith v. Bangham* (1909) 156 C. 359, 104 P. 689, defendant, for consideration, gave plaintiff an option for 2 months to purchase his land. Defendant's wife, with knowledge of the option, declared a homestead on the property. Thereafter plaintiff exercised his election. *Held*, he was entitled to a conveyance. A subsequent purchaser with notice would take subject to the option, and the wife, in declaring a homestead, was in no better position; the declaration created no new title, but merely impressed the homestead claim of exemption on the title as it then stood. (156 C. 364.) (See dissent, 156 C. 369, and *Copple v. Aigeltinger* (1914) 167 C. 706, 711, 140 P. 1073.)

Claremont Terrace Homeowners' Assn. v. United States (1983) 146 C.A.3d 398, 194 C.R. 216, holds that the relation back doctrine applies to defeat a federal tax lien subsequently filed against the optionor: "[W]hen the Association acquired its option to purchase ... , it possessed an indefeasible right to acquire the property and from that moment the taxpayer was helpless to prevent its acquisition by respondent. And when the Association elected to exercise its option to purchase, the contract for sale was merely completed. ... [I]ts right to the property necessarily related back to the date on which it acquired the option from Dickson, therefore achieving priority over both the assessment and appellant's recorded tax lien." (146 C.A.3d 407.)

SUPPLEMENT: [This section is current through the latest supplement]

See *Wachovia Bank v. Lifetime Industries* (2006) 145 C.A.4th 1039, 1052, 52 C.R.3d 168 [optionee's mere exercise of purchase option, without consummation of purchase and sale transaction, failed to provide optionee with title to remainder of property subject to life estate, and thus exercise of option did not relate back to date when option was granted so as to extinguish mechanic's lien that was recorded in interim].



58 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT

- B. Offer.
- 7. Option.
- d. Kinds of Options.
- 2. Other Types.

1 Witkin Sum. Cal. Law Contracts § 173

[§ 173] Other Types.

There are, of course, various types of options in addition to the *common* purchase option discussed in the preceding sections. (See *Warner Bros. Pictures v. Brodel* (1948) 31 C.2d 766, 772, 192 P.2d 949, *supra*, §36 [option to renew employment of child actor for successive yearly periods; court analyzes nature and effect of options generally]; *Dawson v. Goff* (1954) 43 C.2d 310, 315, 273 P.2d 1 [plaintiff's option to sell with defendant's obligation to purchase]; *Jonas v. Leland* (1947) 77 C.A.2d 770, 775, 176 P.2d 764 [option to purchase building where, in event option was not exercised, deposit was to be applied towards purchase of another building]; *Andrade v. Casteel* (1947) 81 C.A.2d 729, 731, 185 P.2d 51 [option to purchase land as running covenant or equitable servitude]; *People v. Ocean Shore R. Co.* (1949) 90 C.A.2d 464, 469, 203 P.2d 579, *infra*, §179 [option to purchase land followed by two supplemental agreements; condemnation action in which issue was whether agreements constituted option to purchase or contract of sale and purchase]; *Beran v. Harris* (1949) 91 C.A.2d 562, 564, 205 P.2d 107 [option to purchase land superseded by deed, and conditions in option omitted from deed not binding on grantee]; *Southern Christian Leadership Conference v. Al Malaikah Auditorium Co.* (1991) 230 C.A.3d 207, 222, 281 C.R. 216 [option to lease concert hall; by returning deposit and renting hall to someone else, optionor repudiated option and breached its contract]; *Orange v. San Diego County Employees Retirement Assn.* (2002) 103 C.A.4th 45, 51, 126 C.R.2d 405 [option contract by which retirement association offered to settle restitution claim against optionee city in exchange for city's suspending litigation until offer was considered].) (On options given to lessees to buy, renew, or extend the term, see 12 *Summary* (10th), *Real Property*, §§528 et seq., 533 et seq.); on option for repurchase by vendor, see 44 *A.L.R.2d* 342; on options under life insurance policy, see 15 *A.L.R.3d* 1317.)

West's Key Number Digest, Contracts k.59

SUPPLEMENT: [This section is current through the latest supplement]



59 of 141 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT

B. Offer.

7. Option.

e. Time of Exercise.

1. Option for Fixed Period.

1 Witkin Sum. Cal. Law Contracts § 174

[§ 174] Option for Fixed Period.

Ordinarily an option is given for a specified period, and it must be exercised within the period. In other words, time is of the essence in an option contract. (*Holiday Inns of America v. Knight* (1969) 70 C.2d 327, 330, 74 C.R. 722, 450 P.2d 42 [extension of time within which option must be exercised "would give the optionee, not the option he bargained for, but a longer and therefore more extensive option"]; *Rosenaur v. Pacelli* (1959) 174 C.A.2d 673, 676, 345 P.2d 102; *Drewry v. Welch* (1965) 236 C.A.2d 159, 167, 46 C.R. 65; 3 Corbin (Rev. ed.), §11.17; 1 Williston 4th, §5:18; 17A Am.Jur.2d (2004 ed.), Contracts §§79, 478, 543; 5A Am.Jur. Legal Forms 2d (2004 ed.), §68:30; 82 A.L.R.3d 790 [option by will to purchase real estate]; 87 A.L.R.3d 805 [timeliness of notice of exercise of option to purchase realty].) (On effect of clause requiring optionee, within specified time prior to expiration of option, to give notice of intention to exercise the option, see 72 A.L.R.2d 1127; on when a recorded option to purchase real property within a fixed period expires of record, see 12 Summary (10th), *Real Property*, §339.)

This rule, however, applies only to *acceptance* (exercise of the option). In *Murfee v. Porter* (1950) 96 C.A.2d 9, 214 P.2d 543, plaintiff lessee, with an option to purchase, gave notice of its exercise within the specified time, but did not tender the purchase price within that time. *Held*, nevertheless, in the absence of an express requirement for acceptance and performance within the prescribed time, timely acceptance is enough. Payment may be made or tendered, as in bilateral contracts generally, within a reasonable time. (96 C.A.2d 16.)

Where the option is *renewable*, relief from forfeiture may be given. (See *Holiday Inns of America v. Knight*, *supra*, 70 C.2d 330, 13 Summary (10th), *Equity*, §69.)

SUPPLEMENT: [This section is current through the latest supplement]
See 1 Williston 4th (2007 ed.), §5:18.



60 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT

B. Offer.

7. Option.

e. Time of Exercise.

2. Option Without Fixed Period.

1 Witkin Sum. Cal. Law Contracts § 175

[§ 175] Option Without Fixed Period.

If the agreement is silent as to the period of the option, it must be exercised within a reasonable time, determined by the circumstances. (*Lohn v. Fletcher Oil Co. (1940) 38 C.A.2d 26, 31, 100 P.2d 505; Bergin v. van der Steen (1951) 107 C.A.2d 8, 13, 236 P.2d 613; Auslen v. Johnson (1953) 118 C.A.2d 319, 322, 257 P.2d 664; see 31 A.L.R.3d 522* [validity of option to purchase realty as affected by indefiniteness of term provided for exercise]; *82 A.L.R.3d 790* [option by will to purchase real estate]; *87 A.L.R.3d 805* [timeliness of notice of exercise of option to purchase realty].) (On when a recorded option to purchase real property, which contains no fixed period, expires of record, see *12 Summary (10th), Real Property, §339.*)

West's Key Number Digest, Contracts k.59

SUPPLEMENT: [This section is current through the latest supplement]



61 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT

B. Offer.

7. Option.

f. Manner of Exercise.

1. In General.

1 Witkin Sum. Cal. Law Contracts § 176

[§ 176] In General.

The form of election prescribed in the option must be strictly followed. (*Flickinger v. Heck* (1921) 187 C. 111, 114, 200 P. 1045; *Callisch v. Farnham* (1948) 83 C.A.2d 427, 430, 188 P.2d 775; *Peebler v. Seawell* (1954) 122 C.A.2d 503, 507, 265 P.2d 109; *Landberg v. Landberg* (1972) 24 C.A.3d 742, 752, 757, 101 C.R. 335; see 3 Corbin (Rev. ed.), §11.8; 1 Williston 4th, §5:18; 17A Am.Jur.2d (2004 ed.), Contracts §71; 5A Am.Jur. Legal Forms 2d (2004 ed.), §68:30.) An objection as to the form of election is waived if the optioner does not specifically point out the defects. (*Riverside Fence Co. v. Novak* (1969) 273 C.A.2d 656, 662, 78 C.R. 536.) (On whether payment or tender of purchase money must be made at time of exercise of option, in absence of specific time requirement for payment, see 71 A.L.R.3d 1201.)

However, unless the terms require a writing, an option may be accepted orally. (*Lawrence v. Settle* (1960) 182 C.A.2d 386, 388, 6 C.R. 49.) And even if the option contract requires written notice, an oral acceptance may be sufficient if the optioner's actions indicate that he or she has waived the writing requirement. (*Collins v. Marvel Land Co.* (1970) 13 C.A.3d 34, 40, 91 C.R. 291 [opening escrow as contemplated by option agreement established waiver by defendants of written notice requirement].)

SUPPLEMENT: [This section is current through the latest supplement]
See 1 Williston 4th (2007 ed.), §5:18.



62 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT

B. Offer.

7. Option.

f. Manner of Exercise.

2. Effective on Deposit in Mail.

1 Witkin Sum. Cal. Law Contracts § 177

[§ 177] Effective on Deposit in Mail.

(1) *General Rule.* The general rule that acceptance of an offer is effective on deposit in the mail (see C.C. 1583, *infra*, §191) is set forth in the Restatement (§63(a)), but an exception is made for options: "an acceptance under an option contract is not operative until *received* by the offeror." (*Rest.2d, Contracts §63(b)*; see 3 Corbin (Rev. ed.), §11.8; 25 Williston 4th, §§67:83, 67:84, 67:115.) Comment f observes that option contracts are commonly subject to a definite time limit, and "the usual understanding is that the notification that the option has been exercised must be received by the offeror before that time." Also, even if there is no time limit, "the offeree takes the risk of loss or delay in the transmission of the acceptance and remains free to revoke the acceptance until it arrives."

(2) *California Law.* California takes the opposite view. In *Dawson v. Goff* (1954) 43 C.2d 310, 316, 273 P.2d 1, a venue case, it was held that option contracts are subject to the general statutory provision on acceptance of an ordinary offer (C.C. 1583, *supra*), and that the option is therefore effectively exercised at the time a written acceptance is deposited in the mail. This rule was reaffirmed in *Palo Alto Town & Country Village v. BBTC Co.* (1974) 11 C.3d 494, 500, 113 C.R. 705, 521 P.2d 1097.[option agreement's use of phrase "giving notice" did not prescribe condition of actual receipt]. (See 63 Cal. L. Rev. 112.)

In *Jenkins v. Tuneup Masters* (1987) 190 C.A.3d 1, 235 C.R. 214, a lease provided that plaintiff lessee could exercise his option to renew by sending a notice of extension, at least 6 months prior to expiration of the lease, by registered or certified mail, and that this notice became effective upon being deposited in the United States mail. Plaintiff testified that, within the prescribed time and in accordance with its normal practice, the notice, with a certified mail sticker and return receipt attached, was placed in a mail sack with other letters and left outside a postal annex, from which a postal truck made a pickup each day. Copies of the notice were on file in plaintiff's office, but defendant lessor claimed that it never received the original. *Held*, the notice was effective.

(a) Once the notice was properly sent by mail, the risk of loss was on defendant. This allocation of risk is based in part on the reliability of the postal service, which, in turn, is based on the sender's complying with the relevant postal regulations. Hence, it is reasonable to interpret the term "certified mail" as requiring plaintiff to comply with all postal regulations essential to the notice's acceptance and transmittal as certified mail. (190 C.A.3d 8, citing *Palo Alto Town &*

Country Village v. BBTC Co. , supra.)

(b) The applicable postal regulation provides that certified mail *may* be mailed at the post office, branch, or station, or be given to a rural carrier, or be deposited in mail drops in post offices, street letter boxes, nonpersonnel units, or any other receptacles for first class mail. The regulation does not specifically mention placing mail in a mail sack outside a postal annex, but, by the use of the word "may," the regulation does not rule out additional methods of mail collection established by local postal practices. Thus, there is compliance when a certified letter actually reaches postal authorities by any method (such as the one used by plaintiff) that is recognized by local practice. (190 C.A.3d 9, 10.)

SUPPLEMENT: [This section is current through the latest supplement]



63 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT

B. Offer.

7. Option.

g. Distinctions.

1. Preemption Agreement.

1 Witkin Sum. Cal. Law Contracts § 178

[§ 178] Preemption Agreement.

(1) *In General.* A type of agreement loosely termed an option to purchase, but distinguishable, is the preemption agreement, or right of first opportunity to purchase. (See *Nelson v. Reisner* (1958) 51 C.2d 161, 165, 331 P.2d 17.) The language of preemption may be "first opportunity," "first right," "first privilege," "first refusal," etc., but, regardless of the language employed, the distinction is that an *option* gives the holder power to compel a sale whether or not the owner wants to sell, while the *preemption agreement* merely gives the holder the first right to buy if the owner wants to sell. (See *Schwartz v. Shapiro* (1964) 229 C.A.2d 238, 255, 40 C.R. 189 [plaintiff's action for partition, without first offering to sell his interest to defendant, not maintainable]; *Mercer v. Lemmens* (1964) 230 C.A.2d 167, 173, 40 C.R. 803 [owner in bad faith held liable for difference between contract price and market value at time of breach]; *Rollins v. Stokes* (1981) 123 C.A.3d 701, 710, 176 C.R. 835, citing the text; 3 Corbin (Rev. ed.), §11.3; 9 *Summary* (10th), *Corporations*, §129; on the rights of the holder of a "first refusal" option on real property in the event of involuntary sale, see 17 A.L.R.3d 962.)

The court in the *Mercer* case, *supra*, notes two additional points: (a) A reasonable time for assertion of the right is measured from the time the seller decides to sell. (b) The right, in personal terms, ends on death of the seller without selling; but death of the seller after contracting to sell to a third person does not prevent enforcement of the right.

(2) *Right of First Refusal Is Preempted by Condemnation.* In *Campbell v. Alger* (1999) 71 C.A.4th 200, 83 C.R.2d 696, a county flood control district brought eminent domain proceedings to condemn a ranch for flood control purposes. One of the ranch owners then sued the district and the other owner to enforce his right of first refusal contained in the owners' cotenant agreement. *Held*, judgment of dismissal affirmed.

(a) A right of first refusal is the conditional right to acquire property, depending on the owner's willingness to sell. The holder of the right merely has the preference to purchase the property over other purchasers if the owner of the property elects to sell the property. In other words, the right does not materialize until the owner of the property *voluntarily* decides to sell the property and *receives a bona fide offer* from a third party. (71 C.A.4th 206.)

(b) The particular facts and circumstances that give effect to the right of first refusal depend on the particular terms

of the contract for the right. Here, the right of first refusal would arise only in the event the other owner determined to sell its interest to a third party after having received a bona fide and written offer for purchase, or made a bona fide and written offer to sell its interest to a third party. The right did not arise here, because the other owner did not voluntarily determine to sell its interest to the district. (71 C.A.4th 207.) "Because condemnation is the involuntary taking of land by a public agency for public use, it does not trigger the private right of first refusal here." (71 C.A.4th 208.)

(c) The Legislature has provided that a public entity in eminent domain litigation should settle with as many owners as swiftly as possible to minimize the costs, uncertainties, and time to obtain the needed land. Private holders of rights of first refusal may not thwart these public purposes by forcing the owner or the subsequent public entity to sell the land to them. (71 C.A.4th 209.)

West's Key Number Digest, Contracts k.59

SUPPLEMENT: [This section is current through the latest supplement]



64 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT

B. Offer.

7. Option.

g. Distinctions.

2. Binding Purchase Agreement.

1 Witkin Sum. Cal. Law Contracts § 179

[§ 179] Binding Purchase Agreement.

Whether an instrument creates an option or a contract of sale is determined not by its title or form, but by an analysis of the obligations imposed. (*Scarbery v. Bill Patch Land & Water Co. (1960) 184 C.A.2d 87, 100, 7 C.R. 408; Welk v. Fainbarg (1967) 255 C.A.2d 269, 276, 63 C.R. 127* [held only an option].)

In *People v. Ocean Shore R. Co. (1949) 90 C.A.2d 464, 203 P.2d 579*, K (first party) made an agreement with M (second party), entitled "option," under which M was given "the exclusive right and option to purchase" certain property on stated installments, with the proviso that on default in an installment K could cancel and retain prior payments, but that K otherwise "shall have no right or claim against second party." *Held*, the agreement was merely an option and not a contract of sale. Despite the fact that M took possession and made regular payments, the language of the instrument showed a studious avoidance of any commitment by M to pay the purchase price, and he could not have been compelled to perform. (*90 C.A.2d 469.*) (For disapproval of *Ocean Shore* on the issue of whether an option is a compensable interest in condemnation, see *7 Summary (10th), Constitutional Law*, §1138.)

In *Partanian v. Flodine (1950) 95 C.A.2d Supp. 931, 213 P.2d 790*, plaintiff and other buyers made an agreement with defendant car dealer, under which the 98 Tucker cars that the dealer expected to get from the manufacturer were allotted to them, "if, as, and when they are produced and made available for delivery through said dealer." It was further provided that "The customer is not hereby bound to order or accept delivery of a Tucker motor car, but may, if he desires, purchase said motor car according to said sequence number." By a separate writing, defendant *sold* and plaintiff *bought* certain accessories (seat covers, radio, heater, etc.) for \$ 237.93, this writing reciting that it was not an agreement to purchase a car. Tucker cars were never produced, and plaintiff sued for the return of the \$ 237.93. *Held*, recovery denied. There was no failure of consideration, for, except as to the accessories to which he was entitled on demand, he merely paid for a place in line, i.e., an option to purchase "if, as and when." "Had plaintiff paid defendant \$ 237.93 for the chance he was offered, without any accessories involved, we would see nothing unconscionable or illegal about the transaction, and dressing up the deal by including the accessories does not render it less valid. Plaintiff, so far as appears, was of age and mentally competent; the chance being taken was not in the nature of a lottery; he took a legitimate chance. That it did not pan out is no reason why he should have his money back." (*95 C.A.2d Supp. 934.*) (See *infra*, §630 et seq., on illegal wagering contracts.)

In *Allen v. Smith* (2002) 94 C.A.4th 1270, 114 C.R.2d 898, plaintiff, using a form entitled "Residential Purchase Agreement (and Receipt for Deposit)," made an offer to purchase defendants' home. Under the offer, plaintiff was required to deposit 3% of the purchase price, consisting of an initial deposit of \$ 20,000 and an additional deposit of \$ 33,250 after the removal of certain contingencies. In defendants' counteroffer, the additional deposit was increased to \$ 80,000, and the total deposit of \$ 100,000 was referred to as "non refundable purchase option monies." Two months later, plaintiff notified defendants that she would not complete the purchase. Conceding that defendants were entitled to retain the original deposit of \$ 20,000 under a liquidated damages clause, plaintiff brought the present action to recover the additional deposit of \$ 80,000, because it did not comply with the liquidated damages statutes (see *infra*, §545). Finding instead that the \$ 80,000 was a *separate option agreement* that was not required to comply with the aforementioned statutes, the trial judge ruled that, after declining to accept the option, plaintiff was not entitled to a refund. *Held*, summary judgment for defendants reversed; the contract was a purchase and sales agreement with a liquidated damages clause, rather than an option for which \$ 100,000 was the nonrefundable consideration.

(a) Express terms such as "option" and "liquidated damages" are not dispositive in the interpretation of a real estate contract. The nature and terms of the agreement and the obligation of the parties are controlling, regardless of how the parties may label the document. (94 C.A.4th 1279, citing *Welk v. Fainbarg*, *supra*.)

(b) The contract in question consists of a California Association of Realtors standard form deposit receipt and counteroffer. These forms ordinarily constitute a binding contract for the purchase and sale of the described property. A legitimate option, on the other hand, ordinarily consists of an agreement to grant an irrevocable right to purchase for independent consideration and a separate purchase and sales agreement attached as an exhibit thereto. (94 C.A.4th 1279.)

(c) The test for distinguishing a purchase and sales agreement from an option is that if both parties are obligated to perform, a sales agreement is involved, but if only one party (the optionor-offeror) is obligated to perform, the agreement is merely an option. Here, the contract contains no provision giving plaintiff the complete discretion to decide whether to proceed with the purchase. For example, with respect to contingencies, the agreement *requires* plaintiff to remove them within a certain time and provides that, on removal, she is conclusively deemed to have elected to proceed with the transaction. A chief advantage of a true option, on the other hand, is that it allows the optionee to inspect the property without meeting contingency requirements. Moreover, defendants conceded that if the inspection contingencies were unsatisfied, plaintiff was entitled to a return of the initial deposit of \$ 20,000. Accordingly, the deposit cannot be considered independent consideration for an option. (94 C.A.4th 1280.)

(d) The contract here does not specify the period within which an option must be exercised, and an option is a right to accept or reject an offer within a *limited time in the future*. Moreover, the contract does not prescribe a mode of acceptance, an additional indication that the parties did not intend to create an option. Finally, the contract contains a "time is of the essence" clause. This provision has nothing to do with an option, because on the lapse of an option period, the matter is completely ended and the offer withdrawn. (94 C.A.4th 1280.)

SUPPLEMENT: [This section is current through the latest supplement]



65 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT
C. Acceptance.
1. Who May Accept Offer.

1 Witkin Sum. Cal. Law Contracts § 180

[§ 180] Who May Accept Offer.

(1) *Person To Whom Offer Is Addressed.* *Rest.2d, Contracts §29*, provides:

(a) The offeror's *manifested intention* determines the person or persons in whom is created a *power of acceptance*.

(b) An offer may create a power of acceptance in a specified person or in one or more of a specified group or class of persons, acting separately or together, or in anyone or everyone who makes a specified promise or renders a specified performance. (See 1 Corbin (Rev. ed.), §3.2; 2 Williston 4th, §6:27; Cal. Transactions Forms, 1 Business Transactions §6:18.)

Where one acceptor only is to be selected, the offeror may use such language as "first come, first served," or the highest bidder or winner of a contest. (*Rest., supra*, Comment b.)

(2) *Person Invited To Furnish Consideration.* "The offeror is master of his offer," and the rule that the power of acceptance is personal to the offeree is applied strictly, even in cases where the offeree after acceptance could assign his or her rights and delegate performance to the assignee. (*Rest.2d, Contracts §52* and Comment a.) However, an offer may be accepted by an agent of the offeree. (*Rest.2d, Contracts §52*, Comment c; see *Rest.2d, Agency §292*.)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Person To Whom Offer Is Addressed.* See 2 Williston 4th (2007 ed.), §6:27; C.E.B., Law of Contracts §4.41 et seq.



66 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT
C. Acceptance.
2. Acceptor Must Have Knowledge of Offer.
a. In General: Bilateral Contracts.

1 Witkin Sum. Cal. Law Contracts § 181

[§ 181] In General: Bilateral Contracts.

"It is essential to a bargain that each party manifest assent with reference to the manifestation of the other." (*Rest.2d, Contracts* §23; see *Rest.2d, Contracts* §22, *supra*, §125); 1 Corbin (Rev. ed.), §§3.5, 3.6).)

The rule that the acceptor must have knowledge of the offer is one of the departures from the objective standard of mutual assent (*supra*, §116). (See *American Bldg. Maintenance Co. v. Indemnity Ins. Co.* (1932) 214 C. 608, 615, 7 P.2d 305; 17 Cal. L. Rev. 441, 444.)

Thus, identical offers to buy and to sell property at a certain price, which cross each other in the mails, each party being ignorant of the other's offer, do not create a contract. (See *Rest.2d, Contracts* §23, Comment d; 1 Corbin (Rev. ed.), §3.5.)

However, an offeree, knowing that an offer has been made to him or her, but not knowing all its terms, may accept whatever terms it contains. (*Hunter v. Sparling* (1948) 87 C.A.2d 711, 725, 197 P.2d 807; *Rest.2d, Contracts* §23, Comment b.) Thus, in *Larrus v. First Nat. Bank of San Mateo County* (1954) 122 C.A.2d 884, 266 P.2d 143, plaintiffs opened an account in defendant bank and signed signature cards that contained a printed statement in which they agreed to be governed by the bylaws and other regulations. Their attention was not called to the clause, nor were they ever advised of the contents of the bank rules. *Held*, the agreement was binding and the bank's ordinary statutory obligations to the plaintiffs were modified by these rules. The court said (quoting Corbin): "It is quite possible for a party to assent to be bound in accordance with terms of which he is then ignorant, just as he may promise to pay a sum yet to be determined by the future market or by an arbitrator." (122 C.A.2d 889.)

SUPPLEMENT: [This section is current through the latest supplement]



67 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT
C. Acceptance.
2. Acceptor Must Have Knowledge of Offer.
b. Unilateral Contracts.

1 Witkin Sum. Cal. Law Contracts § 182

[§ 182] Unilateral Contracts.

(1) *Offer of Reward: General Rule.* An offer of reward is an offer to enter into a unilateral contract, and is made to the public generally, i.e., to anyone to whom it becomes known. One who performs the required act has done all that is necessary for acceptance. But if, notwithstanding this performance, he or she does not intend that his or her acts are to constitute the acceptance of an offer, no contract will result. Hence it seems proper to say that where the offer has not been communicated to the potential offeree, and the offeree has no knowledge of it, no act of his or hers can be deemed an acceptance. (See *Hewitt v. Anderson* (1880) 56 C. 476, 477; *Rest.2d, Contracts* §23, Comment c, and §51, Comment a; 1 Corbin (Rev. ed.), §3.6; 67 *Am.Jur.2d* (2003 ed.), *Rewards* §§18, 19; 86 *A.L.R.3d* 1142 [necessity of knowledge of reward]; 35 *Proof of Facts* 2d 691 [right to reward for information leading to arrest and conviction].)

(2) *Knowledge of Offer Without Knowledge of Terms.* It is enough that the offeree has knowledge of *the offer*, i.e., knowledge that a particular offer has been made to him or her; it is immaterial that the offeree does not know its precise terms or the nature of the performance called for. This is frequently the case where a proposed written contract is accepted without reading it. (See *supra*, §119 et seq.) In *Hunter v. Sparling* (1948) 87 *C.A.2d* 711, 197 *P.2d* 807, plaintiff employee worked in a bank for over 20 years with knowledge of its retirement benefits system, but was unaware of the particular rules and regulations, which were written in Japanese. *Held*, a valid unilateral contract was formed by his acceptance (services rendered after knowledge of the pension plan), for the terms were capable of ascertainment. (87 *C.A.2d* 725.) (See *Rest.2d, Contracts* §23, Comment b.)

(3) *Part Performance Without Knowledge of Offer.* Where part performance has been entered by a person ignorant of the offer, and the person thereafter learns of the offer, the offer may induce completion of the performance. The inference that the offeror intends this result is strengthened when part performance is valueless to him or her unless complete, or when the offeror knows of the offeree's continuing performance and fails to revoke. Hence, unless the offeror manifests a contrary intention, the offeree may accept by completing the requested performance. (*Rest.2d, Contracts* §51, and Comment b.)

SUPPLEMENT: [This section is current through the latest supplement]



68 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT

C. Acceptance.

3. Acceptance Must Be Unqualified.

a. General Rule.

1 Witkin Sum. Cal. Law Contracts § 183

[§ 183] General Rule.

"An acceptance must be absolute and unqualified, or must include in itself an acceptance of that character which the proposer can separate from the rest, and which will conclude the person accepting." (C.C. 1585.) (See *Rest.2d, Contracts §50(1)*, 57, 58; *Hunkins-Willis Lime & Cement Co. v. Los Angeles Warehouse Co.* (1908) 155 C. 41, 45, 99 P. 369; *Patterson v. Clifford F. Reid* (1933) 132 C.A. 454, 456, 23 P.2d 35; *Howard v. Chow* (1938) 27 C.A.2d 755, 757, 81 P.2d 994; *Ajax Holding Co. v. Heinsbergen* (1944) 64 C.A.2d 665, 669, 149 P.2d 189; *Love v. Gulyas* (1948) 87 C.A.2d 608, 613, 197 P.2d 405 [purchaser's acceptance of offer to sell on condition that he could finance the deal held conditional acceptance and insufficient]; *Angus v. London* (1949) 92 C.A.2d 282, 285, 206 P.2d 869 [interlineations made by purchaser in typewritten escrow instructions before signing held qualified acceptance preventing formation of contract]; *Bartone v. Taylor-Benson-Jones Co.* (1953) 119 C.A.2d 79, 80, 258 P.2d 1054 [interlineations in written offer]; *Block Co. v. Palston* (1954) 123 C.A.2d 300, 310, 266 P.2d 856; *American Aeronautics Corp. v. Grand Cen. Aircraft Co.* (1957) 155 C.A.2d 69, 79, 317 P.2d 694; *Apablaza v. Merritt & Co.* (1959) 176 C.A.2d 719, 726, 1 C.R. 500; 1 Corbin (Rev. ed.), §3.28; 2 Williston 4th, §6:10 et seq.; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §§81, 82; 27 *Proof of Facts* 2d 559 [offeree's acceptance of contract offer]; BAJI, No. 10.68 [Acceptance]; CACI, No. 309 [Contract Formation--Acceptance], CACI, No. 311 [Contract Formation--Rejection of Offer].)

In *Roth v. Malson* (1998) 67 C.A.4th 552, 79 C.R.2d 226, plaintiff buyer sought specific performance of an alleged contract with defendant seller for the sale of real property. After plaintiff had made an offer to buy the property, defendant executed a counteroffer, which contained an area called "Acceptance," with lines for date and signature, and a portion below that labeled "Counter to Counter Offer." In response, plaintiff signed the portion labeled "Counter to Counter Offer" and wrote in certain purchase terms on lines provided for "Changes/Amendments." Plaintiff never signed the area marked for "Acceptance," and defendant never accepted the counter-counteroffer. *Held*, no contract was formed. Despite plaintiff's claim that he signed the wrong place by mistake and that his "Changes/Amendments" did not really change or amend anything, his response required the parties and their agents to analyze whether the terms of the counter-counteroffer in fact matched those of the counteroffer. (67 C.A.4th 558.) "Viewing the counter-counteroffer in its entirety and objectively, the counter-counteroffer called for a response from [defendant] before a contract would be formed. In the absence of a response from defendant, no contract was formed." (67 C.A.4th 559.)

SUPPLEMENT: [This section is current through the latest supplement]

See 2 Williston 4th (2007 ed.), §6:10 et seq.; 101 Proof of Facts 3d 285 [offeree's acceptance of real estate contract], superseding 27 Proof of Facts 2d 559, text, p. 218. *Correction:* Page 218, line 15 of section, "*Block Co. v. Palston*" should be "*Lawrence Block Co. v. Palston*".



69 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT

C. Acceptance.

3. Acceptance Must Be Unqualified.

b. Grumbling Acceptance and Implied Qualifications.

1 Witkin Sum. Cal. Law Contracts § 184

[§ 184] Grumbling Acceptance and Implied Qualifications.

An acceptance that is unqualified, though made with some protest, is a "grumbling acceptance," and such an acceptance is sufficient. (*Purdy v. Buffums* (1928) 95 C.A. 299, 301, 272 P. 770; *Chicago Bridge & Iron Co. v. Industrial Acc. Com.* (1964) 226 C.A.2d 309, 316, 38 C.R. 57, quoting the text; *Panagotacos v. Bank of America* (1998) 60 C.A.4th 851, 856, footnote 2, 70 C.R.2d 595, citing the text; see 1 Corbin (Rev. ed.), §3.29.) Likewise, where the offeree accepts unequivocally, a contract results even though he or she requests or expresses a desire for some change in the terms. (See *Rest.2d, Contracts* §59, Comment a, and §61; 1 Corbin (Rev. ed.), §§3.32, 3.33; 2 Williston 4th, §6:16; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §87.)

Even an express qualification or condition on the acceptance may be sufficient if the qualification or condition is reasonably to be implied from the offer; e.g., where the offeree accepts an offer to sell goods on condition that they be of merchantable quality, or an offer to sell land on condition that the title is clear. (See *Rest.2d, Contracts* §59, Comment b; 1 Corbin (Rev. ed.), §§3.32, 3.33; 2 Williston 4th, §6:15; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §86; 18 *Cal. L. Rev.* 82.)

West's Key Number Digest, Contracts k.27

SUPPLEMENT: [This section is current through the latest supplement]
Grumbling acceptance: See 2 Williston 4th (2007 ed.), §6:16.

Implied qualifications: See 2 Williston 4th (2007 ed.), §6:15.



70 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT

C. Acceptance.

4. Effect of Qualified Acceptance.

a. In General.

1 Witkin Sum. Cal. Law Contracts § 185

[§ 185] In General.

"A qualified acceptance is a new proposal." (C.C. 1585.) As such, it is a counteroffer that constitutes a *rejection* of the original offer, with the result that the original offer cannot thereafter be accepted by the offeree. (See *Niles v. Hancock* (1903) 140 C. 157, 161, 73 P. 840; *King v. Stanley* (1948) 32 C.2d 584, 588, 197 P.2d 321; *Hayward Lumber & Inv. Co. v. Construction Products Corp.* (1953) 117 C.A.2d 221, 227, 255 P.2d 473; *Kahn v. Lischner* (1954) 128 C.A.2d 480, 486, 275 P.2d 539 [acceptance held sufficient]; *Landberg v. Landberg* (1972) 24 C.A.3d 742, 752, 757, 101 C.R. 335; *Glende Motor Co. v. Superior Court* (1984) 159 C.A.3d 389, 395, 205 C.R. 682; *Slavin v. Borinstein* (1994) 25 C.A.4th 713, 720, 30 C.R.2d 745; *Panagotacos v. Bank of America* (1998) 60 C.A.4th 851, 855, 70 C.R.2d 595 [counteroffer as to place of payment for property]; *Rest.2d, Contracts* §39, Comment b and §§58, 59; 1 Corbin (Rev. ed.), §3.36; 2 Williston 4th, §§6:13, 6:14; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §85; 27 Proof of Facts 2d 605 [acts constituting rejection of contract offer]; 3 *A.L.R.2d* 256 [variance between offer and acceptance as to place of payment and of delivery]; 16 *A.L.R.3d* 1424 [contract for sale of real property; variance between offer and acceptance]; *BAJI*, No. 10.68 [Acceptance]; *CACI*, No. 309 [Contract Formation--Acceptance]; *supra*, §163.)

In *Smith v. Holmwood* (1965) 231 C.A.2d 549, 41 C.R. 907, plaintiffs, through a broker, made a written offer to buy 800 acres of defendant's land, specifying the price and terms, including "\$ 1,000 cash to be paid upon the acceptance of the within offer." Defendant, satisfied with all terms except one relating to his reservation of 2 acres, returned his acceptance subject to a change giving him a broader area from which to select. Plaintiffs in writing accepted this counteroffer. Shortly thereafter, defendant's attorney wrote plaintiffs that any contract had been "rescinded" for fraud. A subsequent tender of money by plaintiffs was refused, and they sued for specific performance. *Held*, decree granting reversed. Defendant's modified acceptance was a counteroffer; and plaintiffs had to comply with all of its terms, including payment of \$ 1,000 cash on acceptance. Because they did not do so at this time, no contract arose. (231 C.A.2d 552.)

This overtechnical approach was challenged in a dissent (231 C.A.2d 554) that seems preferable in reasoning and result:

(a) The word "upon," taken by the majority to mean simultaneously with, does not have such a fixed meaning, particularly here in an offer made by purchasers to a distant vendor. Obviously, the parties realized that some time must

elapse after the communicated acceptance of the offer before the \$ 1,000 payment could be made. Construing such language in an offer as requiring simultaneous payment would give the purchasers complete control over the inception of the contract; they could complete it by sending the money or reject it by not doing so.

(b) The parties never attached any importance to the \$ 1,000 payment until after the attorney's attempt to *rescind* what he thought was a *contract* for an entirely different reason.

(c) The intent of the parties should be determined by parol evidence.

West's Key Number Digest, Contracts k.23-

SUPPLEMENT: [This section is current through the latest supplement]

See *American Employers Group v. Employment Dev. Dept.* (2007) 154 C.A.4th 836, 845, 65 C.R.3d 233 [in dispute regarding Employment Development Department's (EDD) proposed assessment for additional unemployment insurance contributions, employer and EDD did not manifest mutual assent, where parties' correspondence revealed that they had only tentative settlement agreement, employer proposed changes to tentative agreement, and EDD rejected employer's proposal]; 2 Williston 4th (2007 ed.), §§6:13, 6:14; 102 Proof of Facts 3d 313 [acts constituting rejection of real estate contract offer], superseding 27 Proof of Facts 2d 605, text, p. 220.



71 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT

C. Acceptance.

4. Effect of Qualified Acceptance.

b. Exception for Sale of Goods.

1 Witkin Sum. Cal. Law Contracts § 186

[§ 186] Exception for Sale of Goods.

U.C.C. 2207 changes the rule, for sales of goods, that a qualified acceptance is a rejection. The Code rule operates as follows:

(1) The acceptance is good unless it is expressly made conditional on assent to the additional or different terms.

(2) The additional terms are regarded as proposals for additions to the contract, and become binding unless the offer expressly limits acceptance to its terms, or they materially alter the contract, or reasonable notification of objection to them is given. (See *Steiner v. Mobil Oil Corp.* (1977) 20 C.3d 90, 141 C.R. 157, 569 P.2d 751, 4 Summary (10th), Sales, §39; *Therma-Coustics Mfg. v. Borden* (1985) 167 C.A.3d 282, 295, 213 C.R. 611, 4 Summary (10th), Sales, §38; 76 Harv. L. Rev. 1481; 68 So. Cal. L. Rev. 1239 [shrinkwrap licenses as unenforceable under U.C.C. 2207]; 72 A.L.R.3d 479 [what are "additional terms" that "materially alter" the contract].)

SUPPLEMENT: [This section is current through the latest supplement]



72 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT
C. Acceptance.
5. Acceptance Must Be Communicated.
a. Necessity of Communication.

1 Witkin Sum. Cal. Law Contracts § 187

[§ 187] Necessity of Communication.

Ordinarily, the acceptance must be expressed or communicated by the offeree to the offeror, in order to manifest mutual assent. (See C.C. 1565, 1581; *Drouin v. Fleetwood Enterprises* (1985) 163 C.A.3d 486, 491, 209 C.R. 623, citing the text; 1 Corbin (Rev. ed.), §3.13; 2 Williston 4th, §6:5 et seq.; 17A Am.Jur.2d (2004 ed.), Contracts §69; 27 Proof of Facts 2d 559 [offeree's acceptance of contract offer]; BAJI, No. 10.68 [Acceptance]; CACI, No. 309 [Contract Formation--Acceptance]; supra, §116.)

In *Klose v. Sequoia Union High School Dist.* (1953) 118 C.A.2d 636, 258 P.2d 515, the court pointed out that a subcontractor's bid did not become binding merely upon the awarding of the construction contract to the general contractor. "A subcontractor bidder merely makes an offer that is converted into a contract by a regularly communicated acceptance conveyed to him by the general contractor. No contractual relationship is created between the subcontractor and the general contractor even though the bid is used as part of the general overall bid by the general contractor and accepted by the awarding authority." (118 C.A.2d 641.)

The Restatement (§56) uses a different terminology to express the same rule: "[I]t is essential to an acceptance by promise either that the offeree exercise reasonable diligence to notify the offeror of acceptance or that the offeror receive the acceptance seasonably." Comment b explains why it does not state the requirement as one of "communication": "The rule is more accurately stated as one requiring reasonable diligence," because in cases of misunderstanding "acceptance turns on what each party knew or had reason to know." And in cases of communication by mail or telegram, an acceptance may be effective on dispatch even though it fails to reach the addressee (infra, §191).

SUPPLEMENT: [This section is current through the latest supplement]

See 2 Williston 4th (2007 ed.), §6:5 et seq.; 101 Proof of Facts 3d 285 [offeree's acceptance of real estate contract], superseding 27 Proof of Facts 2d 559, text, p. 221.



73 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT

C. Acceptance.

5. Acceptance Must Be Communicated.

b. Methods of Communication.

1. In General.

1 Witkin Sum. Cal. Law Contracts § 188

[§ 188] In General.

(1) *Formal Methods*. There may be a formal written *offer* and formal written acceptance. (See *Schreiber v. Hooker* (1952) 114 C.A.2d 634, 637, 251 P.2d 55.) Or the offeror may tender a formal written *agreement* or send a letter in the form of a contract, and the offeree may write "accepted" and sign it. (See *Patty v. Berryman* (1949) 95 C.A.2d 159, 166, 212 P.2d 937.)

(2) *Informal Methods*. The offeror may use words, and the offeree may accept either in words or by conduct. (See *Grimes v. Nicholson* (1945) 71 C.A.2d 538, 541, 162 P.2d 934 [offeror stated terms on which he would perform work, offeree said "O.K., we will go to work"]; 1 Corbin (Rev. ed.), §§3.8, 3.12; 2 Williston 4th, §§6:15, 6:43; 17A Am.Jur.2d (2004 ed.), Contracts §93 et seq.; BAJI, No. 10.68 [Acceptance]; CACI, No. 309 [Contract Formation--Acceptance]; supra, §116.) And where the offeror signs and delivers a contract to the offeree, and the latter accepts it, the offeree will be bound although he or she did not sign it. (*Dallman Supply Co. v. Smith-Blair* (1951) 103 C.A.2d 129, 132, 228 P.2d 886 ["It is a settled rule that the receipt and acceptance by one party of a paper signed by the other only, and purporting to embody all the terms of a contract between the two, binds the acceptor, as well as the signer, to the terms of the paper"]; *Beatty v. Oakland Sheet Metal Supply Co.* (1952) 111 C.A.2d 53, 62, 244 P.2d 25 [offeror handed writing to offeree who said that the offer "was entirely satisfactory," and acted on it in further transactions]; *Nissen v. Stovall-Wilcoxson Co.* (1953) 120 C.A.2d 316, 318, 261 P.2d 10; see 2 Williston 4th, §6:43; 17A Am.Jur.2d (2004 ed.), Contracts §95 et seq.)

The Restatement (§30(2)) states the rule broadly: "Unless otherwise indicated by the language or the circumstances, an offer invites acceptance in any manner and by any medium reasonable in the circumstances."

Acceptance by telephone or other instantaneous two-way communication is governed by the principles applicable to acceptances in which the parties are in the presence of each other. (*Rest.2d, Contracts §64*.)

West's Key Number Digest, Contracts k.26

SUPPLEMENT: [This section is current through the latest supplement]

(2) *Informal Methods*. See 2 Williston 4th (2007 ed.), §§6:15, 6:44.



74 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
 Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
 V. FORMATION: MUTUAL CONSENT
 C. Acceptance.
 5. Acceptance Must Be Communicated.
 b. Methods of Communication.
 2. Prescribed Manner or Reasonable Manner.

1 Witkin Sum. Cal. Law Contracts § 189

[§ 189] Prescribed Manner or Reasonable Manner.

The manner in which acceptance is to be communicated may be specified in the offer, in which case no other will suffice. But if the offer prescribes no means, "any reasonable and usual mode may be adopted." (C.C. 1582; see U.C.C. 2206; *Palo Alto Town & Country Village v. BBTC Co. (1974) 11 C.3d 494, 499, 113 C.R. 705, 521 P.2d 1097*, supra, §177; *Rest.2d, Contracts §§60, 65*; 1 Corbin (Rev. ed.), §§3.23, 3.34; 2 Williston 4th, §6:12; *17A Am.Jur.2d (2004 ed.)*, *Contracts* §92 et seq.; BAJI, No. 10.68 [Acceptance]; CACI, No. 309 [Contract Formation--Acceptance].)

Under the "usage of trade" theory, the fact that the offer is communicated in a certain manner, as by posting or personal delivery, authorizes the use of, but does not limit the offeree to, the same method of acceptance. Accordingly, the offeree may use any method, e.g., a telegram, that is reasonable and customary in similar transactions. (*Rest.2d, Contracts* §65; see *16 Cal. L. Rev.* 320.)

In *Estate of Crossman (1964) 231 C.A.2d 370, 41 C.R. 800*, executrices gave M a written option to purchase land. The instrument specified that "Any notice" by either party must be in writing, "either delivered personally or sent by prepaid registered mail," and that notice by registered mail would be deemed consummated 24 hours after deposit. M telephoned notice of exercise of the option on October 26, and sent a letter by *ordinary mail* that same day. The option expired October 27, and the letter was not actually received until October 29. Nevertheless, the parties treated it as adequate: The petition for confirmation of sale was continued to accommodate M, who was having difficulties in performance, and the executrices obtained an order of confirmation. But M appealed, contending that there was no contract. *Held*, order affirmed.

(a) M's first contention was that registered mail was a condition to valid acceptance. This was rejected in the following analysis: Whether such a condition, for the benefit of the offeror, can be waived by him (see *infra*, §201) was not decided. The language did not *create* a condition but merely *suggested* a permissible method; this interpretation was supported by the extrinsic evidence showing that both sides treated the option as exercised (contemporaneous construction, *infra*, §370). (*231 C.A.2d* 373.)

(b) M's second contention was that the notice was not timely. But the requirement was merely that notice must be

"given"; sending, not receipt, was emphasized. And, although C.C. 1583 may not be looked to for interpretation of the agreement (citing the text, *infra*, §191), the statute is helpful in reaching the conclusion that notice was given when placed in the course of transmission. (231 C.A.2d 373.)

SUPPLEMENT: [This section is current through the latest supplement]
See 2 Williston 4th (2007 ed.), §6:12.



75 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT

C. Acceptance.

5. Acceptance Must Be Communicated.

b. Methods of Communication.

3. Acceptance Improperly Dispatched.

1 Witkin Sum. Cal. Law Contracts § 190

[§ 190] Acceptance Improperly Dispatched.

The rule of acceptance on dispatch (*infra*, §191) assumes that the method of transmission is an authorized or reasonable one (see *supra*, §189). Where the acceptance is by an improper means, it is not effective unless actually *received* by the offeror within the time necessary to receive proper acceptance. (See *Rest.2d, Contracts* §§66, 67; 2 Williston 4th, §6:35 et seq.)

Rest.2d, Contracts §66 states that a mailed acceptance is not operative when dispatched unless properly addressed and ordinary precautions are taken to insure safe transmission. But what happens when an acceptance, though improperly dispatched, nevertheless arrives as though it had been properly dispatched? Once the acceptance reaches the offeror, the means of transmission becomes immaterial; hence the improperly dispatched acceptance "is treated as operative upon dispatch if received within the time in which a properly dispatched acceptance would normally have arrived." (*Rest.2d, Contracts* §67, and Comment a.)

In *Johnson v. Banta* (1948) 87 C.A.2d 907, 198 P.2d 100, a venue case, the offer contained a request that the acceptance be mailed to the offeror's attorneys. Instead, the offeree mailed his acceptance from New York to the offeror personally. *Held*, the acceptance was effective upon mailing, because the method of communication was reasonable and usual, and could not have inconvenienced the offeror. (87 C.A.2d 909.)

In *Morello v. Growers Grape Products Assn.* (1947) 82 C.A.2d 365, 186 P.2d 463, a mailed offer contained the proviso that the acceptance should be "in writing or by telegraphic notification *delivered within 5 days.*" *Held*, the contract was completed if the acceptance was *deposited* in the post office within the period. (82 C.A.2d 370.) Thus in this case, the technical legal rule of acceptance on posting was made to serve the unusual purpose of a rule of interpretation of the offeror's language, although it would seem reasonable to suppose that the offeror used the word "delivered" in the ordinary and popular sense of actual receipt of the acceptance.

West's Key Number Digest, Contracts k.26-

SUPPLEMENT: [This section is current through the latest supplement]

1 Witkin Sum. Cal. Law Contracts § 190

See 2 Williston 4th (2007 ed.), §6:35 et seq.



76 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT

C. Acceptance.

5. Acceptance Must Be Communicated.

b. Methods of Communication.

4. Mail or Telegraph.

aa. In General.

1 Witkin Sum. Cal. Law Contracts § 191

[§ 191] In General.

The general rule that a contract is made when the acceptance is posted, even though the letter of acceptance is lost and never reaches the offeror, is covered by C.C. 1583. This section provides that consent is deemed to be fully communicated when the offeree has placed his or her acceptance *in the course of transmission* to the offeror. (See *Ivey v. Kern County Land Co.* (1896) 115 C. 196, 201, 46 P. 926; *Palo Alto Town & Country Village v. BBTC Co.* (1974) 11 C.3d 494, 501, 113 C.R. 705, 521 P.2d 1097, supra, §177; *California v. Agostini* (1956) 139 C.A.2d 909, 915, 294 P.2d 769 [rule applied to acceptance of offer to enter into unilateral contract; written tender of sum required to exercise option to purchase, sent by mail]; *Rest.2d, Contracts* §63(a); 1 Corbin (Rev. ed.), §3.24; 2 Williston 4th, §6:32; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §§99, 100; 7 Proof of Facts 417 [mailing]; 62 *Harv. L. Rev.* 1231; BAJI, No. 10.68 [Acceptance]; CACI, No. 309 [Contract Formation--Acceptance].)

C.C. 1583 in terms applies not only to mailed acceptances but to other forms of transmission as set forth in C.C. 1582 (any reasonable mode, unless offeror has prescribed otherwise). Thus, a telegraphic acceptance completes the contract when the telegram is deposited for transmission. (*Humphry v. Farmers' Union & Milling Co.* (1920) 47 C.A. 211, 214, 190 P. 489; 1 Corbin (Rev. ed.), §3.27; 2 Williston 4th, §6:33.)

The Restatement (§63(a)) states the time when acceptance takes effect: "as soon as put out of the offeree's possession." Comment e points out that the principal application of this rule is to mail and telegraph, "but it would apply equally to any other similar public service instrumentality, even though the instrumentality may for some purposes be the offeree's agent." However, "except where the Government or a telegraph company can make use of its own postal or telegraph facilities, communication by means of the offeree's employee is excluded; the employee's possession is treated as that of the employer."

Comment a explains the modern theory supporting the rule: "It is often said that an offeror who makes an offer by mail makes the post office his agent to receive the acceptance, or that the mailing of a letter of acceptance puts it irrevocably out of the offeree's control. Under United States postal regulations, however, the sender of a letter has long had the power to stop delivery and reclaim the letter. A better explanation of the rule that the acceptance takes effect on

dispatch is that the offeree needs a dependable basis for his decision whether to accept."

SUPPLEMENT: [This section is current through the latest supplement]

General rule: See 2 Williston 4th (2007 ed.), §6:32.

Other modes of transmission: See 2 Williston 4th (2007 ed.), §6:33.



77 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT

C. Acceptance.

5. Acceptance Must Be Communicated.

b. Methods of Communication.

4. Mail or Telegraph.

bb. Revocation Prior to Dispatch.

1 Witkin Sum. Cal. Law Contracts § 192

[§ 192] Revocation Prior to Dispatch.

In *Gibbs v. American Savings & Loan Assn.* (1990) 217 C.A.3d 1372, 266 C.R. 517, plaintiffs, husband and wife, offered to purchase property from defendant for \$ 180,000. On the morning of June 6, plaintiffs received a counteroffer with additional terms and conditions and no mention of purchase price. Plaintiff wife immediately signed the counteroffer, placed it in an envelope, and before 10:00 a.m., handed it to her clerk with instructions to mail it. At 11:00 a.m., defendant's employee, in a telephone conversation with plaintiff wife, advised her that the counteroffer was in error because defendant had intended to increase the sales price to \$ 198,000, and that the counteroffer was revoked. At the trial, it was shown that the postmark on the envelope was June 7, i.e., after the oral revocation. *Held*, no contract was formed. The signed counteroffer (acceptance) was not placed in the course of transmission beyond the control of plaintiffs until it was deposited. And under the Postal Service Manual, the date shown in the meter postmark must be the actual date of deposit. Thus, the postmarked envelope was substantial evidence that the acceptance was not mailed until June 7. (217 C.A.3d 1375, 1376.)

SUPPLEMENT: [This section is current through the latest supplement]



78 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT

C. Acceptance.

5. Acceptance Must Be Communicated.

c. Silence of Offeree.

1. General Rule: No Acceptance.

1 Witkin Sum. Cal. Law Contracts § 193

[§ 193] General Rule: No Acceptance.

Because acceptance must be communicated, ordinarily silence cannot constitute an acceptance of an offer to enter into a bilateral contract. This is so even though the offer states that silence will be taken as consent, for the offeror cannot force the offeree to make an express rejection. (*Leslie v. Brown Bros.* (1929) 208 C. 606, 621, 283 P. 936; *Southern Calif. Acoustics Co. v. C.V. Holder* (1969) 71 C.2d 719, 722, 79 C.R. 319, 456 P.2d 975, citing the text [prime contractor's listing of subcontractor as required by statute cannot be construed as expression of acceptance of subcontractor's bid]; *Wold v. League of the Cross of Archdiocese of San Francisco* (1931) 114 C.A. 474, 479, 300 P. 57; *Russell v. Union Oil Co.* (1970) 7 C.A.3d 110, 114, 86 C.R. 424, citing the text; *Sorg v. Fred Weisz & Associates* (1971) 14 C.A.3d 78, 81, 91 C.R. 918; see *Rest.2d, Contracts* §69 [stating rule and exceptions]; 1 Corbin (Rev. ed.), §3.18 et seq.; 2 Williston 4th, §6:49 et seq.; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §98; 42 *U.C.L.A. L. Rev.* 1315 [negative option offer in consumer service contract as transforming offeree's silence into acceptance]; CACI, No. 310 [Contract Formation--Acceptance by Silence].)

Cases involving demands on trespassers either to remove or pay exorbitant sums are illustrative of this principle. In *Russell v. Union Oil Co.*, *supra*, defendant, mistakenly claiming a license from its predecessor, maintained a single private telephone line over a portion of plaintiff's land. On plaintiff's notice that he denied its right, defendant offered to pay \$ 6 a year, the standard rate for pole attachment rentals. Plaintiff refused, and sent defendant a notice that its conduct was a trespass and use of the line should be terminated, but that a revocable license could be had for \$ 150 per day, and "Your continued use of these facilities will constitute your acceptance." Defendant did not respond and continued to maintain the line. Plaintiff eventually sued for \$ 155,400, on the sole theory of express contract. *Held*, judgment for defendant affirmed. Plaintiff could not reasonably have understood that defendant's silence and continued use of the line under claim of right manifested an acceptance of his proposal. (7 C.A.3d 115.) The court found nothing to support plaintiff's theory that exercise of dominion over the line made applicable the exception for conduct as acceptance (*infra*, §195).

Similarly, in *Sorg v. Weisz & Associates*, *supra*, defendant mistakenly claimed a license to dump rubbish. Plaintiff's lawyers wrote defendant stating that its employees were trespassers, that compensation of \$ 150 per day was demanded for a revocable license, and that continued use of the property for this purpose would constitute an acceptance. Two

weeks later defendant replied, describing the permission from plaintiff's lessee to dump on a particular part of the land; and, 32 days after plaintiff's demand, defendant removed the dumped material. *Held*, judgment for plaintiff reversed:

"The tactic of attempting to create a contract by a letter stating a price, on the theory that silence and inaction would constitute an acceptance, has been consistently rejected by the courts." (14 C.A.3d 81.)

There are two recognized exceptions to the rule that silence does not constitute acceptance: (a) Where a previous relationship or course of dealing is involved (infra, §194), and (b) where the offeree makes use of the consideration (infra, §195). A more controversial exception is based on the offeree's intention to accept (infra, §197). (On acceptance by performance, see infra, §198.)

West's Key Number Digest, Contracts k.22(1)

SUPPLEMENT: [This section is current through the latest supplement]
See 2 Williston 4th (2007 ed.), §6:50 et seq.



79 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT

C. Acceptance.

5. Acceptance Must Be Communicated.

c. Silence of Offeree.

2. Duty To Speak: Previous Relationship or Course of Dealing.

1 Witkin Sum. Cal. Law Contracts § 194

[§ 194] Duty To Speak: Previous Relationship or Course of Dealing.

Where the circumstances or the previous course of dealing between the parties place the offeree under a duty to act or be bound, his or her silence or inactivity will constitute assent. This would be the case, e.g., where goods were ordered on approval (see U.C.C. 2327), or where a seller had on previous occasions shipped goods without an express order and the buyer had retained and paid for them. (See *Wold v. League of the Cross of Archdiocese of San Francisco* (1931) 114 C.A. 474, 481, 300 P. 57; *Rest.2d, Contracts* §69(1)(c) and Comment d, §71(1)(c); 1 Corbin (Rev. ed.), §3.12; 2 Williston 4th, §§6:49, 6:53; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §98; CACI, No. 310 [Contract Formation--Acceptance by Silence].) An *account stated* is another instance in which silence will, after a reasonable time has elapsed, be deemed consent. (See *infra*, §974.)

A *fiduciary relationship* may also place the offeree under a duty to speak. Thus, in *Wood v. Gunther* (1949) 89 C.A.2d 718, 201 P.2d 874, a partnership agreement between the parties provided that, if one member withdrew, the others could purchase his share within a specified time for its fair value. On being notified that plaintiff desired to terminate, defendants exercised their option and offered \$ 45,000 as the fair value. Plaintiff neither accepted nor rejected, but later sued for dissolution and accounting. *Held*, a contract was formed when plaintiff remained silent in the face of defendants' offer. (89 C.A.2d 730.) (See *Meherin v. Meherin* (1949) 93 C.A.2d 459, 466, 209 P.2d 36; *McAulay v. Jones* (1952) 110 C.A.2d 302, 306, 242 P.2d 650 [landlord-tenant relationship with rental based on income]; *infra*, §195.)

In *Shell Chemical Corp. v. Owl Transfer Co.* (1959) 173 C.A.2d Supp. 796, 344 P.2d 108, plaintiff delivered 96 drums of fertilizer to defendant public warehouseman for storage. Some months later, plaintiff gave written instructions to restencil each drum to show a true higher concentration of a valuable chemical. Defendant failed to comply, the fertilizer was mistakenly sold at a lower price than if properly labeled, and plaintiff sued for the loss of \$ 1,783.80, calculated as the value of 991 lbs. of the chemical at \$ 1.80 per lb. The trial judge limited recovery to \$ 135.36, applying the published tariff limitation of 12 1/2 cents per lb. where no greater value is declared at the time of storage. *Held*, reversed. The additional term (or subsidiary contract) arose when the instructions to restencil were given; defendant offeree was then under a duty either to notify of his intention not to comply or to perform (i.e., to speak or act). (173 C.A.2d Supp. 801.)

SUPPLEMENT: [This section is current through the latest supplement]

See *Gentry v. Superior Court* (2007) 42 C.4th 443, 467, 64 C.R.3d 773, 165 P.3d 556, Supp., infra, §336 [failure to opt out of arbitration agreement constituted assent; having signed form explaining that he had to take action to opt out, plaintiff manifested his intent to use his silence as means of acceptance, and having thus indicated his intent, he could not later claim that his silence did not constitute acceptance]; 2 Williston 4th (2007 ed.), §§6:50, 6:55.



80 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

- Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT
C. Acceptance.
5. Acceptance Must Be Communicated.
c. Silence of Offeree.
3. Use of Services, Goods, or Other Consideration.
aa. Conduct as Acceptance.

1 Witkin Sum. Cal. Law Contracts § 195

[§ 195] Conduct as Acceptance.

(1) *In General.* Where the offeree, with freedom to reject them, makes use of services, or other consideration tendered with the offer, this conduct amounts to an acceptance. (See C.C. 1584, 1589; *Acadia, Calif., Ltd. v. Herbert* (1960) 54 C.2d 328, 336, 5 C.R. 686, 353 P.2d 294 [where check was sent to defendant with accompanying statement that its acceptance would confirm understanding modifying prior written agreement, cashing check was acceptance of conditions, despite defendant's written statement of disagreement]; *Durgin v. Kaplan* (1968) 68 C.2d 81, 91, 65 C.R. 158, 436 P.2d 70, *infra*, §767; *McAulay v. Jones* (1952) 110 C.A.2d 302, 306, 242 P.2d 650 [lessor's acceptance of benefit of lessee's improvements was acceptance by conduct]; *Rest.2d, Contracts* §69(1)(a) and Comment b; 1 Corbin (Rev. ed.), §3.21; 2 Williston 4th, §6:50; 17A Am.Jur.2d (2004 ed.), *Contracts* §96; BAJI, No. 10.68 [Acceptance]; CACI, No. 309 [Contract Formation--Acceptance]; on statutory exception for unsolicited merchandise or services, see *infra*, §196.)

In *Golden Eagle Ins. Co. v. Foremost Ins. Co.* (1993) 20 C.A.4th 1372, 25 C.R.2d 242, plaintiffs purchased a mobilehome park, and the sellers' insurance policy with defendant insurer was endorsed over to them effective June 30, 1986. This policy was due to expire on October 1, 1986. On October 17, 1986, defendant's agent sent plaintiffs a certificate of insurance showing renewal of the policy for the period October 1, 1986, to October 1, 1987. The certificate was accompanied by a bill for a premium deposit. Plaintiffs never paid any part of this bill, and, in December 1986, defendant issued a notice of cancellation, effective December 29, 1986, based on nonpayment of premium. The issue was whether the policy was in effect for the period from October 1, 1986, to December 29, 1986. *Held*, despite plaintiffs' inaction, the policy had been renewed and thus was in effect during that period.

(a) *No rejection of offer of renewal.*

(1) On December 9, 1986, plaintiff B informed defendant's agent that because the policy premium was too high, he was not going to pay it *at that time*, but instead was going to shop around for a better rate. Defendant argued that this constituted a rejection of its offer of renewal, but this position is without merit. No due date was stated in the premium deposit. And, instead of constituting an express rejection, plaintiff's action showed only that he was a prudent consumer.

(20 C.A.4th 1384.)

(2) Even more significant is the fact that neither defendant nor its agent treated plaintiff B's failure to pay the premium deposit or his shopping for other coverage as a rejection of the renewal policy. The agent's response was to ask defendant to cancel the policy, which was done by notice on December 16, 1986, effective December 29, 1986, and then to bill plaintiffs for the earned premium for the time that the policy was in effect. Had there been no contract of insurance, there would have been no necessity for a cancellation. (20 C.A.4th 1385.)

(b) *Acceptance of offer of renewal.*

(1) Defendant contended that even if plaintiffs did not expressly reject the offer of renewal neither did they expressly accept it by paying the premium. However, defendant cannot contest coverage on this ground, because it did not require payment of the premium by the insured as a condition of coverage. Under its arrangement with its agent, defendant would issue a policy, collect the premium from the agent, and then leave it to the agent to collect from the insured. Thus, unless the agent requested cancellation, defendant would never know whether or not its insured had paid the premium. (20 C.A.4th 1385.)

(2) The evidence supports the conclusion that, despite their silence and inaction, plaintiffs accepted the offer of renewal. When plaintiffs received the notice of renewal, they could have rejected the renewal policy without any material inconvenience or expense. But instead they retained the certificate of renewal and made no objection to the amount of the premium until nearly 2 months later. In addition, defendant's offer did not come "out of the blue." Instead, plaintiffs knew that the mobilehome park was insured by defendant, they had paid the pro rata share of the premium to the sellers when they purchased the park, and they had been informed by defendant that they had been substituted as the named insured on the original policy. Thus, plaintiffs' conduct in retaining the certificate, together with their existing relationship with defendant, is sufficient evidence of acceptance of the renewal policy under the rule that acceptance may be inferred by voluntary retention of the benefit offered. (20 C.A.4th 1386.)

(3) Furthermore, because defendant led plaintiffs to believe that acceptance could be manifested by inaction, it may not now change its position and argue that such inaction did not constitute acceptance. Defendant's notice to plaintiffs told them that they had been provided with continuous coverage and that the policy in question had been issued. A reasonable person would have concluded, as did plaintiff B, that defendant had renewed the policy without the necessity of any positive act on his part, and that the policy would remain in force should he choose to pay the premium at some future time. Plaintiff B was entitled to rely on defendant's implied representation that inaction would constitute acceptance. And he did so rely, as evidenced by the fact that he did not immediately purchase a replacement policy, but instead engaged in comparison shopping to see if he could obtain a better one. (20 C.A.4th 1387.)

(2) *Acts Not in Conformity With Offer.* If the offeree's acts of ownership are not in conformity with the offer, the privilege of remaining silent no longer applies, and the offeror may elect to sue in tort. But the offeree ordinarily cannot avoid a contract obligation by asserting that he or she is a tortfeasor rather than a promisor; the offeror may hold the offeree to an acceptance even though the obligation may fairly be characterized as quasi-contractual. (*Rest.2d, Contracts* §69(2), Comment e.)

SUPPLEMENT: [This section is current through the latest supplement]
See 2 Williston 4th (2007 ed.), §6:51.



81 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT
C. Acceptance.
5. Acceptance Must Be Communicated.
c. Silence of Offeree.
3. Use of Services, Goods, or Other Consideration.
bb. Exception: Unsolicited Merchandise or Services.

1 Witkin Sum. Cal. Law Contracts § 196

[§ 196] Exception: Unsolicited Merchandise or Services.

The rule that use of tendered goods constitutes an acceptance of the offer (supra, §195) is abrogated by C.C. 1584.5 and C.C. 1584.6:

(1) Sellers are prohibited from offering goods or services for sale "where the offer includes the voluntary and unsolicited sending of such goods ... or services not actually ordered or requested by the recipient." (C.C. 1584.5.)

(2) Receipt of any of these goods or services "shall for all purposes be deemed an unconditional gift to the recipient," and he or she may use or dispose of them without obligation to the sender. (C.C. 1584.5.)

(3) The same rule applies where the recipient is a member of an organization that sells to members, and the recipient notifies the organization of termination of membership by certified mail, return receipt requested. After 30 days from execution of the return receipt, any unordered goods are deemed gifts. (C.C. 1584.6.) If, however, termination of membership is a breach of contract, the new statute only relieves the recipient from liability with respect to the goods; he or she may still be liable for damages for breach. (C.C. 1584.6.)

(4) An additional sanction is provided if the seller sends bills or requests for payment of the goods: The recipient may sue to enjoin this conduct, and the prevailing party is entitled to reasonable attorneys' fees as well as costs. (C.C. 1584.5, 1584.6.)

(5) The prohibition expressly applies to merchandise or services selected by the seller and offered to the consumer, which will be mailed to the consumer for sale or on approval unless he or she exercises an option of rejection. Merchandise or services that are thus selected and offered for sale on a periodic basis "must be affirmatively ordered by a statement or card signed by the consumer as to each periodic offer of merchandise or services." (C.C. 1584.5.)

(6) Contractual plans or arrangements under which the seller periodically provides the consumer with a form rejection notice are excluded from the statute. Any instructions not to ship contained in this notice must be printed in

type as large as all other instructions and terms. And the notice must be preaddressed to the seller (so as to serve as a postal reply card) or be accompanied by a return envelope addressed to the seller. (C.C. 1584.5.)

The rejection procedure must afford the consumer at least 10 days in which to reply; and "clear and conspicuous language" in or immediately adjacent to the membership contract or application form must disclose the material terms of the plan or arrangement, including (a) the rejection procedure, (b) any minimum purchase obligation assumed by the subscriber, (c) the right of a "contract-complete" subscriber to cancel his or her membership at any time, and (d) whether billing charges will include an amount for postage and handling. (C.C. 1584.5.)

(7) Contractual plans or arrangements under which the seller "periodically ships merchandise to a consumer who has consented in advance to receive such merchandise on a periodic basis" are also excluded from the statute. (C.C. 1584.5.)

SUPPLEMENT: [This section is current through the latest supplement]



82 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT
C. Acceptance.
5. Acceptance Must Be Communicated.
c. Silence of Offeree.
4. Offeree's Intention To Accept.

1 Witkin Sum. Cal. Law Contracts § 197

[§ 197] Offeree's Intention To Accept.

The Restatement (§69(1)(b)) states the following exception to the rule that silence does not constitute acceptance:

"Where the offeror has stated or given the offeree reason to understand that assent may be manifested by silence or inaction, and the offeree in remaining silent and inactive intends to accept the offer."

Comment c explains that the offeree may remain silent without accepting, but that the offeree is entitled to rely on the offeror's statement if he or she chooses; and the offeror who has invited acceptance by silent inaction cannot complain of the resulting uncertainty in his or her position.

There is little authority on this exception, and no indication of its approval in California. (See, e.g., *Leslie v. Brown Bros.* (1929) 208 C. 606, 621, 283 P. 936; 1 Corbin (Rev. ed.), §3.19; 2 Williston 4th, §6:52.)

West's Key Number Digest, Contracts k.22(1)

SUPPLEMENT: [This section is current through the latest supplement]
See 2 Williston 4th (2007 ed.), §6:53.



83 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT
C. Acceptance.
5. Acceptance Must Be Communicated.
c. Silence of Offeree.
5. Acceptance by Performance.
aa. In General.

1 Witkin Sum. Cal. Law Contracts § 198

[§ 198] In General.

(1) *Right To Accept by Performance.* The offeree can accept by rendering performance "only if the offer invites such an acceptance." (*Rest.2d, Contracts §53(1)*; see 2 Williston 4th, §6:26; 17A *Am.Jur.2d* (2004 ed.), *Contracts §96*.) And at least part of what the offer requests must be performed or tendered. (*Rest.2d, Contracts §50(2)*.) The offeree, however, may reject the offer, even after he or she has engaged in performance, by manifesting an intention not to accept before the offeror performs his or her own promise. (*Rest.2d, Contracts §53(3)*.)

(2) *Where Offer Invites Either Performance or Promise.* If the offer gives the offeree the choice of promise or performance, "the tender or beginning of the invited performance or a tender of a beginning of it is an acceptance by performance," and it operates as a *promise to render complete performance*. (*Rest.2d, Contracts §62*; see Comment a, stating that in case of doubt the offer is interpreted as inviting the offeree to choose between acceptance by promise and by performance.)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Right To Accept by Performance.* See 2 Williston 4th (2007 ed.), §6:26.



84 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT

C. Acceptance.

5. Acceptance Must Be Communicated.

c. Silence of Offeree.

5. Acceptance by Performance.

bb. Notification to Offeror.

1 Witkin Sum. Cal. Law Contracts § 199

[§ 199] Notification to Offeror.

(1) *General Rule: No Notification Required.* If the offer simply invites acceptance by performance, and does not request a notification to make the acceptance effective, no notification is necessary. (*Rest.2d, Contracts §54(1).*) (See C.C. 1584 ["Performance of the conditions of a proposal ... is an acceptance of the proposal"]; *Davis v. Jacoby* (1934) 1 C.2d 370, 378, 34 P.2d 1026; *Baird v. Loescher* (1908) 9 C.A. 65, 69, 98 P. 49; 1 Corbin (Rev. ed.), §§3.13, 3.16; 2 Williston 4th, §6:5 et seq.; 17A Am.Jur.2d (2004 ed.), *Contracts* §97.)

(2) *When Notification Is Required.* If the offeree "has reason to know that the offeror has no adequate means of learning of the performance with reasonable promptness and certainty," he or she must exercise reasonable diligence to notify the offeror unless the offer indicates that notification is not required. (*Rest.2d, Contracts §54(2)*, and Comment a.) In this situation, although the contract is created without notification, failure to notify results in discharge of the contractual duty. (*Rest.2d, Contracts §54(2)*, and Comment c.)

(3) *Illustration: Guaranty.* The requirement of notification has an important application where the offeror makes an offer to guarantee repayment of money if the offeree will lend it to a third person. The offer to guarantee requires notification to the guarantor. (*Rest.2d, Contracts §54*, Comment d.) (See *Rest.2d, Contracts §31*, Comment b [offer of continuing guaranty, single notification sufficient]; *Skaggs-Stone v. LaBatt* (1960) 182 C.A.2d 142, 143, 5 C.R. 882, supra, §75; 1 Corbin (Rev. ed.), §3.14; 2 Williston 4th, §6:7; 38 Am.Jur.2d (1999 ed.) *Guaranty* §§38, 39; 6 A.L.R.3d 355 [necessity that creditor give guarantor notice of acceptance of guaranty].)

The California rule formerly required notification in guaranty cases, but in 1939, with the revision of California statutes dealing with suretyship and guaranty, C.C. 2795 was amended to provide that an offer to become a surety may be accepted by acting upon it, unless notice of acceptance is expressly required. This section is not necessarily inconsistent with the Restatement rule, which recognizes that the acceptance is good and the contract is formed, but imposes a duty of subsequent notification as a condition to its enforcement.

SUPPLEMENT: [This section is current through the latest supplement]

(1) *General Rule: No Notification Required.* See 2 Williston 4th (2007 ed.), §6:5 et seq.

(3) *Illustration: Guaranty.* See 2 Williston 4th (2007 ed.), §6:7.



85 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT
C. Acceptance.
6. Withdrawal of Mailed Acceptance.

1 Witkin Sum. Cal. Law Contracts § 200

[§ 200] Withdrawal of Mailed Acceptance.

It is generally held that a posted acceptance, which creates a contract (see *supra*, §191), cannot be withdrawn either by wiring a countermanding message that reaches the offeror first, or physically withdrawing the letter from the mails. The reason is that the offeree is not permitted to speculate at the offeror's expense during the time required for the letter to arrive. (See *Rest.2d, Contracts* §63, Comment c; 1 Corbin (Rev. ed.), §3.26; 2 Williston 4th, §6:38; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §100; Cal. Transactions Forms, 1 Business Transactions §6:19; 21 *Cal. L. Rev.* 427.) A few decisions are *contra*, holding that postal regulations permitting withdrawal of a letter from the mails permits the offeree to countermand a mailed acceptance. (See 1 Corbin (Rev. ed.), §3.26; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §100; 62 *Harv. L. Rev.* 326; 8 *Stanf. L. Rev.* 279.)

The Restatement (§63, Comment c) points out that this attempt to withdraw an acceptance may nevertheless have some effects: (1) As a practical matter, if the offeree removes his or her letter from the mails, the offeror may never learn that a contract had been entered into. (2) The purported revocation may amount to an offer to rescind the contract or to a repudiation of it, or may bar the offeree by estoppel from enforcing it.

West's Key Number Digest, Contracts k.26

SUPPLEMENT: [This section is current through the latest supplement]
See 2 Williston 4th (2007 ed.), §6:38.



86 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
V. FORMATION: MUTUAL CONSENT
C. Acceptance.
7. Waiver of Defect in Acceptance.

1 Witkin Sum. Cal. Law Contracts § 201

[§ 201] Waiver of Defect in Acceptance.

The Restatement (§70) takes the position that, if an acceptance is made in an unauthorized manner, or arrives too late, the offeror ordinarily cannot waive the defect and by his or her silence treat the acceptance as complete. The offeror's silence can be effective only in the exceptional cases in which silence by the offeree will constitute acceptance (*supra*, §187). (See 2 Williston 4th, §6:55.)

California cases disagree, holding that the offeror may ignore the delay and treat the acceptance as timely. (*Davies v. Langin* (1962) 203 C.A.2d 579, 585, 21 C.R. 682; *Sabo v. Fasano* (1984) 154 C.A.3d 502, 201 C.R. 270.)

The problem was fully explored in *Sabo v. Fasano, supra*. Defendant vendors listed their property for sale. Plaintiff made a written offer to buy in a "Deposit Receipt" containing the provision that the offer would be deemed revoked unless accepted in writing within 5 days. The broker handling the transaction did not present the offer to the vendors until 1 day after the expiration date; but the vendors signed the deposit receipt and the broker notified the purchaser that they had accepted. The purchaser, with knowledge of the late acceptance, made no objection, and proceeded with the escrow and arrangements to finance the purchase. The vendors admitted that they signed the deposit receipt with intent to be bound; they participated in drafting of escrow instructions; they were informed by the purchaser that he believed they had a contract; and their attorney advised the purchaser's attorney that they would comply with the contract. Nevertheless, the trial judge gave judgment for defendant vendors on the traditional theory that the late acceptance was only a counteroffer. *Held*, reversed.

(a) A provision in an offer specifying the *means* of acceptance may be waived by the offeror, and the same rule should apply to a *time limit* imposed for acceptance. This was the holding in *Davies v. Langin, supra*, and some other courts are in accord. (154 C.A.3d 506.)

(b) The contrary (counteroffer) view is held by legal scholars and courts of other jurisdictions. (154 C.A.3d 506, citing Williston, Corbin, and the Restatement.) But the waiver theory is preferable:

(1) The counteroffer theory does not accurately describe what has transpired. A counteroffer proposes a substituted bargain differing from that proposed by the original offer; a late acceptance is a full and complete acceptance of the terms of the offer. (154 C.A.3d 507.)

(2) The argument that the waiver theory leaves the vendor uncertain as to whether there is a contract may be simply answered: "[T]he seller, who created his own dilemma by accepting late, can resolve any uncertainty by making an inquiry of the buyer. It must be assumed the seller intends to bind herself by the act of acceptance, even if the act is untimely. Indeed, in the case at bar, the Fasanos admitted that by signing the deposit receipt they intended to be bound by its terms. The buyer may or may not waive the time for acceptance but generally this decision will be expressed by his actions after receiving the late acceptance. ... If the seller is in doubt whether the buyer has waived the time limit, the seller should make inquiry. As a matter of fundamental fairness the party who caused the uncertainty by late acceptance of the offer should bear the burden of clarifying matters if clarification is necessary." (154 C.A.3d 508.)

(3) Under the waiver theory, until there is a waiver neither party can enforce the terms of the deposit receipt, but once there is a waiver either party may do so. Under the counteroffer theory, the statute of frauds (C.C. 1624) might operate in some circumstances to bind the vendor but not the purchaser: "The seller's signature on the deposit receipt constituting the counteroffer would satisfy the statute of frauds in a suit by the buyer against the seller but would the buyer's signature on the original offer satisfy the statute of frauds in a suit by the seller against the buyer?" (154 C.A.3d 508.)

SUPPLEMENT: [This section is current through the latest supplement]
See 2 Williston 4th (2007 ed.), §6:56.



87 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VI. FORMATION: CONSIDERATION
A. In General.

1. Requirement of Consideration.

1 Witkin Sum. Cal. Law Contracts § 202

[§ 202] Requirement of Consideration.

The general rule is that every executory contract requires consideration. (C.C. 1550; *Rest.2d, Contracts §71* et seq.) Thus, a promise to make a gift (a donative promise) is generally unenforceable. (*Fritz v. Thompson (1954) 125 C.A.2d 858, 863, 271 P.2d 205*; *Haase v. Cardoza (1958) 165 C.A.2d 35, 37, 331 P.2d 419*; on when consideration is unnecessary, see *infra*, §239 et seq.) Consideration may be an act, forbearance, change in legal relations, or a promise. (*Rest.2d, Contracts §71(3)*; see *infra*, §208 et seq.) (See generally 2 Corbin (Rev. ed.), §5.1 et seq.; 3 Williston 4th, §7:1 et seq.; 17A *Am.Jur.2d (2004 ed.)*, *Contracts §102* et seq.; Cal. Civil Practice, 3 Business Litigation, §24:40 et seq.; Cal. Transactions Forms, 1 Business Transactions §6:27 et seq.; 3 California Affirmative Defenses 2d (2004 ed.), §56:1 et seq.; BAJI, No. 10.61 [Consideration]; CACI, No. 302 [Contract Formation--Essential Factual Elements].)

The fact that a promise is made with the purpose or hope of profit will not sustain it if in fact nothing of value is received. (*Williams v. Hasshagen (1913) 166 C. 386, 390, 137 P. 9.*) On the other hand, if a valid consideration exists, the promise is binding even though some motive other than obtaining the consideration induced the promisor to enter into the agreement. (See *Hamilton v. Oakland School Dist. of Alameda County (1933) 219 C. 322, 330, 26 P.2d 296*; *Rest.2d, Contracts §81*; 2 Corbin (Rev. ed.), §5.7; 3 Williston 4th, §7:17; 17A *Am.Jur.2d (2004 ed.)*, *Contracts §104.*) The Restatement (§81, Comment b) explains the immateriality of motive or cause as follows: "This Section makes explicit a limitation on the requirement that consideration be bargained for. Even in the typical commercial bargain, the promisor may have more than one motive, and the person furnishing the consideration need not inquire into the promisor's motives. Unless both parties know that the purported consideration is mere pretense, it is immaterial that the promisor's desire for the consideration is incidental to other objectives and even that the other party knows this to be so."

Consideration has been the subject of much critical discussion, and the modern law tends to relax the requirement and expand the exceptions thereto. (See 47 *Cal. L. Rev.* 74 [reappraisal of "cause and consideration" in California]; 83 *Cal. L. Rev.* 547 [application of doctrine of consideration as dependent on effect of transaction on distribution of wealth between parties]; 50 *Harv. L. Rev.* 453; 59 *Harv. L. Rev.* 29; 72 *Harv. L. Rev.* 1009 [comparison of civil law treatment]; 7 *Loyola L.A. L. Rev.* 1 [analysis and criticism of doctrine of consideration]; 29 *Loyola L.A. L. Rev.* 713 [consideration as necessary condition for enforcement of promise]; 6 *Stanf. L. Rev.* 229; 27 *Stanf. L. Rev.* 1161 [review of Gilmore's book on "the decline and fall of consideration" and the emergence of an expanded conception of tort as the basis of civil obligations]; 45 *U.C.L.A. L. Rev.* 1005, 1011 [role of probability and chance with regard to consideration].)

West's Key Number Digest, Contracts k.47

SUPPLEMENT: [This section is current through the latest supplement]

General rule: See 3 Williston 4th (2008 ed.), §7:1 et seq.; C.E.B., Law of Contracts §3.42 et seq.; 3 California Affirmative Defenses §56:1 et seq.

Immateriality of motive: See 3 Williston 4th (2008 ed.), §7:17.



88 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VI. FORMATION: CONSIDERATION
A. In General.
2. Benefit or Detriment.

1 Witkin Sum. Cal. Law Contracts § 203

[§ 203] Benefit or Detriment.

Consideration may be either (1) a benefit conferred or agreed to be conferred upon the promisor or some other person; or (2) a detriment suffered or agreed to be suffered by the promisee or some other person. (C.C. 1605; see generally *Seth v. Lew Hing* (1932) 125 C.A. 729, 734, 14 P.2d 537, 15 P.2d 190; *Irving v. Irwin* (1933) 133 C.A. 374, 378, 24 P.2d 215; *Whittell v. Pinney* (1938) 28 C.A.2d 354, 361, 82 P.2d 526; *Millsap v. National Funding Corp. of Calif.* (1943) 57 C.A.2d 772, 776, 135 P.2d 407; *First Nat. Bank of Stockton v. Pomona Tile Mfg. Co.* (1947) 82 C.A.2d 592, 603, 186 P.2d 693; *Johnston v. Twentieth Century-Fox Film Corp.* (1947) 82 C.A.2d 796, 818, 819, 187 P.2d 474; *Stone v. Burke* (1952) 110 C.A.2d 748, 755, 244 P.2d 51; *Brody v. Gabriel* (1961) 193 C.A.2d 644, 645, 14 C.R. 539; *PMC v. Porthole Yachts, Ltd.* (1998) 65 C.A.4th 882, 891, 76 C.R.2d 832, citing the text [agreement for purchase of boat requiring potential buyer to make substantial deposit in order to conduct trial run and marine survey was sufficient detriment to constitute consideration]; 2 Corbin (Rev. ed.), §§5.9, 5.10; 3 Williston 4th, §7:4 et seq.; 17A Am.Jur.2d (2004 ed.), Contracts §117; 29 Cal. L. Rev. 62; BAJI, No. 10.61 [Consideration]; CACI, No. 302 [Contract Formation--Essential Factual Elements].)

Thus, a benefit need not be given to the promisor, but may be given to a third person. (*Adolph Ramish v. Woodruff* (1934) 2 C.2d 190, 207, 40 P.2d 509; *Pacific Coast Cas. Co. v. Davis* (1918) 38 C.A. 152, 154, 175 P. 701; *Creamery Package Mfg. Co. v. Bennett* (1920) 48 C.A. 706, 709, 192 P. 328; *Anchor Cas. Co. v. Surety Bond Savings & Loan Assn.* (1962) 204 C.A.2d 175, 181, 22 C.R. 278; *Cechettini v. Consumer Associates, Ltd.* (1968) 260 C.A.2d 295, 298, 67 C.R. 15, citing the text; *Flojo Int. v. Lassleben* (1992) 4 C.A.4th 713, 719, 6 C.R.2d 99 [corporation's promise to pay royalties to its former owner was supported by former owner's promise to transfer his stock in corporation to its new owner]; *Rest.2d, Contracts* §71(4); on charitable subscription cases, see *infra*, §253.)

C.C. 1605, *supra*, requires that the benefit or detriment be given "as an inducement to the promisor." The quoted phrase reflects the requirement, more clearly enunciated in the Restatement (*Rest.2d, Contracts* §71), that the consideration be a *bargained-for* exchange. (*Jara v. Suprema Meats* (2004) 121 C.A.4th 1238, 1248, 18 C.R.3d 187 [promise by two of three shareholders in closely held corporation to condition any increase in their compensation on approval of all three shareholders was gratuitous, rather than bargained for].)

Because of its emphasis on a bargained for exchange, the Restatement departs from the traditional terminology of benefit or detriment, observing that these are not essential elements of a bargain or an enforceable contract: "If the

requirement of consideration is met, there is no additional requirement of ... a gain, advantage, or benefit to the promisor or a loss, disadvantage, or detriment to the promisee." (*Rest.2d, Contracts §79(a)*.) Comment b explains one of the weaknesses of using the "benefit-detriment" terminology: "Today when it is said that consideration must involve a detriment to the promisee, the supposed requirement is often qualified by a statement that a 'legal detriment' is sufficient even though there is no economic detriment or other actual loss. It is more realistic to say simply that there is no requirement of detriment."

West's Key Number Digest, Contracts k.51, 52

SUPPLEMENT: [This section is current through the latest supplement]
See 3 Williston 4th (2008 ed.), §7:4 et seq.



89 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
VI. FORMATION: CONSIDERATION
A. In General.
3. Given Pursuant to Agreement.

1 Witkin Sum. Cal. Law Contracts § 204

[§ 204] Given Pursuant to Agreement.

The act or forbearance must be something bargained for in exchange for the offeror's promise; i.e., it is immaterial what detriment the offeree suffered or what benefits he or she may have conferred on the offeror, unless the offeror agreed to be bound in return. (*Rest.2d, Contracts §71(1)(2)*; see *Kelley v. Rouse* (1961) 188 C.A.2d 92, 98, 10 C.R. 235; *Enslow v. Von Guenther* (1961) 193 C.A.2d 318, 322, 14 C.R. 231; *Homestead Supplies v. Executive Life Ins. Co.* (1978) 81 C.A.3d 978, 985, 986, 147 C.R. 22, citing the text; *Podolsky v. First Healthcare Corp.* (1996) 50 C.A.4th 632, 654, 58 C.R.2d 89, citing the text; *Saks v. Charity Mission Baptist Church* (2001) 90 C.A.4th 1116, 1131, 110 C.R.2d 45 [church could not be held liable for promissory note signed by its pastor where there was no consideration supporting alleged agreement between plaintiff and church]; 2 Corbin (Rev. ed.), §5.5; 3 Williston 4th, §§7:5, 7.6; 17A Am.Jur.2d (2004 ed.), *Contracts* §102; BAJI, No. 10.61 [Consideration]; CACI, No. 302 [Contract Formation--Essential Factual Elements]; cf. 2 Corbin (Rev. ed.), §5.5 [noting tendency of courts to refer to unbargained for exchanges as "consideration"].)

Thus, in *Bard v. Kent* (1942) 19 C.2d 449, 122 P.2d 8, a lessee, having an option for which no consideration had been given, spent money for architect's drawings of proposed improvements in the property. *Held*, the option was still revocable, for the offeror had not agreed to accept these acts as consideration. (19 C.2d 452.) (See 5 *Stanf. L. Rev.* 785.)

In *Stern v. Franks* (1939) 35 C.A.2d 676, 96 P.2d 802, after defendants' debt to plaintiff was barred by bankruptcy, they agreed to give him a promissory note if he would go into business with them. They made the note, but plaintiff failed to perform. *Held*, the note lacked consideration; although the discharge of the "moral obligation" of the barred debt could have supported the promise under most conditions (see *infra*, §239), in this instance defendants could not benefit from this discharge, because they had bargained for an entirely different consideration. (35 C.A.2d 678.) (See *Simmons v. California Institute of Technology* (1949) 34 C.2d 264, 272, 209 P.2d 581 [consideration bargained for was past services, hence promise was unsupported, despite showing of other acts and promises that would have been sufficient consideration if bargained for].)

Similarly, forbearance to sue on a claim must be in pursuance of an agreement therefor. If the party is not bound to forbear and can institute suit at any time, mere forbearance is not consideration. (*Tiffany & Co. v. Spreckels* (1927) 202 C. 778, 790, 262 P. 742; *Wine Packing Corp. of Calif. v. Voss* (1940) 37 C.A.2d 528, 538, 100 P.2d 325.) But a promise to forbear may be implied. (See *MacDonald v. Rosenfeld* (1948) 83 C.A.2d 221, 237, 188 P.2d 519; *E-P Constructors v.*

Peterson Tractor Co. (1961) 192 C.A.2d 518, 524, 13 C.R. 569; Levine v. Tobin (1962) 210 C.A.2d 67, 69, 26 C.R. 273.)

SUPPLEMENT: [This section is current through the latest supplement]
See 3 Williston 4th (2008 ed.), §§7:5, 7:6.



90 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VI. FORMATION: CONSIDERATION
A. In General.
4. Value and Adequacy.

1 Witkin Sum. Cal. Law Contracts § 205

[§ 205] Value and Adequacy.

The consideration, if it consists of a benefit, must have some value; the words "good consideration" as used in C.C. 1605 mean "valuable consideration." (*Aden v. Vallejo* (1903) 139 C. 165, 168, 72 P. 905; see *Krobitzsch v. Middleton* (1946) 72 C.A.2d 804, 809, 165 P.2d 729; *Grant v. Aerodraulics Co.* (1949) 91 C.A.2d 68, 76, 204 P.2d 683, *infra*, §221 ["something which is completely worthless cannot constitute a valid consideration"]; 3 Williston 4th, §7:16; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §116; BAJI, No. 10.61 [Consideration]; CACI, No. 302 [Contract Formation--Essential Factual Elements].)

However, the consideration need not necessarily be useful, and there is no requirement of adequacy to make the contract enforceable in an action at law. (*Rest.2d, Contracts* §79(b), and Comment c; see *Horton v. Kyburz* (1959) 53 C.2d 59, 65, 346 P.2d 399; 2 Corbin (Rev. ed.), §5.14; 3 Williston 4th, §7:21; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §124 et seq.; 21 *A.L.R.2d* 1061 [enforceability of contract in consideration of naming child].)

Thus, an option to purchase valuable property may be given for a consideration of \$ 1 or some other insignificant sum. (*Marsh v. Lott* (1908) 8 C.A. 384, 390, 97 P. 163; *Chrisman v. Southern Calif. Edison Co.* (1927) 83 C.A. 249, 254, 256 P. 618; *Kowal v. Day* (1971) 20 C.A.3d 720, 727, 98 C.R. 118, *infra*, §233 ["any consideration, however small," is sufficient].) And a promise of an unmarried mother to name her illegitimate child after its father was held to be consideration for a promise to support the child. (*Schumm by Whyner v. Berg* (1951) 37 C.2d 174, 185, 231 P.2d 39, *infra*, §215; see generally 20 *A.L.R.3d* 500 [validity and construction of contract of putative father to support illegitimate child].)

However, adequacy of consideration is significant in several situations:

- (1) Where specific performance is sought. (See 13 *Summary* (10th), *Equity*, §38.)
- (2) Where a judicial sale is challenged for irregularity or unfairness. (See 8 *Cal. Proc.* (4th), *Enforcement of Judgment*, §156.)
- (3) Where the probate court is asked to approve the assignment of an heir's interest in an estate. (See *Estate of Freeman* (1965) 238 C.A.2d 486, 489, 48 C.R. 1, 14 *Summary* (10th), *Wills and Probate*, §724.)

The Restatement also observes that disparity in value may sometimes indicate that the purported consideration was not in fact bargained for (see *supra*, §204), but was a mere formality or pretense, and that promises of this nature are enforced, if at all, either as promises binding without consideration or as promises binding by virtue of their formal characteristics (e.g., negotiable instruments). (*Rest.2d, Contracts* §79, Comment d.)

West's Key Number Digest, Contracts k.53-

SUPPLEMENT: [This section is current through the latest supplement]

Consideration must have value: See 3 Williston 4th (2008 ed.), §7:16. *Consideration need not be useful:* See 3 Williston 4th (2008 ed.), §7:21.

Situations where adequacy of consideration is significant:

(2) *Where judicial sale is challenged:*

Cross-Reference: 8 Cal. Proc. (5th), *Enforcement of Judgment*, §165.



91 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VI. FORMATION: CONSIDERATION
A. In General.
5. Presumption of Consideration.

1 Witkin Sum. Cal. Law Contracts § 206

[§ 206] Presumption of Consideration.

"A *written instrument* is presumptive evidence of a consideration." (C.C. 1614.) Hence, where a pleading alleges that a contract is in writing, it is not only unnecessary to allege consideration, but a lack of consideration must be specially pleaded as a defense. (*Henke v. Eureka Endowment Assn.* (1893) 100 C. 429, 432, 34 P. 1089; *Glickman v. Collins* (1975) 13 C.3d 852, 861, 120 C.R. 76, 533 P.2d 204, *infra*, §626; *Fierce v. Reed* (1930) 106 C.A. 673, 677, 289 P. 855; *California Standard Finance Corp. v. J.D. Millar Realty Co.* (1931) 118 C.A. 185, 190, 5 P.2d 41; *Brooks v. Fidelity Savings & Loan Assn.* (1938) 26 C.A.2d 114, 116, 78 P.2d 1175; see 4 Cal. Proc. (4th), *Pleading*, §§482, 486; 5 Cal. Proc. (4th), *Pleading*, §1015.)

The presumption is rebuttable, and extrinsic evidence is admissible to show lack of consideration. (C.C. 1614; *Ev.C.* 622; *American Nat. Bank of San Francisco v. A.G. Sommerville* (1923) 191 C. 364, 369, 216 P. 376; *Estate of McConnell* (1936) 6 C.2d 493, 499, 58 P.2d 639; see 2 Cal. Evidence (4th), *Documentary Evidence*, §99.) In addition, the presumption is one that affects the burden of producing evidence, rather than the burden of proof. (*Rancho Santa Fe Pharmacy v. Seyfert* (1990) 219 C.A.3d 875, 884, 268 C.R. 505.)

The presumption is limited to "instruments," i.e., *formal* legal documents, and is thus not applicable to wholly informal writings, such as letters. (*Weisbrod v. Weisbrod* (1938) 27 C.A.2d 712, 719, 81 P.2d 633; *Foltz v. First Trust & Savings Bank of Pasadena* (1948) 86 C.A.2d 59, 61, 194 P.2d 135 [letter from cousin promising annuity].)

SUPPLEMENT: [This section is current through the latest supplement]
Written instrument is presumptive evidence of consideration:

Cross-References: 4 Cal. Proc. (5th), *Pleading*, §§521, 525; 5 Cal. Proc. (5th), *Pleading*, §1089.



92 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VI. FORMATION: CONSIDERATION
A. In General.
6. Recital of Consideration.

1 Witkin Sum. Cal. Law Contracts § 207

[§ 207] Recital of Consideration.

A recital in a contract that a specific consideration has been received is an *admission*, and is prima facie evidence that such was the consideration. (*Cooperative Dairymen's League v. Hansen* (1937) 23 C.A.2d 493, 496, 73 P.2d 627; *Podesta v. Mehrten* (1943) 57 C.A.2d 66, 71, 134 P.2d 38.) But it is not conclusive, and may be attacked:

(1) It may be shown that no consideration was in fact received, and that the purported contract is not binding. (See *Ev.C.* 622; *American Nat. Bank of San Francisco v. A.G. Sommerville* (1923) 191 C. 364, 369, 216 P. 376; *Ruess v. Baron* (1932) 217 C. 83, 84, 17 P.2d 119 [option reciting payment of \$ 1 not actually given]; *Kelley v. Rouse* (1961) 188 C.A.2d 92, 96, 10 C.R. 235, citing the text; *Rest.2d, Contracts* §218(2), and Comment e; 2 Corbin (Rev. ed.), §5.17; 3 Williston 4th, §§7:22, 7:23; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §112; 2 *Cal. Evidence* (4th), *Documentary Evidence*, §99.)

(2) The true consideration, different from that recited, may be shown. (See *Rest.2d, Contracts* §218, Comment e; 2 *Cal. Evidence* (4th), *Documentary Evidence*, §99.) In *Lewis v. McWhirter Petroleum Co.* (1948) 89 C.A.2d 453, 200 P.2d 856, plaintiff leased a service station to defendant for 5 years, defendant agreeing to pay as rent 1 cent on each gallon of gas sold, but not intending to sell any and not agreeing to sell any. Defendant made a contemporaneous oral agreement to give plaintiff possession of the service station and the right to sell the company's products there at a discount. *Held*, although the lease standing alone lacked consideration (because defendant assumed no obligation thereunder), the oral agreement furnished mutuality of obligation and consideration for the lease. (89 C.A.3d 455.)

West's Key Number Digest, Contracts k.82

SUPPLEMENT: [This section is current through the latest supplement]
See 3 Williston 4th (2008 ed.), §§7:22, 7:23.



93 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VI. FORMATION: CONSIDERATION
B. What Constitutes Sufficient Consideration.
1. Unilateral Contract: Act or Forbearance.

a. Acts.
1. In General.

1 Witkin Sum. Cal. Law Contracts § 208

[§ 208] In General.

In a unilateral contract, the promise is in consideration of an act or forbearance by the promisee. With a few exceptions, any act or forbearance may be good consideration. (See *Rest.2d, Contracts §72*; 2 Corbin (Rev. ed.), §5.9 et seq.; 3 Williston 4th, §7:3 et seq.; *17A Am.Jur.2d (2004 ed.), Contracts §114* et seq.; Cal. Transactions Forms, 1 Business Transactions §6:29; *infra*, §209 et seq.)

SUPPLEMENT: [This section is current through the latest supplement]
See 3 Williston 4th (2008 ed.), §7:3 et seq.



94 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

- Witkin Summary of California Law
VI. FORMATION: CONSIDERATION
B. What Constitutes Sufficient Consideration.
1. Unilateral Contract: Act or Forbearance.
 a. Acts.
2. Acts Not Involving Performance of Work or Services.

1 Witkin Sum. Cal. Law Contracts § 209

[§ 209] Acts Not Involving Performance of Work or Services.

The following are common illustrations of acts not involving the performance of work or services that have been held to constitute sufficient consideration to form a unilateral contract.

(1) *Payment of money*, as consideration for an option to purchase property. (*Chrisman v. Southern Calif. Edison Co.* (1927) 83 C.A. 249, 254, 256 P. 618; on options, see *supra*, §168 et seq.)

(2) *Transfer of real property* that is subject to a mortgage, the conveyance being consideration not only for the purchase price, but also for the grantee's assumption of the mortgage debt. (*Bean v. Reicker* (1932) 120 C.A. 403, 410, 7 P.2d 1055.)

(3) *Terminating other employment* or business, as consideration for a promise to employ. (*Millsap v. National Funding Corp. of Calif.* (1943) 57 C.A.2d 772, 776, 135 P.2d 407.)

(4) *Change of status, e.g., marriage*, in consideration of a transfer of property or a promise. (*Cohen v. Knox* (1891) 90 C. 266, 273, 27 P. 215.) And a child's living with and acting as the natural child of foster parents was held to be consideration for the foster parents' promise to permit the child to inherit. (*Estate of Grace* (1948) 88 C.A.2d 956, 966, 200 P.2d 189, *supra*, §86.)

SUPPLEMENT: [This section is current through the latest supplement]



95 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VI. FORMATION: CONSIDERATION
B. What Constitutes Sufficient Consideration.
1. Unilateral Contract: Act or Forbearance.
 a. Acts.
3. Performance of Work or Services.

1 Witkin Sum. Cal. Law Contracts § 210

[§ 210] Performance of Work or Services.

A promise to pay given in return for the performance of work or services constitutes an enforceable unilateral contract. (*Los Angeles Traction Co. v. Wilshire* (1902) 135 C. 654, 658, 67 P. 1086; *Parke & Lacy Co. v. San Francisco Bridge Co.* (1904) 145 C. 534, 538, 78 P. 1065, 79 P. 71; *Meyers v. McKillop* (1918) 37 C.A. 144, 145, 173 P. 773.) Thus, the *continuing services of an employee*, whether in public or private employment, are consideration for an employer's promise to pay a pension in the future. (*Kern v. Long Beach* (1947) 29 C.2d 848, 855, 179 P.2d 799 [municipal corporation employer]; *Hunter v. Sparling* (1948) 87 C.A.2d 711, 723, 197 P.2d 807 [private employer].)

Chinn v. China Nat. Aviation Corp. (1955) 138 C.A.2d 98, 291 P.2d 91, reviews the authority on an employer's general offer of bonuses, severance pay, and retirement benefits, follows the *Hunter* case, and makes this general observation: "Of late years the attitude of the courts (as well as of employers in general) is to consider regulations of this type which offer additional advantages to employees as being in effect offers of a unilateral contract which offer is accepted if the employee continues in the employment, and not as being mere offers of gifts. They make the employees more content and happier in their job, cause the employees to forego their rights to seek other employment, assist in avoiding labor turnover, and are considered of advantage to both the employer and the employees." (138 C.A.2d 99.) (See *Newberger v. Rifkind* (1972) 28 C.A.3d 1070, 1073, 1075, 104 C.R. 663 [promise of stock options if employment continued constituted unilateral contract; request for continued employment may be implied]; 57 A.L.R.3d 1241 [employee stock-option contract, sufficiency of consideration]; supra, §203.)

In *Asmus v. Pacific Bell* (2000) 23 C.4th 1, 96 C.R.2d 179, 999 P.2d 71, defendant company issued a "Management Employment Security Policy" (MESP) providing that it would offer all management employees who continued to meet its changing business expectations employment security through reassignment to, and retraining for, other management positions, even if their present jobs were eliminated. Defendant stated that the policy would be maintained so long as there was no change that would materially affect its business plan achievement. Five years later, defendant announced that it would terminate its MESP in 6 months, so that it could achieve more flexibility in conducting its business and compete more successfully in the marketplace, and also announced that it was adopting a new layoff policy to replace the MESP. Plaintiffs, 60 management employees who had remained with defendant for several years following termination of the MESP, and who had received increased pension benefits under the new policy, filed an action in

federal court challenging the termination of the MESP.

In federal district court, 8 of the 60 plaintiffs obtained summary judgment on their breach of contract claim, an issue that was certified for interlocutory appeal to the Ninth Circuit Court of Appeal. Under former C.R.C., Rule 29.5 (now C.R.C., Rule 29.8), the Circuit Court, confronted with a stipulation that there had been no change that would affect defendant's business plan achievement, requested an answer from the California Supreme Court to the following question: "Once an employer's unilaterally adopted policy--which requires employees to be retained so long as a specified condition does not occur--has become a part of the employment contract, may the employer thereafter unilaterally terminate the policy, even though the specified condition has not occurred?" *Held*, an employer may unilaterally terminate in this situation, but only if certain requirements are fulfilled.

(a) *California employment law*. Prior Supreme Court decisions have made clear that employment policies, manuals, and offers are not exempt from the rules governing contract interpretation, and as noted in *Chinn v. China Nat. Aviation Corp.*, *supra*, employment security policies may provide the basis for an enforceable unilateral contract. (23 C.4th 9, citing the text.) However, while the parties agree that employers' policies may become unilateral implied-in-fact contracts when employees accept them by continuing their employment, they disagree on how employers may terminate or modify a unilateral contract that has been accepted by the employees' performance. Plaintiffs assert that defendant was not entitled to terminate its MESP until it could demonstrate a change materially affecting its business plan achievement. Defendant asserts that because it formed the contract unilaterally, it could terminate or modify that contract as long as it did so after a reasonable time, gave affected employees reasonable notice, and did not interfere with the employees' vested benefits, such as pension and other retirement benefits. (23 C.4th 11.)

(b) *Case of first impression*. Because there is no case in point on the present question in California, the parties rely on the rule as stated in other jurisdictions. The majority of other jurisdictions that have addressed the question conclude that an employer may terminate or modify a contract with no fixed duration period after a reasonable time period, if it provides employees with reasonable notice, and the modification does not interfere with vested employee benefits. A minority of jurisdictions hold that an employer cannot terminate or modify a unilateral employment contract without the employees' express knowledge and consent, reasoning that a termination or modification of a unilateral employment contract requires additional consideration by the employer and acceptance by the affected employees. (23 C.4th 11.)

(c) *Application of legal principles*.

(1) *Consideration*. Defendant was not obligated to give separate consideration in addition to continued employment in order to terminate the MESP. As a general rule, once the promisor determines after a reasonable time that it will terminate or modify a unilateral contract and, with respect to an employment contract, provides employees with reasonable notice of the change, additional consideration is not required. The mutuality of obligation principle requiring new consideration for contract termination applies to bilateral contracts only. For an effective modification of a unilateral employment contract, there is consideration in the form of continued employee services. Here, defendant replaced its MESP with a subsequent layoff policy, and plaintiffs' continued employment constituted acceptance of the offer of the modified unilateral contract. (23 C.4th 14, citing the text.)

(2) *Illusoriness*. Promissory words are illusory if they are conditional on some fact or event that is wholly under the promisor's control and bringing it about is left wholly to the promisor's own will and discretion. This is not true, however, if the words used do not leave an unlimited option to the one using them. Thus, an unqualified right to modify or terminate a contract is not enforceable. But the fact that one party reserves the implied power to terminate or modify a unilateral contract is not fatal to its enforcement if the exercise of the power is subject to limitations, such as fairness and reasonable notice. The MESP was not illusory, because plaintiffs obtained its benefits while it was operable. As long as the MESP remained in force, defendant could not treat the contract as illusory by refusing to adhere to its terms; the promise was not optional with defendant and was fully enforceable until terminated or modified. (23 C.4th 15, citing the text.)

(3) *Vested benefits*. The MESP did not confer a vested benefit on plaintiffs, like an accrued bonus or a pension. No court has treated an employment security policy as a vested interest for private sector employees. Further, plaintiffs do not allege that defendant terminated its MESP in *bad faith*. (23 C.4th 16.)

(4) *Condition as definite duration clause*. The MESP was not a contract for a definite duration that defendant was obliged to honor until the specified condition occurred. A specified condition concerning termination of a contract may be one for either definite or indefinite duration. Here, even though the MESP specified that the policy would continue "so long as" defendant did not undergo changes materially affecting its business plan achievement, that condition did not state an ascertainable event that could be measured in any reasonable manner. If the change were to occur, it would result from forces beyond defendant's control and would include major changes in the economy or the public policy arena. These changes would have nothing to do with a fixed or ascertainable event that would govern plaintiffs' or defendant's obligations to each other under the policy. Therefore, the condition in the policy did not restrict the employer's ability to terminate or modify it, as long as it made the change (a) after a reasonable time, (b) on reasonable notice, and (c) in a manner that did not interfere with the employees' vested benefits. These requirements were met. (23 C.4th 16.)

Three justices joined in a lengthy dissent. (23 C.4th 19.) (See 20 California Lawyer 62 (October 2000) [When Is a Contract Over; *Asmus*].)

SUPPLEMENT: [This section is current through the latest supplement]

See 37 Loyola L.A. L. Rev. [*Asmus v. Pacific Bell*].C.R.C., Rule 29.8 is now C.R.C., Rule 8.548.



96 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
VI. FORMATION: CONSIDERATION
B. What Constitutes Sufficient Consideration.
1. Unilateral Contract: Act or Forbearance.
b. Forbearance or Giving Up Right.

1 Witkin Sum. Cal. Law Contracts § 211

[§ 211] Forbearance or Giving Up Right.

(1) *In General.* Consideration may be forbearance to sue on a claim, extension of time, or any other giving up of a legal right, in consideration of some promise. (See *Wells Fargo & Co. v. Enright* (1900) 127 C. 669, 673, 60 P. 439; *Warren Nat. Bank v. Suerken* (1920) 45 C.A. 736, 740, 188 P. 613; *Bacon v. Kessel* (1939) 31 C.A.2d 245, 248, 87 P.2d 857; *Anderson v. Fratis* (1951) 101 C.A.2d 753, 755, 226 P.2d 363; *West v. Stainback* (1952) 108 C.A.2d 806, 814, 240 P.2d 366 [dismissing will contest in consideration of promise to leave property by will]; *Anglo Calif. Nat. Bank of San Franciscov. Far West Lumber Co.* (1957) 152 C.A.2d 284, 287, 313 P.2d 10; *Brody v. Gabriel* (1961) 193 C.A.2d 644, 645, 14 C.R. 539; *Levine v. Tobin* (1962) 210 C.A.2d 67, 69, 26 C.R. 273; *Coldwell, Banker & Co. v. Pepper Tree Office Center Associates* (1980) 106 C.A.3d 272, 280, 165 C.R. 51; 2 Corbin (Rev. ed.), §5.21 et seq.; 3 Williston 4th, §7:43 et seq.; 17A Am.Jur.2d (2004 ed.), *Contracts* §142 et seq.; 78 A.L.R.2d 1414 [forbearance as consideration for guaranty].)

The slightest forbearance will suffice: "Even though the forbearance is for one day only, there is sufficient consideration as the law does not weigh the quantum." (*Krobitzsch v. Middleton* (1946) 72 C.A.2d 804, 809, 165 P.2d 729 [forbearance to serve notice of default under contract of purchase, though for no specified time, held sufficient].) However, if the forbearance has no value, it will not suffice. (*Grant v. Aerodraulics Co.* (1949) 91 C.A.2d 68, 76, 204 P.2d 683, *infra*, §221.)

(2) *Compromise of Claim.* The compromise of a claim, either valid, doubtful, or disputed (but not void) is good consideration, the claimant giving up his or her asserted right to recover the whole amount as consideration for a promise to pay a lesser amount. (*Hamilton v. Oakland School Dist. of Alameda County* (1933) 219 C. 322, 330, 26 P.2d 296; *Poggetto v. Bowen* (1936) 18 C.A.2d 173, 175, 63 P.2d 857; *Carey v. Kraft-Phenix Cheese Corp.* (1938) 24 C.A.2d 517, 525, 75 P.2d 540; *Silver v. Shemanski* (1949) 89 C.A.2d 520, 531, 201 P.2d 418.)

West's Key Number Digest, Contracts k.71

SUPPLEMENT: [This section is current through the latest supplement]

(1) *In General:* See 3 Williston 4th (2008 ed.), §7:44 et seq.



97 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
VI. FORMATION: CONSIDERATION
B. What Constitutes Sufficient Consideration.
2. Bilateral Contract: Mutual Promises.
a. In General.

1 Witkin Sum. Cal. Law Contracts § 212

[§ 212] In General.

In a bilateral contract, the promise of one party is consideration for that of another. The general rule, subject to certain exceptions, is that any valid promise, whether absolute or conditional, is sufficient consideration for another promise. (*Papadakos v. Soares* (1918) 177 C. 411, 412, 170 P. 1114; *Tumansky v. Woodruff* (1936) 14 C.A.2d 279, 283, 57 P.2d 1372 [promissory note given for another note]; *Rest.2d, Contracts* §75 ["a promise which is bargained for" is consideration if "the promised performance would be consideration"]; see 2 Corbin (Rev. ed.), §5.25 et seq.; 3 Williston 4th, 7:12 et seq.; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §128 et seq.)

The Restatement (§75) abandons the requirement of "valid" promise: "[I]t is sometimes suggested that a promise is not consideration if it is not binding, or if it is 'void.' The examples used commonly involve total lack of capacity to contract ... , indefinite promises ... , promises lacking consideration, or promises unenforceable as against public policy. ... Such cases are not exceptions to the rule stated in this Section. In some of them there is no promise within the definition in §2, in others the return promise would not be binding whether the consideration consisted of a promise or of performance, in some the invalidity of the return promise rests on other policies than those embodied in the requirement of consideration." (*Rest.2d, Contracts* §75, Comment d.)

A promise may be consideration for several counter promises. (See *Martin v. World Savings & Loan Assn.* (2001) 92 C.A.4th 803, 808, 112 C.R.2d 225, citing the text [deed of trust provision that, if earthquake insurance was obtained lender was to be named loss payee with control over proceeds, was enforceable without consideration other than loan itself]; *Rest.2d, Contracts* §80(1); 2 Corbin (Rev. ed.), §5.12; 3 Williston 4th, §7:49; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §123; on insurance cases, see 2 *Summary* (10th), *Insurance*, §28).)

West's Key Number Digest, Contracts k.56, 57

SUPPLEMENT: [This section is current through the latest supplement]

Promise as consideration for that of another: See 3 Williston 4th (2008 ed.), §7:12 et seq.

Promise as consideration for several counter promises: See 3 Williston 4th (2008 ed.), §7:51.



98 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
VI. FORMATION: CONSIDERATION
B. What Constitutes Sufficient Consideration.
2. Bilateral Contract: Mutual Promises.
b. Extension Agreement.

1 Witkin Sum. Cal. Law Contracts § 213

[§ 213] Extension Agreement.

Mutual promises to extend time of payment of a matured, liquidated debt, e.g., for 1 year, are good consideration. (See *Occidental Life Ins. Co. v. McCracken* (1937) 19 C.A.2d 239, 241, 65 P.2d 130 [debtor undertook additional obligation to pay interest monthly instead of semiannually]; *Bank of America v. Hollywood Imp. Co.* (1941) 46 C.A.2d 817, 821, 117 P.2d 13; 2 Corbin (Rev. ed.), §5.24 et seq.; 3 Williston 4th, §7:28; 17A Am.Jur.2d (2004 ed.), Contracts §146 et seq.)

SUPPLEMENT: [This section is current through the latest supplement]
See 3 Williston 4th (2008 ed.), §7:28.



99 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
VI. FORMATION: CONSIDERATION
B. What Constitutes Sufficient Consideration.
2. Bilateral Contract: Mutual Promises.
c. Composition With Creditors.

1 Witkin Sum. Cal. Law Contracts § 214

[§ 214] Composition With Creditors.

A composition or compromise agreement between creditors, in which each agrees to give up part of his or her claim in consideration of a similar agreement from the others, is clearly sufficient as to the creditors. As to the debtor, it has been said that the debtor's act in obtaining assent of the creditors, or his or her forbearance to pay one in preference to others, is consideration given by the debtor. (See *Wilson v. Samuels* (1893) 100 C. 514, 520, 35 P. 148, 559; 2 Corbin (Rev. ed.), §7.18; 3 Williston 4th, §7:32; 15A Am.Jur.2d (2000 ed.), *Composition with Creditors* §5.)

Rest.2d, Contracts §80(2), dealing with multiple exchanges, states that "The fact that part of what is bargained for would not have been consideration if that part alone had been bargained for does not prevent the whole from being consideration." Comment c gives the illustration of composition: "The consideration for which each assenting creditor bargains may be any or all of the following: (1) part payment of the sum due him, (2) the promise of each other creditor to forego a portion of his claim, (3) forbearance or promise of forbearance by the debtor to pay the assenting creditors more than equal proportions, (4) the action of the debtor in securing the assent of the other creditors, (5) the part payments made to the other creditors. The first is not consideration, but each of the others may be consideration. The last two are seldom bargained for in fact, but (2) and (3) are practically always bargained for by implication if not in so many words. Still other considerations may be agreed upon in any case."

SUPPLEMENT: [This section is current through the latest supplement]
See 3 Williston 4th (2008 ed.), §7:32.



100 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
VI. FORMATION: CONSIDERATION
B. What Constitutes Sufficient Consideration.
2. Bilateral Contract: Mutual Promises.
d. Compromise of Disputed Claim.

1 Witkin Sum. Cal. Law Contracts § 215

[§ 215] Compromise of Disputed Claim.

The compromise or release of a doubtful or disputed claim, which is not wholly void, is good consideration for a unilateral contract (*supra*, §211), and it is likewise sufficient for a bilateral contract. (*Baker v. Philbin* (1950) 97 C.A.2d 393, 397, 218 P.2d 119 [compromise of unliquidated claim for breach of contract]; *Westwood Temple v. Emanuel Center* (1950) 98 C.A.2d 755, 758, 221 P.2d 146 [compromise of contract and tort claims in consideration of agreement to convey land]; *Dominguez Estate Co. v. Los Angeles Turf Club* (1953) 119 C.A.2d 530, 541, 259 P.2d 962 [same]; *Nesbitt Fruit Products v. Del Monte Beverage Co.* (1960) 177 C.A.2d 353, 361, 2 C.R. 333; *Goldstone-Tobias Agency v. Barbroo Enterprises Productions* (1965) 237 C.A.2d 720, 722, 47 C.R. 347; *Miller v. Johnston* (1969) 270 C.A.2d 289, 299, 75 C.R. 699, citing the text; see 2 Corbin (Rev. ed.), §7.17; 3 Williston 4th, §§7:34, 7:35; 15A Am.Jur.2d (2000 ed.), *Compromise and Settlement* §5; 17A Am.Jur.2d (2004 ed.), *Contracts* §143; 18 Cal. L. Rev. 618.) (On weighing of adequacy of consideration for compromise of claims involving assignment of heir's interest in estate, see *Estate of Freeman* (1965) 238 C.A.2d 486, 489, 48 C.R. 1, 14 *Summary* (10th), *Wills and Probate*, §724.)

In *Schumm by Whyner v. Berg* (1951) 37 C.2d 174, 231 P.2d 39, the action was brought by a child conceived outside of marriage on a contract of support the father made with the child's mother while she was pregnant. Defendant contended that the mother's promise not to sue for support was not consideration because she could sue only as the child's representative. It was held, however, that, because the mother was also legally liable for the support of the child, she had an interest in compelling the father to support and relieve her of that liability. Hence, in agreeing to refrain from suing the father, she suffered a legal detriment. (37 C.2d 184.)

The compromise or release of a claim wholly invalid, or valid but worthless, is not sufficient consideration. (See *infra*, §§220, 221.) However, where the claim is doubtful or believed valid, the Restatement makes a distinction. The First Restatement *required* an honest and reasonable belief in the possible validity of the claim or defense, but the Second Restatement (§74(1)) *substitutes an alternative requirement* of doubtfulness in fact or law or of honest belief. (See *infra*, §220.)

West's Key Number Digest, Contracts k.68

SUPPLEMENT: [This section is current through the latest supplement]

See 3 Williston 4th (2008 ed.), §§7:34, 7:35.



101 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
VI. FORMATION: CONSIDERATION
C. What Constitutes Insufficient Consideration.
1. In General.

1 Witkin Sum. Cal. Law Contracts § 216

[§ 216] In General.

A promise that is *void* for illegality or other reason cannot be consideration for another promise or act. (C.C. 1607; see 2 Corbin (Rev. ed.), §5.30; 3 Williston 4th, §7:3 et seq.; 7A Am.Jur.2d (2004 ed.), *Contracts* §139; *infra*, §419.) And where the promisor knows or should know that an act or forbearance would be insufficient consideration for a unilateral contract, the *promise* of its performance is not good consideration for a bilateral contract. (See *Rest.2d, Contracts* §75 ["[A] promise which is bargained for is consideration if, but only if, the promised performance would be consideration"]; 2 Corbin (Rev. ed.), §5.26; 3 Williston 4th, §7:6; 17A Am.Jur.2d (2004 ed.), *Contracts* §128.)

A lesser sum than that due may be accepted in *discharge of an existing valid contract* (see *infra*, §950 et seq.). But the transfer of a sum of money in exchange for a *promise* to pay a larger sum at the *same time and place* is without consideration; and the same rule applies to fungible goods. (See 18 Cal. L. Rev. 623; 2 Corbin (Rev. ed.), §5.16.)

SUPPLEMENT: [This section is current through the latest supplement]

Where promise void for illegality: See 3 Williston 4th (2008 ed.), §7:3 et seq.

Where promisor knows act or forbearance is insufficient: See 3 Williston 4th (2008 ed.), §7:6. *Correction:* Page 250, first line of page, "7A Am.Jur.2d (2004 ed.), *Contracts* §139" should be "17A Am.Jur.2d (2004 ed.), *Contracts* §139".



102 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
VI. FORMATION: CONSIDERATION
C. What Constitutes Insufficient Consideration.
2. Past Consideration.

1 Witkin Sum. Cal. Law Contracts § 217

[§ 217] Past Consideration.

Past consideration is insufficient; i.e., acts or forbearances previously performed cannot be consideration for a new promise. (*Lagomarsino v. Giannini* (1905) 146 C. 545, 546, 80 P. 698; *Simmons v. California Institute of Technology* (1949) 34 C.2d 264, 272, 209 P.2d 581 [past employment of promisor not consideration for his or her promise]; *Rusk v. Johnston* (1937) 18 C.A.2d 408, 409, 63 P.2d 1167; *Passante v. McWilliam* (1997) 53 C.A.4th 1240, 1247, 62 C.R.2d 298 [promise by corporate directors to give stock to its attorney in gratitude for his having secured financing for company was unenforceable promise to make gift]; see 3 Corbin (Rev. ed.), §9.1 et seq.; 4 Williston 4th, §8:9 et seq.; 17A Am.Jur.2d (2004 ed.), Contracts §152 et seq.; but see *infra*, §222, on moral obligation arising from past consideration, as good consideration.) Thus, where a promissory note is given and the consideration has passed, a guaranty subsequently executed is without consideration. (*Rusk v. Johnston, supra*.)

But a guaranty made coincidentally with the note is supported by the same consideration as the note. (*Mortgage Guarantee Co. v. Chotiner* (1936) 8 C.2d 110, 112, 64 P.2d 138; *Schafer v. Wholesale Frozen Foods* (1957) 151 C.A.2d 96, 100, 311 P.2d 184.) And where a debtor maker promised to secure his wife's signature to a note, and the creditor payee took it on that understanding, the subsequent signature of the wife bound her; the payee gave the money in consideration of both signatures, the one given at the time, and the one promised. (*Cook v. Parker* (1937) 22 C.A.2d 539, 542, 71 P.2d 591.) (See *Pierce v. Wright* (1953) 117 C.A.2d 718, 722, 256 P.2d 1049 [uncompensated personal surety liable on bond given after construction contract completed, where latter contract expressly required a bond]; and see *infra*, §223.)

West's Key Number Digest, Contracts k.79

SUPPLEMENT: [This section is current through the latest supplement]



103 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
VI. FORMATION: CONSIDERATION
C. What Constitutes Insufficient Consideration.
3. Promise To Perform Existing Legal Duty.
a. Duty Owed to Other Contracting Party.

1 Witkin Sum. Cal. Law Contracts § 218

[§ 218] Duty Owed to Other Contracting Party.

Under the definition of consideration in C.C. 1605 (supra, §203), doing or promising to do what one is already legally bound to do cannot be consideration for a promise. (*Pacific Finance Corp. v. First Nat. Bank* (1935) 4 C.2d 47, 49, 47 P.2d 460; *Burner v. American Bar Quartz Mining Co.* (1926) 76 C.A. 774, 782, 246 P. 77; *General Motors Acceptance Corp. v. Brown* (1934) 2 C.A.2d 646, 650, 38 P.2d 482; *Grant v. Aerodraulics Co.* (1949) 91 C.A.2d 68, 75, 204 P.2d 683, *infra*, §221 [promise to pay sum less than that already owing]; *Estate of Bray* (1964) 230 C.A.2d 136, 142, 40 C.R. 750, citing the text; *Williams Const. Co. v. Standard-Pac. Corp.* (1967) 254 C.A.2d 442, 453, 61 C.R. 912, citing the text; *Auerbach v. Great Western Bank* (1999) 74 C.A.4th 1172, 1185, 88 C.R.2d 718, citing the text; *O'Byrne v. Santa Monica-UCLA Med. Center* (2001) 94 C.A.4th 797, 805, 114 C.R.2d 575 [medical staff bylaws adopted as required by regulatory provision are not supported by consideration and thus do not constitute contract between hospital and physician on its staff; whether bylaws become incorporated into separate employment contract was not addressed]; 2 Corbin (Rev. ed.), §7.1 et seq.; 3 Williston 4th, §7:36 et seq.; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §135 et seq.; 18 *Cal. L. Rev.* 614; 47 *Cal. L. Rev.* 93.) (For an analysis and criticism of the traditional rule, see 51 *Cal. L. Rev.* 1001; and cf. U.C.C. 2209, *infra*, §964.)

In *Western Lithograph Co. v. Vanomar Producers* (1921) 185 C. 366, 197 P. 103, defendant contracted to buy labels from plaintiff at certain prices. Later, at the request of plaintiff, defendant agreed to pay a higher price because of an unexpected rise in the market price of labor and materials. *Held*, the new agreement was without consideration. The fact that the new promise was made voluntarily and without any duress was immaterial. (185 C. 369.) Such an increased price could easily have been established if some new consideration had been given, even though insignificant in value, or if the parties had entered into a *novation*, substituting an entirely new contract for the old. (See *House v. Lala* (1963) 214 C.A.2d 238, 243, 29 C.R. 450 [same]; *Cechettini v. Consumer Associates, Ltd.* (1968) 260 C.A.2d 295, 298, 67 C.R. 15 [same]; 2 Corbin (Rev. ed.), §7.20; 3 Williston 4th, §7:27; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §140; 9 *Cal. L. Rev.* 492; 47 *Cal. L. Rev.* 93; 12 *A.L.R.2d* 78 [performance of work previously contracted for as consideration for promise to pay more]; 85 *A.L.R.3d* 259 [voluntary promise of additional compensation because of unforeseen difficulties in performance].)

In *Estate of Sonnicksen* (1937) 23 C.A.2d 475, 73 P.2d 643, decedent's nurse promised to care for him, and he agreed to convey property to her. *Held*, the subsequent marriage of the parties terminated the agreement, for the

marriage relationship implies an obligation of care without compensation. (23 C.A.2d 479.) (See *Brooks v. Brooks* (1941) 48 C.A.2d 347, 350, 119 P.2d 970, *infra*, §624.)

In *Garthofner v. Edmonds* (1946) 74 C.A.2d 15, 167 P.2d 789, plaintiff made a loan to a husband and wife, which they agreed to repay. After the husband's death, the wife orally agreed to pay it individually. *Held*, the second agreement was not a valid novation, because the wife, already jointly and severally liable for the same debt, merely promised to do what she was already bound to do. (74 C.A.2d 17.) This reasoning would appear to be sound if the wife were insisting that the novation effected a discharge of the original obligation. But in this case, the plaintiff creditor, for some reason, did not attempt to sue on the original obligation, and was here denied recovery on the new obligation although he apparently gave consideration: forbearance to file a claim against the old debtor's estate and discharge of the old debtor. (See *infra*, §963, for disapproval of this case on the novation point.)

The Restatement (§73) states the rule as follows: "Performance of a legal duty owed to a promisor which is neither doubtful nor the subject of honest dispute is not consideration; but a similar performance is consideration if it differs from what was required by the duty in a way which reflects more than a pretense of a bargain."

Comment c points out that an unscrupulous promisor may threaten breach in order to obtain a bonus; that in extreme cases a bargain for additional compensation under these circumstances may be voidable for duress (see *infra*, §310; and that "the lack of social utility in such bargains provides what modern justification there is for the rule." However, the broad rule has been much criticized, and slight variations of circumstances may take a case out of it, "particularly where the parties have made an equitable adjustment in the course of performance of a continuing contract, or where an impecunious debtor has paid part of his debt in satisfaction of the whole."

SUPPLEMENT: [This section is current through the latest supplement]

See *In re Marriage of Sabine & Toshio M.* (2007) 153 C.A.4th 1203, 1212, 63 C.R.3d 757, citing the text [wife's forgiveness of husband's accrued child and spousal support arrearages was not consideration for postdissolution settlement].

Promising what one is already obligated to do: See 3 Williston 4th (2008 ed.), §7:36 et seq.

Agreement for different price: See 3 Williston 4th (2008 ed.), §7:27.



104 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
VI. FORMATION: CONSIDERATION
C. What Constitutes Insufficient Consideration.
3. Promise To Perform Existing Legal Duty.
b. Duty Owed to Others or Imposed by Law.

1 Witkin Sum. Cal. Law Contracts § 219

[§ 219] Duty Owed to Others or Imposed by Law.

Where the preexisting duty is owed not to the other contracting party but to third persons, and the promise to perform it is thereafter made, consideration might be found on the theory that, although the party previously bound suffers *no detriment*, the other party receives a *benefit*--the right to enforce the duty; and there is less likelihood of economic coercion or other unfair pressure than there is where the duty is owed to the other contracting party. Hence "the tendency of the law" has been to hold that performance of a contractual duty can be consideration if the duty is not owed to the promisor. (*Rest.2d, Contracts* §73, Comment d; see 2 Corbin (Rev. ed.), §7.7; 3 Williston 4th, §7:41; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §141.)

The situation is different, however, where the duty is owed to the *public*: The danger of express or implied threats to withhold performance affects public as well as private interests. Hence, a bargain by a public official to obtain private advantage for performing his or her duty is illegal and hence not consideration for a promise. (See *Rest.2d, Contracts* §73, Comment b.) Similar reasoning may apply to duties of public utilities and duties of fiduciaries. (Comment b, *supra*.) (See 2 Corbin (Rev. ed.), §7.11; 3 Williston 4th, §7:41.)

Where the duty is imposed by the law of crimes or torts, the promise to perform it is obviously not good consideration: If the only thing bargained for is forbearance to commit a crime or tort, the bargain is unenforceable as against public policy. (*Rest.2d, Contracts*, Comment b.)

The California cases as yet make no exceptions to the general rule denying the validity of consideration in these situations. (See *Lees v. Colgan* (1898) 120 C. 262, 266, 52 P. 502; *Marinovich v. Kilburn* (1908) 153 C. 638, 641, 96 P. 303; *Hamilton v. Oakland School Dist. of Alameda County* (1933) 219 C. 322, 327, 26 P.2d 296; *Poetker v. Lowry* (1914) 25 C.A. 616, 618, 144 P. 981; *Bailey v. Breetwor* (1962) 206 C.A.2d 287, 292, 23 C.R. 740 ["a promise by one to fulfill his own contract with another is no consideration for a promise by a third party"]; *US Ecology v. California* (2001) 92 C.A.4th 113, 127, 111 C.R.2d 689 [memorandum of understanding was not supported by adequate consideration, where plaintiff's promise to maintain schedule set forth in its licensee-designee application or be subject to forfeiture of its performance bond was already required by regulation].)

West's Key Number Digest, Contracts k.75(3)

SUPPLEMENT: [This section is current through the latest supplement]

Duty owed to third persons: See 3 Williston 4th (2008 ed.), §7:42. *Duty owed to public:* See 3 Williston 4th (2008 ed.), §7:42.



105 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
VI. FORMATION: CONSIDERATION
C. What Constitutes Insufficient Consideration.
4. Compromise or Forbearance of Invalid Claim.
a. Claim Wholly Invalid.

1 Witkin Sum. Cal. Law Contracts § 220

[§ 220] Claim Wholly Invalid.

If a claim is wholly invalid, neither forbearance to sue nor a compromise thereof can be good consideration. (*Union Collection Co. v. Buckman* (1907) 150 C. 159, 164, 88 P. 708.) *City Street Imp. Co. v. Pearson* (1919) 181 C. 640, 185 P. 962, applied this doctrine with great strictness. A promissory note was given in consideration of forbearance to foreclose a lien upon a street assessment, which both parties believed was valid. However, the assessment was void for technical reasons that were ascertainable from the public record. *Held*, the note was unsupported by consideration. (181 C. 649.) (See *Orange County Foundation v. Irvine Co.* (1983) 139 C.A.3d 195, 200, 188 C.R. 552 [promise to compromise wholly unfounded claim is not valuable consideration; *City Street Imp. Co. v. Pearson* followed]; 2 Corbin (Rev. ed.), §7.17; 3 Williston 4th, §7:45; 15A Am.Jur.2d (2000 ed.), *Compromise and Settlement* §22 et seq.; 17Am.Jur.2d (2004 ed.), *Contracts* §143.)

On the same theory, the *release* of a party from a contract that is illegal, or void from some other cause, cannot be consideration for another promise or act. (*Shortell v. Evans-Ferguson Corp.* (1929) 98 C.A. 650, 655, 277 P. 519, *infra*, §229.)

The Restatement approach (§74(1)) is different in that it permits forbearance or surrender of an invalid claim or defense to constitute consideration where *either* of the following situations exists:

"(a) the claim or defense is in fact doubtful because of uncertainty as to the facts or the law, or

(b) the forbearing or surrendering party believes that the claim or defense may be fairly determined to be valid."
(See Comment c [settlement of an unliquidated obligation, i.e., one uncertain or disputed in amount, is governed by the same principles].)

Whether there must be a good faith belief in the validity of a claim depends on the circumstances existing at the time the promise to forbear or surrender was made. If at that time the claim was doubtful, no showing of good faith is required. However, if the claim was then obviously invalid (a fact indicating that the invalidity was known to the parties), the forbearing or surrendering party must establish his or her good faith belief in its possible validity. (Comment b.)

Under the Restatement, consideration may also consist of the execution of a bargained for written instrument surrendering a claim or defense, if the executing party is under no duty to do so. And the consideration is good even though the party "is not asserting the claim or defense and believes that no valid claim or defense exists." (*Rest.2d, Contracts §74(2).*)

Comment e explains: "Subsection (2) provides for the situation where the party who would be subject to a claim or defense, if one existed, wants assurance of its non-existence. Such assurance may be useful, for example, to enable him to obtain credit or to sell property. Although surrender of a non-existent claim by one who knows he has no claim is not consideration for a promise, the *execution of an instrument of surrender* may be consideration if there is no improper pressure or deception."

SUPPLEMENT: [This section is current through the latest supplement]
See 3 Williston 4th (2008 ed.), §§7:46, 7:47.



106 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VI. FORMATION: CONSIDERATION
C. What Constitutes Insufficient Consideration.
4. Compromise or Forbearance of Invalid Claim.
b. Valid but Worthless Claim.

1 Witkin Sum. Cal. Law Contracts § 221

[§ 221] Valid but Worthless Claim.

The significance of the legal benefit and detriment theories becomes apparent when the argument is made that a claim or right given up was "worthless" or "valueless" and therefore cannot be good consideration, either for a new promise or for the discharge of an existing obligation.

In *Grant v. Aerodraulics Co. (1949) 91 C.A.2d 68, 204 P.2d 683*, decided by a judgment on the pleadings, plaintiff inventor made a written contract with defendant company for an exclusive license to manufacture and sell his invention. The company agreed to procure a patent on plaintiff's invention and manufacture and sell the device; to pay \$ 10,000 in installments, the whole to become due when a patent was obtained; and to pay royalties on sales. A patent was issued, but only \$ 3,000 was paid. The parties then orally agreed that the contract would be cancelled on payment by the company of \$ 1,000 in two installments. The first installment of \$ 500 was paid, but plaintiff refused the second and sued to cancel the original written contract and recover the \$ 7,000 balance. *Held*, he was entitled to recover.

(a) The first suggested consideration, the agreement to pay \$ 1,000 to discharge an obligation (admittedly due) of \$ 7,000, was insufficient, for the company was only doing what it was already legally bound to do. (*91 C.A.2d 75.*)

(b) The second suggested consideration, giving up the license, was insufficient, for defendant did not allege facts from which it could be inferred that the right was of any value. Because defendant was already in default, and, under the contract, plaintiff was entitled to cancel the license on written notice at any time, no benefit was received by plaintiff from the agreement to surrender it. "It would be fanciful to hold that plaintiff received a benefit through the actions of defendants, who had nothing in the way of a benefit that they could rightly withhold from him, and therefore had nothing to give." (*91 C.A.2d 77.*)

That defendant's pleading failed to state facts from which it might be inferred that a license to produce a patented device has *some value* is indeed remarkable, and this ground of the opinion seems insubstantial. The important question was this: Where a contracting party is in default, and the contract is subject to immediate cancellation on notice by the injured party, but has not yet been so cancelled, does the voluntary surrender of a right under that still-subsisting contract constitute (1) a legal detriment to the defaulting party, or (2) a legal benefit to the injured party? It may reasonably be contended that: (1) Defendant, under the law, might conceivably have obtained equitable relief from its

default on tendering a belated performance, and therefore suffered a legal detriment in wholly surrendering all of its rights. (2) Plaintiff received a benefit in that he eliminated the possibility of such subsequent performance and was relieved of the task--slight, perhaps, but essential--of giving a proper written notice of termination.

SUPPLEMENT: [This section is current through the latest supplement]



107 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
VI. FORMATION: CONSIDERATION
C. What Constitutes Insufficient Consideration.
5. Moral Obligation.
a. Traditional Rule.

1 *Witkin Sum. Cal. Law Contracts* § 222

[§ 222] Traditional Rule.

"An existing legal obligation resting upon the promisor, or a *moral obligation originating in some benefit conferred upon the promisor*, or prejudice suffered by the promisee, is also a good consideration for a promise, to an extent corresponding with the extent of the obligation, but no further or otherwise." (C.C. 1606.)

This section has been construed to mean that a moral obligation will support a promise only *where a valuable consideration once existed*; e.g., where a formerly valid claim has been barred by the statute of limitations or bankruptcy (on formerly valid claim as not requiring additional consideration to support new promise, see *infra*, §239). In the absence of a prior legal obligation founded upon valuable consideration, a moral obligation is insufficient. (*Estate of McConnell* (1936) 6 C.2d 493, 498, 58 P.2d 639; *Herbert v. Lankershim* (1937) 9 C.2d 409, 477, 71 P.2d 220; *Brownfield v. McFadden* (1937) 21 C.A.2d 208, 215, 68 P.2d 993; *Foltz v. First Trust & Savings Bank of Pasadena* (1948) 86 C.A.2d 59, 62, 194 P.2d 135; *Haase v. Cardoza* (1958) 165 C.A.2d 35, 37, 331 P.2d 419; see 3 Corbin (Rev. ed.), §9.21 et seq.; 4 Williston 4th, §8:12 et seq.; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §157 et seq.; 47 *Cal. L. Rev.* 85, 88; 12 *Hastings L. J.* 384.)

Thus, in *Estate of McConnell, supra*, decedent's partner rendered the greater services to the business. After dissolution, decedent declared that he felt obligated to compensate him therefor, and made a promissory note for \$ 5,000, payable out of his estate 6 months after death. *Held*, the note was unenforceable. A partner is not entitled to extra compensation without special agreement; hence no legal claim existed as a foundation for the asserted moral obligation. (6 C.2d 498.)

In *Dow v. River Farms Co. of Calif.* (1952) 110 C.A.2d 403, 243 P.2d 95, the president of defendant corporation performed services as manager from 1913 to 1917, without pay or expectation of pay. In 1917 the directors voted to give him \$ 50,000 for past services, and \$ 1,000 per month for future salary. He expressly rejected the past service payment but accepted the new salary till his death in 1930. His widow brought this action on the promise to pay the \$ 50,000 for past services. *Held*, it was merely a promise to make a gift, and, even if it had not been rejected, it was not supported by a legal consideration. "It is a general principle of common law that a mere moral consideration unconnected with a precedent perfect or imperfect legal consideration, will not support a subsequent promise to pay." (110 C.A.2d 408.) (See *Dugan v. Pettijohn* (1955) 134 C.A.2d 133, 137, 285 P.2d 339 [following *McConnell* and *Dow*

cases].)

West's Key Number Digest, Contracts k.76

SUPPLEMENT: [This section is current through the latest supplement]



108 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VI. FORMATION: CONSIDERATION
C. What Constitutes Insufficient Consideration.
5. Moral Obligation.
b. Departures From Rule.
1. In General.

1 Witkin Sum. Cal. Law Contracts § 223

[§ 223] In General.

Reference is occasionally made to the moral obligation to pay a commission to a real estate broker. The cases deal with the situation where the broker renders valuable services without a written agreement to pay a commission, and subsequently a written agreement is made, which satisfies the statute of frauds (because the memorandum may be made after the actual agreement). But the question remains as to what is consideration for the written agreement. The cases hold that the past services give rise to a "moral obligation" sufficient to support the promise to compensate contained in the new written agreement. (See *Coulter v. Howard* (1927) 203 C. 17, 22, 262 P. 751; *Hillman v. Koch* (1949) 92 C.A.2d 163, 166, 206 P.2d 434; *Torelli v. J.P. Enterprises* (1997) 52 C.A.4th 1250, 1257, 61 C.R.2d 76, *infra*, §804 [citing *Coulter v. Howard*; seller violated implied covenant of good faith in contract with real estate broker by dealing with buyer on substantially same terms as contemplated in counteroffer that included broker's commission, but without paying agreed commission].) No explanation of this apparent departure from the settled interpretation of C.C. 1606 (*supra*, §222) appears in these opinions. Perhaps what is meant is that (1) there was originally a contract, supported by consideration (services), but unenforceable for lack of a writing; (2) the subsequent writing is not a new contract, but a mere memorandum of the existing contract; hence, no new consideration is needed. If this is the theory, the mention of a "moral obligation" is both unnecessary and confusing.

Nevertheless, the moral obligation theory appears as an established principle in *Desny v. Wilder* (1956) 46 C.2d 715, 299 P.2d 257. Plaintiff sued on "implied contract" for the reasonable value of an "idea" for a story. The court exhaustively considered the nature of the obligation sought to be imposed (see 13 *Summary* (10th), *Personal Property*, §69 et seq.), and reversed a summary judgment for defendants. In the course of its discussion, the court declared that where an idea has been conveyed with the expectation of payment, if used, the person receiving it, although not under any legal obligation, may "promise to pay a reasonable compensation for that idea--that is, for the past service of furnishing it to him--and thus create a valid obligation." And the court added, quoting Am.Jur.: "There is considerable authority which supports the view that the moral obligation arising from a benefit of a material or pecuniary kind conferred upon the promisor by past services, rendered in the expectation that they were to be paid for--or, at least, if rendered upon the assumption by the person rendering them, though mistaken, that they would create a real liability--and, otherwise, in circumstances creating a moral obligation on the part of the promisor to pay for the same,

will support an executory promise to do so, although there was, previous to such promise, no legal liability or promise, perfect or imperfect." (46 C.2d 738.) (See 4 U.C.L.A. L. Rev. 296, 327; 98 A.L.R.5th 353 [moral or natural obligation as consideration].)

Corbin's rationalization was quoted in *Haase v. Cardoza* (1958) 165 C.A.2d 35, 38, 331 P.2d 419: "An informal promise without consideration, in any of the senses of that term, creates no duty and is not enforceable. But this statement is not correct if we limit the definition of consideration so as to require it to be a bargained-for equivalent given in exchange for the promise. There are many informal promises that are enforceable, even though there is no consideration as thus defined. In every case, however, an informal promise is never enforceable if it stands utterly alone. To be enforceable, there must be some accompanying factor of the past (generally called 'past consideration'), or there must be some subsequent changes of position in reliance on the promise. Without any such accompanying factor, an informal promise to make a gift is not binding."

In *Wilson v. Wilson* (1960) 54 C.2d 264, 5 C.R. 317, 352 P.2d 725, defendant husband and plaintiff wife made a property settlement agreement under which he agreed to pay (a) child support of \$ 100 per month for each of the children during minority, (b) \$ 250 per month for the wife's support for 2 years after the interlocutory decree, and (c) promissory notes for \$ 6,000 due in 2 years and \$ 3,000 due in 3 years, with no interest until the notes became due. After the decree, defendant paid plaintiff the \$ 250 support for the 2 years, but could not pay the \$ 6,000 note. A new contract was then made under which he agreed to continue support payments of \$ 250 per month for plaintiff's support until the \$ 6,000 note could be discharged in full, and she waived any interest on the note and agreed to forbear legal action to collect it while he paid the monthly sums. It was expressly agreed that these monthly payments were not to be credited on the note. Defendant made payments for another year but could not pay the \$ 3,000 note. Plaintiff then brought this action on that note, and defendant counterclaimed for treble usurious interest, contending that the \$ 250 monthly additional payments were simply usurious interest on the \$ 6,000 note. *Held*, summary judgment for plaintiff affirmed; there was other consideration for defendant's promise to continue support payments.

First, the parties did not stand in the simple relation of debtor and creditor; plaintiff was the mother of children to whom defendant owed a duty of support. And while the children are living with her "their welfare is to a considerable extent dependent upon the economic situation of the mother, because if the mother is lacking in adequate support for herself the children who are living with her must inevitably suffer." (54 C.2d 270.)

Second, the intention of the parties to the original contract was to give the wife \$ 250 a month until the capital sums were paid; these would provide her with enough to invest in a business and become self-supporting. Hence, the provision limiting support payments to 2 years and the promissory note for \$ 6,000 were mutually dependent promises, and failure to pay the note was a failure of consideration for the wife's agreement that support payments should terminate in 2 years. (54 C.2d 271.)

Third, when the substitute agreement was made, apart from the husband's possible legal obligation to continue support payments on his failure to pay the \$ 6,000 note, "he was undoubtedly at least under a moral obligation to do so and we are satisfied that in the situation of these parties that moral obligation is sufficient to furnish consideration for the agreement to continue the payments for support." (54 C.2d 271.) But the court based its conclusion on the more conventional type of moral obligation: "It has frequently been stated that the moral obligation is sufficient to constitute good consideration for a new promise only where a good and valuable consideration once existed. ... This requirement is satisfied in this case by the prior and existing relation of the parties and their children and particularly by the antecedent legal duty of support upon which rests the moral obligation of continued support when the promissory note which was intended to furnish a substitute for the previous monthly support payments was not paid." (54 C.2d 272.)

SUPPLEMENT: [This section is current through the latest supplement]



109 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VI. FORMATION: CONSIDERATION
C. What Constitutes Insufficient Consideration.
5. Moral Obligation.
b. Departures From Rule.
2. Restatement 2d.

1 Witkin Sum. Cal. Law Contracts § 224

[§ 224] Restatement 2d.

The problem of moral obligation (supra, §§222, 223) is treated in *Rest.2d, Contracts* §86, which substitutes the concept of *prior benefit* for *prior legal obligation*:

"(1) A promise made in recognition of a benefit previously received by the promisor from the promisee is binding to the extent necessary to prevent injustice."

"(2) A promise is not binding under Subsection (1)"

"(a) if the promisee conferred the benefit as a gift or for other reasons the promisor has not been unjustly enriched; or"

"(b) to the extent that its value is disproportionate to the benefit."

Comments a and b explain:

"Enforcement of promises to pay for benefit has sometimes been said to rest on 'past consideration' or on the 'moral obligation' of the promisor, and there are statutes in such terms in a few states. Those terms are not used here: 'past consideration' is inconsistent with the meaning of consideration stated in §71, and there seems to be no consensus as to what constitutes a 'moral obligation.' The mere fact of promise has been thought to create a moral obligation, but it is clear that not all promises are enforced. Nor are moral obligations based solely on gratitude or sentiment sufficient of themselves to support a subsequent promise." (Comment a.)

"Enforcement of the subsequent promise sometimes makes it unnecessary to decide a difficult question as to the limits on quasi-contractual relief." Restitution may be denied, e.g., to protect persons who have had benefits thrust upon them, or under rules designed to guard against false claims, stale claims, or claims already litigated. "In many such cases a subsequent promise to make restitution removes the reason for the denial of relief, and the policy against unjust enrichment then prevails. ... Facts such as the definite and substantial character of the benefit received, formality in the making of the promise, part performance of the promise, reliance on the promise or the probability of such reliance may

be relevant to show that no imposition results from enforcement." (Comment b.)

West's Key Number Digest, Contracts k.76

SUPPLEMENT: [This section is current through the latest supplement]



110 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VI. FORMATION: CONSIDERATION

D. Mutuality of Obligation.

1. In General.

a. Nature of Problem.

1 Witkin Sum. Cal. Law Contracts § 225

[§ 225] Nature of Problem.

The doctrine of mutuality of obligation requires that the promises on each side be *binding obligations* in order to be consideration for each other. The doctrine applies to *bilateral contracts*, where there are mutual promises. (*Mattei v. Hopper* (1958) 51 C.2d 119, 122, 330 P.2d 625; *Bleecher v. Conte* (1981) 29 C.3d 345, 350, 352, 213 C.R. 852, 698 P.2d 1154, citing the text [buyers' express and implied obligations to proceed diligently and in good faith to obtain city's approval to develop property sufficient to establish mutuality of obligation]; *Asmus v. Pacific Bell* (2000) 23 C.4th 1, 14, 96 C.R.2d 179, 999 P.2d 71, *supra*, §210, citing the text; *Larwin-Southern Calif. v. JGB Inv. Co.* (1979) 101 C.A.3d 626, 637, 162 C.R. 52, citing the text; see 2 Corbin (Rev. ed.), §6.1; 3 Williston 4th, §7:14; 17A 2d (2004 ed.), Contracts §21 et seq.; Cal. Transactions Forms, 1 Business Transactions §6:30; 4 *Hastings L. J.* 192.) The doctrine is inapplicable in the case of *unilateral contracts*, where there are no mutual promises. (*Clarey v. Security Portland Cement Co.* (1929) 99 C.A. 783, 786, 279 P. 483; *Anchor Cas. Co. v. Surety Bond Savings & Loan Assn.* (1962) 204 C.A.2d 175, 182, 22 C.R. 278.)

Two chief types of promises are condemned by the mutuality rule: (1) where no obligation at all is assumed (illusory agreement); (2) where the promise states a definite obligation, but the promisor has an election to perform or withdraw at his or her pleasure. (See *infra*, §227 et seq.)

An agreement is not illusory merely because it gives broad alternatives to one party. Thus, if a buyer agrees to take a number of units of certain goods, but reserves the right to select the quality or type at different prices, there is some uncertainty that would make ascertainment of damages difficult, but there is mutuality of obligation, because the buyer is bound to perform under one of the alternatives. (See discussion, 10 *So. Cal. L. Rev.* 504.) And a promise subject to a contingency over which the promisor has no control, or to a condition requiring action in good faith, is not illusory. (*Pease v. Brown* (1960) 186 C.A.2d 425, 430, 8 C.R. 917; see *Hansen Pac. Corp. v. Buck Mountain Logging Co.* (1961) 191 C.A.2d 826, 832, 13 C.R. 82; *Black Light Corp. of Los Angeles v. Ultra-Violet Products* (1961) 195 C.A.2d 473, 476, 15 C.R. 852; 2 Corbin (Rev. ed.), §5.31; 3 Williston 4th, §7:7; 17A *Am. Jur.2d* (2004 ed.), Contracts §§132, 133.) (On promise calling for performance to the "satisfaction" of the other party, see *infra*, §783 et seq.)

A "contract" that lacks mutuality is often treated as a mere offer, revocable until accepted, and binding if accepted prior to revocation or other termination. (See *Shortell v. Evans-Ferguson Corp.* (1929) 98 C.A. 650, 660, 277 P. 519;

infra, §229; *Sully-Miller Contracting Co. v. Gledson/Cashman Const.* (2002) 103 C.A.4th 30, 35, 126 C.R.2d 400, quoting the text [written agreement to settle in exchange for money was mere unilateral offer to settle, where no promise to pay money was made; offer could be accepted by tender of payment].) But sometimes the defect is too fundamental: Thus, an "illusory promise," i.e., a promise that does not contain a definite obligation, may be void for uncertainty. (See supra, §138.)

West's Key Number Digest, Contracts k.56

SUPPLEMENT: [This section is current through the latest supplement]

Mutuality of obligation: See 3 Williston 4th (2008 ed.), §7:14.

Agreement giving party broad alternatives: See 3 Williston 4th (2008 ed.), §7:7.



111 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VI. FORMATION: CONSIDERATION
D. Mutuality of Obligation.
1. In General.
b. Restatement 2d.

1 Witkin Sum. Cal. Law Contracts § 226

[§ 226] Restatement 2d.

The Restatement rejects the "supposed requirement" of mutuality of obligation: "If the requirement of consideration is met, there is no additional requirement of ... 'mutuality of obligation.' " (*Rest.2d, Contracts §79(c).*)

Comment f explains: "Such a requirement has sometimes been asserted in the form, 'Both parties must be bound or neither is bound.' That statement is obviously erroneous as applied to an exchange of promise for performance; it is equally inapplicable to contracts governed by §82-94 and to contracts enforceable by virtue of their formal characteristics under §6. Even in the ordinary case of the exchange of promise for promise, §78 makes it clear that voidable and unenforceable promises may be consideration. The only requirement of 'mutuality of obligation' even in cases of mutual promises is that stated in §76-77."

SUPPLEMENT: [This section is current through the latest supplement]



112 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VI. FORMATION: CONSIDERATION
D. Mutuality of Obligation.
2. Desire and Needs Contracts.
a. Desire Contract: Illusory.

1 Witkin Sum. Cal. Law Contracts § 227

[§ 227] Desire Contract: Illusory.

A proposal by one party to furnish to another at a specified price all of the goods of a certain kind that the latter may "want" or "desire" during a certain period is considered an illusory offer that does not, upon acceptance, result in an enforceable contract. The reason is that the offeree may not want any goods, and, even if the proposal is accepted, is not bound to order any. The agreement therefore lacks mutuality of obligation, because it purports to bind the first party and not the second. The result is that there is no contract, but a mere *offer*, which may be accepted by giving an order for goods at the stipulated price until the offer is revoked. (See discussion in *Bartlett Springs Co. v. Standard Box Co.* (1911) 16 C.A. 671, 673, 117 P. 934; and see *Scott v. Cline Elec. Mfg. Co.* (1930) 104 C.A. 122, 125, 285 P. 349; *California Refining Co. v. Producers Refining Corp.* (1938) 25 C.A.2d 104, 106, 76 P.2d 553 [plaintiff agreed to refine oil on certain terms for defendant producer, but defendant made no promise to deliver any specified quantity]; 2 Corbin (Rev. ed.), §§5.28, 6.6; 3 Williston 4th, §7:7; 17A Am.Jur.2d (2004 ed.), Contracts §132; 26 A.L.R.2d 1139 [mutuality of contract to furnish another with his or her needs, wants, desires, requirements, and the like].)

West's Key Number Digest, Contracts k.57

SUPPLEMENT: [This section is current through the latest supplement]
See 3 Williston 4th (2008 ed.), §7:7.



113 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VI. FORMATION: CONSIDERATION
D. Mutuality of Obligation.
2. Desire and Needs Contracts.
b. Needs or Requirements Contract: Not Illusory.

1 Witkin Sum. Cal. Law Contracts § 228

[§ 228] Needs or Requirements Contract: Not Illusory.

Where the proposal is to furnish all goods of a certain kind that the other party may *need or require* in a certain business for a definite period, acceptance results in a contract. Although the acceptor does not in this situation agree to take any particular quantity (for he or she may not need any), there is consideration, because the acceptor has parted with the right to buy the goods elsewhere. (*Bartlett Springs Co. v. Standard Box Co. (1911) 16 C.A. 671, 672, 117 P. 934; Tennant v. Wilde (1929) 98 C.A. 437, 454, 277 P. 137; Andersen v. La Rinconada Country Club (1935) 4 C.A.2d 197, 199, 40 P.2d 571; Ross v. Dunne Co. (1953) 119 C.A.2d 690, 698, 260 P.2d 104; Advance Med. Diagnostic Laboratories v. Los Angeles (1976) 58 C.A.3d 263, 270, 129 C.R. 723, citing the text; see U.C.C. 2306; 2 Corbin (Rev. ed.), §6.5; 3 Williston 4th, §7:12; 17A Am.Jur.2d (2004 ed.), Contracts §132; 52 Harv. L. Rev. 836; 78 Harv. L. Rev. 1212 [comprehensive analysis of problems of drafting and construction]; 8 So. Cal. L. Rev. 243; 26 A.L.R.2d 1139 [mutuality of contract to furnish another with his or her needs, wants, desires, requirements, and the like]; 30 A.L.R.4th 396 [output contracts under §2-306(1) of the Uniform Commercial Code].)*

The doctrine of these cases is not confined to the law of sales, as the court points out in *Fisher v. Parsons (1963) 213 C.A.2d 829, 29 C.R. 210*. The complaint alleged that defendants, who were engineers, required variable quantities of floor space for their operations, depending on the projects undertaken; that they entered into an oral lease with plaintiff, agreeing to take space in its building to the full extent of their needs, at a reasonable rental, and not to relinquish any space in the building until all space in other buildings was first abandoned; and that defendants breached by vacating the space and removing their operations to another building. *Held*, judgment on demurrer for defendants reversed; this was a "needs" contract, valid under the same principle that supports a buyer's agreement to take all the goods that he or she may need. (*213 C.A.2d 834, quoting the text.*)

SUPPLEMENT: [This section is current through the latest supplement]

See 3 Williston 4th (2008 ed.), §7:12. *Correction:* Page 263, line 9 of section, "*Ross v. Dunne Co.*" should be "*Ross v. Frank W. Dunne Co.*"



114 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VI. FORMATION: CONSIDERATION
D. Mutuality of Obligation.
3. Election To Approve or Modify.

1 Witkin Sum. Cal. Law Contracts § 229

[§ 229] Election To Approve or Modify.

Where a principal reserves the election to approve or reject a contract made by his or her agent, no contract results until the approval.

Thus, in *Shortell v. Evans-Ferguson Corp.* (1929) 98 C.A. 650, 277 P. 519, defendant corporation, as agent to sell a tract of land, contracted to "reserve" a lot for plaintiff, and received his first payment of \$ 2,500. The contract provided that "the owner reserves the right to return the above money to the undersigned at any time before a contract of sale is signed by the undersigned and approved by the owner." Some months later, and prior to the execution of the contract of sale, plaintiff demanded back his deposit. *Held*, he was entitled to recover it. The contract purported to bind him alone and hence could bind neither party. (98 C.A. 660.) (See *Sloan v. Stearns* (1955) 137 C.A.2d 289, 297, 290 P.2d 382 [provision that if plaintiff's performance was "accepted," defendants would pay; held not a valid satisfaction clause (infra, §783), but a reserved election to perform or not]; *Prather v. Vasquez* (1958) 162 C.A.2d 198, 203, 327 P.2d 963; 49 A.L.R.2d 508 [sale of goods, provision giving buyer power to control price]; 63 A.L.R.2d 1337 ["escalator" price adjustment clauses].) (On real estate contract conditioning buyer's promise, see 47 Cal. L. Rev. 753.)

On the other hand, in *Wilck v. Herbert* (1947) 78 C.A.2d 392, 178 P.2d 25, defendant writer appointed plaintiff, an author's representative, sole agent for the marketing of his plays. The contract provided that the agent would notify the author within 10 days after receiving a new play whether she would handle it, and if she elected to do so, would use her best efforts to sell. In this action for breach, defendant contended that plaintiff's right to reject any play made the promise illusory. *Held*, the contract was binding. The consideration was: (a) an implied promise to *read* every play submitted within the 10-day period (implication necessary to make the contract reasonable and operative); (b) an express promise to notify defendant, within 10 days of her election to reject, thus assuring him of prompt release of a submitted play for possible sale through other channels. (78 C.A.2d 403.)

SUPPLEMENT: [This section is current through the latest supplement]



115 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VI. FORMATION: CONSIDERATION
D. Mutuality of Obligation.
4. Right To Modify.

1 Witkin Sum. Cal. Law Contracts § 230

[§ 230] Right To Modify.

A right to modify a contract raises a problem similar to that presented by an election to approve or reject (*supra*, §229).

In *Inderkum v. German Old People's Home* (1937) 23 C.A.2d 733, 74 P.2d 83, plaintiff paid \$ 3,500 and entered defendant's home under an agreement that it would maintain her for life. Later, she sued to recover the money, asserting lack of mutuality of obligation because of the contract provision that it was "subject to the Constitution and By-Laws" of defendant, including *future amendments* thereto. *Held*, the agreement was valid; properly construed, the right reserved was merely to make reasonable administrative amendments, and not changes impairing the substance of the contract. (23 C.A.2d 735.) (On validity and construction of life care contracts generally, see 44 A.L.R.3d 1174.)

In *Automatic Vending Co. v. Wisdom* (1960) 182 C.A.2d 354, 6 C.R. 31, defendant cafe owner contracted to give plaintiff vending company a 3-year exclusive concession for the sale of cigarettes by its vending machines. The contract listed percentage commissions on monthly sales (ranging from 4% to 8% on all sales of 1,000 or more packages), but also provided that plaintiff "may change the above cigarette commission rates upon written notice." *Held*, the contract was binding, and plaintiff was entitled to recover damages for repudiation.

The court recognized that an agreement that leaves the price or other performance to the will and discretion of one party is not enforceable, but followed Corbin's view that where it does specify the price or other performance, the fact that one party reserves the power to vary it is not fatal, if the exercise of the power is subject to *prescribed or implied limitations*. And the limitations here were found in the implied covenant of fair dealing (see *infra*, §798 et seq.): "[T]he power given to the Automatic Vending Company to change the commission rates upon written notice would impose a duty upon it to exercise that discretion in good faith and in accordance with fair dealings and fix the commissions in such amount as the object of the contract is reasonably worth. Therefore, it cannot be said that the contract in question is illusory, lacks mutuality of obligation, or is void." (182 C.A.2d 358.) (See *Asmus v. Pacific Bell* (2000) 23 C.4th 1, 16, 96 C.R.2d 179, 999 P.2d 71, *supra*, §210, citing the text; *Powell v. Central Calif. Fed. Savings & Loan Assn.* (1976) 59 C.A.3d 540, 549, 130 C.R. 635 [following Corbin analysis quoted in *Automatic Vending* case, and upholding provision in loan agreement permitting savings and loan association to increase interest rate to maximum of one percent as interest to its depositors was increased]; *24 Hour Fitness v. Superior Court* (1998) 66 C.A.4th 1199, 1213, 78 C.R.2d 533, citing the text [clause in employment agreement allowing employer to modify its personnel handbook unilaterally

was not illusory or lacking in mutuality, because employer's discretionary power to modify terms of handbook indisputably carried with it duty to exercise right fairly and in good faith].) However, it has been recognized that, in addition to acting fairly and in good faith, a party seeking to take advantage of a "change of terms" provision is restricted by an implied limitation that the aforementioned provision applies only to the terms of the original agreement. (*Badie v. Bank of America* (1998) 67 C.A.4th 779, 797, 79 C.R.2d 273 [to permit bank to exercise unilateral rights under change of terms provision in account agreements by adding alternative dispute resolution (ADR) clause, where implied limitation on change of terms provision was universe of terms in original agreements and ADR provision was not in that universe, would open door to claim that agreements were illusory].)

West's Key Number Digest, Contracts k.59

SUPPLEMENT: [This section is current through the latest supplement]



116 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VI. FORMATION: CONSIDERATION
D. Mutuality of Obligation.
5. Unqualified Right To Cancel.
a. Illusory Contract.

1 Witkin Sum. Cal. Law Contracts § 231

[§ 231] Illusory Contract.

The same defect (*supra*, §229) is present where one party reserves the unqualified right to cancel or withdraw from an agreement at his or her pleasure. (*Alameda v. Ross* (1939) 32 C.A.2d 135, 143, 89 P.2d 460; *Fabbro v. Dardi & Co.* (1949) 93 C.A.2d 247, 251, 209 P.2d 91; *Cox v. Hollywood Film Enterprises* (1952) 109 C.A.2d 320, 325, 240 P.2d 713; cf. *Kowal v. Day* (1971) 20 C.A.3d 720, 725, 98 C.R. 118, *infra*, §233 [unenforceable illusory promise treated as enforceable option]; see *Rest.2d, Contracts* §77, Comment a; 2 Corbin (Rev. ed.), §6.12; 3 Williston 4th, §7:7; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §132; 4 *Hastings L. J.* 192; 27 *So. Cal. L. Rev.* 496.)

The Restatement (§77) deals with "Illusory and Alternative Promises" as follows:

"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."

SUPPLEMENT: [This section is current through the latest supplement]
See 3 Williston 4th (2008 ed.), §7:7.



117 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
 VI. FORMATION: CONSIDERATION

D. Mutuality of Obligation.
 5. Unqualified Right To Cancel.
 b. Effect of Part Performance.

1 Witkin Sum. Cal. Law Contracts § 232

[§ 232] Effect of Part Performance.

The situation (*supra*, §231) changes when the promisor partly performs. In *Burgermeister Brewing Corp. v. Bowman* (1964) 227 C.A.2d 274, 38 C.R. 597, plaintiff brewery entered into an express oral agreement giving defendant an exclusive beer distributorship for so long as he used his best efforts to promote the sale and took care of the territory. The agreement was performed satisfactorily for a number of years, at considerable expense to defendant; then plaintiff terminated without notice. Its theory was that, while it bound itself to keep the distributorship in effect so long as defendant used his best efforts and took care of the territory, defendant did not promise to do so; hence, this was a case of election to perform or not (*see supra*, §229). That rule, however, applies only to wholly executory contracts, not to one in which the promisor renders some part performance:

"Assuming, without deciding, that Bowman had not *promised* to exert his best efforts to sell Burgermeister's beer or to take care of the territory, he had in fact done so for a period of 19 years, had provided a fleet of trucks, painting them with Burgermeister advertising, had contributed to the brewery's advertising fund, had built warehouse facilities and had enlarged his inventory beyond his winter needs, etc. Such a contract is not merely an executory promise for a promise." (227 C.A.2d 280.) (See *Money Store Inv. Corp. v. Southern Calif. Bank* (2002) 98 C.A.4th 722, 728, 120 C.R.2d 58, citing the text [illusory nature of lender's closing instructions reserving right to withdraw or amend instructions at any time prior to close of escrow was cured when lender provided money necessary to complete sale].)

SUPPLEMENT: [This section is current through the latest supplement]



118 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VI. FORMATION: CONSIDERATION

D. Mutuality of Obligation.
5. Unqualified Right To Cancel.
c. Effect of Consideration.

1 Witkin Sum. Cal. Law Contracts § 233

[§ 233] Effect of Consideration.

An illusory promise, ineffective as a bilateral contract, may nevertheless be enforceable as an *option* if there is consideration. (See *supra*, §168 et seq.) This theory was invoked in *Kowal v. Day* (1971) 20 C.A.3d 720, 98 C.R. 118. Plaintiff purchaser and defendant vendors made an agreement for the sale of real property. The complaint recited various expenditures and acts of plaintiff in reliance on defendants' promise to sell, and the delivery to defendants of an automobile as partial consideration. The escrow instructions, however, contained a provision that the vendor deposit an agreement permitting the purchaser to rescind within 45 days after close of the escrow. In this action by plaintiff, the trial judge, following the cases on unconditional right to withdraw (*supra*, §231), found the agreement lacking in mutuality of obligation, and gave judgment for defendants on demurrer. *Held*, reversed.

(a) The escrow provision giving the purchaser unrestricted right to rescind destroyed the bilateral character of the agreement. However, such an unenforceable illusory promise could constitute an enforceable option if other consideration was given by the party who made that promise. (20 C.A.3d 725.)

(b) Was good consideration given by plaintiff here? (1) The acts of canceling another lease, contracting to lease space in the property under the agreement, and incurring expenses in contemplation of remodeling and use "are not the type of detrimental reliance that satisfies the consideration requirement because they were not bargained-for considerations." (20 C.A.3d 726.) (2) But the delivery to and acceptance by defendants of the automobile "for their own use and benefit" constituted sufficient consideration for plaintiff's "45-day option to purchase the property." (20 C.A.3d 727.)

(c) "When an optionee, acting pursuant to the bargain, places something of value in the hands of his optionor, the use of that thing satisfies the consideration requirement for the option contract. Moreover, considering the commercially reasonable expectations of the parties, the only reason that the optionee would deposit something of value with the optionor is as consideration for the option. In the event that the optionee does not exercise the option and he regains the thing deposited, the optionor has received the benefit of the use of the thing, and the optionee has suffered the detriment of not having the use of the thing deposited. The consideration requirement is thereby satisfied." (20 C.A.3d 728.)

West's Key Number Digest, Contracts k.59

SUPPLEMENT: [This section is current through the latest supplement]



119 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VI. FORMATION: CONSIDERATION

D. Mutuality of Obligation.
6. Restricted Right To Cancel.
a. Rule and Theory.

1 Witkin Sum. Cal. Law Contracts § 234

[§ 234] Rule and Theory.

The general rule that a right to cancel renders a promise illusory and unenforceable (see *supra*, §231) is, in practice, somewhat misleading. It is not necessary that the obligations be equal, but only that they be mutual. Hence, if the right to cancel is in some way *restricted*, e.g., where a party may cancel for cause, or upon the occurrence of some extrinsic event, or by giving notice for a substantial period of time, consideration will be found. (See generally *Rest.2d, Contracts* §77, Comments c, d; 2 Corbin (Rev. ed.), §6.10 et seq.; 3 Williston 4th, §7:7; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §132; 63 *Harv. L. Rev.* 1013; 27 *So. Cal. L. Rev.* 496; *infra*, §235 et seq.)

A right to terminate for "cause" or "just cause" requires reasonable grounds and good faith. (See *R.J. Cardinal Co. v. R.J. Ritchie* (1963) 218 *C.A.2d* 124, 144, 32 *C.R.* 545.) (On employment contract with provision that employee will perform if physically able, or health permits, etc., see 7 *A.L.R.3d* 898.)

However, it has been suggested that a cancellation provision, even if restricted and presumably valid, destroys mutuality where it provides for cancellation by notification to a *third person* who has no duty to communicate it to the other party. (See *Naify v. Pacific Indem. Co.* (1938) 11 *C.2d* 5, 11, 76 *P.2d* 663 ["It seems questionable whether a contract can validly provide that A is bound thereunder unless B decides to withdraw, and that B's notice of withdrawal may be given to X, a third party who is not A's agent"].)

SUPPLEMENT: [This section is current through the latest supplement]
See 3 Williston 4th (2008 ed.), §7:7.



120 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VI. FORMATION: CONSIDERATION

D. Mutuality of Obligation.
6. Restricted Right To Cancel.
b. Event Restriction.

1 Witkin Sum. Cal. Law Contracts § 235

[§ 235] Event Restriction.

A cancellation provision conditioned on the subsequent occurrence of some specified event, not solely within the control of the promisor, does not destroy mutuality of obligation. (See *Bergman v. Ornbaun* (1939) 33 C.A.2d 680, 682, 92 P.2d 654 [promissory note providing that installment payments should cease on death of payee, held valid]; *Hartman v. San Pedro Commercial Co.* (1944) 66 C.A.2d 935, 936, 153 P.2d 212 [employment contract for definite period, but terminable upon employer's sale of business, or employee's entry into military service, held valid]; 2 Corbin (Rev. ed.), §6.14 et seq.)

SUPPLEMENT: [This section is current through the latest supplement]



121 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VI. FORMATION: CONSIDERATION

D. Mutuality of Obligation.
6. Restricted Right To Cancel.
c. Notice Restriction.

1 Witkin Sum. Cal. Law Contracts § 236

[§ 236] Notice Restriction.

(1) *Notice for Some Specified Period.* A cancellation provision, conditioned on notice of cancellation for some specific period, does not invalidate the contract. In *Thomas v. Anthony* (1916) 30 C.A. 217, 157 P. 823, a contract provided that plaintiff should purchase 50 automobiles from defendant during a certain period at certain prices. Defendant reserved the right to change the prices at any time upon 2 weeks' notice, and also the right to cancel the contract upon 15 days' notice. *Held*, the contract was binding. (30 C.A. 222.) (See 18 Cal. L. Rev. 626.)

In *Brawley v. Crosby Research Foundation* (1946) 73 C.A.2d 103, 166 P.2d 392, plaintiff gave defendant an exclusive license to manufacture, develop, and patent his invention, and defendant agreed to pay royalties. Defendant reserved the right to cancel on 60 days' notice and payment of accrued royalties. *Held*, the right to cancel was substantially restricted, and there was mutuality of obligation. (73 C.A.2d 113.) (See *Phalanx Air Freight v. National Skyway Freight Corp.* (1951) 104 C.A.2d 771, 773, 232 P.2d 510 [contract providing that plaintiff could terminate at any time by giving defendant at least 30 days' notice]; 63 Harv. L. Rev. 1015; 2 Corbin (Rev. ed.), §6.13.)

(2) *Notice Without Time Limitation.* A cancellation provision may be valid if conditioned on notice of cancellation, even though the right may be exercised at any time. Superficially, this appears to give an unqualified right to cancel; but, because the party is bound unless and until notice is given, there is mutuality of obligation. (See *Roehm Distr. Co. v. Burgermeister Brewing Corp.* (1961) 196 C.A.2d 678, 683, 16 C.R. 881, citing the text; *Mutz v. Wallace* (1963) 214 C.A.2d 100, 111, 29 C.R. 170; 2 Corbin (Rev. ed.), §6.13; 27 So. Cal. L. Rev. 496.)

In *Mutz v. Wallace*, *supra*, plaintiff acted as companion of decedent, an elderly and somewhat incapacitated man. They made a written agreement providing for a monthly salary and, on decedent's death, a \$ 10,000 bequest and decedent's residence. The agreement contained a provision that decedent could alter his will and delete the bequest and devise, but would notify plaintiff if he did so. A codicil to carry out the agreement was prepared by decedent's attorney but never executed. *Held*, plaintiff was entitled to specific performance. The thing bargained for was not the property but the physical act of drafting a will in favor of plaintiff, and this was not illusory (214 C.A.2d 108); also, decedent's power of revocation was not unlimited but was exercisable only on notice to plaintiff (214 C.A.2d 111).

West's Key Number Digest, Contracts k.59

SUPPLEMENT: [This section is current through the latest supplement]



122 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VI. FORMATION: CONSIDERATION

D. Mutuality of Obligation.
6. Restricted Right To Cancel.
d. Act Restriction.

1 Witkin Sum. Cal. Law Contracts § 237

[§ 237] Act Restriction.

In *Hawkins v. York* (1969) 2 C.A.3d 98, 82 C.R. 434, plaintiff transferred land to defendants husband and wife in consideration of their promise to pay him \$ 200 per month until death, and not to encumber the property during his lifetime. Nearly 29 years later, after death of defendant husband, plaintiff advised defendant wife that the agreement was lacking in mutuality because it contained a further provision that defendants could reconvey at any time and be relieved of further obligations. *Held*, the agreement was valid and binding. The right to terminate was qualified: Defendants were required, as a condition to termination, (1) to reconvey to plaintiff by *grant deed*, and (2) to *deliver* to plaintiff a *title certificate* showing the property to be free and clear of liens and encumbrances. The delivery of the deed and title certificate would serve to notify plaintiff of termination, and by delivery of the grant deed, defendants would obligate themselves on the implied covenants of C.C. 1113. (2 C.A.3d 105, citing the text.) (See 2 Corbin (Rev. ed.), §6.12.)

SUPPLEMENT: [This section is current through the latest supplement]



123 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VI. FORMATION: CONSIDERATION
D. Mutuality of Obligation.
7. Valid Promise Voidable by Law.

1 Witkin Sum. Cal. Law Contracts § 238

[§ 238] Valid Promise Voidable by Law.

An important exception to the doctrine of mutuality of obligation is that a promise merely *unenforceable or voidable by law* may be sufficient consideration. Where the promise is in terms not binding on the promisor, it cannot be consideration (see *supra*, §229); but where it is binding in its terms, but is within the statute of frauds, or is the voidable promise of a minor or insane person, it is good consideration, despite the election to disaffirm that the law gives the promisor. Thus, a minor, for example, can successfully enforce a contract, but if the other party seeks to enforce the contract against the minor, he or she has the option of disaffirming it. (See *Metropolitan Water Dist. of Southern Calif. v. Marquardt* (1963) 59 C.2d 159, 179, 28 C.R. 724, 379 P.2d 28; *Rest.2d, Contracts* §78; 2 Corbin (Rev. ed.), §5.29; 3 Williston 4th, §§7:3, 7:6; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §134; 18 *Cal. L. Rev.* 624.)

West's Key Number Digest, Contracts k.56

SUPPLEMENT: [This section is current through the latest supplement]
See 3 Williston 4th (2008 ed.), §§7:3, 7:6.



124 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VI. FORMATION: CONSIDERATION
E. Where Consideration Is Unnecessary.
1. Revival of Barred Legal Obligation.
a. Written Promise or Acknowledgment.
1. Rule and Theory.

1 Witkin Sum. Cal. Law Contracts § 239

[§ 239] Rule and Theory.

A debt or other obligation that has been discharged by proceedings in *bankruptcy* or has become barred by the running of the *statute of limitations* is unenforceable, but the discharge or satisfaction of the so-called "moral obligation" that remains is viewed as sufficient "consideration" for a *new promise* to pay it. (*Lambert v. Schmalz* (1897) 118 C. 33, 35, 50 P. 13; *Maurer v. Bernardo* (1931) 118 C.A. 290, 293, 5 P.2d 36; *Forman v. Scott* (1964) 231 C.A.2d 340, 342, 41 C.R. 805; see *Rest.2d, Contracts* §82 [barred by statute of limitations]; §83 [discharged in bankruptcy]; 3 Corbin (Rev. ed.), §9.5 et seq.; 4 Williston 4th, §§8:19, 8:21 et seq.; 9B Am.Jur.2d (1999 ed.), Bankruptcy §4446; 17A Am.Jur.2d (2004 ed.), *Contracts* §161; 51 Am.Jur.2d (2000 ed.), *Limitation of Actions* §301 et seq.; on moral obligation arising from formerly valid claim, see *supra*, §222.)

Although jurisdictions differ as to the effect of an acknowledgment, the California theory is that it gives rise to a new enforceable promise, distinct from the old unenforceable obligation. (*General Credit Corp. v. Pichel* (1975) 44 C.A.3d 844, 848, 118 C.R. 913, citing the text.)

West's Key Number Digest, Contracts k.67

SUPPLEMENT: [This section is current through the latest supplement]

Correction: Page 271, line 9 of section, "9B Am.Jur.2d (1999 ed.), Bankruptcy §4446" should be "9E Am.Jur.2d (1999 ed.), Bankruptcy §3277".



125 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
 VI. FORMATION: CONSIDERATION
 E. Where Consideration Is Unnecessary.
 1. Revival of Barred Legal Obligation.
 a. Written Promise or Acknowledgment.
 2. Writing.

1 Witkin Sum. Cal. Law Contracts § 240

[§ 240] Writing.

(1) *Necessity*. Nearly all the cases on revived legal obligations deal with debts barred by limitations, and *C.C.P.* 360 states: "No acknowledgment or promise is sufficient evidence of a new or continuing contract, by which to take the case out of the operation of this title, unless the same is contained in some *writing, signed by the party to be charged thereby*." Under this important statute, a debt barred by the statute of limitations can be revived only by a writing signed by the debtor; part payment of interest or principal, without a writing, is not sufficient. (*Clunin v. First Fed. Trust Co.* (1922) 189 C. 248, 249, 207 P. 1009, *infra*, §242; see 3 Corbin (Rev. ed.), §9.14; 4 Williston 4th, §8:24; 51 *Am.Jur.2d*, *Limitation of Actions* (2000 ed.) §325 et seq.; 11 *Cal. L. Rev.* 130.)

The rule is different where there is a promise, acknowledgement, or part payment of a note *before the statute has run*. There is then no problem of consideration, and the effect is merely to extend the period within which the action may be brought. (See 3 *Cal. Proc.* (4th), *Actions*, §678.)

(2) *Form*. There may be either an *express promise* to pay, or an *acknowledgment* that the debt exists, from which the promise to pay may be implied. The promise or acknowledgment need not be in any particular form, and may be gathered from several informal writings, such as letters, notices and checks. (See *Searles v. Gonzalez* (1923) 191 C. 426, 429, 216 P. 1003; *Weatherwax v. Hills* (1931) 113 C.A. 557, 558, 298 P. 853; *Van Cauteren v. Forger* (1941) 45 C.A.2d 388, 389, 114 P.2d 6; *Sterling v. Title Ins. & Trust Co.* (1942) 53 C.A.2d 736, 738, 128 P.2d 31; *Bank of America v. McRae* (1947) 81 C.A.2d 1, 11, 183 P.2d 385; *Herman v. Brown* (1949) 91 C.A.2d 758, 760, 205 P.2d 1086, *infra*, §242; 3 Corbin (Rev. ed.), §9.14; 4 Williston 4th, §8:25 et seq.; 51 *Am.Jur.2d* (2000 ed.), *Limitation of Actions* §325 et seq.; 30 *Cal. L. Rev.* 85; 63 *Harv. L. Rev.* 1256, 1259; 3 *Cal. Proc.* (4th), *Actions*, §677.)

West's Key Number Digest, Contracts k.82

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Necessity*.

Cross-Reference: 3 *Cal. Proc.* (5th), *Actions*, §752.(2) *Form*.

Cross-Reference: 3 Cal. Proc. (5th), Actions, §751.



126 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VI. FORMATION: CONSIDERATION
E. Where Consideration Is Unnecessary.
1. Revival of Barred Legal Obligation.
a. Written Promise or Acknowledgment.
3. Unqualified Admission.

1 Witkin Sum. Cal. Law Contracts § 241

[§ 241] Unqualified Admission.

Where the writing is merely an acknowledgment and not a promise, it must be a *distinct and unqualified admission* of the indebtedness; if conditioned or qualified, it does not revive the obligation. (See *Vassere v. Joerger* (1938) 10 C.2d 689, 695, 76 P.2d 656 [promise to pay at future date]; *Foristiere v. Alonge* (1929) 98 C.A. 563, 566, 277 P. 367 [conditional promise, to pay only balance due if credited with certain sum]; *Maurer v. Bernardo* (1931) 118 C.A. 290, 294, 5 P.2d 36 [promise to pay when able]; *Heiser v. McAlpine* (1937) 20 C.A.2d 467, 471, 67 P.2d 141 [conditional promise, to liquidate debt in particular manner--by transfer of stock]; *Steiner v. Croonquist* (1951) 108 C.A.2d Supp. 895, 899, 238 P.2d 690 [letter of inquiry as to what claims creditor was asserting]; 3 Cal. Proc. (4th), Actions, §680; 3 Corbin (Rev. ed.), §9.7; 4 Williston 4th, §8:26; 51 Am.Jur.2d (2000 ed.), Limitation of Actions §§313, 314; 30 Cal. L. Rev. 85.)

This rule was given a common sense interpretation in *Western Coal & Mining Co. v. Jones* (1946) 27 C.2d 819, 167 P.2d 719, where the court rejected the argument that the writing must contain an express statement of willingness to pay. It is enough that (a) there is an admission of a subsisting obligation, and (b) there are no stated conditions or qualifications that indicate an *unwillingness* to pay. Defendant debtor gave notes secured by shares of stock. After the statute had run, defendant arranged for exchange of the shares for new ones in a reorganized corporation, and signed an agreement stating that the new shares should be "subject to the lien of said notes." *Held*, this was a sufficient acknowledgment to revive the obligation. (27 C.2d 824.)

SUPPLEMENT: [This section is current through the latest supplement]
Writing must be unqualified admission of indebtedness:

Cross-Reference: 3 Cal. Proc. (5th), Actions, §754.



127 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VI. FORMATION: CONSIDERATION
E. Where Consideration Is Unnecessary.
1. Revival of Barred Legal Obligation.
b. Communication to Creditor.

1 Witkin Sum. Cal. Law Contracts § 242

[§ 242] Communication to Creditor.

In *Clunin v. First Fed. Trust Co.* (1922) 189 C. 248, 207 P. 1009, an action on a barred promissory note, plaintiff offered in evidence cancelled checks of the deceased debtor, and stubs of those checks obtained by him after the latter's death. The stubs indicated the amount, payee, and other details including the fact that they were paid on the note. *Held*, there was not a sufficient acknowledgment. The checks were not, because they *did not refer to the debt*. And the stubs were not, because, although they clearly identified the debt, they were the debtor's own private memoranda, and were *never communicated* to the creditor by the debtor. (189 C. 250.) (See 4 Williston 4th, §8:36; 51 *Am.Jur.2d* (2000 ed.), *Limitation of Actions* §§337, 338; 11 *Cal. L. Rev.* 130; 4 *So. Cal. L. Rev.* 314.)

In *Van Cauteren v. Forger* (1941) 45 C.A.2d 388, 114 P.2d 6, a few additional facts served to distinguish the *Clunin* case. Pursuant to an oral understanding, the debtor sent regular checks for installments of interest, and the creditor mailed written receipts. *Held*, the checks and the receipts were part of one transaction, and constituted a contract sufficient to revive the debt. (45 C.A.2d 391.)

The new promise or acknowledgment may of course be communicated to the authorized agent or representative of the creditor. (See *Easton v. Ash* (1941) 18 C.2d 530, 536, 116 P.2d 433 [to executrix of creditor's estate].) And it may be communicated to the creditor even though it is *addressed* to someone else. In *Herman v. Brown* (1949) 91 C.A.2d 758, 205 P.2d 1086, the statute began to run on a note in August 1940. In June 1942, the debtor signed a letter, addressed "To My Administrator," directing payment out of his estate. He delivered this to the creditor. In January 1945, he wrote a personal letter to the creditor in which he stated that "had I passed on you have a letter that would have taken care of our business matter." In August 1945, he died. *Held*, the action, commenced in September 1946, was timely, for the two documents, taken together, constituted a sufficient interruption of the running of the statute. (91 C.A.2d 760.) Though the opinion does not discuss the issue, because the statute would have run in June 1945, notwithstanding the first letter, the case also stands for the proposition that a writing wholly insufficient as an acknowledgment may nevertheless be effective if it clearly refers to a prior writing that is sufficient.

But an acknowledgment in a petition filed with the probate court was held not to constitute a communication to the decedent creditor. (*Estate of Azevedo* (1936) 17 C.A.2d 710, 711, 62 P.2d 1058.)

SUPPLEMENT: [This section is current through the latest supplement]



128 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VI. FORMATION: CONSIDERATION
E. Where Consideration Is Unnecessary.
2. Executed Transaction.

1 Witkin Sum. Cal. Law Contracts § 243

[§ 243] Executed Transaction.

The requirement of consideration applies to *executory contracts*; after a contract is fully *executed*, it is no longer possible to attack its validity on this ground. Thus, in *Julian v. Gold* (1931) 214 C. 74, 3 P.2d 1009, premises were occupied under a written lease. The lessor orally and without receiving any other consideration agreed to accept a sum as monthly rental that was less than that specified in the lease, and he did accept this sum regularly for over 2 years. The lessor subsequently sued for the difference. *Held*, to the extent that the contract was executed, i.e., as to those smaller payments actually accepted, the claim of lack of consideration could not be sustained. (214 C. 76.) (See *Stoltenberg v. Harveston* (1934) 1 C.2d 264, 266, 34 P.2d 472; *Kennedy v. Moyer* (1935) 5 C.A.2d 29, 30, 42 P.2d 352; *Schiffman v. Atlas Mill Supply* (1961) 193 C.A.2d 847, 853, 14 C.R. 708; *Miller v. Johnston* (1969) 270 C.A.2d 289, 298, 75 C.R. 699; 20 Cal. L. Rev. 552; 50 Harv. L. Rev. 1314; 5 So. Cal. L. Rev. 245; 30 A.L.R.3d 1259 [necessity and nature of consideration supporting landlord's reduction of rent].)

The *Julian* case, *supra*, relies in part on the doctrine of *waiver*, but this seems unsound; payment of less than the amount due under a contract, even though accepted without objection, does not discharge the obligation unless it is *agreed* that it is to constitute full payment. (See *Macauley v. Jayben Corp.* (1936) 17 C.A.2d 37, 39, 61 P.2d 354 [less than monthly rental due under lease].)

In *Rogers v. Rogers* (1942) 49 C.A.2d 366, 121 P.2d 819, a property settlement agreement was orally modified to release defendant from its obligations except when he had sufficient funds over his own needs. *Held*, there was no discharge when he merely failed to pay, without advising plaintiff that this was pursuant to the oral agreement. (49 C.A.2d 369.) (On *discharge* of obligation by writing without new consideration, see *infra*, §§928, 946, 959.)

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129 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
VI. FORMATION: CONSIDERATION
E. Where Consideration Is Unnecessary.
3. Promissory Estoppel.
a. In General.
1. Nature of Doctrine.

1 Witkin Sum. Cal. Law Contracts § 244

[§ 244] Nature of Doctrine.

In its usual application, estoppel is based upon a representation of fact that the party is not permitted to deny. (See 13 *Summary* (10th), *Equity*, §192.) The doctrine of *promissory estoppel*, however, is distinct in that it applies even though there is no misrepresentation: One who makes a promise upon which another justifiably relies may be bound to perform it, despite lack of consideration; i.e., the estoppel is a substitute for consideration.

The Restatement (§90(1)) states the doctrine as follows:

"A promise which the promisor should reasonably expect to induce action or forbearance on the part of the promisee or a third person and which does induce such action or forbearance is binding if injustice can be avoided only by enforcement of the promise."

Comment b points out that the promisor is affected only by reliance that he or she does or should foresee, and enforcement must be necessary to avoid injustice. "Satisfaction of the latter may depend on the reasonableness of the promisee's reliance, on its definite and substantial character in relation to the remedy sought, on the formality with which the promise is made, on the extent to which the evidentiary, cautionary, deterrent and channeling functions of form are met by the commercial setting or otherwise, and on the extent to which such other policies as the enforcement of bargains and the prevention of unjust enrichment are relevant."

The doctrine has been applied in many cases. (See *Cohen v. Cowles Media Co.* (1991) 501 U.S. 663, 111 S.Ct. 2513, 2518, 115 L.Ed.2d 586, 597, 7 *Summary* (9th), *Constitutional Law*, §366 [First Amendment does not prohibit promissory estoppel cause of action by news source against newspaper that breached promise of confidentiality]; *Drennan v. Star Paving Co.* (1958) 51 C.2d 409, 413, 333 P.2d 757, *infra*, §250; *Tomerlin v. Canadian Indem. Co.* (1964) 61 C.2d 638, 649, 39 C.R. 731, 394 P.2d 571, 2 *Summary* (10th), *Insurance*, §324; *Youngman v. Nevada Irr. Dist.* (1969) 70 C.2d 240, 249, 74 C.R. 398, 449 P.2d 462, *infra*, §247, citing the text, and distinguishing equitable estoppel; *Klein v. Farmer* (1948) 85 C.A.2d 545, 551, 194 P.2d 106; *Wade v. Markwell & Co.* (1953) 118 C.A.2d 410, 419, 258 P.2d 497, *infra*, §248; *R.K.O. Lloyd v. California Pictures Corp.* (1955) 136 C.A.2d 638, 644, 289 P.2d 295; *Graddon v. Knight* (1956) 138 C.A.2d 577, 582, 292 P.2d 632; *Morrison v. Home Savings & Loan Assn. of Los Angeles*

(1959) 175 C.A.2d 765, 768, 346 P.2d 917; *Anchor Cas. Co. v. Surety Bond Savings & Loan Assn.* (1962) 204 C.A.2d 175, 182, 22 C.R. 278; *Greene v. Wilson* (1962) 208 C.A.2d 852, 856, 25 C.R. 630; *Hilltop Properties v. California* (1965) 233 C.A.2d 349, 362, 43 C.R. 605 [allegations that, pursuant to promise by authorized agents of state, plaintiff reserved strips of land from its development for highway widening purposes; complaint sufficient]; *Associated Creditors' Agency v. Haley Land Co.* (1966) 239 C.A.2d 610, 616, 49 C.R. 1; *Swinerton & Walberg Co. v. Inglewood-Los Angeles County Civic Center Authority* (1974) 40 C.A.3d 98, 103, 114 C.R. 834, *infra*, §251; and see generally 3 Corbin (Rev. ed.), §8.1 et seq.; 4 Williston 4th, §8:4 et seq.; 17A Am.Jur.2d (2004 ed.), *Contracts* §109; 28 Am.Jur.2d (2000 ed.), *Estoppel and Waiver* §55 et seq.; 83 Cal. L. Rev. 547 [application of doctrine of promissory reliance as dependent on effect of transaction on distribution of wealth between parties]; 64 Harv. L. Rev. 925; 97 Harv. L. Rev. 678; 10 Hastings L. J. 435; 12 Hastings L. J. 377; 49 Hastings L. J. 1191 [Rescuing Reliance: The Perils of Promissory Estoppel]; 32 So. Cal. L. Rev. 413; 5 Stanf. L. Rev. 783; 11 Stanf. L. Rev. 546; 16 Stanf. L. Rev. 443; 25 U.C. Davis L. Rev. 1099 [Cohen]; 8 U.C.L.A. L. Rev. 272; 48 A.L.R.2d 1069 [promissory estoppel--comment note]; 18 A.L.R.5th 307 [lending institution's promissory estoppel based on promise to lend money]; 4 Cal. Proc. (4th), *Pleading*, §486; *infra*, §245 et seq.)

The doctrine employs equitable principles. Hence, an action based on promissory estoppel, like one relying on estoppel to set up the statute of limitations or the statute of frauds, is deemed an equitable action, with no right to a jury trial. (*C & K Engineering Contractors v. Amber Steel Co.* (1978) 23 C.3d 1, 7, 9, 11, 151 C.R. 323, 587 P.2d 1136; see 31 Hastings L. J. 697.) (On use of the doctrine as a means of avoiding the statute of frauds, see *infra*, §407.) And the party claiming estoppel must specially plead all facts necessary to establish the elements.) (*Smith v. San Francisco* (1990) 225 C.A.3d 38, 48, 275 C.R. 17.)

West's Key Number Digest, Estoppel k.85

SUPPLEMENT: [This section is current through the latest supplement]

Doctrine applied in many cases:

Cross-Reference: 4 Cal. Proc. (5th), *Pleading*, §525.(New) *As applicable against public entity:* Promissory estoppel will not be applied against the government if to do so would effectively nullify a strong rule of policy, adopted for the benefit of the public. (*Poway Royal Mobilehome Owners Assn. v. Poway* (2007) 149 C.A.4th 1460, 1470, 58 C.R.3d 153 [promissory estoppel was unavailable against general law city to enforce alleged contract to provide mobilehome owners association with opportunity to purchase mobilehome park, where any oral representations that may have been made by members of city council were not approved by city].) *Correction:* Page 275, line 3 of last paragraph of page, "7 Summary (9th), *Constitutional Law*, §366" should be "7 Summary (10th), *Constitutional Law*, §366".



130 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
 Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
 VI. FORMATION: CONSIDERATION
 E. Where Consideration Is Unnecessary.
 3. Promissory Estoppel.
 a. In General.
 2. Promise and Reliance.

1 Witkin Sum. Cal. Law Contracts § 245

[§ 245] Promise and Reliance.

(1) *Promise.* The doctrine is inapplicable where no clear promise is made. (See *Southern Calif. Acoustics Co. v. C.V. Holder* (1969) 71 C.2d 719, 723, 79 C.R. 319, 456 P.2d 975 [subcontractor relied on prime contractor's listing in latter's bid, but prime contractor never accepted subcontractor's bid, i.e., never made promise to subcontractor]; *Laks v. Coast Fed. Savings & Loan Assn.* (1976) 60 C.A.3d 885, 891, 131 C.R. 836 ["conditional commitment" to make loan]; *Division of Labor Law Enforcement v. Transpacific Trans. Co.* (1977) 69 C.A.3d 268, 275, 137 C.R. 855, citing the text [discussion of past practice of paying Christmas bonus to employees]; *Lange v. TIG Ins. Co.* (1998) 68 C.A.4th 1179, 1185, 81 C.R.2d 39, quoting the text [letter to insurance brokers stating that insurer had served notice of termination of brokerage agreement effective on certain date did not constitute binding promise that agreement would not be terminated under any circumstances before that date; there was no promise of sufficient definitiveness and clarity to justify applying promissory estoppel]; *Charpentier v. Los Angeles Rams Football Co.* (1999) 75 C.A.4th 301, 311, 89 C.R.2d 115 [failure of football team to offer renewal of seats to season ticket holder after team moved to new city did not breach actionable promise]; *US Ecology v. California* (2001) 92 C.A.4th 113, 130, 111 C.R.2d 689 [defendant agreed to use best efforts to obtain land from federal Government to establish site for disposal facility; although defendant lacked express authority to make legally binding promises, it was reasonable to infer that Legislature intended to provide defendant with this authority as part of its supervisory powers].)

(2) *Reliance.* Even though a promise is made, there is no promissory estoppel unless there is reliance and substantial detriment. (See *Henry v. Weinman* (1958) 157 C.A.2d 360, 366, 321 P.2d 117; *Blatt v. University of Southern Calif.* (1970) 5 C.A.3d 935, 943, 85 C.R. 601; 38 *San Diego L. Rev.* 13 [symposium on reliance]; 4 *Proof of Facts* 2d 641 [detrimental reliance on promise].) Indeed, a failure to allege facts demonstrating reliance is fatal to the cause of action. (*Smith v. San Francisco* (1990) 225 C.A.3d 38, 48, 275 C.R. 17.)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Promise.* See *CalFarm Ins. Co. v. Krusiewicz* (2005) 131 C.A.4th 273, 283, 31 C.R.3d 619 [insurer was estopped from denying liability to homeowners for payment of entire arbitration award in their favor against insured contractor, where counsel provided by insurer to insured told homeowners that insurer would have "no choice" but to pay

arbitrator's award if it was made in general verdict, which could be construed as clear and unambiguous promise to pay full amount of award, including disputed items].



131 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
VI. FORMATION: CONSIDERATION
E. Where Consideration Is Unnecessary.
3. Promissory Estoppel.
a. In General.
2a. (New) Causation.

1 *Witkin Sum. Cal. Law Contracts* § 245A

[§ 245A] (New) Causation.

In *US Ecology v. California* (2005) 129 C.A.4th 887, 28 C.R.3d 894, defendants (the state and several departments and officials) selected plaintiff to develop and operate California's first low-level radioactive waste storage facility. The parties thereafter identified a location for the facility, known as WV, and completed environmental reviews for that site. However, the facility was never built, allegedly because defendants failed to use their best efforts, as promised, to acquire the WV site from the federal Government. Arguing that it spent millions of dollars in development costs in reliance on this promise, plaintiff brought several causes of action, including one for promissory estoppel. The trial judge sustained defendants' demurrer without leave to amend, but on the first appeal, judgment for defendants was reversed on the ground that plaintiff had properly alleged a promissory estoppel claim. Following remand and a second trial, the trial judge again ruled in defendants' favor, and plaintiff again appealed. *Held*, affirmed; a plaintiff has the burden of proving that a defendant's breach caused his or her damages; here, plaintiff failed to sustain this burden.

(a) *Causation as an element of promissory estoppel.*

(1) *Swinerton & Walberg Co. v. Inglewood-Los Angeles County Civic Center Authority* (1974) 40 C.A.3d 98, 114 C.R. 834, text, §251, and several federal and out-of-state cases, with little or no analysis, have assumed that a causation showing is necessary for promissory estoppel. This assumption is correct. Cases have characterized promissory estoppel claims as being basically the same as contract actions, but only missing the consideration element, and therefore the damages recoverable logically are, as in a contract case, limited to those caused by the breaching party. (129 C.A.4th 902, citing *Signal Hill Aviation Co. v. Stroppe* (1979) 96 C.A.3d 627, 158 C.R. 178, text, §246, and *Toscano v. Greene Music* (2004) 124 C.A.4th 685, 21 C.R.3d 732, Supp., *infra*, §246.)

(2) *C & K Engineering Contractors v. Amber Steel Co.* (1978) 23 C.3d 1, 151 C.R. 323, 587 P.2d 1136, text, §244, confirmed that promissory estoppel claims are peculiarly equitable in nature and that courts are given broad discretion to allow or deny these claims. Thus, "even if we were to conclude that causation is not a necessary element of all promissory estoppel claims, we hold that because promissory estoppel is an equitable remedy, courts have the discretion in an appropriate case to deny relief where the plaintiff cannot demonstrate that the defendant's actions caused the plaintiff's damages." (129 C.A.4th 891, 904.)

(3) *Rest.2d, Contracts §349* states that the injured party has a right to damages based on his or her reliance interest, including expenditures made in preparation for performance or in performance, "less any loss that the party in breach can prove with reasonable certainty the injured party would have suffered had the contract been performed." Focusing on the quoted language, plaintiff argued that if there is any causation element in a promissory estoppel claim seeking reliance damages, this is its expression, and that this clause, in addition to creating a defense to a claim of reliance damages, places the burden on the defendant to prove that defense. This contention is without merit. *Rest.2d, Contracts §349* merely states an alternative measure of damages for contract actions, not promissory estoppel claims. Moreover, even if it is applicable to promissory estoppel claims to the extent that they seek reliance damages, it does not purport to state the elements of a promissory estoppel claim, only the measure of reliance damages. (*129 C.A.4th 907.*)

(b) *Proof of causation.*

(1) The test for causation in a breach of contract (or promissory estoppel) action is whether the breach was a substantial factor in causing the damages. Here, it is not reasonably certain that the federal Government would have transferred the WV site had defendants continued to use their best efforts to get it to do so, because the federal Government consistently opposed transfer unless (a) additional testing was accomplished prior to the transfer, (b) it participated in the testing, and (c) a supplemental environmental impact report was prepared. Plaintiff opposed these conditions being put on a possible transfer and threatened the defendants not to agree to the terms, but it would be speculative to conclude that the federal Government would have changed its position even had defendants taken steps to force it to do so. Thus, the hostile action of a third party (the federal Government) meant that not only was it not reasonable for plaintiff to expend funds in reliance on defendants' promise to use their best efforts to obtain the WV site, but also that defendants' breach of this promise was not a substantial factor in causing plaintiff's damages. (*129 C.A.4th 910.*)

(2) Plaintiff asserted that there was substantial evidence that defendants' breach was a substantial factor in causing its damages based on the fact that after defendants abandoned efforts to acquire the WV site, the federal Government did not foreclose the possibility that they could renew their pursuit of the site at a later date. However, simply because the federal Government would not foreclose a future application to have the WV site transferred does not mean that it had changed its position as to the merits. In other words, this evidence did nothing to change the speculative nature of plaintiff's damages. (*129 C.A.4th 910.*)

SUPPLEMENT: [This section is current through the latest supplement]



132 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VI. FORMATION: CONSIDERATION
E. Where Consideration Is Unnecessary.
3. Promissory Estoppel.
a. In General.
3. Damages.

1 Witkin Sum. Cal. Law Contracts § 246

[§ 246] Damages.

The usual remedy in promissory estoppel cases is enforcement of the promise, and the damages are measured by the extent of the obligation assumed and not performed. (*Tomerlin v. Canadian Indem. Co. (1964) 61 C.2d 638, 649, 39 C.R. 731, 394 P.2d 571, 2 Summary (10th), Insurance, §324.*)

"The remedy granted for breach may be limited as justice requires." (*Rest.2d, Contracts §90(1).*) Thus, relief may be restitution, or damages or specific relief measured by the extent of the promisee's reliance rather than by the terms of the promise. (*Rest.2d, Contracts §90, Comment d; see Swinerton & Walberg Co. v. Inglewood-Los Angeles County Civic Center Authority (1974) 40 C.A.3d 98, 105, 114 C.R. 834, infra, §251; on remedies, see §869, 1013.*)

Whether complete contractual recovery may be had under C.C. 3300, including lost profits, has been the subject of conflicting expressions. In the *Swinerton* case, *supra*, the issue was not decided; but the court observed that both the Second Restatement and Corbin opposed broad recovery, and added its own dictum in accord:

"It would seem, however, that the damages that Argo may recover in promissory estoppel might well be limited to those it sustained directly by reason of its justifiable reliance upon the Authority's promise--in other words, to the expenses it incurred in its fruitless participation in the competitive bidding process." (*40 C.A.3d 105; see Kajima/Ray Wilson v. Los Angeles County Metropolitan Trans. Authority (2000) 23 C.4th 305, 315, 96 C.R.2d 747, 1 P.3d 63, infra, §987 [in action by lowest responsible bidder on public construction contract against public agency for misawarding bid to second lowest bidder, damages may be recovered for bid preparation costs, but not for lost profits; Swinerton followed].*)

The court in *Signal Hill Aviation Co. v. Stroppe (1979) 96 C.A.3d 627, 158 C.R. 178*, disagreed:

"Conceptually, promissory estoppel is distinct from contract in that the promisee's justifiable and detrimental reliance on the promise is regarded as a substitute for the consideration required as an element of an enforceable contract. There appears to be no rational basis for distinguishing the two situations in terms of the *damages* that may be recovered; both may involve the problem of ascertaining a future loss of profits, actually a problem of presenting

adequate proof. Complete contractual recovery may include, under some circumstances, loss of profits when the loss is definite rather than speculative. ... We thus decline to limit plaintiff's recovery herein to only actual expenditures made in reliance on defendant's promise." (96 C.A.3d 640.) (See *Kajima/Ray Wilson v. Los Angeles County Metropolitan Trans. Authority*, *supra*, 23 C.4th 321, holding that the preceding dicta in *Signal Hill Aviation* case was not relevant in assessing competing concerns present in public works context.)

SUPPLEMENT: [This section is current through the latest supplement]

In *Toscano v. Greene Music* (2004) 124 C.A.4th 685, 21 C.R.3d 732, plaintiff, being unhappy with his job, contacted defendant and was offered employment to commence on September 1, 2001. In reliance on this offer, plaintiff resigned from his former at-will position on August 1, 2001. Shortly thereafter, defendant withdrew his offer, and plaintiff was forced to accept lesser paying jobs. Plaintiff then sued in promissory estoppel, and defendant contended that plaintiff's reliance damages were limited to the salary that he lost from the time of his resignation on August 1, 2001, until the new job would have commenced on September 1, 2001. Plaintiff, on the other hand, argued that his reliance damages included lost earnings and benefits after September 1, 2001, based on what he would have earned in his former employment. The trial judge ruled for plaintiff, awarding him \$ 536,833 in damages, i.e., the difference between his actual earnings and what he would have earned at his former employment from September 1, 2001, to retirement. *Held*, damages award vacated, but judgment affirmed in all other respects.

(a) Emphasizing the at-will nature of plaintiff's former employment and that an employee cannot establish entitlement to future earnings in the at-will setting, defendant argued that damages for lost future earnings are expectancy damages that are not recoverable under promissory estoppel. This contention is without merit. "Given the equitable underpinnings of the promissory estoppel doctrine, we hold that a plaintiff such as Toscano, who relinquished his job in reliance on an unfulfilled promise of employment, may on an appropriate showing recover the lost wages he would have expected to earn from his former employer but for the defendant's promise. Under these circumstances, such a damage measure is in keeping with the equitable nature of promissory estoppel." (124 C.A.4th 693.) Although the weight of authority is to the contrary, equity is flexible enough to promote right and justice. (124 C.A.4th 692, citing *Signal Hill Aviation Co. v. Stroppe* (1979) 96 C.A.3d 627, 158 C.R. 178, text, p. 278.)

(b) This holding necessarily rejects the notion that the at-will nature of plaintiff's former employment is a strict impediment to the recovery of future wages that he would have earned at the former employment had the plaintiff not relied on the defendant's promise. It is well settled that at-will contractual relations can be the subject of claims for intentional interference with contract, based on the principle that a third party's interference with an at-will contract is actionable interference with the contractual relationship, because the contractual relationship is at the will of the parties, not at the will of outsiders. There is no reason why this principle should not extend to permit recovery of damages under the equitable theory of promissory estoppel, where there is no dispute that defendant induced plaintiff to terminate his at-will employment relationship in reliance on an unfulfilled job offer. Here, plaintiff suffered a compensable loss at the hands of a third party. The only limitation on his recovery is the need to prove with reasonable certainty the fact and extent of his lost future earnings. (124 C.A.4th 694.)

(c) Plaintiff's damages expert admitted that plaintiff could have quit or been fired from his former job from the time that he resigned to the present. She simply assumed that plaintiff would have kept his job with his former employer or another employer at a comparable salary, observing that he had never in the past changed employers for anything other than a pay increase. Hence, it is evident that the expert's supposition of continued employment was based only on plaintiff's history of remaining with his employers until offered new employment. Even taking that evidence as true, evidence of plaintiff's intentions did not establish with any reasonable certainty that his former employer, an at-will employer who had the right to terminate plaintiff at any time for any reason, had a different understanding of the terms of plaintiff's employment, or that it would have continued to employ him until the end of his career. The trial judge based his damages award on the fact that there was no evidence indicating that plaintiff would have left his former employment for a job that paid him substantially less than he was earning there. However, any inference that plaintiff would, therefore, have remained in his former job was too speculative to support a claim of lost future income. (124

C.A.4th 696.)



133 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
VI. FORMATION: CONSIDERATION
E. Where Consideration Is Unnecessary.
3. Promissory Estoppel.
a. In General.
4. Distinction: Act Bargained For.

1 Witkin Sum. Cal. Law Contracts § 247

[§ 247] Distinction: Act Bargained For.

A promissory estoppel may arise where the promisee, in reliance on the promise, does some act other than that called for in his or her own promise. If the only claimed reliance is performance of the act bargained for, the doctrine is inapplicable. (*Healy v. Brewster* (1963) 59 C.2d 455, 463, 30 C.R. 129, 380 P.2d 817; *Youngman v. Nevada Irr. Dist.* (1969) 70 C.2d 240, 249, 74 C.R. 398, 449 P.2d 462; see 51 Cal. L. Rev. 1001.)

In the *Youngman* case, *supra*, the complaint alleged that defendant's superintendent promised at the time of employment of plaintiff Y that he would be granted a merit step increase each April; and that Y relied on this promise in accepting the employment, continuing in it, and refraining from accepting a job elsewhere. Under these allegations, the promise was part of the bargain, and by remaining in his position, Y performed his part of that bargain, i.e., he gave the *consideration* called for by the employment contract. "There is no occasion, therefore, to rely upon the doctrine of promissory estoppel, which is necessary only to supply consideration for a promise when no actual consideration was given by the promisee." (70 C.2d 250.)

In *Raedeke v. Gibraltar Savings & Loan Assn.* (1974) 10 C.3d 665, 111 C.R. 693, 517 P.2d 1157, 3 Cal. Proc. (4th), Actions, §118, G, beneficiary of plaintiffs' note secured by a deed of trust on their hotel, orally agreed to postpone its threatened sale of the property if plaintiffs obtained a willing, responsible buyer. Plaintiffs procured such a buyer, but G sold the hotel and purchased it for the unpaid balance on the note. Plaintiffs then sued for damages for breach of the oral agreement. *Held*, the *Youngman* case, *supra*, was controlling: "If the promisee's performance was requested at the time the promisor made his promise and that performance was bargained for, the doctrine is inapplicable." (10 C.3d 673.) Thus, plaintiffs did not seek to enforce a contract lacking in consideration by showing justifiable reliance and detriment; they showed consideration for the promise, i.e., G promised to postpone the sale if plaintiffs had a purchaser. Plaintiffs' procurement of a purchaser was therefore "the bargained-for performance necessary to support Gibraltar's promise." (10 C.3d 673.)

SUPPLEMENT: [This section is current through the latest supplement]

Raedeke case:

Cross-Reference: 3 Cal. Proc. (5th), Actions, §124.



134 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VI. FORMATION: CONSIDERATION
E. Where Consideration Is Unnecessary.
 3. Promissory Estoppel.
 b. Illustrative Applications.
 1. Promise Not To Foreclose or Forfeit.

1 Witkin Sum. Cal. Law Contracts § 248

[§ 248] Promise Not To Foreclose or Forfeit.

In *Wade v. Markwell & Co. (1953) 118 C.A.2d 410, 258 P.2d 497*, plaintiff pledged her valuable mink coat as collateral for a \$ 270 loan. After the period of redemption had expired, plaintiff was notified by defendant pledgee to repay and reclaim. She said that she was ready, and defendant advised her she had a week to do so, but, within the week, defendant sold the coat. *Held*, defendant had agreed to a week's extension of time, and the agreement was binding without consideration: The representation that the coat could be redeemed in a week induced plaintiff to forbear redemption immediately "in reliance on a promise calculated to induce such forbearance." The court observed that the situation was similar to that in which one purchases property encumbered by a mortgage in reliance on a promise by the mortgagee that he or she will withhold foreclosure for a year. (*118 C.A.2d 419.*)

SUPPLEMENT: [This section is current through the latest supplement]



135 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VI. FORMATION: CONSIDERATION
E. Where Consideration Is Unnecessary.
3. Promissory Estoppel.
b. Illustrative Applications.
2. Promise To Pay Pension or Bonus.

1 Witkin Sum. Cal. Law Contracts § 249

[§ 249] Promise To Pay Pension or Bonus.

In *Hunter v. Sparling* (1948) 87 C.A.2d 711, 725, 197 P.2d 807, an employer was held bound to perform a promise to pay a pension after the employee had served 49 years and had refused other offers of employment in reliance upon the promise. (See *West v. Hunt Foods* (1951) 101 C.A.2d 597, 605, 225 P.2d 978 [pension]; *Frebank Co. v. White* (1957) 152 C.A.2d 522, 525, 313 P.2d 633 [annual bonus]; *Van Hook v. Southern Calif. Waiters Alliance, Local 17* (1958) 158 C.A.2d 556, 570, 323 P.2d 212 [union resolution promising retirement benefits to officer to induce him to reject offer of remunerative employment]; 42 A.L.R.2d 461 [rights and liabilities as between employer and employee with respect to pension or retirement plan]; 43 A.L.R.3d 503 [employer's promise to pay bonus].)

SUPPLEMENT: [This section is current through the latest supplement]



136 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VI. FORMATION: CONSIDERATION
E. Where Consideration Is Unnecessary.
3. Promissory Estoppel.
b. Illustrative Applications.
3. Subcontractor's Bid.

1 Witkin Sum. Cal. Law Contracts § 250

[§ 250] Subcontractor's Bid.

An important practical situation in which the doctrine of promissory estoppel may be invoked occurs where a general contractor takes a number of subcontractors' bids to use in making his or her own bid for the main contract. In the initial stages, the bids are mere offers, and, in the absence of consideration, theoretically revocable. Nationally, there is a conflict of authority as to whether the contractor's reliance on the subcontractors' bids is sufficient to make the offers irrevocable without consideration. (See 1 Corbin (Rev. ed.), §2.31; 47 Cal. L. Rev. 405; 10 Hastings L. J. 435; 10 Stanf. L. Rev. 446; 11 Stanf. L. Rev. 546.)

This conflict was resolved for California in favor of the general contractor in *Drennan v. Star Paving Co.* (1958) 51 C.2d 409, 333 P.2d 757. Plaintiff contractor, relying on defendant subcontractor's paving bid of \$ 7,131.60, was successful in obtaining a school job. The next day defendant advised him that the bid was a mistake and that he would not do the work for less than \$ 15,000. Plaintiff eventually obtained a paving contractor for \$ 10,948.60, and in this action was allowed to recover the difference (\$ 3,817) and costs. (See 47 Cal. L. Rev. 405; 10 Hastings L. J. 435; 12 Hastings L. J. 381; 32 So. Cal. L. Rev. 413; 11 Stanf. L. Rev. 546; 13 Stanf. L. Rev. 839; 18 U.C.L.A. L. Rev. 389.)

The opinion in *Drennan* carefully analyzes the issues of mutual assent and consideration as follows:

(a) *Mutual assent.* Defendant's offer was not in terms irrevocable in exchange for plaintiff's use of the figures, nor was there any basis for interpreting plaintiff's use of it as an acceptance binding on plaintiff; i.e., "there was neither an option supported by consideration or a bilateral contract binding on both parties." (51 C.2d 413.) But the analogous rule that implies a subsidiary promise to keep an offer for a unilateral contract open (supra, §166) is equally appropriate here: "Whether implied in fact or law, the subsidiary promise serves to preclude the injustice that would result if the offer could be revoked after the offeree had acted in detrimental reliance thereon. Reasonable reliance resulting in a foreseeable prejudicial change in position affords a compelling basis also for implying a subsidiary promise not to revoke an offer for a bilateral contract." (51 C.2d 414.)

(b) *Consideration.* In the unilateral contract situation, the consideration for the implied subsidiary promise is part performance by the offeree. Here, promissory estoppel serves the same purpose. (51 C.2d 414.) And the result is both

theoretically sound and highly practical:

"When plaintiff used defendant's offer in computing his own bid, he bound himself to perform in reliance on defendant's terms. Though defendant did not bargain for this use of its bid neither did defendant make it idly, indifferent to whether it would be used or not. On the contrary it is reasonable to suppose that defendant submitted its bid to obtain the subcontract. It was bound to realize the substantial possibility that its bid would be the lowest, and that it would be included by plaintiff in his bid. It was to its own interest that the contractor be awarded the general contract; the lower the subcontract bid, the lower the general contractor's bid was likely to be and the greater its chance of acceptance and hence the greater defendant's chance of getting the paving subcontract. Defendant had reason not only to expect plaintiff to rely on its bid but to want him to. Clearly defendant had a stake in plaintiff's reliance on its bid. Given this interest and the fact that plaintiff is bound by his own bid, it is only fair that plaintiff should have at least an opportunity to accept defendant's bid after the general contract has been awarded to him." (51 C.2d 415.)

The *Drennan* case has been followed in numerous cases. The following are illustrative:

C & K Engineering Contractors v. Amber Steel Co. (1978) 23 C.3d 1, 6, 12, 151 C.R. 323, 587 P.2d 1136 [general contractor complied with alleged industry custom to warn subcontractor that bid was unusually low].

Norcross v. Winters (1962) 209 C.A.2d 207, 215, 25 C.R. 821 [subcontractor's offer irrevocable even though general contractor fails to notify subcontractor that general contractor has been awarded the general contract].

H. W. Stanfield Const. Corp. v. Robert McMullan & Son (1971) 14 C.A.3d 848, 852, 92 C.R. 669 [evidence held sufficient to support findings that general contractor justifiably relied on subcontractor's second bid and did not unreasonably delay in accepting it].

Saliba-Kringlen Corp. v. Allen Engineering Co. (1971) 15 C.A.3d 95, 100, 92 C.R. 799 [plaintiff general contractor relied on defendant subcontractor's bid, latter tried to withdraw 10 minutes before bids opened; plaintiff entitled to recover additional cost of different subcontractor's work].

SUPPLEMENT: [This section is current through the latest supplement]

See *Diede Const. v. Monterey Mechanical Co. (2004) 125 C.A.4th 380, 390, 22 C.R.3d 763* [given trial court's error in concluding that statutes providing relief for mistake in bid on public works contract applied to mistaken bid submitted by subcontractor and that contractor's failure to seek relief negated reasonable reliance in contractor's promissory estoppel action against subcontractor, remand to trial court was warranted for determination whether contractor's reliance was reasonable].



137 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
VI. FORMATION: CONSIDERATION
E. Where Consideration Is Unnecessary.
3. Promissory Estoppel.
b. Illustrative Applications.
4. Government Contract Offered to Bidders.

1 Witkin Sum. Cal. Law Contracts § 251

[§ 251] Government Contract Offered to Bidders.

In *Swinerton & Walberg Co. v. Inglewood-Los Angeles County Civic Center Authority* (1974) 40 C.A.3d 98, 114 C.R. 834, Argo was the lowest bidder on a public works contract that defendant Authority awarded to Swinerton, the second lowest bidder. In its cross-complaint against the Authority and Swinerton, Argo sought damages in tort or contract for its expenses and lost profits. *Held*, a cause of action in contract, but not tort, was stated.

(a) The tort action was precluded by governmental immunity for discretionary acts. (40 C.A.3d 101; see 5 *Summary* (10th), *Torts*, §§217, 218.) But nothing in the governmental tort liability statute affects liability based on contract. (40 C.A.3d 103.)

(b) The pleading met the requirements of the Contracts Restatement (*supra*, §244): "[T]he Authority promised in its solicitation of bids to award the contract to the lowest responsible bidder and Argo's reasonable and detrimental reliance upon this promise brings section 90 into play." (40 C.A.3d 104.)

(c) Defendant, citing the Restatement provision on remedy "limited as justice requires" (*Rest.2d, Contracts* §90(1), *supra*, §244), argued that competitive bidding requirements are only for public protection, and pointed out that the notice of solicitation reserved the right to reject any bids, and hence that an action for damages was precluded. This reasoning is unsound: "To hold that Argo was not entitled to rely upon this promise because of the just-mentioned reservation of the right to reject any and all bids would make the Authority's promise an illusory one and render the whole competitive bidding process nugatory." (40 C.A.3d 104.) (For the dictum against recovery of lost profits, see *supra*, §246.)

West's Key Number Digest, Estoppel k.85

SUPPLEMENT: [This section is current through the latest supplement]



138 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VI. FORMATION: CONSIDERATION
E. Where Consideration Is Unnecessary.
 3. Promissory Estoppel.
 b. Illustrative Applications.
 5. Guaranty.

1 Witkin Sum. Cal. Law Contracts § 252

[§ 252] Guaranty.

The Restatement (§88) applies the promissory estoppel doctrine to reliance on a guaranty, which commonly takes the form of an extension of new credit to the principal obligor or of forbearance to pursue him or her: "A promise to be surety for the performance of a contractual obligation, made to the obligee, is binding if ... (c) the promisor should reasonably expect the promise to induce action or forbearance of a substantial character on the part of the promisee or a third person, and the promise does induce such action or forbearance." (See 2 Corbin (Rev. ed.), §5.23; *17A Am.Jur.2d* (2004 ed.), *Contracts* §167.)

SUPPLEMENT: [This section is current through the latest supplement]



139 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VI. FORMATION: CONSIDERATION
E. Where Consideration Is Unnecessary.
4. Charitable Subscriptions.

1 Witkin Sum. Cal. Law Contracts § 253

[§ 253] Charitable Subscriptions.

The modern view is that subscriptions to a charity are enforceable under the doctrine of promissory estoppel (supra, §244); i.e., when the charitable institution makes expenditures or incurs obligations in reliance upon the promise of a subscriber, the subscriber is estopped from attacking it. There need not be more than a single subscriber; the subscriber can be held to his or her promise as soon as the charity changes position in reliance upon it. (See 48 A.L.R.2d 1069, 1081 [promissory estoppel--comment note]; 97 A.L.R.3d 1054 [enforceability of conditional subscriptions]; 86 A.L.R.4th 241 [failure of consideration for promise to make charitable contribution or subscription].)

Another view is that, *where there are a number of subscribers*, their mutual and reciprocal promises support each other. Under this theory, the subscription can be enforced even though the charity has not yet acted in reliance upon it. (See *Rest.2d, Contracts §90(2)* ["A charitable subscription or a marriage settlement is binding under Subsection (1) without proof that the promise induced action or forbearance"].)

California decisions have approved both theories. (See *University of Southern Calif. v. Bryson* (1929) 103 C.A. 39, 45, 283 P. 949 [reciprocal agreements]; *First Trust & Savings Bank of Pasadena v. Coe College* (1935) 8 C.A.2d 195, 198, 47 P.2d 481 [promissory estoppel]; 18 Cal. L. Rev. 314; 5 Stanf. L. Rev. 787.) If, however, there is no showing of mutual and reciprocal promises, the subscriber's pledge is a mere offer, revocable until steps in reliance thereon are taken; and death of the subscriber prior to these steps revokes the offer. (*Board of Home Missions & Church Extension of Methodist Episcopal Church v. Manley* (1933) 129 C.A. 541, 543, 19 P.2d 21.) (See 4 Williston 4th, §§8:4, 8:5.)

West's Key Number Digest, Subscriptions k.5

SUPPLEMENT: [This section is current through the latest supplement]



140 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VI. FORMATION: CONSIDERATION
E. Where Consideration Is Unnecessary.
5. Stipulations.

1 Witkin Sum. Cal. Law Contracts § 254

[§ 254] Stipulations.

The Restatement (§94) states the familiar rule that stipulations with respect to matters of form and procedure are favored by the courts and enforced without regard to consideration:

"A promise or agreement with reference to a pending judicial proceeding, made by a party to the proceeding or his attorney, is binding without consideration. By statute or rule of court, a stipulation is generally binding only"

"(a) if it is in writing and signed by the party or attorney, or"

"(b) if it is made or admitted in the presence of the court, or"

"(c) to the extent that justice requires enforcement in view of material change of position in reliance on the promise or agreement."

The California law on the form and effect of binding stipulations and relief from stipulations is extensively covered in California Procedure. (See 1 *Cal. Proc. (4th), Attorneys*, §289 et seq.)

SUPPLEMENT: [This section is current through the latest supplement]
California law:

Cross-Reference: 1 *Cal. Proc. (5th), Attorneys*, §263 et seq.



141 of 141 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
VI. FORMATION: CONSIDERATION
E. Where Consideration Is Unnecessary.
6. Premarital Agreements.

1 Witkin Sum. Cal. Law Contracts § 255

[§ 255] Premarital Agreements.

Under the Uniform Premarital Agreement Act (*Family C. 1600* et seq.; see 11 *Summary* (10th), *Community Property*, §24 et seq.), a premarital agreement is enforceable without consideration. (*Family C. 1611.*) And, after marriage, an amended agreement or a revocation is also enforceable without consideration. (*Family C. 1614.*) (On application of statute of frauds to premarital agreements, see *infra*, §399.)

SUPPLEMENT: [This section is current through the latest supplement]



1 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT
A. Mistake.
1. Allocation of Risk.

1 Witkin Sum. Cal. Law Contracts § 256

[§ 256] Allocation of Risk.

Rest.2d, Contracts §154 reads as follows:

"A party bears the risk of a mistake when"

"(a) the risk is allocated to him by agreement of the parties, or"

"(b) he is aware, at the time the contract is made, that he has only limited knowledge with respect to the facts to which the mistake relates but treats his limited knowledge as sufficient, or"

"(c) the risk is allocated to him by the court on the ground that it is reasonable in the circumstances to do so."

"Stating these rules in terms of the allocation of risk avoids such artificial and specious distinctions as are sometimes drawn between 'intrinsic' and 'extrinsic' mistakes or between mistakes that go to the 'identity' or 'existence' of the subject matter and those that go merely to its 'attributes,' 'quality' or 'value.'" (*Rest.2d, Contracts §154*, Comment a.) (See *Raddue v. LeSage* (1956) 138 C.A.2d 852, 855, 292 P.2d 522; 7 Corbin (Rev. ed.), §28.28; 27 Williston 4th, §70:77 et seq.; on distinction between mistake of "basic" fact justifying rescission and less harmless mistakes, see *infra*, §261.)

Comment d deals with allocation of risk by the court: "A court will generally do this, for example, where the seller of farm land seeks to avoid the contract of sale on the ground that valuable mineral rights have been found. ... In dealing with such issues, the court will consider the purposes of the parties and will have recourse to its own general knowledge of human behavior in bargain transactions, as it will in the analogous situation in which it is asked to supply a term under the rule stated in §204." (See 91 Cal. L. Rev. 1573 [Mistake in Contract Law].)

SUPPLEMENT: [This section is current through the latest supplement]
See C.E.B., Law of Contracts §3.32 et seq.



2 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT
A. Mistake.

2. Mistake Preventing Mutual Assent: No Contract.
a. Unilateral Mistake Where Other Party at Fault.

1 Witkin Sum. Cal. Law Contracts § 257

[§ 257] Unilateral Mistake Where Other Party at Fault.

If the language used by the parties is ambiguous, and one party knows this and fails to explain it, mistake of the innocent party is partly a result of the other party's fault, and relief is proper; i.e., the innocent party's interpretation will prevail. (*Merced County Sheriff's Employees' Assn. v. Merced* (1987) 188 C.A.3d 662, 673, 233 C.R. 519; see 7 Corbin (Rev. ed.), §§28.29, 28.38 et seq.; 27 Williston 4th, §70:109; 17A Am.Jur.2d (2004 ed.), Contracts §206; 27A Am.Jur.2d (1996 ed.), Equity §12; Cal. Civil Practice, 3 Business Litigation, §24:28 et seq.; Cal. Transactions Forms, 1 Business Transactions §6:22; 2 California Affirmative Defenses 2d (2004 ed.), §40:1 et seq.; 64 So. Cal. L. Rev. 1 [analysis of cases and theories dealing with liability for mistake in contract formation]; CACI, No. 330 [Affirmative Defense--Unilateral Mistake of Fact].)

But where there is no ambiguity, and neither party is at fault, unilateral mistake will not prevent formation of a contract. Under the objective test, a "meeting of the minds" is unnecessary, and a party may be bound though he or she misunderstood the terms of the offer or proposed contract, and actually had a different undisclosed intention. (*American Bldg. Maintenance Co. v. Indemnity Ins. Co. of North America* (1932) 214 C. 608, 614, 7 P.2d 305; *Brant v. California Dairies* (1935) 4 C.2d 128, 133, 48 P.2d 13; *Brookwood v. Bank of America* (1996) 45 C.A.4th 1667, 1673, 53 C.R.2d 515 [party was bound by arbitration agreement regardless of whether she read it or was aware of arbitration clause; reliance on unilateral mistake not encouraged or fostered by other party is not reasonable when party could have ascertained truth through exercise of reasonable diligence, which requires reading contract before signing it]; 7 Corbin (Rev. ed.), §§28.29, 28.38 et seq.; 17A Am.Jur.2d (2004 ed.), Contracts §§206, 209; 27A Am.Jur.2d (1996 ed.), Equity §12; supra, §116.)

Where the mistake is in the *transmission of an offer by telegraph*, the offeror is bound by the offer as delivered, unless the offeree knew or should reasonably have known from the terms thereof that there was a mistake. (See *Germain Fruit Co. v. Western Union Tel. Co.* (1902) 137 C. 598, 602, 70 P. 658; 1 Corbin (Rev. ed.), §4.11; 2 Williston 4th, §6:57.)

An unusual illustration of the effect of unilateral mistake appears in *Grantham v. State Farm Mut. Auto. Ins. Co.* (1954) 126 C.A.2d Supp. 855, 272 P.2d 959. Plaintiff's automobile insurance expired and he failed to renew, but by clerical error the insurer mailed him a renewal premium receipt. The company's mistake was obvious to plaintiff and

normally would prevent a contract from arising. However, plaintiff invoked *Ins.C. 484* (see 2 *Summary* (10th), *Insurance*, §66), making acknowledgment of receipt of premium *conclusive* despite any stipulation that the policy is not to be binding until actual payment. It was held, however, that *Ins.C. 484* by its terms is limited to acknowledgment "in a policy"; hence, the statute could not apply to the present situation in which, by reason of the mistake, no insurance contract had been created. (126 *C.A.2d Supp.* 858.) (See 2 *U.C.L.A. L. Rev.* 141.)

In re First Capital Life Ins. Co. (1995) 34 *C.A.4th* 1283, 40 *C.R.2d* 816, involved a life insurance company's mistaken issuance of a late notice (the offer), announcing a grace period for a policy that had lapsed for nonpayment of the premium almost 6 months earlier. Upon realization of the error, the insurer rejected the insured's attempt (the acceptance) to reinstate the policy, and the trial judge subsequently denied a claim for benefits under the policy. *Held*, affirmed.

(a) Despite an offer and acceptance after the policy had lapsed, there was no enforceable contract because there was no meeting of the minds between the insured and the insurer. Given the knowledge the insured possessed with respect to the history of the policy and its lapse, it could not reasonably have believed the insurer intended an offer, and at no time did the insured rely on coverage after the lapse; in fact, it purchased a replacement policy in expectation of the impending lapse of coverage. (34 *C.A.4th* 1288, 1289.)

(b) The insurer's notice of an offer to reinstate the policy was not a waiver of its right to declare a forfeiture of the policy. The language of the policy's forfeiture clause left no room for misunderstanding, and the insurer was under no contractual obligation or legal requirement to accept a premium payment after the time for payment specified in the policy. (34 *C.A.4th* 1289.)

SUPPLEMENT: [This section is current through the latest supplement]

See 2 Williston 4th (2007 ed.), §6:58; 2 California Affirmative Defenses §40:1 et seq.; 27A *Am.Jur.2d* (2008 ed.), *Equity* §11.



3 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT
A. Mistake.

2. Mistake Preventing Mutual Assent: No Contract.
 - b. Mutual Mistake: Neither or Both at Fault.

1 Witkin Sum. Cal. Law Contracts § 258

[§ 258] Mutual Mistake: Neither or Both at Fault.

If both parties are mistaken, and neither is at fault or both are equally to blame, the mistake may prevent formation of the contract. (*Merced County Sheriff's Employees' Assn. v. Merced* (1987) 188 C.A.3d 662, 676, 233 C.R. 519 [both parties at fault]; 7 Corbin (Rev. ed.), §§28.29, 28.30; 27 Williston 4th, §§70:17, 70:18; CACI, No. 331 [Affirmative Defense--Bilateral Mistake].)

Thus, both parties may have a different understanding as to the *identity of the subject matter*. In the famous case of *Raffles v. Wichelhaus*, 2 H. & C. 906, there was an agreement to buy goods arriving on the ship "Peerless," and there were two steamers of that name, each party having in mind a different ship. No contract resulted. (See *Barfield v. Price* (1871) 40 C. 535, 542; *French v. Construction Laborers Pension Trust* (1975) 44 C.A.3d 479, 488, 118 C.R. 731, quoting the text; *Chakmak v. H.J. Lucas Masonry* (1976) 55 C.A.3d 124, 129, 127 C.R. 404, *infra*, §259; *Rest.2d, Contracts* §20; 7 Corbin (Rev. ed.), §§28.29, 28.39; 17A Am.Jur.2d (2004 ed.), *Contracts* §202; 24 So. Cal. L. Rev. 490.)

In *Balistreri v. Nevada Livestock Production Credit Assn.* (1989) 214 C.A.3d 635, 641, 262 C.R. 862, citing and quoting the text, the court discussed the *Peerless* case and the acceptance of its doctrine in *Barfield v. Price*, *supra*, and *French v. Construction Laborers Pension Trust*, *supra*. Plaintiffs sought cancellation of a deed of trust securing a loan to their son. The trust deed, by error of a trustee's loan agent, encumbered their own residence instead of property coowned with their son. However, a cover letter identified the encumbered property as the coowned property. The trial judge denied relief on the ground that plaintiffs had failed to read the instrument they signed and that just reading the cover letter was insufficient. *Held*, reversed. This was a mutual mistake case, because both parties were mistaken as to the identity of the encumbered property. Hence, there was no meeting of the minds as to a material matter and no contract was formed. (214 C.A.3d 642.) Furthermore, plaintiffs' failure to read the deed of trust was excusable, because they relied on defendant's cover letter indicating that the deed of trust referred to the coowned property. (214 C.A.3d 640, 643.) A concurring justice thought that the correct legal theory was unilateral mistake induced by defendant's misleading statement in the cover letter. (214 C.A.3d 644.)

Similarly, where the subject matter, or something essential to performance, ceases to exist before the agreement is reached, there is no contract. If the essential thing is destroyed *after* the agreement is made, a contract is formed, but its

performance is excused by impossibility. (See *Dairy Food Store v. Alpert* (1931) 116 C.A. 670, 672, 3 P.2d 61; 7 Corbin (Rev. ed.), §38.39; 28 Williston 4th, §70:160 et seq.; 17A Am.Jur.2d (2004 ed.), Contracts §§204, 655 et seq.; infra §841.)

West's Key Number Digest, Contracts k.93(5)

SUPPLEMENT: [This section is current through the latest supplement]



4 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

A. Mistake.

2. Mistake Preventing Mutual Assent: No Contract.

c. Effect of Negligence.

1 Witkin Sum. Cal. Law Contracts § 259

[§ 259] Effect of Negligence.

The general rule governing mutual mistake applies where neither or both parties are at fault (see *supra*, §258): "An offer is made in terms that the offeree misunderstands; and the latter accepts in terms that the former understands as an assent to the offer that he meant to make. In a case like this, each party is mistaken as to the meaning of the offer; and sometimes this is not discovered until after important changes of position have taken place. It is very clear that no contract should be held to exist unless one of the parties *so negligently expressed* himself that the other was caused reasonably to believe that agreement existed." (*Chakmak v. H.J. Lucas Masonry* (1976) 55 C.A.3d 124, 129, 127 C.R. 404, quoting Corbin.)

In *Chakmak, supra*, two projects for student health centers at state universities at Hayward and Fresno were advertised for bids at the same time. Plaintiff general contractor was bidding only on the Fresno center. Defendant subcontractor, relying on a mistaken listing in his local trade journal, by telephone offered a bid for masonry work, intending it to be for the Hayward center. "Mr. Lucas believed that Tri-Central knew that he was talking about the *Hayward* project and Tri-Central believed that Mr. Lucas was talking about the *Fresno* student health center as that was the only project Tri-Central was bidding on." (55 C.A.3d 127.) *Held*, no contract was made unless defendant was so negligent in expressing himself that plaintiff could reasonably believe that an agreement existed for the Fresno project. Hence, summary judgment for defendant subcontractor was reversed for a trial on the negligence issue. (55 C.A.3d 129.)

SUPPLEMENT: [This section is current through the latest supplement]



5 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

A. Mistake.

3. Mistake That Makes Contract Voidable.

a. Mistake of Fact.

1. Mutual Mistake as to Basic Fact.

aa. General Principle.

1 Witkin Sum. Cal. Law Contracts § 260

[§ 260] General Principle.

(1) *Mistake of Fact*. If there is mutual assent as to the subject matter and parties to the agreement, a contract results; but it may be voidable and subject to rescission where there is a harmful mistake as to some basic or material fact that induced the plaintiff to enter into it.

C.C. 1577 provides: "Mistake of fact is a mistake, not caused by the neglect of a legal duty on the part of the person making the mistake, and consisting in: 1. An unconscious ignorance or forgetfulness of a fact past or present, material to the contract; or, 2. Belief in the present existence of a thing material to the contract, which does not exist, or in the past existence of such a thing which has not existed." It must affect in some material way one of the essential elements of the contract, such as the parties, subject matter, or offer or acceptance, so that it clearly appears that the complaining party would not have entered into it except for his or her mistaken belief. (C.C. 1568; see *Hannah v. Steinman* (1911) 159 C. 142, 146, 112 P. 1094, *infra*, §261; *Levy v. Wolff* (1956) 46 C.2d 367, 368, 294 P.2d 945; *Hess v. Ford Motor Co.* (2002) 27 C.4th 516, 523, 117 C.R.2d 220, 41 P.3d 46 [words in release applying to "all other persons, firms, etc.," were unambiguous, but evidence showed that they were included by mutual mistake]; *C.L. Glover Co. v. Farinacci* (1931) 113 C.A. 183, 185, 298 P. 133; *Union Pac. R. Co. v. Zimmer* (1948) 87 C.A.2d 524, 529, 197 P.2d 363 [release of liability; mutual mistake as to seriousness of injuries]; *Estate of Stuart* (1950) 97 C.A.2d 218, 223, 228, 217 P.2d 723; *Golem v. Fahey* (1961) 191 C.A.2d 474, 476, 13 C.R. 63, citing the text [similar to *Hannah* case, but holding that right to rescind was waived for failure to give notice]; *Williams v. Puccinelli* (1965) 236 C.A.2d 512, 515, 46 C.R. 285, citing the text, *infra*, §261; *Guthrie v. Times-Mirror Co.* (1975) 51 C.A.3d 879, 884, 124 C.R. 577, *infra*, §275, citing the text ["mutual mistake, whether of fact or law, which affects an essential element of the contract and is harmful to one of the parties is subject to rescission by the party harmed"]; *Rest.2d, Contracts* §152; 7 Corbin (Rev. ed.), §§28.29, 28.39, 28.42; 27 Williston 4th, §§70:17, 70:18; 27A *Am.Jur.2d* (1996 ed.), *Equity* §§12, 14; 2 California Affirmative Defenses 2d (2004 ed.), §40:3 et seq.; 48 Proof of Facts 3d 505 [mutual mistake over physical condition of real estate as basis for rescission of contract]; 54 Proof of Facts 3d 527 [sale by acre or in gross as affecting purchaser's relief for mistake in quantity of land sold]; 12 *Hastings L. J.* 465; 43 *Hastings L. J.* 1 [Mistake, Frustration, and the Windfall Principle of Contract Remedies]; 71 *A.L.R.2d* 100 [release of personal injury claim, mutual mistake as to injuries]; 39

A.L.R.3d 1376 [mutual mistake as to tax consequences as ground for relief against property settlement]; *50 A.L.R.3d 1188* [mistake as to physical condition of realty]; *infra*, §261.) Accordingly, mistake as to a *collateral matter* will not suffice. (*Wood v. Kalbaugh* (1974) 39 C.A.3d 926, 932, 114 C.R. 673.)

The usual remedy of the mistaken party is rescission and restitution. (See *infra*, §930 et seq.; *Rest.2d, Contracts* §158.) But in *Levy v. Wolff, supra*, defendant vendor sold land to plaintiff purchasers for \$ 16,500, both parties believing that it was leased. It developed that the purported lease was not binding. Plaintiffs did not rescind; instead, they sought the equivalent of the remedy of a purchaser suing for specific performance against a defaulting vendor--title with compensation for the defect (see 13 *Summary* (10th), *Equity*, §§58, 59.) *Held*, this was proper. "No good reason appears why the same right to compensation for a deficiency in performance should not apply when an action for insufficiency takes place without action for specific performance." (46 C.2d 369.) In other words, "[a] person who has paid money to another as full performance of a contract voidable by the payor for mistake and who has received a part of the agreed exchange is entitled, at his election, to keep what he has received and to have restitution of so much of his payment as has not been compensated for by the other's part performance." (46 C.2d 368.)

(2) *Distinction: Error in Judgment.* In *Mosher v. Mayacamas Corp.* (1989) 215 C.A.3d 1, 263 C.R. 373, defendant in 1982 agreed to buy a Lake Tahoe property from plaintiff as an investment. The property had a high valuation at the time, but in 1985, property values in the area declined drastically because of the impending federal Tax Reform Act of 1986 that substantially eliminated tax benefits for secondary residences. Defendant buyer liquidated the property and ceased payments on the contract; plaintiff seller sued, and defendant cross-complained for rescission on the ground of mistake of fact as to valuation. *Held*, summary judgment for plaintiff affirmed.

Defendant contended that there were triable issues of fact as to whether the parties assumed a continuation of favorable tax treatment of the properties and whether they intended to share the risk of any postsale economic adversity. But the contract contained no language to that effect, and no evidence of any oral agreement was offered. Thus, there was merely an error in *judgment*, not a mistake of fact: "Appellant chose to enter into the subject contract knowing that tax benefits were a major aspect of the value of the properties and presumably knowing that the availability of such benefits could be affected by future legislation, yet it made no provision with respect to tax matters in the contract which its own chief executive officer prepared." (215 C.A.3d 6.)

(3) *Distinction: Possibilities Concerning Which Parties Took Risk.* The kind of mistake that renders a contract voidable does not include mistakes as to matters that the contracting parties had in mind as possibilities and as to the existence of which they took the risk. (*Stermer v. Board of Dental Examiners* (2002) 95 C.A.4th 128, 134, 115 C.R.2d 294 [parties entered into stipulation relating to discipline imposed on dentist by licensing board based on certain offenses, knowing that convictions might later be vacated].)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Mistake of Fact.* See 2 California Affirmative Defenses §40:3 et seq.; 27A *Am.Jur.2d* (2008 ed.), *Equity* §11.



6 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

A. Mistake.

3. Mistake That Makes Contract Voidable.

a. Mistake of Fact.

1. Mutual Mistake as to Basic Fact.

bb. What Constitutes Basic Fact.

1 Witkin Sum. Cal. Law Contracts § 261

[§ 261] What Constitutes Basic Fact.

In *Hannah v. Steinman* (1911) 159 C. 142, 112 P. 1094, defendant leased a lot to plaintiff for 3 years, with the privilege of renewal for 2 years. The parties contemplated that the lessee would erect a wooden building. Both were unaware of a city ordinance prohibiting wooden buildings in that zone. The evidence showed that construction of any other than a wooden building would, under the circumstances, be quite unprofitable, so that the lease was worthless. *Held*, rescission was proper. The court distinguished between mistake as to a *collateral matter* constituting an inducement, such as an expectation of future profits, and mistake as to a *material matter*, affecting an essential element of the contract. Here the mistake was as to an essential element, the subject matter. The mistake was not as to the subject matter's identity, but it did relate to a basic fact about it, for, without the right to construct the wooden building under the short term lease, "the land was a substantially different thing from the land supposed to be contracted for." (159 C. 149.)

In *Williams v. Puccinelli* (1965) 236 C.A.2d 512, 46 C.R. 285, defendant leased the second floor of an old building to plaintiff, both parties contemplating that plaintiff would install and operate a restaurant and bar there. Unknown to the parties, the second floor would not support the "live load" requirements of the city building code, and extensive alterations would have to be made in the unleased portions of the building if the purpose was to be realized. Plaintiff gave notice of rescission. Defendant relied on the lease provision that the premises were leased "as is," and that the lessee would make all alterations at his own expense. *Held*, judgment granting rescission affirmed; both parties had mistakenly assumed that the second floor could be used for the designated purpose without structural changes in the rest of the building. (236 C.A.2d 515.)

In *Merced County Mut. Fire Ins. Co. v. California* (1991) 233 C.A.3d 765, 284 C.R. 680, plaintiff insurer issued a policy to K providing liability coverage for his fruit stand, which was located on property leased from defendant state. Plaintiff then executed a certificate of insurance adding defendant as an additional insured. In this action to rescind the certificate, plaintiff alleged that it would not have issued the certificate but for the misrepresentation or mistake of defendant's agent that the certificate was required as a condition of the lease between defendant and K. *Held*, judgment for defendant on demurrer reversed. The misrepresentation or mistake was material. By issuing the certificate, plaintiff

expanded its risk, because the certificate required plaintiff to assume the obligation to defend defendant against a claim of improper design of the roadways, a theory that greatly increased the cost of defense and the potential for establishing liability. (233 C.A.3d 774.)

On the other hand, in *Vickerson v. Frey* (1950) 100 C.A.2d 621, 224 P.2d 126, plaintiff bought a house consisting of two apartments and a basement which he intended to remodel into an apartment. Unknown to both parties, the height of the basement ceiling was six inches less than the statutory minimum. *Held*, this mistake was not material, for (a) it related to only a portion of the property, and (b) the use of the basement as an apartment was not impossible but merely more difficult and costly than contemplated, for the basement floor level could be lowered to comply with the height limit. The court said: "The mistake did not relate to the intrinsic nature of the bargain, did not vitally affect a fact on the basis of which the parties contracted. Appellant, despite the mistake, would acquire the very lot and building she examined and bargained for. ... It is a mistake pertaining to a collateral matter, a quality or characteristic of the thing sold,—the feasibility of converting the basement into living quarters. In such a case, the difference between the real and the supposed quality or nature of the thing must be so great, so extreme, as to make it virtually a different thing." (100 C.A.2d 628.) (See *Bellwood Discount Corp. v. Empire Steel Bldg. Co.* (1959) 175 C.A.2d 432, 435, 346 P.2d 467 [building contract, mistake of owner as to need for such excluded items as sprinkler system and partition walls; rescission denied].)

Rest.2d, Contracts §152, Comment a, states that the contract is voidable if three conditions are met: "First, the mistake must relate to a 'basic assumption on which the contract was made.' Second, the party seeking avoidance must show that the mistake has a material effect on the agreed exchange of performances. Third, the mistake must not be one as to which the party seeking relief bears the risk." (See 7 Corbin (Rev. ed.), §§28.30, 28.33, 28.35, 28.39; 27 Williston 4th, §70:67 et seq.; 27A *Am.Jur.2d* (1996 ed.), *Equity §11*.)

West's Key Number Digest, Contracts k.93(5)

SUPPLEMENT: [This section is current through the latest supplement]
See 27A *Am.Jur.2d* (2008 ed.), *Equity §10*.



7 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

A. Mistake.

3. Mistake That Makes Contract Voidable.

a. Mistake of Fact.

2. Unilateral Mistake of Fact.

aa. In General.

1 Witkin Sum. Cal. Law Contracts § 262

[§ 262] In General.

Neither C.C. 1577 nor C.C. 1689 requires that mistake of fact be mutual. Mistake by one party is, under some circumstances, grounds for relief. (See *Palace Hardware Co. v. Smith* (1901) 134 C. 381, 384, 66 P. 474; *Forest Lawn Memorial Park Assn. v. De Jarnette* (1926) 79 C.A. 601, 604, 250 P. 581; *Lepper v. Ratterree* (1929) 98 C.A. 245, 255, 276 P. 1037; *Reid v. Landon* (1958) 166 C.A.2d 476, 482, 333 P.2d 432; *Mitidieri v. Saito* (1966) 246 C.A.2d 535, 537, 54 C.R. 665; *Architects & Contractors Estimating Services v. Smith* (1985) 164 C.A.3d 1001, 1007, 211 C.R. 45, citing the text; 7 Corbin (Rev. ed.), §§28.29, 28.39 et seq.; 27 Williston 4th, §70:109 et seq.; 17A Am.Jur.2d (2004 ed.), Contracts §§206, 207; 27A Am.Jur.2d (1996 ed.), Equity §§12, 16; 13 Cal. L. Rev. 246; 12 Hastings L. J. 462; 11 U.C.L.A. L. Rev. 653; 13 A.L.R.4th 686 [modern status of rules as to avoidance of release of personal injury claim on ground of mistake as to nature and extent of injuries].) However, there is authority holding that the mistake must be that of the *complaining party*. (See *Wood v. Metzenbaum* (1951) 107 C.A.2d 727, 731, 237 P.2d 703, 4 Cal. Proc. (4th), Pleading, §507.)

SUPPLEMENT: [This section is current through the latest supplement]

See 27A Am.Jur.2d (2008 ed.), Equity §§11, 14. *Wood case*:

Cross-Reference: 4 Cal. Proc. (5th), Pleading, §546. *Correction:* Page 293, line 5, "*Architects & Contractors Estimating Services v. Smith*" should be "*Architects & Contractors Estimating Service v. Smith*".



8 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

A. Mistake.

3. Mistake That Makes Contract Voidable.

a. Mistake of Fact.

2. Unilateral Mistake of Fact.

bb. Restatement.

1 *Witkin Sum. Cal. Law Contracts* § 263

[§ 263] Restatement.

Under the First Contracts Restatement, unilateral mistake did not render a contract voidable unless the other party had reason to know of the mistake or his or her fault caused the mistake. (See *Larsen v. Johannes* (1970) 7 C.A.3d 491, 503, 86 C.R. 744 [no advantage taken and other party unaware of mistake; no ground for relief]; *Bunnett v. Regents of Univ. of Calif.* (1995) 35 C.A.4th 843, 853, 854, 41 C.R.2d 567 [no rescission for plaintiff's unilateral mistake in absence of evidence that defendant knew about mistake or fostered it]; *Conservatorship of O'Connor* (1996) 48 C.A.4th 1076, 1096, 56 C.R.2d 386 [surety could not rescind bond based on unilateral mistaken beliefs as to validity of principal's appointment as conservator, where there was no evidence that principal was aware of mistakes or unfairly used them to his advantage and enforcing bond would not be unconscionable].) The Second Restatement (§153), although continuing this rule, liberalizes it by adding an additional ground: "the effect of the mistake is such that enforcement of the contract would be *unconscionable*." (*Rest.2d, Contracts* §153(a); see Comments a, c, d, and Reporter's Note.) Comment c points out that the unconscionable contract or term rule (see *infra*, §§330, 331) is not applicable (because unconscionability does not appear at the time the contract is made), but that the standards of unconscionability are similar.

SUPPLEMENT: [This section is current through the latest supplement]



9 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

A. Mistake.

3. Mistake That Makes Contract Voidable.

a. Mistake of Fact.

2. Unilateral Mistake of Fact.

cc. Adoption of Second Restatement Unconscionability Rule.

1 Witkin Sum. Cal. Law Contracts § 264

[§ 264] Adoption of Second Restatement Unconscionability Rule.

In *Donovan v. RRL Corp.* (2001) 26 C.4th 261, 109 C.R.2d 807, 27 P.3d 702, plaintiff read a newspaper ad that listed a specific used vehicle at what seemed to be a very good price. The next day, he went to defendant dealer, tested the vehicle, and stated that he would purchase it at the advertised price. However, defendant refused to sell at that price, claiming that, due to typographical and proofreading errors made by the newspaper, it was approximately \$ 12,000 below the "real" sales price. Plaintiff sued for breach of contract, but lost in the trial court. The Court of Appeal reversed, holding that *Veh.C. 11713.1(e)*, which requires a dealer to sell a vehicle at the advertised total price unless the time for purchasing at that price has elapsed (see 4 *Summary* (10th), *Sales*, §336), favors treating the advertisement as a valid offer. *Held*, judgment of the Court of Appeal reversed; although there was a contract, it could be rescinded on the basis of unilateral mistake about price.

(a) Citing *Hedging Concepts v. First Alliance Mortg. Co.* (1996) 41 C.A.4th 1410, 49 C.R.2d 191, the Court of Appeal relied on the principle that a unilateral misinterpretation of contractual terms, without knowledge by the other party at the time of contract, does not constitute a mistake under either C.C. 1577 (mistake of fact) or C.C. 1578 (mistake of law). *Hedging Concepts* involved a mistake of law. By contrast, defendant's mistake here resulted from an unconscious ignorance that the ad set forth an incorrect price for the automobile, a mistake of fact, and the Court of Appeal erred in concluding otherwise. The Court of Appeal also erred to the extent that it suggested that a unilateral mistake of fact affords a ground for rescission only where the other party is aware of the mistake. (26 C.4th 278.)

(b) *Rest.2d, Contracts §153(a)* authorizes rescission for a unilateral mistake of fact where "the effect of the mistake is such that enforcement of the contract would be unconscionable." This rule "is consistent with our previous decisions [and] we adopt the rule as California law." (26 C.4th 281.)

(c) Where the plaintiff, as here, has no reason to know of and does not cause the defendant's unilateral mistake of fact, the defendant must establish the following facts to obtain rescission of the contract: (1) the defendant made a mistake regarding a basic assumption upon which the contract was made; (2) the mistake has a material effect upon the agreed exchange of performances that is adverse to the defendant; (3) the defendant does not bear the risk of the

mistake; and (4) the effect of the mistake is such that enforcement of the contract would be unconscionable. (26 C.4th 282.)

(d) A significant error in the price term of a contract constitutes a mistake regarding a basic assumption on which the contract is made, and such a mistake ordinarily has a material effect adverse to the mistaken party. In establishing a material mistake, the defendant must show that the resulting imbalance in the agreed exchange is so severe that it would be unfair to require the defendant to perform. Here, enforcing the contract with the mistaken price would require defendant to sell the vehicle to plaintiff for \$ 12,000 less than the intended advertised price—an error amounting to 32% of the price defendant planned to set. Clearly, the exchange of performances would be substantially less desirable for defendant and more desirable for plaintiff, and plaintiff implicitly concedes that defendant's mistake was "material." (26 C.4th 282.)

(e) In determining whether defendant should bear the risk of its mistake, it is necessary to determine whether it was reasonable under the circumstances to allocate to defendant the risk of the mistake in the advertisement. C.C. 1577, as well as prior California decisions, instructs that the risk of a mistake must be allocated to a party where the mistake results from that party's neglect of a legal duty, but it is well established that ordinary negligence does not constitute neglect of a *legal duty* for this purpose (see *infra*, §270). Under *Rest.2d, Contracts §157*, rescission is unavailable only where the mistake results from a failure to act in good faith and in accordance with reasonable standards of fair dealing. To be consistent with California decisions holding that a careless, but significant, mistake is not a breach of a legal duty, this section means that a mistaken party's failure to exercise due care does not necessarily bar rescission under the rule set forth in *Rest.2d, Contracts §153* (authorizing rescission for unilateral mistake of fact where enforcement would be unconscionable). (26 C.4th 283.) Here, there is no allegation that defendant acted in bad faith. (26 C.4th 284.)

(f) Plaintiff contended that *Veh.C. 11713.1(e)* imposes upon automobile dealers an *absolute* obligation to sell a vehicle at the advertised price and therefore supplants the common law regarding rescission of contracts and eliminates the defense of mistake. However, this argument is inconsistent with *Moorpark v. Moorpark Unified School Dist.* (1991) 54 C.3d 921, 1 C.R.2d 896, 819 P.2d 854, *supra*, §130, which held that a statute supplying the parameters for the price term of a contract does not remove the contract-making process from the purview of the common law unless the Legislature intends to occupy the field. *Veh.C. 11713.1(e)* at most reflects an intent to supplement contract law by establishing a ceiling price for the sale of an advertised vehicle, not an intent to occupy the field. Therefore, the common law, including the law governing mistake, remains applicable. (26 C.4th 285.)

(g) The evidence showed that defendant's error was an honest mistake not intended to deceive the public, that proofreading error by the newspaper was the direct cause of the mistake, that ads placed in other newspapers at the same time did not contain the same mistake, and that defendant had established procedures for notifying its sales staff and customers of errors. Defendant's fault consisted of failing to review the advertising proof sheet, relying on the newspaper's advertising staff to do so. Although this omission might constitute negligence, it does not involve a breach of defendant's duty of good faith and fair dealing that should preclude equitable relief for mistake. In these circumstances, it would not be reasonable to allocate the risk of the mistake to defendant. (26 C.4th 289.)

Two dissenting justices argued that granting rescission was improper, because defendant, instead of seeking rescission, consistently argued that no contract was ever formed. (26 C.4th 294.) (See 115 Harv. L. Rev. 724 [*Donovan v. RRL Corp.*].)

SUPPLEMENT: [This section is current through the latest supplement]

See *Grenall v. United of Omaha Life Ins. Co.* (2008) 165 C.A.4th 188, 193, 80 C.R.3d 609 [in purchasing life annuity, annuitant bore risk of mistake in her lack of awareness that she already had terminal disease when she signed contract, thus precluding administrators of her estate from rescinding contract after her death for her unilateral mistake, even though contract did not expressly assign risk of mistake; annuitant knew she had only limited knowledge of facts relating to mistake (that she had terminal disease), but treated limited knowledge as sufficient].



10 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

A. Mistake.

3. Mistake That Makes Contract Voidable.

a. Mistake of Fact.

2. Unilateral Mistake of Fact.

dd. Other Party's Reliance.

1 *Witkin Sum. Cal. Law Contracts* § 265

[§ 265] Other Party's Reliance.

Enforcement of a contract is not unconscionable if the other party has relied on the mistake. (*Rest.2d, Contracts* §153, Comment d.) Thus, in *Drennan v. Star Paving Co. (1958) 51 C.2d 409, 333 P.2d 757*, supra, §250, plaintiff contractor relied on defendant paving subcontractor's bid of \$ 7,131.60 in obtaining a job, and the next day defendant advised plaintiff that the bid was a mistake and that he would not perform for less than \$ 15,000. Plaintiff eventually obtained a paving contractor to do the work for \$ 10,948.60, and was allowed to recover the difference from defendant. Because paving bids customarily varied as much as 160%, plaintiff had no reason to believe that a mistake had been made. "Under these circumstances defendant's mistake, far from relieving it of its obligation, constitutes an additional reason for enforcing it, for it misled plaintiff as to the cost of doing the paving. Even had it been clearly understood that defendant's offer was revocable until accepted, it would not necessarily follow that defendant had no duty to exercise reasonable care in preparing its bid. It presented its bid with knowledge of the substantial possibility that it would be used by plaintiff; it could foresee the harm that would ensue from an erroneous underestimate of the cost. Moreover, it was motivated by its own business interest. Whether or not these considerations alone would justify recovery for negligence had the case been tried on that theory (see *Biakanja v. Irving (1958), 49 C.2d 647, 650, 320 P.2d 16*), they are persuasive that defendant's mistake should not defeat recovery. ... As between the subcontractor who made the bid and the general contractor who reasonably relied on it, the loss resulting from the mistake should fall on the party who caused it." (*51 C.2d 416.*)

SUPPLEMENT: [This section is current through the latest supplement]



11 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

A. Mistake.

3. Mistake That Makes Contract Voidable.

a. Mistake of Fact.

2. Unilateral Mistake of Fact.

ee. No Relief Against Third Party.

1 Witkin Sum. Cal. Law Contracts § 266

[§ 266] No Relief Against Third Party.

In *Neptune Gunite Co. v. Monroe Enterprises* (1964) 229 C.A.2d 439, 40 C.R. 367, a general contractor agreed to develop a subdivision for defendant owner. T had a subcontract for a drainage channel, and plaintiff was T's subcontractor for guniting the slopes. Plaintiff made an inadvertent error in his bid (600%), so that his contract called for \$ 2,721 instead of \$ 12,000. After performance of work of the reasonable value of \$ 5,000, he discovered the mistake and notified T, but T refused to make a new contract. Plaintiff filed a mechanic's lien, and on foreclosure received judgment against defendant owner. *Held*, reversed. In all of the previous cases giving relief from mistake in a bid, the parties were in contractual privity, and this is essential. So, while plaintiff had a right to rescind against T, he could not enforce a new obligation against defendant, with whom he had no contractual relation at all. (229 C.A.2d 444.) (See 27A Am.Jur.2d (1996 ed.), *Equity* §14.)

SUPPLEMENT: [This section is current through the latest supplement]
27A Am.Jur.2d (1996 ed.), *Equity* §14 was deleted in the 2008 revision of that volume.



12 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

A. Mistake.

3. Mistake That Makes Contract Voidable.

a. Mistake of Fact.

2. Unilateral Mistake of Fact.

ff. Contractor's Bid.

1 *Witkin Sum. Cal. Law Contracts* § 267

[§ 267] Contractor's Bid.

One of the common situations in which relief is granted for unilateral mistake occurs when a contractor submits a bid for a construction project. (See *M.F. Kemper Const. Co. v. Los Angeles* (1951) 37 C.2d 696, 701, 235 P.2d 7; *Klose v. Sequoia Union High School Dist.* (1953) 118 C.A.2d 636, 641, 258 P.2d 515 [general contractor listed K Co. as subcontractor instead of R Co., and K Co.'s figure was \$ 500 higher]; *Brunzell Const. Co. of Nevada v. G.J. Weisbrod* (1955) 134 C.A.2d 278, 283, 285 P.2d 989; *White v. Berrenda Mesa Water Dist.* (1970) 7 C.A.3d 894, 900, 87 C.R. 338, *infra*, §271; 7 Corbin (Rev. ed.), §28.40; 27 Williston 4th, §70:121; C.E.B., 1 Construction Contracts & Disputes 3d, §3.61; 10 *Stanf. L. Rev.* 466.)

In the *Kemper* case, *supra*, plaintiff submitted a bid of \$ 780,305, after overworked employees, in transposing figures from a work sheet, had omitted an item of \$ 301,769. Several hours after the bids were opened plaintiff discovered the error and notified defendant city board, but the board nevertheless accepted the bid under the charter provision making it irrevocable. *Held*, plaintiff was entitled to rescission. The mistake was material, and it would be unconscionable to hold plaintiff to it, where the city had knowledge of the unfairness in ample time to award the contract differently (as it ultimately did). (37 C.2d 702.)

The city relied on the statement in the official bid form that bidders "will not be released on account of errors." The court, however, distinguished between errors in judgment such as underestimating the cost of labor or materials (no relief given), and mechanical or clerical errors in tabulating or transcribing figures (relief allowed). "Where a person is denied relief because of an error in judgment, the agreement which is enforced is the one he intended to make, whereas if he is denied relief from a clerical error, he is forced to perform an agreement he had no intention of making. The statement in the bid form in the present case can be given effect by interpreting it as relating to errors of judgment as distinguished from clerical mistakes. If we were to give the language the sweeping construction contended for by the city, it would mean holding that the contractor intended to assume the risk of a clerical error no matter in what circumstances it might occur or how serious it might be. Such interpretation is contrary to common sense and ordinary business understanding and would result in the loss of heretofore well-established equitable rights to relief from certain types of mistake." (37 C.2d 703.)

The *Kemper* court also held that public contracts are subject to rescission on the usual grounds in the same manner as private contracts. (37 C.2d 704.) However, this statement is no longer applicable in view of the statutory procedure for obtaining relief from erroneous bids submitted to public entities. (See *infra*, §989.)

In *Elsinore Union High School Dist. of Riverside County v. Kastorff* (1960) 54 C.2d 380, 6 C.R. 1, 353 P.2d 713, defendant building contractor submitted a bid for a school building, inadvertently failing, as a result of last minute bids for subcontracts, to carry over any figure for plumbing. When his bid of \$ 89,994 was found to be the lowest by \$ 11,306, he was asked if it was correct. He checked it hurriedly in the hall, without his work sheets, and said yes, whereupon the board voted to award him the contract. The next morning, on checking the work sheets, he found the error, immediately informed the architects, and a day later notified the school superintendent. Nevertheless, plaintiff's board refused to reconsider his request for withdrawal, and he refused to sign the contract. After accepting a contract of the next lowest bidder, plaintiff sued for the \$ 12,906 difference and received judgment. *Held*, reversed. Defendant's statement that the bid was correct was not a neglect of legal duty, because he inspected his figures and found the mistake at the earliest practicable moment and promptly rescinded. "Under the circumstances the 'bargain' for which the board presses ... appears too sharp for law and equity to sustain." (54 C.2d 389.)

In *Coleman Engineering Co. v. North Amer. Aviation* (1966) 65 C.2d 396, 55 C.R. 1, 420 P.2d 713, plaintiff contractor was reasonably induced by incorrect plans and specifications to submit a lower bid than he otherwise would have made. *Held*, plaintiff was entitled to recover for the extra work done to comply with the contract. (65 C.2d 404.)

SUPPLEMENT: [This section is current through the latest supplement]

See C.E.B., 1 Construction Contracts, Defects, and Litigation, §5.61 (replacing C.E.B., Construction Contracts and Disputes 3d).



13 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

A. Mistake.

3. Mistake That Makes Contract Voidable.

a. Mistake of Fact.

2. Unilateral Mistake of Fact.

gg. Tax Sale.

1 Witkin Sum. Cal. Law Contracts § 268

[§ 268] Tax Sale.

In *Schultz v. Contra Costa* (1984) 157 C.A.3d 242, 203 C.R. 760, plaintiff, a carpenter, made a successful bid of \$ 9,100 at a tax sale of a lot in the city of El Cerrito. Plaintiff intended to build a home there, and, prior to the sale, he made an inspection of the site and found nothing wrong with the land. A week later, he was informed by the city building department that the lot was in a slide area and unbuildable. He brought this action to rescind the purchase and received judgment on the ground of failure of consideration. *Held*, affirmed.

(a) *Rescission of tax sale and deed.* Failure of consideration is not a ground for rescission of a tax deed unless performance by the grantee was made a condition subsequent. (157 C.A.3d 247.) But the judgment rescinding the deed could be properly supported by proof of mistake; i.e., the remedy of rescission is directed at the contract of purchase and sale, the deed being merely the instrument by which the vendor performs. (157 C.A.3d 247, citing the text.)

(b) *Mistake as sufficient ground for rescission.* Unilateral mistake is recognized as a ground of rescission by both the California Code and the Second Restatement (§154). (157 C.A.3d 249, 250, quoting *Lawrence v. Shutt* (1969) 269 C.A.2d 749, 766, 75 C.R. 533, on balancing the burdens and hardships imposed on the parties.) Plaintiff was mistaken as to a material fact: He believed that the land he was purchasing could be used to build a home. (157 C.A.3d 248.) The mistake did not result from his own negligence; he made an on-site inspection of the parcel and surrounding area, had the title searched, and made reasonable inquiries of the governmental bodies involved without receiving any adverse information. (157 C.A.3d 248.)

(c) *Revenue Code remedies not exclusive.* Defendant's chief contention was that the sole remedies for a purchaser at a tax sale are those provided in the *Revenue and Taxation Code*. (157 C.A.3d 248.) However, the cases relied on deal with former statutes, and Rev.C. 3711 (see 9 *Summary* (10th), *Taxation*, §§259, 266) does not indicate that its remedy is exclusive. (157 C.A.3d 247.)

A strong dissent argues that the Legislature had never changed the historical rule that the doctrine of caveat emptor applies to purchasers at tax sales, and that the statutes merely provide exceptions for fraud and irregularity in the sales.

(157 C.A.3d 251.) Here, there was no irregularity or fraud: The state had no reason to know of physical or legal restrictions on use of the land imposed by local government. The burden was on plaintiff to consult the city building department before the purchase, and the risk of mistake was on him. (157 C.A.3d 251, 252.)

Craland v. California (1989) 214 C.A.3d 1400, 263 C.R. 255, involving a purchaser's breach of contract action based on the failure of the state and county to disclose that the property purchased at a tax sale was over a large landslide, followed the dissent in *Schultz v. Contra Costa*, *supra*, in holding that the state and county are not subject to contractual liability and that tax sale purchasers are limited to statutory remedies. The court said: "It must be kept in mind that the property was 'sold' to the State by operation of law in order to collect delinquent taxes and return the property to the tax rolls. Public policy would not be served by imposing a non-statutory burden on the State, County, and tax collector to search public records to ascertain the suitability of each tax-defaulted parcel for the undisclosed uses secretly intended by prospective bidders at public tax sales." (214 C.A.3d 1408.)

Van Petten v. San Diego (1995) 38 C.A.4th 43, 44 C.R.2d 816, involved a purchaser's misrepresentation and breach of contract action based on his discovery after a tax sale that the assessed value of one of the properties purchased, as listed in the assessor's office, was considerably lower than the "assessed value" as listed in the sales brochure. *Held*, the purchaser was limited to statutory remedies, which did not include rescission or refund based on misrepresentation or breach of contract. The principle of caveat emptor applies "in all its vigor" in tax sales and was particularly applicable here because the sales brochure explicitly stated that the tax defaulted property was to be sold "as is" and warned bidders: "Research Before You Invest!" (38 C.A.4th 50, 51, following *Craland* and rejecting *Schultz*.)

West's Key Number Digest, Contracts k.93(1)

SUPPLEMENT: [This section is current through the latest supplement]



14 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

A. Mistake.

3. Mistake That Makes Contract Voidable.

a. Mistake of Fact.

3. Negligence of Mistaken Party.

aa. Relief Denied.

1 Witkin Sum. Cal. Law Contracts § 269

[§ 269] Relief Denied.

Relief may be granted for mistake "not caused by the neglect of a legal duty on the part of the person making the mistake." (C.C. 1577; on allocation of risk of mistake under the Restatement, see *supra*, §256.)

In *Roller v. California Pac. Title Ins. Co.* (1949) 92 C.A.2d 149, 206 P.2d 694, plaintiff purchaser drafted an offer to buy defendant vendor's real property and then to rent it back to defendant. The offer provided that plaintiff would pay \$ 5,000 down and \$ 13,000 in 30 days, and would assume a mortgage of \$ 42,000 held by P, mortgagee. The offer then provided that defaults by defendant in payment of rent would be offset against plaintiff's payments on the "balance of purchase price." After acceptance by defendant and payment of the \$ 5,000, plaintiff discovered that there could be no offset between the parties because the "balance of purchase price" would be owed, not to defendant, but to P, the mortgagee. *Held*, he was not entitled to rescind. Plaintiff's predicament was caused by his own negligence in drawing the agreement, and defendant was in no way at fault. (92 C.A.2d 152.) (See *Mesmer v. White* (1953) 121 C.A.2d 665, 673, 264 P.2d 60 ["defendant had notice of facts sufficient to put her on inquiry" as to ownership of disputed stock]; *Hernandez v. Badger Const. Equipment Co.* (1994) 28 C.A.4th 1791, 1817, 34 C.R.2d 732 [modification of crane rental agreement to name lessor as additional insured under lessee's policy was not invalid where lessee's mistaken impression that it was required to do so was result of its failure to read agreement]; 7 Corbin (Rev. ed.), §§28.37, 28.38; 27 Williston 4th, §70:109 et seq.; 17A Am.Jur.2d (2004 ed.), Contracts §210; 27A Am.Jur.2d (1996 ed.), Equity §13.)

SUPPLEMENT: [This section is current through the latest supplement]

See *Stewart v. Preston Pipeline* (2005) 134 C.A.4th 1565, 1587, 36 C.R.3d 901 [neglect in failing to read contract before signing was not unilateral mistake of type that would justify rescission]; 27A Am.Jur.2d (2008 ed.), Equity §12.



15 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

A. Mistake.

3. Mistake That Makes Contract Voidable.

a. Mistake of Fact.

3. Negligence of Mistaken Party.

bb. Excusable Neglect.

1 Witkin Sum. Cal. Law Contracts § 270

[§ 270] Excusable Neglect.

"Ordinary" negligence is not ordinarily a bar to relief. Thus, in *M.F. Kemper Const. Co. v. Los Angeles* (1951) 37 C.2d 696, 702, 235 P.2d 7, supra, §267, a serious clerical error was made in a contractor's bid by employees exhausted after working long hours under pressure. In granting relief, the court declared that "not all carelessness constitutes a 'neglect of legal duty' " and observed: "The type of error here involved is one which will sometimes occur in the conduct of reasonable and cautious businessmen, and, under all the circumstances, we cannot say as a matter of law that it constituted a neglect of legal duty such as would bar the right to equitable relief." (See *Sun 'N Sand v. United Calif. Bank* (1978) 21 C.3d 671, 700, 148 C.R. 329, 582 P.2d 920; *Hess v. Ford Motor Co.* (2002) 27 C.4th 516, 529, 117 C.R.2d 220, 41 P.3d 46 [fact that party seeking relief has read instrument and knows its contents does not prevent court from finding that it was executed under mistake; there is element of carelessness in nearly every case of mistake]; *Brunzell Const. Co. of Nevada v. G.J. Weisbrod* (1955) 134 C.A.2d 278, 286, 285 P.2d 989; *Williams v. Puccinelli* (1965) 236 C.A.2d 512, 519, 46 C.R. 285, supra, §261 [plaintiff's son, who acted for her, had no special training, and a nonexpert could not have discovered defect from physical observation of building]; *Architects & Contractors Estimating Service v. Smith* (1985) 164 C.A.3d 1001, 1008, 211 C.R. 45; on other party's reliance on ordinary negligence as creating enforceable contract, see *Drennan v. Star Paving Co.* (1958) 51 C.2d 409, 416, 333 P.2d 757, supra, §250.)

In *Van Meter v. Bent Const. Co.* (1956) 46 C.2d 588, 297 P.2d 644, plaintiff made a subcontract bid to clear a reservoir basin. Defendant contractors represented that a certain area was involved, believing the representation to be true but lacking sufficient information to warrant it. Plaintiff relied on it, but was negligent in not having used reasonable care to ascertain the larger extent of the basin. *Held*, plaintiff could recover for the expense of the greater work. Although degrees of negligence have been much criticized, the California rule is established that ordinary negligence does not amount to the "neglect of a legal duty" (C.C. 1577). Here, there was not only no gross negligence, but reliance in good faith on false representations of the defendant (see *infra*, §301). (46 C.2d 594.)

West's Key Number Digest, Contracts k.93(5)

SUPPLEMENT: [This section is current through the latest supplement]



16 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

A. Mistake.

3. Mistake That Makes Contract Voidable.

a. Mistake of Fact.

3. Negligence of Mistaken Party.

cc. Mixed Mistake of Judgment and Fact.

1 Witkin Sum. Cal. Law Contracts § 271

[§ 271] Mixed Mistake of Judgment and Fact.

"Generally, relief is refused for error in judgment." (*M.F. Kemper Const. Co. v. Los Angeles* (1951) 37 C.2d 696, 703, 235 P.2d 7, supra, §267.) But an error in "judgment" may, on a sympathetic analysis, have sufficient roots in a mistake of fact to justify relief.

Thus, in *White v. Berrenda Mesa Water Dist.* (1970) 7 C.A.3d 894, 87 C.R. 338, plaintiff contractor gave a low bid on a construction project for defendant district. Then he discovered that, relying on soil reports and advice of an engineer, he had made a mistake in computing the amount of hard rock to be excavated. He notified the district of withdrawal of the bid, and at a meeting of the board of directors described the mistake and characterized it as an "error in judgment." Defendant nevertheless accepted the bid on the ground that a judgmental error was not a mistake justifying relief. Plaintiff sought rescission, and the trial judge gave judgment for defendant on its cross-complaint for damages. *Held*, reversed.

(a) Under the *Kemper* test (supra, §267), plaintiff's negligence was ordinary, not gross. The error would sometimes occur in the conduct of reasonable and cautious businessmen; hence it was not caused by a "neglect of legal duty." (7 C.A.3d 902.)

(b) Plaintiff's bid resulted from a mixed mistake of fact and of judgment; i.e., his estimate of the amount of hard rock to be excavated was judgmental, but it was based on a misunderstanding of the facts occasioned in part by reliance on the soil report and engineer's statement. (7 C.A.3d 900.) The trial judge drew too fine a line between mistake of fact and of judgment, and in taking plaintiff "at his word" gave undue emphasis to the words used. (7 C.A.3d 907.)

SUPPLEMENT: [This section is current through the latest supplement]



17 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

A. Mistake.

3. Mistake That Makes Contract Voidable.

b. Mistake of Law.

1. In General.

1 Witkin Sum. Cal. Law Contracts § 272

[§ 272] In General.

"Mistake of law constitutes a mistake ... only when it arises from: 1. A misapprehension of the law *by all parties*, all supposing that they knew and understood it, and all making substantially the *same mistake* as to the law; or, 2. A misapprehension of the law *by one party, of which the others are aware at the time of contracting*, but which they do not rectify." (C.C. 1578; see C.C. 1579 [mistake of foreign law is mistake of fact]; 7 Corbin (Rev. ed.), §28.49 et seq.; 27 Williston 4th, §70:123 et seq.; 27A *Am.Jur.2d* (1996 ed.), *Equity* §15 et seq.; 2 California Affirmative Defenses 2d (2004 ed.), §40:7 et seq.; 12 *Hastings L. J.* 463; 19 *Hastings L. J.* 1225.)

Some early cases declared a "general rule" that, in the absence of fraud or other special circumstances, a mistake of law affords no basis for relief. (See *Kenyon v. Welty* (1862) 20 C. 637, 641; *Gardner v. Watson* (1915) 170 C. 570, 577, 150 P. 994.) This rule originated in the ancient criminal law maxim, ignorance of the law is no excuse. (See 19 *Hastings L. J.* 1226.) It has no proper application to the granting of relief by way of rescission (see *supra*, §260 et seq. and *infra*, §930 et seq.), reformation (see *infra*, §276 et seq.), or restitution (see *infra*, §§936, 1013 et seq.). (See *Rest.2d, Contracts* §151, Comment b [no distinction between mistake of law and mistake of fact]; 7 Corbin (Rev. ed.), §28.49; 27 Williston 4th, §70:123; 45 *Harv. L. Rev.* 336; 61 *Harv. L. Rev.* 553 [justification of "general rule" based on problem of proof]; cf. *Rest., Restitution* §§7, 44 et seq. [distinction between mistake of law and fact recognized, but many exceptions to "general rule" enumerated].)

Few of the later California decisions support the "general rule," and in some cases relief would have been denied whether the mistake were classified as one of law or of fact. (See e.g., *Pixley v. First Fed. Savings & Loan Assn. of Santa Monica* (1952) 110 C.A.2d 427, 431, 243 P.2d 100 [failure to prove existence of alleged mistake]; *Bellwood Discount Corp. v. Empire Steel Bldg. Co.* (1959) 175 C.A.2d 432, 435, 346 P.2d 467 [mistake as to collateral matter].)

West's Key Number Digest, Contracts k.93(4)

SUPPLEMENT: [This section is current through the latest supplement]

See 2 California Affirmative Defenses §40:7 et seq.; 27A *Am.Jur.2d* (2008 ed.), *Equity* §13 et seq.



18 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

A. Mistake.

3. Mistake That Makes Contract Voidable.

b. Mistake of Law.

2. Relief Granted.

aa. Mutual Mistake.

1 Witkin Sum. Cal. Law Contracts § 273

[§ 273] Mutual Mistake.

Relief is proper and commonly given, where a mutual mistake relates to a *specific private right*; i.e., ignorance as to legal rights or obligations under a contract (mistake of law) is treated in much the same way as a mistake of fact. (See *Rued v. Cooper* (1897) 119 C. 463, 468, 51 P. 704; 7 Corbin (Rev. ed.), §28.53; 27 Williston 4th, §70:132; 27A *Am.Jur.2d* (1996 ed.), *Equity* §17.)

Examples where relief has been given are:

(1) A mistake as to which statute governed the right to redeem property sold under foreclosure (*Benson v. Bunting* (1900) 127 C. 532, 537, 59 P. 991).

(2) Mistake in interpretation of mortgage (*Gregory v. Clabrough's Executors* (1900) 129 C. 475, 478, 62 P. 72).

(3) Mistake as to legal effect of contract (*Stafford v. California Canning Peach Growers* (1938) 11 C.2d 212, 217, 78 P.2d 1150).

(4) A mistaken belief by husband and wife that a bank deposit merely permitted withdrawal of certain money after death, instead of creating a joint tenancy (*Spear v. Farwell* (1935) 5 C.A.2d 111, 113, 42 P.2d 391).

(5) A mistaken belief by an insured that his policy had lapsed, when in fact the company's agent had accepted his overdue premium payment (*Spiegelman v. Metropolitan Life Ins. Co.* (1937) 21 C.A.2d 299, 302, 68 P.2d 1006).

(6) A mistaken belief that federal O.P.A. regulations did not govern a lease for particular purposes (*Adams v. Heinsch* (1948) 89 C.A.2d 300, 302, 200 P.2d 796).

(7) A mistaken belief that taking title to plaintiff's property in the names of plaintiff and defendant as joint tenants was necessary and proper to protect defendant, who had signed plaintiff's note as an accommodation maker (*Brown v. Volz* (1949) 90 C.A.2d 793, 800, 204 P.2d 110). (Cf. *American Psychometric Consultants v. Work. Comp. App. Bd.*

(1995) 36 C.A.4th 1626, 43 C.R.2d 254, *infra*, §1022 [restitution denied for mutual mistake of law, where claims were uncontested and paid without protest].)

(8) Discovery of recently enacted statutory amendment destroying plaintiff's case. (*Harris v. Rudin, Richman & Appel* (2002) 95 C.A.4th 1332, 1337, 116 C.R.2d 552 [doctrine applies even if defendants were negligent in failing to discover amendment].)

SUPPLEMENT: [This section is current through the latest supplement]
See 27A Am.Jur.2d (2008 ed.), *Equity* §6.



19 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

A. Mistake.

3. Mistake That Makes Contract Voidable.

b. Mistake of Law.

2. Relief Granted.

bb. Unilateral Mistake.

1 Witkin Sum. Cal. Law Contracts § 274

[§ 274] Unilateral Mistake.

Relief for a unilateral mistake of law is authorized only where one party knows of, does not correct, and takes advantage or enjoys the benefit of another party's mistake. (C.C. 1578, *supra*, §272.) However, in the cases granting relief, the mistake of law of one party is generally found to have been induced, aided, or accompanied by a misrepresentation of another party.

Thus, in *Simmons v. Briggs* (1924) 69 C.A. 447, 231 P. 604, the court set aside a property settlement agreement and deed of trust executed by a wife. Although the husband was aware of his wife's misapprehension of the law relating to her property rights, "he not only failed to rectify the misapprehension, but, having himself created it by his own misconduct, he caused her to continue her erroneous belief by further wrongful conduct on his part." (69 C.A. 461.) (See *Carr v. Sacramento Clay Products Co.* (1917) 35 C.A. 439, 446, 170 P. 446 [employer misrepresented extent of its liability under Employer's Liability Act]; *Bowman v. Payne* (1921) 55 C.A. 789, 796, 204 P. 406 [plaintiff's misapprehension caused by defendant's misrepresentation of legal effect of instrument]; *Hill v. Garvey* (1922) 56 C.A. 98, 103, 205 P. 61 [defendant intentionally deceived plaintiffs by representing the existence of a law which he knew did not exist]; *Hedging Concepts v. First Alliance Mortg. Co.* (1996) 41 C.A.4th 1410, 1420, 49 C.R.2d 191, citing the text.)

An attorney's ignorance of the law may be a ground for rescission by his or her client, where counsel for the opposing party is aware of it and takes advantage of it. (*Estate of Peterson* (1968) 259 C.A.2d 492, 500, 66 C.R. 629, 14 Summary (10th), *Wills and Probate*, §724.)

West's Key Number Digest, Contracts k.93(1)

SUPPLEMENT: [This section is current through the latest supplement]
See 45 *San Diego L. Rev.* 79 [duty to disclose].



20 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

A. Mistake.

3. Mistake That Makes Contract Voidable.

b. Mistake of Law.

3. Mistaken Belief in Future Court Decision.

1 Witkin Sum. Cal. Law Contracts § 275

[§ 275] Mistaken Belief in Future Court Decision.

In *Guthrie v. Times-Mirror Co.* (1975) 51 C.A.3d 879, 124 C.R. 577, the complaint alleged that plaintiffs, shareholders of Sun Co., publisher of the San Bernardino Sun, sold their stock to defendant, the publisher of the Los Angeles Times, for \$ 15 million. Thereafter a federal district court judgment, affirmed by the United States Supreme Court, found that defendant's control of the Sun properties was in violation of section 7 of the Clayton Act, and defendant thus sold the Sun to Gannett Corp. for \$ 17.7 million, retaining for itself some Sun assets worth \$ 1.8 million. The complaint further alleged that all parties to the contract believed that the initial sale was not in violation of federal antitrust laws, and that this mistaken belief induced the execution of the contract. *Held*, judgment for defendant on demurrer affirmed; no cause of action was stated.

(a) There was no mistake concerning either the facts or the law; the parties were aware of the antitrust problem and had advice of counsel. But it cannot be held as a matter of law, on demurrer, that mistaken judgment as to the effect the courts would give a transaction is not a basis for rescission: "[U]nless we know the nature of the legal advice on which the parties relied and their state of mind at the time they contracted, we cannot infer solely from the facts alleged that the parties doubted the validity of the transaction and therefore assumed the risk that the contract might be found to be violative of the federal antitrust laws." (51 C.A.3d 886.)

(b) However, the complaint was fatally defective in failing to show that plaintiffs were harmed by the claimed mistake, i.e., that it materially affected an essential element of the contract. It did not affect the consideration paid or the performance; plaintiffs were not parties to the antitrust action and the federal court decree did not nullify their sale of the Sun to defendant. (51 C.A.3d 887.)

SUPPLEMENT: [This section is current through the latest supplement]



21 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

A. Mistake.

4. Mistake in Writing: Reformation.

a. In General.

1. Nature of Remedy.

1 Witkin Sum. Cal. Law Contracts § 276

[§ 276] Nature of Remedy.

Where the parties come to an agreement, but by mistake (or fraud) the written instrument does not *express* their agreement correctly, it may be *reformed* or revised on the application of the party aggrieved, provided that this can be done without prejudice to rights acquired by third persons in good faith and for value. (C.C. 3399, 3401; see generally *Stafford v. California Canning Peach Growers* (1938) 11 C.2d 212, 218, 78 P.2d 1150; *Hess v. Ford Motor Co.* (2002) 27 C.4th 516, 524, 117 C.R.2d 220, 41 P.3d 46 [where evidence established that release was intended only to apply to other driver and his insurer, and not to car manufacturer, words "all other persons, firms, etc." were deleted on reformation]; *Nunes v. De Faria* (1951) 107 C.A.2d 794, 797, 238 P.2d 106 [misrepresentation of law]; *Demetris v. Demetris* (1954) 125 C.A.2d 440, 443, 270 P.2d 891; *Lane v. Davis* (1959) 172 C.A.2d 302, 307, 342 P.2d 267; 5 Cal. Proc. (4th), Pleading, §762 et seq.; Rest.2d, Contracts §155; 7 Corbin (Rev. ed.), §§28.45, 28.47; 27 Williston 4th, §70:91 et seq.; 66 Am.Jur.2d (2001 ed.), Reformation of Instruments §1 et seq.; Cal. Civil Practice, 3 Business Litigation §28:1 et seq.)

The party *aggrieved* is not always a party to the *contract*. Thus, a grantee of a mortgagor may exercise his or her right of reformation of the note. (*Watson v. Collins* (1962) 204 C.A.2d 27, 32, 21 C.R. 832.) And a beneficiary on a life insurance policy can sue to reform a surrender agreement, despite the fact that the insured retained the right to change beneficiaries. (*Orcutt v. Ferranini* (1965) 237 C.A.2d 216, 226, 46 C.R. 715.) (See 5 Cal. Proc. (4th), Pleading, §765.)

After reforming the instrument, the court may, in the same action, grant full relief, including specific performance. (C.C. 3402; *Holmes v. Anderson* (1928) 90 C.A. 276, 284, 265 P. 1010; see 5 Cal. Proc. (4th), Pleading, §762.) And it may correct mistakes in a judgment or decree that results from it. (*Voge v. Rose* (1962) 205 C.A.2d 534, 538, 23 C.R. 87.)

Reformation to correct a mistake in reducing the *contract to writing* is clearly distinguishable from *rescission*, which is granted where the contract would not have been entered into at all save for the mistake or fraud. (See C.C. 1689; *Barfield v. Price* (1871) 40 C. 535, 542; *Lemoge Elec. v. San Mateo* (1956) 46 C.2d 659, 662, 297 P.2d 638, *infra*, §278; 67 Harv. L. Rev. 528; *infra*, §930; 4 Cal. Proc. (4th), Pleading, §§502, 504.)

A deed or other written instrument relating to title to real property, which contains a restriction as to race or color, "shall be deemed to be revised to omit that provision." (C.C. 782.5; 12 *Summary* (10th), *Real Property*, §201.)

SUPPLEMENT: [This section is current through the latest supplement]

Mistake as ground for reformation:

Cross-Reference: 5 *Cal. Proc.* (5th), *Pleading*, §806 et seq. *Party aggrieved:*

Cross-Reference: 5 *Cal. Proc.* (5th), *Pleading*, §809.

After reformation:

Cross-Reference: 5 *Cal. Proc.* (5th), *Pleading*, §806.

Reformation distinguishable from rescission:

Cross-Reference: 4 *Cal. Proc.* (5th), *Pleading*, §§541, 543.

C.C. 782.5 was amended in 2006 to prohibit discrimination on the same grounds as those listed in the Fair Employment and Housing Act.



22 of 199 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

A. Mistake.

4. Mistake in Writing: Reformation.

a. In General.

2. Waiver of Right.

1 *Witkin Sum. Cal. Law Contracts* § 277

[§ 277] Waiver of Right.

The right to reformation may be waived by failure to assert it at the proper time. Thus, in *Burnand v. Nowell* (1948) 84 C.A.2d 1, 189 P.2d 796, plaintiff contracted to buy a certain piece of land, the acreage of which was specified. After discovering a deficiency in the acreage, he nevertheless paid the entire balance of the price and accepted a deed without objection. *Held*, he was not thereafter entitled to reformation. (84 C.A.2d 3.)

The court in the *Burnand* case confused the holding somewhat by citing *C.C.P. 2076*, on waiver of formal defects in a tender by failure to object (see *infra*, §772). It would seem, however, that the correct explanation of the decision is that an *executed* contract cannot be reformed where the aggrieved party, with knowledge of the facts, accepted performance in accordance with the original agreement. (See *Vantrass Farms v. Sydenstricker* (1970) 11 C.A.3d 943, 950, 90 C.R. 251, citing the text.)

West's Key Number Digest, Contracts k.97(2)

SUPPLEMENT: [This section is current through the latest supplement]



23 of 199 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

A. Mistake.

4. Mistake in Writing: Reformation.

a. In General.

3. Court Cannot Make New Contract.

1 *Witkin Sum. Cal. Law Contracts* § 278

[§ 278] Court Cannot Make New Contract.

Even though the parties act under mistake, if the written agreement actually conforms to the oral understanding there is no basis for reformation. (*Bailard v. Marden* (1951) 36 C.2d 703, 709, 227 P.2d 10; *Lemoge Elec. v. San Mateo* (1956) 46 C.2d 659, 662, 297 P.2d 638; *H. Moffat Co. v. Rosasco* (1953) 119 C.A.2d 432, 441, 260 P.2d 126; *American Home Ins. Co. v. Travelers Indem. Co.* (1981) 122 C.A.3d 951, 963, 964, 175 C.R. 826 [attempt to substitute new parties to an insurance policy]; *Getty v. Getty* (1986) 187 C.A.3d 1159, 1178, 1179, 232 C.R. 603, citing the text [trust providing plaintiff with less income than his brothers, on mistaken belief he would receive inheritance from his grandfather, was not subject to reformation]; see *Rest.2d, Contracts* §155, Comment b; 7 Corbin (Rev. ed.), §§28.45, 28.47; 27 Williston 4th, §70:101; 66 *Am.Jur.2d* (2001 ed.), *Reformation of Instruments* §5; 5 *Cal. Proc.* (4th), *Pleading*, §774.)

This principle, and the significant distinction between the remedies of reformation and rescission (*supra*, §276), are strikingly illustrated by *Lemoge Elec. v. San Mateo*, *supra*. Plaintiff submitted a bid for electrical work to defendant county, which, by clerical error of plaintiff's clerk, was about \$ 11,000 too low. Within the 30-day period for defendant's acceptance, plaintiff notified defendant of the mistake, but defendant, with full knowledge and deliberate intention to bind plaintiff to his erroneous figure (far below that of the other bidders), accepted it. Plaintiff entered into the formal contract, did the work, and brought this action for *reformation* to correct the bid by adding the amount above stated. *Held*, though he could have rescinded (see *M.F. Kemper Const. Co. v. Los Angeles* (1951) 37 C.2d 696, 701, 235 P.2d 7, *supra*, §267), he was not entitled to reformation, for when the formal contract was made, neither party was under any misapprehension as to its terms, defendant never agreed to pay more than the specified contract sum, and therefore the contract did express the intention of the parties. (46 C.2d 663.)

The court also refused to grant reformation indirectly in the guise of quasi-contract recovery for services rendered under mistake. "Plaintiff had a remedy, which it chose not to exercise, that would have relieved it of any hardship that could result from its error. However, instead of rescinding, plaintiff, with full knowledge of its mistake, proceeded to perform the contract, and it cannot now compel defendant to pay the amount which it claims it intended to bid or obtain recovery on a quasi-contractual basis *as if no contract existed*. Such a result would not only be contrary to settled legal principles, but it would also create uncertainty and confusion in the field of competitive bidding." (46 C.2d 665.)

In *Bailard v. Marden*, *supra*, plaintiffs sold defendants a lot that was within a business area, although by its location and other characteristics all parties believed that it was residentially restricted. Later, when defendants discovered that it was not restricted, they decided to build a motel, and plaintiffs sued for reformation of the deed to add the restriction. *Held*, they were not entitled to relief. Although the evidence showed that both parties intended that the property be used for residential purposes, it did not establish that defendants intended to buy the property under a contract *prohibiting* any other use. Therefore reformation would not express their true intention but would *create a new contract*. (36 C.2d 709.)

In cases involving public contracts, reformation has been denied, although the governmental agency was willing to allow it. Thus, in *Paterson v. Board of Trustees of Montecito Union School Dist.* (1958) 157 C.A.2d 811, 321 P.2d 825, plaintiff contractor's mistake was suspected both by him and defendant school trustees, but was not discovered until after the contract was signed. Defendants advised plaintiff to proceed with performance and that they would see to it that he suffered no loss. The trial judge found that defendants were estopped to refuse payment of the additional sum mistakenly omitted, and granted reformation. *Held*, reversed; there was no agreement to pay any amount other than the bid price, nor had either party any other price in mind at the time of signing. Hence, the *Lemoge* case was controlling, and to apply the doctrine of estoppel and compel a modification would be to sanction an act beyond the statutory powers of the governmental agency. (157 C.A.2d 815.)

SUPPLEMENT: [This section is current through the latest supplement]

No basis for reformation:

Cross-Reference: 5 Cal. Proc. (5th), Pleading, §818.



24 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

A. Mistake.

4. Mistake in Writing: Reformation.

b. Instruments That May Be Reformed.

1. In General.

1 Witkin Sum. Cal. Law Contracts § 279

[§ 279] In General.

The topical heading of the reformation article in the Civil Code is "Revision of Contracts," and the basic sections, C.C. 3399, 3400 and 3402, refer only to a written "contract." The remaining section, C.C. 3401, refers to a written "instrument."

Little attention has been paid to this language by the cases, which proceed on the assumption that the statute codifies the equitable action for reformation. Accordingly, the action will lie to reform a contract, executory or executed, or a deed. (See *Robertson v. Melville* (1923) 60 C.A. 354, 356, 212 P. 723 [deed]; *Douglass v. Dahm* (1950) 101 C.A.2d 125, 128, 224 P.2d 914 [deed given pursuant to judgment for specific performance]; *Renshaw v. Happy Valley Water Co.* (1952) 114 C.A.2d 521, 524, 250 P.2d 612 [reformation of decree and deed in partition suit where reservations and restrictions were mistakenly omitted]; *Berendsen v. McIver* (1954) 126 C.A.2d 347, 351, 272 P.2d 76 [deed]; *Vecki v. Sorensen* (1954) 127 C.A.2d 407, 413, 273 P.2d 908; *Stare v. Tate* (1971) 21 C.A.3d 432, 436, 98 C.R. 264 [property settlement agreement after divorce granted]; *Ike v. Doolittle* (1998) 61 C.A.4th 51, 85, 70 C.R.2d 887 [C.C. 3399 permits reformation of trust agreement based on mistake]; 66 *Am.Jur.2d* (2001 ed.), *Reformation of Instruments* §28 et seq.; 32 *A.L.R.3d* 661 [insurance policy]; 5 *Cal. Proc.* (4th), *Pleading*, §763.)

West's Key Number Digest, Contracts k.97(2)

SUPPLEMENT: [This section is current through the latest supplement]
Action to reform deed or contract:

Cross-Reference: 5 *Cal. Proc.* (5th), *Pleading*, §807.



25 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT
A. Mistake.

- 4. Mistake in Writing: Reformation.
- b. Instruments That May Be Reformed.
- 2. Void or Unenforceable Contract.

1 Witkin Sum. Cal. Law Contracts § 280

[§ 280] Void or Unenforceable Contract.

(1) *Illegality*. A contract wholly void for *illegality* cannot be reformed; the theory is that equity cannot make a new contract for the parties. (*Ainsworth v. Morrill* (1916) 31 C.A. 509, 511, 160 P. 1089; *McClure v. Cerati* (1948) 86 C.A.2d 74, 85, 194 P.2d 46 [plaintiff, for no apparent reason, alleged that written contract was "illegal, void, false and erroneous"]; *Kolani v. Gluska* (1998) 64 C.A.4th 402, 407, 75 C.R.2d 257, citing the text; 66 Am.Jur.2d (2001 ed.), *Reformation of Instruments* §29.) But an otherwise valid contract may be reformed by striking out an illegal term inserted by mistake. (See *Strauss v. Bruce* (1934) 139 C.A. 62, 66, 33 P.2d 71, *infra*, §448 [usurious interest].)

(2) *Statute of Frauds*. A contract or deed that is merely unenforceable because of the statute of frauds may be reformed by supplying omitted terms so as to make the reformed writing a sufficient memorandum. (See *Oatman v. Niemeyer* (1929) 207 C. 424, 426, 278 P. 1043 [deed lacking in description of property]; *Calhoun v. Downs* (1931) 211 C. 766, 768, 297 P. 548; *Rest.2d, Contracts* §156; 4 Corbin (Rev. ed.), §15.10 et seq.; 27 Williston 4th, §70:43 et seq.; 66 Am.Jur.2d (2001 ed.), *Reformation of Instruments* §38 et seq.; *infra*, §355.)

(3) *Lack of Consideration*. A contract or conveyance made without consideration will not be reformed *on behalf of the donee* against the donor or grantor. (*Enos v. Stewart* (1902) 138 C. 112, 114, 70 P. 1005; see 27 Williston 4th, §70:33; 66 Am.Jur.2d (2001 ed.), *Reformation of Instruments* §42 et seq.; 43 Harv. L. Rev. 968; 5 Cal. Proc. (4th), *Pleading*, §763; cf. *Robertson v. Melville* (1923) 60 C.A. 354, 356, 212 P. 723 [consideration sufficiently alleged].)

In the *Enos* case, *supra*, the majority rule was applied to deny reformation against the grantor's *heirs*. However, other courts refuse to follow an inflexible rule as to the grantor's successors, and allow reformation where the equities favor the donee, and the heir or other successor of the donor would merely acquire a windfall by the mistake. (See *Reina v. Erassarret* (1951) 103 C.A.2d 258, 265, 229 P.2d 92 [interpreting *Enos* case as consistent with this view]; 43 Harv. L. Rev. 968; 25 So. Cal. L. Rev. 212.)

There is, of course, no objection to reformation at the instance of the *donor* or the donor's successors where, by mistake, a larger estate than intended has been granted. (*Tyler v. Larson* (1951) 106 C.A.2d 317, 319, 235 P.2d 39 [joint tenancy deed revised to make it tenancy in common]; see 27 Williston 4th, §70:33.)

SUPPLEMENT: [This section is current through the latest supplement]
(3) *Lack of Consideration*.

Cross-Reference: 5 *Cal. Proc.* (5th), *Pleading*, §807.



26 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

A. Mistake.

4. Mistake in Writing: Reformation.

c. Types of Mistake.

1 *Witkin Sum. Cal. Law Contracts* § 281

[§ 281] Types of Mistake.

(1) *Mutual or Unilateral Mistake*. C.C. 3399 permits reformation for mutual mistake or for unilateral mistake that the other party knew or suspected. (See *Carman v. Athearn* (1947) 77 C.A.2d 585, 594, 175 P.2d 926 [defendant, with legal advice, drew instrument, representing to plaintiff that it expressed their oral agreement]; *Baines v. Zuieback* (1948) 84 C.A.2d 483, 489, 191 P.2d 67 [mistake known to other party]; *Demetris v. Demetris* (1954) 125 C.A.2d 440, 443, 270 P.2d 891 [father and son agreed to purchase home as tenants in common; son, acting in confidential relation to father, obtained joint tenancy deed]; *Stare v. Tate* (1971) 21 C.A.3d 432, 438, 98 C.R. 264 [unilateral mistake known to other party]; cf. *Perry v. Bedford* (1965) 238 C.A.2d 6, 11, 47 C.R. 461 [no reformation for unilateral mistake not known by other party]; *La Mancha Dev. Corp. v. Sheegog* (1978) 78 C.A.3d 9, 16, 144 C.R. 59 [constructive notice of unilateral mistake insufficient basis for reformation]; 65 Proof of Facts 3d 217 [reformation of deed for grantor's mistake as to amount or nature of interest conveyed].)

It has been said, however, that where the mistake is clear, the court will not strictly insist that it be mutual or that there be knowledge or suspicion by the other party. (*Merkle v. Merkle* (1927) 85 C.A. 87, 105, 258 P. 969; *Carpenter v. Froloff* (1939) 30 C.A.2d 400, 408, 86 P.2d 691; *Tyler v. Larson* (1951) 106 C.A.2d 317, 320, 235 P.2d 39 [administrator of grantor allowed to reform gift deed, where grantor alone mistaken and no finding that defendant knew or suspected]; *Jones v. First Amer. Title Ins. Co.* (2003) 107 C.A.4th 381, 388, 131 C.R.2d 859 [citing *Merkle v. Merkle, supra*; in real estate foreclosure sale, defective substitution of trustee should have been reformed to carry out intent of parties that bank be able to foreclose if borrowers did not perform at time of foreclosure; all parties believed that documents were sufficient to carry out that intent].)

(2) *Mistake of Law*. Relief may also be granted for a mistake of law as to the legal effect of a contract. (*Stafford v. California Canning Peach Growers* (1938) 11 C.2d 212, 217, 78 P.2d 1150; see *Nunes v. De Faria* (1951) 107 C.A.2d 794, 797, 238 P.2d 106 [misrepresentation of law].)

(3) *Mistake of Third Person*. Reformation may be appropriate where the mistake is that of a third person acting for both parties. (See *Mills v. Schulba* (1950) 95 C.A.2d 559, 561, 213 P.2d 408 [jointly employed attorney prepared deed and by mistake omitted description of one lot]; *Martinelli v. Gabriel* (1951) 103 C.A.2d 818, 823, 230 P.2d 444 [surveyor mistakenly ran wrong boundary line]; *Borsook v. Continental Cas. Co.* (1951) 107 C.A.2d 21, 23, 236 P.2d

383 [bonding company gave contractor's completion bond referring to date of unexecuted illustrative form instead of to date of actual contract].)

(4) *Mistake as to Future Fact.* In *F.P. Cutting Co. v. Peterson* (1912) 164 C. 44, 127 P. 163, plaintiff canning company agreed to sell canned tomatoes to defendant, a wholesale grocer, the contract providing that the specified price was "guaranteed against" (i.e., to be governed by) the "opening printed prices for the season of 1908" of the canneries association. The association had for years determined the *market price* by publishing this price list. In 1908, it did not publish any list, but the market price was lower than the contract price. *Held*, the intention of the parties was to guarantee against defendant paying more than the market price, and the contract should be reformed to that effect. (164 C. 47.) (See 1 Cal. L. Rev. 180.)

SUPPLEMENT: [This section is current through the latest supplement]



27 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

A. Mistake.

4. Mistake in Writing: Reformation.

d. Effect of Plaintiff's Negligence.

1 Witkin Sum. Cal. Law Contracts § 282

[§ 282] Effect of Plaintiff's Negligence.

In actions for reformation, the defendant often urges, as a defense, the plaintiff's failure to read the contract. But, as pointed out in the rescission cases (*supra*, §270), negligence of the injured party does not preclude relief, unless it is so gross as to amount to "neglect of a legal duty" (see C.C. 1577). (*Los Angeles & Redondo R. Co. v. New Liverpool Salt Co.* (1906) 150 C. 21, 27, 87 P. 1029; *Mills v. Schulba* (1950) 95 C.A.2d 559, 564, 213 P.2d 408; *Voge v. Rose* (1962) 205 C.A.2d 534, 539, 23 C.R. 87; see *Rest.2d, Contracts* §157 [party's fault in failing to know or discover facts not a bar unless it amounts to failure to act in good faith and in accordance with reasonable standards of fair dealing]; 7 Corbin (Rev. ed.), §28.37; 27 Williston 4th, §§70:48, 70:49; 27A *Am.Jur.2d* (1996 ed.), *Equity* §13; 66 *Am.Jur.2d* (2001 ed.), *Reformation of Instruments* §76 et seq.)

Even failure to read the agreement may be excused where the plaintiff relies on misrepresentations of the other party. (*Nelson v. Meadville* (1937) 19 C.A.2d 68, 69, 64 P.2d 1116; see *National Auto. & Cas. Ins. Co. v. Industrial Acc. Com.* (1949) 34 C.2d 20, 26, 206 P.2d 841 [failure to read insurance policy did not preclude reformation where insured relied on insurer's agent to furnish requested coverage]; *Baines v. Zuieback* (1948) 84 C.A.2d 483, 491, 191 P.2d 67 [failure of lessor to read lease held not to preclude reformation]; *infra*, §301.)

In *Carman v. Athearn* (1947) 77 C.A.2d 585, 175 P.2d 926, plaintiff sought to reform a property settlement agreement for mistake as to its legal effect. Defendant objected that an agreement clear on its face cannot be reformed. The court said: "This is merely another way of urging that plaintiff should have known what he was signing when he signed the document. Such a contention loses sight of the main purpose of reformation which is to make a contract which, through mistake or fraud, fails to express the true intent of the parties, express such intent. Ambiguity has nothing to do with the question as to the right to grant reformation, although it may have on the issue of laches." (77 C.A.2d 596.)

On the other hand, in *McClure v. Cerati* (1948) 86 C.A.2d 74, 194 P.2d 46, the complaint alleged an oral agreement in substantial conflict with the written one, but failed to allege how the asserted mistake occurred, and showed that both parties had prepared the written agreement and acted under its terms for nearly a year. Reformation was denied, the court suggesting that plaintiff affirmatively disclosed his own "gross negligence." (86 C.A.2d 84.)

West's Key Number Digest, Contracts k.97(2)

SUPPLEMENT: [This section is current through the latest supplement]
See *27A Am.Jur.2d* (2008 ed.), *Equity* §12.



28 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT
A. Mistake.

4. Mistake in Writing: Reformation.
e. Intervening Rights of Third Persons.

1 Witkin Sum. Cal. Law Contracts § 283

[§ 283] Intervening Rights of Third Persons.

A written agreement will not be reformed or revised to the injury of third persons who acquired rights "in good faith and for value." (C.C. 3399; see *Rest.2d, Contracts* §155, and Comment f; 7 Corbin (Rev. ed.), §28.45; 27 Williston 4th, §70:45 et seq.; 66 *Am.Jur.2d* (2001 ed.), *Reformation of Instruments* §61 et seq.; 79 *A.L.R.2d* 1180 [right to reformation as affected by intervening rights of third persons].) The "rights acquired by third persons" referred to are "rights acquired by a bona fide purchaser for value from one of the parties to the instrument sought to be reformed after the execution of the instrument." (*Baines v. Zuieback* (1948) 84 C.A.2d 483, 491, 191 P.2d 67.)

A third person is not a bona fide purchaser if he or she acquired the rights "with notice, actual or constructive, of the rights of other persons whose interests have been described defectively in written instruments." (*Shupe v. Nelson* (1967) 254 C.A.2d 693, 698, 62 C.R. 352; see *Dabney-Johnston Oil Corp. v. Walden* (1935) 4 C.2d 637, 646, 52 P.2d 237; *Mountain Club v. Pinney* (1924) 67 C.A. 225, 234, 227 P. 630; *Sieger v. Standard Oil Co.* (1957) 155 C.A.2d 649, 656, 318 P.2d 479; *Wallace v. Williams* (1958) 156 C.A.2d 646, 650, 320 P.2d 211; *Saxon v. Dubois* (1962) 209 C.A.2d 713, 718, 26 C.R. 196.) (On the elements of bona fide purchase, see 12 *Summary* (10th), *Real Property*, §328 et seq., 13 *Summary* (10th), *Trusts*, §251 et seq.)

Where a right of reformation exists against a corporation, and the corporation merges with another, the surviving corporation is not a third person. Under *Corp.C. 1107* (surviving corporation is subject to all debts and liabilities of each of the constituent corporations; see 9 *Summary* (10th), *Corporations*, §198), the surviving corporation is deemed to have the extinct corporation's understanding of the latter's contractual rights and duties, and the other contractual party is entitled to reformation against it. (*Treadaway v. Camellia Convalescent Hosp.* (1974) 43 C.A.3d 189, 194, 199, 118 C.R. 341.)

SUPPLEMENT: [This section is current through the latest supplement]



29 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT
A. Mistake.

5. Exculpatory Clause Protecting Defendant.

1 Witkin Sum. Cal. Law Contracts § 284

[§ 284] Exculpatory Clause Protecting Defendant.

In cases involving formal contracts negotiated by agents, such as insurance policies, protective clauses are usually added that seek to preclude waiver of terms by, or imputed notice from, the defendant's agent (see *infra*, §305). This defense is, ordinarily, unsuccessful.

In *National Auto. & Cas. Ins. Co. v. Industrial Acc. Com.* (1949) 34 C.2d 20, 206 P.2d 841, 2 Summary (10th), Insurance, §§216, 217, the court rejected a defense based on such a clause. The opinion points out that these limitations are not discoverable until after delivery of the policy, and consequently cannot apply to transactions involving the application for and procurement of the policy. (34 C.2d 26.) (See *Eagle Indem. Co. v. Industrial Acc. Com.* (1949) 92 C.A.2d 222, 226, 206 P.2d 877 [similar clause; knowledge of general agent of insurer is imputable to insured, whose failure to read policy is thus excusable]; and see generally 14 Williston 4th, §§41:13, 41:16, 41:30 et seq.; 44A Am.Jur.2d (2003 ed.), Insurance §1573 et seq.)

SUPPLEMENT: [This section is current through the latest supplement]



30 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT
B. Fraud.
1. In General.

1 Witkin Sum. Cal. Law Contracts § 285

[§ 285] In General.

"Fraud is either actual or constructive." (C.C. 1571; see *infra*, §§286 et seq., 294 et seq.)

It may render the contract *void*, or may be ground for *rescission or reformation*. (See C.C. 1566, 1689, 3399; *California Trust Co. v. Cohn* (1932) 214 C. 619, 626, 7 P.2d 297; *Seeger v. Odell* (1941) 18 C.2d 409, 414, 115 P.2d 977; *Wolfe v. Morgan* (1928) 95 C.A. 656, 658, 273 P. 64; *Osborne v. Cal-Am Financial Corp.* (1978) 80 C.A.3d 259, 266, 145 C.R. 584; 26 Williston 4th, §69:1 et seq.; 17A Am.Jur.2d (2004 ed.), *Contracts* §214 et seq.; 37 Am.Jur.2d (2001 ed.), *Fraud and Deceit* §1 et seq.; C.E.B., 1 Real Property Remedies and Damages 2d, §3.1 et seq.; Cal. Transactions Forms, 1 Business Transactions §6:23; BAJI, No. 12.30 et seq. [civil jury instructions on fraud or deceit]; CACI, No. 335 [Affirmative Defense--Fraud], CACI, No. 1900 et seq. [civil jury instructions on fraud or deceit]; 4 Cal. Proc. (4th), *Pleading*, §§505, 506; 5 Cal. Proc. (4th), *Pleading*, §§667 et seq., 768.) (On reformation, see *supra*, §§276 et seq. and *infra*, §404 et seq.)

Fraud also gives rise to the remedy of an action for damages for deceit. (See *DeCampos v. State Comp. Ins. Fund* (1954) 122 C.A.2d 519, 525, 265 P.2d 617; 5 *Summary* (10th), *Torts*, §767 et seq.) (On the election of contract or tort remedies, see 3 Cal. Proc. (4th), *Actions*, §§148 et seq., 152.)

Negligent misrepresentation (see *infra*, §288, 5 *Summary* (10th), *Torts*, §818 et seq.) and innocent misrepresentation (*infra*, §307) are related but distinguishable concepts.

West's Key Number Digest, Contracts k.94(1)

SUPPLEMENT: [This section is current through the latest supplement]
See C.E.B., Law of Contracts §3.11 et seq.

Fraud may render contract void:

Cross-References: 4 Cal. Proc. (5th), *Pleading*, §§544, 545; 5 Cal. Proc. (5th), *Pleading*, §§709 et seq., 812. *Fraud gives rise to remedy of damages:*

Cross-Reference: 3 Cal. Proc. (5th), *Actions*, §152 et seq.



31 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

B. Fraud.

2. Actual Fraud.

a. Elements: Traditional Listing.

1 Witkin Sum. Cal. Law Contracts § 286

[§ 286] Elements: Traditional Listing.

The elements of actual fraud, whether as the basis of the remedy in contract or tort, have been stated as follows: There must be (1) a *false representation* or concealment of a material fact (or, in some cases, an opinion) susceptible of knowledge, (2) made with *knowledge* of its falsity or without sufficient knowledge on the subject to warrant a representation, (3) with the *intent* to induce the person to whom it is made to act upon it; and this person must (4) act in *reliance* upon the representation (5) to his or her *damage*. (See *Harding v. Robinson* (1917) 175 C. 534, 538, 166 P. 808; *Wolfe v. Severns* (1930) 109 C.A. 476, 485, 293 P. 156; 26 Williston 4th, §69:1 et seq.; 37 *Am.Jur.2d* (2001 ed.), *Fraud and Deceit* §20; 5 *Summary* (10th), *Torts*, §772 et seq.; 5 *Cal. Proc.* (4th), *Pleading*, §668.) (For the Restatement analysis and classification, see *Rest.2d, Contracts* §159 et seq., and Introductory Notes, pp. 423, 424.)

The acts constituting actual fraud may be misrepresentation (infra, §287 et seq.), concealment (infra, §§291, 292), false promise (infra, §293), or "[a]ny other act fitted to deceive." (C.C. 1572(5).)

The purpose of the catch-all statement on "any other act" (C.C. 1572(5)) is suggested in *Wells v. Zenz* (1927) 83 C.A. 137, 256 P. 484: "Fraud is a generic term which embraces all the multifarious means which human ingenuity can devise and are resorted to by one individual to get an advantage over another. No definite and invariable rule can be laid down as a general proposition defining fraud, and it includes all surprise, trick, cunning, dissembling, and unfair way by which another is deceived. The statutes of California expressly provide that ... any other act fitted to deceive is actual fraud." (83 C.A.2d 140.)

"Actual fraud is always a question of fact." (C.C. 1574.)

SUPPLEMENT: [This section is current through the latest supplement]
Cross-Reference: 5 *Cal. Proc.* (5th), *Pleading*, §710.



32 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

B. Fraud.

2. Actual Fraud.

b. Acts Constituting Actual Fraud.

1. Misrepresentation.

aa. Intentional Misrepresentation.

1 Witkin Sum. Cal. Law Contracts § 287

[§ 287] Intentional Misrepresentation.

"The suggestion, as a fact, of that which is not true, by one who does not believe it to be true," is "actual fraud." (C.C. 1572(1).) (See *Rest.2d, Contracts §159* ["an assertion that is not in accord with the facts"]; 26 Williston 4th, §69:1 et seq.; 37 *Am.Jur.2d* (2001 ed.), *Fraud and Deceit* §§56 et seq., 104 et seq.; 21 Proof of Facts 3d 455 [immaterial misrepresentation in applying for property insurance]; 38 Proof of Facts 3d 329 [material misrepresentation as to value of insured property]; 67 *So. Cal. L. Rev.* 659 [Insurers' Misrepresentation Defense: The Need for a Knowledge Element]; 71 *A.L.R.2d* 126 [release of personal injury claim, intentional misrepresentation as to injuries]; 16 *A.L.R.3d* 783 [fire insurance, overvaluation of loss of property insured]; 26 *A.L.R.3d* 1061 [insured's false representation of good health or good-faith belief in it]; 27 *A.L.R.3d* 849 [liability insurance, misstatement of name or marital status]; 66 *A.L.R.3d* 749 [materiality of misrepresentation by insurance applicant as to previous cancellations or rejections]; BAJI, No. 12.31 [Fraud and Deceit--Intentional Misrepresentation], BAJI, No. 12.32 [Fraud and Deceit--Expression of Opinion]; CACI, No. 1900 [Intentional Misrepresentation], CACI, No. 1904 [Opinions as Statements of Fact]; 5 *Cal. Proc.* (4th), *Pleading*, §§674 et seq., 679 et seq.)

Although C.C. 1572 speaks of suggestion "as a fact," the aforementioned Restatement section (159) refers to an "assertion"; and Comment d observes that "A person's state of mind is a fact, and an assertion as to one's opinion or intention, including an intention to perform a promise, is a misrepresentation if the state of mind is other than as asserted." (See *Rest.2d, Contracts §168*, Comment a; on false promise, see *infra*, §293.)

There can be no misrepresentation unless there is a *representation*, and sometimes a question arises whether the defendant actually made or adopted a statement upon which the plaintiff claims reliance. In *Mercer Cas. Co. v. Lewis* (1940) 41 *C.A.2d* 918, 108 *P.2d* 65, a broker prepared a liability policy containing certain warranties by the insured, and plaintiff insurance company issued it to defendant insured. Later, the company sought to cancel for breach of warranty. *Held*, despite his acceptance of the policy, the insured did not become bound by the warranties, which were made not by him but by the company's agent. (41 *C.A.2d* 921.) (On collection by beneficiary on insurance policy after agent places false answer in application, see 35 *So. Cal. L. Rev.* 506.)

SUPPLEMENT: [This section is current through the latest supplement]

Cross-Reference: 5 *Cal. Proc.* (5th), *Pleading*, §§718 seq., 723 et seq.



33 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

B. Fraud.

2. Actual Fraud.

b. Acts Constituting Actual Fraud.

1. Misrepresentation.

bb. Negligent Misrepresentation.

1 Witkin Sum. Cal. Law Contracts § 288

[§ 288] Negligent Misrepresentation.

"The positive assertion, in a manner not warranted by the information of the person making it, of that which is not true, though he believes it to be true," is actual fraud. (C.C. 1572(2).) (See *Rest.2d, Contracts* §159, Comments a, b; 26 Williston 4th, §69:28; 37 *Am.Jur.2d* (2001 ed.), *Fraud and Deceit* §128 et seq.; 5 *Summary* (10th), *Torts*, §781 et seq.; 5 *Cal. Proc.* (4th), *Pleading*, §683.)

West's Key Number Digest, Contracts k.94(1)

SUPPLEMENT: [This section is current through the latest supplement]

Cross-Reference: 5 *Cal. Proc.* (5th), *Pleading*, §727.



34 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

B. Fraud.

2. Actual Fraud.

b. Acts Constituting Actual Fraud.

1. Misrepresentation.

cc. Misrepresentation of Law.

1 Witkin Sum. Cal. Law Contracts § 289

[§ 289] Misrepresentation of Law.

It has occasionally been said that, because the representation must be one of fact, a misstatement of the law does not amount to actionable fraud. But the modern tendency, in actions for rescission, is to enlarge the exceptions to this rule so that any reasonable reliance upon a misrepresentation of law may be grounds for relief.

Thus, (1) where one party uses superior knowledge to gain an unconscionable advantage, or (2) where the parties occupy some sort of confidential relationship, even though the guilty party is not a strict fiduciary, rescission is permitted. (See *Bank of America v. Sanchez* (1934) 3 C.A.2d 238, 242, 38 P.2d 787 [escrow officer of bank advised wife of debtor that, although separated from her husband, her signature was necessary on a note and deed of trust and that she would not be personally liable]; *Nunes v. De Faria* (1951) 107 C.A.2d 794, 797, 238 P.2d 106 [representation that joint tenancy deed would not interfere with possession or right to sell property]; 26 Williston 4th, §69:10 et seq.; 37 *Am.Jur.2d* (2001 ed.), *Fraud and Deceit* §97 et seq.; 30 *Cal. L. Rev* 197; 5 *Summary* (10th), *Torts*, §779.)

The Restatement declares that "[i]f an assertion is one as to a matter of law, the same rules that apply in the case of other assertions determine whether the recipient is justified in relying on it." (*Rest.2d, Contracts* §170, based in part on *Rest.2d, Torts* §545 and *Rest., Restitution* §55.) Comment a points out that an assertion that a statute has been enacted or repealed, or that a particular decision has been rendered, is an assertion of fact; and Comment b notes that a statement as to what a court would determine is one of opinion, on which the recipient may rely if the declarant purports to have special expertise.

SUPPLEMENT: [This section is current through the latest supplement]



35 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

B. Fraud.

2. Actual Fraud.

b. Acts Constituting Actual Fraud.

1. Misrepresentation.

dd. Fraudulent Representation.

1 Witkin Sum. Cal. Law Contracts § 290

[§ 290] Fraudulent Representation.

The representation must be made "with intent to deceive" another party to the contract. (C.C. 1572; see 5 *Summary* (10th), *Torts*, §779.)

The Restatement sets forth three ways in which this requirement of "scienter" may be satisfied: (1) The maker knows or believes that the assertion is untrue; (2) the maker does not have the confidence that he or she states or implies in its truth; (3) the maker knows that he or she does not have the basis stated or implied for the assertion. (*Rest.2d, Contracts §162(1)*, and Comment b.)

SUPPLEMENT: [This section is current through the latest supplement]



36 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

B. Fraud.

2. Actual Fraud.

b. Acts Constituting Actual Fraud.

2. Concealment.

aa. In General.

1 Witkin Sum. Cal. Law Contracts § 291

[§ 291] In General.

"The suppression of that which is true, by one having knowledge or belief of the fact" is actual fraud. (C.C. 1572(3).) (See *Williamson & Vollmer Engineering v. Sequoia Ins. Co. (1976)* 64 C.A.3d 261, 273, 134 C.R. 427 [professional liability policy; material fraud in failing to disclose claim when application for policy made]; *Rest.2d, Contracts §160* ["Action intended or known to be likely to prevent another from learning a fact is equivalent to an assertion that the fact does not exist"]; 26 Williston 4th, §69:16 et seq.; 37 *Am.Jur.2d (2001 ed.)*, *Fraud and Deceit* §200 et seq.; 63 Proof of Facts 3d 257 [real estate seller's claim for relief for fraudulent concealment of identity of true purchaser]; 45 *U.C.L.A. L. Rev.* 337 [Moral Complexity in the Law of Nondisclosure]; 14 *A.L.R.3d* 931 [misstatement of marital status or relationship to beneficiary of life insurance]; 72 *A.L.R.3d* 804 [nondisclosure or concealment of physical defects or conditions as avoiding coverage of automobile insurance policy]; 4 *A.L.R.5th* 117 [failure to disclose prior fire on insured property as ground for avoidance of policy]; 15 *A.L.R.5th* 92 [rescission or cancellation of insurance policy for insured's misrepresentation or concealment of information concerning HIV, AIDS, or related health problems]; 15 *A.L.R.4th* 1109 [nondisclosure of information regarding value of property as ground for avoiding liability under property insurance policy]; BAJI, No. 12.35 et seq. [concealment as fraud and deceit]; CACI, No. 1901[Concealment]; 5 *Summary* (10th), *Torts*, §779; 5 *Cal. Proc. (4th)*, *Pleading*, §678.)

The Restatement (§160, *supra*) points out that concealment is an affirmative act, equivalent to a misrepresentation (Comment a); and that it usually consists either in actively hiding something from the other party, or preventing him or her from making an investigation that would have disclosed the true facts (Comment b).

The Restatement (§161) distinguishes *nondisclosure* without concealment: A party is not expected to tell the other party all that he or she knows, and a failure to disclose is equivalent to misrepresentation only in special situations: (1) Where the party knows that disclosure is necessary to prevent some previous assertion from being a misrepresentation; (2) Where the party knows that disclosure would correct a mistake of the other party as to a basic assumption on which that party is making the contract; (3) Where the party knows that disclosure would correct a mistake of the other party as to the contents or effect of a writing evidencing or embodying an agreement; (4) Where there is a relation of trust and confidence between the parties (see *infra*, §295). (See 26 Williston 4th, §69:16 et seq.; 37 *Am.Jur.2d (2001 ed.)*, *Fraud*

and Deceit §203 et seq.; 5 Summary (10th), Torts, §779; 5 Cal. Proc. (4th), Pleading, §678.)

West's Key Number Digest, Contracts k.94(1)

SUPPLEMENT: [This section is current through the latest supplement]

Suppression of that which is true:

Cross-Reference: 5 Cal. Proc. (5th), Pleading, §722.

Restatement distinguishes nondisclosure:

Cross-Reference: 5 Cal. Proc. (5th), Pleading, §722



37 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

B. Fraud.

2. Actual Fraud.

b. Acts Constituting Actual Fraud.

2. Concealment.

bb. Relative Bids.

1 Witkin Sum. Cal. Law Contracts § 292

[§ 292] Relative Bids.

Carver v. Teitsworth (1991) 1 C.A.4th 845, 2 C.R.2d 446, involved a procedure whereby the sales price of property offered for sale by Teitsworth was to be determined by sealed bids at a price not less than \$ 795,000. Of the three bids received, two listed specific amounts, while the third, submitted by Carver, promised to pay \$ 1,000 higher than any other bid. *Held*, relative bids--known as "sharp bids"--constitute a fraudulent practice unless they are either expressly solicited or objectively reasonable as being customary in a particular trade or industry.

(a) If relative bidding is concealed, it defrauds the sum-certain bidders by inducing them to submit bids that are necessarily ineffective and that guarantee the relative bidder's supremacy. However, if the practice is known to be allowed, the fraud by concealment disappears and the question becomes one of business practicality, not fraud. In other words, unconcealed relative bidding would either be abandoned as unworkable or sellers and bidders would adopt protective ground rules to make it workable. (*1 C.A.4th 854*, citing, and adopting the position of, a Minnesota decision.)

(b) Here, there was evidence that Teitsworth's broker had no idea what to do when he opened Carver's bid, thereby indicating that Teitsworth and the sum-certain bidders neither requested nor contemplated the submission of relative bids. However, the record is silent on the separate question of whether the parties reasonably should have anticipated these bids. The answer to this question may depend in large measure on expert evidence of custom and practice in the real estate industry. (*1 C.A.4th 855*.)

SUPPLEMENT: [This section is current through the latest supplement]



38 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witkin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

B. Fraud.

2. Actual Fraud.

b. Acts Constituting Actual Fraud.

3. False Promise.

1 Witkin Sum. Cal. Law Contracts § 293

[§ 293] False Promise.

"A promise made without any intention of performing it" is actual fraud. (C.C. 1572(4).) (See *Rest.2d, Contracts* §159, Comment d, §171; 26 Williston 4th, §69:11; 37 *Am.Jur.2d* (2001 ed.), *Fraud and Deceit*, §90 et seq.; BAJI, No. 12.40 [Fraud and Deceit--False Promise], BAJI 12.41 [Fraud and Deceit--Proof of Intent Not To Perform]; CACI, No. 1902 [False Promise]; 5 *Summary* (10th), *Torts*, §779; 5 *Cal. Proc.* (4th), *Pleading*, §677.)

The Restatement points out that not all statements of intention are to be taken seriously, and that the recipient's reliance must be reasonable; but the recipient may properly interpret a promise as an assertion that the promisor intends to perform it, and if the intent not to perform can be proved, the implied assertion is a misrepresentation. (*Rest.2d, Contracts* §171(2), and Comments a, b.) (On proof of intent, see 5 *Summary* (10th), *Torts*, §802 et seq.)

SUPPLEMENT: [This section is current through the latest supplement]

Cross-Reference: 5 *Cal. Proc.* (5th), *Pleading*, §721.



39 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

B. Fraud.

3. Constructive Fraud.

a. In General.

1 Witkin Sum. Cal. Law Contracts § 294

[§ 294] In General.

Constructive fraud consists of (1) "any *breach of duty* which, *without an actually fraudulent intent, gains an advantage* to the person in fault, or anyone claiming under him, by misleading another to his prejudice, or to the prejudice of anyone claiming under him"; (2) "any such *act or omission as the law specially declares to be fraudulent*, without respect to actual fraud." (C.C. 1573.)

As the court said in *Estate of Arbuckle* (1950) 98 C.A.2d 562, 220 P.2d 950, a lost will case: "Fraud assumes so many shapes that courts and authors have ever been cautious in attempting to define it. ... In its generic sense, constructive fraud comprises all acts, omissions and concealments involving a breach of legal or equitable duty, trust, or confidence, and resulting in damage to another. ... Constructive fraud exists in cases in which conduct, although not actually fraudulent, ought to be so treated--that is, in which such conduct is a constructive or quasi fraud, having all the actual consequences and all the legal effects of actual fraud." (98 C.A.2d 568.) (See *Santa Cruz v. Mcleod* (1961) 189 C.A.2d 222, 234, 11 C.R. 249, citing the text; *Barrett v. Bank of America* (1986) 183 C.A.3d 1362, 1368, 229 C.R. 16 [quoting *Estate of Arbuckle, supra*]; 37 Am.Jur.2d (2001 ed.), *Fraud and Deceit* §§8, 9.)

The first type usually involves the overreaching of a beneficiary by a trustee or other fiduciary. (See *infra*, §295; 13 *Summary* (10th), *Trusts*, §322; 5 *Cal. Proc.* (4th), *Pleading*, §673.) The second is illustrated by the statutes protecting creditors against bulk sales, transfers without change of possession, and transfers made fraudulent by the Uniform Fraudulent Transfer Act. (See 4 *Summary* (10th), *Sales*, §§215 et seq., 219 et seq.; 8 *Cal. Proc.* (4th), *Enforcement of Judgment*, §§467 et seq., 474, 475.)

West's Key Number Digest, Contracts k.94(1)

SUPPLEMENT: [This section is current through the latest supplement]

First type:

Cross-Reference: 5 *Cal. Proc.* (5th), *Pleading*, §717.

Second type:

1 Witkin Sum. Cal. Law Contracts § 294

Cross-Reference: 8 Cal. Proc. (5th), *Enforcement of Judgment*, §§495 et seq., 503, 504.



40 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

B. Fraud.

3. Constructive Fraud.

b. Confidential Relationship.

1 Witkin Sum. Cal. Law Contracts § 295

[§ 295] Confidential Relationship.

Where a confidential or fiduciary relationship exists between the parties, the failure of the person in whom confidence is placed to disclose material facts within his or her knowledge may constitute constructive fraud within the meaning of C.C. 1573(1). (See *McFate v. Bank of America* (1932) 125 C.A. 683, 686, 14 P.2d 146; *Main v. Merrill Lynch* (1977) 67 C.A.3d 19, 32, 136 C.R. 378; *Ford v. Shearson Lehman Amer. Express* (1986) 180 C.A.3d 1011, 1020, 225 C.R. 895; *Barrett v. Bank of America* (1986) 183 C.A.3d 1362, 1369, 229 C.R. 16 [bank and loan customer]; *Oates v. Lincoln* (2001) 93 C.A.4th 25, 35, 112 C.R.2d 790 [holding of reserve funds by city did not create fiduciary relationship between it and property owners so as to support constructive fraud claim based on city's alleged misuse of funds; only bondholders, for whose protection fund was established, had interest in fund]; *Rest.2d, Contracts §161(d)*; 26 Williston 4th, §69:17 et seq.; 37 Am.Jur.2d (2001 ed.), *Fraud and Deceit* §207; 5 *Summary* (10th), *Torts*, §§794, 795; 5 *Cal. Proc.* (4th), *Pleading*, §§673, 797.)

The Restatement (§161, Comment f) points out that the rule in §161(d), dealing with persons in a relation of trust and confidence (e.g., family members), supplements the rule in §173 dealing with *fiduciaries* such as trustees, agents, guardians, and executors and administrators.

The distinction between mere intimate friendship, and confidential relationship upon which a claim of constructive fraud may be based, was invoked in *Wilson v. Zorb* (1936) 15 C.A.2d 526, 59 P.2d 593. Defendant accidentally shot plaintiff. The parties, both physicians and close friends, made a settlement agreement and release of claims after defendant gave plaintiff medical attention and paid certain sums. Later plaintiff sued for damages, asserting that defendant took advantage of their relationship. *Held*, no fiduciary or confidential relationship existed. "Warm friendship, confidence and an affectionate regard for each other were mutual with the parties, and yet each was self-sufficient. ... It takes something more than friendship or confidence in the professional skill and in the integrity and truthfulness of another to establish a fiduciary relationship." (15 C.A.2d 532.) (See *Odorizzi v. Bloomfield School Dist.* (1966) 246 C.A.2d 123, 128, 54 C.R. 533, *infra*, §321.)

SUPPLEMENT: [This section is current through the latest supplement]

Cross-Reference: 5 *Cal. Proc.* (5th), *Pleading*, §§717, 841.



41 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

B. Fraud.

3. Constructive Fraud.

c. Creditor's Duty to Guarantor.

1 Witkin Sum. Cal. Law Contracts § 296

[§ 296] Creditor's Duty to Guarantor.

Where a debt is guaranteed, the creditor's intentional or negligent misrepresentation, concealment, or nondisclosure may discharge the guarantor. This subject was extensively explored, and definitive rules were laid down, in *Sumitomo Bank of Calif. v. Iwasaki* (1968) 70 C.2d 81, 73 C.R. 564, 447 P.2d 956.

N brothers, owners of a grocery, obtained a \$ 10,000 business loan from plaintiff bank in February 1961. Defendant, their insurance agent, helped them procure a second loan of \$ 5,000 in July 1961, when the balance on the first was \$ 6,000. Plaintiff requested both collateral and a continuing guarantor, and defendant signed a "Continuing Guaranty." In January 1962, N brothers borrowed an additional \$ 5,000 to pay federal taxes and also to pay off the balance of the July 1961 loan. Plaintiff's officer knew at this time that N brothers were in financial difficulties but did not notify defendant. In June 1962, N brothers were adjudicated bankrupt, and plaintiff brought this action on defendant's guaranty. The trial judge gave judgment for the amount due on the earlier loans, but held that, as to the January 1962 loan, defendant's liability was discharged by plaintiff's failure to disclose that the loan's purpose was to pay federal taxes. *Held*, reversed.

(a) *Absolute duty of employer distinguished.* The very act of the employer in keeping an employee suggests trust and direct access to information on the employee's performance. Hence, the employer is under an absolute duty to disclose all facts materially affecting the risk to the surety on an employee's fidelity bond. (70 C.2d 86.) This duty continues throughout the relationship because the compensated surety cannot revoke. (70 C.2d 92.) The creditor, however, does not affirm the financial ability of the borrower from whom the guaranty is demanded, and is usually in no better position than the surety to acquire information about the borrower. Hence, the creditor does not owe an absolute duty of full disclosure. (70 C.2d 88.)

(b) *Duty of creditor at inception of relationship.* The limited duty of disclosure, recognized by several prior California cases, is set forth in *Rest.3d, Suretyship and Guaranty §12(3)* (formerly *Rest., Security 124(1)*): If, before the secondary obligation becomes binding, the obligee (creditor) (1) knows facts unknown to the secondary obligor (surety) that materially increase the risk beyond that which the obligee has reason to believe the secondary obligor intends to assume, (2) has reason to believe that these facts are unknown to the secondary obligor, and (3) has a reasonable opportunity to communicate them to the secondary obligor, "the obligee's nondisclosure of these facts to a secondary

obligor constitutes a material misrepresentation." The duty of disclosure is not restricted to cases in which the creditor requested the surety to assume the risk: Those cases are only specific instances of the general rule that applies to all contracts between creditor and surety. (70 C.2d 90.)

(c) *Duty of creditor during course of relationship.* Unlike the surety on a fidelity bond, the guarantor of credit is not bound for any period of time, and he or she may revoke as to future liability merely by giving written notice to the creditor. (C.C. 2815.) But the creditor owes the same limited duty of disclosure prior to every new extension of credit that he or she owes in the inception. This is because each extension of credit creates a new suretyship contract; i.e., a revocable continuing guaranty is a continuing offer that the creditor accepts each time he or she extends credit to the debtor. (70 C.2d 93.)

(d) *No breach of duty here.* Applying the aforementioned three factors identified by the Restatement, no breach of duty was established. No evidence was produced as to the prior financial condition of N brothers, hence there was no showing of the risk defendant intended to assume, or that plaintiff had reason to believe that the risk would be materially increased by the loan for taxes. (70 C.2d 96.) (See *Rest.3d, Suretyship and Guaranty* §12(4) [whether creditor has reason to believe facts are unknown to surety or that facts materially increase surety's risk depends on facts of specific case]; *Rest.3d, Suretyship and Guaranty* §12(5) [nondisclosure by creditor does not constitute material misrepresentation where control relationship exists between surety and principal obligor]; 58 Cal. L. Rev. 203.)

SUPPLEMENT: [This section is current through the latest supplement]



42 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

B. Fraud.

4. Effect of Fraud.

a. Fraud in Inducement.

1. Rescission.

1 Witkin Sum. Cal. Law Contracts § 297

[§ 297] Rescission.

In the usual case of fraud, where the promisor knows what he or she is signing but consent is *induced* by fraud, mutual assent is present and a contract is formed, which, by reason of the fraud, is *voidable*. In order to escape from its obligations, the aggrieved party must *rescind* by prompt notice and offer to restore the consideration received, if any. (See *Rest.2d, Contracts §164*; 21 Proof of Facts 3d 565 [insurer's right to rescind contract for insured's false statements]; 48 Proof of Facts 3d 329 [proof of fraudulent inducement of a contract and entitlement to remedies]; 40 *A.L.R.4th* 627 [real estate purchaser's need to elect between rescission and damages in action for fraud]; *infra*, §930 et seq.)

In *Garcia v. California Truck Co.* (1920) 183 C. 767, 192 P. 708, the party knew he was signing a release, although it was fraudulently represented to him that it contained a provision for his employment. Later, he sued for his injuries. *Held*, the release was merely voidable, and the only remedy was rescission. (183 C. 771.) (See *Taylor v. Hopper* (1929) 207 C. 102, 103, 276 P. 990; *Wilke v. Coinway* (1967) 257 C.A.2d 126, 136, 64 C.R. 845, 5 *Summary* (10th), *Torts*, §776.)

It has been said that the fraud that justifies rescission must induce the *making* of the contract. In *Crow v. Kenworthy* (1939) 30 C.A.2d 313, 86 P.2d 154, a contract was made for sale of an advertising sign, and it was installed. Later, the buyer sued to rescind due to alleged misrepresentations that the sign complied with city regulations. The court said that the fraud related solely to *performance*, and would not be ground for rescission. (30 C.A.2d 315.) It would seem more correct to say that, although the *fraud* in this case might not warrant rescission, the same remedy would be available for *failure of performance*, regardless of fraud.

West's Key Number Digest, Contracts k.94(1)

SUPPLEMENT: [This section is current through the latest supplement]



43 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

B. Fraud.

4. Effect of Fraud.

a. Fraud in Inducement.

2. Reformation.

1 Witkin Sum. Cal. Law Contracts § 298

[§ 298] Reformation.

The fraudulent misrepresentation may be as to the content or effect of a written contract evidencing the agreement of the parties. In such a case, the remedy of reformation may be given to make the writing conform to the intended agreement, just as in cases of mistake (*supra*, §256 et seq.). (See *California Trust Co. v. Cohn* (1932) 214 C. 619, 627, 7 P.2d 297; *Rest.2d, Contracts §166*; 27 Williston 4th, §69:55.)

SUPPLEMENT: [This section is current through the latest supplement]



44 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

B. Fraud.

4. Effect of Fraud.

b. Fraud in Inception.

1 *Witkin Sum. Cal. Law Contracts* § 299

[§ 299] Fraud in Inception.

Despite the statement in C.C. 1566 that "a consent which is not free is nevertheless not absolutely void," the cases recognize the familiar distinction between fraud in the inducement (*supra*, §297), and fraud in the *inception, factum, or execution*. If the fraud goes to the inception or execution of the agreement, so that the promisor is deceived as to the nature of his or her act, and actually does not know what is being signed, or does not intend to enter into a contract at all, mutual assent is lacking, and the contract is *void*. In such a case, the contract may be disregarded without the necessity of rescission. (*Meyer v. Haas* (1899) 126 C. 560, 563, 58 P. 1042; *C.I.T. Corp. v. Panac* (1944) 25 C.2d 547, 548, 154 P.2d 710; *Rosenthal v. Great Western Financial Sec. Corp.* (1996) 14 C.4th 394, 415, 58 C.R.2d 875, 926 P.2d 1061, *infra*, §301 [defendants tricked 79-year-old woman, who was legally blind and suffered from dementia and hypothyroidism, into signing loan agreement by telling her that papers merely authorized them to obtain payoff on her existing mortgage]; *McElhaney v. W.E. Moyer & Co.* (1929) 101 C.A. 53, 57, 281 P. 87; *Tyner v. Axt* (1931) 113 C.A. 408, 413, 298 P. 537; *Raynale v. Yellow Cab Co.* (1931) 115 C.A. 90, 92, 300 P. 991; *Gajanich v. Gregory* (1931) 116 C.A. 622, 633, 3 P.2d 389; *Bonacci v. Massachusetts Bonding & Ins. Co.* (1943) 58 C.A.2d 657, 664, 137 P.2d 487; *Ford v. Shearson Lehman Amer. Express* (1986) 180 C.A.3d 1011, 1028, 225 C.R. 895, citing the text; *Frusetta v. Hauben* (1990) 217 C.A.3d 551, 556, 266 C.R. 62; see *Rest.2d, Contracts* §163; *Erickson v. Bohne* (1955) 130 C.A.2d 553, 556, 279 P.2d 619, 12 *Summary* (10th), *Real Property*, §261 [deed]; 4 *Summary* (10th), *Negotiable Instruments*, §31; 26 *Williston* 4th, §69:4; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §214 et seq.; 37 *Am.Jur.2d* (2001 ed.), *Fraud and Deceit* §§1 et seq., 17.)

In *Meyer v. Haas*, *supra*, plaintiff, who could not read English, signed a release, relying upon the representation of his agent, who also acted as agent for the adverse party, that the instrument was merely a receipt. *Held*, the agreement was void and no rescission was necessary. (126 C. 563.)

In *Frusetta*, *supra*, plaintiff sued for injuries sustained in an automobile accident. Defendant moved for summary judgment on the ground that plaintiff had deposited a \$ 250 check from defendant's insurer that was plainly marked "Bodily injury in full and final settlement," and which on the back explained that the draft was a full release of all claims. However, in her declaration on defendant's summary judgment motion, plaintiff stated that one of the insurance adjusters had told her that the draft was only a partial payment and that "the rest would be paid later." *Held*, summary judgment for defendant reversed. Plaintiff had presented evidence that, if accepted, suggested misrepresentation and

fraud in the factum by the insurer. Hence, there was a triable issue of fact as to whether the insurer engaged in fraudulent or overreaching conduct, thereby inducing plaintiff to misapprehend the provisions of the release. (217 C.A.3d 558.)

Some cases apply the doctrine of fraud in the inception though the plaintiff actually read the agreement and presumably knew what he or she was signing, where, by reason of the plaintiff's physical and mental condition and pressure brought upon him or her, the plaintiff was prevented from giving it any careful consideration and did not fully comprehend its effect. (See *Jordan v. Guerra* (1943) 23 C.2d 469, 475, 144 P.2d 349; *Wetzstein v. Thomasson* (1939) 34 C.A.2d 554, 559, 93 P.2d 1028; *C.I.T. Corp. v. Panac*, *supra*.)

SUPPLEMENT: [This section is current through the latest supplement]



45 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

B. Fraud.

4. Effect of Fraud.

c. Reliance by Defrauded Party.

1. Nature of Requirement.

1 Witkin Sum. Cal. Law Contracts § 300

[§ 300] Nature of Requirement.

(1) *Actual Reliance (Causation)*. The misrepresentation must be an inducing cause of the party's assent. (*Rest.2d, Contracts §167*, based on *Rest.2d, Torts §546*; see 6 *Summary* (10th), *Torts*, §1182.) This is so even though the defendant is in a confidential relationship: Where it is shown that no action was taken until an independent investigation was made, there is no actionable fraud. (See *Colton v. Stanford* (1890) 82 C. 351, 374, 23 P. 16; BAJI, No. 12.51 [Fraud and Deceit--Reliance]; CACI, No. 1907 [Reliance].)

(2) *Justifiable Reliance: Assertions of Opinion*. Reliance must be *justified*, and this requirement raises problems where the statement is of an opinion. (See *Rest.2d, Contracts §164*, Comment d.) When it is reasonable to do so, the recipient may interpret the statement as an assertion that the facts known to the person are not incompatible with the opinion, or that the person knows facts justifying the opinion. (*Rest.2d, Contracts §168*.) But the recipient is not justified in relying on an assertion of opinion unless (a) the recipient stands in such a relation of trust and confidence to the person whose opinion is asserted that it is reasonable to rely on it; (b) the recipient reasonably believes that this person has special skill, judgment, or objectivity with respect to the subject matter; or (c) the recipient "is for some other special reason particularly susceptible to a misrepresentation of the type involved." (*Rest.2d, Contracts §169*.) (See BAJI, No. 12.52 [Fraud and Deceit--Right to Rely]; CACI, No. 1908 [Reasonable Reliance].)

West's Key Number Digest, Contracts k.94(5)

SUPPLEMENT: [This section is current through the latest supplement]



46 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

B. Fraud.

4. Effect of Fraud.

c. Reliance by Defrauded Party.

2. Negligence of Defrauded Party.

1 Witkin Sum. Cal. Law Contracts § 301

[§ 301] Negligence of Defrauded Party.

(1) *In General.* It has been pointed out that one who signs a contract without reading it cannot escape liability in the absence of fraud, mistake, undue influence, or duress. (*Greve v. Taft Realty Co. (1929) 101 C.A. 343, 351, 281 P. 641*; supra, §119.) A different result follows, however, when reliance is placed upon misrepresentations of the other party. The earlier cases in California held the failure to read excusable where a fiduciary or confidential relation existed between the parties, but were not clear as to other situations. (See *Mazuran v. Stefanich (1928) 95 C.A. 327, 331, 272 P. 772*.) It is now settled, however, that the excuse may be asserted even in situations where the parties are in no such relationship.

The rule was stated as follows in *California Trust Co. v. Cohn (1932) 214 C. 619, 7 P.2d 297*: "[W]here the failure to familiarize one's self with the contents of a written contract prior to its execution is traceable *solely to carelessness or negligence*, reformation as a rule should be denied; but ... where such failure, and perhaps negligence, is *induced* ... by the false representations and fraud of the other party to the contract that its provisions are different from those set out, the courts, even in the absence of a fiduciary or confidential relationship between the parties should reform ... the instrument so as to cause it to speak the true agreement of the parties." (214 C. 627.) (See *Dice v. Akron Canton & Youngstown R. Co. (1952) 342 U.S. 359, 72 S.Ct. 312, 314, 96 L.Ed. 398, 403* [misrepresentation by railroad's authorized agents to injured employee, to effect that release was merely receipt]; *Fleury v. Ramacciotti (1937) 8 C.2d 660, 662, 67 P.2d 339*; *Security-First Nat. Bank of Los Angeles v. Earp (1942) 19 C.2d 774, 777, 122 P.2d 900*; *Palmquist v. Mercer (1954) 43 C.2d 92, 98, 100, 272 P.2d 26*; *Kantlehner v. Bisceglia (1951) 102 C.A.2d 1, 3, 226 P.2d 636*; *Cortez v. Weymouth (1965) 235 C.A.2d 140, 149, 45 C.R. 63* [relief granted to ignorant, inexperienced, and unduly credulous person]; *Brown v. FSR Brokerage (1998) 62 C.A.4th 766, 777, 72 C.R.2d 828* [property seller's failure to read escrow documents disclosing broker's dual agency before signing them was excusable where broker had not previously disclosed dual agency as required by statute and seller had already agreed to accept lower price for property]; 26 Williston 4th, §69:28; 17A Am.Jur.2d (2004 ed.), Contracts §§210, 217; 37 Am.Jur.2d (2001 ed.), Fraud and Deceit §§248 et seq., 264 et seq.)

In *Van Meter v. Bent Const. Co. (1956) 46 C.2d 588, 297 P.2d 644*, supra, §270, plaintiff subcontractor was given relief from his mistaken bid, despite negligent failure to investigate. A reason for recovery was the fact that defendants,

though without intent to deceive, made false representations as to the facts not warranted by their information (negligent misrepresentation). The court said: "A defendant who misrepresents the facts and induces the plaintiff to rely on his statements should not be heard in an equitable action to assert that the reliance was negligent unless plaintiff's conduct, in the light of his intelligence and information, is preposterous or irrational." (46 C.2d 595.)

The Restatement takes the position that negligence of the plaintiff will not bar relief "unless it amounts to a failure to act in good faith and in accordance with reasonable standards of fair dealing." (*Rest.2d, Contracts* §172; for similar rule on mistake, see *Rest.2d, Contracts* §157, *supra*, §282.)

(2) *Distinction: Fraud in Execution.* In *Rosenthal v. Great Western Financial Sec. Corp.* (1996) 14 C.4th 394, 58 C.R.2d 875, 926 P.2d 1061, the Supreme Court rejected the rule that misrepresentation is an excuse for failure to read a contract, even in the absence of a fiduciary relationship, with respect to its application when the plaintiff seeks a judicial determination that the contract is *void for fraud in the execution*. Although the rule may be valid when the plaintiff seeks *equitable relief for fraud in the inducement* of a contract, as stated in *Strotz v. Dean Witter Reynolds* (1990) 223 C.A.3d 208, 272 C.R. 680, and *Lynch v. Cruttenden & Co.* (1993) 18 C.A.4th 802, 22 C.R.2d 636, it is too broad. (14 C.4th 420.) The court distinguished *California Trust Co. v. Cohn*, *supra*, and *Van Meter v. Bent Const. Co.*, *supra*, as involving reformation of contracts, rather than the determination that a contract is void for fraud in the execution. (14 C.4th 421.)

Both California law and *Rest.2d, Contracts* §163 require that the plaintiff, in failing to become acquainted with the contents of a written agreement before signing it, not have acted in an objectively unreasonable manner. One party's misrepresentations as to the nature or character of the writing do not negate the other party's apparent manifestation of assent, if the second party had reasonable opportunity to know of the character or essential terms of the proposed contract. "If a party, with such reasonable opportunity, fails to learn the nature of the document he or she signs, such 'negligence' precludes a finding the contract is void for fraud in the execution." (14 C.4th 423.)

Nevertheless, a party may not have a "reasonable opportunity" to discover the true nature of the contract if he or she is prevented from doing so by a physical or other impairment. Thus, two plaintiffs who declared that they understood English too poorly to read the documents presented to them and one plaintiff who declared that she could not read the documents because she was legally blind presented facts that, if proved to be true, deprived them "of a reasonable opportunity to learn the character and essential terms of the documents they signed" and "would suffice to establish reasonable reliance for purposes of showing fraud in the execution of the agreement." (14 C.4th 428, 429.) (See *Jones v. Adams Financial Services* (1999) 71 C.A.4th 831, 837, 84 C.R.2d 151 [79-year-old woman, who was legally blind and suffered from dementia and hypothyroidism, did not have reasonable opportunity to discover real terms of contract before signing it].)

SUPPLEMENT: [This section is current through the latest supplement]



47 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

B. Fraud.

4. Effect of Fraud.

d. Fraud Without Injury or Damage.

1. Injury Without Pecuniary Damage.

1 *Witkin Sum. Cal. Law Contracts* § 302

[§ 302] Injury Without Pecuniary Damage.

It is unnecessary to plead or prove specific pecuniary loss in order to obtain rescission; it is sufficient to show some substantial injury. (*Munson v. Fishburn* (1920) 183 C. 206, 217, 190 P. 808; *Hefferan v. Freebairn* (1950) 34 C.2d 715, 721, 214 P.2d 386; *California Credit & Collection Corp. v. Goodin* (1926) 76 C.A. 785, 793, 246 P. 121; *Dunn v. Stringer* (1940) 41 C.A.2d 638, 644, 107 P.2d 411; see 37 *Am.Jur.2d* (2001 ed.), *Fraud and Deceit* §§272 et seq., 470, 471; 91 *A.L.R.2d* 346 [necessity of showing damage to establish fraud as contract defense]; 4 *Cal. Proc.* (4th), *Pleading*, §§505, 506.)

SUPPLEMENT: [This section is current through the latest supplement]
Cross-Reference: 4 *Cal. Proc.* (5th), *Pleading*, §§544, 545.



48 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

B. Fraud.

4. Effect of Fraud.

d. Fraud Without Injury or Damage.

2. Rescission Without Injury.

1 *Witkin Sum. Cal. Law Contracts* § 303

[§ 303] Rescission Without Injury.

Although injury or damage is an essential element of actionable fraud where damages are sought (see 5 *Summary* (10th), *Torts*, §816), rescission, under some authorities, may be based upon fraud alone. (See *Rest.2d, Contracts* §164, Comment c; 37 *Am.Jur.2d* (2001 ed.), *Fraud and Deceit* §284 et seq.; 91 *A.L.R.2d* 346 [necessity of showing damage to establish fraud as contract defense].)

Some California cases were seemingly contra. (See, e.g., *Darrow v. Houlihan* (1928) 205 C. 771, 774, 272 P. 1049; *Molfino v. Levinson Produce Co.* (1947) 79 C.A.2d 587, 589, 180 P.2d 365.) However, in *Wood v. Jotham Bixby Co.* (1938) 29 C.A.2d 294, 84 P.2d 204, plaintiff relied on a representation that the property purchased was not subject to assessment, but when an assessment was nevertheless levied, the contract was rescinded despite evidence that the assessment actually enhanced the value of the property. (29 C.A.2d 299.) (See 25 *So. Cal. L. Rev.* 206.)

A later California Supreme Court decision follows a liberal approach as to what constitutes "injury." In *Earl v. Saks & Co.* (1951) 36 C.2d 602, 226 P.2d 340, the court said: "[T]his 'no injury, no rescission' formula is not very helpful, because of disagreement in the authorities as to what is meant by 'injury.' In a sense, anyone who is fraudulently induced to enter into a contract is 'injured'; his interest in making a free choice and in exercising his own best judgment in making decisions with respect to economic transactions and enterprises has been interfered with." (36 C.2d 611.)

In the *Earl* case, supra, defendant seller had priced a mink coat at \$ 5,000. B desired to make a gift of it to Mrs. E, but refused to pay more than \$ 4,000. Under a secret agreement between Mrs. E and defendant seller, the latter pretended to sell it to B for \$ 4,000, Mrs. E to pay the balance. Thereafter B refused to pay unless the coat was delivered to him. *Held*, the contract of sale was subject to rescission by B. There was actual fraud--a misrepresentation that the price had been reduced from \$ 5,000 to \$ 4,000. And, although superficially B received exactly what he expected--the coat for \$ 4,000--in fact he did not, for he bargained for a coat fully paid for by himself. "In the present situation ... where the motives of Barbee were clearly noneconomic, the general social interest in stability of transactions is overridden by the interest in not having a seller make intentional misrepresentations which mislead a would-be donor into the erroneous belief that he alone is purchasing and that his donee is to receive from him a fully paid for gift, when the seller is fully aware of the effect which the misrepresentations may have and intends that they should have that

effect." (36 C.2d 612.) (See 39 Cal. L. Rev. 390; 2 Hastings L. J. 59; 25 So. Cal. L. Rev. 204.)

West's Key Number Digest, Contracts k.94(1)

SUPPLEMENT: [This section is current through the latest supplement]



49 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

B. Fraud.

4. Effect of Fraud.

e. Provision Waiving Contest for Fraud.

1. Representations Made by Party.

1 Witkin Sum. Cal. Law Contracts § 304

[§ 304] Representations Made by Party.

A party to a contract who has been guilty of fraud in its inducement cannot absolve himself or herself from the effects of his or her fraud by any stipulation in the contract, either that no representations have been made, or that any right that might be grounded upon them is waived. Such a stipulation or waiver will be ignored, and parol evidence of misrepresentations will be admitted, for the reason that fraud renders the whole agreement voidable, *including the waiver provision*. (*Ferguson v. Koch* (1928) 204 C. 342, 347, 268 P. 342; *Vai v. Bank of America* (1961) 56 C.2d 329, 344, 15 C.R. 71, 364 P.2d 247; *Palladine v. Imperial Valley Farm Lands Assn.* (1924) 65 C.A. 727, 746, 225 P. 291; *Rothstein v. Janss Inv. Corp.* (1941) 45 C.A.2d 64, 67, 113 P.2d 465; *Crawford v. Nastos* (1960) 182 C.A.2d 659, 666, 6 C.R. 425 [provision inserted by vendors, "Buyer has inspected well and accepts same as is"]; *Danzig v. Jack Grynberg & Associates* (1984) 161 C.A.3d 1128, 1138, 208 C.R. 336, quoting the text; *Ron Greenspan Volkswagen v. Ford Motor Land Dev. Corp.* (1995) 32 C.A.4th 985, 996, 38 C.R.2d 783, citing the text; see C.C. 1668, *infra*, §660 [contract extinguished by rescission]; *Rest.2d, Contracts* §196; 15 Corbin (Rev. ed.), §88.8; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §287; 37 *Am.Jur.2d* (2001 ed.), *Fraud and Deceit* §§324, 325; 16 *Cal. L. Rev.* 234, 238, note 17; 37 *Santa Clara L. Rev.* 1031 [merger clause as precluding claim for fraud in inducement]; 33 *So. Cal. L. Rev.* 223; on validity of insurance incontestability clause, see 2 *Summary* (10th), *Insurance*, §226 et seq.)

SUPPLEMENT: [This section is current through the latest supplement]

See *Manderville v. PCG&S Group* (2007) 146 C.A.4th 1486, 1499, 55 C.R.3d 59 [in fraud action by buyers of real estate against sellers' brokers, alleging that brokers intentionally misrepresented that property could be subdivided, exculpatory provisions could not support finding that, as matter of law, buyers could not make prima facie showing that they justifiably relied on brokers' alleged intentional misrepresentations]; *McClain v. Octagon Plaza, LLC* (2008) 159 C.A.4th 784, 793, 71 C.R.3d 885 [disclaimer in shopping center lease that provided that any statement of size set forth in lease or used to calculate rent was reasonable approximation such that any payments based on stated size were not subject to revision did not preclude action by tenant for fraud in inducement or negligent misrepresentation based on size of leased space and tenant's share of common area expenses].

(New) *Distinction: Clause usable to escape liability:* The rule stated in the text that a provision limiting liability,

but contained in a contract that was itself entered into because of fraud in the inducement, does not, as a matter of law, preclude a finding of fraud does not mean that the contract provision is in every case irrelevant. For example, *Hinesley v. Oakshade Town Center* (2005) 135 C.A.4th 289, 37 C.R.3d 364, citing the text, involved an action for fraud and rescission based on fraud in the inducement of a commercial lease between plaintiff tenant and defendant landlord. Although defendant committed fraud in the inducement by falsely representing that certain national chain businesses had signed leases to operate in the vicinity of the premises to be leased by plaintiff, the lease contained a provision specifically disavowing reliance on such representations. *Held*, summary judgment for defendant affirmed. Plaintiff's failure to question, clarify, or confirm defendant's false statements, or to notify his attorney of the false statements, was evidence that he was not relying on them in deciding to execute the lease. (135 C.A.4th 300.)



50 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

B. Fraud.

4. Effect of Fraud.

e. Provision Waiving Contest for Fraud.

2. Agent's Representation: Innocent Principal.

1 *Witkin Sum. Cal. Law Contracts* § 305

[§ 305] Agent's Representation: Innocent Principal.

Where the representations are made by an *agent*, and the contract contains a recital *limiting the agent's authority* to make representations, the problem is somewhat different from that presented by the party's own fraud (*supra*, §304). Earlier California cases, despite some conflict, held the third party bound. (See *Gridley v. Tilson* (1927) 202 C. 748, 751, 262 P. 322; 16 *Cal. L. Rev.* 234.) But in *Speck v. Wylie* (1934) 1 C.2d 625, 627, 36 P.2d 618, this view was repudiated, and the rule of the Restatement of Agency (Rest.2d, Agency §259 et seq.) was adopted.

Under this rule, the *innocent principal* may by a stipulation limiting the agent's authority relieve himself or herself from liability in a *tort action for damages for fraud and deceit*, but the defrauded third party may nevertheless *rescind the contract*. As the court said in *Harnischfeger Sales Corp. v. Coats* (1935) 4 C.2d 319, 320, 48 P.2d 662: "The distinction between the two situations is a sound one. The principal would normally be liable in tort for misrepresentations by an agent acting within the scope of his actual or ostensible authority, and by stipulating in the contract that the agent has no such authority, the principal has done all that is reasonably possible to give notice thereof to the third party. Under such circumstances the innocent principal may justly be relieved of liability for the agent's wrong. But where the principal sues to recover on the contract, he is seeking to benefit through the agent's fraud. This he cannot be permitted to do. His personal liability may be avoided, but the fraudulently procured contract is subject to rescission." (See *Greenberg v. DuBain Realty Corp.* (1935) 2 C.2d 628, 629, 42 P.2d 628; *Graham v. Los Angeles First Nat. Trust & Savings Bank* (1935) 3 C.2d 37, 42, 43 P.2d 543; *Weiner v. Roof* (1937) 10 C.2d 450, 453, 74 P.2d 736 [principal may defend by showing no unjust enrichment]; *Simmons v. California Institute of Technology* (1949) 34 C.2d 264, 273, 209 P.2d 581; *Curtis v. Title Guarantee & Trust* (1935) 3 C.A.2d 612, 620, 40 P.2d 562; 37 *Am.Jur.2d* (2001 ed.), *Fraud and Deceit* §312; 26 *Cal. L. Rev.* 622; 8 *So. Cal. L. Rev.* 146; on liability of agent, see 75 *Harv. L. Rev.* 850.)

West's Key Number Digest, Contracts k.94(1)

SUPPLEMENT: [This section is current through the latest supplement]



51 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

B. Fraud.

4. Effect of Fraud.

e. Provision Waiving Contest for Fraud.

3. Agent's Representation: Guilty Principal.

1 Witkin Sum. Cal. Law Contracts § 306

[§ 306] Agent's Representation: Guilty Principal.

If the principal is not actually innocent, but in fact participates in the fraud, or affirms it afterwards, the stipulation does not relieve him or her of liability for damages. (*Longway v. Newbery* (1939) 13 C.2d 603, 619, 91 P.2d 110; *Rothstein v. Janss Inv. Corp.* (1941) 45 C.A.2d 64, 67, 113 P.2d 465; *Kalkruth v. Resort Properties* (1943) 57 C.A.2d 146, 152, 134 P.2d 513.)

This is the case, e.g., where the principal actually or apparently authorized the particular representations. In *Eamoe v. Big Bear Land & Water Co.* (1950) 98 C.A.2d 370, 220 P.2d 408, agents of defendant vendor showed plaintiff a parcel of land that they described as Lots 2 and 3, Block 164. Plaintiff contracted to buy land so described, but later, after commencing to build on the land shown, he discovered that it was not in Block 164, and that he had no title to it. In reversing a judgment of nonsuit, and holding plaintiff entitled to recover, the court said: "The selling agents in the case now before us were acting within the scope of their ostensible authority when they showed appellant the lots, told him those were the lots he was buying, gave him a receipt purporting to describe correctly the lots which they had shown him, and negligently permitted their mistake to be carried into the formal contract. The recognized and legitimate purpose of the exculpatory provision is to protect an *innocent principal* against liability for statements of an agent beyond the scope of his actual authority by notifying the purchaser of the limits of the agent's authority. Manifestly, despite the provision, the purchaser was justified in believing that the agent had authority to show and sell property of the principal, knew which property belonged to the principal, and was authorized to issue a receipt containing a correct description of the property displayed. Furthermore, it may reasonably be assumed that the principal here relied on the agent to describe the property correctly, since it executed and sent to plaintiff a contract containing the same description as that given by the agent." (98 C.A.2d 373.)

The *legal fault* of the principal may be derived from an application of the doctrine of *imputed notice*. In *Herzog v. Capital Co.* (1945) 27 C.2d 349, 164 P.2d 8, Y, the agent, negotiated the *purchase* of a house for defendant principal. Y knew that the house leaked because of defective construction, and had it patched and repainted. Y then negotiated the *sale* of the house to plaintiff, representing that it was in perfect condition. The house leaked and plaintiff sued for damages. *Held*, defendant was liable. Through its agent it had knowledge of the defects and their deliberate concealment by an appearance of good condition; failure to disclose them was actionable fraud. And a principal "under

a positive duty" to make such disclosure cannot escape liability for failure to do so by relying on the stipulation. (27 C.2d 353.) (See 34 Cal. L. Rev. 751.)

Confusion in analysis led to the statement of a peculiar doctrine in *Podlasky v. Price* (1948) 87 C.A.2d 151, 196 P.2d 608. Defendant broker, attempting to sell defendant owner's apartment house, gave plaintiff a typewritten prospectus listing the rentals and Office of Price Administration ceilings, which misrepresented the penthouse ceiling as \$ 175 (it had no ceiling because of previous owner occupancy, and later its ceiling was set at \$ 100). Among other defenses the parties relied on a printed note at the bottom: "The above statements are based upon information from sources deemed reliable and which we believe to be correct, but we cannot assume responsibility for errors or omissions therein." *Held*, rescission was properly denied. The court described this provision as a "warning" to the buyer to "beware"; declared that "the printed caveat or warning would excuse an innocent misrepresentation or misstatement of fact, even though it would not justify a false representation knowingly made"; and concluded: "Admittedly Bearce [owner] *should have known* of the existence or absence of O.P.A. ceilings on his building, but his *neglect* to know was not *scienter*. The exculpatory notice on the statement presented to respondent by Price [agent] would extend to the *innocent though negligent* representations of Bearce, his principal." (87 C.A.2d 160, 161.)

SUPPLEMENT: [This section is current through the latest supplement]



52 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT
B. Fraud.

5. Innocent Misrepresentation.

a. Ground for Rescission.

1 Witkin Sum. Cal. Law Contracts § 307

[§ 307] Ground for Rescission.

Knowledge of falsity is ordinarily an essential element of actionable fraud. (See *supra*, §286.) If the defendant makes a material misrepresentation, honestly and reasonably believing it to be true, and the other party acts in reliance thereon, damages seem inappropriate, but is rescission possible?

Although C.C. 1689 does not include innocent misrepresentation as a ground for rescission (see *Denovan v. Golden State Woolen Mills* (1930) 104 C.A. 504, 510, 286 P. 714), language in earlier California cases indicated support for this theory. (See *Scott v. Delta Land & Water Co.* (1922) 57 C.A. 320, 328, 207 P. 389; *Giovannoni v. Bartmann* (1922) 59 C.A. 651, 658, 211 P. 844; 27 Williston 4th, §§69:49, 69:54; 37 *Am.Jur.2d* (2001 ed.), *Fraud and Deceit* §135 et seq.; 12 *Hastings L. J.* 458; 71 *A.L.R.2d* 118 [release of personal injury claim, innocent misrepresentation as to injuries].)

In some cases, it may be unnecessary to rely on innocent misrepresentation; the facts may establish *mutual mistake*, i.e., one party mistakenly representing the facts and the other believing the representation. (See *Brown v. Klein* (1928) 89 C.A. 153, 156, 264 P. 496; 4 *Cal. Proc.* (4th), *Pleading*, §507.)

A square holding that innocent misrepresentation is a ground of rescission was finally made in *Crocker-Anglo Nat. Bank v. Kuchman* (1964) 224 C.A.2d 490, 36 C.R. 806. Plaintiffs sued to rescind a sale of stock, in three counts based on actual fraud, constructive fraud, and common count. At the trial, they sought to show innocent misrepresentation, but the trial judge refused to allow the evidence or an amendment to allege innocent misrepresentation and mutual mistake. Plaintiffs then rested and a nonsuit was granted. *Held*, reversed; the evidence was not admissible under either fraud count, but could be introduced under the common count. And the facts alleged were sufficient to support a recovery if they were proved:

(a) Defendants' belief that the stock was worth \$ 30,000 and plaintiffs' reliance thereon would establish mutual mistake. (224 C.A.2d 496, citing the text.)

(b) Although no prior California case expressly held innocent misrepresentation a ground for rescission, several reached this result on the theory of mistake (e.g., *Brown v. Klein*, *Scott v. Delta Land & Water Co.*, *supra*) and "legal writers ... have uniformly stated that innocent misrepresentation is generally considered a ground for rescission in

California." (224 C.A.2d 497, citing the text.) (See *Wood v. Kalbaugh* (1974) 39 C.A.3d 926, 929, 114 C.R. 673.)

SUPPLEMENT: [This section is current through the latest supplement]

Mutual mistake:

Cross-Reference: 4 Cal. Proc. (5th), *Pleading*, §546.



53 of 199 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

B. Fraud.

5. Innocent Misrepresentation.

b. Materiality of Representation.

1 Witkin Sum. Cal. Law Contracts § 308

[§ 308] Materiality of Representation.

The Restatement makes the following distinction: If the representation is fraudulent, it need not be material. If, however, it is nonfraudulent, it must be material. (*Rest.2d, Contracts §163*, Comments a, c; §164, Comment b.) Comment b to §164 explains: "One who makes a non-fraudulent misrepresentation of a seemingly unimportant fact has no reason to suppose that his assertion will induce assent. But a fraudulent misrepresentation is directed to attaining that very end, and the maker cannot insist on his bargain if it is attained, however unexpectedly, as long as the additional requirements of inducement and justifiable reliance are met."

The distinction was recognized in *Wood v. Kalbaugh* (1974) 39 C.A.3d 926, 114 C.R. 673: "[I]f A, with knowledge of B's idiosyncrasy or personal belief, wilfully conceals a fact related to the idiosyncrasy or belief, to induce B to enter into a contract, A should not reap the fruit of his deception merely because it is unlikely that the misrepresentation would have affected a reasonable man. However, where the misrepresentation is unintentional, there are innocent parties on both sides of the contract." (39 C.A.3d 930.)

West's Key Number Digest, Contracts k.94(2)

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54 of 199 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT
C. Duress.

1. Nature and Kinds of Duress.

1 Witkin Sum. Cal. Law Contracts § 309

[§ 309] Nature and Kinds of Duress.

Duress, as defined in C.C. 1569, is of two kinds:

(1) *Duress of person*. This may be: (a) "Unlawful confinement of the person of the party, or the husband or wife of such party, or of an ancestor, descendent, or adopted child of such party, husband, or wife;" or (b) "Confinement of such person, lawful in form, but fraudulently obtained, or fraudulently made unjustly harassing or oppressive." (C.C. 1569(1), (3).) (See *McIntosh v. McIntosh* (1962) 209 C.A.2d 371, 373, 26 C.R. 26 [wife's agreement waiving further alimony obtained after beatings and threats to kill, etc.]; *Sinai Memorial Chapel v. Dudler* (1991) 231 C.A.3d 190, 199, 282 C.R. 263 [rejecting claim that person who signed contract with cemetery while he was very upset over his father's recent death acted under duress]; *Rest.2d, Contracts* §174; 28 Williston 4th, §71:1 et seq.; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §218; 25 *Am.Jur.2d* (1996 ed.), *Duress and Undue Influence* §1 et seq.; Cal. Transactions Forms, 1 Business Transactions §6:24; 2 California Affirmative Defenses 2d (2004 ed.), §33:1 et seq.; CACI, No. 332 [Affirmative Defense--Duress].)

(2) *Duress of property*: "Unlawful detention of the property of any such person." (C.C. 1569(2); see *Harlan v. Gladding, McBean & Co.* (1907) 7 C.A. 49, 53, 93 P. 400 [attachment levied on goods by justice of the peace acting without jurisdiction, contract made to obtain their release]; 28 Williston 4th, §§71:24, 71:40 et seq.; 25 *Am.Jur.2d* (1996 ed.), *Duress and Undue Influence* §5.)

The *threat* of duress, characterized as "*menace*" in C.C. 1570, is classified in the Restatement as a form of duress. (See *infra*, §311.) And modern law recognizes a form of duress that does not involve an unlawful act: *economic compulsion*. (See *infra*, §313.)

Whether duress exists is a factual question. (*Krantz v. BT Visual Images, L.L.C.* (2001) 89 C.A.4th 164, 176, 107 C.R.2d 209 [allegations that plaintiff had reasonable alternatives and was not facing financial jeopardy when he signed agreement and that his attorney was reviewing it were not sufficient, as matter of law, to negate duress claim].)

West's Key Number Digest, Contracts k.95(1)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Duress of person*. See C.E.B., Law of Contracts §3.9 et seq.; 2 California Affirmative Defenses §33:1 et seq.



55 of 199 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT
C. Duress.
2. Effect of Duress.

1 Witkin Sum. Cal. Law Contracts § 310

[§ 310] Effect of Duress.

(1) *Void Contract*. In the rare case of physical compulsion, which causes a person to manifest assent when the person does not understand the transaction or does not intend to enter into the contract, the effect is the same as in cases of fraud in the inception (*supra*, §299): the agreement is void. (See *Rest.2d, Contracts §174; McGrath v. Hyde* (1889) 81 C. 38, 39, 22 P. 293 [complaint to cancel deed, alleging that grantor lacked mental and physical strength to execute or deliver, or understand provisions; held sufficient]; 28 Williston 4th, §71:8; 25 *Am.Jur.2d* (1996 ed.), *Duress and Undue Influence §21*.)

(2) *Voidable Contract*. In other cases, an agreement made under duress is voidable. (See *Rest.2d, Contracts §175; 28 Williston 4th, §71:8; 25 Am.Jur.2d* (1996 ed.), *Duress and Undue Influence §24*; on ratification by party subject to duress, see 77 *A.L.R.2d* 426; 25 *Am.Jur.2d* (1996 ed.), *Duress and Undue Influence §§24, 25*.)

The fraud or duress of a third party is a proper basis for rescission against a defendant who, although the defendant did not participate in the wrongdoing, acquired property for an inadequate consideration with knowledge of the injury to the plaintiff. (*Leeper v. Beltrami* (1959) 53 C.2d 195, 206, 1 C.R. 12, 347 P.2d 12, *infra*, §1032; see *Rest.2d, Contracts §175(2); 28 Williston 4th, §71:17; 25 Am.Jur.2d* (1996 ed.), *Duress and Undue Influence §18*.)

SUPPLEMENT: [This section is current through the latest supplement]

(2) *Voidable Contract*. See *In re Marriage of Balcof* (2006) 141 C.A.4th 1509, 1522, 47 C.R.3d 183 [writing purporting to transmute husband's community property interest in family residence and in 20% of separately owned stock to wife as her separate property was unenforceable, where wife's threats to get divorce and to obstruct husband's relationship with their children, when coupled with husband's state of mind resulting from prior episodes of verbal and physical abuse, constituted duress].



56 of 199 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

C. Duress.

3. Threat of Duress (Menace).

a. In General.

1 Witkin Sum. Cal. Law Contracts § 311

[§ 311] In General.

(1) *California Code*. "Menace" is (a) a threat of *unlawful or fraudulent* confinement of the persons specified in the section on duress (*supra*, §309), (b) a threat of *unlawful and violent* injury to the person or property of any such person, or (c) a threat of injury to the character of any such person. (C.C. 1570; see *Sun-Maid Raisin Growers of Calif. v. Papazian* (1925) 74 C.A. 231, 240 P. 47; *In re Marriage of Gonzalez* (1976) 57 C.A.3d 736, 743, 129 C.R. 566, citing the text [husband's threats to emotionally distraught wife that she would lose her children and be destitute unless she signed marital property settlement agreement]; 28 Williston 4th, §71:1 et seq.; 17A Am.Jur.2d (2004 ed.), Contracts §220; Cal. Transactions Forms, 1 Business Transactions §6:25; 25 Am.Jur.2d (1996 ed.), *Duress and Undue Influence* §9 et seq.; on threats involving legal process and threats not involving legal process, see 79 A.L.R.3d 598, 617, 633.)

(2) *Restatement 2d. Rest.2d, Contracts §176* contains a broad definition of improper threats, which covers not only the traditional areas (threats of physical violence or detention of property) but also the modern concept of economic compulsion (*infra*, §314). The section reads as follows:

"(1) A threat is improper if"

"(a) what is threatened is a crime or a tort, or the threat itself would be a crime or a tort if it resulted in obtaining property,"

"(b) what is threatened is a criminal prosecution,"

"(c) what is threatened is the use of civil process and the threat is made in bad faith, or"

"(d) the threat is a breach of the duty of good faith and fair dealing under a contract with the recipient."

"(2) A threat is improper if the resulting exchange is not on fair terms, and"

"(a) the threatened act would harm the recipient and would not significantly benefit the party making the threat,"

"(b) the effectiveness of the threat in inducing the manifestation of assent is significantly increased by prior unfair

dealing by the party making the threat, or"

"(c) what is threatened is otherwise a use of power for illegitimate ends."

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57 of 199 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

C. Duress.

3. Threat of Duress (Menace).

b. Threat of Criminal Prosecution.

1 Witkin Sum. Cal. Law Contracts § 312

[§ 312] Threat of Criminal Prosecution.

A threat of criminal prosecution is a threat of injury to the character and constitutes menace. (*Morrill v. Nightingale* (1892) 93 C. 452, 455, 28 P. 1068; *Shasta Water Co. v. Croke* (1954) 128 C.A.2d 760, 764, 276 P.2d 88; see *Bridge v. Ruggles* (1927) 202 C. 326, 331, 260 P. 553; *Rest.2d, Contracts §176(1)(b)*; 28 Williston 4th, §71:37 et seq.; 25 *Am.Jur.2d* (1996 ed.), *Duress and Undue Influence §14*.)

Thus, in *Merchants' Collection Agency v. Roantree* (1918) 37 C.A. 88, 173 P. 600, defendant bookkeeper and manager was charged by the head of the firm with having drawn more money than he was entitled to take as salary, and threatened with prosecution for embezzlement unless he signed a note for the alleged overdraft. *Held*, the note was unenforceable. (37 C.A. 90.) (See *Tiffany & Co. v. Spreckels* (1927) 202 C. 778, 784, 262 P. 742 [threat to prosecute wife of promisor]; *Balling v. Finch* (1962) 203 C.A.2d 413, 420, 21 C.R. 490 [threat to attorney to make charges to Corporation Commissioner or district attorney of alleged violation of Corporation Securities Act]; *Bayscene Resident Negotiators v. Bayscene Mobilehome Park* (1993) 15 C.A.4th 119, 127, 18 C.R.2d 626 [threat of city attorney to prosecute under ordinance requiring binding arbitration unless arbitration agreement was signed].)

But there must be something more than mere acts or statements causing apprehension; the fear must arise from a threat of unlawful, not lawful acts. (*Miller v. Walden* (1942) 53 C.A.2d 353, 361, 127 P.2d 952 [relatives of embezzler signed note through fear of prosecution and in hope of preventing it, but victim had made no threat to prosecute or promise to refrain].)

The Restatement (§176, Comment c) clarifies the rule: "An explanation in good faith of the criminal consequences of another's conduct may not involve a threat. But if a threat is made, the fact that the one who makes it honestly believes that the recipient is guilty is *not material*. The threat involves a misuse, for personal gain, of power given for other legitimate ends. ... The threat may be to instigate prosecution against the recipient or some third person, who is commonly although not necessarily a relative of the recipient. The guilt or innocence of the person whose prosecution is threatened is immaterial in determining whether the threat is improper, although it may be easier to show that the threat actually induced assent in the case of guilt. A bargain to suppress prosecution may be unenforceable on grounds of public policy."

West's Key Number Digest, Contracts k.95(5)

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58 of 199 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT
C. Duress.

4. Economic Compulsion.
a. Traditional Rule on Lawful Acts.

1 Witkin Sum. Cal. Law Contracts § 313

[§ 313] Traditional Rule on Lawful Acts.

The early cases generally hold that an act, to constitute duress, must be *unlawful*; i.e., it must be either a *tort* or a *crime*. The mere threat to commit breach of an existing contract, or to refuse to pay money owed, as a means of compelling another to enter into a new agreement, does not amount to legal duress. The aggrieved party has his or her remedy at law for breach or nonpayment, and is, in theory, under no improper compulsion. (See *Tisdale v. Bryant* (1918) 38 C.A. 750, 752, 177 P. 510 [creditor took advantage of debtor's financial embarrassment to obtain a promise to pay a debt actually owed]; *Sistrom v. Anderson* (1942) 51 C.A.2d 213, 220, 124 P.2d 372 [seller acceded to cancellation of contract of sale in order to get money due from buyer for goods previously delivered]; *Nesbitt Fruit Products v. Del Monte Beverage Co.* (1960) 177 C.A.2d 353, 360, 2 C.R. 333 [manufacturer attempted in good faith to terminate bottling franchise; bottler signed compromise agreement to avoid losing its entire investment]; *London Homes v. Korn* (1965) 234 C.A.2d 233, 240, 44 C.R. 262, *infra*, §315; *Goldstone-Tobias Agency v. Barbroo Enterprises Productions* (1965) 237 C.A.2d 720, 723, 47 C.R. 347 [debtor, moving picture actor, signed compromise agreement to avoid bad publicity of suit on claim]; *Odorizzi v. Bloomfield School Dist.* (1966) 246 C.A.2d 123, 128, 54 C.R. 533, *infra*, §321; *Goldstein v. Enoch* (1967) 248 C.A.2d 891, 894, 57 C.R. 19 [speculation and apprehension on part of plaintiff not sufficient].)

West's Key Number Digest, Contracts k.95(2)

SUPPLEMENT: [This section is current through the latest supplement]



59 of 199 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

C. Duress.

4. Economic Compulsion.

b. Modern Rule: Relief Granted.

1 Witkin Sum. Cal. Law Contracts § 314

[§ 314] Modern Rule: Relief Granted.

The theory of "illegal business compulsion" is a ground for quasi-contractual relief (*infra*, §1031), and supports a departure from the strict test of unlawful act (*supra*, §313). (See *International Fishermen & Allied Workers of America v. Stemland* (1950) 97 C.A.2d Supp. 931, 934, 219 P.2d 554; *Thompson Crane & Trucking Co. v. Eyman* (1954) 123 C.A.2d 904, 910, 267 P.2d 1043; *Philippine Export & Foreign Loan Guarantee Corp. v. Chuidian* (1990) 218 C.A.3d 1058, 1077, 267 C.R. 457, *infra*, §315; *CrossTalk Productions v. Jacobson* (1998) 65 C.A.4th 631, 644, 76 C.R.2d 615; 40 Cal. L. Rev. 425.)

In *International Fishermen & Allied Workers v. Stemland*, *supra*, defendant, owner and master of a fishing vessel, had a crew of four union members, who worked for him in violation of union rules and were fined \$ 100 each. Then plaintiff union refused to clear defendant's crew for sailing unless he paid or guaranteed the fines, and he signed a guarantee. *Held*, the contract was invalid for duress: Defendant, to safeguard his business interests, signed the guarantee to pay the union, though he owed no duty to it and the obligation was not his. "[I]t represents a form of extortion which although not criminal in its character, would nevertheless if followed to its logical conclusion justify the 'vilest blackmailer.'" (97 C.A.2d Supp. 934.)

In *Thompson Crane & Trucking Co. v. Eyman*, *supra*, E was engaged by W to do income tax work. E prepared a protest of a large assessment and obtained extensions of time. Then, on a Saturday, 2 days before the Treasury's deadline, E told W that he would not file it unless W agreed to pay him 7 1/2% of any relief secured in addition to the previously agreed \$ 1,000 retainer. Believing that he faced financial ruin, W signed. *Held*, the trial court properly relieved W from the agreement. This was more than a mere breach of contract; E refused to allow W to file the protest already prepared and used this impossible position to enforce his demand. (123 C.A.2d 910.) (See 28 So. Cal. L. Rev. 317.)

Today, the economic compulsion doctrine is recognized by most authorities. (See *Rest.2d, Contracts* §176, and Comments a, e; *Rich & Whillock v. Ashton Dev.* (1984) 157 C.A.3d 1154, 1158, 204 C.R. 86, citing the text and listing California cases; 28 Williston 4th, §71:40 et seq.; 25 *Am.Jur.2d* (1996 ed.), *Duress and Undue Influence* §§6, 7; 79 *A.L.R.3d* 598 [economic duress or business compulsion in execution of promissory note]; 9 *A.L.R.4th* 942 [refusal to pay debt as economic duress or business compulsion avoiding compromise or release]; 12 *A.L.R.4th* 1262 [economic

duress or business compulsion in execution of contract for sale of real property]; CACI, No. 333 [Affirmative Defense--Economic Duress].)

In *Rich & Whillock v. Ashton Dev.*, *supra*, the court said: "The underlying concern of the economic duress doctrine is the enforcement in the marketplace of certain minimal standards of business ethics. Hard bargaining, 'efficient' breaches and reasonable settlements of good faith disputes are all acceptable, even desirable, in our economic system. That system can be viewed as a game in which everybody wins, to one degree or another, so long as everyone plays by the common rules. Those rules are not limited to precepts of rationality and self-interest. They include equitable notions of fairness and propriety which preclude the wrongful exploitation of business exigencies to obtain disproportionate exchanges of value. Such exchanges make a mockery of freedom of contract and undermine the proper functioning of our economic system. The economic duress doctrine serves as a last resort to correct these aberrations when conventional alternatives and remedies are unavailing. The necessity for the doctrine in cases such as this has been graphically described: 'Nowadays, a wait of even a few weeks in collecting on a contract claim is sometimes serious or fatal for an enterprise at a crisis in its history. The business of a creditor in financial straits is at the mercy of an unscrupulous debtor, who need only suggest that if the creditor does not care to settle on the debtor's own hard terms, he can sue. This situation, in which promptness in payment is vastly more important than even approximate justice in the settlement terms, is too common in modern business relations to be ignored by society and the courts.' " (157 C.A.3d 1159.)

The facts of the *Rich* case that were held to support the trial judge's determination that an agreement and release were not binding on plaintiff were as follows: Plaintiff contracted to do grading and excavating for defendant, and submitted bills for work done, which were regularly paid. When the final bill for \$ 72,286.45 was submitted, plaintiff was in financial straits and faced with imminent bankruptcy if not paid; nevertheless, defendant offered \$ 50,000 on a "take it or leave it" basis, and plaintiff, though strenuously protesting these coercive tactics, accepted the amount and signed the release. (157 C.A.3d 1157, 1160.) The trial judge found that defendant acted in bad faith, and gave judgment in favor of plaintiff for the balance due (\$ 22,286.45). (157 C.A.3d 1161.)

SUPPLEMENT: [This section is current through the latest supplement]

See *Uniwill L.P. v. Los Angeles* (2004) 124 C.A.4th 537, 545, 21 C.R.3d 464 [developer properly alleged cause of action against privately owned utility for rescission and restitution for economic duress, based on city's demand that developer grant utility an easement after tentative tract map had been approved; developer had begun construction and was incurring substantial costs each day, leaving it no choice but to comply and later seek recovery].



60 of 199 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

C. Duress.

4. Economic Compulsion.

c. Relief Denied.

1 Witkin Sum. Cal. Law Contracts § 315

[§ 315] Relief Denied.

In *London Homes v. Korn* (1965) 234 C.A.2d 233, 44 C.R. 262, plaintiff builders greatly desired to develop an area that included three parcels of about 40 acres owned by defendants. They contracted to purchase them at \$ 7,100 per acre, and then went to considerable expense in acquiring adjoining land, paying for engineering services, and promoting the entire subdivision. Subsequently, defendants received a higher offer and asserted an erroneous technical defense to completion of the transaction. Plaintiffs, faced with the prospect of a huge loss in the event of litigation, agreed to pay \$ 650 more per acre and received title. Then they brought this action for damages on the theory that the new contract had been forced upon them by "business compulsion." *Held*, judgment for defendants affirmed. It was not duress for defendants to assert a technical view of their contract rights, and to refuse in good faith to perform, even though they were mistaken as to the law; and plaintiffs, who could have brought suit to enforce their contract rights, instead voluntarily chose to renegotiate. (234 C.A.2d 239.)

The court emphasized the distinction between the loose layman's concept of "business compulsion" and the narrow legal doctrine: "[T]he fact that law suits take time and that it was clear that a resort to the courts would prevent the rapid completion of the subdivision is not equivalent to saying that there was a legal right to renegotiate a contract and then sue, after the event, for the difference between what the plaintiff would have preferred to pay for the land and what it later agreed to pay for it. There probably was never a sale of real property in which the buyer would not have preferred to pay less than he did. If the courts should begin to encourage suits like this one, land deals would never be final in this country." (234 C.A.2d 241.)

If the party claiming coercion had a *reasonable alternative* to parting with the consideration to satisfy a false claim, the payment was not under duress; and "[t]he determination of whether there is a reasonable alternative is made by ascertaining as a question of fact whether a reasonably prudent person would follow the alternative course." (*Louisville Title Ins. Co. v. Surety Title & Guaranty Co.* (1976) 60 C.A.3d 781, 801, 802, 132 C.R. 63 [discussing principles laid down in *Leeper v. Beltrami* (1959) 53 C.2d 195, 206, 1 C.R. 12, 347 P.2d 12, *infra*, §1032, citing the text, and holding that the record contained no substantial evidence to support the jury's implied finding of economic compulsion].)

Philippine Export & Foreign Loan Guarantee Corp. v. Chuidian (1990) 218 C.A.3d 1058, 267 C.R. 457, involved threats not against the plaintiff, but against a third party who, in turn, compelled the plaintiff to act in a manner that was

not in its best interest. Plaintiff, a foreign government agency that guaranteed development loans, brought a motion to set aside a stipulated judgment that was based on an allegedly highly unfavorable settlement of its earlier action to recover unpaid loans from defendant businessman, contending that it had been compelled by a former dictator to make the aforementioned settlement, and further that defendant had coerced the former dictator into ordering the settlement by threatening to expose the investments of the dictator and his wife in defendant's enterprises. Plaintiff contended that the agreements were illegal in purpose, coerced, and void, because the purpose of the dictator's action was to buy defendant's silence. The motion was denied. *Held*, affirmed.

(a) "[T]he economic duress doctrine is not limited by early statutory and judicial expressions requiring an unlawful act in the nature of a tort or a crime. ... Instead, the doctrine now may come into play upon the doing of a wrongful act which is sufficiently coercive to cause a reasonably prudent person faced with no reasonable alternative to succumb to the perpetrator's pressure. ... The assertion of a claim known to be false or a bad faith threat to breach a contract or to withhold a payment may constitute a wrongful act for purposes of the economic duress doctrine." (218 C.A.3d 1077, quoting *Rich & Whillock v. Ashton Dev.* (1984) 157 C.A.3d 1154, 204 C.R. 86, *supra*, §314.)

(b) "The question of duress, as that of criminal blackmail, is a factual question; the existence of duress always depends upon the circumstances. Thus, one authority points out that duress is tested, not by the objective nature of the threats, but by 'the state of mind induced thereby in the victim.' " (218 C.A.3d 1078.)

(c) In the present case, the alleged duress of defendant against the former dictator consisted either of threats to prosecute a civil lawsuit or threats to reveal damaging information to the press. "Those types of threats pose the most difficult problems in the law of blackmail and the contract law of duress, because they are threats to take actions which are legal under many circumstances. For instance, a person, generally speaking, has a perfect right to prosecute a lawsuit in good faith, or to provide information to newspapers. Language can be found in many decisions that it is not an illegal threat for a person to do 'what he has a legal right to do.' " (218 C.A.3d 1079, citing the text.) The record in this case contains substantial evidence to support the trial judge's conclusion that defendant did not go beyond the legitimate bounds of pressure upon an adversary in litigation. (218 C.A.3d 1080.)

In *River Bank America v. Diller* (1995) 38 C.A.4th 1400, 45 C.R.2d 790, plaintiff bank sought to enforce guaranty agreements executed as security for nonrecourse construction loans to a limited partnership formed by defendant guarantors. Defendants raised an estoppel defense, based on the contention that plaintiff initially agreed to a joint venture but changed the structure of the transaction at the last moment to loan and guaranties, thereby creating difficulty in finding alternative financing and forcing defendants to execute loans and guaranties under economic duress. *Held*, there were no triable issues of fact concerning defendants' estoppel defense to the extent that it was based on economic duress. (38 C.A.4th 1425, citing *London Homes v. Korn*, *supra*.)

West's Key Number Digest, Contracts k.95(2)

SUPPLEMENT: [This section is current through the latest supplement]

See *Perez v. Uline* (2007) 157 C.A.4th 953, 959, 68 C.R.3d 872 [release that former employee signed in exchange for severance pay was not obtained through economic duress, where former employer did not know it owed former employee any money in addition to what was paid and thus did not use release to avoid paying acknowledged debt, former employee was not on verge of bankruptcy, payment of 6 weeks' salary was not inequitably low, and former employee was not forced to accept settlement amount to stave off financial disaster].



61 of 199 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT
D. Undue Influence.
1. Nature and Types.

1 Witkin Sum. Cal. Law Contracts § 316

[§ 316] Nature and Types.

C.C. 1575 defines undue influence as follows: It consists "1. In the use, by one in whom *a confidence* is reposed by another, or who holds a *real or apparent authority* over him, of such confidence or authority for the purpose of obtaining an *unfair advantage* over him; 2. In taking an unfair advantage of another's *weakness of mind*; or 3. In taking a *grossly oppressive and unfair advantage* of another's *necessities or distress*." (See *Stenger v. Anderson* (1967) 66 C.2d 970, 979, 59 C.R. 844, 429 P.2d 164, *infra*, §438; *Odorizzi v. Bloomfield School Dist.* (1966) 246 C.A.2d 123, 130, 54 C.R. 533, *infra*, §321; *Keithley v. Civil Service Bd.* (1970) 11 C.A.3d 443, 451, 89 C.R. 809, *infra*, §321; *O'Neil v. Spillane* (1975) 45 C.A.3d 147, 153, 154, 119 C.R. 245, *infra*, §317 [breach of confidence and taking unfair advantage of weakness of mind]; *Robison v. Manteca* (2000) 78 C.A.4th 452, 457, 92 C.R.2d 748 ["strong advice" by union representative to sign agreement to undertake substance abuse program or face termination was not coercion, but rather was no more than accurate summation of employee's situation]; 28 Williston 4th, §71:50 et seq.; 17A Am.Jur.2d (2004 ed.), *Contracts* §221; 25 Am.Jur.2d (1996. ed.), *Duress and Undue Influence* §30 et seq.; Cal. Transactions Forms, 1 Business Transactions §6:26; 2 California Affirmative Defenses 2d (2004 ed.), §46:1 et seq.; CACI, No. 334 [Affirmative Defense--Undue Influence]; 4 Cal. Proc. (4th), *Pleading*, §508 et seq.)

Undue influence differs from fraud in that the importunities or beseechings may or may not include fraudulent representations. (*Estate of Ricks* (1911) 160 C. 467, 480, 117 P. 539; see *Weger v. Rocha* (1934) 138 C.A. 109, 114, 32 P.2d 417.) And the law of undue influence affords protection in situations not covered by the rules on duress. (*Rest.2d, Contracts* §177, Comment b.)

In determining whether there was "unfair persuasion" a number of facts may be considered, such as "the unfairness of the resulting bargain, the unavailability of independent advice, and the susceptibility of the person persuaded." (*Rest.2d, Contracts* §177, Comment b.)

West's Key Number Digest, Contracts k.96

SUPPLEMENT: [This section is current through the latest supplement]
See C.E.B., *Law of Contracts* §3.21 et seq.; 2 California Affirmative Defenses §46:1 et seq.

Definition of "undue influence":

1 Witkin Sum. Cal. Law Contracts § 316

Cross-Reference: 4 Cal. Proc. (5th), *Pleading*, §547 et seq.



62 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT
D. Undue Influence.
2. Effect of Undue Influence.

1 Witkin Sum. Cal. Law Contracts § 317

[§ 317] Effect of Undue Influence.

The remedy of the aggrieved party in cases of undue influence is limited to *rescission*; there can be no affirmance and recovery of damages, as in cases of fraud. (*Bancroft v. Bancroft* (1895) 110 C. 374, 379, 42 P. 896; *O'Neil v. Spillane* (1975) 45 C.A.3d 147, 153, 154, 119 C.R. 245; *Rest.2d, Contracts §177(2)*.) (On contract voidable for undue influence of third person, see *Rest.2d, Contracts §177*, Comment c.)

In *O'Neil v. Spillane*, *supra*, plaintiff, an elderly woman, was induced to make a gift deed in joint tenancy to herself and defendants, husband and wife. In this action for rescission and damages, the jury found defendants guilty of undue influence and not guilty of fraud, oppression, or actual malice; but the general verdict and judgment were for both rescission and compensatory damages. *Held*, judgment modified to delete the award of damages.

(a) The same act may give rise to a remedy in both contract and tort (45 C.A.3d 158, citing the text, 5 *Summary* (10th), *Torts*, §2, and 3 *Cal. Proc.* (4th), *Actions*, §139), and the undue influence found by the jury was in the nature of constructive fraud (see *supra*, §294 et seq.), which would support a judgment of rescission under C.C. 1692 (see *infra*, §936) or damages under C.C. 3343 (see 6 *Summary* (10th), *Torts*, §1710). (45 C.A.3d 158.)

(b) However, there was no evidence of deprivation of use and enjoyment of the property, and the damages were improperly awarded solely for pain and suffering. (1) Although C.C. 1692 allows recovery of consequential damages, the settled rule in breach of contract cases rejects mental suffering or injury to reputation as a basis for recovery. (45 C.A.3d 159, citing the text, §884.) (2) Similarly, C.C. 3343 allows recovery of "additional damages" (see 6 *Summary* (10th), *Torts*, §1714 et seq.), but this provision refers to expenses and other consequential damages, and does not extend the measure of damages to include the elements of pain and suffering. And the additional phrase "any legal and equitable remedies" does not pertain to the measure of damages, but merely preserves such remedies as rescission or recovery on warranty. (45 C.A.3d 159.)

SUPPLEMENT: [This section is current through the latest supplement]
Same act gives rise to remedy in contract and tort:

Cross-Reference: 3 *Cal. Proc.* (5th), *Actions*, §144.



63 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

D. Undue Influence.

3. Parties in Confidential Relationship.

a. Fiduciaries.

1 Witkin Sum. Cal. Law Contracts § 318

[§ 318] Fiduciaries.

Where the transaction is with such fiduciaries as trustees, guardians, executors, and administrators, it is voidable, unless fair and assented to by beneficiaries of full capacity with knowledge of the facts and their rights. (See *Rest.2d, Contracts §173*; on trustees, see *Prob.C. 16002, 16004, 13 Summary* (10th), *Trusts*, §§63, 66, 132; on guardians, executors, and administrators, see *Main v. Merrill Lynch* (1977) 67 C.A.3d 19, 31, 136 C.R. 378 [stockbroker]; *Tyler v. Children's Home Soc.* (1994) 29 C.A.4th 511, 550, 35 C.R.2d 291, citing the text [adoption agency]; 14 *Summary* (10th), *Wills and Probate*, §§415 et seq., 901 et seq.)

Similar strictness is shown toward contracts of an attorney. Any transaction (except the original contract employing the attorney and fixing the compensation) in which the attorney obtains an advantage over his or her client is *presumptively invalid*, and the attorney must show not only that it was fair, but that the client was fully informed of all facts necessary to enable the client to deal at arm's length. (*Bradner v. Vasquez* (1954) 43 C.2d 147, 151, 272 P.2d 11; see 42 *Cal. L. Rev.* 865 [criticizing result]; 13 *Hastings L. J.* 3 [same]; 1 *Cal. Proc.* (4th), *Attorneys*, §119 et seq.)

In the *Bradner* case, *supra*, the court said: "When a fiduciary enters into a transaction with a beneficiary whereby the fiduciary's position is improved, or he obtains a favorable opportunity, or where he otherwise gains, benefits, or profits, it may fairly be said that an advantage has been obtained. To declare that the advantage obtained must be shown to be unfair, unjust, or inequitable *before* the presumptions arise would result in the imposition of a condition which is not required by section 2235" (now *Prob.C. 16004(c)*). (43 C.2d 152.) (See *Rader v. Thrasher* (1962) 57 C.2d 244, 251, 18 C.R. 736, 368 P.2d 360, 1 *Cal. Proc.* (4th), *Attorneys*, §122 [extending doctrine of *Bradner* case by stressing requirement of showing adequacy of consideration, even though there was no undue influence because of lack of trust and confidence]; *Gold v. Greenwald* (1966) 247 C.A.2d 296, 306, 310, 55 C.R. 660 [plaintiff attorney engaged in joint venture with defendant businesswoman client; *Bradner* and *Rader* cases followed]; *Rebmann v. Major* (1970) 5 C.A.3d 684, 687, 85 C.R. 399 [attorney, wife of decedent's physician, gave advice to dangerously ill decedent, thereby obtaining valuable property for her own children].)

The presumption of lack of consideration and undue influence does not apply to an attorney until the relationship commences; i.e., it does not apply to the original contract of employment. (See 1 *Cal. Proc.* (4th), *Attorneys*, §125.) The 1963 Legislature made this rule applicable to trustees by the following addition to former C.C. 2235 (now *Prob.C.*

16004(c)): "The presumptions established by this section do not apply to the provisions of an agreement between a trustee and his beneficiary relating to the hiring or compensation of the trustee." (See *Walton v. Broglio* (1975) 52 C.A.3d 400, 404, 125 C.R. 123, 1 Cal. Proc. (4th), Attorneys, §125 [under broad language of amendment, presumption is inapplicable to any agreement relating to fees, even where there is a preexisting attorney-client relationship].)

West's Key Number Digest, Contracts k.96

SUPPLEMENT: [This section is current through the latest supplement]

Attorney contracts:

Cross-Reference: 1 Cal. Proc. (5th), Attorneys, §91 et seq. *Rader case:*

Cross-Reference: 1 Cal. Proc. (5th), Attorneys, §94.

Presumption of undue influence:

Cross-Reference: 1 Cal. Proc. (5th), Attorneys, §97.

Walton case:

Cross-Reference: 1 Cal. Proc. (5th), Attorneys, §97.



64 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

D. Undue Influence.

3. Parties in Confidential Relationship.

b. Agents.

1 Witkin Sum. Cal. Law Contracts § 319

[§ 319] Agents.

Agency is also a confidential relationship giving rise to the usual presumption (*supra*, §318).

Thus, in *Webb v. Saunders* (1947) 79 C.A.2d 863, 181 P.2d 43, an agent prevailed upon an elderly and infirm principal (a woman of 85) to execute a deed to him without consideration. *Held*, "equity regards and treats the relation of principal and agent in the same general manner and with nearly the same strictness as that of trustee and beneficiary," and "the burden is upon the grantee to show that the deed was made freely and voluntarily, and with full knowledge of all the facts and with perfect understanding of the effect of the transfer." (79 C.A.2d 870.) (See *Kent v. First Trust & Savings Bank of Pasadena* (1950) 101 C.A.2d 361, 370, 225 P.2d 625; 3 *Summary* (10th), *Agency and Employment*, §97.)

SUPPLEMENT: [This section is current through the latest supplement]



65 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

D. Undue Influence.

3. Parties in Confidential Relationship.

c. Families and Friends.

1 Witkin Sum. Cal. Law Contracts § 320

[§ 320] Families and Friends.

The California cases are usually not so strict as to the ordinary confidential relationships of parent and child, husband and wife, etc. Thus, mere lack of independent advice is not sufficient to raise a presumption of undue influence or of constructive fraud, even when the consideration appears inadequate. But when to these factors is added some other such as great age, weakness of mind, sickness, or other incapacity, the presumption arises, and the burden is on the other party to show that no oppression took place. (See *Carty v. Connolly* (1891) 91 C. 15, 22, 27 P. 599; *Wilbur v. Wilbur* (1925) 197 C. 1, 14, 239 P. 332; *Brown v. Canadian Industrial Alcohol Co.* (1930) 209 C. 596, 599, 289 P. 613; *Nessen v. Nessen* (1933) 218 C. 59, 61, 21 P.2d 415; *Anderson v. Nelson* (1927) 83 C.A. 1, 5, 256 P. 294; *Donze v. Donze* (1928) 88 C.A. 769, 775, 264 P. 294; *Burrows v. Burrows* (1934) 136 C.A. 323, 329, 28 P.2d 1072; *Hatch v. Penzner* (1941) 44 C.A.2d 874, 879, 113 P.2d 295; *Stevens v. Hutton* (1945) 71 C.A.2d 676, 683, 163 P.2d 479; *Leathers v. Leathers* (1946) 77 C.A.2d 134, 141, 174 P.2d 875; *Helbing v. Helbing* (1948) 89 C.A.2d 224, 229, 200 P.2d 560; *Sparks v. Sparks* (1950) 101 C.A.2d 129, 136, 225 P.2d 238 [grantor without independent advice; grantees, son and son's wife, guilty of fraud and unfair insistence]; *Roeder v. Roeder* (1953) 118 C.A.2d 572, 580, 258 P.2d 581; *Patterson v. Davis* (1953) 121 C.A.2d 152, 160, 262 P.2d 601; cf. *Weil v. Weil* (1951) 37 C.2d 770, 787, 236 P.2d 159 [wife had independent advice; presumption overcome].)

In *Stenger v. Anderson* (1967) 66 C.2d 970, 59 C.R. 844, 429 P.2d 164, *infra*, §438, the principle was extended beyond the family relationships. An elderly lady, while in a weakened mental and physical condition and without independent advice, was induced by a close friend to make an unfair agreement. *Held*, judgment rescinding agreement affirmed: The relationship was "confidential" and the agreement was obtained by undue influence. (66 C.2d 979.)

West's Key Number Digest, Contracts k.96

SUPPLEMENT: [This section is current through the latest supplement]

See *Estate of Young* (2008) 160 C.A.4th 62, 79, 72 C.R.3d 520 [undue influence was established where mother, relying on advice of child, transferred land to trusts for "tax avoidance" before her death; there was no evidence mother needed to avoid taxes or needed extensive trust services, estate was damaged by loss of monetary assets and title to real property, and there was evidence that transactions were entirely disadvantageous to mother and that she would not have entered into them if she had fully understood that they controverted her known prior estate plan to benefit her four

children equally].



66 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT
D. Undue Influence.
4. No Confidential Relationship.

1 Witkin Sum. Cal. Law Contracts § 321

[§ 321] No Confidential Relationship.

The second and third subdivisions of C.C. 1575, i.e., taking an unfair advantage of another's weakness of mind or taking a grossly oppressive and unfair advantage of another's necessities or distress (*supra*, §316), describe undue influence in situations not involving confidential relationships. Where the evidence does not establish such a relationship, there is no presumption arising from advantage gained, and the burden of proof is on the plaintiff to establish undue influence. (*In re Marriage of Bonds* (2000) 24 C.4th 1, 27, 99 C.R.2d 252, 5 P.3d 815, 11 Summary (10th), *Community Property*, §29 [persons entering into prenuptial agreement are not presumed to be in confidential relationship]; *Dorn v. Pichinino* (1951) 105 C.A.2d 796, 801, 234 P.2d 307 [gift in trust]; *Roeder v. Roeder* (1953) 118 C.A.2d 572, 581, 258 P.2d 581 [gift deed].)

This burden has occasionally been met. (See *Weger v. Rocha* (1934) 138 C.A. 109, 115, 32 P.2d 417 [insurance adjuster continually importuned sick and hysterical woman to sign release of claims for inadequate consideration; taking advantage of distress]; *Wells Fargo Bank & Union Trust Co. v. Brady* (1953) 116 C.A.2d 381, 398, 254 P.2d 71 [elderly woman; weakness of mind]; *Odorizzi v. Bloomfield School Dist.* (1966) 246 C.A.2d 123, 130, 54 C.R. 533; *Keithley v. Civil Service Bd.* (1970) 11 C.A.3d 443, 451, 89 C.R. 809; *Channell v. Anthony* (1976) 58 C.A.3d 290, 305, 129 C.R. 704.) (On taking advantage of manic-depressive, see *supra*, §57.)

In the *Odorizzi* case, *supra*, plaintiff, an elementary schoolteacher, was arrested on June 10 on criminal charges of homosexuality. His complaint alleged that the next day, after his arrest and interrogation by police, and after 40 hours without sleep, the superintendent of the school district and the principal of his school came to his apartment; they represented that they were acting in his interests in seeking his immediate resignation, following which they would not publicize the incident so as to jeopardize his chances of employment elsewhere; but they said that if he did not resign immediately they would dismiss him and publicize the proceedings. He signed a written resignation at that time, and the district accepted it on June 13. In July, the criminal charges were dismissed on a motion under P.C. 995 (see 4 *Cal. Crim. Law*. (3d), *Pretrial Proceedings*, §228 et seq.). After being denied reemployment, he brought this action for declaratory relief and rescission of his resignation, on grounds of duress, menace, fraud, undue influence, or mistake. *Held*, judgment for defendant on demurrer reversed.

(a) *Untenable grounds of fraud, mistake and duress.* There was no actual fraud, and no constructive fraud, because no facts were alleged to show a confidential relationship. (246 C.A.2d 128.) There was no mistake as to basic facts; the

parties merely attempted "to evaluate the probable consequences of plaintiff's predicament and to predict the future course of events." (246 C.A.2d 129.) There was no duress or menace, for the school representatives were merely performing their duties in a lawful manner and in good faith. (246 C.A.2d 128.)

(b) *Undue influence: in general.* The complaint sufficiently alleged undue influence of the type described in C.C. 1575(2) and 1575(3)--taking unfair advantage of another's weakness of mind or distress. The "high pressure" or "overpersuasion" may take place under conditions of great weakness of the person influenced, or excessive strength of the influencing party; but the same legal consequences apply. The characteristic elements of such overpersuasion are: "(1) discussion of the transaction at an unusual or inappropriate time, (2) consummation of the transaction in an unusual place, (3) insistent demand that the business be finished at once, (4) extreme emphasis on untoward consequences of delay, (5) the use of multiple persuaders by the dominant side against a single servient party, (6) absence of third-party advisers to the servient party, (7) statements that there is no time to consult financial advisers or attorneys." If a number of these elements are simultaneously present, the persuasion is "excessive." (246 C.A.2d 133.)

(c) *Legitimate persuasion and undue influence distinguished.* (1) If the superintendent had called plaintiff to his office a day or two after release on bail, called his attention to the Education Code provisions authorizing suspension, told him of the intention to file written charges, pointed out the alternative of resignation, advised him that he was free to consult counsel or anyone else and make his decision the next day, "it is extremely unlikely" that any complaint of excessive pressure could ever be made. (246 C.A.2d 134.) (2) Here, however, the complaint's allegations showed that "the representatives of the school board undertook to achieve their objective by overpersuasion and imposition to secure plaintiff's signature but not his consent to his resignation through a high-pressure carrot-and-stick technique." (246 C.A.2d 135.)

Odorizzi was followed in a case with strikingly similar facts, *Keithley v. Civil Service Bd.* (1970) 11 C.A.3d 443, 89 C.R. 809. A city police officer, induced to resign under pressure, sought administrative relief from the Civil Service Board. The board found that his resignation had been coerced and therefore that he had been unlawfully discharged. The trial judge, in an administrative mandamus proceeding, made a contrary determination. *Held*, reversed; the elements of overpersuasion numbered (1), (2), (3), (5), and (6) in *Odorizzi*, *supra*, were all present. (11 C.A.3d 451.)

SUPPLEMENT: [This section is current through the latest supplement]

See *Persson v. Smart Inventions* (2005) 125 C.A.4th 1141, 1152, 1159, 23 C.R.3d 335 [no confidential relationship arose in course of arm's-length buyout negotiations between two equal shareholders, both of whom were represented by counsel and accountants, simply because one stated that he would give plaintiff truest picture possible of where company was at present, and plaintiff relied on him to do so, in absence of evidence of any vulnerability or incapacity of relying party].



67 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT
E. Adhesive or Unconscionable Contracts.
1. Alternate Approaches.

1 Witkin Sum. Cal. Law Contracts § 322

[§ 322] Alternate Approaches.

In *Patterson v. ITT Consumer Financial Corp.* (1993) 14 C.A.4th 1659, 18 C.R.2d 563, the court summarized the alternate approaches set forth in the leading cases of *Graham v. Scissor-Tail* (1981) 28 C.3d 807, 171 C.R. 604, 623 P.2d 165, *infra*, §334, and *A & M Produce Co. v. FMC Corp.* (1982) 135 C.A.3d 473, 186 C.R. 114, *infra*, §332, for determining unconscionability, and, citing *Perdue v. Crocker Nat. Bank* (1985) 38 C.3d 913, 216 C.R. 345, 702 P.2d 503, *infra*, §339, concluded that both approaches should lead to the same result. The court said:

"Two alternative analyses exist under California law for determining whether a contractual provision will be unenforceable because it is unconscionable. ... The first model set out in *Graham v. Scissor-Tail* ... asks initially whether the contract is one of adhesion. ... Since a contract of adhesion is still fully enforceable, the inquiry then turns to whether enforcement should be denied. First, enforcement will be denied if the contract or provision falls outside the reasonable expectations of the weaker party. ... Second, enforcement will be denied even if it does fall within the reasonable expectations of the parties, but it is unduly oppressive or unconscionable." (14 C.A.4th 1663.)

"The alternative analytical model was set out in *A & M Produce Co. v. FMC Corp.* ... It sought to define what rendered a contract or a contractual provision unconscionable and hence unenforceable under *Civil Code section 1670.5*. ... *A & M* concluded that unconscionability has a procedural and a substantive component. ... The procedural component focuses on the factors of oppression and surprise. ... The substantive component of unconscionability looks to whether the contract allocates the risks of the bargain in an objectively unreasonable or unexpected manner. ... To be unenforceable there must be both substantive and procedural unconscionability, though there may be an inverse relation between the two elements." (14 C.A.4th 1664.) (See *California Grocers Assn. v. Bank of America* (1994) 22 C.A.4th 205, 27 C.R.2d 396, *infra*, §339 [expressing preference for *Graham v. Scissor-Tail* approach]; *O'Hare v. Municipal Resource Consultants* (2003) 107 C.A.4th 267, 282, 132 C.R.2d 116 [fact that there was no extrinsic evidence concerning contract negotiations did not preclude finding of procedural unconscionability, where contract itself created sufficient inference of procedural unconscionability]; 5 Corbin (Rev. ed.), §24.29; 7 Corbin (Rev. ed.), §29.1 et seq.; 8 Williston 4th, §18:1 et seq.; Cal. Transactions Forms, 1 Business Transactions §6:41; 3 California Affirmative Defenses 2d (2004 ed.), §55:1 et seq.; 46 *Hastings L. J.* 459 [Unconscionability in California: A Need for Restraint and Consistency]; 5 *U.C. Davis L. Rev.* 187 [From a Gasp to a Gamble: A Proposed Test for Unconscionability].)

In *Dean Witter Reynolds v. Superior Court* (1989) 211 C.A.3d 758, 259 C.R. 789, plaintiff opened a self-directed

IRA account with defendant Dean Witter, and after liquidating it, brought a class action challenging as unconscionable the "close-out" or "termination fee" on closing an IRA. Defendant offered evidence of availability of IRAs from various institutions which either did not charge a termination fee or charged less than \$ 50. In rejecting plaintiff's contention that because the agreement was an adhesion contract, it was, therefore, oppressive, the court said: "While we recognize significant overlap between the two concepts, we are not prepared to hold that they are identical. Were we to accept such an equation, every form contract not subject to negotiation between the parties would be deemed oppressive, totally disregarding the undisputed ability of a contracting party to choose to obtain that for which he bargained from other sources." (211 C.A.3d 769.) In other words: "[E]ven though a contract may be adhesive, the existence of 'meaningful' alternatives available to such contracting party in the form of other sources of supply tends to defeat any claim of unconscionability as to the contract in issue." (211 C.A.3d 771.)

Although procedural and substantive unconscionability must both be present and although procedural unconscionability *generally* takes the form of a contract of adhesion, adhesion is not a prerequisite for unconscionability. For example, a contracting party might have other market options even though the elements of surprise and oppression are present. (*Harper v. Ultimo* (2003) 113 C.A.4th 1402, 1408, 7 C.R.3d 418 [*Graham v. Scissor-Tail* began with adhesion issue, not because adhesion is required, but because adhesion contract was involved in that case].)

SUPPLEMENT: [This section is current through the latest supplement]
See 3 California Affirmative Defenses §55:1 et seq.



68 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

E. Adhesive or Unconscionable Contracts.

2. Adhesion Contracts.

a. In General.

1. Judicial Development of Concept.

1 Witkin Sum. Cal. Law Contracts § 323

[§ 323] Judicial Development of Concept.

"Commentators have characterized the type of agreement before us as a 'contract of adhesion.' The term signifies a standardized contract, which, imposed and drafted by the party of superior bargaining strength, relegates to the subscribing party only the opportunity to adhere to the contract or reject it. ... Such an agreement does not issue from that freedom in bargaining and equality of bargaining which are the theoretical parents of the American law of contracts. Yet, today, the impact of these standardized contracts can hardly be exaggerated. 'Most contracts which govern our daily lives are of a standardized character. We travel under standard terms, by rail, ship, aeroplane, or tramway. We make contracts for life or accident assurances under standardized conditions. We rent houses or rooms under similarly controlled terms; authors or broadcasters, whether dealing with public or private institutions, sign standard agreements; government departments regulate the conditions of purchases by standard conditions.' " (*Neal v. State Farm Ins. Cos.* (1961) 188 C.A.2d 690, 694, 10 C.R. 781.)

This concept has developed rapidly as a basis for modifying or nullifying harsh terms that defeat the reasonable expectations of the parties. (See *Steven v. Fidelity & Cas. Co. of New York* (1962) 58 C.2d 862, 882, 27 C.R. 172, 377 P.2d 284, 2 Summary (10th), *Insurance*, §51; *Gray v. Zurich Ins. Co.* (1966) 65 C.2d 263, 269, 54 C.R. 105, 419 P.2d 168, 2 Summary (10th), *Insurance*, §51; *Neal v. State Farm Ins. Cos.*, *supra*; *Akin v. Business Title Corp.* (1968) 264 C.A.2d 153, 156, 70 C.R. 287; *Schmidt v. Pacific Mut. Life Ins. Co.* (1969) 268 C.A.2d 735, 738, 74 C.R. 367; *Hays v. Pacific Indem. Group* (1970) 8 C.A.3d 158, 162, 86 C.R. 815; *Player v. George M. Brewster & Son* (1971) 18 C.A.3d 526, 533, 96 C.R. 149; *Spence v. Omnibus Industries* (1975) 44 C.A.3d 970, 974, 119 C.R. 171, *infra*, §327, citing the text ["The use of standardized or mass-produced agreements containing a profusion of provisions which allow the stronger party to dictate the terms to the weaker party is viewed with judicial concern"]; *Wilson v. San Francisco Fed. Savings & Loan Assn.* (1976) 62 C.A.3d 1, 7, 132 C.R. 903 [deeds of trust with impound provisions]; *Wheeler v. St. Joseph Hosp.* (1976) 63 C.A.3d 345, 356, 133 C.R. 775, *infra*, §327; 5 Corbin (Rev. ed.), §24.28 et seq.; 34 *Golden Gate L. Rev.* 285 [challenging adhesion contracts in California]; 84 *Harv. L. Rev.* 549 [application of administrative law safeguards to adhesion contracts]; 96 *Harv. L. Rev.* 1174 [social analysis and argument that form terms in contracts of adhesion ought to be considered presumptively unenforceable]; 26 *Hastings L. J.* 383 [adhesion contracts and due process in repossession]; 11 *Loyola L.A. L. Rev.* 297 [Adhesion Theory in California: A Suggested Redefinition and Its

Application to Banking]; 16 *Loyola L.A. L. Rev.* 603 [Adhesion Theory in California: An Update]; 48 *So. Cal. L. Rev.* 1 [Mass Contracts: Lawful Fraud in California]; 14 *Southwestern U. L. Rev.* 222 [application of adhesion doctrine to franchise contracts]; 1 *U.S.F. L. Rev.* 306.) (On the overlap of the concepts of adhesion contract and unconscionability, see *Dean Witter Reynolds v. Superior Court* (1989) 211 C.A.3d 758, 769, 259 C.R. 789, *infra*, §333; *California Grocers Assn. v. Bank of America* (1994) 22 C.A.4th 205, 215, 27 C.R.2d 396, *infra*, §339.)

In *Chow v. Levi Strauss & Co.* (1975) 49 C.A.3d 315, 122 C.R. 816, the court emphasized two points with respect to adhesion contracts:

(a) Whether the contract is within this objectionable classification must be determined as of the time when it was made; hindsight and subsequent circumstances cannot be determinative of the issue of disappointment of reasonable expectations. (49 C.A.3d 325.)

(b) The result of establishing the adhesion classification is only to permit a favorable construction of uncertain or ambiguous terms. In the absence of uncertainty or ambiguity, the contract is enforceable according to its terms. (49 C.A.3d 325.) (See *Marin Storage & Trucking v. Benco Contracting & Engineering* (2001) 89 C.A.4th 1042, 1054, 107 C.R.2d 645 [indemnification clause that was adhesive was nevertheless enforceable where it was not substantively unconscionable].)

From the foregoing, it is clear that characterizing a contract as one of adhesion does not, by itself, mean that it is invalid. It means only that the contract is a standardized agreement imposed on the subscribing party without an opportunity to negotiate the terms; it is nonetheless valid and existing. Thus, "[a] finding of adhesion merely begins another inquiry--whether a particular provision within the contract should be denied enforcement on grounds that it defeats the expectations of the weaker party or it is unduly oppressive or unconscionable." (*Intershop Communications AG v. Superior Court* (2002) 104 C.A.4th 191, 201, 127 C.R.2d 847 [forum selection clause within adhesion contract was enforceable, where plaintiff had full knowledge that he was agreeing to Hamburg, Germany as place of trial, even though he might not have read entire contract].)

West's Key Number Digest, Insurance k.715

SUPPLEMENT: [This section is current through the latest supplement]



69 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

E. Adhesive or Unconscionable Contracts.

2. Adhesion Contracts.

a. In General.

2. Restatement 2d: Standardized Agreements.

1 Witkin Sum. Cal. Law Contracts § 324

[§ 324] Restatement 2d: Standardized Agreements.

Rest.2d, Contracts §211, reads as follows:

"(1) Except as stated in Subsection (3), where a party to an agreement signs or otherwise manifests assent to a writing and has reason to believe that like writings are regularly used to embody terms of agreements of the same type, he adopts the writing as an integrated agreement with respect to the terms included in the writing."

"(2) Such a writing is interpreted wherever reasonable as treating alike all those similarly situated, without regard to their knowledge or understanding of the standard terms of the writing."

"(3) Where the other party has reason to believe that the party manifesting such assent would not do so if he knew that the writing contained a particular term, the term is not part of the agreement."

The Comments explain the scope and effect of the section:

(1) *Utility of standardization.* "Standardization of agreements serves many of the same functions as standardization of goods and services; both are essential to a system of mass production and distribution." Time and skill can be devoted to a class of transactions, forms can be tailored to office routines and personnel training. Sales personnel and customers can focus on meaningful choice among a limited number of significant features. "Operations are simplified and costs reduced, to the advantage of all concerned."

(2) *Assent to unknown terms.* A party who uses a standardized form does not ordinarily expect his or her customers to understand or even to read the standard terms, and customers do not in fact ordinarily understand or read them. "They trust to the good faith of the party using the form and to the tacit representation that like terms are being accepted regularly by others similarly situated. But they understand that they are assenting to the terms not read or not understood, subject to such limitations as the law may impose."

(3) *Review of unfair terms.* "Standardized agreements are commonly prepared by one party. The customer assents to a few terms, typically inserted in blanks on the printed form, and gives blanket assent to the type of transaction

embodied in the standard form. He is commonly not represented in the drafting, and the draftsman may be tempted to overdraw in the interest of his employer. The obvious danger of overreaching has resulted in government regulation of insurance policies, bills of lading, retail installment sales, small loans, and other particular types of contracts.

Regulation sometimes includes administrative review of standard terms, or even prescription of terms. Apart from such regulation, standard terms imposed by one party are enforced. But standard terms may be superseded by separately negotiated or added terms (§203), they are construed against the draftsman (§206), and they are subject to the overriding obligation of good faith (§205) and to the power of the court to refuse to enforce an unconscionable contract or term (§208). Moreover, various contracts and terms are against public policy and unenforceable."

(4) *Noncontractual documents*. The same document may serve both contractual and other purposes, and a party may be bound by his or her assent if the party has reason to know that it is used to embody contract terms. Thus, insurance policies, steamship tickets, bills of lading, and warehouse receipts are obviously contractual; but baggage checks or parking lot tickets may appear to be mere identification tokens. (See *supra*, §120.)

(5) *Equality of treatment*. One who assents to standard contract terms normally assumes that others are doing likewise; and, apart from government regulation, "courts in construing and applying a standardized contract seek to effectuate the reasonable expectations of the average member of the public who accepts it."

(6) *Terms excluded*. "[A] party who adheres to the other party's standard terms does not assent to a term if the other party has reason to believe that the adhering party would not have accepted the agreement if he had known that the agreement contained the particular term. Such a belief or assumption may be shown by the prior negotiations or inferred from the circumstances. Reason to believe may be inferred from the fact that the term is bizarre or oppressive, from the fact that it eviscerates the non-standard terms explicitly agreed to, or from the fact that it eliminates the dominant purpose of the transaction. The inference is reinforced if the adhering party never had an opportunity to read the term, or if it is illegible or otherwise hidden from view. This rule is closely related to the policy against unconscionable terms and the rule of interpretation against the draftsman."

SUPPLEMENT: [This section is current through the latest supplement]



70 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

E. Adhesive or Unconscionable Contracts.

2. Adhesion Contracts.

a. In General.

3. Contract Meeting Adhering Party's Reasonable Expectations.

1 Witkin Sum. Cal. Law Contracts § 325

[§ 325] Contract Meeting Adhering Party's Reasonable Expectations.

In *Allan v. Snow Summit* (1996) 51 C.A.4th 1358, 59 C.R.2d 813, plaintiff was a student in defendant's ski instruction school. Before being allowed to participate, plaintiff had to sign a release exonerating defendant and its instructors even if injury was due to their negligence. After the initial lesson, plaintiff, a beginning skier, was urged by the instructor to try a harder hill. Plaintiff fell numerous times, and he discovered afterwards that he had sustained a serious back injury. In his suit against defendant, plaintiff claimed that the release was a contract of adhesion. *Held*, the release was enforceable.

(a) The release in question, being a standardized contract that gave the weaker party no option other than to "take it or leave it," was an adhesion contract. However, this determination does not end the inquiry as to its enforceability. Rather, courts have considered whether the contract falls within the reasonable expectations of the weaker party and, even if it does, whether the contract, considered in its entire context, is unduly unconscionable. (51 C.A.4th 1375.)

(b) Among the factors accorded great weight in determining whether the contract meets the adhering party's reasonable expectations is notice. Here, the release provisions were prominent and were printed in large, bold type, with the result that plaintiff had to have seen them when filling in his printed name and signing the release at the end. In short, the notice was sufficient to have altered any subjective expectations of plaintiff to the effect that defendant or its instructor would be liable for negligent instruction. Plaintiff cannot avoid this effect by the fact that he did not read the release. (51 C.A.4th 1375.)

(c) Under the approach adopted by *A & M Produce Co. v. FMC Corp.* (1982) 135 C.A.3d 473, 186 C.R. 114, *infra*, §332, plaintiff argued that the release was subjectively unconscionable, i.e., the release produced a one-sided result that allocated the risks in an objectively unreasonable manner. Here, plaintiff knew that skiing could be dangerous; much of what occurred depended on his individual abilities, so that defendant had little control over the situation; defendant's school was not publicly regulated; and skiing, although beneficial, was not an essential activity. "All these factors indicate it is not objectively unreasonable to reallocate the risks to the user rather than the provider of the recreational services. Allan's claim of unconscionability fails." (51 C.A.4th 1377; see *Lee v. Interinsurance Exchange of the Auto. Club of Southern Calif.* (1996) 50 C.A.4th 694, 721, 57 C.R.2d 798 [subscribers' agreement with interinsurance

exchange, whereby they gave exchange discretion over surplus funds, was not adhesion contract, because it was in accord with Insurance Code, and thus met subscribers' reasonable expectations].)

SUPPLEMENT: [This section is current through the latest supplement]



71 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

E. Adhesive or Unconscionable Contracts.

2. Adhesion Contracts.

b. Arbitration Agreements.

1. Valid Agreements.

1 Witkin Sum. Cal. Law Contracts § 326

[§ 326] Valid Agreements.

In *Madden v. Kaiser Foundation Hosp.* (1976) 17 C.3d 699, 131 C.R. 882, 552 P.2d 1178, 3 Summary (10th), *Agency and Employment*, §135, plaintiff state employee, who was enrolled under defendant's hospital plan, sued for malpractice, and defendant moved to compel arbitration. Plaintiff contended that the arbitration provision of the plan was part of a contract of adhesion, and not binding on her because she had no knowledge of its inclusion. *Held*, the provision was binding.

(a) In a characteristic adhesion contract, the stronger party drafts, and the weaker has no opportunity to negotiate concerning its terms; the Kaiser plan was the product of negotiation between Kaiser and the governing board of the State Employees Retirement System, which had parity of bargaining strength. (17 C.3d 711.)

(b) In many adhesion contract cases, the weaker party also has no realistic opportunity to look elsewhere for a more favorable contract; here plaintiff had the opportunity to select from among several plans negotiated by the board, some of which did not include arbitration provisions; or she could have contracted individually for medical care. (17 C.3d 711.)

(c) In all prior adhesion contract cases, the provisions served to limit the obligations or liability of the stronger party; the arbitration provision here bore equally on both Kaiser and the members, and did not detract from Kaiser's duty to use reasonable care or limit its liability for negligence, but merely substituted one forum for another. (17 C.3d 711.) (See *Hawkins v. Superior Court* (1979) 89 C.A.3d 413, 419, 152 C.R. 491, 3 Summary (10th), *Agency and Employment*, §135 [husband's agreement binding on wife]; *Izzi v. Mesquite Country Club* (1986) 186 C.A.3d 1309, 1317, 1318, 231 C.R. 315 [purchase agreement containing arbitration clause; though standardized in form, contract was not adhesive and not unduly oppressive or unconscionable]; *Coon v. Nicola* (1993) 17 C.A.4th 1225, 1234, 21 C.R.2d 846 [medical arbitration agreement was not adhesion contract, where there was no lack of choice as to medical services, no limitation of defendant's liability, no hidden clauses, and no unconscionable terms]; *Spinello v. Amblin Entertainment* (1994) 29 C.A.4th 1390, 1397, 34 C.R.2d 695 [standard agreement for submission of movie script, which included arbitration clause, was not contract of adhesion]; *Powers v. Dickson, Carlson & Campillo* (1997) 54 C.A.4th 1102, 1110, 63 C.R.2d 261, 1 Cal. Proc. (4th), *Attorneys*, Supp., §347 [arbitration provisions of attorney's retainer

agreement and its amendment were enforceable in malpractice action, where agreements were negotiated and individualized and plaintiffs' successful renegotiation of fee arrangements demonstrated possession of substantial bargaining power]; 65 Cal. L. Rev. 355; 10 Loyola L.A. L. Rev. 613; 51 So. Cal. L. Rev. 421; 24 A.L.R.5th 1 [arbitration of medical malpractice claims].)

In *Painters Dist. Council No. 33 v. Moen* (1982) 128 C.A.3d 1032, 181 C.R. 17, a standard form of employer-union agreement was admittedly a contract of adhesion, under which the union clearly possessed superior bargaining strength, because the employer, a small contractor, was in no position to reject it and would have difficulty in obtaining a nonunion job. However, the arbitration provision was upheld: The arbitration panel was a joint union-contractor committee, with equal representation from both sides. (128 C.A.3d 1032.)

Parr v. Superior Court (1983) 139 C.A.3d 440, 188 C.R. 801, applied the tests enunciated in *Graham v. Scissor-Tail* (1981) 28 C.3d 807, 171 C.R. 604, 623 P.2d 165, *infra*, §334, to new arbitration codes of the New York Stock Exchange (NYSE) and the National Association of Securities Dealers. Plaintiff Parr entered into a contract for a "Cash Management Account" with defendant Merrill Lynch. Defendant terminated the contract and dishonored plaintiff's checks, plaintiff sued for rescission and damages, and defendant made a motion to compel arbitration. In upholding the order granting the motion, the court reasoned as follows:

(a) The first *Scissor-Tail* condition--reasonable expectations of the adhering party--was met. The business of the parties took place over 5 months, with numerous transactions and large sums of money involved; plaintiff was an experienced businessman; and his claim that he did not read the arbitration clause was untenable. If this fact could absolve any adhering party from responsibility, he "could choose alternatively to seek arbitration or, should he prefer, to perform and receive the benefits of the contract." (139 C.A.3d 446.)

(b) The second *Scissor-Tail* condition--minimum levels of integrity--was also met. The new arbitration provision of the NYSE was approved by the SEC, and provides a number of safeguards: A majority of the panel must not be from the securities industry; an arbitrator may be peremptorily challenged; the rights to hearing, counsel, and a verbatim record are guaranteed. (139 C.A.3d 447.)

West's Key Number Digest, Arbitration k.6 et seq.

SUPPLEMENT: [This section is current through the latest supplement]

See 83 Proof of Facts 3d 1 [enforcing and avoiding arbitration contracts]. *Powers case*:

Cross-Reference: 1 Cal. Proc. (5th), Attorneys, §331.



72 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

E. Adhesive or Unconscionable Contracts.

2. Adhesion Contracts.

b. Arbitration Agreements.

2. Invalid Agreements.

1 Witkin Sum. Cal. Law Contracts § 327

[§ 327] Invalid Agreements.

In *Spence v. Omnibus Industries* (1975) 44 C.A.3d 970, 119 C.R. 171, plaintiff home owners contracted with defendant building contractor for remodeling of their home. Defendant, a specialist in this work, provided the contract, a standardized document that on its face described the work and the price, and on the reverse side contained "terms and conditions," including an arbitration clause. A dispute arose, and plaintiffs brought suit for damages for breach of contract and fraud, demanding \$ 37,000. Defendants filed a petition for arbitration, which the lower court granted, and also ordered plaintiffs to pay the arbitration filing fee of \$ 720. Plaintiffs appealed from this order. *Held*, reversed.

(a) *Contract of adhesion*. "In the instant contract, over 2,000 words are jammed into a tightly printed jumble of 'terms and conditions.' Although the face of the contract declares that the signatories have read the 'terms and conditions' on the back, it would be optimistic, nay, rash, to venture that one in one hundred home owners ever read the mass of information on the reverse page." (44 C.A.3d 974.)

(b) *Harsh effects of arbitration provision*. The clause incorporated the rules of the American Arbitration Association, which set forth a sliding scale of filing fees, far in excess of court fees; e.g., \$ 1,350 for a claim over \$ 100,000. "To put it mildly, arbitration in these cases with home owners paying the filing fee would have a chilling effect upon the ambition of any home owner to pursue a claim against a builder." (44 C.A.3d 974.)

(c) *Interpretation against defendant*. Plaintiffs initially waived arbitration by filing suit; defendants sought arbitration by their petition; and plaintiffs conceded that the petition was properly granted. But the lower court's order that plaintiffs must pay the fee was error: "[U]nder the rules governing contracts of adhesion, a provision that the parties shall settle their dispute by arbitration may not be so interpreted as to force a claimant into the position of one initiating arbitration when he has, in fact, chosen to waive these proceedings. ... [I]f the defendants really want arbitration they can pay for it." (44 C.A.3d 975.)

(d) *Warning against applying the policy favoring arbitration in a palpably unjust manner*. "In conclusion, there are many citizens who are not paupers who do not have sufficient funds to pursue arbitration when the filing fee is as large as was the filing fee in this case. For these citizens the arbitration remedy is illusory. As a matter of fact, the larger the

extent of the builder's alleged breach, the more insulated he becomes from liability to those financially marginal citizens. There is nothing immoral or illegal in a citizen saving over the years just enough money to remodel his home. However, a contractor may not use a provision in a contract such as this to effectively deny such home owner an opportunity to press a damage claim against him." (44 C.A.3d 976.)

In *Wheeler v. St. Joseph Hosp.* (1976) 63 C.A.3d 345, 133 C.R. 775, Mr. W was admitted to defendant hospital for tests, and suffered brain damage rendering him unable to speak. Plaintiffs, Mr. and Mrs. W, filed a malpractice suit against the hospital and doctors, and defendants petitioned for arbitration. The "Conditions of Admission" form signed by Mr. W contained an "arbitration option" paragraph, which gave the patient the election to reject arbitration by placing his initials in the space provided or by notifying the hospital in writing within 30 days after his discharge. Mr. W did neither, and Mrs. W's declaration stated that he signed the form without reading it and without his attention being called to it, and also that plaintiffs were not provided with a copy. The trial judge ordered arbitration. *Held*, reversed.

(a) The standard form used by defendant was a contract of adhesion; the incoming patient is not in a bargaining position. (63 C.A.3d 357.)

(b) The adhesion principle is particularly applicable to an arbitration clause in a contract for medical services. The patient may fairly assume that no obligations other than payment are imposed, and, without some guidance, cannot be expected to read or understand the clause. (63 C.A.3d 358.) "We conclude that in order to be binding, an arbitration clause incorporated in a hospital's "CONDITIONS OF ADMISSION" form should be called to the patient's attention and he should be given a reasonable explanation of its meaning and effect, including an explanation of any options available to the patient." (63 C.A.3d 361.)

(c) *Madden v. Kaiser Foundation Hosp.* (1976) 17 C.3d 699, 131 C.R. 882, 552 P.2d 1178, *supra*, §326, is not controlling. (1) The reference to an arbitration provision as "proper and usual" was in connection with a group contract negotiated by elected representatives. (2) Mr. W did not have the choice among hospitals similar to the option of the plaintiff in *Madden* to go beyond the plans offered; realistically the patient can only seek admission to the hospital to which his physician directs him. (3) Mr. W was not represented by a state agency with bargaining power and the ability to alert him to the existence of the provision. (63 C.A.3d 365, 366.) Hence: "*Madden* does not alter our conclusion that in the circumstances of the case at bench, there was no valid assent on the part of plaintiffs to the 'ARBITRATION OPTION' in the hospital's 'CONDITIONS OF ADMISSION.' Weighing the policy favoring arbitration against the policy sought to be furthered by the concept of adhesion contracts, the latter should not be submerged by the former." (63 C.A.3d 367.)

A vigorous dissent finds fault with the approach and the reasoning of the majority. The dissenting justice deplores the appellate court's disregard of the trial judge's determination of the issue of fact (Mr. W's awareness of the clause), and contends that *Madden* was in point and should have been followed. He also warns of litigation that will arise from the novel requirement of an "explanation." (63 C.A.3d 373 et seq.) (For the majority's answer to the dissent, see 63 C.A.3d 368.) (See *Patterson v. ITT Consumer Financial Corp.* (1993) 14 C.A.4th 1659, 18 C.R.2d 563, *infra*, §337; *Saika v. Gold* (1996) 49 C.A.4th 1074, 1076, 56 C.R.2d 922 [arbitration agreement between patient and doctor that permitted either party to request trial de novo if arbitration award exceeded \$ 25,000 rendered arbitration illusory remedy for patient and contravened strong public policy in favor of arbitration]; *Bolter v. Superior Court* (2001) 87 C.A.4th 900, 907, 104 C.R.2d 888 [arbitration agreement between large franchisor and small franchisees was adhesive, where agreement was added after initial contract was executed and was accompanied by demand that franchisees had to accept it in order to continue operating their franchises]; *Fitz v. NCR Corp.* (2004) 118 C.A.4th 702, 711, 13 C.R.3d 88 [arbitration agreement's curtailment of discovery (nonwaivable public right, as opposed to waivable private right) fell short of minimum standards of fairness required for employee's vindication of public rights in arbitral forum]; 27 U.S.F. L. Rev. 873 [loan agreement containing arbitration provision in preprinted form, which appeared to be nonnegotiable, held contract of adhesion]; 24 A.L.R.5th 1 [arbitration of medical malpractice claims]; 1 Proof of Facts 3d 495 [invalidity of foreign arbitration agreement or award]; on waiver of the right to arbitration by failing to advise the other contracting party of the provision and the procedure for invoking it, see *Davis v. Blue Cross of Northern Calif.* (1979)

25 C.3d 418, 425, 429, 158 C.R. 828, 600 P.2d 1060; *Beynon v. Garden Grove Med. Group* (1980) 100 C.A.3d 698, 705, 161 C.R. 146 [arbitration provision not called to plaintiff's attention at time of enrollment in health plan and unreasonably limited obligations of health care provider]; and see generally 6 Cal. Proc. (4th), *Proceedings Without Trial*, §504 et seq.)

In *Richards v. Merrill Lynch* (1976) 64 C.A.3d 899, 135 C.R. 26, an arbitration agreement was held invalid because it incorporated unfair rules of procedure. Plaintiff signed a margin agreement drafted by defendant stockbrokerage firm. The agreement was on a 4 x 6-inch card, on the reverse of which were 41 lines of print, including a provision that any controversy should be submitted to arbitration conducted under the Rules of the New York Stock Exchange. Plaintiff filed an action for alleged breach of the agreement, and defendant petitioned for an order compelling arbitration. The trial judge denied the motion on the ground that the arbitration portion of the agreement was a contract of adhesion and unenforceable. *Held*, affirmed; the NYSE rules contained the following unfair provisions:

(a) The arbitrators are to be chosen from the Exchange Board, of which defendant was a member. (64 C.A.3d 903.)

(b) The controversies are to be heard in New York City unless the Exchange, on request, designates some other place. (64 C.A.3d 903.)

(c) The Exchange "may from time to time amend, alter or repeal any of the Rules ... , either generally or in reference to a particular case, as it in its sole discretion may find expedient." This provision "evokes the image of a poker game played with changing wild cards known only to the player who declares himself the winner." (64 C.A.3d 903.)

The court qualified its holding by pointing out that defendant might be entitled to arbitration "under more conventional auspices than the NYSE rules," e.g., the *American Arbitration Association* rules. (64 C.A.3d 904, 906.)

SUPPLEMENT: [This section is current through the latest supplement]

See *Bruni v. Didion* (2008) 160 C.A.4th 1272, 1294, 73 C.R.3d 395 [arbitration provisions incorporated in adhesive warranty agreement signed by home purchasers violated purchasers' reasonable expectations, and thus could not be enforced; provisions were unforeseeably broad, purporting to cover claims not arising out of warranty, including all disputes "arising from or related to ... the subject Home, ... any defect in or to the subject Home ... , or the sale of the subject Home by the Builder," and to cover disputes over arbitrability]; *Thompson v. Toll Dublin, LLC* (2008) 165 C.A.4th 1360, 1372, 81 C.R.3d 736 [arbitration provisions in contract between condominium owners and developers were part of contract of adhesion, where arbitration provisions were part of preprinted form contract, presented on a take-it-or-leave-it basis; "Title 7 Master Declaration," which was incorporated in contract and contained arbitration provisions, was signed solely by developers and was recorded more than 2 years before any owner closed escrow on home]. *Waiver of right to compel arbitration:*

Cross-Reference: 6 Cal. Proc. (5th), *Proceedings Without Trial*, §545 et seq.



73 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

E. Adhesive or Unconscionable Contracts.

2. Adhesion Contracts.

b. Arbitration Agreements.

3. Statutory Compulsory Agreement.

1 Witkin Sum. Cal. Law Contracts § 328

[§ 328] Statutory Compulsory Agreement.

C.C.P. 1295 authorizes compulsory arbitration agreements in medical service contracts, in a prescribed form that warns the signer that the constitutional right to a jury is being waived. (See 6 *Summary* (10th), *Torts*, §940 et seq.) Subdivision (e) states that such a contract, if in compliance with the conditions imposed by subdivisions (a), (b) and (c), "is not a contract of adhesion, nor unconscionable or otherwise improper."

In *Ramirez v. Superior Court* (1980) 103 C.A.3d 746, 163 C.R. 223, Ms. Ramirez brought her sick daughter to the hospital for an examination, and was handed a Spanish version of the agreement in the statutory form, which she signed. Later she brought an action for malpractice, alleging serious injuries due to negligent failure to make a timely diagnosis. Defendants' petition to compel arbitration was granted, and the trial judge, relying on the statute, did not resolve the conflict in the evidence on the issue of whether the mother's agreement was involuntary because she was told to sign and signed the document without reading it. *Held*, reversed for a determination of that issue.

(a) In *Wheeler v. St. Joseph Hosp.* (1976) 63 C.A.3d 345, 133 C.R. 775, *supra*, §327, an arbitration agreement entered into under similar circumstances was characterized as a contract of adhesion and denied enforcement. Here, if the Legislature's declaration that such an agreement is not a contract of adhesion has eliminated that objection, the signer can challenge it only by proof of fraud, imposition, or excusable neglect. (103 C.A.3d 754.)

(b) The legislative declaration cannot be given its full effect, for the conclusive presumption of *C.C.P. 1295* must be construed in conformity with the constitutional right to a jury trial. "We therefore read section 1295 as permitting a party to seek to show that he or she was coerced into signing or did not read the many waiver notices provided and did not realize that the agreement was an agreement to arbitrate." (103 C.A.3d 756.)

(c) In view of the warnings on the form, the plaintiff will have to explain how her eyes avoided the 10-point red type above the signature line, and why she did not ask questions about what she was signing; she will have to show that no one explained the document to her or asked her to read it; and she will have to explain why she did not read it during the 30-day "cooling off" period for rescission. (103 C.A.3d 756, 757.) In some respects, the judge's inquiry will be into fraud or imposition as a cause of failure to read; but, where the agreement is signed as part of the admission procedure

in an emergency room, something less will suffice. (103 C.A.3d 757; see *Coon v. Nicola* (1993) 17 C.A.4th 1225, 1234, 21 C.R.2d 846, 6 Summary (10th), Torts, §950 [because C.C.P. 1295 does not address issue of retroactive application of arbitration agreements, C.C.P. 1295(e) is inapplicable to clauses calling for such retroactive application].)

SUPPLEMENT: [This section is current through the latest supplement]

See *Reigelsperger v. Siller* (2007) 40 C.4th 574, 575, 577, 53 C.R.3d 887, 150 P.3d 764 [arbitration agreement that was signed when chiropractor first treated patient applied to claim arising from treatment for different condition 2 years later, inasmuch as it stated that it was intended to bind patient and health care provider "who now or in the future treats the patient," regardless whether parties had open-book account relationship].



74 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

E. Adhesive or Unconscionable Contracts.

2. Adhesion Contracts.

c. Doctrine Not Applicable.

1 Witkin Sum. Cal. Law Contracts § 329

[§ 329] Doctrine Not Applicable.

The adhesion challenge fails where the objectionable provision is prescribed by law. In *Drennan v. Security Pac. Nat. Bank* (1981) 28 C.3d 764, 170 C.R. 904, 621 P.2d 1318, plaintiff purchased a mobile home that was financed by defendant. The contract permitted payment of the indebtedness in full prior to maturity, with a refund of the unearned portion of the finance charges "computed in accordance with the 'Rule of 78's.' " Under this rule, plaintiff received a smaller refund than if interest had been calculated strictly on the basis of the time he had use of the money. It was conceded that the contract was one of adhesion, but plaintiff's challenge was rejected: The controlling federal regulation prohibits any attempt to make a detailed explanation of the Rule of 78's on the ground that no simple explanation of the complicated formula could be devised. (28 C.3d 771.) The court observed that the Rule was a hidden charge neither revealed to nor understood by the borrower, and that its burdens on the consumer were not justified by the economic needs of the lender, but only the Legislature could adopt a policy repudiating it. (28 C.3d 779.)

The adhesion challenge was rejected in a number of other cases. (See, e.g., *Union Bank v. Ross* (1976) 54 C.A.3d 290, 296, 126 C.R. 646 [lawyer who signed guaranty without reading it not entitled to assert that waiver provisions made it an adhesion contract]; *Powell v. Central Calif. Fed. Savings & Loan Assn.* (1976) 59 C.A.3d 540, 551, 130 C.R. 635 [plaintiffs, "sophisticated borrowers in the field of real estate development," could not assert against defendant lender that loan contract was one of adhesion]; *Division of Labor Standards Enforcement v. Dick Bullis* (1977) 72 C.A.3d Supp. 52, 56, 140 C.R. 267 [unambiguous employment contract held valid and enforceable]; *Security Pac. Nat. Bank v. Adamo* (1983) 142 C.A.3d 492, 497, 498, 191 C.R. 134, citing the text [*Union Bank v. Ross* followed].)

West's Key Number Digest, Contracts k.715

SUPPLEMENT: [This section is current through the latest supplement]



75 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

E. Adhesive or Unconscionable Contracts.

3. Unconscionable Contract or Term.

a. In General.

1. Commercial Code and California Statute.

1 Witkin Sum. Cal. Law Contracts § 330

[§ 330] Commercial Code and California Statute.

(1) *Statutory Provisions.* The *Uniform Commercial Code*, §2-302 provides that a court may refuse to enforce *an unconscionable contract or unconscionable term* in a contract. (See 1 U.L.A. (Master Ed.), §2-302; 64 *Cal. L. Rev.* 1157; 15 *A.L.R.5th* 365 [unconscionability under Unif.Com.C. §2-302 of bank letter of credit or other financial arrangement]; on the similar Restatement provision, see *infra*, §331.) California deleted this provision in adopting the Code, but C.C. 1670.5, enacted in 1979, is in the exact language of Unif.Com.C. §2-302. (See 11 *Pacific L. J.* 391; and see generally *A & M Produce Co. v. FMC Corp.* (1982) 135 *C.A.3d* 473, 186 *C.R.* 114, *infra*, §332; 5 Corbin (Rev. ed.), §24.27; 25 *Hastings L. J.* 1, 53 [exhaustive articles urging adoption of an unconscionability statute for all consumer transactions]; 14 *Southwestern U. L. Rev.* 225 [unconscionable franchise agreements]; 33 *U.C.L.A. L. Rev.* 940 [substantive unconscionability in consumer credit contracts]; 18 *A.L.R.3d* 1305 [unconscionability in contract for sale of goods].)

C.C. 1670.5 reads as follows:

"(a) If the court *as a matter of law* finds the *contract or any clause* of the contract to have been *unconscionable at the time it was made* the court may *refuse to enforce the contract*, or it may *enforce the remainder* of the contract without the unconscionable clause, or it may *so limit the application* of any unconscionable clause as to *avoid any unconscionable result*.

(b) 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."

(2) *Severability of Unconscionable Provision.* In determining, under C.C. 1670.5, whether to sever or restrict the unconscionable terms of a contract or whether to refuse to enforce the entire agreement, the basic principles of severability that emerge from C.C. 1599 and the case law of illegal contracts (*infra*, §421) are fully applicable. "Courts are to look to the various purposes of the contract. If the central purpose of the contract is tainted with illegality, then the contract as a whole cannot be enforced. If the illegality is collateral to the main purpose of the contract, and the

illegal provision can be extirpated from the contract by means of severance or restriction, then such severance and restriction are appropriate." (*Armendariz v. Foundation Health Psychcare Services* (2000) 24 C.4th 83, 121, 99 C.R.2d 745, 6 P.3d 669, 6 Cal. Proc. (4th), *Proceedings Without Trial*, Supp., §494A [arbitration agreement could not be severed where (a) it had both unlawful damages provision and unconscionably unilateral arbitration clause, and (b) agreement's lack of mutuality permeated and there was no single provision court could strike or restrict in order to remove unconscionable taint].) (See *Little v. Auto Stiegler* (2003) 29 C.4th 1064, 1074, 130 C.R.2d 892, 63 P.3d 979, 6 Cal. Proc. (4th), *Proceedings Without Trial*, Supp., §494D, 500 [unconscionable arbitration appeal provision could be severed, because it was only unlawful provision in agreement and could be removed without changing rest of agreement]; *Blake v. Ecker* (2001) 93 C.A.4th 728, 745, 113 C.R.2d 422, 6 Cal. Proc. (4th), *Proceedings Without Trial*, Supp., §46 [arbitration agreement expressly provided for modification by severance of those provisions resulting in claim of unconscionability; thus, employer's willingness to accept severance in order to save arbitration clause was not mere offer to change offending clause, but rather, was reliance on existing and express contractual provision]; *McManus v. CIBC World Markets Corp.* (2003) 109 C.A.4th 76, 101, 134 C.R.2d 446 [although arbitration clauses were procedurally unconscionable and substantively unconscionable in one respect, i.e., requiring employee to pay fees, they were not so permeated with unconscionability that they could not be saved by severing fee provision]; *Harper v. Ultimo* (2003) 113 C.A.4th 1402, 1411, 7 C.R.3d 418 [unlike *Armendariz*, *supra*, issue was not whether to refuse to enforce only single unconscionable provision, but whether to sever arbitral claims from non-arbitral claims; court's refusal to do so was not abuse of discretion]; *Gutierrez v. Autowest* (2003) 114 C.A.4th 77, 92, 7 C.R.3d 267 [because unconscionable arbitration fee provision was collateral to main purpose of arbitration agreement, it was severable, but on remand, court must determine whether cost provision was drafted in bad faith, before exercising discretion to sever]; *Abramson v. Juniper Networks* (2004) 115 C.A.4th 638, 666, 9 C.R.3d 422 [cost-sharing provision of arbitration agreement was not severable]; *Nyulassy v. Lockheed Martin Corp.* (2004) 120 C.A.4th 1267, 1682, 16 C.R.3d 296 [failure to sever multiple unconscionable provisions of mandatory employment arbitration agreement was appropriate, where there was no degree of mutuality, no single provision that could be stricken or restricted in order to remove unconscionable taint, and arbitration clause was permeated by unconscionability].)

(3) *Liquidated Damages*. Where a liquidated damages provision meets the requirements of C.C. 1671 (*infra*, §533 et seq.), no claim may be made that it is nonetheless unconscionable. (*Californians for Population Stabilization v. Hewlett-Packard Co.* (1997) 58 C.A.4th 273, 287, 67 C.R.2d 621.)

West's Key Number Digest, Cancellation of Instruments k.5; Equity k.13

SUPPLEMENT: [This section is current through the latest supplement]

(2) *Severability of Unconscionable Provision*. See *Murphy v. Check 'N Go of Calif.* (2007) 156 C.A.4th 138, 149, 67 C.R.3d 120 [unconscionable provisions in "Dispute Resolution Agreement" between employer and employee were not severable from agreement as a whole, and thus entire agreement was unenforceable in employee's wage and hour suit alleging that employer misclassified its salaried retail managers as exempt employees, where entire agreement was permeated by unconscionability of objectionable provisions specifying that all claims, including those involving unconscionability, would be subject to arbitration]; *Ontiveros v. DHL Express (USA)* (2008) 164 C.A.4th 494, 524, 79 C.R.3d 471 [arbitration agreement that employee signed when she was hired was permeated with unconscionability, and thus, severance of unconscionable provisions was not warranted; entire arbitration agreement was unenforceable with respect to employee's sex discrimination, sexual harassment, and retaliation claims under Fair Employment and Housing Act (FEHA)].

Armendariz case:

Cross-Reference: 6 Cal. Proc. (5th), *Proceedings Without Trial*, §518.

Little case:

Cross-Reference: 6 Cal. Proc. (5th), *Proceedings Without Trial*, §521. *Blake case:*

Cross-Reference: 6 Cal. Proc. (5th), *Proceedings Without Trial*, §520.



76 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

E. Adhesive or Unconscionable Contracts.

3. Unconscionable Contract or Term.

a. In General.

2. Restatement 2d.

1 *Witkin Sum. Cal. Law Contracts* § 331

[§ 331] Restatement 2d.

Rest.2d, Contracts §208 reads as follows:

"If a contract or term thereof is unconscionable at the time the contract is made a court may refuse to enforce the contract, or may enforce the remainder of the contract without the unconscionable term, or may so limit the application of any unconscionable term as to avoid any unconscionable result."

The Comments explain the origin, nature and scope of the concept.

(1) *Scope*. "Like the obligation of good faith and fair dealing (§205), the policy against unconscionable contracts or terms applies to a wide variety of types of conduct. The determination that a contract or term is or is not unconscionable is made in the light of its *setting, purpose and effect*. Relevant factors include *weaknesses in the contracting process* like those involved in more specific rules as to contractual capacity, fraud and other invalidating causes; the policy also overlaps with rules which render particular bargains or terms unenforceable on grounds of *public policy*. Policing against unconscionable contracts or terms has sometimes been accomplished 'by *adverse construction of language*, by *manipulation* of the rules of *offer and acceptance* or by determinations that the clause is contrary to public policy or to the *dominant purpose of the contract*.' *Uniform Commercial Code* §2-302, Comment 1. Particularly in the case of *standardized agreements*, the rule of this Section permits the court to *pass directly* on the unconscionability of the contract or clause rather than to avoid unconscionable results by interpretation."

(2) *Historic Standards*. Earlier cases treated an unfair contract as enforceable at law but not in equity. Modern procedural reforms have blurred the distinction between legal and equitable remedies, and Unif.Com.C. §2-302 states the rule without distinction between law and equity.

(3) *Overall Imbalance*. Gross disparity in the values exchanged may be an important factor in a determination that the contract is unconscionable, and such a disparity may also indicate defects in the bargaining process. "Theoretically it is possible for a contract to be oppressive taken as a whole, even though there is no weakness in the bargaining process and no single term which is in itself unconscionable. Ordinarily, however, an unconscionable contract involves other

factors as well as overall imbalance."

(4) *Weakness in Bargaining Power*. "[G]ross inequality of bargaining power, together with terms *unreasonably favorable* to the stronger party, may confirm indications that the transaction involved elements of *deception or compulsion*, or may show that the weaker party had no meaningful choice, no real alternative, or did not in fact assent or appear to assent to the unfair terms. Factors which may contribute to a finding of unconscionability in the bargaining process include the following: *belief by the stronger party* that there is no reasonable probability that *the weaker party will fully perform* the contract; *knowledge of the stronger party* that the weaker party *will be unable to receive substantial benefits* from the contract; *knowledge of the stronger party* that the weaker party is *unable reasonably to protect his interests* by reason of physical or mental infirmities, ignorance, illiteracy or inability to understand the language of the agreement, or similar factors."

(5) *Unconscionable Terms*. "Particular terms may be unconscionable whether or not the contract as a whole is unconscionable. Some types of terms are not enforced, regardless of context; examples are provisions for unreasonably large liquidated damages, or limitations on a debtor's right to redeem collateral. See *Uniform Commercial Code* §2-718, 9-501(3). Other terms may be unconscionable in some contexts but not in others. Overall imbalance and weaknesses in the bargaining process are then important."

SUPPLEMENT: [This section is current through the latest supplement]



77 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT
E. Adhesive or Unconscionable Contracts.
3. Unconscionable Contract or Term.
b. Procedural and Substantive Unconscionability.
1. In General.

1 Witkin Sum. Cal. Law Contracts § 332

[§ 332] In General.

In *A & M Produce Co. v. FMC Corp.* (1982) 135 C.A.3d 473, 186 C.R. 114, the court began its opinion with the observation that, although this case arose from a simple business transaction, "the issues now require our traversing the labyrinthine complexities of the Uniform Commercial Code, only partially illuminated by California precedent." (135 C.A.3d 478.) The opinion then proceeds to examine the doctrine and to outline "the analytic framework to be used in determining whether a particular contractual provision is unconscionable." (135 C.A.3d 482.)

Plaintiff, a solely owned farming company without experience in growing tomatoes, decided to enter the field, and was informed of the need for weight-sizing equipment. After rejecting a bid from another company, plaintiff signed defendant's field order, paid a deposit, and received the equipment. The machine proved unsatisfactory and the crop was lost. Plaintiff sued for damages for breach of warranty, and defendant set up the contract provisions for disclaimer of warranties and nonliability for consequential damages. The trial judge ruled that these provisions were unconscionable and therefore unenforceable, and the jury returned a general verdict for damages. Judgment was entered on the verdict, with attorneys' fees and prejudgment interest. *Held*, affirmed.

(a) *Unconscionability doctrine applicable under C.C. 1670.5.* Defendant argued that, although a limitation on consequential damages may be unconscionable under U.C.C. 2719(3) (4 *Summary* (10th), *Sales*, §207), there is no such provision in U.C.C. 2316 on disclaimer of warranties, which section deals with the requirement of conspicuousness (4 *Summary* (10th), *Sales*, §82 et seq.). (135 C.A.3d 484.) However, an unconscionable disclaimer of warranty may be denied enforcement under C.C. 1670.5 despite technical compliance with the conspicuousness requirements of U.C.C. 2316. Hence, unconscionability may be urged as to both the consequential damage exclusion and the warranty disclaimer. (135 C.A.3d 484.)

(b) *Nature of unconscionability doctrine: general law.*

(1) The Uniform Commercial Code does not define the term, but it has generally been recognized to include "an absence of meaningful choice on the part of one of the parties together with contract terms which are unreasonably favorable to the other party"; in other words, unconscionability has both a *procedural* and a *substantive* element. (135

C.A.3d 486.)

(2) The *procedural* element focuses on the factors of "oppression" and "surprise." (a) *Oppression* arises from an inequality of bargaining power that results in no real negotiation and an absence of meaningful choice. (b) *Surprise* involves the extent to which the supposedly agreed-upon terms are hidden in a prolix printed form drafted by the party seeking to enforce them, usually the party with the superior bargaining position. (135 C.A.3d 486.)

(3) Commercial practicalities dictate that unbargained-for terms should be denied enforcement only where they are also *substantively unreasonable*. Again there is no precise definition. The cases have spoken in terms of "overly harsh" or "'one-sided' results"; however, a commentator has pointed out that "unconscionability turns not only on a 'one-sided' result, but also on an absence of 'justification' for it." This means that substantive unconscionability must be evaluated as of the time the contract was made. (135 C.A.3d 487.) A contract is largely an allocation of risks, and a contractual term is "substantively suspect" if it reallocates the risks "in an objectively unreasonable or unexpected manner." (135 C.A.3d 487.) "But not all unreasonable risk reallocations are unconscionable; rather, enforceability of the clause is tied to the procedural aspects of unconscionability ... such that the greater the unfair surprise or inequality of bargaining power, the less unreasonable the risk allocation which will be tolerated." (135 C.A.3d 487.)

(c) *Unconscionability doctrine in California.*

(1) The opinion in *Graham v. Scissor-Tail* (1981) 28 C.3d 807, 171 C.R. 604, 623 P.2d 165, *infra*, §334, embodies the elements of both procedural unconscionability (Graham not surprised, provision not outside his reasonable expectations) and substantive unconscionability (all risks allocated to Graham, no minimum level of integrity); and the court's conclusion ties both elements together. (135 C.A.3d 488.)

(2) Although the contract in *Graham v. Scissor-Tail* was not governed by the Uniform Commercial Code, the court's discussion of the factors "leads to the conclusion that unconscionability is a doctrine fundamental to the operation of contract law, irrespective of the particular application." The Legislature's belated enactment of C.C. 1670.5 is an apparent recognition of this fact. (135 C.A.3d 487, footnote 12.)

(d) *Unconscionability in a commercial context.* Procedural unconscionability (unfair surprise or unequal bargaining power) is less easily established by a businessman than by an ordinary consumer. But courts have begun to realize that "experienced but legally unsophisticated businessmen" may be unfairly surprised by unconscionable contract terms, and that even "large business entities" may have relatively little bargaining power under the circumstances. (135 C.A.3d 489, citing *Scissor-Tail*, *supra*.)

(e) *Trial judge's determination supported by the evidence.*

(1) *Procedural unconscionability:* (a) Although the printing of the warranty disclaimer was conspicuous, the terms of the consequential damage exclusion were not; and there was sufficient evidence to conclude that plaintiff was in fact surprised. He had the opportunity to read or seek legal advice; but, in view of the complexity of the terms and defendant's failure to direct his attention to them, his omission may not be totally unreasonable. The burden should be on the seller to show that the buyer had knowledge of any unusual or unconscionable terms. (135 C.A.3d 490.) (b) Apart from unfair surprise, there was ample evidence of unequal bargaining power and a lack of any real negotiation over the terms of the contract. Defendant was a large corporation, the terms of its form contract were standard, and its salesmen were not authorized to negotiate any of the terms involved in this dispute. (135 C.A.3d 491.)

(2) *Substantive unconscionability:* (a) The warranty breached went to the basic performance characteristics of the product; and "it is patently unreasonable to assume that a buyer would purchase a standardized mass-produced product from an industry seller without any enforceable performance standards." (135 C.A.3d 491.) (b) Plaintiff had no previous experience with weight-sizing machines and was forced to rely on the expertise of defendant, as defendant knew. "Especially where an inexperienced buyer is concerned, the seller's performance representations are absolutely necessary to allow the buyer to make an intelligent choice among the competitive options available. A seller's attempt,

through the use of a disclaimer, to prevent the buyer from reasonably relying on such representations calls into question the commercial reasonableness of the agreement and may well be substantively unconscionable." (135 C.A.3d 492.) (c) The exclusion of consequential damages was also unreasonable. They are a commercially recognized type of damages, and here they were clearly foreseeable: all parties were aware that once the tomatoes began to ripen they had to be harvested and packed within a short period of time. (135 C.A.3d 492.) (d) Defendant was the only party reasonably able to prevent the loss resulting from selling a machine inadequate for the expressed needs; and "[i]f there is a type of risk allocation that should be subjected to special scrutiny, it is probably the shifting to one party of a risk that *only* the other party can avoid." (135 C.A.3d 493, 497.) (See *Harper v. Ultimo* (2003) 113 C.A.4th 1402, 1410, 7 C.R.3d 418 [procedural unconscionability is generally proved by showing of adhesion, but that is not only way]; 35 *Hastings L. J.* 161; 16 *Loyola L.A. L. Rev.* 619; 16 *Pacific L. J.* 247; for a comparison of the approaches for determining unconscionability taken in *Graham v. Scissor-Tail* (1981) 28 C.3d 807, 171 C.R. 604, 623 P.2d 15, *infra*, §334, and *A & M Produce Co. v. FMC Corp.*, *supra*, see *Patterson v. ITT Consumer Financial Corp.* (1993) 14 C.A.4th 1659, 18 C.R.2d 563, *supra*, §322.)

SUPPLEMENT: [This section is current through the latest supplement]

See *Morris v. Redwood Empire Bancorp* (2005) 128 C.A.4th 1305, 1313, 27 C.R.3d 797 [merchant's claim that fee charged by bank on termination of credit card account was procedurally unconscionable failed, where, although adhesion contract was involved, merchant did not allege unavailability of another source or that he was under immediate pressure not to seek such sources; with respect to substantive unconscionability, he made no allegation that fee was grossly out of line with fees charged by other banks or that bank incurred no costs for services represented by fee].

Absent unusual circumstances, if one party has overwhelming bargaining power, drafts the contract, and presents it on a take-it-or-leave-it basis, there is "minimal" evidence of procedural unconscionability sufficient to require the court to reach the question of substantive unconscionability, even if the other party has market alternatives. (*Gatton v. T-Mobile USA* (2007) 152 C.A.4th 571, 586, 61 C.R.3d 344.)



78 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

E. Adhesive or Unconscionable Contracts.

3. Unconscionable Contract or Term.

b. Procedural and Substantive Unconscionability.

2. Unconscionability Defense Applied.

1 *Witkin Sum. Cal. Law Contracts* § 333

[§ 333] Unconscionability Defense Applied.

(1) *Defense Upheld.* The following decisions are illustrative of those applying the standards adopted by *A & M Produce Co. v. FMC Corp.* (1982) 135 C.A.3d 473, 186 C.R. 114, *supra*, §332, and upholding the unconscionability defense. (See *Carboni v. Arrospide* (1991) 2 C.A.4th 76, 82, 2 C.R.2d 845, *infra*, §340; *Ellis v. McKinnon Broadcasting Co.* (1993) 18 C.A.4th 1796, 23 C.R.2d 80, *infra*, §341; *Ilkhchooyi v. Best* (1995) 37 C.A.4th 395, 409, 45 C.R.2d 766, 12 *Summary* (10th), *Real Property*, §555 [commercial lease provision conditioning consent to assignment on payment of 75% of consideration to be paid to lessees for specified aspects of business itself held unconscionable].

(2) *Defense Rejected.* In *Kurashige v. Indian Dunes* (1988) 200 C.A.3d 606, 246 C.R. 310, the undisputed facts were: Defendant's park was used by the general public for motorcycle dirt bike riding. Plaintiff motorcycle rider signed a "General Release" agreement, reciting his knowledge and voluntary assumption of the risks. He was injured while riding, and brought this action in which the defense of unconscionability was raised. *Held*, summary judgment for defendant affirmed. Applying the tests of *A & M Produce Co.*, *supra*:

(a) *Procedural element: oppression.* Was there an inequality in bargaining power resulting in no real negotiation and an absence of meaningful choice? Here, there was no real negotiation because the printed agreement had to be signed before using the park; but there was a meaningful choice: Plaintiff could have ridden his motorcycle elsewhere. (200 C.A.3d 614.)

(b) *Procedural element: surprise.* Was plaintiff surprised by supposedly agreed upon terms hidden within a printed form drafted by defendants? No: The warnings of danger, the assumption of risk, and the exculpatory provisions were clearly set forth. (200 C.A.3d 614.)

(c) *Substantive element.* Was the agreement one-sided *and* objectively unreasonable? No: It was clearly one-sided, for all the risk was reallocated to the park's user. But the reallocation was not unreasonable: The agreement warned the user that motorcycling over rough terrain poses a risk of injury from a fall; and to a certain extent, that risk is conditioned on the user's skill and experience, factors over which the park operators have no control. (200 C.A.3d 614.)

In *Dean Witter Reynolds v. Superior Court* (1989) 211 C.A.3d 758, 259 C.R. 789, plaintiff opened a self-directed IRA account with defendant Dean Witter, and after liquidating the account, brought a class action challenging as unconscionable the "close-out" or "termination fee," imposed when closing an IRA. Defendant offered evidence of availability of IRAs from various institutions which either did not charge a termination fee or charged less than \$ 50. In rejecting the challenge to the fee, the court said: "[A]ny claim of 'oppression' may be defeated if the complaining party had reasonably available alternative sources of supply from which to obtain the desired goods or services free of the terms claimed to be unconscionable." (211 C.A.3d 768.) Thus, the defeat of the claim of oppression, plus the absence of evidence of surprise, meant that there was no procedural unconscionability, and even though defendant conceded that there was substantive unconscionability, plaintiff was not entitled to recover unless he established *both* components. (211 C.A.3d 771.)

A number of other cases have applied the standards adopted by *A & M Produce Co.*, *supra*, and rejected the unconscionability defense. The following are illustrative:

Nunes Turfgrass v. Vaughan-Jacklin Seed Co. (1988) 200 C.A.3d 1518, 1539, 246 C.R. 823 [provision limiting seed seller's liability to purchase price held not unconscionable; provision was part of parties' bargain and was known to buyer, who had similar restrictions on its products].

H.S. Perlin Co. v. Morse Signal Devices of San Diego (1989) 209 C.A.3d 1289, 258 C.R. 1, *infra*, §538.

Appalachian Ins. Co. v. McDonnell Douglas Corp. (1989) 214 C.A.3d 1, 22, 262 C.R. 716 [no elements of unconscionability present: no monopoly, no unfair surprise, not standardized form, and not inexperienced buyer].

Shadoan v. World Savings & Loan Assn. (1990) 219 C.A.3d 97, 105, 268 C.R. 207 [loan agreement containing both prepayment penalty and right to demand full payment held neither unconscionable *per se*, in absence of allegations of unequal bargaining power, nor objectively unreasonable].

West v. Henderson (1991) 227 C.A.3d 1578, 1587, 278 C.R. 570 [lease provision limiting lessee, but not lessor, to 6-month period in which to bring action for any wrong was neither procedurally nor substantively unconscionable].

United States Roofing v. Credit Alliance Corp. (1991) 228 C.A.3d 1431, 1450, 279 C.R. 533 [conspicuous disclaimer by financing lessor of all warranties relating to crane was not unconscionable, where parties were in equal bargaining position, and buyer-lessee had adequate remedies against supplier].

Winston v. National Broadcasting Co. (1991) 231 C.A.3d 540, 550, 282 C.R. 498 [provision requiring game-show contestants who lie about their eligibility to forfeit their winnings held not unconscionable].

Vance v. Villa Park Mobilehome Estates (1995) 36 C.A.4th 698, 710, 42 C.R.2d 723 [pass-throughs of increased operating costs in mobilehome park leases were not unconscionable; where procedural element was lacking, mere allegation that pass-throughs exceeded cost or fair value was insufficient to establish substantive unconscionability].

American Software v. Ali (1996) 46 C.A.4th 1386, 54 C.R.2d 477, *infra*, §341.

Robison v. Manteca (2000) 78 C.A.4th 452, 458, 92 C.R.2d 748 [agreement requiring city employee to undertake substance abuse treatment program to avoid termination was not unconscionable; employee failed to establish procedural unconscionability, and it was immaterial that there was no evidence that he made knowing and intelligent waiver of due process rights].

SUPPLEMENT: [This section is current through the latest supplement]

(2) *Defense Rejected.* Other cases rejecting unconscionability defense:

Wayne v. Staples (2006) 135 C.A.4th 466, 481, 37 C.R.3d 544 [office supply company's insurance offered to its

shipping customers at 100% markup of cost was not unconscionable; price of coverage was clearly disclosed, negating any element of surprise; neither coercion nor lack of choice was present in shipping transactions; and, in view of custom in industry, 100% markup did not shock conscience].

Koehl v. Verio (2006) 142 C.A.4th 1313, 1339, 48 C.R.3d 749 [employer's commission plans allowing employer to charge back sales associates' advanced commissions when commercial sales accounts were canceled prior to billing or within 3 months of activation of service were neither procedurally nor substantively unconscionable; following *American Software v. Ali* (1996) 46 C.A.4th 1386, 54 C.R.2d 477, text, §341].



79 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

E. Adhesive or Unconscionable Contracts.

3. Unconscionable Contract or Term.

c. Arbitration Agreement.

1. Underlying Contract or Provision.

aa. Promotor's Contract With Artist.

1 Witkin Sum. Cal. Law Contracts § 334

[§ 334] Promotor's Contract With Artist.

In *Graham v. Scissor-Tail* (1981) 28 C.3d 807, 171 C.R. 604, 623 P.2d 165, plaintiff, an experienced promoter and producer of musical concerts, contracted with defendant Russell, a successful performer and leader of a musical group, and defendant Scissor-Tail, his wholly owned corporation, for a series of concerts. The contracts were the standard A.F. of M. (musicians' union) forms, providing that disputes were to be conclusively determined by the union. A dispute arose concerning the party to bear the loss of one unsuccessful concert. Plaintiff sued for breach of contract and defendants petitioned for arbitration. The petition was granted, and, after an abortive decision by the union without a hearing, a hearing was ordered by the union before a "referee" who was a former union executive officer appointed by the union president. After the hearing, he recommended that plaintiff bear the loss, and the union's executive board made its award accordingly. Plaintiff appealed from the trial court judgment confirming the award. *Held*, reversed.

(a) *Adhesive contract in commercial setting.* Although most of the cases have arisen in the consumer context, adhesion contracts are also found in a commercial setting. Here, although plaintiff's prominence and success ordinarily gave him considerable bargaining strength, he was in reality "reduced to the humble role of 'adherent.'" All concert artists and groups of any significance are members of the union and can sign only union agreements with the provision dictating a union forum for resolution of disputes. (28 C.3d 818, 819, and footnote 13.)

(b) *First limitation on adhesive contract--expectations of adhering party--inapplicable.* Of the two judicially imposed limitations on enforcement of adhesion contracts, the first is that a provision does not fall within the reasonable expectations of the weaker or adhering party. The record in the present case does not support such a challenge: Plaintiff had been a party to thousands of similar contracts, had been involved in prior disputes, and was fully aware of the nature of the union contract arbitration provision. (28 C.3d 820, 821.)

(c) *Second limitation--unconscionability--applicable.* The second limitation is a principle of equity applicable to all contracts: "a contract or provision, even if consistent with the reasonable expectations of the parties, will be denied enforcement if, considered in its context, it is unduly oppressive or 'unconscionable.'" (28 C.3d 820.) The contract is subject to this challenge:

(1) The California Arbitration Act appears to contemplate complete contractual autonomy in the choice of an arbitrator (see *C.C.P.* 1281.6, 1282), and in *Federico v. Frick* (1970) 3 C.A.3d 872, 876, 84 C.R. 74, the court declared that the statute permits the parties to agree to a nonneutral arbitrator. (28 C.3d 822.) However, the better view is that expressed in *Matter of Cross & Brown Company*, a 1957 New York Appellate Division case: The parties may freely designate arbitrators who may have an interest in the dispute or some ordinarily disqualifying relationship, but may not designate a party to the contract as arbitrator. "Apart from outraging public policy, such an agreement is illusory; for while in form it provides for arbitration, in substance it yields the power to an adverse party to decide disputes under the contract." (28 C.3d 824, quoting *Cross*.) "[W]hen as here the contract designating such an arbitrator is the product of circumstances suggestive of adhesion, the possibility of overreaching by the dominant party looms large; contracts concluded in such circumstances, then, must be scrutinized with particular care to insure that the party of lesser bargaining power, in agreeing thereto, is not left in a position depriving him of any realistic and fair opportunity to prevail in a dispute under its terms." (28 C.3d 824.)

(2) The United States Supreme Court in a related context declared that the "contractual machinery" should operate "within some minimum levels of integrity," and the courts must determine--largely on a case by case basis--what these minimum levels must be. (28 C.3d 825.) The "contractual machinery" contemplates some kind of tribunal which hears and decides disputes. Where the designated arbitrator is a party--in name or in fact--the agreement becomes "an engagement to capitulate," and the "minimum levels of integrity" are not achieved. (28 C.3d 825.)

(3) Even if the designated arbitrator is capable of acting as a tribunal in the sense of hearing and deciding on the basis of what it has heard, if the rules under which the arbitration proceeds deprive a party of a fair opportunity to present his side of the dispute, the agreement to arbitrate should not be enforced. (28 C.3d 826.) This denial of enforcement, however, should be the result only in the clearest of cases, when the applicable procedures preclude the possibility of a fair hearing. That is not the case here. (28 C.3d 826, and footnotes 23, 24.)

(4) Applying the foregoing principles to the issue of the present case, the "minimum levels of integrity" are not achieved by an arrangement which designates the union of one of the parties as the arbitrator of disputes arising out of employment, especially when the arrangement is the product of circumstances indicative of adhesion. The party so designated will have an interest in the outcome which will render fair and reasoned decision, based on the evidence presented, a virtual impossibility. (28 C.3d 827, 828, disapproving *Federico v. Frick*, *supra*, to the extent inconsistent.)

The court concluded that the order compelling arbitration before the union was error; but, in light of the strong public policy favoring arbitration, and the parties' agreement to arbitration, they should not be precluded from attempting to agree on an arbitrator who is not disqualified. Accordingly the reversal was with directions to the trial judge: (a) to afford the parties a reasonable opportunity to agree on a suitable arbitrator, and, failing such an agreement, on petition of either party, appoint an arbitrator; (b) in the absence of an agreement or petition to appoint, to proceed to a judicial determination of the controversy. (28 C.3d 831.) (See 70 Cal. L. Rev. 1014; for a comparison of the approaches for determining unconscionability taken in *Graham v. Scissor-Tail*, *supra*, and *A & M Produce Co. v. FMC Corp.* (1982) 135 C.A.3d 473, 186 C.R. 114, *supra*, §332, see *Patterson v. ITT Consumer Financial Corp.* (1993) 14 C.A.4th 1659, 18 C.R.2d 563, *supra*, §322.)

West's Key Number Digest, Cancellation of Instruments k.5; k.Equity 13

SUPPLEMENT: [This section is current through the latest supplement]



80 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

E. Adhesive or Unconscionable Contracts.

3. Unconscionable Contract or Term.

c. Arbitration Agreement.

1. Underlying Contract or Provision.

bb. Purchase Subject to Covenants, Conditions, and Restrictions.

1 Witkin Sum. Cal. Law Contracts § 335

[§ 335] Purchase Subject to Covenants, Conditions, and Restrictions.

In *Villa Milano Homeowners Assn. v. Il Davorge* (2000) 84 C.A.4th 819, 102 C.R.2d 1, plaintiff condominium unit owners and their homeowners association sued defendant developer, seeking damages for construction and design defects. Defendant filed a petition to compel arbitration based on an arbitration clause contained in the covenants, conditions, and restrictions (CC&Rs), which provided that disputes, including those concerning construction or design, between defendant and either a unit owner or the association would be submitted to binding arbitration. The trial court denied the petition, comparing the arbitration clause to an adhesion contract. *Held*, affirmed.

(a) *Agreement to arbitrate*. Contrary to plaintiffs' contention, there was a written agreement to arbitrate. Individual condominium unit owners are deemed to intend and agree to be bound by the written and recorded CC&Rs, inasmuch as they have constructive notice of the CC&Rs when they purchase their homes. CC&Rs have been construed as contracts in various circumstances. The arbitration clause, as a provision of the CC&Rs, is therefore a part of the contract between the parties. (84 C.A.4th 825.)

(b) *Enforceability*. Unless a valid agreement to arbitrate exists, as determined under contract law, the petition to compel arbitration must be denied. Thus, the enforceability of the contractual arbitration clause must be addressed. Because the unit purchasers faced a "take it or leave it" proposition--they either purchased subject to the CC&Rs, or they did not purchase at all--and, because the arbitration clause, unlike other provisions in the CC&Rs, was not subject to amendment, it had the characteristics of an adhesion contract. Nevertheless, the question of the enforceability of the clause remains, because even an adhesion contract may be enforceable. But no contract, whether adhesive or otherwise, will be enforced if it is unconscionable. (84 C.A.4th 826.)

(c) *Procedural unconscionability*. The arbitration clause was procedurally unconscionable, as both the factors of oppression and surprise were present.

(1) *Oppression*. The CC&Rs were drafted solely by defendant and recorded years before the purchasers ever came to buy. There was no possibility that individual buyers could negotiate CC&Rs amendments applicable only to their

own properties. Rather, every buyer took subject to the same set of CC&Rs, or made no purchase at the development at all. There being absolutely no opportunity to negotiate, there was no meaningful choice as to the terms of the CC&Rs. (84 C.A.4th 828.)

(2) *Surprise*. The CC&Rs are 70 pages long and the arbitration clause is buried on pages 67 and 68. Further, at the same time that the purchasers received copies of the CC&Rs, they most likely received a thick stack of additional documents. It is unlikely that the arbitration clause stood out so that the purchasers became immediately aware that by purchasing a home subject to the CC&Rs they were agreeing to the binding arbitration of disputes with the developer. (84 C.A.4th 829.)

(d) *Substantive unconscionability*. The arbitration clause was substantively unconscionable. The homeowners, by agreeing to CC&Rs that include a binding arbitration clause, waive their constitutional right to a jury trial. Those waivers are obtained by way of a stealthy device of the developer that is prohibited by public policy as established by C.C.P. 1298-1298.8, C.C. 1375, and 10 Cal. Code Reg. §2791.8.

(1) C.C.P. 1298-1298.8. Under C.C.P. 1298, an arbitration clause must not only meet specific style criteria, but must also contain a prominent notice provision. By placing the arbitration provision in the CC&Rs, which contain no notice provision and are not signed by the buyer, the developer avoids informing the buyer that he or she is waiving the right to a jury trial. Under C.C.P. 1298.7, a purchaser of real property may pursue a construction and design defect action against the developer in court, even if the purchaser signed an agreement to convey real property containing an arbitration clause. It appears that defendant sought to use the CC&Rs to bar the individual unit owners from filing construction or design defect actions against it in court. (84 C.A.4th 829.) "This flies in the face of the obvious legislative intent to permit home buyers to have their construction and design defects claims heard in a judicial forum. It is a blatant attempt to curtail the statutory rights of the home buyers and simply shocks the conscience." (84 C.A.4th 831.)

(2) C.C. 1375. This statute provides that before a homeowners association may file suit against a builder for construction or design defects, the parties must either attempt to settle the dispute or attempt to agree to submit it to alternative dispute resolution. But if the attempts are unsuccessful, the association may file a judicial action against the developer. The provision demonstrates that the Legislature has chosen to encourage alternative dispute resolution between homeowners associations and developers, but not to require it. *In the end, a homeowners association has access to the courts.* (84 C.A.4th 831.)

(3) 10 Cal. Code Reg. §2791.8. This regulation was adopted as an enforcement mechanism under the Subdivided Lands Act (B. & P.C. 11000 et seq.), which seeks to prevent fraud and sharp practices in the sale of lots or homes by subdividers. Accordingly, the regulation evidences an intent to ensure that arbitration provisions, if contained in CC&Rs, be fair. It does not require that CC&Rs contain arbitration provisions, and it certainly is not a proclamation that binding arbitration is the favored method for resolving construction and design defect disputes between the subdivider and the home buyer. (84 C.A.4th 832.)

SUPPLEMENT: [This section is current through the latest supplement]



81 of 199 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

E. Adhesive or Unconscionable Contracts.

3. Unconscionable Contract or Term.

c. Arbitration Agreement.

1. Underlying Contract or Provision.

cc. Employment Contract.

1 Witkin Sum. Cal. Law Contracts § 336

[§ 336] Employment Contract.

Graham v. Scissor-Tail (1981) 28 C.3d 807, 171 C.R. 604, 623 P.2d 165, supra, §334, was applied to an employment contract in *Hope v. Superior Court* (1981) 122 C.A.3d 147, 175 C.R. 851. The plaintiffs were former account executives of defendant Shearson, a securities brokerage firm. They sued for tortious interference with advantageous business relations and unfair competition, consisting of false and derogatory statements to local brokerage firms, and delaying or refusal to transfer accounts to their new firm. Shearson invoked the arbitration clause of the standard form of employment agreement, prepared by the New York Stock Exchange. *Held*, the agreement was unenforceable.

(a) The contract was adhesive in nature; petitioners' bargaining strength was patently less than Graham's in *Scissor-Tail*. (122 C.A.3d 153.)

(b) The arbitration provisions were unconscionable: The arbitral body was determined by the directors of the New York Stock Exchange, and therefore presumptively biased in favor of Shearson, a member of the *Exchange*. (122 C.A.3d 154.) And the presumption of bias was not dissipated by the circumstance that--unlike the situation in *Scissor-Tail*--the arbitration tribunal was not the board itself but a panel of arbitrators appointed by the chairman of the board with the board's approval. (122 C.A.3d 154.) "Evenhandedness could be assured by a procedure which permits selection of arbitrators by the parties to the dispute or, failing that, through the auspices of some truly neutral party." (122 C.A.3d 155.) (On arbitration of investor-broker disputes, see 65 Cal. L. Rev. 120.)

In *Dryer v. Los Angeles Rams* (1985) 40 C.3d 406, 220 C.R. 807, 709 P.2d 826, plaintiff, a professional football player, sued defendant owners of the team alleging that he had been removed from the active team roster in violation of his contract of employment. Defendant petitioned for arbitration, invoking the comprehensive grievance and arbitration provisions of the binding union agreement. The lower court denied the petition on the ground that another special provision allowed the league commissioner to intervene and finally determine a dispute "involving the integrity of, or public confidence in" the game. *Held*, reversed.

Apart from federal law (see *infra*, §338) and as an independent ground of decision, arbitration should have been

ordered. The provision that the lower court found unconscionable dealt with a contingent procedure in a narrowly circumscribed category of disciplinary matters; and the entire arbitration procedure was invalidated because of a purely speculative possibility that the commissioner might have the power at some point to withdraw the dispute from the normal arbitration process. This was unwarranted. (40 C.3d 417.)

The court added: "Of course, if the commissioner had stepped in or if there existed any reasonable basis in law upon which he might step in, we would have a different case, one in which *Graham* might be controlling. Similarly, the arbitration procedure might fail to meet the 'minimum levels of integrity' required by *Graham* if it could be shown that the possibility of commissioner intervention exerts a substantial 'chilling effect' on the entire arbitration process." (40 C.3d 417.) (See 55 *Hastings L. J.* 987 [unconscionability as defense to mandatory arbitration clauses in employment agreements].)

A number of cases have considered whether an arbitration agreement in an employment contract was unconscionable. The following are illustrative:

Armendariz v. Foundation Health Psychcare Services (2000) 24 C.4th 83, 113, 99 C.R.2d 745, 6 P.3d 669, 6 Cal. Proc. (4th), *Proceedings Without Trial*, Supp., §494A [arbitration agreement in employment contract was unconscionable for lack of mutuality inasmuch as it provided for mandatory arbitration of employees' wrongful termination disputes, but did not subject disputes of employer to arbitration; one-sidedness of agreement was compounded by fact that it did not permit full recovery of damages by employees].

Little v. Auto Stiegler (2003) 29 C.4th 1064, 1071, 130 C.R.2d 892, 63 P.3d 979, 6 Cal. Proc. (4th), *Proceedings Without Trial*, Supp., §§494D, 500 [provision in employment arbitration agreement permitting either party to appeal arbitration award of more than \$ 50,000 to second arbitrator unconscionably benefited defendants, and employer (drafting party) knew that in employment lawsuits it would generally be the defendant].

Kinney v. United HealthCare Services (1999) 70 C.A.4th 1322, 1329, 83 C.R.2d 348 [arbitration agreement in employment contract was both procedurally unconscionable, because employees were pressured into signing as condition to continued employment and had no opportunity to negotiate terms, and substantively unconscionable, because it was essentially unilateral].

Fittante v. Palm Springs Motors (2003) 105 C.A.4th 708, 722, 129 C.R.2d 659 [provision similar to that in *Little, supra*; appeal clause, while bilateral in form, was unilateral in its application, as it would render claim against employer nonbinding if employee won a significant money judgment, but binding if employee lost].

O'Hare v. Municipal Resource Consultants (2003) 107 C.A.4th 267, 273, 132 C.R.2d 116 [arbitration agreement was substantively unconscionable, where it required employee to arbitrate employee's claims but was silent with respect to employer, allowed employer to file lawsuit seeking injunctive and equitable relief against employee, improperly required employee to share costs, and facially prohibited discovery in derogation of law].

McManus v. CIBC World Markets Corp. (2003) 109 C.A.4th 76, 92, 134 C.R.2d 446 [under circumstances, following employment arbitration provisions were not substantively unconscionable: mandatory arbitrator selection process, no requirement that arbitrator be judge or lawyer, employee's discovery rights, no reasonable award requirement, and lack of mutual obligation to arbitrate].

Abramson v. Juniper Networks (2004) 115 C.A.4th 638, 650, 9 C.R.3d 422 [it was error to uphold cost-sharing provisions in arbitration agreement of employment contract; under *Armendariz, supra*, and *Little, supra*, employers may not require employees to pay forum costs that are unique to arbitration].

Martinez v. Master Protection Corp. (2004) 118 C.A.4th 107, 115, 12 C.R.3d 663 [employment arbitration agreement requiring parties to split cost of arbitration and to post fees in advance of hearing unacceptably imposed costs on employee that he would not be required to bear in judicial forum, and thus was substantively unconscionable].

Fitz v. NCR Corp. (2004) 118 C.A.4th 702, 715, 13 C.R.3d 88 [arbitration provisions in employment contract limiting discovery to two depositions and prohibiting further discovery unless parties could demonstrate that fair hearing would be impossible placed employee at disadvantage, where employer had relevant documents in its possession and witnesses in its employ].

Nyulassy v. Lockheed Martin Corp. (2004) 120 C.A.4th 1267, 1281, 16 C.R.3d 296 [where mandatory arbitration provision in employment agreement was nonnegotiable, mere fact that employee was represented by counsel during negotiation and execution did not prevent him from later asserting that agreement was unconscionable].

SUPPLEMENT: [This section is current through the latest supplement]

In *Gentry v. Superior Court (2007) 42 C.4th 443, 64 C.R.3d 773, 165 P.3d 556*, plaintiff retail store manager filed a class action, under *Lab.C. 1194* (3 Summary (10th), *Agency and Employment*, §384), against defendant employer seeking damages for statutory violations arising from defendant's failure to pay its managers overtime wages to which they were allegedly entitled. Under defendant's dispute resolution procedure, employee-related claims were to be handled by an arbitrator who lacked the power to hear class claims (a class arbitration waiver). Plaintiff had 30 days to reject the arbitration provision, but chose not to do so. Defendant then filed a motion to compel arbitration. The trial court granted the motion, and the Court of Appeal affirmed. *Held*, reversed; the arbitration provision was procedurally unconscionable.

(a) Defendant argued that the fact that plaintiff had 30 days to opt out of the arbitration agreement and the class arbitration waiver meant that the terms of the agreement were not procedurally unconscionable and were therefore enforceable. However, this argument misses the point, because the validity of a class arbitration waiver has been analyzed in terms of unwaivable statutory rights, rather than unconscionability. Moreover, because the statutory rights under *Lab.C. 1194* are not waivable, the minimal requirements imposed on arbitration agreements to ensure their vindication cannot be waived by the employee in a *prelitigation* agreement. A waiver can only occur if an employer and an employee knowingly and voluntarily enter into an arbitration agreement after a dispute has arisen. (42 C.4th 467.)

(b) The arbitration provision here was procedurally unconscionable, despite the existence of the opt-out provision, because there are several indications that plaintiff's failure to opt out of the arbitration agreement did not represent an authentic informed choice. For example, although defendant pointed out some of the disadvantages to choosing arbitration (no jury trial and limited recovery), it did not mention any of the additional significant disadvantages that this particular arbitration agreement had, compared to litigation: a shorter statute of limitations; recovery of back pay of only 1 year, instead of 3, from the time that plaintiff knew of the violation of the law; limited punitive damages; and each party's responsibility for his or her own attorneys' fees, as opposed to the statutory provision providing that the prevailing party is entitled to fees and costs. Only a legally sophisticated employee would have realized that he or she had fewer rights than those available in litigation. Finally, it is unclear whether someone in plaintiff's position would have felt free to opt out, because the materials provided to him made it unmistakably clear that defendant preferred that he participate in the arbitration program. Given the inequality between defendant and plaintiff and the economic power that the former wielded over the latter, it is likely that plaintiff felt at least some pressure not to opt out of the arbitration agreement. (42 C. 4th 470.) *Armendariz case*:

Cross-Reference: 6 Cal. Proc. (5th), *Proceedings Without Trial*, §518. *Little case*:

Cross-Reference: 6 Cal. Proc. (5th), *Proceedings Without Trial*, §521.



82 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

E. Adhesive or Unconscionable Contracts.

3. Unconscionable Contract or Term.

c. Arbitration Agreement.

1. Underlying Contract or Provision.

dd. Other Contract or Provision.

1 Witkin Sum. Cal. Law Contracts § 337

[§ 337] Other Contract or Provision.

Numerous other cases concern arbitration agreements, and these agreements have been placed within various contracts or provisions. The following are illustrative:

Engalla v. Permanente Med. Group (1997) 15 C.4th 951, 984, 64 C.R.2d 843, 938 P.2d 903, 6 Cal. Proc. (4th), *Proceedings Without Trial*, Supp., §§502, 504 [health service plan's arbitration agreement was not per se unconscionable despite allegedly biased system of selecting neutral arbitrators; alleged problem was in gap between contractual representations and actual workings of program, which was best addressed by doctrines of fraud and waiver].

Patterson v. ITT Consumer Financial Corp. (1993) 14 C.A.4th 1659, 1664, 18 C.R.2d 563 [arbitration provision in loan agreements setting Minnesota as place of arbitration and requiring prepayment of fee to obtain participatory hearing was unconscionable as applied to small claim disputes involving unsophisticated borrowers of limited means].

Stirlen v. Supercuts (1997) 51 C.A.4th 1519, 1530, 60 C.R.2d 138, 6 Cal. Proc. (4th), *Proceedings Without Trial*, Supp., §500 [arbitration clause providing that only remedy available was money award not to exceed amount of actual damages for breach of contract was unconscionable]; see 38 U.S.F. L. Rev. 49 [Stirlen].

Coast Plaza Doctors Hosp. v. Blue Cross of Calif. (2000) 83 C.A.4th 677, 687, 99 C.R.2d 809 [arbitration clause in service agreement between hospital and health care services provider was not unconscionable, despite disparity in financial strength of companies that enabled provider to impose low reimbursement rates and restricted nature of hospital's discovery rights in arbitration].

Bolter v. Superior Court (2001) 87 C.A.4th 900, 906, 104 C.R.2d 888 [requiring small franchisees to conduct arbitration in Utah was unconscionable given difficulty and costs involved; unconscionable provision severable].

Flores v. Transamerica HomeFirst (2001) 93 C.A.4th 846, 850, 113 C.R.2d 376 [arbitration clause in reverse

mortgage; procedural unconscionability--stronger party inserted clause on "take-it-or-leave-it" basis; substantive unconscionability--clause applied to claims that plaintiff might bring against lender, but not vice versa, and there was no reason for lack of mutuality].

Szetela v. Discover Bank (2002) 97 C.A.4th 1094, 1099, 118 C.R.2d 862 [class action by cardholder against credit card company; provision of arbitration clause prohibiting class treatment of individual claims was substantively and procedurally unconscionable].

Pardee Const. Co. v. Superior Court (2002) 100 C.A.4th 1081, 1088, 123 C.R.2d 288 [homeowners in large development signed agreement to submit all disputes to judicial reference; agreement was procedurally unconscionable in that it was presented on take-it-or-leave-it basis, and waiver of right to recover punitive damages was substantively unconscionable].

Woodside Homes of Calif. v. Superior Court (2003) 107 C.A.4th 723, 728, 730, 132 C.R.2d 35 [judicial reference provision was enforceable, where it was initialed by plaintiff and waiver of jury trial was clearly set forth; further, there was no evidence that provision allowing defendant to opt out was used to its advantage].

Jaramillo v. JH Real Estate Partners (2003) 111 C.A.4th 394, 403, 404, 3 C.R.3d 525 [under C.C. 1953(a)(4), tenant cannot agree to binding arbitration; apart from this statute, arbitration clause in rental agreement that made tenant claims subject to limitation that demand for arbitration must be made within 180 days lacked "bilateralism," and was unconscionable].

Schulster Tunnels/Pre-Con v. Traylor Brothers/Obayashi Corp. (2003) 111 C.A.4th 1328, 1336, 4 C.R.3d 655 [before suing contractor, subcontractor did not have to comply with dispute resolution board (DRB) process, where DRB provision was in contract between contractor and city, and decisional board, which was appointed by contractor and city, was presumptively biased against subcontractor].

Harper v. Ultimo (2003) 113 C.A.4th 1402, 1406, 7 C.R.3d 418 [arbitration agreement requiring all controversies to be settled in accordance with rules of Better Business Bureau was procedurally and substantively unconscionable, where rules, which were not attached to contract, basically limited recovery to out-of-pocket loss].

Gutierrez v. Autowest (2003) 114 C.A.4th 77, 87, 7 C.R.3d 267 [unconscionable to condition arbitration on consumer posting fees that are beyond his or her ability to pay].

Greenbriar Homes Communities v. Superior Court (2004) 117 C.A.4th 337, 345, 11 C.R.3d 371 [provision requiring homeowners to bear half of referee's cost was not unconscionable; because C.C.P. 645.1 allowed referee's fees to be paid as agreed by parties, federal case making such agreements "categorically unreasonable" did not apply].

SUPPLEMENT: [This section is current through the latest supplement]

See 22 A.L.R.6th 49 [claim of unconscionability of contract as subject to compulsory arbitration clause contained in contract].

Engalla case:

Cross-Reference: 6 Cal. Proc. (5th), *Proceedings Without Trial*, §545.

Stirlen case:

Cross-Reference: 6 Cal. Proc. (5th), *Proceedings Without Trial*, §538.

Illustrative cases:

Discover Bank v. Superior Court (2005) 36 C.4th 148, 158, 30 C.R.3d 76, 113 P.3d 1100 [waiver of class

arbitration in adhesion contract is unconscionable when disputes involve small amounts of damages, and when it is alleged that party with superior bargaining power deliberately cheated large numbers of consumers out of small sums of money; under these circumstances, waiver exempts party from responsibility for its own fraud or wilful injury]; *Aral v. Earthlink* (2005) 134 C.A.4th 544, 556, 36 C.R.3d 229 [same]; see 13 A.L.R.6th 145 [validity of arbitration clause precluding class actions].

Crippen v. Central Valley RV Outlet (2004) 124 C.A.4th 1159, 1164, 22 C.R.3d 189 [buyer of motor home failed to establish that arbitration agreement was procedurally unconscionable, where he did not show that execution of purchase contract was characterized by inequality of bargaining power and lack of negotiation or meaningful choice; also, form of document was not procedurally unconscionable, where arbitration addendum was not set in small type or hidden in prolix form].

Independent Assn. of Mailbox Center Owners v. Superior Court (2005) 133 C.A.4th 396, 410, 34 C.R.3d 659 [arbitration provisions in franchise agreements restricting arbitrator from having any power to award punitive, consequential, or incidental damages such as lost profits, attorneys' fees, and costs, were unenforceable as unconscionable to extent they purported to deprive franchisees of remedies authorized by California statutory law].

Higgins v. Superior Court (2006) 140 C.A.4th 1238, 1251, 45 C.R.3d 293 [release agreement containing orphaned siblings' promise to arbitrate any dispute with television producers arising from appearance on home renovation reality show was procedurally unconscionable in that arbitration clause was buried in "miscellaneous" section of 24-page agreement; it was also substantively unconscionable in that only siblings were limited to arbitration and foreclosed from asserting appeal rights, and only television parties were provided with opportunity to change agreement at any time].

Cohen v. DIRECTV (2006) 142 C.A.4th 1442, 1451, 48 C.R.3d 813 [prohibition of class litigation in arbitration clause in customer agreement that was embedded in adhesion contract between satellite television subscribers and satellite broadcasting company was unconscionable; *Discover Bank v. Superior Court*, *supra*, followed].

Gatton v. T-Mobile USA (2007) 152 C.A.4th 571, 586, 61 C.R.3d 344 [provision prohibiting class-wide arbitration in service agreement between cellular phone subscribers and cellular phone provider had high degree of substantive unconscionability such that, combined with even minimal amount of procedural unconscionability, which arose from provision's adhesive nature, provision was unenforceable; subscribers' claims involved individual damages as small as \$ 200, making class action only practicable way for subscribers to seek redress].

Baker v. Osborne Dev. Corp. (2008) 159 C.A.4th 884, 896, 71 C.R.3d 854 [arbitration agreement between home purchasers and builder was substantively unconscionable because it was one-sided; builder would have no conceivable reason to institute legal proceedings against purchasers after escrow closed, but virtually every claim that purchasers might raise against builder would be subject to arbitration].

Thompson v. Toll Dublin, LLC (2008) 165 C.A.4th 1360, 1373, 81 C.R.3d 736 [assuming arbitration provisions in contract between condominium owners and developers covered owners' fraud claims, those provisions were substantively unconscionable, because inclusion of fraud claims in provisions that on their face applied only to construction defects would not have been within reasonable expectations of owners; arbitration provisions were also unfairly one-sided in that developers would have no conceivable reason to institute legal proceedings after escrow closed, while owner claims would be subject to arbitration].

Cf. *Trend Homes v. Superior Court* (2005) 131 C.A.4th 950, 958, 32 C.R.3d 411 [judicial reference provision was not procedurally unconscionable, where it was clearly and conspicuously stated and both parties were required to initial it, where there was no evidence that purchasers were unsophisticated or that vendor denied any purchaser's request to strike provision, and, most importantly, where deprivation of jury right was clearly set forth].



83 of 199 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

E. Adhesive or Unconscionable Contracts.

3. Unconscionable Contract or Term.

c. Arbitration Agreement.

2. Federal Law.

1 Witkin Sum. Cal. Law Contracts § 338

[§ 338] Federal Law.

Tonetti v. Shirley (1985) 173 C.A.3d 1144, 219 C.R. 616, points out that in contracts involving commerce, in which the Federal Arbitration Act controls, the California adhesion and unconscionability principles relied on in *Hope v. Superior Court* (1981) 122 C.A.3d 147, 175 C.R. 851, supra, §336, are inapplicable. *Tonetti* involved the NYSE rules, which have been held by federal courts to be fair and enforceable, contrary to the *Hope* decision. Hence, the trial court's denial of defendant employer's petition to compel arbitration of its dispute with plaintiff employee, without receiving evidence on the actual operation of the NYSE arbitration procedures with respect to plaintiff, was error. "[U]nder federal law, Kidder does not have the burden of rebutting the presumption of institutional bias that exists in *Hope* when moving to compel arbitration. Instead, *Tonetti* has the burden of showing actual bias in the operation of the arbitration procedures." (173 C.A.3d 1150.) The judgment was therefore reversed and the cause remanded "so the issue of unconscionability can be properly determined under federal law and the Rules as they exist at the time of the new hearing." (173 C.A.3d 1151.) (See *Chan v. Drexel Burnham Lambert* (1986) 178 C.A.3d 632, 639, 223 C.R. 838 [following *Tonetti* on adhesion point, but also holding that California rules apply in interpreting the agreement]; *Downs v. Prudential-Bache Sec.* (1988) 202 C.A.3d 616, 621, 622, 248 C.R. 734 [criticizing *Hope* and following *Tonetti*]; cf. *Lewis v. Prudential-Bache Sec.* (1986) 179 C.A.3d 935, 944, 225 C.R. 69 [issue involved was "general practice of securities brokerage firms" raising "legitimate doubts as to the probable institutional bias" of arbitration panel; distinguishing *Tonetti*]; *Lewis v. Lynch, Pierce, Fenner & Smith* (1986) 183 C.A.3d 1097, 1106, 228 C.R. 345 [following *Lewis v. Prudential-Bache Sec.*].)

In *Dryer v. Los Angeles Rams* (1985) 40 C.3d 406, 220 C.R. 807, 709 P.2d 826, plaintiff professional football player sued defendant owners of the team alleging that he had been removed from the active team roster in violation of his contract of employment. Defendant petitioned for arbitration, invoking the comprehensive grievance and arbitration provisions of the binding union agreement. Although the basic provisions fully met standards of due process, the lower court denied the petition on the ground that another special provision allowed the league commissioner to intervene and finally determine a dispute "involving the integrity of, or public confidence in" the game. *Held*, reversed.

Plaintiff's dispute came within §301(a) of the Labor Management Relations Act (see 3 *Summary* (10th), *Agency and Employment*, §537), and was therefore subject to federal law governing enforcement of arbitration provisions. (40 C.3d

411.) Federal law appears to limit a court's inquiry to a few basic questions concerning arbitrability of the dispute and defenses, if any, based on allegations of a lack of fair representation. (40 C.3d 412.) Plaintiff has not shown a lack of fair representation. Instead, he challenges the inherent fairness of the arbitration machinery agreed upon by both union and management, and to apply the reasoning of *Graham v. Scissor-Tail* (1981) 28 C.3d 807, 171 C.R. 604, 623 P.2d 165, supra, §334, would frustrate the goals of national labor policy. (40 C.3d 414, 415.)

In *Thomas v. Perry* (1988) 200 C.A.3d 510, 246 C.R. 156, plaintiff, a former employee of a member firm of the New York Stock Exchange, contended that the Exchange's mandatory arbitration rule was unconscionable in that it provided for no meaningful discovery and required that the arbitrator be selected by the Exchange. *Held*, the Federal Arbitration Act (9 U.S.C., §1 et seq.), which provides that an agreement to arbitrate is valid, irrevocable, and enforceable, preempts *Lab.C.* 229 (right to maintain action for wages despite arbitration agreement), and under federal law, the arbitration rule was not unconscionable. (200 C.A.3d 515.) (See *Erickson v. Aetna Health Plans of Calif.* (1999) 71 C.A.4th 646, 654, 84 C.R.2d 76 [state adhesion contract principles are inapplicable to enforcement of arbitration clauses in agreement governed by Federal Arbitration Act; health care service plan].)

SUPPLEMENT: [This section is current through the latest supplement]



84 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

E. Adhesive or Unconscionable Contracts.

3. Unconscionable Contract or Term.

d. Bank Depositor's Signature Card.

1 Witkin Sum. Cal. Law Contracts § 339

[§ 339] Bank Depositor's Signature Card.

In *Perdue v. Crocker Nat. Bank* (1985) 38 C.3d 913, 216 C.R. 345, 702 P.2d 503, plaintiff filed a class action on behalf of persons with checking accounts at defendant bank, attacking the unilaterally set charge of \$ 6 for processing a NSF (no sufficient funds) check. The complaint alleged that the actual cost was 30 cents, and that the charge was unconscionable. *Held*, reversing judgment for defendant on demurrer, a cause of action could be stated.

(a) *Bank signature card as contract.* The bank signature card was a contract between the depositor and the bank for the handling of the account. (38 C.3d 923; see 4 *Summary* (10th), *Negotiable Instruments*, §74.) And the fact that the bank unilaterally sets the NSF charges does not render the charge unenforceable: If there are reciprocal promises, one party's discretionary power to vary the price or other performance merely requires that party to exercise the power reasonably. (38 C.3d 923, 924.) "[W]e hold as a matter of law that the card is a contract authorizing the bank to impose such charges, subject to the bank's duty of good faith and fair dealing in setting or varying such charges." (38 C.3d 924.)

(b) *Unconscionable charges.*

(1) The allegations of the complaint support the conclusion that the signature card, drafted by the bank and offered to the customer without negotiation, is a contract of adhesion. (38 C.3d 925.)

(2) C.C. 1670.5, codifying the unconscionability doctrine, is a legislative recognition that a claim of unconscionability often requires inquiry into the setting, purpose, and effect of the contract. (38 C.3d 926.) And a price term may be unconscionable. It is not enough for plaintiff to show that the price exceeds cost or fair value, nor is it a complete answer for defendant to show that the price is equal to the market value: The courts consider not only the market price, but the cost of goods or services to the seller, the inconvenience imposed on the seller, and the true value of the product or service. (38 C.3d 926, 927.) The decisions also examine the "procedural aspects," such as absence of meaningful choice, lack of sophistication of the buyer, and deceptive practices by the seller. (38 C.3d 927.)

(3) The facts alleged support plaintiff's right to a *factual hearing*: "Defendant presents the depositor with a document which serves at least in part as a handwriting exemplar, and whose contractual character is not obvious. The contractual language appears in print so small that many could not read it. State law may impose obligations on the

bank ... , but so far as the signature card drafted by the bank is concerned, the bank has all the rights and the depositor all the duties. The signature card provides that the depositor will be bound by the bank's rules, regulations, practices and charges, but the bank does not furnish the depositor with a copy of the relevant documents. The bank reserves the power to change its practices and fees at any time, subject only to the notice requirements of state law." (38 C.3d 928.)

"In short, the bank structured a totally one-sided transaction. The absence of equality of bargaining power, open negotiation, full disclosure, and a contract which fairly sets out the rights and duties of each party demonstrates that the transaction lacks those checks and balances which would inhibit the charging of unconscionable fees. In such a setting, plaintiff's charge that the bank's NSF fee is exorbitant, yielding a profit far in excess of cost, cannot be dismissed on demurrer." (38 C.3d 928.)

In *California Grocers Assn. v. Bank of America* (1994) 22 C.A.4th 205, 27 C.R.2d 396, plaintiff depositor challenged defendant bank's practice of imposing a \$ 3 fee for a "deposited item returned" (DIR), i.e., a check or other item which, after being deposited in the depositor's account, is returned because of insufficient funds, a stop payment order, closure of account, or for any other reason. Because the cost of processing a DIR, plus a 15% profit (the normal profit in the banking industry) was only \$ 1.73, the trial judge held that the fee was unconscionable to the extent that it exceeded that amount. *Held*, this was error.

(a) Although *Perdue v. Crocker Nat. Bank*, *supra*, concluded that the different pathways followed in *A & M Produce Co. v. FMC Corp.* (1982) 135 C.A.3d 473, 186 C.R. 114, *supra*, §332, and *Graham v. Scissor-Tail* (1981) 28 C.3d 807, 171 C.R. 604, 623 P.2d 165, *supra*, §334, would lead to the same result, the one taken in *Graham v. Scissor-Tail* is preferable. As explained in that case, describing a contract as adhesive does not determine its legal effect. Rather, the main issue is whether the contract, although adhesive, is oppressive or unconscionable. However, by speaking in terms of "procedural" unconscionability, the *A & M Produce Co.* approach elevates the fact of adhesiveness to the same level as "substantive" unconscionability, thus tending to obscure the real issue. (22 C.A.4th 214.)

(b) Plaintiff's deposit signature card, which referred to the pamphlet that explained the DIR fee and other conditions of the deposit agreement, is a contract. (22 C.A.4th 215, citing *Perdue v. Crocker Nat. Bank*.) And because plaintiff's only choice was to adhere to the deposit agreement or reject it, it is a classic example of an adhesion contract. (22 C.A.4th 214.) However, as explained above, this conclusion begins, instead of, ends the analysis. The real issue is whether the contract is oppressive or unconscionable. (22 C.A.4th 214.)

(c) The traditional standard for unconscionability is whether the provision in question is so unfair as to shock the conscience. *A & M Produce* departed from this standard by making reasonableness the standard of unconscionability. However, because the traditional standard and other similar formulations are more specific and more demanding, they are preferable to a reasonableness standard, which is far too subjective to provide adequate guidance. Hence, in analyzing defendant's \$ 3 DIR fee for unconscionability, the pivotal issue is whether it shocks the conscience. (22 C.A.4th 215.)

(d) Under this standard, defendant's \$ 3 fee is not unconscionable for two reasons.

First, a factor in determining whether a fee is unconscionable is the fee charged by other similar institutions. Here, defendant's fee is actually at the low end of DIR fees, many of which range from \$ 4 to \$ 10. And although a price within the range of general market prices may yet be held unconscionable if the market is oligopolistic, plaintiff made no showing of oligopoly, and consequent lack of free competition, with respect to the banking industry. (22 C.A.4th 216.)

Second, the \$ 3 fee is simply not so exorbitant as to shock the conscience. Assuming that defendant's cost of processing a DIR is \$ 1.50 (as found by the trial judge), the markup is 100%. And while this may be a generous profit, it is wholly within the range of commonly accepted notions of fair profitability. Price unconscionability generally involves a much greater price-value disparity. (22 C.A.4th 216.)

(e) The huge volume of DIRs, and the consequent cumulative profit to defendant, is inconsequential. If a contract is fair when entered into, it does not become unconscionable merely because thereafter numerous other persons enter into identical contracts with the defendant, thereby increasing its profits. (22 *C.A.4th* 216.)

SUPPLEMENT: [This section is current through the latest supplement]



85 of 199 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT

E. Adhesive or Unconscionable Contracts.

3. Unconscionable Contract or Term.

e. Loan at Excessive Interest.

1 Witkin Sum. Cal. Law Contracts § 340

[§ 340] Loan at Excessive Interest.

In *Carboni v. Arrospide* (1991) 2 C.A.4th 76, 2 C.R.2d 845, defendant, having attempted unsuccessfully to procure a loan from other sources, signed a note and deed of trust in favor of plaintiff, a real estate broker, with an interest rate of 200% per annum. Because a loan by a licensed real estate broker is exempt from California's usury laws (see *infra*, §458), defendant raised the defense of unconscionability in plaintiff's action for judicial foreclosure and deficiency judgment. The trial judge found the interest provision invalid, and entered judgment permitting interest at the rate of 24% per annum. *Held*, affirmed.

(a) "Surprisingly, the parties have not cited, and we have not discovered, any case which applies the doctrine of unconscionability to specifically annul or reform a loan which bears a shockingly high rate of interest. ... Nevertheless, we believe we may look to cases finding unconscionability on the basis of gross price disparity as analogous authority. In essence, the interest rate is the 'price' of the money lent; at some point the price becomes so extreme that it is unconscionable." (2 C.A.4th 81.)

(b) The interest rate of 200% was substantively unconscionable; it was approximately 10 times the rate then prevailing in the credit market for similar loans. "Thus, the 'price' of the credit was, by at least one objective measure, roughly ten times its value. Courts have found sales contracts unconscionable where the price disparity was far less severe." (2 C.A.4th 84.)

(c) There was also evidence of procedural unconscionability. Although there was no surprise, there was an inequality of bargaining power, and defendant was acting under emotional distress. (2 C.A.4th 85.) Even if the procedural aspect was slight in this case, the substantive unconscionability was severe; and "[a] compelling showing of substantive unconscionability may overcome a weaker showing of procedural unconscionability." (2 C.A.4th 86.)

SUPPLEMENT: [This section is current through the latest supplement]



86 of 199 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law
VII. REALITY AND FREEDOM OF CONSENT
E. Adhesive or Unconscionable Contracts.
3. Unconscionable Contract or Term.
f. Employment Contract Terminating Commissions.

1 Witkin Sum. Cal. Law Contracts § 341

[§ 341] Employment Contract Terminating Commissions.

In *Ellis v. McKinnon Broadcasting Co.* (1993) 18 C.A.4th 1796, 23 C.R.2d 80, plaintiff was employed as an advertising salesman by a television station owned by defendant. The written contract between the parties contained a clause providing that plaintiff would receive no commission on advertising fees received by defendant after termination of plaintiff's employment. After plaintiff voluntarily left the station, defendant collected nearly \$ 100,000 in fees on advertising previously sold by plaintiff, and paid plaintiff no commission on these sales. In challenging the forfeiture provision, plaintiff received a favorable ruling before the Labor Commission, but on trial de novo the trial court ruled for defendant. *Held*, reversed; the forfeiture provision was unconscionable.

(a) *Procedural element: surprise.* Because plaintiff was asked to sign the contract without warning and was told that it was a mere formality, he had no reason to suspect that it contained an unusual forfeiture provision that had never been discussed with him previously. Hence, it is understandable why plaintiff did not become aware of the forfeiture provision until he reread the contract shortly before giving notice of intent to leave. (18 C.A.4th 1804.)

(b) *Procedural element: oppression.*

(1) Oppression is based on unequal bargaining power, and this inequality exists here: defendant is a corporation operating a television station, while plaintiff is a single employee who moved across state to take the job and who had no other job offers. (18 C.A.4th 1805.)

(2) Neither the fact that certain aspects of the contract, i.e., starting date, commission rate, etc., were actually negotiated nor the fact that plaintiff never objected to the forfeiture provision proves that the provision was negotiable. Significantly, there was no evidence that the forfeiture provision was missing from the employment contract of any other sales account executive. In any event, despite defendant's contention that individual contracts are sometimes negotiated, plaintiff was never made aware of that option. (18 C.A.4th 1805.)

(c) *Substantive element.*

(1) Relying on *Division of Labor Standards Enforcement v. Dick Bullis* (1977) 72 C.A.3d Supp. 52, 140 C.R. 267,

defendant argued that the forfeiture provision here is justified by the fact that someone else had to perform the postsale servicing of plaintiff's accounts after plaintiff left. This position is without merit. The *Bullis* case is distinguishable on several grounds, including the fact that it rested on the fact that a car was not "sold" until it was delivered (before that, the order could be cancelled), while in the present case, plaintiff's sales of advertising had been completed at the time he left work. (18 C.A.4th 1806.)

(2) Defendant also argued that the forfeiture provision was justified as a means of recovering the salary to which plaintiff was entitled under the contract during the first 3 months of employment even if he sold nothing. This argument too is without merit. If such recovery were truly the object of the forfeiture provision, the "unearned" amounts during the first 3 months could have been recorded on the books as a credit against sums due after termination of employment. As written, however, the provision was commercially unreasonable in that it exacted a penalty (nearly \$ 20,000) far in excess of any potential detriment suffered by defendant (slightly over \$ 6,000). (18 C.A.4th 1806.)

American Software v. Ali (1996) 46 C.A.4th 1386, 54 C.R.2d 477, involving facts analogous to those in *Ellis*, reached a different result. Plaintiff was employed as a salesperson by defendant software company, and her employment contract terminated her right to receive commissions on payments received on her accounts 30 days after severance of her employment. After plaintiff voluntarily resigned, she sought commissions received by defendant more than 30 days after she left. Her claim was denied by the Labor Commissioner, but, upon de novo review, the trial court found the contract provision regarding postemployment commissions to be unconscionable and awarded her approximately \$ 30,000. *Held*, reversed.

(a) *No procedural unconscionability.* Plaintiff was aware of her obligations under the contract and she voluntarily agreed to assume them. In her business as a salesperson, it was reasonable to assume that she had become familiar with contracts and their importance. The salient provisions of the employment contract were straightforward, and the terms used were easily comprehensible to the layman. She had the benefit of counsel. This was not a situation in which one party to the contract is confronted by an absence of meaningful choice. In fact, plaintiff had enough bargaining "clout" to successfully negotiate for more favorable terms on other provisions in the contract. She was aware of the postemployment commissions clause, but did not attempt to negotiate for less onerous terms. "In short, this case is a far cry from those cases where fine print, complex terminology, and presentation of a contract on a take-it-or-leave-it basis constitutes the groundwork for a finding of unconscionability." (46 C.A.4th 1391.)

(b) *No substantive unconscionability.*

(1) Substantive unconscionability is indicated by contract terms so one-sided as to "shock the conscience." This standard, applied by *California Grocers Assn. v. Bank of America* (1994) 22 C.A.4th 205, 27 C.R.2d 396, *supra*, §339, is preferred to the less stringent standard of "reasonableness," which was applied in *A & M Produce Co. v. FMC Corp.* (1982) 135 C.A.3d 473, 186 C.R. 114, *supra*, §332. With a concept as nebulous as "unconscionability," courts should not be thrust in the paternalistic role of intervening to change contractual terms that the parties have agreed to merely because the court believes the terms are unreasonable. The terms must shock the conscience. (46 C.A.4th 1391.)

(2) Plaintiff's arguments of substantive unconscionability rest largely on events that occurred several years after the contract was entered into, but, under C.C. 1670.5(a), unconscionability must be analyzed according to the circumstances as they existed at the time the contract was made. When viewed in light of the circumstances at that time, "we cannot say the contract provision with respect to compensation after termination was so unfair or oppressive in its mutual obligations as to 'shock the conscience.' " (46 C.A.4th 1392.)

(3) The official notes to Unif.Com.C. §2-302, on which C.C. 1670.5 is based, provide that the contract terms are to be evaluated in the light of the general commercial background and the commercial needs of the particular trade or case. The contract provision challenged here is commonplace in employment contracts with sales representatives, such as plaintiff, who have ongoing responsibilities to "service" the account once the sale is made. The reason for deferring commissions is to prevent the burden of servicing buyers pending receipt of revenues from falling on defendant's other

salespersons, who would be unfamiliar with the earlier transaction and would receive nothing for their efforts. (46 C.A.4th 1392.)

(4) The terms of the contract do not represent an overly harsh allocation of risks not justified by the circumstances under which the contract was made. The contract terms with regard to plaintiff's compensation involved certain risks to both parties. Plaintiff took the risk that she would lose commissions if payment was not received by defendant within 30 days after her resignation; defendant took the risk that at the time of plaintiff's termination she would not have earned sufficient commissions to cover the substantial draws "credited" to her. This is part of the bargaining process--it does not necessarily make a contract unconscionable. (46 C.A.4th 1393.)

(c) *Ellis criticized.* The conflict with *Ellis* is explained by the fact that the *Ellis* court closely followed the *A & M Produce Co.* analytical structure in considering whether the commissions provision was "reasonable," an approach specifically rejected in favor of the more rigorous "shock the conscience" standard. The result in *Ellis* is also hard to reconcile with other California appellate decisions that have shown considerable restraint in second-guessing provisions in employment contracts governing payment of sales commissions upon termination of employment. (46 C.A.4th 1394.) (See 46 *Hastings L. J.* 459 [Unconscionability in California: A Need for Restraint and Consistency].)

SUPPLEMENT: [This section is current through the latest supplement]



87 of 199 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

VIII. STATUTE OF FRAUDS

A. In General.

1. Requirement of Writing.

a. History and Modern Approach.

1 Witkin Sum. Cal. Law Contracts § 342

[§ 342] History and Modern Approach.

The statute of frauds is a collective term describing the various statutory provisions that deny enforcement to certain enumerated classes of contracts unless they are reduced to writing and signed by the party to be charged. (See generally Rest.2d, Contracts, Vol. 1, p. 281 [Statutory Note on English and American statutes]; §110 [classes of contracts covered]; 4 Corbin (Rev. ed.), §12.1 et seq.; 9 Williston 4th, §21:1 et seq.; 72 *Am.Jur.2d* (2001 ed.), *Statute of Frauds* §1 et seq.; 53 *Cal. L. Rev.* 590.) However, unenforceability does not necessarily apply to the entire contract. If the contract is severable, the unenforceable part may be disregarded and the valid part enforced. (See *White Lighting Co. v. Wolfson* (1968) 68 C.2d 336, 345, 66 C.R. 697, 438 P.2d 345; 4 Corbin (Rev. ed.), §13.12 et seq.; 10 Williston 4th, §27:8.)

The doctrine has been criticized. "The commentators almost unanimously urge that considerations of policy indicate a restricted application of the statute of frauds, if not its total abolition." (*Sunset-Sternau Food Co. v. Bonzi* (1964) 60 C.2d 834, 838, 36 C.R. 741, 389 P.2d 133, *infra*, §391, footnote 3.) (See *White Lighting Co. v. Wolfson* (1968) 68 C.2d 336, 343, 66 C.R. 697, 438 P.2d 345, *infra*, §367); *Ripani v. Liberty Loan Corp.* (1979) 95 C.A.3d 603, 610, 157 C.R. 272, citing the text; *Shell v. Darneille* (1984) 162 C.A.3d 957, 961, 209 C.R. 68; 68 *Harv. L. Rev.* 383 [discussing statutory revision in England and America].)

West's Key Number Digest, Frauds, Statute of, k.119(1)

SUPPLEMENT: [This section is current through the latest supplement]
See C.E.B., Law of Contracts §4.44 et seq.



88 of 199 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law
VIII. STATUTE OF FRAUDS

A. In General.

1. Requirement of Writing.

b. California Codes.

1 Witkin Sum. Cal. Law Contracts § 343

[§ 343] California Codes.

The California statute of frauds (C.C. 1624) provides that certain contracts "are invalid, unless the same, or some note or memorandum thereof, *is in writing and subscribed by the party to be charged or by his agent.*" (C.C. 1624(a).)

Other provisions requiring a writing are found in various parts of the Codes. (See, e.g., U.C.C. 2201, 9203; C.C. 683, 1135, 1524, 1698, 2309, 2793; *C.C.P.* 360, 1280, 1974; *Prob.C.* 9604.) (On the meaning of "invalid," see *infra*, §344; on the "note or memorandum," see *infra*, §350 et seq.; on the "party to be charged," see *infra*, §359 et seq.; for the provisions of the statute, see *infra*, §363 et seq.; on effect of part performance, see *infra*, §402 et seq.; on estoppel to plead statute, see *infra*, §406 et seq.; on exception for qualified financial contracts, see *infra*, §417.) (See *Cal. Transactions Forms*, 1 Business Transactions §6:37 et seq.; 2 California Affirmative Defenses 2d (2004 ed.), §53:1 et seq.)

West's Key Number Digest, Frauds, Statute of, k.120

SUPPLEMENT: [This section is current through the latest supplement]
See 3 California Affirmative Defenses §53:1 et seq.



89 of 199 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

VIII. STATUTE OF FRAUDS

A. In General.

2. Contract Unenforceable.

a. Defense Waived if Not Asserted.

1 Witkin Sum. Cal. Law Contracts § 344

[§ 344] Defense Waived if Not Asserted.

C.C. 1624(a) states that specified contracts are *invalid* unless in writing and, as a result of this language, it is sometimes said that a noncomplying agreement is *void*. (See *Feeney v. Howard* (1889) 79 C. 525, 535, 21 P. 984; *Wolfsen v. Hathaway* (1948) 32 C.2d 632, 639, 198 P.2d 1 ["invalid"]; *Hanley v. Murphy* (1924) 70 C.A. 157, 163, 232 P. 767; *McClure v. Cerati* (1948) 86 C.A.2d 74, 81, 194 P.2d 46 ["No valid cause of action based on the oral agreement ... was alleged because the services were not to be performed within one year from the making thereof, and it was therefore within the statute of frauds and void"].)

The general rule, however, settled in California by a number of decisions, is that the statute relates to the *remedy* only and not to the substantive validity of the contract. The contract is not void, but merely *unenforceable*. It is effective *for all purposes until*, in an attempt to enforce it by action, *its invalidity is urged as a defense*. (*O'Brien v. O'Brien* (1925) 197 C. 577, 586, 241 P. 861; *Durbin v. Hillman* (1920) 50 C.A. 377, 379, 195 P. 274; *Warder v. Hutchison* (1924) 69 C.A. 291, 295, 231 P. 563; *Offeman v. Robertson-Cole Studios* (1926) 80 C.A. 1, 12, 251 P. 830; *Romano v. Wilbur Ellis & Co.* (1947) 82 C.A.2d 670, 674, 186 P.2d 1012 [pointing out that the party to be charged may waive the defense or may be estopped to use it]; *Mangini v. Wolfschmidt, Ltd.* (1961) 192 C.A.2d 64, 72, 13 C.R. 503, quoting the text; *Bank of America v. Hutchinson* (1962) 212 C.A.2d 142, 149, 27 C.R. 787 [waiver]; *Sloan v. Hiatt* (1966) 245 C.A.2d 926, 937, 54 C.R. 351, citing the text [no objection to oral evidence at trial; defense waived].) (See 4 Corbin (Rev. ed.), §§12.19, 14.1; 10 Williston 4th, §§27:3, 27:4, 27:9 et seq.; 73 Am.Jur.2d (2001 ed.), *Statute of Frauds* §425 et seq.)

West's Key Number Digest, Frauds, Statute of, k.144

SUPPLEMENT: [This section is current through the latest supplement]



90 of 199 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

VIII. STATUTE OF FRAUDS

A. In General.

2. Contract Unenforceable.

b. No Affirmative Action.

1 Witkin Sum. Cal. Law Contracts § 345

[§ 345] No Affirmative Action.

The statute is a *defense* only. Hence, it has been held that where a purchaser pays money under an oral contract for the sale of land, and the vendor is willing to perform on his or her part, the purchaser cannot thereafter sue to recover the money paid. (*Walbridge v. Richards* (1931) 212 C. 408, 413, 298 P. 971; *Thompson v. Schurman* (1944) 65 C.A.2d 432, 437, 150 P.2d 509; but cf. *Wolfsen v. Hathaway* (1948) 32 C.2d 632, 639, 198 P.2d 1 [plaintiffs, holders of subsequent written lease, permitted to sue parties claiming rights under unenforceable oral lease]; *Dusold v. Johnston* (1950) 101 C.A.2d Supp. 907, 909, 225 P.2d 536 [lessee allowed to recover deposit on ground that lease was unenforceable]; 4 Corbin (Rev. ed.), §12.21.)

SUPPLEMENT: [This section is current through the latest supplement]



91 of 199 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law
VIII. STATUTE OF FRAUDS

A. In General.

2. Contract Unenforceable.

c. Evidentiary Effect.

1 Witkin Sum. Cal. Law Contracts § 346

[§ 346] Evidentiary Effect.

Where no attempt is made to enforce the terms of an oral contract within the statute, evidence of it may be introduced. (See *Rest.2d, Contracts §143* ["The Statute of Frauds does not make an unenforceable contract inadmissible in evidence for any purpose other than its enforcement in violation of the Statute"].)

Thus, in *Offeman v. Robertson-Cole Studios* (1926) 80 C.A. 1, 13, 251 P. 830, an oral contract of employment was proved, not in an action to enforce it, but in an action on *quantum meruit*, as tending to show the reasonable value of the services. (See also 21 A.L.R.3d 30 [price for services fixed in contract cannot provide measure of damages in *quantum meruit*, but admissible to show that services were not gratuitous]; 4 Corbin (Rev. ed.), §§12.13, 14.10; 10 Williston 4th, §§27:23, 27:24.)

Similarly, in *Walter H. Leimert Co. v. Woodson* (1954) 125 C.A.2d 186, 270 P.2d 95, defendant real estate agent, after orally promising to act as broker in acquiring a necessary parcel of land for plaintiff, purchased for himself. The oral contract was unenforceable and no action for commission could have been brought thereon by the agent (see *infra*, §392). But this action was by the principal to establish a constructive trust in the land. He was therefore allowed to prove the unenforceable agreement to show the agency and fiduciary relationship, for breach of which the trust was imposed. (125 C.A.2d 190.)

In *George v. Double-D Foods* (1984) 155 C.A.3d 36, 201 C.R. 870, decedent, an expert in vegetable oil processing, was employed by defendant as an executive under an oral agreement providing for salary and bonuses. He left after 28 months and, after his death, plaintiff administratrix brought this action in *quantum meruit* for the unpaid balance due on the reasonable value of his services. Judgment on the jury award was for \$ 96,000, and defendant appealed, contending that it was error to admit two oral promises of defendant as admissions of reasonable value. *Held*, reversed; one promise was not admissible, the other was.

(a) The first promise was to sell decedent 10% of defendant's stock at its book value at the time decedent commenced his employment. An "agreed price" set forth in an unenforceable contract is relevant as evidence of the reasonable value of services rendered. (155 C.A.3d 36, 42, citing *Offeman, supra*.) And a promise to compensate in property can qualify as an agreed price if a dollar value is assigned to the property or a formula is provided by which an

agreed-upon sum of money is readily ascertainable. (155 C.A.3d 42.) However, if the property's value can be determined only by resort to extrinsic evidence--opinions on the fair market value--"the parties have not, by virtue of the promise, agreed upon a price which admits the reasonable value of the services." (155 C.A.3d 42.)

(b) Here, the promise failed to qualify as an agreed price: (1) It was not a promise to pay the decedent in shares of stock, but only to permit him to purchase shares as an added inducement to accept employment. (2) It provided indicia of the value of decedent's services only on the introduction of extrinsic evidence of the monetary value of the shares in excess of the book value; and, because the parties may have differed in their opinion on this value, the promise was not evidence of an agreed price. (155 C.A.3d 42, 43.)

(c) The second promise was to pay decedent a yearly bonus equal to 10% of defendant's annual profits in excess of \$ 200,000. This was admissible: Although no dollar value was assigned, the promise contained a formula by which that value was readily ascertainable by a simple mathematical calculation. (155 C.A.3d 43.)

SUPPLEMENT: [This section is current through the latest supplement]



92 of 199 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

VIII. STATUTE OF FRAUDS

A. In General.

3. How Statute May Be Invoked.

a. Raising Defense in Lower Court.

1 Witkin Sum. Cal. Law Contracts § 347

[§ 347] Raising Defense in Lower Court.

The statute of frauds must ordinarily be asserted in the lower court, and cannot be raised for the first time on appeal. (*Howard v. Adams* (1940) 16 C.2d 253, 257, 105 P.2d 971 [waived at trial by permitting oral proof without objection]; *Durbin v. Hillman* (1920) 50 C.A. 377, 379, 195 P. 274; *Rutland, Edwards & Co. v. Cooke* (1941) 44 C.A.2d 258, 262, 112 P.2d 287; *Mitchell v. Locurto* (1947) 79 C.A.2d 507, 512, 179 P.2d 848; *Romano v. Wilbur Ellis & Co.* (1947) 82 C.A.2d 670, 674, 186 P.2d 1012 ["The promisor may waive the statute . . . There are many factors such as acquiescence, confirmation, and estoppel which may arise when these issues come to trial"]; *Aaker v. Smith* (1948) 87 C.A.2d 36, 43, 196 P.2d 150 [waiver by failure to raise in trial court]; *Coleman v. Satterfield* (1950) 100 C.A.2d 81, 83, 223 P.2d 61; see *Carrier & Braddock v. S.W. Straus & Co.* (1931) 213 C. 508, 513, 2 P.2d 811 [may be raised by motion for nonsuit]; 4 Corbin (Rev. ed.), §14.1 et seq.; 10 Williston 4th, §27:9 et seq.; 73 Am.Jur.2d (2001 ed.), *Statute of Frauds* §505 et seq.; 5 Cal. Proc. (4th), *Pleading*, §§930, 999.)

However, in exceptional situations, such as where the statute is certain to be raised on a retrial, the appellate court will consider it. (See *Ellis v. Klaff* (1950) 96 C.A.2d 471, 475, 216 P.2d 15, *infra*, §349 [affirmance of order granting new trial]; *Dusold v. Johnston* (1950) 101 C.A.2d Supp. 907, 910, 225 P.2d 536.)

SUPPLEMENT: [This section is current through the latest supplement]
Cross-Reference: 5 Cal. Proc. (5th), *Pleading*, §§977, 1072.



93 of 199 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

VIII. STATUTE OF FRAUDS

A. In General.

3. How Statute May Be Invoked.

b. Party to Contract or in Privity.

1 Witkin Sum. Cal. Law Contracts § 348

[§ 348] Party to Contract or in Privity.

Ordinarily, the statute can be invoked only by a party to the contract or his or her transferee or successor. (See *Bumb v. Bennett* (1958) 51 C.2d 294, 302, 333 P.2d 23; *Mitchell v. Locurto* (1947) 79 C.A.2d 507, 512, 179 P.2d 848; *Demeter v. Annenson* (1947) 80 C.A.2d 48, 57, 180 P.2d 998 ["The rule is elementary that the statute of frauds can be invoked only by the parties to the unwritten contract, and is not available to third persons who are not parties to it"]; *Rest.2d, Contracts §144*; 4 Corbin (Rev. ed.), §12.14 et seq.; 10 Williston 4th, §27:12; 73 Am.Jur.2d (2001 ed.), *Statute of Frauds §484* et seq.)

However, in *Wolfsen v. Hathaway* (1948) 32 C.2d 632, 198 P.2d 1, defendants, claiming rights under an unenforceable oral lease, proceeded to use the land despite the lessors' objection. Plaintiffs, holders of a subsequent written lease from the lessors, sued for injury to their possessory interest in the property. *Held*, plaintiffs could recover, for the oral lease was "invalid." (32 C.2d 639.) Thus the court apparently permitted plaintiffs, who were not parties to the contract, to assert affirmatively the objection of the statute of frauds. The case is explainable, however, on the grounds that (1) plaintiffs, with their valid lease, were successors to the interests of the parties to be charged--the lessors, and (2) plaintiffs were not in fact asserting the statute affirmatively, but defensively, in answer to defendants' affirmative claim of rights under the oral lease.

Similarly, in *O'Banion v. Paradiso* (1964) 61 C.2d 559, 39 C.R. 370, 393 P.2d 682, O agreed in writing to sell his "rights & title" to certain real property for \$ 2,000. Plaintiff immediately accepted and offered the purchase price, thereafter placing it in escrow at O's request. Subsequently O sold the property to defendant P, who had knowledge of the prior sale. In this action for specific performance against O, Mrs. O, and P, defendants set up the failure of Mrs. O to agree in writing to the sale (equal dignities rule, *infra*, §388). The trial judge rendered judgment for plaintiff, finding that Mrs. O had agreed to the sale. P alone appealed, and the Court of Appeal decided that, as a nonparty to the original agreement, he could not invoke the statute of frauds. *Held*, reversed. Prior cases, such as *Demeter v. Annenson*, *supra*, involved challenges by persons who were not in privity. Third persons who are in privity may take advantage of the statute; e.g., successors to the vendor--his or her grantee, heir, or personal representative--may raise the statute in the same way the vendor might raise it; otherwise the land might become unsalable. (61 C.2d 562.) (See 5 Santa Clara Lawyer 87.)

West's Key Number Digest, Frauds, Statute of, k.143(1)

SUPPLEMENT: [This section is current through the latest supplement]



94 of 199 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

VIII. STATUTE OF FRAUDS

A. In General.

4. Parol Evidence Rule Distinguished.

1 Witkin Sum. Cal. Law Contracts § 349

[§ 349] Parol Evidence Rule Distinguished.

The statute of frauds, which bars proof of certain agreements when there is no sufficient writing evidencing them, must be distinguished from the parol evidence rule, a rule of substantive law, which applies where there is a *written contract* ("integration"), and bars oral or written extrinsic evidence contradicting its terms. (See 2 *Cal. Evidence* (3d), *Documentary Evidence*, §63.) Oral terms not inconsistent with the contract may be admissible despite the parol evidence rule (see 2 *Cal. Evidence* (3d), *Documentary Evidence*, §§63, 86, 87), but oral evidence cannot supply an essential element of the writing required by the statute of frauds.

This distinction is made clear in *Ellis v. Klaff* (1950) 96 C.A.2d 471, 476, 216 P.2d 15: "The parol evidence rule ... does not ... render inadmissible proof of contemporaneous oral agreements collateral to, and not inconsistent with, a written contract where the latter is either incomplete or silent on the subject, and the circumstances justify an inference that it was not intended to constitute a final inclusive statement of the transaction. ... The statute of frauds, on the other hand, is designed to prevent fraud and perjury by requiring certain contracts to be evidenced exclusively in writing. In order to effectuate that purpose, it demands that every material term of an agreement within its provisions be reduced to written form, whether the parties desire to do so or not. ... Unless the writing, considered alone, expresses the essential terms with sufficient certainty to constitute an enforceable contract, it fails to meet the demands of the statute. ... Accordingly, where the statute of frauds, rather than the parol evidence rule is invoked, it follows that recovery may not be predicated upon parol proof of material terms omitted from the written memorandum, even though the oral understanding is entirely consistent with, and in no way tends to vary or contradict, the written instrument." (See also *Goble v. Dotson* (1962) 203 C.A.2d 272, 281, 21 C.R. 769 [writing not intended as integration, evidence of contemporaneous oral agreement admissible].)

The distinction made in the *Ellis* case is illustrated in *Beazell v. Schrader* (1963) 59 C.2d 577, 30 C.R. 534, 381 P.2d 390. Plaintiff broker alleged that he was orally employed to sell defendant's building at a 5% commission, that he found a purchaser for \$ 200,000, and that the escrow instructions signed by defendant provided for payment of his commission. Thus, the escrow instructions satisfied the statute of frauds memorandum requirement; the trouble was, however, that the amount of commission was expressly stated therein as \$ 2,500 (instead of 5% of sale price or \$ 10,000). *Held*, plaintiff was not entitled to recover the claimed \$ 10,000. The court, reviewing meager authority not too closely in point, concluded that "the parol agreement of which the writing is a memorandum must be one whose terms are consistent with the terms of the memorandum." (59 C.2d 582.)

The curious aspect of the case is that the parol evidence rule does not apply to a mere memorandum that is not an integration (see 2 *Cal. Evidence* (3d), *Documentary Evidence*, §73); hence, so far as that rule was concerned, extrinsic evidence could have been offered to establish terms of the agreement. But the statute of frauds operated here in a manner similar to the parol evidence rule: Plaintiff could recover on his oral contract only if there was a written memorandum of the essential terms of *that oral contract*; the oral contract he sought to prove was one with an entirely different essential term, which was not evidenced by any written memorandum.

SUPPLEMENT: [This section is current through the latest supplement]

In *Sterling v. Taylor* (2007) 40 C.4th 757, 55 C.R.3d 116, 152 P.3d 420, plaintiff buyers agreed to purchase three apartment buildings from defendant sellers. The agreement was evidenced by a handwritten memorandum showing that the price was determined by multiplying the *estimated* gross rental income by a specified factor. However, plaintiffs' extrinsic evidence was that the *actual* rental income was less and that, accordingly, the sales price should be less. After the parties failed to resolve the price controversy, plaintiffs sued, alleging that defendants breached a contract to sell at the lower figure. The trial court granted summary judgment for defendants, but the Court of Appeal reversed. *Held*, judgment of the Court of Appeal reversed; the Court of Appeal did not err in considering extrinsic evidence, but erroneously deemed it legally sufficient under the statute of frauds to establish the price term sought by plaintiffs.

(a) *Introduction of extrinsic evidence.*

(1) The writing requirement of the statute of frauds, which is satisfied by a memorandum, serves only to prevent a contract from being unenforceable; it does not necessarily establish the terms of a contract. Unlike the parol evidence rule, which determines the enforceable and incontrovertible terms of an integrated written agreement, the statute of frauds merely serves an evidentiary purpose. (40 C.4th 766.)

(2) A memorandum can satisfy the statute of frauds, even if its terms are too uncertain to be enforceable when considered by themselves. Because the memorandum itself must include the essential contractual terms, it is clear that extrinsic evidence cannot *supply* those required terms. It can, however, be used to *explain* essential terms that were understood by the parties, but would otherwise be unintelligible to others. (40 C.4th 767.)

(3) "To clarify the law on this point, we disapprove the statements in California cases barring consideration of extrinsic evidence to determine the sufficiency of a memorandum under the statute of frauds. The purposes of the statute are not served by such a rigid rule, which has never been a consistent feature of the common law." (40 C.4th 770; disapproving *Ellis v. Klaff* (1950) 96 C.A.2d 471, 216 P.2d 15, text, §354.)

(4) If a memorandum includes the essential terms of the parties' agreement, but the meaning of those terms is unclear, the memorandum is nevertheless sufficient under the statute of frauds if extrinsic evidence clarifies the terms with reasonable certainty and the evidence as a whole demonstrates that the parties intended to be bound. However, it must be emphasized that a memorandum of the parties' agreement is controlling evidence under the statute of frauds. Thus, extrinsic evidence cannot be employed to prove an agreement at odds with the terms of the memorandum. (40 C.4th 771; citing *Beazell v. Schrader* (1963) 59 C.2d 577, 30 C.R. 534, 381 P.2d 390, text, p. 396.)

(b) *Sufficiency of memorandum.* The extrinsic evidence presented here does not clarify the price term; instead, it applies a different formula. The memorandum based the price on a multiplier times a figure representing the estimated gross income. However, plaintiffs based their price determination on "actual gross income," even though the memorandum does not use that phrase. Had the memorandum stated that the price term would vary depending on proof of later agreement regarding the actual rental income from the buildings, "this would be a different case." (40 C.4th 774.) Even if the trier of fact were to accept plaintiffs' version of the negotiations, the price sought is not reflected in the memorandum. In fact, it is inconsistent with the price term that appears therein. Thus, the extrinsic evidence is insufficient to establish plaintiffs' price term with the reasonable certainty required by the statute of frauds. (40 C.4th 773.)



95 of 199 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

VIII. STATUTE OF FRAUDS

B. The Note or Memorandum.

1. Nature of Requirement.

a. Evidence of Terms.

1 Witkin Sum. Cal. Law Contracts § 350

[§ 350] Evidence of Terms.

The memorandum is not the contract, but merely evidence of its terms; the oral agreement is the contract. Hence, an oral agreement may originally be subject to the bar of the statute, but may become enforceable if a note or memorandum is subsequently made. (*In re Balfour & Garrette* (1910) 14 C.A. 261, 265, 111 P. 615; *Ayoob v. Ayoob* (1946) 74 C.A.2d 236, 243, 168 P.2d 462, *infra*, §357; *Mangini v. Wolfschmidt, Ltd.* (1961) 192 C.A.2d 64, 72, 13 C.R. 503, quoting the text; *Weber v. Dobyns* (1961) 193 C.A.2d 402, 408, 14 C.R. 103, citing the text; see U.C.C. 2201, *infra*, §378; *Rest.2d, Contracts* §131, Comment c, and §136; 4 Corbin (Rev. ed.), §§22.1 et seq., 23.1 et seq.; 10 Williston 4th, §29:1 et seq.; 72 *Am.Jur.2d* (2001 ed.), *Statute of Frauds* §205 et seq.) (On pleading memorandum, see 4 *Cal. Proc.* (4th), *Pleading*, §484.)

Thus, although an oral agreement to pay commissions to a real estate broker is within the statute (see *infra*, §392), subsequent written escrow instructions recognizing the obligation may make it enforceable. (*Coulter v. Howard* (1927) 203 C. 17, 22, 262 P. 751; *Devereux v. Sirkus* (1951) 105 C.A.2d 340, 344, 233 P.2d 644; *Martin v. Chernabaeff* (1954) 124 C.A.2d 648, 650, 269 P.2d 25.)

A memorandum may be made after breach or repudiation, or after the action has begun. (*Rest.2d, Contracts* §136, Comment b.) And the loss or destruction of a memorandum does not deprive it of its effect; its contents may be shown by an unsigned copy or by oral evidence. (*Rest.2d, Contracts* §137, and Comment a.)

West's Key Number Digest, Frauds, Statute of, k.113(1)

SUPPLEMENT: [This section is current through the latest supplement]
Pleading memorandum:

Cross-Reference: 4 *Cal. Proc.* (5th), *Pleading*, §523.



96 of 199 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

VIII. STATUTE OF FRAUDS

B. The Note or Memorandum.

1. Nature of Requirement.

b. Informal Writings.

1 Witkin Sum. Cal. Law Contracts § 351

[§ 351] Informal Writings.

The memorandum may be informal, and may consist of one or more writings; e.g., two telegrams, or separate escrow instructions, each signed by one of the parties. (*Brewer v. Horst & Lachmund Co.* (1900) 127 C. 643, 646, 60 P. 418; *King v. Stanley* (1948) 32 C.2d 584, 588, 197 P.2d 321 [exchange of letters and telegrams]; *Dunham, Carrigan & Hayden Co. v. Thermoid Rubber Co.* (1927) 84 C.A. 669, 673, 258 P. 663 [letters making reference to a written renewal contract not yet executed by parties]; *Steel v. Duntley* (1931) 115 C.A. 451, 452, 1 P.2d 999; *Gibson v. De La Salle Institute* (1944) 66 C.A.2d 609, 626, 152 P.2d 774; *Karl v. JeBien* (1965) 231 C.A.2d 769, 772, 42 C.R. 461; *Wolf v. Price* (1966) 244 C.A.2d 165, 171, 52 C.R. 889; *Kerner v. Hughes Tool Co.* (1976) 56 C.A.3d 924, 934, 128 C.R. 839 [letter]; see *Rest.2d, Contracts* §131, Comment d, and §132; 4 Corbin (Rev. ed.), §22.2; 10 Williston 4th, §29:21 et seq.) (On check given in land transaction as sufficient writing, see 9 A.L.R.4th 1009; on admissibility of parol evidence to connect the writings, see 81 A.L.R.2d 991; on satisfaction of statute of frauds by e-mail, see 110 A.L.R.5th 277.)

Rest.2d, Contracts §132 states that the memorandum may consist of several writings "if one of the writings is signed and the writings in the circumstances clearly indicate that they relate to the same transaction." Thus, explicit incorporation by reference is unnecessary: it is sufficient that the signed writing refers to the unsigned writing by implication, or that the party to be charged physically attaches one document to the other or encloses them in the same envelope. (Comments a, b, and c.) And even if there is no internal reference or physical connection, the writings may be read together if they clearly relate to the same transaction and the party to be charged has acquiesced in the contents of the unsigned writing. (Comment c.)

SUPPLEMENT: [This section is current through the latest supplement]



97 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VIII. STATUTE OF FRAUDS
B. The Note or Memorandum.
1. Nature of Requirement.
c. Writing Not Intended as Memorandum.

1 Witkin Sum. Cal. Law Contracts § 352

[§ 352] Writing Not Intended as Memorandum.

"Except in the case of a writing evidencing a contract upon consideration of marriage, the Statute may be satisfied by a signed writing not made as a memorandum of a contract." (*Rest.2d, Contracts §133*; see 4 Corbin (Rev. ed.), §23.1; 10 Williston 4th, §29:6.)

Thus:

(1) There is no requirement of communication or even knowledge of the other party. "A memorandum may consist of an entry in a diary or in the minutes of a meeting, of a communication to or from an agent of the party, of a public record, or of an informal letter to a third person." (Comment b.)

(2) A writing may be sufficient even though it also repudiates or cancels the contract or asserts that it is not binding because not in writing; but a writing denying the making of the contract is not a sufficient memorandum. (Comment c.)

(3) A written pleading, stipulation, or deposition may serve as a memorandum; but a failure to deny an allegation, though given the procedural effect of an admission, is not the equivalent of a signed writing. (Comment d.)

However, there must be a *writing*: Oral testimony in a distinct proceeding, admitting the making of the contract, is not a compliance with the statute. (*Ragghianti v. Harris (1954) 124 C.A.2d 17, 18, 268 P.2d 45.*) And the defendant's required deposition taken by plaintiff, and signed under compulsion, is not a memorandum binding on the defendant where he pleads the statute of frauds as a defense. (*Keans, Springmann & Stipek v. Alphonzo E. Bell Corp. (1954) 126 C.A.2d 311, 327, 272 P.2d 35.*)

West's Key Number Digest, Frauds, Statute of, k.118(1) et seq.

SUPPLEMENT: [This section is current through the latest supplement]



98 of 199 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

VIII. STATUTE OF FRAUDS

B. The Note or Memorandum.

2. Sufficiency of Memorandum.

a. Strict Rule: Essential Elements of Contract.

1. Restatement 2d: Strict Rule.

1 Witkin Sum. Cal. Law Contracts § 353

[§ 353] Restatement 2d: Strict Rule.

Rest.2d, Contracts §131 makes the contract enforceable if the writing

"(a) reasonably identifies the subject matter of the contract,

(b) is sufficient to indicate that a contract with respect thereto has been made between the parties or offered by the signer to the other party, and

(c) states with reasonable certainty the essential terms of the unperformed promises in the contract."

The authorities generally agree on these three requirements. (See 4 Corbin (Rev. ed.), §22.2 et seq.; 10 Williston 4th, §29:8 et seq.; 72 *Am.Jur.2d* (2001 ed.), *Statute of Frauds* §205 et seq.; 23 *A.L.R.2d* 164 [under statute of frauds, necessity and sufficiency of statement of consideration in contract or memorandum of sale of land].)

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99 of 199 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

VIII. STATUTE OF FRAUDS

B. The Note or Memorandum.

2. Sufficiency of Memorandum.

a. Strict Rule: Essential Elements of Contract.

2. California Cases.

1 *Witkin Sum. Cal. Law Contracts* § 354

[§ 354] California Cases.

(1) *In General.* Under the strict rule (supra, §353), the absence of a description of the property or the names of the parties, in an agreement for the sale of real estate, was held to be fatal. (See *Franklin v. Hansen* (1963) 59 C.2d 570, 574, 30 C.R. 530, 381 P.2d 386; *Allen v. Stellar* (1930) 106 C.A. 67, 70, 288 P. 855; *Gordon v. Perkins* (1930) 108 C.A. 336, 339, 291 P. 644; *Saterstrom v. Glick Bros. Sash, Door & Mill Co.* (1931) 118 C.A. 379, 380, 5 P.2d 21; *Guardianship of Carlon* (1941) 43 C.A.2d 204, 209, 110 P.2d 488; *Cisco v. Van Lew* (1943) 60 C.A.2d 575, 581, 141 P.2d 433; *Roberts v. Lebrain* (1952) 113 C.A.2d 712, 715, 248 P.2d 810 [deposit receipt reciting down payment on "1 Small House and Lot on 115 St. Los Angeles"; insufficient because no description or terms of payment]; *Burge v. Krug* (1958) 160 C.A.2d 201, 203, 325 P.2d 119 [contract to sell "Lot 7, Block 10 of Crescenta Canada Tract"; Block 10 apparently nonexistent, and trial judge found recital unintelligible and not descriptive of any identifiable parcel]; *Ganiats Const. v. Hesse* (1960) 180 C.A.2d 377, 384, 4 C.R. 706.)

In *Ellis v. Klaff* (1950) 96 C.A.2d 471, 216 P.2d 15, plaintiff lessor leased a lot to defendant lessee for 5 years with a 5-year renewal option, at \$ 125 per month. The lease provided that "The lessee agrees to improve said premises by the construction of a building or buildings as soon as building conditions reasonably shall permit," and that the building should comply with the local code, the lessee should carry insurance and pay taxes, and that the building should be part of the real property and inure to the lessor at the termination of the tenancy. Parol evidence was offered to show that defendant lessee agreed to construct a \$ 12,000 auto salesroom and repair shop, had plans and specifications prepared, and filed an application for permit, which was granted. *Held*, the covenant was unenforceable. It was incomplete in failing to specify the number of buildings, their size, type, materials, location, cost, appearance, or details of construction. And the evidence was inadmissible: "The parol evidence was introduced to prove not only that a single building was to be erected, which was not expressed in the writing, but also, as we have pointed out, that the lessee was obligated to construct either a brick or concrete block building of a certain type which would cost approximately \$ 12,000. This was an attempt, not to resolve an ambiguity, but to supply essentials of a complete agreement which were lacking in the writing. It is clear that the receipt of parol evidence for the purpose of adding substantial terms to an otherwise unenforceable writing would be contrary to the requirements of the statute of frauds and destructive of its purpose." (96 C.A.2d 479.)

However, only the essential terms must be stated, and "[w]hat is essential depends on the agreement and its context and also on the subsequent conduct of the parties." (*Seaman's Direct Buying Service v. Standard Oil Co.* (1984) 36 C.3d 752, 762, 206 C.R. 354, 686 P.2d 1158, *infra*, §358 [citing *Rest.2d, Contracts* §131, Comment g]; see *House of Prayer: Renewal and Healing Center of Yuba City v. Evangelical Assn. for India* (2003) 113 C.A.4th 48, 53, 7 C.R.3d 24 [under facts, time of performance was not essential term].)

(2) *Broker's Right to Commission.* A purported real estate broker's authorization that does not even mention the *fact* of employment or authorization of a broker is insufficient. Thus, in *Blanchard v. Pauley* (1949) 92 C.A.2d 244, 206 P.2d 864, the broker procured a prospective purchaser. Then the owner wrote an offer, addressed to the prospect, enclosed it in an envelope and sent it to the broker. *Held*, no commission could be recovered, because the writing in no way referred to the authority of the broker to act for the owner. (92 C.A.2d 247.) (See *Pacific Southwest Dev. Corp. v. Western Pac. R. Co.* (1956) 47 C.2d 62, 68, 301 P.2d 825; *Morrill v. Barneson* (1939) 30 C.A.2d 598, 600, 86 P.2d 924; *Herzog v. Blatt* (1947) 80 C.A.2d 340, 342, 180 P.2d 30 [owner handed broker writing stating that he would take "8400. net" for his property; held merely an offer to sell, not an authorization of the broker].)

In *Franklin v. Hansen, supra*, plaintiff broker, having acted as rental agent for defendant owner, discussed the sale of defendant's residential property with him, and a price was fixed. Plaintiff obtained an offer, telephoned defendant, and received a telegram stating that "This is confirm that I will sell" the described property for the offered sum. Defendant was advised that the sale had taken place and consented to the suggested escrow agent. But when the standard deposit receipt with its 5% commission was presented to him he refused to sign, although admitting that he was "stuck" with the sale and that plaintiff should receive his commission. *Held*, plaintiff could not recover. The telegram, though perhaps a sufficient memorandum of an agreement to sell the property, did not refer to the fact of employment of plaintiff or to any compensation, and it was the alleged commission agreement that was to be enforced. If there had been a reference to employment, compensation could have been inferred; but failure to mention either was fatal. (59 C.2d 574.)

In *Phillippe v. Shapell Industries* (1987) 43 C.3d 1247, 241 C.R. 22, 743 P.2d 1279, plaintiff orally agreed to assist defendant in finding suitable land for the construction of residential housing, and defendant orally promised to pay a commission. When a specific parcel was found, defendant submitted an offer in writing in which he agreed to pay plaintiff a 6% commission, but the transaction was not consummated. Three months later, plaintiff wrote to defendant concerning another parcel, noting that if defendant purchased it, plaintiff was entitled to a 6% commission in accordance with the earlier agreement. Defendant did not respond to this letter and did not purchase the property at that time because of zoning problems. Plaintiff continued in his efforts to effectuate a sale and wrote several letters to defendant, the last of which restated his claim to a commission should the transaction be consummated. When the property was rezoned, defendant purchased it directly from the owner and refused to pay plaintiff a commission. *Held*, judgment awarding plaintiff a commission reversed.

(a) *Agreement subject to statute of frauds.*

(1) Plaintiff argued that there was no "agreement" under C.C. 1624(d) (now C.C. 1624(a)(4)), which requires a broker's agreement to purchase real estate to be in writing, because he was acting as a professional consultant, instead of a broker. However, in one of his letters to defendant, plaintiff stated that he would be working as a *broker* and would be paid a *brokerage* commission of 6%. "We agree with the observation that, 'if an object looks like a duck, walks like a duck and quacks like a duck, it is likely to be a duck.'" (43 C.3d 1256.)

(2) Plaintiff also contended that C.C. 1624(d) (now C.C. 1624(a)(4)) was inapplicable because either (a) defendant was a licensed broker, or (b) the agreement was between brokers to share a commission. Neither point has merit.

First, there is no logical reason why a broker or agent who is acting as a seller or purchaser should not be entitled to the protection afforded by the statute of frauds against false claims by brokers for commissions. The argument that brokers know of the statute and hence do not need its protection is too broad, because, if accepted, all groups presumed

to know of the statute would be stripped of its protection. (43 C.3d 1257.)

Second, the jury found that there was no agreement between plaintiff and defendant to share a broker's commission. Hence, it is unnecessary to decide whether commission-sharing agreements are covered by C.C. 1624(d) (now C.C. 1624(a)(4)), but it is noted that the Courts of Appeal have held that they are not subject to the statute. (43 C.3d 1257.)

(b) *No sufficient writing under statute of frauds.*

(1) The statute of frauds requires a writing that unequivocally shows on its face the fact of employment of the broker seeking to recover a commission. Here, *with respect to the transaction that was completed*, the only writings relating to a commission were from plaintiff, not from defendant. (43 C.3d 1258.) And defendant's earlier written promise to pay a commission with respect to the unconsummated sale was not sufficient to cover the later transaction. "Where a broker's only agreement with his principal relates solely to specifically described property, the principal is not liable to the broker for a commission on the purchase of different property unless the broker's written employment agreement covers the other property." (43 C.3d 1259.)

(2) The earlier writing was also insufficient in that it was devoid of specifics. It contained no agreement as to the price range of properties that plaintiff would present to defendant, no agreement as to location, except a reference to an area (Palos Verdes Peninsula) so large as to be meaningless, and no specification of duration. It is unnecessary to decide whether the absence of any one of these items would be fatal; the problem is the total lack of meaningful terms. (43 C.3d 1259.)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *In General.* See *Sterling v. Taylor* (2007) 40 C.4th 757, 766, 55 C.R.3d 116, 152 P.3d 420, Supp., supra, §349, citing the text [in order for memorandum to satisfy statute of frauds, only essential terms must be stated, while details or particulars need not be; what is essential depends on agreement and its context, and also on parties' subsequent conduct].



100 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

VIII. STATUTE OF FRAUDS

B. The Note or Memorandum.

2. Sufficiency of Memorandum.

b. Relaxation of Rule.

1. Description of Property.

1 Witkin Sum. Cal. Law Contracts § 355

[§ 355] Description of Property.

Several decisions, mainly rendered in actions for reformation, indicate that the memorandum may be sufficient though lacking in one of the material elements, and that parol evidence will be permitted to supply the deficiency. Thus, in *Oatman v. Neimeyer* (1929) 207 C. 424, 278 P. 1043, a deed was drawn that mistakenly omitted the description of the property. *Held*, evidence was admissible to show that the grantor owned only a particular tract, and the instrument was reformed to insert its description. (207 C. 426.) (See *Pray v. Anthony* (1929) 96 C.A. 772, 777, 274 P. 1024 ["my house" held sufficient]; *Potter v. Bland* (1955) 136 C.A.2d 125, 129, 288 P.2d 569; *Alameda Belt Line v. Alameda* (2003) 113 C.A.4th 15, 21, 5 C.R.3d 879 [contractual language "said belt line railroad including all extensions thereof" was sufficient "means or key" by which extrinsic evidence arising after execution of contract could be used to define contractual property]; 65 Harv. L. Rev. 1081; 4 Stanf. L. Rev. 446; 30 A.L.R.3d 935 [property description in real estate brokerage contract]; 62 Proof of Facts 3d 347 [sufficiency of description of property in real estate contract].)

It has also been said that less certainty is required for a description in a contract of sale than in a deed. (*Wright v. L.W. Wilson Co.* (1931) 212 C. 569, 573, 299 P. 521; *Beverage v. Canton Placer Mining Co.* (1955) 43 C.2d 769, 774, 278 P.2d 694; *Diffendorf v. Pilcher* (1931) 116 C.A. 270, 272, 2 P.2d 430; *United Truckmen v. Lorentz* (1952) 114 C.A.2d 26, 29, 249 P.2d 352.)

West's Key Number Digest, Frauds, Statute of, k.110(1)

SUPPLEMENT: [This section is current through the latest supplement]

See *Sterling v. Taylor* (2007) 40 C.4th 757, 773, 55 C.R.3d 116, 152 P.3d 420, Supp., supra, §349 [descriptions of properties only by street address in memorandum for sale did not violate statute of frauds, where neither buyers nor sellers displayed any confusion over their actual location]. *Correction:* Page 403, line 4 of section, "*Oatman v. Neimeyer*" should be "*Oatman v. Niemeyer*".



101 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law

VIII. STATUTE OF FRAUDS

B. The Note or Memorandum.

2. Sufficiency of Memorandum.

b. Relaxation of Rule.

2. Broker's Authorization.

1 Witkin Sum. Cal. Law Contracts § 356

[§ 356] Broker's Authorization.

A writing that, reasonably interpreted, shows the fact of employment of a *broker*, will be sufficient even though the name of the *particular broker* does not appear; parol evidence is admissible to supply the name. (See *Moore v. Borgfeldt* (1929) 96 C.A. 306, 309, 273 P. 1114.) And in *Calhoun v. Downs* (1931) 211 C. 766, 297 P. 548, a real estate broker's contract was reduced to writing, but by mistake the amount of commission and the broker's name were omitted, the last line reading as follows: "I agree to pay a commission of \$ ____ to ____ ." The court held, on the authority of *Oatman v. Neimeyer* (1929) 207 C. 424, 278 P. 1043, supra, §355, that the instrument could be reformed. (211 C. 768.)

In *Hillman v. Koch* (1949) 92 C.A.2d 163, 206 P.2d 434, the owner gave the broker a written offer to sell containing the following: "\$ 22,500 net. Brokers pay escrow fee." Held, the reference to "net" to the owner clearly indicated that any amount in excess thereof was to go to the broker as a commission, and thus the writing contained a promise to pay a commission. (92 C.A.2d 167.) (See *Herring v. Fisher* (1952) 110 C.A.2d 322, 329, 242 P.2d 963 [informal letters held sufficient acknowledgment of a broker's authorization, in the light of past relations of the parties]; *Lathrop v. Gauger* (1954) 127 C.A.2d 754, 764, 274 P.2d 730 [memorandum sufficient if it shows agency; terms of proposed transaction not necessary]; *Woodbridge Realty v. Plymouth Dev. Corp.* (1955) 130 C.A.2d 270, 274, 278 P.2d 713 [same]; *Rader Co. v. Stone* (1986) 178 C.A.3d 10, 21, 24, 223 C.R. 806 [if authority of broker to act is shown, other terms, including amount of commission and even agreement to pay, may be shown by parol]; 9 A.L.R.2d 747 [statutory necessity and sufficiency of written statement as to amount of broker's compensation].)

SUPPLEMENT: [This section is current through the latest supplement]

Correction: Page 404, line 4, "Oatman v. Neimeyer" should be "Oatman v. Niemeyer".



102 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law

VIII. STATUTE OF FRAUDS

B. The Note or Memorandum.

2. Sufficiency of Memorandum.

b. Relaxation of Rule.

3. Noncontractual Writing.

1 Witkin Sum. Cal. Law Contracts § 357

[§ 357] Noncontractual Writing.

In *Ayoob v. Ayoob* (1946) 74 C.A.2d 236, 168 P.2d 462, the court rendered an ultra-liberal decision upholding a memorandum that failed to disclose any agreement. The writing, signed by decedent husband in April 1941, stated that "in the event of my death ... \$ 5,000 ... of my estate should be left to my wife ... to whom I was married on September 6, 1939." After decedent's death in 1943, plaintiff wife brought this action, alleging that decedent, in 1939, orally agreed to pay her that sum if she would marry him and care for him during his lifetime, that she fulfilled these conditions, and that the above writing was subsequently made and delivered to her. *Held*, the paper was a sufficient memorandum of the agreement on consideration of marriage (see *infra*, §399), which was not to be performed during the promisor's lifetime (see *infra*, §371), and its failure to mention the prior oral agreement was immaterial. (74 C.A.2d 242.) The difficulty with the case is, however, that the writing at most disclosed a testamentary intention, and, like a will, could not be considered a memorandum of an *agreement* (see *infra*, §371).

SUPPLEMENT: [This section is current through the latest supplement]



103 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

VIII. STATUTE OF FRAUDS

B. The Note or Memorandum.

2. Sufficiency of Memorandum.

b. Relaxation of Rule.

4. Sale of Goods.

1 Witkin Sum. Cal. Law Contracts § 358

[§ 358] Sale of Goods.

The Uniform Commercial Code changes and greatly liberalizes the memorandum requirement for sales of goods. (See criticism, 63 *Harv. L. Rev.* 574; and see generally 4 Corbin (Rev. ed.), §21.1 et seq.; 10 Williston 4th, §§29:15, 29:16; 72 *Am.Jur.2d* (2001 ed.), *Statute of Frauds* §155 et seq.)

(1) *Memorandum*. A contract is enforceable if "there is some writing sufficient to indicate that a contract for sale has been made." And "[a] writing is not insufficient because it omits or incorrectly states a term agreed upon but the contract is not enforceable under this paragraph beyond the quantity of goods shown in such writing." (U.C.C. 2201(1); see 2 Anderson 3d (1997 Rev. ed.), §2-201:81 et seq.; 84 *Harv. L. Rev.* 1737; 4 *U.S.F. L. Rev.* 177.)

(2) *Confirmation*. A memorandum signed by the party to be charged is not always essential; a written *confirmation* may take its place: "*Between merchants* if within a reasonable time a writing in confirmation of the contract and sufficient against the sender is received and the party receiving it has reason to know its contents," it is sufficient against the party "unless written notice of objection to its contents is given within 10 days after it is received." (U.C.C. 2201(2); see *Procyon Corp. v. Components Direct* (1988) 203 *C.A.3d* 409, 413, 249 *C.R.* 813 [buyer's irrevocable letter of credit specifying terms of oral contract and guaranteeing payment on delivery held sufficient to satisfy writing requirement of U.C.C. 2201(2)]; 2 Anderson 3d (1997 Rev. ed.), §2-201:247 et seq.; 82 *A.L.R.4th* 709 [sales: construction of exception under *UCC* § 2-201(2) for confirmatory writing between merchants].)

In *Seaman's Direct Buying Service v. Standard Oil Co.* (1984) 36 *C.3d* 752, 206 *C.R.* 354, 686 *P.2d* 1158, plaintiff, a ship supply dealer, negotiated a dealership agreement with defendant oil company to supply plaintiff's fuel requirements in connection with its proposed lease of city marina property. Plaintiff requested evidence of the agreement to satisfy the city that it was binding, and defendant wrote a letter setting forth the terms of the agreement. The letter was then signed by representatives of both parties, and the city gave plaintiff the lease. *Held*, the signed letter, specifying the parties and the price to be paid for fuel, was a sufficient memorandum.

(a) Defendant's contention that the writing lacked the essential element of *quantity* is unsound: The obvious implication of the dealership arrangement is that the wholesaler will supply as much fuel as the dealer requires; i.e., this

was a "requirements" contract. And, because these contracts are sufficiently precise to be *enforceable*, they are sufficiently precise to satisfy the statute of frauds. (36 C.3d 763; see *supra*, 228.)

(b) Because this contract contemplated a sale of goods, it had to meet the additional test of U.C.C. 2201, *supra*. Here also, a requirements contract is binding and satisfies the statute of frauds. (36 C.3d 764, citing Anderson and "overwhelming weight of authority.")

West's Key Number Digest, Frauds, Statute of, k.108(5)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Memorandum*. See 2 Lawrence's Anderson 3d (2004 ed.), §2-201:114 et seq.

(2) *Confirmation*. See 2 Lawrence's Anderson 3d (2004 ed.), §2-201:221 et seq.



104 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VIII. STATUTE OF FRAUDS
C. Signed by Party To Be Charged.
1. Who Is Party To Be Charged.

1 Witkin Sum. Cal. Law Contracts § 359

[§ 359] Who Is Party To Be Charged.

The contract, or note or memorandum thereof, must be subscribed by the party to be charged or by his or her agent. (C.C. 1624(a); see U.C.C. 2201(1), *infra*, §378 et seq.) ["signed by the party against whom enforcement is sought or by his authorized agent or broker"]; *Rest.2d, Contracts* §§131, 134, 135; 4 Corbin (Rev. ed.), §23.5 et seq.; 10 Williston 4th, §29:38 et seq.; 72 *Am.Jur.2d* (2001 ed.), *Statute of Frauds* §272 et seq.; 46 *A.L.R.3d* 619 [validity of lease or sublease subscribed by only one party].)

This means the party to be charged in court with the performance of the obligation, i.e., the *defendant* in the action brought to enforce the contract. (*Harper v. Goldschmidt* (1909) 156 C. 245, 246, 104 P. 451; see *Rest.2d, Contracts* §135.) Hence, where two parties contract for the sale of real property, and the vendor signs, the fact that the purchaser has not signed is immaterial if the purchaser brings the action, for the vendor is in such a case the party to be charged. (*Steel v. Duntley* (1931) 115 C.A. 451, 452, 1 P.2d 999.)

West's Key Number Digest, Frauds, Statute of, k.115

SUPPLEMENT: [This section is current through the latest supplement]

See *Sterling v. Taylor* (2007) 40 C.4th 757, 773, 55 C.R.3d 116, 152 P.3d 420, Supp., *supra*, §349 [omission of partnership name of sellers in memorandum for sale of real property that included general partner's name did not violate statute of frauds, where it was not disputed that general partner had authority to act as partnership's agent]; *Ulloa v. McMillin Real Estate & Mortg.* (2007) 149 C.A.4th 333, 339, 57 C.R.3d 1, quoting the text [under statute of frauds, for purchaser to prosecute specific performance action against vendor of real property, purchaser need not have signed contract at all; only party charged, i.e., vendor, need have signed].



105 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VIII. STATUTE OF FRAUDS
C. Signed by Party To Be Charged.
2. Need Not Be at End of Document.

1 Witkin Sum. Cal. Law Contracts § 360

[§ 360] Need Not Be at End of Document.

Although the use of the word "subscribed" would ordinarily indicate a requirement that the signature appear at the *end* of the instrument, it has generally been held to be the practical equivalent of "*signed*." This has been the view in California as to contracts and holographic wills. Hence, the name of the party may be at the beginning or in the body of the instrument, if it is "signed," i.e., if it clearly appears that the name was intended as an *authentication*. (*California Canneries Co. v. Scatena* (1897) 117 C. 447, 449, 49 P. 462 [sufficient]; *Rader Co. v. Stone* (1986) 178 C.A.3d 10, 23, 223 C.R. 806, citing the text; see U.C.C. 1201(38); *Rest.2d, Contracts* §134, Comment b; 4 Corbin (Rev. ed.), §23.41 et seq.; 10 Williston 4th, §29:35 et seq.; 73 *Am.Jur.2d* (2001 ed.), *Statute of Frauds* §§274, 275; 18 *Cal. L. Rev.* 565; 4 *U.S.F. L. Rev.* 184.)

On the other hand, if the name appears to be placed thereon for some other purpose, as for mere identification, this will not satisfy the statutory requirement. (See *McNear v. Petroleum Export Corp.* (1929) 208 C. 162, 167, 280 P. 684.)

SUPPLEMENT: [This section is current through the latest supplement]
U.C.C. 1201 was amended in 2006; the definition of "signed" is now in U.C.C. 1201(b)(37).



106 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VIII. STATUTE OF FRAUDS
C. Signed by Party To Be Charged.
3. Need Not Be Legal Name.

1 Witkin Sum. Cal. Law Contracts § 361

[§ 361] Need Not Be Legal Name.

"The signature to a memorandum may be any symbol made or adopted with an intention, actual or apparent, to authenticate the writing as that of the signer." (*Rest.2d, Contracts §134.*) (See U.C.C. 1201(38) ["any symbol executed or adopted by a party with present intention to authenticate a writing"]; 72 *A.L.R.2d* 1267 [fingerprint as signature].)

Thus, it is not essential that a person's legal name be signed. Nicknames, initials, or intimate designations such as "mother" or "dad," may be sufficient, provided that they were intended as the equivalent of legal signatures. (See *Berdan v. Berdan* (1940) 39 *C.A.2d* 478, 483, 103 *P.2d* 622; *Weiner v. Mullaney* (1943) 59 *C.A.2d* 620, 632, 140 *P.2d* 704; 159 *A.L.R.* 253 [initials].)

SUPPLEMENT: [This section is current through the latest supplement]

U.C.C. 1201 was amended in 2006. The provision referred to in the text is now in U.C.C. 1201(b)(37), which provides that " 'signed' includes using any symbol executed or adopted with present intention to adopt or accept a writing."



107 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VIII. STATUTE OF FRAUDS
C. Signed by Party To Be Charged.
4. Need Not Be Handwritten.

1 Witkin Sum. Cal. Law Contracts § 362

[§ 362] Need Not Be Handwritten.

A typewritten, printed, or rubber-stamped signature may be used. (*Donovan v. RRL Corp. (2001) 26 C.4th 261, 270, 109 C.R.2d 807, 27 P.3d 702, supra, §264 [under U.C.C. 1201(38), providing that "signed" includes any symbol executed or adopted by party with present intention to authenticate writing, defendant's printed name in advertisement constituted signature satisfying statute of frauds]; Weiner v. Mullaney (1943) 59 C.A.2d 620, 634, 140 P.2d 704; Skirball v. RKO Radio Pictures (1955) 134 C.A.2d 843, 863, 286 P.2d 954 [memorandum with typewritten signature initialed]; see Rest.2d, Contracts §134, Comment a.)*

In *Kadota Fig Assn. of Producers v. Case-Swayne Co. (1946) 73 C.A.2d 815, 167 P.2d 523* (not involving a statute of frauds problem), a signature was held binding, though written by another, where affixed with authority and approved by subsequent authorization. The court said: "A signature to an instrument may be attached by (1) the hand of a party thereto, (2) by the hand of another, at the request of a party, or (3) by means of the mark of a party when he is unable to write his name. ... It may be written, printed, stamped, typewritten, engraved or photographed. ... A party may also adopt his signature written by another person, as valid and binding, by subsequent approval or ratification, even though the signature was originally forged." (*73 C.A.2d 819.*)

However, in *Marks v. Walter G. McCarty Corp. (1949) 33 C.2d 814, 205 P.2d 1025*, where the memorandum providing for the plaintiff broker's commission was unsigned, plaintiff argued that, because it was a carbon copy on *defendant's letterhead*, the name on the letterhead was the signature. The court, while recognizing the sufficiency of printed signatures and signatures not subscribed, nevertheless held that the document merely established a clear intention to contract, and in no way authenticated the name as a signature. (*33 C.2d 820.*)

A party to a written communication with a public entity may use a *digital signature*, which is an electronic identifier, created by computer and intended to have the same force and effect as the use of a manual signature. (*Govt.C. 16.5(a), (d).*) A digital signature has the same effect as a manual signature if it (1) is unique to the person using it, (2) is capable of verification, (3) is under the sole control of the person using it, (4) is linked to data such that if the data are changed, the signature is invalidated, and (5) conforms to regulations to be adopted by the Secretary of State. (*Govt.C. 16.5(a).*) (On electronic signatures under Uniform Electronic Transactions Act, see *supra*, §11 et seq.)

West's Key Number Digest, Frauds, Statute of, k.115.2

SUPPLEMENT: [This section is current through the latest supplement]

U.C.C. 1201 was amended in 2006, and the provision discussed in the text is now in U.C.C. 1201(b)(37), which provides that " 'signed' includes using any symbol executed or adopted with present intention to adopt or accept a writing."



108 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

VIII. STATUTE OF FRAUDS

D. Contracts Within the Statute.

1. Contract Not To Be Performed Within a Year.

a. In General.

1 Witkin Sum. Cal. Law Contracts § 363

[§ 363] In General.

"An agreement that *by its terms* is not to be performed within a year from the making thereof" comes within the statute. (C.C. 1624(a)(1); see *McKeany v. Black* (1897) 117 C. 587, 591, 49 P. 710; *Foley v. Interactive Data Corp.* (1988) 47 C.3d 654, 673, 254 C.R. 211, 765 P.2d 373, *infra*, §367, citing the text; *Brockman v. Lane* (1951) 103 C.A.2d 802, 805, 230 P.2d 369; *Munoz v. Kaiser Steel Corp.* (1984) 156 C.A.3d 965, 971, 203 C.R. 345 [plaintiff alleged oral employment contract for minimum of 3 years]; *Rest.2d, Contracts §§110(e)*, 130; 4 Corbin (Rev. ed.), §19.1 et seq.; 9 Williston 4th, §24:1 et seq.; 72 *Am.Jur.2d* (2001 ed.), *Statute of Frauds §10* et seq.)

The important words are "by its terms"; i.e., only those contracts which expressly preclude performance within a year are unenforceable. (See *infra*, §365 et seq.) And these words have been literally and narrowly interpreted:

"To fall within the words of this provision ... , the agreement must be one of which it can truly be said *at the very moment it is made*, 'This agreement is not to be performed within one year'; in general, the cases indicate that *there must not be the slightest possibility that it can be fully performed within one year.*" (*White Lighting Co. v. Wolfson* (1968) 68 C.2d 336, 343, footnote 2, 66 C.R. 697, 438 P.2d 345, *infra*, §367 [quoting Corbin]; *Plumlee v. Poag* (1984) 150 C.A.3d 541, 548, 198 C.R. 66, citing the text; see *Rest.2d, Contracts §130*, Comment a.)

In *Munoz v. Kaiser Steel Corp.*, *supra*, the court held that *Lab.C. 970*, prohibiting false representations to persuade a person to change his or her place of employment (see 3 *Summary* (10th), *Agency and Employment*, §450) does not constitute an exception to C.C. 1624(a)(1). If the Legislature had intended to create such an exception it would have added express words to that effect. (156 C.A.3d 980.) And the two statutes can easily be harmonized: "All that is required is that that portion of *Labor Code section 970* referring to oral representations be limited to those that can be performed within one year." (156 C.A.3d 981.)

SUPPLEMENT: [This section is current through the latest supplement]



109 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

VIII. STATUTE OF FRAUDS

D. Contracts Within the Statute.

1. Contract Not To Be Performed Within a Year.
- b. Commencement and Computation of Period.

1 Witkin Sum. Cal. Law Contracts § 364

[§ 364] Commencement and Computation of Period.

The period commences when the agreement is *made*, not when the performance begins. (*Rest.2d, Contracts §130(1)*, and Comment c.) Thus, an agreement to perform services for exactly 1 year can be made orally; but if it provides that the services are to commence at some time in the future, it is not capable of performance within a year from "the making thereof" and is unenforceable. (*Kraft v. Rooke (1930) 103 C.A. 552, 554, 284 P. 935* [agreement for 1 year's services, made December 24, work to begin January 1].) The same is true of a *lease* for 1 year, which may be oral under C.C. 1624(a)(3), but must be in writing if it is to commence at a date subsequent to its execution. (*Wickson v. Monarch Cycle Mfg. Co. (1900) 128 C. 156, 158, 60 P. 764.*)

The words "from the making thereof" are construed to exclude the day on which the agreement is made; that is, the year is considered to begin with the following day. (See *Columbia Pictures Corp. v. DeToth (1945) 26 C.2d 753, 759, 161 P.2d 217* [contract for a year's employment to commence the following day held not within the statute].) "The one-year period ends at midnight of the anniversary of the day on which the contract is made, on the theory that fractions of a day are disregarded in the way most favorable to the enforceability of the contract. If complete performance is possible before that time, the contract is not within the one-year provision, regardless of what hour of the day the contract is entered into." (*Rest.2d, Contracts §130*, Comment c.) (See 4 Corbin (Rev. ed.), §19.1; 9 Williston 4th, §24:12; 72 *Am.Jur.2d* (2001 ed.), *Statute of Frauds* §13.)

West's Key Number Digest, Frauds, Statute of, k.53

SUPPLEMENT: [This section is current through the latest supplement]



110 of 199 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

VIII. STATUTE OF FRAUDS

D. Contracts Within the Statute.

1. Contract Not To Be Performed Within a Year.

c. Where Performance Possible Within One Year.

1. Period Indefinite.

1 Witkin Sum. Cal. Law Contracts § 365

[§ 365] Period Indefinite.

The contract is unenforceable only where *by its terms* it is *impossible* of performance in the period. If it is merely unlikely that it will be so performed, or the period of performance is *indefinite*, the statute does not apply. (*Dougherty v. Rosenberg* (1882) 62 C. 32, 36; *Hollywood Motion Picture Equipment Co. v. Furer* (1940) 16 C.2d 184, 187, 105 P.2d 299; *Hellings v. Wright* (1916) 29 C.A. 649, 655, 156 P. 365; *Mayborne v. Citizens' Trust & Savings Bank* (1920) 46 C.A. 178, 189, 188 P. 1034; *Fisher v. Parsons* (1963) 213 C.A.2d 829, 836, 29 C.R. 210 [oral lease]; 4 Corbin (Rev. ed.), §§19.1, 19.3; 9 Williston 4th, §24:3; 72 Am.Jur.2d (2001 ed.), Statute of Frauds §15; 28 A.L.R.2d 878 [personal services]; cf. *Bed, Bath & Beyond of La Jolla v. La Jolla Village Square Venture Partners* (1997) 52 C.A.4th 867, 873, 60 C.R.2d 830 [real property lease with actual term exceeding 1 year was within statute of frauds despite precommencement termination provisions making performance possible within 1 year; distinguishing *Fisher v. Parsons*, *supra*].)

This rule is illustrated by cases dealing with agreements to refrain from doing something. In *Long v. Cramer Meat Packing Co.* (1909) 155 C. 402, 101 P. 297, the oral agreement was that certain land should "always" be used for certain purposes. *Held*, the contract called for performance *forever*, and violated the statute. (155 C. 406.) On the other hand, in *Hollywood Motion Picture Equipment Co. v. Furer*, *supra*, defendant agreed to make castings for plaintiff, and not to make any for others, but no time was mentioned. *Held*, the oral agreement was valid. (16 C.2d 187.) However, in *San Francisco Brewing Corp. v. Bowman* (1959) 52 C.2d 607, 343 P.2d 1, the court held that an oral agreement of unspecified duration giving an exclusive distributorship might be brought within the statute of frauds, on the following analysis: The law implies its continuance for a reasonable period; the trier of fact--jury or judge--must therefore determine what period was reasonable under the particular circumstances; and, if the period so determined is in excess of 1 year, it is unenforceable; i.e., the statute of frauds applies to both express and implied terms of a contract. "If the parties choose to submit the determination of what in fact was to have been the duration of the contract to the arbitrament of courts and juries in an action brought thereon, we think the contract as determined in such suit by the trier of fact is the contract which they must be taken as having made." (52 C.2d 607.) (On cases following *Bowman*, see *Aero Bolt & Screw Co. of Calif. v. Iaia* (1960) 180 C.A.2d 728, 740, 5 C.R. 53, 3 Summary (10th), *Agency and Employment*, §102; cf. *Mangini v. Wolfschmidt, Ltd.* (1961) 192 C.A.2d 64, 75, 13 C.R. 503 [liquor distributorship];

statute inapplicable because contract could have been terminated by regulations passed within 1 year of its making]; *Burgermeister Brewing Corp. v. Bowman* (1964) 227 C.A.2d 274, 281, 38 C.R. 597, supra, §232 [contract of indeterminate duration; *Mangini v. Wolfschmidt* followed]; and see 12 *Hastings L. J.* 442.)

SUPPLEMENT: [This section is current through the latest supplement]



111 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

VIII. STATUTE OF FRAUDS

D. Contracts Within the Statute.

1. Contract Not To Be Performed Within a Year.
- c. Where Performance Possible Within One Year.
 2. Conditional Contract.

1 Witkin Sum. Cal. Law Contracts § 366

[§ 366] Conditional Contract.

Some contracts *refer* to a period longer than a year, but do not necessarily *require* such a period of performance. Thus, if an insurance company orally agrees to insure property for 5 years, the contract is enforceable. Though the coverage is for 5 years, the condition may happen at any time (the property may be destroyed), and the promise to pay may thus be performed within a year. (*Rest.2d, Contracts §130*, Illus. 1; see 4 Corbin (Rev. ed.), §§19.2, 19.3; 9 Williston 4th, §24:3; 72 *Am.Jur.2d* (2001 ed.), *Statute of Frauds* §17.)

West's Key Number Digest, Frauds, Statute of, k.50

SUPPLEMENT: [This section is current through the latest supplement]



112 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

VIII. STATUTE OF FRAUDS

D. Contracts Within the Statute.

1. Contract Not To Be Performed Within a Year.
- c. Where Performance Possible Within One Year.
3. Option To Terminate.

1 Witkin Sum. Cal. Law Contracts § 367

[§ 367] Option To Terminate.

Where an oral contract calls for the plaintiff's services for over a year, but either party has the election *to terminate at will*, is the contract within the statute?

(1) The majority rule is that the contract is within the statute and thus unenforceable, because it cannot be *performed* within a year; i.e., termination resulting in discharge from liability is not performance. (See 4 Corbin (Rev. ed.), §19.6; 9 Williston 4th, §24:9; 72 *Am.Jur.2d* (2001 ed.), *Statute of Frauds* §20; 19 *So. Cal. L. Rev.* 55 [criticizing majority rule where right of termination belongs to defendant]; 22 *So. Cal. L. Rev.* 311; 88 *A.L.R.2d* 701 [oral employment contract for more than 1 year but specifically made terminable on death of either party].)

(2) California follows the minority rule that the election to terminate takes the contract out of the statute. (See *White Lighting Co. v. Wolfson* (1968) 68 *C.2d* 336, 344, 66 *C.R.* 697, 438 *P.2d* 345; *Plumlee v. Poag* (1984) 150 *C.A.3d* 541, 550, 198 *C.R.* 66, citing the text; 19 *So. Cal. L. Rev.* 55.)

The California position was rejected in *Newfield v. Insurance Co. of the West* (1984) 156 *C.A.3d* 440, 447, 203 *C.R.* 9, but was reaffirmed in *Steward v. Mercy Hosp.* (1987) 188 *C.A.3d* 1290, 1295, 233 *C.R.* 881. (See *Gray v. Superior Court* (1986) 181 *C.A.3d* 813, 822, 226 *C.R.* 570 [disagreeing with *Newfield*].) In *Foley v. Interactive Data Corp.* (1988) 47 *C.3d* 654, 254 *C.R.* 211, 765 *P.2d* 373, the California Supreme Court disapproved *Newfield* (47 *C.3d* 673, footnote 19), declaring it irreconcilable with *White Lighting Co. v. Wolfson*, *supra*. The court said: "Even if the original oral agreement had expressly promised plaintiff 'permanent' employment terminable only on the condition of his subsequent poor performance or other good cause, such an agreement, if for no specified term, *could* possibly be completed within one year. ... Because the employee can quit or the employer can discharge for cause, even an agreement that strictly defines appropriate grounds for discharge can be completely performed within one year--or within one day for that matter." (47 *C.3d* 672.) (See *Jenkins v. Family Health Program* (1989) 214 *C.A.3d* 440, 445, 262 *C.R.* 798 [following *Foley*].)

Abeyta v. Superior Court (1993) 17 *C.A.4th* 1037, 21 *C.R.2d* 680, rejected the contention that *Foley* was limited to contracts of *indefinite* duration. The court said: "The underscored language in several of the passages quoted from *Foley*

... makes clear the key question is whether the contract can possibly be terminated under any contingency within one year, not the length of time it is contemplated performance may continue beyond the one year. If performance under a contract could be terminated within one year under some contingency it makes no difference whether the contract has a definite outside term of two years, three years or five years--or whether it is for the employee's lifetime or some other 'indefinite' period." (17 C.A.4th 1043.)

SUPPLEMENT: [This section is current through the latest supplement]



113 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

VIII. STATUTE OF FRAUDS

D. Contracts Within the Statute.

1. Contract Not To Be Performed Within a Year.
- c. Where Performance Possible Within One Year.
 4. Option To Extend.

1 Witkin Sum. Cal. Law Contracts § 368

[§ 368] Option To Extend.

An option to extend is treated differently from one to terminate, at least with respect to the majority position (*supra*, §367). An employer's option to extend a 1-year oral employment contract for successive 1-year periods does not bring the contract within the statute, for it can be fully performed within a year if the employer does not exercise his option. (*Columbia Pictures Corp. v. DeToth* (1945) 26 C.2d 753, 759, 161 P.2d 217; *Columbia Pictures Corp. v. DeToth* (1948) 87 C.A.2d 620, 634, 197 P.2d 580; *Keller v. Pacific Turf Club* (1961) 192 C.A.2d 189, 196, 13 C.R. 346; see 4 Corbin (Rev. ed.), §19.7 et seq.; 72 Am.Jur.2d (2001 ed.), Statute of Frauds §21; 22 So. Cal. L. Rev. 311; cf. *Aaker v. Smith* (1948) 87 C.A.2d 36, 43, 196 P.2d 150 [dictum that oral agreement for 1-year lease, with option of annual renewal by tenant for additional 1-year periods, is violative of statute].)

West's Key Number Digest, Frauds, Statute of, k.48

SUPPLEMENT: [This section is current through the latest supplement]



114 of 199 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

VIII. STATUTE OF FRAUDS

D. Contracts Within the Statute.

1. Contract Not To Be Performed Within a Year.
- c. Where Performance Possible Within One Year.
5. Performance Excused or Discharged.

1 Witkin Sum. Cal. Law Contracts § 369

[§ 369] Performance Excused or Discharged.

The theory of the conditional contract cases (i.e., period longer than year referred to, but not required, see *supra*, §366) has been extended to contracts where performance might be *excused*, or the contract *terminated*, within a year. Thus, suppose an oral agreement is made to support a child of 10 years until he or she reaches majority. It cannot be *performed* within a year, but performance may be excused by impossibility if the child dies within a year, and it has been suggested that the agreement is therefore enforceable. (See *Gaskins v. Security-First Nat. Bank of Los Angeles* (1939) 30 C.A.2d 409, 418, 86 P.2d 681.)

This approach could conceivably permit enforcement of almost any oral contract, no matter what its duration, by pointing to some excuse for performance that might possibly arise. (See *Sessions v. Southern Calif. Edison Co.* (1941) 47 C.A.2d 611, 617, 118 P.2d 935 [criticizing failure "to observe the distinction between performing a contract and being discharged from liability under it"].) *Gaskins* was nevertheless cited with approval in *Leonard v. Rose* (1967) 65 C.2d 589, 55 C.R. 916, 422 P.2d 604. An oral agreement was made compromising a claim against a trustee for failure to account to an incompetent beneficiary under guardianship. It provided that defendant trustee and his wife would pay the incompetent certain money down and \$ 200 per month for life; but, in the event of default, the total sum of \$ 54,799.20, less monthly payments received, should become due at the option of plaintiff guardian. Defendants paid 90 monthly installments; i.e., the contract term actually ran for a number of years. *Held*, the statute was not violated, because there was a possibility that, by death of the incompetent, it could be performed within a year. (65 C.2d 592.)

The Restatement (§130, Comment b) generally disagrees with this analysis: "Any contract may be discharged by a subsequent agreement of the parties, and performance of many contracts may be excused by supervening events or by the exercise of a power to cancel granted by the contract. The possibility that such a discharge or excuse may occur within a year is not a possibility that the contract will be 'performed' within a year. This is so even though the excuse is articulated in the agreement. This distinction between performance and excuse for nonperformance is sometimes tenuous; it depends on the terms and the circumstances, particularly on whether the essential purposes of the parties will be attained. Discharge by death of the promisor may be the equivalent of performance in the case of a promise to forbear, such as a contract not to compete." (See 4 Corbin (Rev. ed.), §19.6; 9 Williston 4th, §24:5 et seq.; 49 A.L.R.2d 1293 [contract to support or educate a child as within provision relating to contracts not to be performed within a year].)

SUPPLEMENT: [This section is current through the latest supplement]



115 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

VIII. STATUTE OF FRAUDS

D. Contracts Within the Statute.

1. Contract Not To Be Performed Within a Year.

d. Exception for Complete Performance on One Side.

1 Witkin Sum. Cal. Law Contracts § 370

[§ 370] Exception for Complete Performance on One Side.

Where the contract is unilateral, or, though originally bilateral, has been fully performed by one party, the remaining promise is taken out of the statute, and the party who performed may enforce it against the other. (See *Dutton v. Interstate Inv. Corp.* (1941) 19 C.2d 65, 70, 119 P.2d 138; *Dean v. Davis* (1946) 73 C.A.2d 166, 168, 166 P.2d 15; *Roberts v. Wachter* (1951) 104 C.A.2d 271, 280, 231 P.2d 534; *Bergin v. Van der Steen* (1951) 107 C.A.2d 8, 19, 236 P.2d 613; *Nesson v. Moes* (1963) 215 C.A.2d 655, 656, 30 C.R. 428, citing the text; *Blaustein v. Burton* (1970) 9 C.A.3d 161, 185, 88 C.R. 319, citing the text; *Rest.2d, Contracts §130(2)*, and Comment d; 4 Corbin (Rev. ed.), §19.14; 9 Williston 4th, §24:14; 6 A.L.R.2d 1053 [performance as taking contract not to be performed within a year out of statute of frauds]; 49 A.L.R.2d 1293, 1296 [contract to support or educate child as within provision relating to contracts not to be performed within a year].)

Thus, in *Dean v. Davis*, the oral agreement provided that plaintiff would obtain employment for defendant with different companies, and that defendant would pay 10% of his annual net earnings over a fixed amount. Plaintiff performed and, after several years, sued, alleging that defendant had paid less than the contract called for. Defendant's objection that the annual accounting could not take place until *after a year* had elapsed and thus that the contract had to be in writing was rejected on the ground that *plaintiff* had fully performed. (73 C.A.2d 169.)

SUPPLEMENT: [This section is current through the latest supplement]

(*New*) *Payment of money only:* The principle that full performance takes a contract out of the statute of frauds applies only where performance consists of conveying property, rendering personal services, or doing something other than payment of money. (*Secrest v. Security Nat. Mortg. Loan Trust* 2002-2 (2008) 167 C.A.4th 544, 556, 84 C.R.3d 275 [even if borrowers fully performed their obligations under purported foreclosure forbearance agreement by wire-transferring downpayment to creditor, such performance did not estop transferees of note and deed of trust from asserting statute of frauds as defense to enforcement of agreement, because borrowers' performance consisted only of payment of money].)



116 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VIII. STATUTE OF FRAUDS
D. Contracts Within the Statute.
2. Contract Not To Be Performed During Lifetime.

1 Witkin Sum. Cal. Law Contracts § 371

[§ 371] Contract Not To Be Performed During Lifetime.

(1) *Statutory Provision.* An agreement that by its terms is not to be performed during the lifetime of the promisor must be in writing. (C.C. 1624(a)(5).) The same test is applied as in the case of agreements not to be performed within a year: If, by its terms, the agreement may possibly be performed within the period, it does not violate the section. (*Roy v. Salisbury* (1942) 21 C.2d 176, 182, 130 P.2d 706; see *supra*, §365 et seq.)

However, in *Hagan v. McNary* (1915) 170 C. 141, 148 P. 937, the promisor agreed to pay plaintiff \$ 7,000 if she would take care of him during the term of his natural life. The court held that the services required by the contract could not end until his death, and it was unenforceable. (170 C. 143.) (See *Smith v. Bliss* (1941) 44 C.A.2d 171, 175, 112 P.2d 30.)

(2) *Distinction: Valid Oral Contract To Provide by Will.* Under a statute enacted in 1905 (former C.C. 1624(6)), an agreement to devise or bequeath any property, or to make any provision for any person by will, had to be in writing. (See *O'Brien v. O'Brien* (1925) 197 C. 577, 585, 241 P. 861; *DeMattos v. McGovern* (1938) 25 C.A.2d 429, 432, 77 P.2d 522; *Bogan v. Wiley* (1946) 72 C.A.2d 533, 536, 164 P.2d 912; *Bonnear v. Bank of America* (1948) 84 C.A.2d 107, 109, 190 P.2d 307; *Murdock v. Swanson* (1948) 85 C.A.2d 380, 383, 193 P.2d 81; 37 Cal. L. Rev. 151; 12 *Hastings L. J.* 408.) And a will--noncontractual in nature--was not a memorandum sufficient to take the case out of the statute. (See *Luders v. Security Trust & Savings Bank* (1932) 121 C.A. 408, 410, 9 P.2d 271; *Shive v. Barrow* (1948) 88 C.A.2d 838, 843, 848, 199 P.2d 693; 20 Cal. L. Rev. 654.)

The statute was only partially successful in preventing recovery out of estates of decedents on alleged oral contracts, for two reasons: (a) The plaintiff is entitled to quasi-contractual recovery for the value of services upon a sufficient showing of unjust enrichment. (See *infra*, §1036.) (b) The plaintiff was entitled to "quasi-specific performance"--a constructive trust imposed on distributees of the estate--upon a showing of representation and reliance sufficient to make out a case of estoppel to set up the statute of frauds. (See *infra*, §409; 13 *Summary* (10th), *Equity*, §31; 5 *Cal. Proc.* (4th), *Pleading*, §§744, 761.)

The statutes governing wills and intestate succession were revised and renumbered in 1983. (See 14 *Summary* (10th), *Wills and Probate*, §22 et seq.) The revised law provides for proof of an oral contract concerning a will or succession (see 14 *Summary* (10th), *Wills and Probate*, §326), and C.C. 1624 was amended to conform to the revised

law: It no longer refers to an agreement to devise or bequeath property or to make a will.

West's Key Number Digest, Frauds, Statute of, k.54.5

SUPPLEMENT: [This section is current through the latest supplement]

(2) *Distinction: Valid Oral Contract To Provide by Will.*

Cross-Reference: 5 *Cal. Proc.* (5th), *Pleading*, §§789, 805.



117 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VIII. STATUTE OF FRAUDS
D. Contracts Within the Statute.
3. Promise To Meet Another's Obligation.
a. The Suretyship Provision.
1. Scope of Statute.

1 Witkin Sum. Cal. Law Contracts § 372

[§ 372] Scope of Statute.

"A special promise to answer for the *debt, default, or miscarriage* of another" must, with certain exceptions, be in writing. (C.C. 1624(a)(2); see *Rest.2d, Contracts §110(1)(b)* ["a contract to answer for the duty of another (the suretyship provision)"].) (See C.C. 2787, abolishing distinctions between suretyship and guaranty; subsequent sections generally use the terms "surety" and "suretyship obligation" instead of "guarantor" and "guaranty.")

The statute applies to a promise by the *surety* made to the *creditor*, to pay the debt, or perform any obligation of the *principal debtor*. (See *Harris v. Frank* (1889) 81 C. 280, 288, 22 P. 856; *McClenahan v. Keyes* (1922) 188 C. 574, 582, 206 P. 454; *Rest.2d, Contracts §112* et seq.; *Rest.3d, Suretyship and Guaranty §11* [based on *Rest.2d, Contracts §§110, 112* et seq.]; 4 Corbin (Rev. ed.), §15.2 et seq.; 9 Williston 4th, §22:1 et seq.; 72 *Am.Jur.2d* (2001 ed.), *Statute of Frauds §124* et seq.; Cal. Civil Practice, 3 Business Litigation, §38:1 et seq.; Cal. Transactions Forms, 3 Business Transactions §19:1 et seq.; 32 *A.L.R.2d* 743 [construction]; 35 *A.L.R.2d* 906 [promise by stockholder, officer, or director to pay debt of corporation as within statute]; 64 *A.L.R.2d* 1071 [applicability of statute of frauds to promise to pay for another's medical, dental, or hospital bills]; 84 *A.L.R.4th* 994 [applicability of statute to promise to pay for legal services furnished to another]; *infra*, §373; on whether promise by one other than principal obligor to indemnify one agreeing to become surety is within the statute, see 13 *A.L.R.4th* 1153.) (For the exceptions, see C.C. 2794, *infra*, §375.)

There must, of course, be a principal debtor under a primary liability. If the person whose supposed obligation is guaranteed actually owes nothing to the purported creditor, there is no guaranty but an original promise that need not be written. (*Kilbride v. Moss* (1896) 113 C. 432, 435, 45 P. 812; see *Rest.2d, Contracts §112*, Comment c; 4 Corbin (Rev. ed.), §15.4; 9 Williston 4th, §22:5.)

West's Key Number Digest, Frauds, Statute of, k.13

SUPPLEMENT: [This section is current through the latest supplement]



118 of 199 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law
VIII. STATUTE OF FRAUDS
D. Contracts Within the Statute.
3. Promise To Meet Another's Obligation.
a. The Suretyship Provision.
2. Restatement 2d.

1 Witkin Sum. Cal. Law Contracts § 373

[§ 373] Restatement 2d.

"A contract is not within the Statute of Frauds as a contract to answer for the duty of another unless the promisee is an obligee of the other's duty, the promisor is a surety for the other, and the promisee knows or has reason to know of the suretyship relation." (*Rest.2d, Contracts §112*; see *Rest.3d, Suretyship and Guaranty §11(3)(a)* [based on *Rest.2d, Contracts §112*]; 34 *Loyola L.A. L. Rev.* 231 [California commentary on *Rest.3d, Suretyship and Guaranty*].)

Comment a points out that, although the primary purpose of the statute of frauds is evidentiary, in suretyship contracts it also serves the cautionary function of guarding the promisor against ill-considered action.

Comment b explains that the word "duty" is used in place of "debt, default or miscarriage," and that it includes all kinds of legally recognized duties, whether or not contractual, and whether already incurred or to be incurred; also that the duty may be conditional, voidable, or unenforceable.

SUPPLEMENT: [This section is current through the latest supplement]



119 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

VIII. STATUTE OF FRAUDS

D. Contracts Within the Statute.

3. Promise To Meet Another's Obligation.

b. Where Statute Does Not Apply.

1. Promise to Debtor or Third Person.

1 *Witkin Sum. Cal. Law Contracts* § 374

[§ 374] Promise to Debtor or Third Person.

If the promise is made to the *debtor*, or to a *third person*, the statute is inapplicable; it applies only to promises made to the creditor. (*King v. Smith* (1948) 33 C.2d 71, 74, 199 P.2d 308; *Lawson v. Anderson* (1929) 97 C.A. 499, 500, 275 P. 993; *20th Century Cigarette Vendors v. Shaheen* (1966) 241 C.A.2d 391, 395, 50 C.R. 773; *Rest.2d, Contracts* §123; *Rest.3d, Suretyship and Guaranty* §11(3)(h) [based on *Rest.2d, Contracts* §123]; 4 Corbin (Rev. ed.), §15.12; 9 Williston 4th, §§22:3, 22:4; 72 *Am.Jur.2d* (2001 ed.), *Statute of Frauds* §145.)

SUPPLEMENT: [This section is current through the latest supplement]



120 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VIII. STATUTE OF FRAUDS
D. Contracts Within the Statute.
3. Promise To Meet Another's Obligation.
b. Where Statute Does Not Apply.
2. Original Obligation of Promisor.
aa. In General.

1 Witkin Sum. Cal. Law Contracts § 375

[§ 375] In General.

The statute does not apply where the promise to the creditor, though in form one to meet the obligation of another, is in substance *an original obligation of the promisor*. (See *Rest.3d, Suretyship and Guaranty* §§11(3)(b) [based on *Rest.2d, Contracts* §114], 11(3)(g) [based on *Rest.2d, Contracts* §121].) The following are the important illustrations of this latter rule:

(1) Where the promisor has received property from the debtor, or the discharge of an obligation, in consideration of the promise. (C.C. 2794(1); *Rest.2d, Contracts* §114; 4 Corbin (Rev. ed.), §§15.18, 16.21; 9 Williston 4th, §22:25; 72 *Am.Jur.2d, Statute of Frauds* §134 et seq.)

(2) Where the creditor gives consideration under such circumstances that the promisor is a principal debtor and the third party is the surety. (C.C. 2794(2); see *Parrish v. Greco* (1953) 118 C.A.2d 556, 561, 258 P.2d 566.) This is the case, e.g., where the promisor requests the promisee to deliver goods to another and charge them to the promisor, thus promising to pay his or her own debt. (*Merz v. Poole* (1927) 82 C.A. 12, 15, 254 P. 914; *Madera Sugar Pine Co. v. Weakley* (1932) 127 C.A. 733, 737, 16 P.2d 321; *Rest.2d, Contracts* §114.)

(3) Novation: Where the old debtor's obligation is cancelled, and the new promise is accepted in satisfaction thereof. (C.C. 2794(3); *Rest.2d, Contracts* §115; 4 Corbin (Rev. ed.), §15.20; 9 Williston 4th, §22:30; 72 *Am.Jur.2d* (2001 ed.), *Statute of Frauds* §§141, 142.)

(4) Where a factor or agent undertakes, for a commission, to sell merchandise and act as surety in connection with the sale. (C.C. 2794(5); see *Rest.2d, Contracts* §121; 4 Corbin (Rev. ed.), §16.19; 9 Williston 4th, §22:44; 72 *Am.Jur.2d* (2001 ed.), *Statute of Frauds* §152.)

(5) Where a holder of an instrument for the payment of money transfers it in payment of his or her own precedent debt or for a new consideration, and makes the promise in connection with the transfer. (C.C. 2794(6).)

(6) The "main purpose" or "leading object" rule. (See *infra*, §376.)

West's Key Number Digest, Frauds, Statute of, k.16

SUPPLEMENT: [This section is current through the latest supplement]



121 of 199 DOCUMENTS

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CHAPTER I - Contracts

- Witkin Summary of California Law
 VIII. STATUTE OF FRAUDS
 D. Contracts Within the Statute.
 3. Promise To Meet Another's Obligation.
 b. Where Statute Does Not Apply.
 2. Original Obligation of Promisor.
 bb. Main Purpose or Leading Object Rule.

1 Witkin Sum. Cal. Law Contracts § 376

[§ 376] Main Purpose or Leading Object Rule.

The statute of frauds does not apply "[w]here the promise is upon *a consideration beneficial to the promisor*, whether moving from either party to the antecedent obligation, or from another person." (C.C. 2794(4).) (See *Ogden v. United Bank & Trust Co.* (1929) 206 C. 571, 574, 275 P. 430; *Schumm by Whyner v. Berg* (1951) 37 C.2d 174, 187, 231 P.2d 39; *Johnson v. Coyne* (1929) 99 C.A. 153, 157, 277 P. 1093; *Ackley v. Prime* (1929) 99 C.A. 534, 539, 278 P. 932; *Kale v. Bankamerica Agricultural Credit Corp.* (1934) 2 C.A.2d 113, 116, 37 P.2d 494; *Raboff v. Albertson* (1954) 122 C.A.2d 555, 558, 265 P.2d 139; *Regus v. Schartkoff* (1957) 156 C.A.2d 382, 391, 319 P.2d 721; *Michael Distr. Co. v. Tobin* (1964) 225 C.A.2d 655, 665, 37 C.R. 518, footnote 7, citing the text; *Farr & Stone Ins. Brokers v. Lopez* (1976) 61 C.A.3d 618, 622, 132 C.R. 641; *RCA Corp. v. Hunt* (1982) 133 C.A.3d 903, 906, 184 C.R. 633; *Rest.3d, Suretyship and Guaranty* §11(3)(c) [based on *Rest.2d, Contracts* §116]; 4 Corbin (Rev. ed.), §16.1 et seq.; 9 Williston 4th, §22:20; 72 Am.Jur.2d (2001 ed.), *Statute of Frauds* §135; 36 Cal. L. Rev. 405.)

Thus, in *Ogden*, supra, plaintiff, a contractor, agreed to do farming work for partners who were lessees of a farm, on their representation that defendant bank, the lessor, would finance it. Discovering that the bank had not so agreed, the contractor threatened to quit, and the bank then orally agreed to pay for the work. *Held*, the promise was enforceable, for the bank was to receive as rental part of the crops to be grown through the efforts of plaintiff. (206 C. 574.)

The Restatement (§116) states the rule differently: "if the consideration for the promise is in fact or apparently desired by the promisor mainly for his own economic advantage, rather than in order to benefit the third person." And Comment b states that the fact that there is consideration for the surety's promise is insufficient to bring the rule into play; the expected advantage must be such as to justify the conclusion that his main purpose is to advance his own interests.

SUPPLEMENT: [This section is current through the latest supplement]



122 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

VIII. STATUTE OF FRAUDS

D. Contracts Within the Statute.

3. Promise To Meet Another's Obligation.

c. The Executor-Administrator Provision.

1 Witkin Sum. Cal. Law Contracts § 377

[§ 377] The Executor-Administrator Provision.

No personal representative is chargeable upon a special promise to answer in damages for a liability of the decedent or to pay a debt of the decedent out of the personal representative's own estate unless the agreement or a memorandum thereof is in writing and signed by the personal representative or by some person specifically authorized in writing. (*Prob.C. 9604*; see *Rest.2d, Contracts §110(1)(a)*, 111 and Comments a and b; 4 Corbin (Rev. ed.), §15.1; 9 Williston 4th, §22:2.)

SUPPLEMENT: [This section is current through the latest supplement]



123 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

VIII. STATUTE OF FRAUDS

D. Contracts Within the Statute.

4. Sale of Goods of \$ 500 Value.

a. Scope of Statute.

1 Witkin Sum. Cal. Law Contracts § 378

[§ 378] Scope of Statute.

Certain classes of contracts traditionally subject to the statute of frauds are now governed by the statute of frauds provisions of the Uniform Commercial Code. (See *Rest.2d, Contracts §110(2)*.) U.C.C. 2201 covers "a contract for the sale of goods for the price of five hundred (\$ 500) or more." (See 2 Anderson 3d (1997 rev.) §2-201:1 et seq.; 4 Corbin (Rev. ed.), §21.1 et seq.; 9 Williston 4th, §26:1 et seq.; 72 *Am.Jur.2d* (2001 ed.), *Statute of Frauds §109*; 88 *A.L.R.3d* 416 [construction and application of section]; on relaxed requirement of memorandum, see *supra*, §358; on "goods" as including growing crops, see U.C.C. 2105(1), 4 *Summary* (10th), *Sales*, §26.)

The former Sales Act covered a sale of *shares of stock*. (See *White Lighting Co. v. Wolfson* (1968) 68 *C.2d* 336, 345, 66 *C.R.* 697, 438 *P.2d* 345 [agreement to purchase shares of stock within statute, but other promises severable]; *Bigelow v. Plummer* (1937) 23 *C.A.2d* 441, 444, 73 *P.2d* 638; *Berkey v. Halm* (1950) 101 *C.A.2d* 62, 67, 224 *P.2d* 885.) U.C.C. 2201(1), in effect, does not apply to sales of stock, because another Commercial Code provision excludes "investment securities" from the definition of "goods." (U.C.C. 2105(1).) Also, U.C.C. 8113 provides that a contract for the sale of securities is not subject to the statute of frauds. (See 9 *Summary* (10th), *Corporations*, §135.)

The Uniform Commercial Code statute of frauds contains novel features that have been strongly criticized. (See 63 *Harv. L. Rev.* 573; *supra*, §358; *infra*, §379.) But the most revolutionary change, one which permits enforcement of the oral agreement if the party against whom enforcement is sought admits its making in his or her pleading, testimony, or otherwise in court (Unif.Com.C. §2-201(3)(b)), was initially rejected in California. (See 65 *Cal. L. Rev.* 150, 153 [commenting on reasons for California's rejection of the provision and discussing methods of implementation of the provision by discovery procedure].) However, this change is now part of U.C.C. 2201. (See *infra*, §382.)

West's Key Number Digest, *Frauds, Statute of*, k.81

SUPPLEMENT: [This section is current through the latest supplement]
See 2 Lawrence's Anderson 3d (2004 ed.), §2-201:79 et seq.



124 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

VIII. STATUTE OF FRAUDS

D. Contracts Within the Statute.

4. Sale of Goods of \$ 500 Value.

b. Exceptions.

1. Part Payment and Apportionment.

1 Witkin Sum. Cal. Law Contracts § 379

[§ 379] Part Payment and Apportionment.

Under the law prior to the Uniform Commercial Code, no writing was necessary where the buyer gave something in earnest to bind the contract or in part payment of the price. (Former C.C. 1624a, 1724; former C.C.P. 1973a; see *Sousa v. First Calif. Co. (1950) 101 C.A.2d 533, 543, 225 P.2d 955* ["earnest" and "part payment" have the same meaning].)

U.C.C. 2201(3)(c) requires no writing "[w]ith respect to goods for which payment has been made and accepted." (See 2 Anderson 3d (1997 ed.) §2-201:354 et seq.; 4 Corbin (Rev. ed.), §21.6; 10 Williston 4th, §28:10 et seq.; 72 *Am.Jur.2d* (2001 ed.), *Statute of Frauds* §119; 97 *A.L.R.3d* 908 [construction and application of Unif.Com.C. §2-201(3)(C) with respect to goods for which payment has been made and accepted].)

The Commercial Code provision is directed at goods that are subject to apportionment, and its effect on sale of a single article is unclear. (See 63 *Harv. L. Rev.* 575.) The question was presented, however, in *Lockwood v. Smigel (1971) 18 C.A.3d 800, 96 C.R. 289*, and the old Sales Act rule of part payment was applied, despite language in the Commercial Code to the contrary.

Plaintiff alleged that defendant orally offered to sell him an automobile for \$ 11,400, \$ 100 to be paid on acceptance of the offer and the balance on delivery; that plaintiff accepted and made the downpayment, but defendant refused to deliver and sold to another. *Held*, judgment for defendant on demurrer reversed. Under our former law, the part payment would have taken the case out of the statute. The Commercial Code rule, literally allowing enforcement only to apportioned goods, was intended merely to avoid disputes over quantity, and is contrary to the modern liberal trend in statute of frauds cases. (*18 C.A.3d 803*, and footnote 6.) Here:

"The policies of the law are well served by enforcement of the contract which is alleged in this case. Where there is a part payment instead of a memorandum, this fact evidences the existence of a contract and identifies the party to be charged--i.e., the seller who received the money. Where the buyer is claiming to have purchased no more than one unit, there can be no dispute over quantity. The possibility that other terms of the bargain may be disputed is not a ground for nonenforcement, since a memorandum which satisfies the statute need not state all of the terms fully or accurately. The statutory policy which under the old law permitted the enforcement of oral contracts upon proof of part payment is

equally sound under the new code, as applied to the sale of an indivisible unit." (18 C.A.3d 804.) (See 23 *Hastings L. J.* 633.)

West's Key Number Digest, Frauds, Statute of, k.87 et seq.

SUPPLEMENT: [This section is current through the latest supplement]
See 2 Lawrence's Anderson 3d (2004 ed.), §2-201:303 et seq.



125 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

VIII. STATUTE OF FRAUDS

D. Contracts Within the Statute.

4. Sale of Goods of \$ 500 Value.

b. Exceptions.

2. Acceptance and Receipt of Part of Goods.

1 *Witkin Sum. Cal. Law Contracts* § 380

[§ 380] Acceptance and Receipt of Part of Goods.

The Sales Act made the contract enforceable as to *all of the goods* when the buyer accepted and actually received *part of the goods*. (See *Olcese v. Davis* (1954) 124 C.A.2d 58, 60, 268 P.2d 175; *Ben-Hur Mfg. Co. v. Empire Factors* (1960) 181 C.A.2d 123, 127, 5 C.R. 181 [acceptance by agent]; *Sloan v. Hiatt* (1966) 245 C.A.2d 926, 933, 54 C.R. 351.)

U.C.C. 2201(3)(c) changed the rule to one of apportionment, as in the case of payment (*supra*, §379): The contract is enforceable only "[w]ith respect to *goods* ... which have been received and accepted." (See *Dairyman's Cooperative Creamery Assn. v. Leipold* (1973) 34 C.A.3d 184, 188, 109 C.R. 753 [receipt and acceptance by third person at buyer's direction is sufficient under U.C.C. 2201(3)(c)]; *Allied Grape Growers v. Bronco Wine Co.* (1988) 203 C.A.3d 432, 441, 249 C.R. 872, *infra*, §413 [under U.C.C. 2201(3)(c), partial performance entitles seller to payment only for goods actually received and accepted by buyer]; 2 Anderson 3d (1997 rev.) §2-201:321 et seq.; 4 Corbin (Rev. ed.), §21.6; 10 Williston 4th, §§28:20, 28:21; 72 *Am.Jur.2d* (2001 ed.), *Statute of Frauds* §121 et seq.; 97 *A.L.R.3d* 908 [construction and application of Unif.Com.C. §2-201(3)(C) with respect to goods that have been received and accepted].) (For decisions on former law, but apparently applicable under the Commercial Code, see *Platt v. Union Packing Co.* (1939) 32 C.A.2d 329, 334, 89 P.2d 662 [partial delivery and acceptance of goods need not take place at time of oral agreement but may be made later]; *Samuels v. Los Angeles Mattress Co.* (1951) 102 C.A.2d 827, 829, 228 P.2d 593 [same]; *Sloan v. Hiatt*, *supra*.)

In *Sloan*, the contract was for the sale of standing timber. The buyer agreed to cut it and pay a percentage of the gross sale price received by him from the processed logs. It was impossible to show acceptance and receipt of the goods (unsevered trees) in the usual manner. *Held*, however, entry by the buyer on the land, with the landowner's knowledge and permission, and commencement of cutting, were circumstances sufficient to bring the case within the exception. (245 C.A.2d 932.)

SUPPLEMENT: [This section is current through the latest supplement]

See 2 Lawrence's Anderson 3d (2004 ed.), §2-201:276 et seq.



126 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

VIII. STATUTE OF FRAUDS

D. Contracts Within the Statute.

4. Sale of Goods of \$ 500 Value.

b. Exceptions.

3. Contract To Manufacture Goods.

1 Witkin Sum. Cal. Law Contracts § 381

[§ 381] Contract To Manufacture Goods.

The Sales Act made an exception where "the goods are to be manufactured by the seller especially for the buyer and are not suitable for sale to others in the ordinary course of the seller's business." This was a codification of the Massachusetts rule, previously followed in California. (See *Mitchell Camera Corp. v. Fox Film Corp.* (1937) 8 C.2d 192, 199, 64 P.2d 946; *Golden Eagle Milling Co. v. Old Homestead Bakery* (1922) 59 C.A. 541, 543, 211 P. 56; *United Iron Works v. Standard Brass Casting Co.* (1924) 69 C.A. 384, 388, 231 P. 567; *Murphy v. Munson* (1949) 95 C.A.2d 306, 311, 212 P.2d 603 [standard machine altered at buyer's request and thereby rendered unsalable in ordinary course of business]; *American Cas. Co. v. Curran Productions* (1963) 212 C.A.2d 386, 391, 28 C.R. 131.)

U.C.C. 2201(3)(a) states the exception in modified form: "If the goods are to be specially manufactured for the buyer and are not suitable for sale to others in the ordinary course of the seller's business and the seller, before notice of repudiation is received and under circumstances which reasonably indicate that the goods are for the buyer, has *made either a substantial beginning* of their manufacture or *commitments* for their procurement." (See 2 Anderson 3d (1997 ed.) §2-201:395 et seq.; 4 Corbin (Rev. ed.), §21.4; 9 Williston 4th, §26:19; 72 *Am.Jur.2d* (2001 ed.), *Statute of Frauds* §113; 45 *A.L.R.4th* 1126 ["specially manufactured goods" exception].)

In *Distribu-Dor v. Karadanis* (1970) 11 C.A.3d 463, 90 C.R. 231, plaintiff agreed to supply certain mirrors and tub and shower enclosures for an inn under construction by defendants. A revised quotation list was signed by plaintiff's representative and handed to defendant K for his signature. K refused to sign, but stated that his word was his bond. Plaintiff ordered mirrors of an unusual size and not readily resalable; many had to be recut and edged at great expense and loss; and plaintiff's inventory in shower and tub enclosures was distorted beyond normal requirements. In this action by plaintiff for damages for breach, judgment was for defendants. *Held*, reversed. The express oral contract for sale of the mirrors was enforceable under U.C.C. 2201(3)(a). The tub and shower enclosures, although normally salable, were included in the same contract; hence that part of the contract was also enforceable. (11 C.A.3d 468.)

SUPPLEMENT: [This section is current through the latest supplement]
See 2 Lawrence's Anderson 3d (2004 ed.), §2-201:338 et seq.



127 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

VIII. STATUTE OF FRAUDS

D. Contracts Within the Statute.

4. Sale of Goods of \$ 500 Value.

b. Exceptions.

4. Admission That Contract Was Made.

1 Witkin Sum. Cal. Law Contracts § 382

[§ 382] Admission That Contract Was Made.

California has adopted a provision of the Uniform Commercial Code statute of frauds originally rejected. (See *supra*, §378.) The provision creates an exception "[i]f the party against whom enforcement is sought admits in his or her pleading, testimony, or otherwise in court that a contract for sale was made." However, "the contract is not enforceable under this provision beyond the quantity of goods admitted." (U.C.C. 2201(3)(b).) (See *Isaac v. A & B Loan Co. (1988) 201 C.A.3d 307, 311, 247 C.R. 104* [decided prior to enactment of U.C.C. 2201(3)(b), and holding that seller's admission of oral contract with buyer, contained in pleading involving third party's lis pendens proceeding, did not preclude his using statute of frauds against buyer].)

SUPPLEMENT: [This section is current through the latest supplement]



128 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

VIII. STATUTE OF FRAUDS

D. Contracts Within the Statute.

4. Sale of Goods of \$ 500 Value.

b. Exceptions.

5. Qualified Financial Contract.

1 Witkin Sum. Cal. Law Contracts § 383

[§ 383] Qualified Financial Contract.

U.C.C. 2201(1) does not apply to a qualified financial contract as defined in C.C. 1624(b)(2) (infra, §417) if either (1) there is, as provided in C.C. 1624(b)(3), sufficient evidence to indicate that a contract has been made, or (2) the parties to the contract, by means of a prior or subsequent written contract, have agreed to be bound by the terms of the qualified financial contract from the time they reached agreement on those terms. (U.C.C. 2201(4).)

SUPPLEMENT: [This section is current through the latest supplement]



129 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VIII. STATUTE OF FRAUDS
D. Contracts Within the Statute.
5. Sale of Chose in Action of \$ 5,000 Value.

1 Witkin Sum. Cal. Law Contracts § 384

[§ 384] Sale of Chose in Action of \$ 5,000 Value.

The Uniform Commercial Code statute of frauds, with the limit of \$ 500, applies only to sales of goods. (U.C.C. 2201, *supra*, §378.) A contract for the sale of choses in action comes under a different section which, recognizing the normal informality of such transactions, raises the limit to \$ 5,000. (U.C.C. 1206(1); see Official Comment; and see generally *Rest.2d, Contracts §110(2)(c)*; 1 Anderson 3d (1997 rev.) §2-201:106; 4 Corbin (Rev. ed.), §21.7; 62 *A.L.R.5th* 137 [construction and application of Unif.Com.C., § 1-206].)

Under the same conditions previously stated (see *supra*, §383, U.C.C. 1206(1)) does not apply to a qualified financial contract (see *infra*, §417). (U.C.C. 1206(3).)

SUPPLEMENT: [This section is current through the latest supplement]
See 2 Lawrence's Anderson 3d (2004 ed.), §2-201:99.

U.C.C. 1206 was repealed in 2006 and replaced by C.C. 1624.5, added in 2006, governing the enforceability of contracts for the sale of personal property valued at more than \$ 5,000. *Qualified financial contract:* U.C.C. 1206(3) was repealed in 2006. The exemption for a qualified financial contract is now in C.C. 1624.5(c), added in 2006.



130 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VIII. STATUTE OF FRAUDS
D. Contracts Within the Statute.
6. Sale or Lease of Real Property.
a. Scope of Statute.

1 *Witkin Sum. Cal. Law Contracts* § 385

[§ 385] Scope of Statute.

(1) *In General*. "An agreement for the leasing for a longer period than one year, or for the sale of real property, or of an interest therein" is within the statute of frauds. (C.C. 1624(a)(3); see C.C. 1091; C.C.P. 1971; *Keans, Springmann & Stipek v. Alphonzo E. Bell Corp.* (1954) 126 C.A.2d 311, 326, 272 P.2d 35 [oil lease]); *Bed, Bath & Beyond of La Jolla v. La Jolla Village Square Venture Partners* (1997) 52 C.A.4th 867, 873, 60 C.R.2d 830 [real property lease]; *Rest.2d, Contracts* §110(1)(d), 125; *Rest.2d, Property (Landlord & Tenant)* §2.1 et seq. [leases]; 4 Corbin (Rev. ed.), §17.1 et seq.; 9 Williston 4th, §25:1 et seq.; 72 *Am.Jur.2d* (2001 ed.), *Statute of Frauds* §49 et seq.; 42 *A.L.R.3d* 242 [applicability of statute to agreement to rescind land sale]. (On priorities where contract was originally unenforceable but subsequently becomes enforceable, see *Rest.2d, Contracts* §146.)

Rest.2d, Contracts §127 defines an "interest in land" as any "right, privilege, power or immunity, or combination thereof, which is an interest in land under the law of property and is not 'goods' within the Uniform Commercial Code." Comment a points out that the test is set forth in the Property Restatement, and that both present and future interests, legal and equitable, are covered. Comment b notes that easements and profits and interests created by restrictive covenants are covered, but a license is not.

Comment c, on sale of goods to be severed from land (e.g., minerals, structure), distinguishes between goods to be severed by the seller (sales of goods provision applies) and goods to be severed by the buyer (land contract provision applies); but a sale of growing crops or other things capable of being severed without harm to the land is a sale of goods regardless of whether the buyer or seller is to sever.

An assignment of a fractional interest in oil produced from certain land is a transfer of an interest in real property and within the statute. (*Denio v. Brennecke* (1935) 6 C.A.2d 678, 680, 45 P.2d 229; cf. *Anderson v. Stansbury* (1952) 38 C.2d 707, 715, 242 P.2d 305 [oil and gas prospecting permit].)

It has also been suggested that an agreement restricting the right of an owner of land to *alienate it* might be within the statute. (See *Pellerito v. Dragna* (1940) 41 C.A.2d 85, 89, 105 P.2d 1011.)

(2) *Donative Transfers*. *Rest.2d, Property (Donative Transfers)* §31.4 prohibits donative transfers of land, or of an

interest therein, except to the extent allowed by the statute of frauds. Hence, an oral lease that is rent free is invalid if it exceeds the one-year period specified in the statute of frauds. (Comment b.) However, rent-free leases that include no fixed or computable period exceeding the statutory period, including periodic tenancies and tenancies at will that satisfy this requirement, are valid. The fact that a periodic tenancy may go on and on from period to period and eventually exceed the period specified in the statute is not significant, nor is the fact that a tenancy at will is terminable from its inception at the will of either party without advance notice (assuming that the parties have not specified any fixed or computable period that exceeds the period specified in the statute of frauds). (Comments c and d.)

West's Key Number Digest, Frauds, Statute of, k.55

SUPPLEMENT: [This section is current through the latest supplement]

(1) *In General*. See 12 *A.L.R.6th* 123 [sufficiency of description of terms and conditions of lease, or lease provision, to comply with statute of frauds].



131 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VIII. STATUTE OF FRAUDS
D. Contracts Within the Statute.
6. Sale or Lease of Real Property.
b. Distinctions and Exceptions.
1. In General.

1 Witkin Sum. Cal. Law Contracts § 386

[§ 386] In General.

In applying this provision (*supra*, §385), the following distinctions and exceptions should be noted:

(1) An agreement to *share the profits of a sale* of real estate is not within the statute. (*Dutton v. Interstate Inv. Corp.* (1941) 19 C.2d 65, 70, 119 P.2d 138 [agreement construed to give profits under an oil lease rather than a fractional interest in the oil produced].)

(2) A *partnership agreement* to deal in real estate is not within the statute. (*Bates v. Babcock* (1892) 95 C. 479, 484, 30 P. 605; *En Taik Ha v. Kang* (1960) 187 C.A.2d 84, 90, 9 C.R. 425; see 9 *Summary* (10th), *Partnership*, §24.) And, for reasons not clearly expressed, the same rule is applied to an orally created *joint venture* that, in most respects, is subject to the rules of partnership. (See *Lasry v. Lederman* (1957) 147 C.A.2d 480, 488, 305 P.2d 663; *Jaffe v. Heffner* (1959) 173 C.A.2d 512, 516, 343 P.2d 374; *Epstein v. Stahl* (1959) 176 C.A.2d 53, 63, 1 C.R. 143; 45 *Cal. L. Rev.* 373.) However, although agreements among partners or joint venturers regarding real property are generally not within the statute of frauds, this exception applies only when the agreement does not contemplate a transfer of title to real property from one joint venturer or partner to another for consideration. (*Kaljjan v. Menezes* (1995) 36 C.A.4th 573, 587, 42 C.R.2d 510 [agreement between developers and landowners for development of real property involved sale of property by owners to developers].) (See 4 *Corbin* (Rev. ed.), §17.12; 9 *Williston* 4th, §25:17.)

(3) A *license* is not deemed an interest in land and may be created orally, even though, where the licensee expends money in improvements, it becomes irrevocable. (*Stepp v. Williams* (1921) 52 C.A. 237, 254, 198 P. 661; see *Rest.2d, Contracts* §127, Comment b; 4 *Corbin* (Rev. ed.), §17.9; 9 *Williston* 4th, §25:14; 12 *Summary* (10th), *Real Property*, §430.)

(4) *Disputed boundaries* of adjoining lands may be located by an oral agreement and acquiescence. (*Silva v. Azevedo* (1918) 178 C. 495, 497, 173 P. 929; *Muchenberger v. Santa Monica* (1929) 206 C. 635, 642, 275 P. 803; see *Rest.2d, Contracts* §128(1); 4 *Corbin* (Rev. ed.), §17.13; 9 *Williston* 4th, §25:5; 12 *Summary* (10th), *Real Property*, §278.)

(5) A *partition* by oral agreement is valid when fully executed. (*Tuffree v. Polhemus* (1895) 108 C. 670, 677, 41 P. 806; see *Rest.2d, Contracts* §128(2); 4 Corbin (Rev. ed.), §17.14; 9 Williston 4th, §25:5; 12 *Summary* (10th), *Real Property*, §65.)

(6) A sale of *growing periodical crops* is treated as a transfer of personal property, and not within the provision. (*Vulicevich v. Skinner* (1888) 77 C. 239, 240, 19 P. 424.) The same is true of an agreement for location of mining rights (*Neet v. Holmes* (1944) 25 C.2d 447, 464, 154 P.2d 854) and a contract for sale of standing timber (*infra*, §396; see 7 A.L.R.2d 517 [standing timber]). (See *Rest.2d, Contracts* §127, Comment c.)

(7) An oral *settlement agreement rescinding a contract of purchase and sale* of land is enforceable. (See *infra*, §387.)

(8) In a land sale transaction, the statute of frauds does not require written memorialization of an agreement regarding covenants, conditions, and restrictions to be recorded against the property, where the plaintiff does not seek to enforce these covenants, conditions, and restrictions but, rather, the purchase agreement itself and that agreement satisfies the statute of frauds. (*Gaggero v. Yura* (2003) 108 C.A.4th 884, 894, 134 C.R.2d 313, 6 Cal. Proc. (4th), *Proceedings Without Trial*, Supp., §216.)

SUPPLEMENT: [This section is current through the latest supplement]

(8) *Land sale transaction:*

Gaggero case:

Cross-Reference: 6 Cal. Proc. (5th), *Proceedings Without Trial*, §240.



132 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

VIII. STATUTE OF FRAUDS

D. Contracts Within the Statute.

6. Sale or Lease of Real Property.

b. Distinctions and Exceptions.

2. Oral Rescission of Sales Contract.

1 Witkin Sum. Cal. Law Contracts § 387

[§ 387] Oral Rescission of Sales Contract.

In *Hastings v. Matlock* (1985) 171 C.A.3d 826, 217 C.R. 856, plaintiff building contractor (and his wife) contracted to sell to defendants a lot and home to be built on it for \$ 206,800. While the house was under construction, defendants paid \$ 50,000 to plaintiffs and expended \$ 92,842.86 for improvements. When construction was substantially complete, defendants took possession under a rental agreement; however, they discovered structural and other defects, the escrow was never closed, and they refused to pay rent. Plaintiffs sued for damages for breach and restitution; but negotiations led to an oral settlement agreement, under which plaintiffs agreed to pay defendants \$ 142,842.86, defendants agreed to vacate the premises, and the purchase agreement would be rescinded. Judgment was thereafter given for plaintiffs. Defendants appealed, contending that the settlement agreement was within the statute of frauds because it contemplated (a) a transfer of defendants' title to the improvements, and (b) a surrender of defendant's equitable title as purchasers. *Held*, affirmed.

(a) Because the escrow never closed, no deed was delivered to defendants, and plaintiffs at all times retained title. Thus, the settlement agreement did not contemplate a transfer of title to the improvements but rather a payment of their costs; and a promise to pay for improvements made on land is not within the statute of frauds. (171 C.A.3d 836.)

(b) Although defendants, as purchasers, held an equitable title by virtue of the doctrine of equitable conversion, a transfer of that title to plaintiffs did not require a writing; Rescission of a written contract for purchase and sale of an interest in real property may be accomplished by an oral agreement. (171 C.A.3d 836; *infra*, §928.)

The court concluded by pointing out that settlements are highly favored, and for this and the other reasons stated, "we hold that where, as here, an oral out-of-court settlement agreement purports to effect a rescission of a written contract for the purchase and sale of real property, the settlement agreement is not within the statute of frauds." (171 C.A.3d 837.)

West's Key Number Digest, Frauds, Statute of, k.59

SUPPLEMENT: [This section is current through the latest supplement]



133 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

VIII. STATUTE OF FRAUDS

D. Contracts Within the Statute.

7. Agency To Contract in Writing.

a. Authority To Bind Principal.

1. Equal Dignities Rule.

1 Witkin Sum. Cal. Law Contracts § 388

[§ 388] Equal Dignities Rule.

C.C. 2309 provides: "*An oral authorization is sufficient for any purpose, except that an authority to enter into a contract required by law to be in writing can only be given by an instrument in writing.*" This special California statute is known as the "equal dignities rule," and it requires that the agent have written authority *to bind his principal* upon any agreement within the class of contracts covered by the statute of frauds or other sections that make a writing necessary. (*O'Banion v. Paradiso* (1964) 61 C.2d 559, 563, 39 C.R. 370, 393 P.2d 682, *supra*, §348 [husband's authority to make contract affecting wife's interest in land requires writing]; *Cano v. Tyrrell* (1967) 256 C.A.2d 824, 830, 64 C.R. 522 [same]; *Estate of Stephens* (2002) 28 C.4th 665, 672, 122 C.R.2d 358, 49 P.3d 1093, *infra*, §389; *W.P. Herbert Co. v. Powell* (1928) 90 C.A. 782, 790, 266 P. 620 [statute applied to *transfer* of automobile by agent, on ground that law requires signing of certificate in order to transfer title]; *Alton v. Haywood* (1934) 136 C.A. 191, 193, 28 P.2d 385; *Monte Carlo Motors v. Volkswagenwerk, G.M.B.H.* (1960) 177 C.A.2d 107, 112, 1 C.R. 920, *infra*, §416; *McGirr v. Gulf Oil Corp.* (1974) 41 C.A.3d 246, 254, 115 C.R. 902; see 28 Cal. L. Rev. 64, 74 [criticism of *W.P. Herbert Co. v. Powell*].)

C.C. 2309 applies only where a *statute or judicial decision* requires a writing; where the writing is required only by an *agreement*, the equal dignities rule is inapplicable. (*Ripani v. Liberty Loan Corp.* (1979) 95 C.A.3d 603, 610, 157 C.R. 272 [lease gave option to renew by written notice; oral notice by agent with ostensible authority sufficient]; see 3 California Affirmative Defenses (2004 ed.), §54:1 et seq.) And lack of original written authority may be cured by subsequent written ratification. (See C.C. 2310; *Moore v. Hoar* (1938) 27 C.A.2d 269, 279, 81 P.2d 226; *Cano v. Tyrrell*, *supra*; 3 *Summary* (10th), *Agency and Employment*, §§92, 139.)

Although C.C. 2309 covers *all* contracts required to be in writing, C.C. 1624(a)(3) specifically provides that where a contract for the sale of real property or an interest therein, or for the leasing of real property for a longer period than 1 year, is made by an agent, the agent must have written authority. C.C. 1091 makes similar provision as to an "estate in real property." (See *Moore v. Hoar*, *supra*, 27 C.A.2d 279; *Cano v. Tyrrell*, *supra*.)

West's Key Number Digest, Principal and Agent k.10 et seq.

SUPPLEMENT: [This section is current through the latest supplement]

See 3 California Affirmative Defenses §54:1 et seq. *Sale or leasing of real property:* See *Elias Real Estate, LLC v. Tseng* (2007) 156 C.A.4th 425, 429, 67 C.R.3d 360 [purchase agreement for real property executed by one of four owners was unenforceable against other three owners, in absence of evidence of these owners' written authorization for first owner to sell property, notwithstanding first owner's oral and written representations that he was authorized to do so].



134 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law

VIII. STATUTE OF FRAUDS

D. Contracts Within the Statute.

7. Agency To Contract in Writing.

a. Authority To Bind Principal.

2. Exceptions.

aa. Agent Acting Mechanically.

1 Witkin Sum. Cal. Law Contracts § 389

[§ 389] Agent Acting Mechanically.

The equal dignities rule does not apply where the agent acts *mechanically*; i.e., where he or she does not have discretionary authority to enter into a contract, but purely mechanical authority to sign the principal's name to a contract already made. (See *Ellis v. Mihelis* (1963) 60 C.2d 206, 214, 32 C.R. 415, 384 P.2d 7.)

The simplest situation is where the agent acts in the immediate presence of the principal and executes the instrument at the principal's discretion. (See *Videau v. Griffin* (1863) 21 C. 389, 392; *Knaugh v. Baender* (1927) 84 C.A. 142, 148, 257 P. 606; *Lathrop v. Gauger* (1954) 127 C.A.2d 754, 764, 274 P.2d 730.) But the exception is not confined to that situation: "An oral request of the defendant to have his name signed was perfectly valid, whether the name was signed in or out of his presence." (*Murphy v. Munson* (1949) 95 C.A.2d 306, 312, 212 P.2d 603; see *Kadota Fig Assn. of Producers v. Case-Swayne Co.* (1946) 73 C.A.2d 815, 821, 167 P.2d 523 [authority given orally, over the telephone].)

The situation becomes more complicated where the mechanically acting agent (an amanuensis) is also an *interested party*. In *Estate of Stephens* (2002) 28 C.4th 665, 122 C.R.2d 358, 49 P.3d 1093, a probate proceeding, the trial judge rejected the petition of L, decedent's son, to return property to the estate. The property in question had been deeded to S, decedent's daughter, as a gift for the assistance that she had rendered to decedent and his wife before their deaths, and to show displeasure with L, who had moved out of state when his parents needed help. In 1989, decedent executed a written durable power of attorney naming S as his attorney-in-fact, and the following year, he transferred his home to her as a gift. When the deed was typed, decedent, in the presence of a witness, orally instructed S to sign his name. This was done (not in decedent's presence), but was challenged by L. Holding that the deeded property belonged to S, the trial judge relied on the amanuensis rule, which states that where the signing of the grantor's name is done with the grantor's express authority, the person signing is *not deemed an agent* but is instead regarded as a mere instrument or amanuensis of the grantor, and that the signature is deemed to be that of the grantor. The Court of Appeal reversed, in part because it considered S to be an agent whose authorization was not in writing as required by the equal dignities rule (supra, §388). *Held*, opinion of the Court of Appeal reversed.

(a) *As agent*. As agent, S lacked the authority to transfer the property to herself for the following reasons: (1) the

equal dignities rule of C.C. 2309, as well as C.C. 1091, provides that authority to enter into a contract required to be in writing (as here) must itself be in writing, and S's authorization was oral; (2) the only written authority that S had from decedent was in the form of a power of attorney to sell, exchange, and transfer real property, and both *Prob.C. 4264(c)* and case law preclude such a power from being construed as authorizing a gift; (3) under C.C. 2310, for decedent to have validly ratified S's authorization, the ratification must have been in writing; (4) *Sunset-Sternau Food Co. v. Bonzi* (1964) 60 C.2d 834, 36 C.R. 741, 389 P.2d 133, *infra*, §391, and *Rakestraw v. Rodrigues* (1972) 8 C.3d 67, 104 C.R. 57, 500 P.2d 1401, holding that C.C. 2309 and 2310 do not apply to *disputes* between principal and agent, do not apply here, because a gift was involved. (28 C.4th 671.)

(b) *As amanuensis*. S argued that the transaction was valid as a deed signed by decedent and that S acted as decedent's amanuensis, because she performed the mere mechanical function of signing decedent's name to the deed. This rule has been successfully invoked as an exception to the equal dignities rule, but L argued that S did not qualify as an amanuensis, because she did not sign in decedent's presence. However, this principle has been rejected by a number of decisions. (28 C.4th 674, citing *Ellis*, *Kadota Fig Assn.*, and *Murphy*.) "[W]e again reject the formalistic notion that an amanuensis must sign the document in the presence of the principal. Whether the principal directs the amanuensis by telephone or, as in the present case, the principal, in person, tells the amanuensis to sign the document and the actual signing is done outside the principal's presence, courts are required to determine whether the signing is a mechanical act." (28 C.4th 676.)

(c) *As interested amanuensis*.

(1) Because she was the sole beneficiary of the transfer, S was an *interested amanuensis*, and whether this type of amanuensis is an exception to the equal dignities rule and to *Prob.C. 4264(c)* is a question of first impression in *California*. (28 C.4th 676.) "Because unscrupulous parties could attempt to use the amanuensis rule to sidestep the protections contained in these code sections, we hold that the signing of a grantor's name by an interested amanuensis must be presumed *invalid*. In such a case, the interested amanuensis bears the burden to show that his or her signing of the grantor's name was a mechanical act in that the grantor intended to sign the document using the instrumentality of the amanuensis." (28 C.4th 677.)

(2) Here, the presumption was rebutted by the following evidence: (a) S kept decedent informed as to each step of the transfer process, and decedent approved her actions and instructed her as to what to do next; (b) decedent told a person in the recorder's office that he intended to make a gift to S; (c) after the deed was recorded, it was mailed to decedent, who instructed S to keep it in safekeeping; (d) decedent told the witness to the oral authorization that S had followed decedent's instructions and had executed the deed; and (e) decedent informed his brother that he had disinherited L and that he was grateful to S for caring for him. (28 C.4th 670.)

SUPPLEMENT: [This section is current through the latest supplement]



135 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

VIII. STATUTE OF FRAUDS

D. Contracts Within the Statute.

7. Agency To Contract in Writing.

a. Authority To Bind Principal.

2. Exceptions.

bb. Executive Officer of Corporation.

1 *Witkin Sum. Cal. Law Contracts* § 390

[§ 390] Executive Officer of Corporation.

The equal dignities rule is also inapplicable where the agent is an *executive officer* of a corporation. This is explained on the theory that such an officer is "more than an agent," and is "the representative of the corporation itself." (*Jeppi v. Brockman Holding Co.* (1949) 34 C.2d 11, 17, 206 P.2d 847 ["This reasoning squares with sound principles and the necessities of modern business"]; *Showers v. Rober* (1928) 92 C.A. 171, 174, 267 P. 884; *Carrier v. Piggly Wiggly of San Francisco* (1936) 11 C.A.2d 180, 182, 53 P.2d 400; *Herring v. Fisher* (1952) 110 C.A.2d 322, 330, 242 P.2d 963; see 17 Cal. L. Rev. 70.)

In *Corporation of America v. Harris* (1935) 5 C.A.2d 452, 458, 43 P.2d 307, it was suggested that this exception is limited to cases where the making of the contract is within the scope of the officer's authority, but this dictum was disapproved in *Jeppi, supra*.

SUPPLEMENT: [This section is current through the latest supplement]



136 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

VIII. STATUTE OF FRAUDS

D. Contracts Within the Statute.

7. Agency To Contract in Writing.

a. Authority To Bind Principal.

2. Exceptions.

cc. Liability of Principal to Agent.

1 Witkin Sum. Cal. Law Contracts § 391

[§ 391] Liability of Principal to Agent.

In *Sunset-Sternau Food Co. v. Bonzi* (1964) 60 C.2d 834, 36 C.R. 741, 389 P.2d 133, defendant principal, owning a stock of apricot pits used for processing, made an oral agency agreement with plaintiff agent to procure a buyer in plaintiff's own name, which was well known. Plaintiff found a buyer and contracted with it for the sale of 75 tons, with approval of defendant. Then fire destroyed most of the available stock of pits in California, and defendant, refusing to deliver, sold his pits for a much higher price to others. The buyer recovered from plaintiff, and plaintiff brought this action for indemnity. Because the contract was for the sale of goods of over \$ 500 value, it was within the statute of frauds (see supra, §378); hence, in terms the equal dignities rule called for written authority of the agent. The court, however, affirmed judgment for plaintiff agent on the following reasoning:

(a) Modern policy calls for restricted application of the statute of frauds. (60 C.2d 838, footnote 3.)

(b) The language of C.C. 2309 is unclear and ambiguous, for "authority" technically refers to the power of an agent to bind the principal to a third party, not to obligations between principal and agent. And the analogous provision of C.C. 1624(5) (now C.C. 1624(a)(4)), dealing with the agent's right to commissions, has been held inapplicable to an agreement for sale of personal property (60 C.2d 840, footnote 8, quoting the text) and to a contract between principal and agent (60 C.2d 839).

(c) To hold C.C. 2309 inapplicable here does not nullify the statute and allow the third party to do indirectly (through the agent's indemnity suit) what he cannot do directly (ultimately fasten liability on the principal). C.C. 2309 still retains its vitality as a curtailment of rights of the third party: The third party cannot sue the principal or enforce ancillary rights (such as attachments) against him or her; and the principal incurs no liability until the agent satisfies the third party's judgment against him or her (hence the agent's insolvency precludes recovery). (60 C.2d 841.)

(d) The crucial policy question is not whether the third party gains an indirect benefit, but whether the loss should be borne by the principal or agent. The principal should be accountable for the agent's liability incurred by reason of the principal's refusal to perform; otherwise the principal profits by his or her own wrong. (60 C.2d 842, 843.) (See

Rakestraw v. Rodrigues (1972) 8 C.3d 67, 76, 104 C.R. 57, 500 P.2d 1401 [following *Sunset-Sternau*.])

West's Key Number Digest, Principal and Agent k.12

SUPPLEMENT: [This section is current through the latest supplement]



137 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

VIII. STATUTE OF FRAUDS

D. Contracts Within the Statute.

7. Agency To Contract in Writing.

b. Real Estate Agent's Right to Commissions.

1. Nature and Effect of Statute.

1 Witkin Sum. Cal. Law Contracts § 392

[§ 392] Nature and Effect of Statute.

C.C. 1624(a)(4) deals with a contract not covered in the original statute of frauds: "An agreement authorizing or employing an agent, broker, or any other person to purchase or sell real estate, or to lease real estate for a longer period than one year, or to procure, introduce, or find a purchaser or seller of real estate or a lessee or lessor of real estate where the lease is for a longer period than one year, for compensation or a commission."

This statute must be distinguished from C.C. 1624(a)(3). If the agent's authority is not in writing, the contract that he or she makes is *not binding upon the principal*. (Supra, §388.) This, however, would *not* prevent the agent from recovering a commission from the principal upon full performance of his or her duties. But under C.C.P. 1624(a)(4), the agent cannot recover compensation or commission unless his or her original authority was in writing. (*Glazer v. Hanson* (1929) 98 C.A. 53, 59, 276 P. 607 [section applies to agreement to *exchange* real property]; *Phillippe v. Shapell Industries* (1987) 43 C.3d 1247, 1255, 241 C.R. 22, 743 P.2d 1279, supra, §354; *Duckworth v. Schumacher* (1933) 135 C.A. 661, 662, 27 P.2d 919; *Morrill v. Barneson* (1939) 30 C.A.2d 598, 600, 86 P.2d 924; *Sweeley v. Gordon* (1941) 47 C.A.2d 381, 383, 118 P.2d 14; *Colburn v. Sessin* (1949) 94 C.A.2d 4, 5, 209 P.2d 989; *Hooper v. Mayfield* (1952) 114 C.A.2d 802, 805, 251 P.2d 330 [section applies to person acting as middleman]; *Jaffe v. Albertson Co.* (1966) 243 C.A.2d 592, 603, 53 C.R. 25; *Rosenbaum v. Rosenbaum* (1967) 257 C.A.2d 193, 198, 64 C.R. 632, 3 Summary (10th), *Agency and Employment*, §75; *Deeter v. Angus* (1986) 179 C.A.3d 241, 248, 224 C.R. 801; see 4 Corbin (Rev. ed.), §17.17; 9 A.L.R.2d 747 [necessity and sufficiency of written statement as to amount of real estate broker's compensation].)

This requirement is so strictly applied that, contrary to the usual rule governing contracts within the statute of frauds, the agent cannot recover in quantum meruit. (*Gould v. Otto* (1927) 81 C.A. 409, 411, 254 P. 272; *Augustine v. Trucco* (1954) 124 C.A.2d 229, 237, 268 P.2d 780; 31 So. Cal. L. Rev. 425.)

SUPPLEMENT: [This section is current through the latest supplement]



138 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

VIII. STATUTE OF FRAUDS

D. Contracts Within the Statute.

7. Agency To Contract in Writing.

b. Real Estate Agent's Right to Commissions.

2. Scope of Statute.

aa. Oral Agreement To Lease.

1 Witkin Sum. Cal. Law Contracts § 393

[§ 393] Oral Agreement To Lease.

A lease is technically personal property ("chattel real"), and formerly an agreement to sell a lease or procure a lease did not require a writing. (See *Lind v. Huene* (1928) 205 C. 569, 573, 271 P. 1087; *Dabney v. Edwards* (1935) 5 C.2d 1, 6, 53 P.2d 962; *Guy v. Brennen* (1923) 60 C.A. 452, 454, 213 P. 265; 17 Cal. L. Rev. 187.) This rule was changed by a 1963 amendment adding the following language to what is now C.C. 1624(a)(4) (supra, §392): "or to lease real estate for a longer period than one year."

However, where the agent is engaged to obtain a *modification* of an existing lease, the statute does not apply. In *Shell v. Darneille* (1984) 162 C.A.3d 957, 209 C.R. 68, plaintiff, an experienced oil lobbyist, was requested to obtain an amendment to defendant Westates' oil drilling lease with Standard Oil Co. whereby defendant would have secondary recovery rights, thus increasing the lease value by \$ 9 million. Plaintiff and T, chairman of the board of defendant, orally agreed that if plaintiff were successful he would receive compensation based on what he obtained for defendant. Plaintiff was successful, but defendant refused to pay the substantial commission requested, and in this action set up the defense of C.C. 1624(d) (now C.C. 1624(a)(4)). *Held*, construing the statute strictly (see supra, §363), it does not, on its face, apply to such an agreement: "Whatever need there may be for this protection at the inception of the lease, we see no purpose in applying the statute when a party hires an agent to try to procure subsequent amendments or modifications to the lease." (162 C.A.3d 961.) The court adds:

"The draconian consequences of applying the statute of frauds is another consideration dissuading us from applying it to this transaction. In this case it would permit Westates, which concedes it hired Shell to renegotiate its lease, to retain the benefit of Shell's endeavor on its behalf, in the neighborhood of \$ 9 million, but to pay him nothing." (162 C.A.3d 962.)

SUPPLEMENT: [This section is current through the latest supplement]



139 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

VIII. STATUTE OF FRAUDS

D. Contracts Within the Statute.

7. Agency To Contract in Writing.

b. Real Estate Agent's Right to Commissions.

2. Scope of Statute.

bb. Oral Agreement To Obtain Option.

1 Witkin Sum. Cal. Law Contracts § 394

[§ 394] Oral Agreement To Obtain Option.

An *option* to purchase real property merely confers a personal right and does not transfer an interest in the land; hence, it has been argued that a broker may recover on an oral contract of employment to obtain an option. But in *Pacific Southwest Dev. Corp. v. Western Pac. R. Co.* (1956) 47 C.2d 62, 301 P.2d 825, the court came to the opposite conclusion, holding that the statutory phrase "purchase or sell" includes services "to aid or assist in the purchase or sale." "Such broad construction of the term conforms with one of the primary purposes of the statute, the protection of real estate owners from the assertion of false claims by brokers and agents. ... [T]he procurement of an option agreement for the purchase of real property is a contract that aids or assists in the purchase or sale of real property, and properly comes within the provisions of the statute. ... To hold otherwise would open the door to the assertion of unfounded claims by brokers and others on the pretense of oral employment in real estate transactions relative to options, and so frustrate the purpose of the statute." (47 C.2d 67.)

West's Key Number Digest, Frauds, Statute of, k.74(1)

SUPPLEMENT: [This section is current through the latest supplement]



140 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

VIII. STATUTE OF FRAUDS

D. Contracts Within the Statute.

7. Agency To Contract in Writing.

b. Real Estate Agent's Right to Commissions.

2. Scope of Statute.

cc. Oral Finders Agreement.

1 *Witkin Sum. Cal. Law Contracts* § 395

[§ 395] Oral Finders Agreement.

(1) *Statutory Coverage.* Formerly, C.C. 1624(a)(4) did not apply to an oral "finders agreement," under which the agent agrees merely to introduce a prospective purchaser and not to negotiate for a sale of the property. (See *Palmer v. Wahler* (1955) 133 C.A.2d 705, 709, 285 P.2d 8 [relying on cases holding that the Real Estate Brokers Act did not require a license for a "finder"; 3 *Summary* (10th), *Agency and Employment*, §56; 44 *Cal. L. Rev.* 413, criticizing the distinction]; 24 *A.L.R.3d* 1160 [validity, construction, and enforcement of "finder's fee" contract].) The rule was changed by the 1963 amendment to former C.C. 1624(d) (now C.C. 1624(a)(4)), adding the following: "or to procure, introduce, or find a purchaser or seller of real estate or a lessee or lessor of real estate where the lease is for a longer period than one year." (See *Osborne v. Huntington Beach Union High School Dist.* (1970) 5 C.A.3d 510, 514, 85 C.R. 793.)

The 1963 amendment, however, left a gap: It was placed in a subdivision that dealt with an agent or broker, and merely codified the existing law on licensed brokers and agents. It therefore left untouched the rule that an *unlicensed* person's agreement of this type was not within the statute. (See *Porter v. Cirod* (1966) 242 C.A.2d 761, 764, 51 C.R. 784 [suit by finder, not licensed broker or agent, to recover reasonable compensation for finding purchaser for \$ 2 million sale; cause of action stated]; *Zappas v. King Williams Press* (1970) 10 C.A.3d 768, 771, 89 C.R. 307 [applying *Porter* rule to pre-1967 transaction].) A 1967 amendment filled in the gap by making the statute refer to an agreement authorizing or employing "an agent, broker, or any other person." (See *Tenzer v. Superscope* (1985) 39 C.3d 18, 26, 216 C.R. 130, 702 P.2d 212.)

(2) *Distinction: Finder Contracting With Broker.* In *Grant v. Marinell* (1980) 112 C.A.3d 617, 169 C.R. 414, plaintiff finder entered into an oral agreement with defendant broker, under which plaintiff would introduce defendant to parties interested in securing the services of a broker, and would be paid a finder's fee of 10% of income received by defendant from employment resulting from any such introductions. At first glance, the contract appeared to come within the scope of the 1967 amendment, but the court declared that neither the 1963 nor 1967 amendment indicated a legislative intent to protect any class other than purchasers or sellers. (112 C.A.3d 621.) Thus, oral contracts between brokers, or between brokers and salesmen, to cooperate in a sale or purchase and share commissions are enforceable. (112 C.A.3d 619.) And "[a]n agreement by a person who is neither a buyer nor a seller, to find prospective customers

for a broker in return for a finder's fee," is analogous: it is not the type of agreement that C.C. 1624(5) (now C.C. 1624(a)(4)) was intended to cover. (*112 C.A.3d 621.*)

SUPPLEMENT: [This section is current through the latest supplement]



141 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

VIII. STATUTE OF FRAUDS

D. Contracts Within the Statute.

7. Agency To Contract in Writing.

b. Real Estate Agent's Right to Commissions.

3. Exception: Agreement To Sell Personal Property.

1 Witkin Sum. Cal. Law Contracts § 396

[§ 396] Exception: Agreement To Sell Personal Property.

(1) *Personal Property Alone*. Obviously, by its terms, the commission provision (supra, §392) does not apply to an agreement for sale of *personal property*. For example, if an agency is orally created authorizing the agent for commission to buy or sell goods of over \$ 500 value, the contract of sale is within the statute of frauds, and the agency is consequently within the equal dignities rule (C.C. 2309, supra, §388). Hence, the *contract of sale*, even if in writing, will not bind the principal to the third party. But, because the sale was one involving personal property, the oral contract of agency will bind the principal to pay commissions to the agent. In other words, except in the case of real estate agents, the statute of frauds *does not apply between principal and agent*, and the agent may recover. (*A.L. Jameson & Co. v. Redfield* (1931) 118 C.A. 59, 61, 4 P.2d 817 [client orally authorized stockbroker to execute "short sale" of shares, and broker sued for losses sustained]; *Meadows v. Clark* (1939) 33 C.A.2d 24, 29, 90 P.2d 851 [contract of sale carried out, but principal refused to pay full commission].) (See *Rutland, Edwards & Co. v. Cooke* (1941) 44 C.A.2d 258, 262, 112 P.2d 287; *Shell v. Darneille* (1984) 162 C.A.3d 957, 962, 209 C.R. 68 [agreement to obtain modification of oil lease for term of years--a chattel real and personality]; 20 Cal. L. Rev. 563; 5 So. Cal. L. Rev. 233.)

Standing timber purchased separately from the land for the purpose of severance is regarded as personal property, and a contract to procure a buyer for it is not within the statute. (*Palmer v. Wahler* (1955) 133 C.A.2d 705, 711, 285 P.2d 8; see 4 Summary (10th), Sales, §26.)

(2) *Personal and Real Property*. A problem of severability arises where the authorization covers both real and personal property. In *Marks v. Walter G. McCarty Corp.* (1949) 33 C.2d 814, 205 P.2d 1025, plaintiff broker, acting without a sufficient written authorization, obtained a purchaser for defendant's hotel. The total price was \$ 2,250,000, the personal property was valued at \$ 600,000 (for tax purposes), and the agreed commission was \$ 57,500. *Held*, plaintiff was entitled to recover \$ 30,150, which the trial judge found was the reasonable value of his services in selling the personal property. The court said: "It may be conceded that as between the parties to the purchase the contract was indivisible. As between broker and selling party, however, the broker's right to a commission depends, not on whether the real and personal property would have been separately sold, but on whether the sale price of the personal property actually sold can be ascertained." (33 C.2d 823.) This obscure statement would appear to mean that the requirement of severability does not apply in statute of frauds cases, or, perhaps, that it may be disregarded in broker's authorization

cases. (Cf. *Young v. Bank of California* (1948) 88 C.A.2d 184, 187, 198 P.2d 543, contra [court refused to allow broker to recover commission for sale of crops, on ground that agreement for sale of land and crops was one transaction].)

SUPPLEMENT: [This section is current through the latest supplement]



142 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

VIII. STATUTE OF FRAUDS

D. Contracts Within the Statute.

7. Agency To Contract in Writing.

b. Real Estate Agent's Right to Commissions.

4. Distinctions.

1 *Witkin Sum. Cal. Law Contracts* § 397

[§ 397] Distinctions.

In applying C.C. 1624(a)(4) (*supra*, §392), several distinctions should be borne in mind.

(1) The agent may be protected by a subsequent memorandum contained in escrow instructions (see *supra*, §350), or by the estoppel doctrine (see *infra*, §410).

(2) The section does not apply to an oral contract *between brokers* to share commissions to be earned as a result of a sale. (*Kennedy v. Johnson* (1930) 109 C.A. 662, 666, 293 P. 698; *Holland v. Morgan & Peacock Properties Co.* (1959) 168 C.A.2d 206, 210, 335 P.2d 769; see 44 A.L.R.2d 741 [agreement between brokers as within statute requiring agreements for commission for sale of real estate to be in writing].)

(3) Although the statute of frauds bars contract recovery against the owner, a broker may bring a tort action against a third party for interference with the unenforceable contract. (*Buckaloo v. Johnson* (1975) 14 C.3d 815, 122 C.R. 745, 537 P.2d 865, 5 Summary (10th), Torts, §748; *Friedman v. Jackson* (1968) 266 C.A.2d 517, 520, 72 C.R. 129; *Keely v. Price* (1972) 27 C.A.3d 209, 216, 103 P.2d 531, *infra*, §414; see 36 *Santa Clara L. Rev.* 1219 [Intentional Interference With Prospective Economic Advantage: A Tort That Eviscerates the Real Estate Brokers' Statute of Frauds].)

(4) It is probable that the statutory commission under *Prob.C.* 10164 and 10165 for a broker negotiating a probate sale is payable irrespective of any express written contract. (See *Estate of Rule* (1944) 25 C.2d 1, 13, 152 P.2d 1003.)

SUPPLEMENT: [This section is current through the latest supplement]



143 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VIII. STATUTE OF FRAUDS
D. Contracts Within the Statute.
8. Contract To Loan Money or Extend Credit.

1 Witkin Sum. Cal. Law Contracts § 398

[§ 398] Contract To Loan Money or Extend Credit.

A contract, promise, undertaking, or commitment to loan money or to grant or extend credit in an amount greater than \$ 100,000, if made by a person engaged in the business of lending or arranging for the lending of money or extending credit, is within the statute of frauds, provided the transaction is not primarily for personal, family, or household purposes. A contract, promise, undertaking, or commitment "to loan money secured solely by residential property consisting of one to four dwelling units" is deemed to be one for "personal, family, or household purposes." (C.C. 1624(a)(7).)

SUPPLEMENT: [This section is current through the latest supplement]



144 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VIII. STATUTE OF FRAUDS
D. Contracts Within the Statute.
9. Marital and Premarital Agreements.

1 *Witkin Sum. Cal. Law Contracts* § 399

[§ 399] Marital and Premarital Agreements.

(1) *Former Law.* C.C. 1624 originally covered the traditional marriage provision: "An agreement made upon consideration of marriage other than a mutual promise to marry." (See *Rest.2d, Contracts* §110(1)(c), 124; 4 Corbin (Rev. ed.), §20.1 et seq.; 9 Williston 4th, §23:1 et seq.; 72 *Am.Jur.2d* (2001 ed.), *Statute of Frauds* §182 et seq.; 75 *A.L.R.2d* 633 [what constitutes such a promise].) Thus, an agreement to convey property to a woman on consideration that she marry the promisor had to be in writing, although equity could enforce the oral agreement where there was actual fraud and change of position in reliance thereon. (See *Peek v. Peek* (1888) 77 C. 106, 108, 19 P. 227; *Hughes v. Hughes* (1920) 49 C.A. 206, 209, 193 P. 144; *Stevenson v. Pantaleone* (1933) 131 C.A. 401, 403, 21 P.2d 703; *Sudbrock v. Kroener* (1934) 136 C.A. 624, 627, 29 P.2d 435.)

(2) *New Statute.* In 1985, the Uniform Premarital Agreement Act (*Family C. 1600* et seq., former C.C. 5300 et seq.) was enacted to govern agreements "between prospective spouses made in contemplation of marriage and to be effective upon marriage" (*Family C. 1610(a)*), and C.C. 1624 was amended to delete the old marriage provision (see supra). (See 17 *Pacific L. J.* 696; 11 *Summary* (10th), *Community Property*, §24 et seq.)

The new Act requires that premarital agreements be "in writing and signed by both parties" (*Family C. 1611*), and similarly that postmarital amendments and revocations be "by a written agreement, signed by the parties" (*Family C. 1614*).

(3) *New Law: Applicability of Exceptions.* In *Hall v. Hall* (1990) 222 C.A.3d 578, 271 C.R. 773, decedent, some months after the death of his first wife, executed a revocable trust and quitclaim deed transferring the fee interest in his residence to himself as trustee. Under the trust terms, he was the sole beneficiary, and at his death his sons were to share equally in the property. Shortly thereafter, decedent met plaintiff C and asked her to marry him. She agreed, and they made an oral premarital agreement under which (a) she gave up her job and took early Social Security benefits in order to give him \$ 10,000 to start the marriage; and (b) he promised that she could live in the home for the rest of her life. Decedent asked his attorney to prepare an amendment to the trust to give C a life estate, but he died before executing the amendment. C brought this action against the executor and trustee, and obtained a judgment granting her the life estate. *Held*, affirmed.

(a) C.C. 5311 (replaced by *Family C. 1611*) is the statute of frauds provision of the Uniform Premarital Agreement

Act, *supra*, and it requires that the agreement be in writing in order to be enforceable. Because this agreement was not in writing, the issue here is whether traditional exceptions to the statute of frauds remain viable under the *Uniform Act*. (222 C.A.3d 583.)

(b) Exceptions have traditionally been recognized as to all statute of frauds provisions. These exceptions were applied in enforcement of premarital agreements under the statute in effect prior to the Uniform Act (C.C. 5134); relief could be granted when the party seeking to enforce the oral agreement performed his or her part of the bargain and in so doing irretrievably changed his or her position. Although the new Act does not specifically refer to the exceptions, it does not preclude them; hence, it must be assumed that the framers intended them to continue. (222 C.A.3d 585, citing the text, §§318, 319, 325.)

(c) The trial judge found that C would not have married without some agreement with respect to her financial security. "Marrying Decedent and paying him \$ 10,000 in accordance with the agreement would not, standing alone, have been sufficient performance to take the case out of the statute of frauds. But by her additional acts of stopping work and applying for early Social Security Carol irretrievably changed her position in reliance on Decedent's promise to provide a house for the rest of her life." (222 C.A.3d 586.) Hence, her performance constituted detrimental reliance on his promise sufficient to justify enforcement. (222 C.A.3d 586.)

West's Key Number Digest, Frauds, Statute of, k.144

SUPPLEMENT: [This section is current through the latest supplement]



145 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VIII. STATUTE OF FRAUDS
D. Contracts Within the Statute.
10. Miscellaneous Provisions.

1 Witkin Sum. Cal. Law Contracts § 400

[§ 400] Miscellaneous Provisions.

(1) *Assumption of Mortgage Debt.* Formerly, it was the rule that, where a mortgagor granted land, the grantee's assumption of the mortgage debt could be oral or implied. In 1937, the assumption agreement was brought within the California statute of frauds. The statute covers "[a]n agreement by a purchaser of real property to pay an indebtedness secured by a mortgage or deed of trust upon the property purchased, *unless* assumption of the indebtedness by the purchaser is specifically provided for in the *conveyance* of the property." (C.C. 1624(a)(6); see *11 So. Cal. L. Rev.* 109; *4 Summary* (10th), *Security Transactions in Real Property*, §21.) The correct construction of this provision should be that a separate assumption agreement is not enforceable if there is no written memorandum, but, even if there is no such writing, it is binding if provided for in the conveyance.

(2) *Joint Tenancy in Personal Property.* C.C. 683, providing that a joint tenancy in personal property may be created by a written transfer, instrument, or agreement, is a statute of frauds. (*California Trust Co. v. Bennett* (1949) 33 C.2d 694, 697, 204 P.2d 324.)

(3) *Revival of Debt Barred by Limitation.* C.C.P. 360 provides that a debt barred by the statute of limitations can be revived only by a writing signed by the debtor. (See *supra*, §240.)

(4) *Modification of Written Agreement.* C.C. 1698 provides that a written contract can be modified by a contract in writing, by an executed oral agreement, or by an oral agreement supported by a new consideration. (See U.C.C. 2209(2) [modification of signed agreement by signed writing]; *infra*, §968.)

(5) *Arbitration Agreement.* C.C.P. 1281 provides that a written arbitration agreement is valid, enforceable, and irrevocable. (See 6 *Cal. Proc.* (4th), *Proceedings Without Trial*, §490 et seq.)

(6) *Spouse's Waiver of Reimbursement for Contributions to Community Property.* Family C. 2640(b) provides that, in a division of community property, "unless a party has made a written waiver of the right to reimbursement or has signed a writing that has the effect of a waiver, the party shall be reimbursed for the party's contributions to the acquisition of property of the community property estate to the extent the party traces the contributions to a separate property source." (See *In re Marriage of Fabian* (1986) 41 C.3d 440, 451, 224 C.R. 333, 715 P.2d 253 [statute applies prospectively; retroactive application would violate constitutional due process]; *11 Summary* (10th), *Community*

Property, §222 et seq.)

(7) *Contract To Construct Single-Family Dwelling.* A contract (and changes in it) between an owner and a contractor for the construction of a single-family dwelling to be retained by the owner for at least 1 year must be evidenced by a writing signed by both parties (*B. & P.C. 7164(a)*) and containing specified information (*B. & P.C. 7164(b)*). The writing may also contain any other matters agreed to by the parties. (*B. & P.C. 7164(c)*.) (See *Arya Group v. Cher* (2000) 77 C.A.4th 610, 618, 91 C.R.2d 815 [plaintiff contractor entitled to seek to enforce its contract claim against defendant homeowner to extent that defendant would be unjustly enriched, even though plaintiff failed to produce written contract signed by both parties]; 28 *Lincoln L. Rev.* 51 [*Arya Group*].)

SUPPLEMENT: [This section is current through the latest supplement]

(5) *Arbitration Agreement.*

Cross-Reference: 6 *Cal. Proc.* (5th), *Proceedings Without Trial*, §512 et seq.



146 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VIII. STATUTE OF FRAUDS
E. Where the Statute Does Not Apply.
1. Executed Oral Agreement.

1 Witkin Sum. Cal. Law Contracts § 401

[§ 401] Executed Oral Agreement.

Because the statute of frauds is a "shield" and not a "sword," i.e., a defense and not a basis for affirmative action (see *supra*, §345), it cannot be used to attack an oral contract that has been fully performed. (*Colon v. Tosetti* (1910) 14 C.A. 693, 695, 113 P. 366; *McComsey v. Leaf* (1939) 36 C.A.2d 132, 142, 97 P.2d 242; *Kreling v. Walsh* (1947) 77 C.A.2d 821, 832, 176 P.2d 965; *Aaker v. Smith* (1948) 87 C.A.2d 36, 43, 196 P.2d 150; *Realty Corp. of America v. Burton* (1958) 162 C.A.2d 44, 57, 327 P.2d 948; *Dallman Co. v. Southern Heater Co.* (1968) 262 C.A.2d 582, 588, 68 C.R. 873; see *Rest.2d, Contracts* §145; 4 Corbin (Rev. ed.), §12.10; 10 Williston 4th, §27:19 et seq.; 78 A.L.R.2d 933 [oral surrender of lease].)

Thus, the transfer or exchange of separate real property to community property may be made by an executed oral agreement of the spouses. (*Estate of Sill* (1932) 121 C.A. 202, 204, 9 P.2d 243; see 11 *Summary* (10th), *Community Property*, §151 et seq.; *Nicolds v. Storch* (1944) 67 C.A.2d 8, 16, 153 P.2d 561 [oral surrender by beneficiary of resulting trust to trustee]; *Prince v. Varona* (1956) 144 C.A.2d 673, 675, 301 P.2d 512.)

In *Tobola v. Wholey* (1946) 75 C.A.2d 351, 170 P.2d 952, defendant, owner of a ranch, orally agreed to give plaintiff a half interest in exchange for plaintiff's promise to manage the property as a joint enterprise between them. After the parties had operated under this agreement for 12 years, the ranch was sold, and subsequently defendant refused to recognize plaintiff's interest. *Held*, plaintiff was entitled to recover half the proceeds. (75 C.A.2d 357.)

In *Pollyanna Homes v. Berney* (1961) 56 C.2d 676, 16 C.R. 345, 365 P.2d 401, defendants orally agreed to transfer real property to plaintiff and to install improvements adjacent thereto. They deeded the land, thus performing the part within the statute of frauds, but did not install the improvements. In this action by plaintiff, the court held that the statute was not a bar: The divisible part of the agreement, within the statute, having been fully performed, the part dealing with work and labor could be the basis of an action. (56 C.2d 678.)

SUPPLEMENT: [This section is current through the latest supplement]



147 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
VIII. STATUTE OF FRAUDS
E. Where the Statute Does Not Apply.
2. Part Performance: Transfer of Land.
a. Scope of Exception.

1 Witkin Sum. Cal. Law Contracts § 402

[§ 402] Scope of Exception.

C.C.P. 1971 requires a writing for the creation of an *estate or interest in real property* (see *supra*, §385), and *C.C.P. 1972(a)* states that the *C.C.P. 1971* "shall not be construed to abridge the power of any court to compel the specific performance of an agreement, in case of part performance thereof."

It has been held, therefore, that the exception stated in *C.C.P. 1972* applies only where there has been a transfer of an *interest in real property*, and that other classes of oral agreements within the statute of frauds remain unenforceable, notwithstanding part performance. (See *Trout v. Ogilvie* (1919) 41 C.A. 167, 174, 182 P. 333; *Forbes v. Los Angeles* (1929) 101 C.A. 781, 788, 282 P. 528; *Baker v. Bouchard* (1932) 122 C.A. 708, 710, 10 P.2d 468; *Hall v. Hall* (1990) 222 C.A.3d 578, 586, 271 C.R. 773, *supra*, §399, citing the text; 4 Corbin (Rev. ed.), §18.1 et seq.; 10 Williston 4th, §§28:3 et seq., 28:8, 28:9; 20 Cal. L. Rev. 654; 73 Am.Jur.2d (2001 ed.), *Statute of Frauds* §311 et seq.; 55 Proof of Facts 3d 441 [establishing part performance exception to statute of frauds in real estate transactions]; 85 Am.Jur. Trials 99 [circumstances entitling donee to equitable performance of oral gift of land]; for distinct sales exceptions, see *supra*, §379 et seq.)

This strict limitation has been questioned, however (see 3 *Stanf. L. Rev.* 283), and is challenged by the holding in *Maddox v. Rainoldi* (1958) 163 C.A.2d 384, 329 P.2d 599. Plaintiff wife (daughter of defendant) and her husband agreed to make necessary improvements on defendant's ranch property, on defendant's agreement to share its use during her lifetime and leave it to them on her death. Plaintiffs made extensive and valuable improvements probably exceeding the value of the property, but thereafter defendant repudiated and announced her intention to sell. *Held*, on this showing, plaintiffs were entitled to enforce a constructive trust. The court declared that *Trout v. Ogilvie*, *supra*, was no longer controlling in view of the repeal of former C.C. 1741 (part performance mentioned only in connection with contracts for the sale of land) and thought that *Monarco v. Lo Greco* (1950) 35 C.2d 621, 220 P.2d 737 (*infra*, §408), an estoppel case, justified application of the part performance rule to an oral contract not to be performed in the lifetime of the promisor. (163 C.A.2d 390.) (See *Estate of Rivolo* (1961) 194 C.A.2d 773, 777, 15 C.R. 268 [contract to adopt or a contract of inheritance]; *MacMorris Sales Corp. v. Kozak* (1968) 263 C.A.2d 430, 442, 69 C.R. 719 [agreement not to be performed within 1 year].)

West's Key Number Digest, Frauds, Statute of, k.144

SUPPLEMENT: [This section is current through the latest supplement]



148 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
VIII. STATUTE OF FRAUDS
E. Where the Statute Does Not Apply.
2. Part Performance: Transfer of Land.
b. What Constitutes Part Performance.
1. In General.

1 Witkin Sum. Cal. Law Contracts § 403

[§ 403] In General.

The typical part performance consists in taking possession or making substantial improvements on the property. And the general condition has been laid down that the acts of part performance must clearly appear to be related to and in pursuance of the agreement sought to be enforced. (*Foster v. Maginnis* (1891) 89 C. 264, 266, 26 P. 828; *Paul v. Layne & Bowler Corp.* (1937) 9 C.2d 561, 564, 71 P.2d 817 [taking possession not under an existing oral lease, but in reliance on alleged oral agreement to execute a lease, held insufficient]; *Johnson v. Servaes* (1962) 210 C.A.2d 392, 398, 26 C.R. 733; *Hall v. Hall* (1990) 222 C.A.3d 578, 586, 271 C.R. 773, supra, §399, citing the text; see analysis and criticism of this theory, 4 Corbin (Rev. ed.), §18.7; 10 Williston 4th, §28:3 et seq.; 64 Harv. L. Rev. 1381; 5 Hastings L. J. 258; 3 Stanf. L. Rev. 285; and see 73 Am.Jur.2d (2001 ed.), *Statute of Frauds* §319 et seq.; 80 A.L.R.2d 425 [doctrine with respect to renewal option in lease]; 63 Proof of Facts 3d 105 [part performance of oral land contract].)

In *Sutton v. Warner* (1993) 12 C.A.4th 415, 15 C.R.2d 632, defendants, who had inherited a one-third interest in a residence, desired to buy out the other heirs. Being unable to afford the required loan, defendants sought assistance from plaintiffs, their friends to whom they rented the property for \$ 1,000 per month beginning in October 1983. Approximately 3 months later, the parties entered into a lease-option agreement under which plaintiffs, after making a downpayment of \$ 15,000 on the purchase price of \$ 185,000, were given 5 years to purchase the property, beginning on the date that defendants obtained the loan necessary to buy out the other heirs. Plaintiffs also agreed to make all mortgage payments and real estate tax payments. In reliance on this oral agreement, plaintiffs made a number of improvements to the property. Once defendants obtained the loan, plaintiffs' monthly payments increased to \$ 1,881 per month, the full amount of the new loan's monthly mortgage payment. In 1988, when the value of the property had increased considerably, defendants offered to sell it to plaintiffs for \$ 250,000, and plaintiffs sought specific enforcement of the oral agreement giving them 5 years in which to make the purchase for \$ 185,000. *Held*, judgment for plaintiffs affirmed; plaintiffs' partial performance was sufficient to remove the bar of the statute of frauds.

(a) Defendants argued that plaintiffs could not demonstrate adequate part performance because they never entered possession *under* the oral agreement, but instead originally took possession as tenants and merely continued in possession after the making of the agreement. This position is without merit. Although the possession must be actual, visible, notorious, and exclusive, a *transfer* of possession is not always necessary to support part performance. Instead,

continued possession may be sufficient where there are additional acts or peculiar circumstances that sufficiently refer the possession to the oral contract. (12 C.A.4th 423, citing the text.)

(b) Here, *after* entering into the oral agreement, plaintiffs made a \$ 15,000 downpayment and increased their monthly payment to cover the mortgage payments due under defendants' loan. They also reimbursed defendants for property taxes in the sum of \$ 800 every 6 months. And, although it was disputed whether the dollar value of improvements made by plaintiffs in reliance on the oral agreement was "substantial," it was undisputed that many of the improvements, such as painting the interior of the house and installing a toilet and entry lamp, were done by plaintiffs' own labor. The trial judge's determination that these actions were unequivocally related to the oral purchase agreement cannot be disturbed on appeal. (12 C.A.4th 423.)

(c) Although defendants contested the time at which the option to purchase expired, they did not dispute the existence of the option. Hence, the aforementioned actions taken by plaintiffs in reliance on the oral agreement, when considered together with defendants' admission that there was an oral agreement of some duration, satisfy both elements of the part performance doctrine, i.e., evidence of the existence of the oral contract on the terms found by the trial judge and reliance by plaintiffs on that contract warranting specific performance relief. (12 C.A.4th 424.)

SUPPLEMENT: [This section is current through the latest supplement]



149 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VIII. STATUTE OF FRAUDS
E. Where the Statute Does Not Apply.
2. Part Performance: Transfer of Land.
b. What Constitutes Part Performance.
2. Sufficiency of Possession.

1 Witkin Sum. Cal. Law Contracts § 404

[§ 404] Sufficiency of Possession.

(1) *View That Possession Alone Is Insufficient.* The First Restatement of Contracts took the position that, where possession is the basis, there must also be at least part payment of the purchase price. A number of jurisdictions similarly require something in addition to possession, e.g., part payment, improvements, or a rendition of services. (See 4 Corbin (Rev. ed.), §18.14; 10 Williston 4th, §28:5; 73 *Am.Jur.2d* (2001 ed.), *Statute of Frauds* §327; for the Second Restatement position, see *infra*, §405.)

(2) *California View.* Possession alone is sufficient in other jurisdictions, including California. (See *Calanchini v. Branstetter* (1890) 84 C. 249, 253, 24 P. 149; *Meridian Oil Co. v. Dunham* (1907) 5 C.A. 367, 369, 90 P. 469; *Haskell v. First Nat. Bank* (1939) 33 C.A.2d 399, 402, 91 P.2d 934 [oral trust in land enforceable where beneficiary enters into possession with consent of trustee]; *Engasser v. Jones* (1948) 88 C.A.2d 171, 176, 198 P.2d 546 [taking possession of house, furnishing it, making arrangements for purchase of water rights; held sufficient]; 73 *Am.Jur.2d* (2001 ed.), *Statute of Frauds* §327; 19 *Cal. L. Rev.* 78; 3 *Stanf. L. Rev.* 286.)

The possession must, however, be actual, open, and notorious. In *Wood v. Anderson* (1926) 199 C. 440, 249 P. 862, the purchaser brought a few loads of gravel on the land, planted some trees, and claimed it as his own before third persons, but did not seek to have the property reassessed in his name, and paid neither purchase price nor taxes. *Held*, the acts were not sufficient to justify specific performance. (199 C. 445.) A similar result was reached in *Hambey v. Wise* (1919) 181 C. 286, 290, 184 P. 9, where the vendor, with a tenant at will on the land, orally agreed to sell, and the purchaser never took actual possession but merely made a lease to the vendor's old tenant.

Taking possession or making improvements without the knowledge or consent of the vendor is also insufficient. (*Wolfsen v. Hathaway* (1948) 32 C.2d 632, 642, 198 P.2d 1 [oral lease for more than a year]; *Stark v. Byington* (1937) 21 C.A.2d 642, 648, 69 P.2d 995.) Payment of even the whole of the purchase price is not ground for relief in equity, for the remedy at law is adequate. (*Woerner v. Woerner* (1915) 171 C. 298, 300, 152 P. 919; *Forbes v. Los Angeles* (1929) 101 C.A. 781, 788, 282 P. 528.) And neither marriage alone, nor marriage and personal services rendered by the wife, will satisfy the requirement. (*Trout v. Ogilvie* (1919) 41 C.A. 167, 171, 182 P. 333; *Stevenson v. Pantaleone* (1933) 131 C.A. 401, 404, 21 P.2d 703.)

West's Key Number Digest, Frauds, Statute of, k.144

SUPPLEMENT: [This section is current through the latest supplement]



150 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VIII. STATUTE OF FRAUDS
E. Where the Statute Does Not Apply.
2. Part Performance: Transfer of Land.
b. What Constitutes Part Performance.
3. Restatement 2d.

1 Witkin Sum. Cal. Law Contracts § 405

[§ 405] Restatement 2d.

Under *Rest.2d, Contracts §129*, restating the part performance doctrine, it is sufficient to show that the party seeking enforcement, "in reasonable reliance on the contract and on the continuing assent of the party against whom enforcement is sought, has so changed his position that injustice can be avoided only by specific enforcement." The Reporter's Note states that the former section was entirely rewritten "to accord with the overwhelming weight of American authority" that the part performance doctrine rests on estoppel and virtual fraud, rather than on ideas of livery of seisin or on evidentiary considerations.

Comment d adds: "Where specific enforcement is rested on a transfer of possession plus either part payment of the price or the making of improvements, it is commonly said that the action taken by the purchaser must be unequivocally referable to the oral agreement. But this requirement is not insisted on if the making of the promise is admitted or is clearly proved. The promisee must act in reasonable reliance on the promise, before the promisor has repudiated it, and the action must be such that the remedy of restitution is inadequate. If these requirements are met, neither taking of possession nor payment of money nor the making of improvements is essential. Thus, the rendering of peculiar services not readily compensable in money may justify specific performance, particularly if the promisee has also taken other action in reliance on the promise."

SUPPLEMENT: [This section is current through the latest supplement]



151 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
 Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
 VIII. STATUTE OF FRAUDS
 E. Where the Statute Does Not Apply.
 3. Estoppel To Plead Statute.
 a. In General.
 1. Theory of Exception.

1 Witkin Sum. Cal. Law Contracts § 406

[§ 406] Theory of Exception.

Where the defendant by his or her words or conduct represents that he or she proposes to stand by the oral contract, and the plaintiff, in reliance thereon, changes his or her position, the defendant will be *estopped* to set up the bar of the statute. This exception applies to any of the classes of contracts listed in the statute. (See generally *Seymour v. Oelrichs* (1909) 156 C. 782, 794, 106 P. 88; *Wilson v. Bailey* (1937) 8 C.2d 416, 421, 65 P.2d 770; *Grant v. Long* (1939) 33 C.A.2d 725, 740, 92 P.2d 940; *Nicolds v. Storch* (1944) 67 C.A.2d 8, 17, 153 P.2d 561; *Haumeder v. Lipsett* (1949) 90 C.A.2d 167, 175, 202 P.2d 819; *Associated Creditors' Agency v. Haley Land Co.* (1966) 239 C.A.2d 610, 617, 49 C.R. 1, citing the text; *Hall v. Hall* (1990) 222 C.A.3d 578, 587, 271 C.R. 773, supra, §399; *Byrne v. Laura* (1997) 52 C.A.4th 1054, 1068, 60 C.R.2d 908 [decendent's estate was estopped from asserting statute of frauds as defense to oral promise to support plaintiff, where plaintiff had changed her position in reliance on promise, even though change was made because of love for decedent and not merely because of desire for decedent's property]; *Sutherland v. Barclays Amer./Mortg. Corp.* (1997) 53 C.A.4th 299, 311, 61 C.R.2d 614, citing the text [borrower relied to her detriment on mortgagee's oral statement that she could postpone mortgage payments; mortgagee could not rely on absence of writing in order to declare borrower in default for missing payments]; *Estate of Housley* (1997) 56 C.A.4th 342, 352, 65 C.R.2d 628, 14 Summary (10th), *Wills and Probate*, §326, quoting the text; 4 Corbin (Rev. ed.), §12.8; 10 Williston 4th, §§27:13 et seq., 28:2; 37 Cal. L. Rev. 151; 53 Cal. L. Rev. 590; 5 Hastings L. J. 258; 35 McGeorge L. Rev. 319 [estoppel to avoid statute of frauds]; 27 So. Cal. L. Rev. 471; 3 Stanf. L. Rev. 288; 4 Stanf. L. Rev. 281, 288; 73 Am.Jur.2d, *Statute of Frauds* §468 et seq.; 54 A.L.R.3d 715 [employee's reliance on employment contract]; 56 A.L.R.3d 1037 [comment note--promissory fraud as basis of avoidance of statute of frauds]; 83 A.L.R.3d 1294 [oral gift of land].)

In *Seymour*, plaintiff was orally offered a 10-year contract as overseer of property of defendants, which he accepted with the understanding that the contract was to be reduced to writing. He thereupon gave up his former position, and went to work for defendants. The contract was never put in writing, but plaintiff performed, and received the specified salary for several years, when he was discharged. *Held*, the circumstances were such as to estop defendants from pleading the statute. The court declared that it was unnecessary to show an *antecedent fraud*, i.e., an intent to defraud at the time the contract was made; the estoppel arises, irrespective of any fraudulent intent, if the effect of setting up the statute would be to perpetrate a fraud. (156 C. 794.) (See 3 Stanf. L. Rev. 291.)

It should be noted that *part performance* in this class of cases has no effect; the rights of the defrauded party are based upon his or her change of position in reliance upon the representations. Hence, the rights of plaintiff in *Seymour* arose when he left his former position. (See *Fleming v. Dolfin* (1931) 214 C. 269, 270, 4 P.2d 776; *Kraft v. Rooke* (1930) 103 C.A. 552, 555, 284 P. 935; 19 Cal. L. Rev. 80; 20 Cal. L. Rev. 663.)

In *Klein v. Farmer* (1948) 85 C.A.2d 545, 194 P.2d 106, decedent delivered shares of stock to defendant, stating that, if defendant would care for him during his life, she could have the shares, but that if she left him she must return them. Defendant cared for decedent for 7 years until he died. His administrator sued to quiet title to the stock. *Held*, the doctrine of *Seymour* applied and decedent was not entitled to recover the stock. (85 C.A.2d 551.) The result reached is sound, but there seems little reason to invoke the doctrine of estoppel, for (a) the agreement was wholly executed (stock delivered, services performed), and (b) the administrator was improperly trying to use the statute of frauds as a basis of affirmative attack. (See *supra*, §§345, 401.)

SUPPLEMENT: [This section is current through the latest supplement]



152 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VIII. STATUTE OF FRAUDS
E. Where the Statute Does Not Apply.
3. Estoppel To Plead Statute.
a. In General.
2. Restatement 2d: Promissory Estoppel.

1 Witkin Sum. Cal. Law Contracts § 407

[§ 407] Restatement 2d: Promissory Estoppel.

(1) *Doctrine Applied to Statute of Frauds.* Section 90 of the First Restatement makes promissory estoppel a substitute for *consideration*. (See *supra*, §244.) Section 139 of the Second Restatement states the same rule for the statute of frauds, applying it also to promises supported by consideration:

(a) "A promise which the promisor should reasonably expect to induce action or forbearance on the part of the promisee or a third person and which does induce the action or forbearance is enforceable notwithstanding the Statute of Frauds if injustice can be avoided only by enforcement of the promise. The remedy granted for breach is to be limited as justice requires." (See *Munoz v. Kaiser Steel Corp. (1984) 156 C.A.3d 965, 974, 203 C.R. 345* ["we interpret the prerequisite in section 139 that 'injustice can be avoided only by enforcement of the promise' as meaning essentially the same thing substantively as the cited California authorities mean by their requirement of unjust enrichment to the defendant or unconscionable injury to the plaintiff"]; *66 Cal. L. Rev. 1219* [argument that California should accept Rest.2d view]; *29 A.L.R.4th 1006* [promissory estoppel as basis for avoiding Unif.Com.C. 2-201].)

(2) *Relevant Factors.* Rest.2d, Contracts §139(2) reads as follows:

"In determining whether injustice can be avoided only by enforcement of the promise, the following circumstances are significant:"

"(a) the availability and adequacy of other remedies, particularly cancellation and restitution;"

"(b) the definite and substantial character of the action or forbearance in relation to the remedy sought;"

"(c) the extent to which the action or forbearance corroborates evidence of the making and terms of the promise, or the making and terms are otherwise established by clear and convincing evidence;"

"(d) the reasonableness of the action or forbearance;"

"(e) the extent to which the action or forbearance was foreseeable by the promisor."

Comment b observes that, like §90, §139 states a flexible principle, but the requirement of consideration is more easily displaced than the requirement of a writing. "Each factor relates either to the extent to which reliance furnishes a compelling substantive basis for relief in addition to the expectations created by the promise or to the extent to which the circumstances satisfy the evidentiary purpose of the Statute and fulfill any cautionary, deterrent and channeling functions it may serve."

SUPPLEMENT: [This section is current through the latest supplement]



153 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
VIII. STATUTE OF FRAUDS
E. Where the Statute Does Not Apply.
3. Estoppel To Plead Statute.
b. Conduct of Defendant.
1. In General.

1 Witkin Sum. Cal. Law Contracts § 408

[§ 408] In General.

Earlier cases took the strict view that *the mere omission to put the contract in writing* is not sufficient to create the estoppel, and that the conduct of the defendant must amount to a *representation* that the statute will not be relied upon. (*Seymour v. Oelrichs* (1909) 156 C. 782, 797, 106 P. 88; *Zellner v. Wassman* (1920) 184 C. 80, 87, 193 P. 84; *Stowe v. Fay Fruit Co.* (1928) 90 C.A. 421, 426, 265 P. 1042; *Albany Peanut Co. v. Euclid Candy Co. of Calif.* (1938) 30 C.A.2d 35, 38, 85 P.2d 471 [holding that reliance and intention to change position must have been known to other party]; *Sackett v. Starr* (1949) 95 C.A.2d 128, 135, 212 P.2d 535 [same].)

The following cases illustrate the type of conduct held sufficient to constitute the required "representation." In *Berkey v. Halm* (1950) 101 C.A.2d 62, 224 P.2d 885, the allegations held sufficient to take the case out of the bar of the statute were that defendants repeatedly promised that the contract would be reduced to writing and executed by them. (101 C.A.2d 68.) In *Moore v. Day* (1954) 123 C.A.2d 134, 266 P.2d 51, the estoppel arose where defendant buyer repeatedly represented that he would perform the oral agreement, in reliance upon which plaintiffs refrained from selling the goods to others. (123 C.A.2d 138.) And in *Pruitt v. Fontana* (1956) 143 C.A.2d 675, 300 P.2d 371, an action for breach of contract to sell realty, the representation of intention to stand on the oral contract was implied from defendant's deposit of a deed in escrow. (143 C.A.2d 688.)

Later decisions in California hold that the representation by the defendant is not essential. They interpret the earlier cases refusing to find an estoppel in the absence of a representation as holding that no unconscionable injury would result or that the remedy of quantum meruit for services was adequate.

In *Monarco v. Lo Greco* (1950) 35 C.2d 621, 220 P.2d 737, the court, after exhaustively reviewing the cases, declared that "where either an unconscionable injury or unjust enrichment would result from refusal to enforce the contract, the doctrine of estoppel has been applied whether or not plaintiff relied upon representations going to the requirements of the statute itself." (35 C.2d 625.) And the opinion added this rationalization: "In reality it is not the representation that the contract will be put in writing or that the statute will not be invoked, but the promise that the contract will be performed that a party relies upon when he changes his position because of it. Moreover, a party who has accepted the benefits of an oral contract will be unjustly enriched if the contract is not enforced whether his

representations related to the requirements of the statute or were limited to affirmations that the contract would be performed." (35 C.2d 626.) (See *Berkey v. Halm*, *supra*, 101 C.A.2d 67; *Goldstein v. McNeil* (1954) 122 C.A.2d 608, 611, 265 P.2d 113; *Kerner v. Hughes Tool Co.* (1976) 56 C.A.3d 924, 934, 128 C.R. 839 [estoppel to set up defense of equal dignities rule, *supra*, §388]; 53 Cal. L. Rev. 590; 3 Stanf. L. Rev. 294, 297; *infra*, §409 et seq.)

West's Key Number Digest, Frauds, Statute of, k.144

SUPPLEMENT: [This section is current through the latest supplement]



154 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law

VIII. STATUTE OF FRAUDS

E. Where the Statute Does Not Apply.

3. Estoppel To Plead Statute.

b. Conduct of Defendant.

2. Change of Position and Unjust Enrichment.

aa. In General.

1 Witkin Sum. Cal. Law Contracts § 409

[§ 409] In General.

(1) *Modern Rule.* The oral agreement will be held binding, regardless of the absence of any representation by the defendant, if (a) the plaintiff, in reliance upon it, has so changed his or her position that unconscionable injury would be suffered, or (b) the defendant, having accepted the benefits of the oral contract, would be unjustly enriched by nonenforcement. Although the plaintiff's change of position could take place without the defendant being unjustly enriched, and vice versa, both elements are so frequently present that the same decisions may be cited on both theories. (See generally *Monarco v. Lo Greco* (1950) 35 C.2d 621, 623, 220 P.2d 737; *Phillippe v. Shapell Industries* (1987) 43 C.3d 1247, 1262, 241 C.R. 22, 743 P.2d 1279, *infra*, §414; *Berkey v. Halm* (1950) 101 C.A.2d 62, 67, 224 P.2d 885; *Hall v. Hall* (1990) 222 C.A.3d 578, 585, 271 C.R. 773, *supra*, §399, citing the text; *Estate of Housley* (1997) 56 C.A.4th 342, 352, 65 C.R.2d 628, 14 Summary (10th), *Wills and Probate*, §326, quoting the text; 3 *Stanf. L. Rev.* 281, 289.)

If none of the three elements (representation, change of position, or unjust enrichment) is established, there is no basis for an estoppel. Nor will equity give specific performance of the agreement where the remedy at law is adequate. (See discussion, *Monarco v. Lo Greco*, *supra*, 35 C.2d 625; *Pacific Southwest Dev. Corp. v. Western Pac. R. Co.* (1956) 47 C.2d 62, 70, 301 P.2d 825.)

(2) *Illustrations: Agreement To Leave Property by Will.* Many of the estoppel cases involve the former statute of frauds provision on an agreement to leave property by will. Although this provision was eliminated in 1983 (see *supra*, §371), the cases may still be useful as illustration of conduct by the defendant and reliance by the plaintiff that may give rise to an estoppel. (See *Notten v. Mensing* (1935) 3 C.2d 469, 474, 45 P.2d 198; *Day v. Greene* (1963) 59 C.2d 404, 410, 29 C.R. 785, 380 P.2d 385; *Redke v. Silvertrust* (1971) 6 C.3d 94, 101, 98 C.R. 293, 490 P.2d 805; *Crail v. Blakely* (1973) 8 C.3d 744, 752, 106 C.R. 187, 505 P.2d 1027; *Juran v. Epstein* (1994) 23 C.A.4th 882, 891, 28 C.R.2d 588 [enactment of *Prob.C. 150(a)* (replaced by *Prob.C. 21700(a)*), specifying sole means of establishing contract to make, or not to revoke, a will, did not abolish doctrine of equitable estoppel]; *Estate of Brenzikofer* (1996) 49 C.A.4th 1461, 1466, 57 C.R.2d 401; *Estate of Housley*, *supra*, 56 C.A.4th 352, [following *Juran*, *supra*, and holding that equitable estoppel doctrine is applicable even when alleged promisor is dead]; 53 *Cal. L. Rev.* 590; 8 *Pepperdine L. Rev.* 41; 39 *Santa Clara L. Rev.* 1187 [California Oral Will Contracts: The Decline of Testator Intent in the Shadow of Equitable

Estoppel].)

SUPPLEMENT: [This section is current through the latest supplement]



155 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

VIII. STATUTE OF FRAUDS

E. Where the Statute Does Not Apply.

3. Estoppel To Plead Statute.

b. Conduct of Defendant.

2. Change of Position and Unjust Enrichment.

bb. Real Estate Broker's Authorization.

1 Witkin Sum. Cal. Law Contracts § 410

[§ 410] Real Estate Broker's Authorization.

In *Owens v. Foundation for Ocean Research* (1980) 107 C.A.3d 179, 165 C.R. 571, the court pointed out that brokers, who are versed in real estate law, are presumed to know that listing agreements are unenforceable unless written, and that ordinarily a broker's reliance on the seller's oral promise to stand on the agreement or put it in writing is not a sufficient change of position to raise an estoppel. (107 C.A.3d 183.)

This case, however, was unique: Plaintiff alleged that he orally agreed to act as defendant's broker in selling a tract of land and that he had been assured by defendant's attorney that the agreement had been reduced to writing and adopted in resolution form by the board of directors. *Held*, reliance on the representation was reasonable and the estoppel rule applied. "Since such representations would lead one to believe that contract complies with the statute of frauds, a broker's reliance may be reasonable even presuming his familiarity with the law. ... To hold otherwise would suggest a broker cannot trust *anything* the seller says. This is impractical in everyday business transactions which often depend upon the personal integrity of the parties. The statute of frauds should not necessarily require a broker's insistence on seeing the actual written contract before doing any work." (107 C.A.3d 183.)

SUPPLEMENT: [This section is current through the latest supplement]



156 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

VIII. STATUTE OF FRAUDS

E. Where the Statute Does Not Apply.

3. Estoppel To Plead Statute.

b. Conduct of Defendant.

2. Change of Position and Unjust Enrichment.

cc. Finder's Agreement.

1 Witkin Sum. Cal. Law Contracts § 411

[§ 411] Finder's Agreement.

In *Tenzer v. Superscope* (1985) 39 C.3d 18, 216 C.R. 130, 702 P.2d 212, plaintiff, a director of defendant corporation, alleged that T, its president, promised to pay him a 10% finder's fee if he would procure a buyer for the corporation's real property, that he found the buyer and the purchase was made, but that defendant refused to pay the fee. *Held*, the complaint stated a cause of action.

(a) Under the pleaded facts T, as agent of defendant, promised to pay plaintiff for valuable information that could have been sold elsewhere; plaintiff, in reliance on this promise, disclosed the identity of the buyer whom he had found; and defendant, having profited from plaintiff's performance, refused to perform its obligation. Assuming that plaintiff could show that, despite his fiduciary obligation as a director, he was not obligated to reveal the information without compensation (see 9 *Summary* (10th), *Corporations*, §90 et seq.), defendant would be unjustly enriched by retaining the benefits of the information without paying for it. (39 C.3d 27, 28.)

(b) Defendant's argument that an estoppel cannot be based on a refusal to pay a real estate commission is unsound: The cases so holding involved licensed real estate brokers, and the decisions were related to the statutory licensing requirements. (39 C.3d 27, 28, citing *Keely v. Price* (1972) 27 C.A.3d 209, 103 P.2d 531, *infra*, §414.) There is no reason to extend this rule to finders who need not be licensed brokers or even be involved professionally in the real estate business. (39 C.3d 28.)

West's Key Number Digest, Frauds, Statute of, k.144

SUPPLEMENT: [This section is current through the latest supplement]



157 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

VIII. STATUTE OF FRAUDS

E. Where the Statute Does Not Apply.

3. Estoppel To Plead Statute.

b. Conduct of Defendant.

2. Change of Position and Unjust Enrichment.

dd. Other Situations.

1 Witkin Sum. Cal. Law Contracts § 412

[§ 412] Other Situations.

A number of cases apply the estoppel doctrine where (1) an oral lease is made for more than a year, (2) the lessor represents expressly or by conduct that he or she will not rely on the statute of frauds, and (3) thereafter, the lessee changes position by going into possession and making valuable improvements on the leased property. (*Beverly Hills Nat. Bank & Trust Co. v. Seres* (1946) 76 C.A.2d 255, 261, 172 P.2d 894; *Frey v. Corbin* (1948) 84 C.A.2d 536, 540, 191 P.2d 21; *Kaye v. Melzer* (1948) 87 C.A.2d 299, 305, 197 P.2d 50; *Hall v. Hall* (1990) 222 C.A.3d 578, 271 C.R. 773, *supra*, §399.) (For other cases in which estoppel defense was applied, see *Green v. Brown* (1951) 37 C.2d 391, 399, 232 P.2d 487 [making expenditures and improvements in reliance on oral gift of right to occupy property]; *Goble v. Dotson* (1962) 203 C.A.2d 272, 278, 21 C.R. 769 [dictum: contract to sell land, with oral agreement that purchasers would get boat berthing rights in nearby lagoon; payment of price in reliance thereon]; *Mosekian v. Davis Canning Co.* (1964) 229 C.A.2d 118, 123, 40 C.R. 157 [defendant's agent represented to plaintiff peach grower that written contract would be prepared and that picking would soon begin for canning; plaintiff held his crop until too late to harvest it for fresh fruit packing]; *Sloan v. Hiatt* (1966) 245 C.A.2d 926, 933, 54 C.R. 351 [entry of logger on land in reliance on contract to sell standing timber]; *Dallman Co. v. Southern Heater Co.* (1968) 262 C.A.2d 582, 589, 68 C.R. 873, citing the text [plaintiff changed position in reliance on defendant's promise to provide and service heaters].)

In *Wilk v. Vencill* (1947) 30 C.2d 104, 180 P.2d 351, plaintiff purchaser sought to buy a residence held by defendants, husband and wife, in joint tenancy. The husband signed the agreement, and the wife stated that she approved of it and would sign, but wished to defer execution until she and her husband had completed arrangements for property settlement. Plaintiff, in reliance on these representations, gave up an opportunity to purchase another home. *Held*, plaintiff had sufficiently changed his position, and defendants were estopped to raise the defense of the statute. (30 C.2d 107.) (See 3 *Stanf. L. Rev.* 289.)

In *Irving Tier Co. v. Griffin* (1966) 244 C.A.2d 852, 53 C.R. 469, plaintiff sold hospital equipment to defendants under oral contracts. Defendants repudiated, never taking any goods, so unjust enrichment could not be shown. But unconscionable injury was established by evidence that some items were custom made for defendants' place of business and had no ready resale market. (244 C.A.2d 865.) (See U.C.C. 2201(3)(a), *supra*, §381 [statutory exception for

nonresalable goods].)

In *Carlson v. Richardson* (1968) 267 C.A.2d 204, 72 C.R. 769, plaintiffs alleged that defendant orally agreed to sell them a tract of land; that in reliance on the promise for the next 3 years, they passed up opportunities to buy other land, which thereafter became more expensive; and that they bought nearby land to serve as temporary quarters while they built their home. *Held*, the complaint was good. Although neither the loss of opportunities to buy other land nor the rise in values was sufficient to raise the estoppel, the purchase of the other land for temporary quarters was a serious change of position. (267 C.A.2d 208.)

A remarkable extension of the estoppel doctrine was made in *Goldstein v. McNeil* (1954) 122 C.A.2d 608, 265 P.2d 113. Plaintiff, a used car dealer in Los Angeles, orally agreed to sell 14 used cars for \$ 29,450 to defendant dealers in San Francisco, f.o.b. Shreveport, Louisiana, defendants to pay caravan expenses and caravan permit costs. Plaintiff brought the cars out from Louisiana, but defendants refused to accept them. Plaintiff resold them for \$ 26,400 and sued for the deficiency plus expenses of the sale, \$ 3,865.22. *Held*, judgment for plaintiff affirmed.

The court recognized that ordinarily the buyer's refusal to accept goods cannot give rise to an estoppel, but held that the trial court had "discretion" to determine the "question of fact." The circumstance thought sufficient to raise the estoppel was that plaintiff would not have brought the cars to California without a purchaser, and, because of such performance, plaintiff missed a high market at the time of contracting, and was caught in a sharp slump in demand and market price. (122 C.A.2d 612.) (See criticism, 53 Cal. L. Rev. 605; 27 So. Cal. L. Rev. 471.)

In *Allied Grape Growers v. Bronco Wine Co.* (1988) 203 C.A.3d 432, 249 C.R. 872, involving an oral contract for the delivery of 850 tons of Carnelian grapes, defendant accepted and paid for one load, but rejected the rest. There was evidence that plaintiff had originally contracted to sell the grapes to a third party, but had received permission to sell them to defendant instead, and that given bad weather conditions, the highly perishable nature of the grapes, and defendant's last-minute scheduling changes, it was too late for plaintiff to resell the grapes to the third party or to any other party. *Held*, plaintiff had so changed its position in reliance on the oral contract that it would suffer unconscionable injury were enforcement barred by the statute of frauds. (203 C.A.3d 445.)

SUPPLEMENT: [This section is current through the latest supplement]



158 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VIII. STATUTE OF FRAUDS
E. Where the Statute Does Not Apply.
3. Estoppel To Plead Statute.
c. Where Recovery Will Be Denied.
1. No Substantial Change of Position.
aa. In General.

1 *Witkin Sum. Cal. Law Contracts* § 413

[§ 413] In General.

In *Ruinello v. Murray* (1951) 36 C.2d 687, 227 P.2d 251, plaintiff merely alleged that he gave up a "permanent life-time position" in reliance upon defendant's oral promise to employ him for 5 years. (See 4 Cal. Proc. (4th), Pleading, §485.) *Held*, no unconscionable injury was shown. The former position was for an indefinite period terminable at will, and "[t]he leaving of such employment for employment with defendant that is also terminable at the will of either party ... does not result in unconscionable injury." (36 C.2d 690.) (On increased job security protection now accorded at-will employments, see 3 *Summary* (10th), *Agency and Employment*, §231 et seq.)

In *Munoz v. Kaiser Steel Corp.* (1984) 156 C.A.3d 965, 203 C.R. 345, plaintiff entered into an oral employment contract in Highland, California, for a minimum of 3 years, and brought this action for breach. However, contrary to an allegation in his pleading, he did not relinquish an existing employment to accept the job with defendant; he was unemployed at the time, having lost two jobs within a period of 6 months in Texas, and he wanted to come to the area where his close relatives lived. He sold his house in Texas, but bought a comparable house in Highland for approximately the same price for which the Texas house was sold. *Held*, these facts were insufficient to establish an estoppel. (156 C.A.3d 972, 973, 974.) (For other illustrations of no substantial change of position, see *Bogan v. Wiley* (1946) 72 C.A.2d 533, 538, 164 P.2d 912 [oral agreement to leave by will one-half interest in furniture business; no evidence that plaintiff's rejection of another employment opportunity was due to this promise]; *Bonnear v. Bank of America* (1948) 84 C.A.2d 107, 114, 190 P.2d 307 [money payments, being less than husband was bound to make under property settlement, were not sufficient change of position to take case out of statute of frauds]; *Shive v. Barrow* (1948) 88 C.A.2d 838, 843, 199 P.2d 693 [neither payment of money, even though in full amount, nor rendering of services that formed consideration is sufficient part performance to take oral agreement out of statute of frauds]; *Parker v. Solomon* (1959) 171 C.A.2d 125, 133, 340 P.2d 353, 5 Cal. Proc. (4th), Pleading, §744 [agreement by daughter to refrain from asserting any claim against her father and "to remain out of his life" in return for father's oral promise to transfer to her one-half of his estate; no allegations of unconscionable injury or unjust enrichment]; *Fallon v. American Trust Co.* (1959) 176 C.A.2d 381, 384, 1 C.R. 386 [oral agreement to devise part of estate to plaintiff if she would forbear from suing for divorce, even though she was entitled to divorce, was within statute of frauds, where estate

consisted entirely of separate property]; *Isaac v. A & B Loan Co. (1988) 201 C.A.3d 307, 312, 247 C.R. 104* [no unconscionable injury where plaintiff buyers' downpayment was returned with interest].)

SUPPLEMENT: [This section is current through the latest supplement]

Cross-Reference: 4 *Cal. Proc. (5th), Pleading*, §524.

Parker case:

Cross-Reference: 5 *Cal. Proc. (5th), Pleading*, §789.



159 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VIII. STATUTE OF FRAUDS
E. Where the Statute Does Not Apply.
3. Estoppel To Plead Statute.
c. Where Recovery Will Be Denied.
1. No Substantial Change of Position.
bb. Real Estate Broker's Authorization.

1 *Witkin Sum. Cal. Law Contracts* § 414

[§ 414] Real Estate Broker's Authorization.

In *Keely v. Price* (1972) 27 C.A.3d 209, 103 P.2d 531, plaintiff broker released the seller of realty from his oral promise to pay plaintiff's commission, in reliance on the buyer's *oral promise* to pay the commission. *Held*, because plaintiff did not give up an enforceable right in reliance on the buyer's oral promise to pay, the defense of estoppel was not available to avoid operation of the statute of frauds. (27 C.A.3d 212.)

The *Keely* court implied that if the plaintiff had released the other party from an *enforceable, written* contact, the estoppel defense would have been available. This principle had been applied in *Le Blond v. Wolfe* (1948) 83 C.A.2d 282, 188 P.2d 278, but *Le Blond* was disapproved in *Phillippe v. Shapell Industries* (1987) 43 C.3d 1247, 1262, 241 C.R. 22, 743 P.2d 1279, where the court stated that "a licensed real estate broker or sales person cannot assert equitable estoppel against a statute of frauds defense to an oral commission agreement that is subject to *Civil Code* section 1624(d) unless there is a showing of *actual fraud* by the party to be charged under the invalid oral agreement." (43 C.3d 1264) (On C.C. 1624(d), now C.C. 1624(a)(4), see *supra*, §392 et seq.) The court made the following points:

(a) *No unconscionable injury to broker.*

(1) In order for a broker who relies on an oral commission agreement to suffer the unconscionable injury required by the equitable estoppel doctrine, his or her reliance must be reasonable. But a licensed broker is conclusively presumed to know of the statute of frauds, and any reliance on an oral agreement is unreasonable; i.e., the broker assumes the risk inherent in reliance. (43 C.3d 1262, citing *Pacific Southwest Dev. Corp. v. Western Pac. R. Co.* (1956) 47 C.2d 62, 301 P.2d 825, *supra*, §394.)

(2) *Tenzer v. Superscope* (1985) 39 C.3d 18, 216 C.R. 130, 702 P.2d 212, *supra*, §411, held that an *unlicensed* real estate finder was entitled to invoke equitable estoppel against a statute of frauds defense, but it carefully distinguished between unlicensed finders and licensed brokers. (43 C.3d 1260.) The distinction between licensed brokers and unlicensed finders is still valid. (43 C.3d 1261.)

(b) *Policy reasons for denying equitable estoppel to licensed broker.*

(1) C.C. 1624(d) (now C.C. 1624(a)(4)) is a durable and significant statute that should be modified only by the Legislature. However, the Legislature has demonstrated an increasing desire to provide consumers with the certainty and security of written contracts. (43 C.3d 1265.) And this statute, which can be characterized as perhaps the state's first consumer protection statute, is especially important in view of the significant role that the purchase or sale of real estate plays in the lives of most people. (43 C.3d 1266.) Hence, "we cannot conclude that section 1624(d) is a legislative anachronism that should be judicially swept away." (43 C.3d 1267.)

(2) Plaintiff argued that brokers, especially in the commercial real estate market, lack the bargaining power to obtain written contracts, and that C.C. 1624(d) should not be a valid defense in commercial transactions, because it is contrary to industry custom and practice. This argument fails on numerous grounds: (a) C.C. 1624(d) does not include an exception based on the relative bargaining power of the parties, and any such exception must be created by the Legislature. (43 C.3d 1267.) (b) Plaintiff introduced no evidence of an inequitable disparity between himself and defendant, and amicus curiae and the legal commentators cited no facts to support their criticism that the market place and the statute are in conflict. (43 C.3d 1268.) (c) Holding that the validity of a commission agreement depends on relative bargaining power would create great uncertainty, because the parties could not know at the time of entering into an oral agreement whether it would be enforceable. (43 C.3d 1268.) (d) Plaintiff's contention that written agreements are not often used in commercial real estate transactions is unsupported, and the only empirical study on the subject suggests that the business community prefers written agreements. (43 C.3d 1268.) However, even if the custom were as suggested by plaintiff, C.C. 1624(d), which unequivocally contains no exception for commercial transactions, would prevail over mere custom. (43 C.3d 1269.)

(c) *Licensed broker not left unprotected.* The broker's reliance on a representation that a written contract has *in fact been executed* may be reasonable, and may support an action for fraud or the assertion of equitable estoppel. (43 C.3d 1270.)

Two justices dissented. (See *Colburn v. Sessin* (1949) 94 C.A.2d 4, 7, 209 P.2d 989 [purchasers of realty who do not agree to pay broker's commission may not be held liable by reason of their purported connivance with sellers in frustrating broker's recovery of compensation for bringing parties together].)

SUPPLEMENT: [This section is current through the latest supplement]



160 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VIII. STATUTE OF FRAUDS
E. Where the Statute Does Not Apply.
3. Estoppel To Plead Statute.
c. Where Recovery Will Be Denied.
2. No Unjust Enrichment.

1 Witkin Sum. Cal. Law Contracts § 415

[§ 415] No Unjust Enrichment.

Where the plaintiff performs ordinary services and receives their reasonable value, the defendant is not unjustly enriched when he or she fails to render promised performance in addition thereto. (See *Ruinello v. Murray* (1951) 36 C.2d 687, 690, 227 P.2d 251; *Jirschik v. Farmers & Merchants Nat. Bank of Los Angeles* (1951) 107 C.A.2d 405, 406, 237 P.2d 49; *Andreotti v. Andreotti* (1964) 224 C.A.2d 533, 538, 36 C.R. 709 [claimed parol gift of real property followed by improvements; proof failed to show that monetary detriment suffered by donee exceeded benefit of use of land without rental charge].)

The fact that the principal does not pay for the broker's services under an unenforceable oral contract, even though the services were the procuring cause of the sale, does not, by itself, establish unjust enrichment sufficient to support equitable estoppel. To hold otherwise would conflict with the principle that brokers who have relied on invalid oral agreements are also prohibited from recovery in quantum meruit (see supra, §392). (*Phillippe v. Shapell Industries* (1987) 43 C.3d 1247, 1263, 241 C.R. 22, 743 P.2d 1279.) As pointed out in *Phillippe*: "If nonpayment is insufficient to allow recovery in quantum meruit, nonpayment is equally insufficient to support equitable estoppel on the ground of unjust enrichment." (43 C.3d 1264.)

West's Key Number Digest, Frauds, Statute of, k.144

SUPPLEMENT: [This section is current through the latest supplement]



161 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VIII. STATUTE OF FRAUDS
E. Where the Statute Does Not Apply.
3. Estoppel To Plead Statute.
c. Where Recovery Will Be Denied.
3. Contract Made by Agent.

1 Witkin Sum. Cal. Law Contracts § 416

[§ 416] Contract Made by Agent.

In *Monte Carlo Motors v. Volkswagenwerk, G.M.B.H.* (1960) 177 C.A.2d 107, 1 C.R. 920, L, agent of defendant German corporation manufacturing automobiles, offered a wholesale distributorship to plaintiff. He exhibited a printed form of agreement signed by defendant's general manager, with a blank for the name of the other party and a blank for his signature. An oral agreement was made, then repudiated by defendant corporation. Plaintiff sued for damages consisting of expenditures and efforts incurred in reliance on the oral agreement, unenforceable because not to be performed within a year. *Held*, judgment for defendant affirmed.

(a) An agent's representations cannot furnish the basis of reliance so as to raise an estoppel against his or her principal; some conduct of the principal must be shown. (177 C.A.2d 110.)

(b) If the principal entrusts an executed document with blanks to the agent, and the agent fills them in so that he or she delivers a completed instrument to the third party, and the latter relies on it without notice that the principal did not fill in the blanks, the principal will be held. (See 3 *Summary* (10th), *Agency and Employment*, §148.) But here the blank instrument was shown to plaintiff, who then knew that defendant principal did not fill them in; i.e., there was no act of the principal on which plaintiff could rely. (177 C.A.2d 111.)

(c) An additional reason why defendant was not estopped is that an agent's authority to contract in writing where the contract is within the statute of frauds must be in writing (the equal dignities rule, *supra*, §388). The California decisions applying this rule to filling in blanks are deed cases, but the principle is equally applicable here: A third party is on notice that the agent can fill in blanks only if his or her authority is in writing. (177 C.A.2d 112.)

In *McGirr v. Gulf Oil Corp.* (1974) 41 C.A.3d 246, 115 C.R. 902, the court, holding that the evidence did not support a claim of estoppel to set up the defense of the equal dignities rule, emphasized the necessity of showing some conduct of the principal: "It must be he who lulls the third person into believing that the agent has written authority or does not need it; it must be he who retains the benefits of the contract with knowledge of the circumstances." (41 C.A.3d 258.)

SUPPLEMENT: [This section is current through the latest supplement]



162 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
VIII. STATUTE OF FRAUDS
E. Where the Statute Does Not Apply.
4. Qualified Financial Contract.

1 Witkin Sum. Cal. Law Contracts § 417

[§ 417] Qualified Financial Contract.

(1) *In General.* Notwithstanding the invalidity under the statute of frauds of an agreement that by its terms is not to be performed within a year of its making (C.C. 1624(a)(1); supra, §363 et seq.), a qualified financial contract that is otherwise valid and enforceable is not invalid for lack of a note, memorandum, or other writing and is enforceable by way of action or defense, provided that (a) there is sufficient evidence to indicate that a contract has been made, or (b) the parties to the contract, by means of a prior or subsequent written contract, have agreed to be bound by the terms of the qualified financial contract from the time they reached agreement on those terms. (C.C. 1624(b)(1).)

(2) *"Qualified Financial Contract" Defined.* A "qualified financial contract" means any of the following agreements, each of the parties to which is not a natural person:

(a) For the purchase and sale of foreign exchange, foreign currency, bullion, coin or precious metals on a forward, spot, next-day value, or other basis. (C.C. 1624(b)(2)(A).)

(b) A contract (other than a contract for the purchase of a commodity for future delivery on, or subject to the rules of, a contract market, or board of trade) for the purchase, sale, or transfer of a commodity or a similar good, article, service, right, or interest that is presently or in the future becomes the subject of a dealing in the forward contract trade, or a product or byproduct thereof, with a maturity date more than 2 days after the date the contract is entered into. (C.C. 1624(b)(2)(B).)

(c) For the purchase and sale of currency, or interbank deposits denominated in United States dollars. (C.C. 1624(b)(2)(C).)

(d) For a currency option, currency swap, or cross-currency rate swap. (C.C. 1624(b)(2)(D).)

(e) For a commodity swap or a commodity option (other than an option contract traded on, or subject to the rules of, a contract market or board of trade). (C.C. 1624(b)(2)(E).)

(f) For a rate swap, basis swap, forward rate transaction, or an interest rate option. (C.C. 1624(b)(2)(F).)

(g) For a security-index swap or option, or a security or securities price swap or option. (C.C. 1624(b)(2)(G).)

(h) An agreement that involves another similar transaction relating to a price or index (including, without limitation, a transaction or agreement involving a combination of the foregoing, any cap, floor, collar, or similar transaction with respect to a rate, commodity price, commodity index, security or securities price, security index, other price index, or loan price). (C.C. 1624(b)(2)(H).)

(i) An option with respect to any of the foregoing. (C.C. 1624(b)(2)(I).)

(3) *Evidence of Existence of Contract*. There is sufficient evidence that a contract has been made in any of the following circumstances:

(a) There is evidence of an electronic communication (including, without limitation, the recording of a telephone call or the tangible written text produced by computer retrieval), admissible in evidence under California law, sufficient to indicate that in the communication a contract was made between the parties. (C.C. 1624(b)(3)(A).)

(b) A confirmation in writing sufficient to indicate that a contract has been made between the parties and sufficient against the sender is received by the party against whom enforcement is sought no later than the fifth business day after the contract is made (or another period of time agreed to in writing) and the sender does not receive, on or before the third business day after receipt (or the other period of time agreed to in writing), written objection to a material term of the confirmation. A confirmation or an objection thereto is received at the time there has been an actual receipt by an individual responsible for the transaction or, if earlier, at the time there has been constructive receipt, which is the time actual receipt by that individual would have occurred if the receiving party, as an organization, had exercised reasonable diligence. A "business day" is a day on which both parties are open and transacting business of the kind involved in the qualified financial contract that is the subject of confirmation. (C.C. 1624(b)(3)(B).)

(c) The party against whom enforcement is sought admits in its pleading, testimony, or otherwise in court that a contract was made. (C.C. 1624(b)(3)(C).)

(d) There is a note, memorandum, or other writing sufficient to indicate that a contract has been made, signed by the party against whom enforcement is sought or by its authorized agent or broker. (C.C. 1624(b)(3)(D).)

For purposes of these provisions, evidence of an electronic communication indicating the making in that communication of a contract, or a confirmation, admission, note, memorandum, or writing is not insufficient because it omits or incorrectly states one or more material terms agreed on, as long as the evidence provides a reasonable basis for concluding that a contract was made. (C.C. 1624(b)(3).)

(4) *Electronic Communication*. The tangible written text produced by the transmission of electronic signals constitutes a writing, and a symbol executed or adopted by a party with the present intention to authenticate a writing constitutes a signing. The confirmation and notice of objection referred to in C.C. 1624(b)(3)(B), supra, may be communicated by the transmission of electronic signals, provided that a party claiming to have communicated in that manner must, unless the parties have otherwise agreed in writing, have the burden of establishing actual or constructive receipt by the other party as set forth in C.C. 1624(b)(3)(B). (C.C. 1624(b)(4).)

SUPPLEMENT: [This section is current through the latest supplement]

(3) *Evidence of Existence of Contract*.

C.C. 1624(b)(3)(C): See *Pietrobon v. Libarle* (2006) 137 C.A.4th 992, 998, 40 C.R.3d 718 [written agreement memorializing settlement of civil action was not rendered invalid by statute of frauds despite lack of defendant's signature, where defendant had agreed to specific terms of agreement in open court and, during trial in plaintiff's action seeking redress for breach of agreement, admitted that he had agreed to terms of settlement as set forth in writing prepared by his attorney].



163 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witkin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
VIII. STATUTE OF FRAUDS
E. Where the Statute Does Not Apply.
5. Personal Property Leases.

1 Witkin Sum. Cal. Law Contracts § 418

[§ 418] Personal Property Leases.

The general statute of frauds (C.C. 1624) does not apply to leases that are subject to Division 10 of the Commercial Code on personal property leases. (C.C. 1624(c); on statute of frauds governing personal property leases, see U.C.C. 10201, 13 *Summary* (10th), *Personal Property*, §201.)

SUPPLEMENT: [This section is current through the latest supplement]



164 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
IX. ILLEGALITY: IN GENERAL
A. What Constitutes Illegality.
1. Illegal Consideration.

1 Witkin Sum. Cal. Law Contracts § 419

[§ 419] Illegal Consideration.

The consideration for a promise must be lawful. (C.C. 1607; see *Heaps v. Toy* (1942) 54 C.A.2d 178, 182, 128 P.2d 813.) "If any part of a single consideration for one or more objects, or of several considerations for a single object, is unlawful, the entire contract is void." (C.C. 1608.)

In other words, where the illegal consideration goes to the whole of the promise, the entire contract is illegal. (*Teachout v. Bogy* (1917) 175 C. 481, 486, 166 P. 319; *First Nat. Bank of Calexico v. Thompson* (1931) 212 C. 388, 404, 298 P. 808; *Fong v. Miller* (1951) 105 C.A.2d 411, 414, 233 P.2d 606; *Updeck v. Samuel* (1954) 123 C.A.2d 264, 267, 266 P.2d 822 [claim of property rights based on oral agreement to live in adultery]; *Novo v. Hotel Del Rio* (1956) 141 C.A.2d 304, 307, 295 P.2d 576 [discharge of gambling debt is not legal consideration for check issued in payment, hence payee gains no legal right to funds]; *Lawn v. Camino Heights* (1971) 15 C.A.3d 973, 980, 93 C.R. 621; *Grasko v. Los Angeles City Bd. of Education* (1973) 31 C.A.3d 290, 297, 107 C.R. 334; *Schaefer v. Williams* (1993) 15 C.A.4th 1243, 1247, 19 C.R.2d 212 [candidate's promise to refrain from defaming other candidates in accordance with Code of Fair Campaign Practices (former Elec.C. 12500 et seq., now *Elec. C. 20400* et seq.) is not legal consideration]; see 15 Corbin (Rev. ed.), §89.5 et seq.; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §223, 330; Cal. Transactions Forms, 1 Business Transactions §6:40; 2 California Affirmative Defenses (2004), §37:1 et seq.)

Where a promissory note is based upon an illegal consideration, a *renewal note* is tainted with the same illegality. (*Imperial Livestock & Mortg. Co. v. Tracy* (1929) 208 C. 205, 212, 281 P. 50.)

SUPPLEMENT: [This section is current through the latest supplement]

See C.E.B., Law of Contracts §3.36 et seq.; 2 California Affirmative Defenses §37:1 et seq.



165 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
IX. ILLEGALITY: IN GENERAL
A. What Constitutes Illegality.
2. Illegal Object.

1 Witkin Sum. Cal. Law Contracts § 420

[§ 420] Illegal Object.

The object of a contract must be lawful (C.C. 1550); i.e., it must not be in conflict either with express statutes or public policy. (See *infra*, §§451, 452.) If the contract has a single object, and that object is unlawful (whether in whole or in part), the entire contract is void. (C.C. 1598; see *Stockton Morris Plan Co. v. California Tractor & Equipment Corp.* (1952) 112 C.A.2d 684, 689, 247 P.2d 90, *infra*, §430; *Homami v. Iranzadi* (1989) 211 C.A.3d 1104, 1112, 260 C.R. 6 [oral agreement to pay interest on loan, even though written agreement stated there would be no interest, was tax evasion scheme, hence unenforceable]; *McIntosh v. Mills* (2004) 121 C.A.4th 333, 343, 17 C.R.3d 66 [illegality doctrine applied to fee-sharing agreement between nonattorney and attorney, because agreement violated Rule of Professional Conduct embodying public interest concerns, even though nonattorney was not bound Rules of Professional Conduct]; 15 Corbin (Rev. ed.), §79.1 et seq.; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §§29, 222, 223.)

An important distinction was made in *McGillycuddy v. Los Verjels Land & Water Co.* (1931) 213 C. 145, 2 P.2d 19. Plaintiff agreed to perform services, for which payment was to be made in stock of a certain value, the parties believing that this stock could be issued. A permit to issue the stock was ultimately refused. *Held*, plaintiff could recover the reasonable value of his services. The object of the contract was not the illegal sale of stock, and, while the specified consideration could not be lawfully delivered, an implied contract to pay the value of the services arose. (213 C. 146.) (See C.C. 1612, 1613.)

Trumbo v. Bank of Berkeley (1947) 77 C.A.2d 704, 176 P.2d 376, represents an application of the distinction made in *McGillycuddy*. Plaintiff, an accountant with banking experience, orally contracted with the promoters of a banking corporation to render certain services, in consideration of their promise that the corporation would employ him as a vice-president, at a minimum salary of \$ 300 per month, for life. The services were rendered and the corporation refused to perform. In this suit, the court first pointed out that the promoters' promise to employ might not even be illegal but merely unenforceable, i.e., not binding until ratification. But then, assuming that the promise was illegal because it purported to place restrictions on the discretion of the directors to choose corporate officers, the court held that recovery should be allowed, not for breach of the void promise, but for the reasonable value of the services rendered to the promoters, there being nothing against public policy in the nature of those services. (77 C.A.2d 709.) (See *Lawn v. Camino Heights* (1971) 15 C.A.3d 973, 980, 93 C.R. 621.)

SUPPLEMENT: [This section is current through the latest supplement]

See *Yoo v. Jho* (2007) 147 C.A.4th 1249, 1254, 55 C.R.3d 243 [buyer and seller of retail store dealing in counterfeit goods were precluded from using court to enforce illegal bargain; evidence established that both parties entered into agreement with knowledge of its illegality and that buyer intended to continue selling counterfeit merchandise after assuming control].



166 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law

IX. ILLEGALITY: IN GENERAL

A. What Constitutes Illegality.

3. Partial Illegality and Severability.

a. General Principles.

1 Witkin Sum. Cal. Law Contracts § 421

[§ 421] General Principles.

Where the consideration is only partly illegal and the agreement is severable, the legal portion may be enforced. (See *Keene v. Harling* (1964) 61 C.2d 318, 324, 38 C.R. 513, 392 P.2d 273, *infra*, §422; *Rest.2d, Contracts* §183 ["If the parties' performances can be apportioned into corresponding pairs of part performances so that the parts of each pair are properly regarded as agreed equivalents and one pair is not offensive to public policy, that portion of the agreement is enforceable by a party who did not engage in serious misconduct"]; 15 Corbin (Rev. ed.), §§89.6, 89.7; 8 Williston 4th, §19:69 et seq.; 17A Am.Jur.2d (2004 ed.), *Contracts* §318; on applicability of severability rules to unconscionable contracts, see *supra*, §330.)

Similarly, if the contract has several distinct objects, of which at least one is lawful, the contract is valid and enforceable as to the lawful object, provided that this is clearly severable from the rest. (C.C. 1599; see *Hedges v. Frink* (1917) 174 C. 552, 554, 163 P. 884; *Joy Mfg. Co. v. Julian Petroleum Corp.* (1929) 208 C. 168, 171, 280 P. 952; *Trutalli v. Meraviglia* (1932) 215 C. 698, 700, 12 P.2d 430; *Edwards v. Mullin* (1934) 220 C. 379, 382, 30 P.2d 997; *McCahan v. McCahan* (1920) 47 C.A. 176, 183, 190 P. 460; *Pitts v. Highland Const. Co.* (1953) 115 C.A.2d 206, 212, 252 P.2d 14; *Crowell v. Downey Community Hosp. Foundation* (2002) 95 C.A.4th 730, 739, 115 C.R.2d 810, 6 Cal. Proc. (4th), *Proceedings Without Trial*, Supp., §521A; *Mercuro v. Superior Court* (2002) 96 C.A.4th 167, 184, 116 C.R.2d 671, 6 Cal. Proc. (4th), *Proceedings Without Trial*, Supp., §494A; *Rest.2d, Contracts* §184; 15 Corbin (Rev. ed.), §89.4 et seq.; 17A Am.Jur.2d (2004 ed.), *Contracts* §319; 55 *Hastings L. J.* 987 [*Mercuro*].)

Where severability is not found, the contract is void. (See *Cash v. Blackett* (1948) 87 C.A.2d 233, 236, 196 P.2d 585 [plaintiff, legally entitled to act as architect but not as contractor, agreed to perform both types of services in constructing a building for a consideration of 10% of its cost; held not severable]; *Fong v. Miller* (1951) 105 C.A.2d 411, 414, 233 P.2d 606 [agreement to operate restaurant and bar in consideration of proceeds thereof and 25% of proceeds from illegal gambling devices].)

West's Key Number Digest, Contracts k.101(1)

SUPPLEMENT: [This section is current through the latest supplement]

See *Hyon v. Selten* (2007) 152 C.A.4th 463, 468, 60 C.R.3d 896 [contract that was partially illegal in that consultant,

who agreed to manage parties' business litigation, was to recruit counsel in violation of attorney-referral statute, was not severable notwithstanding consultant's other obligations under contract, because contract provided for single consideration in exchange for all consultant's services, including attorney referral]; *Chiba v. Greenwald* (2007) 156 C.A.4th 71, 81, 67 C.R.3d 86 [unlawful object of cohabiting partners' agreement, compensation to woman barred by Talent Agencies Act, was not severable from lawful object, compensation owed her under *Marvin* agreement; woman's pleading inconsistencies regarding separate consideration for two objects of agreement belied her claim that objects were not inextricably intertwined]. *Crowell case*:

Cross-Reference: 6 Cal. Proc. (5th), *Proceedings Without Trial*, §576.

Mercuro case:

Cross-Reference: 6 Cal. Proc. (5th), *Proceedings Without Trial*, §519.



167 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law

IX. ILLEGALITY: IN GENERAL

A. What Constitutes Illegality.

3. Partial Illegality and Severability.

b. Liberal Rule of Severability.

1 Witkin Sum. Cal. Law Contracts § 422

[§ 422] Liberal Rule of Severability.

The California cases take a very loose view of severability, enforcing valid parts of an apparently indivisible contract where the interests of justice or the policy of the law (as the court conceives it) would be furthered. (See *Calvert v. Stoner* (1948) 33 C.2d 97, 104, 199 P.2d 297 [attorney's contingent fee contract; invalid provision preventing client from compromising suit without attorney's consent severed from valid provision for attorney's fee]; *Carter v. Seaboard Finance Co.* (1949) 33 C.2d 564, 573, 203 P.2d 758 [severing illegal consideration from legal consideration]; *Costello v. Campbell* (1947) 81 C.A.2d 452, 453, 184 P.2d 315 [plaintiff sold and installed refrigeration equipment and performed services as contractor, without license; held entitled to recover for valid sale and installation, under *B. & P. C.* 7045]; *Werner v. Knoll* (1948) 89 C.A.2d 474, 476, 201 P.2d 45 [clause in lease exempting lessor from liability "from any cause" held to relieve him from liability for ordinary negligence, even though it was invalid under C.C. 1668 insofar as it applied to liability for fraud, wilful injury, or violation of law]; 15 Corbin (Rev. ed.), §89.4 et seq.; 15 Williston 4th, §45:1 et seq.; 17A Am.Jur.2d (2004 ed.), *Contracts* §312.)

As the court observed in *Keene v. Harling* (1964) 61 C.2d 318, 38 C.R. 513, 392 P.2d 273: "[A] contract is severable if the court can, consistent with the intent of the parties, reasonably relate the illegal consideration on one side to some specified or determinable portion of the consideration on the other side." (61 C.2d 321.) And C.C. 1608 does not set forth a test, but rather states the result where the court otherwise determines that the partially illegal contract is not severable. (61 C.2d 324.)

In *Keene*, plaintiffs sold defendants a coin machine route and equipment for \$ 50,000, payable in installments. Part of the equipment consisted of illegal pinball machines, the market value of which at the time of sale was found to be \$ 4,600. In this action against the buyers on the promissory note, the trial judge deducted the \$ 4,600 as severable illegal consideration, and gave judgment for the balance. *Held*, affirmed.

Defendants argued that there was a single consideration (\$ 50,000) for the entire business, and that the judge could not apportion where the parties had not done so. The court, disapproving the case of *Ryan v. Mike-Ron Corp.* (1964) 226 C.A.2d 71, 74, 37 C.R. 794, on this point (61 C.2d 323, footnote 2), gave the following answer: (a) "That argument exalts form over substance." (b) Usurious interest is severable from a valid obligation to repay principal (citing *Haines v. Commercial Mortg. Co.* (1927) 200 C. 609, 254 P. 956, 255 P. 805, *infra*, §471). (c) The parties here did recognize

the possibility of partial illegality by providing for reduced payments where local authorities determined that bingo-type games were illegal. (61 C.2d 323.)

SUPPLEMENT: [This section is current through the latest supplement]

See *Templeton Development Corp. v. Superior Court* (2006) 144 C.A.4th 1073, 1084, 51 C.R.3d 19 [because illegal terms of construction contract, i.e., that state mediation must take place in Nevada, were clearly collateral to main purpose of agreement and were easily severed from other provisions dealing with mediation, those terms would be severed]; *Adair v. Stockton Unified School Dist.* (2008) 162 C.A.4th 1436, 1450, 77 C.R.3d 62 [statute requiring teachers' salaries to be classified on basis of uniform allowance for years of training and years of experience rendered void portion of collective bargaining agreement purporting to waive benefits of statute's uniformity provisions; thus, that portion of agreement was severable].



168 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

IX. ILLEGALITY: IN GENERAL

A. What Constitutes Illegality.

4. Indirect Connection With Illegal Transaction.

a. Remote Connection or Mere Knowledge.

1. General Rule and Theory.

1 Witkin Sum. Cal. Law Contracts § 423

[§ 423] General Rule and Theory.

An independent, lawful contract will not ordinarily be denied enforcement for being remotely connected with or indirectly aiding in the accomplishment of an illegal object. (See *Keating v. Preston* (1940) 42 C.A.2d 110, 116, 108 P.2d 479 [lessee of restaurant occasionally placed racing bets for customers; held, lessee's personal and trivial violation of law did not make *lease* unlawful, and rescission (forfeiture) was not justified]; *Robertson v. Hyde* (1943) 58 C.A.2d 667, 670, 137 P.2d 703; *Anderson v. Fratis* (1951) 101 C.A.2d 753, 755, 226 P.2d 363 [man and woman severed meretricious relationship and made agreement settling existing property rights]; *Boloyan v. Contente* (1952) 113 C.A.2d 439, 442, 248 P.2d 96; *Rest.2d, Contracts* §178, Comment d, §182; 15 Corbin (Rev. ed.), §89.11; 8 Williston 4th, §19:11 et seq.; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §227; 74 *Harv. L. Rev.* 1659 [agreement to indemnify for losses arising from antecedent illegal act may be unenforceable if closely related]; 8 *U.C.L.A. L. Rev.* 638 [recovery under lawful contract denied because of seriously illegal method of performance]; on illegal methods of performance, see 12 *Hastings L. J.* 372; cf. *C.C.P.* 1161(4) [lease terminable if tenant uses premises for illegal purpose].)

In *Aaker v. Smith* (1948) 87 C.A.2d 36, 196 P.2d 150, defendants were operating a bar without serving food, thus violating the Alcoholic Beverage Control Act. Then, to comply with the law, they leased part of the premises to plaintiff to operate a restaurant. Later they evicted plaintiff, and, in the ensuing action for damages, defendants contended that the separation of legal ownership of the bar and restaurant was not a compliance with the statutory requirements and that the lease was therefore illegal. *Held* (without deciding the question of legality of this method of operation), plaintiff, in suing for damages for eviction, was not relying upon any illegal agreement, because a lease for restaurant purposes was clearly a separate legal transaction, irrespective of whether defendants' operation of their bar was illegal. (87 C.A.2d 47.)

SUPPLEMENT: [This section is current through the latest supplement]



169 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law

IX. ILLEGALITY: IN GENERAL

A. What Constitutes Illegality.

4. Indirect Connection With Illegal Transaction.

a. Remote Connection or Mere Knowledge.

2. Seller of Goods.

1 Witkin Sum. Cal. Law Contracts § 424

[§ 424] Seller of Goods.

A seller can recover the price of goods sold, in spite of knowledge that they were bought for an illegal purpose, provided (a) it is not made a part of the contract that they are to be so used, and (b) the seller does nothing in furtherance of the unlawful design. (*Gallick v. Castiglione* (1934) 2 C.A.2d 716, 717, 38 P.2d 858; see *Rest.2d, Contracts §182*; 15 Corbin (Rev. ed.), §89.3; 8 Williston 4th, §19:13 et seq.)

SUPPLEMENT: [This section is current through the latest supplement]



170 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

IX. ILLEGALITY: IN GENERAL

A. What Constitutes Illegality.

4. Indirect Connection With Illegal Transaction.

a. Remote Connection or Mere Knowledge.

3. Lender of Money.

aa. In General.

1 Witkin Sum. Cal. Law Contracts § 425

[§ 425] In General.

In *Moore v. Russell* (1931) 114 C.A. 634, 300 P. 479, plaintiff lent money to defendant, and took his promissory note for the debt, knowing that the money was to be used in pursuance of an illegal contract for the purchase of stock in violation of the terms of a permit. *Held*, he could recover; the illegal purpose was not a part of the loan transaction, and plaintiff himself did nothing to further that purpose. (114 C.A. 639.)

If, however, the lender, with full knowledge of the facts, participates in an illegal transaction, recovery will be denied. (See *Stockton Morris Plan Co. v. California Tractor & Equipment Corp.* (1952) 112 C.A.2d 684, 689, 247 P.2d 90, *infra*, §430.) (On loan to gambler, see *infra*, §426.)

West's Key Number Digest, Contracts k.101(1)

SUPPLEMENT: [This section is current through the latest supplement]



171 of 199 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

IX. ILLEGALITY: IN GENERAL

A. What Constitutes Illegality.

4. Indirect Connection With Illegal Transaction.

a. Remote Connection or Mere Knowledge.

3. Lender of Money.

bb. Loan to Gambler.

1 Witkin Sum. Cal. Law Contracts § 426

[§ 426] Loan to Gambler.

(1) *In General.* The rule that *mere knowledge* by a lender of the borrower's improper purpose will not invalidate a loan applies to money lent to one who intends to gamble with it. However, the lender is subject to the defense of illegality either (a) if he or she makes the illegal use a part of the loan transaction, or (b) if he or she participates in the illegal activity. In an attempt to preserve formal legality, gambling houses often cash checks for patrons and place no restrictions on the use of the money. However, the cashing of checks for unrestricted use satisfies only the first of the aforementioned conditions; thus, if the gambling house or other lender *participates in the illegal game with the borrower*, it cannot recover the money in an action on the check. (See *Lavick v. Nitzberg* (1948) 83 C.A.2d 381, 383, 188 P.2d 758 [checks given for chips in gambling house, to be used in poker game: held unenforceable, as contrary to good morals, under C.C. 1667, regardless of whether particular form of gambling is prohibited by statute or not]; *Braverman v. Horn* (1948) 88 C.A.2d 379, 381, 198 P.2d 948 [checks given for chips or cash for use in house dice game]; *Rose v. Nelson* (1947) 79 C.A.2d 751, 752, 180 P.2d 749 [plaintiff lender and defendant borrower engaged in poker game with several other participants]; *Sasner v. Ornsten* (1949) 93 C.A.2d 467, 471, 209 P.2d 44 [defense held available against holder with notice]; *Lane & Pyron v. Gibbs* (1968) 266 C.A.2d 61, 66, 71 C.R. 817; 22 Thomas Jefferson L. Rev. 219 [Internet gambling debt liability]; 4 U.S.F. L. Rev. 135; 74 A.L.R.5th 369 [right to recover money lent for gambling purposes]; 71 Proof of Facts 3d 193 [enforcement of casino gambling debts].)

In *Hamilton v. Abadjian* (1947) 30 C.2d 49, 52, 179 P.2d 804, checks were given to obtain money for gambling, but judgment against the drawer was upheld by weighing the then presumption of legality against the evidence of illegal purpose. This rule was changed by the adoption of the Evidence Code in 1965, abolishing the statutory presumption of legality (*Ev.C. 520, 1 Cal. Evidence (4th), Burden of Proof and Presumptions, §14*), and abrogating the judicial doctrine that a presumption is evidence (*Ev.C. 600(a), 1 Cal. Evidence (4th), Burden of Proof and Presumptions, §52*).

In *Lane, supra*, a Nevada gambling establishment offered N free transportation, lodging, meals and drinks. Defendant, a guest of N, cashed five checks totaling \$ 1,900 at two gambling houses and lost all of it. He dishonored the checks, and plaintiff sued as assignee of the holders. Defendant produced uncontradicted testimony that the money was *obtained and used* for gambling. Plaintiff merely proved that *no restriction* had been placed on his use of the money.

Held, plaintiff could not recover.

The issue, said the court, is whether the check was cashed *for the purpose* of providing funds to gamble; if so, the gambling house operator participated in the illegal transaction. And the evidence on this issue was without conflict: "The only inferences reasonably available from uncontradicted evidence were ... the gambling purpose of the cashier's booths in or near the gaming areas; the gambling purpose of the customer in cashing the checks; the gambling purpose of the club in supplying the check cashing service; and the mutual participation of customer and club in gambling with the proceeds." (266 C.A.2d 68.)

The court was unimpressed by the stratagem of handling checks not at the gaming table but in a separate "neutral" place--the cashier's cage some 14 feet away. The "camouflaged cashier's booth" provided "no reasonable or solid evidence of a nongambling purpose or nongambling use." (266 C.A.2d 68.) (See 4 U.S.F. L. Rev. 135.)

(2) *Policy Against Enforcement of Gambling Debts.* In *Metropolitan Creditors Service of Sacramento v. Sadri* (1993) 15 C.A.4th 1821, 19 C.R.2d 646, defendant, a California resident, received \$ 22,000 worth of chips from a Nevada casino in exchange for two checks and two memoranda of indebtedness. Defendant lost the chips playing baccarat and subsequently stopped payment on the checks and memoranda. Although credit instruments evidencing gambling debts owed to licensed persons are enforceable under Nevada law, plaintiff, as the assignee of the casino's claims, sought enforcement in California. *Held*, the debts were not enforceable in this state.

(a) *California's right to refuse enforcement.* Because plaintiff was attempting to enforce its Nevada *cause of action*, instead of a Nevada judgment, California, as the forum state, could refuse enforcement if the enforcement would be contrary to its strong public policy, i.e., if enforcement would violate a recognized standard of morality and the general interests of California citizens. (15 C.A.4th 1824; see 7 Summary (10th), *Constitutional Law*, §§35, 36; 8 Cal. Proc. (4th), *Enforcement of Judgment*, §416.)

(b) *California public policy.* From the inception of statehood, California has always had a strong public policy against judicial enforcement of gambling debts. (15 C.A.4th 1824.) And *Hamilton* stated the antienforcement rule in a context that is on all fours with the present case: A gambling establishment owner who honors a check for the purpose of providing a prospective customer with funds with which to gamble and who then participates in the gambling transaction cannot recover on the check. Hence, to the extent that *Hamilton* still reflects the public policy of this state, it precludes judicial enforcement of defendant's gambling debts. (15 C.A.4th 1826.)

(c) *Effect of increased acceptance of gambling.*

(1) *Crockford's Club Ltd. v. Si-Ahmed* (1988) 203 C.A.3d 1402, 250 C.R. 728, supra, §89, involved a foreign country's judgment, which, like a sister state cause of action, may be refused enforcement if the underlying cause of action is contrary to the public policy of this state. Emphasizing the increased acceptance of gambling in California, as indicated primarily by the lottery, the court in that case held that enforcement of the foreign judgment was not contrary to the public policy of this state. (15 C.A.4th 1828.)

(2) Although it cannot be denied that California's historic public policy against gambling has been substantially eroded, *Crockford's Club* failed to draw the critical distinction between public acceptance of gambling itself and California's deep-rooted policy against *enforcement* of gambling debts, which has never depended on the criminalization of gambling itself. "The cornerstone of the *Hamilton* rule against enforcement of gaming house debts is not simply that the game played is unlawful, but that the judiciary should not encourage gambling *on credit* by enforcing gambling debts, whether the game is lawful or not." (15 C.A.4th 1829.)

(3) There is a special reason for treating gambling on credit differently from gambling itself. Gambling debts are characteristic of pathological gambling, a mental disorder recognized by the American Psychiatric Association. Unlike the social gambler, the pathological gambler is out of control. "If Californians want to play, so be it. But the law should not invite them to play themselves into debt. The judiciary cannot protect pathological gamblers from themselves, but

we can refuse to participate in their financial ruin." (15 C.A.4th 1830.)

(4) California's public policy against gambling on credit has not been altered by the California State Lottery Act (Govt.C. 8880 et seq.). The lottery law expressly states that it is not to be construed to repeal or modify existing state law regarding the prohibition of gambling other than the state lottery. (15 C.A.4th 1821.) Also, the policy against gambling on credit has not been changed by the Gaming Registration Act (B. & P.C. 19800 et seq.), which requires registration of establishments where legal games such as draw poker are played (The Gaming Registration Act has since been replaced by the Gambling Control Act, also at B. & P.C. 19800 et seq. and containing similar regulation). There is nothing in the legislative history of this Act, the express purpose of which is to give the state concurrent jurisdiction with local governments over legal gaming houses, to suggest that the Legislature intended to alter the rule against enforcement of gambling debts. (15 C.A.4th 1831.) (See *Kelly v. First Astri Corp.* (1999) 72 C.A.4th 462, 486, 84 C.R.2d 810, supra, §1028 [following *Metropolitan* with respect to distinction between public acceptance of gambling and policy regarding enforceability of gambling-related claims; claim to recover gambling losses, rather than claim for gambling debt].)

SUPPLEMENT: [This section is current through the latest supplement]

(2) *Policy Against Enforcement of Gambling Debts.* See 87 Proof of Facts 3d 347 [enforceability of international gambling debts].

Cross-Reference: 8 Cal. Proc. (5th), *Enforcement of Judgment*, §447.



172 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

IX. ILLEGALITY: IN GENERAL

A. What Constitutes Illegality.

4. Indirect Connection With Illegal Transaction.

b. Severance of Executory and Executed Phases.

1. Agreement To Sell and Sale.

1 Witkin Sum. Cal. Law Contracts § 427

[§ 427] Agreement To Sell and Sale.

A far-reaching extension of the doctrine of severability (see *supra*, §§421, 422) was made in *Robbins v. Pacific Eastern Corp.* (1937) 8 C.2d 241, 65 P.2d 42, where the court held that illegality in the *making* of a contract may be severed from its legal *performance*. An executory contract for the exchange of certificates of stock was made in California between a foreign corporation and a California corporation; this was illegal for lack of a permit. The court found that the parties, in good faith and without intent to evade the California Corporate Securities Act, contemplated performance, i.e., delivery of the certificates, in New York, and that the exchange actually took place there. *Held*, assuming that the *executory* agreement was illegal, this did not affect the validity of the subsequent *executed sale*, validly made in New York. (8 C.2d 278.) (See 8 Williston 4th, §§19:39, 19:40; 26 Cal. L. Rev. 265; 31 Cal. L. Rev. 95.)

Robbins was distinguished and limited in *Bourke v. Frisk* (1949) 92 C.A.2d 23, 206 P.2d 407. There the *executory* transaction (negotiation of a contract for sale of stock), and part of the *executed* transaction (payment of the purchase price), *both took place* before issuance of a permit. The only step that was taken afterwards was the delivery of the certificates. *Held*, the whole transaction was tainted with illegality. The court stated the distinction as follows: "A sale cannot be partly invalid, partly valid--it is entirely void--though a valid sale can be made after prior invalid negotiations." (92 C.A.2d 31.)

SUPPLEMENT: [This section is current through the latest supplement]



173 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

IX. ILLEGALITY: IN GENERAL

A. What Constitutes Illegality.

4. Indirect Connection With Illegal Transaction.

b. Severance of Executory and Executed Phases.

2. Title Resulting From Performance.

1 Witkin Sum. Cal. Law Contracts § 428

[§ 428] Title Resulting From Performance.

The theory of *Robbins v. Pacific Eastern Corp.* (1937) 8 C.2d 241, 65 P.2d 42, supra, §427, tends to overcome the rule that no action can be maintained where the illegal contract is the foundation of the suit (infra, §440). That rule seems now subject to practical evasion whenever the evidence will sustain the theory that the illegal transaction has been "executed," and that some new obligation or right is "the foundation" of the suit.

Thus, in *Wagner v. Worrell* (1946) 76 C.A.2d 172, 172 P.2d 751, decedent, secretary of defendant irrigation district association, obtained an insurance broker's license, so that he could handle all such business for the members and use the premiums to help pay his salary and expenses as the officer of the association. He did this for 16 years. On his death, his administrator claimed the balance of premium collections, in a bank account labeled "Insurance Account," and sued to quiet title. *Held*, judgment for defendants affirmed. Both parties assumed that the arrangement was an illegal rebate of commissions. The court held, nevertheless, that this was not an action to enforce an illegal contract but to determine ownership of property--a fund--acquired under the contract. "There is nothing executory about it. Whatever the arrangement was, whether legal or illegal, it has been wholly executed and closed." (76 C.A.2d 180.) It would seem, however, that the title to the money in decedent's bank account presumably vested in his heirs or legatees, and the only way that defendant association could establish its claim of title was to prove the *making and performance of the illegal agreement*.

SUPPLEMENT: [This section is current through the latest supplement]



174 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

IX. ILLEGALITY: IN GENERAL

A. What Constitutes Illegality.

4. Indirect Connection With Illegal Transaction.

c. Executory Agreement Superseding Illegal Agreement.

1 Witkin Sum. Cal. Law Contracts § 429

[§ 429] Executory Agreement Superseding Illegal Agreement.

The severability theory (*supra*, §422) was also applied to evade the illegality defense in cases in which a new "valid" executory agreement superseded a former illegal agreement. In *Denning v. Taber* (1945) 70 C.A.2d 253, 160 P.2d 900, plaintiff and defendant formed a partnership to run a saloon, and defendant took out the license in his name alone, in violation of the statutory requirement that each partner be licensed. They quarreled, quit the business, and informally agreed to divide the assets. *Held*, plaintiff was entitled to an accounting because (among other reasons) there was a separate and distinct *oral agreement* to divide the assets equally, entered into *after* the illegal partnership had terminated. The court observed that it "is not expected to trace the source of property beyond the issues necessarily involved, merely to determine whether it is tainted with illegality so as to punish the parties for violation of the law." (70 C.A.2d 259.)

The justices were undoubtedly influenced by the mildness of the illegality (a legal business conducted in technical violation of licensing regulations), and by the fact that the plaintiff was not *in pari delicto* (*infra*, §431 et seq.). But the basic difficulty in the case is that, unless the original illegal agreement was proved and utilized, there was *no consideration* for the supposed new promise by defendant to pay half the value of the assets to plaintiff; obviously, the consideration consisted of performance of, or giving up rights under, the original agreement. Nevertheless, *Denning* was approved and followed in *Norwood v. Judd* (1949) 93 C.A.2d 276, 209 P.2d 24 (*infra*, §444). The opinion in *Norwood* shows how tenuous is the basis of invalidity by declaring that a plaintiff may recover in those situations "where the cause of action is not directly predicated on the partnership agreement, but is *or can be* predicated on a new promise arising out of the executed partnership agreement." (93 C.A.2d 284.)

Similar reasoning was employed in *Croslin v. Scott* (1957) 154 C.A.2d 767, 316 P.2d 755. Plaintiff man, living in a meretricious relationship with defendant woman, sued on an alleged oral agreement to put a lot in their joint names in return for plaintiff's labor and materials. In reversing a judgment of nonsuit, the court held that the evidence would have warranted a finding that (a) there was an original agreement conditioned upon plaintiff's returning to live with defendant (deemed invalid); but (b) subsequently, a new agreement was made to deed the property in consideration of his services and materials (valid), and that the continuance of the meretricious relationship was not a condition or consideration. (154 C.A.2d 771.) (On rights arising from nonmarital relationships generally, see 11 *Summary* (10th), *Community Property*, §271 et seq.)

SUPPLEMENT: [This section is current through the latest supplement]



175 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

IX. ILLEGALITY: IN GENERAL

A. What Constitutes Illegality.

5. Illegal Contract the Foundation of Suit.

1 Witkin Sum. Cal. Law Contracts § 430

[§ 430] Illegal Contract the Foundation of Suit.

Even though the action is not brought directly to enforce the terms of the illegal agreement, if the agreement is nevertheless the foundation of the suit, or the claim cannot be established except by proving the illegal agreement, recovery is denied. "The test whether a demand connected with an illegal transaction is capable of being enforced is whether the plaintiff requires the aid of the illegal transaction to establish his case. If the plaintiff cannot establish his case without showing that he has broken the law, the court will not assist him, whatever his claim in justice may be upon the defendant." (*Hooper v. Barranti* (1947) 81 C.A.2d 570, 576, 184 P.2d 688; see *Shenson v. Fresno Meat Packing Co.* (1950) 96 C.A.2d 725, 730, 216 P.2d 156; *Huber v. Peek-A-Boot* (1961) 189 C.A.2d 512, 515, 11 C.R. 467; *Kiely Corp. v. Gibson* (1964) 231 C.A.2d 39, 45, 41 C.R. 559; 15 Corbin (Rev. ed.), §89.15; 17A Am.Jur.2d (2004 ed.), Contracts §§305, 323; 12 Hastings L. J. 354.)

In *Holm v. Bramwell* (1937) 20 C.A.2d 332, 67 P.2d 114, plaintiff, a licensed contractor, agreed to construct buildings for defendant owner at cost plus 10%. Plaintiff contracted with an unlicensed subcontractor to furnish materials and labor, paying him \$ 1,108.63 therefor. This action was for the balance due on the building costs. *Held*, plaintiff could not recover the item of \$ 1,108.63. The agreement with the unlicensed contractor was in violation of the Contractor's License Law, and plaintiff could not establish the cost item except by reference to the price fixed by the illegal contract. (20 C.A.2d 334.)

The decision in *Del Rey Realty Co. v. Fourl* (1941) 44 C.A.2d 399, 403, 112 P.2d 649, is even more strict, and seems inconsistent with the *Robbins* case (illegal making severable from performance, see *supra*, §427). An unlicensed real estate broker obtained an oil sublease for defendant under a contract calling for a 10% interest in the sublease as compensation. A written instrument assigning the interest was delivered, but in a suit on this separate instrument the court denied recovery, holding that the action was, in effect, to enforce the original illegal contract. (See *Kyne v. Kyne* (1940) 16 C.2d 436, 440, 106 P.2d 620 [denying recovery of money deposited as bet, after happening of event]; 29 Cal. L. Rev. 418.)

In *Stockton Morris Plan Co. v. California Tractor & Equipment Corp.* (1952) 112 C.A.2d 684, 247 P.2d 90, a county supervisor unlawfully purchased a machine in the name of a county agency, and plaintiff finance company took an assignment of the installment contract from the seller. In this action to recover the amount paid for the assignment, recovery was denied, for plaintiff, with full knowledge of the facts, participated in the illegal transaction and aided in

carrying out the illegal object. (112 C.A.2d 690.)

In *Hooperi*, involving a partnership to conduct a retail liquor tavern business with only one partner licensed, the unlicensed partner was denied an accounting and division of assets. *Denning v. Taber* (1945) 70 C.A.2d 253, 259, 160 P.2d 900, supra, §429, was distinguished on the ground that in this case, there was no severable agreement to terminate and divide the assets. The difficulty of finding a substantial basis of distinction between *Denning* and *Hooper* is enhanced by *Norwood v. Judd* (1949) 93 C.A.2d 276, 284, 209 P.2d 24 (supra, §444), which follows *Denning*.

If, however, the plaintiff's case can be established without relying on an illegal contract, the result is different. In *Cal-Neva Lodge v. Marx* (1960) 178 C.A.2d 186, 2 C.R. 889, plaintiff operated a gambling casino in Nevada. Defendant, as its agent, collected money from eight persons, and owed plaintiff for credit extended as a result of their gambling losses. In this action for money received, defendant contended that a suit in California to recover gambling debts was contrary to public policy. *Held*, judgment for plaintiff affirmed. The eight debtors paid in full without complaint and were not parties; hence, under the issues before the court, plaintiff proved that defendant collected money for its use and benefit and failed to pay. In other words, defendant's duty arose not from any illegal gambling but from a separate agreement to collect for and pay to his principal the moneys in question. (178 C.A.2d 189.)

West's Key Number Digest, Contracts k.108(2)

SUPPLEMENT: [This section is current through the latest supplement]



176 of 199 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

IX. ILLEGALITY: IN GENERAL

B. Effect of Illegality.

1. In General: Contract Void.

a. Malum In Se and Malum Prohibitum.

1 Witkin Sum. Cal. Law Contracts § 431

[§ 431] Malum In Se and Malum Prohibitum.

A somewhat artificial distinction is made between contracts malum in se--(against good morals), and those which are malum prohibitum--(prohibited by statute).

The distinction has little significance save where the parties are not *in pari delicto* (see *infra*, §438 et seq.). This is because, as a general rule, the contract itself is void, whether malum in se or malum prohibitum. (*United States v. Mississippi Valley Generating Co.* (1961) 364 U.S. 520, 81 S.Ct. 294, 316, 5 L.Ed.2d 268, 296 [contract in violation of federal conflict-of-interest statute]; *Smith v. Bach* (1920) 183 C. 259, 262, 191 P. 14; *Severance v. Knight-Counihan Co.* (1947) 29 C.2d 561, 568, 177 P.2d 4, *infra*, §440; *Loving & Evans v. Blick* (1949) 33 C.2d 603, 607, 204 P.2d 23; *Lewis & Queen v. N.M. Ball Sons* (1957) 48 C.2d 141, 150, 308 P.2d 713, *infra*, §486; *Hooper v. Barranti* (1947) 81 C.A.2d 570, 574, 184 P.2d 688, *supra*, §430; *Stockton Morris Plan Co. v. California Tractor & Equipment Corp.* (1952) 112 C.A.2d 684, 689, 247 P.2d 90, *supra*, §430; *Holt v. Morgan* (1954) 128 C.A.2d 113, 116, 274 P.2d 915; *Shepard v. Lerner* (1960) 182 C.A.2d 746, 750, 6 C.R. 433, 12 Summary (10th), *Real Property*, §518 [lease authorizing use of premises in violation of safety and health regulations, void]; *R.M. Sherman Co. v. W.R. Thomason* (1987) 191 C.A.3d 559, 566, 236 C.R. 577, *infra*, §437; *Kolani v. Gluska* (1998) 64 C.A.4th 402, 408, 75 C.R.2d 257, citing the text; see 15 Corbin (Rev. ed.), §79.5; 8 Williston 4th, §§19:45, 19:74; 17A Am.Jur.2d (2004 ed.), *Contracts* §303.)

SUPPLEMENT: [This section is current through the latest supplement]

Correction: Page 473, line 13 of second paragraph of section, "*Shepard v. Lerner*" should be "*Shephard v. Lerner*".



177 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

IX. ILLEGALITY: IN GENERAL

B. Effect of Illegality.

1. In General: Contract Void.

b. No Ratification, Waiver, or Estoppel.

1 Witkin Sum. Cal. Law Contracts § 432

[§ 432] No Ratification, Waiver, or Estoppel.

Because an illegal contract is void, it *cannot be ratified* by any subsequent act, and no person can be *estopped to deny its validity*. (*Colby v. Title Ins. & Trust Co.* (1911) 160 C. 632, 644, 117 P. 913; *Wood v. Imperial Irr. Dist* (1932) 216 C. 748, 759, 17 P.2d 128; *Regan v. Albin* (1933) 219 C. 357, 360, 26 P.2d 475; *Fewel & Dawes v. Pratt* (1941) 17 C.2d 85, 91, 109 P.2d 650; *Wells v. Comstock* (1956) 46 C.2d 528, 532, 297 P.2d 961; *City Lincoln-Mercury Co. v. Lindsey* (1959) 52 C.2d 267, 274, 339 P.2d 851; *Reno v. American Ice Machine Co.* (1925) 72 C.A. 409, 413, 237 P. 784; *Miller v. Martinez* (1938) 28 C.A.2d 364, 370, 82 P.2d 519; *Spector v. Pete* (1958) 157 C.A.2d 432, 436, 321 P.2d 59; *Cook v. King Manor & Convalescent Hosp.* (1974) 40 C.A.3d 782, 792, 115 C.R. 471, citing and quoting the text [penalty disguised as liquidated damages]; *Downey Venture v. LMI Ins. Co.* (1998) 66 C.A.4th 478, 511, 78 C.R.2d 142, quoting the text; 15 Corbin (Rev. ed.), §89.14; 6 Williston 4th, §12:5; 17A Am.Jur.2d (2004 ed.), *Contracts* §§308, 309.)

Similarly, the defense of illegality cannot be waived by stipulation in the contract. (See *Hollywood State Bank v. Wilde* (1945) 70 C.A.2d 103, 112, 160 P.2d 846; 6 Williston 4th §§12:4, 12:5; 17A Am.Jur.2d (2004 ed.), *Contracts* §309.)

West's Key Number Digest, *Contracts* k.134, 138(4)

SUPPLEMENT: [This section is current through the latest supplement]

See *Black Hills Inv. v. Albertson's* (2007) 146 C.A.4th 883, 895, 53 C.R.3d 263, quoting the text [purchaser of two parcels in shopping center did not ratify contracts, which were void under Subdivision Map Act for vendor's failure to record parcel map prior to real estate sale, by objecting to proposed changes to contracts following vendor's belated recordation of parcel map]; *WRI Opportunity Loans II, LLC v. Cooper* (2007) 154 C.A.4th 525, 541, 65 C.R.3d 205, citing the text [loan guarantors could raise usury defense to void written loan guaranty notwithstanding that they had earlier waived other defenses].



178 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law

IX. ILLEGALITY: IN GENERAL

B. Effect of Illegality.

1. In General: Contract Void.

c. No Validity by Statutory Repeal.

1 Witkin Sum. Cal. Law Contracts § 433

[§ 433] No Validity by Statutory Repeal.

In *Interinsurance Exchange of the Auto. Club of Southern Calif. v. Ohio Cas. Ins. Co.* (1962) 58 C.2d 142, 23 C.R. 592, 373 P.2d 640, an action between two insurance companies to determine which was liable for claims arising out of an automobile accident, defendant relied on a clause in its policy excluding permittees. The clause had been declared contrary to public policy in *Wildman v. Government Employees Ins. Co.* (1957) 48 C.2d 31, 38, 307 P.2d 359, 2 Summary (10th), Insurance, §170, but defendant contended that former Veh.C. 415 (now Veh.C. 16450, 16451), the statute construed in the opinion, had been amended to change the rule, and that this statutory repeal had the effect of validating its policy. *Held*, repeal did not validate the illegal contract.

(a) Assuming that the amendment did make the clause valid, the repeal of such a statute does not retroactively validate a contract illegal and void at the time of making. The theory is either that (1) if the illegal contract was void, there never was anything to enforce after the repeal, or (2) the "polluted hand" remains stained after repeal. (58 C.2d 146, 147, 148, distinguishing usury statutes as exceptional.)

(b) Even though defendant's policy was silent as to liability for permittees, the statute, as construed in *Wildman*, *supra*, became a part of the insurance policy as a matter of law. (58 C.2d 148.) The Legislature could have constitutionally removed from all policies in force at the time of enactment any such mandatory coverage, but there was nothing in the 1957 amendment to former Veh.C. 415 to suggest this intent, and retroactive effect is not the preferred construction. (58 C.2d 149.) (See 15 Corbin (Rev. ed.), §89.14; 17A Am.Jur.2d (2004 ed.), Contracts §235.)

SUPPLEMENT: [This section is current through the latest supplement]



179 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

IX. ILLEGALITY: IN GENERAL

B. Effect of Illegality.

1. In General: Contract Void.

d. Pleading Unnecessary.

1 Witkin Sum. Cal. Law Contracts § 434

[§ 434] Pleading Unnecessary.

The failure to plead illegality as a defense is not a waiver. The point may be raised at any time, in the trial court or on appeal, by the parties or on the court's own motion. (See *Lewis & Queen v. N.M. Ball Sons* (1957) 48 C.2d 141, 147, 308 P.2d 713, *infra*, §486; *LaFortune v. Ebie* (1972) 26 C.A.3d 72, 75, 102 C.R. 588; 15 Corbin (Rev. ed.), §89.15; 6 Williston 4th, §12:5; 17A Am.Jur.2d (2004 ed.), *Contracts* §§333, 324; 5 Cal. Proc. (4th), *Pleading*, §1023.)

However, this rule is sometimes limited to illegality that appears on the face of the contract or that is disclosed by the evidence. (See 5 Cal. Proc. (4th), *Pleading*, §1024.) And it is good practice for the defendant to raise the issue at the first opportunity, by appropriate pleading. (See 5 Cal. Proc. (4th), *Pleading*, §1025.)

The rule was subjected to a questionable limitation in *Fomco v. Joe Maggio* (1961) 55 C.2d 162, 10 C.R. 462, 358 P.2d 918. Defendant agreed to sell carrots grown during a certain season to plaintiff dealer, and, on breach, plaintiff sued and recovered judgment for damages. On motion for a new trial, defendant for the first time sought to prove that plaintiff lacked the dealer's license required by the Food and Agricultural Code. *Held*: (a) Because defendant made no showing of diligence, it was not entitled to a new trial on the basis of newly discovered evidence. (b) The illegality claim therefore failed, because there was no evidence before the trial court to show whether or not plaintiff was licensed. A prior superseded opinion had affirmed the judgment for plaintiff on the grounds that the statutory license provision did not in fact apply to this transaction, and that plaintiff could make out his case without relying on an illegal contract. But the final opinion contains language suggestive of the surprising proposition that, no matter how serious the illegality, it may be waived by failure to exercise diligence in discovering the facts: "None of the decided cases hold that after a judgment has been entered without any evidence having been introduced establishing illegality, the court must grant a motion for a new trial on the ground of newly discovered evidence of illegality even though the moving party has failed to show the exercise of the diligence required." (55 C.2d 166.) It would seem that this statement should have been qualified by a restatement of the power of the trial or appellate court, in any case, to raise illegality on its own motion.

West's Key Number Digest, Contracts k.138(.5)

SUPPLEMENT: [This section is current through the latest supplement]

See *Yoo v. Jho* (2007) 147 C.A.4th 1249, 1258, 55 C.R.3d 243 [in action to enforce agreement between buyer and seller of business substantially involved in sale of counterfeit goods, trial court should have raised issue of illegality on its own motion in order to dispose of matter].

Failure to plead illegality not a waiver of defense:

Cross-Reference: 5 Cal. Proc. (5th), Pleading, §1097.

Rule limited to illegality appearing on face of contract:

Cross-Reference: 5 Cal. Proc. (5th), Pleading, §1098.

Method of pleading:

Cross-Reference: 5 Cal. Proc. (5th), Pleading, §1099.



180 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

IX. ILLEGALITY: IN GENERAL

B. Effect of Illegality.

1. In General: Contract Void.

e. Form Disregarded: Use of Parol Evidence.

1 Witkin Sum. Cal. Law Contracts § 435

[§ 435] Form Disregarded: Use of Parol Evidence.

The court will look through provisions, valid on their face, and, with the aid of parol evidence, determine that the contract is actually illegal or is part of an illegal transaction. (See *Morey v. Paladini* (1922) 187 C. 727, 739, 203 P. 760; *Lewis & Queen v. N.M. Ball Sons* (1957) 48 C.2d 141, 148, 308 P.2d 713, *infra*, §486; *De Armas v. Dickerman* (1952) 108 C.A.2d 548, 552, 239 P.2d 65; *May v. Herron* (1954) 127 C.A.2d 707, 711, 274 P.2d 484; *Precision Fabricators v. Levant* (1960) 182 C.A.2d 637, 642, 6 C.R. 395; *Geffen v. Moss* (1975) 53 C.A.3d 215, 222, 125 C.R. 687; *Homami v. Iranzadi* (1989) 211 C.A.3d 1104, 1112, 260 C.R. 6; Corbin §580; 11 Williston 4th, §§33:17, 33:18; 2 Cal. Evidence (4th), Documentary Evidence, §100.)

SUPPLEMENT: [This section is current through the latest supplement]



181 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

IX. ILLEGALITY: IN GENERAL

B. Effect of Illegality.

1. In General: Contract Void.

f. No Quasi-Contract Recovery.

1 Witkin Sum. Cal. Law Contracts § 436

[§ 436] No Quasi-Contract Recovery.

Ordinarily, none of the guilty parties may recover in quasi-contract the value of his or her performance or the consideration paid. (See *Takeuchi v. Schmuck* (1929) 206 C. 782, 788, 276 P. 345; *Lewis & Queen v. N.M. Ball Sons* (1957) 48 C.2d 141, 150, 308 P.2d 713, *infra*, §486; *Owens v. Haslett* (1950) 98 C.A.2d 829, 833, 221 P.2d 252; *Fong v. Miller* (1951) 105 C.A.2d 411, 413, 233 P.2d 606; *Mansfield v. Hyde* (1952) 112 C.A.2d 133, 139, 245 P.2d 577; *Rest.2d, Contracts §197*; *Rest., Restitution §140*; 8 Williston 4th, §19:76; 19 *Hastings L. J.* 1143; 74 *A.L.R.3d* 637 [money paid to unlicensed person required by law to have occupational or business license or permit to make contract].)

However, there have been some departures from this strict rule in cases involving contracts for attorneys' fees. (See *Rosenberg v. Lawrence* (1938) 10 C.2d 590, 594, 75 P.2d 1082; 1 *Cal. Proc.* (4th), *Attorneys*, §224; *Wiley v. Silsbee* (1934) 1 C.A.2d 520, 522, 36 P.2d 854; *cf. Trumbo v. Bank of Berkeley* (1947) 77 C.A.2d 704, 710, 176 P.2d 376 [contract to perform services for corporation; quoting *Wiley* with approval]; 100 *A.L.R.2d* 1378 [attorney's recovery in quantum meruit under illegal contract]; and see *infra*, §438 *et seq.*)

SUPPLEMENT: [This section is current through the latest supplement]

Rosenberg case:

Cross-Reference: 1 *Cal. Proc.* (5th), *Attorneys*, §198.



182 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law

IX. ILLEGALITY: IN GENERAL

B. Effect of Illegality.

1. In General: Contract Void.

g. No Setoff Where Public Interest Involved.

1 Witkin Sum. Cal. Law Contracts § 437

[§ 437] No Setoff Where Public Interest Involved.

R.M. Sherman Co. v. W.R. Thomason (1987) 191 C.A.3d 559, 236 C.R. 577, involved separate public works contracts between plaintiff subcontractor and defendant contractor. The initial contract violated the Subletting and Subcontracting Fair Practices Act (see *infra*, §1001), because defendant failed to comply with the requirement of identifying plaintiff as a subcontractor. The second contract was legal. After defendant withheld money due under the second contract, claiming a setoff based on money allegedly owed by plaintiff under the initial contract, plaintiff initiated the present action. The trial judge allowed a setoff in the amount claimed by defendant, and ruled that the parties take nothing. *Held*, reversed.

(a) Defendant's claim was based on a supposed analogy to cases permitting an unlicensed contractor to assert a setoff based on a contract for building services, even though the contract was otherwise illegal. This analogy is unsound:

First, in the context of licensing statutes, when penalties are provided by statute, the courts will not impose additional penalties for violation of the licensing requirement. Hence, because *B. & P.C. 7031* (see *infra*, §490 et seq.) merely prevents an unlicensed contractor from *maintaining* an action, it does not prohibit him, *when sued*, from setting up as a defense any sums equitably due to him from the plaintiff. (191 C.A.3d 565.) However, the Subletting and Subcontracting Fair Practices Act merely provides that illegality is no defense *to the contractor* in an action by the subcontractor. (*Pub.Contr.C. 4112*.) Hence, while foreseeing situations where cross-demands might arise, the Legislature gave the right to sue only to the subcontractor, thereby impliedly denying a reciprocal right to the contractor, as well as any defense predicated on such a right. (191 C.A.3d 565.)

Second, the unlicensed contractor cases also justify a setoff on theories that the contract was merely *malum prohibitum* (see *supra*, §431), and that there was no public interest question, but merely a matter of balancing the equities between the parties. Presumably, the rationale is that where a contract in violation of a licensing statute designed to protect *private* economic interests has been substantially performed, a member of the protected class may not use the violation as a defense while seeking affirmative relief in connection with the same transaction. (191 C.A.3d 566.) However, the Subletting and Subcontracting Fair Practices Act is designed to protect *public* interests by allowing the *public* agency involved to investigate and approve any proposed subcontractor in order to ensure that irresponsible

bidding practices will not result in substandard materials or workmanship. (191 C.A.3d 567.) And this goal is consistent with cases holding that a subcontractor replaced without compliance with the Act has a cause of action, because such an action vindicates the public interest in efficient management of public affairs. Hence, the analogy with the licensing cases fails completely. (191 C.A.3d 568.)

(b) Even if a setoff could, in some circumstances, be based on a contract violating the Act, it could not operate as a defense to a claim such as plaintiff's, which arose from a wholly separate and unrelated transaction. Plaintiff's "fortuitous agreement to provide further services to Thomason should not operate to convert void claims into legally cognizable rights." (191 C.A.3d 568.)

SUPPLEMENT: [This section is current through the latest supplement]



183 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

IX. ILLEGALITY: IN GENERAL

B. Effect of Illegality.

2. Effect of Being, or Not Being, in *Pari Delicto*.

a. Restitution or Quasi-Contract Recovery.

1. Plaintiff's Right to Restitution.

1 Witkin Sum. Cal. Law Contracts § 438

[§ 438] Plaintiff's Right to Restitution.

The law may lend its assistance to one of the parties who, though not wholly innocent, is either actually or in the eyes of the law not *in pari delicto*, i.e., not in equal wrong with the other. The court will not, ordinarily, enforce the contract (see *infra*, §440), but will permit the relatively innocent party to obtain restitution of the consideration or its value. (See *Colby v. Title Ins. & Trust Co.* (1911) 160 C. 632, 641, 117 P. 913; *Tiedje v. Aluminum Taper Milling Co.* (1956) 46 C.2d 450, 454, 296 P.2d 554; *Marshall v. La Boi* (1954) 125 C.A.2d 253, 267, 272, 270 P.2d 99; *Smith v. Turner* (1965) 238 C.A.2d 141, 149, 47 C.R. 582, *infra*, §446; *Rest.2d, Contracts* §198(b); 15 Corbin (Rev. ed.), §89.19 et seq.; 6 Williston 4th, §12:7; 8 Williston 4th, §§19:79, 19:80; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §315 et seq.; 19 *Hastings L. J.* 1146.)

In *Stenger v. Anderson* (1967) 66 C.2d 970, 977, 59 C.R. 844, 429 P.2d 164 defendant, a close friend who took care of decedent, induced decedent to enter into a contract for lifetime care, and contemporaneously to grant defendant a joint tenancy interest in decedent's home. Former Welf.C. 16200, 16300 (now *Health & Saf.C.* 1250 et seq., 1770 et seq.), enacted for the protection of elderly persons from inadequate life care agreements, required a license from a state agency. Defendant, unlicensed, contended that the statute was designed only for institutional contracts. *Held*, it covered individual agreements, and decedent's administrator was entitled to rescind the agreement and joint tenancy deed. (An alternative ground for rescission was undue influence by a person in a confidential relationship.) (66 C.2d 979.)

The degree of wrongfulness is said to be material only where the contract is *malum prohibitum*; where it is *malum in se*, the decisions indicate that the court will not consider the relative guilt of the parties. (*Smith v. Bach* (1920) 183 C. 259, 263, 191 P. 14; *Schmitt v. Gibson* (1910) 12 C.A. 407, 412, 107 P. 571; see *supra*, §431.)

In *Yuba Cypress Housing Partners, Ltd. v. Area Developers* (2002) 98 C.A.4th 1077, 120 C.R.2d 273, plaintiff disaffirmed his contract with defendant developer when he discovered that the contract was unlawful because defendant violated the Subdivided Lands Act. On remand, plaintiff recovered the attorneys' fees expended at trial and on appeal, and defendant argued that the trial judge erred in awarding plaintiff any fees that were based on the attorneys' fees clause of the contract that had been voided due to illegality. *Held*, there was no error.

(a) The purpose of the Subdivided Lands Act is to protect members of the public who purchase lots or houses from developers. Hence, when a plaintiff purchases land under a contract that does not comply with the Act, courts will allow the plaintiff to either enforce the contract against the seller or disaffirm the contract. In other words, the contract is *voidable*, not void. Because the contract here does not have an illegal object, it is not one that *neither* party may enforce. If neither party could enforce the contract, any attorneys' fees clause contained therein would likewise be unenforceable. (98 C.A.4th 1083.)

(b) Although plaintiff chose to "void" the contract, this does not preclude him from recovering attorneys' fees via the attorneys' fees clause in the contract. Rather, defendant, who violated the Subdivided Lands Act, is estopped from asserting the invalidity of the contract. To deny plaintiff the attorneys' fees to which he is entitled as a result of the contract would permit defendant to benefit from the illegality that it created, thus disserving the goal of deterring illegal conduct. Accordingly, the trial judge properly concluded that the attorneys' fees clause of the contract was enforceable. (98 C.A.4th 1083.)

West's Key Number Digest, Contracts k.139

SUPPLEMENT: [This section is current through the latest supplement]



184 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

IX. ILLEGALITY: IN GENERAL

B. Effect of Illegality.

2. Effect of Being, or Not Being, in *Pari Delicto*.

a. Restitution or Quasi-Contract Recovery.

2. Sales Contract.

1 Witkin Sum. Cal. Law Contracts § 439

[§ 439] Sales Contract.

(1) *Rights of Seller Defendant.* A relatively innocent buyer of property under an illegal contract of sale may recover the consideration paid. And, because the buyer is asserting that the contract is void, he or she must give up the property to which he or she receives no title.

In *Williams v. Caruso Enterprises* (1956) 140 C.A.2d Supp. 973, 295 P.2d 592, the court examined the question whether the seller was entitled to anything in addition to retaining possession of the property. Plaintiff bought an automobile on conditional sale, which failed to comply with C.C. 2982 (see 4 *Summary* (10th), *Sales*, §255); hence, plaintiff was allowed to recover the price and the defendant to retain possession of the repossessed car. The seller was also held entitled to *an offset for depreciation* caused by the buyer's use, but not for depreciation resulting from a general fall in market value. "In our view the most to which a guilty seller is entitled, and which at the same time is equitable to the innocent buyer, is an offset in an amount representing the depreciation in value of the car occasioned by the use made of it by the buyer while in his possession, which necessarily excludes any allowance for depreciation resulting from a general decline in the market value of such automobile during the period in question. Thus the vendee is, in effect, required to return the vehicle in substantially the same condition it was in at the time he received it. It seems hardly necessary to add that in no event may the seller, by way of offset, obtain an affirmative judgment against the buyer. That is to say, the right of offset in any and all events is restricted to an amount not exceeding that which the buyer is entitled to recover." (140 C.A.2d Supp. 980.) (See *City Lincoln-Mercury Co. v. Lindsey* (1959) 52 C.2d 267, 275, 339 P.2d 851 [approving offset theory].)

(2) *Rights of Seller Plaintiff.* In *Ryan v. Mike-Ron Corp.* (1964) 226 C.A.2d 71, 37 C.R. 794, plaintiff sold 23 items of personal property to defendant for \$ 100,000. Defendant defaulted, and after 15 months' use plaintiff repossessed and sold all the items for \$ 10,860. In this action for a deficiency judgment, the trial judge gave judgment for \$ 91,347.90, less the proceeds of a foreclosure sale under a chattel mortgage on four items, and deducting an automobile because of noncompliance with C.C. 2982. *Held*, reversed. The court first held that the contract was indivisible; on this point it has been expressly disapproved (*supra*, §422). The court then declared that, nevertheless, the buyer would be unjustly enriched by 15 months' uncompensated use, and held that plaintiff seller was entitled to return of all the goods except the automobile, and to the fair market value of their use. (226 C.A.2d 75, 76.)

West's Key Number Digest, Contracts k.139

SUPPLEMENT: [This section is current through the latest supplement]



185 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

IX. ILLEGALITY: IN GENERAL

B. Effect of Illegality.

2. Effect of Being, or Not Being, in *Pari Delicto*.

b. Enforcement of Contract.

1. General Rule: No Enforcement.

1 Witkin Sum. Cal. Law Contracts § 440

[§ 440] General Rule: No Enforcement.

Normally, relief given to one who is not in equal wrong is limited to rescission and restitution; he or she will not be permitted to *enforce* the contract. Thus, in *Severance v. Knight-Counihan Co.* (1947) 29 C.2d 561, 177 P.2d 4, defendant, a printer in financial difficulties, made a contract with plaintiff employee giving the latter an option to purchase certain plates at about one-fourth their value. Later plaintiff left his employment, gave notice of exercise of the option, and, on defendant's refusal to perform, brought this action. Defendant testified, and the court found, that the purpose of the agreement was to safeguard materials for later operation of the business in the event that creditors liquidated the company. *Held*, plaintiff could not recover; the agreement was made for the purpose of defrauding creditors, and, assuming that plaintiff's fault was less than defendant's, this did not justify enforcement of the contract. (29 C.2d 569.) (Several strong dissenting opinions contend that the court failed to consider the purposes of the statutes prohibiting fraudulent conveyances, and that the decision fosters rather than discourages this type of illegal agreement.) (See *Kashani v. Tsann Kuen China Enterprise Co., Ltd.* (2004) 118 C.A.4th 531, 547, 13 C.R.3d 174 [agreement violated executive orders and implementing regulations prohibiting dealings with Iran]; *Malek v. Blue Cross of Calif.* (2004) 121 C.A.4th 44, 71, 16 C.R.3d 687 [arbitration provision violating statute designed to protect insureds from unknowingly waiving right to jury trial could not be enforced]; *McIntosh v. Mills* (2004) 121 C.A.4th 333, 347, 17 C.R.3d 66 [exception to nonenforceability where parties are not *in pari delicto* did not apply to fee-sharing agreement between attorney and nonattorney where nonattorney was not blameless; attorney entered into agreement as nonattorney's agent, agent's knowledge of illegality was imputed to nonattorney, and nonattorney participated in illegal scheme].)

SUPPLEMENT: [This section is current through the latest supplement]



186 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

IX. ILLEGALITY: IN GENERAL

B. Effect of Illegality.

2. Effect of Being, or Not Being, in *Pari Delicto*.

b. Enforcement of Contract.

2. When Contract Will Be Enforced.

aa. In General.

1 *Witkin Sum. Cal. Law Contracts* § 441

[§ 441] In General.

In situations in which no strong objections of public policy are present, a party to the illegal agreement may be permitted to enforce it, often on the ground that the parties are not *in pari delicto*. Other reasons that have been assigned, either singly, or together are: (1) the violation of law did not involve serious moral turpitude; (2) the adverse party would be unjustly enriched if enforcement were denied; (3) the forfeiture would be disproportionately harsh in proportion to the extent of illegality. (See *Lewis & Queen v. N.M. Ball Sons* (1957) 48 C.2d 141, 153, 308 P.2d 713486; *Tri-Q v. Sta-Hi Corp.* (1965) 63 C.2d 199, 219, 45 C.R. 878, 404 P.2d 486; *Asdourian v. Ajar* (1985) 38 C.3d 276, 292, 293, 211 C.R. 703, 696 P.2d 95; *Robertson v. Hyde* (1943) 58 C.A.2d 667, 672, 137 P.2d 703 [denial of enforcement would defeat main purpose of illegality statute]; *Denning v. Taber* (1945) 70 C.A.2d 253, 258, 160 P.2d 900, *infra*, §429; *Norwood v. Judd* (1949) 93 C.A.2d 276, 289, 209 P.2d 24, *infra*, §444; *Wilson v. Stearns* (1954) 123 C.A.2d 472, 481, 267 P.2d 59 [real estate broker allowed to recover his commission to extent of completed performance to avoid unjust enrichment of seller]; *Nichols v. Boswell-Alliance Const. Corp.* (1960) 181 C.A.2d 584, 587, 5 C.R. 546, 3 *Summary* (10th), *Agency and Employment*, §76 [same]; *Emmons, Williams, Mires & Leech v. State Bar* (1970) 6 C.A.3d 565, 569, 570, 86 C.R. 367, 1 *Cal. Proc.* (4th), *Attorneys*, §30; *Homestead Supplies v. Executive Life Ins. Co.* (1978) 81 C.A.3d 978, 990, 147 C.R. 22, citing the text; *Calwood Structures v. Herskovic* (1980) 105 C.A.3d 519, 522, 164 C.R. 463; *Johnson v. Johnson* (1987) 192 C.A.3d 551, 557, 237 C.R. 644, citing the text [criteria of *Norwood*, satisfied, and contract enforced]; *Dunkin v. Boskey* (2000) 82 C.A.4th 171, 196, 98 C.R.2d 44, 10 *Summary* (10th), *Parent and Child*, §206 [although contract between unmarried woman and man, which granted man paternity, visitation, and custody rights to child conceived by artificial insemination with anonymous donor, was unenforceable by man on public policy grounds insofar as he sought damages for emotional harm, he could recover his economic loss under unjust enrichment theory]; 15 *Corbin* (Rev. ed.), §89.19 et seq.; 6 *Williston* 4th, §12:6; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §302 et seq.; 12 *Hastings L. J.* 361; *infra*, §§442, 443, 449.)

The court in *Homestead Supplies*, *supra*, quoted *Corbin* as follows: "It is far from correct to say that an illegal bargain is necessarily 'void,' or that the law will grant no remedy and will always leave the parties to such a bargain where it finds them. ... Before granting or refusing a remedy, the courts have always considered the degree [of] the

offense, the extent of public harm that may be involved, and the moral quality of the conduct of the parties in the light of the prevailing mores and standards of the community." (81 C.A.3d 990.)

Where the illegality is due to *facts* of which the defendant is aware but the plaintiff is excusably ignorant, recovery of the value of performance is permitted. (*Lewis v. Wainscott* (1954) 124 C.A.2d 345, 351, 268 P.2d 835; *Holland v. Morgan & Peacock Properties Co.* (1959) 168 C.A.2d 206, 210, 335 P.2d 769; 15 Corbin (Rev. ed.), §89.21; 6 Williston 4th, §12:6; and see *Rest.2d, Contracts* §180, 198(a).)

SUPPLEMENT: [This section is current through the latest supplement]

See *Maudlin v. Pacific Decision Sciences Corp.* (2006) 137 C.A.4th 1001, 1012, 40 C.R.3d 724 [retiree was not precluded from enforcing stock redemption contract with company that was structured so as to evade taxes, inasmuch as parties were not *in pari delicto*; company structured contract with no input from retiree and derived tax advantage, while retiree paid taxes on all received income at ordinary income rate, and refusal to enforce the agreement would unjustly enrich company]; *California Physicians' Service v. Aoki Diabetes Research Institute* (2008) 163 C.A.4th 1506, 1514, 78 C.R.3d 646 [any illegality in health care provider's organization as nonprofit corporation did not negate health care service plan's contractual obligation to pay for provider's services, because contract was not *malum in se* and plan would be unjustly enriched if it were allowed to retain benefit of services bestowed on its subscribers without compensating provider]; cf. *Kelton v. Stravinski* (2006) 138 C.A.4th 941, 949, 41 C.R.3d 877 [criteria for enforcing invalid covenant not to compete were absent].

Emmons, Williams, Mires & Leech case:

Cross-Reference: 1 *Cal. Proc.* (5th), *Attorneys*, §13. *Correction:* Page 481, line 10 of section, "*Asdourian v. Ajar*" should be "*Asdourian v. Araj*".



187 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

IX. ILLEGALITY: IN GENERAL

B. Effect of Illegality.

2. Effect of Being, or Not Being, in *Pari Delicto*.

b. Enforcement of Contract.

2. When Contract Will Be Enforced.

bb. License Cases.

1 *Witkin Sum. Cal. Law Contracts* § 442

[§ 442] License Cases.

The most common illustrations of the liberal approach described in the preceding section are actions involving an unlicensed person.

In *Denning v. Taber* (1945) 70 C.A.2d 253, 160 P.2d 900 (supra, §429), a partnership agreement to operate a saloon was illegal as a result of defendant's action in taking the license in his own name. Plaintiff, who had relied on defendant to procure licenses for both, was allowed to recover his share of the assets after termination. (70 C.A.2d 258.) (See *Latipac v. Superior Court* (1966) 64 C.2d 278, 287, 49 C.R. 676, 411 P.2d 564, infra, §499; *Keller v. Thornton Canning Co.* (1967) 66 C.2d 963, 966, 59 C.R. 836, 429 P.2d 156, infra, §502 [unlicensed carrier allowed to sue to recover statutory minimum rate; in light of statutory objectives, preservation of rate structure is more essential than penalizing unlicensed carriers]; *Hedlund v. Sutter Med. Service Co.* (1942) 51 C.A.2d 327, 333, 124 P.2d 878 [statutory restriction on practice of medicine is for protection of the public, including plaintiff, "and not at all for the protection of one who wrongfully engages in its practice"]; *Hooper v. Barranti* (1947) 81 C.A.2d 570, 577, 184 P.2d 688, supra, §430, [distinguishing but emphasizing this basis of *Denning*]; *Norwood v. Judd* (1949) 93 C.A.2d 276, 289, 209 P.2d 24, infra, §444, [following *Denning* on this ground]; *Oddo v. Hedde* (1950) 101 C.A.2d 375, 386, 225 P.2d 929; *Marshall v. Von Zumwalt* (1953) 120 C.A.2d 807, 810, 262 P.2d 363 [plaintiff owner denied right to recover money paid to unlicensed contractor for satisfactory performance]; *Nevcal Enterprises v. Cal-Neva Lodge* (1963) 217 C.A.2d 799, 806, 32 C.R. 106 [unlicensed person allowed to recover to avoid injustice; plaintiff ignorant of illegality known to defendant]; *Greene v. Brooks* (1965) 235 C.A.2d 161, 168, 45 C.R. 99 [following *Denning* and *Norwood*]; 15 Corbin (Rev. ed.), §88.1 et seq.)

In *Southfield v. Barrett* (1970) 13 C.A.3d 290, 294, 91 C.R. 514, plaintiff contracted to market hay grown by defendant on certain land, on a commission basis, and advanced \$ 40,000 to defendant. After partial performance, defendant refused to deliver any hay, and in plaintiff's action for breach of contract defendant set up the defense of plaintiff's noncompliance with the license requirements of former Ag.C. 1263 (now *Food & Ag.C. 56181*) for commission merchants or brokers. *Held*, although the contract was illegal, the case came within the recognized exceptions to the rule of unenforcement: "The violation of law was one which did not involve serious moral turpitude;

the policy of protecting the public from the future consequences of the contract will not be furthered because the transaction has been completed; neither party can be said to have been guilty of the 'greatest moral fault;' defendant would be unjustly enriched at the expense of plaintiff were he not required at least to repay the balance owing on the \$ 40,000 advance payment; and the penalty resulting from denial of relief would be disproportionately harsh in relation to the violation involved." (13 C.A.3d 294.) (See *Asdourian v. Araj* (1985) 38 C.3d 276, 292, 293, 211 C.R. 703, 696 P.2d 95, *infra*, §500 [citing *Southfield*].)

In *Culbertson v. Cizek* (1964) 225 C.A.2d 451, 37 C.R. 548, the court, citing such cases as *Marshall*, declared that an unlicensed contractor unable to obtain an affirmative judgment may nevertheless offset as a defense against sums due the owner any amounts that would otherwise be payable on the contract. "The philosophy of these cases permits the unlicensed contractor to assert his counterdemands defensively as it were, to the end of reducing in whole or in part the claims against him but without authorizing an affirmative judgment in the contractor's favor for an excess." (225 C.A.2d 473.)

SUPPLEMENT: [This section is current through the latest supplement]

See *Medina v. Safe-Guard Products, Int.* (2008) 164 C.A.4th 105, 110, 78 C.R.3d 672 [statute providing that where contract has but single object, and such object is unlawful, whether in whole or in part, entire contract is void does not preclude consumer who innocently purchases insurance policy from company unlicensed in California from enforcing insurance contract, because contract's objective of providing insurance to innocent consumer is severable and lawful].



188 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law

IX. ILLEGALITY: IN GENERAL

B. Effect of Illegality.

2. Effect of Being, or Not Being, in *Pari Delicto*.

b. Enforcement of Contract.

2. When Contract Will Be Enforced.

cc. Plaintiff in *Pari Delicto*.

1 Witkin Sum. Cal. Law Contracts § 443

[§ 443] Plaintiff in *Pari Delicto*.

In a few cases, a party *in pari delicto* has been allowed to maintain an action based on the contract. Two distinct underlying reasons appear in the opinions: the possible defeat of the statutory object by strict application of the rules of illegality, and the relatively slight or technical illegality in some "illegal" agreements.

The first reason is illustrated by *Butler v. Bell Oil & Refining Co.* (1945) 70 C.A.2d 728, 161 P.2d 559. Plaintiff carrier contracted to transport oil for defendant at rates below the minimum set by the Public Utilities Commission under the Highway Carriers Act, and later sued to recover the difference. The right to recover was upheld as a means of effectuating the statutory purpose: "Collusion between the carrier and the shipper to circumvent the law, which would otherwise be easy of accomplishment, will be practically eliminated." (70 C.A.2d 730.) (See *South Tahoe Gas Co. v. Hofmann Land Imp. Co.* (1972) 25 C.A.3d 750, 760, 102 C.R. 286 [forfeiture of legal charge would defeat statutory policy against discounts or rebates to public utility customers]; 64 Harv. L. Rev. 1000.)

The second reason is illustrated by *Henry v. General Forming Ltd.* (1948) 33 C.2d 223, 200 P.2d 785. A used car dealer purchased a new car but registered it in the name of M, a private individual, contrary to the provisions of Veh.C. 5600. The reason for the transaction was to enable the used car dealer to obtain scarce new cars for resale at a premium, by using M as a dummy buyer. *Held*, the dealer's title was good against an attaching general creditor of M, the registered owner. The court reasoned that the *contract* of purchase was legal, despite the failure of title to pass for lack of compliance with the statutory formalities. "The requirements for registration of title and ownership ... were enacted in the interest of the public welfare to protect innocent purchasers and afford identification of vehicles and persons responsible in cases of accident and injury. ... [P]laintiff, as a general creditor of the defendant [M], is not one for whose protection the ownership registration requirements were intended." (33 C.2d 227.) (See discussion in dissenting opinion in *Severance v. Knight-Counihan Co.* (1947) 29 C.2d 561, 572, 580, 177 P.2d 4, *supra*, §440.)

West's Key Number Digest, Contracts k.139-

SUPPLEMENT: [This section is current through the latest supplement]



189 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

IX. ILLEGALITY: IN GENERAL

B. Effect of Illegality.

2. Effect of Being, or Not Being, in *Pari Delicto*.

b. Enforcement of Contract.

2. When Contract Will Be Enforced.

dd. Illegal Partnership.

1 Witkin Sum. Cal. Law Contracts § 444

[§ 444] Illegal Partnership.

Some licensing acts recognize a partnership as an entity and require a special partnership license; in addition, the statutes may require that each partner be individually licensed. The effect of these statutes is, normally, to preclude any action on a contract between third persons and the unlicensed partnership. (But see 9 *Summary* (10th), *Partnership*, §24.) Where, however, the action does not involve third parties or even the continuance of the unlicensed partnership activity, but is merely the attempt by one partner to obtain from the other his or her share of the partnership assets after dissolution, some California cases have allowed recovery either on the theory of severability (see *supra*, §422) or on a more liberal approach to the doctrine of *in pari delicto* by emphasizing *the parties' conduct* and the *purposes of the statute*.

Thus, in *Denning v. Taber* (1945) 70 C.A.2d 253, 256, 160 P.2d 900 (*supra*, §429), and in *Norwood v. Judd* (1949) 93 C.A.2d 276, 209 P.2d 24, plaintiff partner relied on defendant partner to obtain the necessary license and the latter failed to do so. In *Norwood*, the court observed that the licensing acts were enacted for the protection of the public and not "for the benefit of a greedy partner who seeks to keep for himself all of the fruits of the partnership enterprise to the exclusion of another partner entitled to share therein." (93 C.A.2d 286.) The court then criticized the application of the doctrine of equal wrong "blindly," without regard to "realities," and added: "Where, by applying the rule, the public cannot be protected because the transaction has been completed, where no serious moral turpitude is involved, where the defendant is the one guilty of the greatest moral fault, and where to apply the rule will be to permit the defendant to be unjustly enriched at the expense of the plaintiff, the rule should not be applied." (93 C.A.2d 289.) (See *Epstein v. Stahl* (1959) 176 C.A.2d 53, 59, 1 C.R. 143, *infra*, §498.)

West's Key Number Digest, Contracts k.139

SUPPLEMENT: [This section is current through the latest supplement]



190 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law

IX. ILLEGALITY: IN GENERAL

B. Effect of Illegality.

2. Effect of Being, or Not Being, in *Pari Delicto*.

c. Member of Protected Class.

1 Witkin Sum. Cal. Law Contracts § 445

[§ 445] Member of Protected Class.

If a person is a member of a class for whose benefit a statute was passed, he or she is usually considered not *in pari delicto*. (See *Rest.2d, Contracts §198(b)*; 15 Corbin (Rev. ed.), §89.20; 17A *Am.Jur.2d* (2004 ed.), *Contracts §316*.)

Thus, the former Corporate Securities Act made illegal a contract to sell corporate stock without a permit from the Commissioner of Corporations, or in violation of the terms of such a permit. The statute was designed to protect *buyers*, and the penalties specified therein were on the seller. Accordingly, the buyer in the ordinary case was permitted to recover the money or other consideration given for the stock. (*Tatterson v. Kehrlein* (1927) 88 C.A. 34, 49, 263 P. 285; *Randall v. Beber* (1951) 107 C.A.2d 692, 701, 237 P.2d 994; see 84 A.L.R.2d 479 [violations of Corporate Securities Acts]; 15 Corbin (Rev. ed.), §88.6.) (On present Corporation Securities Law of 1968, see 9 *Summary* (10th), *Corporations*, §401 et seq.) [neither sale nor security void; instead, standards of conduct are established for buyers and sellers of securities, and specific remedies provided for persons injured by violations of such standards].

Other cases illustrate the same principle. (See *McAllister v. Drapeau* (1939) 14 C.2d 102, 112, 92 P.2d 911 [debtor mortgagor who executed secret second mortgage in violation of H.O.L.C. Act under threat of foreclosure not *in pari delicto* with creditor mortgagee]; *Stock v. Meek* (1950) 35 C.2d 809, 817, 221 P.2d 15 [borrower who pays usurious interest not *in pari delicto* with lender].)

A remarkable departure from the general rule appears in *Lewis v. Ferrari* (1939) 34 C.A.2d Supp. 767, 90 P.2d 384, where a woman employee, under direction of her employer, worked overtime in violation of former Lab.C. 1354, but was paid only the regular minimum wage for 48 hours per week. In a suit for the value for her overtime, the court denied recovery on the theory that she had acted voluntarily, and that the statute was not designed exclusively for the benefit of employees. (34 C.A.2d Supp. 770.)

The opposite conclusion was reached in *Bartholomew v. Heyman Properties* (1955) 132 C.A.2d Supp. 889, 281 P.2d 921. The court invoked Lab.C. 1194, which then provided that a woman or minor paid less than the minimum wage could recover the unpaid amount. Plaintiff, required to work 86 hours per week for wages based on less than that number of hours, was awarded judgment for the deficiency. The court said that section 1194 "is a declaration by the Legislature of the public policy of this state that an employee who is paid less than a minimum wage shall not be

considered *in pari delicto* with the employer who has violated the statute." (132 C.A.2d Supp. 894.) *Lewis v. Ferrari* was distinguished (and in effect disapproved) on the grounds that the facts showed a conspiracy by employer and employee to falsify records of hours worked, and *Lab.C. 1194* was not considered. (132 C.A.2d Supp. 895.)

SUPPLEMENT: [This section is current through the latest supplement]



191 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

IX. ILLEGALITY: IN GENERAL

B. Effect of Illegality.

2. Effect of Being, or Not Being, in *Pari Delicto*.

d. Determination of Relative Wrong.

1 Witkin Sum. Cal. Law Contracts § 446

[§ 446] Determination of Relative Wrong.

The question of relative wrong is often one of fact. (See *Domenigoni v. Imperial Live Stock & Mortg. Co.* (1922) 189 C. 467, 475, 209 P. 36 [no recovery by buyer of stock who was himself attempting to circumvent Corporate Securities Act]; *Takeuchi v. Schmuck* (1929) 206 C. 782, 785, 276 P. 345 [child held guilty of intent to violate former Alien Land Law; see criticism, 18 Cal. L. Rev. 75]; *Sontag v. Denio* (1937) 23 C.A.2d 319, 323, 73 P.2d 248 [client who engages in fraudulent transfer of assets in reliance on advice of attorney is not *in pari delicto* with attorney]; *Menke v. Rand Mining Co.* (1947) 81 C.A.2d 169, 174, 183 P.2d 755 [reversal for court's refusal to hear evidence on issue whether buyer of stock was *in pari delicto*]; *May v. Herron* (1954) 127 C.A.2d 707, 711, 274 P.2d 484 [contractor who initiated illegal transaction denied recovery]; 15 Corbin (Rev. ed.), §89.17 et seq.; 12 *Hastings L. J.* 362.)

Nevertheless, in *Elmers v. Shapiro* (1949) 91 C.A.2d 741, 205 P.2d 1052, the court refused to give any weight to the *fact* of equal wrong where the party seeking relief was a member of the protected class (see *supra*, 445). Plaintiff, a veteran, using his preference under the federal Veterans' Emergency Housing Act of 1946, bought a house from defendant. As part of the deal, plaintiff offered his own property as a trade-in at a substantial undervaluation, with the result that he actually paid more than the ceiling price. In plaintiff's suit to recover the overcharge, defendant relied on evidence that plaintiff knew all the facts and importuned him to accept the deal. *Held*, plaintiff could recover; the statute, enacted for the protection of the veteran, imposes penalties on those who deal with him but not on the veteran himself, and he commits no offense in paying the excessive price. The general rule denying relief to a party in equal wrong has no application to transactions violative of a statute, "where such statute is aimed at protecting one of the parties to the transaction. In such cases, there is no parity of *delictum*, and the one protected by the law may, at any time, resort to the law to recover money paid even though the illegal transaction is completed." (91 C.A.2d 754.) The conclusion reached was doubtless in accord with the purposes of the particular legislation, as indicated by federal decisions in the field of price control, which the court discusses, but the rule quoted above seems too broad in view of the California cases dealing with the buyers of corporate securities (see *Menke* and *Domenigoni*).

Smith v. Turner (1965) 238 C.A.2d 141, 47 C.R. 582, again shows how membership in the protected class is more important than the facts of wrongdoing. Defendant induced plaintiffs to put money into his corporation. Plaintiffs, inexperienced in business, (1) paid money for their shares in violation of former Corp.C. 25153; and (2) after defendant misrepresented to the Corporation Commissioner that the money had been returned to them, plaintiffs signed receipts

falsely reciting the return. In this action by plaintiffs to recover the money, the first wrong--technical violation of the regulatory statute--could be excused on the ground of plaintiffs' lack of experience in corporate transactions. But the second involved deliberate false representations to a public officer concerning compliance with a regulation which by that time was fully known to plaintiffs. Their explanation--that they signed to protect their interests, trusting defendant to do whatever was right--was accepted, not because it excused their wrongdoing, but because it was the only way to keep the major wrongdoer from profiting at the expense of the others. (238 C.A.2d 149.)

Licensing acts do not always place the penalties on one side. Thus, former B. & P.C. 10259 and 10260, prohibiting transactions of unlicensed business opportunity brokers, provided for a \$ 500 fine for the broker and a \$ 50 fine for the person who paid the commission. In *Willig v. Gold* (1946) 75 C.A.2d 809, 171 P.2d 754, the owner sought to recover the commission paid, arguing that the *difference* in the size of the penalties showed a legislative intent to treat the owner as not *in pari delicto*. *Held*, he could not recover; both parties were "marked as the criminals" by the legislative imposition of penalties on each. (75 C.A.2d 811.)

SUPPLEMENT: [This section is current through the latest supplement]



192 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

IX. ILLEGALITY: IN GENERAL

B. Effect of Illegality.

3. Voluntary Withdrawal From Executory Contract.

1 Witkin Sum. Cal. Law Contracts § 447

[§ 447] Voluntary Withdrawal From Executory Contract.

Recovery of consideration is also allowed to a party who is equally guilty with the other, if that party repudiates the illegal transaction and attempts to withdraw from it before the illegal purpose has been accomplished. The period during which the contract is unexecuted is called the *locus poenitentiae*, and the theory of the rule is that it offers an inducement to the parties to give up the illegal object. Hence, not only is it immaterial that the parties are *in pari delicto*, but it is likewise immaterial that the contract is *malum in se*. (See *Wasserman v. Sloss* (1897) 117 C. 425, 428, 49 P. 566; *National Stone Tile Corp. v. Voorheis* (1928) 93 C.A. 738, 743, 270 P. 286; cf. *Moss v. Moss* (1942) 20 C.2d 640, 643, 128 P.2d 526; 5 Cal. Proc. (4th), *Pleading*, §830 [trial court has discretion to deny relief where parties are *in pari delicto*]; and see *Rest.2d, Contracts* §199; 15 Corbin (Rev. ed.), §89.23; 8 Williston 4th, §19:78; 17A Am.Jur.2d (2004 ed.), *Contracts* §313; 18 Cal. L. Rev. 80; 27 Cal. L. Rev. 602.)

SUPPLEMENT: [This section is current through the latest supplement]

Moss case:

Cross-Reference: 5 Cal. Proc. (5th), *Pleading*, §876.



193 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
IX. ILLEGALITY: IN GENERAL
B. Effect of Illegality.
4. Illegal Provision Inserted by Mistake.

1 Witkin Sum. Cal. Law Contracts § 448

[§ 448] Illegal Provision Inserted by Mistake.

In connection with illegal agreements, the following distinction is fundamental: (1) A party may obtain *reformation* of a contract so as to strike out its illegal part, if the party can show that the actual terms agreed upon were different, and that the *illegal provision was placed in the writing by mistake*. (2) But neither party can excuse illegality by claiming mistake of law, i.e., no knowledge of the *illegality of the terms agreed upon*. (See *Strauss v. Bruce* (1934) 139 C.A. 62, 66, 33 P.2d 71 [usurious interest provision]; 74 A.L.R.3d 1239 [reformation of usurious contract]; 6 Williston 4th, §12:6.)

This distinction was overlooked in *Adams v. Heinsch* (1948) 89 C.A.2d 300, 200 P.2d 796. Plaintiff lessor leased his apartment house to defendant lessee for \$ 350 per month, a rental in excess of the O.P.A. ceiling (\$ 100). Subsequently plaintiff sued for rescission and the reasonable value of use of the premises, claiming that the lease was made in the mistaken belief that the regulations did not apply. *Held*, "to deny a rescission in the face of the record showing an innocent misunderstanding of a highly complicated legal matter and a mutually unknown factual situation, amounts to a violation of fundamental equitable principles." (89 C.A.2d 304.) Accordingly, the trial court was directed to give judgment rescinding the lease and denying relief to defendant on his cross-complaint for recovery of the overcharge. The meaning of the decision would appear to be that ignorance of the law may be a good ground for relief if the law consists of voluminous and complicated (and, perhaps, disfavored) administrative regulations. But it is by no means clear why the lessee was denied recovery of the excess amounts; the effect of this part of the holding is that the lessor, though formally seeking relief from the illegal contract, was in fact allowed to enforce its illegal terms for the period during which it was operative. (Cf. *Elmers v. Shapiro* (1949) 91 C.A.2d 741, 750, 205 P.2d 1052, *supra*, §446 [rejecting the claims of good faith and reliance on advice of an administrative official]; and see 15 Corbin (Rev. ed.), §89.22; 6 Williston 4th, §12:6; 11 A.L.R.3d 1498 [usury as affected by mistake in amount or calculation of interest or service charges for loan].)

SUPPLEMENT: [This section is current through the latest supplement]



194 of 199 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
IX. ILLEGALITY: IN GENERAL
B. Effect of Illegality.
5. Relief Against Forfeiture.

1 Witkin Sum. Cal. Law Contracts § 449

[§ 449] Relief Against Forfeiture.

The theory that an illegal contract is wholly void and consequently need not be rescinded could easily lead to a forfeiture; but in *People v. Barenfeld* (1962) 203 C.A.2d 166, 21 C.R. 501, the court refused to carry the theory to that conclusion.

The complaint alleged that defendants conspired to defraud the state by purchasing property needed by the state, then leasing and selling to the state at an inflated figure; and that this was accomplished by means of gifts to state employees and illegal lobbying. The prayer was for retention of the property and recovery of all rentals and purchase money paid; i.e., the state did not seek rescission and did not offer to restore the property. *Held*, judgment for defendants on the pleadings affirmed. The allegations clearly established illegal conduct that made the contract invalid. But the state sought to enforce a forfeiture, contrary to the equitable principle (see 13 *Summary* (10th), *Equity*, §20), which is applicable to the state as well as to a private litigant. (203 C.A.2d 178.) "We conclude that there was no impediment to a rescission of the instant contracts by the state or to a restoration by it of the benefits received from defendant wrongdoers. In this respect the state is on a parity with a private suitor in the case at bar and its failure to rescind and restore or offer to restore precludes it from recovering from defendants any of the moneys paid out by the state." (203 C.A.2d 183.) (See 17A *Am.Jur.2d* (2004 ed.), *Contracts* §§301, 574 et seq.)

Restitution may be given, to avoid a forfeiture, even though the parties are *in pari delicto*. In *Griffis v. Squire* (1968) 267 C.A.2d 461, 73 C.R. 154, plaintiff claimant under the federal Desert Land Entries Act illegally contracted to transfer a portion of the land to defendants before the patent issued. Defendants entered and made improvements. *Held*, defendants were entitled to the value of the improvements. (267 C.A.2d 473.) (See *Rest.2d*, *Contracts* §197, Comment b; 15 *Corbin* (Rev. ed.), §89.16; 8 *Williston* 4th, §19:75; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §§301, 574 et seq.)

West's Key Number Digest, Contracts k.138

SUPPLEMENT: [This section is current through the latest supplement]



195 of 199 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

IX. ILLEGALITY: IN GENERAL

B. Effect of Illegality.

6. Attempt To Evade Illegality by Arbitration.

1 Witkin Sum. Cal. Law Contracts § 450

[§ 450] Attempt To Evade Illegality by Arbitration.

(1) *Illegality of Entire Contract.* A contract may contain an arbitration provision making the arbitrators' award conclusive on questions of *law* as well as fact. An attempt to use "the transforming process of arbitration" to sustain an illegal agreement was defeated by a divided court in *Loving & Evans v. Blick* (1949) 33 C.2d 603, 204 P.2d 23. A contractor's agreement with defendant owner contained an arbitration clause covering "any controversy" arising between the parties. After a dispute arose as to the balance due, the matter was submitted to arbitration and an award was made in favor of plaintiffs, the contractors. In this action to confirm the award, defendant set up plaintiffs' failure to comply with the licensing provisions of the statute. Plaintiffs' position, substantially adopted in the dissenting opinions, was that the issue of illegality is a mixed question of law and fact; that an arbitrator has power to determine both kinds of questions; that the final award, being a substitute for an action, is as conclusive as a judgment by a court; and that to allow the redetermination of the question of illegality thereafter is "a backward step in the science of jurisprudence and in the administration of justice, as the law favors the submission of matters to arbitration." (33 C.2d 625.) *Held*, the award could not preclude the defense of illegality.

(a) The power of the arbitrator to determine rights under a contract is *dependent upon the existence of a valid contract* under which this right might arise, and the question of the validity of the basic contract is essentially a *judicial question*, which cannot be finally determined by an arbitrator. (33 C.2d 610.)

(b) This is true regardless of the procedural situation; i.e., if the illegality appears to the court when a petition is filed seeking an order for arbitration, the court should deny the petition; if the illegality does not appear until later, when the petition is to confirm the award, the court should deny confirmation and vacate the award. "A claim that cannot be made the basis of a suit cannot be made the basis of an arbitration. The mere submission of an illegal matter to arbitrators and reducing it to an award does not purge it of its illegality." (33 C.2d 611, quoting a Texas case.)

The majority opinion sums up its position as follows: "If this were not the rule, courts would be compelled to stultify themselves by lending their aid to the enforcement of contracts which have been declared by statute to be illegal and void. A party seeking confirmation cannot be permitted to rely upon the arbitrator's conclusion of legality for the reason that paramount considerations of public policy require that this vital issue be committed to the court's determination whenever judicial aid is sought." (33 C.2d 614.) (See *Franklin v. Goldstone Agency* (1949) 33 C.2d 628, 632, 204 P.2d 37; *Black v. Cutter Laboratories* (1955) 43 C.2d 788, 799, 278 P.2d 905; *Green v. Mt. Diablo Hosp.*

Dist. (1989) 207 C.A.3d 63, 74, 254 C.R. 689 [*Loving & Evans v. Blick*, *supra*, does not require uncontroverted evidence of illegality; it merely stands for proposition that legality must first be judicially determined]; 30 So. Cal. L. Rev. 397.)

(2) *Partial Illegality of Contract*. In *Moncharsh v. Heily & Blase* (1992) 3 C.4th 1, 10 C.R.2d 183, 832 P.2d 899, 6 Cal. Proc. (4th), *Proceedings Without Trial*, §521, the court held that *Loving & Evans*, *supra*, and *All Points Traders v. Barrington Associates* (1989) 211 C.A.3d 723, 259 C.R. 780, both of which involved a claim that the *entire* contract was illegal, do not authorize judicial review where but a single provision is challenged on the ground of illegality. In that situation, the proper rule is as follows: "[T]he normal rule of limited judicial review may not be avoided by a claim that a provision of the contract, construed or applied by the arbitrator, is 'illegal,' except in rare cases when according finality to the arbitrator's decision would be incompatible with the protection of a statutory right." (3 C.4th 33.)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Illegality of Entire Contract*. See *Duffens v. Valenti* (2008) 161 C.A.4th 434, 454, 74 C.R.3d 311, citing the text [arbitration agreements were not severable from dating service contracts that were void because they did not provide that clients could elect to be relieved of obligation to make payments for services upon death, disability, or relocation, and thus clients could not be compelled to arbitrate their claims of fraud and violations of statutory dating service contract requirements, because omitted provisions were central to policy of dating service statutes]. (2) *Partial Illegality of Contract*.

Moncharsh case:

Cross-Reference: 6 Cal. Proc. (5th), *Proceedings Without Trial*, §574. *Correction:* Page 491, line 8 of third full paragraph, "*Franklin v. Goldstone Agency*" should be "*Franklin v. Nat C. Goldstone Agency*".



196 of 199 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

IX. ILLEGALITY: IN GENERAL

C. Classes of Illegal Contracts.

1. In General.

1 Witkin Sum. Cal. Law Contracts § 451

[§ 451] In General.

The Civil Code places illegal contracts in three groups: (1) those contrary to *express statutes*; (2) those contrary to the *policy of express statutes*; (3) those otherwise *contrary to good morals*. (C.C. 1667.) (See *Mason v. Hosta* (1984) 152 C.A.3d 980, 987, 199 C.R. 859 [\$ 250 per month to be paid by doctor to hospital administrator for each hospital client referred to doctor; violation of B. & P.C. 650]; 15 Corbin (Rev. ed.), §79.2; 5 Williston 4th, §12:1 et seq.; Cal. Civil Practice, 3 Business Litigation §24:47 et seq.)

These distinctions only relate to the determination of illegality; where its effect is concerned, the only distinction of any consequence is between those *malum in se* and *malum prohibitum*. (See *supra*, §431.) Contracts violative of express statutes are considered herein in some detail. (See *infra*, §455 et seq.); and see 4 *Summary* (10th), *Sales*, §255; 12 *Summary* (10th), *Real Property*, §808 et seq.

SUPPLEMENT: [This section is current through the latest supplement]



197 of 199 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law
IX. ILLEGALITY: IN GENERAL
C. Classes of Illegal Contracts.
2. Contracts Contrary to Public Policy.
a. General Principle.

1 Witkin Sum. Cal. Law Contracts § 452

[§ 452] General Principle.

Anything that has a tendency to injure the public welfare is, in principle, against public policy. But to determine what contracts fall into this vague class is exceedingly difficult. It has been frequently observed that the question is primarily for the Legislature, and that, in the absence of a legislative declaration, a court will be very reluctant to hold the contract void. (*Maryland Cas. Co. v. Fidelity & Cas. Co. of New York* (1925) 71 C.A. 492, 497, 236 P. 210; *San Bernardino v. Gate City Creamery Co.* (1930) 103 C.A. 367, 373, 284 P. 457; *Winklemen v. Sides* (1939) 31 C.A.2d 387, 408, 88 P.2d 147; *Burkhardt v. Lofton* (1944) 63 C.A.2d 230, 239, 146 P.2d 720; *Vick v. Patterson* (1958) 158 C.A.2d 414, 417, 322 P.2d 548; and see *A.C. Frost & Co. v. Coeur D'Alene Mines Corp.* (1941) 312 U.S. 38, 61 S.Ct. 414, 417, 85 L.Ed. 500, 505; *Bovard v. American Horse Enterprises* (1988) 201 C.A.3d 832, 839, 247 C.R. 340, *infra*, §454; 15 Corbin (Rev. ed.), §79.3; 5 Williston 4th, §12:1 et seq.; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §237 et seq.)

An example of a requisite legislative declaration is found in provisions in specified construction subcontracts either requiring a dispute to be litigated or determined outside California or precluding a party from litigating or otherwise resolving the dispute in this state. The Legislature has stated that these provisions are void and unenforceable. (*C.C.P.* 410.42; see 2 *Cal. Proc.* (4th), *Jurisdiction*, §350.)

West's Key Number Digest, Contracts k.108(1)

SUPPLEMENT: [This section is current through the latest supplement]

See 119 *Harv. L. Rev.* 1445 [legal and economic aspects of contracts against public policy].*C.C.P.* 410.42:

Cross-Reference: 2 *Cal. Proc.* (5th), *Jurisdiction*, §359.



198 of 199 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law
IX. ILLEGALITY: IN GENERAL
C. Classes of Illegal Contracts.
2. Contracts Contrary to Public Policy.
b. Restatement 2d.

1 *Witkin Sum. Cal. Law Contracts* § 453

[§ 453] Restatement 2d.

The Restatement (§§178 and 179) treats this problem as follows:

(1) *The Weighing Process: General Rule.* "A promise or other term of an agreement is unenforceable on grounds of public policy if legislation provides that it is unenforceable or the interest in its enforcement is clearly outweighed in the circumstances by a public policy against the enforcement of such terms." (*Rest.2d, Contracts* §178(1).)

(2) *The Weighing Process: Interest in Enforcement.* "In weighing the interest in the enforcement of a term, account is taken of

"(a) the parties' justified expectations,"

"(b) any forfeiture that would result if enforcement were denied, and"

"(c) any special public interest in the enforcement of the particular term." (*Rest.2d, Contracts* §178(2).)

"(3) *The Weighing Process: Public Policy Against Enforcement.* "In weighing a public policy against enforcement of a term, account is taken of"

"(a) the strength of that policy as manifested by legislation or judicial decisions,"

"(b) the likelihood that a refusal to enforce the term will further that policy,"

"(c) the seriousness of any misconduct involved and the extent to which it was deliberate, and"

"(d) the directness of the connection between that misconduct and the term." (*Rest.2d, Contracts* §178(3).)

(4) *Bases of Public Policies Against Enforcement.* *Rest.2d, Contracts* §179 reads as follows:

"A public policy against the enforcement of promises or other terms may be derived by the court from"

"(a) legislation relevant to such a policy, or"

"(b) the need to protect some aspect of the public welfare, as is the case for the judicial policies against, for example,"

"(i) restraint of trade (§§186-188),"

"(ii) impairment of family relations (§§189-191), and"

"(iii) interference with other protected interests (§§192-196, 356)."

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199 of 199 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law
IX. ILLEGALITY: IN GENERAL
C. Classes of Illegal Contracts.
2. Contracts Contrary to Public Policy.
c. Illustrations.

1 Witkin Sum. Cal. Law Contracts § 454

[§ 454] Illustrations.

An illustration of the process of finding illegality on "elementary" principles of public policy, without statutory provision or case law in point, is furnished by *Grimes v. Allen* (1949) 93 C.A.2d 653, 209 P.2d 651. Defendant police chief, after arresting plaintiff on a felony charge, made an agreement to purchase plaintiff's land for a low price, and had the deed executed, acknowledged, and recorded while plaintiff was in custody and unrepresented by counsel. *Held*, plaintiff was entitled to rescind; the transaction was void under the general principle that any contract by an officer that interferes with the unbiased discharge of his or her public duties is against public policy. The court considered the danger of oppression of prisoners so obvious that the vice of illegality was present even though the trial judge had expressly found no duress. (93 C.A.2d 656.)

On the other hand, in *Vick v. Patterson* (1958) 158 C.A.2d 414, 322 P.2d 548, plaintiff sued defendants to recover salary under a contract to do part-time television announcing. The defense was that plaintiff, a San Francisco fireman, was violating a Fire Department rule against engaging in other gainful occupations. *Held*: (a) The doctrine that a contract to do an act prohibited by statute is illegal, while applicable to municipal ordinances and rules of a regulatory commission, does not necessarily extend to rules of a municipal department governing its administrative affairs. (b) The department rule may be enforced by disciplinary proceedings against the employee, but its violation is not so serious as to call for nullification of the contract and consequent unjust enrichment of defendants. (158 C.A.2d 417.)

In *Bovard v. American Horse Enterprises* (1988) 201 C.A.3d 832, 247 C.R. 340, B sued R to recover on promissory notes executed in connection with the sale of a corporation devoted primarily to the manufacture of paraphernalia used in smoking marijuana (the corporation also manufactured some jewelry). Although the manufacture of drug paraphernalia was not itself illegal when the contract was executed, the trial judge found that a public policy against this manufacture was implicit in the statute making the possession, use, and transfer of marijuana unlawful. *Held*, judgment for defendant affirmed; applying the Restatement criteria (*supra*, §453), the contract was illegal and void.

(a) *Interest in enforcement.* The interest in enforcing the contract is very weak:

(1) "Neither party was reasonably justified in expecting the government would not eventually act to geld ... a business harnessed to the production of paraphernalia used to facilitate the use of an illegal drug." (201 C.A.3d 841.)

(2) "[A]lthough voidance of the contract imposed a forfeiture on Bovard, he did recover the corporate machinery, the only assets of the business which could be used for lawful purposes, i.e., to manufacture jewelry. Thus, the forfeiture was significantly mitigated if not negligible." (201 C.A.3d 841.)

(3) "[T]here is no special public interest in the enforcement of this contract, only the general interest in preventing a party to a contract from avoiding a debt." (201 C.A.3d 841.)

(b) *Policy against enforcement.* The factors favoring a public policy against enforcement of the contract are very strong:

(1) "[T]he public policy against manufacturing paraphernalia to facilitate the use of marijuana is strongly implied in the statutory prohibition against the possession, use, etc., of marijuana, a prohibition which dates back at least to 1929." (201 C.A.3d 841.)

(2) "Obviously, refusal to enforce the instant contract will further that public policy not only in the present circumstances but by serving notice on manufacturers of drug paraphernalia that they may not resort to the judicial system to protect or advance their business interests." (201 C.A.3d 841.)

(3) "[I]t is immaterial that the business conducted by American Horse Enterprises was not expressly prohibited by law when Bovard and Ralph made their agreement since both parties knew that the corporation's products would be used primarily for purposes which were expressly illegal." (201 C.A.3d 841.)

In *Cariveau v. Halferty* (2000) 83 C.A.4th 126, 99 C.R.2d 417, a securities dealer was investigated and disciplined by the National Association of Securities Dealers (NASD) after a former client complained of the dealer's misconduct. The dealer then sued the client for breach of a confidentiality clause in an earlier "forbearance agreement," which prohibited the client from discussing the dealer's misconduct with regulatory authorities. The trial court, finding that the confidentiality clause was void and unenforceable as a violation of public policy, entered judgment for the client. *Held*, affirmed.

(a) Public policy, in the context of a court's refusal to enforce a contract term, may be based on the policy expressed in a statute or the rules of a voluntary regulatory entity, or may be implied from the language of the statute or rule. When the policy of the statute or rule outweighs the interest in enforcement of the contract term, a court will not assist in giving effect to the offending term. (83 C.A.4th 132.)

(b) NASD rules require reporting outside business activities to a member's employer so that the employer can maintain effective oversight of the activities, and also encourage aggrieved investors to report wrongdoing so that the integrity of the system is preserved. The rules are derived from, and carry out the purposes of, the Securities Exchange Act of 1934 (15 U.S.C., §78a et seq.). They serve the statutory objectives of protecting the public from unethical practices, providing supervision of the activities of NASD members, and promoting public confidence in the integrity of effective self-regulation. Thus, the NASD rules are a valid source of public policy. (83 C.A.4th 133.)

(c) The forbearance agreement required suppression of information that the dealer was required to report to her employer and the NASD. It also allowed the dealer to continue to violate NASD rules, facilitated her periodic false reports to her employer, and frustrated the NASD's self-regulation policies. Although the agreement did not require affirmative falsehoods, it concealed the dealer's misconduct and other actions harmful to the public in general. The use of confidentiality agreements that purport to restrict a dealer's customers from reporting improper conduct to the NASD serves to perpetuate the improper conduct and is condemned by NASD policies. (83 C.A.4th 134.)

(d) *Rest.2d, Contracts* §178 (supra, §453) provides a weighing process for determining whether public policy considerations militate against the interest in enforcing a contract term. Although there is a general policy in favor of promoting the settlement of disputes without litigation, this is outweighed by the public policy, both express and implied, in the securities laws and regulations. Refusing to enforce the confidentiality clause does not affect the

settlement of the dispute between the parties, but merely declines assistance to the dealer's concealment of her wrongdoing. On the other hand, to permit the dealer's violations of rules and shield them from administrative review in an agreement to silence wrongdoing would undermine the public's confidence in the integrity of securities oversight. (83 C.A.4th 136.)

Other types of illegality recognized by the courts without express statutory directives include the following:

(1) A promise to commit a tort or to induce the commission of a tort. (See *Rest.2d, Contracts* §192; 15 Corbin (Rev. ed.), §85.1; 7 Williston 4th, §16:14.)

(2) A promise that tortiously interferes with performance of a contract with a third person. (See *Rest.2d, Contracts* §194; 15 Corbin (Rev. ed.), §85.16; 7 Williston 4th, §16:14.)

(3) A promise to commit a breach of contract. (See *Rest.2d, Contracts* §194; 15 Corbin (Rev. ed.), §85.16; 7 Williston 4th, §16:14.)

(4) An agreement not to disclose discreditable facts about another. (See *Brown v. Freese* (1938) 28 C.A.2d 608, 618, 83 P.2d 82; *Allen v. Jordanos'* (1975) 52 C.A.3d 160, 166, 125 C.R. 31 [agreement that defendant employer would withhold information of plaintiff's discharge for misconduct in order that he might obtain unemployment benefits].)

(5) A promise by a fiduciary to violate his or her fiduciary duty, or one that tends to induce such a violation. (See *Rest.2d, Contracts* §193.)

(6) An automobile insurance policy that does not cover the statutory liability under the driving with permission law. (See *Wildman v. Government Employees Ins. Co.* (1957) 48 C.2d 31, 39, 307 P.2d 359, 2 Summary (10th), *Insurance*, §170.) (On validity of liability policy provision requiring insured to reimburse insurer for payments made, see 29 A.L.R.3d 291.)

(7) "Pay-if-paid" clauses in construction subcontracts. (See 33 U.S.F. L. Rev. 99 [suggesting that these clauses in contracts for professional services should not be enforced].)

West's Key Number Digest, Contracts k.108(2)

SUPPLEMENT: [This section is current through the latest supplement]



1 of 40 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

A. Usury.

1. California Legislation.

a. Usury Law.

1 Witkin Sum. Cal. Law Contracts § 455

[§ 455] Usury Law.

Prior to 1934, the Usury Law made 7% the ordinary legal rate of interest, and 12% the maximum. Numerous problems of constitutionality and interpretation arose under this statute. (See *Wallace v. Zinman* (1927) 200 C. 585, 589, 254 P. 946; *In re Washer* (1927) 200 C. 598, 604, 254 P. 951; *Haines v. Commercial Mortg. Co.* (1927) 200 C. 609, 615, 254 P. 956, 255 P. 805; *Beneficial Loan Soc. v. Haight* (1932) 215 C. 506, 509, 11 P.2d 857; *Heald v. Friis-Hansen* (1959) 52 C.2d 834, 837, 345 P.2d 457; *People v. Campbell* (1930) 110 C.A. Supp. 783, 786, 291 P. 161; *Crooks v. People's Finance & Thrift Co. of Pomona Valley* (1930) 111 C.A. Supp. 769, 775, 292 P. 1065; 16 Cal. L. Rev. 281, 387; 20 Cal. L. Rev. 361; 1 So. Cal. L. Rev. 253; 2 So. Cal. L. Rev. 195; 18 Stanf. L. Rev. 1381 [discussion of history and aims of usury legislation, and "California's Model Approach"]; and see generally 21 Cal. L. Rev. 72; 13 Loyola L.A. L. Rev. 1 [Recent Changes in California and Federal Usury Laws]; 15 Pepperdine L. Rev. 151 [Consumer Debt and Usury: A New Rationale for Usury]; 8 San Diego L. Rev. 193; 6 Southwestern L. Rev. 166 [A Comprehensive View of California Usury Law]; 4 U.C. Davis L. Rev. 335, 421; 20 U.C. Davis L. Rev. 397 [Usury Law in California: A Guide Through the Maze]; 15 Corbin (Rev. ed.), §87.1 et seq.; 9 Williston 4th, §20:1 et seq.; 45 Am.Jur.2d (1999 ed.), Interest and Usury §1 et seq.; 14C Am.Jur. P.P. Forms (2003 ed.), Interest and Usury, §1 et seq.; Cal. Civil Practice, 5 Business Litigation §54:1 et seq.; 2 California Affirmative Defenses (2004 ed.), §37:13.)

Because it was an initiative measure, the statute (see Stats. 1919, p. lxxxiii) is uncodified. However, it is set forth in West's Annotated Codes at C.C. 1916-1 et seq.

In *Regents of Univ. of Calif. v. Superior Court* (1976) 17 C.3d 533, 131 C.R. 228, 551 P.2d 844, the court pointed out that the law, as then worded, applied to any "person, association, copartnership or corporation," and contained no express exception for the state, its subdivisions, or agencies. Whether an exception is to be implied depends upon whether inclusion would result in an infringement on sovereign governmental powers. As to petitioner, University of California, a public corporation: It is not clothed with state sovereignty, and has previously been held to come within the scope of general statutes. In investing its endowment fund by loans to borrowers, it is acting in the same capacity as a private university, corporation, or individual investing in a similar manner; its investment decisions are not so closely related to its educational decisions as to cloak the former with immunity even if the latter are immune. Hence the usury laws apply to its loans. (17 C.3d 537.)

As amended, the statute now applies to any "person, company, association or corporation." (Stats. 1919, p. lxxxiii, §§2, 3; C.C. 1916-2, 1916-3.) However, the effect of the law has been limited by subsequently adopted constitutional provisions. (See *infra*, §456.)

West's Key Number Digest, Usury k.3-

SUPPLEMENT: [This section is current through the latest supplement]
See 2 California Affirmative Defenses §37:13.



2 of 40 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

A. Usury.

1. California Legislation.
- b. Constitutional Provision.
1. Former Section and Revision.

1 Witkin Sum. Cal. Law Contracts § 456

[§ 456] Former Section and Revision.

(1) *Former Section.* In 1934, former Article XX of the California Constitution was amended to add section 22, limiting the maximum rate to 10%, but exempting nearly all *institutions* in the business of lending money, such as banks, building and loan associations, personal property brokers, etc. The Legislature was permitted to prescribe a maximum rate for and regulate the charges of these organizations.

In *Penziner v. West Amer. Finance Co.* (1937) 10 C.2d 160, 171, 74 P.2d 252, it was held that the Usury Law (see *supra*, §454) was still in force except as modified by inconsistent provisions of the constitutional amendment of 1934 reducing the maximum rate of interest. (See *French v. Mortgage Guarantee Co.* (1940) 16 C.2d 26, 34, 104 P.2d 655.) And in *Carter v. Seaboard Finance Co.* (1949) 33 C.2d 564, 586, 203 P.2d 758, it was held that the institutions exempted from the operation of former Cal. Const., Art. XX, §22, were not subject to the 10% maximum rate provided therein, and that there were no restrictions on the interest charges of these institutions unless the Legislature so provided. (See *Heald v. Friis-Hansen* (1959) 52 C.2d 834, 836, 345 P.2d 457, *infra*, §469.)

(2) *Revised Provision.* Article XX, §22 was repealed in 1976, and new Article XV, §1 was adopted in its place. As amended in 1979, §1 sets the maximum rate as follows: (a) for money, goods, or things in action for use primarily for personal, family, or household purposes--10%; (b) for any other uses--the higher of (1) 10% or (2) 5% plus the Federal Reserve Bank of San Francisco's rate on the 25th day of the month preceding the earlier of the date the contract was contracted for or was executed. (On exemptions, see *infra*, §§457, 458.)

The constitutional amendment was retroactive in its effect. (*Chapman v. Farr* (1982) 132 C.A.3d 1021, 1023, 183 C.R. 606.)

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3 of 40 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

A. Usury.

1. California Legislation.
- b. Constitutional Provision.
 2. Exemptions.
 - aa. In General.

1 Witkin Sum. Cal. Law Contracts § 457

[§ 457] In General.

The constitutional section (supra, §456) exempts the following from its regulatory provisions:

(1) Institutions in the business of lending money, including building and loan associations, industrial loan companies, credit unions, licensed pawnbrokers, and personal property brokers, banks, and specified nonprofit organizations engaged in loaning money for agricultural purposes. (See *Agapitov v. Lerner* (2003) 108 C.A.4th 830, 835, 133 C.R.2d 837 [exemption for licensed pawnbrokers applies only to pawn transactions made within scope of pawnbroker license, rather than to all loans made by pawnbroker; here, personal loan to plaintiffs was not pawn transaction, and thus was not exempt from prohibition against usury].)

(2) "[A]ny loans, made or arranged by any person licensed as a real estate broker ... and secured in whole or in part by liens on real property." (See infra, §458.)

(3) "[A]ny other class of persons authorized by statute." Recent statutes include:

(a) C.C. 1917.067, 1917.220. A lender is exempt from the constitutional usury provisions with respect to shared appreciation loans (loans lowering the interest rate in return for payment of a portion of the appreciated value of the property securing the loan; see 4 *Summary* (10th), *Security Transactions in Real Property*, §42) made on behalf of a pension fund subject to the federal Employee Retirement Income Security Act of 1974 (ERISA; 29 U.S.C., §1001 et seq.). (C.C. 1917.067.) Pension funds or retirement systems subject to ERISA are an exempt class of persons pursuant to Article XV, §1, and the constitutional usury provisions therefore do not apply to any obligation or forbearance of such a fund or system or to any loan made by it. (C.C. 1917.220.) (See *Varr v. Olimpia* (1996) 45 C.A.4th 675, 680, 684, 53 C.R.2d 106 [C.C. 1917.220, which exempts ERISA plans from constitutional usury provisions, is itself preempted by ERISA, but Cal. Const., Art. XV, §1 is not so preempted; thus, this constitutional provision applied to loans from law firm's profit-sharing plan].)

(b) *Fin.C. 31953*. This section provides a retroactive exemption from the constitutional usury provisions for loans

or forbearances by any licensed business and industrial development corporation. (On exemption of these corporations from the California Finance Lenders Law, see *infra*, §464.)

(c) *Corp.C. 25116, 25211.5*. An evidence of indebtedness issued under a Corporate Securities Law qualification, and its purchaser, are exempt from the constitutional usury provisions, as is a broker-dealer acting pursuant to a broker-dealer certificate.

(d) *Corp.C. 25118*. An evidence of indebtedness issued by an entity or guaranteed by an entity that is an affiliate of a borrower that, on the day the evidence of indebtedness issued or guaranty is first issued or entered into, has total assets of at least \$ 2 million according to its then most recent financial statements, and the purchasers or holders of the evidence of indebtedness, are exempt from the constitutional usury provisions.

(e) *Fin.C. 23106*. Persons and entities subject to the California Deferred Deposit Transaction Law (*Fin.C. 23000 et seq.*), which regulates transactions in which a lender defers depositing a consumer's personal check until a specific date pursuant to agreement, are exempt from the constitutional usury provisions.

(f) *Fin.C. 1504*. The usury restrictions do not apply to obligations or forbearances of specified institutions authorized to engage in the trust business, when acting in a fiduciary capacity. (See *Jones v. Wells Fargo Bank (2003) 112 C.A.4th 1527, 1537, 1538, 5 C.R.3d 835* [because *Fin.C. 1504* applies to all fiduciary relationships of bank and does not single out ERISA plans, it does not trigger ERISA preemption; usurious intent is irrelevant].)

(4) "[A]ny successor in interest to any loan or forbearance exempted under this article."

SUPPLEMENT: [This section is current through the latest supplement]

(3) *Any other class of persons authorized by statute:*

(a) *C.C. 1917.067, C.C. 1917.220*. See *WRI Opportunity Loans II, LLC v. Cooper (2007) 154 C.A.4th 525, 537, 65 C.R.3d 205* [applying similar statutory usury exemption, loan on condominium development project did not entitle secured lender to "contingent deferred interest" and thus was not shared appreciation loan].



4 of 40 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

A. Usury.

1. California Legislation.
- b. Constitutional Provision.
2. Exemptions.
- bb. Real Estate Brokers.

1 Witkin Sum. Cal. Law Contracts § 458

[§ 458] Real Estate Brokers.

(1) *In General.* The constitutional exemption for secured loans made or arranged by licensed real estate brokers was implemented by C.C. 1916.1, added in 1983 and amended in 1985. The statute provides that the exemption applies to these types of loans whether they are secured "directly or collaterally" by liens on real property. Also, it provides that "made or arranged" includes any loan made by a licensed real estate broker acting as a principal or as an agent for others, whether or not the broker is acting within the course and scope of his or her license. (See *Garcia v. Wetzel* (1984) 159 C.A.3d 1093, 1097, 1098, 206 C.R. 251 [exemption applies to personal loan made by broker to enable property owners to redeem property from foreclosure, even though broker was not acting in his capacity as such]; *Green v. Future Two* (1986) 179 C.A.3d 738, 742, 225 C.R. 3 [loan is made by broker when broker acts as lender; exemption is inapplicable when broker is the borrower]; *Winnett v. Roberts* (1986) 179 C.A.3d 909, 917, 225 C.R. 82 [same]; 26 *Santa Clara L. Rev.* 403 [arguing that exemption should be amended by Legislature or declared unconstitutional on equal protection grounds].)

(2) *When Loan Is "Arranged."* The 1985 amendment to C.C. 1916.1 specifies that a loan is arranged by a real estate broker when the broker: (a) acts for or in expectation of compensation, either "for soliciting, negotiating, or arranging the loan for another," or for arranging a loan or refinancing of a loan for another in connection with specified transactions involving real property or a business; or (b) "arranges or negotiates for another a forbearance, extension, or refinancing" of a loan secured by real property in connection with specified past transactions in which he acted for or in expectation of compensation. (See *Green v. Future Two*, *supra*, 179 C.A.3d 742, 743 [for loan to be arranged by broker, he or she must act for another, and must receive or expect compensation]; *Winnett v. Roberts*, *supra*, 179 C.A.3d 918, 921 [loan arranger is one who acts as intermediary; where transaction is between borrower and lender with no third-party intermediary, loan is not "arranged" within meaning of exemption].)

Stickel v. Harris (1987) 196 C.A.3d 575, 242 C.R. 88, involved the following issue: "whether a loan bearing a 30 percent annual rate of interest obtained by a licensed real estate broker *on behalf of himself and certain fellow partners and joint venturers* is exempt from the interest limitations of the usury law." *Held*, the loan was exempt.

(a) The broker here satisfied both requirements for "arranging" a loan: (1) He solicited the loan as the intermediary for the partnership and the joint venture, and he did not forfeit that status solely because he became a member of these entities. (2) He testified that he expected to be compensated from the profits generated by the sale of the property at the conclusion of the venture. These anticipated profits qualify as compensation. (196 C.A.3d 585.)

(b) To defeat the conclusion that the broker arranged the loan, defendants made three contentions:

First, that the broker was not acting for the joint venture, because that entity had not yet been formed when the loan was negotiated. However, there is ample evidence that, once formed, the venture ratified the broker's actions, and hence became bound by them. (196 C.A.3d 586.)

Second, that because the broker did not need a license to borrow money from plaintiff and was not being *paid for negotiating the loan* he was not acting in a licensed capacity, and hence was not subject to the professional discipline that was the basis for exempting brokers from interest rate limitations. (196 C.A.3d 587.) This contention is without merit: "Acting as he was in negotiating the loans on behalf of others and in expectation of compensation, Buttici was performing in his licensed capacity and was thus subject to the state's authority to discipline him. There is consequently no basis for excluding this transaction from the usury exemption as defendants suggest." (196 C.A.3d 589.)

Third, that a broker must receive, or expect to receive, compensation that is separate and independent from any right to receive a share of the venture's profits, i.e., he or she must be compensated directly for negotiating the loan. (196 C.A.3d 589.) However, such a requirement is negated by the provision in C.C. 1916.1 that a loan is arranged if the broker negotiates a forbearance, extension, or refinancing of any loan in connection with a *past* transaction in which he *had acted* for compensation. In other words, a broker's subsequent expenditure of effort to preserve an accrued expectation of compensation does not require a separate compensation. (196 C.A.3d 590.) (See *Jones v. Kallman* (1988) 199 C.A.3d 131, 134, 136, 244 C.R. 609 [applying analysis of "compensation" in *Stickel v. Harris* and holding different form of compensation sufficient for exemption under C.C. 1916.1]; *Del Mar v. Caspe* (1990) 222 C.A.3d 1316, 1329, 272 C.R. 446 [acts performed in consolidating loans and advances into one current note, e.g., conducting searches, calculating interest, preparing documents, etc., constituted "arranging" loan under C.C. 1916.1]; *Park Terrace Ltd. v. Teasdale* (2002) 100 C.A.4th 802, 805, 122 C.R.2d 797 [general partner, a licensed real estate broker, arranged loans for five partnerships and had right to participate in partnership profits; exemption for loans arranged by licensed real estate broker applied]; *Gibbo v. Berger* (2004) 123 C.A.4th 396, 400, 19 C.R.3d 829 [preparing loan documents according to instructions and on terms provided by parties on prepared forms, ordering title insurance, and disbursing funds, all in accordance with parties' instructions, was not conduct that resulted in loan being obtained or procured, and thus real estate broker did not "arrange" loan; criticizing *Del Mar*].)

(3) *No Exemption for Attorney Acting as Broker.* In *Del Mar v. Caspe*, *supra*, plaintiff borrower argued that the constitutional usury provision applied to a note that was arranged by an attorney who was not a licensed real estate broker. In rejecting this contention, the trial judge reasoned that because lawyers are authorized by *B. & P.C. 10133* and *10133.1* to do what brokers do, they should also qualify for the brokers usury exemption. *Held*, this reasoning, although deceptively simple and appealing, is incorrect.

(a) Article XV explicitly enumerates those who are exempt from the interest rate ceiling. Lawyers are not listed; and, although Article XV has, since 1979, authorized the Legislature to create other statutory exemptions, the Legislature has not yet explicitly created an exemption for lawyers. (222 C.A.3d 1330.)

(b) There is nothing in either the language or legislative history of *B. & P.C. 10133* and *10133.1* to suggest that because those sections exempt licensed attorneys working for clients from the statutory brokers license requirements, they also necessarily exempt attorneys from the totally unrelated constitutional prohibition against usury. (222 C.A.3d 1331.)

(c) The exemptions in Article XV generally involve those in the business of lending or mortgage brokering and

provide a means of increasing the funds available for borrowing, while the exemptions from the brokers license requirements focus on those who may have occasion to deal with their own or a client's real property and include, in addition to some lenders, such parties as cemeteries and holders of powers of attorney. Given the difference in focus and purpose between the two kinds of exemptions, it is impossible to infer that in creating exemptions from the brokers license requirements, the Legislature also intended to create exemptions from the interest rate ceiling. And the fact that several types of lenders are mentioned in both Article XV and B. & P.C. 10133 and 10133.1 suggests that those not separately and expressly listed in both places do not enjoy both exemptions. (222 C.A.3d 1332.)

(d) The only reason to single out lawyers for special treatment is the belief that, because lawyers possess expertise and are subject to regulation and discipline, it is wise and safe for them to enjoy the same usury exemption as real estate brokers. However, because this conclusion is legislative in nature, the creation of a lawyers exemption is a matter for the Legislature. (222 C.A.3d 1333.)

West's Key Number Digest, Usury k.4

SUPPLEMENT: [This section is current through the latest supplement]

(2) *When Loan Is "Arranged."* See *Stoneridge Parkway Partners, LLC v. MW Housing Partners III, L.P.* (2007) 153 C.A.4th 1373, 1378, 64 C.R.3d 61 [broker who negotiated and arranged loan from lender to developer was acting as exempt third-party intermediary, even though broker was officer and employee of affiliate of lender, where broker negotiated on behalf of lender rather than on own behalf, lender was legal entity separate and distinct from broker and broker's employer, and lender was not alter ego of broker's employer].



5 of 40 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

A. Usury.

1. California Legislation.

c. Pawnbroker Regulations.

1 *Witkin Sum. Cal. Law Contracts* § 459

[§ 459] Pawnbroker Regulations.

Pawnbrokers are regulated by *Fin.C. 21200* et seq. (See generally *53A Am.Jur.2d* (1996 ed.), *Moneylenders and Pawnbrokers* §1 et seq.)

The statutes limit their charges to 21/2% per month on loans up to \$ 225; 2% per month on \$ 225-\$ 900; 11/2% per month on \$ 900-\$ 1,650; one percent per month on amounts in excess of \$ 1,650; \$ 1 per month on loans when the monthly charge would otherwise be less than the minimum charge. (*Fin.C. 21200(a)*.) One month's interest may be charged for any part of the month in which the pawned property is redeemed. (*Fin.C. 21200(b)*.)

A schedule of charges for short-term pawnbroker's loans (30-day and 90-day loans) is also set forth (*Fin.C. 21200.5*). This schedule, as well as the preceding one, must be posted in a place clearly visible to the public. (*Fin.C. 21200.5, 21200.7*.)

Charges for the first 90 days of a loan made pursuant to a written contract required by *Fin.C. 21201* must be determined by application of the schedule of charges in *Fin.C. 21200.5*, and charges after that time must be determined by application of the schedule of maximum compensation in *Fin.C. 21200*. (*Fin.C. 21201.4*.)

The limitations set forth in *Fin.C. 21200* and *21200.5* are inapplicable to loans having a bona fide principal amount of \$ 2,500 or more, if this statute is not used to evade the division covering pawnbrokers (*Fin.C. 21000* et seq.). (*Fin.C. 21051(a)*.)

SUPPLEMENT: [This section is current through the latest supplement]

Fin.C. 21200(a) was amended in 2008 to increase the allowable charge to \$ 3 per month on loans when the monthly charge would otherwise be less than the minimum charge.

See *53A Am.Jur.2d* (2006 ed.), *Moneylenders and Pawnbrokers* §1 et seq.



6 of 40 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

A. Usury.

1. California Legislation.

d. Industrial Loan Law.

1 Witkin Sum. Cal. Law Contracts § 460

[§ 460] Industrial Loan Law.

(1) *In General.* Industrial loan companies are regulated by the Industrial Loan Law (also known as the Industrial Banking Law or the Thrift and Loan Law.) (*Fin.C. 18000 et seq.*) "Industrial loan company," "thrift and loan company," or "company," as used in this Law, means a premium finance agency as defined in *Fin.C. 18560* (see *infra*, this section). The Law does not apply to industrial banks subject to *Fin.C. 1400 et seq.*

Charges of industrial loan companies are limited to 2% per month on the unpaid principal balance of a loan up to \$ 1,000, and one percent per month on any remainder of the balance in excess of \$ 1,000. (*Fin.C. 18212(a)*.) As an alternative to these charges, the Law authorizes two methods of computing interest: (a) 1.6% per month on the unpaid principal balance (*Fin.C. 18212(b)*); or (b) five-sixths of one percent per month plus one-twelfth of the Federal Reserve Bank of San Francisco's annual rate on the 25th day of the second month of the quarter preceding the quarter in which the loan is made (*Fin.C. 18212.1*). Industrial loan companies may not precompute interest on their loans. (*Fin.C. 18213.*)

A bona fide loan of a principal amount of \$ 5,000 or more is exempted from the limitations on interest. (*Fin.C. 18191.5(a)*.) Also, the statute authorizes industrial loan companies to collect certain additional charges that are not included in computing the maximum interest allowable. (See *Fin.C. 18212.2* [administrative fee on loan not over \$ 2,500; 5% or \$ 50, whichever is lesser], 18215 [cost of publication, statutory fee, and premiums], 18216(a) [appraisal fee, for loan with face amount in excess of \$ 5,000, fee not to exceed actual cost of appraisal], 18217 [escrow fee].) And a loan commitment fee may be charged for a loan "secured by real property having a face amount in excess of" \$ 5,000, "whether or not the loan is consummated, or in connection with the purchase, sale, or origination of a lease as lessor." Also, an application fee may be charged for a loan having an original principal balance in excess of \$ 5,000 or for a lease whose payments are in excess of \$ 5,000. (*Fin.C. 18211.*)

(2) *Sale, Merger, or Conversion.* A sale, merger, or conversion involving an industrial loan company and another industrial loan company, a bank, or a savings association is subject to the Depository Corporation Sale, Merger, and Conversion Law (*Fin.C. 4800 et seq.*). (*Fin.C. 18139.*)

(3) *Issuance of Credit Cards.* An industrial loan company may issue credit cards and may acquire or hold

obligations resulting from their use. (*Fin.C. 18245(a).*) Except as otherwise provided by regulation or order of the Commissioner of Corporations, the acquiring and holding of these obligations are not subject to *Fin.C. 18205* et seq., governing the terms and maximum charges for loans. (*Fin.C. 18245(b).*)

(4) *Insurance Premium Finance Agencies.* Insurance premium finance agencies, which are also regulated by the Industrial Loan Law (see *Fin.C. 18560* et seq.), are defined in *Fin. C. 18560* as any industrial loan company that, by the terms of its authority to engage in the industrial loan business, is (a) "permitted to issue or sell investment certificates subject to the limitations" of *Fin.C. 18596*, and (b) "its business is limited to that set forth in" the chapter on insurance premium financing.

Finance charges are limited to 2% per month on the unpaid principal balance of a loan up to \$ 1,000, and one percent per month on any remainder of such balance in excess of \$ 1,000. As an alternative, an agency may charge 1.6% per month on the unpaid principal balance. (*Fin.C. 18626.*) A minimum finance charge of \$ 25 may be imposed if the finance charge would otherwise be less. (*Fin.C. 18627.*) Premium finance companies may precompute interest (*Fin.C. 18636*), but must rebate a portion of any precomputed charge upon partial or full prepayment of the loan (*Fin.C. 18637, 18638*). (See *11 Pacific L. J. 401.*)

(5) *Inapplicability of Other Usury Laws.* Corporations subject to the Industrial Loan Law are not subject to the California Finance Lenders Law (see *infra*, §462 et seq.). (*Fin.C. 18027*; Stats 1994, Chap. 1115, §9.)

West's Key Number Digest, Usury k.4

SUPPLEMENT: [This section is current through the latest supplement]



7 of 40 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

A. Usury.

1. California Legislation.

e. Loans Secured by Real Property.

1 Witkin Sum. Cal. Law Contracts § 461

[§ 461] Loans Secured by Real Property.

The real estate loan statute of 1955 (formerly C.C. 3081.1 et seq., now *B. & P.C. 10240* et seq.) was enacted to reach the evil of short-term loans on real property (1-2 years) with final payments so large that the borrower often could not pay. In this event, the borrower was compelled to refinance periodically, with new brokerage fees and other charges, so that in practical effect he or she paid a usurious interest on the loan. (See generally *Sedia v. Elkins* (1962) 201 C.A.2d 440, 448, 20 C.R. 278.)

The statute requires real estate brokers who negotiate loans secured directly or collaterally by liens on real property to furnish full information to the borrower on the nature of all charges. The required information must be furnished within 3 business days of receipt of a completed written loan application, or before the borrower becomes obligated on the note, whichever is earlier. (*B. & P.C. 10240(a), 10241.*) In a federally regulated residential mortgage loan transaction, a real estate broker may satisfy the disclosure requirements of *B. & P.C. 10240* by providing the borrower with certain information under specified provisions of federal law and *B. & P.C. 10241(h)*. Prior to becoming obligated on the loan, the borrower must acknowledge, in writing, receipt of that information. (*B. & P.C. 10240(c).*)

B. & P.C. 10240(b), which provides that the required information must be given if a broker represents to a borrower that he or she will act as an agent in arranging a loan, but in fact makes the loan from his or her own funds, does not limit the coverage of *B. & P.C. 10240* to those situations. The provision must be read as broadening the coverage of *B. & P.C. 10240* to include not only situations where a broker acts as mortgage broker (*B. & P.C. 10240(a)*), but also situations where a broker initially offers himself or herself as a mortgage broker but in fact ends up the lender (*B. & P.C. 10240(b)*). In either situation, a broker must give the notice required. (See *Engstrom v. Kallins* (1996) 49 C.A.4th 773, 780, 56 C.R.2d 842.)

The statute also makes detailed provision for maximum charges on loans secured by a dwelling. (*B. & P.C. 10240.1, 10242.*) The law limits late charges (*B. & P.C. 10242.5*) and prepayment charges (*B. & P.C. 10242.6*), and provides that balloon payments on specified short term loans may not be more than twice the amount of the smallest installment on the loan (*B. & P.C. 10244, 10244.1*). (See 5 *Pacific L. J.* 310 et seq.) Civil remedies are specified for violations. (*B. & P.C. 10246* et seq.)

Except for certain required disclosures and the limits on prepayment charges, the act does not apply to first mortgages of \$ 30,000 or more and second mortgages of \$ 20,000 or more. (*B. & P.C. 10245.*)

SUPPLEMENT: [This section is current through the latest supplement]



8 of 40 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

A. Usury.

1. California Legislation.

f. California Finance Lenders Law.

1. In General.

aa. Former Statutes and New Law.

1 Witkin Sum. Cal. Law Contracts § 462

[§ 462] Former Statutes and New Law.

(1) *Repealed Statutes.* *Personal property brokers* were subjected to regulation in 1949 by amendments to the Personal Property Brokers Law. (Former Fin.C. 22000 et seq.; see *West Pico Furniture Co. v. Pacific Finance Loans* (1970) 2 C.3d 594, 86 C.R. 793, 469 P.2d 665; *Draper v. American Funding Ltd.* (1991) 234 C.A.3d 345, 285 C.R. 640; 37 Cal. L. Rev. 652, 59 Cal. L. Rev. 287; 6 Southwestern L. Rev. 183.)

The 1939 Legislature enacted the California Small Loan Act (former Fin.C. 24000 et seq.) limiting interest and other charges on loans not over \$ 1,000, but exempting banks and many other institutions. The 1981 Legislature repealed this Act and enacted the Consumer Finance Lenders Law (former Fin.C. 24000 et seq.), which provided a schedule of maximum monthly charges that a *consumer finance lender* could charge on the unpaid balance of a loan (former Fin. C. 24451). (See 13 Pacific L. J. 593; on the Small Loan Act, see 27 Cal. L. Rev. 286; 29 Cal. L. Rev. 332; 12 So. Cal. L. Rev. 87; 14 So. Cal. L. Rev. 186; 20 So. Cal. L. Rev. 172.)

Commercial finance lenders were regulated by the Commercial Finance Lenders Law, enacted in 1982. (Former Fin.C. 26000 et seq.) This law covered loans of a principal amount of \$ 5,000 or more, as well as loans under an open end credit program, whether secured or unsecured, the proceeds of which were intended by the borrower for use primarily for *other* than personal, family, or household purposes. (Former Fin.C. 26007.5.)

(2) *New Law.* The 1994 Legislature repealed the Personal Property Brokers Law, the Consumer Finance Lenders Law, and the Commercial Finance Lenders Law and replaced them with the California Finance Lenders Law (Fin.C. 22000 et seq.). Both the repeals and the new statute became operative on July 1, 1995. (Infra, §463 et seq.) (See 75 Proof of Facts 3d [violation of usury consumer loan statute].)

West's Key Number Digest, Usury k.4

SUPPLEMENT: [This section is current through the latest supplement]



9 of 40 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

A. Usury.

1. California Legislation.

f. California Finance Lenders Law.

1. In General.

bb. Scope and Effect.

1 Witkin Sum. Cal. Law Contracts § 463

[§ 463] Scope and Effect.

The scope and effect of the new statute is stated in the enacting legislation as follows:

"The Legislature finds that the regulation of consumer and commercial loans would be enhanced by consolidating into one licensing law the existing regulation of personal property brokers, consumer finance lenders, and commercial finance lenders. It is the intent of the Legislature that this act shall not affect the validity of any existing loans and this act shall be interpreted as a consolidation of the authority previously granted to each type of lender. The Legislature finds that varying treatment of each type of lender, as provided in this act, is proper and that it is reasonable to allow free-market competition and to provide consumer protections with respect to the terms of the specified transactions. It is the intent of the Legislature that all previous judicial precedents upholding the regulation of these lenders continue to apply as the constitutional basis of this act." (1994 Stats., Chap. 1115, §10.)

The Act must be liberally construed and applied to promote its underlying purposes and policies. (*Fin.C. 22001(a).*)

The Act creates a class of exempt persons under Cal. Const., Art. XV, §1. And it is the intent of the Act to preserve existing exemptions under Cal. Const., Art. XV, §1 and statutory law for lenders formerly regulated by the Personal Property Brokers Law, the Consumer Finance Lenders Law, and the Commercial Finance Lenders Law. These lenders are to remain exempted by the Act even if a particular provision is found to be invalid with respect to a particular lender or class of lenders. (*Fin.C. 22002*; see 9 Williston 4th, §20:3.)

SUPPLEMENT: [This section is current through the latest supplement]



10 of 40 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

A. Usury.

1. California Legislation.

f. California Finance Lenders Law.

1. In General.

cc. Exemptions.

1 Witkin Sum. Cal. Law Contracts § 464

[§ 464] Exemptions.

The following persons and institutions are exempted from coverage under the California Finance Lenders Law:

(1) The California Infrastructure and Economic Development Bank and the California Integrated Waste Management Board (*Fin.C. 22056*).

(2) Banks and similar institutions (*Fin.C. 22050(a)*).

(3) Broker-dealers acting under a certificate issued under *Corp.C. 25211* (*Fin.C. 22050(b)*).

(4) Colleges or universities making student loans (*Fin.C. 22050(c)*).

(5) Check cashers acting under the authority of a valid permit issued under C.C. 1789.37 and persons acting under the authority of a valid license issued under *Fin.C. 23005* (*Fin.C. 22050(d)*). (On regulation of check cashers, see 3 *Summary* (10th), *Sales*, §342.)

(6) Persons making no more than one loan in a 12-month period if the loan is a commercial loan as defined in *Fin.C. 22502* (*Fin.C. 22050(e)*).

(7) Public corporations as defined in *Govt.C. 67510*, public entities other than the state as defined in *Govt.C. 811.2*, or agencies of these corporations or entities, when making a loan as long as the corporation, entity, or agency complies with all applicable federal and state laws and regulations (*Fin.C. 22050(f)*).

(8) Cemetery brokers licensed under *B. & P.C. 9600* et seq. (*Fin.C. 22058*).

(9) Other specified associations and corporations (*Fin.C. 22051*).

In addition to the persons and institutions listed above, the following transactions are also exempt under the Act:

(1) Loans of credit made by a person not licensed under the Act through a credit card plan meeting specified characteristics (*Fin.C. 22052*).

(2) Bona fide conditional contracts of sale involving the disposition of personal property, unless the purpose of these contracts is to evade the Act (*Fin.C. 22054*).

(3) Premium financing, as defined in *Fin.C. 18563* (*Fin.C. 22055*).

(4) Loans made or arranged by a licensed real estate broker and secured by a lien on real property, or to such brokers when making a loan of this type (*Fin.C. 22057*).

(5) Loans made or arranged by a licensed residential mortgage lender or servicer when acting under the authority of that license (*Fin.C. 22060*).

(6) Nonprofit church extension funds (*Fin.C. 22061*).

(7) Commercial bridge loans made by a venture capital company to an operating company (*Fin.C. 22062*).

(8) Franchise loans made by a franchisor to a franchisee or a subfranchisor or by a subfranchisor to a franchisee (*Fin.C. 22063*).

SUPPLEMENT: [This section is current through the latest supplement]



11 of 40 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

A. Usury.

1. California Legislation.

f. California Finance Lenders Law.

2. Consumer Loans.

aa. Definitions.

1 Witkin Sum. Cal. Law Contracts § 465

[§ 465] Definitions.

A "consumer loan" is a loan that is either secured or unsecured, "the proceeds of which are intended by the borrower for use primarily for personal, family, or household purposes." (*Fin.C. 22203.*) In addition, a loan for less than \$ 5,000 is a "consumer loan" even though it is the borrower's intention to use the proceeds primarily for other than personal, family, or household purposes. (*Fin.C. 22204(a).*) (On when "consumer loan" under *Fin.C. 22204(a)* is secured, see *Fin.C. 22204(b).*)

In either case, the lender may rely on any written statement of intended purposes signed by the borrower and is not required to ascertain that the proceeds are used in accordance with the statement. (*Fin.C. 22203, 22204.*)

SUPPLEMENT: [This section is current through the latest supplement]



12 of 40 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

A. Usury.

1. California Legislation.

f. California Finance Lenders Law.

2. Consumer Loans.

bb. Rate of Charges.

1 Witkin Sum. Cal. Law Contracts § 466

[§ 466] Rate of Charges.

The California Finance Lenders Law provides a schedule of maximum monthly charges that a lender may charge on the unpaid balance of the loan: 21/2% on loans up to \$ 225; 2% on \$ 226-\$ 900; 11/2% on \$ 901-\$ 1,650; and one percent on amounts in excess of \$ 1,650. (*Fin.C. 22303.*) As an alternative, a lender may charge the greater of: (a) 1.6% per month on the unpaid principal balance; or (b) five-sixths of one percent plus one-twelfth of the Federal Reserve Bank of San Francisco's annual rate on the 25th day of the second month of the quarter preceding the quarter in which the loan is made. (*Fin.C. 22304.*)

These restrictions on interest, however, do not apply to a loan of a bona fide principal amount of \$ 2,500 or more. (*Fin.C. 22303, 22304.*) The principles that apply in determining the "bona fide" nature of a loan are set out in *Fin. C. 22251*; these principles are framed in terms of determining whether the face amount of the loan is the true amount.

If a loan is secured by real property, an appraisal fee not exceeding the actual cost of appraisal may be charged for a written appraisal by a qualified appraiser. This fee is not included in determining the maximum monthly charge. (*Fin.C. 22317.*) The Act also exempts certain other charges and fees in determining the maximum charge allowable and contains detailed provisions on computation of charges. (See *Fin.C. 22301, 22305 et seq., 22400 et seq.*)

Except in the case of precomputed loans, a lender may contract for and receive a specified delinquency fee for a default in a loan payment. (*Fin.C. 22320.5.*) However, this provision does not apply to a loan of a bona fide principal amount of \$ 5,000 or more. (*Fin.C. 22250(b).*)

SUPPLEMENT: [This section is current through the latest supplement]

Appraisal fee: Under *Fin.C. 22317.2*, added in 2006, a licensee may collect a fee for use of an automated valuation model result prepared by a third party not to exceed the actual cost paid to the third party for a written automated valuation model result in lieu of an appraisal.



13 of 40 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

A. Usury.

1. California Legislation.

f. California Finance Lenders Law.

3. Commercial Loans.

1 Witkin Sum. Cal. Law Contracts § 467

[§ 467] Commercial Loans.

A "commercial loan" is a loan of a principal amount of \$ 5,000 or more, as well as a loan under an open end credit program, whether secured or unsecured, "the proceeds of which are intended by the borrower for use primarily for other than personal, family, or household purposes." (*Fin.C. 22502*; on principles for determining whether a commercial loan is bona fide loan of principal amount specified, see *Fin.C. 22551*.)

The California Finance Lenders Law exempts commercial lenders from the constitutional restrictions on interest (see *supra*, §456.) (*Fin.C. 22002*), but does not set a maximum rate of fees and charges that may be imposed.

SUPPLEMENT: [This section is current through the latest supplement]



14 of 40 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

A. Usury.

2. Effect of Usurious Provision.

a. In General.

1 Witkin Sum. Cal. Law Contracts § 468

[§ 468] In General.

(1) *Interest Provision Void*. If a transaction is usurious on its face, neither good faith nor the absence of guilty intent is material. (*Martin v. Kuchler* (1931) 212 C. 536, 539, 299 P. 52; *Denny v. Hartley* (1957) 154 C.A.2d 304, 306, 315 P.2d 893.) The usurious interest provision is void, but the principal of the loan is unaffected. (*Haines v. Commercial Mortg. Co.* (1927) 200 C. 609, 622, 254 P. 956, 255 P. 805; *Teichner v. Klassman* (1966) 240 C.A.2d 514, 524, 49 C.R. 742; *Rochester Capitol Leasing Corp. v. K & L Litho Corp.* (1970) 13 C.A.3d 697, 703, 91 C.R. 827, *supra*, §88; see 6 Southwestern L. Rev. 186 [remedies and defenses]; 18 *Stanf. L. Rev.* 1391 [same]; and see generally 15 Corbin (Rev. ed.), §87.14; 9 Williston 4th, §20:35 et seq.; 45 *Am.Jur.2d* (1999 ed.), *Interest and Usury* §224 et seq., 252 et seq.; 16 *A.L.R.3d* 510, 517 [borrower's initiation of, or his or her fraud contributing to, usurious transaction].)

Because the principal of the loan is unaffected, the usurious interest provision results in a note payable at maturity without interest; and the creditor-payee is entitled to interest at the legal rate from the date of maturity to the date of judgment. (*Epstein v. Frank* (1981) 125 C.A.3d 111, 123, 124, 177 C.R. 831; *Mark McDowell Corp. v. LSM* 128 (1989) 214 C.A.3d 1427, 1432, 263 C.R. 310 [following *Epstein*].)

(2) *Entire Contract Void: Special Statutes*. Under the Industrial Loan Law (*supra*, §460), the entire contract is void, so that neither principal nor interest can be recovered, unless the excess charge results from a bona fide error in computation. (See *Fin.C. 18439* [exception for "accidental and bona fide" error in computation].) Under the California Finance Lenders Law (*supra*, §462 et seq.), the contract is also void *if the violation is wilful*, and such a violation, without exception, precludes the recovery of both principal and interest. (*Fin. C. 22750*.) However, *if the violation is not wilful*, the licensee must forfeit all interest and charges, but may collect or receive the principal. (*Fin. C. 22751(a)*.) And if the licensee establishes that the violation was not intentional and resulted from a bona fide error and if, within 60 days of discovering the error, the licensee notifies the borrower of the error and makes whatever adjustments are necessary, he or she does not even forfeit the interest and charges. (*Fin.C. 22751(b)*.)

SUPPLEMENT: [This section is current through the latest supplement]



15 of 40 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

A. Usury.

2. Effect of Usurious Provision.

b. Penalty of Treble Interest.

1 Witkin Sum. Cal. Law Contracts § 469

[§ 469] Penalty of Treble Interest.

A penalty of treble interest is recoverable where usurious interest has already been collected. (Stats. 1919, p. lxxxiii, §3(a); C.C. 1916-3(a); see generally *Terry Trading Corp. v. Barsky* (1930) 210 C. 428, 434, 292 P. 474; *Westman v. Dye* (1931) 214 C. 28, 35, 4 P.2d 134; *Taylor v. Budd* (1933) 217 C. 262, 266, 18 P.2d 333; *Douglas v. Klopfer* (1930) 107 C.A. Supp. 765, 767, 288 P. 36; *Brocke v. Naseath* (1955) 134 C.A.2d 23, 25, 285 P.2d 291; *Alston v. Goodwin* (1959) 174 C.A.2d 16, 19, 343 P.2d 993; 21 Cal. L. Rev. 526; 39 Cal. L. Rev. 605; 6 Southwestern L. Rev. 191; 18 Stanf. L. Rev. 1392.)

The constitutional provision on the maximum rate (supra, §456) was in effect an amendment of the Usury Law in this respect, and the Usury Law, with its treble interest provision, is to be read with the constitutional limit. Hence, treble interest is recoverable where the charge is over the constitutional maximum. (*Heald v. Friis-Hansen* (1959) 52 C.2d 834, 839, 345 P.2d 457.)

However, to maintain an action for treble interest, the plaintiff must be a "borrower" within the meaning of Cal. Const., Art. XV, §1. (See *Barnes v. Hartman* (1966) 246 C.A.2d 215, 220, 54 C.R. 514 [plaintiff did not negotiate or receive a loan, but merely signed his lessee's deed of trust securing the lessee's promissory note]; *Roes v. Wong* (1999) 69 C.A.4th 375, 379, 81 C.R.2d 596 [holder of junior encumbrance who pays off senior lienholder to stave off foreclosure on senior indebtedness may not assert claim for usury; following *Barnes v. Hartman*].) And the penalty can be recovered only from the recipient of the interest; agents, or other persons aiding the creditor, are under no statutory liability. (*Clarke v. Horany* (1963) 212 C.A.2d 307, 311, 27 C.R. 901; see 4 A.L.R.3d 650 [liability for statutory penalty of person other than offending lender].)

The borrower may also be barred by estoppel. (See *Buck v. Dahlgren* (1972) 23 C.A.3d 779, 788, 100 C.R. 462 [plaintiff borrower estopped from recovering both the amount of usurious interest paid and treble damages thereon].)

West's Key Number Digest, Usury k.78

SUPPLEMENT: [This section is current through the latest supplement]



16 of 40 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

A. Usury.

2. Effect of Usurious Provision.

c. Recovery of Interest.

1 Witkin Sum. Cal. Law Contracts § 470

[§ 470] Recovery of Interest.

Even if the statutory penalty (supra, §469) is barred by its 1-year statute of limitations, the borrower may still recover the actual usurious interest paid within 2 years in an action for money had and received. (*Stock v. Meek (1950) 35 C.2d 809, 816, 221 P.2d 15*; see 39 *Cal. L. Rev.* 606; 18 *Stanf. L. Rev.* 1392.) And if the lender sues on the indebtedness, all usurious payments may be set off in reduction of the principal, without regard to the statute of limitations on the borrower's affirmative remedy. (*Shirley v. Britt (1957) 152 C.A.2d 666, 670, 313 P.2d 875*; see 6 *Southwestern L. Rev.* 192.)

An unusual application of conflicting principles was made in *White v. Seitzman (1964) 230 C.A.2d 756, 41 C.R. 359*. Plaintiff, the borrower, was operating a "trust deed factory," and initiated the usurious transaction as a scheme to evade the law. In this action against the lender, he sought recovery of interest and treble interest. *Held*:

(a) He could not recover treble interest, for the policy of the Usury Law was overcome by the policy of C.C. 3517 (no one can take advantage of his or her own wrong). (*230 C.A.2d 764*.)

(b) But he could recover unlawful interest paid, because both parties were acting wrongfully and each should suffer some detriment. "To deny the recovery of usurious interest paid simply because treble damages are not allowed as a punitive measure would shift the penalty for a usurious contract onto the borrower instead of the lender which is patently contrary to the law of this state." (*230 C.A.2d 764*.)

SUPPLEMENT: [This section is current through the latest supplement]



17 of 40 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

A. Usury.

3. What Constitutes Usury.

a. General Rule and Test.

1 Witkin Sum. Cal. Law Contracts § 471

[§ 471] General Rule and Test.

(1) *In General.* The essential elements of usury are: (a) The transaction must be a loan or forbearance; (b) the interest to be paid must exceed the statutory maximum; (c) the loan and interest must be absolutely repayable by the borrower; and (d) the lender must have a wilful intent to enter into a usurious transaction. A transaction is rebuttably presumed not to be usurious. The borrower bears the burden of proving the essential elements of a usurious transaction. (See *Ghirardo v. Antonioli* (1994) 8 C.4th 791, 798, 35 C.R.2d 418, 883 P.2d 960; 6 Southwestern L. Rev. 174 [elements of usury].)

Within the statutory limits, the parties may freely contract and may provide for interest payments in advance, compound interest, or accelerated maturity for nonpayment of installments, so long as the total interest does not exceed the maximum rate per annum for the full period of the loan. (*Haines v. Commercial Mortg. Co.* (1927) 200 C. 609, 616, 625, 254 P. 956, 255 P. 805; *Sharp v. Mortgage Sec. Corp. of America* (1932) 215 C. 287, 290, 9 P.2d 819.)

(2) *Test To Determine Usurious Transaction* The courts will not permit an evasion of the usury law by any subterfuge, and it is always permissible to show that a transaction ostensibly lawful actually constitutes a usurious loan. The test is whether there was an *intent* to evade the law, and the circumstances and negotiations that preceded or accompanied the transaction may be material in determining intent. (*Terry Trading Corp. v. Barsky* (1930) 210 C. 428, 432, 292 P. 474; *Liebelt v. Carney* (1931) 213 C. 250, 252, 2 P.2d 144; *Milana v. Credit Discount Co.* (1945) 27 C.2d 335, 340, 163 P.2d 869 [contract of sale of accounts receivable at a discount, with provision for repurchase if the accounts were not paid within 60 days; held a loan by buyer to seller at usurious rates]; *Thomas v. Hunt Mfg. Corp.* (1954) 42 C.2d 734, 740, 269 P.2d 12; *Burr v. Capital Reserve Corp.* (1969) 71 C.2d 983, 989, 80 C.R. 345, 458 P.2d 185; *West Pico Furniture Co. v. Pacific Finance Loans* (1970) 2 C.3d 594, 603, 86 C.R. 793, 469 P.2d 665; *Martin v. Ajax Const. Co.* (1954) 124 C.A.2d 425, 429, 269 P.2d 132 ["advance" of \$ 5,000 for construction purposes, in return for \$ 10,000 1-year promissory note]; *Abbot v. Stevens* (1955) 133 C.A.2d 242, 249, 284 P.2d 159; *Cowles v. Zlaket* (1959) 167 C.A.2d 20, 28, 334 P.2d 55 [sale of notes with option to repurchase]; *Janisse v. Winston Inv. Co.* (1957) 154 C.A.2d 580, 582, 317 P.2d 48, *infra*, §479; see 15 Corbin (Rev. ed.), §87.1; 9 Williston 4th, §20:4 et seq.; 59 Cal. L. Rev. 289; 10 Pacific L. J. 923 [argument that "wrap-around" deed of trust is nonusurious]; 2 So. Cal. L. Rev. 502 [installment sale contract]; 16 A.L.R.3d 475 [agreement for share in earnings or income in lieu of, or in addition to, interest]; 94 A.L.R.3d 640 [transactions characterized as "leases"]; 45 Am.Jur.2d (1999 ed.), *Interest and Usury* §84 et seq.; Cal. Civil Practice, 5 Business Litigation §54:23 et seq.)

In *Maze v. Sycamore Homes* (1964) 230 C.A.2d 746, 41 C.R. 338, the scheme was an "investment agreement" similar to that condemned in *Martin v. Ajax Const. Co.*, *supra*. Plaintiffs loaned defendant developer \$ 24,000, which defendant agreed to repay in 1 year, plus \$ 4,800, "representing a return based on a profit participation" in the sale of lots in a tract; the total sum (\$ 28,800), was "to be secured by an assignment" of \$ 2,400 per lot. *Held*, reversing the trial judge, the transaction was an unlawful attempt to make a loan at 20% interest. There was no evidence that money from the sale of houses constituted profits in which plaintiffs could participate; plaintiffs acquired no interest in defendant's business; plaintiffs were to receive their guaranteed return regardless of whether defendant made or lost money; the assignment was not a lien against the property and not a true security for repayment. (230 C.A.2d 753.)

In *Mong v. Bass* (1967) 248 C.A.2d 377, 56 C.R. 579, the lender advanced sums to an automobile dealer on used cars (from \$ 10 to \$ 1,150 per car), making a flat "documentation charge" of \$ 25 per car, collected even though the obligation was repaid within a few days. *Held*, the charge was usurious interest, even though the lender had some expenses in connection with each loan. (248 C.A.2d 383.)

In *Glaire v. La Lanne-Paris Health Spa* (1974) 12 C.3d 915, 117 C.R. 541, 528 P.2d 357, defendant club charged \$ 408 for membership whether its fee was paid in full or in monthly installments of \$ 17. Plaintiff elected to pay in installments. As was its usual business practice, defendant immediately sold the contract to Universal, an interlocking corporation with common ownership and control, for \$ 225. The trial court ruled that this practice did not involve interest as a matter of law. *Held*, reversed, citing *Milana v. Credit Discount Co.*, *supra*. "[T]he good faith of the parties is crucial to the insulation of discount transactions from usury consideration, and good faith is ultimately a question of fact"; the sustaining of the demurrer "precluded plaintiff from offering evidence that defendants' practice of discounting notes in fact operated to conceal the imposition of usurious interest charges, and in so doing the court clearly erred." (12 C.3d 927.)

West's Key Number Digest, Usury k.11

SUPPLEMENT: [This section is current through the latest supplement]



18 of 40 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

A. Usury.

3. What Constitutes Usury.

b. Excessive Interest, Charges, or Bonus.

1. In General.

1 Witkin Sum. Cal. Law Contracts § 472

[§ 472] In General.

(1) *Where Maximum Interest Charged.* If the maximum is charged, it cannot be *compounded* within the year; it cannot be made payable *monthly in advance*; the *first month's interest* cannot be deducted in advance; and any additional charges for "fees," "brokerage," or "commissions" are void unless actual services of such reasonable value are rendered. (*Haines v. Commercial Mortg. Co.* (1927) 200 C. 609, 625, 254 P. 956, 255 P. 805; *Taylor v. Budd* (1933) 217 C. 262, 265, 18 P.2d 333; *Burr v. Capital Reserve Corp.* (1969) 71 C.2d 983, 992, 80 C.R. 345, 458 P.2d 185; *Anderson v. Lee* (1951) 103 C.A.2d 24, 28, 228 P.2d 613 [bonus]; *Clarke v. Horany* (1963) 212 C.A.2d 307, 310, 27 C.R. 901 [commission payable by borrower to lender's agent]; *Forte v. Nolfi* (1972) 25 C.A.3d 656, 678, 102 C.R. 455 [bonus]; see 15 Corbin (Rev. ed.), §§87.8, 87.9; 9 Williston 4th, §§20:18, 20:19, 20:28; 6 Southwestern L. Rev. 198 [common techniques for circumventing usury law]; 52 A.L.R.2d 703 [commission to intermediaries]; 57 A.L.R.2d 630 [charging interest in advance]; 91 A.L.R.2d 1389 [charge for procuring loan]; 41 A.L.R.3d 682 [revolving charge accounts]; 92 A.L.R.3d 769 [leaving part of loan on deposit with lender]; 45 Am.Jur.2d (1999 ed.), *Interest and Usury* §355 et seq.; on compound interest, see *infra*, §473.)

(2) *Variable Interest Agreement.* If the interest charge for *different portions* of the loan period is at *different rates*, the amount payable for one portion has no bearing on the amount payable for another. Hence, the rate for each portion must come within the maximum, and the fact that the total interest paid for the full term does not exceed the maximum will not be a defense where the interest paid for a particular portion is usurious. (*Arneill Ranch v. Petit* (1976) 64 C.A.3d 277, 293, 134 C.R. 456; cf. *McConnell v. Merrill Lynch* (1978) 21 C.3d 365, 377, 146 C.R. 371, 578 P.2d 1375, *infra*, §473 [pointing out that *Arneill Ranch* involved an agreement allegedly designed to evade the usury law, and that a variable interest agreement will be upheld if the transaction was in good faith and without intent to violate the law]; see 67 Cal. L. Rev. 621; 13 Loyola L.A. L. Rev. 17; 30 Hastings L. J. 1843; 18 A.L.R.4th 1068 [variable interest rate as usury].)

(3) *Distinction: Unauthorized Act of Agent or Trustee.* Where the agent of the lender exacts a bonus for his or her own benefit and without the knowledge or consent of the lender, there is no usury. (*Nuckolls v. Bank of Calif.* (1937) 10 C.2d 278, 285, 74 P.2d 271; *Vaughan v. People's Mortg. Co.* (1933) 130 C.A. 632, 640, 20 P.2d 335; *Thunderbird Inv. Corp. v. Rothschild* (1971) 19 C.A.3d 820, 828, 97 C.R. 112 [lenders received no part of commission paid by borrowers

to third party and received no benefit or credit by reason of that payment[.]) Similarly, a loan from a trust does not become usurious where a trustee, acting on behalf of the trust, deducts a commission from the principal sum for his or her own benefit without the knowledge of the trust beneficiary. (*Hobbs v. Buck* (1981) 115 C.A.3d 176, 180, 181, 183, 171 C.R. 258 [applying *Thunderbird* and other agent cases, supra, to trustee who by statute is agent for the trust].)

West's Key Number Digest, Usury k.42

SUPPLEMENT: [This section is current through the latest supplement]



19 of 40 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

A. Usury.

3. What Constitutes Usury.

b. Excessive Interest, Charges, or Bonus.

2. Compound Interest.

1 *Witkin Sum. Cal. Law Contracts* § 473

[§ 473] Compound Interest.

A distinction is made where interest is compounded annually after default. Overdue interest is simply money due, and parties may, after interest becomes due, agree that interest at the maximum rate is to be paid on the accrued amount of interest. Because they may do this after it becomes due, they may likewise anticipate the possibility by providing in the loan agreement that accrued interest is to bear maximum interest, and, if it is compounded only annually, the law is not violated. (*Heald v. Friis-Hansen* (1959) 52 C.2d 834, 839, 345 P.2d 457; see 10 A.L.R.3d 421 [meaning of compound interest]; 28 A.L.R.3d 449 [interest after maturity].)

Section 2 of the Usury Law provides that "interest shall not be compounded ... unless an agreement to that effect is clearly expressed in writing and signed by the party to be charged therewith." In *McConnell v. Merrill Lynch* (1983) 33 C.3d 816, 191 C.R. 458, 662 P.2d 916, plaintiffs entered into a written "customer's agreement" with defendant brokerage firm for the purchase of securities on margin. The agreement made the following provision for payment of interest on sums advanced by the broker: "The monthly debit balance in my account(s) shall be charged, *in accordance with your usual custom* with interest at a rate which shall include the average rate paid by you on your general loans." Defendant compounded interest monthly, adding interest owing at the end of each month to the debit balance. In an earlier appeal, the court held that the term "usual custom" did not on its face clearly express an understanding that interest would be compounded. (*McConnell v. Merrill Lynch* (1978) 21 C.3d 365, 373, 146 C.R. 371, 578 P.2d 1375.) In the retrial extrinsic evidence was admitted, consisting of (1) testimony from several customers of defendant on whether they were aware that it was defendant's "usual custom" to charge compound interest; and (2) samples of monthly statements, from which it could be determined on examination that this interest had been charged. *Held*, this was error.

"If we were to hold that a lending agreement unclear on its face as to whether compound interest would be charged could be explained by parol evidence of some borrowers' understanding, we would be doing violence not only to the express terms of the section, but also to its objectives. The section was designed to prevent the uncertainty inherent in the evaluation of such evidence." (33 C.3d 822.) Moreover, "[i]f each borrower's understanding of the language used in a lending agreement were admissible as an aid to 'interpreting' its meaning, a cause of action for violation of the section would often be rendered inappropriate for prosecution as a class action." (33 C.3d 823.) (See *Curry v. Moody* (1995) 40

C.A.4th 1547, 1553, 48 C.R.2d 627 [compound interest on unpaid promissory note secured by trust deed on house could not be awarded from date of loan's inception, where note stated only that "interest" would be paid from inception until house was sold and only clear expression of compound interest referred to interest accruing after sale; extrinsic evidence was inadmissible to show parties' intent as to compound interest, quoting *McConnell*.)]

West's Key Number Digest, Usury k.49

SUPPLEMENT: [This section is current through the latest supplement]



20 of 40 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

A. Usury.

3. What Constitutes Usury.

c. Payments Under Collateral Contract.

1 Witkin Sum. Cal. Law Contracts § 474

[§ 474] Payments Under Collateral Contract.

Excessive interest disguised as payments under a collateral contract will violate the law. (*Terry Trading Corp. v. Barsky* (1930) 210 C. 428, 432, 292 P. 474; see 45 *Am.Jur.2d* (1999 ed.), *Interest and Usury* §§183, 184; 6 Southwestern L. Rev. 215; 81 *A.L.R.2d* 1280 [payments under ostensibly independent contract as usury]; 31 *A.L.R.3d* 763 [borrower's agreement to secure another debt owed to lender].)

In *Golden State Lanes v. Fox* (1965) 232 C.A.2d 135, 42 C.R. 568, plaintiff had a 20-year lease on a bowling alley. It needed \$ 150,000 for remodeling. A deal was arranged under which defendants advanced this sum and plaintiff assigned the lease to them. In this action for relief from the agreement, defendants contended that the transaction was the sale of a lease, not a loan. The court held it to be a usurious loan, on the following evidence: The agreement provided that plaintiff take back a sublease, paying the originally specified rent to the lessor, and \$ 30,000 a year rental to defendants in addition; plaintiff agreed to repurchase the lease from defendants in 8 years for \$ 150,000, with the privilege of earlier purchase at twice that sum; plaintiff gave a chattel mortgage on all its equipment; plaintiff's stockholders pledged their shares and individually guaranteed performance; and defendants had the right to take possession and terminate all their rights on default. Thus, defendants had an almost risk-free loan of \$ 150,000, repayable in full in 8 years, after payment of interest at 20%. Pointing out that this was merely another attempt "to clothe a loan in the garments of a sale by using the forms of absolute conveyance," the court said: "The essence of this case is that Golden State is absolutely bound to pay back the identical sum advanced, and the Fox Group is absolutely bound to reconvey the property on payment of the specified sum." (232 C.A.2d 141.)

In *Rice v. Dunlap* (1928) 205 C. 133, 135, 270 P. 196, defendant purchased stock from a salesman, in payment of which he executed two 8% promissory notes, with provisions making the salesman agent of defendant to sell and discount them. Plaintiff agreed to buy them if the salesman would divide his 15% commission with him. *Held*, plaintiff was guilty of usury, because he received more than 12% on the loan. The decision is somewhat unusual, because the borrower (defendant) only paid 8%. (See 17 *Cal. L. Rev.* 73.)

SUPPLEMENT: [This section is current through the latest supplement]



21 of 40 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

A. Usury.
3. What Constitutes Usury.
d. Forbearance.

1 Witkin Sum. Cal. Law Contracts § 475

[§ 475] Forbearance.

Both the usury statute (Stats. 1919, p. lxxxiii, §2; C.C. 1916-2) and the constitutional provision (Cal. Const., Art. XV, §1) limit the interest rate on a "loan or forbearance" of money, goods, or things in action. "Forbearance" is the giving of further time or an agreement not to enforce claims at the due date. (See *Calimpco v. Warden* (1950) 100 C.A.2d 429, 440, 443, 224 P.2d 421 [release of personal liability held a permanent forbearance, and excessive charge therefore usurious]; *DCM Partners v. Smith* (1991) 228 C.A.3d 729, 735, 278 C.R. 778, *infra*, §477 [forbearance within meaning of usury law is an agreement, made either before or after obligation's due date, to extend time for payment]; *De Guere v. Universal City Studios* (1997) 56 C.A.4th 482, 509, 65 C.R.2d 438, 6 Cal. Proc. (4th), *Proceedings Without Trial*, Supp., §60 [provisions in agreement between creator of television series and studio governing creator's net profits and providing methods of calculating interest on production costs and profits did not constitute loan or forbearance, where agreement did not require creator to repay costs of producing and distributing series]; *Sheehy v. Franchise Tax Bd.* (2000) 84 C.A.4th 280, 283, 100 C.R.2d 760 [Franchise Tax Board's delay in recovering unpaid taxes was not forbearance; thus, interest rate charged for late payment, although exceeding constitutionally prescribed maximum, was not usurious]; 9 Williston 4th, §20:6; 45 *Am.Jur.2d* (1999 *ed.*), *Interest and Usury* §95; 6 *Southwestern L. Rev.* 174.)

West's Key Number Digest, Usury k.13

SUPPLEMENT: [This section is current through the latest supplement]
De Guere case:

Cross-Reference: 6 Cal. Proc. (5th), *Proceedings Without Trial*, §66.



22 of 40 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

A. Usury.

4. Where Statute Does Not Apply.

a. Sale of Property.

1. In General.

1 Witkin Sum. Cal. Law Contracts § 476

[§ 476] In General.

To constitute usury there must be a *borrowing and lending or forbearance* of money. Hence, in a bona fide sale, where a seller offers property at a certain price for cash and at a much greater price on credit, there is no usury. (*Verbeck v. Clymer* (1927) 202 C. 557, 562, 261 P. 1017; *Burr v. Capital Reserve Corp.* (1969) 71 C.2d 983, 994, 80 C.R. 345, 458 P.2d 185 [bona fide business equipment leases]; *Boerner v. Colwell Co.* (1978) 21 C.3d 37, 46, 145 C.R. 380, 577 P.2d 200 ["practical considerations of significant moment justify the regulation of credit sales by a means more flexible than that provided by the usury laws"]; *Ricker v. Fay Sec. Co.* (1931) 110 C.A. 750, 753, 294 P. 732; *Rose v. Wheeler* (1934) 140 C.A. 217, 220, 226, 35 P.2d 220; *Lenes v. Dean* (1976) 64 C.A.3d 845, 848, 135 C.R. 14, citing the text; *La France Enterprises v. Van Der Linden* (1977) 70 C.A.3d 375, 380, 138 C.R. 690; *Fox v. Federated Dept. Stores* (1979) 94 C.A.3d 867, 873, 881, 156 C.R. 893 [finance charges on revolving charge accounts are within time-price doctrine of bona fide credit sale; following *Boerner*]; see 15 Corbin (Rev. ed.), §87.4; 9 Williston 4th, §20:11 et seq.; 45 *Am.Jur.*2d (1999 ed.), *Interest and Usury* §101 et seq.; 71 *Harv. L. Rev.* 1143; 6 *Southwestern L. Rev.* 209, 217 [time-price doctrine]; 14 *A.L.R.*3d 1065 [advance in price for credit sale as usury].) (On usury where sale is not bona fide, see *supra*, §471.)

In *O'Connor v. Televideo System* (1990) 218 C.A.3d 709, 267 C.R. 237, plaintiff performed assembly work for defendant computer manufacturer, and when the work was complete, sent invoices to defendant stating that payments not made within 30 days were subject to a late charge of 11/2% per month or 18% per year. *Held*, the late charge was a valid liquidated damages provision.

(a) *Crestwood Lumber Co. v. Citizens Savings & Loan Assn.* (1978) 83 C.A.3d 819, 148 C.R. 129, and *Mark McDowell Corp. v. LSM* 128 (1989) 214 C.A.3d 1427, 1431, 263 C.R. 310, which held that a penalty charge added after the maturity of a debt was usurious, failed to apply or even discuss the principle that a transaction not usurious at its inception cannot become usurious by virtue of the debtor's voluntary default. Applying this rule to the facts here demonstrates that the transaction was not usurious. Because the late charge was added only if defendant failed to make timely payment, it was a contingency solely within defendant's control, and hence could not be deemed usurious. (218 C.A.3d 716, citing the text; declining to follow *Crestwood* and *Mark McDowell Corp.*)

(b) The late charge did not constitute a forbearance; i.e., plaintiff did not agree to forgo its right to collect the money immediately, but only stated that a penalty would be imposed if it was made to wait. If the invoice truly constituted an agreement to give more time in exchange for an 18% surcharge on the principal, then defendant could conceivably forbear forever, so long as the finance charge was paid. Common sense indicates that the invoice cannot be interpreted in this manner, and plaintiff's institution of the present action negates a finding of an implied agreement to forbear. (218 C.A.3d 717.)

(c) Although *Fox v. Federated Dept. Stores, supra*, involved consumer goods subject to the Unruh Act (see 4 Summary (10th), Sales, §263 et seq.), while the present case involves nonconsumer goods, *Fox* held, apart from the Unruh Act, that the time-price doctrine and the debtor's control over the assessment of late charges established that the transaction was not usurious. "These principles are no less applicable simply because a transaction involves nonconsumer goods." (218 C.A.3d 718.)

(d) The usury laws were enacted primarily to protect the indigent, who are helpless to protect themselves. This case, on the other hand, involves two companies with relatively equal bargaining power that evidently dealt at arm's length and freely agreed to use an invoice form that is commonplace in this type of transaction. And there was no suggestion that the invoices were a subterfuge for an intent to evade the usury laws. (218 C.A.3d 718.)

In *Southwest Concrete Products v. Gosh Const. Corp.* (1990) 51 C.3d 701, 274 C.R. 404, 798 P.2d 1247, the Supreme Court came to the same conclusion, approving *O'Connor* and disapproving *Crestwood* and *Mark McDowell Corp.*. The opinion states:

"To summarize, we conclude that the late charge provided in the contract is not subject to the usury law because it does not constitute payment for the 'loan or forbearance of any money.' ... It is exempt from the usury law under the time-price doctrine and the principle that a debtor by voluntary act cannot render an otherwise valid contract usurious." (51 C.3d 709.) (See dissent of two justices, disagreeing with the second sentence quoted.) (See 18 *Pepperdine L. Rev.* 1211 [*Southwest*].)

However, an installment sale of a motor vehicle, even a bona fide sale, is subject to statutory limitations on the time-price differential. (See 4 Summary (10th), Sales, §239.) And the same is true of any retail credit or installment sale, under the Unruh Act. (See 4 Summary (10th), Sales, §278.)

SUPPLEMENT: [This section is current through the latest supplement]



23 of 40 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

A. Usury.

4. Where Statute Does Not Apply.

a. Sale of Property.

2. Modification of Interest Rate on Secured Note.

1 Witkin Sum. Cal. Law Contracts § 477

[§ 477] Modification of Interest Rate on Secured Note.

In *DCM Partners v. Smith* (1991) 228 C.A.3d 729, 278 C.R. 778, plaintiff purchased real property with a downpayment and a secured promissory note that provided for monthly installments of interest only with the entire balance due on a specified date. After being informed that plaintiff could not pay the note when due, defendant seller agreed to an extension, provided that the interest rate was increased from 10% to 15%. Plaintiff paid the note in full on its new due date, and then initiated the present action to obtain reimbursement of the 15% interest. *Held*, judgment for plaintiff reversed; the 15% rate was usurious, but the modified secured note was exempt from the usury law.

(a) Although the distinction between a credit sale and a loan or forbearance of money is often artificial, it is well established that the former is not subject to the usury laws. Hence, the initial transaction between the parties was not usurious. The issue here is whether it became usurious when the note was modified to provide for a usurious rate of interest. (228 C.A.3d 732.)

(b) "Let us assume that when the parties in this case agreed to 10 percent interest the maximum allowable interest was 8 percent. Let us assume further that within a few days after the initial transaction they agreed to reduce the interest to 9 percent for no other reason than Smith's concern with DCM's financial well-being. If we were to accept DCM's argument, the reduced interest rate would be usurious even though the higher rate was not." (228 C.A.3d 735.) This would be an inequitable and absurd result. Furthermore, the parties could have avoided the usury laws had defendant bought the property at a foreclosure sale following plaintiff's default, and then resold the property to plaintiff at an increased rate of interest on the secured note. "If the parties could lawfully avoid the usury laws indirectly by going through the foregoing convoluted process, there should be no reason why they should not be able to do so directly." (228 C.A.3d 736.)

(c) The cost to the consumer of holding the modification usurious outweighs any potential benefit. "To declare a privately negotiated bargain as illegal where the original bargain was not, will only chill the willingness of nonexempt lenders to extend credit in private transactions where there is no apparent unlawfulness in so doing. ... 'Although technically the continuation of a loan past its original due date is in effect a new loan, the lender is actually benefitting the borrower by not demanding payment. The lender who wishes to accommodate the borrower either must force the

borrower into a hardship position to pay or lose the security for the loan, or extend the loan and commit usury, or incur the expense of additional broker's fees by requiring the extension to be negotiated by a broker [thereby making the transaction exempt]. The imposition of the usury limitations in such cases merely harms the impecunious borrower that the law is intended to protect.' " (228 C.A.3d 737, quoting 4 Miller & Starr 2d, §10.12.) (See *Ghirardo v. Antonioli* (1994) 8 C.4th 791, 803, 35 C.R.2d 418, 883 P.2d 960 [applying *DCM Partners* to resale situation and holding that settlement notes given by second buyer to original seller were functional equivalent to modification of an originally exempt credit sale, and hence not subject to usury law]; 22 *Pepperdine L. Rev.* 1790 [*Ghirardo*].)

SUPPLEMENT: [This section is current through the latest supplement]



24 of 40 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

A. Usury.

4. Where Statute Does Not Apply.

b. Purchase of Property Subject to Loan.

1 Witkin Sum. Cal. Law Contracts § 478

[§ 478] Purchase of Property Subject to Loan.

The defense of usury is *personal to the borrower*, and one who is not a party to the usurious contract may not attack it. (*Zimmerman v. Boyd* (1929) 97 C.A. 406, 408, 275 P. 509.) So, where a purchaser buys property subject to a loan, and the amount thereof is deducted from the purchase price, he or she will not be permitted to complain of usury in the inception of the loan. (*Esposti v. Rivers Bros.* (1929) 207 C. 570, 572, 279 P. 423; *Ames v. Occidental Life Ins. Co.* (1930) 210 C. 271, 273, 291 P. 182; see 6 Southwestern L. Rev. 197.)

SUPPLEMENT: [This section is current through the latest supplement]



25 of 40 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

A. Usury.

4. Where Statute Does Not Apply.

c. Purchase of Note at Discount.

1 *Witkin Sum. Cal. Law Contracts* § 479

[§ 479] Purchase of Note at Discount.

The bona fide purchase of notes secured by trust deeds at a discount, without intent to evade the law, does not subject the buyer to the penalties. (*Harris v. Pollack* (1950) 101 C.A.2d 26, 28, 224 P.2d 824; see *Klett v. Security Acceptance Co.* (1952) 38 C.2d 770, 780, 242 P.2d 873 [purchase of conditional sales contracts at discount]; 45 *Am.Jur.2d* (1999 ed.), *Interest and Usury* §119 et seq.)

But in *Janisse v. Winston Inv. Co.* (1957) 154 C.A.2d 580, 317 P.2d 48, plaintiff executed a 6% note for \$ 4,700 to G, but received only \$ 3,055. Defendants, claiming to be bona fide purchasers of the note for \$ 3,055, actually fixed the amount and made the loan through G as a dummy. *Held*, plaintiff was entitled to a reduction of principal and treble interest. (154 C.A.2d 582.)

West's Key Number Digest, Usury k.26

SUPPLEMENT: [This section is current through the latest supplement]



26 of 40 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

A. Usury.

4. Where Statute Does Not Apply.

d. Partnership or Joint Venture.

1 Witkin Sum. Cal. Law Contracts § 480

[§ 480] Partnership or Joint Venture.

If an agreement to advance money calls for a share in profits as compensation, it may be regarded as a partnership or joint venture rather than a loan transaction. (See *Batchelor v. Mandigo* (1950) 95 C.A.2d 816, 823, 213 P.2d 762; *Moore v. Dealy* (1953) 117 C.A.2d 89, 95, 254 P.2d 888; *Lindsey v. Campbell* (1955) 132 C.A.2d 746, 751, 282 P.2d 948; *Whittemore Homes v. Fleishman* (1961) 190 C.A.2d 554, 557, 12 C.R. 235, citing the text, but holding rule inapplicable and affirming judgment for usurious interest; *Wooton v. Coerber* (1963) 213 C.A.2d 142, 148, 28 C.R. 635, citing the text; 45 *Am.Jur.2d* (1999 ed.), *Interest and Usury* §99; 42 *Cal. L. Rev.* 198; 6 *Southwestern L. Rev.* 195, 201; 16 *A.L.R.3d* 475 [agreement for share in earnings or income in lieu of, or in addition to, interest].)

SUPPLEMENT: [This section is current through the latest supplement]



27 of 40 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

A. Usury.

4. Where Statute Does Not Apply.

e. Payments Contingent.

1 *Witkin Sum. Cal. Law Contracts* § 481

[§ 481] Payments Contingent.

(1) *Principal Payment Contingent*. Where the *principal sum* is subject to business hazards, and repayment of the loan is subject to the contingency of profits being earned, there is no usury. (See *Ambrose v. Alioto* (1944) 65 C.A.2d 362, 367, 150 P.2d 502; 15 Corbin (Rev. ed.), §87.7; 9 Williston 4th, §20:17; 45 Am.Jur.2d (1999 ed.), *Interest and Usury* §132 et seq.; 42 Cal. L. Rev. 198; 92 A.L.R.3d 623 [contingency as to borrower's receipt of money from which loan is to be repaid].)

(2) *Interest Payment Contingent*. Where the payment of the full legal interest or any part of it is subject to a contingency, so that the lender's lawful profit is wholly or partially put in hazard, the interest need not be limited to the legal rate, if the parties are contracting in good faith and without intent to evade the usury law. (See *Wooton v. Coerber* (1963) 213 C.A.2d 142, 157, 28 C.R. 635 [concurring opinion quoting the text]; *Thomassen v. Carr* (1967) 250 C.A.2d 341, 346, 58 C.R. 297, citing the text; 6 Southwestern L. Rev. 211; 9 Williston 4th, §20:17; 45 Am.Jur.2d (1999 ed.), *Interest and Usury* §133.)

Thomassen, supra, points out that the hazard rule applies not only where the principal is payable on a contingency but where, as here, the interest payment alone was contingent: The borrowers promised unconditionally to pay principal and interest at the end of 18 months, but for the first 18 months were only obligated to pay a share of profits, if any. But in *Jameson v. Warren* (1928) 91 C.A. 590, 267 P. 372, there was a pledge of stock as security for a note. Although the interest rate was only 8%, it was also provided that the lender should receive a share of the dividends on the stock. *Held*, it appeared from the evidence that large dividends were expected that would bring the total return well over the maximum rate, and that the intention was thereby to violate the law. (91 C.A. 595.) (See *Teichner v. Klassman* (1966) 240 C.A.2d 514, 522, 49 C.R. 742, quoting the text; 42 Cal. L. Rev. 199; 2 So. Cal. L. Rev. 195.)

In *Arneill Ranch v. Petit* (1976) 64 C.A.3d 277, 134 C.R. 456, defendants were lenders of \$ 1,116,750 under a promissory note secured by a deed of trust. The note called for interest "at the rate of 7 1/2 percent per annum, or at the prime rate plus 2 percent as announced from time to time by the Bank of America National Trust and Savings Association, whichever is greater." The fluctuating prime rate resulted in a temporary payment (from April to October) of interest at the rate of 10.008%. Plaintiff sued for treble damages, and the trial judge granted summary judgment for defendant. *Held*, reversed.

(a) If the contingency that makes the interest excessive is under the borrower's control and he or she brings about the usurious charge, e.g., where the borrower voluntarily prepays the loan, the transaction is not usurious. (64 C.A.3d 284, citing *French v. Mortgage Guarantee Co. (1940)* 16 C.2d 26, 31, 104 P.2d 655, and *Grall v. San Diego Bldg. & Loan Assn. (1932)* 127 C.A. 250, 254, 15 P.2d 797, both *infra*, §482.)

(b) If the contingency is not under the borrower's control--as in the instant case--the contract does not then become usurious as a matter of law, i.e., the receipt of excessive interest does not give rise to liability if the defendant was contracting in good faith and without intent to violate the law. (64 C.A.3d 285 et seq., discussing *Jameson v. Warren* and *Thomassen v. Carr*, *supra*.)

(c) Although the showing made by the declarations of the parties was consistent with the existence of good faith (the prime rate during the first year was 5 1/2% or less), the issue was one of fact that should have been tried, and summary judgment was improper. (64 C.A.3d 294.)

West's Key Number Digest, Usury k.36

SUPPLEMENT: [This section is current through the latest supplement]



28 of 40 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

A. Usury.

4. Where Statute Does Not Apply.

f. Voluntary Exercise of Prepayment Option.

1 *Witkin Sum. Cal. Law Contracts* § 482

[§ 482] Voluntary Exercise of Prepayment Option.

Where the borrower has the option to pay the debt, together with some months' unearned interest, *before its due date*, there is no usury. (*French v. Mortgage Guarantee Co. (1940)* 16 C.2d 26, 31, 104 P.2d 655; *McCarty v. Mellinkoff (1931)* 118 C.A. 11, 13, 4 P.2d 595; *Grall v. San Diego Bldg. & Loan Assn. (1932)* 127 C.A. 250, 254, 15 P.2d 797; *Abbot v. Stevens (1955)* 133 C.A.2d 242, 247, 284 P.2d 159; *Lazzareschi Inv. Co. v. San Francisco Fed. Savings & Loan Assn. (1971)* 22 C.A.3d 303, 307, 99 C.R. 417; 15 Corbin (Rev. ed.), §87.11; 9 Williston 4th, §20:23; 45 *Am.Jur.2d* (1999 ed.), *Interest and Usury* §§173, 174, 185; 21 *Cal. L. Rev.* 289; 6 *Southwestern U.L. Rev.* 203; 75 *A.L.R.2d* 1265 [effect of repayment, or borrower's option to repay, before maturity]; 86 *A.L.R.3d* 599 [construction and effect, as to interest due, of clause authorizing prepayment].)

SUPPLEMENT: [This section is current through the latest supplement]



29 of 40 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
B. Consumer Credit Laws.
1. Federal Law.

1 Witkin Sum. Cal. Law Contracts § 483

[§ 483] Federal Law.

(1) *Nature of Act and Regulation Z.* The federal Consumer Credit Protection Act ("Truth in Lending") became effective on July 1, 1969. (See 15 U.S.C., §1601 et seq.) It is implemented by Regulation Z (see 12 CFR, Part 226), prescribed by the Board of Governors of the Federal Reserve System.

The Act and its implementing regulations are designed to protect consumers by requiring disclosure of charges by individuals or organizations that extend or arrange credit for which a finance charge is or may be payable or which is repayable in more than four installments. (15 U.S.C., §1602; Regulation Z, §226.2 (12 CFR §226.2).) (See generally *Perez v. United States* (1971) 402 U.S. 146, 91 S.Ct. 1357, 1358, 28 L.Ed.2d 686, 688 [constitutionality of statute upheld; Congress has power under Commerce Clause to prohibit intrastate "loan sharking" activities]; *Mourning v. Family Publications Service* (1973) 411 U.S. 356, 93 S.Ct. 1652, 36 L.Ed.2d 318; *Household Credit Services v. Pfenning* (2004) 541 U.S. 232, 124 S.Ct. 1741, 1745, 158 L.Ed.2d 450, 457 [Regulation Z's interpretation of term "finance charge" as used in Truth in Lending Act (15 U.S.C., § 1605(a)) to exclude over-limit fees, which are imposed only when consumer-borrower exceeds his or her credit limit, was not arbitrary, capricious, or manifestly contrary to statute, and was thus binding on courts]; *Glaire v. La Lanne-Paris Health Spa* (1974) 12 C.3d 915, 924, 117 C.R. 541, 528 P.2d 357, supra, §471 [systematic purchase of installment sale contracts at a discount held within act despite no reduction in price for cash purchasers]; *King v. Central Bank* (1977) 18 C.3d 840, 848, 135 C.R. 771, 558 P.2d 857, 4 Summary (10th), Sales, §271 [sale of automobile insurance policy]; Cal. Civil Practice, 5 Business Litigation §57:1 et seq.; 2 Pepperdine Dispute Resolution L. J. 263 [dominance of arbitration in truth-in-lending claims]; 14 Santa Clara Lawyer 491 [Truth in Lending litigation]; 52 So. Cal. L. Rev. 1005 [Open-End Credit Disclosure Requirements]; 27 Stanf. L. Rev. 101 [Class Actions and Proposed Alternatives]; 26 U.C.L.A. L. Rev. 711 [Functional Analysis of Truth in Lending]; Cal. Transactions Forms, 5 Business Transactions §32:1 et seq.; 73 Proof of Facts 3d 275 [violation of Truth-in-Lending Act and Regulation Z]; 76 Proof of Facts 3d 193 [class action for failure to disclose under Truth-in-Lending Act and Regulation Z]; 157 A.L.R. Fed 419 [Who is "Creditor" Within Meaning of §103(f) of Truth in Lending Act (15 U.S.C.A. §1602(f)).]

(2) *Content and Scope of Act.* The Act is applicable whenever credit is extended to natural persons for personal, family, or household uses where the amount of credit extended does not exceed \$ 25,000. (15 U.S.C., §1602,1603; see *Weber v. Langholz* (1995) 39 C.A.4th 1578, 1582, 46 C.R.2d 677 [\$ 160,000 loan obtained to fund investment program in coins was, as matter of law, for business investment and thus exempt from Act; even assuming Act applied, obligor's

right to rescind loan expired upon sale of secured property notwithstanding lender's alleged failure to disclose rescission rights].) All credit transactions in which a security interest is acquired in real property, or in personal property to be used as the consumer's principal dwelling, are covered regardless of the amount of credit extended. (15 U.S.C., §1603(3).)

In addition to its disclosure requirements, the Act contains restrictions on garnishment of earnings (15 U.S.C., §1671 et seq.), prescribes procedures for fair credit reporting (15 U.S.C., §1681 et seq.), allows a consumer 3 days to rescind when the consumer enters into a second mortgage on his or her home (15 U.S.C., §1635); and controls extortionate credit transactions (18 U.S.C., §891 et seq.). (See *Jones v. Adams Financial Services* (1999) 71 C.A.4th 831, 839, 84 C.R.2d 151 [three-day "cooling off" period under regulation Z did not apply where loan agreement was obtained through fraud in execution; defrauded person, who thought papers she signed merely related to payoff of existing mortgage, did not know that she had entered into transaction encumbering title to her home]; *Johnson v. Capital One Bank* (2004) 120 C.A.4th 942, 945, 15 C.R.3d 917 [credit card holders' state law breach of contract claims against credit card issuer were improper, where state statute limited borrowers to remedies under federal law when claim was based on conduct regulated under Truth in Lending Act, and claims by card holders, which pertained to late charge penalties, fell squarely within purview of Act].)

State consumer credit legislation is not preempted by the Act unless the state laws are inconsistent with the federal law, and in that event only to the extent of the inconsistency. (15 U.S.C., §1610.)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Nature of Act and Regulation Z.* See 198 A.L.R. Fed 631 [validity and effect of Home Ownership and Equity Protection Act of 1994 (HOEPA) (15 U.S.C., §§1602(aa), 1610, 1639, 1640), amending Truth in Lending Act to curb "reverse redlining" in home mortgage loans]. (2) *Content and Scope of Act.* See *Pacific Shore Funding v. Lozo* (2006) 138 C.A.4th 1342, 1351, 42 C.R.3d 283 [based on lender's violation of disclosure requirements under Truth In Lending Act, borrowers were entitled to rescind their loan even though it had already been refinanced; disagreeing with federal case]; *LaLiberte v. Pacific Mercantile Bank* (2007) 147 C.A.4th 1, 8, 53 C.R.3d 745 [plaintiffs who sued bank for violations of Truth in Lending Act were not entitled to amend their class action rescission claim following demurrer; rescission under TILA was personal remedy not suitable for class action treatment].



30 of 40 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
B. Consumer Credit Laws.
2. California Law.

1 Witkin Sum. Cal. Law Contracts § 484

[§ 484] California Law.

(1) *In General.* Consumer credit sales are subject to the Unruh Act (C.C. 1801 et seq., regulating retail installment sales of consumer goods and services; see 4 *Summary* (10th), *Sales*, §263 et seq.) and the Rees-Levering Act (C.C. 2981 et seq., regulating the conditional sale of automobiles; see 4 *Summary* (10th), *Sales*, §239 et seq.). The burden of double disclosure under these Acts and federal Regulation Z (see supra, §483) is minimized by provisions permitting information to be disclosed in the manner required or permitted by Regulation Z. (C.C. 1801.5, 2982; see 4 *Summary* (10th), *Sales*, §§243, 275).

Other regulatory statutes include the Credit Card Act (C.C. 1747 et seq.; see 4 *Summary* (10th), *Negotiable Instruments*, §144 et seq.), the Consumer Credit Reporting Agencies Act (C.C. 1785.1 et seq.; see 4 *Summary* (10th), *Sales*, §297), C.C. 1916.5 (required provisions where document charges variable interest rate), and *B. & P.C. 17538* (restrictions on telephone, mail order, catalog business, and Internet or other electronic means of communication). (On consumer credit law in general, see Cal. Transactions Forms, 5 Business Transactions §32:1 et seq.; 27 *Stanf. L. Rev.* 951 [rates, costs, and benefits of consumer credit law]; for the 1974 revised Uniform Consumer Credit Code, see 7A (Part 1) U.L.A. (Master Ed.), p. 1.)

(2) *Limitation on Jurisdiction of Outside Forum.* An agreement entered into or renewed on or after January 1, 2003, establishing an *out-of-state* forum for an action arising from an offer or provision of goods, services, property, or extensions of credit primarily for personal, family, or household purposes that is otherwise within the jurisdiction of a small claims court of this state is contrary to public policy and is void and unenforceable. (C.C.P. 116.225; on jurisdiction of small claims court, see 2 *Cal. Proc.* (4th), *Courts*, §287 et seq.)

SUPPLEMENT: [This section is current through the latest supplement]

(2) *Limitation on Jurisdiction of Outside Forum.*

Cross-Reference: 2 *Cal. Proc.* (5th), *Courts*, §281 et seq.



31 of 40 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

C. Contracts of Unlicensed Persons.

1. General Principles.

a. Scope of Rule.

1 Witkin Sum. Cal. Law Contracts § 485

[§ 485] Scope of Rule.

In *Payne v. De Vaughn* (1926) 77 C.A. 399, 246 P. 1069, the court said: "It has frequently been held that a statute or ordinance requiring the payment of a license and procurement of a certificate to perform the services of an insurance agent, attorney, contractor and builder, freight solicitor, insurance broker, peddler, architect, plumber, real estate agent, or stock breeder, is not to be construed as a revenue law alone, but as a police measure, for the protection of the public, and that a contract of an unlicensed person for the furnishing of such services will not be upheld." (77 C.A. 403.) (See *Fewel & Dawes v. Pratt* (1941) 17 C.2d 85, 90, 109 P.2d 650; *Holm v. Bramwell* (1937) 20 C.A.2d 332, 334, 67 P.2d 114; *Loesch v. Bartholomew* (1992) 5 C.A.4th Supp. 8, 13, 8 C.R.2d 27; *Waisbren v. Peppercorn Productions* (1995) 41 C.A.4th 246, 261, 48 C.R.2d 437 [oral agreement, pursuant to which personal manager performed duties of talent agent by procuring employment for artistic production company, was void where manager acted without first obtaining necessary license under Talent Agencies Act (*Lab.C. 1700* et seq.)]; *Rest.2d, Contracts §181*; 15 Corbin (Rev. ed.), §88.1 et seq.; 8 Williston 4th, §19:46 et seq.; 51 *Am.Jur.2d* (2000 ed.), *Licenses and Permits §79* et seq.; 2 California Affirmative Defenses (2004 ed.), §§37:15, 39:1 et seq.) (For general discussions of occupational licenses in California, see 14 *Stanf. L. Rev.* 640; on real estate agents and brokers, see 3 *Summary* (10th), *Agency and Employment*, §47 et seq.; on stock brokers, see 3 *Summary* (10th), *Agency and Employment*, §46, 9 *Summary* (10th), *Corporations*, §434 et seq.; for special rules governing architects, see *infra*, §487; on contractors, see *infra*, §488 et seq.)

An unlicensed person who causes personal injury or damage to another as a result of providing goods or services for which a license is required is liable for treble damages, costs, and attorneys' fees. (*C.C.P. 1029.8*.)

In addition, a person engaged in any act for which a license is required *under the Business and Professions Code* may not bring any action, or recover in law or equity, for the collection of compensation for the performance of any act or contract for which a license is required, unless the person alleges and proves that he or she was duly licensed at all times during that performance. (*B. & P.C. 143(a)*; see 22 *Pacific L. J.* 395.)

The judicial doctrine of substantial compliance (see *infra*, §499 et seq.) does not apply to *B. & P.C. 143*. (*B. & P.C. 143(b)*.) However, *B. & P.C. 143* does not apply to an act or contract that qualifies as lawful licensed practice under *B. & P.C. 121* (no illegal practice during period between renewal of license and receipt of evidence of renewal). (*B. & P.C. 143(c)*.)

West's Key Number Digest, Licenses k.40(1)

SUPPLEMENT: [This section is current through the latest supplement]
See 2 California Affirmative Defenses §§37:15, 39:1 et seq.



32 of 40 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

C. Contracts of Unlicensed Persons.

1. General Principles.
- b. Test: Regulatory Statute.

1 Witkin Sum. Cal. Law Contracts § 486

[§ 486] Test: Regulatory Statute.

A statute that does not expressly prohibit a contract may nevertheless impose a penalty for doing business in disregard of the requirement of securing a license. A contract made by a person who fails to comply with this type of statute is not necessarily void. The rule is that "when the object of the statute or ordinance in requiring a license for the privilege of carrying on a certain business is to prevent improper persons from engaging in that particular business, or is for the purpose of *regulating* it for the protection of the public ... , the imposition of the penalty amounts to a prohibition against doing business without a license and a contract made by an unlicensed person in violation of the statute or ordinance is void." (*Wood v. Krepps* (1914) 168 C. 382, 386, 143 P. 691; see *Levinson v. Boas* (1907) 150 C. 185, 192, 88 P. 825; *Payne v. De Vaughn* (1926) 77 C.A. 399, 403, 246 P. 1069; *Dale v. Palmer* (1951) 106 C.A.2d 663, 667, 235 P.2d 650; *Mansfield v. Hyde* (1952) 112 C.A.2d 133, 139, 245 P.2d 577; *Albaugh v. Moss Const. Co.* (1954) 125 C.A.2d 126, 131, 269 P.2d 936; *California Chicks v. Viebrock* (1967) 254 C.A.2d 638, 641, 62 C.R. 269; *Loesch v. Bartholomew* (1992) 5 C.A.4th Supp. 8, 13, 8 C.R.2d 27; *Rest.2d, Contracts §181*; 29 A.L.R.4th 884 [person engaged in business of making loans]; 44 A.L.R.4th 271 [building and construction artisan or contractor].)

In *Orlinoff v. Campbell* (1949) 91 C.A.2d 382, 205 P.2d 67, an unlicensed highway carrier was denied recovery against a shipper on his contract to transport goods. After pointing out that these regulatory statutes seek to protect the public by some form of screening out of the dishonest and incompetent, the court said: "[T]he penalty of nonenforceability of contracts, in addition to those of fine and imprisonment, may be a necessary requirement to accomplish the results intended by the legislation. ... The penalty is not imposed by way of punishment of the individual but is resorted to as a deterrent from conduct which would tend directly to defeat the purpose of the regulatory measure." (91 C.A.2d 388.)

Lewis & Queen v. N.M. Ball Sons (1957) 48 C.2d 141, 308 P.2d 713; gives a more comprehensive explanation: "The reason for this refusal is not that the courts are unaware of possible injustice between the parties, and that the defendant may be left in possession of some benefit he should in good conscience turn over to the plaintiff, but that this consideration is outweighed by the importance of deterring illegal conduct. Knowing that they will receive no help from the courts and must trust completely to each other's good faith, the parties are less likely to enter an illegal arrangement in the first place. ... In some cases, on the other hand, the statute making the conduct illegal, in providing for a fine or administrative discipline excludes by implication the additional penalty involved in holding the illegal contract

unenforceable; or effective deterrence is best realized by enforcing the plaintiff's claim rather than leaving the defendant in possession of the benefit; or the forfeiture resulting from unenforceability is disproportionately harsh considering the nature of the illegality. In each such case, how the aims of policy can best be achieved depends on the kind of illegality and the particular facts involved." (48 C.2d 150.)

If, however, the object of the statute or ordinance in imposing the requirement of a license is not regulation for the protection of the public, but is simply to raise public *revenue*, a contract made by an unlicensed person is valid, even though that person may be subjected to a penalty for the failure to secure a license. (*Wood v. Krepps*, supra, 168 C. 386.)

SUPPLEMENT: [This section is current through the latest supplement]



33 of 40 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

C. Contracts of Unlicensed Persons.

2. Illustrations.

a. Architects.

1 Witkin Sum. Cal. Law Contracts § 487

[§ 487] Architects.

(1) *General License Requirement.* It is a misdemeanor for any person to practice architecture in this state without a license. (*B. & P.C. 5536.*) This statute is considered a police measure for the protection of the public; hence, a contract made by an unlicensed party for the rendition of architectural services is illegal and void. (*Payne v. De Vaughn (1926) 77 C.A. 399, 404, 246 P. 1069; see 5 Am.Jur.2d (1995 ed.), Architects §4; 58 Proof of Facts 3d 1 [architect's liability for failure to meet foreign state's licensing requirements]; 82 A.L.R.2d 1013 [what amounts to architectural or engineering services within licensing requirements]; 32 A.L.R.3d 1151 [right of architect or engineer licensed in one state to recover for services rendered in another state where not licensed].*)

(2) *Exemptions and Exceptions.* Certain professional persons, insofar as they practice the profession for which they are registered and do not use the title "architect," are exempted from the statutory provisions requiring licensing as architects: (a) Structural engineer (*B. & P.C. 5537.1*); (b) professional engineer (*B. & P.C. 5537.4*); (c) civil engineer (*B. & P.C. 5537.5*); (d) landscape architect (*B. & P.C. 5537.6*); (e) land surveyor (*B. & P.C. 5537.7*); (f) contractor, while performing services within the classification for which his or her license is issued (including preparation of shop and field drawings and design of systems and facilities for work that the contractor has contracted or offered to perform), or while performing under the direct supervision of a licensed architect or a licensed professional or civil engineer (*B. & P.C. 5537.2*).

Certain designated types of activities are also exempted from the licensing requirements of the statute. *B. & P.C. 5537* permits any person to prepare plans, drawings, or specifications for buildings "of woodframe construction not more than two stories and basement in height." (See *Medak v. Cox (1970) 12 C.A.3d 70, 77, 90 C.R. 452.*) This section further exempts "[a]gricultural and ranch buildings of woodframe construction, unless the building official having jurisdiction deems that an undue risk to the public health, safety, or welfare is involved." (*B. & P.C. 5537(a)(4).*)

Any person acting alone or with contractors, if required by *B. & P.C. 7000 et seq.*, may furnish labor and materials to be used for nonstructural or nonseismic storefronts, interior alterations or additions, etc., unless these alterations change or affect the building's structural system or safety. (*B. & P.C. 5538.*) Moreover, the licensing requirement does not prevent a corporation from contractually furnishing or supplying architectural services by and under the responsible control of a licensed architect. (*B. & P.C. 5535.3; for definition of "responsible control," see B. & P.C. 5535.1.*)

(3) *Distinction: Violation of Procedural Rule.* A person preparing plans, etc., must affix a stamp that, at a minimum, contains the licensee's name and license number and the legends "licensed architect" and "State of California," and that provides a means of indicating the license renewal date. (*B. & P.C.* 5536.1(a), (b).) In *Felix v. Zlotoff* (1979) 90 C.A.3d 155, 153 C.R. 301, decided when the statute required only a signature and registered number, plaintiff, a licensed architect, prepared plans, but his contract was unsigned and did not bear his number. *Held*, he was entitled to recover. The public policy aimed at protecting the public from incompetent designers was not involved in this technical violation of a procedural rule. (90 C.A.3d 161, 163.) (See *Gonzales v. Concord Gardens Mobile Home Park Ltd.* (1979) 90 C.A.3d 871, 873, 875, 153 C.R. 559, *infra*, §490, for similar holding as to licensed contractor.)

(4) *Necessity for Written Contract.* With certain exceptions, an architect contracting to provide professional services must use a written contract, executed by the architect and the client and containing certain specified information. (*B. & P.C.* 5536.22.)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *General License Requirement.* See 5 *Am.Jur.2d* (2007 ed.), *Architects* §3.



34 of 40 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
C. Contracts of Unlicensed Persons.

2. Illustrations.

b. Contractors.

1. Scope of Act.

aa. In General.

1 Witkin Sum. Cal. Law Contracts § 488

[§ 488] In General.

The chapter governing the licensing of contractors (*B. & P.C. 7000* et seq.) constitutes, and may be cited as, the Contractors' State License Law. (*B. & P.C. 7000*.) The Law applies to any "builder," i.e., a person engaging in construction, alteration, or repair of buildings or other structures, including a "subcontractor" and "specialty contractor." (*B. & P.C. 7026*; see *Loving & Evans v. Blick* (1949) 33 C.2d 603, 607, 609, 204 P.2d 23; *Franklin v. Nat C. Goldstone Agency* (1949) 33 C.2d 628, 632, 204 P.2d 37 [interior decorator]; *Albaugh v. Moss Const. Co.* (1954) 125 C.A.2d 126, 131, 269 P.2d 936 [subcontractor]; 19 A.L.R.3d 1407 [who is a "contractor" within meaning of licensing statutes].)

The term "contractor" includes all the following:

(1) Persons who maintain or service air-conditioning, heating, or refrigeration equipment that is a fixed part of the structure to which it is attached. (*B. & P.C. 7026.1(a)*.)

(2) Persons or specified entities who construct buildings or home improvement projects. (*B. & P.C. 7026.1(b)*.)

(3) Temporary labor service agencies that, as employers, provide employees for the performance of work covered by the Contractors' State License Law, unless there is a properly licensed contractor who exercises supervision in accordance with *B. & P.C. 7068.1* (responsibility of person qualifying on behalf of person or firm) and who is directly responsible for the final results of the work. (*B. & P.C. 7026.1(c)*.)

(4) Persons who perform tree removal or pruning, stump removal, or tree cabling or guying; but not nurserypersons who perform incidental pruning or guying, or gardeners who perform incidental pruning of trees measuring less than 15 feet in height. (*B. & P.C. 7026.1(d)*.)

(5) Persons who construct, improve, or abandon water wells, cathodic protection wells, or monitoring wells. (*B. & P.C. 7026.1(e)*.)

(6) Persons who construct, install, alter, repair, or prepare for moving mobilehomes or mobilehome accessory

buildings and structures on sites for the purpose of occupancy as dwellings, including manufacturers engaged in on-site work pursuant to specialized plans; but not manufacturers when performing off-site or warranty work, or sellers who hold a retail dealer's license and certify that installation is to be performed by a licensed contractor. (*B. & P.C. 7026.2.*)

(7) Persons who install or contract for the installation of carpet that is attached to the structure by any conventional method as determined by custom and usage in the trade; but not sellers of installed carpet who hold a retail furniture dealer's license and certify that installation is to be performed by a licensed contractor. (*B. & P.C. 7026.3.*) (See *Hydrotech Systems, Ltd. v. Oasis Waterpark* (1991) 52 C.3d 988, 277 C.R. 517, 803 P.2d 370, *infra*, §489, rejecting several arguments for implied exemptions; *Contractors Labor Pool v. Westway Contractors* (1997) 53 C.A.4th 152, 163, 61 C.R.2d 715 [company that provided workers to subcontractor on public works project was not acting in capacity of "contractor" within meaning of *B. & P.C. 7026*]; *Holland v. Morse Diesel Int.* (2001) 86 C.A.4th 1443, 1448, 104 C.R.2d 239 [where individual agreed to perform cleanup services at fixed price, rather than hourly rate, he was "subcontractor"; also, complaint was couched in language that unmistakably indicated that individual enjoyed subcontractor status].)

Home improvement contractors, including swimming pool contractors, are also governed by the law. (*B. & P.C. 7150.1.*)

West's Key Number Digest, Licenses k.11(5)

SUPPLEMENT: [This section is current through the latest supplement]



35 of 40 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

C. Contracts of Unlicensed Persons.

2. Illustrations.

b. Contractors.

1. Scope of Act.

bb. No Exemption for Exceptional Circumstances.

1 Witkin Sum. Cal. Law Contracts § 489

[§ 489] No Exemption for Exceptional Circumstances.

In *Hydrotech Systems, Ltd. v. Oasis Waterpark* (1991) 52 C.3d 988, 277 C.R. 517, 803 P.2d 370, plaintiff was a New York corporation that manufactured and installed patented equipment designed to simulate ocean waves. Defendant O, owner of a water-oriented amusement park, used defendant W as its general contractor for construction. Plaintiff contracted with W to design and construct a surfing pool using plaintiff's equipment, for a contract price of \$ 850,000. Plaintiff, concerned about licensing problems, wanted only to sell and deliver its equipment, but O insisted that plaintiff's expertise in design and construction was essential, and defendants allegedly promised that W would arrange for a California contractor to work with plaintiff on any construction activities that required a California license. The complaint sought recovery for the unpaid balance due on the contract. *Held*, no cause of action was stated, either in contract or in tort.

(a) *B. & P.C. 7031* states that a person may not sue to recover "compensation" for "any act or contract" that requires a California license, unless the person alleges and proves that he or she was duly licensed at all times during the performance. The chapter on contractors contains numerous express exemptions from the law, but those exemptions do not include foreign contractors, isolated transactions, or "unique" building services and capabilities. (52 C.3d 994, 995.)

(b) The purpose of the law is to protect the public from incompetence and dishonesty, and the obvious statutory intent is to discourage persons who have failed to comply with the law from offering or providing their unlicensed services for pay. Because of the strength and clarity of this policy, the statute applies despite injustice to the unlicensed contractor. (52 C.3d 995, citing *Lewis & Queen v. N.M. Ball Sons* (1957) 48 C.2d 141, 308 P.2d 713, *supra*, §486.)

(c) The authorities dealing with the doctrine of substantial compliance (see *infra*, §499 et seq.) do not support plaintiff's contention that "exceptional circumstances" may justify a departure from the literal terms of the statute. "The protective purposes of the licensing law cannot be satisfied in full measure unless 'the continuing competence and responsibility' of those engaged in the work for which compensation is sought have been officially examined and favorably resolved. ... Hydrotech does not state that it ever sought or obtained any such favorable official determination of its qualifications, or those of its agents involved in the pool construction." (52 C.3d 996.)

(d) The statute bars all actions, however they are characterized, that effectively seek "compensation" for illegal unlicensed contract work. The statutory prohibition operates even where the person for whom the work was performed knew that the contractor was unlicensed. (52 C.3d 997.) Hence, an unlicensed contractor may not circumvent the law simply by alleging that when the illegal contract was made, the other party had no intention of performing: "Section 7031 places the risk of such bad faith squarely on the unlicensed contractor's shoulders." (52 C.3d 998.)

(e) Plaintiff cites three Court of Appeal decisions to the point that section 7031 does not bar claims for fraud. (52 C.3d 999, citing *Grant v. Weatherholt* (1954) 123 C.A.2d 34, 266 P.2d 185, *infra*, §497, *Brunzell Const. Co. of Nevada v. Barton Dev. Co.* (1966) 240 C.A.2d 442, 49 C.R. 667, and *Pickens v. American Mortg. Exchange* (1969) 269 C.A.2d 299, 74 C.R. 788.) Dicta in these decisions suggest that tort damages are not prohibited "compensation," and therefore that the statute is inapplicable whenever the unlicensed contractor asserts that he or she was induced to do illegal work by fraudulent promises or representations. However, "[t]aken out of context, such a rule is naive, overbroad, unsupported by the authority cited, and impossible to reconcile with our reasoning in *Lewis & Queen*." (52 C.3d 1000.)

Nevertheless, "we stop short of disapproving" these cases, and conclude that *Grant* and its progeny are properly interpreted in the context of their particular facts: "In each case, the plaintiff's involvement as an unlicensed contractor was incidental to the overall agreement or transaction between the parties. By the same token, the primary fraud alleged in each case was external to the arrangement for construction work as such, and was thus unrelated to any protective concern of the licensing law. Under these extraordinary circumstances, the Courts of Appeal understandably concluded that the peripheral involvement of unlicensed contract work did not shield defendants from *all* tort liability." (52 C.3d 1001.) But "we decline to extend *Grant's* reasoning" to "the garden-variety dispute" involved here: "However artful the pleadings, if the primary fraud alleged is a false promise to pay for unlicensed construction work, and the primary relief sought is compensation for the work, section 7031 bars the action." (52 C.3d 1002.) (See *Vallejo Dev. Co. v. Beck Dev. Co.* (1994) 24 C.A.4th 929, 941, 29 C.R.2d 669 [following *Hydrotech Systems* and refusing to create exception for "master developers" who administer or supervise work of licensed contractors]; 19 *Pepperdine L. Rev.* 236 [*Hydrotech Systems*].)

SUPPLEMENT: [This section is current through the latest supplement]



36 of 40 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

C. Contracts of Unlicensed Persons.

2. Illustrations.

b. Contractors.

2. Licensing Requirement.

aa. In General.

1 Witkin Sum. Cal. Law Contracts § 490

[§ 490] In General.

The contractor cannot bring or maintain any action for the collection of compensation for the performance of any act or contract for which a license is required, without alleging that he or she was a duly licensed contractor at all times during the performance of that act or contract, regardless of the merits of the cause of action. (*B. & P.C. 7031(a)*; see *Owens v. Haslett* (1950) 98 C.A.2d 829, 832, 221 P.2d 252; *General Ins. Co. v. Superior Court* (1972) 26 C.A.3d 176, 179, 102 C.R. 541, *infra*, §499; *Rushing v. Powell* (1976) 61 C.A.3d 597, 605, 130 C.R. 110; 44 A.L.R.4th 271 [contractor's failure to procure license as affecting enforceability of contract or right of recovery].) (For exceptions, see *infra*, §§495, 496.) In addition, a security interest taken to secure payment for the performance of work for which a license is required is unenforceable unless the contractor was duly licensed at all times during performance. (*B. & P.C. 7031(c)*.) And, except where there is substantial compliance as provided in *B. & P.C. 7031(e)* (*infra*, §501), a person utilizing the services of an unlicensed contractor may bring an action in any court of competent jurisdiction in this state to recover all compensation paid to the unlicensed contractor. (*B. & P.C. 7031(b)*.)

In *Matchett v. Gould* (1955) 131 C.A.2d 821, 829, 281 P.2d 524, plaintiff unlicensed *subcontractor*, who furnished work and materials to defendant unlicensed contractor, was allowed to recover, on the theory that the licensing statutes are designed to protect innocent members of the public, including owners, materialmen, and subcontractors. But this reasoning was disapproved in *Lewis & Queen v. N.M. Ball Sons* (1957) 48 C.2d 141, 153, 308 P.2d 713, *supra*, §486. The court pointed out that the statute expressly requires subcontractors to be licensed, and held that they cannot therefore be deemed within the protected class. (See criticism, 10 *Hastings L. J.* 89.)

A party to a contractor's action may go behind the fact of licensure to defeat the contractor's claim based on the defective exercise of the license. (*Buzgheia v. Leasco Sierra Grove* (1997) 60 C.A.4th 374, 385, 70 C.R.2d 427 [defendant could attack contractor's license by going behind face of license and proving that contractor's required "responsible managing employee" was sham].)

If the contractor is licensed, he or she may be allowed to recover despite an inadvertent failure to comply with a regulatory rule of the licensing board (*Oddo v. Hedde* (1950) 101 C.A.2d 375, 378, 225 P.2d 929 [rule requiring

supplemental classification based on major contracting activity]; *Gonzales v. Concord Gardens Mobile Home Park Ltd.* (1979) 90 C.A.3d 871, 873, 875, 153 C.R. 559 [contractor failed to give prescribed notice of lien laws (former B. & P.C. 7018, now B. & P.C. 7159.4) and the prescribed statement of licensing requirement and board's address (B. & P.C. 7030)]; see 26 A.L.R.3d 1395 [failure of contractor to comply with regulation requiring work permit or submission of plans]; for similar rule as to licensed architect, see *supra*, §487). Engaging in the contracting business without a license is a misdemeanor. (B. & P.C. 7028.)

SUPPLEMENT: [This section is current through the latest supplement]

See *Great West Contractors v. WSS Industrial Const.* (2008) 162 C.A.4th 581, 592, 76 C.R.3d 8 [corporate subcontractor's act in drafting shop drawings was work performed under subcontract, rather than prefatory task, such that subcontractor was required to be licensed; license was also required before subcontractor could order materials meant to be incorporated in ultimate construction project, even though it did not do work itself, but instead coordinated and oversaw work that was actually performed by third-party vendor].

(New) *Time license acquired:* Because B. & P.C. 7031(a) requires a license "at all times during *performance*," a contractor who is unlicensed when performance begins may not recover compensation for individual acts performed after a license is issued. However, where a contractor acquires its license before it begins performance, it is not barred from recovering compensation solely because it is unlicensed when the contract is *executed*. (*MW Erectors v. Niederhauser Ornamental & Metal Works Co.* (2005) 36 C.4th 412, 425, 435, 30 C.R.3d 755, 115 P.3d 41.)

(New) *Actions against unlicensed contractor:* A claim brought under the Contractors' State License Law against an unlicensed contractor may appropriately form the basis for a right-to-attach order. The agreement for performance of services lies at the heart of such a claim. (*Goldstein v. Barak Const.* (2008) 164 C.A.4th 845, 853, 79 C.R.3d 603.) *Notice of lien laws:* B. & P.C. 7159.4 was repealed in 2005. The prescribed notice of lien laws is now in B. & P.C. 7159.



37 of 40 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

C. Contracts of Unlicensed Persons.

2. Illustrations.

b. Contractors.

2. Licensing Requirement.

bb. Burden of Proof of Due Licensure.

1 Witkin Sum. Cal. Law Contracts § 491

[§ 491] Burden of Proof of Due Licensure.

If licensure or proper licensure is controverted, proof of licensure must be made by production of a verified certificate of licensure from the Contractors' State License Board, establishing that the contractor was duly licensed in the proper classification at all times during performance. Nothing in the statute requires any person or entity controverting licensure or proper licensure to produce a verified certificate. When licensure or proper licensure is controverted, the burden of proof is on the licensee. (*B. & P.C. 7031(d)*.)

In *Buzgheia v. Leasco Sierra Grove* (1997) 60 C.A.4th 374, 70 C.R.2d 427, plaintiff contractor brought an action against defendant developer for fraud. Plaintiff did not hold a license personally but did business under a company name. The company held a license by virtue of its employment of a "responsible managing employee" (RME), who held a facially valid license. When defendant introduced evidence to challenge whether plaintiff's purported RME was bona fide under *B. & P.C. 7068*, and thus, whether plaintiff was properly licensed, the trial judge instructed the jury that the company's license certificate created a rebuttable presumption of licensure, the effect of which was to place the burden of proving the issue on defendant. *Held*, jury award in favor of plaintiff reversed.

As a contractor seeking compensation, plaintiff had the burden of proving due licensure, which included the burden of proving compliance with the RME requirements that defendant challenged. Although *B. & P.C. 7031(c)* (now *B. & P.C. 7031(d)*) provides that "proof of licensure ... shall be made by production of a verified certificate," production of the certificate merely establishes a rebuttable presumption of licensure. Because defendant introduced evidence to support a finding of nonlicensure based on noncompliance with the RME requirements, the presumption of proper licensure was rebutted, and plaintiff reassumed the burden of proof. (*60 C.A.4th 380*.)

SUPPLEMENT: [This section is current through the latest supplement]

See *Advantec Group v. Edwin's Plumbing Co.* (2007) 153 C.A.4th 621, 626, 63 C.R.3d 195 [developer's general denial to plumbing contractor's breach of contract cross-complaint containing allegation that contractor was duly licensed was sufficient to controvert contractor's allegation of licensure such that contractor was required by statute to prove licensure by producing verified certificate from Contractors' State License Board].



38 of 40 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

C. Contracts of Unlicensed Persons.

2. Illustrations.

b. Contractors.

2. Licensing Requirement.

cc. Unlicensed Status as Defense Against Assignees.

1 Witkin Sum. Cal. Law Contracts § 492

[§ 492] Unlicensed Status as Defense Against Assignees.

In *Wilson v. Steele* (1989) 211 C.A.3d 1053, 259 C.R. 851, an action by plaintiff special administrator to cancel an instrument, the decedent's daughter had contracted with an unlicensed contractor to refurbish decedent's property. The daughter obtained two loans, and executed two promissory notes and two deeds of trust on the property. The second loan was from the contractor, who was named the payee of the second promissory note and trustee on the second deed of trust. For a discounted price, the contractor assigned the second note to defendants. Hence, the issue presented was whether the contractor's unlicensed status was a defense that could be asserted against defendant assignees who were holders in due course. *Held*, judgment for defendants reversed; plaintiff was entitled to assert the defense of illegality.

(a) Under *B. & P.C. 7031* (supra, §490), a contract executed by an unlicensed contractor is void. (211 C.A.3d 1059.) Under U.C.C. 3305(2)(b) (now 3305(b)) (see 4 *Summary* (10th), *Negotiable Instruments*, §31), a holder in due course takes the instrument subject to a defense of illegality that renders the obligation void. Hence, the contractor's assignee was subject to the illegality defense as to both the note and the deed of trust. (211 C.A.3d 1060, 1062.)

(b) The case must be remanded so that the trial judge can make a finding as to the purpose of the second loan. If he determines that the loan was for construction purposes, the licensing/illegality defense will bar defendants from enforcing the instruments. However, if he determines that it was merely a cash loan to decedent's daughter, the contractor's unlicensed status will be unavailing to plaintiff. (211 C.A.3d 1063.)

SUPPLEMENT: [This section is current through the latest supplement]



39 of 40 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

C. Contracts of Unlicensed Persons.

2. Illustrations.

b. Contractors.

2. Licensing Requirement.

dd. No Requirement That Contract Be for Payment of Money.

1 Witkin Sum. Cal. Law Contracts § 493

[§ 493] No Requirement That Contract Be for Payment of Money.

In *K & K Services v. Irwindale* (1996) 47 C.A.4th 818, 54 C.R.2d 836, plaintiff, an unlicensed contractor, sued defendant city for breach of a contract that gave plaintiff the exclusive right to run a "fill" operation on city-owned land, under which it would collect dumping fees from third parties. The trial court found that the action was barred by *B. & P.C. 7031*. *Held*, affirmed.

(a) *B. & P.C. 7031* applies to an action "for the collection of compensation for the performance of any act or contract for which a license is required." It thus bars a suit for breach of contract. The term "compensation" embraces damages suffered by a contractor lacking the requisite license for breach of a contractual obligation where either (1) the making of the contract or (2) the performance during which the breach occurs comes within the licensing requirement. Under *Hydrotech Systems, Ltd. v. Oasis Waterpark* (1991) 52 C.3d 988, 277 C.R. 517, 803 P.2d 370, *supra*, §489, an unlicensed contractor cannot recover either for the agreed contract price or for the reasonable value of labor and materials. Here, plaintiff agreed to perform specific work for the benefit of defendant in exchange for an exclusive renewable permit for fill rights. Those rights were plainly the "compensation" or "agreed contract price" for plaintiff's work. That plaintiff's compensation under the contract was a permit to fill a quarry instead of cash does not take the action outside the bar of *B. & P.C. 7031*. (47 C.A.4th 823.)

(b) Plaintiff may not avoid application of *B. & P.C. 7031* by characterizing its contract with defendant as a development agreement instead of a contract for which a contractor's license is required. The contract required plaintiff to provide, place, and compact an average of 825,000 cubic yards per year of solid fill material in a quarry; to supervise and control the project at all times; to strip and stockpile all existing organic matter; and to pave a haul road approximately 300 feet in length. These duties come within the definition of "contractor" under *B. & P.C. 7026* (*supra*, §488) and hence require a contractor's license. (47 C.A.4th 824.)

(c) *B. & P.C. 7040* (Contractors' State License Law does not apply to authorized representatives of public entities; *infra*, §495) does not exempt contracts between public entities and unlicensed contractors from the requirements of the law. The statute exempts "an authorized representative" of a public entity from being licensed; it does not apply to

contracts between the public entity and an unlicensed contractor. (*47 C.A.4th 825.*)

SUPPLEMENT: [This section is current through the latest supplement]



40 of 40 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

C. Contracts of Unlicensed Persons.

2. Illustrations.

b. Contractors.

2. Licensing Requirement.

ee. General Building Contractor's License as Covering Site Preparation Work.

1 Witkin Sum. Cal. Law Contracts § 494

[§ 494] General Building Contractor's License as Covering Site Preparation Work.

In *Hazard, Jr. Enterprises v. Insurance Co. of the West* (1997) 52 C.A.4th 1088, 60 C.R.2d 921, plaintiff, a licensed general building contractor, sued to recover the unpaid portion of a contract to do site preparation work for defendant's development. No actual building construction was involved. Defendant contended that plaintiff was not properly licensed, because it did not have a general *engineering* contractor's license. Defendant argued that a general building contractor could do site preparation work only if its contract also included the construction of a structure. *Held*, judgment for defendant reversed.

(a) The fallacy in defendant's position is seen in *B. & P.C. 7057*, the statute defining a "general building contractor." "The plain words of the statute show a general building contractor's operation is not limited solely to the construction of structures. A general building contractor is defined as one 'whose principal contracting business is in connection with any structure built [i.e., remodeling or repair], being built [i.e., new construction], or to be built ... requiring in its construction the use of ... unrelated building trades or crafts. ...' The phrase 'in connection with any structure ... to be built' is meaningless unless general building contractors are authorized to perform, or superintend, work limited to site preparation for future construction or alteration of a structure, or for construction of, for instance, sidewalks, landscaping, pools, fencing and other exterior components of residential or commercial development with respect to which the construction of the buildings is yet to occur." (52 C.A.4th 1095.)

(b) Defendant relied on a Contractors' License Board regulation prohibiting contractors licensed in one classification from constructing in the field of any other classification. Specifically, defendant contended that the tasks done in site preparation were within the statute defining a general engineering contractor. However, the board's regulation may only limit the scope of a general building contractor as defined by statute and, as has been seen, that statute includes site preparation. Thus, plaintiff was not constructing in any other field, but was working within his own field. (52 C.A.4th 1096.)

(c) Defendant argued that it was the legislative intent to allow general building contractors to do site preparation only if it was done in conjunction with the construction of a structure. It is true that the Legislature could have

prevented a general building contractor from performing stand-alone site preparation. However, it would have been illogical for it to have done so, because this legislation would have done little towards fostering the primary goal behind the contractor's licensing requirement of protecting the public safety by insuring that contractors were properly qualified. In other words, it makes little sense to allow a general building contractor to do site preparation if it is done in conjunction with the construction of a particular building, but to prohibit this work if no building construction is planned. It is illogical to assume that a general building contractor is qualified to perform site preparation in connection with a structure to be built by the contractor, but to conclude that the same contractor suddenly becomes unqualified to do the work when no building is to be built. (52 C.A.4th 1097.)

(d) Even if the phrase "to be built" is not considered, plaintiff could perform the work in question. The statute defining a general building contractor's duties refers to the *principal* duties of such a contractor. In the vast majority of the cases, the contractor's site preparation work will be done in conjunction with the erection of a particular structure. However, there is nothing in the statute that would prevent a contractor whose principal business meets the statutory criteria from contracting for other types of work from time to time. (52 C.A.4th 1098.) (See *Denver D. Darling v. Controlled Environments Const.* (2001) 89 C.A.4th 1221, 1229, 108 C.R.2d 213 [pre-1998 language of B. & P.C. 7057 allowed general contractor to accept contracts requiring use of two or fewer building trades so long as contractor's *principal* contracting business dealt with structures requiring two or more unrelated building trades].)

SUPPLEMENT: [This section is current through the latest supplement]



1 of 40 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

C. Contracts of Unlicensed Persons.

2. Illustrations.

b. Contractors.

3. Where Act Does Not Apply.

aa. In General.

1 Witkin Sum. Cal. Law Contracts § 495

[§ 495] In General.

In the following situations, the Act does not apply:

(1) Where the action is to recover the price based on a *sale or installation* of personal property that does not become a fixed part of the structure, or where personal property is constructed, altered, improved, or repaired; but the Act does apply if the contract involves *installation* of home improvement goods or a mobile home to be used as a dwelling. (*B. & P.C. 7045, 7046*; see *Costello v. Campbell* (1947) 81 C.A.2d 452, 453, 184 P.2d 315 [cold storage plant]; *Hagan v. Allen* (1949) 93 C.A.2d 854, 856, 210 P.2d 65 [steam generator].)

(2) Where a person contracts in this state to construct or demolish a building in another state. The purpose of the law is to protect only those persons involved in structures located in California. (*Conderback v. Standard Oil Co. of Calif.* (1966) 239 C.A.2d 664, 679, 48 C.R. 901.) (See 1 U.S.F. L. Rev. 301.)

(3) Where the contract on its face calls for hybrid services, some requiring a license and some not, and the contract can reasonably be interpreted in the particular case to require work for which no license is necessary. (See *Executive Landscape Corp. v. San Vicente Country Villas IV Assn.* (1983) 145 C.A.3d 496, 500, 501, 193 C.R. 377 [contract for management and maintenance of common areas of condominium complex; services mainly landscaping and general maintenance].)

(4) Where the action is by property owners building or improving structures on their property for their own use. (*B. & P.C. 7044*.)

(5) Where the contract price is less than \$ 500, provided the work is not part of a larger operation and is not performed by a person holding himself or herself out as a contractor. (*B. & P.C. 7048*.)

(6) Where the action involves a materialman, manufacturer, or supplier who furnishes materials or supplies but does not install or consume them in the performance of his or her work. (*B. & P.C. 7045, 7052*.)

Also exempt from the licensing requirement are (a) governmental representatives acting in their official capacity (B. & P.C. 7040; see *K & K Services v. Irwindale* (1996) 47 C.A.4th 818, 825, 54 C.R.2d 836, supra, §493 [B. & P.C. 7040 does not exempt contracts between public entities and unlicensed contractors from requirements of licensing law]) and court officers acting within the scope of their offices (B. & P.C. 7041); (b) public utilities and cable television corporations in their own business operations (B. & P.C. 7042, 7042.5); (c) oil or gas drilling and operations (B. & P.C. 7043); (d) irrigation and drainage ditch work and agricultural or fire prevention work (B. & P.C. 7049); (e) licensed architects or registered civil and professional engineers acting solely in their professional capacity, licensed structural pest control operators acting within the scope of their license, or licensees operating within the scope of the Geologist and Geophysicist Act (B. & P.C. 7051); (f) contractors acting in joint venture or combination, if each contractor is individually licensed as a contractor and the licensees have merely failed to obtain the joint venture or combination license required by B. & P.C. 7029 (B. & P.C. 7031(a)); (g) admitted surety insurers when engaging a contractor to undertake the completion of a contract on which the surety insurer issued a performance or completion bond, provided all actual construction work is performed by duly licensed contractors (B. & P.C. 7044.2).

SUPPLEMENT: [This section is current through the latest supplement]

(4) *Property owners:* See *Communications Relay Corp. v. Los Angeles* (2005) 130 C.A.4th 162, 166, 30 C.R.3d 1 [B. & P.C. 7044 only exempts owner-builders from Contractors' State License Law, not from other statutes that mandate specific licenses; thus, property owners were not exempt from licensing requirement set forth in *Water C. 13750.5* applicable to construction of water wells].

B. & P.C. 7049: See *Moehring v. Thomas* (2005) 126 C.A.4th 1515, 1522, 25 C.R.3d 118 [with total population of 44,301, Siskiyou County is rural county, and thus Contractors' State License Law did not apply to clearance or other work done therein for fire prevention].

(6) *Furnishing materials, but not installing:* See *Banis Restaurant Design v. Serrano* (2005) 134 C.A.4th 1035, 1045, 36 C.R.3d 532 [by filing mechanic's lien, unlicensed restaurant design corporation in essence characterized materials or supplies it furnished as fixtures, making Govt.C. 7045 exception inapplicable].



2 of 40 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

C. Contracts of Unlicensed Persons.

2. Illustrations.

b. Contractors.

3. Where Act Does Not Apply.

bb. Employees.

1 *Witkin Sum. Cal. Law Contracts* § 496

[§ 496] Employees.

(1) *Statutory Exception. B. & P.C. 7053* was added in 1949 to exempt employees whose sole compensation is wages.

In *Jackson v. Pancake* (1968) 266 C.A.2d 307, 72 C.R. 111, defendant theatre owner engaged plaintiff, operator of a plumbing shop, to install plumbing. Plaintiff informed him that he was neither a licensed contractor nor a union plumber, and agreed to work for \$ 5 per hour plus the retail cost of materials used. *Held*, this was clearly employment within the meaning of *B. & P.C. 7053*, with the incidental furnishing of materials under *B. & P.C. 7052* (see *supra*, §495), and plaintiff was entitled to recover for his labor and materials. (266 C.A.2d 308, 311.) (See *Johnson v. Silver* (1958) 161 C.A.2d Supp. 853, 855, 327 P.2d 245 [employee entitled to enforce mechanic's lien although his employer was unlicensed contractor].)

The 1982 Legislature amended *B. & P.C. 7053* to add the conditions that the employee "does not customarily engage in an independently established business, and does not have the right to control or discretion as to the manner of performance so as to determine the final results of the work performed."

(2) *Presumption of Lab.C. 2750.5 Inapplicable.* In *Fillmore v. Irvine* (1983) 146 C.A.3d 649, 656, 194 C.R. 319, the court held that the presumption of employment status in *Lab.C. 2750.5* (see 3 *Summary* (10th), *Agency and Employment*, §§32, 33) does not apply to a determination, in an action by a worker against a property owner, of whether the worker is a contractor required by *B. & P.C. 7031* to have a license or an employee excepted from the license requirement under *B. & P.C. 7053*.

West's Key Number Digest, Licenses k.19(3)

SUPPLEMENT: [This section is current through the latest supplement]



3 of 40 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
C. Contracts of Unlicensed Persons.
3. Distinctions and Exceptions.
a. Tort or Breach of Separate Contract.

1 Witkin Sum. Cal. Law Contracts § 497

[§ 497] Tort or Breach of Separate Contract.

(1) *In General.* Even though a regulatory statute is violated, an action may be brought that does not call for enforcement of the contract. "The sections of the code which shield from liability those who enter into contracts with unlicensed persons do not purport to shield them from responsibility for their own torts, nor do they relate to actions or proceedings except those that are based upon contract liability." (*Grant v. Weatherholt* (1954) 123 C.A.2d 34, 43, 266 P.2d 185.) (See 51 Am.Jur.2d (2000 ed.), *Licenses and Permits* §105.)

In *Grant v. Weatherholt*, *supra*, plaintiff, an unlicensed contractor, agreed to perform construction services and to advance \$ 25,000 in a joint venture. After collapse of the venture, he sued for damages for fraud, a defendant having represented that the property was unencumbered. *Held*, he was entitled to recover. He could not sue for compensation for performance, but his cause of action for deceit was not barred. "The validity or invalidity of his contract does not affect that right. Proof of the contract under the cause of action for fraud was merely proof of the circumstances under which plaintiff's services were rendered and his money was expended." (123 C.A.2d 43.) (See *Pickens v. American Mortg. Exchange* (1969) 269 C.A.2d 299, 303, 74 C.R. 788 [following *Grant*]; *Holland v. Morse Diesel Int.* (2001) 86 C.A.4th 1443, 1449, 104 C.R.2d 239 [racial discrimination alleged during performance of construction cleanup services by unlicensed contractor; *B. & P.C. 7031* precluded recovery of sums due under contract, but unlicensed contractor could recover damages under 42 U.S.C., §1981].)

Similarly, the statute prohibits only those transactions or contracts for construction and similar work that call for a license; an unlicensed contractor may sue for breach of a contract not within the scope of the statute. (*Davis Co. v. Superior Court* (1969) 1 C.A.3d 156, 159, 81 C.R. 453 [action for breach of warranty against materialman furnishing material used by subcontractor].)

(2) *Cross-Action by Developer/General Contractor Against Subcontractor for Indemnity and Contribution.* In *Ranchwood Communities Ltd. Partnership v. Jim Beat Const. Co.* (1996) 49 C.A.4th 1397, 57 C.R.2d 386, the homeowners associations of two separate condominium projects brought construction defect actions against the developers/general contractors on the projects, both of whom were unlicensed. Defendants cross-complained against numerous subcontractors on the projects, alleging two groups of theories: (a) express indemnity, breach of contract and warranties, and declaratory relief regarding contractual duties; and (b) equitable indemnity, implied contractual and total

indemnity, contribution, and recovery in negligence. *Held*, summary judgments for subcontractors reversed.

(a) The causes of action for express indemnity, breach of contract, breach of warranties, and declaratory relief on contractual indemnity rights are barred by the licensing requirements of *B. & P.C. 7031*. These contract-based causes of action are inseparable from the construction subcontracts and recovery on those subcontracts in the form of express indemnity cannot be sought by the unlicensed general contractors. Express indemnity payments are very similar to breach of contract damages in this context, and the construction subcontracts are illegal due to the lack of a developer/general contractor license, so they may not be enforced and no compensation can be sought under them. (49 *C.A.4th* 1416.)

(b) However, the tort-based causes of action for equitable indemnity, implied contractual and total indemnity, and contribution are not barred by *B. & P.C. 7031*. The developers/general contractors acted in a dual capacity, both as general contractors, who had to be licensed in order to pursue an action for compensation for their work, and as developers, who could be held strictly liable in damages to the homeowners/plaintiffs in the actions for defective construction, and who would normally be allowed to seek to spread that loss among all culpable parties. Thus, the primary relief sought in these causes of action was not merely compensation for the work performed, but rather the spreading of the cost of a plaintiff's damages incurred because of defective work by others. "Any total ban on subcontractor liability for equitable indemnity, arising from a too strict interpretation of the licensing law, would be a windfall and would not be within the protective purpose of the licensing statute." (49 *C.A.4th* 1421.)

(c) The negligence claims, like those for equitable indemnity and related concepts, are outside the scope of the contractual claims and thus are not barred by the licensing requirements. As pled in the cross-complaints, they do not allege any negligence damages beyond those suffered by the homeowner-plaintiffs, except for litigation expenses, and thus they are closely related to the indemnity claims. (49 *C.A.4th* 1421.)

SUPPLEMENT: [This section is current through the latest supplement]



4 of 40 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
C. Contracts of Unlicensed Persons.
3. Distinctions and Exceptions.
b. Action To Dissolve Joint Venture.

1 Witkin Sum. Cal. Law Contracts § 498

[§ 498] Action To Dissolve Joint Venture.

In *Epstein v. Stahl* (1959) 176 C.A.2d 53, 1 C.R. 143, plaintiff and defendant entered into an oral joint venture to convert four old buildings, on real property owned by defendant, into modern apartments for operation and resale. Defendant agreed to convey a half interest to plaintiff, and both agreed to convey their interests to the joint venture; defendant agreed to provide the money, plaintiff the services of redesigning, remodeling, and reconstruction, labor and materials, building equipment, etc. Both performed and the apartments were completed, but defendant took exclusive possession and retained the rents. Plaintiff sued for dissolution of the joint venture and an accounting. Defendant demurred on the ground that plaintiff was not licensed as a contractor. *Held*, judgment for defendant reversed, on the theory of *Norwood v. Judd* (1949) 93 C.A.2d 276, 283, 209 P.2d 24 (supra, §444). Illegality in operating a contracting joint venture without a license does not preclude a party thereto from instituting proceedings for dissolution of the venture and accounting:

"The facts at bar present a far stronger case for not permitting a greedy and avaricious joint venturer to keep for himself all the fruits of the venture to the exclusion of another venturer" than do other cases, including *Norwood*. "Here the joint venture did not render services, furnish materials to third persons, or act as a contractor. ...Plaintiff did not engage in the business of contracting. He did not act as a contractor in the strict sense of the term. The parties dealt solely between themselves The suit is not one to divide money or assets derived from dealing with the public in an unlicensed capacity. It is neither against public interest nor public policy to permit plaintiff to maintain the suit. In justice and equity he should not be precluded from recovering his just share of the profits of the venture." (176 C.A.2d 62.)

West's Key Number Digest, Licenses k.43(2)

SUPPLEMENT: [This section is current through the latest supplement]



5 of 40 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

- C. Contracts of Unlicensed Persons.
 - 3. Distinctions and Exceptions.
 - c. Substantial Compliance by Contractor.
 - 1. Earlier Conflicting Cases.

1 Witkin Sum. Cal. Law Contracts § 499

[§ 499] Earlier Conflicting Cases.

(1) *Recovery Allowed.* The opinion in *Latipac v. Superior Court* (1966) 64 C.2d 278, 49 C.R. 676, 411 P.2d 564, reached a conclusion hard to reconcile with *Lewis & Queen v. N.M. Ball Sons* (1957) 48 C.2d 141, 149, 308 P.2d 713, supra, §486. Plaintiff contractor had a valid license at the time of contracting. Allegedly because of a mental breakdown of its office manager, the renewal application was not made, and renewal did not take place until a year later. The construction contract, begun and performed for 15 months with a license, was completed during the unlicensed period. *Held*, plaintiff was entitled to recover the unpaid balance of over \$ 400,000.

The court relied on the doctrine of substantial compliance, illustrated by such cases as *Gatti v. Highland Park Builders* (1946) 27 C.2d 687, 690, 166 P.2d 265. The factors justifying application of the doctrine here were: (a) Plaintiff held a valid license at the time of contracting, the crucial period for third persons to determine responsibility and competence. (64 C.2d 281.) (b) The renewal was readily obtained. (c) Plaintiff's actual responsibility and competence (i.e., the responsibility and competence of its managing officer) were established. (64 C.2d 282, 285.)

Three dissenting justices, stressing the language of *Lewis & Queen v. N.M. Ball Sons*, contended that the majority opinion was unsupported by any prior decision and dangerously weakened the regulatory statute. But the majority felt that its innovation was desirable to prevent unjust enrichment of defendant at the expense of plaintiff and its creditors. "We are not disposed to decree vast forfeitures in the aid of no ascertainable public policy." (64 C.2d 287.) (See *Asdourian v. Araj* (1985) 38 C.3d 276, 283, 211 C.R. 703, 696 P.2d 95, infra, §500; *Vitek v. Alvarado Ice Palace* (1973) 34 C.A.3d 586, 592, 110 C.R. 86 [contractor not licensed at time of contracting, but license renewed before work commenced]; *Airfloor Co. of Calif. v. Regents of Univ. of Calif.* (1978) 84 C.A.3d 1004, 1010, 149 C.R. 130; 7 Santa Clara Lawyer 157; 1 U.S.F. L. Rev. 298.)

(2) *Recovery Denied.* In *Frank v. Kozlovsky* (1970) 13 C.A.3d 120, 91 C.R. 297, the only condition met was competence. (a) Plaintiffs did not hold a valid license at the time of contracting; (b) they did not readily obtain a renewal. Dissolution of the partnership left the new partnership unlicensed, and the license obtained after the time of contracting was a new one, not a renewal. (13 C.A.3d 125.)

The issue was reexamined in an exhaustive opinion in *General Ins. Co. v. Superior Court* (1972) 26 C.A.3d 176, 102 C.R. 541. W, a personally licensed contractor, conducted his business under the fictitious name of Pacific Coast Pipeline Contractors Co. In September 1969, he incorporated the business under the name of Pacific Coast Pipeline, and in March 1970, he transferred his solely owned business to the corporation. The corporation was a purely formal entity: It had no bylaws, issued no stock, and held no meetings; W was its sole owner, president, chairman of the board, and responsible managing officer. The corporation could have obtained a license by the appearance of W as its responsible managing officer. But W mistakenly believed that his personal license was sufficient, and he did not apply. In October 1970, the corporation contracted to perform work, which W competently managed and supervised. The work was completed in June 1971. The corporation received \$ 106,871.78 on account, and sued for the unpaid balance of \$ 72,249.09. The complaint disclosed on its face that the corporation had no license. *Held*, mandamus issued to compel granting of defendants' motions for judgment on the pleadings and summary judgment.

(a) *The Latipac tests.* *Frank v. Kozlovsky*, *supra*, suggested that all three elements set forth in *Latipac*, *supra*, must be found. (13 C.A.3d 124.) But the *Latipac* majority expressly declined to rule on that point. (26 C.A.3d 181, quoting *Latipac*, 64 C.2d 281: "Since all these elements here concur, we need not determine whether any of them, singly or in more limited combination, would constitute 'substantial compliance.'")

(b) *License at time of contracting.* From the standpoint of the ultimate statutory purpose, this element has little significance; the statute requires a license during "performance," and a license at that time is the important requirement. But in legal theory the element is highly significant: If the contractor is unlicensed at the time the contract is executed, the contract is illegal under general law, irrespective of the provisions of B. & P.C. 7031. (26 C.A.3d 182.) And no case holds the substantial compliance doctrine applicable where the contractor was unlicensed at that time. (26 C.A.3d 183.)

(c) *License at time of performance.* This was not one of the *Latipac* elements, but, from the standpoint of practical enforcement of the law, it is the important consideration. And it is controlling here: Plaintiff was not only not licensed at the time of contracting but remained unlicensed during performance. (26 C.A.3d 184.)

(d) *No disregard of corporate entity.* The argument that there was in truth no corporation, and that W was a licensed contractor operating with the corporation as a shell, was rejected on policy grounds: "[T]o disregard its corporate existence ... would nullify that part of the licensing law requiring a separate license for a corporation ... , and to hold that plaintiff has nevertheless substantially complied ... would emasculate the statutory language and nullify the section's purpose of pragmatically enforcing the Contractors License Law." (26 C.A.3d 184.)

The court took note, in conclusion, of the express exception for partnerships, where each partner is personally licensed but the partnership has no separate license (B. & P.C. 7031), and added: "It may well be that an exception should likewise be made for the situation involving a corporation wholly owned, controlled and supervised by one person who is duly licensed." (26 C.A.3d 184.) (See *Brown v. Solano County Business Dev.* (1979) 92 C.A.3d 192, 195, 154 C.R. 700 [contractor licensed at time of contracting, license expired and major part of performance took place while he was unlicensed].) (On legislative changes to doctrine of substantial compliance, see *infra*, §501.)

SUPPLEMENT: [This section is current through the latest supplement]



6 of 40 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

- C. Contracts of Unlicensed Persons.
 - 3. Distinctions and Exceptions.
 - c. Substantial Compliance by Contractor.
 - 2. Modern Test.

1 Witkin Sum. Cal. Law Contracts § 500

[§ 500] Modern Test.

In *Asdourian v. Araj* (1985) 38 C.3d 276, 211 C.R. 703, 696 P.2d 95, plaintiff contractor performed work on several remodeling contracts for defendants, received partial payment, and brought actions to recover the balance due as compensation for the reasonable value of work and materials. The evidence showed that plaintiff obtained a license for "Artko Remodeling and Construction," a sole proprietorship, with his name and signature as "responsible managing party." He had planned to incorporate under that name, but did not do so, and he did not obtain a separate license in his name or have the existing license changed. *Held*, he had substantially complied with *B. & P.C. 7031* and was entitled to recover.

(a) *Latipac v. Superior Court* (1966) 64 C.2d 278, 49 C.R. 676, 411 P.2d 564, *supra*, §499 listed the factors that might warrant application of the doctrine of substantial compliance, but did not decide whether less than all of them would be sufficient. However: "If the facts clearly indicate substantial compliance which satisfies the policy of the Contractors License Law, the failure to establish all of the *Latipac* factors should not defeat plaintiff's claim." (38 C.3d 284.)

(b) Plaintiff established compliance with the relevant factors:

(1) The first factor was satisfied by the evidence that plaintiff's firm held a valid license at the time of the contracts: Although the license was issued to Artko, it bore plaintiff's name as the responsible managing party, and that provided sufficient evidence of his qualifications. Hence, though use of his own name in contracting was a technical violation of *B. & P.C. 7028.5*, "it did not prevent defendant from receiving the full and effective protection of the statute." (38 C.3d 285.)

(2) The second factor (renewal) serves the purpose of confirmation of continuing competence, and this "was met by the existence of the valid license issued to Artko." (38 C.3d 286.)

(3) Plaintiff clearly met the third factor, for his competence and experience formed the basis of the license issued to Artko, and issuance of a license in his own name "would not have provided defendant with any greater assurances that

he was dealing with an experienced and competent contractor," or have provided any different information concerning the status or solvency of the business. (38 C.3d 286.)

(c) *General Ins. Co. v. Superior Court* (1972) 26 C.A.3d 176, 102 C.R. 541, supra, §499, denying recovery, relied in part on the logic of the *Latipac* dissent, and to that extent it is disapproved. (38 C.3d 288.) *Schantz v. Ellsworth* (1971) 19 C.A.3d 289, 96 C.R. 783, involving a real estate license (see 3 Summary (10th), *Agency and Employment*, §77), is persuasive here. (38 C.2d 288.)

(d) "Defendant attempts to rely on a technicality to defeat plaintiff's claims. This technicality is unrelated to defendant's real dispute with plaintiff--the *terms* of the remodeling agreements. That dispute was resolved by the trial court in plaintiff's favor. To allow defendant to prevail on a technicality would be to allow section 7031 to be used as a 'shield for the avoidance of a just obligation.' " (38 C.2d 289.) The purpose of the licensing requirement is to protect the public from the perils incident to contracting with incompetent or untrustworthy contractors; that purpose has been realized here, and, as in *Latipac*, fidelity to precedent and considerations of equity precludes requiring the wholly gratuitous enrichment of defendants at the expense of plaintiff. (38 C.3d 289.)

One dissenting justice asserted that the majority emasculated a legislative enactment that is clear and unambiguous; and that "by deft legerdemain" they found that "the policy" if not the text of the law was satisfied. He therefore adopted as his own the Court of Appeal opinion following *General Ins. Co. v. Superior Court* and denying recovery. (38 C.3d 295 et seq.)

Asdourian was followed in *Knapp Dev. & Design v. Pal-Mal Properties, Ltd.* (1985) 173 C.A.3d 423, 219 C.R. 44. The court said: "While *Asdourian* involved an individual and a sole proprietorship and the instant case involves an individual and a corporation, that distinction does not compel a different result here." (173 C.A.3d 435; see *G.E. Hetrick & Associates v. Summit Const. & Maintenance Co.* (1992) 11 C.A.4th 318, 329, 13 C.R.2d 803 [finding triable issue as to whether licensed individual was unlicensed corporation's responsible managing officer so as to constitute substantial compliance with licensing requirement]; cf. *Ranchwood Communities Ltd. Partnership v. Jim Beat Const. Co.* (1996) 49 C.A.4th 1397, 1414, 57 C.R.2d 386, supra, §497 [neither fact that owner/lender of one of two unlicensed contractors obtained license for last year of 7-year period of construction, nor contractors' hiring of licensed subcontractors and licensed general contractor as manager, raised triable issues to show substantial compliance with licensing requirement or established it as a matter of law under *Asdourian*]; 28 *Santa Clara L. Rev.* 143.) (On legislative changes to doctrine of substantial compliance, see *infra*, §501.)

SUPPLEMENT: [This section is current through the latest supplement]



7 of 40 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

- C. Contracts of Unlicensed Persons.
 - 3. Distinctions and Exceptions.
 - c. Substantial Compliance by Contractor.
 - 3. Legislative Changes.

1 Witkin Sum. Cal. Law Contracts § 501

[§ 501] Legislative Changes.

The Legislature, beginning in 1989, has attempted to resolve the confusion by adding subsections to *B. & P.C. 7031*. Under one of these provisions, the judicial doctrine of substantial compliance (*supra*, §499, 500) is inapplicable "where the person who engaged in the business or acted in the capacity of a contractor has never been a duly licensed contractor in this state." However, the court may determine that there has been substantial compliance with the licensure requirement if it is shown at an evidentiary hearing that the person (1) had been licensed as a contractor in California prior to the performance of the act or contract, (2) acted reasonably and in good faith to maintain proper licensure, (3) did not know or reasonably should not have known that he or she was not duly licensed when performance of the act or contract commenced, and (4) acted promptly and in good faith to reinstate his or her license on learning that it was invalid. (*B. & P.C. 7031(e)*.) And *B. & P.C. 143*, which applies to "any business or profession for which a license is required" and which in subsection (b) provides that the judicial doctrine of substantial compliance is inapplicable (see *supra*, §485), does not apply to *contractors* subject to *B. & P.C. 7031(e)*. (*B. & P.C. 7031(e)*.)

The exceptions stated above in *B. & P.C. 7031(e)* to the prohibition against application of the substantial compliance doctrine apply to all contracts entered into on or after January 1, 1992, and to all actions or arbitrations arising therefrom, although there are special provisions pertaining to acts or arbitrations commenced before, on, or after January 1, 1995. (*B. & P.C. 7031(f)*.) (See *Construction Financial, LLC v. Perlite Plastering Co.* (1997) 53 C.A.4th 170, 178, 61 C.R.2d 574 [holding, under former version of *B. & P.C. 7031(d)* (now *B. & P.C. 7031(e)*), that negligent failure of subcontractor to have valid license precluded showing of substantial compliance with licensing law, and that statutory exception applied only if all requirements stated in statute were fulfilled]; *ICF Kaiser Engineers v. Superior Court* (1999) 75 C.A.4th 226, 241, 89 C.R.2d 88 [licensee met burden of proof that it did not know, and reasonably should not have known, that it was unlicensed, where, among other factors, no one at licensee knew its license had been suspended, licensing board misled licensee's employees to believe that they had complied with procedures necessary to avoid suspension, and board itself did not know of suspension at time of its occurrence]; *Pacific Custom Pools v. Turner Const. Co.* (2000) 79 C.A.4th 1254, 1264, 94 C.R.2d 756 [subcontractor who did construction work for 7 months without license, failed to timely renew license after notice of its expiration, and, when it did attempt to renew license, sent filing fee for check that was dishonored, could not establish that it acted reasonably to maintain licensure or that it

lacked actual or constructive knowledge that it was not licensed; distinguishing *ICF Kaiser Engineers*]; *Slatkin v. White* (2002) 102 C.A.4th 963, 967, 126 C.R.2d 54 [contractor lost license due to bond cancellation 32 months after start of project and with only 3 months remaining; under B. & P.C. 7031(e), contractor does not lose right to be compensated simply because he or she performs additional work after discovering loss of licensure, if contractor had no knowledge of the loss before start of job]; 34 *Loyola L.A. L. Rev.* 1539 [substantial compliance with Contractors' State License Law].)

SUPPLEMENT: [This section is current through the latest supplement]

See *MW Erectors v. Niederhauser Ornamental & Metal Works Co.* (2005) 36 C.4th 412, 431, 30 C.R.3d 755, 115 P.3d 41 [where contractor did not obtain license until after it began performing, substantial performance doctrine was unavailable, because contractor was unable to establish that it was duly licensed at some point "prior to the performance" within meaning of former B. & P.C. 7031(d) (now B. & P.C. 7031(e))]; *Opp v. St. Paul Fire & Marine Ins. Co.* (2007) 154 C.A.4th 71, 76, 64 C.R.3d 260 [corporate contractor not licensed in California could not recover against surety even though corporate president was individually licensed; distinguishing *G.E. Hetrick & Associates v. Summit Const. & Maintenance Co.* (1992) 11 C.A.4th 318, 13 C.R.2d 803, text, §500, on ground that *Hetrick* applied pre-1989 version of B. & P.C. 7031].



8 of 40 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

C. Contracts of Unlicensed Persons.

3. Distinctions and Exceptions.

d. Paramount Public Policy Involved.

1 Witkin Sum. Cal. Law Contracts § 502

[§ 502] Paramount Public Policy Involved.

Another exception to the rule denying recovery to unlicensed persons has been made, not to protect the plaintiff from loss but to carry out a paramount public policy objective of the particular regulatory statute.

In *Keller v. Thornton Canning Co.* (1967) 66 C.2d 963, 59 C.R. 836, 429 P.2d 156, L Co., a common carrier, was first a partnership and then a corporation. On a change in the partnership organization, it failed to obtain a transfer of its permit; later the Public Utilities Commission authorized transfer of the permit to the corporation. During the period of no permit, the company undercharged certain shippers. This action was brought, under direction of the Commission, to collect the undercharges. *Held*, the action was maintainable.

(a) The Highway Carriers Act provides criminal penalties and administrative sanctions, and impliedly excludes the additional penalty of nullifying contracts. The primary purpose of regulation of carriers is to prevent ruinous competition, and the principal sanction is the requirement that the underpaid carrier sue for the statutory minimum rate. Pressure by shippers for illegal lower rates is unlikely if the shipper knows that the legal rates may still be recovered. Thus, the more important objective of protecting the minimum rate structure prevails over that of penalizing the unlicensed carrier; i.e., the "kind of illegality" involved in unlawful tariffs is more serious than that involved in lack of a license. (66 C.2d 967.)

(b) "To decree that the lack of a license prevents the collection of the minimum rate would be to give preference to a means of executing a lesser statutory purpose over a mechanism for enforcing its principal purpose. Our implementation of the higher legislative policy will serve to frustrate shipper and unlicensed carrier alike from devising with impunity schemes evasive of the minimum rate structure." (66 C.2d 969.)

West's Key Number Digest, Automobiles k.107(1)

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9 of 40 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

D. Penalties and Liquidated Damages.

1. Law Preceding Revised Statute.

a. What Constitutes Unenforceable Penalty.

1. In General.

1 Witkin Sum. Cal. Law Contracts § 503

[§ 503] In General.

(1) *Overview of Former and Revised Law.* Former C.C. 1670 stated: "Every contract by which the amount of damages to be paid, or other compensation to be made, for a breach of an obligation, is determined in anticipation thereof, is to that extent *void*, except as expressly provided in the next section." And former C.C. 1671 read: "The parties to a contract may agree therein upon an amount which shall be presumed to be the amount of damages sustained by a breach thereof, when, from the nature of the case, it would be *impracticable or extremely difficult to fix the actual damage*." (See *United Savings & Loan Assn. v. Reeder Dev. Corp.* (1976) 57 C.A.3d 282, 296, 129 C.R. 113 [former C.C. 1671 created rebuttable presumption affecting burden of producing evidence]; *Barbera v. Sokol* (1980) 101 C.A.3d 725, 732, 161 C.R. 843 [same]; 10 Cal. L. Rev. 8; 60 Cal. L. Rev. 84 [comprehensive study and recommended legislative changes]; 21 So. Cal. L. Rev. 400; 35 So. Cal. L. Rev. 301.)

The 1977 Legislature revised the law of liquidated damages by the repeal of the above two sections and the enactment of new Civil Code Title 4.5 (C.C. 1671 et seq.). The revised statute (§533 et seq.) changes the law by declaring a general rule of *validity* of a liquidated damage provision, a rule that can be overcome if the party seeking to invalidate the provision establishes unreasonableness. However, with respect to various kinds of contracts (see §540 et seq.), the revised law incorporates the substance of the former law (C.C. 1671(d)). Also, by its terms, the revised law does not affect special statutes applicable to particular contracts (see *infra*, §534). Hence, case law prior to the revised statute is still relevant and illustrative of the problems involved, and the special statutes remain in effect after enactment of the new law.

(2) *Mere Recital of Impracticability or Difficulty.* Under the former law, a mere recital in a contract that the damages for breach would be impracticable or difficult to ascertain was not conclusive; it was necessary for the party seeking to enforce a provision for liquidated damages to plead and prove that the facts of the case brought it within the exception of former C.C. 1671. See *Leslie v. Brown Bros.* (1929) 208 C. 606, 616, 283 P. 936; *Robert Marsh & Co. v. Tremper* (1930) 210 C. 572, 575, 292 P. 950; *Rice v. Schmid* (1941) 18 C.2d 382, 385, 115 P.2d 498; *Sun-Maid Raisin Growers of Calif. v. Paul A. Mosesian & Son* (1928) 90 C.A. 1, 5, 265 P. 828; *Kelly v. McDonald* (1929) 98 C.A. 121, 123, 276 P. 404; *Kekich v. Blum* (1941) 43 C.A.2d 525, 527, 111 P.2d 411; *Electrical Products Corp. v. Williams* (1953) 117 C.A.2d Supp. 813, 820, 256 P.2d 403 [detailed recitals of impracticability held insufficient where damages

easily ascertainable]; *Cook v. King Manor & Convalescent Hosp.* (1974) 40 C.A.3d 782, 792, 115 C.R. 471 [judgment awarding only actual damages affirmed].

(3) *Penalty and Equitable Relief*. It is not only a stipulated fixed sum as damages that violates the former statute; any provision by which money or property would be forfeited without regard to the actual damage is an unenforceable penalty, and equity will grant affirmative relief from it pursuant to C.C. 3275. (*Ebbert v. Mercantile Trust Co. of Calif.* (1931) 213 C. 496, 499, 2 P.2d 776; *Mente & Co. v. Fresno Compress & Warehouse Co.* (1931) 113 C.A. 325, 330, 298 P. 126; *White v. San Diego* (1932) 126 C.A. 501, 508, 14 P.2d 1062; *Hill v. Hearron* (1952) 113 C.A.2d 763, 766, 249 P.2d 54; *Vernon v. Southern Calif. Edison Co.* (1961) 191 C.A.2d 378, 392, 12 C.R. 701.)

(4) *Distinction: Limitation of Liability*. A liquidated damages provision is usually inserted for the benefit of the prospective aggrieved plaintiff, while a limitation of liability clause is intended to protect the wrongdoer defendant from unlimited liability. With respect to a limitation of liability, there is no requirement that the damages be difficult to ascertain, and no fixed sum is recoverable; actual damages, within the limited amount, must be proved. (See *Western Union Tel. Co. v. Nester* (1940) 309 U.S. 582, 60 S.Ct. 769, 772, 84 L.Ed. 960, 963; *Wheeler v. Oppenheimer* (1956) 140 C.A.2d 497, 499, 295 P.2d 128; Corbin §1068; 24 Williston 4th, §65:3 et seq.; 60 Cal. L. Rev. 92; 13 So. Cal. L. Rev. 154; 5 Stanf. L. Rev. 824; 42 A.L.R.2d 591 [limited liability or stipulated damages clause in alarm service contract].)

SUPPLEMENT: [This section is current through the latest supplement]

(4) *Distinction: Limitation of Liability*. See 11 Corbin (Rev. ed.), §58.16.



10 of 40 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

D. Penalties and Liquidated Damages.

1. Law Preceding Revised Statute.

a. What Constitutes Unenforceable Penalty.

2. Illustrations.

1 Witkin Sum. Cal. Law Contracts § 504

[§ 504] Illustrations.

In *Greenbach Bros. v. Burns* (1966) 245 C.A.2d 767, 54 C.R. 143, defendant contracted to purchase plaintiff's hotel for \$ 1,360,000 cash. The liquidated damages clause required a deposit of \$ 50,000 (later increased by an additional \$ 25,000). On defendant's default, plaintiff sued for the amount of the deposit. *Held*, the provision was unenforceable: (1) Expenses incurred by plaintiff for attorneys' fees in preparation for the transfer were readily ascertainable. (245 C.A.2d 771.) (2) Plaintiff's intended use of the cash proceeds for a lucrative investment in Seattle was unknown to defendant, hence not within contemplation of the parties. (245 C.A.2d 771.) Thus, the provision was not a reasonable estimation of compensation for loss, but rather an amount arbitrarily fixed. (245 C.A.2d 772.)

In *Smith v. Royal Mfg. Co.* (1960) 185 C.A.2d 315, 8 C.R. 417, the seller and the buyer agreed upon a fixed sum as liquidated damages for breaches of varying degree, and the damages were the same whether the breach occurred after the buyer took 1 or 99 of the 100 machines contracted for. *Held*, the provision was a penal forfeiture and void. (185 C.A.2d 324.)

In *Vernon v. Southern Calif. Edison Co.* (1961) 191 C.A.2d 378, 12 C.R. 701, an agreement between plaintiff city and defendant public utility corporation provided that defendant would forfeit payments it would otherwise receive on termination if it established or maintained electric rates higher than those charged by a municipally owned system in a neighboring city. *Held*, the provision amounted to a penalty, for in effect it coerced defendant into maintaining plaintiff's rates even at the expense of defendant's public duties to others. (191 C.A.2d 390.)

West's Key Number Digest, Damages k.75

SUPPLEMENT: [This section is current through the latest supplement]



11 of 40 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

D. Penalties and Liquidated Damages.

1. Law Preceding Revised Statute.

a. What Constitutes Unenforceable Penalty.

3. Late-Charge Interest.

1 Witkin Sum. Cal. Law Contracts § 505

[§ 505] Late-Charge Interest.

In two court of appeal decisions, a provision for increased interest on late installment payments was held to be a valid contractual provision to pay a higher rate of interest on the contingency of a default in payment of principal. (*O'Connor v. Richmond Savings & Loan Assn.* (1968) 262 C.A.2d 523, 529, 68 C.R. 882; *Walsh v. Glendale Fed. Savings & Loan Assn.* (1969) 1 C.A.3d 578, 585, 81 C.R. 804; see 60 Cal. L. Rev. 128.) These decisions were disapproved in *Garrett v. Coast & Southern Fed. Savings & Loan Assn.* (1973) 9 C.3d 731, 737, 108 C.R. 845, 511 P.2d 1197.

Plaintiff brought a class action seeking to determine the invalidity of late-charge provisions in deeds of trust. They alleged that, on failure to make timely installment payments under their notes, defendant assessed a charge consisting of a percentage of the unpaid principal balance of the loan during the period of default. The provision read: "The undersigned further agrees that in the event that payments of either principal or interest on this note becomes in default, the holder may, without notice, charge additional interest at the rate of two per cent (2%) per annum on the unpaid principal balance of this note from the date unpaid interest started to accrue until the close of the business day upon which payment curing the default is received." *Held*, a cause of action was stated.

(a) *Distinction.* A provision varying performance on the happening of a contingency is valid; but this is not such a provision: The parties agreed that the borrowers were to pay an additional sum as *damages for breach*. (9 C.3d 738.)

(b) *Invalidity of late charge here.* Late charges serve a dual purpose: (1) compensation of the lender for the administrative expenses and cost of money wrongfully withheld; and (2) encouragement of the borrower to make timely future payments. But if the sum exceeds substantial damages suffered by the lender, it is an invalid penalty. And here the 2% on the unpaid principal balance, though not unusual in the savings and loan industry, is not reasonably calculated merely to compensate the injured lender. (9 C.3d 740, and footnotes 8 and 9.) "We conclude, accordingly, that because the parties failed to make a reasonable endeavor to estimate a fair compensation for a loss which would be sustained on the default of an installment payment, the provision for late charges is void." (9 C.3d 740.)

(c) *Qualification.* The court qualified its holding in two respects: (1) Despite the invalidity of this late charge, the borrower remains liable for actual damages resulting from his or her default (loss of money withheld plus administrative

costs). (2) A late-charge provision is not necessarily invalid: A defendant might show impracticability under certain circumstances; e.g., where the measure of actual damages would be a comparatively small amount, and it would be economically impracticable to require the lender to prove it. (9 C.3d 741.) (See 62 Cal. L. Rev. 465; 14 Santa Clara Lawyer 706; 27 Stanf. L. Rev. 1133; 63 A.L.R.3d 50 [provision imposing "late charge" for delay in making periodic payments].)

Garrett was followed in *Sybron Corp. v. Clark Hosp. Supply Corp.* (1978) 76 C.A.3d 896, 143 C.R. 306. Defendant buyers were sued for goods sold, and a settlement was reached under which defendants agreed to pay plaintiff \$ 72,000 in 12 monthly installments with 10% interest on the unpaid balance. It was further provided, however, that if defendants should default on a payment, after notice and opportunity to cure, a stipulated judgment for \$ 100,000 could be entered in favor of plaintiff. Defendants were delinquent in a number of installments, and the trial judge denied equitable relief against forfeiture (C.C. 3275) and entered judgment in accordance with the contract. *Held*, reversed. A provision for liquidated damages for late payment, which bears no relation to actual damages suffered by the delay, is an unenforceable penalty. (76 C.A.3d 900.) And the provision involved here was much harsher than that involved in *Garrett*: Enforcement would result in a \$ 28,000 penalty for delay in payment of \$ 30,000. (76 C.A.3d 903.) (See *Crestwood Lumber Co. v. Citizens Savings & Loan Assn.* (1978) 83 C.A.3d 819, 826, 148 C.R. 129; *Baypoint Mortg. Corp. v. Crest Premium Real Estate Inv. Retirement Trust* (1985) 168 C.A.3d 818, 829, 214 C.R. 531.)

SUPPLEMENT: [This section is current through the latest supplement]

See *Greentree Financial Group v. Execute Sports* (2008) 163 C.A.4th 495, 497, 501, footnote 2, 78 C.R.3d 24 [amendment to C.C. 1671 that limited range of contracts in which determining actual damages had to be "impracticable or extremely difficult" in order for liquidated damages clauses to be enforceable did not invalidate rule of *Sybron Corp. v. Clark Hosp. Supply Corp.* (1978) 76 C.A.3d 896, 143 C.R. 306, text, p. 556, that penalties bearing no proportional relationship to damages that might actually flow from breach are unenforceable].



12 of 40 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

D. Penalties and Liquidated Damages.

1. Law Preceding Revised Statute.

b. Valid Provisions: In General.

1. Rule and Test.

1 Witkin Sum. Cal. Law Contracts § 506

[§ 506] Rule and Test.

If the plaintiff meets the requirement of showing that it would be impracticable or extremely difficult to fix the actual damage (former C.C. 1671, *supra*, §503), a liquidated damages provision may be enforced. (See *Better Food Markets v. American Dist. Tel. Co.* (1953) 40 C.2d 179, 184, 253 P.2d 10; *Lowe v. Massachusetts Mut. Life Ins. Co.* (1976) 54 C.A.3d 718, 734, 127 C.R. 23; *Angell v. Rowlands* (1978) 85 C.A.3d 536, 543, 149 C.R. 574 [clause in residential sale contract providing for particular amount to be paid the seller per day for failure to close the transaction on a certain date]; 60 Cal. L. Rev. 84; 27 So. Cal. L. Rev. 209; 5 Stanf. L. Rev. 822; 9 Stanf. L. Rev. 382; 4 U.C.L.A. L. Rev. 126.)

The provision is valid if *at the time the contract is made* the damages are difficult to ascertain; it is not rendered unenforceable by reason of the fact that at the time of trial no such difficulty exists. (*Better Food Markets v. American Dist. Tel. Co.*, *supra*, 40 C.2d 185; *Hanlon Drydock & Shipbuilding Co. v. G.W. McNear* (1924) 70 C.A. 204, 210, 232 P. 1002; see 60 Cal. L. Rev. 131.)

But the emphasis on the element of difficulty in fixing actual damages tends to obscure another requirement of a valid liquidated damage clause: The amount specified must not be an arbitrary sum but must represent a reasonable endeavor by the parties to estimate a *fair compensation* for any loss that may be sustained by breach. (See *Dyer Bros. Golden West Iron Works v. Central Iron Works* (1920) 182 C. 588, 592, 189 P. 445 [approving the provision]; *Clermont v. Secured Inv. Corp.* (1972) 25 C.A.3d 766, 771, 102 C.R. 340; 60 Cal. L. Rev. 136.)

West's Key Number Digest, Damages k.79(1)

SUPPLEMENT: [This section is current through the latest supplement]



13 of 40 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

D. Penalties and Liquidated Damages.

1. Law Preceding Revised Statute.

b. Valid Provisions: In General.

2. Illustrations.

aa. Cooperative Marketing Agreements.

1 Witkin Sum. Cal. Law Contracts § 507

[§ 507] Cooperative Marketing Agreements.

Cooperative marketing agreements containing liquidated damage provisions have generally been upheld, on the theory that the refusal of a member to perform might endanger the existence of the association and defeat its purposes. (*Anaheim Citrus Fruit Assn. v. Yeoman* (1921) 51 C.A. 759, 763, 197 P. 959; see *Sun-Maid Raisin Growers v. Paul A. Mosesian & Son* (1928) 90 C.A. 1, 3, 265 P. 828; 60 Cal. L. Rev. 125; *Food & Ag.C.* 54264 [codifying rule].)

However, *Olson v. Biola Cooperative Raisin Growers Assn.* (1949) 33 C.2d 664, 204 P.2d 10, limited the trend by a narrow and doubtful construction of the statute and the agreement. The contract of members of the association called for sale and delivery to the association of "all of the raisins," "properly cured and in good condition." Defendant members delivered *all* the crop, but in poor condition, unsuitable for sale. This action was brought to enforce the liquidated damage provisions of the contract. Damages were computable at a percentage of the value of raisins that the member "fails to deliver in accordance with the terms" thereof. *Held*, the history of these provisions showed that they were designed to apply only to defaults in *quantity*, i.e., to a failure to deliver the entire crop; neither the statute nor the contract was designed to authorize liquidated damages where the performance was defective only in *quality*. Three justices dissented, pointing out that, because the poor quality of the product delivered prevented their packing and marketing to certain purchasers in fulfillment of prior commitments, the effect of the default in quality was equivalent to a failure to deliver. (33 C.2d 681.)

SUPPLEMENT: [This section is current through the latest supplement]



14 of 40 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

D. Penalties and Liquidated Damages.

1. Law Preceding Revised Statute.

b. Valid Provisions: In General.

2. Illustrations.

bb. Service Installations.

1 Witkin Sum. Cal. Law Contracts § 508

[§ 508] Service Installations.

In *Atkinson v. Pacific Fire Extinguisher Co.* (1953) 40 C.2d 192, 253 P.2d 18, defendant installed a fire detection system in plaintiffs' planing mill, under a lease calling for payments of \$ 15 monthly. A fire started, the system failed to operate, and the mill was destroyed. Plaintiffs' judgment for \$ 97,437, based on the actual loss, was modified to reduce it to \$ 25, pursuant to the following provision of the lease: "in case of failure to perform such service and a resulting loss its liability hereunder shall be limited to and fixed at the sum of Twenty-five dollars as liquidated damages, and not as a penalty, and this liability shall be exclusive." The court emphasized the unpredictable elements of extent and cause of loss by fire, making damages difficult to fix. (40 C.2d 195.)

Two points should be noted in appraising this novel case: (a) The \$ 25 provision was contained in a standard form used by defendant in all of its installations, and in no real sense was there any attempt to estimate the probable damages from breach in the particular case. (See dissent, 40 C.2d 200; 5 *Stanf. L. Rev.* 824.) (b) Usually, a liquidated damage clause gives the plaintiff the advantage of an assured recovery of a substantial amount, without the necessity of proving actual damages. Here the clause prevented the plaintiff from receiving any substantial recovery, and was, in effect, a stipulation limiting liability rather than a liquidated damage provision. (See 5 *Stanf. L. Rev.* 824; 60 *Cal. L. Rev.* 109; *infra*, §§509 et seq., 677, 678.)

Better Food Markets v. American Dist. Tel. Co. (1953) 40 C.2d 179, 186, 253 P.2d 10, is a similar case, involving the failure of a burglar alarm system to operate. The liquidated damage provision (\$ 50) was upheld on the same reasoning and the decision seems subject to the same criticism as *Atkinson*. (See 27 *So. Cal. L. Rev.* 209; 9 *Stanf. L. Rev.* 382.)

The court in the *Better Food Markets* case also held that the limitation applied to a tort cause of action based on negligence: "[T]he duty created by the contract was one for which liability for a breach thereunder was fixed, and whether the action is brought in tort or in contract the nature of the duty remains the same." (40 C.2d 188.) (See *Feary v. Aaron Burglar Alarm* (1973) 32 C.A.3d 553, 556, 108 C.R. 242 [following *Better Food Markets*].) These decisions, although having been strongly criticized, have nevertheless been upheld under the revised law. (See *infra*, §538.)

SUPPLEMENT: [This section is current through the latest supplement]



15 of 40 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

D. Penalties and Liquidated Damages.

1. Law Preceding Revised Statute.

b. Valid Provisions: In General.

3. Other Valid Provisions.

aa. Contract Payment or Rate.

1 Witkin Sum. Cal. Law Contracts § 509

[§ 509] Contract Payment or Rate.

A minimum guaranteed payment or rate in a contract for personal services or a contract of sale is valid as part of the direct obligation of the contract, and is not a penalty for breach. (*Payne v. Pathe Studios* (1935) 6 C.A.2d 136, 140, 44 P.2d 598.) Similarly, where defendant father contracted to pay his son's school tuition for an entire year, and the son was dismissed for good cause, the school proprietor was held entitled to recover the remaining installments of tuition. The action was not for liquidated damages but to enforce the terms of an *entire* contract. (*Stewart v. Claudius* (1937) 19 C.A.2d 349, 354, 65 P.2d 933.)

In *Powis v. Moore Machinery Co.* (1945) 72 C.A.2d 344, 164 P.2d 822, a provision in an employment contract that the employee, a salesman, on leaving his employment, should receive only half his commissions on goods sold but undelivered and unpaid for, was held to be not an illegal forfeiture but a valid provision on payment for services. "Undoubtedly, it was a motive of defendant in placing that provision in the contract to create an incentive for plaintiff to remain with the company, but such a motive did not make the contract illegal. The provision was *not one whereby earned commissions were to be withheld* in the event plaintiff resigned." (72 C.A.2d 354.) (See *Feiger v. Winchell* (1962) 205 C.A.2d 123, 128, 22 C.R. 901 [partnership agreement provision giving partner option of meeting a call for contribution of capital or having his profit and loss percentage adjusted]; *Division of Labor Standards Enforcement v. Dick Bullis* (1977) 72 C.A.3d Supp. 52, 57, 140 C.R. 267 [following *Powis*]; 2 *Hastings L. J.* 57.)

West's Key Number Digest, Damages k.78(6)

SUPPLEMENT: [This section is current through the latest supplement]



16 of 40 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

D. Penalties and Liquidated Damages.

1. Law Preceding Revised Statute.

b. Valid Provisions: In General.

3. Other Valid Provisions.

bb. Alternative Contract.

1 *Witkin Sum. Cal. Law Contracts* § 510

[§ 510] Alternative Contract.

(1) *General Rule.* In *Miller v. California Trust Co.* (1936) 15 C.A.2d 612, 59 P.2d 1035, an agreement designated a "loan" of shares of stock, which permitted return of the shares, or their stipulated value at the time they were received, was held valid. It was in effect an *alternative* contract, under which the "borrower" could pay money instead of stock. In failing to return the stock, he committed *no breach*; hence the provision for payment of money was not an attempt to fix a penalty for breach. (15 C.A.2d 619.) (See 60 Cal. L. Rev. 94; 2 Hastings L. J. 57; 141; Corbin §§1070, 1079 et seq.; 14 Williston 4th, §42:10; 24 Williston 4th, §65:3 et seq.; 22 Am.Jur.2d (2003 ed.), Damages §§116, 515.)

(2) *Withdrawal-From-Sale Clause in Exclusive-Right-To-Sell Contract.* In *Blank v. Borden* (1974) 11 C.3d 963, 115 C.R. 31, 524 P.2d 127, the court upheld the validity of a clause in the Standard Form of the California Real Estate Association providing that if the property "is withdrawn from sale" by the owner, the agent will receive 6% of the stated sale price. Defendant owner signed this agreement for a 7-month period and plaintiff broker engaged in diligent efforts to sell. About 2 months later, after an argument, defendant repudiated the agreement. *Held*, plaintiff was entitled to recover the stated sum, 6% of \$ 85,000 or \$ 5,000 with interest.

(a) *Baumgartner v. Meek* (1954) 126 C.A.2d 505, 272 P.2d 552, rejected the contention that this clause was an unlawful penalty provision, holding that it presents the owner with an option or alternative if, during the term of the contract, the owner changes his or her mind and terminates the agent's authority by payment of the stated sum. (11 C.3d 970.)

(b) Like other commission contracts, it is result-oriented--regardless of effort expended the broker gets no compensation unless a sale occurs; the owner's withdrawal may be viewed as an anticipatory breach of the main contract, and the damage sustained is the value of the lost opportunity to make a sale and receive compensation. (11 C.3d 972.)

(c) The rule of *Fracasse v. Brent* (1972) 6 C.3d 784, 100 C.R. 385, 494 P.2d 9, 1 Cal. Proc. (4th), Attorneys, §245, should not be extended to this situation. The contingent fee contract of an attorney has no provision for alternative

performance, and the attorney is in a special relationship with his or her client involving a public policy right to discharge at any time with or without cause. (11 C.3d 973.)

An extremely vigorous dissent (two justices) contended that (a) the label of "alternative" and "option" is wrong; an owner would not bargain for an option of withdrawal by paying the full commission of a sale; (b) the contract is in a standard form that gives no real choice to the owner; (c) the *Baumgartner* theory is unsound, and the approach of *Garrett v. Coast & Southern Fed. Savings & Loan Assn.* (1973) 9 C.3d 731, 737, 108 C.R. 845, 511 P.2d 1197, supra, §505 should be followed. (See 64 Cal. L. Rev. 102.)

In *Western Camps v. Riverway Ranch Enterprises* (1977) 70 C.A.3d 714, 138 C.R. 918, the court, discussing *Garrett* and *Blank*, upheld a provision in a sublease for payment of \$ 60,000 to the sublessee on termination of the sublease by the sublessor. The provision was designed to permit the sublessor to buy the sublessee's estate for an agreed price, hence was a bargained-for alternative promise. (70 C.A.3d 726, 727.)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *General Rule.* See 11 Corbin (Rev. ed.), §§58.18 et seq., 59.4 et seq.

(2) *Withdrawal-From-Sale Clause in Exclusive-Right-To-Sell Contract.* *Fracasse case:*

Cross-Reference: 1 Cal. Proc. (5th), Attorneys, §216.



17 of 40 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

D. Penalties and Liquidated Damages.

1. Law Preceding Revised Statute.

b. Valid Provisions: In General.

3. Other Valid Provisions.

cc. Commitment Fee to Lender.

1 Witkin Sum. Cal. Law Contracts § 511

[§ 511] Commitment Fee to Lender.

In *Lowe v. Massachusetts Mut. Life Ins. Co.* (1976) 54 C.A.3d 718, 127 C.R. 23, plaintiff's assignor applied to defendant for a loan of \$ 4,850,000 to construct a real estate project. The application contained the following provision: "Stand-by deposit of \$ 48,500 (to be increased to \$ 97,000 upon approval of this application) accompanies (or will be paid to you immediately upon advice of your approval of) this application. Said deposit is to be returned when the loan is completed; but if the loan is not closed within the time to be agreed upon, said deposit shall be retained by you as liquidated damages (beyond the direct costs which applicant agrees ... to pay)." The amount of the loan was later reduced to \$ 4.7 million, and a total deposit of \$ 94,000 was paid, but the project was never completed. Plaintiff then brought this action to recover the amount deposited. *Held*, judgment for defendant affirmed. The court, citing cases from other jurisdictions, observed that the "commitment fee" of a small percentage of the loan was commonly upheld as a "stand-by fee" or consideration for the loan commitment. (54 C.A.3d 725.) (See 93 A.L.R.3d 1156 [enforceability of provision authorizing lender to charge standby fee, commitment fee, or similar deposit].)

SUPPLEMENT: [This section is current through the latest supplement]



18 of 40 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

D. Penalties and Liquidated Damages.

1. Law Preceding Revised Statute.

b. Valid Provisions: In General.

3. Other Valid Provisions.

dd. Prepayment Penalty.

1 Witkin Sum. Cal. Law Contracts § 512

[§ 512] Prepayment Penalty.

A clause in a deed of trust providing a "penalty" or reasonable charge for payment of the principal in whole or in part before maturity is neither a penalty nor a liquidated damage provision. The charge is not imposed for breach of the agreement or for default, but rather for the opposite: performance before the promisor was obligated to perform; and the charge is merely the equivalent of unearned interest. "The clear import of this provision is to give the borrower an option to either pay the note in the manner contemplated by the contract or to prepay the balance due upon condition that a surcharge be added for the privilege of exercising the option. The clause does not penalize for the 'breach of an obligation' as contemplated by section 1670. No breach is involved in the prepayment transaction, only the exercise of the option given to the debtor for an alternative method of paying the debt." (*Meyers v. Home Savings & Loan Assn.* (1974) 38 C.A.3d 544, 546, 113 C.R. 358.) (See *Lazzareschi Inv. Co. v. San Francisco Fed. Savings & Loan Assn.* (1971) 22 C.A.3d 303, 307, 99 C.R. 417; *Pacific Trust Co. TTEE v. Fidelity Fed. Savings & Loan Assn.* (1986) 184 C.A.3d 817, 822, 823, 229 C.R. 269; 4 *Summary* (10th), *Security Transactions in Real Property*, §92 et seq; on alternative contracts generally, see *supra*, §510.)

West's Key Number Digest, Damages k.82

SUPPLEMENT: [This section is current through the latest supplement]



19 of 40 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

D. Penalties and Liquidated Damages.

1. Law Preceding Revised Statute.

b. Valid Provisions: In General.

3. Other Valid Provisions.

ee. Deposit by Bidder on Government Contract.

1 Witkin Sum. Cal. Law Contracts § 513

[§ 513] Deposit by Bidder on Government Contract.

Provisions in *contracts* should be distinguished from a requirement by municipal ordinance that a bidder for a municipal contract deposit a certain sum with his or her *bid*, to be forfeited on failure to enter into the contract if awarded. This requirement is valid, because it is considered a necessary means of carrying out the objective of genuine competitive bidding. (*Palo & Dodini v. Oakland* (1947) 79 C.A.2d 739, 747, 180 P.2d 764; *A & A Electric v. King* (1976) 54 C.A.3d 457, 466, 126 C.R. 585; cf. *Petrovich v. Arcadia* (1950) 36 C.2d 78, 84, 222 P.2d 231 [rule recognized but bid form held lacking in words of forfeiture]; *M.F. Kemper Const. Co. v. Los Angeles* (1951) 37 C.2d 696, 705, 235 P.2d 7, supra, §267; see 60 Cal. L. Rev. 118.)

SUPPLEMENT: [This section is current through the latest supplement]



20 of 40 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

D. Penalties and Liquidated Damages.

1. Law Preceding Revised Statute.

b. Valid Provisions: In General.

3. Other Valid Provisions.

ff. Renewal Commissions Dependent on Continued Agency.

1 Witkin Sum. Cal. Law Contracts § 514

[§ 514] Renewal Commissions Dependent on Continued Agency.

A life insurance company employing a general agent may provide for service fees or renewal commissions during the employment but ending on termination of the employment. This provision has the proper objective of making it financially worthwhile for agents to remain with the company. (*Bach v. Curry* (1968) 258 C.A.2d 676, 681, 66 C.R. 220.) (See *Buskuhl v. Family Life Ins. Co.* (1969) 271 C.A.2d 514, 521, 76 C.R. 602 [same holding where commissions cut off not on mere termination of employment but on additional conduct injurious to former employer].)

West's Key Number Digest, Insurance k.652(3)

SUPPLEMENT: [This section is current through the latest supplement]



21 of 40 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

D. Penalties and Liquidated Damages.

1. Law Preceding Revised Statute.

b. Valid Provisions: In General.

3. Other Valid Provisions.

gg. Faithful Performance Bond.

1 Witkin Sum. Cal. Law Contracts § 515

[§ 515] Faithful Performance Bond.

A faithful performance bond in a specified penal sum is a valid contract, but is enforceable only to the extent of actual damages suffered. (*Los Angeles v. Margulis* (1935) 6 C.A.2d 57, 60, 44 P.2d 608; see *Rest.2d, Contracts* §356(2); 60 Cal. L. Rev. 93; 12 Am.Jur.2d (1997 ed.), *Bonds* §44 et seq.)

SUPPLEMENT: [This section is current through the latest supplement]

See *Merced v. American Motorists Ins. Co.* (2005) 126 C.A.4th 1316, 1323, 24 C.R.3d 788 [city suffered damage by obligor's inability to complete deferred work, permitting recovery against surety on performance bond, even though another contractor performed obligor's share of work at no cost to city; other contractor only promised to be responsible for obligor's share of improvements in return for city's promise to repay him if city prevailed in its action against surety].



22 of 40 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

D. Penalties and Liquidated Damages.

1. Law Preceding Revised Statute.

c. Provisions in Leases.

1. Unenforceable Penalties.

1 Witkin Sum. Cal. Law Contracts § 516

[§ 516] Unenforceable Penalties.

A simple liquidated damage provision in a lease is invalid. Hence, where money is paid by the lessee to the lessor as security for the performance of the terms of the lease, *and is subject to forfeiture*, it is treated as an unenforceable penalty, and cannot be retained by the lessor upon the lessee's breach. Actual damages for the lessee's breach are considered readily susceptible of ascertainment and proof, and the lessor must prove them. (*Redmon v. Graham* (1931) 211 C. 491, 493, 295 P. 1031; *Bacciocco v. Curtis* (1938) 12 C.2d 109, 114, 82 P.2d 385; *Servais v. Klein* (1931) 112 C.A. 26, 28, 296 P. 123; *Fox Chicago Realty Corp. v. Zukor's Dresses* (1942) 50 C.A.2d 129, 133, 122 P.2d 705; see generally 49 Am.Jur.2d (1995 ed.), *Landlord and Tenant* §763 et seq.; 26 Cal. L. Rev. 385; 27 Cal. L. Rev. 83; 60 Cal. L. Rev. 100; 15 So. Cal. L. Rev. 412.)

An unsuccessful attempt at evasion of the rule has been made by the use of an *acceleration clause*, providing, e.g., that on default by the lessee and 30 days' notice thereof, the entire rent is to become due. In *Ricker v. Rombough* (1953) 120 C.A.2d Supp. 912, 261 P.2d 328, the provision was held invalid as an obvious penalty. The court distinguished the valid acceleration clause in a promissory note: The debtor is required to pay a sum for which he or she has already received the entire consideration, while the lessee would be paying for future occupancy that he or she did not receive. (120 C.A.2d Supp. 920.) (See *Electrical Products Corp. v. Williams* (1953) 117 C.A.2d Supp. 813, 817, 256 P.2d 403 [same holding as to acceleration clause in lease of electrical display sign]; cf. *Puritan Leasing Co. v. August* (1976) 16 C.3d 451, 456, 457, 128 C.R. 175, 546 P.2d 679, citing the text, *Ricker* and *Electrical Products*, but adding: "Whether or not the holdings of *Ricker* and *Electrical Products* are sound (and we express no opinion thereon), they are not applicable to the clause at issue.") (16 C.3d 457.)

However, in *McCarthy v. Tally* (1956) 46 C.2d 577, 297 P.2d 981, an ordinary liquidated damage clause in a large sum (\$ 10,000) was upheld because the property was a summer resort, and default by the lessee during the season would seriously impair the goodwill of the business. (46 C.2d 583.)

West's Key Number Digest, Damages k.79(5)

SUPPLEMENT: [This section is current through the latest supplement]

See 49 *Am.Jur.2d* (2006 ed.), *Landlord and Tenant* §98.



23 of 40 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

D. Penalties and Liquidated Damages.

1. Law Preceding Revised Statute.

c. Provisions in Leases.

2. Valid Provisions.

aa. Advance Rent Payment.

1 Witkin Sum. Cal. Law Contracts § 517

[§ 517] Advance Rent Payment.

An *absolute payment* of rent in advance, e.g., covering the last part of the term, is valid, and the money thus unconditionally paid may be retained by the lessor. (*Wetzler v. Patterson* (1925) 73 C.A. 527, 532, 238 P. 1077; *Warming v. Shapiro* (1953) 118 C.A.2d 72, 76, 257 P.2d 74; see 49 Am.Jur.2d (1995 ed.), *Landlord and Tenant* §667.)

However, in *Butt v. Bertola* (1952) 110 C.A.2d 128, 242 P.2d 32, the lessor sought to retain the payment after his own act of eviction, relying on the provision that the lessee could not reclaim the money if the lease terminated "for any cause or reason whatsoever." The court refused to construe this language as authorizing the lessor wrongfully to deprive the lessee of his last 6 months of the term. (110 C.A.2d 135.) (See 49 Am.Jur.2d (1995 ed.), *Landlord and Tenant* §408.)

SUPPLEMENT: [This section is current through the latest supplement]

See 49 Am.Jur.2d (2006 ed.), *Landlord and Tenant* §582.



24 of 40 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

D. Penalties and Liquidated Damages.

1. Law Preceding Revised Statute.

c. Provisions in Leases.

2. Valid Provisions.

bb. Bonus for Execution.

1 Witkin Sum. Cal. Law Contracts § 518

[§ 518] Bonus for Execution.

A bonus or consideration for the execution of the lease may be unconditionally paid, and this is upheld even though the lease provides further that in the event of faithful performance the amount thereof will be credited to the lessee on his or her last rental payments. (*A-1 Garage v. Lange Inv. Co. (1935) 6 C.A.2d 593, 596, 44 P.2d 681; Parigian v. Citizens Nat. Trust & Savings Bank of Los Angeles (1941) 42 C.A.2d 773, 779, 110 P.2d 117; Warming v. Shapiro (1953) 118 C.A.2d 72, 75, 257 P.2d 74; see 26 Cal. L. Rev. 387; cf. Bacciocco v. Curtis (1938) 12 C.2d 109, 115, 82 P.2d 385 [use of term "bonus" not conclusive where other provisions inconsistent with theory of absolute payment]; *Thompson v. Swiryn (1950) 95 C.A.2d 619, 627, 213 P.2d 740 [same]; 27 Cal. L. Rev. 83; and see Graham v. Wood (1935) 8 C.A.2d 451, 457, 48 P.2d 124 [where lease prematurely terminated without fault of lessee, he or she can recover the money paid as bonus on theory of failure of consideration].*)*

SUPPLEMENT: [This section is current through the latest supplement]



25 of 40 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

D. Penalties and Liquidated Damages.

1. Law Preceding Revised Statute.

c. Provisions in Leases.

2. Valid Provisions.

cc. Options.

1 Witkin Sum. Cal. Law Contracts § 519

[§ 519] Options.

(1) *Option To Terminate*. In *Kuhlemeier v. Lack* (1942) 50 C.A.2d 802, 123 P.2d 918, a provision that the lessee may voluntarily terminate the lease, but in this event will "forfeit" the deposit, was upheld. The court emphasized the fact that the money was not taken as damages for breach, and thought the bonus cases were in point. "If such a payment can be upheld as a consideration for entering into a lease, it would appear equally logical to sustain it as consideration for the right to terminate the lease." (50 C.A.2d 808.) (See 49 Am.Jur.2d (1995 ed.), Landlord and Tenant §1222.)

(2) *Option To Enter into Lease*. In *Folden v. Lobrovich* (1959) 171 C.A.2d 627, 341 P.2d 368, plaintiff lessees (food center proprietors) entered into a contract with defendant owner. The owner agreed to remodel and to prepare a 10-year lease with a 10-year option to renew. The tenant agreed to pay \$ 2,400 to apply to the last 6 months. The lease was to become effective only if plaintiffs secured additional adjacent leases for their center, and if not the obligations were to be void, but the owner could retain the \$ 2,400 "as liquidated and accrued damages." The other leases were not obtained. *Held*, defendant was entitled to keep the \$ 2,400. The provision was not an attempt to fix a penalty for breach of contract, for there was no breach; plaintiffs simply bought for \$ 2,400 the privilege of having defendant's building available for the term if they were able to negotiate the other leases; having failed, the contract was by its own terms performed and at an end. This being so, the mistaken use of the term "liquidated damages" did not alter the nature or legal effect of the payment. (171 C.A.2d 629, quoting *Kuhlemeier v. Lack*, *supra*.)

West's Key Number Digest, Damages k.79(5)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Option To Terminate*. See 49 Am.Jur.2d (2006 ed.), Landlord and Tenant §196 et seq.



26 of 40 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witkin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

D. Penalties and Liquidated Damages.

1. Law Preceding Revised Statute.

c. Provisions in Leases.

2. Valid Provisions.

dd. Increased Rent for Holding Over.

1 Witkin Sum. Cal. Law Contracts § 520

[§ 520] Increased Rent for Holding Over.

A provision fixing a sum as *rental* to be paid if the tenant holds over after expiration of the lease is not treated as a penalty, though much greater in amount than that previously specified. (*Vucinich v. Gordon (1942) 51 C.A.2d 434, 437, 124 P.2d 868* [graduated rental, latter part of term \$ 100 per month, \$ 500 per month for holding over]; see 49 Am.Jur.2d (1995 ed.), Landlord and Tenant §§1240, 1241.)

SUPPLEMENT: [This section is current through the latest supplement]
See 49 Am.Jur.2d (2006 ed.), Landlord and Tenant §292.



27 of 40 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

D. Penalties and Liquidated Damages.

1. Law Preceding Revised Statute.

d. Deposit To Secure Performance.

1. In General.

1 Witkin Sum. Cal. Law Contracts § 521

[§ 521] In General.

A provision calling merely for a deposit as security for performance, without a forfeiture clause, is valid. The entire sum is not taken on breach, but is a source of payment of actual damages proved, with any balance returned to the lessee. (*Thompson v. Swiryn* (1950) 95 C.A.2d 619, 627, 213 P.2d 740; *Ace Realty Co. v. Friedman* (1951) 106 C.A.2d 805, 812, 236 P.2d 174; see 49 Am.Jur.2d (1995 ed.), *Landlord and Tenant* §§11, 28, 30, 763 et seq.; 26 Cal. L. Rev. 385; 22 *Hastings L. J.* 1373; 12 *Loyola L.A. L. Rev.* 37 [Tenant Front End Payments]; 63 A.L.R.4th 901 [landlord-tenant security deposit legislation].) (For a discussion of statutes providing for interest payments to the tenant on such deposits, see 26 U.C.L.A. L. Rev. 396.)

In 1970, a statute was enacted (former C.C. 1951) to regulate the use of these provisions. (See 22 *Hastings L. J.* 1374.) The statute was repealed in 1977 and replaced by C.C 1950.5 and 1950.7, dealing separately with residential property and other property. (See 9 *Pacific L. J.* 628; infra, §§522, 523.)

West's Key Number Digest, Landlord and Tenant k.184(2)

SUPPLEMENT: [This section is current through the latest supplement]
See 49 Am.Jur.2d (2006 ed.), *Landlord and Tenant* §105 et seq.



28 of 40 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

D. Penalties and Liquidated Damages.

1. Law Preceding Revised Statute.

d. Deposit To Secure Performance.

2. Residential Leases.

aa. Statutory Regulation: In General.

1 Witkin Sum. Cal. Law Contracts § 522

[§ 522] Statutory Regulation: In General.

(1) *Scope.* C.C. 1950.5 applies to *security* for a rental agreement for residential property, "that is, property used as the dwelling of the tenant." (C.C. 1950.5(a).) (See 34 *McGeorge L. Rev.* 495 [2002 amendments to C.C. 1950.5].)

(2) *Meaning of Security.* C.C. 1950.5(b) defines the basic term: "Security" means any payment, fee, deposit, or charge, including, but not limited to, an advance payment of rent, used or to be used for any purpose, including, but not limited to, any of the following: (a) The compensation of a landlord for a *tenant's default* in the payment of rent. (b) The *repair of damages* to the premises, exclusive of ordinary wear and tear, caused by the tenant or by a guest or licensee of the tenant. (c) The *cleaning* of the premises upon termination of the tenancy. (d) To remedy future defaults by the tenant in any obligation under the rental agreement to restore, replace, or return personal property or appurtenances, exclusive of ordinary wear and tear, if the security deposit is authorized to be applied thereto by the rental agreement. Also included within the definition of "security" are any charges imposed at the beginning of the tenancy, other than application screening fees, that are associated with processing a new tenant. With respect to cleaning charges on the termination of the tenancy, where the tenant's right to occupy begins after January 1, 2003, the term includes only the charges "necessary to return the unit to the same level of cleanliness it was in at the inception of the tenancy." (See *Granberry v. Islay Inv. (1984)* 161 C.A.3d 382, 207 C.R. 652, *infra*, §526 [interpreting statutory definition].)

(3) *Maximum Amount.* C.C. 1950.5(c) limits the security that may be demanded or received: (a) For *unfurnished residential property*, the amount of 2 months' rent; for *furnished residential property*, the amount of 3 months' rent; and either may be in addition to rent for the first month paid on or before initial occupancy. (b) The subdivision does not prohibit an advance payment of not less than 6 months' rent where the term of the lease is 6 months or longer. (c) It does not prohibit a mutual agreement under which the landlord, at the tenant's request and for a specified charge, makes "structural, decorative, furnishing, or other similar alterations" other than cleaning and repairing for which the previous tenant may be charged (subdivision (e), *infra*, this section).

(4) *Priority of Tenant's Claim to Security.* The security must be held by the landlord for the tenant, and the claim of the tenant to the security is prior to the claim of any creditor of the landlord. (C.C. 1950.5(d).) (See *Korens v. R.W.*

Zukin Corp. (1989) 212 C.A.3d 1054, 261 C.R. 137, infra, §527.)

(5) *Limitation on Landlord's Claim to Security.* (a) The landlord may claim "only those amounts as are *reasonably necessary* for the purposes specified in subdivision (b)." (C.C. 1950.5(e).) (b) The landlord may not assert a claim "for damages to the premises or any defective conditions that preexisted the tenancy, for ordinary wear and tear or the effects thereof," whether occurring prior to or during the tenancy, "or for the *cumulative effects* of ordinary wear and tear" during one or more tenancies. (C.C. 1950.5(e); see C.C. 1950.5(o) [1985 amendment to subdivision (e) is declaratory of existing law].)

(6) *Rights, Obligations, and Liabilities of Successor in Interest.* In the event of noncompliance with C.C. 1950.5(h) (landlord's duties on termination of landlord's interest; *infra*, §524), the successor in interest: (a) is jointly and severally liable with the landlord for repayment of any portion of the security to which the tenant is entitled; and (b) may not require the posting of replacement security until the transferee either makes restitution under C.C. 1950.5(h) or gives the tenant an accounting under C.C. 1950.5(g). However, the successor in interest is not precluded from recovering from the tenant compensatory damages in excess of the security paid. (C.C. 1950.5(j).) On receipt of any portion of the security under C.C. 1950.5(h), *supra*, the successor in interest has all of the rights and obligations of a landlord with respect to this security. (C.C. 1950.5(k).)

(7) *Damages for Violation.* The bad faith claim or retention by a landlord of the security or any portion thereof, or the bad faith demand of replacement security in violation of C.C. 1950.5(j), may subject the landlord to statutory damages of up to twice the amount of the security, in addition to actual damages. The court may award damages for bad faith whenever the facts warrant, regardless of whether the injured party has specifically requested relief. (C.C. 1950.5(l).)

The successor in interest is not liable for the damages allowed by C.C. 1950.5(l), or for any security not properly transferred, "if, upon inquiry and reasonable investigation," he or she "has a good faith belief" that the security deposit was transferred or returned as required by C.C. 1950.5(h). (C.C. 1950.5(j); see *Cal. Civil Practice*, 3 Real Property Litigation §17:48.)

The landlord or his or her transferee has the burden of proof as to the reasonableness of the amounts claimed or the authority to demand additional deposits. (C.C. 1950.5(l).)

(8) *Illegal Provision Against Refund.* "No lease or rental agreement may contain any provision characterizing any security as 'nonrefundable.'" (C.C. 1950.5(m).)

(9) *Jurisdiction of Small Claims Court.* An action under the section may be maintained in the small claims court if the damages claimed (actual or statutory or both) are within the jurisdictional amount of *C.C.P. 116.220* (see 2 *Cal. Proc.* (4th), *Courts*, §287). (C.C. 1950.5(n).)

(10) *Proof of Deposit.* The existence and amount of a security deposit may be proved "by any credible evidence," including a cancelled check, a receipt, a lease indicating the requirement and amount of a deposit, the landlord's or tenant's prior consistent statements or actions, or a statement under penalty of perjury satisfying the credibility requirements of *Ev.C. 780* (see 3 *Cal. Evidence* (4th), *Presentation at Trial*, §259 et seq.). (C.C. 1950.5(o).)

SUPPLEMENT: [This section is current through the latest supplement]

(9) *Jurisdiction of Small Claims Court.* C.C. 1950.5(n) was amended in 2006 to also apply to the jurisdictional amount of *C.C.P. 116.221*.

Cross-Reference: 2 *Cal. Proc.* (5th), *Courts*, §281.



29 of 40 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

- Witkin Summary of California Law
- X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
- D. Penalties and Liquidated Damages.
1. Law Preceding Revised Statute.
- d. Deposit To Secure Performance.
2. Residential Leases.
- bb. Statutory Regulation: Tenant's Right to Initial Inspection by Landlord.

1 Witkin Sum. Cal. Law Contracts § 523

[§ 523] Statutory Regulation: Tenant's Right to Initial Inspection by Landlord.

Within a reasonable time after notification of either party's intention to terminate the tenancy, or before the end of the lease term, the landlord must notify the tenant in writing of the tenant's option to request an initial inspection of the premises and to be present at that inspection. At a reasonable time, but no earlier than 2 weeks before the termination or the end of lease date, the landlord must, on the tenant's request, make an initial inspection prior to any final inspection the landlord makes after vacation of the premises. The purpose of the initial inspection is to allow the tenant an opportunity to remedy identified deficiencies, in a manner consistent with the rental agreement, in order to avoid deductions from the security. If an inspection is requested, the parties must attempt to schedule the inspection at a mutually acceptable date and time. Whether or not such an agreement is reached, the landlord must give at least 48 hours' prior written notice of the date and time of the inspection, and any waiver of this notice must be in writing. The landlord may proceed with the inspection whether the tenant is present or not. The requirements of these provisions do not apply when the tenancy is terminated pursuant to *C.C.P. 1161(2)*, (3), or (4) (unlawful detainer proceedings; see *4 Summary (9th)*, *Real Property*, §700 et seq.). (C.C. 1950.5(f)(1).)

Based on the inspection, the landlord must give the tenant an itemized statement specifying repairs or cleaning that are proposed to be the basis of deductions from the security. This statement must also include the text of paragraphs (1) through (4) of C.C. 1950.5(b). The statement must be given to the tenant, if present for the inspection, or left inside the premises. (C.C. 1950.5(f)(2).) The tenant must be given the opportunity during the period between the initial inspection and termination of the tenancy to remedy identified deficiencies, in a manner consistent with the rental agreement, in order to avoid the deductions. (C.C. 1950.5(f)(3).)

The landlord is not precluded from using the security for deductions itemized in the statement that have not been cured by the tenant so long as the deductions are for damages authorized by the statute. (C.C. 1950.5(f)(4).) Nor is the landlord prevented from using the security for any authorized purpose that occurs between completion of the initial inspection and termination of the tenancy or that is not identified during the initial inspection due to the presence of a tenant's possessions. (C.C. 1950.5(f)(5).)

SUPPLEMENT: [This section is current through the latest supplement]

Correction: Page 568, end of first paragraph of section, "4 *Summary* (9th), *Real Property*, §700 et seq." should be "4 *Summary* (10th), *Real Property*, §703 et seq."



30 of 40 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

D. Penalties and Liquidated Damages.

1. Law Preceding Revised Statute.

d. Deposit To Secure Performance.

2. Residential Leases.

cc. Statutory Regulation: Termination of Landlord's Interest.

1 Witkin Sum. Cal. Law Contracts § 524

[§ 524] Statutory Regulation: Termination of Landlord's Interest.

On termination of the landlord's interest in the premises (whether by sale, assignment, death, appointment of receiver, or otherwise), the landlord must do one of the following acts (either of which will relieve him or her of further liability with respect to the security): (1) *Transfer to the landlord's successor in interest* the portion of the security remaining after lawful deductions, and *notify the tenant* of the transfer, of claims made against the security and the amount of the security deposited, and of the name, address, and telephone number of the successor in interest. The notification may be made by first-class mail, postage prepaid, or by personal delivery; in the latter case the tenant must sign an acknowledgment of receipt of the notice. (2) *Return* to the tenant the portion of the security remaining after lawful deductions, with an *accounting* as provided in C.C 1950.5(g). (C.C. 1950.5(h).)

Prior to a *voluntary transfer*, the landlord must also deliver to his or her successor in interest a written statement indicating: (1) the security remaining after lawful deductions; (2) an itemization of lawful deductions; and (3) his or her election under C.C 1950.5(h) regarding transfer or return of the remainder. (C.C. 1950.5(i).)

SUPPLEMENT: [This section is current through the latest supplement]



31 of 40 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

D. Penalties and Liquidated Damages.

1. Law Preceding Revised Statute.

d. Deposit To Secure Performance.

2. Residential Leases.

dd. Disposition of Security.

1 Witkin Sum. Cal. Law Contracts § 525

[§ 525] Disposition of Security.

(1) *Furnishing of Itemized Statement and Return of Remaining Security.* No later than 21 calendar days after the tenant has vacated the premises, but not earlier than the time that either the landlord or the tenant provides a notice to terminate the tenancy under C.C. 1946, 1946.1 (see 12 *Summary* (10th), *Real Property*, §680) or under *C.C.P. 1161* (see 12 *Summary* (10th), *Real Property*, §720 et seq.), or not earlier than 60 calendar days prior to the expiration of a fixed-term lease, the landlord must furnish the tenant, by personal delivery or by first-class mail, postage prepaid, a copy of an itemized statement indicating the basis for, and the amount of, any security received and the disposition of the security. The landlord must also return at that time any remaining portion of the security to the tenant. (C.C. 1950.5(g)(1).)

These mailings must be sent to the address provided by the tenant. If the tenant does not provide an address, the mailings must be sent to the unit that has been vacated. (C.C. 1950.5(g)(6).) (On what constitutes security, see *infra*, §526.)

(2) *Documentation of Charges Incurred and Deducted.* Along with the itemized statement, the landlord must also include copies of documents showing charges incurred and deducted by the landlord to repair or clean the premises, as follows:

(a) If the landlord or landlord's employee did the work, the itemized statement must reasonably describe the work performed. The itemized statement must include the time spent and the reasonable hourly rate charged. (C.C. 1950.5(g)(2)(A).)

(b) If the landlord or landlord's employee did not do the work, the landlord must provide the tenant a copy of the bill, invoice, or receipt supplied by the person or entity performing the work. The itemized statement must provide the tenant with the name, address, and telephone number of the person or entity, if the bill, invoice, or receipt does not include that information. (C.C. 1950.5(g)(2)(B).)

(c) If a deduction is made for materials or supplies, the landlord must provide a copy of the bill, invoice, or receipt. If a particular material or supply item is purchased by the landlord on an ongoing basis, the landlord may document the cost of the item by providing a copy of a bill, invoice, receipt, vendor price list, or other vendor document that reasonably documents the cost of the item used in the repair or cleaning of the unit. (C.C. 1950.5(g)(2)(C).)

(3) *Estimation of Charges.* If a repair to be done by the landlord or the landlord's employee cannot reasonably be completed within 21 calendar days after the tenant has vacated the premises, or if the documents from a person or entity providing services, materials, or supplies are not in the landlord's possession within 21 calendar days after the tenant has vacated the premises, the landlord may deduct the amount of a good faith estimate of the charges that will be incurred and provide that estimate with the itemized statement. If the reason for the estimate is because the documents from a person or entity providing services, materials, or supplies are not in the landlord's possession, the itemized statement must include the name, address, and telephone number of the person or entity. Generally, the landlord must complete the requirements in C.C. 1950.5(g)(1) and (g)(2) in the manner specified within 14 calendar days of completing the repair or receiving the documentation. (C.C. 1950.5(g)(3).)

(4) *When Documentation Requirements Excused.* Generally, the landlord need not comply with C.C. 1950.5(g)(2) or (g)(3) if (a) the deductions for repairs and cleaning together do not exceed \$ 125 or (b) the tenant waived the rights specified. The waiver is only effective if signed by the tenant at the same time or after a notice to terminate a tenancy under C.C. 1946 or 1946.1 has been given, a notice under *C.C.P. 1161* has been given, or no earlier than 60 calendar days prior to the expiration of a fixed-term lease. The waiver must substantially include the text of C.C. 1950.5(g)(2). (C.C. 1950.5(g)(4).)

Notwithstanding C.C. 1950.5(g)(4), however, the landlord must comply with C.C. 1950.5(g)(2) and (g)(3) when a tenant makes a request for documentation within 14 calendar days after receiving the itemized statement. The landlord must comply within 14 calendar days after receiving the request from the tenant. (C.C. 1950.5(g)(5).)

SUPPLEMENT: [This section is current through the latest supplement]



32 of 40 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

D. Penalties and Liquidated Damages.

1. Law Preceding Revised Statute.

d. Deposit To Secure Performance.

2. Residential Leases.

ee. What Constitutes Security.

1 Witkin Sum. Cal. Law Contracts § 526

[§ 526] What Constitutes Security.

The difficult task of interpreting the security provision of C.C. 1950.5(b) (*supra*, §522) was undertaken in *Granberry v. Islay Inv. (1984) 161 C.A.3d 382, 207 C.R. 652*.

Defendant Islay, a partnership renting apartments, formerly charged tenants a "refundable security deposit" in addition to the first month's rent. On the enactment of C.C. 1950.5, Islay converted its deposit to a "non-refundable cleaning fee," determined by whatever the market would bear. After an appellate decision that this fee would entitle tenants to relief under the statute, Islay charged a fixed amount for the first month's rent for each new tenancy, with a lower rent for subsequent months if the tenant elected to continue the tenancy on a monthly basis. Plaintiff tenants, in this class action, contended that the larger sum charged for the first month (in this case \$ 100) was not rent but a disguised security. The trial judge gave summary judgment for defendant Islay. *Held*, reversed.

(a) The original version of subdivision (b) of the statute defined "security" in terms of the purpose for which the front-end payment was taken; as amended it refers to "any payment," and the listed examples do not comprise the exclusive definition. (*161 C.A.3d 387*.) The language, literally applied, would make an advance payment of rent a security. (*161 C.A.3d 388*.)

(b) A statute should be construed to promote the general purpose and policy of the law, and to avoid an absurd result; hence "legitimate rent" must be excluded from the definition of security. (*161 C.A.3d 388, 389*.)

(c) The trier of fact must look to various factors in determining whether a particular payment is a security or legitimate rent; e.g., whether the payment was usual or customary in the particular kind of tenancy, and the historical practices of the landlord. (*161 C.A.3d 390*.)

"Historically, Islay charged a security deposit in much the same manner that it now currently charges tenants a higher amount for the first month's rent when those tenants elect to rent on a month to month tenancy. Rental increases for Islay apartments are based on increases in the consumer price index. Islay's rent schedules show that rent increases

were applied only to the second month's rent, and not the portion of 'extra rent' charged for the first month. While Islay professes to base its rental practices on the theory that it will encourage and secure longer term tenancies in a popular resort area, an employee of the City of Santa Barbara Housing Authority estimated the vacancy rate where Islay's apartments are located to be less than 1 percent. Although it may be true as Islay argues, that a low vacancy rate does not necessarily mean a low turnover rate, it could be concluded that Islay's method to induce holdovers is unwarranted here." (161 C.A.3d 391.)

Accordingly, the case was remanded to the trial court for further consideration of the declarations submitted on the summary judgment motion, in order to decide "whether there are conflicting inferences to be drawn from the evidence to establish that material issues of fact" are yet to be determined on the issue of whether the "rent" was a "disguised security." (161 C.A.3d 392.) See *Granberry v. Islay Inv.* (1995) 9 C.4th 738, 38 C.R.2d 650, 889 P.2d 970, *infra*, §529 [wrongful retention of security deposits, because in good faith, did not preclude landlords from asserting setoff claims for unpaid rent, repairs, and cleaning against money due tenants for security deposit refunds]

In *Kraus v. Trinity Management Services* (2000) 23 C.4th 116, 96 C.R.2d 485, 999 P.2d 718, 13 Summary (10th), *Equity*, §127, defendants assessed a nonrefundable tenant charge for pre-lease administrative services (TIER fee). The fee was collected from every new tenant, usually when the tenant signed a standard form lease, which imposed an obligation to pay the fee before occupying the premises. *Held*, this was not an unrefundable security fee prohibited by C.C. 1950.5. Reading the statute as a whole confirms that, even though a security is not limited to the examples set out in C.C. 1950.5(b), a security is limited to charges imposed to secure the landlord against *future tenant defaults*. A fee imposed at the outset of the tenancy to reimburse the landlord for expenses incurred for such purposes as providing application forms, listing, interviewing, screening the applicant, and checking credit references is not a security governed by the statute. (23 C.4th 139.)

West's Key Number Digest, Landlord and Tenant k.184(1)

SUPPLEMENT: [This section is current through the latest supplement]



33 of 40 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

D. Penalties and Liquidated Damages.

1. Law Preceding Revised Statute.

d. Deposit To Secure Performance.

2. Residential Leases.

ff. Landlord Need Not Pay Interest to Tenant.

1 Witkin Sum. Cal. Law Contracts § 527

[§ 527] Landlord Need Not Pay Interest to Tenant.

In *Korens v. R.W. Zukin Corp.* (1989) 212 C.A.3d 1054, 261 C.R. 137, plaintiff tenant argued that the provision in C.C. 1950.5(d) that the deposit "shall be held by the landlord for the tenant" created a trust relationship with a duty to pay interest to the tenant. *Held*, the relationship is debtor-creditor, with no obligation to pay interest; and the Legislature has repeatedly refused to enact legislation that would require this payment. (212 C.A.3d 1058, 1059; on priority of tenant's claim to security, see *supra*, §522.)

SUPPLEMENT: [This section is current through the latest supplement]



34 of 40 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

D. Penalties and Liquidated Damages.

1. Law Preceding Revised Statute.

d. Deposit To Secure Performance.

2. Residential Leases.

gg. Payment of Unreturnable Deposits to Tenants' Union.

1 Witkin Sum. Cal. Law Contracts § 528

[§ 528] Payment of Unreturnable Deposits to Tenants' Union.

In *People v. Parkmerced Co. (1988) 198 C.A.3d 683, 244 C.R. 22*, the trial judge ordered that security deposits that could not be returned to tenants because they could not be located be paid to the tenants' organization representing the apartment complex involved. *Held*, this was proper.

(a) *C.C.P. 1519.5*, providing that unclaimed funds escheat to the state, also provides that it does not affect a court's authority to order equitable remedies. And *B. & P.C. 17200* and *17203* give trial courts wide equitable power to rectify unlawful business practices. Hence, it is clear that the Legislature did not intend escheat to be the sole remedy when dealing with unclaimed property. (*198 C.A.3d 693*.)

(b) The refund to the tenants organization was an appropriate disposition of the fund because, although the organization was not a party to the action, it took a continuing interest in the matter, assisted the district attorney in gathering information, and had a vested interest in the outcome. (*198 C.A.3d 693*.)

SUPPLEMENT: [This section is current through the latest supplement]



35 of 40 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
D. Penalties and Liquidated Damages.
1. Law Preceding Revised Statute.
d. Deposit To Secure Performance.
2. Residential Leases.
hh. Landlord's Right to Setoff Despite Failure To Comply With Statute.

1 Witkin Sum. Cal. Law Contracts § 529

[§ 529] Landlord's Right to Setoff Despite Failure To Comply With Statute.

In *Granberry v. Islay Inv.* (1995) 9 C.4th 738, 38 C.R.2d 650, 889 P.2d 970, landlords, whose excess rental charges had been found to be disguised security deposits (see earlier appeal, *supra*, §526), had wrongfully retained the deposits in violation of the statute (by failing to provide a written accounting). *Held*, they were entitled to assert setoff claims for unpaid rent, repairs, and cleaning against money due tenants for security deposit refunds, because they had not retained them in bad faith. Precluding landlords from asserting setoff claims even though the retention of security deposits was in good faith would be inconsistent with the legislative intent, which includes a remedy for bad faith retention of security (see *supra*, §522). Also, precluding setoff claims in all cases in which landlords fail to comply with the statute would violate equitable principles of flexibility in fashioning remedies. (9 C.4th 743.) (See 23 *Pepperdine L. Rev.* 754 [Granberry].)

SUPPLEMENT: [This section is current through the latest supplement]

Under *Granberry v. Islay Inv.* (1995) 9 C.4th 738, 38 C.R.2d 650, 889 P.2d 970, text, p. 574, a landlord who in good faith violates C.C. 1950.7 may offset against its damages only those amounts which it properly could have claimed of the security deposit in the first place. Thus, where a landlord wrongly retained the security deposit to cover future rent damages, i.e., damages against which the deposit could not have been applied under C.C. 1950.7, and thereby, unlike the landlords in *Granberry*, profited from its own wrong, the landlord was not entitled to pursue setoff for future rent. (250 L.L.C. v. PhotoPoint Corp. (USA) (2005) 131 C.A.4th 703, 726, 32 C.R.3d 296.)



36 of 40 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

D. Penalties and Liquidated Damages.

1. Law Preceding Revised Statute.

d. Deposit To Secure Performance.

3. Other Property.

1 Witkin Sum. Cal. Law Contracts § 530

[§ 530] Other Property.

(1) *Scope and Effective Date.* C.C. 1950.7 applies to (a) any *payment or deposit of money* "the primary function of which is to secure the *performance* of a rental agreement for *other than residential property*" or (b) any part of such an agreement, "other than a payment or deposit, including an advance payment of rent, made to secure the *execution* of a rental agreement." (C.C. 1950.7(a).) "This section is *declarative of existing law* and therefore operative as to all tenancies, leases, or rental agreements for other than residential property created or renewed on or after *January 1, 1971*." (C.C. 1950.7(g).)

(2) *Priority of Tenant's Claim to Payment or Deposit.* The payment or deposit must be held by the landlord for the tenant, and the claim of the tenant to it is prior to the claim of any creditor of the landlord *except a trustee in bankruptcy*. (C.C. 1950.7(b).)

(3) *Limitation on Landlord's Claim to Payment or Deposit.* (a) If the landlord's claim is for defaults in the payment of rent, and the security deposit equals no more than 1 month's rent plus a deposit amount clearly described as the payment of the last month's rent, any remaining portion of the payment or deposit must be returned to the tenant at a time mutually agreed on by the landlord and tenant, but in no event later than 30 days from the date the landlord receives possession of the premises. (C.C. 1950.7(c)(1).) (b) If the landlord's claim is for defaults in the payment of rent, and the security deposit exceeds the amount of 1 month's rent plus a deposit amount clearly described as the payment of the last month's rent, any remaining portion of the payment or deposit in excess of an amount equal to 1 month's rent must be returned to the tenant no later than 2 weeks after the date the landlord receives possession of the premises, with the remainder to be returned or accounted for within 30 days from the date the landlord receives possession of the premises. (C.C. 1950.7(c)(2).) (c) Where the landlord's claim includes amounts reasonably necessary for repairing or cleaning the premises, any remaining portion of the payment or deposit must be returned to the tenant within a mutually agreeable period, but in no event later than 30 days from the date the landlord receives possession of the premises. (C.C. 1950.7(c)(3).)

(4) *Landlord's Duties on Termination of His Interest.* On termination of the landlord's interest in the unit (whether by sale, assignment, death, appointment of receiver, or otherwise), the landlord must do one of the following acts (either

of which will relieve him or her of further liability with respect to the payment or deposit): (a) *Transfer to his or her successor in interest* the portion of the payment or deposit remaining after lawful deductions, and *notify the tenant* of the transfer, of any claims made against the payment or deposit, and of the transferee's name and address. The notification may be made by certified mail or by personal delivery; in the latter case the tenant must sign an acknowledgment of receipt of the notice. (b) Return to the tenant the portion of the payment or deposit remaining after lawful deductions are made under subdivision (c), *supra*. (C.C. 1950.7(d).)

(5) *Transferee's Rights and Obligations*. On receipt of any portion of the payment or deposit under subdivision (d), *supra*, the transferee has all of the rights and obligations of a landlord with respect to the payment or deposit. (C.C. 1950.7(e).)

(6) *Bad Faith Retention of Payment or Deposit*. The bad faith retention of any portion of a payment or deposit in violation of the section "may" subject the landlord or the transferee to damages of not over \$ 200, in addition to actual damages. (C.C. 1950.7(f).)

(7) *Statement Required in Lease or Agreement*. Any requirement in a commercial lease or nonresidential tenancy agreement of payment of money, including "key money," however denominated, or the lessor's attorney's fees, as a condition of initiating, continuing, or renewing the lease or agreement is prohibited unless the amount of the payment is stated in the written lease or agreement. One violating this provision is subject to a civil penalty of three times the amount of actual damages and is assessed costs. (C.C. 1950.8.) (See *Edamerica v. Superior Court* (2003) 114 C.A.4th 819, 825, 7 C.R.3d 921 [by allowing demand for "key money" as long as amount of payment is stated in written lease, Legislature did not intend to discourage demanding such money as condition of lease; hence, purpose of C.C. 1950.8 is to prohibit landlords from failing to state amount of payment in written lease].)

SUPPLEMENT: [This section is current through the latest supplement]



37 of 40 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

D. Penalties and Liquidated Damages.

1. Law Preceding Revised Statute.

e. Recovery Without Actual Damages Suffered.

1 Witkin Sum. Cal. Law Contracts § 531

[§ 531] Recovery Without Actual Damages Suffered.

The object and usual effect of the liquidated damage provision is to allow the injured party to recover for actual injury suffered, without being required to prove the specific elements or items of damage. May the defendant therefore defeat recovery by a showing that no damage at all was suffered as a result of the breach? This theory has some support in other jurisdictions and has received favorable mention in a few California cases. (See *Starr v. Lee* (1928) 88 C.A. 344, 348, 263 P. 376; *Kelly v. McDonald* (1929) 98 C.A. 121, 125, 276 P. 404; *Bay Shore Motors v. Baker* (1949) 90 C.A.2d Supp. 895, 898, 202 P.2d 865; 9 *Stanf. L. Rev.* 381.)

However, the majority view to the contrary was established as the California rule in *McCarthy v. Tally* (1956) 46 C.2d 577, 297 P.2d 981, expressly disapproving *Kelly* and *Starr* (46 C.2d 587). The provision was in a lease by T to M of a resort ranch, involving possible injury to the goodwill of the summer resort business (as where a lessee defaults in the middle of a season). The court said: "We hold that in order to recover on a contract provision for liquidated damages the plaintiff must plead and prove that at the time the contract was entered into damages in the event of a breach would be impracticable or extremely difficult of ascertainment; that the sum agreed upon represented a reasonable endeavor to ascertain what such damages would be; and that a breach of the contract had occurred. In other words, no actual damage is necessary in order to recover under a liquidated damages provision provided that the case is, in other respects, a proper one under the conditions set forth in section 1671 of the Civil Code." (46 C.2d 586.) (See 22 *Am.Jur.2d* (2003 ed.), *Damages* §528; 60 *Cal. L. Rev.* 138; 9 *Stanf. L. Rev.* 381 [criticizing the rule]; 4 *U.C.L.A. L. Rev.* 126 [approving the rule].)

SUPPLEMENT: [This section is current through the latest supplement]



38 of 40 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
D. Penalties and Liquidated Damages.
2. Restatement 2d.

1 *Witkin Sum. Cal. Law Contracts* § 532

[§ 532] Restatement 2d.

Rest.2d, Contracts §356(1), a revision of the former section to harmonize with U.C.C. 2718(1), reads as follows:

"Damages for breach by either party may be liquidated in the agreement but only at an amount that is reasonable in the light of the anticipated or actual loss caused by the breach and the difficulties of proof of loss. A term fixing unreasonably large liquidated damages is unenforceable on grounds of public policy as a penalty."

The Comments explain the nature of the rule and the test of a penalty.

(1) *Rule and Limitations.* Enforcement of liquidated damage provisions saves the time of court proceedings and reduces the expense of litigation; but the parties to a contract are not free to provide a penalty for breach: The principle of compensation governs, and punishment of a promisor for having broken his promise has no economic or other justification. (Comment a.)

(2) *Test of Penalty.* Whether the amount fixed is a penalty turns on a combination of two factors:

(a) The *anticipated or actual loss* caused by the breach. "The amount fixed is reasonable to the extent that it approximates the actual loss that has resulted from the particular breach, even though it may not approximate the loss that might have been anticipated under other possible breaches. Furthermore, the amount fixed is reasonable to the extent that it approximates the loss anticipated at the time of the making of the contract, even though it may not approximate the actual loss."

(b) The *difficulty of proof of loss*. "The greater the difficulty either of proving that loss has occurred or of establishing its amount with the requisite certainty ... , the easier it is to show that the amount fixed is reasonable. To the extent that there is *uncertainty as to the harm*, the estimate of the court or jury may not accord with the principle of compensation any more than does the advance estimate of the parties. If the *difficulty of proof of loss is great*, considerable latitude is allowed in the approximation of anticipated or actual harm. If, on the other hand, the difficulty of proof of loss is slight, less latitude is allowed in that approximation. If, to take an extreme case, it is clear that no loss at all has occurred, a provision fixing a substantial sum as damages is unenforceable." (Comment b.)

(3) *Disguised Penalties.* "Neither the parties' actual intention as to its validity nor their characterization of the term

as one for liquidated damages or a penalty is significant in determining whether the term is valid. Sometimes parties attempt to disguise a provision for a penalty by using language that purports to make payment of the amount an alternative performance under the contract, that purports to offer a discount for prompt performance, or that purports to place a valuation on property to be delivered. Although the parties may in good faith contract for alternative performances and fix discounts or valuations, a court will look to the substance of the agreement to determine whether this is the case or whether the parties have attempted to disguise a provision for a penalty that is unenforceable under this Section. In determining whether a contract is one for alternative performances, the relative value of the alternatives may be decisive." (Comment c.)

SUPPLEMENT: [This section is current through the latest supplement]



39 of 40 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

D. Penalties and Liquidated Damages.

3. Revised Liquidated Damages Law.

a. In General.

1. Nature and Purpose of Revision.

1 Witkin Sum. Cal. Law Contracts § 533

[§ 533] Nature and Purpose of Revision.

(1) *Purpose: To Encourage Use of Provisions.* Our prior statutes (former C.C. 1670 and 1671, *supra*, §503) were enacted in 1872 and never amended. Both the former statutes and the decisions disclose a somewhat strict attitude toward liquidated damage clauses. (See 13 Cal. Law Rev. Com. Reports 1739.) The Law Revision Commission, following a background study (see 60 Cal. L. Rev. 84; 11 Cal. Law Rev. Com. Reports 1229), concluded that liquidated damage provisions are useful and should be encouraged: (a) The parties may avoid the cost, difficulty, and delay of proving damages, and eliminate the issues of causation and foreseeability. (b) They may avoid what they consider inequities in the normal rules of damages. (c) A party may fear that, without such a provision, the other party will lack incentive to perform. (d) There is a danger that, without such a provision, the defaulting party may recover the full contract price because losses due to the breach are not provable. (e) A party engaged in a high risk enterprise may wish to limit liability for his or her own breach. (f) Enforcement of these provisions may improve judicial administration and conserve judicial resources because of fewer contract breaches, fewer lawsuits, and less extended trials. (13 Cal. Law Rev. Com. Reports 1740, 1741.)

A liquidated damages provision is not invalid merely because it is intended to encourage a party to perform, so long as it represents a reasonable attempt to anticipate the losses to be suffered. (*Californians for Population Stabilization v. Hewlett-Packard Co.* (1997) 58 C.A.4th 273, 289, 67 C.R.2d 621, citing the text.)

(2) *Dangers and Statutory Restrictions.* The Law Revision Commission commented on the risk of oppressive use of liquidated damage provisions by a party able to dictate the terms of an agreement, and against a party who does not fully appreciate its effect. Hence, while recommending encouragement of these provisions where the contracting parties have relatively equal bargaining power, the Commission Report adds (p. 1741): "However, the limitations of existing law should be retained and additional protection provided in cases where the parties have substantially unequal bargaining power. Typical of such cases are transactions involving the sale or leasing of personal property or services to consumers or the sale or leasing of residential housing."

(3) *Enactment of Revised Law.* The new statute (Civil Code, Title 4.5, C.C. 1671 et seq., entitled LIQUIDATED DAMAGES) was enacted in 1977 to carry out the Commission's recommendations. (See 9 *Pacific L. J.* 325; 16 *San*

Diego L. Rev. 967.) The statute became operative on July 1, 1978, and applies only to contracts made on or after that date. (Stats. 1977, Chap. 198, §§15, 16.)

Conforming amendments were made as follows: C.C. 1951.5 (see 12 *Summary* (10th), *Real Property*, §701) was amended to make C.C. 1671 applicable to a lease of real property; C.C. 3358 (see *infra*, §875) was amended to add "Except as expressly provided by statute"; and several amendments were made to the Education Code, the Government Code, and the Streets and Highways Code (see *infra*, §549). Also, the language of former C.C. 1670 (see *supra*, §503) was transferred to new C.C. 1671(d) (see *infra*, §540).

(4) *Applicability to Arm's-Length Commercial Transactions.* A different set of rules does not apply to arm's-length commercial transactions involving small business owners. These owners, as well as consumers, are entitled to C.C. 1671's protection against unreasonable penalties and to relief from contractual forfeiture under C.C. 3275. (*Ridgley v. Topa Thrift & Loan Assn.* (1998) 17 C.4th 970, 981, footnote 5, 73 C.R.2d 378, 953 P.2d 484, *infra*, §537.)

West's Key Number Digest, Damages k.84

SUPPLEMENT: [This section is current through the latest supplement]



40 of 40 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

D. Penalties and Liquidated Damages.

3. Revised Liquidated Damages Law.

a. In General.

2. Organization and Scope of Law.

1 Witkin Sum. Cal. Law Contracts § 534

[§ 534] Organization and Scope of Law.

(1) *Organization*. The revised law first declares a general rule of validity. (C.C. 1671(b), *infra*, §535.) It then treats separately the validity of provisions in a consumer's contract for property or services (C.C. 1671(c)(1), 1671(d), *infra*, §540 et seq.); a lease of a dwelling (C.C. 1671(c)(2), 1671(d), *infra*, §543); a real property purchase contract (C.C. 1675 et seq., *infra*, §544 et seq.); and public works construction contracts (*infra*, §549).

(2) *Special Statutes Unaffected*. C.C. 1671(a) states: "This section *does not apply* in any case where *another statute expressly applicable* to the contract prescribes the rules or standard for determining the validity of a provision in the contract liquidating the damages for the breach of the contract." (See listing in 13 Cal. Law Rev. Com. Reports 1740, footnote 6; Law Rev. Com. Comment to C.C. 1671(a).)

SUPPLEMENT: [This section is current through the latest supplement]



1 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
D. Penalties and Liquidated Damages.
3. Revised Liquidated Damages Law.
a. In General.
3. General Rule of Validity.

1 Witkin Sum. Cal. Law Contracts § 535

[§ 535] General Rule of Validity.

"*Except as provided in subdivision (c), a provision in a contract liquidating the damages for the breach of the contract is valid unless the party seeking to invalidate the provision establishes that the provision was unreasonable under the circumstances existing at the time the contract was made.*" (C.C. 1671(b); see Law Rev. Com. Comment.)

The exception is for consumer cases and leases of dwellings (see *infra*, §§541, 543). In all other cases: (1) The burden of proof on the issue of reasonableness is on the party seeking to invalidate the provision. (2) Reasonableness is determined at the time the contract was made, not as it appears in retrospect; hence the amount of damages actually suffered is immaterial. (3) All the circumstances are considered in determining unreasonableness. (Law Rev. Com. Comment to C.C. 1671(b); see *O'Connor v. Televideo System* (1990) 218 C.A.3d 709, 718, 267 C.R. 237, *supra*, §476 [defendant failed to establish that invoice provision requiring late charge of 18% per year on all past due accounts was unreasonable under C.C. 1671(b)]; *Weber, Lipshie & Co. v. Christian* (1997) 52 C.A.4th 645, 655, 60 C.R.2d 677 [provision stating that if expelled partner took plaintiff partnership's clients, damages would be twice time charges for those clients for 12 months preceding their departure, was valid as reasonable attempt to account for how long clients would have remained with plaintiff had partner not breached restrictive covenant]; *Californians for Population Stabilization v. Hewlett-Packard Co.* (1997) 58 C.A.4th 273, 287, 67 C.R.2d 621, citing the text [deputation agreement between company based in India and computer engineers it hired to work for companies in California; provision for recovery of liquidated damages of \$ 30,000 from employee who breached agreement by, among other things, quitting before finishing assignment was valid]; *Harbor Island Holdings v. Kim* (2003) 107 C.A.4th 790, 795, 132 C.R.2d 406 [for breach of commercial lease, jury awarded landlord \$ 13,970 for tenant's failure to maintain premises; deferred rent provision providing for double rent in event of breach (in amount of \$ 240,912) was void, because it bore no reasonable relationship to actual damages].)

The Commission observes that subdivision (b) gives the parties "considerable leeway" in determining the damages. "All the circumstances existing at the time of making of the contract are considered, including the relationship that the damages provided in the contract bear to the range of harm that reasonably could be anticipated at the time of the making of the contract. Other relevant considerations in the determination of whether the amount of liquidated damages is so high or so low as to be unreasonable include, but are not limited to, such matters as the relative equality of the

bargaining power of the parties, whether the parties were represented by lawyers at the time the contract was made, the anticipation of the parties that proof of actual damages would be costly or inconvenient, the difficulty of proving causation and foreseeability, and whether the liquidated damages provision is included in a form contract."

The Comment also notes that damages actually suffered are considered under two special statutes: U.C.C. 2718 (see 4 *Summary* (10th) *Sales*, §205); C.C. 1675(e)(2) (see *infra*, §546).

The reference in C.C. 1671(b) to "a *provision* in a contract liquidating the damages," means that the contract must contain "a meaningful provision for liquidated damages, which normally stipulates a pre-estimate of damages in order that the parties may know with reasonable certainty the extent of liability for breach of their contract." (*ABI v. Los Angeles* (1984) 153 C.A.3d 669, 685, 200 C.R. 563.)

In *ABI*, plaintiff developer deposited a "developer fee" as a condition for participating in defendant city's home mortgage revenue bond program, but was unable to participate in the program. In plaintiff's action seeking a refund of the fee, defendant city relied on a provision in the agreement that no portion of a developer fee should be reduced or returned as a result of reallocation of unused funds. *Held*, plaintiff was entitled to recover the sum paid. "If the City wanted to claim the developer fee as liquidated damages, upon reallocation, it should have written the instrument to say so in a manner which would clearly express this intention. The language used is far from purporting to be a preestimate of damages for breach of contract, particularly since it is possible for the conditions causing reallocation to be without fault on the part of the developer. These deficiencies manifest that the language in question cannot effectively qualify as a provision for the liquidation of damages. To give it such a designation would constitute a trap for the unwary." (153 C.A.3d 685; see *Californians for Population Stabilization v. Hewlett-Packard Co.*, *supra*, 58 C.A.4th 288 [ABI does not hold that preestimate of damages is mandatory].)

West's Key Number Digest, Damages k.74

SUPPLEMENT: [This section is current through the latest supplement]



2 of 79 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

- D. Penalties and Liquidated Damages.
 - 3. Revised Liquidated Damages Law.
 - b. Illustrative Applications of General Rule.
 - 1. Deposits.

1 Witkin Sum. Cal. Law Contracts § 536

[§ 536] Deposits.

A contract may require a deposit as security for performance (see *supra*, §521).

(1) If the parties provide that it will be liquidated damages for breach, the question whether it may be retained on breach is determined in accordance with the standard provided in C.C. 1671(b) (ordinary contracts, *supra*, §535) or C.C. 1671(d) (consumer contracts and dwelling leases, *infra*, §§540 et seq., 543). (On real property purchase contracts, see C.C. 1675 et seq., *infra*, §544 et seq.)

(2) If the parties do not intend that the deposit shall constitute liquidated damages, it is merely a fund to secure the payment of actual damages if any are determined. (Law Rev. Com. Comment to C.C. 1671, calling attention to C.C. 1951.5, on real property lease; see *infra*, §543.)

SUPPLEMENT: [This section is current through the latest supplement]



3 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
D. Penalties and Liquidated Damages.
3. Revised Liquidated Damages Law.
b. Illustrative Applications of General Rule.
2. Prepayment Fee Contingent on Late Interest Payments.

1 Witkin Sum. Cal. Law Contracts § 537

[§ 537] Prepayment Fee Contingent on Late Interest Payments.

In *Ridgley v. Topa Thrift & Loan Assn.* (1998) 17 C.4th 970, 73 C.R.2d 378, 953 P.2d 484, defendant made a "bridge" loan to plaintiffs, secured by real property plaintiffs had improved and intended to sell. Plaintiffs sold the property before the loan matured and, on defendant's demand, repaid the loan principal, together with a prepayment fee equal to 6 months' interest. Under the loan agreement, plaintiffs owed defendant the prepayment fee at the time of sale only if plaintiffs had been more than 15 days late with any scheduled interest payment or had defaulted on any other contractual obligation to defendant. The fee was imposed because plaintiffs had been late with an interest payment. Plaintiffs sued to recover the prepayment charge, claiming that, because it was conditioned on late interest payments, it constituted an unenforceable liquidation of damages or penalty for late payment of interest. The trial court entered judgment for plaintiffs, but the Court of Appeal reversed. *Held*, the trial court correctly understood the prepayment provision to be a penalty for delinquency in meeting the contractual interest payments and thus correctly held the penalty to be unenforceable, because it bore no relationship to the potential damages defendant would incur from a late interest payment.

(a) Pursuant to C.C. 1671(b), a provision in a contract liquidating the damages for breach of the contract is valid unless the party seeking to invalidate the provision establishes that the provision was unreasonable under the circumstances existing at the time the contract was made. A liquidated damages clause will generally be considered unreasonable, and hence unenforceable as a penalty, if it bears no reasonable relationship to the range of actual damages that the parties could have anticipated would flow from a breach. (17 C.4th 977.)

(b) Charges for late payment of loan installments have been held unenforceable where they bore no reasonable relationship to the injury the creditor might suffer from late payments. (17 C.4th 978.) *Garrett v. Coast & Southern Fed. Savings & Loan Assn.* (1973) 9 C.3d 731, 108 C.R. 845, 511 P.2d 1197, *supra*, §505, which so held, was not abrogated when C.C. 1671(b) (*supra*, §535) replaced the more restrictive rule of former C.C. 1670. (17 C.4th 981, footnote 5.) However, contractual prepayment charges of the loan principal are generally considered valid provisions for alternative performance, rather than penalties or liquidated damages for breach. Payment before maturity is not a breach of the contract, but simply an additional mode of performance on the borrower's part. Thus, the prepayment charge is not a penalty imposed for default, but an agreed form of compensation to the lender for interest lost through prepayment,

additional tax liability, or other disadvantage. (17 C.4th 978, citing *Meyers v. Home Savings & Loan Assn.* (1974) 38 C.A.3d 544, 113 C.R. 358, supra, §512.)

(c) A complication arises here because the charge imposed under the disputed provision of the loan agreement is contingent on both prepayment of principal and late payment of an interest installment. It can be described, therefore, as both a prepayment charge and a late payment penalty. Looking to the substance rather than the form of the disputed provision, it is invalid because it is intended to, and does, operate as a penalty for late payment. Despite the manner in which one describes its form, the intent and effect of the disputed provision is that any late payment or other default by plaintiffs results in a severe penalty--the inability to sell the property without payment of a sizable preset charge. The circumstances of this transaction rendered the forfeited opportunity to sell without penalty before maturity of the loan particularly significant to plaintiffs, who had improved the property with the intent of selling it and had obtained the loan merely to "bridge" the period until sale. To defendant, moreover, the value of the disputed provision was clearly to be found in its operation as a penalty for late payment rather than as compensation for prepayment. (17 C.4th 979.)

(d) The disputed provision cannot reasonably be regarded as a prepayment charge, because the condition that limits its operation--the late payment of interest--is logically unrelated to the charge's purported function as compensation for prepayment. The charge provision is, instead, plainly intended as an incentive for prompt payment of interest. That would not be fatal if the amount of the preset charge constituted a reasonable attempt to estimate potential losses from late payment, but the charge of 6 months' interest on the entire principal, imposed for any late payment or other default, cannot be defended as a reasonable attempt to anticipate damages from default. (17 C.4th 981.)

(e) That the prepayment fee might have been imposed without condition does not imply that it may validly be imposed on the condition of plaintiffs' late payment of interest. A forfeiture or unreasonable penalty, imposed only upon the other party's default, is unenforceable even though the same money, property, or other consideration might have validly been bargained for as a form of contractual performance. A contrary conclusion would allow unreasonable late charges and other penalties to escape legal scrutiny through simple rephrasing as a conditional waiver. (17 C.4th 982.)

SUPPLEMENT: [This section is current through the latest supplement]



4 of 79 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

- D. Penalties and Liquidated Damages.
 - 3. Revised Liquidated Damages Law.
 - b. Illustrative Applications of General Rule.
 - 3. Service Installations.

1 Witkin Sum. Cal. Law Contracts § 538

[§ 538] Service Installations.

The cases of *Better Food Markets v. American Dist. Tel. Co.* (1953) 40 C.2d 179, 186, 253 P.2d 10, supra, §508, and *Atkinson v. Pacific Fire Extinguisher Co.* (1953) 40 C.2d 192, 253 P.2d 18, supra §508, were strongly criticized in *Fireman's Fund Ins. Co. v. Morse Signal Devices* (1984) 151 C.A.3d 681, 198 C.R. 756. "Upon what possible, rational basis can it be said that the sum of \$ 25 bears *any* reasonable relation to *any* loss which the parties considered might be sustained? Considering the price of lumber in 1939 (the time the contract was entered into), it might almost be said as a matter of judicial notice that \$ 25 would not be reasonable compensation for a bale of shingles! But the majority, to sustain its unsound position, must strain at gnats to find a reason why the sum of \$ 25 might bear some relation to any possible loss!" (151 C.A.3d 689, quoting *Atkinson* dissent.) "The court in *Better Food Mkts.* and *Atkinson* reached its conclusions through a meaningless exercise of imagining trivial thefts of hams, and fires contained to burning sawdust which would cause damage under the \$ 50 and \$ 25 limits. This is a very unfortunate manner of reaching a limitation of damages." (151 C.A.3d 690.)

Despite this criticism of *Atkinson* and *Better Foods Markets*, *H.S. Perlin Co. v. Morse Signal Devices of San Diego* (1989) 209 C.A.3d 1289, 258 C.R. 1, upheld the enforceability of a similar liquidated damages provision in a service installation contract. In 1974, plaintiffs and defendant entered into a contract under which defendant, for an initial \$ 300 payment and a \$ 50 monthly service charge, agreed to provide burglar and fire alarm service for plaintiffs' coin and stamp store. The second page of the contract contained a provision setting the liquidated damages at \$ 250. A paragraph on the first page, printed in bold type with red underlining, stated that plaintiffs had read and understood the liquidation clause. The contract was automatically renewed in 1979, and in 1980, a burglary of plaintiffs' store resulted in an alleged uninsured loss of \$ 958,000. Defendant's employees were notified that an interruption of service had occurred at plaintiffs' store, but inexplicably took no action. *Held*, the liquidated damages provision was valid.

(a) *Better Food Markets* and *Atkinson* have been consistently followed. (209 C.A.3d 1297.) Because the provision here is in all material aspects indistinguishable from the language approved in *Better Food Markets*, that case would be controlling under the law prior to the 1977 amendments to C.C. 1671 (see supra, §533 et seq.). (209 C.A.3d 1298.)

(b) The same result can be reached under the amended version of C.C. 1671 (see supra, §535). In developing a new

statutory scheme, the Law Revision Commission cited *Better Food Markets* for the proposition that a limitation on liability is acceptable where the beneficiary of the limitation is engaged in a high-risk enterprise. (209 C.A.3d 1298.) This reliance suggests that the risk allocation scheme upheld in *Better Food Markets* meets the procedural and substantive requirements of C.C. 1671(b). (209 C.A.3d 1299.)

(c) Even accepting plaintiffs' argument that *Better Food Markets* is inapplicable, the limited damages provision is enforceable for the following reasons: (1) Despite the lack of opportunity for negotiation, the provision was reasonable in that plaintiffs could have obtained insurance to cover the risks that defendant was unwilling to assume. (209 C.A.3d 1299.) (2) Plaintiffs were not unfairly surprised. The provision was highlighted in the contract; it was defendant's custom to point out such provisions to its customers; and plaintiffs had been parties to other alarm service contracts with similar provisions. (209 C.A.3d 1299.) (3) Because plaintiffs were aware that the initial \$ 300 payment and the \$ 50 monthly charge were far less than the cost of insurance, they cannot claim that the provision allocated the potentially high risks of the bargain in an objectively unreasonable and unexpected manner. (209 C.A.3d 1300.)

SUPPLEMENT: [This section is current through the latest supplement]

See 36 A.L.R.6th 305 [exculpatory and limitation of liability clauses in home and business monitoring service contracts].



5 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

- D. Penalties and Liquidated Damages.
 - 3. Revised Liquidated Damages Law.
 - b. Illustrative Applications of General Rule.
 - 4. Bank's Charge for NSF Checks.

1 *Witkin Sum. Cal. Law Contracts* § 539

[§ 539] Bank's Charge for NSF Checks.

The contention that a bank's charge for checks drawn without sufficient funds is an unlawful penalty was rejected in *Perdue v. Crocker Nat. Bank* (1985) 38 C.3d 913, 216 C.R. 345, 702 P.2d 503 (supra, §339); *Hoffman v. Security Pac. Nat. Bank* (1981) 121 C.A.3d 964, 968, 176 C.R. 14, and *Shapiro v. United Calif. Bank* (1982) 133 C.A.3d 256, 262, 184 C.R. 34, held that the depositor has no statutory or contractual obligation to refrain from drawing NSF checks; hence the writing of this type of check is not a breach of contract, and the fee charged for processing it is not an unlawful penalty. (38 C.3d 931.) This is correct: "The fee that the bank may charge for processing such a check is limited by principles of good faith, reasonableness, unconscionability, and the like, but it is not limited to the amount which a bank could recover in a suit for breach of contract." (38 C.3d 932.)

SUPPLEMENT: [This section is current through the latest supplement]



6 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
D. Penalties and Liquidated Damages.
3. Revised Liquidated Damages Law.
c. Consumer's Contract for Property or Services.
1. In General.

1 Witkin Sum. Cal. Law Contracts § 540

[§ 540] In General.

The general rule favoring liquidated damage provisions (see *supra*, §535) does not apply where the liquidated damages are sought to be recovered from "[a] party to a contract for the *retail purchase, or rental*, by such party of *personal property or services*, primarily for the party's *personal, family, or household purposes*." (C.C. 1671(c)(1).)

In such cases, the prior law under former C.C. 1670 and 1671 (see *supra*, §503) remains, with no changes of substance, in C.C. 1671(d):

"In the cases described in subdivision (c), a provision in a contract liquidating damages for the breach of the contract is *void except* that the parties to such a contract may agree therein upon an amount which shall be *presumed* to be the amount of damage sustained by a breach thereof, when, from the nature of the case, it would be *impracticable or extremely difficult to fix the actual damage*." (C.C. 1671(d).)

The Law Revision Commission notes that where the *party seeking to avoid* the provision is the *nonconsumer party*, the rule favoring the provision (C.C. 1671(b), *supra*, §535) applies. (Law Rev. Com. Comment to C.C. 1671.)

SUPPLEMENT: [This section is current through the latest supplement]

(New) Reasonable endeavor test: In *Utility Consumers' Action Network v. AT&T Broadband of Southern Calif.* (2006) 135 C.A.4th 1023, 37 C.R.3d 827, plaintiff nonprofit consumer advocacy group sued numerous cable Internet service providers for unfair competition (*B. & P.C. 17200 et seq.*; see 13 *Summary* (10th), *Equity*, §105 et seq.). Defendants' service agreements stated that charges for late payment and nonpayment were liquidated damages intended to be a reasonable advance estimate of the costs resulting from the late payments or nonpayments by their customers, costs that were impracticable to determine in advance. To test the validity of these provisions, the parties brought simultaneous summary judgment motions, and the trial court ruled that the provisions were valid. *Held*, summary judgment for defendants affirmed.

(a) The contracts at issue here qualify as consumer services contracts under C.C. 1671(d). Moreover, by stipulating that defendants performed an analysis to determine their actual late payment costs, plaintiff conceded that the late fee

was reasonable. Thus, the only issue remaining is whether the liquidated damages provisions are invalid simply because defendants, rather than negotiating the late fee amount individually with each customer, set it unilaterally. (135 C.A.4th 1025.)

(b) Earlier cases developed a two-part test for determining whether a liquidated damages provision is valid. The first, tracking the statutory language, requires that fixing the amount of actual damages has to be impracticable or extremely difficult (this part of the test is not at issue here). The second, a judicially crafted requirement, mandates that the amount selected as liquidated damages represent a reasonable endeavor "by the parties" to estimate fair compensation for the loss. In 1977, the Legislature adopted a California Law Revision Commission report recommending a new liquidated damages law (text, §533), and the report, with respect to the issue under discussion, required only that a liquidated damages provision reflect a reasonable endeavor to estimate actual damages. "We find it significant that the Commission did not state that *the parties* must make a reasonable endeavor to estimate actual damages." (135 C.A.4th 1029.)

(c) The Law Revision Commission report relied primarily on two decisions, *Better Food Markets v. American Dist. Tel. Co.* (1953) 40 C.2d 179, 253 P.2d 10, text, §508, and *McCarthy v. Tally* (1956) 46 C.2d 577, 297 P.2d 981, text, §531. In *Better Food*, although the court used the phrase "by the parties," it took no issue with the fact that the liquidated damages provision being considered was found in a non-negotiated, form contract, as was the situation here (defendants have over 500,000 subscribers). The *McCarthy* decision also used the phrase "by the parties," but it was clear from other passages in the decision that a reasonable endeavor was all that was required. (135 C.A.4th 1030.)

(d) *Better Food* and *McCarthy* relied, in turn, on *Dyer Bros. Golden West Iron Works v. Central Iron Works* (1920) 182 C. 588, 189 P. 445, and *Rice v. Schmid* (1941) 18 C.2d 382, 115 P.2d 498. The former decision did not use "by the parties"; the latter did. However, both decisions treated the reasonable endeavor test as though it involved the result and effect of the liquidated damages provisions being considered and had nothing to do with whether both parties to the contract negotiated the amount. Furthermore, *Lowe v. Massachusetts Mut. Life Ins. Co.* (1976) 54 C.A.3d 718, 127 C.R. 23, text, §511, specifically held that it was not necessary for the parties to bargain over the amount of liquidated damages so long as the amount agreed upon was reasonable under all the circumstances. (135 C.A.4th 1031.)

(e) "Liquidated damages do serve an important function. They remove the uncertainty factor from determining damages from a breach of contract and reduce litigation. ... Requiring a large enterprise to negotiate the terms of a late fee provision with thousands or hundreds of thousands of potential customers would effectively make it impossible to provide for late fees, even when they are warranted by the impracticability of determining damages and even when the amount selected by the business was designed to do no more than cover its damages and bore the proper relationship to the amount of such damages. We refuse to endorse such an interpretation of the reasonable endeavor requirement." (135 C.A.4th 1038.)

(f) The primary case relied on by plaintiff was *United Savings & Loan Assn. v. Reeder Dev. Corp.* (1976) 57 C.A.3d 282, 129 C.R. 113. However, "[w]e ... conclude that *Reeder* was wrongly decided and is inapplicable." In addition, two other decisions cited by plaintiff, *Westinghouse Elec. Corp. v. Los Angeles* (1982) 129 C.A.3d 771, 181 C.R. 332, and *Barbera v. Sokol* (1980) 101 C.A.3d 725, 161 C.R. 843, were wrongly decided, to the extent that they uncritically followed *Reeder*. (135 C.A.4th 1039.)



7 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

- D. Penalties and Liquidated Damages.
 - 3. Revised Liquidated Damages Law.
- c. Consumer's Contract for Property or Services.
 - 2. Fees Against Credit Card Customers.

1 Witkin Sum. Cal. Law Contracts § 541

[§ 541] Fees Against Credit Card Customers.

(1) *In General. Hitz v. First Interstate Bank (1995) 38 C.A.4th 274, 44 C.R.2d 890*, involved a class action by plaintiff credit card customers challenging defendant bank's assessment of late and overlimit fees. The trial judge awarded damages to plaintiffs under C.C. 1671(d). *Held*, affirmed, but the amount of the judgment was reduced.

(a) *Credit card agreement is consumer contract.* C.C. 1671(d) is applicable. A credit card agreement is a consumer contract for the provision of services within the meaning of C.C. 1671(c)(1) (see *supra*, §540). Whether or not an extension of credit, pure and simple, is a consumer contract, a credit card agreement is much more than that, encompassing convenience services in addition to the extension of credit. (38 C.A.4th 286.)

(b) *Reasonable endeavor to estimate fair average compensation.* To be valid under C.C. 1671(d), the amount of liquidated damages must represent the result of a reasonable endeavor by the parties to estimate a fair average compensation for any loss that may be sustained. Whether a "reasonable endeavor" is made depends on the motivation and purpose in imposing liquidated damages and their effect. If a charge is designed to exceed substantially the damages suffered, the provision for the additional sum, whatever its label, is an invalid attempt to impose a penalty. The focus is not on whether liquidated damages are disproportionate to the loss from breach, but on whether they were intended to exceed loss substantially--a result of which is to generate a profit. (38 C.A.4th 288.)

(c) *Calculation of actual damages.* In calculating defendant's actual damages resulting from the late payment and overlimit breaches in order to deduct them from plaintiffs' recovery, the trial judge erred by offsetting the "net benefit" to defendant from finance charges imposed on delinquent and overlimit balances. The amount of the offset was determined by subtracting from the full amount of collected finance charges defendant's cost of borrowing these sums (for lending to plaintiffs) based on the average federal funds interest rate. The offset was error for three reasons:

(1) Under C.C. 3289(a) (see *infra*, §896), the contract rate of interest continued to be chargeable on the delinquent and overlimit balances after the breach. But the judge's ruling, in effect, denied defendant recovery of any contract interest over and above the federal funds interest rate. (38 C.A.4th 280.)

(2) The treatment of the finance charges on delinquent and overlimit balances as gains that could not have been made had there been no breach, and thus an offset against defendant's actual damages, was improper. The delinquent and overlimit cardholders forced defendant to extend additional credit to them, resulting in more finance charges, but defendant's credit card business was "expandable": it could have made similar loans to other customers had breach never occurred, and thus the gain from the additional finance charges was not made possible only by breach. A converse rule for postbreach gains applies: " 'Gains made by the injured party on other transactions after the breach are never to be deducted from the damages that are otherwise recoverable, *unless* such gains could not have been made, had there been no breach.' ... That is, *only* those gains that could not have been made had there been no breach are treated as an offset against actual damages." (38 C.A.4th 282.)

(c) Even under the trial judge's own approach, his determination of the benefit conferred on defendant was flawed. Although the judge acknowledged that the benefit was dependent on defendant's cost of extending credit, which had to include direct costs other than the cost of funds, in determining the cost of extending credit on delinquent and overlimit balances, he used only the cost of funds at the federal funds interest rate. (38 C.A.4th 285.)

(2) *Right to Monetary Relief.* *Beasley v. Wells Fargo Bank* (1991) 235 C.A.3d 1383, 1 C.R.2d 446, was a class action by plaintiff credit card customers, challenging defendant bank's assessment of fees against customers who failed to make timely payments or who exceeded their credit limits. In addition to finding that the fees were invalid liquidated damages under C.C. 1671(d), the jury awarded plaintiffs monetary relief based on the amount by which the fees exceeded defendant's costs. *Held*, this relief was proper.

(a) In contending that plaintiffs were not entitled to monetary relief under C.C. 1671(d), defendant relied on *Dean Witter Reynolds v. Superior Court* (1989) 211 C.A.3d 758, 259 C.R. 789, *supra*, §333, which held that C.C. 1670.5, prescribing the defense of unconscionability (see *supra*, §330), does not create an affirmative cause of action. This holding has no application here: Unlike the common law as codified by C.C. 1670.5, which provides only a defense of unconscionability, the common law as codified by C.C. 1671(d) permits a consumer to seek monetary relief, both offensively and defensively, from liquidated damages. (235 C.A.3d 1399.) Moreover, more recent decisions indicate, without expressly holding, that C.C. 1671(d) may be the basis for a claim for affirmative relief. (235 C.A.3d 1400, citing *Garrett v. Coast & Southern Fed. Savings & Loan Assn.* (1973) 9 C.3d 731, 108 C.R. 845, 511 P.2d 1197, *supra*, §505, and *Bondanza v. Peninsula Hosp. & Med. Center* (1979) 23 C.3d 260, 152 C.R. 446, 590 P.2d 22, *infra*, §542.)

(b) Defendant also argued that C.C. 1671(d) could not support monetary relief unless plaintiffs concomitantly asserted some other cause of action, such as accounting or money had and received. However, the label attached to a cause of action when a party seeks relief from a contractual penalty is not controlling. Thus, in *Freedman v. The Rector, Wardens & Vestrymen of St. Matthias Parish of Los Angeles* (1951) 37 C.2d 16, 230 P.2d 629, 13 Summary (10th), *Equity*, §22, the court allowed a plaintiff who breached a real property sales contract to recover the excess of his downpayment over the damages caused by the breach, even though the suit was only for specific performance. (235 C.A.3d 1400.)

West's Key Number Digest, Damages k.78(1)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *In General.* See *Morris v. Redwood Empire Bancorp* (2005) 128 C.A.4th 1305, 1313, 27 C.R.3d 797 [where credit card merchant account agreement could be terminated at any time, termination was not breach of contract, as required to trigger liquidated damages provision, and thus termination fee was alternative to performance; following *Blank v. Borden* (1974) 11 C.3d 963, 115 C.R. 31, 524 P.2d 127, text, §510].



8 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

- D. Penalties and Liquidated Damages.
 - 3. Revised Liquidated Damages Law.
- c. Consumer's Contract for Property or Services.
 - 3. Agreement To Pay Collection Costs.

1 Witkin Sum. Cal. Law Contracts § 542

[§ 542] Agreement To Pay Collection Costs.

In *Bondanza v. Peninsula Hosp. & Med. Center* (1979) 23 C.3d 260, 152 C.R. 446, 590 P.2d 22, plaintiff patients of defendant hospital were required to sign admission agreements providing that, if the account was referred to a collection agency or attorney for collection, the debtor would pay "reasonable attorney's fees and collection expense." *Held*, the requirement was an unlawful and unfair business practice (*B. & P.C. 17200*; see 13 *Summary* (10th), *Equity*, §105 et seq.), and also a violation of C.C. 1671(c)(1) (see footnote 6).

(a) The attack was not only on the agreement but on the practice of implementing it by making a charge of one-third the balance due at the time of assignment without regard to the actual collection costs. Under the principles discussed in *Garrett v. Coast & Southern Fed. Savings & Loan Assn.* (1973) 9 C.3d 731, 108 C.R. 845, 511 P.2d 1197, *supra*, §505, this practice is invalid: There was no effort made to estimate a fair compensation for the breach; only the hospital and the collection agency determined the amount, and the record contained no showing of difficulty of fixing actual collection costs. (23 C.3d 266.)

(b) The underlying unfairness of the practice is also clear, for the admission agreement is a contract of adhesion (see *supra*, §323). (23 C.3d 267.)

(c) There may be no relationship between the charge assessed and the actual expense of collection, for the charge is calculated on the amount due at the time of assignment, and the patient or his insurer may pay most of the obligation shortly after assignment (as here). (23 C.3d 267.)

(d) Defendants contended that the charge was a valid provision for liquidated damages because it was the precise amount that the hospital pays the collection agency. This contention does not meet the requirements of C.C. 1671, and is also answered by the principle that a creditor cannot increase the burden on a debtor by assigning the debt. (23 C.3d 268.)

(5) The final contention was that the charge is reasonable because a collection agency must apportion its overall expenses among the accounts that it collects in order to reimburse itself for expenses incurred in pursuing uncollectible

accounts. This is contrary to the rule of *Garrett*: "Pursuant to this rule an individual debtor may not be charged a fee calculated on the income that a collection agency to which the debt is assigned needs or desires in order to flourish economically." (23 C.3d 269.)

Three justices dissented, stressing the practical aspect of collection agency operations.

SUPPLEMENT: [This section is current through the latest supplement]



9 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
D. Penalties and Liquidated Damages.
3. Revised Liquidated Damages Law.
d. Lease of Dwelling.

1 Witkin Sum. Cal. Law Contracts § 543

[§ 543] Lease of Dwelling.

The former strict rule, restated in C.C. 1671(d) (*supra*, §540), also applies where the liquidated damages are sought to be recovered from "[a] party to a lease of real property for use as a dwelling by the party or those dependent upon the party for support." (C.C. 1671(c)(2); see Law Rev. Com. Comment on nonconsumer party seeking to avoid provision, *supra*, §540.) (See *Orozco v. Casimiro* (2004) 121 C.A.4th Supp. 7, 11, 17 C.R.3d 175 [landlord who neither pleaded nor proved that late rental payment fee was "impracticable or extremely difficult to fix" within meaning of C.C. 1671(d) was not entitled to presumption that fee represented actual damages suffered, and thus late fee provision was void and unenforceable]; on distinction for deposit to secure performance, see *supra*, §521 et seq.)

SUPPLEMENT: [This section is current through the latest supplement]



10 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
D. Penalties and Liquidated Damages.
3. Revised Liquidated Damages Law.
e. Real Property Purchase Contract.
1. Scope of Chapter.

1 Witkin Sum. Cal. Law Contracts § 544

[§ 544] Scope of Chapter.

Chapter 2 of Title 4.5 (see *supra*, §533) deals with the *buyer's default* on a real property purchase contract, either for residential property (C.C. 1675, *infra*, §545 et seq.) or other property (C.C. 1676, *infra*, §548). (See 39 *A.L.R.5th* 33 [provision in land contract for liquidated damages upon default of purchaser as affecting right of vendor to maintain action for damages for breach of contract]). The chapter *does not apply* to the following:

(1) Any other provision for liquidated damages in a real property purchase contract; e.g., a provision liquidating the damages if the *seller* fails to perform. Any such provision is governed by the general rule of C.C. 1671(b). (C.C. 1679; see *supra*, §535, and Law Rev. Com. Comment.)

(2) An installment land contract as defined in C.C. 2985. (C.C. 1681; see 4 *Summary* (10th), *Security Transactions in Real Property*, §§24, 25.)

(3) The seller's right to obtain specific performance; i.e., a liquidated damage provision does not deprive the seller of his or her election to seek specific performance rather than damages, pursuant to C.C. 3389. (C.C. 1680; see Law Rev. Com. Comment.) (See 91 *Am.Jur.* Trials 333 [action respecting liquidated damages on real estate purchaser's default].)

West's Key Number Digest, Damages k.79(5)

SUPPLEMENT: [This section is current through the latest supplement]



11 of 79 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

- D. Penalties and Liquidated Damages.
- 3. Revised Liquidated Damages Law.
- e. Real Property Purchase Contract.
- 2. Residential Property: In General.

1 Witkin Sum. Cal. Law Contracts § 545

[§ 545] Residential Property: In General.

(1) *What Constitutes Residential Property.* C.C. 1675(a) defines "residential property" for the purpose of the section as "real property primarily consisting of a dwelling" that meets both of the following requirements:

(a) The dwelling "contains not more than four residential units."

(b) At the time the contract to purchase and sell the property is made, "the buyer intends to occupy the dwelling or one of its units as his or her residence."

(2) *Conditions of Validity.* C.C. 1675 provides that a liquidated damages provision in this type of contract, i.e., a provision that all or any part of a payment made by the buyer will constitute liquidated damages to the seller on the buyer's failure to complete the purchase, is valid under the following conditions:

(a) "[T]o the extent that payment in the form of cash or check, including a postdated check, is actually made." (C.C. 1675(b).) The Law Revision Commission observes that "generally the buyer of residential housing, including the buyer who does not read the contract or does not understand it, expects to lose the 'earnest money' deposit if the purchase of the property is not completed." However: (1) If the contract specifies liquidated damages in an amount greater than that actually paid by the buyer, the seller may not claim the excess. (2) If the amount paid is greater than the amount specified, only the specified amount may be retained by the seller. (Law Rev. Com. Comment to C.C. 1675.)

(b) The provision satisfies formal requirements (separate signing or initialing, printing type) of C.C. 1677 and 1678. (C.C. 1675(b); see *infra*, §545.)

(c) The provision is upheld under the burden of proof established for amounts over or not over 3% of the purchase price. (C.C. 1675(c), (d); see *infra*, §546.)

(d) The provision is upheld under the standards of reasonableness. (C.C. 1675(e); see *infra*, §546.)

(3) *Formal Requirements.* C.C. 1677 establishes formal requirements for validity, applicable not only to residential

property contracts but to all real property purchase contracts:

(a) *Separate signing or initialing.* The provision must be separately signed or initialed by each party to the contract. (C.C. 1677(a).) This requirement was adapted from the Real Estate Purchase Contract and Receipt for Deposit approved for use in simple transactions by the California Real Estate Association and the State Bar, and is designed to bring the consequences of this important provision to the attention of the parties. (Law Rev. Com. Comment to C.C. 1677.) (See *Allen v. Smith* (2002) 94 C.A.4th 1270, 1282, 114 C.R.2d 898, supra, §179 [counteroffer did not refer to additional deposit as "liquidated damages," but it complied with C.C. 1677 in that it was signed by parties who, at same time, signed deposit receipt]; *Timney v. Lin* (2003) 106 C.A.4th 1121, 1126, 131 C.R.2d 387 [provision was invalid even though it was contained in settlement agreement, rather than in contract]; on the effect of violation of the requirement, see *Guthman v. Moss* (1984) 150 C.A.3d 501, 198 C.R. 54, infra, this section.)

(b) *Printing.* If the provision is included in a printed contract, it must be in at least 10-point bold type or contrasting red print in at least 8-point bold type. (C.C. 1677(b).) This requirement, also designed to assure awareness of the consequences of the provision, is taken from several recent statutes (C.C. 2984.1, 2984.3, 1803.2, 1803.7). (Law Rev. Com. Comment to C.C. 1677.)

(c) *Separate signing or initialing for subsequent payments.* C.C. 1678, applicable only to *residential property* contracts, provides as follows:

"If more than one payment made by the buyer is to constitute liquidated damages under Section 1675, the amount of any payment after the first payment is valid as liquidated damages only if (1) the total of all such payments satisfies the requirements of Section 1675 and (2) a separate liquidated damages provision satisfying the requirements of Section 1677 is separately signed or initialed by each party to the contract for each such subsequent payment."

The Commission explains the purpose of this requirement: "The section recognizes that frequently a deposit is made at the time the agreement to sell and to purchase the property is made and a second payment is made at the time the escrow is opened. The payment made at the time the escrow is opened (or at some other time) can be retained by the seller as liquidated damages only if there is a valid agreement so providing and there is a separate signing or initialing for the subsequent payment." (Law Rev. Com. Comment to C.C. 1678.)

(4) *Effect of Violation.* In *Guthman*, plaintiff sellers and defendant buyers made an agreement to sell residential real property. Their amended escrow instructions contained a provision for liquidated damages of \$ 24,000 if either party defaulted. The provision was approved by defendants' attorney over the telephone, it appeared in close proximity to the parties' signatures, and all parties intended it to be included; but it was not separately signed and initialed as required by C.C. 1677(a). The buyers failed to close escrow; the sellers filed suit and then sold the property for \$ 65,000 less than the contract price. The buyers stipulated to summary judgment for \$ 24,000, and judgment in that sum was accordingly entered against them. The sellers, however, contended that the liquidated damages provision was void, and appealed from the limited judgment. *Held*, affirmed.

(a) C.C. 1677 provides that a liquidated damages clause that fails to meet its requirements is "invalid." The legislative history does not show an intent to make it void, and the word "invalid" is often interpreted as meaning voidable (e.g., in the statute of frauds). Accordingly, violation of the requirements of C.C. 1677 merely renders the provision voidable. (150 C.A.3d 509.)

(b) C.C. 1679 provides that if a *seller* agrees to pay liquidated damages and defaults, the validity of the clause is determined under the general rule in C.C. 1671; i.e., C.C. 1675 et seq. are inapplicable. But C.C. 1675 et seq. created an exception to the general rule, to protect a defaulting *buyer* from forfeiting an unreasonably large sum as liquidated damages. (150 C.A.3d 511.) "We therefore hold that section 1677 gives the buyer the option of either enforcing the agreement or voiding it when the statutory formalities are not satisfied. However, since sellers are not members of that class sought to be protected by the statute, they are precluded from voiding the clause." (150 C.A.3d 512.)

West's Key Number Digest, Damages k.78(7)

SUPPLEMENT: [This section is current through the latest supplement]



12 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

D. Penalties and Liquidated Damages.

3. Revised Liquidated Damages Law.

e. Real Property Purchase Contract.

3. Residential Property: Proof.

1 Witkin Sum. Cal. Law Contracts § 546

[§ 546] Residential Property: Proof.

(1) *Burden Dependent on Amount Paid.* C.C. 1675(c) and (d) protect the buyer of residential housing from forfeiting an unreasonably large amount as liquidated damages, by establishing a different burden of proof where the amount paid is in excess of 3% of the purchase price:

(a) *If the amount paid is not over 3%,* the liquidated damage provision has the usual favored treatment; it is valid to the extent of payment actually made unless the buyer establishes that the amount is unreasonable. (C.C. 1675(c).)

(b) *If the amount paid is over 3%,* the strict rule applies; i.e., the provision is invalid unless the party seeking to uphold it (usually the seller) establishes that the amount actually paid is reasonable. (C.C. 1675(d).) The Commission notes that under this subdivision, a buyer may seek to uphold the provision in order to limit his or her liability where the seller may be able to show higher actual damages. (Law Rev. Com. Comment to C.C. 1675.) (See *Allen v. Smith* (2002) 94 C.A.4th 1270, 1281, 114 C.R.2d 898, supra, §179 [defendants failed to show that amount over 3% was reasonable].)

(2) *Standard for Determining Reasonableness.* C.C. 1675(e) sets forth the standard for determining reasonableness in cases coming under subdivisions (c) or (d). Both of the following must be considered:

(a) "The *circumstances existing at the time the contract was made.*" (C.C. 1675(e)(1).) (For the meaning of "circumstances" at the time of making, see Law Rev. Com. Comment to C.C. 1671, supra, §535.)

(b) "The price and other terms and *circumstances of any subsequent sale or contract to sell and purchase the same property* if the sale or contract is made within six months of the buyer's default." (C.C. 1675(e)(2).) The Commission observes that consideration of the subsequent sale will avoid a possible windfall to the seller in a rising market; and the 6-month limitation recognizes that relevance of a subsequent sale to reasonableness of the amount paid decreases as the time between default and subsequent sale increases. (11 Cal. Law Rev. Com. Reports 1745.) And the Comment to C.C. 1675(e) adds that the circumstances to be considered "include, but are not limited to, items such as the cost of taxes, interest, and insurance during the period after the original contract to purchase the property was made and any additional broker fees which are a result of the buyer's default."

West's Key Number Digest, Damages k.78(7)

SUPPLEMENT: [This section is current through the latest supplement]



13 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
D. Penalties and Liquidated Damages.
3. Revised Liquidated Damages Law.
e. Real Property Purchase Contract.
4. Condominiums.

1 Witkin Sum. Cal. Law Contracts § 547

[§ 547] Condominiums.

(1) *In General.* C.C. 1675(f) specifies accounting and other prerequisites to retention of liquidated damages where the buyer defaults in certain condominium sales. These requirements apply notwithstanding C.C. 1675(c) or (d) (limitations on amount of liquidated damages on default in residential real estate transactions generally; see *supra*, §546). (C.C. 1675(f)(1).)

(2) *Properties Covered.* The requirements apply on "the initial sale of newly constructed attached condominium units ... that involves the sale of an attached residential condominium unit located within a structure of 10 or more residential condominium units," where the amount actually paid to the seller pursuant to a liquidated damages provision exceeds 3% of the purchase price of that unit. (C.C. 1675(f)(1).) The term "structure" means either (a) improvements constructed on a common foundation or (b) improvements constructed by the same owner that must be constructed concurrently due to the design characteristics of the improvements or physical characteristics of the property on which the improvements are located. (C.C. 1675(f)(6).)

(3) *Accounting and Refund.* On the buyer's default, the seller must perform an accounting of its costs and revenues related to and fairly allocable to the construction and sale of the unit within 60 calendar days after the final close of escrow. (C.C. 1675(f)(1)(A).) The accounting must include all costs and revenues related to the construction and sale of the property and any delay caused by the buyer's default. The seller must make reasonable efforts to mitigate any damages arising from the default. (C.C. 1675(f)(1)(B).)

The seller must refund to the buyer any amounts previously retained as liquidated damages in excess of the greater of either 3% of the originally agreed-on purchase price of the residential property or the amount of the seller's losses resulting from the buyer's default, as calculated by the accounting. (C.C. 1675(f)(1)(B).) The refund must be sent to the buyer's last known address within 90 days after the final close of escrow of the sale or lease of all the residential condominium units within the structure. (C.C. 1675(f)(2).) C.C. 1675(d) (providing for invalidity of liquidated damages exceeding 3% absent seller's showing of reasonableness; see *supra*, §546) does not apply. (C.C. 1675(f)(4).)

Notwithstanding the general time periods regarding the performance of the accounting, if a "new qualified buyer"

has entered into a contract to purchase the property in question, the seller must perform the accounting within 60 calendar days after that buyer has entered into a contract to purchase. (C.C. 1675(f)(5).) The term "new qualified buyer" means a buyer that (a) has been issued a loan commitment, satisfying the purchase agreement loan contingency requirement, by an institutional lender to obtain a loan for an amount equal to the purchase price less any downpayment possessed by the buyer and (b) has contracted to pay a purchase price that is greater than or equal to the purchase price to be paid by the original buyer. (C.C. 1675(f)(7).)

(4) *Amount Must Be Reasonable*. If the amount retained by the seller after the accounting does not exceed 3% of the purchase price, the amount is valid unless the buyer establishes that the amount is unreasonable as liquidated damages pursuant to C.C. 1675(e) (determination of reasonableness of liquidated damages; see *supra*, §546). (C.C. 1675(f)(3).)

SUPPLEMENT: [This section is current through the latest supplement]

(3) *Accounting and Refund*. C.C. 1675(f)(7) was amended in 2008 to provide that the term "new qualified buyer" means a buyer who satisfies *either* of the two requirements listed in the text, p. 595.

(5) *(New) Large Units*. C.C. 1675(g), added in 2008, is nearly identical to C.C. 1675(f), text, pp. 594, 595. However, it applies to an attached residential condominium unit that (a) is located within a structure of 20 or more residential condominium units, standing over eight stories high, that is high-density infill development and that is located in a city, county, or city and county with a population density of 1,900 residents per square mile or greater; and (b) has a purchase price exceeding \$ 1 million. (C.C. 1675(g)(1)(B).) The accounting provisions specified in C.C. 1675(f) apply when the amount actually paid to the seller pursuant to the liquidated damages provision exceeds 6% of the purchase price. (C.C. 1675(g)(1)(A).) The provisions concerning refund and the reasonableness of the amount retained by the seller are nearly identical to those provided by C.C. 1675(f). (C.C. 1675(g)(2), (g)(3), (g)(4), (g)(5), (g)(6).)

Commencing on July 1, 2010, and annually thereafter, the dollar amount of the minimum purchase price must be adjusted by the Real Estate Commissioner based on the change in the median price of a single-family home in California, as determined by the most recent data available from the Federal Housing Finance Board. Upon determining the amount of the adjustment, the Real Estate Commissioner must publish the current dollar amount of the minimum purchase price on the Department of Real Estate's Internet website. (C.C. 1675(g)(8).)

Prior to the execution of a contract for sale, the seller must provide to the buyer the following notice, in at least 12-point type:

"Important Notice Regarding Your Deposit: Under California law, in a contract for the initial sale of a newly constructed attached condominium unit in a building over eight stories tall, containing 20 or more residential units, and located in a high-density infill development in a city, county, or city and county with 1,900 residents or more per square mile, where the price is more than one million dollars (\$ 1,000,000), as adjusted by the Department of Real Estate, liquidated damages of 6 percent of the purchase price are presumed valid if the buyer defaults, unless the buyer establishes that the amount is unreasonable."

If the seller fails to provide this notice, the amount of any liquidated damages is subject to limitations contained in C.C. 1675(c) and (d). (C.C. 1675(g)(9).)

C.C. 1675 becomes inoperative on July 1, 2014, when it will be replaced by a version that does not contain this subdivision (g). (C.C. 1675(h).)



14 of 79 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

D. Penalties and Liquidated Damages.

3. Revised Liquidated Damages Law.

e. Real Property Purchase Contract.

5. Other Real Property.

1 Witkin Sum. Cal. Law Contracts § 548

[§ 548] Other Real Property.

The restrictive provisions on residential housing contracts (C.C. 1675, *supra*, §545), do not apply to other real estate purchase contracts. As to these, the liberal rule of C.C. 1671(b) favoring liquidated damages provisions is applied, so that parties to commercial transactions have assurance that a reasonable provision will be held valid. (See 13 Cal. Law Rev. Com. Reports 1745, and Comment to C.C. 1676; *Hong v. Somerset Associates* (1984) 161 C.A.3d 111, 114, 207 C.R. 597.) Accordingly, C.C. 1676 states:

"Except as provided in Section 1675, a provision in a contract to purchase and sell real property liquidating the damages to the seller if the buyer fails to complete the purchase of the property is *valid* if it satisfies the requirements of Section 1677 and the requirements of subdivision (b) of Section 1671." (On C.C. 1671(b), see *supra*, §535; on C.C. 1677, governing the required format, see *supra*, §545.) "Hence, if the applicable requirements of Section 1677 are satisfied, the liquidated damages provision is valid unless the buyer establishes that the provision was unreasonable under the circumstances existing at the time the contract was made." (Law Rev. Com. Comment to C.C. 1676.) (See *Hong v. Somerset Associates*, *supra*, 161 C.A.3d 116 [provision held reasonable where buyers were experienced, sale was for \$ 1,325,000 and liquidated damages were \$ 25,000].)

SUPPLEMENT: [This section is current through the latest supplement]



15 of 79 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

- D. Penalties and Liquidated Damages.
- 3. Revised Liquidated Damages Law.
- f. Public Works Construction Contracts.

1 Witkin Sum. Cal. Law Contracts § 549

[§ 549] Public Works Construction Contracts.

Several statutes regulating public works construction contracts require or permit the inclusion of liquidated damages provisions for late completion, but do not provide a standard for determining the validity of the provisions. Because they come within the exception of C.C. 1671(a) (another statute expressly applicable; see *supra*, §533), C.C. 1671 does not apply, but amendments were made restating the general rule of validity and favorable standard set forth in C.C. 1671(b) (see *supra*, §535). (See 13 Cal. Law Rev. Com. Reports 1746, 1760 et seq.)

(1) *Miscellaneous Contracts.* The statutes dealing with local public works contracts (*Govt.C. 53069.85*), street and highway improvement (former Sts. & H.C. 5254.5, now *Pub.Contr.C. 20427*), state contracts (former *Govt.C. 14376*, now *Pub.Contr.C. 10226*), and contracts for the California State University and Colleges (former *Educ.C. 90226*, now *Pub.Contr.C. 10826*), were amended to provide that the amount specified "is valid as liquidated damages *unless manifestly unreasonable* under the circumstances existing at the time the contract was made." (See *Vrgora v. Los Angeles Unified School Dist. (1984) 152 C.A.3d 1178, 1186, 200 C.R. 130 [Govt.C. 53069.85; provision held valid]; 12 A.L.R.4th 903 [validity of public contract provision for per diem payments for delay in performance]; 15 A.L.R.5th 376 [liability of contractor abandoning building project before completion for liquidated damages for delay].)*

In *Vrgora*, a contractor was assessed liquidated damages at the rate of \$ 100 per day, as specified in the contract, for delay in completing an automotive service shed for a school district. His argument that, because the district used a portion of the facility prior to completion, the liquidated damages should be apportioned to avoid unjust enrichment, was rejected on the authority of *London Guarantee & Acc. Co., Ltd. v. Las Lomitas School Dist. (1961) 191 C.A.2d 423, 12 C.R. 598. (152 C.A.3d 1187.)* (See Corbin §1072; 24 Williston 4th, §65:19 et seq.) The amount of enrichment could not have been determined at the time of the contract; hence "it must be presumed that certain direct or indirect benefits which might be enjoyed by the public entity, even though delay and breach were due to no fault of that party, were considered by the contracting parties." Thus, in agreeing to the liquidated damages provision, the contractor "bargained away" any offsetting claim for unjust enrichment. (*152 C.A.3d 1188.*)

(2) *Contracts of University of California.* *Educ.C. 92050* contains the same quoted statement of validity (see *supra*), but adds the following: "Nothing in this section restricts the authority of the Regents of the University of California to include any other provision concerning liquidated damages in any contract for a construction project." As the

Commission points out, any "other provisions" would be governed by C.C. 1671 (supra, §535). (Law Rev. Com. Comment to C.C. 1671.)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Miscellaneous Contracts*. See 11 Corbin (Rev. ed.), §58.12.



16 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
E. Restraint of Trade and Other Illegal Trade Practices.

1. Federal Law.

a. In General.

1. Common Law and Statutory Policy.

1 Witkin Sum. Cal. Law Contracts § 550

[§ 550] Common Law and Statutory Policy.

Restraint of trade acts have a common law basis. The fundamental policy underlying both the common law and statutes is the encouragement of free competition by prevention of substantial restraints thereon. (See *United States v. E.I. Du Pont de Nemours Co.* (1956) 351 U.S. 377, 76 S.Ct. 994, 1002, 100 L.Ed. 1264, 1275; *Rest.2d, Contracts* §186 et seq.)

A major text on antitrust law is Areeda and Hovenkamp, *Antitrust Law*. (For other comprehensive treatments of the subject, see 15 Corbin (Rev. ed.), §75.7 et seq.; 6 Williston 4th, §13:1 et seq.; 54, 54A *Am.Jur.2d* (1996 ed.), *Monopolies, Restraints of Trade, and Unfair Trade Practices* §1 et seq.; C.E.B., *Sales and Mergers of California Businesses*, §5.1; and see 29 *Stanf. L. Rev.* 1311 [review of Posner, *Antitrust Law: An Economic Perspective*]; 15 *U.C. Davis L. Rev.* 521 [review of Kintner, *Treatise on the Antitrust Laws of the United States*]; 26 *U.C.L.A. L. Rev.* 682 [review of Bork, *The Antitrust Paradox: A Policy at War With Itself*]; 66 *Cal. L. Rev.* 1317 [same].)

A considerable volume of law review commentary on this subject is also available. (See, e.g., 72 *Cal. L. Rev.* 1 [Antitrust Market Definition: An Integrated Approach]; 74 *Cal. L. Rev.* 1515 [The "New Learning" and the Euthanasia of Antitrust]; 75 *Cal. L. Rev.* 787 [Symposium: Anticipating Antitrust's Centennial: Foreword]; 75 *Cal. L. Rev.* 797 [The Durability, Relevance, and Future of American Antitrust Policy]; 75 *Cal. L. Rev.* 959 [Monopolization, Mergers, and Markets: A Century Past and the Future]; 75 *Cal. L. Rev.* 1005 [Antitrust Deregulation, and the Newly Liberated Marketplace]; 77 *Cal. L. Rev.* 1365 [Antitrust and the Market for Corporate Control]; 30 *Cal. Western L. Rev.* 275 [Preparing for Telco-Cable Cross-Ownership: Are Existing and Proposed Regulatory Safeguards Sufficient To Deter Anti-Competitive Conduct?]; 94 *Harv. L. Rev.* 937 [Market Power in Antitrust Cases]; 94 *Harv. L. Rev.* 802 [Antitrust and Nonprofit Entities]; 95 *Harv. L. Rev.* 1521 [Joint Ventures and Antitrust Policy]; 104 *Harv. L. Rev.* 667 [The Scope of Antitrust Process; distinction between state action and private action]; 116 *Harv. L. Rev.* 917 [rationalization of antitrust]; 34 *Hastings L. J.* 65 [Wealth Transfers as the Original and Primary Concern of Antitrust]; 38 *Hastings L. J.* 517 [An Antitrust Allegory]; 52 *Hastings L. J.* 795 [Symposium on Antitrust Law in the Digital Age]; 55 *Hastings L. J.* 271 [antitrust enforcement in California electricity crisis]; 60 *So. Cal. L. Rev.* 1059 [arbitrability of antitrust disputes]; 74 *So. Cal. L. Rev.* 657 [issue of intent in antitrust law]; 12 *Southwestern L. Rev.* 161 [Symposium, "Changing Perspectives in Antitrust Litigation"]; 12 *Southwestern U. L. Rev.* 379, 405 [Industrial Concentration and Antitrust

Reform]; 25 *Southwestern U. L. Rev.* 487 [Antitrust Symposium: Antitrust Issues in the Telecommunications and Software Industries]; 43 *Stanf. L. Rev.* 1417 [Myth, Empiricism, and America's Competitive Edge: The Intellectual Property Antitrust Protection Act]; 45 *Stanf. L. Rev.* 1161 [Contract Penalties, Monopolizing Strategies, and Antitrust Policy]; 47 *Stanf. L. Rev.* 615 [proposed alternative system for antitrust classification of agreements]; 56 *Stanf. L. Rev.* 253 [Defining Better Monopolization Standards]; 21 *U.C. Davis L. Rev.* 327 [Should There Be an Essential Facility Doctrine?]; 14 *U.C.L.A. L. Rev.* 979 [antitrust policy: legal and economic considerations]; 16 *U.C.L.A. L. Rev.* 1 ["Politics, Planning and Trade Regulation"]; 20 *U.C.L.A. L. Rev.* 311 [An Alternative to Divestiture in Antitrust Enforcement]; 42 *U.C.L.A. L. Rev.* 47 [The Paradox of Antitrust and Lanham Act Standing]; 18 *U.S.F. L. Rev.* 221 [A Consumer Oriented Approach to Market Definition Under the Antitrust Laws].)

West's Key Number Digest, Monopolies k.10-

SUPPLEMENT: [This section is current through the latest supplement]

Commentary: See 39 *U.C. Davis L. Rev.* 85 [development of Supreme Court's antitrust jurisprudence from 1870 to 1920]; 40 *U.S.F. L. Rev.* 561 [modernization of antitrust law is best left to judiciary].



17 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

E. Restraint of Trade and Other Illegal Trade Practices.

1. Federal Law.
 - a. In General.
2. Federal Statutes.

1 Witkin Sum. Cal. Law Contracts § 551

[§ 551] Federal Statutes.

The major part of the antitrust field is covered by federal statutes applicable to activities within the power of Congress over commerce. The interpretation and enforcement of these statutes have created a vast accumulation of complex and constantly changing case law. Although the federal law is beyond the scope of this work, a general knowledge of its nature is essential even to lawyers whose practice is limited to intrastate business, for some problems arising under state antitrust laws are similar to those in the federal field. (See *Chicago Title Ins. Co. v. Great Western Financial Corp.* (1968) 69 C.2d 305, 315, 70 C.R. 849, 444 P.2d 481; *Corwin v. Los Angeles Newspaper Service Bureau* (1971) 4 C.3d 842, 852, 94 C.R. 785, 484 P.2d 953, *infra*, §606; *People v. Santa Clara Valley Bowling Proprietors' Assn.* (1965) 238 C.A.2d 225, 232, 47 C.R. 570; *Widdows v. Koch* (1968) 263 C.A.2d 228, 234, 69 C.R. 464; *Carl N. Swenson Co. v. E.C. Braun Co.* (1969) 272 C.A.2d 366, 368, 77 C.R. 378; 54 Am.Jur.2d (1996 ed.), *Monopolies, Restraints of Trade, and Unfair Trade Practices* §1 *et seq.*; C.E.B., *Sales and Mergers of California Businesses*, §5.2 *et seq.*; 40 *San Diego L. Rev.* 555 [antitrust laws and Telecommunications Act of 1996].) Hence the principal statutes will be briefly described and the major topics outlined, with references to useful source material. (See *infra*, §555 *et seq.*)

SUPPLEMENT: [This section is current through the latest supplement]
See 40 *U.S.F. L. Rev.* 627 [federalism and antitrust reform].



18 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
E. Restraint of Trade and Other Illegal Trade Practices.

1. Federal Law.
 - a. In General.
3. Enforcement and Procedure.
 - aa. In General.

1 Witkin Sum. Cal. Law Contracts § 552

[§ 552] In General.

The antitrust laws are enforced by a number of methods, including criminal prosecution, civil suit by the government, civil injunction suit by a private person, civil suit for treble damages by a private person, and administrative proceedings before the Federal Trade Commission. (See generally *54 Am.Jur.2d* (1996 ed.), *Monopolies, Restraints of Trade, and Unfair Trade Practices* §306 et seq.; *18 Am.Jur. P.P. Forms* (1997 ed.), *Monopolies, Restraints of Trade, and Unfair Trade Practices*, §1 et seq.)

The following may be consulted on particular methods of enforcement:

(1) *Criminal Prosecution*. (See *United States v. Wise* (1962) 370 U.S. 405, 82 S.Ct. 1354, 1357, 1361, 8 L.Ed.2d 590, 592, 597 [criminal liability of corporate officer]; *United States v. United States Gypsum Co.* (1978) 438 U.S. 422, 98 S.Ct. 2864, 2874, 57 L.Ed.2d 854, 869 [element of intent]; 86 *Harv. L. Rev.* 693 [Antitrust Penalties and Attitudes Toward Risk: An Economic Analysis]; 92 *Harv. L. Rev.* 288 [Gypsum]; 16 *Santa Clara L. Rev.* 55 [The Constitutionality of the Per Se Rule in Criminal Antitrust Prosecutions]; 32 *Hastings L. J.* 499 [same].)

(2) *Civil Suits by Government*. (See 69 *Cal. L. Rev.* 1 [right to jury trial of antitrust issues]; 81 *Harv. L. Rev.* 1558 [direct appeal by government to Supreme Court]; 11 *Loyola L.A. L. Rev.* 513 [the big antitrust case and procedural reform]; 24 *Am.Jur. Trials* 1 et seq. [defending antitrust lawsuits]; on consent decrees, see 53 *Cal. L. Rev.* 627; 79 *Harv. L. Rev.* 391; 80 *Harv. L. Rev.* 1303; 91 *Harv. L. Rev.* 1020; 35 *Hastings L. J.* 133; 41 *So. Cal. L. Rev.* 418.)

(3) *Action by State Attorney General*. The Hart-Scott-Rodino Antitrust Improvements Act of 1976 (15 U.S.C., §15c et seq.) authorizes state attorneys general to seek recovery of monetary damages on behalf of state residents for violations of federal antitrust laws. (See 9 *Pacific L. J.* 315; see also *B. & P.C.* 16750(j) [district attorneys may not exercise federal authority "except at direction of Attorney General"]; 34 *Hastings L. J.* 179 [Parens Patriae Actions on Behalf of Indirect Purchasers]; 34 *Stanf. L. Rev.* 203 [same]; 26 *U.C.L.A. L. Rev.* 1321; 17 *U.S.F. L. Rev.* 477 [Goods or Realty Exemption to Premiermer Notification Under Hart-Scott-Rodino Antitrust Improvements Act].)

(4) *Action by Foreign Nation*. (See *Pfizer v. Government of India* (1978) 434 U.S. 308, 98 S.Ct. 584, 591, 54 L.Ed.2d 563, 574, 4 Cal. Proc. (4th), *Pleading*, §95 [action for treble damages under Section 4 of Clayton Act]; 10 Cal. Western L. Rev. 286 [Supranational Control of the International Corporation: A Dissenting View]; 12 *Loyola L.A. L. Rev.* 285 [Multinational Businesses Beware: The Long Arm of the United States Antitrust Laws May Reach You]; 35 *San Diego L. Rev.* 1163 [Extraterritorial Application of Antitrust Laws and the U.S.-EU Dispute Over the Boeing and McDonnell Douglas Merger: From Comity to Conflict? An Argument for a Binding International Agreement on Antitrust Enforcement and Dispute Resolution].)

(5) *Administrative Proceedings*. (See 54 *Am.Jur.2d* (1996 ed.), *Monopolies, Restraints of Trade, and Unfair Trade Practices* §319 et seq.; 59 *Cal. L. Rev.* 1113 [public participation in enforcement of antitrust laws]; 21 *Hastings L. J.* 904 [merger jurisdiction of Federal Maritime Commission].)

(6) *Private Suits*. (See *infra*, §553.)

SUPPLEMENT: [This section is current through the latest supplement]

See 18C *Am.Jur. P.P. Forms* (2005 ed.), *Monopolies, Restraints of Trade, and Unfair Trade Practices*, §1 et seq.(2) *Civil Suits by Government*. See 40 *U.S.F. L. Rev.* 567 [civil monetary remedies available to federal antitrust enforcers].

(4) *Action by Foreign Nation*.

Pfizer case:

Cross-Reference: 4 *Cal. Proc.* (5th), *Pleading*, §109.



19 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
E. Restraint of Trade and Other Illegal Trade Practices.

1. Federal Law.

a. In General.

3. Enforcement and Procedure.

bb. Private Suits: Cause of Action.

1 Witkin Sum. Cal. Law Contracts § 553

[§ 553] Private Suits: Cause of Action.

(1) *In General.* (See *Texas Industries v. Radcliff Materials* (1981) 451 U.S. 630, 101 S.Ct. 2061, 2067, 68 L.Ed.2d 500, 508 [defendants have no right of contribution against other participants in unlawful conspiracy]; 54 *Am.Jur.2d* (1996 ed.), *Monopolies, Restraints of Trade, and Unfair Trade Practices* §330 et seq.; 51 *Cal. L. Rev.* 955 [collateral estoppel effect of state court judgment]; 53 *Cal. L. Rev.* 627 [consent decree and private action]; 60 *Cal. L. Rev.* 1656 [attorneys' fees in class actions]; 69 *Cal. L. Rev.* 1 [right to jury trial of antitrust issues]; 72 *Cal. L. Rev.* 403 [segregation of damages as burden on private plaintiff]; 86 *Harv. L. Rev.* 693 [Antitrust Penalties and Attitudes Toward Risk: An Economic Analysis]; 89 *Harv. L. Rev.* 1127 [Antitrust Violations Without Damage Recoveries]; 21 *Hastings L. J.* 877 [retroactive application of antitrust decisions]; 11 *Loyola L.A. L. Rev.* 513 [the big antitrust case and procedural reform]; 37 *So. Cal. L. Rev.* 389 [damage measurement in motion picture industry private actions]; 19 *Stanf. L. Rev.* 1101 [immunity of federal officials from civil liability]; 37 *Stanf. L. Rev.* 1445 [The Scope of Liability for Antitrust Violations]; 11 *U.C.L.A. L. Rev.* 792 [ambiguity in Clayton Act, §5(a)]; 24 *Am.Jur. Trials* 1 et seq. [defending antitrust lawsuits].)

(2) *Statute of Limitations.* (See *Minnesota Mining & Mfg. Co. v. New Jersey Wood Finishing Co.* (1965) 381 U.S. 311, 85 S.Ct. 1473, 1479, 14 L.Ed.2d 405, 413 [tolling statute of limitations]; *Leh v. General Petroleum Corp.* (1965) 382 U.S. 54, 86 S.Ct. 203, 206, 15 L.Ed.2d 134, 136 [same]; *Zenith Radio Corp. v. Hazeltine Research* (1971) 401 U.S. 321, 91 S.Ct. 795, 800, 28 L.Ed.2d 77, 85 [exemption from statute of limitations when damages were previously unascertainable]; 54 *Am.Jur.2d* (1996 ed.), *Monopolies, Restraints of Trade, and Unfair Trade Practices* §517 et seq.; 55 *So. Cal. L. Rev.* 255 [*Zenith* case]; 31 *U.C.L.A. L. Rev.* 1061 [antitrust statute of limitations in a contractual context]; 11 *U.S.F. L. Rev.* 429 [argument that statute of limitations should be tolled while antitrust claimant is before regulatory agency].)

(3) *Defenses.* (See *Perma-Life Mufflers v. Int. Parts Corp.* (1968) 392 U.S. 134, 88 S.Ct. 1981, 1985, 20 L.Ed.2d 982, 989 [*in pari delicto* defense not applicable to treble damages action]; 54 *Am.Jur.2d* (1996 ed.), *Monopolies, Restraints of Trade, and Unfair Trade Practices* §527; 57 *Cal. L. Rev.* 1182 [*Perma-Life Mufflers*]; 78 *Harv. L. Rev.* 1240 [*in pari delicto* and consent defenses]; 10 *Loyola L.A. L. Rev.* 709 [*in pari delicto* defense]; 5 *San Diego L. Rev.*

171 [same]; 6 *San Diego L. Rev.* 117 [same].)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *In General.* See 39 *U.S.F. L. Rev.* 141 [class certification in antitrust litigation]; 42 *U.S.F. L. Rev.* 879 [benefits of private antitrust enforcement].



20 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
E. Restraint of Trade and Other Illegal Trade Practices.

1. Federal Law.

a. In General.

3. Enforcement and Procedure.

cc. Private Suits: Remedies.

1 Witkin Sum. Cal. Law Contracts § 554

[§ 554] Private Suits: Remedies.

(1) *Treble Damages*. (See *Hanover Shoe v. United Shoe Machinery Corp.* (1968) 392 U.S. 481, 88 S.Ct. 2224, 2226, 20 L.Ed.2d 1231, 1236; 46 Cal. L. Rev. 98 [*Hanover Shoe*]; 56 Cal. L. Rev. 968 [Section 7, Clayton Act as basis for treble damages action]; 61 Cal. L. Rev. 1319 [Antitrust Treble-Damage Actions: Do They Work?]; 72 Cal. L. Rev. 437 [standing to sue for treble damages]; 75 Harv. L. Rev. 1395 [role of state law in treble damage actions]; 80 Harv. L. Rev. 1566 [same: practice problems and damages]; 23 Santa Clara L. Rev. 663 [nonprofit professional association held liable for treble damages for agents' antitrust violations]; 42 So. Cal. L. Rev. 460 [illegal mergers and treble damages]; 8 Southwestern L. Rev. 505 [Symposium on Effectiveness of the Private Treble Damages Action: Introductory Comments], 510 [View from the Senate], 515 [A Government Perspective], 525 [Some Remarks from the Judiciary], 531 [A More Active Role for Local Government], 539 [Efficiency and Equity Considerations], 550 [The Only Game in Town], 560 [A Defense Viewpoint], 564 [Panel Discussion]; 14 U.C.L.A. L. Rev. 1060 [public agency treble damage suit].)

In *Hanover Shoe v. United Shoe Machinery Corp.*, *supra*, a treble damage action under §4 of the Clayton Act, the defense was that the ultimate consumers, rather than immediate purchasers, were the injured parties, because illegal overcharges are normally passed on to them. The court rejected the defense, and the same holding was made in *Illinois Brick Co. v. Illinois* (1977) 431 U.S. 720, 97 S.Ct. 2061, 52 L.Ed.2d 707: "We think the longstanding policy of encouraging vigorous private enforcement of the antitrust laws ... supports our adherence to the *Hanover Shoe* rule, under which *direct purchasers* are not only spared the burden of litigating the intricacies of pass-on but also are permitted to recover the full amount of the overcharge." (97 S.Ct. 2074, 52 L.Ed.2d 725.) (See *California v. ARC America Corp.* (1989) 490 U.S. 93, 109 S.Ct. 1661, 1665, 104 L.Ed.2d 86, 95 [§4 of Clayton Act, construed in *Illinois Brick Co.* as being applicable only to direct purchasers, held not to preempt state statutes permitting recovery by indirect purchasers]; *Atlantic Richfield Co. v. USA Petroleum Co.* (1990) 495 U.S. 328, 110 S.Ct. 1884, 1889, 109 L.Ed.2d 333, 344 [company does not suffer "antitrust injury," and hence lacks standing to sue under §4 of Clayton Act, when it loses sales to competitor charging nonpredatory prices under vertical price-fixing scheme]; *Kansas v. Utilicorp United* (1990) 497 U.S. 199, 110 S.Ct. 2807, 2812, 111 L.Ed.2d 169, 180 [in cases involving supplier's overcharging utility that, in

turn, passes overcharges on to its customers, only utility has standing to sue under §4 of Clayton Act]; 91 *Harv. L. Rev.* 221; 103 *Harv. L. Rev.* 1717 [The Indirect Purchaser Rule and Cost-Plus Sales]; 104 *Harv. L. Rev.* 319 [*Atlantic Richfield Co.*]; 34 *Hastings L. J.* 179; 35 *Hastings L. J.* 629 [*Illinois Brick Co.*]; 35 *Stanf. L. Rev.* 763 [antitrust damages and fringe producer].)

However, §4 of the Clayton Act authorizes "any person" injured in his or her "business or property" to sue. A consumer who has to pay a higher price for goods purchased for personal use sustains this kind of an injury; hence a class action, on behalf of plaintiff and all persons in the United States who purchased hearing aids manufactured by defendant corporations, was proper. (*Reiter v. Sonotone Corp.* (1979) 442 U.S. 330, 99 S.Ct. 2326, 2333, 60 L.Ed.2d 931, 940; 93 *Harv. L. Rev.* 228.) (See *Blue Shield of Virginia v. McCready* (1982) 457 U.S. 465, 102 S.Ct. 2540, 2544, 73 L.Ed.2d 149, 155 [group health plan subscriber had standing to sue for treble damages based on defendants' refusal to reimburse subscribers for psychotherapy performed by psychologists]; cf. *Associated General Contractors of Calif. v. California State Council of Carpenters* (1983) 459 U.S. 519, 103 S.Ct. 897, 903, 74 L.Ed.2d 723, 731 [action by labor union; complaint insufficient]; 20 *U.C. Davis L. Rev.* 159 [*Associated General Contractors*].)

(2) *Injunctive Relief*. (See *California v. American Stores Co.* (1990) 495 U.S. 271, 110 S.Ct. 1853, 1856, 109 L.Ed.2d 240, 248 [divestiture held to be form of injunctive relief within meaning of §16 of Clayton Act]; 19 *Pacific L. J.* 143 [Section 16 of the Clayton Act: Divestiture an Intended Type of Injunctive Relief].)

Section 16 of the Clayton Act provides that any person, firm, corporation, or association may obtain injunctive relief against threatened loss or damage by a violation of the antitrust laws. *Cargill v. Monfort of Colorado* (1986) 479 U.S. 104, 107 S.Ct. 484, 93 L.Ed.2d 427, involving an action by the nation's fifth largest beef packer to enjoin the second largest packer from acquiring the third largest packer, held that (a) under §16, the plaintiff must allege an injury of the type the antitrust laws were designed to prevent (107 S.Ct. 490, 93 L.Ed.2d 436), and (b) threatened loss of profits due to possible price competition following a merger does not constitute a threat of antitrust injury (107 S.Ct. 492, 93 L.Ed.2d 440). Predatory pricing, which has as its aim the elimination of competition, instead of merely increasing market share, is an antitrust injury, but this type of pricing was neither raised nor proved by plaintiff. (107 S.Ct. 493, 93 L.Ed.2d 440.)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Treble Damages*. See 40 *U.S.F. L. Rev.* 651 [antitrust damages].



21 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
E. Restraint of Trade and Other Illegal Trade Practices.
1. Federal Law.
b. Activities Subject to Regulation.
1. In General.

1 Witkin Sum. Cal. Law Contracts § 555

[§ 555] In General.

The decisions have broadly interpreted the Sherman Act terms "trade or commerce among the several states" (*infra*, §563). (See *54 Am.Jur.2d* (1996 ed.), *Monopolies, Restraints of Trade, and Unfair Trade Practices* §§8, 10 et seq.)

(1) *Dealings in commodities*, such as buying and selling. (See *33 Stanf. L. Rev.* 1069 [Defining International Geographic Markets in American Antitrust Suits].)

(2) *News Gathering and Publishing*. (See *Associated Press v. United States* (1945) 326 U.S. 1, 65 S.Ct. 1416, 1418, 1421, 89 L.Ed. 2013, 2023, 2027; *Lorain Journal Co. v. United States* (1951) 342 U.S. 143, 72 S.Ct. 181, 185, 96 L.Ed. 162, 170; 66 Harv. L. Rev. 137; 82 Harv. L. Rev. 319; 7 San Diego L. Rev. 268.)

(3) *Moving Pictures and Legitimate Theatre*. (See *United States v. Paramount Pictures* (1948) 334 U.S. 131, 68 S.Ct. 915, 922, 92 L.Ed. 1260, 1285; *United States v. Shubert* (1955) 348 U.S. 222, 75 S.Ct. 277, 280, 99 L.Ed. 279, 284; 28 So. Cal. L. Rev. 433; 31 So. Cal. L. Rev. 150; 32 So. Cal. L. Rev. 325 [motion picture industry, 1908-1915]; 20 U.C.L.A. L. Rev. 142.)

(4) *Service trades and professions*, e.g., dry cleaning, medical and hospital services, the legal profession, engineering, and the service of realtors. (See *Atlantic Cleaners & Dyers v. United States* (1932) 286 U.S. 427, 52 S.Ct. 607, 608, 76 L.Ed. 1204, 1209; *American Med. Assn. v. United States* (1943) 317 U.S. 519, 63 S.Ct. 326, 328, 87 L.Ed. 434, 438; *United States v. National Assn. of Real Estate Bds.* (1950) 339 U.S. 485, 70 S.Ct. 711, 715, 94 L.Ed. 1007, 1013; *Goldfarb v. Virginia State Bar* (1975) 421 U.S. 773, 95 S.Ct. 2004, 2016, 44 L.Ed.2d 572 [legal profession]; *National Soc. of Professional Engineers v. United States* (1978) 435 U.S. 679, 98 S.Ct. 1355, 1360, 55 L.Ed.2d 637 [engineering profession]; *Summit Health, Ltd. v. Pinhas* (1991) 500 U.S. 322, 111 S.Ct. 1842, 1848, 114 L.Ed.2d 366, 377 [medical peer-review process]; 70 Cal. L. Rev. 595 [antitrust aspects of decisions by hospitals to limit or deny medical staff or clinical positions]; 91 Cal. L. Rev. 543 [anticompetitive implications of hospital mergers]; 37 *Hastings L. J.* 377 [antitrust aspects of preferred provider organizations; e.g., Blue Shield]; 13 *Hastings Const. L. Q.* 487 [Scrutinizing Lawyer Advertising and Solicitation Rules Under Commercial Speech and Antitrust Doctrine]; 51 *So. Cal. L. Rev.* 657 [restrictive practices in accreditation of medical schools]; 20 *U.C.L.A. L. Rev.* 983 [Private Physician

Unions: Federal Antitrust and Labor Law Implications]; 27 *Hastings L. J.* 55 [same].)

(5) *Stock Exchange*. (See *Silver v. New York Stock Exchange* (1963) 373 U.S. 341, 83 S.Ct. 1246, 1249, 10 L.Ed.2d 389, 391; *Ricci v. Chicago Mercantile Exchange* (1973) 409 U.S. 289, 93 S.Ct. 573, 575, 34 L.Ed.2d 525; *Gordon v. New York Stock Exchange* (1975) 422 U.S. 659, 95 S.Ct. 2598, 2611, 45 L.Ed.2d 463 [distinguishing *Silver* and *Ricci*]; 54 *Am.Jur.2d* (1996 ed.), *Monopolies, Restraints of Trade, and Unfair Trade Practices* §283, 284; 77 *Harv. L. Rev.* 156; 85 *Harv. L. Rev.* 794 [minimum brokerage fees]; 9 *Loyola L.A. L. Rev.* 226 [Gordon]; 18 *Stanf. L. Rev.* 213; 13 *U.C.L.A. L. Rev.* 567.)

(6) *Banks*. (See 54 *Am.Jur.2d* (1996 ed.), *Monopolies, Restraints of Trade, and Unfair Trade Practices* §251 et seq.; 42 *So. Cal. L. Rev.* 225; 83 *A.L.R.2d* 374 [antimonopoly and antitrust laws as applied to banks and banking institutions].)

(7) *Shipping*. (See *Carnation Co. v. Pacific Westbound Conference* (1966) 383 U.S. 213, 86 S.Ct. 781, 783, 15 L.Ed.2d 709, 712; 54 *Am.Jur.2d* (1996 ed.), *Monopolies, Restraints of Trade, and Unfair Trade Practices* §293 et seq.)

(8) *Trade Associations*. (See 54 *Am.Jur.2d* (1996 ed.), *Monopolies, Restraints of Trade, and Unfair Trade Practices* §262 et seq.; 19 *Hastings L. J.* 505.)

(9) *Sports*. (See *infra*, §556.)

West's Key Number Digest, Monopolies k.11

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Dealings in commodities*: See 56 *Hastings L. J.* 1121 [antitrust analysis of buyers' exercise of market power]; 46 *Santa Clara L. Rev.* 231 [product disparagement under Sherman Act]; 39 *U.S.F. L. Rev.* 11 [maintaining competition in pharmaceutical markets]; 39 *U.S.F. L. Rev.* 81 [anticompetitive behavior involving delayed market entry of generic drugs].



22 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

E. Restraint of Trade and Other Illegal Trade Practices.

1. Federal Law.

b. Activities Subject to Regulation.

2. Sports.

1 Witkin Sum. Cal. Law Contracts § 556

[§ 556] Sports.

The early case of *Federal Baseball Club v. National League of Professional Baseball Clubs* (1922) 259 U.S. 200, 42 S.Ct. 465, 466, 66 L.Ed. 898, 900, held that professional baseball was not within the scope of the federal antitrust acts, and created the impression that other local exhibitions of sport or similar entertainment involving personal services might be exempt. But later cases repudiated this view, both as to theatre and sports. (See generally 54 *Am.Jur.2d* (1996 ed.), *Monopolies, Restraints of Trade, and Unfair Trade Practices* §11; 81 *Harv. L. Rev.* 418; 104 *Harv. L. Rev.* 1299 [Sherman Act Invalidation of the NCAA Amateurism Rules]; 26 *Loyola L.A. L. Rev.* 1213 [Illegal Procedures: The NCAA's Unlawful Restraint of the Student-Athlete]; 4 *Pepperdine L. Rev.* 285 [Player Restraints in Professional Team Sports]; 23 *Santa Clara L. Rev.* 55 [Professional Sports Franchise Movements and the Sherman Act: When and Where Teams Should Be Able To Move]; 36 *Santa Clara L. Rev.* 823 [Picking Players in the College Draft Could Be Picking Trouble With Antitrust Law]; 37 *Santa Clara L. Rev.* 821 [Escaping Antitrust Immunity--Decertification of the National Basketball Players Association]; 61 *So. Cal. L. Rev.* 943 [The Evolving Confusion of Professional Sports Antitrust, the Rule of Reason, and the Doctrine of Ancillary Restraints]; 32 *U.C.L.A. L. Rev.* 219 [sports leagues and the Sherman Act]; 46 *U.C.L.A. L. Rev.* 577 [Will America's Pastime Be a Part of America's Future?: An Antitrust Analysis That Enables Sports Leagues to Compete Effectively in the Entertainment Market].)

The present situation appears to be as follows:

(1) *Baseball* is still exempt solely because of the court's unwillingness to overrule *Federal Baseball* after nearly 80 years of reliance thereon and congressional inaction. (See *Toolson v. New York Yankees* (1953) 346 U.S. 356, 74 S.Ct. 78, 79, 98 L.Ed. 64, 69; *Flood v. Kuhn* (1972) 407 U.S. 258, 92 S.Ct. 2099, 2112, 32 L.Ed.2d 728, 744; 8 *Pepperdine L. Rev.* 313 [Organized Baseball: Collective Bargaining and the Antitrust Exemption Enter the 80's]; 8 *San Diego L. Rev.* 92 [baseball's reserve clause].)

However, activities that affect employment as a major league baseball player are subject to the laws to the extent that they affect interstate commerce. Thus, 15 U.S.C., §27a(a) provides that, with certain specified exceptions, "the conduct, acts, practices, or agreements of persons in the business of organized professional major league baseball directly relating to or affecting employment of major league baseball players to play baseball at the major league level

are subject to the antitrust laws to the same extent such conduct, acts, practices, or agreements would be subject to the antitrust laws if engaged in by persons in any other professional sports business affecting interstate commerce." (See 38 *Santa Clara L. Rev.* 1223 [Congress in Relief: The Economic Importance of Revoking Baseball's Antitrust Exemption].)

(2) *Football* is subject to the laws. (*Radovich v. National Football League* (1957) 352 U.S. 445, 77 S.Ct. 390, 394, 1 L.Ed.2d 456, 461; see 6 Cal. Western L. Rev. 133 [draft and option provisions]; 71 *Harv. L. Rev.* 170 [Radovich]; 28 U.C.L.A. L. Rev. 252 [reserve and compensation systems].)

(3) *Boxing* is also subject to the laws. (*United States v. International Boxing Club of New York* (1955) 348 U.S. 236, 75 S.Ct. 259, 261, 99 L.Ed. 290, 294; *International Boxing Club of New York v. United States* (1959) 358 U.S. 242, 79 S.Ct. 245, 247, 3 L.Ed.2d 270, 274.)

West's Key Number Digest, Monopolies k.12(6)

SUPPLEMENT: [This section is current through the latest supplement]

(2) *Football*: See 34 *Southwestern U. L. Rev.* 133 [antitrust aspects of National Football League's cross-ownership ban].



23 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
E. Restraint of Trade and Other Illegal Trade Practices.
1. Federal Law.
c. Exempt Activities.
1. Regulated Businesses.

1 Witkin Sum. Cal. Law Contracts § 557

[§ 557] Regulated Businesses.

Certain industries regulated by governmental agencies, such as the Interstate Commerce Commission, Federal Communications Commission, and Civil Aeronautics Board, are given a measure of exemption from federal antitrust statutes. (See *California v. Federal Power Com.* (1962) 369 U.S. 482, 82 S.Ct. 901, 903, 8 L.Ed.2d 54, 57; *Pan Amer. World Airways v. United States* (1963) 371 U.S. 296, 83 S.Ct. 476, 482, 9 L.Ed.2d 325, 335; *Hughes Tool Co. v. Trans World Airlines* (1973) 409 U.S. 363, 93 S.Ct. 647, 659, 660, 34 L.Ed.2d 577, 592, 593 [following *Pan American*]; *United States v. Citizens & Southern Nat. Bank* (1975) 422 U.S. 86, 95 S.Ct. 2099, 2104, 45 L.Ed.2d 41, 47 [banks]; cf. *Ricci v. Chicago Mercantile Exchange* (1973) 409 U.S. 289, 93 S.Ct. 573, 580, 34 L.Ed.2d 525, 535 [antitrust action stayed pending agency action on issue of exemption under Commodity Exchange Act]; *Otter Tail Power Co. v. United States* (1973) 410 U.S. 366, 93 S.Ct. 1022, 1028, 35 L.Ed.2d 359, 366 [refusal to wholesale power to municipalities not exempt under Federal Power Act]; *Federal Maritime Com. v. Seatrain Line* (1973) 411 U.S. 726, 93 S.Ct. 1773, 1780, 36 L.Ed.2d 620, 628 [one-time agreement for total acquisition of assets of one carrier by another not exempt under Shipping Act of 1916]; *Gordon v. New York Stock Exchange* (1975) 422 U.S. 659, 95 S.Ct. 2598, 2606, 45 L.Ed.2d 463, 483 [fixed commission rates of brokers, authorized by Securities and Exchange Commission, valid; SEC Act worked implied repeal of Sherman Act in that respect]; *United States v. National Assn. of Sec. Dealers* (1975) 422 U.S. 694, 95 S.Ct. 2427, 2447, 2450, 45 L.Ed.2d 486, 507, 509 [fixed prices of dealers' sales of mutual funds, and restrictions on negotiability and transferability, valid under Investment Company Act and SEC regulatory scheme]; *National Gerimedical Hosp. & Gerontology Center v. Blue Cross of Kansas City* (1981) 452 U.S. 378, 101 S.Ct. 2415, 2421, 69 L.Ed.2d 89, 99 [substantial regulation does not necessarily prove intent to repeal antitrust laws with respect to all actions within the regulated industry]; 54 *Am.Jur.2d* (1996 ed.), *Monopolies, Restraints of Trade, and Unfair Trade Practices* §243 et seq.; 67 *Harv. L. Rev.* 436; 77 *Harv. L. Rev.* 163; 89 *Harv. L. Rev.* 202 [Gordon and Securities Dealers]; 9 *Loyola L.A. L. Rev.* 226 [same]; 27 *Hastings L. J.* 1207 [Antitrust Implications of Network Programming]; 28 *Hastings L. J.* 387 [criticism of Securities Dealers]; 27 *U.C.L.A. L. Rev.* 265.)

SUPPLEMENT: [This section is current through the latest supplement]

See *Credit Suisse Sec. (USA) LLC v. Billings* (2007) 551 U.S. 264, 127 S.Ct. 2383, 2389, 168 L.Ed.2d 145, 152 [securities laws implicitly precluded antitrust claims; securities laws are clearly incompatible with antitrust laws].



24 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
E. Restraint of Trade and Other Illegal Trade Practices.
1. Federal Law.
c. Exempt Activities.
2. Labor Organizations.

1 Witkin Sum. Cal. Law Contracts § 558

[§ 558] Labor Organizations.

The Clayton Act (*infra*, §569 et seq.) provides that labor organizations may not be restrained from lawfully carrying out their legitimate objects, and are not to be considered illegal combinations or conspiracies in restraint of trade. (15 U.S.C., §17.) And the Norris-La Guardia Anti-Injunction Act prohibits injunctions against certain kinds of concerted action. (29 U.S.C., §101.)

The effect of these statutes is to make ordinary concerted action by a union immune from antitrust sanctions. (See *Apex Hosiery Co. v. Leader* (1940) 310 U.S. 469, 60 S.Ct. 982, 1002, 84 L.Ed. 1311, 1328; *United States v. Hutcheson* (1941) 312 U.S. 219, 61 S.Ct. 463, 465, 85 L.Ed. 788, 790; *Hunt v. Crumboch* (1945) 325 U.S. 821, 65 S.Ct. 1545, 1547, 89 L.Ed. 1954, 1956; *United Brotherhood of Carpenters & Joiners of America v. United States* (1947) 330 U.S. 395, 67 S.Ct. 775, 779, 91 L.Ed. 973, 982 [Norris-La Guardia Act]; *Local Union No. 189, Amalgamated Meat Cutters & Butcher Workmen of North America, AFL-CIO v. Jewel Tea Co.* (1965) 381 U.S. 676, 85 S.Ct. 1596, 1601, 14 L.Ed.2d 640, 649; *American Federation of Musicians of the United States & Canada v. Carroll* (1968) 391 U.S. 99, 88 S.Ct. 1562, 1567, 20 L.Ed.2d 460, 466; *H.A. Artists & Associates v. Actors' Equity Assn.* (1981) 451 U.S. 704, 101 S.Ct. 2102, 2108, 68 L.Ed.2d 558, 666 [union's system of franchising agents held within labor exemption]; 48A *Am.Jur.2d* (1994 ed.), *Labor and Labor Relations* §895 et seq., 3701 et seq.; 80 *Cal. L. Rev.* 757 [The Antitrust Liability of Labor Unions for Anticompetitive Litigation]; 82 *Harv. L. Rev.* 275; 104 *Harv. L. Rev.* 874 [Union Consent and the Nonstatutory Labor Exemption]; 22 *Loyola L.A. L. Rev.* 151 [Labor Unions and the Sherman Act: Rethinking Labor's Nonstatutory Exemption]; 20 *U.C.L.A. L. Rev.* 983 [Private Physician Unions: Federal Antitrust and Labor Law Implications]; 27 *Hastings L. J.* 55 [same]; for a criticism of the exemption, see 13 *Pacific L. J.* 29 [Monopoly Union Power, Wage, Competition, and the Labor Antitrust Exemption: "Which Side Are You On?"].)

However, if the activity goes beyond labor objectives, as where a union enters into a combination with businessmen to create a monopoly or fix prices, the Sherman Act applies. (See *Allen Bradley Co. v. Local Union No. 3, Int. Brotherhood of Electrical Workers* (1945) 325 U.S. 797, 65 S.Ct. 1533, 1539, 89 L.Ed. 1939, 1947; *Los Angeles Meat & Provision Drivers Union, Local 626 v. United States* (1962) 371 U.S. 94, 83 S.Ct. 162, 165, 9 L.Ed.2d 150, 156 [combination with businessmen enjoined]; *United Mine Workers of America v. Pennington* (1965) 381 U.S. 657, 85 S.Ct. 1585, 1589, 14 L.Ed.2d 626, 632; 55 *Cal. L. Rev.* 254; 79 *Harv. L. Rev.* 177; 3 *San Diego L. Rev.* 55.) (See also

Connell Const. Co. v. Plumbers & Steamfitters Local Union No. 100 (1975) 421 U.S. 616, 95 S.Ct. 1830, 1841, 44 L.Ed.2d 418, 433 [agreement outside context of collective-bargaining relationship and not restricted to particular jobsite not immune]; 89 Harv. L. Rev. 234 [*Connell Const. Co.*]; 5 San Fernando Valley L. Rev. 259 [*Connell Const. Co.*].)

West's Key Number Digest, Monopolies k.12(8)

SUPPLEMENT: [This section is current through the latest supplement]

Effect of statutes: See 45 Santa Clara L. Rev. 155 [application of labor exemption to National Football League's rule limiting undergraduates' entry into league]; 48 Am.Jur.2d (2005 ed.), *Labor and Labor Relations* §682 et seq.; 48B Am.Jur.2d (2005 ed.), *Labor and Labor Relations* §2742 et seq.



25 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
 Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
 X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
 E. Restraint of Trade and Other Illegal Trade Practices.
 1. Federal Law.
 c. Exempt Activities.
 3. State Action.

1 Witkin Sum. Cal. Law Contracts § 559

[§ 559] State Action.

Under the doctrine of *Parker v. Brown* (1943) 317 U.S. 341, 63 S.Ct. 307, 87 L.Ed. 315, state action is not subject to federal antitrust statutes: "We find nothing in the language of the Sherman Act or in its history which suggests that its purpose was to restrain a state or its officers or agents from activities directed by its legislature. In a dual system of government in which, under the Constitution, the states are sovereign, save only as Congress may constitutionally subtract from their authority, an unexpressed purpose to nullify a state's control over its officers and agents is not lightly to be attributed to Congress." (63 S.Ct. 313, 87 L.Ed. 326.) (See 54 Am.Jur.2d (1996 ed.), *Monopolies, Restraints of Trade, and Unfair Trade Practices* §21 et seq.; 73 Cal. L. Rev. 1829 [municipal regulatory activity]; 75 Cal. L. Rev. 227 [Antitrust and the New State Action Doctrine: A Return to Deferential Economic Federalism]; 99 Harv. L. Rev. 713; 104 Harv. L. Rev. 667 [distinction between state and private action]; 24 Hastings L. J. 287; 61 So. Cal. L. Rev. 1293 ["capture" preemption standard for antitrust law]; 61 So. Cal. L. Rev. 1343 [same]; 7 U.S.F. L. Rev. 453.)

(1) *Immunity Upheld.* (See *Parker v. Brown*, *supra* [state regulation of raisin crop]; *Hoover v. Ronwin* (1984) 466 U.S. 558, 104 S.Ct. 1989, 1994, 80 L.Ed.2d 590, 597 [grading of law exams by state committee]; *Hallie v. Eau Claire* (1985) 471 U.S. 34, 105 S.Ct. 1713, 1716, 85 L.Ed.2d 24, 28 [city's monopoly over sewage treatment]; *Southern Motor Carriers Rate Conference v. United States* (1985) 471 U.S. 48, 105 S.Ct. 1721, 1729, 85 L.Ed.2d 36, 46 [state policy permitting collective ratemaking by motor carriers]; *Fisher v. Berkeley* (1986) 475 U.S. 260, 106 S.Ct. 1045, 1049, 89 L.Ed.2d 206, 212, affirming 37 C.3d 644, 209 C.R. 682, 693 P.2d 261, 12 Summary (10th), *Real Property*, §578 [city rent control ordinance]; *Columbia v. Omni Outdoor Advertising* (1991) 499 U.S. 365, 111 S.Ct. 1344, 1351, 113 L.Ed.2d 382, 391 [no conspiracy exception to *Parker*]; *Camarillo v. Spadys Disposal Service* (1983) 144 C.A.3d 1027, 1030, 193 C.R. 22, 27 [municipal grant of monopoly for waste disposal to one company; *Lafayette* test applied (see *infra*, this section)]; 105 Harv. L. Rev. 360 [*Columbia*]; 27 U.C. Davis L. Rev. 141 [Politics, Corruption, and the Sherman Act After *City of Columbia's* Blighted View].)

(2) *Immunity Denied.* (See *Cantor v. Detroit Edison Co.* (1976) 428 U.S. 579, 96 S.Ct. 3110, 3117, 49 L.Ed.2d 1141, 1150 [regulated utility not immune for tying sale of electricity and light bulbs pursuant to state approved tariff]; *Lafayette v. Louisiana Power & Light Co.* (1978) 435 U.S. 389, 98 S.Ct. 1123, 1127, 55 L.Ed.2d 364, 366 [municipalities not immune when actions were not directed or authorized by state as part of regulatory policy];

Community Communications Co. v. Boulder (1982) 455 U.S. 40, 102 S.Ct. 835, 837, 70 L.Ed.2d 810, 813 [city ordinance regulating cable television not entitled to state action immunity]; *Patrick v. Burget* (1988) 486 U.S. 94, 108 S.Ct. 1658, 1665, 100 L.Ed.2d 83, 95 [physicians not immune for activities on peer-review committee established under state law, but not subject to active state supervision]; *Federal Trade Com. v. Ticor Title Ins. Co.* (1992) 504 U.S. 621, 112 S.Ct. 2169, 2180, 119 L.Ed.2d 410, 426 [fact that fees for title searches were fixed by state-licensed bureau did not render member companies immune from antitrust liability]; 14 Cal. Western L. Rev. 325 [same; effect on airport car rental concessions]; 90 Harv. L. Rev. 229 [Cantor]; 29 Hastings L. J. 211 [same]; 92 Harv. L. Rev. 277 [Lafayette]; 95 Harv. L. Rev. 435 [immunity for state action after Lafayette]; 96 Harv. L. Rev. 268 [Boulder]; 33 Hastings L. J. 337, 342 [same]; 25 Santa Clara L. Rev. 129 [same]; 22 Santa Clara L. Rev. 901 [Lafayette and Boulder].)

West's Key Number Digest, Monopolies k.12(1.5)

SUPPLEMENT: [This section is current through the latest supplement]



26 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

E. Restraint of Trade and Other Illegal Trade Practices.

1. Federal Law.

c. Exempt Activities.

4. Other Activities.

aa. Agricultural Cooperatives.

1 Witkin Sum. Cal. Law Contracts § 560

[§ 560] Agricultural Cooperatives.

Agricultural organizations instituted for mutual help are exempt. (See *Sunkist Growers v. Winckler & Smith Citrus Products Co.* (1962) 370 U.S. 19, 82 S.Ct. 1130, 1135, 8 L.Ed.2d 305, 311; *Case-Swayne Co. v. Sunkist Growers* (1967) 389 U.S. 384, 88 S.Ct. 528, 532, 19 L.Ed.2d 621, 623; *National Broiler Marketing Assn. v. United States* (1978) 436 U.S. 816, 98 S.Ct. 2122, 2127, 56 L.Ed.2d 728, 735; 54 Am.Jur.2d (1996 ed.), *Monopolies, Restraints of Trade, and Unfair Trade Practices* §246 et seq.; 19 *Hastings L. J.* 331; 11 *U.C. Davis L. Rev.* 537.) However, they do not have a right to engage in predatory activity. (*Maryland & Virginia Milk Producers Assn. v. United States* (1960) 362 U.S. 458, 80 S.Ct. 847, 853, 4 L.Ed.2d 880, 888.)

SUPPLEMENT: [This section is current through the latest supplement]



27 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

E. Restraint of Trade and Other Illegal Trade Practices.

1. Federal Law.
- c. Exempt Activities.
4. Other Activities.
- bb. Insurance.

1 Witkin Sum. Cal. Law Contracts § 561

[§ 561] Insurance.

The McCarran Act (15 U.S.C., §1011 et seq.), nullifying the holding in *United States v. South-Eastern Underwriters Assn.* (1944) 322 U.S. 533, 64 S.Ct. 1162, 88 L.Ed.2d 1440, exempted the "business of insurance." (See 54 Am.Jur.2d (1996 ed.), *Monopolies, Restraints of Trade, and Unfair Trade Practices* §274 et seq.; 17 Pacific L. J. [what constitutes "business of insurance"]; on nature and purpose of McCarran-Ferguson Act, see *American Int. Group v. Superior Court* (1991) 234 C.A.3d 749, 756, 285 C.R. 765; *Smith v. Pacificare Behavioral Health of Calif.* (2001) 93 C.A.4th 139, 152, 113 C.R.2d 140, 6 Cal. Proc. (4th), *Proceedings Without Trial*, Supp., §488.) However, *agreements* of insurers are not exempt. (*Group Life & Health Ins. Co. v. Royal Drug Co.* (1979) 440 U.S. 205, 99 S.Ct. 1067, 1075, 59 L.Ed.2d 261, 270; *Union Labor Life Ins. Co. v. Pireno* (1982) 458 U.S. 119, 102 S.Ct. 3002, 3006, 73 L.Ed.2d 647, 653 [peer review committee that advised insurance company on whether treatments were necessary and reasonable, not exempt; following *Royal Drug*]; *Hartford Fire Ins. Co. v. California* (1993) 509 U.S. 764, 113 S.Ct. 2891, 125 L.Ed.2d 612; *Humana v. Forsyth* (1999) 525 U.S. 299, 119 S.Ct. 710, 714, 142 L.Ed.2d 753, 758 [McCarran-Ferguson Act did not preclude application of Racketeer Influenced and Corrupt Organizations Act (RICO) (18 U.S.C., §1961 et seq.) in action for insurance fraud, where RICO could be applied in harmony with state regulations]; see 7 *Pepperdine L. Rev.* 763; 56 *So. Cal. L. Rev.* 913 [*Union Labor Life*].) (On the "boycott" exception in the McCarran Act, providing that the Sherman Act remains applicable to any agreement to boycott, coerce, or intimidate, see *St. Paul Fire & Marine Ins. Co. v. Barry* (1978) 438 U.S. 531, 98 S.Ct. 2923, 2737, 57 L.Ed.2d 932, 938; 105 *Harv. L. Rev.* 1414.)

SUPPLEMENT: [This section is current through the latest supplement]
Smith case:

Cross-Reference: 6 Cal. Proc. (5th), *Proceedings Without Trial*, §509.



28 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

E. Restraint of Trade and Other Illegal Trade Practices.

1. Federal Law.

c. Exempt Activities.

4. Other Activities.

cc. Attempts To Influence Government Action.

1 Witkin Sum. Cal. Law Contracts § 562

[§ 562] Attempts To Influence Government Action.

The *Noerr-Pennington* doctrine was announced in *Eastern Railroad Presidents Conference v. Noerr Motor Freight* (1961) 365 U.S. 127, 81 S.Ct. 523, 528, 5 L.Ed.2d 464, 470, holding that efforts to influence legislation do not violate the Sherman Act. (See *California Motor Transport Co. v. Trucking Unlimited* (1972) 404 U.S. 508, 92 S.Ct. 609, 612, 30 L.Ed.2d 642, 646 ["sham" exception to *Noerr*; complaint alleged conspiracy to bar competitors from meaningful access to adjudicatory tribunals; cause of action stated]; *Otter Tail Power Co. v. United States* (1973) 410 U.S. 366, 93 S.Ct. 1022, 1029, 1031, 35 L.Ed.2d 359, 366 [refusal to sell power at wholesale rates to municipalities violated Act; issue of sham litigation remanded in light of *California Motor Transport*]; *Allied Tube & Conduit Corp. v. Indian Head* (1988) 486 U.S. 492, 108 S.Ct. 1931, 1942, 100 L.Ed.2d 497, 511 [*Noerr* doctrine not applicable to steel conduit's action to influence provisions of private electric code promulgated by fire protection association and routinely adopted into law]; *Columbia v. Omni Outdoor Advertising* (1991) 499 U.S. 365, 111 S.Ct. 1344, 1355, 113 L.Ed.2d 382, 400 [no conspiracy exception to immunity for attempts to influence government action under *Noerr*]; *Professional Real Estate Investors v. Columbia Pictures Industries* (1993) 508 U.S. 49, 113 S.Ct. 1920, 1929, 123 L.Ed.2d 611, 622 ["sham" exception]; *BE & K Const. Co. v. N.L.R.B.* (2002) 536 U.S. 516, 122 S.Ct. 2390, 2392, 153 L.Ed.2d 499, 513 ["[b]ecause of its objective component, *Professional Real Estate Investors*' sham litigation standard protects reasonably based petitioning from antitrust liability; because of its subjective component, it also protects petitioning that is unmotivated by anticompetitive intent, whether it is reasonably based or not"]; *Blank v. Kirwan* (1985) 39 C.3d 311, 320, 321, 322, 216 C.R. 718, 703 P.2d 58; *Hi-Top Steel Corp. v. Lehrer* (1994) 24 C.A.4th 570, 574, 29 C.R.2d 646 [holding exception applicable]; 61 Cal. L. Rev. 1254 [corporate lobbyists abroad]; 80 Cal. L. Rev. 1177 [Making Sense of Antitrust Petitioning Immunity]; 75 Harv. L. Rev. 199; 81 Harv. L. Rev. 847 [application of Act to attempts to influence government action]; 87 Harv. L. Rev. 1720 [*Otter Tail Power*]; 22 Hastings L. J. 1016 [exception: conspiracy to utilize judicial and administrative agencies as restraint of trade]; 41 Hastings L. J. 905 [Interest Groups, Political Freedom, and Antitrust: A Modern Reassessment of the *Noerr-Pennington* Doctrine]; 11 Hastings Const. L. Q. 329 ["sham" activity exception to *Noerr-Pennington* doctrine]; 14 U.C.L.A. L. Rev. 1211 [*Noerr*]; 39 U.C.L.A. L. Rev. 979 [Slapp Suits: Weaknesses in First Amendment Law and in the Courts' Responses to Frivolous Litigation]; 17 U.C. Davis L. Rev. 549 [detailed critical analysis of the doctrine]; 16 U.S.F. L. Rev. 41 [Litigation as an Antitrust Violation];

28 U.S.F. L. Rev. 681 [foundation of *Noerr-Pennington* and burden of proving sham petitioning; argument for "clear and convincing" standard]; 94 A.L.R.5th 455 [application of *Noerr-Pennington* doctrine by state courts]; 193 A.L.R. Fed 139 ["sham" exception to *Noerr-Pennington* doctrine].)

SUPPLEMENT: [This section is current through the latest supplement]

See *Premier Med. Management Systems v. California Ins. Guarantee Assn.* (2006) 136 C.A.4th 464, 479, 39 C.R.3d 43 [Noerr-Pennington defense applied to defendant's petitioning Workers' Compensation Appeals Board].



29 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
E. Restraint of Trade and Other Illegal Trade Practices.
1. Federal Law.
d. Sherman Antitrust Act.
1. The Statute.

1 Witkin Sum. Cal. Law Contracts § 563

[§ 563] The Statute.

The Sherman Antitrust Act of 1890 (15 U.S.C., §1) is the basic statute, expressing the common law policy in extremely general terms.

Section 1 states that "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is hereby declared to be illegal."

Section 2 states that "Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony."

Section 33 makes the statutory prohibitions applicable to the District of Columbia and other federal territories, and Sections 1 and 2 make it applicable to *foreign commerce*. (On activities in foreign commerce, see *Timken Roller Bearing Co. v. United States* (1951) 341 U.S. 593, 71 S.Ct. 971, 975, 95 L.Ed. 1199, 1207; 54 Am.Jur.2d (1996 ed.), *Monopolies, Restraints of Trade, and Unfair Trade Practices* §17 et seq.; 41 Cal. L. Rev. 439; 72 Harv. L. Rev. 1588; 10 Loyola L.A. L. Rev. 677; 4 Stanf. L. Rev. 559; on USPS as not "person," separate from United States, who may be sued under Sherman Act, see *U.S. Postal Service v. Flamingo Industries (USA) Ltd.* (2004) 540 U.S. 736, 124 S.Ct. 1321, 1324, 158 L.Ed.2d 19, 25.)

The act has been the subject of extensive and continual comment in texts and law reviews. (See generally 54 Am.Jur.2d (1996 ed.), *Monopolies, Restraints of Trade, and Unfair Trade Practices* (1996 ed.) §1 et seq.; C.E.B., Sales and Mergers of California Businesses, §5.5 et seq.; 43 Cal. L. Rev. 596; 74 Cal. L. Rev. 263 [Farewell to the Sea of Doubt: Jettisoning the Constitutional Sherman Act]; 63 Harv. L. Rev. 50; 67 Harv. L. Rev. 29; 70 Harv. L. Rev. 280; 84 Harv. L. Rev. 1912 [applicability of antitrust laws to educational accrediting associations]; 95 Harv. L. Rev. 661 [Conspiring Entities Under Section 1]; 104 Harv. L. Rev. 548 [The Antitrust Implications of Airport Lease Restrictions]; 114 Harv. L. Rev. 1623 [Sherman Act Section 2 monopolization analysis]; 35 Hastings L. J. 115 [business judgment defense to Sherman Act conspiracy charge]; 47 Hastings L. J. 5 [The Antitrust Analysis of Network Joint Ventures]; 49 So. Cal. L. Rev. 154 [The Development of the Sherman Act Section 2 Market Share Test and Its

Inapplicability to Dynamic Markets]; 61 *So. Cal. L. Rev.* 1219 [The Sherman Act and the Balance of Power]; 10 *Southwestern L. Rev.* 35 [Symposium]; 27 *Stanf. L. Rev.* 841 [Some Preliminary Notes on the American Antitrust Laws' Economic Tests of Legality]; 28 *Stanf. L. Rev.* 285 [Innovation Competition: Beyond *Telex v. IBM*]; 46 *Stanf. L. Rev.* 919 [College Financial Aid and Antitrust: Applying the Sherman Act to Collaborative Nonprofit Activity]; 23 *U.C.L.A. L. Rev.* 737 [*Telex v. IBM*: Remodeling the Crisis in Antitrust]; 27 *U.C.L.A. L. Rev.* 265 [Recent Antitrust Developments: Defining the Scope of Exemptions, Expanding Coverage, and Refining the Rule of Reason]; 4 *U.S.F. L. Rev.* 217 [applicability of antitrust laws to public bodies]; 38 *U.S.F. L. Rev.* 431 [Supreme Court review of Sherman Act foreign trade exemption]; on intraenterprise or "bathtub" conspiracies, see 71 *Cal. L. Rev.* 1732; 97 *Harv. L. Rev.* 451; 18 *Loyola L.A. L. Rev.* 857; 9 *San Diego L. Rev.* 869.)

West's Key Number Digest, Monopolies k.10-

SUPPLEMENT: [This section is current through the latest supplement]

See *Bell Atlantic Corp. v. Twombly* (2007) 550 U.S. 544, 127 S.Ct. 1955, 1965, 167 L.Ed.2d 929, 940 [action alleging combination in restraint of trade must show facts suggesting agreement, as opposed to identical independent action]. *Foreign commerce:* Under the Foreign Trade Antitrust Improvements Act of 1982 (15 U.S.C., §6a), the Sherman Act "shall not apply to conduct involving trade or commerce (other than import trade or import commerce) with foreign nations" except where both of the following apply:

(1) The conduct "has a direct, substantial, and reasonably foreseeable effect" on "trade or commerce which is not trade or commerce with foreign nations," on "import trade or import commerce with foreign nations," or on "export trade or export commerce with foreign nations," and that trade or commerce is of "a person engaged in such trade or commerce in the United States." (15 U.S.C., §6a(1).)

(2) That effect gives rise to a Sherman Act claim. (15 U.S.C., §6a(2).)

See 1 *A.L.R. Fed* 2d 483 [construction and application of Foreign Trade Antitrust Improvements Act].

Commentary: See 35 *Southwestern U. L. Rev.* 207 [bundled rebates and exclusive dealing contracts under Sherman Act]; 52 *U.C.L.A. L. Rev.* 365 [targeting of particular competitors as test of predatory conduct under Sherman Act].



30 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
E. Restraint of Trade and Other Illegal Trade Practices.

1. Federal Law.

d. Sherman Antitrust Act.

2. Monopolies and Rule of Reason.

1 Witkin Sum. Cal. Law Contracts § 564

[§ 564] Monopolies and Rule of Reason.

In *Standard Oil of New Jersey Co. v. United States* (1911) 221 U.S. 1, 31 S.Ct. 502, 515, 55 L.Ed. 619, 645, the court declared the "rule of reason" in the interpretation of the Sherman Act. This was, briefly, that not every act or combination restraining trade is illegal, but only those that have an undue or unreasonable tendency toward monopoly or its attendant evils. The doctrine was developed and applied in subsequent decisions, although its fundamental uncertainty makes prediction extremely difficult. (See 54 Am.Jur.2d (1996 ed.), *Monopolies, Restraints of Trade, and Unfair Trade Practices* §§48, 49.)

In *United States v. E.I. Du Pont de Nemours Co.* (1956) 351 U.S. 377, 76 S.Ct. 994, 100 L.Ed. 1264, the court, affirming a district court holding of no monopoly where the product (cellophane) was interchangeable with other competitive materials, made this observation concerning the rule of reason: "While it is fair to say that the Rule is imprecise, its application in Sherman Act litigation, as directed against enhancement of price or throttling of competition, has given a workable content to antitrust legislation. ... This Court has not receded from its position on the Rule. There is not, we think, any inconsistency between it and the development of the judicial theory that agreements as to maintenance of prices or division of territory are in themselves a violation of the Sherman Act. It is logical that some agreements and practices are invalid *per se*, while others are illegal only as applied to particular situations." (76 S.Ct. 1002, 100 L.Ed. 1276.) (On the doctrine of *per se* illegality, see *infra*, §565 et seq.)

In *Continental T.V. v. GTE Sylvania* (1977) 433 U.S. 36, 97 S.Ct. 2549, 2562, 53 L.Ed.2d 568, 584, *infra*, §567, the court overruled *United States v. Arnold, Schwinn & Co.* (1967) 388 U.S. 365, 87 S.Ct. 1856, 18 L.Ed.2d 1249, *infra*, §567, which had adopted a *per se* rule for vertical restriction agreements, and restored application of the rule of reason to these agreements, in conformity with *White Motor Co. v. United States* (1963) 372 U.S. 253, 83 S.Ct. 696, 9 L.Ed.2d 738, and *Northern Pac. Ry. Co. v. United States* (1958) 356 U.S. 1, 78 S.Ct. 514, 2 L.Ed.2d 545.) (See *National Collegiate Athletic Assn. v. Board of Regents of University of Oklahoma* (1984) 468 U.S. 85, 104 S.Ct. 2948, 2962, 82 L.Ed.2d 70, 83 [rule of reason held applicable to N.C.A.A.'s exclusive football telecasting plan]; *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.* (1985) 472 U.S. 585, 105 S.Ct. 2847, 2860, 86 L.Ed.2d 467, 484 [no business reason established to justify ski resort operator's termination of marketing arrangement with smaller competitor]; 14 Cal. Western L. Rev. 632; 91 Harv. L. Rev. 231; 98 Harv. L. Rev. 255 [N.C.A.A.]; 99 Harv. L. Rev. 275 [Aspen Skiing Co.];

38 *Hastings L. J.* 471 ["What, Never? Well, Hardly Ever": Strict Antitrust Scrutiny as an Alternative to Per Se Antitrust Illegality]; 40 *Hastings L. J.* 285 [The "Rule of Reason" in Antitrust Law: Property Logic in Restraint of Competition]; 19 *Loyola L.A. L. Rev.* 437 [same]; 17 *San Diego L. Rev.* 335; 37 *San Diego L. Rev.* 1 [The Market Power Requirement in Antitrust Rule of Reason Cases: A Rhetorical History]; 55 *So. Cal. L. Rev.* 441 [how to assess reasonableness under new standard]; 64 *So. Cal. L. Rev.* 685 [Reconciling the Per Se and Rule of Reason Approaches to Antitrust Analysis]; 30 *U.C.L.A. L. Rev.* 1 [Intrabrand "Cartels" Under *GTE Sylvania*].)

"In determining what constitutes unreasonable restraint, we do not think the dollar volume is in itself of compelling significance; we look rather to the percentage of business controlled, the strength of the remaining competition, whether the action springs from business requirements or purpose to monopolize, the probable development of the industry, consumer demands, and other characteristics of the market." (*United States v. Columbia Steel Co. (1948)* 334 U.S. 495, 68 S.Ct. 1107, 1124, 92 L.Ed. 1533, 1554; see *United States v. Yellow Cab Co. (1947)* 332 U.S. 218, 67 S.Ct. 1560, 1564, 91 L.Ed. 2010, 2017 ["it is enough if some appreciable part of interstate commerce is the subject of a monopoly, a restraint or a conspiracy"]); *Lorain Journal Co. v. United States (1951)* 342 U.S. 143, 72 S.Ct. 181, 185, 96 L.Ed 162, 170; *United States v. First Nat. Bank & Trust Co. of Lexington (1964)* 376 U.S. 665, 84 S.Ct. 1033, 1034, 12 L.Ed.2d 1, 5; *United States v. Grinnell Corp. (1966)* 384 U.S. 563, 86 S.Ct. 1698, 1704, 16 L.Ed.2d 778, 786 ["Relevant Market"].)

West's Key Number Digest, Monopolies k.12(1.10)

SUPPLEMENT: [This section is current through the latest supplement]

See 57 *Hastings L. J.* 235 [Antitrust Implications of Casino Mergers: The Gamble of Defining a Relevant Market]; 40 *U.S.F. L. Rev.* 381 [market definition analysis and merger of Spanish-language radio enterprises].



31 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

E. Restraint of Trade and Other Illegal Trade Practices.

1. Federal Law.

d. Sherman Antitrust Act.

3. Price Fixing and Control.

1 Witkin Sum. Cal. Law Contracts § 565

[§ 565] Price Fixing and Control.

Price fixing is said to be illegal *per se*; hence agreements or practices designed to fix prices are illegal regardless of reasonableness of the price, where the parties control a trade or business in a substantial manner. "Price-fixing is *per se* an unreasonable restraint of trade. It is not for the courts to determine whether in particular settings price-fixing serves an honorable or worthy end. An agreement, shown either by adherence to a price schedule or by proof of consensual action fixing the uniform or minimum price, is itself illegal under the Sherman Act, no matter what end it was designed to serve. That is the teaching of an unbroken line of decisions." (*United States v. National Assn. of Real Estate Bds.* (1950) 339 U.S. 485, 70 S.Ct. 711, 714, 94 L.Ed. 1007, 1012.) (See *Sugar Institute v. United States* (1936) 297 U.S. 553, 56 S.Ct. 629, 634, 80 L.Ed. 859, 877; *United States v. Socony-Vacuum Oil Co.* (1940) 310 U.S. 150, 60 S.Ct. 811, 839, 84 L.Ed. 1129, 1162; *United States v. Bausch & Lomb Optical Co.* (1944) 321 U.S. 707, 64 S.Ct. 805, 812, 88 L.Ed. 1024, 1033; *United States v. Paramount Pictures* (1948) 334 U.S. 131, 68 S.Ct. 915, 922, 92 L.Ed. 1260, 1285; *United States v. Parke, Davis & Co.* (1960) 362 U.S. 29, 80 S.Ct. 503, 511, 4 L.Ed.2d 505, 515; *Simpson v. Union Oil Co. of Calif.* (1964) 377 U.S. 13, 84 S.Ct. 1051, 1054, 12 L.Ed.2d 98, 102; *United States v. Sealy* (1967) 388 U.S. 350, 87 S.Ct. 1847, 1851, 18 L.Ed.2d 1238, 1243; *United States v. Container Corp. of America* (1969) 393 U.S. 333, 89 S.Ct. 510, 512, 21 L.Ed.2d 526, 530; *Citizen Publishing Co. v. United States* (1969) 394 U.S. 131, 89 S.Ct. 927, 929, 22 L.Ed.2d 148, 154; *Goldfarb v. Virginia State Bar* (1975) 421 U.S. 773, 95 S.Ct. 2004, 44 L.Ed.2d 572 [bar association minimum fee schedules, applied to legal services for title examination in real estate purchases, held violative of the Sherman Act]; *National Soc. of Professional Engineers v. United States* (1978) 435 U.S. 679, 98 S.Ct. 1355, 1361, 55 L.Ed.2d 637, 639 [engineering association's canon of ethics prohibiting competitive bidding violates Sherman Act]; *Arizona v. Maricopa County Med. Soc.* (1982) 457 U.S. 332, 102 S.Ct. 2466, 2453, 73 L.Ed.2d 48, 57 [action of physician members of foundation for medical care in setting, by majority vote, maximum fees for health services provided under insurance plans]; *Monsanto Co. v. Spray-Rite Service Corp.* (1984) 465 U.S. 752, 104 S.Ct. 1464, 1472, 79 L.Ed.2d 775, 788 [termination of distributor's contract with manufacturer held part of conspiracy between manufacturer and other distributors to fix resale prices].) However, the *per se* rule has been held not to apply to "vertical maximum price fixing." (*State Oil Co. v. Khan* (1997) 522 U.S. 3, 118 S.Ct. 275, 283, 139 L.Ed.2d 199, 212, overruling *Albrecht v. Herald Co.* (1968) 390 U.S. 145, 88 S.Ct. 869, 872, 19 L.Ed.2d 998, 1003; see 112 Harv. L. Rev. 293 [*Khan*].)

A manufacturer may fix the minimum price at which a product may be resold by a retail dealer. (*Chavez v. Whirlpool Corp.* (2001) 93 C.A.4th 363, 369, 113 C.R.2d 175, 13 Summary (10th), *Equity*, §123 [provided there is no coercion, manufacturer can announce its resale price in advance, and distributor is free to comply with manufacturer's demand in order to avoid refusal to deal].)

Commentators have explored various aspects of the per se rule. (See 54 *Am.Jur.2d* (1996 ed.), *Monopolies, Restraints of Trade, and Unfair Trade Practices* §50, 70 et seq.; 57 *Cal. L. Rev.* 182; 80 *Cal. L. Rev.* 815 [Spiff, Polish, and Consumer Demand Quality: Vertical Price Restraints Revisited]; 88 *Harv. L. Rev.* 597 [Predatory Pricing and Related Practices Under Section 2 of the Sherman Act]; 98 *Harv. L. Rev.* 983 [Vertical Price-Fixing, Vertical Market Restrictions, and the New Antitrust Policy]; 18 *U.S.F. L. Rev.* 559 [same]; 28 *Pacific L. J.* 311 [Private Enforcement of Predatory Price Laws Under the California Unlawful Practices Act and the Federal Antitrust Acts]; 68 *So. Cal. L. Rev.* 73 [Relaxation of the Per Se Mantra in the Vertical Price Fixing Arena]; 15 *Stanf. L. Rev.* 638; 16 *Stanf. L. Rev.* 1080 [cooperative advertising]; 26 *Stanf. L. Rev.* 493 [Oligopolistic Pricing Suits, the Sherman Act, and Economic Welfare], 717 [same]; 27 *Stanf. L. Rev.* 307 [same]; 28 *Stanf. L. Rev.* 45 [same]; 40 *Stanf. L. Rev.* 561 [Price Fixing and Civil Damages: An Economic Analysis]; 47 *Stanf. L. Rev.* 615 [proposed alternative system for antitrust classification of agreements]; 53 *Stanf. L. Rev.* 1581 [role of recoupment in predatory pricing analysis]; 7 *U.C. Davis L. Rev.* 218 [Antitrust Implications in Prescription Drug Promotion]; 31 *U.C.L.A. L. Rev.* 384 [distinction between price and nonprice distribution restrictions]; 34 *U.C.L.A. L. Rev.* 1305 [Price Manipulation in the Commodity Futures Markets: A Reexamination of the Justifications for Simultaneous Causes of Action Under the CEA and the Sherman Act]; 45 *U.C.L.A. L. Rev.* 143 [Price Theory and Vertical Restraints: A Misunderstood Relation]; 22 *Western State L. Rev.* 75 [blanket licenses for permission to use copyrighted musical works as price-fixing under Sherman Act].)

SUPPLEMENT: [This section is current through the latest supplement]

Cf. *Texaco v. Dagher* (2006) 547 U.S. 1, 126 S.Ct. 1276, 1279, 164 L.Ed.2d 1, 7 [decision by two oil companies' production and marketing joint venture to sell separately branded gasoline to service station owners at same price was not per se illegal horizontal price fixing, as companies were not competing in relevant market; rather, decision amounted to no more than price setting by single entity]; *Leegin Creative Leather Products v. PKSK* (2007) 551 U.S. 877, 127 S.Ct. 2705, 2714, 168 L.Ed.2d 623, 636 [application of per se rule is unwarranted as to vertical agreements to fix minimum resale prices, because it cannot be stated with confidence that these agreements always or almost always tend to restrict competition and decrease output]; 121 *Harv. L. Rev.* 1600 [*Leegin*: Internet and resale price maintenance].



32 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
E. Restraint of Trade and Other Illegal Trade Practices.
1. Federal Law.
d. Sherman Antitrust Act.
4. Boycott.

1 Witkin Sum. Cal. Law Contracts § 566

[§ 566] Boycott.

A group boycott is a concerted refusal by businessmen to deal with another businessman. It is generally considered illegal per se. (See *Klor's v. Broadway-Hale Stores* (1959) 359 U.S. 207, 79 S.Ct. 705, 708, 3 L.Ed.2d 741, 744; *United States v. General Motors Corp.* (1966) 384 U.S. 127, 86 S.Ct. 1321, 1330, 16 L.Ed.2d 415, 426; 54 Am.Jur.2d (1996 ed.), *Monopolies, Restraints of Trade, and Unfair Trade Practices* §117 et seq.; 47 Cal. L. Rev. 383 [Klor's]; 71 Harv. L. Rev. 1531; 87 Harv. L. Rev. 1720 [Refusals To Deal by Vertically Integrated Monopolists]; 92 Harv. L. Rev. 1440 [Arab boycott]; 19 Hastings L. J. 505 [boycotts by trade associations]; 13 Loyola L.A. L. Rev. 85 [politically motivated boycotts]; 4 San Diego L. Rev. 1; 10 San Diego L. Rev. 412 [concerted refusals to deal in professional sports]; 55 So. Cal. L. Rev. 1 [application of Sherman Act antiboycott law to industry self-regulation]; 55 So. Cal. L. Rev. 983 [Political Boycotts, the Sherman Act, and the First Amendment]; 15 Stanf. L. Rev. 638; 28 U.C. Davis L. Rev. 1273 [Political Boycotts: Protected by the Political Action Exception to Antitrust Liability or Illegal Per Se?]; 18 U.S.F. L. Rev. 577 [numerosity requirement for group boycotts].)

In *Klor's v. Broadway-Hale Stores*, *supra*, the court reaffirmed the doctrine that a group boycott is illegal per se, despite its relatively minor effect on the consuming public. Defendant department store chain, with a San Francisco unit on the same block as plaintiff's retail store, contracted with a number of manufacturers and distributors of appliances to handle their goods only if they refused to sell to plaintiff or sold to him only on unfavorable terms. The defense, upheld by the lower federal courts, was that there were many other dealers close by selling the same or competing goods, and that the boycott against plaintiff caused no public injury. (See 73 Harv. L. Rev. 200; 75 Harv. L. Rev. 1233; 11 Stanf. L. Rev. 338) But the Supreme Court said:

"This is not a case of a single trader refusing to deal with another, nor even of a manufacturer and a dealer agreeing to an exclusive distributorship. ... This combination takes from Klor's its freedom to buy appliances in an open competitive market and drives it out of business as a dealer in the defendants' products. It deprives the manufacturers and distributors of their freedom to sell to Klor's at the same prices and conditions made available to Broadway-Hale and in some instances forbids them from selling to it on any terms whatsoever. ... It clearly has, by its 'nature' and 'character,' a 'monopolistic tendency.' As such it is not to be tolerated merely because the victim is just one merchant whose business is so small that his destruction makes little difference to the economy. Monopoly can as surely thrive by

the elimination of such small businessmen, one at a time, as it can by driving them out in large groups." (79 S.Ct. 710, 3 L.Ed.2d 745.)

A similar result was reached in *Federal Trade Com. v. Superior Court Trial Lawyers Assn.* (1990) 493 U.S. 411, 110 S.Ct. 768, 107 L.Ed.2d 851, where a group of about 100 experienced trial lawyers refused to represent indigent defendants in criminal cases unless their fee for doing so was raised to a specified level. In rejecting a contention that the lawyers' boycott was harmless, the court said: "[A]n assumption that, absent proof of market power, the boycott disclosed by this record was totally harmless ... is flatly inconsistent with the clear course of our antitrust jurisprudence. Conspirators need not achieve the dimensions of a monopoly, or even a degree of market power any greater than that already disclosed by this record, to warrant condemnation under the antitrust laws." (110 S.Ct. 782, 107 L.Ed.2d 874.)

An agreement by a buyer to purchase goods or services from one supplier rather than another is not subject to the rule that group boycotts are illegal per se, even if there is no legitimate business reason for the purchasing decision, in the absence of proof of harm not just to a single competitor but to the competitive process. The per se rule in the boycott context is limited to cases involving horizontal agreements among direct competitors. (*NYNEX Corp. v. Discon* (1998) 525 U.S. 128, 119 S.Ct. 493, 498, 142 L.Ed.2d 510, 517.)

West's Key Number Digest, Monopolies k.12(9)

SUPPLEMENT: [This section is current through the latest supplement]



33 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
E. Restraint of Trade and Other Illegal Trade Practices.
1. Federal Law.
d. Sherman Antitrust Act.
5. Other Prohibited Acts.

1 Witkin Sum. Cal. Law Contracts § 567

[§ 567] Other Prohibited Acts.

(1) *Agreement To Divide Territory: Horizontal Limitations.* (See *Timken Roller Bearing Co. v. United States* (1951) 341 U.S. 593, 71 S.Ct. 971, 973, 95 L.Ed. 1199, 1206; *United States v. Topco Associates* (1972) 405 U.S. 596, 92 S.Ct. 1126, 1134, 31 L.Ed.2d 515, 526; 54 Am.Jur.2d (1996 ed.), *Monopolies, Restraints of Trade, and Unfair Trade Practices* §108 et seq.; 75 Cal L. Rev. 835 [The Viability of the Current Law on Horizontal Restraints]; 33 U.C.L.A. L. Rev. 1019 [horizontal restrictions and the per se rule].)

(2) *Territorial and Customer Restrictions: Vertical Limitations.* (See *White Motor Co. v. United States* (1963) 372 U.S. 253, 83 S.Ct. 696, 700, 9 L.Ed.2d 738, 745; *United States v. Arnold, Schwinn & Co.* (1967) 388 U.S. 365, 87 S.Ct. 1856, 1862, 18 L.Ed.2d 1249, 1256; 54 Am.Jur.2d (1996 ed.), *Monopolies, Restraints of Trade, and Unfair Trade Practices* §§111, 112; 51 Cal. L. Rev. 608 [White Motor Co.]; 81 Harv. L. Rev. 1419 [same]; 56 Cal. L. Rev. 198 [Schwinn]; 75 Cal. L. Rev. 933 [The Viability of Vertical Restraints Doctrine]; 40 Hastings L. J. 511 [A Genealogy of Vertical Restraints Doctrine]; 50 Hastings L. J. 573 [Procompetitive Theories of Vertical Control]; 21 Loyola L.A. L. Rev. 1273 [Dual Distribution and Antitrust Law]; 61 So. Cal. L. Rev. 215 [Vertical Territorial Restrictions as Patent Misuse].)

In *Continental T.V. v. GTE Sylvania* (1977) 433 U.S. 36, 97 S.Ct. 2549, 53 L.Ed.2d 568, the rule of reason test (supra, §564) was applied in an action challenging a distribution agreement limiting retail sales to a particular location, and *Schwinn* was overruled. (a) Although *Schwinn* had involved an agreement with a retail customer restriction rather than a location restriction, the economic intent and competitive effect of the two types are indistinguishable. (97 S.Ct. 2556, 53 L.Ed.2d 578.) (b) The reasons for *Schwinn's* adoption of a per se rule were poorly explained, and the decision has received little support from commentators in the intervening years. (97 S.Ct. 2556, 2557, 53 L.Ed.2d 579.) (c) In fact, the economic effect of vertical restrictions is complex, because they reduce intraproduct competition, but increase interproduct competition. (97 S.Ct. 2560, 53 L.Ed.2d 581.) Hence, "[w]hen anticompetitive effects are shown to result from particular vertical restrictions they can be adequately policed under the rule of reason, the standard traditionally applied for the majority of anticompetitive practices challenged under §1 of the [Sherman] Act." (97 S.Ct. 2562, 53 L.Ed.2d 585, 586.) (See *Business Electronics Corp. v. Sharp Electronics Corp.* (1988) 485 U.S. 717, 108 S.Ct. 1515, 1521, 99 L.Ed.2d 808, 819 [rule of reason applied to agreement between manufacturer and dealer to terminate second

dealer because of its price-cutting practices]; 68 *Cal. L. Rev.* 1, 13; 14 *Cal. Western L. Rev.* 632; 91 *Harv. L. Rev.* 231; 47 *Stanf. L. Rev.* 615; *supra*, §564.)

(3) *Abuse of Patent Rights.* The legal patent monopoly has given rise to a considerable amount of specialized litigation and decisions dealing with attempts to monopolize and price-fixing of patented products. (See *Mercoird Corp. v. Mid-Continent Inv. Co.* (1944) 320 U.S. 661, 64 S.Ct. 268, 271, 88 L.Ed. 376, 380; *Hartford Empire Co. v. United States* (1945) 323 U.S. 386, 65 S.Ct. 373, 384, 89 L.Ed. 322, 358; *Transparent-Wrap Machine Corp. v. Stokes & Smith Co.* (1947) 329 U.S. 637, 67 S.Ct. 610, 612, 91 L.Ed. 563, 567; *United States v. Line Material Co.* (1948) 333 U.S. 287, 68 S.Ct. 550, 559, 92 L.Ed. 701, 717; *United States v. United States Gypsum Co.* (1948) 333 U.S. 364, 68 S.Ct. 525, 544, 92 L.Ed. 746, 768; *United States v. New Wrinkle* (1952) 342 U.S. 371, 72 S.Ct. 350, 353, 96 L.Ed. 417, 425; *Zenith Radio Corp. v. Hazeltine Research* (1969) 395 U.S. 100, 89 S.Ct. 1562, 1583, 23 L.Ed.2d 129, 155; 54 *Am.Jur.2d* (1996 ed.), *Monopolies, Restraints of Trade, and Unfair Trade Practices* §133 et seq.; 71 *Harv. L. Rev.* 815; 97 *Harv. L. Rev.* 1815 [The Patent-Antitrust Intersection: A Reappraisal]; 11 *U.S.F. L. Rev.* 640 [Impact of United States Antitrust Laws on Territorially-Limited International Patent Licensing Agreements].)

SUPPLEMENT: [This section is current through the latest supplement]

(4) *(New) Predatory Bidding.* See *Weyerhaeuser v. Ross-Simmons Hardwood Lumber* (2007) 549 U.S. 312, 127 S.Ct. 1069, 1072, 166 L.Ed.2d 911, 916 [plaintiff in claim of predatory bidding must prove that predatory bidding led to below-cost pricing of predator's outputs, which drove competitors out of business, and that predator thus had dangerous probability of recouping losses incurred in bidding up input prices].



34 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
E. Restraint of Trade and Other Illegal Trade Practices.
1. Federal Law.
e. Federal Trade Commission Act.

1 Witkin Sum. Cal. Law Contracts § 568

[§ 568] Federal Trade Commission Act.

The Federal Trade Commission Act of 1914 as amended (15 U.S.C., §41, 45) prohibits "unfair methods of competition" and "unfair or deceptive acts or practices in commerce," irrespective of contract or combination. It also establishes the Federal Trade Commission as an expert regulatory body to supplement judicial enforcement of the antitrust laws. (See *Federal Trade Com. v. Keppel & Bros.* (1934) 291 U.S. 304, 54 S.Ct. 423, 425, 78 L.Ed. 814, 817; *Federal Trade Com. v. A.P.W. Paper Co.* (1946) 328 U.S. 193, 66 S.Ct. 932, 936, 90 L.Ed. 1165, 1171 [effect of 1938 amendment adding prohibition against "unfair or deceptive acts or practices in commerce" regardless of existence of competition]; *Federal Trade Com. v. Cement Institute* (1948) 333 U.S. 683, 68 S.Ct. 793, 800, 92 L.Ed. 1010, 1030 [cumulative remedies under Sherman Act and Federal Trade Commission Act]; *Federal Trade Com. v. Motion Picture Advertising Service Co.* (1953) 344 U.S. 392, 73 S.Ct. 361, 363, 97 L.Ed. 426, 430; *Federal Trade Com. v. Colgate-Palmolive Co.* (1965) 380 U.S. 374, 85 S.Ct. 1035, 1042, 13 L.Ed.2d 904, 914 [deceptive television "mock up"]; *Atlantic Refining Co. v. Federal Trade Com.* (1965) 381 U.S. 357, 85 S.Ct. 1498, 1505, 14 L.Ed.2d 443, 453 [defining company's agreement to sponsor sale of tires and other products of rubber company in wholesale outlets and service stations]; *Federal Trade Com. v. Carter Paint Co.* (1965) 382 U.S. 46, 86 S.Ct. 219, 221, 15 L.Ed.2d 128, 129 [deceptive advertising]; *Federal Trade Com. v. Dean Foods* (1966) 384 U.S. 597, 86 S.Ct. 1738, 1741, 16 L.Ed.2d 802, 805 [preliminary injunction against merger]; *Federal Trade Com. v. Texaco* (1968) 393 U.S. 223, 89 S.Ct. 429, 431, 21 L.Ed.2d 394, 397 [applying theory of *Atlantic Refining Co.*]; *Federal Trade Com. v. Indiana Federation of Dentists* (1986) 476 U.S. 447, 106 S.Ct. 2009, 2013, 90 L.Ed.2d 445, 451 [dentists' refusal to submit X-rays to insurers]; *California Dental Assn. v. Federal Trade Com.* (1999) 526 U.S. 756, 119 S.Ct. 1604, 1611, 143 L.Ed.2d 935, 944 [Federal Trade Commission's jurisdiction extends to nonprofit professional association that provides substantial economic benefit to its for-profit members]; 54A *Am.Jur.2d* (1996 ed.), *Monopolies, Restraints of Trade, and Unfair Trade Practices* §1152 et seq.) (On the Webb-Pomerene Act, 15 U.S.C., §61 et seq., extending regulatory authority of the Commission to unfair competition in exporting, see 54 *Am.Jur.2d* (1996 ed.), *Monopolies, Restraints of Trade, and Unfair Trade Practices* §262 et seq.)

The problems arising in exercise of the authority of the Commission have been the subject of extensive comment. (See 77 *Harv. L. Rev.* 873 [reciprocal dealing]; 78 *Harv. L. Rev.* 385 [rule-making procedures in enforcement]; 80 *Harv. L. Rev.* 1008 [comprehensive article on Developments in the Law of Deceptive Advertising]; 85 *Harv. L. Rev.* 477

["corrective advertising" orders]; 86 *Harv. L. Rev.* 1380 [comprehensive study of use of adverse publicity by various agencies]; 89 *Harv. L. Rev.* 715 [The State Action Exemption and Antitrust Enforcement under the Federal Trade Commission Act]; 22 *Hastings L. J.* 1268 [private relief under FTCA]; 25 *Hastings L. J.* 1142 [FTC Attempts To Abolish Vicarious Liability Defenses for Deceptive Sales Practices: Strict Liability for Manufacturers?]; 34 *Hastings L. J.* 106 [goals]; 15 *Pacific L. J.* 879 [pyramid sales schemes]; 6 *Pepperdine L. Rev.* 439 [Deceptive Advertising and the Federal Trade Commission: A Perspective]; 8 *Pepperdine L. Rev.* 697 [FTC Regulation of Endorsements in Advertising: In the Consumer's Behalf?]; 16 *Santa Clara L. Rev.* 815 [FTC rule on preservation of consumers' claims and defenses]; 38 *So. Cal. L. Rev.* 320 [department store's collection of contributions from suppliers to finance promotional activities]; 39 *So. Cal. L. Rev.* 1 [deceptive advertising]; 46 *So. Cal. L. Rev.* 1116 [Concentrated Control of Iron Ore by Major Steel Companies as an Unfair Method of Competition]; 64 *So. Cal. L. Rev.* 417 [A Critique of the Credit Practices Rule 81]; 10 *Southwestern L. Rev.* 763 [Commission as prosecutor and judge]; 14 *U.C.L.A. L. Rev.* 997 [enforcement problems]; 14 *U.S.F. L. Rev.* 1 [preliminary injunction against merger]; 65 *A.L.R.2d* 225 [deceptive advertising.]) (On jurisdiction and practice before the Commission, see *supra*, §552.)

SUPPLEMENT: [This section is current through the latest supplement]



35 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

E. Restraint of Trade and Other Illegal Trade Practices.

1. Federal Law.

f. Clayton Act.

1. In General.

1 Witkin Sum. Cal. Law Contracts § 569

[§ 569] In General.

The Clayton Act of 1914 as amended (15 U.S.C., §12 et seq.) is more detailed than the Sherman Act. (See 54 *Am.Jur.2d* (1996 ed.), *Monopolies, Restraints of Trade, and Unfair Trade Practices* §155 et seq.; C.E.B., Sales and Mergers of California Businesses, §5.2 et seq.; 93 *Harv. L. Rev.* 598 [Section 4; treble damages and standing of purchasers to sue]; 34 *Hastings L. J.* 839 [Discharged Employees: Should They Ever Have Antitrust Standing Under Section 4 of the Clayton Act?]; 10 *Loyola L.A. L. Rev.* 237 [equitable relief under §16 of Act]; 27 *Stanf. L. Rev.* 841 [Some Preliminary Notes on the American Antitrust Laws' Economic Tests of Legality]; 10 *Southwestern L. Rev.* 667 [injury and causation under Sections 4 and 7].)

The main prohibitions of the Act are against (1) price discrimination (Section 2, 15 U.S.C., §13, same as provision in later Robinson-Patman Act, *infra*, §572), and (2) interlocking directorates (Section 8, 15 U.S.C., §19; see *United States v. W.T. Grant Co.* (1953) 345 U.S. 629, 73 S.Ct. 894, 896, 97 L.Ed. 1303, 1308; 54 *Am.Jur.2d* (1996 ed.), *Monopolies, Restraints of Trade, and Unfair Trade Practices* §156 et seq.) (On tying and exclusive dealing provisions, see *infra*, §570; on acquisitions of stock and mergers, see *infra*, §571; on injunctive relief under §16 of the Clayton Act, see *Cargill v. Monfort of Colorado* (1986) 479 U.S. 104, 107 S.Ct. 484, 93 L.Ed.2d 427, *supra*, §554.)

SUPPLEMENT: [This section is current through the latest supplement]



36 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

E. Restraint of Trade and Other Illegal Trade Practices.

1. Federal Law.

f. Clayton Act.

2. Tying and Exclusive Dealing Provisions.

1 Witkin Sum. Cal. Law Contracts § 570

[§ 570] Tying and Exclusive Dealing Provisions.

Section 3 of the Act (15 U.S.C., §14) makes it unlawful to lease or sell a commodity, patented or unpatented, or to fix a price, discount or rebate therefor, "on the condition, agreement, or understanding that the lessee or purchaser thereof shall not use or deal in the goods, wares, merchandise, machinery, supplies, or other commodities of a competitor or competitors of the lessor or seller, where the effect of such lease, sale or contract for sale or such condition, agreement, or understanding may be to substantially lessen competition or tend to create a monopoly in any line of commerce." A number of cases have considered the validity of tying and exclusive dealing provisions under the Clayton Act and other antitrust statutes. (See *Motion Picture Patents Co. v. Universal Film Mfg. Co.* (1916) 243 U.S. 502, 37 S.Ct. 416, 421, 61 L.Ed. 871, 879; *United Shoe Machinery Corp. v. United States* (1921) 258 U.S. 451, 42 S.Ct. 363, 365, 66 L.Ed. 708, 716; *International Business Machines Corp. v. United States* (1936) 298 U.S. 131, 56 S.Ct. 701, 703, 80 L.Ed. 1085, 1088; *International Salt Co. v. United States* (1947) 332 U.S. 392, 68 S.Ct. 12, 15, 92 L.Ed. 20, 26; *Standard Oil Co. v. United States* (1949) 337 U.S. 293, 69 S.Ct. 1051, 1055, 93 L.Ed. 1371, 1379; *Federal Trade Com. v. Motion Picture Advertising Service Co.* (1953) 344 U.S. 392, 73 S.Ct. 361, 363, 97 L.Ed. 426, 430; *Times-Picayune Publishing Co. v. United States* (1953) 345 U.S. 594, 73 S.Ct. 872, 878, 97 L.Ed. 1277, 1288 [reviewing cases and discussing effect of Sherman (supra, §563), Clayton, and Federal Trade Commission (supra, §558) Acts]; *Northern Pac. Ry. Co. v. United States* (1958) 356 U.S. 1, 78 S.Ct. 514, 518, 2 L.Ed.2d 545, 550; *Tampa Elec. Co. v. Nashville Coal Co.* (1961) 365 U.S. 320, 81 S.Ct. 623, 627, 5 L.Ed.2d 580, 586; *United States v. Loew's* (1962) 371 U.S. 38, 83 S.Ct. 97, 99, 9 L.Ed.2d 11, 18 [block booking: moving picture distributors compelled TV stations to take group of films; violation of Sherman Act, §1]; *White Motor Co. v. United States* (1963) 372 U.S. 253, 83 S.Ct. 696, 700, 9 L.Ed.2d 738, 744; *Fortner Enterprises v. United States Steel Corp.* (1969) 394 U.S. 495, 89 S.Ct. 1252, 1256, 22 L.Ed.2d 495, 502 [extension of credit conditioned on purchase of prefabricated homes; violation of Sherman Act, §1]; *Jefferson Parish Hosp. Dist. No. 2 v. Hyde* (1984) 466 U.S. 2, 104 S.Ct. 1551, 1560, 80 L.Ed.2d 2, 8 [exclusive contract between hospital and firm of anesthesiologists; no violation of Sherman Act, §1]; *Eastman Kodak Co. v. Image Technical Services* (1992) 504 U.S. 451, 112 S.Ct. 2072, 2080, 119 L.Ed.2d 265, 281 [defendant sold parts only to buyers using its service and made it harder for independent servicers to obtain parts elsewhere; factual issues arose as to violations of Sherman Act, §§1, 2]; 54 *Am.Jur.2d* (1996 ed), *Monopolies, Restraints of Trade, and Unfair Trade Practices* §90 et seq., 157 et seq.) (For the subsequent litigation in *Fortner Enterprises*, see *United States Steel Corp. v. Fortner Enterprises* (1977) 429 U.S. 610,

97 S.Ct. 861, 868, 51 L.Ed.2d 80, 90 [evidence insufficient to establish violation: "The unusual credit bargain offered ... proves nothing more than a willingness to provide cheap financing in order to sell expensive houses".])

Commentary, as usual, has been voluminous. (See 58 Cal. L. Rev. 1085 [franchise tie-ins]; 60 Cal. L. Rev. 1557; 90 Cal. L. Rev. 903 [possibilities for new separate-product test in technology tying cases]; 35 Cal. Western L. Rev. 1 [Consistently Wrong: The Single Product Issue and the Tying Claims Against Microsoft]; 65 Harv. L. Rev. 913; 72 Harv. L. Rev. 50; 77 Harv. L. Rev. 170; 84 Harv. L. Rev. 1717; 85 Harv. L. Rev. 670; 106 Harv. L. Rev. 328 [Eastman Kodak]; 33 Hastings L. J. 325 [Tying Arrangements in the Real Estate Market]; 36 Hastings L. J. 173 [The Futility of Antitrust Attack on Tie-In Sales: An Economic and Legal Analysis]; 4 San Diego L. Rev. 1 [refusals to deal]; 9 Santa Clara Lawyer 266 [franchising]; 46 So. Cal. L. Rev. 160 [product severability]; 50 So. Cal. L. Rev. 271 [voluntary tying arrangements and Sherman Act]; 73 So. Cal. L. Rev. 1133 [leveraging of products protected by patent or copyright as permissible use of intellectual property; Eastman Kodak]; 33 Southwestern U. L. Rev. 447 [exclusive dealing and resale price maintenance in combination]; 15 Stanf. L. Rev. 638; 18 Stanf. L. Rev. 457 [newcomer defense]; 39 Stanf. L. Rev. 737 [An Economic Analysis of Tie-In Sales: Re-examining the Leverage Theory]; 15 U.C. Davis L. Rev. 405 [tying franchise to trademark]; 37 U.C.L.A. L. Rev. 693 [The Leasing Monopolist]; 40 U.C.L.A. L. Rev. 1447 [Eastman Kodak]; 4 U.S.F. L. Rev. 65 [dealer franchising in the gasoline industry].)

West's Key Number Digest, Monopolies k.17.5(2)

SUPPLEMENT: [This section is current through the latest supplement]

See *Illinois Tool Works v. Independent Ink* (2006) 547 U.S. 28, 126 S.Ct. 1281, 1284, 164 L.Ed.2d 26, 36 [in all cases involving tying arrangement, plaintiff must prove that defendant has market power in tying product, and mere fact that tying product is patented does not support presumption of market power].



37 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

E. Restraint of Trade and Other Illegal Trade Practices.

1. Federal Law.

f. Clayton Act.

3. Acquisitions of Stock and Mergers.

1 Witkin Sum. Cal. Law Contracts § 571

[§ 571] Acquisitions of Stock and Mergers.

Acquisitions of stock and mergers are prohibited where the effect "may be substantially to lessen competition, or to tend to create a monopoly." (Section 7, 15 U.S.C., §18.) And, as amended in 1950 by the Celler "Antimerger Act," the section is applicable to mergers accomplished by acquisition of *assets as well as stock*. (See *United States v. Du Pont de Nemours Co.* (1957) 353 U.S. 586, 77 S.Ct. 872, 875, 1 L.Ed. 1057, 1064; *United States v. Du Pont de Nemours Co.* (1961) 366 U.S. 316, 81 S.Ct. 1243, 1250, 6 L.Ed.2d 318, 323; *Brown Shoe Co. v. United States* (1962) 370 U.S. 294, 82 S.Ct. 1502, 1516, 8 L.Ed.2d 510, 527; *United States v. Philadelphia Nat. Bank* (1963) 374 U.S. 321, 83 S.Ct. 1715, 1726, 10 L.Ed.2d 915, 929 [bank merger]; *United States v. El Paso Natural Gas Co.* (1964) 376 U.S. 651, 84 S.Ct. 1044, 1047, 12 L.Ed.2d 12, 17; *United States v. Penn-Olin Chemical Co.* (1964) 378 U.S. 158, 84 S.Ct. 1710, 1715, 12 L.Ed.2d 775, 779; *United States v. Continental Can Co.* (1964) 378 U.S. 441, 84 S.Ct. 1738, 1743, 12 L.Ed.2d 953, 958; *Federal Trade Com. v. Consolidated Foods Corp.* (1965) 380 U.S. 592, 85 S.Ct. 1220, 1221, 14 L.Ed.2d 95, 97; *United States v. Von's Grocery Co.* (1966) 384 U.S. 270, 86 S.Ct. 1478, 1481, 16 L.Ed.2d 555, 559; *United States v. Pabst Brewing Co.* (1966) 384 U.S. 546, 86 S.Ct. 1665, 1667, 16 L.Ed.2d 765, 769; *Federal Trade Com. v. Proctor & Gamble Co.* (1967) 386 U.S. 568, 87 S.Ct. 1224, 1229, 18 L.Ed.2d 303, 309; *United States v. Third Nat. Bank* (1968) 390 U.S. 171, 88 S.Ct. 882, 885, 19 L.Ed.2d 1015, 1024; *United States v. Greater Buffalo Press* (1971) 402 U.S. 549, 91 S.Ct. 1692, 1696, 29 L.Ed.2d 170, 176; *Ford Motor Co. v. United States* (1972) 405 U.S. 562, 92 S.Ct. 1142, 1147, 31 L.Ed.2d 492, 499; *United States v. Falstaff Brewing Corp.* (1973) 410 U.S. 526, 93 S.Ct. 1096, 1100, 35 L.Ed.2d 475, 481 [acquisition by company on edge of market and already exerting competitive influence may lessen competition]; *United States v. General Dynamics Corp.* (1974) 415 U.S. 486, 94 S.Ct. 1186, 1196, 39 L.Ed.2d 530, 546 [probable future ability of acquired company to compete, not its past production, properly considered to show that acquisition would not lessen competition]; *United States v. Connecticut Nat. Bank* (1974) 418 U.S. 656, 94 S.Ct. 2788, 2792, 2795, 41 L.Ed.2d 1016, 1025, 1026 [savings banks improperly considered part of market for commercial banks, and entire state, rather than local area in which acquired bank directly competed, improperly considered relevant geographic market]; *United States v. Marine Bancorporation* (1974) 418 U.S. 602, 94 S.Ct. 2856, 2871, 41 L.Ed.2d 978, 1002 [acquisition of commercial bank in local market would not lessen competition because of legal barriers to direct entry into that market]; 54 *Am.Jur.2d* (1996 ed.), *Monopolies, Restraints of Trade, and Unfair Trade Practices* §167 et seq.)

The law reviews cover all aspects of this subject. (See 56 *Cal. L. Rev.* 968 [section 7 as basis for treble damage action]; 71 *Cal. L. Rev.* 281 [Symposium: Justice Department's 1982 Merger Guidelines]; 71 *Cal. L. Rev.* 1580 [Efficiency Considerations in Merger Enforcement]; 71 *Cal. L. Rev.* 1697 [could merger lead to both monopoly and lower prices]; 77 *Cal. L. Rev.* 777 [Price Effects of Horizontal Mergers]; 5 *Cal. Western L. Rev.* 101 [section 7 as guideline for opposing conglomerate mergers]; 74 *Harv. L. Rev.* 226; 75 *Harv. L. Rev.* 756; 78 *Harv. L. Rev.* 1313 [conglomerate mergers]; 78 *Harv. L. Rev.* 275; 79 *Harv. L. Rev.* 181 [*Consolidated Foods*]; 82 *Harv. L. Rev.* 1007 [*Penn-Olin*]; 14 *U.C.L.A. L. Rev.* 1028 [same]; 86 *Harv. L. Rev.* 772; 88 *Harv. L. Rev.* 251 [*Marine Bancorporation*]; 92 *Harv. L. Rev.* 491 [horizontal mergers after *General Dynamics*]; 95 *Harv. L. Rev.* 1914 [commercial bank mergers]; 96 *Harv. L. Rev.* 907 [same]; 31 *Hastings L. J.* 371 [vertical mergers]; 33 *Hastings L. J.* 1441 [conglomerate joint ventures under §7]; 35 *Hastings L. J.* 937 [Merger Actions for Damages]; 38 *Hastings L. J.* 547 [proposed merger legislation]; 20 *Pacific L. J.* 75 [ease of entry doctrine]; 16 *Pepperdine L. Rev.* 1069 [critique of Department of Justice merger guidelines]; 33 *San Diego L. Rev.* 515 [efficiency claims with respect to horizontal mergers]; 39 *So. Cal. L. Rev.* 526 [mergers involving American and foreign corporations]; 23 *Stanf. L. Rev.* 205 [transactional mergers]; 14 *U.C.L.A. L. Rev.* 653 [*Von's Grocery*]; 80 *Harv. L. Rev.* 245 [same]; 15 *U.C.L.A. L. Rev.* 1153 [vertical mergers]; 48 *U.C.L.A. L. Rev.* 743 [*Von's Grocery*; mergers in grocery retailing industry]; 16 *U.S.F. L. Rev.* 583 [multinational joint ventures under §7].)

SUPPLEMENT: [This section is current through the latest supplement]

Law reviews: See 45 *Santa Clara L. Rev.* 41 [government review of consummated mergers under Section 7 of Clayton Act].



38 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

E. Restraint of Trade and Other Illegal Trade Practices.

1. Federal Law.

g. Robinson-Patman Act.

1. Price Discrimination Prohibited.

1 Witkin Sum. Cal. Law Contracts § 572

[§ 572] Price Discrimination Prohibited.

The Robinson-Patman Act (15 U.S.C., §13) amended Section 2 of the Clayton Act to make price discrimination unlawful (1) where its effect "may be substantially to lessen competition or tend to create a monopoly"; or (2) "to injure, destroy or prevent competition" with any person who either grants or knowingly receives the benefit, or with customers of either. (See *Federal Trade Com. v. Cement Institute* (1948) 333 U.S. 683, 68 S.Ct. 793, 813, 92 L.Ed. 1010, 1032 [basing point system of pricing goods]; *Federal Trade Com. v. Morton Salt Co.* (1948) 334 U.S. 37, 68 S.Ct. 822, 826, 92 L.Ed. 1196, 1202 [quantity price discounts actually a means of giving special prices to a few exceedingly large buyers]; *Federal Trade Com. v. Ruberoid Co.* (1952) 343 U.S. 470, 72 S.Ct. 800, 803, 96 L.Ed. 1081, 1087 [function of Federal Trade Commission]; *Automatic Canteen Co. v. Federal Trade Com.* (1953) 346 U.S. 61, 73 S.Ct. 1017, 1019, 97 L.Ed. 1454, 1457 [act applied to buyer--dominant vending machine company operating in 33 states obtained large discounts from many sellers]; *Moore v. Mead's Fine Bread Co.* (1954) 348 U.S. 115, 75 S.Ct. 148, 149, 99 L.Ed. 145, 149 [interstate business started local price war to force intrastate merchant out of business]; *Nashville Milk Co. v. Carnation Co.* (1958) 355 U.S. 373, 78 S.Ct. 352, 353, 2 L.Ed.2d 340, 343 [no treble damages recoverable under §3 of the Robinson-Patman Act]; *Federal Trade Com. v. Broch & Co.* (1960) 363 U.S. 166, 80 S.Ct. 1158, 1161, 4 L.Ed.2d 1124, 1128 [Act, §2(c), applied to seller's broker]; *Federal Trade Com. v. Anheuser-Busch* (1960) 363 U.S. 536, 80 S.Ct. 1267, 1271, 4 L.Ed.2d 1385, 1389 [Act, §2a; selling to local buyers at less than prices charged to outsiders]; *Federal Trade Com. v. Broch & Co.* (1962) 368 U.S. 360, 82 S.Ct. 431, 433, 7 L.Ed.2d 353, 356; *United States v. National Dairy Products Corp.* (1963) 372 U.S. 29, 83 S.Ct. 594, 596, 9 L.Ed.2d 561, 564; *Utah Pie Co. v. Continental Baking Co.* (1967) 386 U.S. 685, 87 S.Ct. 1326, 1331, 18 L.Ed.2d 406, 414; *Federal Trade Com. v. Meyer* (1968) 390 U.S. 341, 88 S.Ct. 904, 908, 19 L.Ed.2d 1222, 1228 [promotional allowances and price reductions to supermarket operator]; *Payne Co. v. Chrysler Motors Corp.* (1981) 451 U.S. 557, 101 S.Ct. 1923, 1926, 68 L.Ed.2d 442, 447 [measure of damages under §2(a)]; *Texaco v. Hasbrouck* (1990) 496 U.S. 543, 110 S.Ct. 2535, 2550, 110 L.Ed.2d 492, 521 [although legitimate functional discounts constituting reasonable reimbursement for purchaser's actual marketing functions do not violate §2a of Clayton Act, record showed that discounts in question were not legitimate]; *Brooke Group, Ltd. v. Brown & Williamson Tobacco Corp.* (1993) 509 U.S. 209, 113 S.Ct. 2578, 2598, 125 L.Ed.2d 168, 199 [evidence was insufficient to sustain claim that volume rebates to cigarette wholesalers constituted price discrimination having reasonable possibility of injuring competition in violation of Robinson-Patman Act]; 54 *Am.Jur.2d* (1996 ed.),

Monopolies, Restraints of Trade, and Unfair Trade Practices §190 et seq.) (For permissible practices and defenses, see *infra*, §573.)

Commentators have dealt with the major provisions of the Act and the leading cases. (See 40 *Cal. L. Rev.* 526; 80 *Cal. L. Rev.* 247 [regulation of intraenterprise pricing]; 60 *Harv. L. Rev.* 571; 63 *Harv. L. Rev.* 308; 74 *Harv. L. Rev.* 1597; 77 *Harv. L. Rev.* 1308 [brokers]; 81 *Harv. L. Rev.* 773 [Act criticized]; 82 *Harv. L. Rev.* 266 [Meyer]; 86 *Harv. L. Rev.* 765 [intrastate sales]; 107 *Harv. L. Rev.* 322 [Brooke Group]; 22 *Hastings L. J.* 1245 ["commerce" requirement]; 3 *Loyola L.A. L. Rev.* 84 [price discrimination trends]; 28 *Pacific L. J.* 311 [Private Enforcement of Predatory Price Laws Under the California Unlawful Practices Act and the Federal Antitrust Acts]; 14 *Santa Clara Lawyer* 211 [functional discounts]; 28 *So. Cal. L. Rev.* 280; 30 *So. Cal. L. Rev.* 241; 48 *So. Cal. L. Rev.* 899 [The Disfavored *Indirect Purchaser*]; 15 *Stanf. L. Rev.* 547 [What Is a Competitor?]; 25 *Stanf. L. Rev.* 764 [class actions]; 17 *U.C. Davis L. Rev.* 309 [Judicial Reconstruction of the Robinson-Patman Act: Predatory Differential Pricing]; 8 *U.C.L.A. L. Rev.* 363 [territorial discrimination]; 16 *U.C.L.A. L. Rev.* 304 [competitive injury in primary line of commerce]; 8 *U.S.F. L. Rev.* 497 [Moore]; 13 *A.L.R.2d* 362 [furnishing of services or facilities]; 164 *A.L.R. Fed* 633 ["meeting competition" defense under §2(b) of Clayton Act, as amended by Robinson-Patman Act]; 170 *A.L.R. Fed* 425 [increased costs charged to, or expenses incurred by, buyer as secondary-line price discrimination under Clayton Act, as amended by Robinson-Patman Act]; 171 *A.L.R. Fed* 581 [primary-line price discrimination under §2(a) of Clayton Act, as amended by Robinson-Patman Act]; 172 *A.L.R. Fed* 267 [discount as cause of secondary-line competitive injury under §2(a) of Clayton Act, as amended by Robinson-Patman Act].)

West's Key Number Digest, Monopolies k.17(2.1)

SUPPLEMENT: [This section is current through the latest supplement]

See *Volvo Trucks North America v. Reeder-Simco GMC* (2006) 546 U.S. 164, 126 S.Ct. 860, 866, 163 L.Ed.2d 663, 771 [manufacturer could not be liable for secondary-line price discrimination under Robinson-Patman Act, absent showing it discriminated between dealers contemporaneously competing to resell its product to same retail customer].



39 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

E. Restraint of Trade and Other Illegal Trade Practices.

1. Federal Law.

g. Robinson-Patman Act.

2. Permissible Practices and Defenses.

1 Witkin Sum. Cal. Law Contracts § 573

[§ 573] Permissible Practices and Defenses.

Price differentials are permitted in certain situations; e.g., differences in grade or quality of goods; differences in costs resulting from quantities or methods of sale; changes in market conditions; possible deterioration of perishable goods; obsolescence of seasonal goods; sales under court process or in discontinuance of business in the goods. And it is further provided that a seller may offer evidence to show that the discrimination was made in good faith to meet competition. (See *Standard Oil Co. v. Federal Trade Com.* (1951) 340 U.S. 231, 71 S.Ct. 240, 248, 95 L.Ed. 239, 243; *Federal Trade Com. v. Standard Oil Co.* (1957) 355 U.S. 396, 78 S.Ct. 369, 370, 2 L.Ed.2d 359, 362; *Federal Trade Com. v. Simplicity Pattern Co.* (1959) 360 U.S. 55, 79 S.Ct. 1005, 1011, 3 L.Ed.2d 1079, 1082; *Federal Trade Com. v. Sun Oil Co.* (1963) 371 U.S. 505, 83 S.Ct. 358, 364, 9 L.Ed.2d 466, 475; *Federal Trade Com. v. Borden Co.* (1966) 383 U.S. 637, 86 S.Ct. 1092, 1095, 16 L.Ed.2d 153, 156 [test of "like grade and quality"]; *Abbott Laboratories v. Portland Retail Druggists Assn.* (1976) 425 U.S. 1, 96 S.Ct. 1305, 1314, 47 L.Ed.2d 537, 549 [scope of exemption of sales to nonprofit hospitals under 15 U.S.C., §13c]; *Great Atlantic & Pacific Tea Co. v. Federal Trade Com.* (1979) 440 U.S. 69, 99 S.Ct. 925, 934, 59 L.Ed.2d 153, 164 [buyer's defense]; *Jefferson County Pharmaceutical Assn. v. Abbott Laboratories* (1983) 460 U.S. 150, 103 S.Ct. 1011, 1024, 74 L.Ed.2d 882, 899 [sale of pharmaceutical products to state and local government hospitals for resale in competition with private pharmacies not exempt]; *Falls City Industries v. Vanco Beverage* (1983) 460 U.S. 428, 103 S.Ct. 1282, 1297, 75 L.Ed.2d 174, 196 [showing necessary for meeting-competition defense]; 54 *Am.Jur.2d* (1996 ed.), *Monopolies, Restraints of Trade, and Unfair Trade Practices* §§213, 228 et seq., 234 et seq.)

Commentary deals mainly with meeting competition in good faith. (See 55 *Cal. L. Rev.* 535 [Borden]; 80 *Harv. L. Rev.* 236 [same]; 25 *U.C.L.A. L. Rev.* 46 [same]; 13 *Cal. Western L. Rev.* 195 [Abbott]; 65 *Harv. L. Rev.* 750; 80 *Harv. L. Rev.* 463; 90 *Harv. L. Rev.* 1476; 7 *U.C.L.A. L. Rev.* 548; 9 *U.C.L.A. L. Rev.* 481; 164 *A.L.R. Fed* 633 ["meeting competition" defense under §2(b) of Clayton Act, as amended by §13b of Robinson-Patman Act].)

SUPPLEMENT: [This section is current through the latest supplement]



40 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
E. Restraint of Trade and Other Illegal Trade Practices.
1. Federal Law.
h. Racketeer Influenced and Corrupt Organizations Act.
1. Nature and Scope of Statute.

1 Witkin Sum. Cal. Law Contracts § 574

[§ 574] Nature and Scope of Statute.

The Racketeer Influenced and Corrupt Organizations Act (RICO) was enacted in 1970. (18 U.S.C., §1961 et seq.) This statute, part of the Organized Crime Control Act of 1970, is designed to prevent and punish "racketeering activity," and it strikes not only at mobsters and organized criminals, but also at otherwise law-abiding businesspersons. (See *Sedima, S.P.R.L. v. Imrex Co.* (1985) 473 U.S. 479, 105 S.Ct. 3275, 3286, 87 L.Ed.2d 346, 360; *Holmes v. Securities Investor Protection Corp.* (1992) 503 U.S. 258, 112 S.Ct. 1311, 1316, 117 L.Ed.2d 532, 542 [stock manipulation conspiracy causing two broker-dealers to be unable to meet obligations to customers, thereby triggering plaintiff corporation's statutory duty to advance funds to broker-dealers' trustees; plaintiff corporation lacked standing, because it was not subrogated to rights of nonpurchasing customers]; *Cianci v. Superior Court* (1985) 40 C.3d 903, 909, 221 C.R. 575, 710 P.2d 375, *infra*, §576; *Douglas v. Superior Court* (1989) 215 C.A.3d 155, 159, 263 C.R. 473 [pleading sufficient]; *People v. Highland Fed. Savings & Loan* (1993) 14 C.A.4th 1692, 1713, 19 C.R.2d 555; 21 Cal. Western L. Rev. 243 et seq. [symposium]; 99 Harv. L. Rev. 312; 19 Loyola L.A. L. Rev. 851; 18 Pacific L. J. 31 [1984 amendments]; 37 U.C.L.A. L. Rev. 1 [proposal to limit private civil RICO]; 20 U.S.F. L. Rev. 339; 171 A.L.R. Fed 1 [validity, construction, and application of RICO].)

The statute authorizes any person injured by a violation of the section describing unlawful activity (§1962) to sue in the federal district court and recover treble damages, costs, and attorneys' fees. (§1964.) (On jurisdiction of state court, see *infra*, §576; on RICO offenses, see *infra*, §575 et seq.) However, the McCarran-Ferguson Act precludes a RICO action by an insured. (See *American Int. Group v. Superior Court* (1991) 234 C.A.3d 749, 752, 285 C.R. 765 ["[A] civil RICO cause of action cannot be asserted by an insured in California against an insurer for alleged misrepresentations made in the course of the marketing, sale or performance of an insurance policy contract"].) (On nature and purpose of McCarran-Ferguson Act, see *supra*, §561.)

West's Key Number Digest, Monopolies k.10

SUPPLEMENT: [This section is current through the latest supplement]

(*New*) *Proximate cause:* The illegal activity must be the proximate cause of the plaintiff's injury. (*Anza v. Ideal Steel Supply Corp.* (2006) 547 U.S. 451, 126 S.Ct. 1991, 1996, 164 L.Ed.2d 720, 729 [competitor's alleged defrauding of state

tax authority and using proceeds therefrom to lower prices, and alleged submission of fraudulent tax returns to conceal conduct, was not proximate cause of entrepreneur's lost sales; state was direct victim of fraud, competitor could have lowered its prices for any number of reasons, and entrepreneur's lost sales could have resulted from factors other than competitor's alleged fraud]; see *Bridge v. Phoenix Bond & Indem. Co.* (2008) 553 U.S. ___, 128 S.Ct. 2131, 2141, 170 L.Ed.2d 1012, 1024 [plaintiff asserting RICO claim predicated on mail fraud need not show that it relied on defendant's misrepresentations in order to establish requisite element of causation]; 39 U.S.F. L. Rev. 319 [problem of causation in fraud-based claims under RICO].)



41 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
E. Restraint of Trade and Other Illegal Trade Practices.
1. Federal Law.
h. Racketeer Influenced and Corrupt Organizations Act.
2. Offenses.

1 Witkin Sum. Cal. Law Contracts § 575

[§ 575] Offenses.

(1) *In General.* RICO makes it unlawful for any *person* to do the following acts with respect to an *enterprise* engaged in, or affecting, *interstate or foreign commerce*: (a) to acquire an interest in, or the establishment or operation of, the enterprise *through the use of income derived* from a pattern of racketeering activity or collection of an unlawful debt; (b) to acquire or maintain an interest in, or control of, the enterprise *through a pattern of* racketeering activity or collection of an unlawful debt; (c) where the person is employed by, or associated with, the enterprise, *to conduct or participate* in the conduct of the *enterprise's affairs through a pattern of* racketeering activity or collection of an unlawful debt; (d) to *conspire* to do any of the aforementioned acts. (18 U.S.C., §1962.) (See *Reves v. Ernst & Young* (1993) 507 U.S. 170, 113 S.Ct. 1163, 1170, 122 L.Ed.2d 525, 537 [to conduct or participate in conduct of enterprise's affairs, one must, under "operation or management test," participate in operation or management of enterprise itself]; *National Organization for Women v. Scheidler* (1994) 510 U.S. 249, 114 S.Ct. 798, 803, 127 L.Ed.2d 99, 108 [nothing in 18 U.S.C., §1962(c) requires that alleged racketeering enterprise be accompanied by underlying economic motive]; *United States v. Robertson* (1995) 514 U.S. 669, 115 S.Ct. 1732, 1733, 131 L.Ed.2d 714, 717 [where some of equipment, supplies, and workers were from out of state and where some of mine's output was taken out of state, mine was enterprise engaged in interstate commerce]; *Cedric Kushner Promotions, Ltd. v. King* (2001) 533 U.S. 158, 121 S.Ct. 2087, 2092, 150 L.Ed.2d 198, 205 [when corporate employee unlawfully conducts affairs of corporation of which employee is sole owner, whether employee conducts those affairs within or beyond scope of corporate authority, 18 U.S.C., §1962(c) applies; need for two distinct entities, i.e., "person" and "enterprise," is satisfied]; 108 Harv. L. Rev. 351 [Scheidler]; 108 Harv. L. Rev. 1405 [scope of RICO liability after *Reves*]; 17 Southwestern U. L. Rev. 565 ["separateness" issue, i.e., whether enterprise element must be substantially different from acts constituting pattern of racketeering activity]; 31A Am.Jur.2d (2002 ed.), *Extortion, Blackmail, and Threats* §112 et seq.)

(2) *Definitions.* The following terms are defined in 18 U.S.C., §1961:

(a) "Person" refers to "any individual or entity capable of holding a legal or beneficial interest in property." (18 U.S.C., §1961(3).)

(b) "Enterprise" refers to "any individual, partnership, corporation, association, or other legal entity, and any union

or group of individuals associated in fact although not a legal entity." (18 U.S.C., §1961(4).) (On whether "enterprise" may be defendant in RICO action, see *infra*, §577.)

(c) "Racketeering activity" refers to a long list of specified state and federal crimes. (18 U.S.C., §1961(1).)

(d) A "pattern of racketeering activity" requires at least two acts of racketeering activity within a 10-year period, one of which occurred after October 15, 1970. (18 U.S.C., §1961(5).)

(e) "Unlawful debt" refers to a debt incurred in connection with (1) an unlawful gambling activity, or (2) the business of lending money at a usurious rate, where the rate is at least twice the enforceable rate. (18 U.S.C., §1961(6).)

The following material deals with these definitions. (See *H.J. v. Northwestern Bell Tel. Co.* (1989) 492 U.S. 229, 109 S.Ct. 2893, 2900, 106 L.Ed.2d 195, 208; *Globe Int. v. Superior Court* (1992) 9 C.A.4th 393, 395; 12 C.R.2d 109; *Gervase v. Superior Court* (1995) 31 C.A.4th 1218, 1233, 1236, 37 C.R.2d 875; *Atascadero v. Merrill Lynch* (1998) 68 C.A.4th 445, 485, 80 C.R.2d 329, 13 Summary (10th), Trusts, §150; 24 Cal. Western L. Rev. 1 [interpreting "pattern of racketeering activity" requirement after *Sedima, S.P.R.L. v. Imrex Co.* (1985) 473 U.S. 479, 105 S.Ct. 3275, 87 L.Ed.2d 346, *supra*, §574]; 27 *San Diego L. Rev.* 183 [Reversal of a RICO Predicate Offense on Appeal: Should the RICO Count be Vacated?].)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *In General.* See *Wilkie v. Robbins* (2007) 551 U.S. 537, 127 S.Ct. 2588, 2605, 168 L.Ed.2d 389, 408 [alleged violations of Hobbs Act by employees of Bureau of Land Management (BLM) in efforts to obtain easement over Wyoming landowner's property for benefit of Government were not predicate offenses for RICO action against individual employees, because Hobbs Act does not apply when national Government is beneficiary of extortionate acts by government employees; also predicate offense was not shown by violations of Wyoming's blackmail statute by BLM employees, because alleged conduct does not fit definition of extortion]; 10 *A.L.R. Fed* 2d 461 [application of RICO to terrorists and acts of terrorism].



42 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
E. Restraint of Trade and Other Illegal Trade Practices.
1. Federal Law.
h. Racketeer Influenced and Corrupt Organizations Act.
3. State Court Jurisdiction Over Actions.

1 Witkin Sum. Cal. Law Contracts § 576

[§ 576] State Court Jurisdiction Over Actions.

In *Cianci v. Superior Court* (1985) 40 C.3d 903, 221 C.R. 575, 710 P.2d 375, plaintiff doctors sued defendant doctors in a dispute over operation of a medicine department at a hospital. Defendant doctors cross-complained, alleging two main causes of action: (1) violation of RICO, and (2) violation of the California Cartwright Act (B. & P.C. 16700 et seq.). *Held*: (1) State courts have concurrent jurisdiction over RICO cases, and (2) the Cartwright Act applies to the professions (see *infra*, §592).

(a) State courts have jurisdiction over cases arising under federal laws unless Congress has made express provision to the contrary, or there is a disabling incompatibility between the federal claim and state court jurisdiction. Concurrent jurisdiction is therefore presumed unless rebutted by a strong showing of the need for exclusive jurisdiction. (40 C.3d 910.)

(b) No such showing has been made. (1) The statute does not state or suggest that jurisdiction is to be exclusive. (40 C.3d 910.) (2) The legislative history shows that Congress never considered the question of jurisdiction. (40 C.3d 911, 912, 913.) (3) There is no disabling incompatibility between RICO claims and state court adjudication: The statute does not require uniform interpretation, and federal courts have no superior expertise in adjudicating a *RICO* claim. (40 C.3d 914, 915; two justices dissented from this holding.) (See *Tafflin v. Levitt* (1990) 493 U.S. 455, 110 S.Ct. 792, 794, 107 L.Ed.2d 887, 893; *Gervase v. Superior Court* (1995) 31 C.A.4th 1218, 1228, 37 C.R.2d 875; 18 Pacific L. J. 1267 [Cianci].)

SUPPLEMENT: [This section is current through the latest supplement]



43 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
E. Restraint of Trade and Other Illegal Trade Practices.
1. Federal Law.
h. Racketeer Influenced and Corrupt Organizations Act.
4. Procedure.

1 Witkin Sum. Cal. Law Contracts § 577

[§ 577] Procedure.

(1) *Venue and Process*. RICO civil actions may be instituted in the federal district court for any district in which the defendant "resides, is found, has an agent, or transacts his affairs." (18 U.S.C., §1965(a).) (On civil actions generally, see 31A Am.Jur.2d (2002 ed.), *Extortion, Blackmail, and Threats* §178 et seq.) If the interest of justice requires the presence of parties residing in other districts, the court may cause the parties to be summoned, and process may be served in any district. (18 U.S.C., §1965(b).)

In any civil or criminal action, subpoenas compelling the attendance of witnesses may be served in any district, except that a civil subpoena may not be served on any person residing in another district at a place more than 100 miles from the issuing court without a showing of good cause. (18 U.S.C., §1965(c).)

(2) *Expedited Action*. In any civil action instituted by the United States, the Attorney General may file a certificate stating his or her opinion that the case is one of general public importance. Upon receipt of a copy, the presiding judge must immediately designate a judge to hear the action. (18 U.S.C., §1966.)

(3) *Discovery*. If the Attorney General has reason to believe that a person or enterprise has possession, custody, or control of documentary materials relevant to a racketeering investigation, he or she may, prior to the institution of a civil or criminal proceeding, issue a *civil investigative demand* requiring the person to produce the materials for examination. (18 U.S.C., §1968(a); on content, procedure, and remedy for noncompliance, see 18 U.S.C., §1968(b)-(j).)

(4) *Open or Closed Trial*. After considering the rights of affected persons, the trial judge has discretion to determine whether civil proceedings should be open or closed to the public. (18 U.S.C., §1967.)

(5) *"Enterprise" as Defendant in Civil Action*. *Gervase v. Superior Court* (1995) 31 C.A.4th 1218, 37 C.R.2d 875, involved the sale of highly risky limited partnership interests that defendant represented were safe investments. The issue was whether an "enterprise" under RICO can also be a defendant in a civil RICO claim. The court distilled the following points from federal decisions: (a) The issue will not arise where the enterprise is an association in fact and not a legal entity. The issue can arise only where the RICO enterprise has sufficient status to qualify as a "person" under 18

U.S.C., §1961(3) (see *supra*, §575), because only then can the enterprise be a potential defendant. (b) Because an enterprise must be established, but need not be anything other than an association in fact and need not be given a nominal identifier, a named defendant that is a legal entity will not necessarily be the RICO enterprise and, therefore, cannot claim automatic immunity under the authorities that hold that the RICO enterprise cannot also be a RICO defendant. (c) While a majority of lower federal courts have held that a RICO enterprise cannot be a RICO defendant under *18 U.S.C., §1962(c)*, the overwhelming majority of those courts have concluded that there is no impediment to naming the RICO enterprise as a defendant under the other subsections of *18 U.S.C., §1962* (see *supra*, §575). Given that RICO may not be restricted beyond the limitations inherent in its statutory language, this is the correct view, even assuming that the enterprise cannot be a defendant under *18 U.S.C., §1962(c)*. However, a plaintiff cannot avoid the issue simply by claiming a violation of *18 U.S.C., §1962(a)*, (b), or (d) absent facts to support such a claim. (*31 C.A.4th 1238, 1239.*)

SUPPLEMENT: [This section is current through the latest supplement]



44 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
E. Restraint of Trade and Other Illegal Trade Practices.
1. Federal Law.
h. Racketeer Influenced and Corrupt Organizations Act.
5. Penalties and Remedies.

1 Witkin Sum. Cal. Law Contracts § 578

[§ 578] Penalties and Remedies.

(1) *Criminal Punishment.* A person convicted of violating RICO must be fined or imprisoned for not more than 20 years (or for life if the underlying offense is punishable by life imprisonment), or both. In lieu of a fine otherwise authorized, a convicted defendant may be fined not more than twice the gross profits or other proceeds derived from the offense. (18 U.S.C., §1963(a).) (See 31A Am.Jur.2d (2002 ed.), *Extortion, Blackmail, and Threats* §152 et seq.)

In addition to fine and imprisonment, a convicted defendant must forfeit the following: (a) an interest acquired or maintained in violation of RICO; (b) an interest in, security of, claim against, or property or contractual right affording a source of influence over, an enterprise that the defendant established, operated, controlled, conducted, or participated in the conduct of, in violation of RICO; and (c) property constituting, or derived from, proceeds obtained from racketeering activity or unlawful debt collection in violation of RICO. (18 U.S.C., §1963(a); on constitutionality of forfeiture provisions, see *Alexander v. United States* (1993) 509 U.S. 544, 113 S.Ct. 2766, 2770, 2274, 125 L.Ed.2d 441, 449, 453 [although forfeiture provisions effectively closed defendant's adult entertainment business, they did not constitute improper prior restraint of, or have improper chilling effect on, free speech]; 107 Harv. Rev. 244 [*Alexander*]; 14 *Hastings Const. L. Q.* 451; 17 *Hastings Const. L. Q.* 659; 26 *Pacific L. J.* 165; 66 *So. Cal. L. Rev.* 1675.)

All right, title and interest in forfeited property vests in the United States upon commission of the act giving rise to the forfeiture. Property subsequently transferred is subject to forfeiture, unless the transferee establishes that he or she was a bona fide purchaser without cause to believe that the property was subject to forfeiture. (18 U.S.C., §1963(c).) (See 39 *Stanf. L. Rev.* 663 [forfeiture of property used to pay attorneys' fees].) In addition to these transferees, any other person asserting a legal interest in property ordered forfeited may petition for a hearing to establish his or her right. (18 U.S.C., §1963(l).)

(2) *Civil Remedies.* A person injured in his or her business or property by a RICO violation is entitled to treble damages, plus costs and attorneys' fees. (18 U.S.C., §1964(c).) (See *Agency Holding Corp. v. Malley-Duff & Associates* (1987) 483 U.S. 143, 107 S.Ct. 2759, 2764, 97 L.Ed.2d 121, 130 [Clayton Act's 4-year statute of limitations held applicable to RICO civil enforcement actions]; *Beck v. Prupis* (2000) 529 U.S. 494, 120 S.Ct. 1608, 1616, 146 L.Ed.2d 561, 571 [cause of action under 18 U.S.C., §1964(c) based on violation of 18 U.S.C., §1962(d) may not be brought for

injury caused by overt act that is not act of racketeering or otherwise wrongful under RICO]; 31A *Am.Jur.2d* (2002 ed.), *Extortion, Blackmail, and Threats* §198 et seq.; 30 Cal. Western L. Rev. 119 [Civil RICO and Anti-Abortion Protest: Must Protestors Profit?]; 33 *Golden Gate L. Rev.* 47 [civil RICO conspiracy liability]; 20 *U.C. Davis L. Rev.* 883 [The Economics of Civil RICO]; 21 *U.C. Davis L. Rev.* 1233 [Tax Fraud and Civil RICO: Implications for Business and Governmental Entities]; 62 *A.L.R.4th* 654 [civil action for damages under RICO for losses from racketeering activity]; 88 *A.L.R. Fed* 419 [civil liability of antiabortion protesters under RICO].)

The Attorney General may petition for an order preventing and restraining RICO violations. (18 U.S.C., §1964(a), (b).) These orders may include, but are not limited to, those directing (a) divestiture of a person's interest in an enterprise, (b) imposition of reasonable restrictions on future activities, and (c) dissolution or reorganization of an enterprise. (18 U.S.C., §1964(a).) (See 31A *Am.Jur.2d* (2002 ed.), *Extortion, Blackmail, and Threats* §203 et seq.; 100 *Harv. L. Rev.* 1288 [need for criminal procedural protection in 18 U.S.C., §1964 actions]; 18 *Pacific L. J.* 1199 [Civil RICO: Should Private Plaintiffs Be Granted Equitable Relief].)

SUPPLEMENT: [This section is current through the latest supplement]



45 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
E. Restraint of Trade and Other Illegal Trade Practices.
2. California Law.
a. Contracts Not To Compete.
1. In General.

1 Witkin Sum. Cal. Law Contracts § 579

[§ 579] In General.

B. & P.C. 16600 provides that, subject to exceptions contained in its chapter (*infra*, §583 et seq.), "every contract by which anyone is restrained from engaging in a lawful *profession, trade, or business* of any kind is to that extent void." (See *Endicott v. Rosenthal* (1932) 216 C. 721, 726, 16 P.2d 673 [agreement to fix prices or restrict competition is illegal]; *Hunter v. Superior Court* (1939) 36 C.A.2d 100, 113, 97 P.2d 492; *Kolani v. Gluska* (1998) 64 C.A.4th 402, 408, 75 C.R.2d 257 [policy of *B. & P.C. 16600* would be undermined by construing illegal covenant not to compete as merely barring misappropriation of confidential customer lists and trade secrets]; 15 Corbin (Rev. ed.), §80.4 et seq.; 6 Williston 4th, §13:1 et seq.; 54A Cal. Civil Practice, 6 Business Litigation, §62:1 et seq.; 2 California Affirmative Defenses (2004 ed.), §37:14; C.E.B., Sales and Mergers of California Businesses, §2.12; 26 So. Cal. L. Rev. 208; 51 U.C.L.A. L. Rev. 593 [choice of law provisions in noncompete agreements]; *Am.Jur.2d* (1996 ed.), *Monopolies, Restraints of Trade, and Unfair Trade Practices* §840 et seq.; 42 *Am.Jur.2d* (2000 ed.), *Injunctions* §136 et seq.; 3 A.L.R.2d 522 [statutes prohibiting restraint on profession, trade, or business as applicable to restrictions in employment or agency contracts]; 60 A.L.R.4th 965 [anticompetitive covenants in aerial spray dust business]; 12 A.L.R.5th 847 [successor's right to enforce anticompetitive covenant entered into by predecessor and its employees]; on covenants not to compete in leases, see 12 *Summary* (10th), *Real Property*, §660 et seq.)

B. & P.C. 16600, based on former C.C. 1673, "is basically a codification of the common law," and is to be construed in the light of common law decisions on the same subject. (*Centeno v. Roseville Community Hosp.* (1979) 107 C.A.3d 62, 68, 69, 167 C.R. 183.) A balancing test is applied, and the courts tend to uphold reasonable limited restrictions. (*Centeno v. Roseville Community Hosp.*, *supra*, 107 C.A.3d 69, 70, and footnote 2 [hospital's exclusive radiology medical services contract valid]; on a noncompetitive provision in a law partnership agreement, see *Haight, Brown & Bonesteel v. Superior Court* (1991) 234 C.A.3d 963, 285 C.R. 845, 1 Cal. Proc. (4th), *Attorneys*, §59.)

In *King v. Gerold* (1952) 109 C.A.2d 316, 240 P.2d 710, an agreement not to manufacture an unpatented house trailer after termination of a license agreement was held valid. Defendant was not prohibited from carrying on *his business* of manufacturing trailers, but merely barred from making those of plaintiff's design, which he was licensed to use for only a limited time. (109 C.A.2d 318.) (See 26 So. Cal. L. Rev. 208.)

West's Key Number Digest, Monopolies k.12(4)

SUPPLEMENT: [This section is current through the latest supplement]

See 2 California Affirmative Defenses §37:14.*Haight, Brown & Bonesteel case:*

Cross-Reference: 1 *Cal. Proc.* (5th), Attorneys, §34.



46 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
E. Restraint of Trade and Other Illegal Trade Practices.
2. California Law.
a. Contracts Not To Compete.
2. Restatement 2d.

1 Witkin Sum. Cal. Law Contracts § 580

[§ 580] Restatement 2d.

(1) *General Common Law Rule. Rest.2d, Contracts §186* creates a rule of reason:

(a) "A promise is unenforceable on grounds of public policy if it is *unreasonably* in restraint of trade."

(b) "A promise is in restraint of trade if its performance would limit competition in any business or restrict the promisor in the exercise of a gainful occupation."

Comment a points out that the rule necessarily has somewhat vague outlines; however: "Whether a restraint is reasonable is determined in the light of the circumstances of the transaction, including not only the particular facts but general social and economic conditions as well. The promise is viewed in terms of the effects that it could have had and not merely what actually occurred. Account is taken of such factors as the protection that it affords for the promisee's legitimate interests, the hardship that it imposes on the promisor, and the likely injury to the public."

(2) *Non-Ancillary Restraints Invalid.* "A promise to refrain from competition that imposes a restraint that is not ancillary to an otherwise valid transaction or relationship is *unreasonably in restraint of trade.*" (*Rest.2d, Contracts §187.*) Comment b points out that the promisee must have an interest worthy of protection that can be balanced against the hardship on the promisor and the likely injury to the public, and that a promise not ancillary to some valid transaction or relationship (e.g., sale of a business, employer-employee relationship) is unreasonable, because it protects no legitimate interest of the promisee.

(3) *Ancillary Restraints.* These may be sustained under some circumstances.

(a) *Invalid:* A restraint, even though ancillary to an otherwise valid transaction or relationship, is unreasonable if it is greater than needed to protect the promisee's legitimate interest, or the promisee's need is outweighed by the hardship to the promisor and the likely injury to the public. (*Rest.2d, Contracts §188(1).*)

(b) *Valid:* *Rest.2d, Contracts §188(2)* lists some restraints that are ancillary to a valid transaction or relationship (see *infra*, §583 et seq.):

(1) "a promise by the seller of a business not to compete with the buyer in such a way as to injure the value of the business sold."

(2) "a promise by an employee or other agent not to compete with his employer or other principal."

(3) "a promise by a partner not to compete with the partnership."

SUPPLEMENT: [This section is current through the latest supplement]



47 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
E. Restraint of Trade and Other Illegal Trade Practices.
2. California Law.
a. Contracts Not To Compete.
3. Employment Agreements.
aa. In General.

1 Witkin Sum. Cal. Law Contracts § 581

[§ 581] In General.

(1) *General Rule of Invalidity.* In *Morris v. Harris* (1954) 127 C.A.2d 476, 274 P.2d 22, defendant janitor agreed that, after leaving the employ of plaintiff's janitorial services business, he would not accept work from any of plaintiff's clients for 10 years. No trade secrets or customers' lists were involved. *Held*, this restraint, though only partial, was nevertheless illegal. (127 C.A.2d 478.)

In *Gordon Termite Control v. Terrones* (1978) 84 C.A.3d 176, 148 C.R. 310, defendant employee signed an agreement that, should he terminate his employment with plaintiff, he would not call on any of plaintiff's accounts with which he had dealt as an employee; and that, in the event of breach he agreed to pay plaintiff \$ 50 for each account called on. Plaintiff, suing for breach, contended that the agreement was merely an assignment of accounts at a fixed price, and was thus legal. *Held*, it was a covenant not to compete and illegal. (84 C.A.3d 179.) (See *Golden State Linen Service v. Vidalin* (1977) 69 C.A.3d 1, 9, 11, 137 C.R. 807 [rejecting argument that sale of goodwill exception (infra, §583) can be invoked to uphold the agreement]; *KGB v. Giannoulas* (1980) 104 C.A.3d 844, 847, 164 C.R. 571, 13 Summary (10th), Equity, §104; *Metro Traffic Control v. Shadow Traffic Network* (1994) 22 C.A.4th 853, 860, 27 C.R.2d 573 [no protectible trade secret; agreement held invalid]; *Application Group v. Hunter Group* (1998) 61 C.A.4th 881, 894, 72 C.R.2d 73, supra, §73 [covenant not to compete in employment contract between Maryland resident and Maryland corporation was unenforceable under California law as against California corporation]; *D'sa v. Playhut* (2000) 85 C.A.4th 927, 931, 102 C.R.2d 495 [confidentiality agreement containing covenant not to render services for 1 year after separation "in connection with any Competing Product" was illegal despite its severability; nor could it be saved by construing it as restraint against disclosure of trade secrets]; 15 Corbin (Rev. ed.), §80.15 et seq.; 6 Williston 4th, §13:13; 73 Harv. L. Rev. 625; 57 So. Cal. L. Rev. 531 [proposal for reform of law on employee covenants]; 60 So. Cal. L. Rev. 1465 [postemployment noncompetition agreements formed after commencement of at-will employment]; 54A Am.Jur.2d (1996 ed.), Monopolies, Restraints of Trade, and Unfair Trade Practices §888 et seq.; 8 Proof of Facts 2d 663 [enforceability of covenant not to compete]; 20 Proof of Facts 3d 705 [unreasonableness of promise not to compete]; 3 A.L.R.2d 522 [statute prohibiting restraint of trade as applicable to restrictions in employment or agency]; 41 A.L.R.2d 15 [enforceability of restrictive covenant, ancillary to employment contract, as affected by restriction's

duration]; 43 A.L.R.2d 94 [employment restriction as affected by territorial extent of restriction]; 50 A.L.R.3d 746 [covenant ancillary to franchise agreement]; 62 A.L.R.3d 1014 [restrictions on right of medical practitioner, incident to employment agreement]; 15 A.L.R.4th 559 [covenant in accountant's employment contract]; 36 A.L.R.4th 1139 [radio or television personality's covenant not to compete]; 52 A.L.R.4th 139 [employee's promise to reimburse former employer for lost business]; on valid noninterference agreement, see, *infra*, §582.)

(2) *Rejection of Doctrine of Inevitable Disclosure.* Under the doctrine of *inevitable disclosure*, a plaintiff may prove a claim of trade secret misappropriation by demonstrating that a former employee's new employment will inevitably lead that employee to rely on the plaintiff's trade secrets. The justification for the doctrine, which results in an injunction prohibiting employment, not just use of trade secrets, is that unless the former 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. This doctrine is contrary to California's law rejecting covenants not to compete (*supra*, §579), and is rejected. (*Whyte v. Schlage Lock Co. (2002) 101 C.A.4th 1443, 1458, 125 C.R.2d 277* [when, as here, *confidentiality agreement* is in place, inevitable disclosure doctrine in effect converts that agreement into covenant not to compete].) (See 75 So. Cal. L. Rev. 1257 [conflict between policy of worker mobility and inevitable disclosure doctrine].)

(3) *Employee's Pension Plan.* In *Muggill v. Revben H. Donnelley Corp. (1965) 62 C.2d 239, 42 C.R. 107, 398 P.2d 147*, plaintiff employee retired from defendant corporation's employment with benefits in its retirement plan. The plan, regarded as part of the employment contract, contained a provision that annuity payments should be terminated if the retired employee entered an occupation or did an act in competition with his former employer. Plaintiff went to work for a competitor and defendant gave notice of termination. *Held*, because there was no trade secret involved, the provision was an illegal restraint of trade. (62 C.2d 242.) (See *Merrill Lynch v. Ware (1973) 414 U.S. 117, 94 S.Ct. 383, 38 L.Ed.2d 348* [affirming *Ware v. Merrill Lynch (1972) 24 C.A.3d 35, 43, 100 C.R. 791*, which held that forfeiture of employee's profit-sharing rights was invalid]; *Frame v. Merrill Lynch (1971) 20 C.A.3d 668, 672, 97 C.R. 811* [same]; *Rest.2d, Contracts §185*, Reporter's Note; 18 A.L.R.3d 1246 [validity of provision, in retirement plan, forfeiting or suspending benefits in event of competitive employment].)

(4) *Distinction: Customer List.* A covenant by an employee that he or she will not, for a 1-year period following termination of employment, use a confidential list of preferred customers (a valuable trade secret) is valid. (*Gordon v. Landau (1958) 49 C.2d 690, 694, 321 P.2d 456*; see *Buskuhl v. Family Life Ins. Co. (1969) 271 C.A.2d 514, 522, 76 C.R. 602* [life insurance agent's contract, conditioning right to future commission on not attempting to induce customers to leave former employer, valid]; *John F. Matull & Associates v. Cloutier (1987) 194 C.A.3d 1049, 1054, 240 C.R. 211*; 5 Corbin §80.15 et seq.; 6 Williston 4th, §13:14; 54A Am.Jur.2d (1996 ed.), *Monopolies, Restraints of Trade, and Unfair Trade Practices* §888 et seq.; 7A Am.Jur. P.P. Forms 2000 ed., *Master and Servant*, §175 et seq.; 29 *Hastings L. J.* 297 [antitrust implications of overly broad restrictive covenants for protection of trade secrets].)

West's Key Number Digest, Monopolies k.12(1)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *General Rule of Invalidity.* In *Edwards v. Arthur Andersen LLP (2008) 44 C.4th 937, 81 C.R.3d 282, 189 P.3d 285*, plaintiff certified public accountant was hired as a tax manager by the Los Angeles office of defendant accounting firm. Defendant's employment offer was contingent upon plaintiff signing a noncompetition agreement containing the following challenged clauses: (1) For 18 months after termination of employment, plaintiff was prohibited from performing professional services of the type he had provided while at defendant, for any client on whose account he had worked during 18 months prior to his termination. (2) For a year after termination, plaintiff was prohibited from "soliciting," i.e., providing professional services to any client of defendant's Los Angeles office. Five years later, HSBC purchased a portion of defendant's tax practice, including plaintiff's group, and made plaintiff an employment offer. In order to obtain defendant's agreement to his resignation from defendant and his subsequent employment by HSBC, plaintiff was required to execute a Termination of Non-Compete Agreement (TONC) that released defendant from "any and all" claims arising from plaintiff's employment with defendant.

Plaintiff refused to sign the TONC, and sued defendant for intentional interference with prospective economic advantage (see 5 *Summary* (10th), *Torts*, §741 et seq.) and for violation of the Cartwright Act, *B. & P.C. 16720* et seq. (see text, §591 et seq.). The trial court sustained defendant's demurrer to the Cartwright Act claim and entered judgment for defendant on the interference claim, holding that (1) the noncompetition agreement was valid under *B. & P.C. 16600* (see text, §579 et seq.), and (2) the TONC did not purport to waive plaintiff's rights to *indemnification* in violation of *Lab.C. 2802* (3 *Summary* (10th), *Agency and Employment*, §121 et seq.). The Court of Appeal reversed. *Held*, judgment of the Court of Appeal affirmed in part and reversed in part; the noncompetition agreement was invalid, but the TONC was valid. (On discussion of TONC aspect of case, see 3 *Summary* (10th), *Agency and Employment*, §122.)

(a) California courts have consistently held that *B. & P.C. 16600* evinces a settled policy in favor of open competition (see, e.g., *D'sa v. Playhut* (2000) 85 C.A.4th 927, 102 C.R.2d 495, text, p. 637), and they have invalidated anticompetition agreements even if they were narrowly tailored (see, e.g., *Muggill v. Reuben H. Donnelley Corp.* (1965) 62 C.2d 239, 42 C.R. 107, 398 P.2d 147, text, p. 638). (44 C.4th 945.)

(b) *B. & P.C. 16600* invalidates contracts that *restrain* anyone from engaging in a lawful profession. Defendant argued that "restrain" should be interpreted to mean "prohibit," so that only contracts that totally prohibited an employee from engaging in his or her profession would be illegal, while a mere limitation on an employee's ability to practice his or her vocation, as in this case, would be permissible, as long as it was reasonably based. Defendant claimed that *B. & P.C. 16600* was the statutory embodiment of prior common law that embraced the rule of reasonableness in evaluating competitive restraints. However, cases defendant cited to support a relaxation of the statutory rule simply recognized that the statutory exceptions to *B. & P.C. 16600* reflected the same exceptions to the rule against noncompetition agreements that were implied in the common law (see e.g., *South Bay Radiology Med. Associates v. Asher* (1990) 220 C.A.3d 1074, 269 C.R. 15, text, §585). Thus, defendant's contention was without merit, and the fact that the anticompetition agreement restricted plaintiff's ability to practice his profession was sufficient to invalidate the agreement. (44 C.4th 946.)

(c) Although some California courts have permitted restrictions where the former employee was barred from pursuing only a small or limited part of a business, trade, or profession, the cases relied on to create a "narrow restraint" exception are not in point. Thus, "[w]e reject Andersen's contention that we should adopt a narrow-restraint exception to section 16600 and leave it to the Legislature, if it chooses, either to relax the statutory restrictions or adopt additional exceptions to the prohibition-against-restraint rule under section 16600." (44 C.4th 950.)(2) *Rejection of Doctrine of Inevitable Disclosure*. See 36 A.L.R.6th 537 [inevitable disclosure doctrine].*Correction*: Page 638, first line of paragraph (3), "*Muggill v. Revben H. Donnelley Corp.*" should be "*Muggill v. Reuben H. Donnelley Corp.*"



48 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
E. Restraint of Trade and Other Illegal Trade Practices.
2. California Law.
a. Contracts Not To Compete.
3. Employment Agreements.
aa-1. (New) No-Hire Provision.

1 *Witkin Sum. Cal. Law Contracts* § 581A

[§ 581A] (New) No-Hire Provision.

In *VL Systems v. Unisen* (2007) 152 C.A.4th 708, 61 C.R.3d 818, plaintiff computer consulting company and defendant entered into a contract whereby plaintiff agreed to assist defendant in migrating to a new server. The contract had a no-hire provision under which defendant promised that it would not hire any of plaintiff's employees for 12 months after the contract's termination, subject to a liquidated damages provision. When defendant breached the no-hire provision, plaintiff sued for breach of contract, and the trial court awarded it part of the amount that it sought under the liquidated damages provision. *Held*, reversed; the no-hire provision was unenforceable.

(a) *B. & P.C. 16600* (text, §579) invalidates employment contracts that prohibit an employee from working for a competitor when the employment has terminated, and no actionable wrong is committed by a competitor who hires one of his competitor's employees who is not under contract. In short, although no action in tort would lie against defendant, the question here is whether two parties, as a matter of contract, can agree on a no-hire provision. Freedom of contract is an important principle, and courts should not blithely apply public policy reasons to void contract provisions. However, a no-hire provision may seriously impact the rights of a broad range of third parties, such as those employees of the plaintiff who had rendered no service to the defendant, as well as the employees who had not even been hired by the plaintiff at the time the contract between the parties had been entered into. (152 C.A.4th 713.)

(b) The only California case in point is *Webb v. West Side Dist. Hosp.* (1983) 144 C.A.3d 946, 193 C.R. 80, text, §598, which upheld a no-hire provision. However, the no-hire provision in *Webb* was limited to the plaintiff's employees who actually performed work for the defendant. This fact sharply distinguishes it from the no-hire provision here, which applied to any of plaintiff's employees. Another distinguishing factor is that the plaintiff in *Webb* apparently suffered actual damages when the contract in question was terminated prior to the defendant's employment of one of the plaintiff's employees. (152 C.A.4th 713, 714.) Moreover, cases from other states support the conclusion that no-hire provisions are unenforceable. (152 C.A.4th 716.)

(c) As a general principle, if the interests of the employee trump the interests of the employers as a matter of public policy, then it logically follows that a broad-ranging contractual provision restricting employment cannot stand. This

principle applies here. R, plaintiff's employee who was hired by defendant, did no work for defendant, worked for plaintiff for only a short time, was not even employed by plaintiff when it negotiated its contract with defendant, and initiated the process by which he became an employee of defendant. Indeed, R chose to apply for employment with defendant independent of any connection between plaintiff and defendant. Moreover, there is nothing in the record to suggest that R's brief employment with plaintiff was the causal factor in defendant's decision to hire him. (152 C.A.4th 714, 715.)

(d) Plaintiff claimed that enforcing the no-hire provision would not have limited defendant's ability to hire R or R's mobility. This argument is without merit. Defendant believed that the no-hire provision did not apply to R. If it had known that hiring R would lead to a large payment or a lawsuit, it would never have chosen R over another applicant. Thus, under the circumstances of this case, upholding the no-hire provision would unfairly narrow the mobility of an employee who had never worked for defendant while employed by plaintiff and who had independently sought out defendant's job opportunity. (52 C.A.4th 715, 716.) "Thus, contrary to [plaintiff's] arguments, we find that enforcing this clause would present many of the same problems as covenants not to compete and unfairly limit the mobility of an employee who actively sought an opportunity with [defendant]." (152 C.A.4th 716.)

(e) "[W]e take no position on whether a more narrowly drawn and limited no-hire provision would be permissible under California law." (152 C.A.4th 718.)

SUPPLEMENT: [This section is current through the latest supplement]



49 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
E. Restraint of Trade and Other Illegal Trade Practices.
2. California Law.
a. Contracts Not To Compete.
3. Employment Agreements.
bb. Valid Noninterference Agreement.

1 Witkin Sum. Cal. Law Contracts § 582

[§ 582] Valid Noninterference Agreement.

In *Loral Corp. v. Moyes* (1985) 174 C.A.3d 268, 219 C.R. 836, the court considered the effect of *B. & P.C. 16600* (supra, §579) on an employee's agreement not to interfere with his former employer's work staff. Defendant, executive officer of plaintiff corporation and its subsidiary, resigned and entered into a termination agreement providing that he would not "disrupt, damage, impair or interfere" with plaintiff's business "whether by way of interfering with or raiding its employees, disrupting its relationship with customers, agents, representatives or vendors or otherwise." Defendant then became an executive of Aydin Corporation, and offered jobs with his new employer to key employees of plaintiff. In plaintiff's action for breach of the agreement, the trial judge granted a nonsuit on the ground that the restriction against hiring away plaintiff's employees was void. *Held*, reversed.

(a) *B. & P.C. 16600* invalidates provisions in employment contracts prohibiting an employee from working for a competitor after completion of employment unless the provisions are necessary to protect trade secrets. (174 C.A.3d 275.) "Our question then is whether a noninterference agreement not to solicit former coworkers to leave the employer is more like a noncompetition agreement which is invalid, or a nondisclosure or nonsolicitation agreement which may be valid." (174 C.A.3d 276.)

(b) Rest.2d, Agency §393, Comment e, states: "The limits of proper conduct with reference to securing the services of fellow employees are not well marked. An employee is subject to liability if, before or after leaving the employment, he causes fellow employees to break their contracts with the employer. On the other hand, it is normally permissible for employees of a firm, or for some of its partners, to agree among themselves, while still employed, that they will engage in competition with the firm at the end of the period specified in their employment contracts. However, a court may find that it is a breach of duty for a number of the key officers or employees to agree to leave their employment simultaneously and without giving the employer an opportunity to hire and train replacements." (174 C.A.3d 276.)

(c) Few cases deal with noninterference agreements, but two decisions from Georgia hold these agreements valid, and their reasoning is persuasive. (174 C.A.3d 278.) "Defendant is restrained from disrupting, damaging, impairing or interfering with his former employer by raiding Conic employees under his termination agreement. This does not appear

to be any more of a significant restraint on his engaging in his profession, trade or business than a restraint on solicitation of customers or on disclosure of confidential information." (174 C.A.3d 279.)

(d) The restriction only slightly affects plaintiff's employees: "They are not hampered from seeking employment with Aydin nor from contacting Moyes. All they lose is the option of being contacted by him first." (174 C.A.3d 279.)

The opinion concludes: "The restriction presumably was sought by plaintiffs in order to maintain a stable work force and enable the employer to remain in business. This restriction has the apparent impact of limiting Moyes' business practices in a small way in order to promote Conic's business. This noninterference agreement has no overall negative impact on trade or business. We hold that this contract, as construed, is not void on its face under *Business and Professions Code section 16600*." (174 C.A.3d 280.)

SUPPLEMENT: [This section is current through the latest supplement]



50 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
E. Restraint of Trade and Other Illegal Trade Practices.
2. California Law.
a. Contracts Not To Compete.
4. Exceptions.
aa. Sale of Goodwill of Business.

1 Witkin Sum. Cal. Law Contracts § 583

[§ 583] Sale of Goodwill of Business.

(1) *Statutory Provision.* Any person who sells the goodwill of a business "may agree with the *buyer* to refrain from carrying on a similar business within a *specified geographic area in which the business so sold ...* has been carried on, *so long as the buyer, or any person deriving title to the goodwill ...* from the buyer, carries on a like business therein." (B. & P.C. 16601; see *Dowd v. Bryce* (1950) 95 C.A.2d 644, 645, 213 P.2d 500 [agreement violated by seller's lease to person with knowledge that latter would compete]; *Harrison v. Cook* (1963) 213 C.A.2d 527, 528, 29 C.R. 269; *Rest.2d, Contracts* §188, Comments c, f; 38 *Am.Jur.2d* (1999 ed.), *Good Will* §1 et seq.; 12B *Am.Jur.* P.P. Forms (1999 ed.), *Good Will*, §1 et seq.; 4 *Santa Clara Lawyer* 110; 6 *So. Cal. L. Rev.* 238; 8 *So. Cal. L. Rev.* 241; 26 *So. Cal. L. Rev.* 208; 65 *A.L.R.2d* 502 [sale of business without covenant not to compete as transferring goodwill by implication]; 62 *A.L.R.3d* 918 [sale of medical practice]; 13 *A.L.R.4th* 661 [sale of accountant's practice]; *infra*, §584.) (On legality of sale of goodwill of law practice, see 1 *Cal. Proc.* (4th), *Attorneys*, §62; 6 *Williston* 4th, §§13:8, 13:9.)

(2) *Territorial Limitation.* In *Monogram Industries v. Sar Industries* (1976) 64 C.A.3d 692, 134 C.R. 714, decided when the statute referred to covenants not to compete in specified "counties or cities," the covenant was nationwide in scope, and the injunction followed its terms. In affirming the order, the court declared that "[t]he territorial limits are coextensive with the entire area in which the parties conducted all phases of their business" (64 C.A.3d 702). The statutory limitation to counties or cities was not discussed. (See *Kaplan v. Nalpak Corp.* (1958) 158 C.A.2d 197, 201, 322 P.2d 226 [B. & P.C. 16601 is "consistent with the common-law rule under which the territorial limits for permissible operation of covenants in restraint of competition were coextensive with the area in which the goodwill of the business in question had been established"]; *Fleming v. Ray-Suzuki* (1990) 225 C.A.3d 574, 583, 275 C.R. 150 [counties and cities provision did not limit covenant to California]; following *Monogram Industries*; on meaning of terms "city" or "town," see 45 *A.L.R.3d* 1339.)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Statutory Provision.*

Cross-Reference: 1 *Cal. Proc.* (5th), *Attorneys*, §36.(2) *Territorial Limitation.* See *Alliant Ins. Services v. Gaddy*

(2008) 159 C.A.4th 1292, 1300, 72 C.R.3d 259 [noncompetition covenant prohibiting seller of construction insurance brokerage from offering any insurance services anywhere in California for 3 years after his termination from company that bought brokerage was not illegal restraint on trade, even though sold brokerage had clients in only six counties, because sold brokerage also carried on business that depended on goodwill in all 58 counties of California by procuring insurance from insurance companies statewide].



51 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

E. Restraint of Trade and Other Illegal Trade Practices.

2. California Law.

a. Contracts Not To Compete.

4. Exceptions.

bb. Sale of Ownership Interest in Business.

1 Witkin Sum. Cal. Law Contracts § 584

[§ 584] Sale of Ownership Interest in Business.

(1) *Former Law: Agreement by Shareholder.* In 1945, *B. & P.C. 16601* supra, §583 was amended to allow an agreement not to compete to be made by a *shareholder* who transferred shares in a corporation. The 1963 Legislature extended this exception to allow a shareholder to make the agreement where the corporation itself sold its assets. (See *Vacco Industries v. Van Den Berg* (1992) 5 C.A.4th 34, 47, 6 C.R.2d 602 [covenant would be enforced to extent that it was reasonable and necessary in terms of time, activity, and territory to protect the buyer's interest]; *Hilb, Rogal & Hamilton Ins. Services v. Robb* (1995) 33 C.A.4th 1812, 1824, 39 C.R.2d 887 [*B. & P.C. 16601* applied where shareholder transferred shares in a corporation that merged with another corporation, even though shareholder received shares in merged corporation as consideration for the shares in original corporation]; cf. *Hill Med. Corp. v. Wycoff* (2001) 86 C.A.4th 895, 901, 103 C.R.2d 779 [covenant not to compete contained in stock repurchase agreement was invalid under *B. & P.C. 16601*, where repurchase price was far below market value and price did not include any payment for goodwill].)

(2) *Revised Law: Agreement on Transfer of Any Ownership Interest.* *B. & P.C. 16601* was amended in 2002 to allow agreements not to compete in connection with the transfer of *any ownership interest* in a business entity. "Any ... owner of a business entity selling or otherwise disposing of all of his or her ownership interest in the business entity, or any owner of a business entity that sells (a) all or substantially all of its operating assets together with the goodwill of the business entity, (b) all or substantially all of the operating assets of a division or a subsidiary of the business entity together with the goodwill of that division or subsidiary, or (c) all of the ownership interest of any subsidiary, may agree with the buyer to refrain from carrying on a similar business within a specified geographic area" in which the business of the entity, division, or subsidiary "has been carried on, so long as the buyer, or any person deriving title to the goodwill or ownership interest from the buyer, carries on a like business therein."

(3) *Definitions.* A "business entity" is defined as "any partnership (including a limited partnership or a limited liability partnership), limited liability company, or corporation." An "owner of a business entity" is "any partner, in the case of a business entity that is a partnership (including a limited partnership or a limited liability partnership), or any member, in the case of a business entity that is a limited liability company, or any owner of capital stock, in the case of

a business entity that is a corporation." "Ownership interest" means "a partnership interest, in the case of a business entity that is a partnership (including a limited partnership [or] a limited liability partnership), a membership interest, in the case of a business entity that is a limited liability company, or a capital stockholder, in the case of a business entity that is a corporation." "Subsidiary" means "any business entity over which the selling business entity has voting control or from which the selling business entity has a right to receive a majority share of distributions upon dissolution or other liquidation of the business entity (or has both voting control and a right to receive these distributions.)" (*B. & P.C. 16601*).

West's Key Number Digest, Monopolies k.21.6

SUPPLEMENT: [This section is current through the latest supplement]

(2) *Revised Law: Agreement on Transfer of Any Ownership Interest.* A nonsolicitation agreement executed in conjunction with the sale of a business must, to be enforceable, bar the seller from soliciting the sold business's employees and customers. (*Strategix, Ltd. v. Infocrossing West (2006) 142 C.A.4th 1068, 1072, 48 C.R.3d 614* [nonsolicitation covenants between seller of business and buyer wrongly barred seller from soliciting buyer's customers and employees, rather than former customers and employees of seller who were tied to sold business].)



52 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
E. Restraint of Trade and Other Illegal Trade Practices.
2. California Law.
a. Contracts Not To Compete.
4. Exceptions.
cc. Dissolution of Partnership.

1 Witkin Sum. Cal. Law Contracts § 585

[§ 585] Dissolution of Partnership.

(1) *Former Law.* *B. & P.C. 16602* formerly provided that "Partners may, upon or in anticipation of a dissolution of the partnership, agree that none of them will carry on a similar business within the same city or town or a specified part thereof, where the partnership business has been transacted."

This section restricted partners more than other persons (see *B. & P.C. 16601*, supra, §§583, 584); thus, a covenant by a selling partner not to compete in a particular county was unenforceable. (See *Swenson v. File* (1970) 3 C.3d 389, 392, 90 C.R. 580, 475 P.2d 852, infra, §753 [old law applied; covenant valid to extent that it fell within limits permitted by statute; evidence did not establish a "carrying on" of business within city]; *Du Bois v. Padgham* (1912) 18 C.A. 298, 300, 123 P. 207; *Anderson Crop Dusters v. Matley* (1958) 159 C.A.2d 811, 812, 324 P.2d 710; *Roberts v. Pfefer* (1970) 13 C.A.3d 93, 97, 91 C.R. 308 [old law applied; quoting and following *Swenson*].)

(2) *Revised Law.* The statute was changed in 1961 by an amendment that made the scope of *B. & P.C. 16601* and *16602* the same (*B. & P.C. 16602(a)*), and by a 1996 amendment that made the statute applicable, in addition to dissolution, to dissociation of a partner and to a sale or other disposition of a partner's interest (*B. & P.C. 16602(b)*). After further amendment in 2002, the statute provides that "[a]ny partner may, upon or in anticipation of any of the circumstances described in subdivision (b), agree that he or she will not carry on a similar business with a specified geographic area where the partnership business has been transacted, so long as any other member of the partnership, or any person deriving title to the business or its goodwill from any such other member of the partnership, carries on a like business therein." (*B. & P.C. 16602(a)*.) (See 6 Williston 4th, §13:16; 54A Am.Jur.2d (1996 ed.), *Monopolies, Restraints of Trade, and Unfair Trade Practices* §§853, 938; 59A Am.Jur.2d (2003 ed.), *Partnership* §335 et seq.; 19A Am.Jur. P.P. Forms (1997 ed.), *Partnership*, §§292, 304; on covenant requiring withdrawing law partners to forego certain benefits if they compete with their former law firm, see *Howard v. Babcock* (1993) 6 C.4th 409, 25 C.R.2d 80, 863 P.2d 150, 1 Cal. Proc. (4th), *Attorneys*, §60.)

(3) *No Need To Compensate for Goodwill.* In *South Bay Radiology Med. Associates v. Asher* (1990) 220 C.A.3d 1074, 269 C.R. 15, a medical partnership agreement that provided that a dissolving partner would receive no allowance

for goodwill also contained a covenant not to compete within a specified geographical area for 5 years. In opposing confirmation of an arbitration award upholding the covenant not to compete, Asher, a dissolving partner, argued that the goodwill requirement of *B. & P.C. 16601* (supra, §583) must be read into *B. & P.C. 16602*, and consequently that the covenant not to compete was unenforceable unless he was compensated for the value of the partnership's goodwill. *Held*, confirmation order affirmed.

(a) "[W]e cannot accept Asher's argument the goodwill requirement of section 16601 should be read into section 16602. For almost 120 years versions of each statute have stood together, first in the Civil Code and now in the Business and Professions Code. Though given the opportunity through the recodification and amendment of both provisions, the Legislature has never expressly made the compensation for goodwill a predicate to application of section 16602. Rather, ... the only attempt to harmonize the two statutes has been with respect to the permissible territory and duration of limitations on competition." (220 C.A.3d 1083.)

(b) Asher's argument confuses the concepts of transfer of goodwill, compensation for goodwill, and consideration for a covenant not to compete. " 'Goodwill' and a 'covenant against competition' are closely related. In general a covenant not to compete is employed to protect the intangible asset denominated 'goodwill.' However in terms of consideration for a contract, there is obviously consideration for a mutual agreement among partners prospectively to preclude competition when one of them departs the partnership. The promise of each to protect the goodwill of the partnership is consideration for the promise of the other. Nonetheless Asher argues the covenant not to compete must be sustained not simply by consideration, but by specific dollar payment of some sort for the covenant. It is this concept which we reject, finding no support for it in the statute, legislative history or common law. Thus, we find the South Bay partners were free under section 16602 to both impose a covenant not to compete on each other and to refrain from paying a withdrawing partner any amount for the partnership's goodwill." (220 C.A.3d 1084.)

SUPPLEMENT: [This section is current through the latest supplement]

(2) *Revised Law.* See 19A Am.Jur. P.P. Forms (2007 ed.), Partnership, §§214, 220.

Howard case:

Cross-Reference: 1 Cal. Proc. (5th), Attorneys, §35.



53 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

E. Restraint of Trade and Other Illegal Trade Practices.

2. California Law.

a. Contracts Not To Compete.

4. Exceptions.

dd. Dissolution of Limited Liability Company.

1 Witkin Sum. Cal. Law Contracts § 586

[§ 586] Dissolution of Limited Liability Company.

Any member of a limited liability company may, on or in anticipation of its dissolution, agree that the member will not carry on a similar business within a specified geographic area where the limited liability company business has been transacted. The agreement may apply so long as any other member, or any person deriving title to the business or its goodwill from any other member, carries on a like business in that area. (*B. & P.C. 16602.5.*)

SUPPLEMENT: [This section is current through the latest supplement]

As amended in 2006, *B. & P.C. 16602.5* also applies to the termination of one's interest in a limited liability company.



54 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
E. Restraint of Trade and Other Illegal Trade Practices.
2. California Law.
a. Contracts Not To Compete.
4. Exceptions.
ee. Partially Valid Agreements.

1 Witkin Sum. Cal. Law Contracts § 587

[§ 587] Partially Valid Agreements.

The sections just considered (*supra*, §583 et seq.) expressly limit the *duration* of an agreement (so long as the buyer or his or her successor remain in business). (See 15 Corbin (Rev. ed.), §80.26; 6 Williston 4th, §§13:21, 13:22; 54A *Am.Jur.2d* (1996 ed.), *Monopolies, Restraints of Trade, and Unfair Trade Practices* §976 et seq.; 45 *A.L.R.2d* 77 [effect of duration of restriction]; 61 *A.L.R.3d* 397 [enforceability, insofar as restrictions would be reasonable, of contract containing unreasonable restrictions on competition]; 13 *A.L.R.4th* 661 [validity and construction of contractual restriction on right of accountant to practice, incident to sale of practice or withdrawal from accountancy partnership].) In *Martinez v. Martinez* (1953) 41 *C.2d* 704, 263 *P.2d* 617, an agreement was reformed to insert a covenant not to engage in business. Despite testimony that it called for permanent noncompetition, the court limited the covenant to the period of the buyer's or his successor's business. (41 *C.2d* 706.)

SUPPLEMENT: [This section is current through the latest supplement]



55 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
E. Restraint of Trade and Other Illegal Trade Practices.
2. California Law.
a. Contracts Not To Compete.
5. Enjoining Attempt To Enforce Out-of-State Covenant Not To Compete.

1 Witkin Sum. Cal. Law Contracts § 588

[§ 588] Enjoining Attempt To Enforce Out-of-State Covenant Not To Compete.

In *Advanced Bionics Corp. v. Medtronic* (2002) 29 C.4th 697, 128 C.R.2d 172, 59 P.3d 231, employee S went to work for M, a corporation headquartered in Minnesota that manufactured implantable neurostimulation devices. He signed an agreement containing a covenant not to compete for 2 years after termination of employment and a choice-of-law provision stating that the agreement would be governed by Minnesota law. Five years later, S went to work for AB corporation, a competitor of M that was headquartered in California. On the same day, S and AB sued M in California, alleging that M's covenant not to compete was in violation of California law as reflected in *B. & P.C. 16600*. M removed the California action to federal court and also filed a Minnesota action alleging claims for breach of, and interference with, a contract. M then obtained a temporary restraining order (TRO) enjoining AB from hiring S in any competitive role and barring both parties from taking any action interfering with the Minnesota lawsuit. After the California case was remanded from the federal court, M unsuccessfully moved to dismiss or stay the California action. The Minnesota court then issued a preliminary injunction that, as amended, was similar to its TRO, and S and AB appealed. S and AB countered by obtaining a TRO from the California court prohibiting M from taking any further steps in the Minnesota action. M appealed, but the Court of Appeal affirmed, holding that (1) the TRO was necessary to protect the interest of S and AB pending final disposition of the case, (2) California law should apply, and (3) because the action was first filed in California, California courts should decide the dispute. *Held*, reversed.

(a) Although *Spreckels v. Hawaiian Commercial & Sugar Co.* (1897) 117 C. 377, 49 P. 353, 2 Cal. Proc. (4th), Courts, §213, recognized that a California court might have power to issue a TRO to prevent multiple proceedings, and implicitly recognized a forum court's power to restrain proceedings, the *Spreckels* court never suggested, implicitly or otherwise, that a court may ignore additional proceedings that arise after the initial action commences. And several out-of-state decisions hold that even if a sister state applies different substantive law than the forum state, that fact alone does not justify the issuance of a TRO enjoining proceedings in the sister state. (29 C.4th 704.)

(b) Earlier California cases holding that a TRO is sometimes necessary to prevent multiplicity of suits involved conflicts *between California courts*; when different states are involved, however, judicial restraint assumes a more significant role. The possibility of an embarrassing race to judgment or potentially inconsistent adjudications does not outweigh the respect and deference owed to independent foreign proceedings. (29 C.4th 705, quoting from a federal

case.)

(c) S and AB argued that although California should pay deference to foreign state proceedings, its strong public policy against noncompetition agreements under *B. & P.C. 16600* weighs against allowing the action to proceed in Minnesota and provides the exceptional circumstance that warrants upholding the California court's TRO. This argument is unpersuasive. "We agree that California has a strong interest in protecting its employees from noncompetition agreements under section 16600. But even assuming a California court might reasonably conclude that the contractual provision at issue here is void in this state, this policy interest does not, under these facts, justify issuance of a TRO against the parties in the Minnesota court proceedings. A parallel action in a different state presents sovereignty concerns that compel California courts to use judicial restraint when determining whether they may properly issue a TRO against parties pursuing an action in a foreign jurisdiction." (29 *C.4th* 706.) The comity principle also supports this conclusion. (29 *C.4th* 707.)

(d) Notwithstanding comity principles, AB contended that the first-filed rule provides alternative support for the Court of Appeal's decision to uphold the TRO and to enjoin the litigants from proceeding in Minnesota. This contention is also without merit. In California, the first-filed rule means that when two courts *of the same sovereignty* have concurrent jurisdiction, the first to assume jurisdiction over a particular subject matter of a particular controversy takes it exclusively, and the second court should not thereafter assert control over that subject matter. The first-filed rule was never meant to apply where the two courts involved are not courts of the same sovereignty. (29 *C.4th* 707.)

(e) "We hold that the trial court improperly issued the TRO enjoining Medtronic from proceeding in the Minnesota action. We also conclude, however, that the Minnesota action does not divest California of jurisdiction, and Advanced Bionics remains free to litigate the California action unless and until Medtronic demonstrates to the Los Angeles County Superior Court that any Minnesota judgment is binding on the parties. As stated above, potentially conflicting judgments naturally result from parallel proceedings but do not provide a reason for issuing a TRO." (29 *C.4th* 708.)

SUPPLEMENT: [This section is current through the latest supplement]

See *Biosense Webster v. Superior Court* (2006) 135 *C.A.4th* 827, 835, 37 *C.R.3d* 759 [trial court abused its discretion in issuing TRO prohibiting former employer from enforcing any noncompetition agreement in sister state action; exceptional circumstances required by *Advanced Bionics Corp. v. Medtronic* (2002) 29 *C.4th* 697, 128 *C.R.2d* 172, 59 *P.3d* 231, text, p. 645, were not present].

Spreckels case:

Cross-Reference: 2 *Cal. Proc.* (5th), *Courts*, §212.



56 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
E. Restraint of Trade and Other Illegal Trade Practices.
2. California Law.
b. Contracts for Exclusive Dealing.
1. In General.

1 Witkin Sum. Cal. Law Contracts § 589

[§ 589] In General.

Earlier California cases held that an agreement by one party to take, exclusively from another, all the goods required in his or her business was illegal. (See *Coombs v. Burk* (1919) 40 C.A. 8, 10, 180 P. 59; *Fidelity Credit Assurance Co. of Calif. v. Cosby* (1928) 90 C.A. 22, 25, 265 P. 372; cf. *Hunter v. Superior Court* (1939) 36 C.A.2d 100, 114, 97 P.2d 492 [agreement to manufacture certain machines exclusively for other contracting party and not to manufacture similar or any other machines to perform the particular work for others, held void].) However, later decisions upheld these agreements.

Thus, in *Associated Oil Co. v. Myers* (1933) 217 C. 297, 18 P.2d 668, defendant owners of a service station leased it to plaintiff company for the sale of its products and signed a "license agreement," by which defendants were to occupy the premises and sell plaintiff's products only. *Held*, the agreement was valid. Plaintiff had a right so to limit the sale of products by its licensees on its leased property. (217 C. 304.) (See 26 A.L.R.2d 219 [restrictive agreement respecting purchase of petroleum products by filling station operator].)

In *Great Western Distillery Products v. John A. Wathen Distillery Co.* (1937) 10 C.2d 442, 74 P.2d 745, the court applied the "rule of reason" (*supra*, §564) to a contract by which defendant agreed to sell its whiskey warehouse receipts in California solely to plaintiff (and one other), provided plaintiff purchased and exploited only those of defendant. *Held*, the contract was valid; it was designed merely to create a market and promote the business of the two parties in a particular territory through the medium of an exclusive sales agency; and there was no intent to secure a monopoly or control prices. (10 C.2d 445.) Following *Associated Oil Co.* and disapproving *Coombs*, the court said: "The decisions in this state have recognized and applied the distinction made by authority elsewhere that if the public welfare be not involved and the restraint upon one party be not greater than protection to the other requires, the contract will be sustained *although it in some degree may be said to restrain trade.*" (10 C.2d 448.) (See *Keating v. Preston* (1940) 42 C.A.2d 110, 123, 108 P.2d 479 [lease of restaurant space in hotel interpreted as prohibiting lessor from leasing to competing business, held valid]; *Rolley v. Merle Norman Cosmetics* (1954) 129 C.A.2d 844, 850, 278 P.2d 63; 6 Williston 4th, §13:17; 54A Am.Jur.2d (1996 ed.), *Monopolies, Restraints of Trade, and Unfair Trade Practices* §1001 et seq.; 6 U.C.L.A. L. Rev. 547; 12 Summary (10th), *Real Property*, §660 et seq.)

As the court said in *Dayton Time Lock Service v. Silent Watchman Corp.* (1975) 52 C.A.3d 1, 124 C.R. 678:

"Exclusive-dealing contracts are not necessarily invalid. They may provide an incentive for the marketing of new products and a guarantee of quality-control distribution. They are proscribed when it is probable that performance of the contract will foreclose competition in a substantial share of the affected line of commerce. ... A determination of illegality requires knowledge and analysis of the line of commerce, the market area, and the affected share of the relevant market." (52 C.A.3d 6.)

The validity of an agreement giving an *exclusive right to solicit patronage* at a railroad station was upheld in *Demeter v. Annenson* (1947) 80 C.A.2d 48, 180 P.2d 998. Plaintiff taxi company, by agreement with Southern Pacific Co. in consideration of a fixed rental, obtained the exclusive right to park cabs and solicit passengers on the station grounds at Palo Alto. *Held*, plaintiff could enjoin defendants (other taxi companies) from parking and soliciting there. After noting that only a few states condemn these agreements, the court approved the general view that the result is beneficial to the traveling public, serving convenience and promoting safety of passengers. (80 C.A.2d 52.) The principal ground of attack was that a railroad is prohibited from discriminating in its charges or facilities (see *Pub.Util.C.* 461.5). The court held, however, that these statutory regulations are applicable solely to the railroad's business *as a carrier* (the transportation of passengers and property *by the railroad company*), and have no application to transportation to or from its depot. (80 C.A.2d 58.) (See 74 A.L.R.3d 1268 [contract between hospital and physician providing for exclusive medical services]; 42 A.L.R.4th 1072 [contract between insurer and independent agent restricting agent's business with other insurers].)

West's Key Number Digest, Monopolies k.17(2.2)

SUPPLEMENT: [This section is current through the latest supplement]

Dayton Time Lock Service case: See *Kelton v. Stravinski* (2006) 138 C.A.4th 941, 947, 41 C.R.3d 877 [*Dayton Time Lock Service* exception applies to franchisor-franchisee situation, and thus it did not validate covenant not to compete as between two equal partners who had formed partnership for purpose of developing industrial warehouses].



57 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

E. Restraint of Trade and Other Illegal Trade Practices.

2. California Law.

b. Contracts for Exclusive Dealing.

2. Tying Agreements.

1 Witkin Sum. Cal. Law Contracts § 590

[§ 590] Tying Agreements.

(1) *In General. B. & P.C. 16727* makes it unlawful to (a) lease or sell goods, merchandise, machinery, supplies, or commodities for use within the state, or (b) fix a price charged for them or discount or rebate, on the condition that the lessee or buyer not deal with a competitor of the lessor or seller, where the effect "may be to substantially lessen competition or tend to create a monopoly in any line of trade or commerce in any section of the State." (See *Chicago Title Ins. Co. v. Great Western Financial Corp.* (1968) 69 C.2d 305, 315, 70 C.R. 849, 444 P.2d 481 [statute incorporates in essence Clayton Act, §3, supra, §570; hence, federal decisions interpreting §3 are applicable]; *Corwin v. Los Angeles Newspaper Service Bureau* (1971) 4 C.3d 842, 852, 853, 94 C.R. 785, 484 P.2d 953, infra, §606 [same; statute goes beyond the codified common law]; *Bert G. Gianelli Distr. Co. v. Beck & Co.* (1985) 172 C.A.3d 1020, 1049, 1050, 219 C.R. 203 [same]; *Saxer v. Philip Morris* (1975) 54 C.A.3d 7, 24, 126 C.R. 327 [complaint sufficient]; *Morrison v. Viacom* (1998) 66 C.A.4th 534, 546, 78 C.R.2d 133, infra, §606 [B. & P.C. 16727 does not apply when tying item is service]; for illustrations of tying agreements, see infra, §606.)

(2) *Sale or Consignment of Publications. B. & P.C. 16604* makes it a misdemeanor for the seller or consignor of "any magazine, book, or other publication," to require that the buyer or consignee buy or receive for sale "any other magazine, book or other publication." Exceptions are (a) an agreement to accept a minimum number of copies of a single edition or issue of a magazine, or of a particular book or other publication; (b) the sale or consignment of a newspaper of general circulation.

(3) *Sale of Property or Loan on Security of Property. Ins.C. 770* forbids a lender financing the purchase of real or personal property, or lending money on the security of property, from requiring, as a condition to the financing, that the borrower negotiate or renew insurance covering the property through a particular insurance agent or broker. Similarly, *Ins.C. 776* prohibits a vendor of real property from requiring, as a condition to the sale, that the purchaser negotiate or renew insurance through a particular agent, broker, or solicitor.

SUPPLEMENT: [This section is current through the latest supplement]



58 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
E. Restraint of Trade and Other Illegal Trade Practices.
2. California Law.
c. Cartwright Act.
1. Nature of Act.

1 Witkin Sum. Cal. Law Contracts § 591

[§ 591] Nature of Act.

(1) *In General.* The Cartwright Act (B. & P.C. 16700 et seq.) makes unlawful a "trust," defined as a *combination* of capital, skill, or acts by two or more persons, firms, partnerships, corporations, or associations of persons to restrict trade, limit production, increase or fix prices, or prevent competition. (B. & P.C. 16702, 16720, 16726; see generally *Ghirardelli Co. v. Hunsicker* (1912) 164 C. 355, 362, 128 P. 1041; *People v. H. Jevne Co.* (1919) 179 C. 621, 625, 178 P. 517; *Speegle v. Board of Fire Underwriters of the Pac.* (1946) 29 C.2d 34, 44, 172 P.2d 867 [the act "merely articulates in greater detail a public policy against restraint of trade that has long been recognized at common law"]; *People v. Building Maintenance Contractors' Assn.* (1953) 41 C.2d 719, 723, 264 P.2d 31; *Oakland-Alameda County Builders' Exchange v. F.P. Lathrop Const. Co.* (1971) 4 C.3d 354, 362, 93 C.R. 602, 482 P.2d 226, *infra*, §605; *Corwin v. Los Angeles Newspaper Service Bureau* (1971) 4 C.3d 842, 852, 94 C.R. 785, 484 P.2d 953, *infra*, §606; *Mailand v. Burckle* (1978) 20 C.3d 367, 377, 143 C.R. 1, 572 P.2d 1142 [price-fixing scheme]; *Quelimane Co. v. Stewart Title Guaranty Co.* (1998) 19 C.4th 26, 48, 77 C.R.2d 709, 960 P.2d 513 [complaint alleging that title to property conveyed by tax deed had become unmarketable in county as result of title insurers' efforts to convince public that insurance was necessity, and that three insurers conspired to refuse to insure title to tax-defaulted property, sufficiently pleaded concerted action in restraint of trade in violation of Cartwright Act]; *Aguilar v. Atlantic Richfield Co.* (2001) 25 C.4th 826, 843, 107 C.R.2d 841, 24 P.3d 493, 6 Cal. Proc. (4th), *Proceedings Without Trial*, Supp., §216; *Kold Kist v. Amalgamated Meat Cutters & Butchers Workmen of North America, Local No. 421* (1950) 99 C.A.2d 191, 196, 221 P.2d 724; *Lowell v. Mother's Cake & Cookie Co.* (1978) 79 C.A.3d 13, 23, 144 C.R. 664, 5 Summary (10th), Torts, §747 [complaint insufficient]; *Kolling v. Dow Jones & Co.* (1982) 137 C.A.3d 709, 718, 723, 187 C.R. 797 [termination of distributorship for anticompetitive reason--noncompliance with illegal price-fixing policy; pleading and proof sufficient to support verdict for damages]; *Roth v. Rhodes* (1994) 25 C.A.4th 530, 543, 30 C.R.2d 706; *Scripps Clinic v. Superior Court* (2003) 108 C.A.4th 917, 936, 134 C.R.2d 101 [policy of medical group and insurer allowing patient litigants to be transferred was not violation of Cartwright Act where evidence showed that purpose of policy was to protect patient-physician relationship, not to restrain trade]; *Fisherman's Wharf Bay Cruise Corp. v. San Francisco Superior Court* (2003) 114 C.A.4th 309, 334, 7 C.R.3d 628; C.E.B., Sales and Mergers of California Businesses, §5.10; Cal. Civil Practice, 6 Business Litigation, §63:1 et seq.; 3 California Affirmative Defenses (2d), §37:14; 35 So. Cal. L. Rev. 393; 2 Stanf. L. Rev. 200; 6 U.C.L.A. L. Rev. 540 [comparison of California and federal law].) (On origin, nature,

and effect of Cartwright Act, see *California v. Texaco* (1988) 46 C.3d 1147, 1153, 252 C.R. 221, 762 P.2d 385, *infra*, §595; *Bert G. Gianelli Distr. Co. v. Beck & Co.* (1985) 172 C.A.3d 1020, 1042, 219 C.R. 203; for the Uniform State Antitrust Act, approved in 1974 and adopted in four states, see 7C U.L.A. (Master Ed.), p. 351; on *B. & P.C. 16727*, prohibiting tying agreements, see *supra*, §590; on *B. & P.C. 16721, 16721.5*, prohibiting specified discriminatory practices as unlawful trusts, see 8 *Summary* (10th), *Constitutional Law*, §905 et seq.)

(2) *Requirement of Separate Entities.* The statute refers to concert of action between individuals or entities maintaining separate and independent interests; hence a complaint alleging that defendant corporation entered into a combination with its officers and directors to prevent competition stated no cause of action. (*Bondi v. Jewels by Edwar, Ltd.* (1968) 267 C.A.2d 672, 678, 73 C.R. 494.) Furthermore, whether *multiple corporations* are distinct entities capable of conspiring depends on the particular facts, such as the extent to which corporate policies are set by a single individual or corporation, or the extent to which separate corporations compete among themselves. (*MacManus v. A.E. Realty Partners* (1983) 146 C.A.3d 275, 287, 288, 194 C.R. 567 [complaint sufficiently alleged that parent corporation and wholly owned subsidiary were distinct entities].)

In *MacManus v. A.E. Realty Partners* (1987) 195 C.A.3d 1106, 241 C.R. 315, MacManus purchased a house from AERP, and as a condition of the sale, was required to use REI, a wholly owned subsidiary of AERP, for escrow purposes. Alleging that REI's escrow fees were in excess of the standard charge, MacManus filed a class action under the Cartwright Act. The trial judge entered summary judgment for defendants, based on *Copperweld Corp. v. Independence Tube Corp.* (1984) 467 U.S. 752, 104 S.Ct. 2731, 81 L.Ed.2d 628, which held that a parent corporation and its subsidiary are incapable of forming a conspiracy. *Held*, reversed; the *Copperweld Corp.* decision did not preclude the present action. "In order to implement the AERP/REI scheme, the acquiescence of a third party was necessary, namely the homebuyer. No interference with other escrow companies' access to the general home buying public was implicated until MacManus sought to purchase an AERP home, allegedly conditioned upon his use of REI's services. It is the purchase agreement between AERP/REI and MacManus, or between AERP/REI and other coerced buyers, and the required arrangement between MacManus and REI that creates the illegal 'combination' proscribed by the Cartwright Act." (195 C.A.3d 1112.) (See *Roth v. Rhodes* (1994) 25 C.A.4th 530, 543, 30 C.R.2d 706 [complaint insufficient]; *Aguilar v. Atlantic Richfield Co.*, *supra*, 25 C.4th 843 [same].)

West's Key Number Digest, Monopolies k.10

SUPPLEMENT: [This section is current through the latest supplement]

(1) *In General.* See *Eddins v. Redstone* (2005) 134 C.A.4th 290, 314, 35 C.R.3d 863 [independent video rental retailers presented insufficient evidence showing horizontal conspiracy among major movie studios to deprive independent retailers of terms comparable to those offered to nation's largest video renter retailer]; 2 California Affirmative Defenses §37:14. *Aguilar case*:

Cross-Reference: 6 *Cal. Proc.* (5th), *Proceedings Without Trial*, §239.

Uniform State Antitrust Act: Old volume 7C of the Uniform Laws Annotated was replaced in 2006 by a new volume 7C. The reference in the text should now be to 7C U.L.A. (Master Ed.), p. 337.



59 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
E. Restraint of Trade and Other Illegal Trade Practices.
2. California Law.
c. Cartwright Act.
2. Scope of Act.

1 Witkin Sum. Cal. Law Contracts § 592

[§ 592] Scope of Act.

(1) *Activity in Both Interstate and Intrastate Commerce.* In *R.E. Spriggs Co. v. Adolph Coors Co.* (1974) 37 C.A.3d 653, 112 C.R. 585, defendant Coors, a Colorado corporation, sold beer solely in interstate commerce to wholesale distributors. Plaintiff, a longtime distributor, had its contract terminated, and brought suit alleging that the Coors distribution agreements had territorial limitations and involved price-fixing in violation of the Cartwright Act. The trial judge dismissed this cause of action for lack of jurisdiction. *Held*, reversed. In this activity involving both interstate and intrastate aspects, the California Cartwright Act could be applied: There was no express congressional intent in the Sherman Act to preempt and supplant state legislation; and the nature of the subject matter does not call for such preemption.

"In sum, we deal with a state act which operates in furtherance of the purpose and intent of the federal antitrust legislation, not in contravention of it. Likewise, application of the state act is solely directed to the intrastate effect of the trade involved." Hence, there is no exclusive federal jurisdiction. (37 C.A.3d 666.)

(2) *Service Trades.* The Act applies to service trades, including realtors. (See *Marin County Bd. of Realtors v. Palsson* (1976) 16 C.3d 920, 927, 130 C.R. 1, 549 P.2d 833, *infra*, §607.)

(3) *Professions.* In *Willis v. Santa Ana Community Hosp. Assn.* (1962) 58 C.2d 806, 809, 26 C.R. 640, 376 P.2d 568, the court declared that the word "trade" in this statute could not be interpreted to include the professions, and held that no action could be brought on behalf of plaintiff doctor against a hospital association for alleged restraint of fair competition in the medical field of a county. (See *Osteopathic Physicians & Surgeons of Calif. v. California Med. Assn.* (1964) 224 C.A.2d 378, 396, 36 C.R. 641 [following *Willis*]; *Blank v. Palo Alto-Stanford Hosp. Center* (1965) 234 C.A.2d 377, 392, 44 C.R. 572 [exclusion of plaintiff from use of X-ray department of hospital center held reasonable].)

In *Cianci v. Superior Court* (1985) 40 C.3d 903, 221 C.R. 575, 710 P.2d 375, *Willis* was overruled.

(a) The Act is broad in scope, and its plain language, embracing every type of business, necessarily includes the professions. (40 C.3d 917, 918.) Moreover, its principal purpose--consumer welfare--leads to the conclusion that

medical services are covered. (40 C.3d 918, 919.)

(b) *Goldfarb v. Virginia State Bar* (1975) 421 U.S. 773, 95 S.Ct. 2004, 44 L.Ed.2d 572, holding that professions are within the coverage of the Sherman Act, is persuasive. (40 C.3d 920.) *Willis* can no longer be followed: (1) The case has been strongly criticized, particularly since the *Goldfarb* decision. (2) The use of *B. & P.C. 16600* as an aid to construction of the Cartwright Act is not helpful. (40 C.3d 921, 922.) (3) Legislative silence following *Willis* does not constitute approval. (40 C.3d 923.) (4) The *Willis* holding is inconsistent with the policy of liberal construction of the Cartwright Act; and, in the light of *Marin County Bd. of Realtors v. Palsson*, *supra*, "*Willis* clearly stands merely as an aberration, an obstacle to the attainment of the legislative goal of free and open competition." (40 C.3d 924.)

(4) *Regulated Utilities*. The fact that utilities are subject to the regulatory authority of the Public Utilities Commission does not preclude an action under the Cartwright Act. (*Cellular Plus v. Superior Court* (1993) 14 C.A.4th 1224, 1243, 18 C.R.2d 308 [to bring claim under Cartwright Act based on price-fixing, it is not necessary to first bring claim before Public Utilities Commission].)

(5) *Insurance Industry*. In *Manufacturers Life Ins. Co. v. Superior Court* (1995) 10 C.4th 257, 41 C.R.2d 220, 895 P.2d 56, an insurance agency brought statutory causes of action against various insurance companies for violation of the Cartwright Act, the Unfair Competition Act (*B. & P.C. 17200* et seq.; see 13 *Summary* (10th), *Equity*, §105), and the Unfair Insurance Practices Act (UIPA) (*Ins.C. 790* et seq.; see 2 *Summary* (10th), *Insurance*, §252 et seq.), alleging that defendants had engaged in an unlawful boycott against it. The trial judge sustained defendants' demurrers to the Cartwright Act causes of action, but the Court of Appeal issued mandamus directing the trial judge to overrule the demurrers. *Held*, affirmed.

(a) Neither the language nor the history of the UIPA suggests that the Legislature intended to abolish the Cartwright Act remedies for conduct that the UIPA also proscribes. For example, *Ins.C. 790.09* (civil and criminal liability is unaffected by cease-and-desist order under UIPA) cannot be construed as indicating a legislative intent that only the Insurance Commissioner be authorized to remedy unlawful conduct by insurance companies. Because the commissioner has no power to initiate a criminal proceeding against, or an action to impose civil liability on, a person who engages in unfair trade practices, such a construction would render that part of the statute preserving civil and criminal liability meaningless. Further, a conclusion that the Legislature intended to displace Cartwright Act remedies would be contrary to consistent administrative construction of the Act and construction by courts in other states that have adopted the same or substantially similar statutes. (10 C.4th 272.)

(b) *Stare decisis* does not require the court to construe the UIPA as creating a wholesale exemption from remedies under the Cartwright Act for the insurance industry. *Chicago Title Ins. Co. v. Great Western Financial Corp.* (1968) 69 C.2d 305, 70 C.R. 849, 444 P.2d 481, which stated that certain statutory and common law protections against combinations in restraint of the insurance trade were superseded by specific provisions of the Insurance Code, did not hold that the UIPA supersedes and displaces the Cartwright Act prohibitions on anticompetitive activities and unfair business practices by insurers. The court has never held that the insurance industry is exempt from antitrust and unfair competition laws or that it enjoys immunity from civil liability for that conduct. (10 C.4th 277.)

(c) The Cartwright Act does not create a wholesale exemption from remedies thereunder for the insurance industry, and because the state scheme of regulation of the insurance industry is not wholly inconsistent with application of those remedies, no exemption may be implied. (10 C.4th 277.)

(d) The enactment of *Ins.C. 1861.03(a)* (insurance business is subject to laws of state applicable to any other business) did not imply that, prior to enactment, the insurance industry was exempt from antitrust regulation other than that of the *Insurance Code*. (10 C.4th 281.)

SUPPLEMENT: [This section is current through the latest supplement]



60 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
 X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

E. Restraint of Trade and Other Illegal Trade Practices.

2. California Law.

c. Cartwright Act.

3. Activities Not Covered.

aa. Statutory and Case Law Exceptions.

1 *Witkin Sum. Cal. Law Contracts* § 593

[§ 593] Statutory and Case Law Exceptions.

(1) *Labor. B. & P.C. 16703* states that "labor, whether skilled or unskilled, is not a commodity" within the meaning of the act. Thus, ordinary concerted action by unions to further legitimate labor objectives is not illegal. (*Schweizer v. Local Joint Executive Bd. of San Diego, Comprising Waiters & Bartenders Union Local No. 500* (1953) 121 C.A.2d 45, 52, 262 P.2d 568; *Los Angeles Pie Bakers Assn. v. Bakery Drivers Local No. 276* (1953) 122 C.A.2d 237, 238, 264 P.2d 615 [association of businessmen workers within exception]; 11 *Stanf. L. Rev.* 579; 6 *U.C.L.A. L. Rev.* 553.) However, the exception is not applicable where the purpose is not a legitimate labor objective. (*Messner v. Journeymen Barbers etc. Union of America, Local 256* (1960) 53 C.2d 873, 886, 4 C.R. 179, 351 P.2d 347, 3 *Summary* (10th), *Agency and Employment*, §548; *O'shea v. Tile Layers Union, Local 19* (1957) 155 C.A.2d 373, 376, 318 P.2d 102; *Alfred M. Lewis v. Warehousemen, Teamsters, Chauffeurs and Helpers Local Union No. 542* (1958) 163 C.A.2d 771, 782, 330 P.2d 53.)

California Dental Assn. v. California Dental Hygienists' Assn. (1990) 222 C.A.3d 49, 271 C.R. 410, elaborately examined and applied the labor exemption to an association that was not a formal labor union. Plaintiff dentists' association sued defendant dental hygienists' association, alleging a conspiracy to fix and inflate compensation dentists paid to hygienists working under them. The trial judge gave judgment for defendant on demurrer. *Held*, affirmed.

(a) "Like its federal Clayton Act counterpart, section 16703 was intended to insulate from antitrust liability concerted activities by workers seeking to improve their working terms and conditions. Although the generally worded statute necessarily draws specific reach and limits from case law interpreting and applying it, one thing is clear: the exemption broadly covers combinations, agreements, and concerted activities for the purpose of negotiating or otherwise fixing workers' rates of wages or compensation." (222 C.A.3d 63, citing and discussing *Los Angeles Pie Bakers, Messner, and Marin County Bd. of Realtors v. Palsson* (1976) 16 C.3d 920, 130 C.R. 1, 549 P.2d 833, *infra*, §607.)

(b) What plaintiffs characterize as restraints of trade "are nothing more or less than organizational and concerted activities of a sector of working people, for the classically legitimate labor objective of increasing the wages they are paid." (222 C.A.3d 65.) The contention that the hygienists are "entrepreneur service providers" is untenable: In *Los*

Angeles Pie Bakers, the independent drivers, who possessed far more indicia of independent contractors, were treated for compensation-fixing purposes as within the labor exemption, because their practical "economic function" was akin to employees in the bakers' pie manufacture and distribution enterprise. (222 C.A.3d 66.)

(c) The contention that the case falls outside the exemption because defendants' activity did not constitute collective bargaining is likewise untenable: "Certainly, the goal of modern labor relations law in general, and the labor exemption to the Cartwright Act in particular, is to foster and preserve the integrity of collective bargaining by employees with employers. But collective bargaining itself cannot occur without antecedent employee activity, including the formation of labor organizations and internal agreement on terms to be presented at the bargaining table. Moreover, civil bargaining sometimes must be supplemented by more one-sided activity, such as picketing, boycotting, or even striking. The history of the labor antitrust exemptions reveals that insulation of all of these concerted activities from liability was necessary and intended. ... Indeed, practicality dictates that an exemption for 'collective bargaining' or collective bargaining agreements alone would be an empty protection, because if other, enabling activities were actionable, the resting point of collective bargaining itself might never be reached." (222 C.A.3d 67.) "In sum, section 16703's exemption protects joint efforts of employees or working people to improve their compensation. These include collective bargaining as such, and also collective efforts as a precursor or adjunct to such bargaining. The activities alleged in the complaint all fall within this protected area." (222 C.A.3d 69.)

(d) The contention that defendant organization is not exempt because it is not a labor union is equally lacking in merit. The statutory language is not limited to activities of "labor unions," and defendant is a "labor organization" under relevant statutory definitions. (222 C.A.3d 69.)

(2) *Agricultural Products*. Statutes establishing proration plans for marketing of agricultural products (see *Brock v. Superior Court* (1937) 9 C.2d 291, 293, 71 P.2d 209) are also expressly exempted from the restrictions of the Cartwright Act, Fair Trade Act, or other statutes or rules governing restraint of trade. (See, e.g., *Food & Ag.C.* 58655.)

(3) *Professional Football*. The Act is inapplicable to a professional football league. (See *Partee v. San Diego Chargers Football Co.* (1983) 34 C.3d 378, 385, 194 C.R. 367, 668 P.2d 674 [application to NFL player-team-league relationship held an unreasonable burden on interstate commerce]; *Hebert v. Los Angeles Raiders, Ltd.* (1991) 23 C.A.4th 414, 422, 29 C.R.2d 540 [following *Partee*]; 85 A.L.R.3d 970 [application of state antitrust laws to athletic leagues or associations].)

(4) *Political Subdivisions*. The Act is directed at combinations of private persons, individual or corporate; it does not apply to activities of a municipality engaging in governmental acts. (*Widdows v. Koch* (1968) 263 C.A.2d 228, 235, 69 C.R. 464, 5 Summary (10th), *Torts*, §354; *People v. San Francisco* (1979) 92 C.A.3d 913, 920, 155 C.R. 319, following *Widdows* [no action lies against city that fixed taxicab fares].)

In *Penn v. San Diego* (1987) 188 C.A.3d 636, 233 C.R. 514, plaintiff cardroom owner brought an action against defendant city and its police chief, alleging that a municipal code section setting \$ 2.50 as the maximum hourly rate for players in the cardroom violated the Cartwright Act. Plaintiff argued that the holding in *People v. San Francisco* that municipalities are not "persons" subject to suit under the Cartwright Act, was undermined by the holding in *Cianci v. Superior Court* (1985) 40 C.3d 903, 221 C.R. 575, 710 P.2d 375, *supra*, §592, that professions, though not expressly within the definition of "persons," are nevertheless subject to suit under the Act. *Held*, summary judgment for defendants affirmed; *People v. San Francisco* is still controlling.

(a) *People v. San Francisco* deals with harmonizing the language of B. & P.C. 16702, defining the "persons" that *can be sued* under the Cartwright Act, with that of B. & P.C. 16750(a) and (b), defining the "persons" *entitled to sue* under the Act. The court concluded that because B. & P.C. 16750(b) specifically provides that the state and its political subdivisions (which includes cities) are "persons" within the meaning of *that section*, it was the Legislature's intent to exclude governmental entities from the definition of "persons" in B. & P.C. 16702, which does not specifically refer to these entities. (188 C.A.3d 642.)

(b) *Cianci* did not deal with language in the Act showing the Legislature's intent not to include professions within the *B. & P.C. 16702* definition of persons subject to suit. Hence, its reasoning does not undermine the statutorily grounded reasoning of *People v. San Francisco*. (188 C.A.3d 643.) Also, just 5 months prior to *Cianci*, the Supreme Court, in *Blank v. Kirwan* (1985) 39 C.3d 311, 216 C.R. 718, 703 P.2d 58, *infra*, §594, relied on the former decision for the proposition that the actions of the state and its political subdivisions are outside the scope of the Act. (188 C.A.3d 643.)

The court also summarily rejected plaintiff's contention that the *B. & P.C. 16702* reference to "corporations," as being within the definition of "persons," should be read to include "municipal corporations." The quoted terms obviously have separate and distinct meaning. (188 C.A.3d 643.)

(5) *Health Care Services*. *B. & P.C. 16770* declares that the formation of groups and combinations of health care providers and purchasers contributes to the maintenance of high-quality, cost-effective health care, and provides that these combinations constitute the creation of a new product and are subject only to those antitrust prohibitions that apply to other presumptively legitimate enterprises. (See *Health & Saf.C. 1342.6* [similar provision]; *Ins.C. 10133.6* [similar provision]; *Schmidt v. Foundation Health* (1995) 35 C.A.4th 1702, 1714, 42 C.R.2d 172 [as interpreted to prohibit broker of health care service plans from giving commission rebates to clients, *Health & Saf.C. 1340* et seq. and related administrative regulations do not violate antitrust provisions of Cartwright Act].)

SUPPLEMENT: [This section is current through the latest supplement]

(5) *Health Care Services*. See *Lori Rubinstein Physical Therapy v. PTPN* (2007) 148 C.A.4th 1130, 1139, 56 C.R.3d 351 [exclusive contract between health insurer and group of physical therapy practices, which was preferred provider under preferred provider organization (PPO), to provide services to health insurer's subscribers was authorized by PPO statute, and was thus immune from antitrust suit by physical therapy providers whose ability to compete was inhibited].



61 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

E. Restraint of Trade and Other Illegal Trade Practices.

2. California Law.

c. Cartwright Act.

3. Activities Not Covered.

bb. Efforts To Influence Governmental Action.

1 Witkin Sum. Cal. Law Contracts § 594

[§ 594] Efforts To Influence Governmental Action.

In *Blank v. Kirwan* (1985) 39 C.3d 311, 216 C.R. 718, 703 P.2d 58, plaintiff alleged in substance that private individual and public official defendants successfully conspired to legalize and monopolize the operation of poker clubs through government action. (38 C.3d 318, 322.) *Held*, no cause of action under the Cartwright Act was stated.

(a) In interpreting the Act, California courts look to the Sherman Act and cases construing it. (39 C.3d 320; see *infra*, §597.) Thus, the *Noerr-Pennington* doctrine, that efforts to influence government action are not within the scope of the Sherman Act, is controlling here. (39 C.3d 321, 322; see *supra*, §562.)

(b) The actions of a political subdivision of the state, such as defendant city, and the effects of these actions, are outside the scope of the *Cartwright Act*. (39 C.3d 323, citing *Widdows v. Koch* (1968) 263 C.A.2d 228, 69 C.R. 464, 5 *Summary* (10th), *Torts*, §354; *People v. San Francisco* (1979) 92 C.A.3d 913, 155 C.R. 319, *supra*, 593.) "To hold individual defendants liable under the Cartwright Act for influencing government action that is itself outside the scope of the act is untenable." (39 C.3d 323.)

(c) The allegation that defendant city officials were coconspirators does not render the *Noerr-Pennington* doctrine inapplicable. (39 C.3d 323, 324.)

(d) "Our conclusion that plaintiff has not stated a Cartwright Act cause of action does not, of course, imply that we take lightly, less still condone, unethical and illegal conduct, especially on the part of public officials. ... Because there is here no trade restraint violative of the Cartwright Act, we cannot hold defendants liable under the act no matter how reprehensible their conduct may be. ... [W]e therefore leave defendants to be sued or prosecuted under other laws--as, it appears, they have been." (39 C.3d 328; see footnote 5, judicially noticing federal indictments, pleas, and sentences.)

Two concurring justices reasoned that the action had been properly dismissed for lack of prosecution and that the discussion of the *Noerr-Pennington* doctrine was thus unnecessary to the decision. (39 C.3d 334.) (See 94 A.L.R.5th 455 [application of *Noerr-Pennington* doctrine by state courts].)

West's Key Number Digest, Monopolies k.12(16.5)

SUPPLEMENT: [This section is current through the latest supplement]



62 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
E. Restraint of Trade and Other Illegal Trade Practices.
2. California Law.
c. Cartwright Act.
3. Activities Not Covered.
cc. Mergers.

1 Witkin Sum. Cal. Law Contracts § 595

[§ 595] Mergers.

In *California v. Texaco* (1988) 46 C.3d 1147, 252 C.R. 221, 762 P.2d 385, the California Attorney General brought an action against defendant Texaco to enjoin it from acquiring the California assets of Getty Oil Co. under a merger between the two companies. The action was based on the Cartwright Act and the Unfair Practices Act (see *infra*, §609 et seq.). With respect to the Cartwright Act cause of action, the Attorney General argued that a merger is a "combination of capital" under *B. & P.C. 16720* (see *supra*, §591), and hence is covered by the Act. Defendant contended that "combination" refers to companies that combine for a certain purpose, but which maintain their separate identities. *Held*, the Act does not apply to mergers.

(a) *Model for Cartwright Act.*

(1) The roots of the Cartwright Act can be traced to a United States Senate Bill that was introduced in 1888 as an alternative to the Sherman Act, but rejected in amended form in 1890. However, the specific model for the Cartwright Act was an 1889 Texas statute that defined "trust" as a "combination of capital, skill or acts" for various improper purposes. (46 C.3d 1154.) By the time the Cartwright Act was enacted in 1907, decisions in Texas and Michigan, which had enacted a similar statute in 1889, had construed the term "combination" as not applying to the purchase of one business by another one engaged in the same business. (46 C.3d 1157.)

(2) Prior to 1907, some states, including Texas, had amended their antitrust statutes to include antimerger provisions covering monopolies and corporate mergers. (46 C.3d 1159.) However, the Cartwright Act included neither an antimerger provision nor language designed to avoid the prevailing narrow construction of the term "combination." (46 C.3d 1161.) "Given this history, we must conclude that the drafters intended that their Act apply, as its words had been construed, only to entities that 'combine,' in the sense of those who *perdure* (i.e., continue as separate, independent, competing entities during and after their collusive action)--and therefore that the drafters did not intend the Cartwright Act to regulate the bona fide purchase and sale of one firm by another. Any other interpretation of the drafters' intent cannot be reconciled with the Act's history." (46 C.3d 1163.)

(3) This conclusion is supported by the facts that (a) the state decisions construing the term "combination" were widely known and available to the California Legislature through the legal resources of the period, and (b) in the last 80 years, the California Legislature, in contrast to those of other states, has never enacted an antimerger provision. (46 C.3d 1162, 1163).

(b) *Sherman Act not controlling.*

(1) In support of the contention that the Cartwright Act applies to mergers, the Attorney General cited authorities stating that the Act was modeled after the Sherman Act (see supra, §563), which has been construed as applying to mergers. Admittedly, statements in some decisions support this position (see, e.g., *Marin County Bd. of Realtors v. Palsson* (1976) 16 C.3d 920, 130 C.R. 1, 549 P.2d 833, infra, §607), but, as discussed supra, historical and textual analysis establishes that the Act was actually modeled after the Texas and Michigan Acts of 1889. (46 C.3d 1164.)

(2) Even if the Attorney General's argument is accepted, the Sherman Act decisions relied on do not support the present action. Those decisions permit challenges to mergers only if an *actual* restraint of trade is established. However, no such restraint was alleged here. Rather, the complaint was framed under §7 of the Clayton Act (see supra, §571), which permits challenges to *incipient* threats to competition, i.e., mergers having a probable anticompetitive effect. (46 C.3d 1165.)

(c) *Common law not controlling.*

(1) At common law, the majority view was that certain forms of mergers or acquisitions were illegal. However, as with the decisions construing the Sherman Act, the common law cases involved actual, instead of merely incipient, threats to competition, and hence are not relevant here. (46 C.3d 1167.)

(2) The Cartwright Act departed from the common law in a significant way: At common law, an illegal agreement was merely void and unenforceable, while under the Act it is subject to civil damages and criminal punishment. In view of such dramatically enhanced sanctions, it is logical to assume that the drafters of the Act intended to cover only those collusions where the parties continue as separate, independent entities, and to exclude situations where, by virtue of purchase or sale or merger, one or more of the entities ceases to exist. (46 C.3d 1167.)

(d) *Breadth of Cartwright Act.*

(1) As support for the contention that the Cartwright Act was broader in scope than the Sherman Act and the common law, the Attorney General relied on the statement in *Palsson* that the rejected Senate Bill, on which California's Act was purportedly based, "was designed not to narrow the scope of the Sherman Act but to broaden it." However, although that shorthand description of the Cartwright Act's derivation was adequate for the analysis involved in *Palsson*, it is not completely accurate, because, as previously discussed, the Act was modeled after the Texas and Michigan Acts of 1889. (46 C.3d 1169.) However, even if the Cartwright Act is in some respects broader than the Sherman Act, there is nothing indicating that it was intended to be broader on the question of merger coverage. (46 C.3d 1169.)

(2) The Attorney General also relied on the statement in *Cianci v. Superior Court* (1985) 40 C.3d 903, 221 C.R. 575, 710 P.2d 375, supra, §592, that the Cartwright Act is "broader in range and deeper in reach than the Sherman Act," and that it "reaches beyond the Sherman Act to threats to competition in their incipiency--much like section 7 of the Clayton Act." However, "[i]n view of the evidence to the contrary, *Cianci's* conclusory and substantively suspect dicta simply cannot support the Attorney General's claim. In light of (i) the authoritative construction of identical language in similar state laws and (ii) the existence (in at least three states) of explicit merger regulations at the time of the Cartwright Act, we believe that the Legislature did not intend for the Act to reach a merger or acquisition." (46 C.3d 1169.)

Three dissenting justices argued that the Act was intended to apply to mergers, based on its express language, its

purpose of protecting consumers, and the canons of statutory construction. (46 C.3d 1170.) (See 16 *Pepperdine L. Rev.* 1146.)

SUPPLEMENT: [This section is current through the latest supplement]



63 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
E. Restraint of Trade and Other Illegal Trade Practices.
2. California Law.
c. Cartwright Act.
4. Validity of Act.

1 Witkin Sum. Cal. Law Contracts § 596

[§ 596] Validity of Act.

(1) *Severability of Provisions.* Former B. & P.C. 16723 provided that no combination, association, or agreement is unlawful the object of which is to conduct operations "at a *reasonable* profit" or to "market at a reasonable profit those products which cannot otherwise be so marketed." In *Cline v. Frink Dairy Co.* (1926) 274 U.S. 445, 47 S.Ct. 681, 683, 71 L.Ed. 1146, 1151, a substantially similar Colorado statute was held invalid on the ground that its proviso as to "reasonable" profit made the act uncertain, and left it without a fixed standard of guilt. This decision was followed in *Ward v. Auctioneers Assn.* (1944) 67 C.A.2d 183, 185, 153 P.2d 765, holding the act and proviso inseparable, and the whole unconstitutional. (See 12 So. Cal. L. Rev. 312; 15 So. Cal. L. Rev. 220.)

Ward was overruled in *Speegle v. Board of Fire Underwriters of the Pac.* (1946) 29 C.2d 34, 172 P.2d 867, holding that the general provisions prohibiting combinations in restraint of trade were constitutional, and that the proviso with respect to "reasonable" profits was severable. Plaintiff's complaint alleged that, as an insurance agent and broker, he placed fire insurance with various companies; that defendant association of companies known as the Board of Fire Underwriters of the Pacific ("board companies") terminated his contracts with its members on his refusal to refrain from doing business with "non-board companies." *Held*, a cause of action was stated for interference with contractual relations. (29 C.2d 46.)

(2) *Invalidity of "Reasonable Profit" Proviso.* *Speegle*, left open the question of the validity of the proviso in former B. & P.C. 16723. In *People v. Building Maintenance Contractors' Assn.* (1953) 41 C.2d 719, 264 P.2d 31, *Cline* was followed and the proviso held void for uncertainty. Defendants, an association of building maintenance contractors, had an agreement that if any member was asked to bid by a customer who already had a contract with another member, and the existing service was found by the association to be satisfactory, the new bid would be higher than the current price. *Held*, this was a price-fixing agreement, and violative of the act. (41 C.2d 724.) Former B. & P.C. 16723 was repealed in 1961.

SUPPLEMENT: [This section is current through the latest supplement]



64 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
E. Restraint of Trade and Other Illegal Trade Practices.
2. California Law.
c. Cartwright Act.
5. Applicability of Federal Cases.
aa. In General.

1 Witkin Sum. Cal. Law Contracts § 597

[§ 597] In General.

(1) *Sherman Act Cases*. Federal Sherman Act cases are persuasive on Cartwright Act problems. (See *Chicago Title Ins. Co. v. Great Western Financial Corp.* (1968) 69 C.2d 305, 315, 70 C.R. 849, 444 P.2d 481; *Corwin v. Los Angeles Newspaper Service Bureau* (1971) 4 C.3d 842, 852, 94 C.R. 785, 484 P.2d 953, *infra*, §606 [B. & P.C. 16720 and 16726 "were patterned after the Sherman Act ... and decisions under the latter act are applicable to the former"]; *Marin County Bd. of Realtors v. Palsson* (1976) 16 C.3d 920, 927, 130 C.R. 1, 549 P.2d 833, *infra*, §607; *Mailand v. Burckle* (1978) 20 C.3d 367, 376, 143 C.R. 1, 572 P.2d 1142; *Blank v. Kirwan* (1985) 39 C.3d 311, 320, 216 C.R. 718, 703 P.2d 58, *supra*, §594; *People v. Santa Clara Valley Bowling Proprietors' Assn.* (1965) 238 C.A.2d 225, 232, 47 C.R. 570; *Widdows v. Koch* (1968) 263 C.A.2d 228, 234, 69 C.R. 464; *Carl N. Swenson Co. v. E.C. Braun Co.* (1969) 272 C.A.2d 366, 368, 77 C.R. 378; *Saxer v. Philip Morris* (1975) 54 C.A.3d 7, 19, 126 C.R. 327; *Suburban Mobile Homes v. AMFAC Communities* (1980) 101 C.A.3d 532, 540, 161 C.R. 811; *Guild Wineries & Distilleries v. J. Sosnick & Son* (1980) 102 C.A.3d 627, 633, 162 C.R. 87 ["horizontal restraint," *per se* violation]; *Rosack v. Volvo of America Corp.* (1982) 131 C.A.3d 741, 751, 182 C.R. 800; *Bert G. Gianelli Distr. Co. v. Beck & Co.* (1985) 172 C.A.3d 1020, 1042, 219 C.R. 203; *Redwood Theatres v. Festival Enterprises* (1988) 200 C.A.3d 687, 694, 248 C.R. 189, *infra*, §598; *Biljac Associates v. First Interstate Bank* (1990) 218 C.A.3d 1410, 1420, 267 C.R. 819, *Supp.*, *infra*, §608; *Roth v. Rhodes* (1994) 25 C.A.4th 530, 542, 30 C.R.2d 706; *Morrison v. Viacom* (1998) 66 C.A.4th 534, 541, 78 C.R.2d 133, *infra*, §606; 21 Santa Clara L. Rev. 533 [Guild Wineries].)

"[T]he appropriate use of federal cases interpreting the Sherman Act is as an aid in interpreting our own Cartwright Act, not as controlling precedent." (*Cellular Plus v. Superior Court* (1993) 14 C.A.4th 1224, 1240, 18 C.R.2d 308 [federal decisions holding that there was no Sherman Act action where rates had been approved by regulatory agency did not preclude action under Cartwright Act].)

(2) *Federal Per Se Rule*. The rule established by federal case law, that certain acts are illegal *per se* and not subject to the rule of reason (price-fixing, division of markets, group boycotts, and tying arrangements), also applies under the Cartwright Act. (See *Oakland-Alameda County Builders' Exchange v. F.P. Lathrop Const. Co.* (1971) 4 C.3d 354, 361, 93 C.R. 602, 482 P.2d 226, *infra*, §605; *Corwin v. Los Angeles Newspaper Service Bureau*, *supra*, 4 C.3d 853 [quoting

Northern Pac. Ry. Co. v. United States (1958) 356 U.S. 1, 78 S.Ct. 514, 2 L.Ed.2d 545]; *People v. Santa Clara Valley Bowling Proprietors' Assn.*, *supra*, 238 C.A.2d 233 [partial boycott by bowling association, requiring bowlers seeking to participate in member house tournaments to do certain amount of bowling in member houses]; *Bert G. Gianelli Distr. Co. v. Beck & Co.*, *supra*, 172 C.A.3d 1044; *Redwood Theatres v. Festival Enterprises*, *supra*, 200 C.A.3d 697.)

SUPPLEMENT: [This section is current through the latest supplement]



65 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
E. Restraint of Trade and Other Illegal Trade Practices.
2. California Law.
c. Cartwright Act.
5. Applicability of Federal Cases.
bb. Rule of Reason.

1 Witkin Sum. Cal. Law Contracts § 598

[§ 598] Rule of Reason.

Both the Sherman and Cartwright Acts have been interpreted to permit reasonable restraints. (*Corwin v. Los Angeles Newspaper Service Bureau* (1971) 4 C.3d 842, 853, 855, 94 C.R. 785, 484 P.2d 953, *infra*, §606 [question is one of fact]; *Bert G. Gianelli Distr. Co. v. Beck & Co.* (1985) 172 C.A.3d 1020, 1048, 219 C.R. 203; *Reynolds v. California Dental Service* (1988) 200 C.A.3d 590, 597, 246 C.R. 331 [under federal precedent and legislative intent as expressed in *B. & P.C. 16770(a)*, (d), rule of reason was applicable to charge that prepaid dental plan constituted illegal price fixing]; *Kim v. Servosnax* (1992) 10 C.A.4th 1346, 1361, 13 C.R.2d 422 [in deciding whether restraint is unreasonable, courts consider facts peculiar to business to which restraint is applied]; *Roth v. Rhodes* (1994) 25 C.A.4th 530, 542, 30 C.R.2d 706 [under rule of reason, alleged vertical restraint by lessor who refused to rent space in its medical buildings to podiatrists was not illegal where landlord controlled less than 10% of market].) In determining whether a restraint is reasonable, the court should consider "[t]he history of the restraint, the evil believed to exist, the reason for adopting the particular remedy, the purpose or end sought to be obtained, ... the percentage of business controlled, the strength of the remaining competition [and] whether the action springs from business requirements or purpose to monopolize." (*Corwin v. Los Angeles Newspaper Service Bureau*, *supra*, 4 C.3d 854 [quoting *Chicago Bd. of Trade v. United States* (1918) 246 U.S. 231, 38 S.Ct. 242, 244, 62 L.Ed. 683, 687, and *United States v. Columbia Steel Co.* (1948) 334 U.S. 495, 68 S.Ct. 1107, 1124, 92 L.Ed. 1533, 1554])

Thus, a manufacturer has a natural monopoly of a product sold under his or her brand name, may exercise his or her own judgment as to the parties with whom to trade, may give an exclusive dealership, and, under the "rule of reason" (*supra*, §564), may refuse to renew a dealer's contract without being guilty of an unreasonable restraint of trade in violation of the Act. (*Milton v. Hudson Sales Corp.* (1957) 152 C.A.2d 418, 440, 313 P.2d 936.) Because this is so, no violation of the Act occurs where a dealership is not renewed on the ground of the dealer's taking on a competitor's line of goods. (*A.B.C. Distr. Co. v. Distillers Distr. Corp.* (1957) 154 C.A.2d 175, 188, 316 P.2d 71; *cf. Shasta Douglas Oil Co. v. Work* (1963) 212 C.A.2d 618, 622, 28 C.R. 190 [not unlawful under Cartwright Act for a consignor to fix the price at which he or she authorizes consignee to sell goods]; *LaFortune v. Ebie* (1972) 26 C.A.3d 72, 75, 102 C.R. 588 [rule applicable to vertical territorial limitations].)

Webb v. West Side Dist. Hosp. (1983) 144 C.A.3d 946, 193 C.R. 80, described the balancing process as follows: "The reasonableness of contracts which tend to restrain trade is measured by a number of factors, including the appropriateness of the restraint to advancing the interests to be protected; the availability of less harmful alternatives; the nature of the interest interfered with; the intent of the parties or the tendency of the restraint to create a monopoly; and the social or economic justification for any monopoly, if it does result." The court upheld a hospital contract with a doctor to recruit, train, and furnish physicians for an emergency department, with a provision that if the hospital terminated the contract and employed the trainee itself, it must pay the doctor a specified sum to cover the cost of recruitment and training. (144 C.A.3d 953.)

In *Redwood Theatres v. Festival Enterprises* (1988) 200 C.A.3d 687, 248 C.R. 189, plaintiff was an independent motion picture exhibitor operating a theatre in Modesto. Defendants were a competing exhibitor operating a circuit of theatres in Modesto and five other Northern California markets, and three major film distributors. Plaintiff alleged that, in violation of the Cartwright Act, defendant exhibitor entered into an oral agreement with each of defendant distributors under which it would receive the license to all or substantially all first-run films. There was no allegation that defendant distributors conspired among themselves or were parties to a plan to drive plaintiff out of business; instead, it was alleged that the agreements were part of a business policy of dealing preferentially with theatre circuits. To establish this preference, plaintiff moved to compel production of defendant distributors' "cutoff cards," i.e., records of film rentals in each market. The motion was denied, and summary judgment was entered for defendants. *Held*, reversed as to two of three defendant distributors; affirmed as to the third.

(a) *Applicability of federal law.* Although the complaint stated a cause of action under the Cartwright Act, the briefs in this appeal relied almost exclusively on federal precedent under the Sherman Act. This approach is supported by a long line of California cases holding that federal decisions interpreting the Sherman Act are applicable to problems arising under the Cartwright Act (see *supra*, §597). (200 C.A.3d 694.)

(b) *Per se violation analysis.*

(1) *United States v. Paramount Pictures* (1948) 334 U.S. 131, 68 S.Ct. 915, 92 L.Ed. 1260, suggests that an exclusive agreement with a theatre circuit is a per se violation of the Sherman Act; but that case was decided at a time when the major distributors themselves controlled circuits of theatres. By requiring the distributors to divest themselves of such circuits and placing stringent restrictions on future acquisitions, *Paramount Pictures* changed the structure of the motion picture industry, and with it, the issues concerning circuit dealing. (200 C.A.3d 697.)

(2) In the years since *Paramount Pictures* was decided, a line of cases approved the allegation that a competing exhibitor and major distributors conspired to deprive independent exhibitors of first-run films. This theory falls within the conventional definition of "group boycott," which has been identified by the United States Supreme Court as a per se violation of the Sherman Act (see *supra*, §566). (200 C.A.3d 698, 699.)

(3) Here, an inference of boycott is no doubt facilitated by market conditions common to the industry, i.e., the unique character of films and the highly consolidated market structure, and by the existence of more than one alleged agreement between the competing exhibitor and the major distributors. (200 C.A.3d 702.) But plaintiff produced no evidence of predatory intent: The evidence suggests that the agreements reflect the perceived business advantage to defendant distributors of dealing with large theatre circuits, and hence falls far short of establishing the evidentiary threshold needed to sustain a boycott theory of per se liability. (200 C.A.3d 703.)

(c) *Rule of reason analysis.*

(1) The facts here may be viewed as a vertical restraint, subject to a rule of reason analysis to determine its impact on competition (see *supra*, §567). (200 C.A.3d 703.) In applying the rule of reason to vertical restraints, the courts have required a threshold inquiry into the defendant's market power, which is usually equated with market share. Based on ticket sales, the defendant distributors' average market shares for the 5-year period at issue were 16%, 15%, and 3%,

respectively. Because these shares cannot be aggregated in the absence of any allegation or evidence of collusion among defendant distributors, they fail to pass the threshold test of establishing defendants' market power. (200 C.A.3d 704.)

(2) However, market power is also measured by product differentiation. And plaintiff has offered to prove that profitable operations in the theatre business depend on a limited supply of a unique product, i.e., popular first-run films. (200 C.A.3d 705.) This hypothesis has merit: "The unusual competitive conditions of the theatre business, marked by the presence of a unique product in short supply, put an entirely different complexion on the issue of market power. Exclusive dealing agreements involving a dominant firm in an industry have long been subject to antitrust scrutiny. But where competitive survival depends on gaining access to a unique product, these agreements may present serious antitrust questions in any well-consolidated industry even if it is dominated by no single firm." (200 C.A.3d 707.)

(3) An exhibitor lacking access to a substantial share of popular first-run films may be placed at a grave competitive disadvantage. (200 C.A.3d 707.) Hence, the presence of exclusive dealing agreements between theatre circuits and major distributors may, contrary to the intent of the Sherman Act, entrench the positions of established exhibitors and pose formidable barriers to entrepreneurs seeking to enter the theatre business or enlarge a small foothold. (200 C.A.3d 708.)

(4) In the 3 years from 1983 through 1985, two of defendant distributors produced no less than 31 of the 60 pictures placing among the top 20 box office hits in each year. (200 C.A.3d 707.) Hence, the alleged agreements with these distributors, if proved, would present a triable issue of an unreasonable restraint of trade under the *Cartwright Act*. (200 C.A.3d 713.)

(d) *Disposition*. The summary judgment is reversed as to the two distributors producing a significant percentage of major hits but is affirmed as to the third defendant distributor. During the period covered, this defendant achieved only a 3% market share, and none of its films were among the big moneymakers. Hence, "it would be anomalous to hold that it was responsible for imposing barriers to fair competition among exhibitors." (200 C.A.3d 714.) (See *Exxon Corp. v. Superior Court* (1997) 51 C.A.4th 1672, 1680, 60 C.R.2d 195 [under rule of reason, relevant market in determining whether vertical restraint had anticompetitive effect was, as matter of law, all gasoline, rather than merely defendant's brand; distinguishing *Redwood Theatres* on basis of interchangeability of products].)

SUPPLEMENT: [This section is current through the latest supplement]



66 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
E. Restraint of Trade and Other Illegal Trade Practices.

- 2. California Law.
- c. Cartwright Act.
- 6. Enforcement.
- aa. In General.

1 Witkin Sum. Cal. Law Contracts § 599

[§ 599] In General.

(1) *Methods of Enforcement.* The Cartwright Act permits enforcement by a number of methods (see *B. & P.C. 16750 et seq.*), including civil or criminal actions filed by the Attorney General or district attorney (see *infra*, §§600, 603), and civil suits for treble damages filed by private persons (see *infra*, §602). (See *Cal. Civil Practice*, 6 Business Litigation, §63:23 *et seq.*)

(2) *Statute of Limitations.* A 4-year statute of limitations governs in *civil actions*. (*B. & P.C. 16750.1*; see *90 A.L.R.4th 1102* [time when cause of action accrues for civil action under state antitrust, monopoly, or restraint of trade statutes].)

(3) *Summary Judgment Disfavored.* The United States Supreme Court has observed that a summary judgment in favor of defendants is rarely warranted in antitrust cases. "We believe that summary procedures should be used sparingly in complex antitrust litigation where motive and intent play leading roles, the proof is largely in the hands of the alleged conspirators, and hostile witnesses thicken the plot. It is only when the witnesses are present and subject to cross-examination that their credibility and the weight to be given their testimony can be appraised. Trial by affidavit is no substitute for trial by jury which so long has been the hallmark of 'even handed justice.' " (*Corwin v. Los Angeles Newspaper Service Bureau* (1971) 4 C.3d 842, 852, 94 C.R. 785, 484 P.2d 953, *infra*, §606, quoting *Poller v. Columbia Broadcasting* (1962) 368 U.S. 464, 82 S.Ct. 486, 491, 7 L.Ed.2d 458, 464, also quoted in *Fortner Enterprises v. United States Steel Corp.* (1969) 394 U.S. 495, 89 S.Ct. 1252, 1257, 22 L.Ed.2d 495, 503.)

(4) *Recovery of Costs, Fees, and Interest.* A successful plaintiff in a civil damage suit is entitled to reasonable attorneys' fees and costs of suit, and may be awarded prejudgment interest on *actual* damages at the rate of 10% per annum. (*B. & P.C. 16750(a)*, 16761; see *Carver v. Chevron U.S.A.* (2004) 119 C.A.4th 498, 503, 14 C.R.3d 467 [universal fee shifting provision (*B. & P.C. 16750(a)*) prohibited award of attorney fees to oil company for successfully defending gasoline dealers' overlapping claims of antitrust violations under Cartwright Act and non-Cartwright Act claims, notwithstanding alternative available contractual fee provisions]; 15 *Pacific L. J.* 490.) In determining whether to award prejudgment interest, the court must consider whether, as revealed by various actions of the parties involved, a

party engaged in intentionally dilatory behavior or otherwise acted in bad faith for the purpose of increasing the cost of the litigation. (B. & P.C. 16761.)

(5) *Injunction*. A person injured in his or her business or property by conduct violating the Cartwright Act may obtain "preliminary or permanent injunctive relief when and under the same conditions and principles as injunctive relief is granted by courts generally under the laws of this state and the rules governing these proceedings." (B. & P.C. 16750.)

(6) *Arbitration*. In *Crown Homes v. Landes* (1994) 22 C.A.4th 1273, 27 C.R.2d 827, the trial court ordered a cause of action under the Cartwright Act to arbitration under an arbitration provision in mobilehome park leases. *Held*, affirmed. The holding in *Bos Material Handling v. Crown Controls Corp.* (1982) 137 C.A.3d 99, 186 C.R. 740, that these disputes are not arbitrable has been undermined by subsequent U.S. Supreme Court decisions, e.g., *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth* (1985) 473 U.S. 614, 105 S.Ct. 3346, 87 L.Ed.2d 444; *Shearson/Amer. Express v. McMahon* (1987) 482 U.S. 220, 107 S.Ct. 2332, 96 L.Ed.2d 185; and *Rodriguez de Quijas v. Shearson/Amer. Express* (1989) 490 U.S. 477, 109 S.Ct. 1917, 104 L.Ed.2d 526. (22 C.A.4th 1276, 1283.) There is nothing in the language of the arbitration statute or the Cartwright Act suggesting that antitrust violations are not subject to arbitration. The California Supreme Court has repeatedly emphasized the strong public policy favoring arbitration. Finally, the arbitration agreement, with broadly inclusive language, did not exclude antitrust violations from the scope of the disputes that would be arbitrable. (22 C.A.4th 1283.)

West's Key Number Digest, Monopolies k.28(1.2)

SUPPLEMENT: [This section is current through the latest supplement]



67 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

E. Restraint of Trade and Other Illegal Trade Practices.

2. California Law.

c. Cartwright Act.

6. Enforcement.

bb. Action by Attorney General or District Attorney.

1 Witkin Sum. Cal. Law Contracts § 600

[§ 600] Action by Attorney General or District Attorney.

(1) *Statutory Authorization.* "The Attorney General, or the district attorney of any county, subject to the notice requirements of subdivision (g) of Section 16750, shall initiate civil actions or criminal proceedings for violation of this chapter." (*B. & P.C. 16754*; see *B. & P.C. 16759* [giving district attorney the investigative and subpoena powers granted to Attorney General under *Govt.C. 11180 et seq.*]; *Pacific Gas & Elec. Co. v. Stanislaus* (1997) 16 C.4th 1143, 1151, 69 C.R.2d 329, 947 P.2d 291 [Cartwright Act provisions relating to suits by Attorney General or district attorney do not divest local public entities of authority they otherwise possess under *B. & P.C. 16750(a), (b)* (see *infra*, §601) to bring action on their own behalf; instead, those provisions simply establish *additional* avenues for pursuing violations of Act]; 14 Cal Western L. Rev. 1 [impediments to and prospects for antitrust enforcement by local prosecutors]; 9 *Pacific L. J.* 314.)

The act also authorizes the Attorney General or district attorney of the proper county to institute proceedings to forfeit the rights of a corporation or association violating the law. (*B. & P.C. 16752, 16753.*)

In any civil action brought by the Attorney General or a district attorney, the court may grant (a) "such prohibitory injunctions and other restraints as it may deem expedient to deter the defendant from, and insure against, his committing a future violation of this chapter," and (b) "such mandatory injunctions as may be reasonably necessary to restore and preserve fair competition in the trade or commerce affected by the violation." (*B. & P.C. 16754.5*; on injunctive relief in Cartwright Act actions generally, see *supra*, §599; on remedies available to state or political subdivision generally, see *infra*, §601.)

(2) *Venue.* Civil and criminal proceedings may be brought in the superior court in any county in which the offense or a part is committed, or where any of the offenders reside or any corporate defendant does business. (*B. & P.C. 16754.*)

(3) *Procedure.* The Attorney General must give written notice to any political subdivision or public agency of the intention to bring an action on its behalf, and the subdivision or agency then has 30 days within which to withdraw the

Attorney General's authority to bring the action. (*B. & P.C. 16750(c).*) When the *district attorney* brings an action on behalf of a political subdivision of the relevant county, he or she must give written notice, and the subdivision has 30 days within which to withdraw the district's attorney's authority. (*B. & P.C. 16750(i).*)

The *district attorney*, at least 30 days prior to filing an action, must file with the Attorney General a copy of the proposed complaint and a confidential memorandum and report of the facts. Similar notice of any proposed settlement or consent judgment must also be given. (*B. & P.C. 16750(g).*) The *Attorney General*, pursuant to his or her powers under *Govt.C. 12550* (see 4 *Cal. Crim. Law. (3d), Introduction to Criminal Procedure, §15*), may take full charge of any action of this kind. (*B. & P.C. 16750(g), 16754.*)

(4) *Cooperation With Private Plaintiffs.* In any damage action brought by the Attorney General under either federal or state antitrust laws, the Attorney General may cooperate in investigation and prosecution with private plaintiffs with whom it is advantageous to act jointly, and may also render legal services to, or obtain legal services from, any state or federal agency that has brought or intends to bring a similar action. (*B. & P.C. 16750(e).*) The district attorney, on obtaining approval from the county, may exercise the same powers in any action brought by him or her. (*B. & P.C. 16750(h).*)

West's Key Number Digest, Monopolies k.28(5)

SUPPLEMENT: [This section is current through the latest supplement]



68 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

E. Restraint of Trade and Other Illegal Trade Practices.

2. California Law.

c. Cartwright Act.

6. Enforcement.

cc. Remedies Available to State or Subdivision.

1 Witkin Sum. Cal. Law Contracts § 601

[§ 601] Remedies Available to State or Subdivision.

The state or any subdivision or public agency is a person entitled to sue for *treble damages*. (*B. & P.C. 16750(a)(b)*; see *Pacific Gas & Elec. Co. v. Stanislaus* (1997) 16 C.4th 1143, 1150, 69 C.R.2d 329, 947 P.2d 291 [*B. & P.C. 16750(a)*, (b) authorized county, under direction of its board of supervisors, to bring multicounty class action under Cartwright Act; county was not limited to filing suit only if it was represented by Attorney General or district attorney]; on right to injunctive relief, see *supra*, §§599, 600.)

A violation of the Cartwright Act may also violate the unfair competition statutes (see 13 *Summary* (10th), *Equity*, §98), and the state may seek additional remedies under those statutes. (*B. & P.C. 17200 et seq.*; see *People v. National Assn. of Realtors* (1981) 120 C.A.3d 459, 473, 174 C.R. 728.) (See also *People v. National Assn. of Realtors* (1984) 155 C.A.3d 578, 585, 202 C.R. 243 [under *B. & P.C. 17206*, penalty must be imposed for *each* violation of Cartwright Act].)

SUPPLEMENT: [This section is current through the latest supplement]



69 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

E. Restraint of Trade and Other Illegal Trade Practices.

2. California Law.

c. Cartwright Act.

6. Enforcement.

dd. Treble Damage Action by Private Person.

1 *Witkin Sum. Cal. Law Contracts* § 602

[§ 602] Treble Damage Action by Private Person.

(1) *In General.* Any person injured in his or her business or property may recover *treble damages*. (*B. & P.C. 16750(a)*.) The statute, like its federal counterpart, does not confine its protection to competitors of the defendant; consumers, purchasers, and others injured by the restraint of trade have standing to sue. (*Saxer v. Philip Morris* (1975) 54 C.A.3d 7, 26, 126 C.R. 327; see *Cellular Plus v. Superior Court* (1993) 14 C.A.4th 1224, 1232, 18 C.R.2d 308 [independent corporate sales agents of one defendant, who alleged they had lost sales due to defendants' anticompetitive conduct, had standing to sue under Cartwright Act].) (On class action and certification of class, see *Rosack v. Volvo of America Corp.* (1982) 131 C.A.3d 741, 182 C.R. 800, 4 Cal. Proc. (4th), *Pleading*, §257; on requirement that public works contractor assign cause of action under Act to government agency, see *supra*, §1001; on right to injunctive relief, see *supra*, §§599, 600.)

The factors that favor giving a plaintiff standing include the following: (a) the existence of an antitrust violation causing harm to the plaintiff; (b) an injury of a type that the antitrust laws are designed to redress; (c) a direct causal connection between the asserted injury and the alleged restraint of trade; (d) the absence of more direct victims, so that denial of standing would leave a significant antitrust violation unremedied; and (e) lack of a potential for double recovery. (*Vinci v. Waste Management* (1995) 36 C.A.4th 1811, 1814, 43 C.R.2d 337.) Recovery was denied under the facts of *Vinci*. Plaintiff had owned and operated a recycling business. Defendant acquired the business, plaintiff became an employee, and defendant later fired him. Plaintiff then sued under the Cartwright Act for alleged monopolistic practices, i.e., the acquisition of competitors and predatory pricing. Plaintiff alleged two distinct forms of injury: the loss of his recycling business and the loss of his job with defendant. The trial judge sustained defendant's demurrer. *Held*, affirmed.

(a) Plaintiff could not sue for loss of the recycling corporation, even if he were the sole shareholder. The remedy for the injury rested with the corporation, to avoid double recovery. (36 C.A.4th 1815.)

(b) Plaintiff could not sue for his lost job under the Cartwright Act. The loss of a job is not the type of loss the antitrust law is intended to forestall. He did not allege an employment boycott or that he was so essential to the

monopolistic scheme that his firing was itself an anti-competitive act. Competitors and consumers allegedly injured by defendant's predatory price competition and acquisition of market power could remedy any antitrust violations. Plaintiff's only remedy was a wrongful termination action. (36 C.A.4th 1816.) (See 47 *Hastings L. J.* 509 [standing of wrongfully discharged employee to bring antitrust suit; analysis of *Vinci*].)

(2) *Venue*. A damage action may be brought in any county where the defendant or any agent resides or is found, or where service may be obtained. (B. & P.C. 16750(a).)

(3) *Notice to Attorney General of Appeal or Writ Proceeding*. A private party "who commences, by writ or appeal, any proceeding" in the Supreme Court or Court of Appeal must, unless time is extended for good cause, serve notice thereof on the Attorney General within 3 days after commencement. "No relief, temporary or permanent, shall be granted until proof of service of this notice is filed with the court." (B. & P.C. 16750.2; see 15 *Pacific L. J.* 491.)

West's Key Number Digest, Monopolies k.30

SUPPLEMENT: [This section is current through the latest supplement]

(1) *In General*.

Rosack case:

Cross-Reference: 4 *Cal. Proc.* (5th), *Pleading*, §282.



70 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

E. Restraint of Trade and Other Illegal Trade Practices.

2. California Law.

c. Cartwright Act.

6. Enforcement.

ee. Parens Patriae Action.

1 Witkin Sum. Cal. Law Contracts § 603

[§ 603] Parens Patriae Action.

(1) *In General.* The Attorney General may bring a civil action, as *parens patriae* on behalf of natural persons residing in the state, for monetary damages to their property caused by violation of the Act. (B. & P.C. 16760(a)(1); see 9 Pacific L. J. 314.) The district attorney, when the violations occur primarily within his or her county, may also bring this type of action, on compliance with the notice requirements of B. & P.C. 16750(g) (see supra, §600). (B. & P.C. 16760(g).) Under comparable federal law, "natural person" is defined as excluding "proprietorships or partnerships." (See 15 U.S.C., §15g(3).)

(2) *Notice.* Notice of the action must be published in the manner and with the content ordered by the superior court. If due process would otherwise be denied, the court may order further notice to particular persons. (B. & P.C. 16760(b)(1).)

(3) *Election To Be Excluded.* Any person on whose behalf the action is brought may file a notice electing to be excluded. (B. & P.C. 16760(b)(2).) The final judgment is res judicata as to all persons who do not file this notice. (B. & P.C. 16760(b)(3).)

(4) *Dismissal or Compromise.* The action may not be dismissed or compromised without court approval, and notice of any proposed dismissal or compromise must be given in the manner directed by the court. (B. & P.C. 16760(c).)

(5) *Damages.* Treble damages are awarded. (B. & P.C. 16760(a)(2).) In computing damages, a "reasonable system of estimating aggregate damages," including use of statistical or sampling methods or pro rata allocation of overcharges or excess profits, may be used. Individual damages need not be shown. (B. & P.C. 16760(d).) The court must, however, exclude from the award any amount that duplicates other awards for the same injury, or that is allocable to persons who have excluded their claims. (B. & P.C. 16760(a)(1).) The court must also award the state costs, attorneys' fees, and prejudgment interest (B. & P.C. 16760(a)(2)), and may award attorneys' fees to a prevailing defendant if the Attorney General or district attorney "acted in bad faith, vexatiously, wantonly, or for oppressive reasons" (B. & P.C. 16760(a)(3)).

(6) *Distribution of Recovery*. Monetary relief must be distributed as follows:

(a) Funds are distributed in such a manner as "to insure, to the extent possible," each person "a reasonable opportunity to secure his or her appropriate portion." (*B. & P.C. 16760(e)(1)*) [court may employ *cy pres* or fluid recovery mechanisms as way of providing value to persons injured as result of Cartwright Act violation.]

(b) Costs and attorneys' fees are awarded by the court to the Attorney General. (*B. & P.C. 16760(e)(2).*)

(c) Any remaining funds are treated as if they were unclaimed property under *C.C.P. 1530* et seq., *1540* et seq. (*B. & P.C. 16760(e)(3).*) (On unclaimed property, see 13 *Summary* (10th), *Personal Property*, 36 et seq.)

SUPPLEMENT: [This section is current through the latest supplement]



71 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
E. Restraint of Trade and Other Illegal Trade Practices.
2. California Law.
c. Cartwright Act.
6. Enforcement.
ff. Action for Indirect Injury.

1 Witkin Sum. Cal. Law Contracts § 604

[§ 604] Action for Indirect Injury.

In *Illinois Brick Co. v. Illinois* (1977) 431 U.S. 720, 97 S.Ct. 2061, 52 L.Ed.2d 707, the court held that only direct purchasers could sue for treble damages under the Clayton Act. (See *supra*, §569.) California and other states promptly enacted legislation to reject the federal rule in state actions. In California, the 1978 Legislature added the following amendment to *B. & P.C. 16750(a)*: "This action may be brought by any person who is injured in his or her business or property by reason of anything forbidden or declared unlawful by this chapter, regardless of whether such injured person dealt directly or indirectly with the defendant." (See *Union Carbide Corp. v. Superior Court* (1984) 36 C.3d 15, 201 C.R. 580, 679 P.2d 14; *Crown Oil Corp. v. Superior Court* (1986) 177 C.A.3d 604, 223 C.R. 164; *B.W.I. Custom Kitchen v. Owens-Illinois* (1987) 191 C.A.3d 1341, 1347, 235 C.R. 228, 4 Cal. Proc. (4th), *Pleading*, §257 [indirect purchasers of glass containers were entitled to maintain class action under Cartwright Act]; 10 *Pacific L. J.* 299; 11 *Pacific L. J.* 121.)

In *Union Carbide Corp. v. Superior Court*, *supra*, plaintiffs, alleging an illegal price-fixing conspiracy by petitioners, sued as indirect purchasers of industrial gas from petitioners. Claiming a substantial risk of multiple liability, petitioners sought mandamus to compel joinder of other parties in the chain of distribution. *Held*, writ denied.

(a) The dissent in *Illinois Brick* argued that indirect purchasers were persons injured by illegal overcharges, and that the possibility of multiple liability did not justify a rule against recovery by these purchasers. The 1978 amendment to *B. & P.C. 16750* in effect indorses this dissenting view for Cartwright Act actions. (36 C.3d 19, 21.)

(b) Petitioners were also sued in the federal court by direct purchasers. However, this does not subject them to a substantial risk of multiple liability. Federal law allows recovery only by the direct purchaser regardless of whether the overcharge was passed on, while the California statute allows indirect purchasers to recover regardless of any federal claim by the direct purchaser. Hence, "[q]uestions of whether overcharges were passed on, essential to the indirect purchaser's California claim, are irrelevant to, and thus not subject to inconsistent determination in, a suit on the direct purchaser's federal claim." (36 C.3d 23.) (On court's interpretation of *C.C.P. 389*, dealing with joinder, see 4 *Cal. Proc.* (4th), *Pleading*, §159.)

Crown Oil Corp. v. Superior Court, *supra*, rejected the contention that the 1978 amendment was in conflict with the federal law, and therefore invalid under the Supremacy Clause (see 7 *Summary* (10th), *Constitutional Law*, §8 et seq.): "The fact that the injured indirect purchasers may recover under state laws does not obstruct the federal scheme which only permits recovery by direct purchasers." (177 C.A.3d 612.)

An additional challenge, that the amendment violated due process by permitting multiple recovery, was also rejected in *Crown Oil* as "sheer speculation": "We, as others, are confident that when the threat of double recovery occurs, the trial court will fashion relief accordingly." (177 C.A.3d 613.)

SUPPLEMENT: [This section is current through the latest supplement]

See 81 So. Cal. L. Rev. 69 [*Illinois Brick Co.*: approach to indirect purchaser rule]; 35 A.L.R.6th 245 [right of buyer of price-fixed product to sue manufacturer on state antitrust claim].

B.W.I. Custom Kitchen case:

Cross-Reference: 4 Cal. Proc. (5th), *Pleading*, §282.*Interpretation of C.C.P.* 389:

Cross-Reference: 4 Cal. Proc. (5th), *Pleading*, §177.



72 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
E. Restraint of Trade and Other Illegal Trade Practices.
2. California Law.
c. Cartwright Act.
7. Illustrations.
aa. Bid Depositories.

1 Witkin Sum. Cal. Law Contracts § 605

[§ 605] Bid Depositories.

In *Oakland-Alameda County Builders' Exchange v. F.P. Lathrop Const. Co.* (1971) 4 C.3d 354, 93 C.R. 602, 482 P.2d 226, plaintiff operated a "locked box" bid depository, under which subcontractors submitted sealed bids to the depository, and the general contractor prepared his own bid on the basis of those deposited. The object was to prevent "bid piracy" and similar practices. (See 19 *Hastings L. J.* 505, 520.) Defendant general contractor, in breach of the rules, rejected deposited low bids of two subcontractors and accepted lower bids from other subcontractors who had not used the depository. The depository and the subcontractors sued for damages. *Held*, judgment on the pleadings for defendant affirmed; the arrangement violated the Cartwright Act.

(a) *Illegal price-fixing.* The depository is a combination of subcontractors with the purpose and effect of restraining open price competition among subcontractors. The subscribing subcontractors agree not to engage in open price competition, for they submit sealed bids, and neither other subcontractors nor the general contractor is aware of the amount bid. (4 C.3d 362.) Agreements fixing or tampering with prices are illegal per se. (4 C.3d 363; see *supra*, §565.) "It should be apparent that the 'economic forces of supply and demand' can have little impact on a bidding system which is conducted in secrecy and which leaves general contractors no alternative but to accept the lowest bids submitted through the Depository or withdraw from the bidding." (4 C.3d 363.)

(b) *Boycott of subcontractors.* The rules result in agreements by general contractors to boycott subcontractors whose bids are not processed through the depository. (4 C.3d 364.) Under traditional antitrust principles, group boycotts are illegal per se. (4 C.3d 365; see *supra*, §566.)

(c) *Boycott of contractors.* The rules result in a boycott by participating subcontractors of all general contractors who do not use the depository. (4 C.3d 365.)

The court approved two prior Court of Appeal decisions (*People v. Inland Bid Depository* (1965) 233 C.A.2d 851, 44 C.R. 206, and *Carl N. Swenson Co. v. E.C. Braun Co.* (1969) 272 C.A.2d 366, 77 C.R. 378), and both distinguished and disapproved *Associated Plumbing Contractors of Marin, Sonoma & Mendocino Counties v. F.W. Spencer & Son*

(1963) 213 C.A.2d 1, 28 C.R. 425. (4 C.3d 367, 368.) (See 60 Cal. L. Rev. 769, 772.)

SUPPLEMENT: [This section is current through the latest supplement]



73 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

E. Restraint of Trade and Other Illegal Trade Practices.

2. California Law.

c. Cartwright Act.

7. Illustrations.

bb. Tying Arrangements.

1 Witkin Sum. Cal. Law Contracts § 606

[§ 606] Tying Arrangements.

In *Corwin v. Los Angeles Newspaper Service Bureau* (1971) 4 C.3d 842, 94 C.R. 785, 484 P.2d 953, defendant bureau, organized in 1934, handled most of the legal advertising of newspapers qualified to print legal advertisements in Los Angeles County. Plaintiff Statewide, organized in 1966 to provide a service for deed of trust trustees, operated a legal advertising business limited to notices of sales by trustees under deeds of trust. Defendant bureau's newspaper members, under their contract, made the bureau their exclusive representative in soliciting and servicing legal advertising; they paid 15% commission to the bureau on every advertisement they published, regardless of whether it was placed by the bureau, and they received a pro-rata distribution of the bureau's net profits. But a member who withdrew any class of legal advertising waived his or her right to a distribution of profits. The result was that Statewide, if it published trustees' notices in any of the bureau's newspapers, could not collect a commission from them (they would not pay double), but had to look to the trustees, or to publish in one of the newspapers not bound by the bureau's contract, often an impossibility. Statewide brought this action for injunction and damages. *Held*, summary judgment for defendant reversed; triable issues of fact were presented.

(a) *Restraint of trade*. The agreements between the bureau and its members restrained trade and therefore violated the Cartwright Act unless shown to be reasonable. (1) Because Statewide could not obtain the normal 15% commission from newspapers that were bureau members, it had to accept either a reduced profit level or charge its client trustees a higher fee. Clients would naturally turn to the bureau that could charge a lesser fee. Thus, the effect of the agreements was to reduce the profit margin and competitive strength of independent agencies such as *Statewide*. (4 C.3d 854.) (2) The other part of the agreements, waiver of all profits by withdrawing any class of advertising, penalized the privilege of withdrawal, and forced independent agencies such as *Statewide* to compete for representation for all classes of legal advertising. This increase in the categories of services that a competitor must offer impedes and discourages the entry of others into the market. (4 C.3d 854.)

(b) *Illegal tying arrangement*. Defendant's representation agreement could also be an illegal tying arrangement. The possible "tie" arises from the provision that the withdrawing member loses all right to participate in the net profits of the bureau, thus increasing the price for services on the advertising he or she still places with the bureau. (4 C.3d 857.) In

most tying cases, the seller absolutely refuses to sell one product separately from another. Here, a higher price is exacted for the tying product if the tied product is not also purchased, and this seems to present many of the evils inherent in a classic tying arrangement. (4 C.2d 857, footnote 13; see 72 Harv. L. Rev. 65.) And, although the bureau claimed that it sold only a single, unitary service, the facts must be examined to see if normally separate items were combined as a disguised tie-in. (4 C.3d 858, 859.)

The court concluded with a recital of the factors to be considered in determining the issue. "(1) Whether competitors offer to sell the products or services separately or only as a unit. (2) Whether the combined product or service is composed of varying assortments of component parts. (3) Whether buyers are or can be charged separately for the allegedly separate products or services. (4) Whether the defendant ever sells or offers to sell the products or services separately." (4 C.3d 858.) (See 60 Cal. L. Rev. 769, 778.)

After reversal of the summary judgment in the *Corwin* case, the trial resulted in judgment for defendants (see *Corwin v. Los Angeles Newspaper Service Bureau* (1978) 22 C.3d 302, 148 C.R. 918, 583 P.2d 777). *Held*, affirmed; the findings, based on sufficient evidence, showed a different contract from the one considered on the summary judgment appeal; in particular, the contract had never been applied to penalize a member newspaper for excluding a class of advertising from the agreement. (22 C.3d 312.)

In *Morrison v. Viacom* (1997) 52 C.A.4th 1514, 61 C.R.2d 544, customers of a cable television company brought a class action against the company, alleging that defendant's practice of tying the sale of satellite and premium channels to the sale of broadcast channels was an illegal tying agreement in violation of B. & P.C. 16720 (unlawful trusts), 16727 (unlawful tying agreements; see *supra*, §590). The trial court sustained defendant's demurrer on the ground that the antitrust claims were preempted by the federal Cable Acts of 1984 and 1992. *Held*, reversed; the antitrust claims were only partially preempted by the federal Acts. (52 C.A.4th 1519.) At a second trial, *Morrison v. Viacom* (1998) 66 C.A.4th 534, 78 C.R.2d 133, the trial court again sustained defendant's demurrer, this time on the ground that plaintiffs' complaint failed to state a cause of action under either B. & P.C. 16720 or 16727. *Held*, affirmed.

(a) A tying arrangement is a requirement that a buyer purchase one product or service as a condition of the purchase of another. Traditionally, the product that is the inducement for the arrangement is called the "tying product," and the product or service that the buyer is required to purchase is called the "tied product." A tying arrangement may be condemned under either or both B. & P.C. 16720 and 16727. (66 C.A.4th 540.)

(b) The elements of a per se tying arrangement violative of B. & P.C. 16720 are: (1) a tying agreement, arrangement, or condition existed whereby the sale of the tying product was linked to the sale of the tied product or service; (2) the party had sufficient economic power in the tying market to coerce the purchase of the tied product; (3) a substantial amount of sale was affected in the tied product; and (4) the complaining party sustained pecuniary loss as a consequence of the unlawful act. Under B. & P.C. 16727, a per se violation is established if either element (2) or (3) is established along with elements (1) and (4). (66 C.A.4th 541.)

(c) *Violation of B. & P.C. 16720 was not alleged.* The complaint did not sufficiently allege element (3) above, because plaintiffs failed to allege facts establishing that there was an actual effect on competition in the tied product market for local broadcast television. Plaintiffs contended that defendant compelled them to purchase the tied product--broadcast television, defined as local broadcast television channels concurrently available without charge over the airwaves--even though they neither needed nor desired to purchase from defendants or any other cable company that which was readily available to them without charge over the air waves. But plaintiffs failed to plead the requisite tied product market foreclosure because they did not allege that they would have purchased the broadcast channels from someone else if not forced to buy them from defendant. Indeed, plaintiffs did not even allege sufficient facts to show that defendant had competitors in the tied product market. *A transaction cannot restrain trade when no competitor exists from whom to purchase the tied product.* Further, plaintiffs' concession that, if not for defendant's business practice, they would not have bought broadcast channels at all because they were available for free over the airwaves, established that the challenged practice had no effect on competition in the tied product market. (66 C.A.4th 542.)

(d) *Violation of B. & P.C. 16727 was not alleged.* Plaintiffs failed to state a cause of action under *B. & P.C. 16727*, because that section does not apply when the *tying* item is a service. The statute provides that a sale or contract for sale of "goods, merchandise, machinery, supplies, commodities" is unlawful when conditioned on the agreement that the purchaser "shall not use or deal in the goods, merchandise, machinery, supplies, commodities, or services of a competitor or competitors." The term "services" is used to describe tied items and is not used to describe tying items. The tying item here--satellite and/or premium channels, or cable television--is a service and not a commodity, as shown by applicable federal authority construing the parallel provision of the *Clayton Act*. (66 C.A.4th 546.)

(e) *Antitrust injury was not adequately alleged.* The plaintiff in a Cartwright Act proceeding must show that an antitrust violation was the proximate cause of plaintiff's injuries. An antitrust injury must be proved; that is, the type of injury the antitrust laws were intended to prevent, and that flows from the invidious conduct rendering the defendant's acts unlawful. Here, plaintiffs failed to allege antitrust injury because they failed to allege any facts showing that they suffered an injury that was caused by restraints on competition. Forcing a customer to buy something that he or she would not buy elsewhere does not injure competition. In light of plaintiffs' concession that they could obtain local broadcast television free of charge, the real injury about which they complained was that defendant had inflated its cable rates by requiring that customers pay a fee for broadcast television. This practice may implicate rate regulations, but it does not constitute an anticompetitive tying arrangement. (66 C.A.4th 548.)

Some courts have required a finding of actual restraint of competition in order to hold a tie-in illegal; California courts do not. (*People v. National Assn. of Realtors* (1984) 155 C.A.3d 578, 583, 202 C.R. 243.)

A number of other decisions involve alleged tying arrangements violative of the Cartwright Act. (See *Sherman v. Mertz Enterprises* (1974) 42 C.A.3d 769, 779, 117 C.R. 188; *Suburban Mobile Homes v. AMFAC Communities* (1980) 101 C.A.3d 532, 542, 161 C.R. 811; *Classen v. Weller* (1983) 145 C.A.3d 27, 36, 37, 192 C.R. 914; *MacManus v. A.E. Realty Partners* (1983) 146 C.A.3d 275, 286, 194 C.R. 567; *Kim v. Servosnax* (1992) 10 C.A.4th 1346, 1359, 13 C.R.2d 422 [agreement linking franchisor's agreement to provide cafeteria services to host company's agreement not to purchase commodities sold in cafeteria from others was not illegal per se and restraint on trade involved was not unreasonable]; *Lloyd Design Corp. v. Mercedes-Benz of North America* (1998) 66 C.A.4th 716, 721, 78 C.R.2d 185 [luxury car distributor's decision to include floor mats as standard equipment in its vehicles did not constitute illegal tying arrangement between purchase of its vehicles and of floor mats]; *Fisherman's Wharf Bay Cruise Corp. v. San Francisco Superior Court* (2003) 114 C.A.4th 309, 339, 7 C.R.3d 628 [ticket entitling passenger to seat on boat to Alcatraz Island was not "commodity" for purposes of *B. & P.C. 16727* but merely incidental to provision of service; citing *Morrison*].)

West's Key Number Digest, Monopolies k.17.5(2)

SUPPLEMENT: [This section is current through the latest supplement]

Alleged tying arrangements: See *RLH Industries v. SBC Communications* (2005) 133 C.A.4th 1277, 1283, 35 C.R.3d 469 [tele- phone company did not tie its telephone service to its high-voltage protection (HVP) service merely by packaging them together, because customers could choose to buy telephone service and HVP service from different parties and because company had no direct financial interest in other, approved HVP providers]; *Belton v. Comcast Cable Holdings, LLC* (2007) 151 C.A.4th 1224, 1234, 60 C.R.3d 631 [cable service provider's requirement that subscribers who wished to purchase only music service had to purchase basic cable package that included television did not create unlawful tying arrangement under Cartwright Act; because subscribers did not want cable television, which was the tied product, provider's alleged practice could not have injured competition in tied product market]; *SC Manufactured Homes v. Liebert* (2008) 162 C.A.4th 68, 87, 76 C.R.3d 73 [allegations in mobilehome dealer's complaint, concessions by counsel, and attachments to complaint established that dealer could not state cause of action against mobilehome park and other dealers based upon illegal tying arrangement that required tenants to purchase mobilehomes from specific dealers in order to rent space in new section of park, as tenants were not forced to buy mobilehome from any particular dealer; distinguishing *Suburban Mobile Homes v. AMFAC Communities* (1980) 101 C.A.3d 532, 161 C.R. 811, text, p. 678].



74 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

E. Restraint of Trade and Other Illegal Trade Practices.

2. California Law.

c. Cartwright Act.

7. Illustrations.

cc. Realtors Multiple Listing Service.

1 Witkin Sum. Cal. Law Contracts § 607

[§ 607] Realtors Multiple Listing Service.

In *Marin County Bd. of Realtors v. Palsson* (1976) 16 C.3d 920, 130 C.R. 1, 549 P.2d 833, the court held invalid a multiple listing service, operated by a county board of realtors, which limited its membership to persons primarily engaged in the real estate business and denied nonmembers access to the service.

The multiple-listing service was established for residential property in Marin County. The system pooled each member's listing, so that any other broker could sell the property, and obtain a share of the commission.

But the county board's bylaws (a) made listings available only to members, and (b) offered membership only to persons "primarily engaged in the real estate business." Palsson, a licensed real estate salesman employed by a member, was denied membership on the ground that he was an airline flight engineer, hence was not "primarily engaged" in the business. A member employing a person denied membership was subject to board sanctions; hence denial of membership had the effect of denial of employment with 75% of the residential brokers in the county. Palsson contested the board's decision, the board brought this suit for declaratory relief, and Palsson cross-complained seeking declaratory and injunctive relief. The trial judge ruled in favor of the board. *Held*, reversed.

(a) *Act applies to sale of services.* Federal decisions under the Sherman Act, applicable to the Cartwright Act (see *supra*, §597), make it clear that antitrust legislation applies to the service trades, including the service of realtors (see *supra*, §555). California decisions on the sale of services are in accord. (16 C.3d 927; see *supra*, §592.) The "labor" exception (see *supra*, §593) was not designed to exempt the sale of services: "The relevant question, in every case, is whether the practice in question is meant to further the interest of tradesmen as employees in a collective bargaining context, or whether it is designed to advance their interests as entrepreneurs." (16 C.3d 927.)

(b) *Rule of reason applies.* Palsson contended that the board's "access" rule (members will not inform nonmembers of multiple listings) was a concerted refusal to deal, and that the "primarily engaged" rule was an agreement by member brokers not to employ licensed part-time salesmen and, as such, was a group boycott. These contentions, if upheld, would make the "per se" rule applicable (see *supra*, §597); but they are unsound. The commentators have distinguished

direct boycotts aimed at coercing parties to adopt noncompetitive practices (*per se* rule applies) and indirect boycotts, which result in refusals to deal only as a byproduct of the agreement (rule of reason, *supra*, §598, applies). (16 C.3d 932.) Here, the primary intent of the association is to impose internal, not external, restraints; nonmember brokers are excluded from the advantages of board facilities and thereby foreclosed from market opportunities, but these consequences are only incidental products of the internal restraints. Hence, the rule of reason governs. (16 C.3d 934.)

(c) *Anticompetitive effects of board's rules.* (1) The "access" rule seriously hampers the effectiveness of nonmember salesmen and brokers, for the members have most of the business and offer the advantages of multiple listings. "Under these circumstances, one does not need an advanced degree in economics to predict whose services a buyer or seller of a home is likely to engage." (16 C.3d 936.) (2) The "primarily engaged" rule inflicts severe economic detriment on a part-time salesperson, for he or she is denied employment by three-fourths of the residential real estate brokers in the county, and unless employed by a licensed broker, the part-time salesperson may not legally sell real estate. (16 C.3d 936.) (3) The home buyer or seller also suffers; the choice of a broker or salesman is narrowed, and there is an impaired ability to seek services at a commission lower than that prevailing. (16 C.3d 937.)

(d) *Asserted justification for board's "access" rule.* The "access" rule is justified on the theory that it makes membership desirable by providing attractive benefits not available to outsiders. However, an association's freedom to exclude nonmembers from its activities must yield to antitrust laws when the association has the power to shape and influence the economic environment of its particular market, as the board does here. (16 C.3d 938.)

(e) *Asserted justification for "primarily engaged" rule.* This rule is justified on the ground that the association has the right to choose its own members. However, when membership is a practical economic necessity, as here, the bases of exclusion are open to judicial review. (16 C.3d 938.) In ordinary cases, the test is simply whether the membership rules are rationally related to legitimate purposes and fairly applied. (16 C.3d 938.) But in an antitrust case, where the rule poses serious anticompetitive dangers to society, "the rule of reason requires not only a demonstration that the anticompetitive practice relates to a legitimate purpose, but also that it is reasonably necessary to accomplish that purpose and narrowly tailored to do so." (16 C.3d 939.) Here, the board's theory that the rule has the legitimate goal of furthering the professional and ethical competence of the profession cannot be sustained: The regulatory statutes perform this function in the main, and there is no reason to believe that a part-time salesperson will devote less effort to self-improvement or service to his or her client. Moreover, by excluding *all* part-time salespersons, even the most highly qualified, the "primarily engaged" rule cannot be justified under the rule of reason. (16 C.3d 940.)

(f) *Judgment with directions.* "The board's rules denying access of nonmembers to the multiple listing service must be eliminated, although nonmembers may be charged a reasonable fee for use of the service consistent with the per-capita costs of operation. In addition, as long as membership in the board is necessary for employment by an active member, the board should be enjoined from enforcing or promulgating any bylaw or other rule which conditions associate membership on primary engagement in the real estate industry." (16 C.3d 940.) (See *Glendale Bd. of Realtors v. Hounsell* (1977) 72 C.A.3d 210, 212, 139 C.R. 830 [following *Palsson*]; *Feldman v. Sacramento Bd. of Realtors* (1981) 119 C.A.3d 739, 744, 748, 174 C.R. 231 [plaintiff's pleading insufficient to make *Palsson* applicable]; *People v. National Assn. of Realtors* (1981) 120 C.A.3d 459, 467, 468, 174 C.R. 728 [following *Palsson*]; *People v. National Assn. of Realtors* (1984) 155 C.A.3d 578, 202 C.R. 243, [appeal from judgment after remand in 120 C.A.3d 459, *supra*]; 4 Cal. Western L. Rev. 298; 22 A.L.R.4th 103 [application of state antitrust laws to activities of real estate agents or associations].)

A multiple-listing service with access restricted to licensed real estate brokers is not violative of antitrust law. (*Derish v. San Mateo-Burlingame Bd. of Realtors* (1982) 136 C.A.3d 534, 540, 186 C.R. 390; see C.C. 1086 et seq. defining multiple-listing service.)

In *Freeman v. San Diego Assn. of Realtors* (1999) 77 C.A.4th 171, 91 C.R.2d 534, formation of a single countywide multiple-listing service by previously separate regional real estate associations, some of which contracted with the countywide service to provide "enhanced services" that were packaged with access to its data, was held not to constitute

a tying arrangement, price-fixing, a group boycott, or market exclusion by excessive pricing in violation of the *Cartwright Act*. (77 C.A.4th 183.)

SUPPLEMENT: [This section is current through the latest supplement]



75 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
E. Restraint of Trade and Other Illegal Trade Practices.
2. California Law.
c. Cartwright Act.
7. Illustrations.
dd. Interest Rates.

1 Witkin Sum. Cal. Law Contracts § 608

[§ 608] Interest Rates.

In *Biljac Associates v. First Interstate Bank* (1990) 218 C.A.3d 1410, 267 C.R. 819, plaintiff commercial borrowers brought a Cartwright Act action against defendant banks and banking trade associations, alleging conspiracy to set and manipulate the variable interest rates charged on loans to "middle market" commercial borrowers. Specifically, plaintiffs alleged that when lending to middle market borrowers, defendants conspired over time to abandon the traditional prime-based, fixed-rate loans in favor of "floating" or variable-rate loans linked to a new and more volatile base rate controlled by defendants themselves. It was further alleged that defendants conspired to set rate fluctuations on the basis of fluctuations in short-term commercial paper rates. This led to noncompetitive, higher rates for middle market borrowers while allowing defendants to make below-"prime" loans to preferred borrowers in order to keep those borrowers from entering the commercial paper market themselves. *Held*, summary judgment for defendants affirmed; plaintiffs failed to raise a triable issue of fact regarding antitrust conspiracy.

(a) *Defendants' proof.* Defendants met their burden of proof by negating the required element of conspiracy. An unbroken chain of bank officers charged with determining the prime rate and commercial loan pricing policies from 1970 to 1986 denied receiving or sharing competitive information with other banks, or giving notice of rate changes to other banks in advance of divulging them to the public. Their declarations explained how rates were influenced by market forces and the importance of making changes when other banks made changes in order to compete. And the employees responsible for making the changes public detailed the procedures used. (218 C.A.3d 1423.)

(b) *Plaintiffs' proof.*

(1) Plaintiffs failed to meet their burden of offering admissible evidence raising a reasonable inference of conspiracy, despite being aided by California and federal decisions urging restraint in granting defendants summary judgment in complex antitrust litigation. (218 C.A.3d 1425, citing *Corwin v. Los Angeles Newspaper Service Bureau* (1971) 4 C.3d 842, 94 C.R. 785, 484 P.2d 953, *supra*, §606.)

(2) Plaintiffs' theory was that, instead of conspiring to fix rates, defendants conspired to set in place a system by

which they acted independently, in the sense that each periodically adjusted its own prime rate more or less in accord with other banks' rate changes, but which had the net effect of asserting anticompetitive control over rates. Hence, the ultimate question is whether the changes in rates for middle market borrowers were the result of conspiracy or of independent business judgment in response to market forces. (218 C.A.3d 1429.)

(3) Plaintiffs submitted evidence that loan pricing and interest rates were the subject of trade association panel discussions, publications, etc. in the 1970s, when the shift to floating rates occurred. "It is not disputed that those topics were discussed. However, such activity is condoned under antitrust policy, and thus no inference of conspiracy may be drawn from it without proof of agreement or concerted action to manipulate the commercial loan market with such information." (218 C.A.3d 1430.)

(4) Plaintiffs also introduced evidence that some banks instituted formulas for tying their primes in varying ways to market indices, such as short-term commercial paper rates or certificate of deposit rates. However, these formulas differed from one another, were often changed, and received widespread publicity. Of the three defendants that experimented with formulas, two abandoned them in the early 1970's, and the third did not do so until 1981. Such action hardly connotes a conscious commitment to a common scheme, especially in the face of undisputed evidence that these defendants set their formulas independently. (218 C.A.3d 1431.)

(c) *Conclusion.* "Here, the *only* logical inference is that the movement from a fixed prime to individually set 'primes' was due to market forces. It is undisputed that these changes were industry-wide and evolved over almost 10 years, with different banks (conspirators in plaintiffs' view) trying and ultimately abandoning many alternatives during that time. Even plaintiffs' experts in this case, economists who felt that some of those practices were anticompetitive, agreed that they were consistent with prevailing economic pressures and independent business judgment. It is almost a contradiction in terms to say that defendants could 'conspire' to achieve a uniform result and yet take 10 years (with independent, halting attempts to arrive at the right system) to accomplish that conspiracy." (218 C.A.3d 1429.)

SUPPLEMENT: [This section is current through the latest supplement]



76 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
E. Restraint of Trade and Other Illegal Trade Practices.
2. California Law.
d. Unfair Practices Act.
1. Nature of Act.

1 Witkin Sum. Cal. Law Contracts § 609

[§ 609] Nature of Act.

The Unfair Practices Act (B. & P.C. 17000 et seq.) chiefly prohibits selling articles *below cost*, or giving them away, for the purpose of injuring competitors and destroying competition, except in such cases as "seasonal clearances"; and the Act also prohibits *rebates* or special privileges to purchasers that have these purposes or tendencies. Its constitutionality has been upheld. (See *Wholesale Tobacco Dealers Bureau of Southern Calif. v. National Candy & Tobacco Co.* (1938) 11 C.2d 634, 640, 82 P.2d 3; *Food & Grocery Bureau of Southern Calif. v. Garfield* (1942) 20 C.2d 228, 232, 125 P.2d 3 [giving of trading stamps does not violate law]; *People v. Pay Less Drug Store* (1944) 25 C.2d 108, 113, 153 P.2d 9; *Tri-Q v. Sta-Hi Corp.* (1965) 63 C.2d 199, 207, 45 C.R. 878, 404 P.2d 486; *Harris v. Capitol Records Distr. Corp.* (1966) 64 C.2d 454, 457, 50 C.R. 539, 413 P.2d 139 [history, purposes and scope of regulations]; *Manufacturers Life Ins. Co. v. Superior Court* (1995) 10 C.4th 257, 41 C.R.2d 220, 895 P.2d 56, supra, §592 [Legislature did not intend to displace remedies under Unfair Practices Act for conduct also proscribed by the Unfair Insurance Practices Act (*Ins.C.* 790 et seq.; see 2 Summary (10th), *Insurance*, §252 et seq.)]; *Cel-Tech Communications v. Los Angeles Cellular Tel. Co.* (1999) 20 C.4th 163, 171, 83 C.R.2d 548, 973 P.2d 527, 13 Summary (10th), *Equity*, §107 [to violate B. & P.C. 17043, prohibiting sales below cost, defendant must act with purpose, i.e., desire, of injuring competitors or destroying competition; mere knowledge that injury or destruction will occur is insufficient]; *People v. Kahn* (1936) 19 C.A.2d Supp. 758, 763, 60 P.2d 596; *Dunnell v. Shelley* (1940) 38 C.A.2d 118, 120, 100 P.2d 830; *People v. Gordon* (1951) 105 C.A.2d 711, 717, 234 P.2d 287; *Page v. Bakersfield Uniform & Towel Supply Co.* (1966) 239 C.A.2d 762, 770, 49 C.R. 46 [selling below cost]; *Paramount General Hosp. Co. v. National Med. Enterprises* (1974) 42 C.A.3d 496, 503, 117 C.R. 42 [definitions broad and open-ended; "article or product," as defined by B. & P.C. 17024, may cover lease of medical office and related services as a package]; *Amarel v. Connell* (1988) 202 C.A.3d 137, 150, 248 C.R. 276 [cause of action alleging below-cost sales of California rice to Korea, which had adverse effect on California markets, was not preempted by Sherman Antitrust Act]; *Turnbull & Turnbull v. ARA Trans.* (1990) 219 C.A.3d 811, 822, 825, 268 C.R. 856 [B. & P.C. 17043, prohibiting sales below cost, was neither violative of due process nor preempted by Sherman Act]; *Diesel Elec. Sales & Service v. Marco Marine San Diego* (1993) 16 C.A.4th 202, 212, 20 C.R.2d 62 [pleading was sufficient to state cause of action under B. & P.C. 17045, prohibiting secret allowance of unearned discount that injures competitor and tends to destroy competition]; *Western Union Financial Services v. First Data Corp.* (1993) 20 C.A.4th 1530, 1538, 25 C.R.2d 341 [in determining whether

sale of money transfers was below cost, defendant could classify all such transfers as one product; it was not required to allocate costs according to method adopted by a competitor]; *Kunert v. Mission Financial Services Corp.* (2003) 110 C.A.4th 242, 259, 1 C.R.3d 589 [dealers' assignment of conditional sales contracts to lenders who then paid "dealer reserve" to dealers was not "secret" within B. & P.C. 17045, where such payments were not secret from competitors of either dealers or lenders, and thus did not prevent or destroy fair competition]; see also *Safeway Stores v. Oklahoma Retail Grocers Assn.* (1959) 360 U.S. 334, 79 S.Ct. 1196, 1199, 3 L.Ed.2d 1280, 1283; C.E.B., Sales and Mergers of California Businesses, §5.11; Cal. Civil Practice, 6 Business Litigation, §§60.25 et seq., 60.57 et seq.; 24 Cal. L. Rev. 645; 27 Cal. L. Rev. 449; 45 Cal. L. Rev. 378; 63 Harv. L. Rev. 705; 96 Harv. L. Rev. 621 ["Little FTC Acts"]; 28 Pacific L. J. 311 [private enforcement of predatory price practices under California Unfair Practices Act and Federal Antitrust Act]; 10 So. Cal. L. Rev. 18; 27 So. Cal. L. Rev. 106; 6 U.C.L.A. L. Rev. 498; 2 U.S.F. L. Rev. 165 [extensive review and criticism of Act and court interpretation]; 54A Am.Jur.2d (1996 ed.), *Monopolies, Restraints of Trade, and Unfair Trade Practices* §1077 et seq.; 70 A.L.R.2d 1080 [trading stamps]; 67 A.L.R.3d 26 [state statutes forbidding area price discrimination]; 41 A.L.R.4th 612 [state statutes prohibiting sales below cost]; 41 A.L.R.4th 675 [state statute prohibiting unfair trade practice or discriminatory rebates, etc.]; 49 A.L.R.4th 1240 [health provider's agreement as to patient's copayment liability after insurer's payment as unfair trade practice under state law]; 90 A.L.R.4th 213 [insurance anti-rebate statutes].)

The Act is similar to the federal Robinson-Patman Act (supra, §572), and decisions under the federal act are persuasive. (*Unedus v. California Shoppers* (1978) 86 C.A.3d 932, 937, 150 C.R. 596.)

West's Key Number Digest, Monopolies k.10

SUPPLEMENT: [This section is current through the latest supplement]

See *People's Choice Wireless v. Verizon Wireless* (2005) 131 C.A.4th 656, 668, 31 C.R.3d 819 [cellular service provider/retailer's conduct in selling telephones to customers below cost in certain circumstances when independent dealers could not afford to compete did not constitute unfair competition; no antitrust policy would justify preventing retailer, which was single entity that neither possessed nor threatened monopoly, from discounting in situations in which independent dealers could not discount]; 26 A.L.R.6th 249 [validity, construction, and application of state statutory provisions prohibiting sale of gasoline below cost].



77 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

E. Restraint of Trade and Other Illegal Trade Practices.

2. California Law.

d. Unfair Practices Act.

2. Scope of Act and Distinctions.

1 Witkin Sum. Cal. Law Contracts § 610

[§ 610] Scope of Act and Distinctions.

(1) *Warranty Service Below Cost*. *B. & P.C. 17048.5* makes it unlawful for "any manufacturer, wholesaler, distributor, jobber, contractor, broker, retailer, or other vendor, or any agent of any such person," to contract with a service or repair agency for warranty service and repair of the products manufactured, distributed, or sold, "below the cost to such service or repair agency of performing the warranty service or repair." "Cost" is defined in *B. & P.C. 17026* as including "the cost of parts, transporting the parts, labor, and all overhead expenses of the service agency." (See *9 Pacific L. J. 334*.)

(2) *Exclusive Distributorship*. The Act regulates horizontal, not vertical, price relations (see *Harris v. Capitol Records Distr. Corp.* (1966) 64 *C.2d* 454, 50 *C.R.* 539, 413 *P.2d* 139, *infra*, §612); hence, it is not violated by a manufacturer who creates an exclusive distributorship for his or her product, thereby requiring retail purchasers to purchase from the distributor rather than directly from the manufacturer. (*Plotkin v. Tanner's Vacuums* (1975) 53 *C.A.3d* 454, 459, 125 *C.R.* 697.)

(3) *Exemption for Publicly Owned Utility*. *B. & P.C. 17024(2)* makes the Act inapplicable to a service sold or furnished by a publicly owned public utility on which the rates would have been established by the Public Utilities Commission if the service had been offered by a public utility corporation. (See *Hladek v. Merced* (1977) 69 *C.A.3d* 585, 590, 138 *C.R.* 194 [action by plaintiff private taxicab companies alleging that defendant city commenced "dial-a-ride" service at a loss; complaint failed to negative the statutory exemption].)

(4) *Application to Government Entity*. The Unfair Practices Act does not apply to governmental entities to the extent that inclusion would result in an infringement on their sovereign governmental powers. Thus, a county's operation of a hospital in competition with private hospitals for nonindigent patients was not subject to the Act; preventing the hospital from accepting paying patients as a means of meeting its obligation to indigents would infringe on its sovereign governmental powers. (*Community Memorial Hosp. of San Buena Ventura v. Ventura* (1996) 50 *C.A.4th* 199, 209, 56 *C.R.2d* 732.)

SUPPLEMENT: [This section is current through the latest supplement]



78 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
E. Restraint of Trade and Other Illegal Trade Practices.
2. California Law.
d. Unfair Practices Act.
3. Enforcement.

1 Witkin Sum. Cal. Law Contracts § 611

[§ 611] Enforcement.

(1) *In General.* "Any person or trade association" may sue to *enjoin any violation* and to recover damages. (*B. & P.C. 17070*; see *People v. Centr-O-Mart* (1950) 34 C.2d 702, 704, 214 P.2d 378 [state is proper party plaintiff]; *Kofsky v. Smart & Final Iris Co.* (1955) 131 C.A.2d 530, 531, 281 P.2d 5 [because statute carries out public policy, unclean hands of plaintiff not a defense]; 54A Am.Jur.2d (1996 ed.), *Monopolies, Restraints of Trade, and Unfair Trade Practices* §1098 et seq.; 24 So. Cal. L. Rev. 132.)

The plaintiff need not furnish *bond* (*B. & P.C. 17081*), and need not allege or prove either actual or threatened damage. (*B. & P.C. 17082*.)

In a civil or criminal action brought by the Attorney General or a district attorney, no person may refuse to give testimony or produce evidence on the ground of self-incrimination; but immunity from prosecution and from penalties is granted to the witness. (*B. & P.C. 17087*; see *B. & P.C. 17086* [immunity from prosecution based on information disclosed under compulsion]; on power of district attorney to make investigations and issue subpoenas, see *B. & P.C. 16759*, *supra*, §600.)

(2) *Presumptions.* Proof of sales below cost or at discriminatory prices, together with proof of injurious effect, is presumptive evidence of intent to injure competitors or destroy competition. (*B. & P.C. 17071*.)

Moreover, without a showing of injurious effect, *B. & P.C. 17071.5* establishes a presumption of intent to injure competitors or destroy competition, where a retailer sells products below cost but on terms limiting quantity that a customer can buy to an amount less than the entire supply. In *Dooley's Hardware Mart v. Food Giant Markets* (1969) 1 C.A.3d 105, 81 C.R. 451, the court explained the rational connection between the conduct involved (sale below cost with quantity limited) and the fact presumed (intent): If a businessperson is selling at a loss to get rid of an article for which the market has disappeared, he or she is willing to sell as much to any customer as the latter will take; and the same is true where the businessperson has to lower the price to meet an equally low price of a competitor. But if the businessperson offers to sell at a loss in limited quantities, it is reasonably inferable that he or she is not trying to get rid of a white elephant or to meet competition. (1 C.A.3d 108.)

(3) *Injunctive Relief*. The court "shall enjoin" any violation, and may in its discretion include "such other restraint as it may deem expedient in order to deter the defendant" from future violations. (*B. & P.C. 17078, 17079*.) The injunction "shall cover every article or product" and not merely the particular ones involved in the action. (*B. & P.C. 17080*; see *People v. Pay Less Drug Store* (1944) 25 C.2d 108, 119, 153 P.2d 9; cf. *Ellis v. Dallas* (1952) 113 C.A.2d 234, 242, 248 P.2d 63 [conflicting evidence as to intent; denial of injunction affirmed].)

(4) *Treble Damages*. *B. & P.C. 17082* provides that "any plaintiff in any such action shall be entitled to recover three times the amount of the actual damages." Treble damages are mandatory under the federal Robinson-Patman Act, and *B. & P.C. 17082* should be similarly interpreted; i.e., they are to be imposed in addition to actual damages without proof of malice or other condition precedent. (*Unedus v. California Shoppers* (1978) 86 C.A.3d 932, 941, 150 C.R. 596; see *Turnbull & Turnbull v. ARA Trans.* (1990) 219 C.A.3d 811, 827, 268 C.R. 856 [plaintiff relying solely on violation of Unfair Practices Act held limited to treble damages under *B. & P.C. 17082*; hence, affording plaintiff election between punitive and treble damages was error].)

(5) *Attorneys' Fee and Costs*. The successful plaintiff must be awarded a reasonable attorneys' fee and costs of suit. (*B. & P.C. 17082*.)

(6) *Remedies Cumulative*. The remedies for violation of the Unfair Practices Act are cumulative. Thus, a civil action by a district attorney against a smog check facility for issuing certificates for vehicles not in compliance with the law did not preclude a subsequent administrative action for suspension or revocation of its license. (See *Setliff Bros. Service v. Bureau of Automotive Repair* (1997) 53 C.A.4th 1491, 1494, 62 C.R.2d 25.)

(7) *Determination of Cost Is Fact Issue*. The determination of cost under the Unfair Practices Act is an issue of fact to be determined by the jury. Thus, where both parties present cost models that are rational and sufficiently allocated to comply with the requirement of the Act, both models should be submitted to the jury. (*Pan Asia Venture Capital Corp. v. Hearst Corp.* (1999) 74 C.A.4th 424, 432, 88 C.R.2d 118 [alleged sale by newspaper of advertising space below cost in violation of *B. & P.C. 17043*; trial court erred in deciding that only plaintiff's method of determining cost was appropriate and in precluding defendant from presenting its method to jury]; *Fisherman's Wharf Bay Cruise Corp. v. San Francisco Superior Court* (2003) 114 C.A.4th 309, 321, 7 C.R.3d 628 [whether competitor had engaged in predatory price discrimination by offering bay cruise tickets to wholesalers at below cost could not be determined by summary judgment].)

West's Key Number Digest, Monopolies k.28

SUPPLEMENT: [This section is current through the latest supplement]



79 of 79 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
E. Restraint of Trade and Other Illegal Trade Practices.
2. California Law.
d. Unfair Practices Act.
4. Price Differential to Rack-Jobber.

1 Witkin Sum. Cal. Law Contracts § 612

[§ 612] Price Differential to Rack-Jobber.

In *Harris v. Capitol Records Distr. Corp.* (1966) 64 C.2d 454, 50 C.R. 539, 413 P.2d 139, defendant distributed phonograph records of various manufacturers at a standard retail dealer discount of 38% off list price. Plaintiff, a Los Angeles retail dealer, bought records from defendant at that discount. D, a rack-jobber (subdistributor who buys from distributors and places records in self-service racks in supermarkets and similar outlets), was given a discount of 48% off list price, to compensate for his extra expense. D opened a retail store near plaintiff's store and sold records at 50% off list price, i.e., below cost. *Held*, D (who became insolvent and was dismissed) was guilty of violation of the Act, but defendant distributor was not.

(a) The prohibition against discrimination "between different locations" (*B. & P.C. 17031, 17040*) has a geographical meaning (unlike the Robinson-Patman Act prohibition against discrimination "between different purchasers"). To come within the statute, the seller must have at least two different places of business and must sell at a lower price in one than in the other. (64 C.2d 460.)

(b) The Act is a horizontal, not a vertical regulation; it applies only to the primary competition, not to the secondary competition between those who purchase from the alleged discriminator. Hence, a seller can lawfully discriminate in favor of a *buyer* to enable him or her to meet competition, so long as there is no intent on the part of the seller to prevent competition of *other sellers* at the seller's level. (64 C.2d 461.)

(c) The differential price treatment given a rack-jobber is a permissible "functional classification" under *B. & P.C. 17042*. (64 C.2d 463.) There was therefore no unlawful act by the distributor, and there was no showing of actual collusion with D, the rack-jobber. The injury suffered by plaintiff was entirely due to D's misuse of his favored classification to sell below cost. (64 C.2d 463.) (See *ABC Int. Traders v. Matsushita Elec. Corp. of America* (1997) 14 C.4th 1247, 61 C.R.2d 112, 931 P.2d 290, *infra*, §613 [distinguishing *Harris*, and holding that *B. & P.C. 17045*, which prohibits secret payment of rebates or unearned discounts, applies to "secondary" as well as "primary" line of commerce].)

SUPPLEMENT: [This section is current through the latest supplement]



1 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
E. Restraint of Trade and Other Illegal Trade Practices.
2. California Law.
d. Unfair Practices Act.
5. Secret Payment of Rebates or Unearned Discounts.

1 Witkin Sum. Cal. Law Contracts § 613

[§ 613] Secret Payment of Rebates or Unearned Discounts.

In *ABC Int. Traders v. Matsushita Elec. Corp. of America* (1997) 14 C.4th 1247, 61 C.R.2d 112, 931 P.2d 290, plaintiff wholesale distributor of telephone equipment and other electronic products sued defendant manufacturer of electronic products and two other competing wholesale distributors for violations of the Unfair Practices Act (UPA). Plaintiff alleged that the manufacturer was providing an unearned, secret 5% discount to the two other distributors in violation of *B. & P.C. 17045*, which prohibits the secret payment or allowance or rebates, refunds, commissions, or unearned discounts to the injury of a competitor and where the payment or allowance tends to destroy competition. The trial court dismissed plaintiff's action against the manufacturer, and the Court of Appeal affirmed on the ground that the elements of a violation of *B. & P.C. 17045* were not met, because plaintiff did not allege any injury to defendant's competitors or any tendency to destroy competition among electronics *producers*. *Held*, reversed. The class of "competitors" and the "competition" protected under *B. & P.C. 17045* is not restricted to competitors of the person allowing an unearned discount (the "primary" line of commerce), as opposed to competitors of the person receiving it (the "secondary" line of commerce).

(a) *B. & P.C. 17045* does not expressly restrict its application to competitors of the person allowing an unearned discount. Indeed, to the extent any inference can be drawn from the law's wording, it is to the contrary. On its face, the statute is aimed at preventing a distributor from discriminating between customers. Because the statute is focused patently on discrimination among purchasers, it is reasonable to assume the legislative purposes included protecting purchasers, such as wholesalers and retailers, against the competitive injury resulting from discrimination by those higher up the marketing chain. (14 C.4th 1254.)

(b) Although the statute does not contain an explicit reference to secondary line competitive injury as do the federal Clayton and Robinson-Patman Acts, the absence of a specific reference does not, in the context of other provisions of the UPA, constitute an implied restriction. While *B. & P.C. 17045* does not focus directly on the purchaser's acts in obtaining a discriminatory price or other preference, *B. & P.C. 17046* et seq., prohibiting acts furthering violations of the UPA, do. They indicate the Legislature's concern with the wrongful receipt, as well as payment, of discriminatory prices, and, inferentially, with the injurious effect wrongful receipt would have on the recipient's competitors. (14 C.4th 1255.)

(c) The purposes of the UPA are to safeguard the public against monopolies and to foster competition (*B. & P.C. 17002*), and the Act must be liberally construed to further those purposes (*B. & P.C. 17002*). *B. & P.C. 17045* would more fully serve the UPA's purposes if its protections were extended to the secondary line of commerce. A deceptive practice that tends to destroy competition is no less repugnant to the policy of the UPA because the competitive injury occurs among wholesalers or retailers, rather than among producers. Further, the legislative history of the UPA's prohibition on unearned discounts confirms that *B. & P.C. 17045* was intended primarily to protect against competitive injury at the level of the discount's recipient. Here, plaintiff alleged this type of injury and tendency to destroy competition. (*14 C.4th 1256*.)

(d) *Harris v. Capitol Records Distr. Corp.* (1966) 64 C.2d 454, 50 C.R. 539, 413 P.2d 139, supra, §612, has no binding precedential effect on this case. (*14 C.4th 1263*.) Moreover, the *Harris* court's analysis of *B. & P.C. 17040* as intended to apply only to competition on the same "level" as the person allegedly creating the locality discrimination is not persuasive that the application of *B. & P.C. 17045* should be similarly restricted. The particular threats to competition the two statutes are primarily intended to meet are fundamentally different, and that difference is reflected in their language. Whereas *B. & P.C. 17031, 17040* are tailored to address the problem of a distributor, typically a retailer, selling out of many locations, who might use geographical price discrimination as a predatory practice against its own competitors, *B. & P.C. 17045* forbids discrimination in favor of "certain purchasers" at the expense of other "purchasers." (*14 C.4th 1266*.)

One justice dissented. (See *Fisherman's Wharf Bay Cruise Corp. v. San Francisco Superior Court* (2003) 114 C.A.4th 309, 331, 7 C.R.3d 628 [tour operator's agreement to accept specified number of Alcatraz tickets per day showed no acquiescence that other tour operators should receive more tickets on discriminatory and unfair terms in violation of *B. & P.C. 17045*].)

SUPPLEMENT: [This section is current through the latest supplement]

See *Eddins v. Redstone* (2005) 134 C.A.4th 290, 335, 35 C.R.3d 863 [factual issue existed as to whether secrecy requirements of UPA were met in claim by independent video rental retailers that major movie studios gave secret, unearned discount to nation's largest video rental retailer; evidence that agreements between studios and largest retailer were reported in media did not establish that secrecy requirement was not met, inasmuch as other evidence indicated that key economic points were not known to public].



2 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
E. Restraint of Trade and Other Illegal Trade Practices.
2. California Law.
d. Unfair Practices Act.
6. Loss Leaders.

1 Witkin Sum. Cal. Law Contracts § 614

[§ 614] Loss Leaders.

(1) *In General.* A "loss leader" is defined as a sale of any article or product below cost for the purpose of inducing the purchase of other merchandise or with the effect of tending to mislead purchasers or diverting trade from or otherwise injuring competitors. (*B. & P.C. 17030.*) The sale or use of any article or product as a "loss leader" is unlawful. (*B. & P.C. 17044*; see 2 *U.S.F. L. Rev. 181.*)

In *Dooley's Hardware Mart v. Food Giant Markets* (1971) 21 *C.A.3d* 513, 98 *C.R.* 543, plaintiff brought an action to enjoin defendant from selling loss leaders. Defendant admitted the act, but offered evidence that this practice was common in the area and that its purpose was to meet competition, not to injure competitors or destroy competition. *Held*, an injunction was properly denied; an *intent* to injure competitors or destroy competition is required for violation of section 17044 as well as other sections of the *Unfair Practices Act*. (21 *C.A.3d* 516.) *B. & P.C. 17071.5* creates a presumption of the required intent, which affects the burden of proof (21 *C.A.3d* 517); but defendant met this burden by evidence of its legitimate purpose. (21 *C.A.3d* 518; see *Cel-Tech Communications v. Los Angeles Cellular Tel. Co.* (1999) 20 *C.4th* 163, 175, 83 *C.R.2d* 548, 973 *P.2d* 527, 13 *Summary* (10th), *Equity*, §107 [company's sale of cellular telephones below cost to gain subscribers for its cellular service did not violate *B. & P.C. 17044*, because company did not act with purpose of injuring competitors].)

(2) *Service as Loss Leader.* *B & P.C. 17024* defines "article or product" to include "service or output of a service trade." In *Garner v. Journeyman Barbers' etc. Union* (1963) 223 *C.A.2d* 101, 35 *C.R.* 693, the State Board of Barber Examiners fixed \$ 1.29 as the minimum price for a haircut in Santa Monica. Plaintiff barber gave haircuts for \$ 1.35. Defendant union agreed to a price of not less than \$ 1.75. To "meet plaintiff's competition," defendant union had its representatives outside the shop, offering \$ 1 free coupons for a haircut at nearby union shops, giving directions to get there. *Held*, injunction upheld. The sale of a haircut from a proprietor barber is a service or output of a service trade, and the sale of a haircut below cost is a loss leader constituting an unfair trade practice. "This activity, under the guise of peaceful picketing, is carried on by means made unlawful by the Unfair Practices Act." (223 *C.A.2d* 108.)

West's Key Number Digest, Trade Regulation k.893

SUPPLEMENT: [This section is current through the latest supplement]



3 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

E. Restraint of Trade and Other Illegal Trade Practices.

2. California Law.

d. Unfair Practices Act.

7. Discount to Cigarette Distributors.

1 Witkin Sum. Cal. Law Contracts § 615

[§ 615] Discount to Cigarette Distributors.

B. & P.C. 17043 prohibits sales below cost, and *B. & P.C. 17026* states that "[d]iscounts granted for cash payments shall not be used to reduce costs." In *E & H Wholesale v. Glaser Bros. (1984) 158 C.A.3d 728, 204 C.R. 838*, the court held that discounts from list price that cigarette manufacturers regularly granted to distributors were cash discounts and hence could not be used to reduce the cost of goods. (*158 C.A.3d 733, 735.*)

This holding was nullified by *B. & P.C. 17026.5*, an urgency statute enacted in 1985: "Notwithstanding the provisions of Section 17026, regular term discounts granted to distributors by manufacturers of cigarettes for cash payment customarily offered to distributors without discrimination may be used to reduce cost. This section shall not apply to any anticipatory or special discount for cash that may be offered by the manufacturers of cigarettes."

SUPPLEMENT: [This section is current through the latest supplement]



4 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
E. Restraint of Trade and Other Illegal Trade Practices.
2. California Law.
d. Unfair Practices Act.
8. Cellular Telephones.

1 Witkin Sum. Cal. Law Contracts § 616

[§ 616] Cellular Telephones.

Notwithstanding *B. & P.C. 17026* (supra, §615), commissions or rebates regularly earned by retailers of cellular telephones may be used to reduce cost, but these reductions may not exceed the greater of 10% of cost or \$ 20. (*B. & P.C. 17026.1(a)(1)*.) And providers of cellular services may sell cellular telephones below cost if below-cost sales are a good faith endeavor to meet the legal market prices of competitors in the same locality or trade area. (*B. & P.C. 17026.1(a)(2)*.)

Retailers of cellular telephones may not refuse to sell a cellular telephone to any customer solely on the basis of the customer's refusal to activate the telephone with the provider of cellular service for whom the retailer is an agent. (*B. & P.C. 17026.1(c)*.) Moreover, retailers must post a large, conspicuous sign in each retail location stating that (1) activation of any cellular telephone is not required, and (2) the advertised price of the telephone is not contingent on activation, acceptance, or denial of cellular service by any cellular provider. (*B. & P.C. 17026.1(b)*.)

SUPPLEMENT: [This section is current through the latest supplement]



5 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
E. Restraint of Trade and Other Illegal Trade Practices.
2. California Law.
e. Royalty Contracts for Performance of Copyrighted Musical Works.

1 Witkin Sum. Cal. Law Contracts § 617

[§ 617] Royalty Contracts for Performance of Copyrighted Musical Works.

(1) *In General.* *B. & P.C. 21750* et seq. regulate contracts between specified proprietors of retail establishments and copyright owners and performing rights societies regarding the payment of royalties by proprietors for the public performance of copyrighted nondramatic musical works. These provisions were enacted to establish safeguards for proprietors in the operation of their businesses that will protect them from arbitrary, capricious, and unfair trade practices, permit them to negotiate fairly with copyright owners or their agents for the use of nondramatic musical copyrighted works in their places of business, and thereafter will assure them the ability to ascertain their obligations and rights in the future use of copyrighted works. (Stats. 1996, Chap. 340, §1.) (On federal copyright protection of literary and artistic property, see 13 *Summary* (10th), *Personal Property*, §57 et seq.)

(2) *Definitions.* The following definitions apply:

(a) "Copyright owner" means the owner of a copyright of a nondramatic musical work recognized and enforceable under 17 U.S.C., §101 et seq., but does not include the owner of a copyright in all or part of a motion picture or audiovisual work. (*B. & P.C. 21750(a).*)

(b) "Performing rights society" means an association or corporation that licenses the public performance of nondramatic musical works on behalf of copyright owners, such as the American Society of Composers, Authors and Publishers (ASCAP), Broadcast Music, Inc. (BMI), and SESAC, Inc. (*B. & P.C. 21750(b).*)

(c) "Proprietor" means the owner of a retail establishment, restaurant, inn, bar, tavern, or any other similar place of business or professional office located in California in which the public may assemble and in which nondramatic musical works may be performed, broadcast, or otherwise transmitted for the enjoyment of the public. (*B. & P.C. 21750(c).*)

(d) "Royalty" or "royalties" means the fees payable to a copyright owner or performing rights society for the public performance of a nondramatic musical work. (*B. & P.C. 21750(d).*)

(3) *Required Schedule of Rates and Notice.* A copyright owner or performing rights society may not enter into a

contract for the payment of royalties by a proprietor unless, at least 72 hours prior to execution of the contract, it provides the following to the proprietor in writing:

(a) A schedule of the rates and terms of royalties under the contract. (*B. & P.C. 21751(a).*)

(b) A notice that the proprietor is entitled to that information as well as an electronic version of the most current available list of the members and affiliates represented by the performing rights society and the most current available list of the performed works that the society licenses. (*B. & P.C. 21751(b), 21751.5* [performing rights society may make additional information available to proprietor at reasonable cost].)

(4) *Form and Contents of Contract.* A contract for the payment of royalties must be in writing and be signed by the parties. (*B. & P.C. 21752(a), (b).*) It must also include at least the following information:

(a) The proprietor's name and business address. (*B. & P.C. 21752(c)(1).*)

(b) The name and location of each place of business to which the contract applies. (*B. & P.C. 21752(c)(2).*)

(c) The duration of the contract. (*B. & P.C. 21752(c)(3).*)

(d) The schedule of rates and terms of the royalties to be collected under the contract, including any sliding scale or schedule for any increase or decrease of those rates for the duration of the contract. (*B. & P.C. 21752(c)(4).*)

(5) *Prohibited Acts by Representative or Agent.* A representative or agent of a performing rights society may not do the following:

(a) Discuss with a proprietor or the proprietor's employee, without first identifying himself or herself, a contract for payment of royalties by the proprietor or the use of copyrighted works by the proprietor. (*B. & P.C. 21753(a)(1).*)

(b) Engage in any coercive conduct, act, or practice that is substantially disruptive of a proprietor's business, or use or attempt to use a fraudulent act, as defined in C.C. 1572 (*supra*, §286 et seq.). (*B. & P.C. 21753(a)(2).*)

(c) Fail to comply with *B. & P.C. 21751, 21751.5, or 21752.* (*B. & P.C. 21753(a)(3).*)

However, a copyright owner or performing rights society may conduct investigations to determine the existence of music use by a proprietor or inform a proprietor of the proprietor's obligations under 17 U.S.C., §101 et seq. (*B. & P.C. 21753(b).*)

(6) *Violations.* Each wilful violation of *B. & P.C. 21750* et seq. is punishable by a civil penalty of \$ 5,000. (*B. & P.C. 21754.*) A proprietor may bring an action or assert a counterclaim against a copyright owner or performing rights society to enjoin a violation and to recover damages sustained as a result of a violation. If successful, the proprietor may recover treble damages, filing fees, and reasonable costs of suit, in addition to any other legal or equitable relief. A proprietor who prevails in a cause of action alleging a wilful violation of *B. & P.C. 21753(a)(2)* may be awarded reasonable attorneys' fees. (*B. & P.C. 21755.*)

(7) *Other Remedies.* The rights, remedies, and prohibitions provided by *B. & P.C. 21750* et seq. are in addition to, and do not deny, abrogate, or impair, any other right, remedy, or prohibition accorded by law. (*B. & P.C. 21756.*)

(8) *Applicability of Provisions.* *B. & P.C. 21750* et seq. do not apply to contracts between copyright owners or performing rights societies and broadcasters licensed by the Federal Communications Commission. However, if a copyright owner or performing rights society is so licensed, those provisions apply to contracts between that copyright owner or performing rights society and a proprietor. (*B. & P.C. 21757.*)

B. & P.C. 21750 et seq. do not apply to conduct engaged in while enforcing P.C. 653w, 2 Cal. Crim. Law (3d),

Crimes Against Property, §227 [failure to disclose origin of sound recording]. (*B. & P.C. 21758.*)

SUPPLEMENT: [This section is current through the latest supplement]



6 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
E. Restraint of Trade and Other Illegal Trade Practices.
2. California Law.
f. Fair Trade Laws Abrogated.

1 Witkin Sum. Cal. Law Contracts § 618

[§ 618] Fair Trade Laws Abrogated.

(1) *Former California Fair Trade Act.* In 1931, the Fair Trade Act (former B. & P.C. 16900 et seq.) was enacted to permit a contract fixing the *resale price* of a commodity (a) that bore the *trademark, brand, or name* of the producer or owner, and (2) that was in *fair and open competition* with other commodities of the same general class. In 1933, the Act was amended to extend its application to "nonsigners," i.e., it was made *actionable unfair competition* for any retailer knowingly to sell below the agreed price *whether he or she was a party to the contract or not*. (See *Max Factor & Co. v. Kunsman* (1936) 5 C.2d 446, 454, 55 P.2d 177; *Dr. Miles Calif. Co. v. Sontag Chain Stores Co.* (1937) 8 C.2d 178, 179, 64 P.2d 726; *Cal-Dak Co. v. Sav-On Drugs* (1953) 40 C.2d 492, 493, 254 P.2d 497; *Scovill Mfg. Co. v. Skaggs Pay Less Drug Stores* (1955) 45 C.2d 881, 888, 291 P.2d 936 [nonsigner; "fair and open competition" test not fatally uncertain]; *Downs v. Benatar's Cut Rate Drug Stores* (1946) 75 C.A.2d 61, 65, 170 P.2d 88 [nonsigner]; 69 *Harv. L. Rev.* 316 [exhaustive study of business and legal aspects of fair trade programs].)

The Act was subjected to strong criticism, and was repealed in 1975, except in connection with sale of liquor (infra, this section). (See 7 *Pacific L. Rev.* 297.)

(2) *Former Federal Acts Legalizing State Fair Trade Acts.* The former Miller-Tydings Act and former McGuire Act amended the Sherman Act to permit agreements fixing resale prices under state fair trade acts, and thus made the acts applicable to interstate transactions. (See *United States v. Bausch & Lomb Optical Co.* (1944) 321 U.S. 707, 64 S.Ct. 805, 810, 88 L.Ed.2d 1024, 1034; *Hudson Distributors v. Eli Lilly & Co.* (1964) 377 U.S. 386, 84 S.Ct. 1273, 1278, 12 L.Ed.2d 394, 397; *Cal-Dak Co. v. Sav-On Drugs* (1953) 40 C.2d 492, 495, 254 P.2d 497; 70 *Harv. L. Rev.* 170; 75 *Harv. L. Rev.* 843.)

Both statutes were repealed in 1975. (See 32 *Am.Jur.2d* (1995 ed.), Fair Trade Laws §2.)

(3) *Sale of Liquor.* The sale of alcoholic beverages was governed by the former Alcoholic Beverage Control Act (B. & P.C. 24749 et seq.), and former B. & P.C. 24755 required that all retail sales of distilled spirits be made pursuant to a minimum retail price filed with the Department of Alcoholic Beverage Control. The constitutionality of this statute was originally upheld (see *Samson Market Co. v. Alcoholic Bev. Control App. Bd.* (1969) 71 C.2d 1215, 1218, 81 C.R. 251, 459 P.2d 667); but *Rice v. Alcoholic Bev. Control App. Bd.* (1978) 21 C.3d 431, 146 C.R. 585, 579 P.2d 476, held that it

was in conflict with the Sherman Act and was not sanctioned by the Twenty-First Amendment.

The court in *Rice* examined the prior statutory and case law, state and federal, and concluded that the major purposes of liquor price maintenance laws--promotion of orderly marketing conditions and temperance--no longer justified the statutes: "[W]e find that the policies underlying the Sherman Act are clearly violated by the liquor price maintenance laws, and that on the other side of the balance there is doubt whether such laws promote temperance, there is a clear national trend against fair trade laws, and there exist means other than mandatory price fixing to achieve the ends which those laws seek to attain." (21 C.3d 459.) (See 324 *Liquor Corp. v. Duffy* (1987) 479 U.S. 335, 107 S.Ct. 720, 725, 730, 93 L.Ed.2d 667, 677, 683 [following *California Retail Liquor Dealers Assn. v. Midcal Aluminum* (1980) 445 U.S. 97, 100 S.Ct. 937, 63 L.Ed.2d 233]; *Midcal Aluminum v. Rice* (1979) 90 C.A.3d 979, 983, 153 C.R. 757 [wholesale price maintenance provisions relating to wine are also unconstitutional under holding of *Rice*]; 67 *Cal. L. Rev.* 546; 12 *U.C. Davis L. Rev.* 176.)

Former B. & P.C. 24756, which required every manufacturer, rectifier, and wholesaler of distilled spirits to maintain with the department a written price list reflecting sales prices and to sell to retailers in compliance with the posted list, was held unconstitutional in *Lewis-Westco & Co. v. Alcoholic Bev. Control App. Bd.* (1982) 136 C.A.3d 829, 832, 835, 836, 186 C.R. 552, following *Rice* and *Midcal*.

Section 24755 was repealed in 1980, and the entire Alcoholic Beverage Control Act was repealed in 1994.

West's Key Number Digest, Monopolies k.17(1.5)

SUPPLEMENT: [This section is current through the latest supplement]

(2) *Former Federal Acts Legalizing State Fair Trade Acts.Repeal of statutes:* 32 Am.Jur.2d, Fair Trade Laws was deleted in the 2007 revision of that volume.



7 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

F. Contracts Concerning Domestic Relations.

1. Invalid Agreements.

a. Contract Restraining Marriage.

1 Witkin Sum. Cal. Law Contracts § 619

[§ 619] Contract Restraining Marriage.

"Every contract in restraint of the marriage of *any person*, other than a *minor*, is void." (C.C. 1669; see *Heaps v. Toy* (1942) 54 C.A.2d 178, 179, 128 P.2d 813; 15 Corbin (Rev. ed.), §§81.1, 81.2; 7 Williston 4th, §16:17; 2 California Affirmative Defenses (2004 ed.), §37:19; 54 Harv. L. Rev. 473; 52 Am.Jur.2d (2000 ed.), Marriage §114 et seq.; cf. Rest.2d, Contracts §189 ["A promise is unenforceable on grounds of public policy if it is *unreasonably* in restraint of marriage"]; on transfer of property with condition in restraint of marriage, see 12 Summary (10th), Real Property, §§197, 198.)

West's Key Number Digest, Contracts k.111

SUPPLEMENT: [This section is current through the latest supplement]



8 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

F. Contracts Concerning Domestic Relations.

1. Invalid Agreements.

b. Contract Promotive of Divorce (Dissolution).

1. In General.

1 Witkin Sum. Cal. Law Contracts § 620

[§ 620] In General.

A contract having as its object the dissolution of a marriage, or a contract that facilitates this result, is void. (*Newman v. Freitas* (1900) 129 C. 283, 289, 61 P. 907; *Pereira v. Pereira* (1909) 156 C. 1, 5, 103 P. 488; *Moss v. Moss* (1942) 20 C.2d 640, 642, 128 P.2d 526; *McCahan v. McCahan* (1920) 47 C.A. 173, 175, 190 P. 458; *Theisen v. Keough* (1931) 115 C.A. 353, 357, 1 P.2d 1015; *In re Marriage of Noghrey* (1985) 169 C.A.3d 326, 330, 215 C.R. 153, *infra*, §622; *Rest.2d, Contracts* §190(2); 15 Corbin (Rev. ed.), §§81.1, 81.2; 7 Williston 4th, §16:19; 24 *Am.Jur.2d* (1998 ed.), *Divorce and Separation* §17,18; 54 *Harv. L. Rev.* 478; 93 *A.L.R.3d* 523 [contract between husband or wife and third person promotive of divorce or separation].)

In *Hill v. Hill* (1943) 23 C.2d 82, 87, 142 P.2d 417, the court listed a number of typical illegal agreements relating to a divorce action, including paying counsel fees in the event of a divorce. (See 1 *Cal. Proc.* (4th), *Attorneys*, §205.) (On valid stipulation to try divorce case by default, see 11 *Summary* (10th), *Husband and Wife*, §§100, 102.)

West's Key Number Digest, Contracts k.111

SUPPLEMENT: [This section is current through the latest supplement]

See 2 California Affirmative Defenses §37:14; 24 *Am.Jur.2d* (2008 ed.), *Divorce and Separation* §§17, 18.

Cross-Reference: 1 *Cal. Proc.* (5th), *Attorneys*, §177.



9 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

F. Contracts Concerning Domestic Relations.

1. Invalid Agreements.

b. Contract Promotive of Divorce (Dissolution).

2. Married Person's Promise To Marry.

1 Witkin Sum. Cal. Law Contracts § 621

[§ 621] Married Person's Promise To Marry.

An agreement by a *married person* to marry is promotive of divorce and illegal, because it contemplates that the married person will obtain a divorce from his or her present spouse. (See *Beach v. Arblaster* (1961) 194 C.A.2d 145, 160, 14 C.R. 854; *Santoro v. Carbone* (1972) 22 C.A.3d 721, 733, 99 C.R. 488; 54 Harv. L. Rev. 476.)

However, in *Norman v. Burks* (1949) 93 C.A.2d 687, 690, 209 P.2d 815, such an agreement was held untainted with illegality where the man and his wife were separated, she had already brought suit for divorce, and he had defaulted in the action. As in *Howard v. Adams* (1940) 16 C.2d 253, 256, 105 P.2d 971, *infra*, §626, the existence of "a complete, matured cause of action for divorce" was the justification for the decision. (See *Santoro v. Carbone*, *supra*, 22 C.A.3d 733.)

In *Santoro*, *supra*, plaintiff husband and defendant wife were divorced, and both remarried. Plaintiff obtained an interlocutory divorce from his second wife and promised to remarry defendant. Defendant had not commenced divorce proceedings against her second husband, but promised to remarry plaintiff if he purchased a house and put title in their names as joint tenants. He did, she moved in, and left him 2 months later. He sued to quiet title to her joint tenancy interest on the ground of fraud (false promise) and recovered judgment. *Held*, reversed with directions to determine whether the agreement to remarry was illegal and a bar to recovery. "Here, plaintiff Santoro legally could promise to remarry defendant if the promise was made after plaintiff obtained an interlocutory divorce from his second wife, and the remarriage was to take place only after the final decree was entered. Whether plaintiff is entitled to relief in this action on the basis of defendant's failure to perform her promise depends upon whether plaintiff knew defendant was married when she made the promise, and whether the performance of the promise was contingent upon defendant's obtaining a divorce from her husband." (22 C.A.3d 734.)

SUPPLEMENT: [This section is current through the latest supplement]



10 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

F. Contracts Concerning Domestic Relations.

1. Invalid Agreements.

b. Contract Promotive of Divorce (Dissolution).

3. Agreement for Compensation on Divorce.

1 Witkin Sum. Cal. Law Contracts § 622

[§ 622] Agreement for Compensation on Divorce.

In re Marriage of Noghrey (1985) 169 C.A.3d 326, 215 C.R. 153, involved an agreement signed by defendant husband and plaintiff wife just before their wedding, reading as follows: "I, Kambiz Noghrey, agree to settle on Farima Hunan the house ... and \$ 500,000.00 or one-half of my assets, whichever is greater, in the event of a divorce." After 71/2 months of marriage, Farima sued for dissolution. In a bifurcated trial, the judge first found the premarital agreement valid. *Held*, reversed.

(a) A premarital agreement dealing with property owned prior to marriage and property and earnings accumulated subsequent to marriage is ordinary valid. (*169 C.A.3d 330*, citing *In re Marriage of Dawley (1976) 17 C.3d 342, 131 C.R. 3, 551 P.2d 323; 11 Summary (10th), Community Property, §24 et seq.*)

(b) This agreement is different: "It constitutes a promise by the husband to give the wife a very substantial amount of money and property, *but only upon the occurrence of a divorce*. No one could reasonably contend this agreement encourages the husband to seek a dissolution. Common sense and fiscal prudence dictate the opposite. Such is not the case with the wife. She, for her part, is encouraged by the very terms of the agreement to seek a dissolution, and with all deliberate speed, lest the husband suffer an untimely demise, nullifying the contract, and the wife's right to the money and property." (*169 C.A.3d 331.*)

(c) "The prospect of receiving a house and a minimum of \$ 500,000 by obtaining the no-fault divorce available in California would menace the marriage of the best intentioned spouse." (*169 C.A.3d 331.*) (See *In re Marriage of Dajani (1988) 204 C.A.3d 1387, 1390, 251 C.R. 871* [following *In re Marriage of Noghrey*; Jordanian marriage contract allowing wife to receive dowry upon dissolution held unenforceable under California law].)

West's Key Number Digest, Contracts k.111

SUPPLEMENT: [This section is current through the latest supplement]



11 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

F. Contracts Concerning Domestic Relations.

1. Invalid Agreements.

c. Contract To Alter Marital Obligations.

1 Witkin Sum. Cal. Law Contracts § 623

[§ 623] Contract To Alter Marital Obligations.

A contract made prior to marriage that purports to alter any of the legal duties and obligations of the marriage is invalid. (See *Rest.2d, Contracts §190(1)* [promise that "would change some essential incident of the marital relationship in a way detrimental to the public interest in the marriage relationship"]; 15 Corbin (Rev. ed.), §§81.1, 81.2; 7 Williston 4th, §16:17; 41 *Am.Jur.2d* (1995 ed.), *Husband and Wife* §139; 54 *Harv. L. Rev.* 478.)

SUPPLEMENT: [This section is current through the latest supplement]
See 41 *Am.Jur.2d* (2005 ed.), *Husband and Wife* §81 et seq.



12 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

F. Contracts Concerning Domestic Relations.

1. Invalid Agreements.

d. Contract To Compensate for Domestic Services.

1 Witkin Sum. Cal. Law Contracts § 624

[§ 624] Contract To Compensate for Domestic Services.

An agreement to pay for a spouse's services incidental to the marital status is against public policy; it degrades the spouse, promotes discord in the home and makes frauds upon creditors possible. Thus, in *Brooks v. Brooks* (1941) 48 C.A.2d 347, 119 P.2d 970, plaintiff's nurse told him that she would leave unless he married her and agreed to continue paying her \$ 80 per month. He did so, and after several years she left him. *Held*, the contract was void and he could recover the prior payments made thereunder. (48 C.A.2d 349.) The opinion does not disclose the reasons why the court assumed that the plaintiff was not *in pari delicto*, but it was apparently influenced by his helpless condition. (See *Borelli v. Brusseau* (1993) 12 C.A.4th 647, 654, 16 C.R.2d 16, 11 Summary (10th), *Husband and Wife*, §40 [following *Brooks v. Brooks*, and invalidating husband's promise to leave wife certain property in exchange for her agreement to care for him at home during his illness]; 41 Am.Jur.2d, *Husband and Wife* §137.)

Brooks was distinguished in *Ayoob v. Ayoob* (1946) 74 C.A.2d 236, 168 P.2d 462, *supra*, §357, where the court held that the consideration was *marriage*, in contrast with the agreement in *Brooks*, in which marriage was viewed as merely incidental to the rendition of services by the wife as a nurse. Although the agreement in *Ayoob* did recite the promise of services by the wife, the court said: "These were vows which she might have put into words at the altar ... and which were implicit in her engagement to marry. Surely she should not be penalized for expressing them elsewhere." (74 C.A.2d 248.)

SUPPLEMENT: [This section is current through the latest supplement]
See 41 Am.Jur.2d (2005 ed.), *Husband and Wife* §118.



13 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
F. Contracts Concerning Domestic Relations.
1. Invalid Agreements.
e. Traditional Surrogacy Contract.

1 Witkin Sum. Cal. Law Contracts § 625

[§ 625] Traditional Surrogacy Contract.

In re Marriage of Moschetta (1994) 25 C.A.4th 1218, 30 C.R.2d 893, 10 Summary (10th), *Parent and Child*, §23, refused to enforce a "traditional" surrogacy contract, i.e., one in which a woman is impregnated with the sperm of a married man with the understanding that the resulting child is to be legally the child of the married man and his infertile wife. Applying the analysis used in *Johnson v. Calvert* (1993) 5 C.4th 84, 19 C.R.2d 494, 851 P.2d 776, 10 Summary (10th), *Parent and Child*, §22, the court made the following points:

(a) *Johnson* differed from the present case in that it involved a "gestational" surrogacy contract, i.e., one where the sperm of a married man is artificially united with an egg of *his wife*, and the resulting embryo is implanted in another woman's womb. In holding that this contract did not, on its face, offend public policy, and thus could be used to ascertain the intent of the parties, the *Johnson* court never held that gestational surrogacy contracts are enforceable per se. And it certainly never held that traditional surrogacy contracts are enforceable per se. (25 C.A.4th 1230.)

(b) *Johnson* analyzed parentage in terms of the Uniform Parentage Act and concluded that some tiebreaker, i.e., the surrogacy contract itself, was needed, because a genetic-but-not-birth mother and a birth-but-not-genetic mother have equal claims to maternity under the terms of the Act. However, no such tiebreaker is needed in the case of traditional surrogacy where the two usual means of showing maternity, i.e., genetics and birth, coincide in one woman. Hence, enforcing a traditional surrogacy contract would be improper, because doing so would ignore the analysis employed in *Johnson*. (25 C.A.4th 1231.)

(c) The surrogacy contract in question could not serve as an adoption agreement, because the birth parents did not specifically consent to an adoption in the presence of a social worker, as required by *Family C. 8814* (10 Summary (10th), *Parent and Child*, §129. (25 C.A.4th 1231.)) (See 7 Williston 4th, §16:22; 29 *Hastings Const. L. Q.* 339 [constitutional rights in gestational surrogacy contract]; 15 *J. Juvenile Law* 313 [analysis of *Johnson*]; 31 *McGeorge L. Rev.* 673 [Reproductive Surrogacy at the Millennium: Proposed Model Legislation Regulating "Non-Traditional" Gestational Surrogacy Contracts]; 28 *U.S.F. L. Rev.* 572 [Surrogacy Legislation in California: Proposals and Commentary]; 77 *A.L.R.4th* 70 [validity and construction of surrogate parenting agreement]; on the validity of surrogate motherhood contracts, see *infra*, §628.)

SUPPLEMENT: [This section is current through the latest supplement]



14 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

F. Contracts Concerning Domestic Relations.

2. Valid Agreements.

a. Separation and Property Agreements.

1 Witkin Sum. Cal. Law Contracts § 626

[§ 626] Separation and Property Agreements.

The Code provisions (*Family C. 1620, 3580*) permit the husband and wife to enter into an agreement for separation, and thereafter to contract for a division of their property. (See *Brown v. Brown* (1927) 83 C.A. 74, 76, 256 P. 595.) Moreover, the early strict view that condemned agreements having any tendency to lead to divorce was subsequently relaxed, and later cases upheld agreements in contemplation of divorce, and even those conditioned upon divorce, *where a valid cause for divorce existed prior to the agreement*. (See *Howard v. Adams* (1940) 16 C.2d 253, 256, 105 P.2d 971; *Hill v. Hill* (1943) 23 C.2d 82, 88, 142 P.2d 417; 7 Williston 4th, §16:18; 24 Am.Jur.2d (1998 ed.), *Divorce and Separation* §1116 et seq.; 54 Harv. L. Rev. 479; on no-fault dissolution under current law, see 11 *Summary* (10th), *Husband and Wife*, §59 et seq.)

In *Barham v. Barham* (1949) 33 C.2d 416, 202 P.2d 289, a property settlement agreement, purporting to settle the wife's future rights at the total sum of \$ 300 per month, was made in anticipation of a divorce. After the initial divorce, the parties remarried each other, and later the wife brought another action for divorce. *Held*, the original property agreement, construed to avoid illegality, did not limit any rights resulting from the *second marriage*; hence, in the present divorce action, the wife was entitled to additional alimony, community property, and a homestead award. (33 C.2d 427.)

Glickman v. Collins (1975) 13 C.3d 852, 120 C.R. 76, 533 P.2d 204, involved the following unique situation: (a) Claire and Gerald Glickman had an unsatisfactory marriage, and finally separated. Gerald wanted to marry Hilda Collins, with whom he was living, and asked Claire to get a Nevada divorce. Claire agreed, and a property settlement agreement with provision for alimony and child support was made. But Claire demanded that Hilda guarantee Gerald's support payments, and Hilda signed this guaranty. (b) Claire then obtained a Nevada divorce, and Gerald married Hilda. (c) Later Hilda obtained a divorce from Gerald. (d) Shortly thereafter, Gerald ceased alimony and support payments, and Claire obtained judgment against him for arrears of \$ 8,852.80. (e) The judgment was not satisfied, and plaintiff Claire brought the present action on the guaranty against defendant Hilda. Defendant contended that the agreement was intended to induce plaintiff to divorce Gerald, and was therefore illegal; alternatively she contended that it was lacking in consideration. *Held*, the agreement was valid.

(a) The marriage of Claire and Gerald was beyond redemption; Claire had a ground for divorce (Gerald living with

Hilda); and reconciliation was never considered. (13 C.3d 859.)

(b) Prior cases have held that no public policy is violated by an agreement facilitating dissolution of a marriage that has irreparably broken down. (13 C.3d 857, citing *Hill* and *Howard*, *supra*.) In these cases, "Divorce is often, in fact, the preferred solution." (13 C.3d 859.)

The court also rejected defendant's contention that the guaranty was lacking in consideration: (a) The obligations of both spouses under their original agreement and under the final one were different, and the new burdens imposed on plaintiff and new benefits conferred on Gerald were sufficient consideration for defendant's guaranty. (b) Also, plaintiff's agreement to institute divorce proceedings promptly on receipt of the guaranty was a new consideration benefiting both Gerald and defendant, who were enabled immediately to enter into a valid marriage. (13 C.3d 861.) (See 93 A.L.R.3d 523 [contract between husband or wife and third person promotive of divorce or separation].)

West's Key Number Digest, Contracts k.111

SUPPLEMENT: [This section is current through the latest supplement]
See 24A Am.Jur.2d (2008 ed.), *Divorce and Separation* §1035 et seq.



15 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

F. Contracts Concerning Domestic Relations.

2. Valid Agreements.

b. Contract Affecting Child Custody.

1 Witkin Sum. Cal. Law Contracts § 627

[§ 627] Contract Affecting Child Custody.

An agreement by a husband and wife in a divorce or dissolution proceeding concerning custody of the children is subject to control of the court, but is, nevertheless, between the parties, a legal agreement. (*Brown v. Brown* (1951) 104 C.A.2d 88, 91, 230 P.2d 651; see 24 Am.Jur.2d (1998 ed.), *Divorce and Separation* §938; 10 Summary (10th), *Parent and Child*, §206.)

The Restatement provides that a promise affecting custody is unenforceable on grounds of public policy unless disposition as to custody is consistent with the best interests of the child. (*Rest.2d, Contracts* §191.) Only agreements compromising parents' statutory child support obligation or purporting to divest the family court of jurisdiction over child support orders are void as against public policy. (See *Dunkin v. Boskey* (2000) 82 C.A.4th 171, 183, 98 C.R.2d 44, 10 Summary (10th), *Parent and Child*, §206 [contract between unmarried woman and man, which granted man paternity, visitation, and custody rights to child conceived by artificial insemination with anonymous donor, was valid and enforceable; plaintiff sought damages for breach of contract, not custody of child].)

SUPPLEMENT: [This section is current through the latest supplement]
See 24A Am.Jur.2d (2008 ed.), *Divorce and Separation* §856.



16 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

F. Contracts Concerning Domestic Relations.

2. Valid Agreements.

c. Surrogate Motherhood Contracts.

1 Witkin Sum. Cal. Law Contracts § 628

[§ 628] Surrogate Motherhood Contracts.

A married couple may enter into a valid agreement with another woman whereby a zygote created from the husband's sperm and the wife's egg is implanted in the other woman who, upon birth, agrees to relinquish all parental rights to the couple. (*Johnson v. Calvert* (1993) 5 C.4th 84, 95, 19 C.R.2d 494, 851 P.2d 776, 10 Summary (10th), *Parent and Child*, §22.)

Jaycee B. v. Superior Court (1996) 42 C.A.4th 718, 49 C.R.2d 694, 10 Summary (10th), *Parent and Child*, §385, involved a variation of this type of contract. A married couple entered into a gestational surrogacy contract, under which a sperm and an egg from *anonymous donors* were artificially united and implanted in the uterus of another woman, with the intention that the offspring would be legally the child of the *married couple*. Subsequently, the wife sought temporary child support from the husband in a proceeding related to dissolution of marriage, but the trial court ruled that it had no jurisdiction to make a temporary child support order, because it had not yet been established that the child was a child of the marriage. *Held*, mandamus issued directing the trial court to hold a hearing to determine an appropriate child support order. The undisputed fact of the husband's signing the surrogacy agreement showed by a preponderance of the evidence that he would likely be found to be the child's father. (42 C.A.4th 721.) (See 102 *Harv. L. Rev.* 1074 [review of Field, Surrogate Motherhood]; 40 *Hastings L. J.* 1111 [same]; 15 *J. Juvenile Law* 313 [analysis of *Johnson*]; 19 *J. Juvenile Law* 437 [Surrogate Contracts: Another Cry From the California Courts for Legislative Action]; 24 *Loyola L.A. L. Rev.* 395; 31 *McGeorge L. Rev.* 673 [Reproductive Surrogacy at the Millennium: Proposed Model Legislation Regulating "Non-Traditional" Gestational Surrogacy Contracts]; 28 *U.S.F. L. Rev.* 572 [Surrogacy Legislation in California: Proposals and Commentary]; 77 *A.L.R.4th* 70 [validity and construction of surrogate parenting agreement]; on the invalidity of "traditional" surrogacy contracts, see, *supra*, §625.)

SUPPLEMENT: [This section is current through the latest supplement]



17 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
F. Contracts Concerning Domestic Relations.
2. Valid Agreements.
d. Other Agreements.

1 *Witkin Sum. Cal. Law Contracts* § 629

[§ 629] Other Agreements.

(1) *Premarital Agreement*. A valid agreement may be made between prospective spouses in contemplation of marriage and to be effective on marriage, concerning their property and personal rights and obligations. (*Family C. 1610, 1612*; see *In re Marriage of Dawley* (1976) 17 C.3d 342, 358, 131 C.R. 3, 551 P.2d 323.) The nature and scope of the agreement, and the formal requirements (writing signed by both parties), are governed by the Uniform Premarital Agreement Act (*Family C. 1600 et seq.*). (See 11 *Summary* (10th), *Community Property*, §24 et seq.)

(2) *Agreement Between Nonmarital Cohabitants*. A valid agreement may be made between persons living together to pool earnings and share in their joint accumulations, or to keep each partner's earnings and property separate and apart. (*Marvin v. Marvin* (1976) 18 C.3d 660, 674, 134 C.R. 815, 557 P.2d 106, 11 *Summary* (10th), *Community Property*, §271; see 25 U.C. Davis L. Rev. 1029 [Applying *Marvin v. Marvin* to Same-Sex Couples: A Proposal for a Sex-Preference Neutral Cohabitation Contract Statute].)

West's Key Number Digest, Contracts k.111

SUPPLEMENT: [This section is current through the latest supplement]



18 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

G. Wagering and Gambling Contracts.

1. What Constitutes Illegal Wager.

a. In General.

1 Witkin Sum. Cal. Law Contracts § 630

[§ 630] In General.

An agreement for a bet or wager, i.e., one in which the promisor agrees to perform on the happening of a condition, and for which performance he or she receives no agreed exchange, is illegal. (See *Kyne v. Kyne* (1940) 16 C.2d 436, 438, 106 P.2d 620; *Schenck v. Hirshfeld* (1913) 22 C.A. 709, 710, 136 P. 725; *Matthews v. Lopus* (1914) 24 C.A. 63, 66, 140 P. 306; *Szadolci v. Hollywood Park Operating Co.* (1993) 14 C.A.4th 16, 21, 17 C.R.2d 356 [plaintiffs' purchase of shares in defendant's "Pick-9" ticket, which, unknown to plaintiffs had been cancelled through defendant's bribery of track clerk, constituted illegal wager]; 15 Corbin (Rev. ed.), §86.1 et seq.; 7 Williston 4th, §17:1 et seq.; 2 California Affirmative Defenses (2004 ed.), §37:20; 29 Cal. L. Rev. 418; 38 Am.Jur.2d (1999 ed.), Gambling §201 et seq.; 71 Proof of Facts 3d 193 [enforcement of casino gambling debts].) And checks given to furnish funds for illegal gambling are unenforceable. (See *supra*, §426.) (On recovery of gambling losses in quasi-contract, see *infra*, §1028.)

West's Key Number Digest, Gaming k.1

SUPPLEMENT: [This section is current through the latest supplement]
See 2 California Affirmative Defenses §37:20.



19 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

G. Wagering and Gambling Contracts.

1. What Constitutes Illegal Wager.

b. Lottery.

1 Witkin Sum. Cal. Law Contracts § 631

[§ 631] Lottery.

(1) *Illegal Lottery*. The principal illustration of an illegal wagering transaction (see *supra*, §630) is a *lottery*, defined by statute as a scheme for the distribution of property by chance to a person who has paid a valuable consideration for the chance of winning the prize. (P.C. 319; see Cal. Const., Art. IV, §19(a) [prohibiting sale of lottery tickets]; *Ins.C.* 251, 252; 15 Corbin (Rev. ed.), §86.9; 7 Williston 4th, §17:4; 38 *Am.Jur.2d* (1999 ed.), *Gambling* §5 et seq., 61 et seq.; 14 *A.L.R.3d* 1423 [referral sales plan as illegal lottery]; 64 *A.L.R.4th* 1021 [rights of entrants in private contests and lotteries].)

In *Holmes v. Saunders* (1952) 114 *C.A.2d* 389, 250 *P.2d* 269, plaintiff alleged that defendant offered, in consideration of \$ 1, a 6-month subscription to Associated Bulletin and a numbered ticket entitling the winner at a drawing to a Buick sedan; and that plaintiff had the winning ticket. *Held*, reversing judgment for plaintiff, the allegations described an illegal lottery. It is immaterial that the consideration (\$ 1) was paid for the chance *and* something else; courts will not be deceived by ingenious schemes, but "will inquire, not into the name, but into the game, however skillfully disguised." (114 *C.A.2d* 391.) (Cf. option to purchase conditioned on production, *supra*, §179.)

On the other hand, in *California Gasoline Retailers v. Regal Petroleum Corp.* (1958) 50 *C.2d* 844, 330 *P.2d* 778, defendants, independent distributors of oil and gas, engaged in "give-away" programs to bring new patronage to their service stations. Prize tickets were given away free to anyone, including some who did not ask for them; some were given to persons not in the station, and were not dependent on purchase of merchandise. *Held*, there was no lottery, even if the larger number of people did pay a consideration. "If any person could receive a ticket or tickets without paying anything therefor, it would appear that the question of consideration should not rest on the percentage of those receiving tickets with purchases as opposed to those receiving tickets without such purchases." (50 *C.2d* 859.) (See 12 *Hastings L. J.* 452.)

(2) *Constitutionally Authorized Lotteries*. Cal. Const., Art. IV, §19(c), permits the Legislature by statute to "authorize cities and counties to provide for bingo games, but only for charitable purposes." (See P.C. 326.5, 2 *Cal. Crim. Law* (3d), *Crimes Against Public Peace and Welfare*, §267 [specifying conditions under which communities may authorize bingo games].) And Cal. Const., Art. IV, §19(d), adopted by an initiative measure, authorizes "the establishment of a California State Lottery." The California State Lottery Act of 1984 (*Govt.C.* 8880 et seq.), added by

the same initiative measure, provides for the establishment and regulation of the lottery. (See *Western Telcon v. California State Lottery* (1996) 13 C.4th 475, 488, 53 C.R.2d 812, 917 P.2d 651 [California State Lottery (CSL) could not, consistent with its constitutional and statutory authority, operate game it called Keno, because game was banking game, with CSL acting as bank rather than lottery]; *Hair v. California* (1991) 2 C.A.4th 321, 327, 2 C.R.2d 871 [lottery winner was bound by lottery commission's rule requiring payment over 18 years, even though out-of-date sign in store specified 10 years]; 40 A.L.R.4th 662 [state lotteries: actions by ticket holders against state or contractor for state]; 90 A.L.R.4th 784 [enforceability of contract to share winnings from legal lottery ticket]. (On assignability of lottery payments, see *infra*, §717; on criminal aspects of lotteries, see 2 Cal. Crim. Law (3d), *Crimes Against Public Peace and Welfare*, §262 et seq.)

Cal. Const., Art. IV, §19 was amended by a legislative constitutional amendment to provide that lottery games may be conducted by federally recognized Indian tribes on Indian lands in California in accordance with federal law, pursuant to compacts negotiated by the Governor and ratified by the Legislature. (Cal. Const., Art. IV, §19(f) [first of two subdivisions with same letter]; on gambling on Indian lands generally, see *infra*, §634.)

SUPPLEMENT: [This section is current through the latest supplement]



20 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

G. Wagering and Gambling Contracts.

1. What Constitutes Illegal Wager.

c. Raffles by Nonprofit Organizations.

1 Witkin Sum. Cal. Law Contracts § 632

[§ 632] Raffles by Nonprofit Organizations.

Cal. Const., Art. IV, §19 was amended by a legislative constitutional amendment to provide that the Legislature may authorize private, nonprofit eligible organizations, as defined by the Legislature, to conduct raffles to fund their own or another similar organization's beneficial and charitable works. However, at least 90% of the gross receipts from the raffle must go directly to beneficial or charitable purposes in California, and any person who receives compensation in connection with the operation of the raffle must be an employee of the organization conducting the raffle. (Cal. Const., Art. IV, §19(f) [second of two subdivisions with same letter].)

The constitutional provision is implemented by P.C. 320.5. (See 2 *Cal. Crim. Law (3d)*, *Crimes Against Public Peace and Welfare*, Supp., §267.)

SUPPLEMENT: [This section is current through the latest supplement]



21 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

G. Wagering and Gambling Contracts.

1. What Constitutes Illegal Wager.

d. Endless Chain Scheme.

1 Witkin Sum. Cal. Law Contracts § 633

[§ 633] Endless Chain Scheme.

An endless chain scheme is defined as "any scheme for the disposal or distribution of property whereby a participant pays a valuable consideration for the chance to receive compensation for introducing one or more additional persons into participation in the scheme or for the chance to receive compensation when a person introduced by the participant introduces a new participant." (P.C. 327.)

A participant in an endless chain scheme may rescind the contract on which it is based, and recover all consideration paid, less any amounts paid to him or her. (C.C. 1689.2.)

SUPPLEMENT: [This section is current through the latest supplement]



22 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

G. Wagering and Gambling Contracts.

1. What Constitutes Illegal Wager.

e. Gambling on Indian Land.

1 Witkin Sum. Cal. Law Contracts § 634

[§ 634] Gambling on Indian Land.

The Indian Gaming Regulatory Act of 1988 (18 U.S.C., §1166 et seq. and 25 U.S.C., §2701 et seq.) authorizes specified types of gambling on Indian land. *Govt.C. 12012.25* and *12012.5* ratify several tribal-state compacts entered into in accordance with that Act, provide for ratification of future compacts, and designate the Governor as the state officer responsible for negotiating and executing the compacts.

Govt.C. 98000 et seq., adopted by proposition, provides for mandatory terms of tribal-state compacts unless a tribe requests that the Governor negotiate a compact under federal law. However, the proposition was held invalid as conflicting with Cal. Const., Art. IV, §19(e), providing that the Legislature has no power to authorize casinos of the type currently operating in Nevada and New Jersey. (See *Hotel Employees & Restaurant Employees Int. Union v. Davis* (1999) 21 C.4th 585, 589, 88 C.R.2d 56, 981 P.2d 990.) In response to this decision, Cal. Const., Art. IV, §19, was amended by a legislative constitutional amendment to provide that, notwithstanding Cal. Const., Art. IV, §19(a) (supra, §631), Cal. Const., Art. IV, §19(e), and other state laws, the Governor may negotiate and conclude compacts, subject to legislative ratification, for the operation of slot machines and for the conduct of lottery games and banking and percentage card games by federally recognized Indian tribes on Indian lands in California in accordance with federal law. (Cal. Const., Art. IV, §19(f) [first of two subdivisions with same letter].)

In *Flynt v. California Gambling Control Com.* (2002) 104 C.A.4th 1125, 129 C.R.2d 167, plaintiffs (a card room owner and state-licensed card rooms) brought a declaratory relief action against the Gambling Control Commission and the Attorney General to specify that tribal-state compacts that had been entered into under Proposition 1A (Cal. Const., Art. IV, §19(f)) and that granted the right to Indian tribes to operate slot machines, lottery games, and banking and percentage card games (class III gaming), activities prohibited to plaintiffs, violated the federal Indian Gaming Regulatory Act (IGRA). Defendants' demurrer was sustained, and plaintiffs appealed. *Held*, affirmed.

(a) The IGRA requires that class III gaming may be conducted on tribal lands only after a tribe has negotiated a compact with the state for the regulation of the gaming. For purposes of this appeal, the key provision of the IGRA (25 U.S.C., §2710(d)(1)(B)) provides that class III gaming activities are lawful on Indian lands *only* if these activities are located in a state that permits them for any purpose by any person, organization, or entity. (104 C.A.4th 1132.)

(b) Following the enactment of the IGRA, California attempted to enact various tribal-state compacts, but disagreement about the forms of gaming rendered the attempt unsuccessful. Against this backdrop, proponents of tribal gaming obtained voter approval of an initiative (Proposition 5) to facilitate tribal-state compacts, but the initiative was later ruled unconstitutional. This led to the passage of Proposition 1A, which was designed to correct the constitutional infirmities of the earlier initiative. (104 C.A.4th 1136.)

(c) Plaintiffs argued that 25 U.S.C., §2710(d)(1)(B) precludes California from granting Indian tribes exclusive class III gaming rights, because Congress intended that this type of gaming would only take place in states that permitted *non-Indians* to conduct similar gaming activities. In rebuttal, defendants argued that the tribal-state compacts, standing alone, are sufficient state authorization to satisfy the statutory requirement that the state allow class III gaming to *any person, organization, or entity*. Defendants' position is correct. There is nothing in the text of 25 U.S.C., §2710(d)(1)(B) indicating that its purpose was to achieve economic parity between tribes and commercial gaming. Instead, the IGRA was designed to reconcile the tribal claims that their sovereignty prevented state control over the use of Indian land, while preserving state autonomy to prohibit gambling within its borders. Thus, Section 2710(d)(1)(B), as an initial step, requires that states approve a form of proposed gambling before it is allowed on Indian land. In other words, the state must legalize a game, *even if only for tribes*, before it can become a compact term. (104 C.A.4th 1138.)

(d) "California's decision to 'permit' tribes to operate class III gaming facilities within the context of IGRA and the compacts, while denying those rights to other persons, organizations, and entities, is a policy judgment, which whether one agrees with it or not, does not conflict with IGRA's goal of maintaining state authority while protecting Indian gaming from discrimination. By contrast, to interpret IGRA to require the states to cho[o]se between no class III gaming anywhere and class III gaming everywhere would not further any of IGRA's goals and would limit the states' authority and flexibility without any resulting benefit to the tribes." (104 C.A.4th 1139, quoting a federal decision.)

Based on Congress' statement of purpose and the comprehensive regulatory scheme of the *Indian Gaming Regulatory Act*, *supra*, federal courts have exclusive jurisdiction to review issues involving Indian gaming activities. Further, 28 U.S.C., §1360, which gives state courts jurisdiction over civil causes arising in Indian territory between Indians or to which Indians are parties, does not permit resolution of Indian gaming and gaming contract disputes in state court, even as against individual Indians. (*Great Western Casinos v. Morongo Band of Mission Indians* (1999) 74 C.A.4th 1407, 1424, 88 C.R.2d 828 [state court lacked jurisdiction in action against Indian tribe and its officials for breach of contract and related causes of action arising out of cancellation of plaintiff's contract to manage gambling enterprise on tribal reservation]; see 30 *McGeorge L. Rev.* 1025 [tribal sovereignty and Indian gaming]; 197 *A.L.R. Fed* 459 [jurisdictional issues arising under Indian Gaming Regulatory Act].)

SUPPLEMENT: [This section is current through the latest supplement]

See 40 *U.S.F. L. Rev.* 423 [tribal gaming industry and state-recognized tribes]; 27 *A.L.R. Fed* 2d 93 [preemption of state law by Indian Gaming Regulatory Act].



23 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
G. Wagering and Gambling Contracts.
2. Where Promisor Receives Agreed Exchange.

1 *Witkin Sum. Cal. Law Contracts* § 635

[§ 635] Where Promisor Receives Agreed Exchange.

(1) *In General.* If the promisor is to receive something in exchange for his or her promise, there is no wager, even though the counterperformance is due only upon the happening of a condition. The typical example is an insurance contract, under which the promisor pays a premium, and receives in exchange a conditional promise to pay him or her or some beneficiary in the event of loss of property, injury, or death. (See 2 *Summary* (10th), *Insurance*, §75 et seq.)

In *Garratt v. Baker* (1936) 5 C.2d 745, 56 P.2d 225, three partners made mutual promises that, when one died, the two survivors would pay a specified monthly sum to the decedent's widow as long as she and they lived. Plaintiff, widow of one partner, sued the others as a third-party beneficiary. *Held*, the contract was valid. Its object was proper: instead of permitting the business to be wound up and the partnership assets sold to meet the needs of decedent's widow, the survivors undertook the personal obligation of this support. Also, none of the allegedly "betting" partners could receive the "stake." (5 C.2d 747.) (On third-party beneficiaries, see *infra*, §685 et seq.)

(2) *Agreement for Prize.* A valid agreement may be made by one person to offer a prize or premium to others who compete for it; the competition is deemed the agreed exchange. (See *Hankins v. Ottinger* (1896) 115 C. 454, 457, 47 P. 254; 15 Corbin (Rev. ed.), §86.11; 7 Williston 4th, §17:6; 29 Cal. L. Rev. 62; 38 Am.Jur.2d (1999 ed.), *Gambling* §245 et seq.; 40 A.L.R.4th 662 [state lotteries: actions by ticket holders against state or contractor for state]; 64 A.L.R.4th 1021 [private contests and lotteries: entrants' rights and remedies].)

(3) *Sale of Stock.* Contracts for the sale of stock without any intention to deliver the same are void. (*Corp.C.* 29104, formerly Cal. Const., Art. IV, §26; see *Willcox v. Edwards* (1912) 162 C. 455, 459, 123 P. 276; *Hartnett v. Wilson* (1916) 31 C.A. 678, 681, 161 P. 281.) This provision was designed to prohibit dealing in futures where the intention is simply to "pay off" upon the rise or fall of the market during fixed periods. It does not render illegal the ordinary purchase of stock on *margin*. Nor does it prevent "short sales," if, as is the usual practice, actual delivery of the shares is contemplated. (*Griffin v. Payne* (1933) 133 C.A. 363, 372, 24 P.2d 370; 15 Corbin (Rev. ed.), §86.20 et seq.; 7 Williston 4th, §17:9 et seq.; 38 Am.Jur.2d (1999 ed.), *Gambling* §208 et seq.)

West's Key Number Digest, Gaming k.5

SUPPLEMENT: [This section is current through the latest supplement]



24 of 75 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
H. Contracts Obstructing Administration of Justice.
1. Contracts Involving Evidence.

1 Witkin Sum. Cal. Law Contracts § 636

[§ 636] Contracts Involving Evidence.

(1) *Contract With Witness.* An agreement to suppress evidence, to conceal a witness, or to procure false testimony is illegal. (See P.C. 137, 138; *Smith v. Superior Court* (1996) 41 C.A.4th 1014, 1025, 49 C.R.2d 20, citing the text [agreement to suppress evidence is void]; 2 *Cal. Crim. Law* (3d), *Crimes Against Governmental Authority*, §38 et seq.) And a contract providing for compensation of witnesses, under which payment is contingent on the promisor winning the suit, is also illegal. (*Pelkey v. Hodge* (1931) 112 C.A. 424, 425, 296 P. 908; *Von Kesler v. Baker* (1933) 131 C.A. 654, 658, 21 P.2d 1017; *Van Norden v. Metson* (1946) 75 C.A.2d 595, 599, 171 P.2d 485 [contract by engineer, both to procure evidence and to act as a witness, for a contingent fee]; cf. *People v. Green* (1951) 102 C.A.2d 831, 834, 228 P.2d 867 [condemning prosecutor's agreement to dismiss charge against accomplice on condition that he testify and his testimony result in the other defendant being held to answer]; and see generally on contract to testify, 15 Corbin (Rev. ed.), §83.3; 7 Williston 4th, §15:6; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §250.)

Under specified circumstances, a witness to a crime may not accept money or other consideration for providing information obtained thereby. (P.C. 132.5; see 2 *Cal. Crim. Law* (3d), *Crimes Against Governmental Authority*, §13.) A contract in violation of this statute is void as contrary to public policy. The Attorney General or the district attorney of the county where the violation of P.C. 132.5 occurred may bring a civil action, or intervene in any civil action, to enjoin the enforcement of the contract. (C.C. 1669.7.)

(2) *Contract With Investigator.* Contracts with investigators are not subject to the same restrictions as those with witnesses. A contract is clearly valid where payment is to be made for services rendered, irrespective of what facts are actually ascertained and irrespective of success in the litigation, even though the investigator is employed to search for certain evidence. (See *Hare v. McGue* (1918) 178 C. 740, 742, 174 P. 663.) But a contract to procure evidence of a certain character or to establish a particular state of facts deemed necessary for success in a suit is void. (*Harris v. Moore* (1929) 102 C.A. 413, 416, 283 P. 76.) (See 15 Corbin (Rev. ed.), §83.3; 7 Williston 4th, §15:6; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §249.)

Formerly, it was thought that agreements for *contingent fees* for procuring evidence were illegal. But in *Wilhelm v. Rush* (1937) 18 C.A.2d 366, 63 P.2d 1158, the court declared that, like attorney's contingent fee contracts, they are illegal only in cases involving *domestic relations*. The action in *Wilhelm* was based on fraud, and the contract upheld was one that employed plaintiff investigator to search for "such discoverable evidence of actual, existing facts as would

tend to support" the claim, for a retainer and additional compensation only in the event of recovery by the client. (18 C.A.2d 367, 368, 369.)

(3) *Distinction: Settlement Negotiations.* An agreement not to use settlement negotiations in future litigation promotes the public policy of encouraging settlements and is thus enforceable unless otherwise objectionable. (*Tower Acton Holdings v. Los Angeles County Waterworks Dist. No. 37 (2002) 105 C.A.4th 590, 600, 129 C.R.2d 640* [no fraud, mistake, change in circumstances, or other reason not to enforce agreement].)

West's Key Number Digest, Contracts k.129(.5)

SUPPLEMENT: [This section is current through the latest supplement]



25 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
H. Contracts Obstructing Administration of Justice.
2. Agreement With "Heir Hunter."

1 Witkin Sum. Cal. Law Contracts § 637

[§ 637] Agreement With "Heir Hunter."

Somewhat related to the contingent fee contracts of attorneys, witnesses, and ordinary investigators (*supra*, §636) are the agreements under which "heir hunters"--investigators who discover persons entitled to share in an estate--receive compensation in the amount of a percentage of the share recovered by the heir. These agreements are normally upheld if they are kept within the limited field of compensation for investigation. Indirectly recognizing their validity, a statute gives the probate court power to determine the reasonableness of the consideration, and to cut down the amount called for in the contract. (*Prob.C. 11604*; see *Estate of Cohen (1944)* 66 C.A.2d 450, 459, 152 P.2d 485; 14 *Summary* (10th), *Wills and Probate*, §723 et seq.)

Neither the Probate Code nor any decision, however, establishes as valid an heir-hunting contract that violates some other statute or rule of public policy. In *Estate of Butler (1947)* 29 C.2d 644, 177 P.2d 16, respondent conducted a large scale "probate research" business; he examined probate proceedings, solicited heirs and obtained authorizations to appear for them and to furnish counsel, agreed to pay attorneys' fees and costs, and in general assumed complete control of litigation on their behalf. *Held*, the contract was illegal as involving practice of the law by an unlicensed person. The court also found general objections of public policy: "Respondent's speedy solicitation of appellants, who may properly be regarded as 'known' heirs, emphasizes the detrimental results typical of his general business practice, whereby beneficiaries, who would ordinarily receive their shares of estates in the usual course and without any deduction for attorney's fees or for the compensation of solicitors, may be imposed upon by foreign agents to make assignments of substantial percentages of their distributive shares in estates, and to execute accompanying powers of attorney. Such system of intermeddling for profit is not reconcilable with the policy of probate courts 'to protect beneficiaries of estates from imposition or unnecessary expense.' " (29 C.2d 651.) (See *Estate of Reilly (1947)* 81 C.A.2d 564, 568, 184 P.2d 922; *Estate of Larson (1949)* 92 C.A.2d 267, 272, 206 P.2d 852; *Estate of Collins (1968)* 268 C.A.2d 86, 92, 73 C.R. 599.)

SUPPLEMENT: [This section is current through the latest supplement]



26 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

H. Contracts Obstructing Administration of Justice.

3. Contract To Refrain From Prosecution.

a. In General.

1 Witkin Sum. Cal. Law Contracts § 638

[§ 638] In General.

An agreement to refrain from criminal prosecution is a crime. (P.C. 153; *Colby v. Title Ins. & Trust Co.* (1911) 160 C. 632, 638, 117 P. 913; see *Woodham v. Allen* (1900) 130 C. 194, 198, 62 P. 398; 15 Corbin (Rev. ed.), §§83.1, 83.2; 7 Williston 4th, §§15:8, 15:9; 17A Am.Jur.2d (2004 ed.), Contracts §254; 1 So. Cal. L. Rev. 1.)

In *Bowyer v. Burgess* (1960) 54 C.2d 97, 4 C.R. 521, 351 P.2d 793, B, a route salesman for plaintiff, withheld funds collected, and plaintiff threatened criminal prosecution. An agreement was then made between plaintiff and B, B's wife, and two guarantors to make complete restitution to avoid prosecution. In this action on the agreement, plaintiff contended that, where no prosecution is pending, the actual commission of a crime must be shown to make the agreement not to prosecute illegal. *Held*, judgment for defendants affirmed. Assuming, though not deciding, the correctness of this rule, the agreement recited that B had been "withholding for his own use certain funds," which is a lay description of embezzlement; also, plaintiff testified on cross-examination that B had been stealing. (54 C.2d 100.)

West's Key Number Digest, Contracts k.129(4)

SUPPLEMENT: [This section is current through the latest supplement]



27 of 75 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

H. Contracts Obstructing Administration of Justice.

3. Contract To Refrain From Prosecution.

b. Distinction: Contract for Dismissal of Charge.

1 Witkin Sum. Cal. Law Contracts § 639

[§ 639] Distinction: Contract for Dismissal of Charge.

In *Hoines v. Barney's Club* (1980) 28 C.3d 603, 170 C.R. 42, 620 P.2d 628, plaintiff was arrested by defendant's employees in a Nevada gambling establishment on a charge of disturbing the peace. He was held in jail for 2 hours and released on \$ 25 bail. The next morning, he discussed the matter with C, an assistant district attorney, indicating that he wished to file a criminal complaint against defendant. C advised him that he thought probable cause existed for the arrest and that he would oppose issuance of the proposed complaint; and he also offered to dismiss the charge against plaintiff if plaintiff would sign a release of all claims against other parties involved in the arrest, including the county and state. C testified that he was partly influenced by plaintiff's fear that a pending charge might have an adverse effect on his admission to the California bar, and was also concerned with the cost to the public of a jury trial on a matter involving a likely penalty of \$ 25, and felt that it would be unfair to fail to protect the concerned parties against a civil action. Plaintiff freely and voluntarily agreed to the proposal and signed a general release, following which his bail money was returned and the charge against him was dismissed. He then brought this action against defendant corporations doing business in California, seeking compensatory and punitive damages for assault, battery, false imprisonment, malicious prosecution, and intentional infliction of emotional distress. In a separate trial on the affirmative defense of release, the jury returned a verdict for defendants and judgment was entered accordingly. *Held*, affirmed; an agreement between a prosecutor and a criminal defendant to dismiss a criminal charge in exchange for defendant's waiver of civil action rights is not contrary to public policy.

(a) The public policy contention is based on P.C. 153, making it a crime to accept a consideration for an agreement not to prosecute (compounding a crime). (See *supra*, §638.) But the prosecutor did not personally receive any consideration for moving to dismiss the charge. And the challenged practice is routine and in no way contrary to public policy. (28 C.3d 610.) As the dissenting justice observed in the superseded Court of Appeal opinion: "Municipal court judges for many years have been accustomed to dismissing minor misdemeanor cases on motion of the district attorney upon assurance that law enforcement officers, public agencies or private parties will not be subjected to civil litigation by the criminal defendant. This occurs not infrequently in shoplifting cases, disturbances involving husbands and wives, and a myriad of other disturbance situations. Often, the arrest and temporary detention of a person pending posting of bail or the releasing of the individual on his own recognizance is sufficient to defuse an otherwise volatile situation, to the end that further criminal prosecution is unnecessary and undesirable. Further prosecution in many cases would cause

embarrassment in employment, unnecessary matrimonial hostility or, as in the instant case, a possible thwarting of a future career. The reasons are multitudinous for the district attorney not to want to pursue the prosecution of a person arrested with probable cause for a minor public offense, in the best interest not only of society but of the individual involved. At the same time, it is reasonable to seek to protect the arresting officer or the complaining individual from the burden of civil litigation arising out of the incident." (28 C.3d 610, footnote 7.)

(b) P.C. 1379, limiting the circumstances under which a criminal charge may be compromised, does not have the sweeping effect of depriving the prosecutor of his recognized discretion to decide not to file a formal charge or prosecute an arrestee. (28 C.3d 611.)

(c) The properly conducted release-dismissal transaction is supported by the same policy considerations that justify properly conducted plea bargaining transactions: The net effect of both is to relieve the state of prosecuting while imposing on the accused some lesser disability than might have been anticipated--a lesser criminal sanction or a civil disability. "In neither case is there any compulsion preventing the accused from standing his ground and asserting his right to be free from all disabilities, both criminal and civil." (28 C.3d 612.)

Three justices dissented. (See 7 Williston 4th, §15:9; 26 A.L.R.4th 245 [note on *Hoines*].)

SUPPLEMENT: [This section is current through the latest supplement]



28 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
H. Contracts Obstructing Administration of Justice.
4. Illegal Contracts of Attorney.

1 Witkin Sum. Cal. Law Contracts § 640

[§ 640] Illegal Contracts of Attorney.

(1) *Attorney's Contract Preventing Settlement.* A provision in the contract prohibiting the client from settling the case without the attorney's consent is probably void. (See *Calvert v. Stoner* (1948) 33 C.2d 97, 103, 199 P.2d 297; *Hall v. Orloff* (1920) 49 C.A. 745, 749, 194 P. 296 [penalty provision against client for dismissal of action without consent of attorney is void]; 15 Corbin (Rev. ed.), §83.11; footnote 37; 7 Williston 4th, §15:2.; 7 Am.Jur.2d (1997 ed.), *Attorneys at Law* §192, 193; 1 Cal. Proc. (4th), *Attorneys*, §204.)

(2) *Contracts Violating Attorneys' Rules of Ethics.* An attorney should not represent conflicting interests, and a provision for dual representation may sometimes be deemed illegal and unenforceable. Thus, where the same insurance company represented both drivers in an automobile collision case, and each driver had an affirmative claim against the other, the cross-complainant was held entitled to independent counsel although his policy called for representation by company attorneys. (*O'Morrow v. Borad* (1946) 27 C.2d 794, 798, 167 P.2d 483.) (For a full discussion of conflict of interest, see 1 Cal. Proc. (4th), *Attorneys*, §128 et seq.)

Solicitation of business by an attorney is condemned by statute and rules of ethics; and a contract for professional services secured through a runner or capper is void. (*B. & P.C. 6154(a)*; see 1 Cal. Proc. (4th), *Attorneys*, §585.)

However, a forwarding fee agreement, for payment of a fee by one lawyer to another for referral of a case, is valid in California. (See *Moran v. Harris* (1982) 131 C.A.3d 913, 922, 182 C.R. 519; 1 Cal. Proc. (4th), *Attorneys*, §§187, 188.)

(3) *Contingent Fee Agreements.* An ordinary contract making an attorney's fee contingent on the outcome of the case is valid in California. (See 1 Cal. Proc. (4th), *Attorneys*, §202; on denial of recovery of excessive fees, see 1 Cal. Proc. (4th), *Attorneys*, §203.) The exceptions are divorce (dissolution) and filiation cases. (See *Theisen v. Keough* (1931) 115 C.A. 353, 356, 1 P.2d 1015 [divorce]; *Kyne v. Kyne* (1943) 60 C.A.2d 326, 329, 140 P.2d 886 [filiation]; 1 Cal. Proc. (4th), *Attorneys*, §205.) And even in divorce cases, the rule against enforcement applies only to contracts with a party seeking a divorce. (*Krieger v. Bulpitt* (1953) 40 C.2d 97, 101, 251 P.2d 673, 1 Cal. Proc. (4th), *Attorneys*, §205.)

In *Coons v. Kary* (1968) 263 C.A.2d 650, 69 C.R. 712, Mrs. K made a property settlement agreement with her

husband and filed suit for divorce. Then she replaced her original attorneys with Y, on a \$ 6,000 retainer plus a contingent fee of one-third of the value of any property he might obtain for her in excess of that given by the property agreement. Y first dismissed the divorce action and filed a separate maintenance complaint, then at the trial amended to seek a divorce. Mrs. K received a decree and additional property. The judge, unaware of the contingent fee arrangement, awarded Y a total of \$ 4,500 attorneys' fees. Y's assignee then sued Mrs. K for the contingent fee. *Held*, judgment for plaintiff reversed. Y's theory was that a contingent fee agreement made after a divorce suit has already been filed is valid, because it cannot be promotive of divorce. The court's answer was that the possibility of reconciliation must be considered, and that an attorney's financial interest in the divorce could lead him to oppose reconciliation. (263 C.A.2d 653.)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Attorney's Contract Preventing Settlement*. See 7 Am.Jur.2d (2007 ed.), *Attorneys at Law* §185.

Cross-Reference: 1 Cal. Proc. (5th), *Attorneys*, §179.

(2) *Contracts Violating Attorneys' Rules of Ethics*.

Conflict of interest:

Cross-Reference: 1 Cal. Proc. (5th), *Attorneys*, §103 et seq.

Solicitation of business:

Cross-Reference: 1 Cal. Proc. (5th), *Attorneys*, §523.

Moran case:

Cross-Reference: 1 Cal. Proc. (5th), *Attorneys*, §162.

(3) *Contingent Fee Agreements*.

Valid agreement:

Cross-Reference: 1 Cal. Proc. (5th), *Attorneys*, §176.

Excessive fees:

Cross-Reference: 1 Cal. Proc. (5th), *Attorneys*, §178.

Dissolution and filiation cases:

Cross-Reference: 1 Cal. Proc. (5th), *Attorneys*, §177

Krieger case:

Cross-Reference: 1 Cal. Proc. (5th), *Attorneys*, §177.



29 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
H. Contracts Obstructing Administration of Justice.
5. Contract To Pay Child Sex Victim.

1 Witkin Sum. Cal. Law Contracts § 641

[§ 641] Contract To Pay Child Sex Victim.

A contract between a minor who allegedly is the victim of an unlawful sex act and the alleged perpetrator of that act that requires the perpetrator or his or her legal representative to pay money or other consideration to the minor or the minor's legal representative more than 1 year after the date of execution of the contract is void as contrary to public policy. (C.C. 1669.5(a).) "Unlawful sex act" refers to a felony sex offense committed against a minor. (C.C. 1669.5(e).)

The statute does not apply (1) after the date of a final criminal judgment against the alleged perpetrator for the unlawful sex act (C.C. 1669.5(b)); (2) to a contract for the payment of money or other consideration from a nonrevocable trust established for the benefit of the minor, if the alleged perpetrator has no access to, or control over, the trust (C.C. 1669.5(c)); or (3) to the extent that the alleged perpetrator agrees to pay, or is required by court order to pay, child support for the alleged victim upon a dissolution or legal separation (C.C. 1669.5(d)).

A district attorney may bring an action or intervene in any action to enjoin enforcement of a contract in violation of the statute. (C.C. 1669.5(a).) However, a district attorney also has the option of enforcing such a contract against the payor. In that case, the proceeds of the contract must be deposited in the State Children's Trust Fund under Welf.C. 18969. (C.C. 1669.5(f).)

SUPPLEMENT: [This section is current through the latest supplement]



30 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
H. Contracts Obstructing Administration of Justice.
6. Contract To Refrain From Performing Legally Required Act.

1 Witkin Sum. Cal. Law Contracts § 642

[§ 642] Contract To Refrain From Performing Legally Required Act.

In *Picton v. Anderson Union High School Dist.* (1996) 50 C.A.4th 726, 57 C.R.2d 829, plaintiff teacher entered into an agreement with defendant school district under which plaintiff agreed to resign after having been accused by four female students of various acts of unprofessional misconduct. As consideration for the promise to resign, defendant agreed to refuse to disclose the nature of the most serious charges (that plaintiff had raped a student) after plaintiff had settled with the alleged rape victim, who had then withdrawn the accusation. Specifically, with respect to the charges, defendant agreed only to disclose that plaintiff had resigned due to four charges by female students, the most serious (not specified) of which had been withdrawn. However, defendant forwarded full details about the rape charge to the Committee on Teacher Credentialing, and the principal of the rape victim's school, and one of defendant's attorneys testified that although the rape charges had been withdrawn, they were "true." After plaintiff's teaching credentials had been withdrawn, he filed this action, which included a breach of contract cause of action. *Held*, judgment on demurrer for defendant affirmed.

(a) By regulation, defendant was required to notify the committee of the facts constituting a basis for the disciplinary action it had taken against one of its employees. This regulation required full disclosure of the facts, because it was the fact of the rape that was crucial in causing defendant to seek plaintiff's resignation. Defendant's duty of disclosure could not be satisfied by the "sanitized" version of the facts, and to the extent that the agreement prevented full disclosure, it was illegal as being in violation of a legal requirement. (50 C.A.4th 732.)

(b) Plaintiff argued that because the rape accusation had been withdrawn, it could not have been a basis for defendant's disciplinary action against plaintiff, and thus defendant had no duty to report it to the committee. This argument is without merit. The regulation in question specifically provides that the duty to disclose exists despite the fact that the charges have been withdrawn in consideration of the employee's resignation. Furthermore, to foster the public policy of overseeing the credentials of teachers, the fact that the charges have been withdrawn cannot be used to delete their "significance" to the committee. (50 C.A.4th 736.)

SUPPLEMENT: [This section is current through the latest supplement]



31 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
I. Agreement Tending To Defraud Third Person.
1. In General.

1 Witkin Sum. Cal. Law Contracts § 643

[§ 643] In General.

An agreement tending to defraud or otherwise injure a third person may be deemed "contrary to good morals" and therefore illegal. (*Haley v. Bloomquist* (1928) 204 C. 253, 256, 268 P. 365 [sham bid and fake sale]; *American Trust Co. v. California Western States Life Ins. Co.* (1940) 15 C.2d 42, 66, 98 P.2d 497; *Bacciocco v. Transamerica Corp.* (1934) 2 C.A.2d 595, 596, 38 P.2d 417 [agreement to maintain public selling price in stock, above its real value, to deceive other stockholders and the public]; 15 Corbin (Rev. ed.), §85.1 et seq.; 7 Williston 4th, §16:14; 17A Am.Jur.2d (2004 ed.), Contracts §273; 2 California Affirmative Defenses (2004 ed.), §37:21.)

In *Gugolz v. Gehrkins* (1913) 164 C. 596, 130 P. 8, an heir who had been practically disinherited contracted with the executors named in the will to bequeath to them a portion of the estate if they would aid her in having the will set aside. *Held*, the agreement was void, not only as a fraud upon the other legatees, but as contemplating a collusive proceeding that would be a fraud on the probate court. (164 C. 601.) (See *Kopasz v. Wymer* (1953) 118 C.A.2d 119, 121, 257 P.2d 707; *Russell v. Soldinger* (1976) 59 C.A.3d 633, 643, 131 C.R. 145 [agreement between two bidders at probate sale to limit bidding and make advantageous purchase at expense of estate; following *Kopasz*]; *infra*, §§644, 645.)

Occasionally, the reluctance of a court to characterize the object as fraudulent leads to enforcement of questionable agreements. Thus, in *Maryland Cas. Co. v. Fidelity & Cas. Co. of New York* (1925) 71 C.A. 492, 236 P. 210, plaintiff, as an employer's insurance company, was liable for workers' compensation to an injured employee. It agreed with defendant, the insurance company insuring a hospital liable for damages for improper treatment, not to disclose to the employee his right of action resulting from the improper treatment if defendant would pay the additional expense resulting therefrom. *Held*, there was no violation of public policy. The court thought there was no relationship of trust or confidence that imposed a duty on the employer to advise his or her employee of the facts. (71 C.A. 496.) (See *Pellett v. Sonotone Corp.* (1945) 26 C.2d 705, 713, 160 P.2d 783; *Estate of Hurley* (1938) 28 C.A.2d 584, 590, 83 P.2d 61; 3 Cal. Proc. (4th), Actions, §81.)

West's Key Number Digest, Contracts k.113(2)

SUPPLEMENT: [This section is current through the latest supplement]
See 2 California Affirmative Defenses §37:21. *Enforcement of questionable agreements:*

Cross-Reference: 3 Cal. Proc. (5th), Actions, §31.



32 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
I. Agreement Tending To Defraud Third Person.
2. Collusive Settlement in Joint Tort Action.

1 Witkin Sum. Cal. Law Contracts § 644

[§ 644] Collusive Settlement in Joint Tort Action.

A release of one of several joint or concurrent tortfeasors, which unfairly discriminates against others, violates the good faith clause of *C.C.P. 877*, and is therefore an illegal contract, subject to challenge by the third party nonsettling tortfeasor whose interests are adversely affected. (*River Garden Farms v. Superior Court* (1972) 26 C.A.3d 986, 1000, 103 C.R. 498; see 47 So. Cal. L. Rev. 1393; 5 Summary (10th), Torts, §78.)

SUPPLEMENT: [This section is current through the latest supplement]



33 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS I. Agreement Tending To Defraud Third Person. 3. Agreement Seeking To Evade Taxes.

1 Witkin Sum. Cal. Law Contracts § 645

[§ 645] Agreement Seeking To Evade Taxes.

In *Redke v. Silvertrust* (1971) 6 C.3d 94, 98 C.R. 293, 490 P.2d 805, wife Ann, in her last illness, wanted to change her will to leave all of her separate property to daughter M, instead of half to husband Sam. Sam assured her that this was unnecessary, that she could leave the will as it was and that he would see that it went to M on his own death. Wife Ann, relying on the oral promise, made no change. After her death, Sam remarried and made a new will eliminating all provision for M. On his death, plaintiff M brought this action against his executors and testamentary trustees to declare a constructive trust. *Held*, judgment for plaintiff affirmed. The statute of frauds was not a defense because of estoppel (see *supra*, §406), but the issue of fraudulent evasion of taxes was more difficult to decide.

(a) *Improper claim of marital deduction.* The federal marital deduction (26 U.S.C., §2056) permits avoidance of death taxes on a spouse's separate property, but only if the surviving spouse is given the *unrestricted* right to dispose of the property as he or she chooses; any limitation on the right results in loss of the deduction. In the original estate plan, Sam was given half of Ann's separate property for life, with an unlimited power of appointment; this satisfied the statute. The oral agreement deprived him of that unlimited power, making the marital deduction unavailable. Nevertheless, on Ann's death, he claimed the deduction and obtained substantial tax savings, without disclosing the agreement precluding them. (6 C.3d 102.)

(b) *Test of illegality.* An agreement seeking to evade any tax imposed by the Internal Revenue Code is a criminal offense (26 U.S.C., §7201), and if Ann and Sam had made their agreement with the intent of fraudulently concealing its existence from the tax authorities "it is likely that we would hold the agreement unenforceable." (6 C.3d 102.) On the other hand, the agreement would have been entirely valid if Sam had disclosed its existence to the tax authorities or had chosen not to claim the deduction. (6 C.3d 102.)

(c) *Finding of Ann's intent.* The trial judge found that Ann, inexperienced in business and suffering from terminal cancer, had no concern with or understanding of tax consequences and left the method of carrying out the agreement entirely to Sam. And her failure to disclose the oral agreement to her attorneys and tax advisers, when she made other changes in her estate plan, merely presented a question of fact as to her intent. On this issue, the trial judge's finding of innocent intent was binding on appeal; i.e., that she either "innocently forgot to mention the agreement or simply failed to appreciate its significance from a tax standpoint." (6 C.3d 103.)

(d) *Finding of Sam's intent.* This was "less clear," because he claimed the deduction without disclosing the agreement. But, assuming that he acted fraudulently, this does not preclude enforcement against him by the innocent party (M). (6 C.3d 104.)

(e) *Public policy.* Defendants further argued that, regardless of the intent of the parties, oral agreements of this type should be declared void as a deterrent to tax evasion. But the deterrence would be rare, and taxing authorities have remedies against persons guilty of wilful fraud. "We conclude that in the absence of fraudulent intent by the promisee spouse, an oral agreement to make a testamentary disposition of the nature involved herein is not void or unenforceable as against public policy." (6 C.3d 104.) (See *American & National Leagues of Professional Baseball Clubs v. Major League Baseball Players Assn.* (1976) 59 C.A.3d 493, 499, 130 C.R. 626 [basic agreement valid, arbitration award challenged as encouraging tax evasion; challenge rejected, following theory of *Redke v. Silvertrust, supra*].)

West's Key Number Digest, Contracts k.113(1)

SUPPLEMENT: [This section is current through the latest supplement]



34 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
J. Contracts Adversely Affecting Public Welfare.
1. Contracts To Influence Public Officers.

1 Witkin Sum. Cal. Law Contracts § 646

[§ 646] Contracts To Influence Public Officers.

(1) *Valid Lobbying Agreement.* In its broadest sense, lobbying refers to an attempt to influence legislators in order to enact or defeat legislation. However, only bribery, promise of reward, intimidation, or other dishonest means of influencing legislators are prohibited by the Constitution. (Cal. Const., Art. IV, §15.) Thus, only dishonest, secret, or unfair means of influence are prohibited; open advocacy is entirely proper, and a contract to compensate for these services is valid. (*Colusa v. Welch* (1898) 122 C. 428, 430, 55 P. 243; *Crawford v. Imperial Irr. Dist.* (1927) 200 C. 318, 321, 253 P. 726; *Gilchrist v. Harrah* (1941) 45 C.A.2d 154, 156, 113 P.2d 712; see ; 15 Corbin (Rev. ed.), §84.1 et seq.; 7 Williston 4th, §16:2 et seq.; 51 Am.Jur.2d (2000 ed.), *Lobbying* §1 et seq.; 15 Cal. L. Rev. 344; 42 A.L.R.3d 1046 [validity and construction of state and municipal enactments regulating lobbying].)

The Political Reform Act of 1974 contains detailed provisions for registration and control of lobbyists. (*Govt.C. 86100* et seq.; see 7 *Summary* (10th), *Constitutional Law*, §§279, 280).

(2) *Improper Agreement To Obtain Public Contracts.* Agreements for services rendered in procuring government contracts are illegal and unenforceable where corrupt methods, such as bribery or personal influence and solicitation of administrative or executive officers, unrelated to the merits of the case, are contemplated or required. (See 15 Corbin (Rev. ed.), §84.4; 7 Williston 4th, §16:5; 17A Am.Jur.2d (2004 ed.), *Contracts* §266 et seq.; 6 U.C.L.A. L. Rev. 699.)

West's Key Number Digest, Contracts k.125

SUPPLEMENT: [This section is current through the latest supplement]

See 35 A.L.R.6th 1 [validity, construction, and application of state and municipal enactments regulating lobbying], superseding 42 A.L.R.3d 1046, text, p. 720.



35 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
J. Contracts Adversely Affecting Public Welfare.
2. Contract Without Competitive Bidding.

1 Witkin Sum. Cal. Law Contracts § 647

[§ 647] Contract Without Competitive Bidding.

Where competitive bidding is required by statute, charter, or ordinance, a contract let without compliance with the requirement is void; and, for reasons of public policy, there can be no recovery in quasi-contract for benefits conferred. (*Reams v. Cooley* (1915) 171 C. 150, 153, 152 P. 293; *Miller v. McKinnon* (1942) 20 C.2d 83, 87, 124 P.2d 34; *Pasadena Live, LLC v. Pasadena* (2004) 114 C.A.4th 1089, 1094, 8 C.R.3d 233; see 6 Williston 4th, §13:24; 64 *Am.Jur.2d* (2001 ed.), *Public Works and Contracts* §37; 12 *So. Cal. L. Rev.* 210; 2 *U.C.L.A. L. Rev.* 591; *infra*, §976 et seq.; on splitting work to avoid competitive bidding, see *Pub.Contr.C.* 20123.5, 20163.)

The rule is different where the conditions specified in *Pub.Contr.C.* 5110(a) are satisfied. (See *Marshall v. Pasadena Unified School Dist.* (2004) 119 C.A.4th 1241, 1259, 15 C.R.3d 344 [where contractor acted in good faith, recovery allowed; distinguishing *Miller*].)

SUPPLEMENT: [This section is current through the latest supplement]



36 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

J. Contracts Adversely Affecting Public Welfare.

3. Contract Violating Public Debt Limitation.

a. Constitutional Provisions and General Rule.

1 Witkin Sum. Cal. Law Contracts § 648

[§ 648] Constitutional Provisions and General Rule.

A contract imposing an indebtedness or liability upon a county, municipality, or school district in excess of its yearly revenue, unless approved by a two-thirds vote at an election held for that purpose, is void. (Cal. Const., Art. XVI, §18(a); see *American Co. v. Lakeport* (1934) 220 C. 548, 557, 32 P.2d 622; *Palm Springs v. Ringwald* (1959) 52 C.2d 620, 623, 342 P.2d 898; *Redondo Beach v. Taxpayers, Property Owners, Citizens & Electors* (1960) 54 C.2d 126, 133, 5 C.R. 10, 352 P.2d 170 [bonds approved at valid election]; *Saratoga v. Huff* (1972) 24 C.A.3d 978, 981, 1006, 101 C.R. 32, 102 C.R. 376 [special assessment bonds for improvements on lands of a junior college district]; *Starr v. San Francisco* (1977) 72 C.A.3d 164, 174, 140 C.R. 73; *Barkley v. Blue Lake* (1996) 47 C.A.4th 309, 313, 54 C.R.2d 679 [constitutional debt limitation did not preclude summary judgment for plaintiff in action on judgment against city for breach of contract, because plaintiff's right to reestablish claim in action on judgment was settled in earlier appeal, and constitutional debt limitation affected only right to obtain payment]; *Law Offices of Cary S. Lapidus v. Wasco* (2004) 114 C.A.4th 1361, 1365, 8 C.R.3d 680 [city could not escape its obligation by breaching otherwise lawful contract under Cal. Const., Art. XVI, §18, i.e., attorney contingency fee agreement, where city's debt would be from amount recovered, rather than from general fund]; 23 Cal. L. Rev. 445; 29 Cal. L. Rev. 779; 7 Golden Gate L. Rev. 641; 41 So. Cal. L. Rev. 19.)

A similar limitation is imposed on the state: The Legislature cannot incur debts or liabilities exceeding \$ 300,000 without approval of a majority of the voters. (Cal. Const., Art. XVI, §1; see *Dean v. Kuchel* (1950) 35 C.2d 444, 446, 218 P.2d 521; 38 Cal. L. Rev. 962.) (On constitutional debt limitation, see 7 Summary (10th), *Constitutional Law*, §308.)

The aforementioned constitutional limitation on local indebtedness was held invalid as a violation of the equal protection clause in *Westbrook v. Mihaly* (1970) 2 C.3d 765, 87 C.R. 839, 471 P.2d 487. But the United States Supreme Court upheld the constitutionality of a provision requiring more than a majority vote to approve bond issues in *Gordon v. Lance* (1971) 403 U.S. 1, 91 S.Ct. 1889, 29 L.Ed.2d 273, and subsequently vacated the judgment in *Westbrook* and remanded the case for reconsideration by the California Supreme Court. Upon reconsideration, the California Supreme Court, by minute order, rejected the claim of invalidity.

Cal. Const., Art. XVI, §18(b) provides that a proposition for the incurrence of an indebtedness on a school district,

community college district, or county office of education in the form of general obligation bonds for the construction, rehabilitation, or replacement of school facilities must be approved by 55% of the voters at an election.

SUPPLEMENT: [This section is current through the latest supplement]

Cal. Const., Art. XVI, §1: See *Pension Obligation Bond Com. v. All Persons Interested in the Matter of the Validity of the Calif. Pension Obligation Bonds To Be Issued* (2007) 152 C.A.4th 1386, 1401, 62 C.R.3d 364 [bonds proposed to be issued to finance state's employer contribution to Public Employees Retirement System (PERS) did not fall within exception to constitutional debt limit for obligations imposed by law; exception was inapplicable because state's obligation to fund PERS was one Legislature voluntarily imposed upon itself, and thus it was not obligation "imposed by law"].



37 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
J. Contracts Adversely Affecting Public Welfare.
3. Contract Violating Public Debt Limitation.
b. Exceptions.

1 *Witkin Sum. Cal. Law Contracts* § 649

[§ 649] Exceptions.

Neither of the constitutional restrictions (see *supra*, §648) is violated by an installment lease calling merely for annual rental payments and not creating any immediate indebtedness for the aggregate sum. (*Dean v. Kuchel* (1950) 35 C.2d 444, 446, 218 P.2d 521; *Los Angeles v. Byram* (1951) 36 C.2d 694, 700, 227 P.2d 4; *Rider v. San Diego* (1998) 18 C.4th 1035, 1042, 77 C.R.2d 189, 959 P.2d 347 [lease-back financing plan under which joint powers agency agreed to lease convention center from district, issue lease revenue bonds to finance expansion of center, and sublease expanded center to city, with rental payments equaling agency's obligations, did not violate constitutional debt limitation]; *Los Angeles v. Nesvig* (1965) 231 C.A.2d 603, 609, 41 C.R. 918; see 38 Cal. L. Rev. 962.) Moreover, the restriction does not apply to an obligation or liability imposed by law, as distinguished from one voluntarily incurred. (*Wright v. Compton Unified School Dist.* (1975) 46 C.A.3d 177, 181, 120 C.R. 115.)

Revenue bonds payable solely from a *special fund* are valid where the governmental body is not required to maintain the special fund (in event of its insufficiency) out of general funds or tax levies. (*Oxnard v. Dale* (1955) 45 C.2d 729, 733, 290 P.2d 859; *Walnut Creek v. Silveira* (1957) 47 C.2d 804, 813, 306 P.2d 453; cf. *Palm Springs v. Ringwald* (1959) 52 C.2d 620, 623, 342 P.2d 898 [sales and use taxes pledged, special fund test not met].) In *Oxnard*, the bonds were for construction of an improvement to become part of an existing sewer system, and were secured by revenues of the *entire system*. *Held*, nevertheless, there was no violation of the constitutional provision; i.e., the special fund doctrine applies even though the fund is not restricted to revenues from the particular improvement. The court overruled *Garrett v. Swanton* (1932) 216 C. 220, 13 P.2d 725, on this point. (45 C.2d 737.) (See *Board of Supervisors v. Dolan* (1975) 45 C.A.3d 237, 248, 119 C.R. 347.)

SUPPLEMENT: [This section is current through the latest supplement]



38 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

J. Contracts Adversely Affecting Public Welfare.

4. Contract of Interested Public Officer.

a. In General.

1 Witkin Sum. Cal. Law Contracts § 650

[§ 650] In General.

It is contrary to public policy for a public officer to have personal interests that interfere or conflict with his or her public duties and responsibilities. (See *Stockton Plumbing & Supply Co. v. Wheeler* (1924) 68 C.A. 592, 601, 229 P. 1020; *Schaefer v. Berinstein* (1956) 140 C.A.2d 278, 290, 295 P.2d 113; 63C Am.Jur.2d (1997 ed.), *Public Officers and Employees* §249; on conflicts of interest of state legislators, see 76 Harv. L. Rev. 1209.) Accordingly, a public contract made by an interested officer is illegal. (See *Thomson v. Call* (1985) 38 C.3d 633, 645, 646, 214 C.R. 139, 699 P.2d 316, *infra*, §657; *Terry v. Bender* (1956) 143 C.A.2d 198, 206, 300 P.2d 119; *People v. Barenfeld* (1962) 203 C.A.2d 166, 172, 21 C.R. 501; 7 Williston 4th, §16:11; 63C Am.Jur.2d (1997 ed.), *Public Officers and Employees* §260 et seq.; 56 Am.Jur.2d (2000 ed.), *Municipal Corporations, Counties, and Other Political Subdivisions* §252 et seq.; 2 California Affirmative Defenses (2004 ed.), §37:17; 44 Cal. L. Rev. 355 [detailed examination of statutes and proposals for legislative revision]; 28 So. Cal. L. Rev. 335; 36 So. Cal. L. Rev. 186; 5 Stanf. L. Rev. 61.)

State statutes, generally declaratory of the common law, cover the field. (See *infra*, §651, 652.) Similarly, the federal conflict of interest statute prohibits a federal officer or employee from engaging in transactions on behalf of the federal government if by virtue of his or her private interests the officer may benefit from the outcome of those transactions. (18 U.S.C., §208; see *United States v. Mississippi Valley Generating Co.* (1961) 364 U.S. 520, 81 S.Ct. 294, 308, 325, 5 L.Ed.2d 268, 287 [decided under previous statute]; 63C Am.Jur.2d (1997 ed.), *Public Officers and Employees* (1997 ed.) §378; 53 Cal. L. Rev. 402; 76 Harv. L. Rev. 1113; 22 A.L.R.4th 237 [validity and construction of orders and enactments requiring public officers and employees, or candidates for office, to disclose financial condition, interests, or relationships].)

Although the Legislature may enact a broad statute in lieu of or supplementing the many specific provisions (see *infra*, §651), the act must be limited to transactions that have some relationship to official duties. In *Carmel-By-The-Sea v. Young* (1970) 2 C.3d 259, 85 C.R. 1, 466 P.2d 225, a 1969 statute required that every public officer (state and local) and every candidate for state or local public office file a statement as a public record, of all investments over \$ 10,000, of himself or herself, spouse, or minor child. Violation was made a misdemeanor, and knowing violation a felony. *Held*, the statute was an unconstitutional invasion of the newly recognized right of privacy (see 7 Summary (10th), *Constitutional Law*, §§558, 559). The disclosure requirements were not restricted to those that might be expected to show a conflict of interest; they involved the danger of inviting intrusion by salespersons, of unwarranted demands and

lawsuits, and of exposure to criminal elements. (2 C.3d 270.) Nor was any overriding necessity shown for this broad inquiry into both relevant and irrelevant private financial affairs of those affected by it. (2 C.3d 272.) (See 59 Cal. L. Rev. 158; 18 U.C.L.A. L. Rev. 534; 37 A.L.R.3d 1338 [validity and construction of statutes requiring public officers or candidates for office to disclose finances or relationships].)

The "rule of necessity" allows public officials to take actions that they would otherwise be disqualified from taking by operation of conflict-of-interest rules if their disqualification would make it impossible for the public agency to fulfill one of its vital duties. (*Finnegan v. Schrader* (2001) 91 C.A.4th 572, 581, 110 C.R.2d 552 [rule not applicable here; even assuming that sanitary district had legal duty to hire permanent manager, rule of necessity did not legalize appointment of board member to be district manager, because district had no duty to appoint board member as manager].)

West's Key Number Digest, Officers and Public Employees k.110-

SUPPLEMENT: [This section is current through the latest supplement]
See 2 California Affirmative Defenses §37:17.



39 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

J. Contracts Adversely Affecting Public Welfare.

4. Contract of Interested Public Officer.

b. California Legislation.

1. General Statute.

1 Witkin Sum. Cal. Law Contracts § 651

[§ 651] General Statute.

The principal provisions are in *Govt.C. 1090* et seq.: Legislators and state, county, district, judicial district, and city officers and employees may not be *financially interested* in any contract made by them in their official capacity, and these officers and employees may not be purchasers at any sale or vendors at any purchase made by them in this capacity. (*Govt.C. 1090*; see *People v. Vallerga* (1977) 67 C.A.3d 847, 864, 136 C.R. 429; *Fraser-Yamor Agency v. Del Norte* (1977) 68 C.A.3d 201, 208, 211, 137 C.R. 118, *infra*, §654; *Campagna v. Sanger* (1996) 42 C.A.4th 533, 540, 49 C.R.2d 676; *BreakZone Billiards v. Torrance* (2000) 81 C.A.4th 1205, 1230, 97 C.R.2d 467 [*Govt.C. 1090* prohibits self-dealing, not representation of interests of others]; *Finnegan v. Schrader* (2001) 91 C.A.4th 572, 579, 110 C.R.2d 552 [*Govt.C. 1090* applies to "any contract," including employment contract].) Although the statute states that these contracts "may be avoided" (*Govt.C. 1092*), a contract or sale in violation of *Govt.C. 1090* is void, not merely voidable. (*People v. Drinkhouse* (1970) 4 C.A.3d 931, 935, 84 C.R. 773, 7 Cal. Proc. (4th), *Judgment*, §291); see *Govt.C. 1092.5* [real property contract may not be avoided in derogation of interest of good faith lessee, purchaser, or encumbrancer]; 36 So. Cal. L. Rev. 199.)

In *People v. Honig* (1996) 48 C.A.4th 289, 55 C.R.2d 555, 2 Cal. Crim. Law (3d), *Crimes Against Governmental Authority*, §105, the state Superintendent of Public Instruction and his wife started a nonprofit corporation (QEP) that paid his wife a salary and paid rent for office space in their home. The superintendent arranged contracts with the state Department of Education to fund staff positions in QEP through the local school districts where those staff members had been employed. In a criminal prosecution, he was convicted of four counts of violating *Govt.C. 1090*. *Held*, affirmed.

(a) The conflict-of-interest statutes are based on "[t]he truism that a person cannot serve two masters simultaneously." They are concerned with what might have happened rather than merely what actually happened, and are aimed at eliminating temptation, avoiding the appearance of impropriety, and assuring the government of a public officer's undivided and uncompromised allegiance. Their objective is to remove or limit the possibility of any personal influence, either direct or indirect, which might bear on an official's decision. (48 C.A.4th 313.)

(b) Given the purposes of the conflict-of-interest statutes, their scope is not limited to instances of actual fraud,

dishonesty, unfairness, or loss to the governmental entity. They may not be given a narrow or technical interpretation. Thus, under *Stigall v. Taft* (1962) 58 C.2d 565, 25 C.R. 441, 375 P.2d 289, *infra*, §653, "making" a contract within the meaning of *Govt.C. 1090* encompasses the planning, preliminary discussion, compromises, drawing of plans and specifications, and solicitation of bids that lead up to the formal making of the contract. Similarly, the term "financially interested" in *Govt.C. 1090* cannot be interpreted in a restricted and technical manner. A public officer may have a prohibited interest in a contract without acquiring a transferable interest in it or sharing directly in the profits to be realized from it. The fact that the officer's interest is small or indirect is immaterial. The court "must disregard the technical relationship of the parties and look behind the veil which enshrouds their activities in order to discern the vital facts." (48 C.A.4th 315.)

(c) Prohibited financial interests are not limited to express agreements for benefit and need not be proven by direct evidence. Rather, forbidden interests extend to expectations of benefit by express or implied agreement and may be inferred from the circumstances. The types of prohibited financial interests are many and varied, as indicated by numerous judicial decisions. In addition to the judicial authorities, the scope of *Govt.C. 1090* can be derived by reference to *Govt.C. 1091* (*infra*, §655) and 1091.5 (*infra*, §656), providing for remote and minimal interests not deemed to be prohibited. (48 C.A.4th 315.)

(d) *Govt.C. 1090* does not require that the prohibited interest have a "material" effect on the public official's source of income. What is material to some persons may be regarded as immaterial by others and some public officials may be tempted by relatively trivial sums while others may be incorruptibly resistant to the promise of even significant gain. The statute is not directed at the actuality of significant personal influence, but at the mere possibility of this influence. It establishes an objective and absolute standard of conduct for public officials. (48 C.A.4th 322.)

(e) *Govt.C. 1090* and *Govt.C. 87103*, which requires a foreseeably "material financial effect" on a public official or his or her family for there to be a "financial interest" for purposes of the Political Reform Act of 1974 (*Govt.C. 87100* et seq., *infra*, §652), can fairly be said to relate to the same subject. However, the phrase "financially interested" in *Govt.C. 1090* does not mean the same thing as a "financial interest" in *Govt.C. 87103*, and it should not be rewritten under the guise of a construction that the statutes relate to the same subject. There is no indication of a legislative intent to have the definition of "financial interest" in *Govt.C. 87103* supersede the settled judicial construction of "financially interested" in *Govt.C. 1090*. Because *Govt.C. 1090* is aimed at a more specific and limited form of official behavior by public officers and employees, it must be considered the more specific and thus controlling legislation in the circumstances in which it applies. (48 C.A.4th 325.)

(f) The evidence in support of the convictions was compelling. The superintendent was clearly financially interested in his wife's employment and remuneration by QEP, as well as in the rental payments from QEP to the couple jointly. A person's interest in a spouse's employment and income is an interest within the meaning of *Govt.C. 1090*, and the limited exclusion provided by *Govt.C. 1091.5(a)(6)* is not applicable here. It makes no difference that QEP was a nonprofit corporation, because a position as a member or officer of a nonprofit corporation is excluded from *Govt.C. 1090* only when the position is nonsalaried or noncompensated and may be treated as a remote interest only if specified disclosure and abstention requirements of *Govt.C. 1091* and 1091.5 are met. And an interest as a landlord may be treated as remote only with disclosure and abstention. (48 C.A.4th 319.)

SUPPLEMENT: [This section is current through the latest supplement]
Govt.C. 1092 was subdivided in 2007. The words quoted in the text are now in *Govt.C. 1092(a)*.

See *California Housing Finance Authority v. Hanover/Calif. Management & Accounting Center* (2007) 148 C.A.4th 682, 691, 56 C.R.3d 92 [in *Govt.C. 1090*, phrase "officers and employees" includes independent contractors]; *Klistoff v. Superior Court* (2007) 157 C.A.4th 469, 479, 68 C.R.3d 704 [waste hauling business and its president, who allegedly made payments to city official in exchange for official's efforts to ensure that another company in which president was officer obtained contract from city to provide refuse collection, were not legally capable of violating *Govt.C. 1090*, given that they were not public officials or employees, and thus business and its president could not be

found liable for conspiracy to violate statute].

Drinkhouse case:

Cross-Reference: 7 Cal. Proc. (5th), Judgment, §461.



40 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
J. Contracts Adversely Affecting Public Welfare.
4. Contract of Interested Public Officer.
b. California Legislation.
2. Other Statutes.

1 Witkin Sum. Cal. Law Contracts § 652

[§ 652] Other Statutes.

(1) *Political Reform Act of 1974*. This initiative measure contains detailed provisions on conflicts of interest (*Govt.C. 87100 et seq.*), including a general prohibition on participation by state or local public officials in any decision in which the official has a "financial interest" (*Govt.C. 87100*). (See 7 *Summary* (10th), *Constitutional Law*, §558.)

(2) *Statutes Directed at Particular Officers*. Some statutes are directed at specific categories of public officers. (See, e.g., *B. & P.C. 450.3*; *Educ.C. 35233, 72533, 19423*; *Health & Saf.C. 50904, 50905*; *P.C. 99, 100*; *Pub.Util.C. 12392, 12722*; 36 *So. Cal. L. Rev. 201*.)

(3) *Local Agencies*. An officer or employee of a city, county, political subdivision, district, or municipal corporation may not engage in employment or activity for compensation that is incompatible with or inimical to his or her duties to the employing agency or with the duties, functions, or responsibilities of the appointing power or employing agency. Outside work for compensation is prohibited where any part of these efforts will be subject to approval by any other officer, employee, or board of the employing agency, unless otherwise approved by the appointing power. (*Govt.C. 1125 et seq.*; see *Long Beach Police Officers Assn. v. Long Beach* (1988) 46 *C.3d* 736, 741, 250 *C.R. 869, 759 P.2d 504* [*Govt.C. 1126* construed as merely illustrating, not exhausting, the types of off-duty activities subject to local agency control]; 3 *Pacific L. J. 402*; on conflict of interest by member of water replenishment district board, see *Water C. 60167*.)

(4) *Legislators, State Officers, and Judges*. A "Code of Ethics" prohibits legislators, state elective or appointive officers, and judges or justices from having "any interest," or engaging in any business or transaction, or incurring any obligation, "in substantial conflict" with their duties and responsibilities. (*Govt.C. 8920 et seq.*) This code also contains specific prohibitions on actions by legislators in conflict with their legislative responsibilities. (*Govt.C. 8920(b)*.)

SUPPLEMENT: [This section is current through the latest supplement]



41 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

J. Contracts Adversely Affecting Public Welfare.

4. Contract of Interested Public Officer.

c. What Constitutes Making of Contract.

1 Witkin Sum. Cal. Law Contracts § 653

[§ 653] What Constitutes Making of Contract.

In *Stigall v. Taft* (1962) 58 C.2d 565, 25 C.R. 441, 375 P.2d 289, B was a member of the city council and owner of a plumbing business. His company's low bid for work was received by the council but, on objection that he was interested, all bids were rejected. When new bids were received, his company was again low. A special meeting was then called to award the contract, and, at that meeting, B's resignation was given and accepted, and the contract was awarded to his company. *Held*, the complaint of plaintiff taxpayer to declare the contract void stated a cause of action.

The defense of B and the council was that a contract is not "made" until an offer is accepted and both parties are bound. But this technical rule of contractual assent does not govern the interpretation of conflict of interest statutes, which are designed to remove the possibility of personal influence, direct or indirect, which might bear on an officer's decision. "The circumstances in the instant case present a most pertinent illustration of what might transpire with impunity at other times and places, should the construction insisted upon by defendant prevail. A council member could participate in all negotiations giving a contract its substance and meaning, be instrumental in establishing specifications and schedules most advantageous to his or his firm's particular mode of operation, participate in the selection of his or his firm's offer, resign just prior to formal acceptance of that offer and execute the contract as the other party thereto." (58 C.2d 570.) (See *People v. Vallerger* (1977) 67 C.A.3d 847, 868, 136 C.R. 429; *Fraser-Yamor Agency v. Del Norte* (1977) 68 C.A.3d 201, 211, 137 C.R. 118, *infra*, §654 [membership on board of supervisors involves participation in making of contract, irrespective of whether member personally abstains from negotiations]; *People v. Honig* (1996) 48 C.A.4th 289, 55 C.R.2d 555, *supra*, §651 [citing *Stigall*]; *People v. Gnass* (2002) 101 C.A.4th 1271, 1292, 125 C.R.2d 225 [although attorney for public financing authority was in position to give advice before authority entered into various joint powers agreements concerning issuance of revenue bonds, evidence was insufficient to show that he "made" the agreements].)

SUPPLEMENT: [This section is current through the latest supplement]



42 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

J. Contracts Adversely Affecting Public Welfare.

4. Contract of Interested Public Officer.

d. What Constitutes Financial Interest.

1 Witkin Sum. Cal. Law Contracts § 654

[§ 654] What Constitutes Financial Interest.

Prior to 1963, *Govt.C. 1090* (supra, §651) referred only to "interest"; a 1963 amendment added "financial," and the new phrase was construed in *Fraser-Yamor Agency v. Del Norte* (1977) 68 C.A.3d 201, 137 C.R. 118. F was a substantial shareholder and a salaried officer in plaintiff insurance brokerage agency, which was employed by defendant county to procure its insurance. F became a member of defendant county's board of supervisors. Acting under legal advice, he disclosed his interest in the agency to the board and announced that he would take no part in discussions of insurance. He also made arrangements with the agency for nonparticipation in the county insurance business and for no sharing in the commissions derived from the business. The agency brought this action for a declaration that the insurance policies procured by it were valid, and defendant county cross-complained, seeking a declaration that they were void. The trial judge granted summary judgment for plaintiff. *Held*, reversed.

(a) The insurance policies could not be declared invalid without affording the insurance companies, as indispensable parties, an opportunity to protect their rights. Also, a declaration of invalidity of the policies would deprive the county of its insurance coverage. Accordingly, this issue was left undetermined. (68 C.A.3d 214.)

(b) The issue that could be decided was F's financial interest. The fact that he did not receive direct profit from the county business was immaterial; he had an investment in the agency and derived a financial benefit from its success, which in turn was enhanced by the volume of business produced. (68 C.A.3d 214.)

(c) The final issue--whether the interest was remote (see *infra*, §655)--could not be resolved on the record, and was left for retrial in the lower court. (68 C.A.3d 215, 218.) (See *People v. Honig* (1996) 48 C.A.4th 289, 55 C.R.2d 555, supra, §651 [state Superintendent of Public Instruction had prohibited financial interest in contracts with state Department of Education, where contracts funded staff positions in nonprofit corporation that paid salary to his wife and paid rent for office space in their home]; *People v. Gnass* (2002) 101 C.A.4th 1271, 1298, 125 C.R.2d 225 [city created public financing authority that, in turn, entered into joint powers agreements for issuance of revenue bonds; fact that attorney for both city and public financing authority might be offered position of "disclosure counsel" in relation to bonds' issuance gave him financial interest" in agreements].)

West's Key Number Digest, Officers and Public Employees k.110

SUPPLEMENT: [This section is current through the latest supplement]



43 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
J. Contracts Adversely Affecting Public Welfare.
4. Contract of Interested Public Officer.
e. Remote Nondisqualifying Interest.

1 Witkin Sum. Cal. Law Contracts § 655

[§ 655] Remote Nondisqualifying Interest.

(1) *In General.* Where the interest of an officer or employee is direct and substantial, or there is knowledge or bad faith, his or her contract is void. However, the statutes now protect a contract made in *good faith* by a member of a *body or board* whose interest is *remote*. *Govt.C. 1091(a)* provides that an officer "shall not be deemed to be interested in a contract entered into by a body or board of which" the officer is a member if (a) his or her interest is "remote"; (b) that interest is disclosed and noted in the records of the body or board; and (c) the body or board authorizes, approves or ratifies the contract in good faith without counting his or her vote. *Govt.C. 1091(c)* adds that the officer must not attempt to influence any other member.

Even wilful failure of the officer to disclose a remote interest does not invalidate the contract unless the contracting party had knowledge of it at the time of contracting. (*Govt.C. 1091(d).*)

(2) *What Constitutes Remote Interest.* *Govt.C. 1091(b)* specifically defines "remote interest" to mean any of the following:

(a) That of an officer or employee of a nonprofit entity exempt from taxation or a nonprofit corporation, except as provided in *Govt.C. 1091.5(a)(8)* (*infra*, §656). (*Govt.C. 1091(b)(1).*)

(b) That of an employee or agent of the contracting party, if the contracting party has 10 or more other employees and if the officer was an employee or agent of that contracting party for at least three years prior to the officer initially accepting his or her office and the officer owns less than 3 percent of the shares of stock of the contracting party; and the employee or agent is not an officer or director of the contracting party and did not directly participate in formulating the bid of the contracting party.

The time of employment (3 years) is counted even though the contracting party has converted to a different form of business organization, if the "real or ultimate ownership" is substantially similar; and stockholders, bondholders, partners, or other persons having an interest in the contracting party are regarded as having the "real or ultimate ownership." (*Govt.C. 1091(b)(2).*)

(c) That of an employee or agent of the contracting party if (1) the person is an officer of a local public agency in a county with a population of less than 4 million; (2) the contract is competitively bid, and not for personal services; (3) the employee or agent has no primary management capacity with, or ownership interest in, the contracting party, and is not an officer or director thereof; (4) the contracting party has 10 or more other employees; (5) the employee or agent did not directly participate in formulating the contracting party's bid; and (6) the contracting party is the lowest responsible bidder. (*Govt.C. 1091(b)(3).*)

(d) That of parent in the earnings of his or her minor child for personal services. (*Govt.C. 1091(b)(4).*)

(e) That of a landlord or tenant of the contracting party. (*Govt.C. 1091(b)(5).*)

(f) That of an attorney of the contracting party or of an owner, officer, employee, or agent of a firm rendering service to the contracting party in the capacity of stockbroker, insurance agent, insurance broker, real estate agent, or real estate broker, provided that (1) the person does not receive "remuneration, consideration, or a commission as a result of the contract," and (2) the person has an ownership interest of 10 percent or more in the law practice or firm, stock brokerage firm, insurance firm, or real estate firm. (*Govt.C. 1091(b)(6).*)

(g) That of a member of a nonprofit agricultural cooperative. (*Govt.C. 1091(b)(7).*)

(h) That of supplier of goods or services who has supplied the goods or services to the contracting party for at least 5 years prior to supplier's election or appointment to office. (*Govt.C. 1091(b)(8).*)

(i) That of a person subject to the provisions of *Govt.C. 1090* in any contract or agreement entered into pursuant to the provisions of California Land Conservation Act of 1965. (*Govt.C. 1091(b)(9).*)

(j) That of a director of or a person having an ownership interest of 10 percent or more in a bank, bank holding company, or savings and loan association with which a party to the contract has a relationship of borrower, depositor, debtor, or creditor, except as provided in *Govt.C. 1091.5(b)* (*infra*, §656). (*Govt.C. 1091(b)(10).*)

(k) That of an engineer, geologist, or architect employed by a consulting engineering or architectural firm, so long as the employee does not serve in a primary management capacity and is not an officer or director. (*Govt.C. 1091(b)(11).*)

(l) That of an officer, elected on or after November 1, 1986, and otherwise subject to *Govt.C. 1090*, in any housing assistance payment contract entered into under 42 U.S.C., §1437f, if the contract was in existence before *Govt.C. 1090* became applicable to the officer and will be renewed or extended only as to (1) the existing tenant, or (2) new tenants in a unit previously under a housing assistance payment contract, if the unit is in a jurisdiction in which the rental vacancy rate is less than 5%. (*Govt.C. 1091(b)(12).*)

(m) That of a person receiving salary, per diem, or reimbursement for expenses from a government entity. (*Govt.C. 1091(b)(13).*)

(n) That of a person owning less than 3% of the shares of a contracting for-profit corporation, provided that the ownership of the shares derives from his or her employment with that corporation. (*Govt.C. 1091(b)(14).*)

As used in *Govt.C. 1091*, "remote interest" also includes a person who has a financial interest in a contract, if (a) the agency of which the person is a board member is a special district serving a population of less than 5,000 that is a landowner voter district; (b) the district is one that does not distribute water for any domestic use; (c) the contract is for a specified purpose; (d) the person did not participate in the formulation of the contract on behalf of the district; (e) at a public meeting, the district's governing body both determines that the property acquisition or maintenance and repair services cannot otherwise be obtained at a reasonable price and adopts a resolution stating why the contract is necessary to carry out the agency's responsibilities. (*Govt.C. 1091.4.*)

In *Fraser-Yamor Agency v. Del Norte* (1977) 68 C.A.3d 201, 217, 137 C.R. 118, supra, §654, the court concluded that F, as a shareholder and officer of an insurance brokerage agency, was both an agent of and supplier of services to the contracting insurance company, but left for retrial the issue of whether F had been an agent and supplier for the requisite time periods. (68 C.3d 216; see *People v. Honig* (1996) 48 C.A.4th 289, 55 C.R.2d 555, supra, §651 [state Superintendent of Public Instruction's interest in contracts with state Department of Education to fund staff positions in nonprofit corporation that paid salary to his wife and paid rent for office space in their home was not remote].)

SUPPLEMENT: [This section is current through the latest supplement]

(2) *What Constitutes Remote Interest.* The definition of "remote interest" has been broadened to additionally mean the following:(o) (New) That of a party to litigation involving the body or board of which the officer is a member in connection with an agreement in which all of the following apply: (a) the agreement is entered into as part of a settlement of litigation in which the body or board is represented by legal counsel; (b) after a review of the merits of the agreement and other relevant facts and circumstances, a court of competent jurisdiction finds that the agreement serves the public interest; (c) the interested member has recused himself or herself from all participation, direct or indirect, in the making of the agreement on behalf of the body or board. (*Govt.C. 1091(b)(15)*, added in 2008.)



44 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
J. Contracts Adversely Affecting Public Welfare.
4. Contract of Interested Public Officer.
f. Other Nondisqualifying Interest.

1 Witkin Sum. Cal. Law Contracts § 656

[§ 656] Other Nondisqualifying Interest.

Govt.C. 1091.5(a) provides that an officer or employee *shall not be deemed interested* in any contract if his or her interest is any of the following:

(a) Ownership of less than 3% of the shares of a corporation for profit, provided his or her total annual income "from dividends, including the value of stock dividends, from the corporation does not exceed 5 percent of his or her total annual income, and any other payments" from the corporation to him or her do not exceed 5% of his or her total annual income. (*Govt.C. 1091.5(a)(1).*)

(b) That of an officer in being reimbursed for expenses incurred in the performance of official duty. (*Govt.C. 1091.5(a)(2).*)

(c) That of a recipient of public services generally provided by the public body or board of which he or she is a member, on the same terms as if the recipient were not a member of the board. (*Govt.C. 1091.5(a)(3)*; see *Vernon v. Central Basin Mun. Water Dist.* (1999) 69 C.A.4th 508, 513, 81 C.R.2d 650.)

(d) That of a landlord or tenant of the contracting party if the contracting party is the federal government, this state, an adjoining state, or a department, agency, or political subdivision thereof, unless the subject matter of the contract is property of which the officer or employee is the landlord or tenant, in which event his or her interest will be deemed remote subject to the provisions of *Govt.C. 1091* (see *supra*, §655). (*Govt.C. 1091.5(a)(4).*)

(e) That of a tenant in a public housing authority in which he or she serves as a commissioner. (*Govt.C. 1091.5(a)(5).*)

(f) That of a spouse of an officer or employee of a public agency in his or her spouse's employment or officeholding if his or her spouse's employment or officeholding has existed for at least one year prior to his or her election or appointment. (*Govt.C. 1091.5(a)(6)*; see *Thorpe v. Long Beach Community College Dist.* (2000) 83 C.A.4th 655, 660, 99 C.R.2d 897 [intent of *Govt.C. 1091.5(a)(6)* is to continue status quo as to spouse already employed for more than year, but to prohibit spouse's employment in different position that requires approval of governing body of which

employee's spouse is member].)

(g) That of a nonsalaried member of a nonprofit corporation, provided the interest is disclosed to the body or board at the time of first consideration of the contract and is noted in the official records. (*Govt.C. 1091.5(a)(7).*)

(h) That of a noncompensated (except for reimbursement of expenses) officer of a nonprofit, tax-exempt corporation, which as a primary purpose "supports the functions of the body or board or to which the body or board has a legal obligation to give particular consideration," provided the interest is noted in the official records. (*Govt.C. 1091.5(a)(8).*)

An officer or employee shall not be deemed interested in a contract *competitively bid* if his or her sole interest is that of officer, director, or employee of a bank or savings and loan association with which a contracting party has the relationship of borrower, depositor, debtor, or creditor. (*Govt.C. 1091.5(b).*)

(i) That of a person receiving salary, per diem, or reimbursement for expenses from a government entity, unless the contract directly involves the department of the government entity employing the officer or employee, provided that the interest is disclosed to the body or board at the time of consideration of the contract and is noted in its official record. (*Govt.C. 1091.5(a)(9).*) (See *People v. Gnass (2002) 101 C.A.4th 1271, 1301, 125 C.R.2d 225* [*Govt.C. 1091.5(a)(9)*] deals with contracts between two public agencies; hence, government employee who serves on board of another agency is not financially interested in contract between that agency and his or her employer (if government employee discloses his or her employment to board), unless contract directly involves particular department in which he or she is employed].)

(j) That of an attorney of the contracting party or that of an owner, officer, employee, or agent of a firm rendering service to the contracting party as stockbroker, insurance agent, insurance broker, real estate agent, or real estate broker, provided the person does not receive remuneration, consideration, or a commission as a result of the contract, and the person has an ownership interest of less than 10% in the law practice or firm, stock brokerage firm, insurance firm, or real estate firm. (*Govt.C. 1091.5(a)(10).*)

(k) Except as provided in *Govt.C. 1091.5(b)*, supra, that of an officer or employee of, or person having less than a 10% ownership interest in, a bank, bank holding company, or savings and loan association with which a contracting party has the relationship of borrower, depositor, debtor, or creditor. (*Govt.C. 1091.5(a)(11).*)

(l) That of (1) a bona fide nonprofit, tax-exempt corporation having among its primary purposes the conservation, preservation, or restoration of park and natural lands or historical resources for public benefit, which enters into an agreement with a public agency to provide services related to park and natural lands or historical resources and which services are found by the public agency, prior to entering into the agreement or as part of the agreement, to be necessary to the public interest, and (2) an officer, director, or employee acting pursuant to the agreement on behalf of the nonprofit corporation. (*Govt.C. 1091.5(a)(12).*)

SUPPLEMENT: [This section is current through the latest supplement]

(c) *Recipient of public services:* *Govt.C. 1091.5(a)(3)* was amended in 2005 to refer to public services provided on the same terms as if the recipient were not a member of the *body* or board.(m) (*New*) That of an officer, employee, or member of the Board of Directors of the California Housing Finance Agency with respect to a loan product or programs if such person participated in the planning, discussions, development, or approval of the loan product or program and the product or program (1) is or may be originated by any lender approved by the agency and (2) is generally available to qualifying borrowers on terms and conditions that are substantially the same for all qualifying borrowers at the time the loan is made. (*Govt.C. 1091.5(a)(13)*, added in 2005.)



45 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
J. Contracts Adversely Affecting Public Welfare.
4. Contract of Interested Public Officer.
g. Effect of Violation.

1 *Witkin Sum. Cal. Law Contracts* § 657

[§ 657] Effect of Violation.

Contracts involving a public officer's financial interest have been considered void. (See *Berka v. Woodward* (1899) 125 C. 119, 127, 57 P. 777; *People v. Deysher* (1934) 2 C.2d 141, 146, 40 P.2d 259; *Thomson v. Call* (1985) 38 C.3d 633, 646, 214 C.R. 139, 699 P.2d 316; *Hobbs, Wall & Co. v. Moran* (1930) 109 C.A. 316, 318, 293 P. 145; *Hotchkiss v. Moran* (1930) 109 C.A. 321, 323, 293 P. 148; *Miller v. Martinez* (1938) 28 C.A.2d 364, 367, 82 P.2d 519; *Marin v. Messner* (1941) 44 C.A.2d 577, 589, 112 P.2d 731; *People v. Becker* (1952) 112 C.A.2d 324, 327, 246 P.2d 103; *People v. Darby* (1952) 114 C.A.2d 412, 420, 250 P.2d 743; *Schaefer v. Berinstein* (1956) 140 C.A.2d 278, 290, 295 P.2d 113; *Terry v. Bender* (1956) 143 C.A.2d 198, 206, 300 P.2d 119; *Campagna v. Sanger* (1996) 42 C.A.4th 533, 540, 49 C.R.2d 676.)

It is unnecessary to show either fraud or loss to the governmental agency, or direct financial interest in the transaction. (*Thomson v. Call*, *supra*, 38 C.3d 649.)

Thus, it was frequently held that where a member of a city council was also an employee of a private corporation, a contract entered into by the council to purchase goods from the corporation was void, and the money paid the corporation could be recovered. (*Miller v. Martinez*, *supra*; see 44 *Cal. L. Rev.* 361; 5 *Stanf. L. Rev.* 63.)

In *Thomson*, defendant Call, while a member of a city council, participated in a complex transaction in which he sold to the city a parcel of land for \$ 258,000 which he had previously acquired for a much lower price. In this taxpayers' suit, the trial judge rendered a judgment allowing the city to keep the land and also recover the \$ 258,000 with interest from defendant. *Held*, judgment affirmed.

(a) Although defendant used a corporation as a conduit, his interest in the transaction was clearly a pecuniary interest forbidden by *Govt.C. 1090* and the decisions on conflict of interest; and neither the absence of actual fraud nor the possibility of a good faith mistake can alter the conclusion that the contract was void. (38 C.3d 646.)

(b) The trial judge's remedy was consistent with the established case law: (1) No recovery can be had for goods delivered or services rendered to a public agency pursuant to a contract violative of a conflict-of-interest statute. (38 C.3d 646.) (2) A public agency is entitled to recover any consideration paid pursuant to this type of a contract without

restoring the benefits received. (38 C.3d 647.)

(c) (1) It is immaterial that defendant was not found to have committed a fraud, but in fact sought advice from the city attorney on how to act: "It follows from the goals of eliminating temptation, avoiding the appearance of impropriety, and assuring the city of the officer's undivided and uncompromised allegiance that the violation of section 1090 cannot turn on the question of whether actual fraud or dishonesty was involved." (38 C.3d 648.) (2) Nor is actual loss to the public agency necessary: The contract cannot be sustained by showing that it is fair, just, and equitable, or even more advantageous to the public entity than others might be. (38 C.3d 649.)

(d) A public officer cannot escape liability for a section 1090 violation merely by abstaining from voting or participating in discussions or negotiations, or by making a full disclosure of his or her interest. (38 C.3d 649.)

(e) Although the forfeiture in this case is harsh, other less drastic solutions (e.g., allowing defendant to retain the fair market value of the land or the amount actually paid for it) raise difficult practical problems and defeat the goal of deterrence. The trial judge's approach "is consistent with the policy of strict enforcement of conflict-of-interest statutes, it provides a strong disincentive for those officers who might be tempted to take personal advantage of their public offices, and it is a bright-line remedy which may be appropriate in many different factual situations." (38 C.3d 652.)

West's Key Number Digest, Officers and Public Employees k.119

SUPPLEMENT: [This section is current through the latest supplement]

See *Carson Redevelopment Agency v. Padilla* (2006) 140 C.A.4th 1323, 1332, 44 C.R.3d 881 [because of extortion payment required by city official to approve contract, official had financial interest in contract that allowed city to void contract and recover monies paid]; *San Bernardino v. Walsh* (2007) 158 C.A.4th 533, 549, 69 C.R.3d 848 [disgorgement of billboard lessee's profits, from assignment of billboard lease for which lessee had bribed county administrator to push through needed permits, was appropriate remedy for lessee's participation in violation of statute prohibiting county administrator from having financial interest in public contract approved by administrator in official capacity; county may obtain forfeiture of proceeds of tainted contract, even when proceeds were received from third party rather than from public entity itself].



46 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witkin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
J. Contracts Adversely Affecting Public Welfare.
5. Contracts of Health Care Service Plans.

1 Witkin Sum. Cal. Law Contracts § 658

[§ 658] Contracts of Health Care Service Plans.

Provisions in health care service plans that adversely affect public welfare are covered in another article of the Summary. (See 2 *Summary* (10th), *Insurance*, §127 et seq.)

SUPPLEMENT: [This section is current through the latest supplement]



47 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
J. Contracts Adversely Affecting Public Welfare.
6. (New) Contracts for Bringing Person to United States.

1 Witkin Sum. Cal. Law Contracts § 658A

[§ 658A] (New) Contracts for Bringing Person to United States.

C.C. 1670.7, added in 2008, makes void as against public policy any provision of a contract purporting to allow a deduction from a person's wages for the cost of emigrating and transporting that person to the United States.

SUPPLEMENT: [This section is current through the latest supplement]



48 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
J. Contracts Adversely Affecting Public Welfare.
7. (New) Subcontractor Enrolled in Wrap-Up Insurance Policy.

1 Witkin Sum. Cal. Law Contracts § 658B

[§ 658B] (New) Subcontractor Enrolled in Wrap-Up Insurance Policy.

All contracts entered into after January 1, 2009, for a residential construction project on which a wrap-up insurance policy or other consolidated insurance program is applicable and that require an enrolled and participating subcontractor or other participant to indemnify, hold harmless, or defend another for any claim or action covered by the consolidated insurance program and arising out of the residential construction project are unenforceable. (C.C. 2782.9(a), added in 2008.) A wrap-up insurance policy is one covering risks associated with a work of improvement and covering two or more contractors or subcontractors that work on the improvement. (*Ins.C. 11751.82(b).*)

SUPPLEMENT: [This section is current through the latest supplement]



49 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

K. Exemption From and Limitation of Liability.

1. In General.

a. Restatement 2d.

1 Witkin Sum. Cal. Law Contracts § 659

[§ 659] Restatement 2d.

Rest.2d, Contracts §195(1) and 195(2) cover exemption from liability for harm caused intentionally, recklessly, or negligently.

(1) *Intentionally or recklessly caused harm*: "A term exempting a party from tort liability for harm caused intentionally or recklessly is unenforceable on grounds of public policy." (*Rest.2d, Contracts §195(1).*)

(2) *Negligently caused harm*: "A term exempting a party from tort liability for harm caused negligently is unenforceable on grounds of public policy *if*"

"(a) the term exempts an employer from liability to an employee for injury in the course of his or her employment;"

"(b) the term exempts one charged with a duty of public service from liability to one to whom that duty is owed for compensation for breach of that duty, or"

"(c) the other party is similarly a member of a class protected against the class to which the first party belongs." (*Rest.2d, Contracts §195(2).*)

Rest.2d, Contracts §195(3) deals with *strict products liability*: "A term exempting a seller of a product from his special tort liability for physical harm to a user or consumer is unenforceable on grounds of public policy unless the term is fairly bargained for and is consistent with the policy underlying that liability." Comment c cites *Rest.2d, Torts §402A*, Comment m (now *Rest.3d, Torts: Products Liability §18*, Comment a), for the general rule that a term exempting a seller from products liability is unenforceable, and adds that the exception might apply, e.g., where the term is in a fairly negotiated contract between two merchants for the sale of an experimental product.

Rest.2d, Contracts §196 deals with exemption from consequences of *misrepresentation*: "A term unreasonably exempting a party from the legal consequences of a misrepresentation is unenforceable on grounds of public policy." Comment a points out that the rule applies to nonfraudulent as well as fraudulent misrepresentations.

SUPPLEMENT: [This section is current through the latest supplement]



50 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

K. Exemption From and Limitation of Liability.

1. In General.

b. California Code.

1 Witkin Sum. Cal. Law Contracts § 660

[§ 660] California Code.

C.C. 1668 provides: "All contracts which have for their object, directly or indirectly, to exempt anyone from responsibility for his own *fraud*, or *willful injury* to the person or property of another, or *violation of law*, whether willful or *negligent*, are against the policy of the law." (See *Nunes Turfgrass v. Vaughan-Jacklin Seed Co.* (1988) 200 C.A.3d 1518, 1538, 246 C.R. 823 [provision limiting seed seller's liability for negligence to purchase price held governed by U.C.C. 2719(3) (see 3 *Summary* (10th), *Sales*, §207), instead of C.C. 1668]; *National Union Fire Ins. Co. v. Lynette C.* (1991) 228 C.A.3d 1073, 1085, 279 C.R. 394, 2 *Summary* (10th), *Insurance*, §109; *Wilson v. Century 21 Great Western Realty* (1993) 15 C.A.4th 298, 304, 18 C.R.2d 779 [under C.C. 1668, "as is" provision in real estate sales contract does not shield seller from liability for affirmative or negative fraud]; 2 *California Affirmative Defenses* (2004 ed.), §37:10 et seq.; on *Ins.C.* 533 exempting insurer from liability for wilful acts of insured, see 2 *Summary* (10th), *Insurance*, §100 et seq.)

The earlier California cases were in conflict, some tending to apply the statute strictly, so as to make void any contract for exemption from liability for negligence. (See *Union Const. Co. v. Western Union Tel. Co.* (1912) 163 C. 298, 314, 125 P. 242 [negligent delay in delivery of telegram resulting in loss of business deal by plaintiff; provision exempting from liability unless sender paid higher rate of repeated message]; *Hiroshima v. Bank of Italy* (1926) 78 C.A. 362, 374, 248 P. 947 [provision relieving bank from liability for failure to stop payment of check].)

The present view is that a contract exempting from liability for ordinary negligence is valid where no public interest is involved (see *infra*, §§662, 671) and no statute expressly prohibits it (see *infra*, §666). (See *Gardner v. Downtown Porsche Audi* (1986) 180 C.A.3d 713, 716, 225 C.R. 757, *infra*, §663, quoting the text.) Limitation of liability provisions are valid in similar circumstances. (See *infra*, §§677, 678.)

But there can be no exemption from liability for intentional wrong, gross negligence, or violation of law. (See *Halliday v. Greene* (1966) 244 C.A.2d 482, 488, 53 C.R. 267 [valid exculpatory clause in lease cannot cover violation of industrial safety order]; 15 *Corbin* (Rev. ed.), §85.18; 8 *Williston* 4th, §19:18 et seq.; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §280 et seq.; 57A *Am.Jur.2d* (2004 ed.), *Negligence* §58; on invalidity of a disclaimer of warranty where the warranty is *fraudulent*, see *Klein v. Asgrow Seed Co.* (1966) 246 C.A.2d 87, 100, 54 C.R. 609, 4 *Summary* (10th), *Sales*, §94.)

Exemptions and limitation provisions in contracts of carriers, warehouse persons, and other bailees are considered in a later chapter. (See 13 *Summary* (10th), *Personal Property*, §§176, 178 et seq.)

SUPPLEMENT: [This section is current through the latest supplement]

See *Capri v. L.A. Fitness Int., LLC* (2006) 136 C.A.4th 1078, 1085, 39 C.R.3d 425 [member's action against fitness club for injury caused by fall on club's pool deck was not barred by exculpatory clause in membership agreement, where member alleged that club violated statutes regulating swimming pools and that violation was cause of his fall; as such, release was invalid as falling within statutory prohibition against contractual exculpation for "violation of law"]; 2 California Affirmative Defenses §37:10 et seq.



51 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

K. Exemption From and Limitation of Liability.

1. In General.

c. Distinctions.

1 Witkin Sum. Cal. Law Contracts § 661

[§ 661] Distinctions.

Contractual exemption from liability or limitation of liability should be distinguished from the following:

(1) *Stipulations of Agreed Value of Goods*. These stipulations provide limits on the amount of damages recoverable by an owner or shipper. (See 57A *Am.Jur.2d* (2004 ed.) *Negligence* §49; 44 *Cal. L. Rev.* 123; 4 *Summary* (10th), *Sales*, §45.)

(2) *Penalties or Liquidated Damages*. (See 14 *Williston* 4th, §42:10; 5 *Stanf. L. Rev.* 824; *supra*, §503 et seq.)

(3) *Indemnity Provisions*. (See *Goldman v. Ecco-Phoenix Elec. Corp.* (1964) 62 *C.2d* 40, 48, 41 *C.R.* 73, 396 *P.2d* 377, 5 *Summary* (9th), *Torts*, §101; *John E. Branagh & Sons v. Witcosky* (1966) 242 *C.A.2d* 835, 838, 51 *C.R.* 844, citing the text; *Lemat Corp. v. American Basketball Assn.* (1975) 51 *C.A.3d* 267, 278, 124 *C.R.* 388; *State Farm Fire & Cas. Co. v. Eddy* (1990) 218 *C.A.3d* 958, 966, 267 *C.R.* 379, 2 *Summary* (10th), *Insurance*, §106; but see *infra*, §666 for statutes prohibiting indemnity.)

(4) *Risk-Shifting by Insurance*. (See *Franklin v. Marie Antoinette Condominium Owners Assn.* (1993) 19 *C.A.4th* 824, 832, 23 *C.R.2d* 744 [nonnegligent condominium association shifted risk of loss to condominium owner through insurance]; 29 *U.S.F. L. Rev.* 415 [*Franklin*].)

SUPPLEMENT: [This section is current through the latest supplement]

Correction: Page 738, line 2 of paragraph (3), "5 *Summary* (9th), *Torts*, §101" should be "5 *Summary* (10th), *Torts*, §125".



52 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

K. Exemption From and Limitation of Liability.

2. Invalid Provisions.

a. Areas Involving Public Interest.

1. Medicine

1 Witkin Sum. Cal. Law Contracts § 662

[§ 662] Medicine

The statutory policy against exemptions where the public interest is involved was emphatically restated in *Tunkl v. Regents of Univ. of Calif.* (1963) 60 C.2d 92, 32 C.R. 33, 383 P.2d 441. Plaintiff was accepted as a charity patient in defendant's nonprofit medical research center, on signing the required release of liability for negligent or wrongful acts or omissions of its employees if it used due care in their selection. He sued for injuries resulting from alleged negligence. *Held*, judgment for defendant reversed.

(a) An exculpatory provision in favor of a party whose business involves the public interest is void. And, although there is no precise test, the decisions indicate the characteristics of such a transaction: "It concerns a business of a type generally thought suitable for public regulation. The party seeking exculpation is engaged in performing a service of great importance to the public, which is often a matter of practical necessity for some members of the public. The party holds himself out as willing to perform this service for any member of the public who seeks it, or at least for any member coming within certain established standards. As a result of the essential nature of the service, in the economic setting of the transaction, the party invoking exculpation possesses a decisive advantage of bargaining strength against any member of the public who seeks his services. In exercising a superior bargaining power the party confronts the public with a standardized adhesion contract of exculpation, and makes no provision whereby a purchaser may pay additional reasonable fees and obtain protection against negligence. Finally, as a result of the transaction, the person or property of the purchaser is placed under the control of the seller, subject to the risk of carelessness by the seller or his agents." (60 C.2d 98.)

(b) A business meets the test if it has some of the characteristics; here it had all of them. In particular, defendant's center held itself out as an institution performing services for those members of the public who could qualify for them, and "[t]he admission room of a hospital contains no bargaining table where, as in a private business transaction, the parties can debate the terms of their contract." (60 C.2d 102.)

(c) "[T]he integrated and specialized society of today, structured upon mutual dependency, cannot rigidly narrow the concept of the public interest. Even if the hospital's doors are open only to those in a specialized category, the hospital cannot claim isolated immunity in the interdependent community of our time. It, too, is part of the social fabric,

and prearranged exculpation from its negligence must partly rend the pattern and necessarily affect the public interest." (60 C.2d 104.) (See *Belshaw v. Feinstein* (1968) 258 C.A.2d 711, 726, 65 C.R. 788 [release of surgeons and hospital, where surgeons were only ones in area capable of performing particular operations, invalid]; 57A Am.Jur.2d (2004 ed.), *Negligence* §§60, 61; 52 Cal. L. Rev. 350; 11 U.C.L.A. L. Rev. 639; 6 A.L.R.3d 704 [validity and construction of contractual provision exempting hospital or doctor from negligence to patient].)

The *Tunkl* test was applied in *Westlake Community Hosp. v. Superior Court* (1976) 17 C.3d 465, 131 C.R. 90, 551 P.2d 410. Defendant hospital's bylaws provided that a staff member waived the right of personal redress against the staff or board members for disciplinary action taken. Such a provision was upheld in early cases (see *Levy v. Magnolia Lodge*, No. 29 I.O.O.F. (1895) 110 C. 297, 309, 42 P. 887; *Robinson v. Templar Lodge*, No. 17, I.O.O.F. (1897) 117 C. 370, 374, 49 P. 170), but later decisions are contra: Insofar as the provision attempts to bar a claim based on intentional wrongdoing it violates C.C. 1668 (supra, §660); and as applied to nonwilful injuries, it is invalid where the public interest is involved:

"Under these guidelines, we do not doubt that the instant exculpatory clause cannot stand. Hospitals, both public and private, are of course subject to extensive public regulation and provide a service of great importance to both the public and to doctors seeking to use their facilities. Moreover, hospitals are required to establish reasonable, nonarbitrary membership standards. Such institutions certainly occupy a 'superior bargaining position' to an individual physician with respect to the granting or withholding of their own membership privileges. Finally, the exculpatory clause in question, incorporated into the hospital's bylaws, constitutes the epitome of an adhesive provision, offered to affected doctors strictly on a 'take it or leave it' basis." (17 C.3d 480.)

Levy and *Robinson*, supra, to the extent inconsistent, were overruled. (17 C.3d 481.)

In *Health Net of California v. Department of Health Services* (2003) 113 C.A.4th 224, 6 C.R.3d 235, plaintiff health plan provider contracted with defendant Department of Health Services (DHS) to be one of two health plans providing managed care services to Medi-Cal patients in a particular county. However, in violation of Welf.C. 14087.305(j) and its implementing regulations, defendant assigned all who failed to select a plan to the competing health plan. Plaintiff sued for damages, but the contract contained an exculpatory clause providing that any remedies for non-compliance with laws not expressly incorporated into the contract did not include money damages, but may include equitable remedies such as injunctive relief or specific performance. In granting summary judgment for defendant on the basis of this clause, the trial judge, on the ground that no public interest was involved, rejected the applicability of C.C. 1668. In reversing, the Court of Appeal made the following points:

(a) Because C.C. 1668 refers to any "violation of law," there is no reason why it should not be extended to cover regulatory violations. (113 C.A.4th 227.)

(b) Despite C.C. 1668, a contract exempting from liability for ordinary negligence is valid, where no public interest is involved. However, there can be no exemption from liability for violation of law, as in this case, regardless of whether the public interest is involved. (113 C.A.4th 234.)

(c) Here, the exculpatory clause, although invalid under C.C. 1668 even if it did not affect the public interest, did, in fact, affect such interest. The exculpatory clause affects the public interest under the six factors listed in *Tunkl* "because it deters, and makes more expensive, participation in a transaction which serves the public interest, which transaction is subject to public regulation, and which performs a service of 'practical necessity for some members of the public' ... managed care for Medi-Cal beneficiaries." (113 C.A.4th 238.)

(d) Defendant argued that, because the exculpatory clause excluded money damages but not equitable relief, and was thus a mere limitation of liability, rather than a complete exemption, it was not invalid under C.C. 1668. This contention is without merit. *Klein v. Asgrow Seed Co.* (1966) 246 C.A.2d 87, 54 C.R. 609, supra, §660, applied C.C. 1668 to invalidate a provision that limited liability. Moreover, here the limitation of liability, which applies to any

damages for any statutory violation, rises to the level of an exemption from responsibility within the meaning of the statute. *Farnham v. Superior Court* (1997) 60 C.A.4th 69, 70 C.R.2d 85, *infra*, §675, held that an exculpatory clause that left a "sole remedy" was not rendered invalid by C.C 1668, but that court ignored the *Klein* decision. Moreover, "*Farnham's* enforcement of a 'sole remedy' clause in the context of a common law tort claim in a transaction not affecting the public interest cannot guide our analysis of an exculpatory clause covering statutory and regulatory violations in a transaction affecting the public interest." (113 C.A.4th 241.)

West's Key Number Digest, Release k.4-

SUPPLEMENT: [This section is current through the latest supplement]



53 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
K. Exemption From and Limitation of Liability.
2. Invalid Provisions.
a. Areas Involving Public Interest.
2. Automobiles.

1 Witkin Sum. Cal. Law Contracts § 663

[§ 663] Automobiles.

In *Gardner v. Downtown Porsche Audi* (1986) 180 C.A.3d 713, 225 C.R. 757, plaintiff took his 1976 Porsche to be repaired at defendant's shop, and signed a form repair order with this disclaimer: "NOT RESPONSIBLE FOR LOSS OR DAMAGE TO CARS OR ARTICLES LEFT IN CARS IN CASE OF FIRE, THEFT OR ANY OTHER CAUSE BEYOND OUR CONTROL." While it was parked in the repair garage, the car was stolen as a result of defendant's negligence. Plaintiff sued defendant bailee for hire on its liability for failure to redeliver (see 13 *Summary* (10th), *Personal Property*, §186), and recovered judgment for \$ 16,000. The court said: "This case raises an issue common in daily life yet one which has received almost no attention in California appellate decisions. May an automobile repair garage avoid liability for its negligence by having car owners sign a waiver form when they leave their cars with the garage?" *Held*, judgment affirmed; the disclaimer was invalid.

(a) *Common law and statutory background.* The policy of the common law found expression in C.C. 1668, enacted in 1872. This section made it clear that a party could not contract away liability for negligent violations of *statutory law*, but it was less clear on violations of *common law* standards of care. "While acknowledging some conflict in the case, Witkin concludes California now follows the modern view of the Restatement of Contracts--'a contract exempting from liability for *ordinary* negligence is valid where *no public interest* is involved ... and no statute expressly prohibits it.' " (180 C.A.3d 716, quoting the text.)

(b) *Contract affecting public interest.* *Tunkl v. Regents of Univ. of Calif.* (1963) 60 C.2d 92, 32 C.R. 33, 383 P.2d 441, *supra*, §662, set forth six characteristics of contracts affecting the public interest, in which exculpatory clauses are invalid. (180 C.A.3d 716.) The court did not, however, indicate how many of these characteristics have to be satisfied--or which ones. (180 C.A.3d 717.)

(c) *Effect of Tunkl on prior decisions.* The *Tunkl* court noted the lack of uniformity in prior California opinions on the validity of these clauses, with authority on both sides as to many kinds of transactions. (180 C.A.3d 716, footnote 2.) "As a result, the pre-*Tunkl* decisions are of limited value in deciding whether and when exculpatory clauses are enforceable under *Civil Code* section 1668. If a certain specie of agreement fully satisfies the *Tunkl* characteristics, it 'affects the public interest' no matter how it may have been classified in earlier years. Thus, courts may well strike down

any exculpatory clauses in these agreements despite pre-*Tunkl* authority approving such clauses in this category of contract." (180 C.A.3d 717, footnote 2.)

(d) *All Tunkl criteria satisfied in automobile repair shops.*

First, the business is licensed and regulated. (B. & P.C. 9880 et seq.) (180 C.A.3d 717.)

Second, these shops perform a service of great importance to the public—one which is a necessity for nearly all members of the public. "[T]his element of the *Tunkl* test appears to boil down to the following question: Is the service merely an optional item consumers can do without if they don't want to waive their rights to recover for negligence or is it something they need enough so they have little choice if the provider attaches a liability disclaimer?" (180 C.A.3d 718.)

Third, defendant held itself out as willing to perform this important service for anyone owning an automobile of the type it was equipped to repair. (180 C.A.3d 718.)

Fourth, defendant possesses a decisive advantage of bargaining strength against a member of the public who seeks its services. (180 C.A.3d 719.)

Fifth, defendant confronts the public with a standardized adhesion contract of exculpation, incorporated in a printed form "repair order" which all customers are expected to sign. (180 C.A.3d 719.)

Sixth, plaintiff's car was placed under the control of defendant and thereby was subject to the risk of carelessness by defendant. (180 C.A.3d 713.)

(e) *U Drive case no longer authority. U Drive & Tour v. System Auto Parks* (1937) 28 C.A.2d Supp. 782, 71 P.2d 354, 13 Summary (10th), *Personal Property*, §186, a parking lot case, held that the lot owner could limit liability. (1) The case is distinguishable on its facts, for the disclaimer terminated the bailment after closing time, while here defendant's disclaimer covered negligence during the bailment. (2) The disclaimer in *U Drive* might not be lawful under the subsequently enacted C.C. 1630.5 (no exemption from liability for theft where keys required to be left in vehicle). (3) "[W]e expressly disapprove the appellate department opinion in *U Drive* at least to the extent it is interpreted to allow garages to exempt themselves from liability for negligent care of the vehicles entrusted to them." (180 C.A.3d 721.)

(f) *Extent of holding.* "Although this particular contract was construed to create a bailment, that is not critical to our holding. If the garage could be held liable for its negligence *under any theory* in the absence of an exculpatory clause it can be held liable for this negligence despite the clause. A garage's attempt to exempt itself from liability for its negligence in caring for cars entrusted to it is unlawful irrespective of whether the contract is a bailment or purports to create some other legal relationship." (180 C.A.3d 720, footnote 8.)

West's Key Number Digest, Automobiles k.368

SUPPLEMENT: [This section is current through the latest supplement]



54 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

K. Exemption From and Limitation of Liability.

2. Invalid Provisions.

a. Areas Involving Public Interest.

3. Employment.

1 Witkin Sum. Cal. Law Contracts § 664

[§ 664] Employment.

In *Baker Pac. Corp. v. Suttles* (1990) 220 C.A.3d 1148, 269 C.R. 709, plaintiff, a licensed asbestos abatement and remediation contractor, employed asbestos removal workers on a project-by-project basis, and defendants S and R had previously been so employed by plaintiff. In October, 1987, plaintiff contracted with Metropolitan for removal of asbestos from an office building. An express condition precedent to awarding the contract was the signing by plaintiff's employees of a comprehensive release form, under which the employees assumed all risks and released the owner from any liability except under applicable workers' compensation laws. Defendants refused to sign, and Metropolitan would not permit plaintiff to employ them. Plaintiff then brought an action for declaratory relief against defendants, contending that the release was a private voluntary transaction in which one party, for a consideration, agreed to shoulder a risk which the law would otherwise have placed upon the other party. The trial judge entered a declaratory judgment in favor of plaintiff, stating that the release was not void as against public policy or otherwise. *Held*, reversed.

(a) The broad terms of the release clearly covered fraud, wilful injury, or violation of law, and thus on its face violated C.C. 1668. Plaintiff's contention, accepted by the dissenting opinion, was that the requirement of signing would not be contrary to law because the release, as broadly interpreted, would be of no force and effect. But the workers were given the choice of adhering to its terms or foregoing gainful employment:

"This 'pistol to the head' approach of an employment relationship, where hiring is conditioned on acceptance of statutorily proscribed terms ... has potential for bringing serious mischief to the work place. We cannot expect workers generally to be cognizant of judicial decisions concerning the interpretation of exculpatory provisions within releases. We reject the concept that a worker, compelled by economic necessity to secure employment, can be thus coerced into signing sweeping agreements exculpating various responsible entities from *all* aspects of tort liability in the uninformed hope that the agreement will not be enforced by the courts. We foresee situations where the uninformed releasing employee will forego legitimate claims rather than assume the risk of expensive, time-consuming litigation for an uncertain result." (220 C.A.3d 1155.)

(b) Forms of release in common use containing "any and all" language are designed for the settlement of cases at the conclusion of an adversarial relationship as an accord and satisfaction. They are not appropriate as conditions of

employment tendered to prospective employees. (220 C.A.3d 1157.)

SUPPLEMENT: [This section is current through the latest supplement]



55 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

K. Exemption From and Limitation of Liability.

2. Invalid Provisions.

a. Areas Involving Public Interest.

4. Other Areas.

1 *Witkin Sum. Cal. Law Contracts* § 665

[§ 665] Other Areas.

In *Simmons v. Bank of America* (1958) 159 C.A.2d 566, 570, 323 P.2d 1043, an exculpatory clause in an escrow holder's contract was upheld. However, in *Akin v. Business Title Corp.* (1968) 264 C.A.2d 153, 70 C.R. 287, the court held that *Tunkl v. Regents of Univ. of Calif.* (1963) 60 C.2d 92, 32 C.R. 33, 383 P.2d 441, supra, §662, had removed the basis for the *Simmons* holding. The *Tunkl* criteria were applied as follows: (1) The escrow business is regulated (*Fin.C. 17200* et seq.). (2) The escrow company performs an important public service. (3) The company has a decisive advantage in bargaining, presenting a "standardized adhesion contract of exculpation," and giving the customer no opportunity to pay an additional fee for protection against negligence. (4) The transaction places the individuals under the control of the company and subject to the risk of its carelessness. (264 C.A.2d 156, 157; cf. *Rooz v. Kimmel* (1997) 55 C.A.4th 573, 587, 64 C.R.2d 177 [*Akin v. Business Title Corp.*, supra, did not hold that *all* transactions conducted by title companies necessarily affect public interest; hold-harmless agreement absolving title company of liability for negligence in accommodation recording of deed of trust was enforceable].)

In *Pelletier v. Alameda Yacht Harbor* (1986) 188 C.A.3d 1551, 230 C.R. 253, plaintiff signed an agreement with defendant for lease of a covered berth for a boat which he intended to restore. The boat sank at its berth on two occasions, and plaintiff sued for negligence, alleging that the sinkings were caused by vandalism made possible by inadequate harbor security. Defendant relied on the exculpation clause in the lease, stating that the space was to be used at the sole risk of the boat owner, and that defendant was not responsible for its care or protection or liable for loss or damage. *Held*, judgment for defendant reversed.

(a) The transaction came within all six of the guidelines established in *Tunkl* (188 C.A.3d 1555):

(1) The business was subject to public regulation under the Harbors and Navigation Code.

(2) The defendant was performing a service of great importance to the public: "For persons with boats, the availability of berths in harbors is a matter of practical necessity."

(3) Defendant held itself out as willing to perform the service for any member of the public who seeks it.

(4) Defendant had a decisive advantage of bargaining strength; a 42-foot berth was not easily obtainable.

(5) The agreement was a standardized adhesion contract, giving plaintiff no opportunity to obtain protection against negligence by paying an additional sum.

(6) Plaintiff's property was placed under the control of defendant.

(b) Defendant's contention that C.C. 1668 permits exemption from liability for *passive* negligence is untenable: "*Tunkl* establishes that *any* exculpation provision is invalid if it involves the public interest; the court did not recognize an exception for exemptions from liability for passive negligence." (188 C.A.3d 1557.)

In *Blankenheim v. E.F. Hutton & Co.* (1990) 217 C.A.3d 1463, 266 C.R. 593, the action was based on negligent misrepresentation by a stockbrokerage firm and several agreements contained hold-harmless clauses. *Held*, the agreements were invalid. (217 C.A.3d 1471.) The court said: "[A] contract which exempts a party from liability for his own positive assertions, made in a manner not warranted by the information, which are untrue, is against the policy of the law." (217 C.A.3d 1473.) (See *Henriouille v. Marin Ventures* (1978) 20 C.3d 512, 518, 143 C.R. 247, 573 P.2d 465, 4 Summary (10th), *Real Property*, §567 [exculpatory clause in residential lease invalid]; *Vilner v. Crocker Nat. Bank* (1979) 89 C.A.3d 732, 736, 152 C.R. 850 [exculpatory clause in night depository agreement (bailment)]; *Cohen v. Kite Hill Community Assn.* (1983) 142 C.A.3d 642, 654, 655, 191 C.R. 209 [exculpatory clause in homeowners association declaration no bar to suit by member against association for breach of fiduciary duty]; *Salton Bay Marina v. Imperial Irr. Dist.* (1985) 172 C.A.3d 914, 939, 218 C.R. 839 [agreements purporting to discharge water district from liability for damages or injury caused by flooding]; *Gavin W. v. YMCA of Metropolitan Los Angeles* (2003) 106 C.A.4th 662, 670, 131 C.R.2d 168 [release of child care services provider was void as against public policy]; *Sweat v. Big Time Auto Racing* (2004) 117 C.A.4th 1301, 1308, 12 C.R.3d 678 [release signed by speedway observer did not extend to collapse of pit-area bleaches; bleacher collapse was not hazard related to automobile race and its observation]; 69 A.L.R.3d 1025 [contract exempting agricultural fair or similar bailee from liability for articles delivered for exhibition]; on validity of provision releasing school from liability for injuries to students caused by interscholastic and other extracurricular activities], see 85 A.L.R.4th 344; on rule prohibiting attorney from limiting liability for malpractice, see 1 Cal. Proc. (4th), *Attorneys*, §333.)

SUPPLEMENT: [This section is current through the latest supplement]

Prohibition against limiting attorney liability for malpractice: Cross-Reference: 1 Cal. Proc. (5th), *Attorneys*, §307.



56 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

K. Exemption From and Limitation of Liability.

2. Invalid Provisions.

b. Construction and Trucking Indemnity Contracts.

1. Statutory Prohibitions.

1 Witkin Sum. Cal. Law Contracts § 666

[§ 666] Statutory Prohibitions.

(1) *Construction Indemnity Contracts*. Because an indemnity agreement is merely an allocation of liability, it does not violate C.C. 1668 (see *supra*, §661), and it has been frequently used in construction contracts. The typical provision is one in which the general contractor, as promisor, agrees to hold others harmless for their own negligence. (See C.E.B., 2 *Construction Contracts & Disputes* 3d, §9.54 et seq.)

However, the Legislature has prohibited indemnity agreements in several situations involving construction contracts. For example, C.C. 2782(a) states that provisions in *any construction contract* "which purport to indemnify the promisee against liability for damages for death or bodily injury to persons, injury to property, or any other loss, damage or expense arising from the sole negligence or willful misconduct of the promisee or the promisee's agents, servants or independent contractors who are directly responsible to such promisee, or for defects in design furnished by such persons, are against public policy and are void and unenforceable." (See *Whitmire v. H.K. Ferguson Co. (1968) 261 C.A.2d 594, 602, 68 C.R. 78* [statute not applicable retroactively]; 3 *Lincoln L. Rev.* 54; on definition of "design defect," see C.C. 2784.) C.C. 2782(b) bars provisions in *construction contracts with public agencies* that would relieve the agency from liability for its own *active negligence*. (See *Ins.C. 11580.04* [additional insured endorsement for benefit of public agency may not provide any duty of indemnity coverage for active negligence of additional insured in any case where agreement to indemnify additional insured would be invalid under C.C. 2782(b).] And *B. & P.C. 7034(a)* prohibits contractors who are required to be licensed from (1) inserting in any contract, or (2) being a party with a licensed subcontractor to any contract containing a provision in violation of C.C. 2782. (See 8 *Pacific L. J.* 209.)

In *Southern Pac. Trans. Co. v. Sandyland Protective Assn. (1990) 224 C.A.3d 1494, 274 C.R. 626*, Sandyland, a homeowners association, made an agreement with Southern Pacific railroad, under which the association would construct and maintain a roadway across the railroad's tracks to give its members access to their property. The agreement contained a clause requiring the association to indemnify Southern Pacific for any liability arising from construction or use of the roadway. Two persons injured when their car was hit by a train sued Southern Pacific, and Southern Pacific cross-complained against Sandyland for indemnity. *Held*, summary judgment for Sandyland affirmed.

(a) Southern Pacific contended that C.C. 2782(a) covers only agreements that have construction and maintenance as

their primary purpose, and that in the crossing agreement, construction and maintenance were "merely incidental terms." Nothing in the statute supports this interpretation; moreover, even accepting the interpretation, construction and maintenance of the road were among the "primary purposes" of the contract. (224 C.A.3d 1497, 1498.)

(b) Southern Pacific further argued that because the statute only proscribes indemnity for "the sole negligence" of the promisee, the indemnity clause is enforceable because the plaintiffs in the underlying tort action were concurrently negligent. This is unsound: "[W]e construe the phrase 'sole negligence ... of the promisee' to mean that as between the promisee and the promisor, the promisee was solely negligent. Therefore, absent negligence on the part of the association, a party to the agreement, the negligence, if any, of the plaintiffs, who are third parties, is immaterial. That the plaintiffs may have been members of the association is also immaterial. The association is a corporation. The railroad cites no authority for imputing the negligence of a member to the association." (224 C.A.3d 1498.)

(2) *Trucking Indemnity Contracts*. C.C. 2784.5 states a similar prohibition against indemnity provisions in a *hauling, trucking, or cartage contract*: The promisor cannot contract to hold the promisee harmless for negligence of the promisee or his or her employees except when they are under the direct control of the promisor. (See 3 *Lincoln L. Rev.* 53.)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Construction Indemnity Contracts*. See C.C. 2782.8, added in 2006 [in contracts for design professional services that are entered into on or after January 1, 2007, provisions indemnifying public agency against liability for claims against it are unenforceable, except for claims that arise out of negligence, recklessness, or wilful misconduct of design professional].

The portion of C.C. 2782(a) quoted in the text was amended in 2005 without substantive change.

See C.E.B., 2 *Construction Contracts, Defects, and Litigation*, §12.58 et seq. (replacing C.E.B., *Construction Contracts and Disputes* 3d).

(*New*) *Applicability to insurance contracts*: C.C. 2782 does not affect the validity of an insurance contract. (C.C. 2782(a).) Hence, a provision in a liability insurance policy providing coverage to an additional insured will not be deemed contrary to public policy or unenforceable merely because the additional insured incurred claim liability due to its "sole negligence" within the meaning of C.C. 2782. (*American Cas. Co. of Reading, PA. v. General Star Indem. Co.* (2005) 125 C.A.4th 1510, 1524, 24 C.R.3d 34.)



57 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
K. Exemption From and Limitation of Liability.
2. Invalid Provisions.
b. Construction and Trucking Indemnity Contracts.
2. Exceptions.

1 Witkin Sum. Cal. Law Contracts § 667

[§ 667] Exceptions.

The prohibitions stated in C.C. 2782 (supra, §666) are subject to the following exceptions:

(1) Agreements by which the contractor fully indemnifies a landowner or lessee who allows the contractor to enter his or her land to perform construction work for a third party. (C.C. 2782.1.)

(2) Agreements by which a self-insured owner of a plant or facility having a net worth exceeding \$ 10 million indemnifies a professional engineer, his or her agents or employees, against liability in providing inspection services. (C.C. 2782.2(a).) However, indemnification is permitted only for liability in excess of \$ 250,000 (C.C. 2782.2(a)(5)), and is not allowed for "*wilful misconduct*" (C.C. 2782.2(b)).

(3) Express agreements negotiated between owner and contractor allocating or limiting between the parties "liability (a) for design defects, or (b) of the promisee to the promisor" arising from the construction contract. (C.C. 2782.5; see *Markborough Calif. v. Superior Court* (1991) 227 C.A.3d 705, 277 C.R. 919, *infra*, §677; 12 *Pacific L. J.* 598.)

(4) Agreements to indemnify a professional engineer or geologist from liability in providing services relating to hazardous materials, if the services address subterranean contamination or other concealed conditions caused by these materials, and the promisor is at least potentially responsible for all or part of the contamination. (C.C. 2782.6.)

West's Key Number Digest, Indemnity k.3

SUPPLEMENT: [This section is current through the latest supplement]



58 of 75 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

K. Exemption From and Limitation of Liability.

2. Invalid Provisions.

c. Residential Leases.

1. Former Law: Exemption Upheld.

1 Witkin Sum. Cal. Law Contracts § 668

[§ 668] Former Law: Exemption Upheld.

In *Inglis v. Garland* (1936) 19 C.A.2d Supp. 767, 64 P.2d 501, plaintiff tenant sued defendant landlord for damages resulting from negligent maintenance of a part of the premises retained by the landlord, for which negligence the landlord would ordinarily be liable. But the lease provided that the tenant "shall not make any claim against Landlord for any injury, loss or damage to person or property occurring therein from any cause." *Held*, this clause exempted the landlord from liability, and, being a matter of *private contract* with which the general public was not concerned, it was valid. (19 C.A.2d Supp. 771.) (See *Mills v. Ruppert* (1959) 167 C.A.2d 58, 63, 333 P.2d 818 [quoting Corbin: "a landlord may contract so as to be bound to pay for repairs and yet exempt himself from liability for consequential injuries caused by his failure to perform his contractual duty"]; 15 Corbin (Rev. ed.), §85.18; 11 So. Cal. L. Rev. 296; on lease provisions, see 12 A.L.R.3d 958 [effect on nonsigner]; 14 A.L.R.3d 446 [railroad company's lease]; 15 A.L.R.3d 786 [liability for fire].)

SUPPLEMENT: [This section is current through the latest supplement]



59 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

K. Exemption From and Limitation of Liability.

2. Invalid Provisions.

c. Residential Leases.

2. Exemption Limited to Passive Negligence.

1 Witkin Sum. Cal. Law Contracts § 669

[§ 669] Exemption Limited to Passive Negligence.

The exemption clause is sometimes found inapplicable by strict construction (see *infra*, §673); and this approach was used in *Barkett v. Brucato* (1953) 122 C.A.2d 264, 264 P.2d 978, upholding a judgment for damages for wrongful eviction. Defendant relied on the clause under which the lessee agreed that "the lessor shall not be liable for damages or injury to any person, personal property, or effects in said premises from any cause whatever." But the lessor had intentionally undertaken extensive construction, including removal of the roof of a dwelling, during the rainy season. The court explained the decisions upholding exemption clauses as follows:

"These cases hold that the matter is simply one of interpreting a contract; that both parties are free to contract; that the relationship of landlord and tenant does not affect the public interest; that such a provision affects only the private affairs of the parties. They hold that such a clause will exempt the landlord from liability for injuries to the tenant caused by the negligence of the landlord and prevents the landlord from being held for a breach of the covenant of quiet enjoyment based on such negligent acts. These California cases exempting the landlord from liability all deal with what might be called passive negligence. They usually involve injuries caused by some piece of equipment or machinery inherently defective leased or loaned to the tenant by the landlord, or injuries caused by the elements not aggravated by the landlord, or injuries caused by the negligence of other tenants or individuals for whose acts the landlord might otherwise be liable." (122 C.A.2d 276.)

However, "[t]here is a marked tendency in the more recent cases involving the landlord and tenant relationship to hold that by such clauses the parties could not have intended to provide that the landlord should not be liable for acts amounting to active and affirmative negligence, and to limit such clauses to injuries caused by defects resulting from wear or tear, inherent defects, the elements, and not actively aggravated by the landlord, or to injuries caused by other tenants. In other words, these cases hold, based on the presumed intent of the parties, that such general clauses were never intended to immunize the landlord from responsibility for his acts of affirmative negligence. ... California has definitely aligned itself with this school of thought." (122 C.A.2d 278.)

SUPPLEMENT: [This section is current through the latest supplement]



60 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

K. Exemption From and Limitation of Liability.

2. Invalid Provisions.
- c. Residential Leases.
3. Exemption Rejected.

1 Witkin Sum. Cal. Law Contracts § 670

[§ 670] Exemption Rejected.

In *Henriouille v. Marin Ventures* (1978) 20 C.3d 512, 143 C.R. 247, 573 P.2d 465, plaintiff, an unemployed widower with two children, was receiving public assistance in the form of a rent subsidy. He signed a printed residential lease form for an apartment. The lease contained a clause providing that the lessor would not be liable for any injury to the tenant occurring on the premises. Plaintiff was injured when he tripped on a rock on a common stairway. The jury found that the injury was proximately caused by defendant lessor's negligence; that plaintiff's damages was \$ 5,000; that plaintiff had been contributorily negligent; that the relative fault was plaintiff, 30% and defendant, 70%. Verdict was accordingly entered for \$ 3,500, but defendant's motion for judgment notwithstanding the verdict was granted on the ground that the exculpatory clause relieved it of liability. *Held*, reversed.

(a) All criteria specified in *Tunkl v. Regents of Univ. of Calif.* (1963) 60 C.2d 92, 32 C.R. 33, 383 P.2d 441, *supra*, §662, were met. (1) Housing and residential leases are increasingly the subject of governmental regulation. (2) A lessor of residential property provides shelter, a basic necessity of life. (3) The lessor offered to rent its units to all members of the public. (4) Unequal bargaining strength was present; there is a severe shortage of low-cost housing. (5) No provision was made for payment of an additional sum to obtain protection against negligence. (6) Plaintiff was exposed to the risk of injury through defendant's carelessness. (20 C.3d 518, 519.)

(b) *Tunkl* cites language in *Barkett v. Brucato* (1953) 122 C.A.2d 264, 264 P.2d 978, *supra*, §669, to the effect that the relationship of landlord and tenant does not affect the public interest. However: (1) This was merely given as an example of the inquiry by courts into the question of public interest; the statement did not indorse the result reached in applying the test. (2) And, "even if at the time of *Barkett* and the earlier decisions cited therein, a residential lease may have been correctly characterized as not involving the public interest, for the reasons stated above this court is convinced this is not true today." (20 C.3d 519.)

(c) An increasing number of jurisdictions hold that exculpatory clauses in residential leases violate public policy. (20 C.3d 519.)

(d) C.C. 1953, enacted in 1975, declares exculpatory clauses invalid as to leases executed on or after January 1,

1976. However, nothing in the legislative history suggests that the Legislature intended to sanction these clauses in leases executed before that date; hence, they are governed by the common law principles discussed above. (20 C.3d 520, 521.)

C.C. 1953, mentioned in *Henriouille* states that "[a]ny provision of a lease or rental agreement of a dwelling by which the lessee agrees to modify or waive any of the following rights" is void as contrary to public policy. (See 12 *Summary* (10th), *Real Property*, §567.) Among these rights is: "(5) His right to have the landlord exercise a duty of care to prevent personal injury or personal property damage where that duty is imposed by law."

SUPPLEMENT: [This section is current through the latest supplement]



61 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
K. Exemption From and Limitation of Liability.
3. Valid Exemption Where No Public Interest Involved.
a. In General.
1. Valid Despite C.C. 1668.

1 Witkin Sum. Cal. Law Contracts § 671

[§ 671] Valid Despite C.C. 1668.

Despite the language of C.C. 1668 (*supra*, §660), contracts exempting from liability for ordinary negligence are valid where the public interest is not involved. (See *Stephens v. Southern Pac. Co.* (1895) 109 C. 86, 88, 41 P. 783; *Inglis v. Garland* (1936) 19 C.A.2d Supp. 767, 773, 64 P.2d 501, *supra*, §668; *Nichols v. Hitchcock Motor Co.* (1937) 22 C.A.2d 151, 156, 70 P.2d 654; *Werner v. Knoll* (1948) 89 C.A.2d 474, 475, 201 P.2d 45; *Delta Air Lines v. Douglas Aircraft Co.* (1965) 238 C.A.2d 95, 100, 47 C.R. 518; *Cregg v. Ministor Ventures* (1983) 148 C.A.3d 1107, 1111, 196 C.R. 724 [lease of storage space for personal and household goods; broad exculpatory clause and plaintiff advised of option to obtain insurance at low premium]; *McAtee v. Newhall Land & Farming Co.* (1985) 169 C.A.3d 1031, 1034, 216 C.R. 465 [motorcycle race]; *Okura v. United States Cycling Federation* (1986) 186 C.A.3d 1462, 1468, 231 C.R. 429 [bicycle race]; *Philippine Airlines v. McDonnell Douglas Corp.* (1987) 189 C.A.3d 234, 240, 234 C.R. 423 [limitation of liability clause precluded airline from recovering indemnity from airplane manufacturer for loss sustained when passengers were injured due to manufacturer's negligence; clause was bargained for and insurable shift of risk of economic loss in commercial setting]; *Powers v. Superior Court* (1987) 196 C.A.3d 318, 321, 242 C.R. 55 [clear, legible releases need not be denied effect merely because they appear in multiple documents containing somewhat different exculpatory clauses]; *Buchan v. United States Cycling Federation* (1991) 227 C.A.3d 134, 149, 277 C.R. 887 [release of international bicycle racing federation]; *Guido v. Koopman* (1991) 1 C.A.4th 837, 842, 2 C.R.2d 437 [horseback riding]; *McCarn v. Pacific Bell Directory* (1992) 3 C.A.4th 173, 181, 4 C.R.2d 109, citing the text, [contract to advertise in telephone directory; exculpatory provision could be eliminated by paying extra charge]; *Randas v. YMCA of Metropolitan Los Angeles* (1993) 17 C.A.4th 158, 161, 21 C.R.2d 245 [swimming at public pool]; *Westlye v. Look Sports* (1993) 17 C.A.4th 1715, 1733, 22 C.R.2d 781 [lessor of skiing equipment; courts have consistently declined to apply *Tunkl v. Regents of Univ. of Calif.* (1963) 60 C.2d 92, 32 C.R. 33, 383 P.2d 441, *supra*, §662, to invalidate exculpatory agreements in recreational sports context]; *Paralift v. Superior Court* (1993) 23 C.A.4th 748, 754, 29 C.R.2d 177 [parachuting activities]; *Allabach v. Santa Clara County Fair Assn.* (1996) 46 C.A.4th 1007, 1013, 54 C.R.2d 330 [observing automobile race from restricted area]; *Olsen v. Breeze* (1996) 48 C.A.4th 608, 55 C.R.2d 818, 13 *Summary* (10th), *Equity*, §123 [releases from liability required as condition for purchasing, renting, or obtaining service on ski bindings]; *YMCA of Metropolitan Los Angeles v. Superior Court* (1997) 55 C.A.4th 22, 27, 63 C.R.2d 612 [release of YMCA from negligence liability arising from use of premises, facilities, or equipment, in return for right to

participate in senior program, was voluntary and did not violate public policy]; *Sanchez v. Bally's Total Fitness Corp.* (1998) 68 C.A.4th 62, 65, 79 C.R.2d 902 [release of health club from liability for injuries sustained by members' use of club facilities was valid, even though release clause did not include term "negligence"]; *Lund v. Bally's Aerobic Plus* (2000) 78 C.A.4th 733, 737, 93 C.R.2d 169 [waiver and release form included in signed membership contract with health club precluded suit for injuries sustained while using club's weight lifting equipment under supervision]; *Solis v. Kirkwood Resort Co.* (2001) 94 C.A.4th 354, 360, 114 C.R.2d 265 [whether release contained in season pass allowing use of defendant's facilities Monday through Friday applied to accident occurring on Sunday, which was covered by separate pass containing no release, was triable factual issue; distinguishing *Paralift* and *Lund*]; *Platzer v. Mammoth Mountain Ski Area* (2002) 104 C.A.4th 1253, 1258, 128 C.R.2d 885 [release absolved ski resort from liability for ordinary negligence; courts have consistently declined to apply *Tunkl* in recreational sports context]; *Benedek v. PLC Santa Monica LLC* (2002) 104 C.A.4th 1351, 1356, 129 C.R.2d 197 [health club member could not recover from club for injuries suffered in moving TV set, where he had signed form releasing club from liability for all injuries "whether using exercise equipment or not"; criticizing *Leon v. Family Fitness Center No. 107* (1998) 61 C.A.4th 1227, 71 C.R.2d 923, *infra*, §673]; 5 Corbin (Rev. ed.), §85.18; 57A Am.Jur.2d (2004 ed.), *Negligence* §45; 24 Cal. Western L. Rev. 127 [risk release in high-risk sports]; 1 A.L.R.2d 1155 [stipulation relieving bank from stop-payment order]; on exemption of operator of amusement facility, see 54 A.L.R.5th 513.)

West's Key Number Digest, Contracts k.114

SUPPLEMENT: [This section is current through the latest supplement]



62 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

K. Exemption From and Limitation of Liability.

3. Valid Exemption Where No Public Interest Involved.

a. In General.

1a. (New) Distinction: "Any Negligent Act" Does Not Include Gross Negligence.

1 Witkin Sum. Cal. Law Contracts § 671A

[§ 671A] (New) Distinction: "Any Negligent Act" Does Not Include Gross Negligence.

In *Santa Barbara v. Superior Court* (2007) 41 C.4th 747, 62 C.R.3d 527, 161 P.3d 1095, plaintiffs, the parents of a 14-year-old developmentally disabled child who drowned while participating in a city's recreational program for disabled children, brought a wrongful death action against defendants city and M, a program counselor. Plaintiff mother had signed an application form releasing defendant city and its employees from liability for "any negligent act." Upon being informed that decedent child was prone to epileptic seizures, often occurring in water, and that she needed supervision while swimming, defendant city assigned defendant M to act as a counselor with the responsibility to keep decedent under close observation during the camp's swimming sessions. While decedent was involved in diving and swimming to the pool's edge, she had a mild seizure, but after 45 minutes was allowed to resume diving. When decedent was swimming back to the pool's edge, defendant M looked away for about 15 seconds, and during that time decedent disappeared from sight. After a search of 2 to 5 minutes, which was made more difficult by the presence of approximately 300 nonprogram children, the pool was evacuated, and decedent was found on the bottom. After plaintiffs filed their wrongful death action, defendants, relying upon the release, moved unsuccessfully for summary judgment. Defendants then filed a petition for mandamus, but the Court of Appeal denied the petition, holding that, although the release was effective insofar as it concerned defendants' liability for future *ordinary* negligence, it was unenforceable insofar as it purported to constitute a release of liability for future *gross* negligence. Addressing only the question whether a release of liability relating to recreational activities generally is effective as to gross negligence, the Supreme Court granted review. *Held*, affirmed.

(a) C.C. 1668 (text, §660), which invalidates most exculpatory clauses, reflects the traditional skepticism concerning agreements designed to release liability for future torts. With respect to negligence, *Tunkl v. Regents of Univ. of Calif.* (1963) 60 C.2d 92, 32 C.R. 33, 383 P.2d 441, text, §662, held that under C.C. 1668 an exculpatory provision involving ordinary negligence is enforceable, but only if it does not involve and impair the public interest. Accordingly, many decisions have invalidated releases of liability for future ordinary negligence under the public interest analysis set forth in *Tunkl*, while many other decisions, especially those involving sports and recreation, have upheld similar releases on the ground that they did not affect the public interest. (41 C.4th 754.)

(b) No California case has considered an agreement purporting to release liability for future gross negligence.

However, the vast majority of out-of-state decisions hold that these agreements are void on the ground that public policy precludes enforcement of a release that would shelter aggravated misconduct. "The reasoning of the ... out-of-state decisions ... is based upon a public policy analysis that is different from the 'public interest' factors considered under *Tunkl* ... *Tunkl*'s public interest analysis focuses upon the overall transaction--with special emphasis upon the importance of the underlying service or program, and the relative bargaining relationship of the parties--in order to determine whether an agreement releasing future liability for *ordinary* negligence is unenforceable. By contrast, the out-of-state cases ... focus ... upon the degree or extent of the misconduct at issue," as well as on the public policy against sheltering aggravated misconduct. (41 C.4th 762.)

(c) Because C.C. 1668 does not list gross negligence as one of the types of liability that may not be released, defendants argued that it thus represents an implied legislative determination to allow releases of liability for gross negligence, as long as the release does not affect the public interest under the principles of *Tunkl*. However, C.C. 1668 has not been interpreted to authorize all releases that are not expressly invalidated. Indeed, *Tunkl* itself went beyond the language of C.C. 1668 to invalidate releases of liability for negligence under certain circumstances. "Accordingly, we reject defendants' argument that, by enacting section 1668 more than 130 years ago, our Legislature established a policy generally *allowing* releases of liability for future gross negligence, and hence a policy precluding this court from adopting, on public policy grounds, the opposite--and clearly majority--rule." (41 C.4th 763.)

(d) Also rejected is defendants' argument that courts may not recognize or employ, as a basis for invalidating a release, any public policy rationale different from that set out in *Tunkl*. Nothing in *Tunkl* is inconsistent with the public-policy-based majority rule employed by other jurisdictions. Nor can *Tunkl* reasonably be read to stand for the proposition that, assuming that public interest factors do not preclude enforcement of an agreement releasing liability for future *ordinary* negligence, the same agreement also should be construed to release liability for future gross negligence. (41 C.4th 762.)

(e) Many out-of-state decisions supporting the proposition that liability for future gross negligence cannot be released arise in jurisdictions that define this form of negligence not as California does, i.e., as either (1) a failure to exercise even slight care or (2) an extreme departure from the ordinary standard of conduct, but instead define that term as conduct tantamount to wanton, reckless, or wilful misconduct. However, even if some decisions arguably are distinguishable on that basis, other out-of-state authority is not so readily distinguishable. For example, Washington, Massachusetts, and Nebraska, all of which view gross negligence consistently with the California definition, refuse to permit the release of liability for this type of negligence. (41 C.4th 764.)

(f) Defendants argued that unless providers of recreational services and related programs can be assured that agreements purporting to release liability for future gross negligence will be enforced, (1) subsequent suits against recreational service providers will not be readily resolvable in favor of defendants on summary judgment, with the result that unwarranted liability will be threatened or imposed, and (2) service providers will react by greatly restricting these services or programs in California. However, the California definition of gross negligence has long been employed in numerous cases applying statutes conferring limited immunity for ordinary negligence while expressly denying immunity for gross negligence, and, in light of the experience under these statutes, it does not appear that the application of the California gross negligence standard tends to impair the summary judgment process or confuse juries and lead to judgments erroneously imposing liability. Moreover, defendants offered no evidence supporting their assertion that unless recreation service providers can dependably enforce agreements to release liability for both future ordinary negligence and future gross negligence, the inevitable result will be fewer and more expensive programs. Indeed, defendants offered no empirical evidence indicating that this dire prediction has occurred either in states refusing to enforce agreements releasing liability for future gross negligence or in states refusing to enforce agreements releasing liability for future ordinary negligence. (41 C.4th 765.)

(g) The distinction between ordinary and gross negligence reflects a rule of policy that harsher legal consequences should flow when negligence is aggravated instead of merely ordinary. Therefore, "we hold that an agreement purporting to release liability for future gross negligence committed against a developmentally disabled child who

participates in a recreational camp designed for the needs of such children violates public policy and is unenforceable." Parties believing that the viability of their particular industry rests upon the ability to secure valid releases of liability for future gross negligence should petition the *Legislature*. (41 C.4th 776.)

A concurring and dissenting opinion, with one justice concurring, agreed that the release of liability at issue is unenforceable as to gross negligence, but argued that, as with ordinary negligence, this conclusion should have been reached by analyzing the *Tunkl* factors, instead of by relying on the public policy of discouraging aggravated misconduct. (41 C.4th 782.) A dissenting opinion asserted that, under C.C. 1668, a full release of negligence, which includes gross negligence, is enforceable. (41 C.4th 787.)

SUPPLEMENT: [This section is current through the latest supplement]



63 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

K. Exemption From and Limitation of Liability.

3. Valid Exemption Where No Public Interest Involved.

a. In General.

2. Meaning of Term "Negligent" in C.C. 1668.

1 Witkin Sum. Cal. Law Contracts § 672

[§ 672] Meaning of Term "Negligent" in C.C. 1668.

In *Werner v. Knoll* (1948) 89 C.A.2d 474, 475, 201 P.2d 45, defendant lessor leased farm land and a tractor, and plaintiff lessee's son was killed as a result of a latent defect in the tractor known to defendant. The special defense based on a clause exempting the lessor from liability for "personal injuries" from "any cause" was upheld, the court saying: "Clearly said section 1668 does not declare unlawful all contracts, the object of which is to exempt individuals from the consequence of their own acts, but only those contracts which would exempt one from the consequence of his own fraud, willful injury or violation of law whether willful or negligent. It is noteworthy that the only use of the word negligent in said section is in a restrictive sense and only in connection with violations of law. Therefore it necessarily follows, that by the obvious omission from the provisions of said *section 1667 of the Civil Code*, contracts seeking to relieve individuals from the results of their own negligence are not invalid as against the policy of the law as therein provided, and hence are neither contrary to public policy nor expressed provision of the law as set forth in said section 1667." (89 C.A.2d 475.) Apart from the debatable interpretation of "violation of law" as limited strictly to violation of *statutes*, the explanation appears to make an unsatisfactory distinction between (1) valid exemptions from liability for injury or death resulting from types of ordinary or gross negligence not expressed in statutes, and (2) invalid exemptions where the negligence consists of violation of one of the many hundreds of statutory provisions setting forth standards of care.

SUPPLEMENT: [This section is current through the latest supplement]



64 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

K. Exemption From and Limitation of Liability.

3. Valid Exemption Where No Public Interest Involved.

a. In General.

3. Exemption Strictly Construed.

1 Witkin Sum. Cal. Law Contracts § 673

[§ 673] Exemption Strictly Construed.

A number of cases have indirectly limited the right to contract for exemption from liability by strict construction of the provision.

In *Butt v. Bertola* (1952) 110 C.A.2d 128, 242 P.2d 32, a lease of a ground-floor restaurant provided that the lessor "shall not be liable for damages to any goods, property, or effects in or upon said demised premises, caused by gas, water, or other fluid from any source whatsoever." The plumbing system, under the lessor's control, leaked and contaminated the premises. *Held*, plaintiff was entitled to recover damages for eviction. The exemption clause would have been a defense against a claim of ordinary negligence (see *Inglis v. Garland* (1936) 19 C.A.2d Supp. 767, 773, 64 P.2d 501, *supra*, §668; *Werner v. Knoll* (1948) 89 C.A.2d 474, 475, 201 P.2d 45, *supra*, §672); but here the object sought was "exemption of the defendants from responsibility for their own misconduct in knowingly maintaining defective sewerage facilities and in taking patently inadequate measures for the repair of those facilities, with knowledge of the injuries to plaintiff's property which would ensue." (110 C.A.2d 138.)

In *Celli v. Sports Car Club of America* (1972) 29 C.A.3d 511, 105 C.R. 904, defendants, operators of track facilities, sponsored an automobile race. Spectators who purchased general admission tickets were located in the protected grandstand and infield area, but those who purchased special pit passes were allowed in the paddock and pit areas, with no protection except a row of parked automobiles. Defendants were aware of accidents resulting from cars going out of control, and C, the particular driver involved in the present accident, had already had four spins and a crash. Nevertheless, defendants, with authority to disqualify contestants lacking skill, did not disqualify C; and, with knowledge of safety precautions used on other tracks (e.g., ditch, pit wall, strong barriers), did not employ them. While making a practice run C's vehicle went out of control, killing C and injuring plaintiffs in the pit. The principal defense was a release agreement in the pit passes. *Held*, judgment for plaintiffs on jury verdicts affirmed. The general clause releasing from liability for injuries "resulting from any accident or other occurrence" did not cover liability for active negligence--here a negligent omission: the failure to provide a barrier or other protection for persons admitted to the dangerous area. (29 C.A.3d 519.) The court added this dictum: "[W]e question whether public policy in this state would permit judicial enforcement of a provision printed in such small type and designed to permit a tortfeasor to shift the risk of the injury to the victim even where the release is sufficient to encompass defendants' own negligence." (29 C.A.3d

521.)

In *Hohe v. San Diego Unified School Dist.* (1990) 224 C.A.3d 1559, 274 C.R. 647, plaintiff, a 15-year-old high school pupil, participated in a campus hypnotism show sponsored by the parent, teacher, and student association as a fundraiser. She was one of a number of volunteers selected at random, and was injured when she slid from her chair and fell to the floor. In this action against the association and the school district, defendants set up the release signed by plaintiff and her father as a bar. *Held*, summary judgment for defendants reversed; a triable issue of fact was presented on the issue whether the release sufficiently apprised plaintiff of the risk.

(a) The forms signed by plaintiff and her father were "general releases." "There is no language which specifically speaks to a release from liability for negligence. Nor is there any language which specifically alerts the parent his child is barred from a recovery based on her bodily injury." (224 C.A.3d 1567.)

(b) "Our analysis is not based on the mechanical application of some formula. The presence or absence of the words 'negligence' or 'bodily injury' is not dispositive. We look instead to the intention of the parties as it appears in the release forms before the court. In this instance, the intention ... is not clear. Although the parent waived all liability it was in the context of two documents which focused on mental and nervous disorders, defamation and broadcast rights. The scope of the waiver is ambiguous." (224 C.A.3d 1567.) (See 36 U.S.F. L. Rev. 535 [*Hohe*].)

Leon v. Family Fitness Center No. 107 (1998) 61 C.A.4th 1227, 71 C.R.2d 923, involved a liability release contained in a retail installment contract plaintiff signed to become a member of defendant fitness club. Plaintiff brought a negligence action after a bench collapsed beneath him while he was using defendant's sauna. *Held*, summary judgment for defendant reversed.

(a) Although the release clause was in a separate paragraph and was plainly worded, it was in the middle of the document, it was not prefaced by a heading, it contained no bold lettering, and it was in the same smaller font size as most of the document. Nor was there language to alert a reader that defendant intended the release to exculpate it from claims based on its own negligence. (61 C.A.4th 1232.)

(b) Defendant's negligence was not reasonably related to the object or purpose for which the release was given, that is, injuries from participating in sports or exercise rather than from merely reclining on the facility's furniture. (61 C.A.4th 1235.)

(c) "Reading the entire document leads to the inescapable conclusion the release does not clearly, explicitly and comprehensibly set forth to an ordinary person untrained in the law, such as Leon, that the intent and effect of the document is to release claims for his own personal injuries resulting from the enterprise's own negligent acts, regardless whether related to the sports or exercise activities it marketed." (61 C.A.4th 1235.) (See *Vinnell Co. v. Pacific Elec. Ry. Co.* (1959) 52 C.2d 411, 415, 340 P.2d 604; *Basin Oil Co. of Calif. v. Baash-Ross Tool Co.* (1954) 125 C.A.2d 578, 594, 271 P.2d 122 [seller of oil equipment had contracted only to relieve itself from a strict warranty liability; exemption clause was thus no defense to tort action for negligence]; *Sproul v. Cuddy* (1955) 131 C.A.2d 85, 94, 280 P.2d 158 [following *Basin*]; *Fields v. Oakland* (1955) 137 C.A.2d 602, 608, 291 P.2d 145; *Oakland v. Oakland Unified School Dist.* (1956) 141 C.A.2d 733, 735, 297 P.2d 752 [lease exemption provision held not to cover particular area where negligent injury occurred]; *American Auto. Ins. Co. v. Seaboard Surety Co.* (1957) 155 C.A.2d 192, 197, 318 P.2d 84; *Woodall v. Wayne Steffner Productions* (1962) 201 C.A.2d 800, 814, 20 C.R. 572 [knowingly furnishing an incompetent person to work with plaintiff in hazardous stunt]; *Ferrell v. Southern Nevada Off-Road Enthusiasts, Ltd.* (1983) 147 C.A.3d 309, 315, 316, 317, 318, 195 C.R. 90; *Conservatorship of Link* (1984) 158 C.A.3d 138, 205 C.R. 513 [release agreement was unenforceable because it was printed in 5 1/2 -point type and could not be easily read by persons of ordinary vision and because it was unclear, not explicit, and so lengthy and convoluted that it was not comprehensible; typeface smaller than 8-point is unsatisfactory reading medium]; *Bennett v. United States Cycling Federation* (1987) 193 C.A.3d 1485, 239 C.R. 55; *Kurashige v. Indian Dunes* (1988) 200 C.A.3d 606, 246 C.R. 310; *Burnett v. Chimney Sweep* (2004) 123 C.A.4th 1057, 1064, 20 C.R.3d 562 [although no public issue was involved,

exculpatory clause was silent as to negligence, thereby shielding lessor only for passive negligence, but complaint alleged that lessor was actively negligent in refusing to remediate problems caused by excessive moisture and mold infestation; following *Butt*].)

SUPPLEMENT: [This section is current through the latest supplement]

See *Queen Villas Homeowners Assn. v. TCB Property Management (2007) 149 C.A.4th 1, 5, 56 C.R.3d 528* [provision in contract between homeowners association and property manager stating that association would indemnify and hold manager harmless did not bar association's action arising from manager's alleged improper payment of association's funds to association's board member; nothing in provision indicated that it went beyond ordinary context of third-party indemnification to second-party exculpation].



65 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
K. Exemption From and Limitation of Liability.
3. Valid Exemption Where No Public Interest Involved.
b. Illustrations.
1. Purchase of Airplane.

1 Witkin Sum. Cal. Law Contracts § 674

[§ 674] Purchase of Airplane.

The meaning of "public interest," and the related policy disfavoring "contracts of adhesion" (see *supra*, §323) were explored in *Delta Air Lines v. Douglas Aircraft Co.* (1965) 238 C.A.2d 95, 47 C.R. 518. Plaintiff bought a DC-7 airplane from defendant manufacturer for \$ 2,250,000. A defective nose wheel caused the plane to veer off a runway, with resulting property damages of \$ 233,881.35 (the cost of repair). The contract of sale contained a clause under which plaintiff buyer waived all "liabilities, express or implied, arising by law or otherwise ... and whether or not occasioned by Seller's negligence." *Held*, this provision relieved defendant of liability for the damages suffered by plaintiff.

(a) The clause clearly covered not only warranty but also tort liability for negligence. (238 C.A.2d 100.)

(b) Exemption from liability for negligence is permissible where the public interest is not involved, and this is such a case. The fact that plaintiff was a regulated carrier did not clothe this private business transaction with a public character; passengers were not involved, and the question was simply which of two persons should bear the risk of economic loss caused by defective product. (238 C.A.2d 104.)

(c) This was not a contract of adhesion. Even though defendant used a standard form, the terms were open to negotiation; and plaintiff, represented by experienced executives and attorneys, was free to buy its plane elsewhere or to pay the higher price offered by defendant for those desiring elimination of the exculpatory clause. (238 C.A.2d 102.) Distinguishing other exemption and adhesion cases the court said: "[T]he case at bench involves none of the elements of inequality of bargaining on which the cited cases, and other recent cases of the same sort, have laid their stress. Delta, bargaining for the purchase and delivery of an airplane yet to be built, is hardly the pain-wracked sufferer seeking emergency admission to the hospital whose plight secured relief in *Tunkl*; it was not faced, as were *Henningsen* and *Vandermark*, with an industry-wide stock contract not open to negotiation; it is not now faced with a 'fine print' clause not known to it when it signed the contract; and it did not stand as a single inexperienced individual purchaser vis-a-vis a large seller relatively indifferent to the making or not making of a single purchase." (238 C.A.2d 102.)

SUPPLEMENT: [This section is current through the latest supplement]



66 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

- Witkin Summary of California Law
- X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS
- K. Exemption From and Limitation of Liability.
3. Valid Exemption Where No Public Interest Involved.
- b. Illustrations.
2. "Sole Remedy" Provision in Employment Contract.

1 Witkin Sum. Cal. Law Contracts § 675

[§ 675] "Sole Remedy" Provision in Employment Contract.

In *Farnham v. Superior Court* (1997) 60 C.A.4th 69, 70 C.R.2d 85, plaintiff, a corporate officer, sued the corporation and two corporate directors for defamation arising out of a letter written by the directors. Under a "sole remedy" provision in plaintiff's employment contract, he had the right to arbitrate any claims against the corporation arising from a breach of the contract, but waived his right to sue the corporation's officers, directors, and shareholders for damages arising out of it. The corporation filed for arbitration and the claims against the directors were severed, because they were not parties to the employment agreement. Plaintiff won an arbitration award, which was reduced to a judgment. The two directors then demurred to plaintiff's amended complaint, contending that plaintiff, by agreeing to the "sole remedy" provision in his employment contract, had waived all his rights for a lawsuit for damages against the corporation's directors. The trial court sustained the demurrer, rejecting plaintiff's claim that the directors were acting in their individual capacities when they defamed him. *Held*, reversed; the "sole remedy" provision is compatible with California's public policy and, therefore, is not unenforceable *per se*, but its enforceability in this case cannot be resolved on demurrer.

(a) C.C. 1668 is not strictly applied. It does not *per se* prohibit a contractual release of future liability for ordinary negligence unless the "public interest" is involved or unless a statute expressly forbids it. Nor does it bar either contractual indemnity or insurance, notwithstanding that (aside from semantics) the practical effect of both is an "exemption" from liability for negligence. Although exemptions from all liability for intentional wrongs, gross negligence and violations of the law have been consistently invalidated, "we have not found any case addressing a *limitation* on liability for intentional wrongs, gross negligence or violations of the law." (60 C.A.4th 74.) The question, therefore, is whether plaintiff's retention of his rights against the corporation permits the view that the waiver of his claims against the directors is a *limitation* on liability rather than a complete exemption from *all* liability. (60 C.A.4th 75: on limitations as to amount, see *infra*, §§677, 678.)

(b) Plaintiff's waiver should not be viewed in the abstract, and its validity must be determined in light of his retention of arbitration rights against the corporation. When the corporation petitioned for arbitration, plaintiff did not oppose the petition and did not object when the directors sought severance. Instead, he won his defamation claim at arbitration, and he now wants to litigate the identical claim against the directors. Indulging all presumptions in plaintiff's

favor, it is *possible* that he could prove he was not fully compensated by the arbitration award, or that he could prove the damages caused by the directors somehow differed from those found by the arbitrator, or that he could persuade a different trier of fact that he is entitled to punitive damages against one or both of the directors, even though the arbitrator found he was not entitled to such damages against the corporation. Thus, but for the "sole remedy" provision, plaintiff has pled a right to another bite at the defamation apple. (60 C.A.4th 76.)

(c) Under the circumstances of the "sole remedy" provision in plaintiff's contract, the waiver with respect to the directors is not *per se* prohibited by C.C. 1668. Because a contract exempting liability for ordinary negligence is valid under some circumstances, notwithstanding the language of the statute, it follows that the contractual limitation on the liability of directors for defamation arising out of their roles as directors is equally valid where, as here, the injured party retains his right to seek redress from the corporation. (60 C.A.4th 77, citing cases from other jurisdictions holding that contractual indemnity may validly cover liability for "bad faith" acts, and that limitations on liability may apply to intentional torts as well as negligence.) The "sole remedy" provision in the contract does not conflict with any public interest but is instead the result of a private, voluntary transaction in which plaintiff simply agreed to look to the corporation to shoulder a risk that might otherwise have fallen on its officers, directors, and shareholders. (60 C.A.4th 78.)

(d) Nevertheless, the "sole remedy" provision *would* violate C.C. 1668 if it were read to include any and all wrongful acts by the directors, without regard to whether those acts were related to their roles as directors. Thus, this case cannot be resolved by demurrer, because plaintiff is entitled to an opportunity to present whatever evidence he might have to prove that the directors were, as alleged, acting as individuals and for their own self-interests (that is, not for the benefit of the corporation) when they defamed him. (60 C.A.4th 77, footnote 6.)

SUPPLEMENT: [This section is current through the latest supplement]



67 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

K. Exemption From and Limitation of Liability.

3. Valid Exemption Where No Public Interest Involved.

b. Illustrations.

3. Other Illustrations.

1 Witkin Sum. Cal. Law Contracts § 676

[§ 676] Other Illustrations.

In *Nichols v. Hitchcock Motor Co.* (1937) 22 C.A.2d 151, 156, 70 P.2d 654, plaintiff bought a new automobile from defendant under an agreement for 90 days' service. It was further provided that, if an employee of defendant seller was furnished to drive the car for instruction or any other reason, the buyer agreed "to assume full responsibility" for any damage to the car, or to any other person or property while the employee was so engaged. At plaintiff's request, defendant sent its employee to his home to get the car for servicing. The employee negligently damaged it while driving it back to plaintiff's home. *Held*, defendant was not liable; the contract terms and the nature of the services showed that no public interest was involved. (22 C.A.2d 156.)

In *Hulsey v. Elsinore Parachute Center* (1985) 168 C.A.3d 333, 214 C.R. 194, plaintiff enrolled in the "First Jump Course" offered by defendant, and signed an agreement releasing defendant from liability for any injuries resulting from parachuting activities. The court, citing decisions from other jurisdictions on high-risk sport activities, held the release binding. Under the factors enunciated in *Tunkl v. Regents of Univ. of Calif.* (1963) 60 C.2d 92, 32 C.R. 33, 383 P.2d 441, 662, there was nothing in the activity to make the agreement one involving the public interest, and *Celli v. Sports Car Club of America* (1972) 29 C.A.3d 511, 105 C.R. 904, *supra*, §673, was distinguished on the ground that the agreement was in simple, clear, and unambiguous language and was printed in 10-point type. (168 C.A.3d 339, 340, 341, 342.)

In *Appalachian Ins. Co. v. McDonnell Douglas Corp.* (1989) 214 C.A.3d 1, 262 C.R. 716, involving the failure of a telecommunications satellite to reach the desired orbit, defendant manufacturer's contract contained exculpatory clauses. The court, applying each of the *Tunkl* factors (214 C.A.3d 28), concluded that "the exculpatory clauses here do not conflict with the public interest, but were the result of 'private, voluntary transactions in which one party, for a consideration, agrees to shoulder a risk which the law would otherwise have placed upon the other party.' " (214 C.A.3d 31.)

SUPPLEMENT: [This section is current through the latest supplement]

See *CAZA Drilling (Calif.) v. TEG Oil & Gas U.S.A.* (2006) 142 C.A.4th 453, 468, 48 C.R.3d 271 [exculpatory provision in contract between drilling company and oil corporation, placing liability on corporation for *economic* loss,

was not invalid as involving public interest, because, while production of oil was important to public, this drilling was important only to parties; where only question is which of two equal bargainers, as here, should bear risk of economic loss, there is no reason for courts to remake parties' agreement]; *Booth v. Santa Barbara Biplane Tours, LLC* (2008) 158 C.A.4th 1173, 1178, 70 C.R.3d 660 [re- lease that tourists signed prior to aerial sightseeing tour was not void as matter of public policy, because aerial sightseeing tour was not essential service or necessity affecting public interest].



68 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

K. Exemption From and Limitation of Liability.

4. Valid Limitation Provisions.

a. In General.

1 Witkin Sum. Cal. Law Contracts § 677

[§ 677] In General.

Contractual limitations of liability have been frequently upheld. (See *Wheeler v. Oppenheimer* (1956) 140 C.A.2d 497, 500, 295 P.2d 128 [applying rule to vendor-purchaser contract provision that if vendor did not complete sale liability would be limited to "costs and expenses"]; 15 Corbin (Rev. ed.), §85.18; 24 Williston 4th, §65:6; 17A Am.Jur.2d (2004 ed.), Contracts §280 et seq.; 57A Am.Jur.2d (2004 ed.), Negligence §43 et seq.; 5 Stanf. L. Rev. 825; on limitation of owner's liability for mechanic's liens, see 16 Hastings L. J. 179; on shipowner's limitation of liability, see 13 Hastings L. J. 229 [pleasure craft]; 16 Stanf. L. Rev. 370.)

Special rules apply to limitation of liability of carriers (13 Summary (10th), Personal Property, §162), warehouseman (13 Summary (10th), Personal Property, §170), innkeepers (13 Summary (10th), Personal Property, §176), and bailees (13 Summary (10th), Personal Property, §181 et seq.).

A limitation of liability provision operates as a limitation on the maximum amount recoverable; the plaintiff must of course still plead and prove his or her actual loss or damages. (See *Wheeler v. Oppenheimer*, *supra*, 140 C.A.2d 499; 5 Stanf. L. Rev. 825.)

In *Markborough Calif. v. Superior Court* (1991) 227 C.A.3d 705, 277 C.R. 919, a provision in a construction contract between plaintiff developer and defendant engineer limited the latter's damages to \$ 67,640. The provision was in paragraph 28 of 38 paragraphs typed in fine print on the reverse side of a standard form contract. Plaintiff contended that it was invalid because it had not been negotiated and expressly agreed on, as required by C.C. 2782.5 (permitting express limitation agreements negotiated between owner and contractor; see *supra*, §667). *Held*, the provision was valid.

(a) There is nothing in the legislative history of either C.C. 2782 (*supra*, §666) or 2782.5 (*supra*, §667) that supports plaintiff's contention that the phrase "negotiating and expressly agreeing" imposes on parties such as defendant the affirmative duty to specifically advise the other party of the inclusion of a liability limitation clause and of the risks involved in the project in question. If the Legislature had intended to impose this duty, it could have used language similar to that found in numerous other statutes imposing disclosure requirements. (227 C.A.3d 713.)

(b) "Since the common law sanctioned the use of limitation of liability clauses so long as they were not against public policy and not unconscionable, and in light of the legislative materials pertaining to section 2782.5 which indicate no intent to change the law regarding these clauses, we hold that 'negotiating' as used in section 2782.5 and applied to a particular contract containing a limitation of liability clause simply means that the agreement was reached between parties wherein each party had an opportunity to accept, reject or modify such a provision. If the parties had such an opportunity with respect to the provision, the provision is valid even if there is no actual discussion regarding the provision but rather it is simply proposed and accepted." (227 C.A.3d 715.)

(c) Here the limitation clause was included in a standard form contract submitted by defendant to plaintiff by a cover letter, wherein defendant stated that it would begin construction as soon as it received a signed contract from plaintiff, but that any requested changes would have to be approved before work could start. This language clearly indicated that plaintiff had an opportunity to request a change in any provision of the contract, including the limitation clause. (227 C.A.3d 716.)

(d) As support for its contention that the inconspicuousness of the limitation clause alone should invalidate it, plaintiff relied on *Conservatorship of Link* (1984) 158 C.A.3d 138, 205 C.R. 513, *infra*, §673, and *Windsor Mills v. Collins & Aikman Corp.* (1972) 25 C.A.3d 987, 101 C.R. 347, *supra*, §122. These decisions are distinguishable: The present case involves neither a provision that was offered on a take-it-or-leave-it basis, as in *Link*, nor one that was contained in a document whose contractual nature was not obvious, as in *Windsor*. "When the parties are dealing in an arm's length transaction with an opportunity to accept, reject or modify the terms of the agreement, different rules apply. The parties are bound by the terms of the contract even if they do not read it." (227 C.A.3d 716; on negligence in signing or accepting instrument, see *supra*, §118.)

West's Key Number Digest, Vendor and Purchaser k.345

SUPPLEMENT: [This section is current through the latest supplement]



69 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

K. Exemption From and Limitation of Liability.

4. Valid Limitation Provisions.

b. Regulated Public Utility.

1 Witkin Sum. Cal. Law Contracts § 678

[§ 678] Regulated Public Utility.

(1) *Case Law.* A telephone company is free from any substantial liability for omissions or mistakes in the *directory*, which is not a part of its common carrier service. A *limitation* to the amount of the charge paid may be made by general rule on file with the Public Utilities Commission; it need not be stated in a special contract as ordinarily required of carriers by C.C. 2174. (*Riaboff v. Pacific Tel. & Tel. Co.* (1940) 39 C.A.2d Supp. 775, 778, 102 P.2d 465; *Cole v. Pacific Tel. & Tel. Co.* (1952) 112 C.A.2d 416, 417, 246 P.2d 686; 47 A.L.R.4th 882 [telephone company's liability for directory mistakes or omissions].)

In *Cole*, the court offered the following justification for limited liability: "The theory underlying these decisions is that a public utility, being strictly regulated in all operations with considerable curtailment of its rights and privileges, shall likewise be regulated and limited as to its liabilities. In consideration of its being peculiarly the subject of state control, 'its liability is and should be defined and limited.' ... There is nothing harsh or inequitable in upholding such a limitation of liability when it is thus considered that the rates as fixed by the commission are established with the rule of limitation in mind. Reasonable rates are in part dependent upon such a rule." (112 C.A.2d 419.)

In *Product Research Associates v. Pacific Tel. & Tel. Co.* (1971) 16 C.A.3d 651, 94 C.R. 216, defendants' tariff rules, approved by the Public Utilities Commission, provided a "credit allowance" for interruptions and failures of service, not to exceed the total fixed charges for the period. Plaintiff alleged that defendant negligently failed to give him adequate telephone service, as a result of which he lost a valuable business opportunity. The lower court gave summary judgment for defendant. *Held*, reversed. Assuming that the Commission could properly approve a rule limiting liability for negligence, the schedule did not do so: Its "credit allowance" against service charges applied regardless of whether the company was free from negligence; the express language was confined to interruptions and failures of service, and it provided for a return of a charge paid because no benefit was conferred--a failure of consideration. "Nowhere in the schedule is it stated or implied that the credit allowance is in lieu of compensatory damages caused by a telephone company's negligence, or that such allowance is the sole remedy which a subscriber is permitted to invoke." (16 C.A.3d 658.) *Riaboff* and *Cole* were criticized as having failed to consider the principles of public policy of *Tunkl v. Regents of Univ. of Calif.* (1963) 60 C.2d 92, 32 C.R. 33, 383 P.2d 441, *supra*, §662, and distinguished on the ground that in each case the tariff schedule expressly purported to limit liability. (16 C.A.3d 659.)

But the *Cole* holding was reaffirmed in two other court of appeal decisions. (*Davidian v. Pacific Tel. & Tel. Co.* (1971) 16 C.A.3d 750, 753, 94 C.R. 337; *Hall v. Pacific Tel. & Tel. Co.* (1971) 20 C.A.3d 953, 954, 98 C.R. 128 [distinguishing *Product Research*, which involved a failure to provide service, from the directory cases].)

In *Waters v. Pacific Tel. Co.* (1974) 12 C.3d 1, 114 C.R. 753, 523 P.2d 1161, the court approved the *Riaboff*, *Cole* and *Davidian* holdings that the general considerations of public policy applicable to disputes between private parties do not control where regulated public utilities are concerned, for limitations of liability are considered in fixing rates, and liability insurance against service and directory errors of telephone companies is not available. (12 C.3d 1, and footnote 5.) The opinion notes that in 1970, the Commission, after an extensive investigation, reaffirmed its rule that a credit allowance device limits liability for ordinary negligence, but also ordered that liability be imposed, in specified amounts, for gross negligence. (12 C.3d 8, 11, footnote 9.) (See *Stern v. General Tel. Co.* (1975) 50 C.A.3d 538, 542, 123 C.R. 373 [new rule on gross negligence is prospective]; *Colich & Sons v. Pacific Bell* (1988) 198 C.A.3d 1225, 1236, 244 C.R. 714 [tariff's limitation of liability is binding on public generally; hence contractor which disrupted plaintiff's service by cutting cable was barred from seeking equitable indemnity for ordinary negligence from concurrently negligent telephone utility]; 9 U.S.F. L. Rev. 561; 67 A.L.R.3d 76 [liability of telephone company to subscriber for failure or interruption of service].)

The rule established by *Riaboff*, *Cole* and the cases following them is also applicable to the tariff provisions of a telegraph company limiting its liability to a fixed amount. (*Trammell v. Western Union Tel. Co.* (1976) 57 C.A.3d 538, 549, 129 C.R. 361.)

Trammell raised a new issue for California, whether the limitation of liability provisions applied to a third person not a party to the contract for service. Plaintiff alleged that he was the addressee of a telegram recalling him to work, that the telegram was delivered to the wrong person, and that in consequence he lost his job. The court, following cases from other jurisdictions, held that the theory supporting the limitation (reasonable rates) was applicable and that the limitation was valid. (57 C.A.3d 553.) The court also held that the limitation provisions can apply to instances of gross negligence. (57 C.A.3d 555.)

(2) *Statutory Termination of Commission's Jurisdiction Over Telephone Directories*. Pub.Util.C. 728.2, added in 1979, terminated the Public Utility Commission's jurisdiction over classified telephone directories and the commercial advertising therein (see 8 *Summary* (10th), *Constitutional Law*, §1104). Hence, the aforementioned cases on a telephone company's liability for directory errors, all of which were decided before 1979, are no longer controlling.

SUPPLEMENT: [This section is current through the latest supplement]



70 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

L. Waivers of Statutory Rights.

1. Valid Waivers.

a. Procedural Provisions.

1 Witkin Sum. Cal. Law Contracts § 679

[§ 679] Procedural Provisions.

C.C. 3513 provides: "Anyone may waive the advantage of a law intended solely for his benefit. But a law established for a *public reason* cannot be contravened by a private agreement." (See generally *28 Am.Jur.2d* (1999 ed.), *Estoppel and Waiver* §213 et seq.; 8 Williston 4th, §19:56 et seq.; 2 California Affirmative Defenses (2004 ed.), §47:1 et seq.) This loose statement places the burden upon the court in each case to determine whether the statute is for public or private benefit.

(1) *Statute of Limitations.* (a) The statute of limitations may be waived by the prospective *obligee* by a provision in a contract that any suit arising out of it must be brought within a *shorter period* than that specified in the statute, provided that the shortened period is reasonable, i.e., gives sufficient time for the effective pursuit of the judicial remedy. (See 3 *Cal. Proc.* (4th), *Actions*, §437 et seq.) (b) The statute may also be waived by the *obligor*, by an agreement not to set up the defense of the statute. (See 3 *Cal. Proc.* (4th), *Actions*, §436.)

(2) *Time Limitation on Substantive Right.* Where the time provision is not an ordinary statute of limitations (barring the remedy) but is one which *extinguishes* the substantive right itself, a waiver may be deemed contrary to the policy of the statute and invalid. (See *Midstate Horticultural Co. v. Pennsylvania R. Co.* (1943) 320 U.S. 356, 64 S.Ct. 128, 129, 88 L.Ed. 96, 99, reversing 21 C.2d 243, 131 P.2d 544 [provision of I.C.C. Act that carrier's action to recover charges "shall be begun" within stated period "and not after"]; 3 *Cal. Proc.* (4th), *Actions*, §414.)

(3) *Notice of Claim Clause.* A contractual provision may require that notice of claim for loss or injury must be given within a certain period in order to enforce the liability. The provision is frequently found in bills of lading, warehouse receipts, and similar instruments, and is designed to give the carrier or warehouseman a timely opportunity to ascertain the facts concerning the asserted loss. It is universally upheld if the period is reasonable. (On notice of claim provisions in bills of lading and warehouse receipts, see U.C.C. 7204(3), 7309(3); 3 *Cal. Proc.*, 4th, *Actions*, §166; on similar provisions in insurance policies, see 3 *Cal. Proc.* (4th), *Actions*, §221; on similar provisions in other types of agreements, see 3 *Cal. Proc.* (4th), *Actions*, §222.)

An *informal notice* is liberally construed. Thus, in *Thayer v. Pacific Elec. Ry. Co.* (1961) 55 C.2d 430, 11 C.R. 560, 360 P.2d 56, plaintiff ordered a machine from Illinois, which arrived via defendant carrier in damaged condition on

March 29, 1955. After negotiating with defendant's agent for some time over the freight charges and damage claims, plaintiff refusing to pay the charges because of fear of waiver, the agent wrote on the freight bill, "Damage on this shipment, 4/20/55, C. D. Hileman." Plaintiff then wrote a check for the charges. Investigation of the extent of damage took considerable time and the amount was finally ascertained to be \$ 3,500. Then, over 9 months after delivery of the machine, plaintiff's attorney sent his letter detailing the damage. This was rejected under the bill of lading requirement of notice of claim within 9 months. *Held*, judgment for plaintiff affirmed. The court followed federal cases holding that the notice is to be construed "in a practical way," and is sufficient if the carrier can only draw the inference that a claim for damages is contemplated, even though the writing does not contain a formal demand for damages. The written documents need be "of a minimal character only," and "informal in expression." (55 C.2d 435.) Here, the combination of the agent's inspection report and the notation on the freight bill met this test. (55 C.2d 436.) (See *Outboard Marine Corp. v. Superior Court* (1975) 52 C.A.3d 30, 41, 124 C.R. 852 [manufacturer sued under Consumers Legal Remedies Act may waive compliance with notice requirements by treating informal notification as sufficient].)

West's Key Number Digest, Contracts k.105; Estoppel k.52-

SUPPLEMENT: [This section is current through the latest supplement]
See 2 California Affirmative Defenses §47:1 et seq.

(1) *Statute of Limitations.*

Agreement that period be shortened:

Cross-Reference: 3 Cal. Proc. (5th), Actions, §469 et seq.

Agreement not to set up defense:

Cross-Reference: 3 Cal. Proc. (5th), Actions, §468.

(2) *Time Limitation on Substantive Right.*

Cross-Reference: 3 Cal. Proc. (5th), Actions, §441.(3) *Notice of Claim Clause.* In 2006, U.C.C. 7204 and 7309 were repealed and reenacted. The notice-of-claim provisions are now in U.C.C. 7204(c) and 7309(c).

Bills of lading:

Cross-Reference: 3 Cal. Proc. (5th), Actions, §228.

Insurance policies:

Cross-Reference: 3 Cal. Proc. (5th), Actions, §229.

Other agreements:

Cross-Reference: 3 Cal. Proc. (5th), Actions, §230.



71 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS L. Waivers of Statutory Rights. 1. Valid Waivers. b. Other Rights.

1 Witkin Sum. Cal. Law Contracts § 680

[§ 680] Other Rights.

Waivers of the following have been upheld:

(1) The right of a tenant of a dwelling house to make repairs at the expense of the landlord. (C.C. 1942; see 12 *Summary* (10th), *Real Property*, §623.)

(2) The right of a wife to succeed to her share of community property, or to a family allowance, though the court will scrutinize the contract for fairness. (See 14 *Summary* (10th), *Wills and Probate*, §788.)

(3) The right of a wife to support in exchange for a more favorable disposition of community property. (See *Adams v. Adams* (1947) 29 C.2d 621, 628, 177 P.2d 265; *Patton v. Patton* (1948) 32 C.2d 520, 523, 196 P.2d 909; see 11 *Summary* (9th), *Husband and Wife*, §187.)

(4) The right of a cotenant to partition. (*Asels v. Asels* (1919) 43 C.A. 574, 578, 185 P. 419; *Miranda v. Miranda* (1947) 81 C.A.2d 61, 65, 183 P.2d 61; see 12 *Summary* (10th), *Real Property*, §73.)

(5) The statutory provision (C.C. 1542) that a general release does not extend to material claims that were unknown at the time thereof. (*Berry v. Struble* (1937) 20 C.A.2d 299, 302, 66 P.2d 746; see 30 *Cal. L. Rev.* 111; *infra*, §947; but see *infra*, §948 [simple reference in release of unknown claims is no waiver].)

(6) The provisions of *Prob.C. 15602*, requiring a trustee's bond for the protection of beneficiaries of a testamentary trust. (*Estate of Shapiro* (1947) 79 C.A.2d 731, 734, 181 P.2d 117 [beneficiaries may waive, in absence of creditors]; *Estate of Cibulk* (1998) 67 C.A.4th 690, 692, 79 C.R.2d 168 [following *Estate of Shapiro*].)

(7) The statutory provision (C.C. 2809) that the obligation of a surety cannot exceed that of the principal may be waived by a contract provision that the surety's liability will not terminate on discharge of the debtor through a composition of creditors. (*Bloom v. Bender* (1957) 48 C.2d 793, 803, 313 P.2d 568; see *River Bank America v. Diller* (1995) 38 C.A.4th 1400, 45 C.R.2d 790.)

(8) A guarantor or surety may waive the rights to require the creditor to proceed first against the principal debtor

and to exhaust security. He or she may also waive the right to the benefit of any security given by the principal debtor. (*American Guaranty Corp. of Calif. v. Stody* (1964) 230 C.A.2d 390, 394, 41 C.R. 69; *Engelman v. Bookasta* (1968) 264 C.A.2d 915, 916, 71 C.R. 120; *Union Bank v. Ross* (1976) 54 C.A.3d 290, 294, 126 C.R. 646; see 4 *Summary* (10th), *Security Transactions in Real Property*, §§131, 132); cf. *Durgin v. Kaplan* (1968) 68 C.2d 81, 90, footnote 8, 65 C.R. 158, 436 P.2d 70, *infra*, §767 [dictum: waiver that could require guarantor to pay principal's debt several times probably invalid].

(9) A surviving spouse may waive various property rights, e.g., the right to receive property by intestate succession or testamentary disposition, as well as the right to be appointed as the personal representative of the decedent's estate. (*Prob.C. 141.*)

(10) Incontestable clauses in insurance policies have been upheld. (See 2 *Summary* (10th), *Insurance*, §226 et seq.)

SUPPLEMENT: [This section is current through the latest supplement]

(11) (*New*) A guarantor may waive the right of exoneration arising from modification of the guaranty agreement. (*Central Bldg., LLC v. Cooper* (2005) 127 C.A.4th 1053, 1060, 26 C.R.3d 212.) *Correction:* Page 766, last line of paragraph (3), "11 *Summary* (9th), *Husband and Wife*, §187" should be "11 *Summary* (10th), *Husband and Wife*, §187".



72 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

L. Waivers of Statutory Rights.

2. Invalid Waivers.

a. Waivers by Mortgagors.

1 Witkin Sum. Cal. Law Contracts § 681

[§ 681] Waivers by Mortgagors.

C.C. 2953 prohibits agreements by mortgagors to waive certain statutory protections. The section declares "void and of no effect" any "express agreement made ... at the time of or in connection with the making of or renewing of any loan," whereby the borrower agrees to waive any rights or privileges under C.C. 2924, C.C. 2924b, C.C. 2924c, C.C.P. 580a, or C.C.P. 726. Instruments securing bonds or other indebtedness authorized by the Corporation Commissioner, or made by a public utility, are exempt. (See *Winklemen v. Sides* (1939) 31 C.A.2d 387, 404, 88 P.2d 147, decided independently of the statute, and holding waiver of C.C.P. 726 void; *California Bank v. Stimson* (1949) 89 C.A.2d 552, 554, 201 P.2d 39 [waiver of C.C.P. 580a, establishing 3-month limitation period for suing for deficiency judgment, void]; 22 So. Cal. L. Rev. 502.) (See 4 Summary (10th), *Security Transactions in Real Property*, §131.)

However, the purpose of the rule is to prevent waivers *in advance*, exacted from the debtor at the time of making the loan and as a condition thereof; *subsequent waivers* are valid. (*Salter v. Ulrich* (1943) 22 C.2d 263, 266, 138 P.2d 7; *Morello v. Metzenbaum* (1944) 25 C.2d 494, 499, 154 P.2d 670; *Russell v. Roberts* (1974) 39 C.A.3d 390, 394, 114 C.R. 305.)

SUPPLEMENT: [This section is current through the latest supplement]



73 of 75 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

L. Waivers of Statutory Rights.

2. Invalid Waivers.

b. Waivers by Employees.

1 Witkin Sum. Cal. Law Contracts § 682

[§ 682] Waivers by Employees.

A number of statutes expressly preclude waivers of employment rights, including:

- (1) The benefits of the Workers' Compensation Law. (*Lab.C. 2804.*)
- (2) Rights or benefits under the Unemployment Insurance Act. (*Unemp.Ins.C. 1342.*)
- (3) The 7-year limitation on duration of personal services contracts. (*Lab.C. 2855; DeHaviland v. Warner Bros. Pictures (1944) 67 C.A.2d 225, 234, 153 P.2d 983; 3 Summary (10th), Agency and Employment, §206.*)
- (4) The statutory provisions regulating payment of wages. (*Lab.C. 219(a); cf. Breitman v. Brody (1952) 113 C.A.2d 642, 644, 248 P.2d 932 [collective bargaining agreement limiting time for claim held not a violation of the statute].*)
- (5) The statutory prohibition against an employer taking an employee's tips. (*Lab.C. 356; Rihn v. Franchise Tax Bd. (1955) 131 C.A.2d 356, 364, 280 P.2d 893.*)
- (6) The provision of *Elec.C. 14000* allowing an employee 2 hours off to vote, *with pay*. (*Benane v. International Harvester Co. (1956) 142 C.A.2d Supp. 874, 878, 299 P.2d 750 [collective labor agreement provision for time off "without pay" held void].*)
- (7) Release of claim for wages due or to become due. (*Lab.C. 206.5.*)

A waiver of rights may also be held void under the general provisions of C.C. 3513 (law established for public reason cannot be contravened by private agreement, see *supra*, §679). (See *Grier v. Alameda-Contra Costa Transit Dist. (1976) 55 C.A.3d 325, 334, 335, 127 C.R. 525, 3 Summary (10th), Agency and Employment, §400 [provision in collective bargaining agreement authorizing greater wage deduction for tardiness than allowed by *Lab.C. 2928* held invalid under C.C. 3513]; *Henry v. Amrol (1990) 222 C.A.3d Supp. 1, 5, 272 C.R. 134, [Lab.C. 227.3 giving terminated employees right to be paid for accrued but unused vacation time is law established for public reason within meaning of C.C. 3513, and hence cannot be waived].*)*

SUPPLEMENT: [This section is current through the latest supplement]



74 of 75 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

L. Waivers of Statutory Rights.

2. Invalid Waivers.

c. Waivers by Tenants.

1 Witkin Sum. Cal. Law Contracts § 683

[§ 683] Waivers by Tenants.

A number of statutes prohibit waivers of rights by tenants:

(1) C.C. 1953 prohibits the waiver by a tenant of certain important rights specified in the statute. (See 12 *Summary* (10th), *Real Property*, §567.)

(2) A waiver of a landlord's duty to provide tenantable premises is void. (C.C. 1942.1; see 12 *Summary* (10th), *Real Property*, §623.)

(3) A waiver of the legibility requirements for automatic lease renewal provisions is void. (C.C. 1945.5.)

(4) A contract provision authorizing a landlord to make a forcible entry to dispossess a defaulting tenant is violative of C.C.P. 1159 and 1160, and consequently illegal. (*Jordan v. Talbot* (1961) 55 C.2d 597, 604, 610, 12 C.R. 488, 361 P.2d 20, 12 *Summary* (10th), *Real Property*, §759.)

In *Lovett v. Bell* (1947) 30 C.2d 8, 14, 180 P.2d 335, a tenant's waiver of the benefits of federal statutory rent regulations was held void. And a waiver of the landlord's duty, imposed by administrative regulation, to keep the premises free from vermin was also held invalid. (*Buckner v. Azulai* (1967) 251 C.A.2d Supp. 1013, 1015, 59 C.R. 806, 12 *Summary* (10th), *Real Property*, §623.)

West's Key Number Digest, Forcible Entry and Detainer k.4, 5; Landlord and Tenant k.29(1), 811/2 et seq.

SUPPLEMENT: [This section is current through the latest supplement]



75 of 75 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
X. ILLEGALITY: PARTICULAR ILLEGAL CONTRACTS

L. Waivers of Statutory Rights.
2. Invalid Waivers.
d. Miscellaneous Substantive Rights.

1 *Witkin Sum. Cal. Law Contracts* § 684

[§ 684] Miscellaneous Substantive Rights.

(1) *Exemptions From Execution.* A provision in a contract or promissory note by which the promisor waives his or her statutory exemptions from execution is void. (*Industrial Loan & Inv. Co. of San Francisco v. Superior Court* (1922) 189 C. 546, 547, 209 P. 360; see 8 *Cal. Proc.* (4th), *Enforcement of Judgment*, §163; 4 *Summary* (10th), *Negotiable Instruments*, §19.)

(2) *Mechanics' Liens.* Neither the owner nor the original contractor may waive the lien rights of other persons, except by written consent; such consent generally must be given pursuant to the statutorily prescribed waiver and release form. Any contract provision in violation of these requirements, and any written consent not accompanied by the prescribed waiver and release, is void. (C.C. 3262; see 16 *Pacific L. J.* 534.)

A "pay-if-paid" provision in a subcontract, which makes payment by the owner to the general contractor a condition precedent to the general contractor's obligation to pay the subcontractor, is contrary to public policy and is unenforceable. Although such a provision does not take the *form* of a waiver of mechanic's lien rights, it is in *substance* a waiver of those rights and has the same practical effect as an express waiver prohibited under C.C. 3262. (See *Wm. R. Clarke Corp. v. Safeco Ins. Co. of America* (1997) 15 C.4th 882, 888, 64 C.R.2d 578, 938 P.2d 372; *Capitol Steel Fabricators v. Mega Const. Co.* (1997) 58 C.A.4th 1049, 1058, 68 C.R.2d 672 [applying rule to public works contract]; 21 *Thomas Jefferson L. Rev.* 253 [*Wm. R. Clarke Corp. v. Safeco Ins. Co. of America.*])

Under the statutory language of the mechanic's lien release (C.C. 3262, *supra*), a subcontractor or materialman waives his or her mechanic's lien, stop notice, or bond rights in exchange for a progress payment for services and materials furnished only through the date specified in the release, whether or not the subcontractor or materialman has received compensation for all of those services and materials.

(3) *Family Allowance and Probate Homestead.* The right to a family allowance and probate homestead cannot be released by the wife alone where there are minor children. (*Estate of Branam* (1944) 66 C.A.2d 309, 316, 152 P.2d 354; see 14 *Summary* (10th), *Wills and Probate*, §765 et seq.); 65 A.L.R.2d 727 [antinuptial agreements waiving or barring surviving spouse's right to probate homestead or surviving family's similar homestead right or exemption].)

(4) *Public Safety Regulation*. *Veh.C. 24007* prohibiting sale of a motor vehicle not in compliance with code provisions is designed to protect the public as well as the buyer. Hence, it cannot be waived by a "merger" or "as is" clause. (*Mulder v. Casho* (1964) 61 C.2d 633, 637, 39 C.R. 705, 394 P.2d 545 [failure to test brakes].)

(5) *Consumer Remedies*. Any waiver by a consumer of the provisions of the Consumers Legal Remedies Act (see 4 *Summary* (10th), *Sales*, §296) is void. (C.C. 1751.)

(6) *Legibility Requirements in Automobile Parking or Storage Contract*. The requirements for limitation of liability provisions cannot be waived. (C.C. 1630; see *supra*, §123.)

(7) *Confession of Judgment*. A provision authorizing an agent or attorney to confess judgment on behalf of a debtor is invalid. (See 6 *Cal. Proc.* (4th), *Proceedings Without Trial*, §102 et seq.; 4 *Summary* (10th), *Negotiable Instruments*, §§10, 19.)

(8) *Credit and Installment Sales*. The provisions of the "Unruh Act" regulating retail credit and installment sales (see 4 *Summary* (10th), *Sales*, §263 et seq.) cannot be waived. (C.C. 1801.1.)

(9) *Mental Health Services Coverage*. An insurance policy that was issued, renewed, or amended on or after January 1, 1988, and that includes mental health services coverage in nongroup contracts may not include a lifetime waiver for that coverage; such a waiver is deemed unenforceable. (*Ins.C. 10176* [individual disability policy], *Ins.C. 10177* [self-insured employee welfare benefit plan], *Health & Saf.C. 1374.5* [health care service plan].)

(10) *MICRA Limitations on Attorneys' Contingent Fees*. The Medical Injury Compensation Reform Act (*B. & P.C. 6146*) contains limitations on the amounts that an attorney may collect as a contingent fee for representing a plaintiff in a medical malpractice case, and these limitations may not be waived. (*Fineberg v. Harney & Moore* (1989) 207 C.A.3d 1049, 255 C.R. 299 [waiver of statutory contingent fee limitations was void notwithstanding attorney's reputation and expertise]; see 6 *Summary* (10th), *Torts*, §942.)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Exemptions From Execution*.

Cross-Reference: 8 *Cal. Proc.* (5th), *Enforcement of Judgment*, §171.

(2) *Mechanics' Liens*.

Stop notice: C.C. 3262 was amended in 2005 to state that a stop notice claimant may reduce the amount of, or release in its entirety, a stop notice that has been served on an owner. The reduction or release may be served in a form other than the forms of release set forth in C.C. 3262.(7) *Confession of Judgment*.

Cross-Reference: 6 *Cal. Proc.* (5th), *Proceedings Without Trial*, §128 et seq.



1 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law XI. RIGHTS AND OBLIGATIONS OF THIRD PARTIES A. Third-Party Beneficiaries. 1. Nature of Right.

1 Witkin Sum. Cal. Law Contracts § 685

[§ 685] Nature of Right.

(1) *In General.* The prevailing American rule, laid down in *Lawrence v. Fox* (1859) 20 N.Y. 268, permits a third-party beneficiary under a contract to enforce it by a suit in his or her own name. And C.C. 1559 provides: "A contract, *made expressly* for the benefit of a third person, may be enforced by him at any time before the parties thereto rescind it." (See generally *Brown v. Superior Court* (1949) 34 C.2d 559, 564, 212 P.2d 878 [agreement to make mutual wills in favor of third persons; intended devisees and legatees entitled to enforce rights as beneficiaries]; *Schumm by Whyner v. Berg* (1951) 37 C.2d 174, 182, 231 P.2d 39 [mother's contract with father for support of expected illegitimate child]; *Hess v. Ford Motor Co.* (2002) 27 C.4th 516, 524, 117 C.R.2d 220, 41 P.3d 46 [intent to benefit third party is required; fact that literal interpretation of contractual language will result in benefit to third party is not sufficient to entitle that party to demand performance]; *Pitzer v. Wedel* (1946) 73 C.A.2d 86, 90, 165 P.2d 971; *Reliance Life Ins. Co. of Pittsburgh v. Jaffe* (1953) 121 C.A.2d 241, 244, 263 P.2d 82 [property settlement agreement under which husband promised to maintain his life insurance policy in favor of minor children]; *Waxman v. Citizens Nat. Trust & Savings Bank of Los Angeles* (1954) 123 C.A.2d 145, 149, 266 P.2d 48 [same]; *Shell v. Schmidt* (1954) 126 C.A.2d 279, 290, 272 P.2d 82; *Allred v. Bekins Wide World Van Services* (1975) 45 C.A.3d 984, 989, 120 C.R. 312, citing the text [contract between plaintiff's employer and defendant to pack and ship plaintiff's personal effects from foreign jobsite]; *Outdoor Services v. Pabagold* (1986) 185 C.A.3d 676, 681, 230 C.R. 73, citing the text; *Operating Engineers Pension Trust v. Insurance Co. of the West* (1995) 35 C.A.4th 59, 67, 42 C.R.2d 1 [action by union trust funds, as third-party beneficiaries, to collect on construction company's payment and performance bonds for unpaid fringe benefits preempted by federal Employee Retirement Income Security Act]; *Rest.2d, Contracts* §302 et seq., and Introductory Note, Vol. 2, Chap. 14, p. 438; Corbin §772 et seq.; 13 Williston 4th, §37:1 et seq.; 17A Am.Jur.2d (2004 ed.), *Contracts* §425 et seq.; Cal. Civil Practice, 3 Business Litigation, §25:1 et seq.; 10 Cal. L. Rev. 62; 26 Cal. L. Rev. 627; 27 Cal. L. Rev. 497; 6 Hastings L. J. 354; 27 Hastings L. J. 137; 50 Harv. L. Rev. 458; 98 Harv. L. Rev. 1111 [development and extensive current application of rule]; 21 A.L.R.2d 1061, 1067 [contract in consideration of naming child]; 22 A.L.R.2d 647 [right of owner's employee, injured by subcontractor, to recover against general contractor for breach of contract between latter and owner requiring contractor and subcontractor to carry insurance]; cf. *Burnett v. Chimney Sweep* (2004) 123 C.A.4th 1057, 1069, 20 C.R.3d 562 [exculpatory clause in lease did not relieve property manager from liability to lessees for toxic mold on premises; manager was not party to lease, and clause titled "Exemption of Lessor from Liability" was not intended to extend to third-party beneficiaries].)

(2) *Distinction: Beneficiary of Trust.* C.C. 1559 has no application where a trust has been created in favor of the third-party beneficiary and the contract is between the trustee and the trustee's agents. Under the Probate Code, the probate department has exclusive jurisdiction of proceedings concerning the internal affairs of trusts. (*Saks v. Damon Raiké & Co.* (1992) 7 C.A.4th 419, 431, 8 C.R.2d 869.)

(3) *Enforcement of Agreement After Termination but Before Rescission.* If a contract has not been rescinded according to the statutory procedures (see C.C. 1689, *infra*, §927 et seq.), but the contract is instead terminated for some other reason, a third-party beneficiary may still enforce the agreement. (See *Principal Mut. Life Ins. Co. v. Vars, Pave, McCord & Freedman* (1998) 65 C.A.4th 1469, 1485, 1486, 77 C.R.2d 479 [lender, as third-party beneficiary, could enforce attornment clause in lease after foreclosing on property, even though foreclosure extinguished lease by operation of law, because lease was not rescinded and attornment clause was specifically designed to take effect upon its extinction by foreclosure].)

West's Key Number Digest, Contracts k.187(1)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *In General.* See *Medical Staff of Doctors Med. Center in Modesto v. Kamil* (2005) 132 C.A.4th 679, 685, 33 C.R.3d 853 [hospital medical staff, which oversees physicians who practice at hospital, was not third-party beneficiary of contract between hospital and insurer, because there was no showing that medical staff ever received or was intended to receive payments that were primary purpose of that contract]; C.E.B., *Law of Contracts* §7.61 et seq.; 9 Corbin (Rev. ed.), §44.1 et seq.



2 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law XI. RIGHTS AND OBLIGATIONS OF THIRD PARTIES

A. Third-Party Beneficiaries.

2. Classification.

a. Creditor and Donee Beneficiaries.

1 Witkin Sum. Cal. Law Contracts § 686

[§ 686] Creditor and Donee Beneficiaries.

(1) *First Restatement.* The first Contracts Restatement made the following classification of third-party beneficiary contracts: The third party is a *donee beneficiary* if the intent is to make a gift to him or her ("a gift promise"), and the third party is a *creditor beneficiary* if the intention is to satisfy a duty owed to him or her by the promisee ("promise to discharge a duty"). The test is not the existence of an actual enforceable obligation, but rather the *intention* to satisfy an obligation, real or supposed. Hence, the third party is a creditor beneficiary, though the duty the promisee owes him or her is barred by the statute of limitations, bankruptcy, or the statute of frauds. (See Corbin §774, 782 et seq.; 13 Williston 4th, §§37:7, 37:9 et seq.; 17A Am.Jur.2d (2004 ed.), Contracts §439 et seq.; 6 Hastings L. J. 363; 98 Harv. L. Rev. 1165.)

(2) *California Decisions.* Although C.C. 1559, supra, §685, makes no reference to donee and creditor beneficiaries, the first Restatement classification has been followed by California decisions. (See *Hartman Ranch Co. v. Associated Oil Co.* (1937) 10 C.2d 232, 73 P.2d 1163, infra, §697; *Martinez v. Socoma Cos.* (1974) 11 C.3d 394, 400, 113 C.R. 585, 521 P.2d 841, infra, §691, citing the text; *Anderson v. Calaveras Cen. Mining Corp.* (1936) 13 C.A.2d 338, 343, 57 P.2d 560; *Dick v. Woolson* (1951) 106 C.A.2d 415, 419, 235 P.2d 119; *Wilson v. Anderson* (1962) 208 C.A.2d 62, 64, 25 C.R. 105, citing the text [creditor beneficiary]; *Gourmet Lane v. Keller* (1963) 222 C.A.2d 701, 705, 35 C.R. 398, infra, §703 [donee beneficiary]; *COAC v. Kennedy Engineers* (1977) 67 C.A.3d 916, 919, 136 C.R. 890, infra, §701; *Gilbert Financial Corp. v. Steelform Contracting Co.* (1978) 82 C.A.3d 65, 70, 145 C.R. 448; *Dateline Builders v. Santa Rosa* (1983) 146 C.A.3d 520, 526, 194 C.R. 258, citing the text; *Outdoor Services v. Pabagold* (1986) 185 C.A.3d 676, 681, 682, 230 C.R. 73; 26 Cal. L. Rev. 627; 27 Cal. L. Rev. 497; 27 Hastings L. J. 137.)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *First Restatement.* See 9 Corbin (Rev. ed.), §44.3 et seq. (2) *California Decisions.* See *Souza v. Westlands Water Dist.* (2006) 135 C.A.4th 879, 891, 38 C.R.3d 78 [on third-party beneficiary theory, landowners could not successfully sue water district to recover additional charges assessed to their property as result of breach of contract between water district and landowners' tenants; landowners were neither creditor nor donee beneficiaries].



3 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law XI. RIGHTS AND OBLIGATIONS OF THIRD PARTIES

A. Third-Party Beneficiaries.

2. Classification.

b. Intended and Incidental Beneficiaries.

1. Restatement 2d.

1 Witkin Sum. Cal. Law Contracts § 687

[§ 687] Restatement 2d.

(1) *In General.* *Rest.2d, Contracts §302* introduced new terminology:

(a) Unless otherwise agreed between promisor and promisee, a beneficiary of a promise is an *intended beneficiary* if recognition of a right to performance in the beneficiary is appropriate to effectuate the intention of the parties and either (1) the performance of the promise will satisfy an obligation of the promisee to pay money to the beneficiary; or (2) the circumstances indicate that the promisee intends to give the beneficiary the benefit of the promised performance. (*Rest.2d, Contracts §302(1)*; see *infra*, §688.)

(b) An *incidental beneficiary* is a beneficiary who is not an intended beneficiary. (*Rest.2d, Contracts §302(2)*; see *infra*, §689 et seq.)

(2) *Terminology.* The beneficiary described in §302(1)(a) is equivalent to a "creditor beneficiary," and the one described in §302(1)(b) is equivalent to a "donee beneficiary." These terms were eliminated in the Second Restatement because they "carry overtones of obsolete doctrinal difficulties." (*Rest.2d, Contracts, Introductory Note, Vol. 2, p. 439.*) However, the term "intended beneficiary" now covers all those included as donee and creditor beneficiaries in the First Restatement. (*Rest.2d, Contracts §302, Reporter's Note.*) (See *Gilbert Financial Corp. v. Steelform Contracting Co. (1978) 82 C.A.3d 65, 71, 145 C.R. 448* ["[T]he creditor-donee dichotomy as applied to third party beneficiaries is beginning to vanish. Although the two concepts are still viable, the specific descriptive words are being dropped by the courts and academicians to permit broader application of the doctrine"]; *Outdoor Services v. Pabagold (1986) 185 C.A.3d 676, 683, 230 C.R. 73* [noting Restatement change in terminology].)

West's Key Number Digest, Contracts k.187(3)

SUPPLEMENT: [This section is current through the latest supplement]



4 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law XI. RIGHTS AND OBLIGATIONS OF THIRD PARTIES

A. Third-Party Beneficiaries.

2. Classification.

b. Intended and Incidental Beneficiaries.

2. Intended Beneficiaries.

1 Witkin Sum. Cal. Law Contracts § 688

[§ 688] Intended Beneficiaries.

(1) *In General.* It is not necessary that the intent to benefit the third party be manifested by the promisor; it is sufficient that the promisor *understand* that the promisee has this intent. (*Lucas v. Hamm* (1961) 56 C.2d 583, 591, 15 C.R. 821, 364 P.2d 685, *infra*, §699; *Shepherd v. Miles & Sons* (1970) 10 C.A.3d 7, 15, 89 C.R. 23; see *Harper v. Wausau Ins. Co.* (1997) 56 C.A.4th 1079, 1090, 66 C.R.2d 64, 2 *Summary* (10th), *Insurance*, §304 [liability insurance policy's medical payments provision was not intended to protect only insured, but was intended to confer direct benefit on third parties injured on insured's property]; *Cione v. Foresters Equity Services* (1997) 58 C.A.4th 625, 636, 68 C.R.2d 167, 6 *Cal. Proc.* (4th), *Proceedings Without Trial*, Supp., §494B [securities dealer was intended beneficiary of arbitration clause in former employee's application form for registration with securities industry's self-regulatory organization]; *Johnson v. Superior Court* (2000) 80 C.A.4th 1050, 1064, 95 C.R.2d 864 [anonymous donor to sperm bank was intended beneficiary of contract between bank and recipients of donated sperm to keep donor's identity and related information confidential]; *Prouty v. Gores Technology Group* (2004) 121 C.A.4th 1225, 1233, 18 C.R.3d 178 [former employees were third-party beneficiaries, as matter of law, of purchase agreement between new parent company and former employer; provision in agreement was patently intended to preclude early termination of affected employees and to provide those terminated soon after closing with comparable severance benefits; distinguishing *Eastern Aviation Group v. Airborne Express* (1992) 6 C.A.4th 1448, 8 C.R.2d 355, *infra*, §692]; *Corbin* §776; 13 *Williston* 4th, §37:8; 16 *Proof of Facts* 2d 55 [intent of contracting parties to benefit third person]; *BAJI*, No. 10.59 [third-party beneficiary contract]; *CACI*, No. 301 [third-party beneficiary].)

In *Neverkovec v. Fredericks* (1999) 74 C.A.4th 337, 87 C.R.2d 856, 5 *Summary* (10th), *Torts*, §73, involving a two-vehicle accident, the court held that there was a triable issue of fact as to whether a general release signed by a passenger in one of the vehicles when settling with the insurer of that vehicle was intended also to release the driver of the other vehicle from suit. The court stated that the question was best suited to resolution under well-settled contract principles governing third-party beneficiaries. In reviewing numerous cases, the court outlined those principles as follows:

(a) A third party should not be permitted to enforce covenants made not for that party's benefit, but rather for others. The third party is not a contracting party; his or her right to performance is predicated on the contracting parties'

intent to benefit him or her. (b) The circumstance that a literal contract interpretation would result in a benefit to the third party is not enough to entitle that party to demand enforcement. The contracting parties must have intended to confer a benefit on the third party. (c) It is not necessary for the third party to be specifically named in the contract, but such a party bears the burden of proving that the promise sought to be enforced was actually made to him or her personally or to a class of which he or she is a member. (d) The fact that the contract, if carried out to its terms, would inure to the third party's benefit is insufficient to entitle him or her to demand enforcement. (e) However broad may be the terms of a contract, it extends only to those things concerning which it appears that the parties intended to contract. Whether a third party is an intended beneficiary to the contract involves construction of the parties' intent, gleaned from reading the contract as a whole in light of the circumstances under which it was entered. (74 C.A.4th 348.)

(2) *Payment to Another*. One may be a third-party beneficiary of an agreement to pay money although the contract calls for payment to another; i.e., performance need not necessarily be rendered directly to the beneficiary. Thus, in *Arata v. Bank of America* (1963) 223 C.A.2d 199, 35 C.R. 703, H, a woman, had illicit relations with decedent A. While pregnant with the first child she orally agreed with A, at his request, to come to live with him and give the child his family name, and he agreed to pay her not less than \$ 500 per month for support of the child until majority, as well as all expenses of delivery. A similar oral contract was made for the second child, in the amount of \$ 300. A died, and the two children brought this action against his estate to enforce the contract. *Held*, plaintiffs were third-party beneficiaries, despite the fact that the payments were promised to and were to be made to H, the mother. Direct performance could not have been made to the two children because of their age, and the benefits to the mother were purely incident. (233 C.A.2d 206.)

(3) *Promissory Estoppel*. *Rest.2d, Contracts* §90, stating the doctrine of promissory estoppel (see *supra*, §244), refers to action or forbearance on the part of the promisee "or a third person." Comment c explains: "If a promise is made to one party for the benefit of another, it is often foreseeable that the beneficiary will rely on the promise. Enforcement of the promise in such cases rests on the same basis and depends on the same factors as in cases of reliance by the promisee. Justifiable reliance by third persons who are not beneficiaries is less likely, but may sometimes reinforce the claim of the promisee or beneficiary." (See *Aronowicz v. Nalley's* (1972) 30 C.A.3d 27, 45, 106 C.R. 424.)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *In General*. See *Amaral v. Cintas Corp. No. 2* (2008) 163 C.A.4th 1157, 1192, 78 C.R.3d 572 [employees of company that contracted with city to provide uniforms and launder such uniforms were third-party beneficiaries of contract in which company agreed to comply with city's living wage ordinance, and thus, employees could sue company for breach of contract for failing to pay living wage pursuant to ordinance]; 9 Corbin (Rev. ed.), §44.1 et seq.

Cione case:

Cross-Reference: 6 Cal. Proc. (5th), *Proceedings Without Trial*, §522.



5 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law XI. RIGHTS AND OBLIGATIONS OF THIRD PARTIES

A. Third-Party Beneficiaries.

2. Classification.

b. Intended and Incidental Beneficiaries.

3. Incidental Beneficiaries.

aa. General Rule.

1 Witkin Sum. Cal. Law Contracts § 689

[§ 689] General Rule.

The contract must be *expressly* for the benefit of the third party. Hence, a person only remotely benefited, or a mere *incidental beneficiary*, cannot enforce it. (*Martinez v. Socoma Cos.* (1974) 11 C.3d 394, 406, 113 C.R. 585, 521 P.2d 841, *infra*, §691; *Garcia v. Truck Ins. Exchange* (1984) 36 C.3d 426, 436, 437, 204 C.R. 435, 682 P.2d 1100; *Mottashed v. Central & Pac. Imp. Corp.* (1935) 8 C.A.2d 256, 260, 47 P.2d 525; *Thode v. McAmis* (1950) 96 C.A.2d 833, 839, 216 P.2d 548; *Shutes v. Cheney* (1954) 123 C.A.2d 256, 262, 266 P.2d 902; *San Francisco v. Western Air Lines* (1962) 204 C.A.2d 105, 120, 22 C.R. 216; *Chacksfield v. Los Angeles County Flood Control Dist.* (1966) 245 C.A.2d 193, 194, 53 C.R. 774; *Gordon Bldg. Corp. v. Gibraltar Savings & Loan Assn.* (1966) 247 C.A.2d 1, 7, 55 C.R. 884; *Walters v. Calderon* (1972) 25 C.A.3d 863, 870, 102 C.R. 89; *Walters v. Marler* (1978) 83 C.A.3d 1, 32, 33, 147 C.R. 655; *Kirst v. Silna* (1980) 103 C.A.3d 759, 763, 163 C.R. 230; *Dateline Builders v. Santa Rosa* (1983) 146 C.A.3d 520, 526, 194 C.R. 258, citing the text; *Sofias v. Bank of America* (1985) 172 C.A.3d 583, 587, 218 C.R. 388; *Ascherman v. General Reinsurance Corp.* (1986) 183 C.A.3d 307, 311, 228 C.R. 1, citing the text; *Brown v. California State Lottery Com.* (1991) 232 C.A.3d 1335, 1340, 284 C.R. 108; *Fireman's Fund Ins. Co. v. Maryland Cas. Co.* (1994) 21 C.A.4th 1586, 1600, 26 C.R.2d 762; *Kalmanovitz v. Bitting* (1996) 43 C.A.4th 311, 314, 50 C.R.2d 332, 13 Summary (10th), Equity, §34; *Bancomer, S.A. v. Superior Court* (1996) 44 C.A.4th 1450, 1458, 52 C.R.2d 435; *Berclain America Latina v. Baan Co.* (1999) 74 C.A.4th 401, 405, 87 C.R.2d 745; see *Rest.2d, Contracts* §302(2) ["An incidental beneficiary is a beneficiary who is not an intended beneficiary"]; §315 [incidental beneficiary acquires no right]; *Corbin* §779C et seq.; 13 *Williston* 4th, §37:19 et seq.; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §§433 et seq., 447; 26 *Cal. L. Rev.* 627; 61 *Harv. L. Rev.* 1054; 6 *Hastings L. J.* 368; 27 *Hastings L. J.* 137; 75 *A.L.R.4th* 836 [employee as incidental beneficiary of contract between security services company and employer].)

West's Key Number Digest, Contracts k.187(1)

SUPPLEMENT: [This section is current through the latest supplement]

See *Landale-Cameron Court v. Ahonen* (2007) 155 C.A.4th 1401, 1410, 66 C.R.3d 776 [condominium homeowners association was not third-party beneficiary of contract between decking and flooring company and condominium

builder-developers, where association was not yet in existence when contract was executed and there was no evidence that association was intended to benefit from contract]; 9 Corbin (Rev. ed.), §44.9.



6 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law XI. RIGHTS AND OBLIGATIONS OF THIRD PARTIES

A. Third-Party Beneficiaries.

2. Classification.

b. Intended and Incidental Beneficiaries.

3. Incidental Beneficiaries.

bb. Audit Reports.

1 Witkin Sum. Cal. Law Contracts § 690

[§ 690] Audit Reports.

In *Mariani v. Price Waterhouse* (1999) 70 C.A.4th 685, 82 C.R.2d 671, plaintiffs, major stockholders of a leasing corporation who had guaranteed the corporation's lines of credit through their investment partnerships, sued the corporation's auditor for breach of contract, alleging that defendant misrepresented the financial condition of the corporation. *Held*, judgment for defendant on demurrer sustained.

(a) Two aspects of audit reports necessarily have an impact on an analysis of the third-party beneficiary issue in audit report cases: (1) In ordinary circumstances, the audit report is not produced, in fact, for the third parties who may ultimately be influenced by it. Rather, the client company is the entity for whom the audit report is produced and to whom it is addressed and delivered. (2) Audit reports have a public function; they serve to communicate accounting information to persons outside an enterprise who use the information to make various financial decisions. Thus, there is a potential for widespread third-party impact that is *inherent* in the contractual relationship for audit services. Given the conceivably limitless class of persons who legitimately rely on any particular audit report, additional factors must be present if persons from within this broad class will be contractually entitled to rely on the report arising from a particular engagement for audit services. The class of *inherent* third-party beneficiaries is not the class of *express* third-party beneficiaries, or else the distinction between incidental and express beneficiaries (see *Rest.2d, Contracts* §302, *supra*, §687) would lose all meaning in the audit report context. (70 C.A.4th 700.) Thus, "as a matter both of policy and of reality there are no 'express third party beneficiaries' of an ordinary, white-bread audit engagement contract. There are only incidental beneficiaries who have no legal rights arising from the contract." (70 C.A.4th 701.)

(b) Plaintiffs failed to allege facts that would permit an inference that defendant's services were performed pursuant to a contract that was out of the ordinary, i.e., that established plaintiffs as third-party beneficiaries: (1) There was no allegation of a formal or informal contract in which the corporation agreed to provide an audit report to plaintiffs as a condition of their agreement to guarantee the corporation's debts. (2) There was no allegation that the audit contract contemplated that defendant would provide audit reports or financial advice directly to plaintiffs, whether described individually or as part of a class. (3) There were no allegations that the corporation intended the audit report to guide decisions plaintiffs might make as guarantors. (4) There were no allegations that the course of dealing between the

corporation and defendant permitted an inference that the corporation intended to use the audit report to influence plaintiffs in any particular transaction or type of transaction. (*70 C.A.4th 701.*)

SUPPLEMENT: [This section is current through the latest supplement]



7 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XI. RIGHTS AND OBLIGATIONS OF THIRD PARTIES

A. Third-Party Beneficiaries.

2. Classification.

b. Intended and Incidental Beneficiaries.

3. Incidental Beneficiaries.

cc. No Action Against Government Contractor.

1 Witkin Sum. Cal. Law Contracts § 691

[§ 691] No Action Against Government Contractor.

The elusive distinction between express and incidental beneficiaries was the subject of a 4-3 opinion in *Martinez v. Socoma Cos.* (1974) 11 C.3d 394, 113 C.R. 585, 521 P.2d 841. The federal Economic Opportunity Act instituted Special Impact Programs to make federal funds available for contracts with local private industry for the benefit of hard-core unemployed residents. Plaintiffs brought this class action on behalf of over 2,000 East Los Angeles residents who were certified as disadvantaged and qualified for employment under these contracts. They alleged that, although the government paid out funds to defendant contractors, the latter did not provide the number of jobs authorized. *Held*, judgment for defendants on demurrer affirmed.

(a) Congress exercised its power to accomplish a public purpose--alleviation of national unemployment--not to make gifts. (11 C.3d 401.)

(b) Even if a person is not the intended recipient of a *gift*, he or she may be a donee beneficiary if it appears that the promisee's purpose was to confer on him or her a *right* against the promisor. But no such purpose was expressed in the government contracts, and it cannot be inferred simply from the fact that third persons were intended to enjoy the benefits. (11 C.3d 401.)

(c) In addition to this lack of manifested intent to make a gift, the contract provisions for retaining government control over determination of disputes and for liquidated damages indicate a purpose to exclude direct rights against defendants. (11 C.3d 402, 403, footnote 3.)

(d) Thus, despite the fact that they would benefit more directly than other members of the public, plaintiffs were merely incidental beneficiaries. (11 C.3d 406.)

The lengthy dissent argued that, so long as the contract expressly declares an intent to benefit a particular class, its members may enforce their rights in it notwithstanding the absence of a provision for damages for them in the event of breach. (11 C.3d 414.) (See *Zigas v. Superior Court* (1981) 120 C.A.3d 827, 835, 837, 174 C.R. 806 [following *Shell v.*

Schmidt (1954) 126 C.A.2d 279, 272 P.2d 82, *infra*, §819]; *Marina Tenants Assn. v. Deauville Marina Dev. Co.* (1986) 181 C.A.3d 122, 129, 130, 226 C.R. 321, *infra*, §694 [following *Zigas*]; 63 Cal. L. Rev. 126; 88 Harv. L. Rev. 646; 27 *Hastings L. J.* 137; 4 *Hastings Const. L. Q.* 769.)

Rest.2d, Contracts §313(1) states that the general rules apply to government contracts except where application would contravene the policy of the law authorizing the contract or prescribing remedies for its breach. Subsection (2) states that a promisor who contracts with a governmental agency to do an act for or render a service to the public is not liable to a member of the public for consequential damages resulting from performance or failure to perform unless "(a) the terms of the promise provide for such liability; or (b) the promisee is subject to liability to the member of the public for the damages and a direct action against the promisor is consistent with the terms of the contract and with the policy of the law authorizing the contract and prescribing remedies for its breach."

SUPPLEMENT: [This section is current through the latest supplement]



8 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law XI. RIGHTS AND OBLIGATIONS OF THIRD PARTIES

A. Third-Party Beneficiaries.

2. Classification.

b. Intended and Incidental Beneficiaries.

3. Incidental Beneficiaries.

dd. Other Illustrations.

1 *Witkin Sum. Cal. Law Contracts* § 692

[§ 692] Other Illustrations.

In *Sheppard v. Banner Food Products* (1947) 78 C.A.2d 808, 178 P.2d 455, plaintiff alleged that defendant Bortz contracted to sell real property to defendant Banner, and that, in reliance on this agreement, plaintiff lent money to Banner, the security to be a trust deed on the property. *Held*, plaintiff was only an incidental beneficiary of the contract, and could not obtain specific performance of Bortz' obligation to convey to Banner. (78 C.A.2d 812.)

In *Southern Calif. Gas Co. v. ABC Const. Co.* (1962) 204 C.A.2d 747, 22 C.R. 540, plaintiff alleged that defendant contracted with the Los Angeles County Flood Control District to install a storm drain, and that, in breach of a contract to comply with laws and regulations concerning the work, it caused an explosion damaging plaintiff's pipeline. *Held*, plaintiff was only an incidental beneficiary of that agreement, and was not entitled to recover in contract; different considerations might have applied if the suit had been in tort. (204 C.A.2d 752.)

In *Luis v. Orcutt Town Water Co.* (1962) 204 C.A.2d 433, 22 C.R. 389, Union Oil Co. contracted to supply O Water Co. with such water from Union's wells as the Water Co. required for its consumers in the Town of Orcutt. Plaintiff contended that as a result of failure of these defendants to furnish water (opening the valve) at the time of a fire, his mercantile store was destroyed. *Held*, a water company is not liable to a consumer for failure to furnish water or sufficient pressure for fire protection in the absence of an express contract with him or her for that purpose. And here, the plaintiff was only an incidental beneficiary of the contract between the water producer and the water distributor. (204 C.A.2d 441.) (See 6 *Summary* (10th), *Torts*, §1179.)

In *Eastern Aviation Group v. Airborne Express* (1992) 6 C.A.4th 1448, 8 C.R.2d 355, defendant contracted to buy a designated number of noise reduction systems for aircraft, and to make payment to an account held jointly by the seller and by plaintiff, who, as an investor in the seller, was entitled to 50% of the profits. When defendant instead made payments directly to the seller, which allegedly converted them to its own use, plaintiff sued as a third-party beneficiary. *Held*, plaintiff was merely an incidental beneficiary. The contract here was simply a sales contract under which a purchaser agreed to pay the seller for goods delivered. Hence, defendant's promise was to pay the seller, which it did, and the provision directing payment to a particular account was merely to accommodate the seller. This was not a

situation where defendant promised to pay the seller's creditors in order to obtain the seller's performance. (6 C.A.4th 1453.)

SUPPLEMENT: [This section is current through the latest supplement]



9 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law XI. RIGHTS AND OBLIGATIONS OF THIRD PARTIES

A. Third-Party Beneficiaries.

3. Rights, Remedies, Duties, and Defenses.

a. Duties of Promisor.

1 Witkin Sum. Cal. Law Contracts § 693

[§ 693] Duties of Promisor.

(1) *Duty to Intended Beneficiary.* The promisor owes a duty to any intended beneficiary, and the latter may enforce the duty. (See *Rest.2d, Contracts §304*; Corbin §810; 13 Williston 4th, §37:9 et seq.; on rights of the beneficiary, see *infra*, §694.)

(2) *Duty to Promisee.* *Rest.2d, Contracts §305* states the overlapping duties to the beneficiary and the promisee: (a) A promise in a contract creates a duty in the promisor to the promisee to perform the promise even though he or she also has a similar duty to an intended beneficiary. (b) Whole or partial satisfaction of the promisor's duty to the beneficiary satisfies to that extent the promisor's duty to the promisee. (See *Kraus v. Willow Park Public Golf Course* (1977) 73 C.A.3d 354, 371, 140 C.R. 744, citing the text; Corbin §§823, 824; 13 Williston 4th, §§37:52, 37:53; *infra*, §694.)

West's Key Number Digest, Contracts k.187(5)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Duty to Intended Beneficiary.* See 9 Corbin (Rev. ed.), §46.1.

(2) *Duty to Promisee.* See 9 Corbin (Rev. ed.), §46.1 et seq.



10 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law XI. RIGHTS AND OBLIGATIONS OF THIRD PARTIES

A. Third-Party Beneficiaries.

3. Rights, Remedies, Duties, and Defenses.

b. Rights and Remedies of Beneficiary.

1 Witkin Sum. Cal. Law Contracts § 694

[§ 694] Rights and Remedies of Beneficiary.

A "creditor beneficiary" (or "intended beneficiary" under the Second Restatement) can sue either the promisor or the promisee, or may join them and obtain judgment against both, for the promisee is indebted to the beneficiary on the old obligation and the promisor on the new promise. No assent by the beneficiary, or knowledge of the contract, is necessary to give the beneficiary a right of action; but he or she may voluntarily waive or disclaim his or her rights at any reasonable time after learning of the existence and terms of the contract. (See *Rest.2d, Contracts §306*; *Bass v. John Hancock Mut. Life Ins. Co. (1974) 10 C.3d 792, 796, 112 C.R. 195, 518 P.2d 1147*, *infra*, §705 [no waiver found]; *Stanley v. Robert S. Odell & Co. (1950) 97 C.A.2d 521, 533, 218 P.2d 162*; *Corbin §811*; *13 Williston 4th, §37:57 et seq.*)

Satisfaction by either the promisee or promisor, in whole or in part, will operate as complete or partial satisfaction of the liability of the other. (See *Anderson v. Calaveras Cen. Mining Corp. (1936) 13 C.A.2d 338, 343, 57 P.2d 560*; *Kraus v. Willow Park Public Golf Course (1977) 73 C.A.3d 354, 371, 140 C.R. 744*, citing the text; *Rest.2d, Contracts §310*; *Corbin §792*; *13 Williston 4th, §37:54*; *6 Hastings L. J. 369.*) (On remedy of specific performance, see *Rest.2d, Contracts §307*; on enforcement by personal representative of deceased promisee, see *76 A.L.R.2d 231*; and see *infra*, §697 *et seq.*)

The beneficiary cannot assert greater rights than those of the promisee. Thus, in *Marina Tenants Assn. v. Deauville Marina Dev. Co. (1986) 181 C.A.3d 122, 226 C.R. 321*, Los Angeles County leased public land to defendant developer for construction of apartments. The lease provided that rents to be charged tenants "shall be fair and reasonable" and subject to approval by the county's director. Although the director did approve rents charged during a 4-year period, plaintiff tenants brought this action, as third-party beneficiaries, alleging that the rents were excessive, and seeking damages in the amount of excess rents actually paid. *Held*, judgment for defendant on demurrer affirmed.

(a) Although the lease contained ambiguities, it could be interpreted to make the tenants intended beneficiaries, for the tenants would obviously be the beneficiaries of the restriction on rents. (*181 C.A.3d 130, 131, 132.*)

(b) However, the lease not only provided for fair and reasonable rents but also for determination by the County that the rents were fair and reasonable. Once the County determined that they were, the County itself (promisee) was bound

by them and could not seek a retroactive modification against the developer-lessee (promisor). (181 C.A.3d 133.) "For the Tenants to seek a *redetermination* of the rents after the County's approval of all rates is to arrogate to them a right that does not exist under the lease, and further, would subject the Lessees' activities to a two-tier review. Requiring all rents to be approved as 'fair and reasonable' twice, once by the County and again by the Tenants possibly through court process, would make the Lessees' performance substantially more burdensome." (181 C.A.3d 133.)

SUPPLEMENT: [This section is current through the latest supplement]

Right of action:

See *Schauer v. Mandarin Gems of Calif.* (2005) 125 C.A.4th 949, 957, 23 C.R.3d 233 [in breach of contract action alleging that defendant jeweler sold inferior engagement ring to fiancée, who gave it to plaintiff, plaintiff had standing to sue as third-party beneficiary, based on allegation that defendant-promisor entered into contract knowing that fiancée-promisee purchased ring for sole purpose of giving it to plaintiff]; 9 Corbin (Rev. ed.), §46.1.

Effect of satisfaction by promisee or promisor: See 9 Corbin (Rev. ed.), §45.1.



11 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law XI. RIGHTS AND OBLIGATIONS OF THIRD PARTIES

A. Third-Party Beneficiaries.

3. Rights, Remedies, Duties, and Defenses.

c. Defenses of Promisor.

1 Witkin Sum. Cal. Law Contracts § 695

[§ 695] Defenses of Promisor.

The beneficiary can recover from the promisor only if there is a valid and existing obligation between the promisor and the promisee. Hence, any defense of the promisor against the promisee may be set up against the beneficiary. (See *Rest.2d, Contracts §309*; *Corbin §816 et seq.*; *13 Williston 4th, §§37:17, 37:23 et seq.*; *17 Am.Jur.2d (2004 ed.)*, *Contracts §460*; *13 Stanf. L. Rev. 926* [supervening defenses].)

The following are examples:

(1) *Contract voidable or unenforceable.* (See *Johnson v. Superior Court (2000) 80 C.A.4th 1050, 1065, 95 C.R.2d 864*, citing the text [contract between sperm bank and recipients of donated sperm precluding disclosure of donor's identity and related confidential information under all circumstances was contrary to public policy and thus unenforceable by donor]; *Rest.2d, Contracts §309(1)*; *Corbin §818*; *13 Williston 4th, 37:55 et seq.*; *31 Golden Gate L. Rev. 193* [Johnson].)

(2) *Impossibility or failure of performance.* (See *Rest.2d, Contracts §309(2)*; *Corbin §818*; *13 Williston 4th, 37:55 et seq.*)

(3) *Breach by the promisee.* If the promisee breaches the contract, and the damages to the promisor exceed the amount he or she was obligated to pay, the third-party beneficiary is not entitled to any recovery. (*Votaw Precision Tool Co. v. Air Canada (1976) 60 C.A.3d 52, 56, 131 C.R. 335.*)

(4) *Statute of Limitations.* In *Skylawn v. Superior Court (1979) 88 C.A.3d 316, 151 C.R. 793*, plaintiff advanced the discredited theory that the contract between the promisor and promisee is a mere offer to the third-party beneficiary that must be accepted by him or her before the cause of action arises. On this theory, plaintiff's action, brought more than 4 years after execution of the contract, would be timely because he had no knowledge of that contract until shortly before filing of the action. *Held*, the cause of action on a third-party beneficiary contract accrues at the time of its execution or maturation of the obligation assumed, and the beneficiary is as much subject to the statute of limitations as the promisee, despite his or her ignorance of the contract. (*88 C.A.3d 319.*) By way of explanation, the court quoted *Corbin* as follows: "[T]he right of the creditor came to him by a sort of 'unexpected grace' and without consideration from him.

If the statute should bar his remedy by a like accident because of his ignorance he would still be in exactly as good a position as his own contract originally put him. The law giveth and the law taketh away. The 'unexpected grace' is nullified by the unexpected limitation." (88 C.A.3d 320.) (See *Bogart v. George K. Porter Co.* (1924) 193 C. 197, 201, 223 P. 959; *Sanders v. American Cas. Co. of Redding, Pennsylvania* (1969) 269 C.A.2d 306, 308, 74 C.R. 634 [statute of limitations in surety bond barred materialman unaware of the limitation]; 11 Cal. L. Rev. 429; 27 Cal. L. Rev. 497, 522.)

SUPPLEMENT: [This section is current through the latest supplement]

Promisor's defenses available against beneficiary: See 9 Corbin (Rev. ed.), §46.1 et seq.

(1) *Contract voidable or unenforceable.* See 9 Corbin (Rev. ed.), §46.5.

(2) *Impossibility or failure of performance.* See 9 Corbin (Rev. ed.), §46.5.



12 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XI. RIGHTS AND OBLIGATIONS OF THIRD PARTIES
A. Third-Party Beneficiaries.
3. Rights, Remedies, Duties, and Defenses.
d. Promisee's Right To Bring Damage Action Against Promisor.

1 Witkin Sum. Cal. Law Contracts § 696

[§ 696] Promisee's Right To Bring Damage Action Against Promisor.

In re Marriage of Smith & Maescher (1993) 21 C.A.4th 100, 26 C.R.2d 133, involved a Massachusetts separation agreement under which defendant husband promised plaintiff wife that he would pay for their son Peter's college education. When defendant breached this agreement, plaintiff advanced Peter \$ 11,109 for his senior year of college, and then brought the present action against defendant to recover that amount. *Held*, judgment for plaintiff reversed.

(a) Defendant incorrectly contends that only Peter, as the intended third-party beneficiary as to college expenses, could enforce defendant's promise to pay for these expenses. In fact, both Peter and plaintiff, as the promisee, could enforce the contract by obtaining specific performance against defendant. (*21 C.A.4th 105*, citing *Walsh v. Walsh (1940) 42 C.A.2d 282, 108 P.2d 760*, *infra*, §699, numerous Massachusetts cases, and *Rest.2d, Contracts §307*.)

(b) However, this does not mean that plaintiff was automatically entitled to bring a damage action when defendant breached the promise. Instead, the existence of this right depends upon whether Peter was a creditor or donee beneficiary. If the promisor does not pay the promisee's debt to a creditor beneficiary, then the promisee remains liable to the beneficiary and can directly suffer damages in the amount of the debt. However, if the promisor fails to perform his or her obligation to a donee beneficiary, the promisee is not liable to the beneficiary for the performance and suffers only nominal damages. Hence, in the donee beneficiary situation, the promisee has no cause of action for damages in the event of the promisor's breach of contract. (*21 C.A.4th 107*, noting that neither California nor Massachusetts law deals with this issue and thus adopting principles set forth in *Rest.2d, Contracts §§304, 307, 310*.)

(c) Here, there is no evidence that plaintiff had a legal obligation to pay Peter's college expenses if defendant did not. Hence, Peter was a donee beneficiary who had a direct cause of action against defendant for breach of the contract, but who had no legal recourse against plaintiff for payment of his college expenses. And the fact that plaintiff voluntarily made a loan to Peter without any legal obligation to do so does not establish that she incurred legal damages as a result of defendant's breach of the separation agreement. (*21 C.A.4th 108*.)

SUPPLEMENT: [This section is current through the latest supplement]



13 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law XI. RIGHTS AND OBLIGATIONS OF THIRD PARTIES

A. Third-Party Beneficiaries.

4. Particular Beneficiaries Who May Enforce Agreement.

a. Beneficiary of Assumption Agreement.

1 Witkin Sum. Cal. Law Contracts § 697

[§ 697] Beneficiary of Assumption Agreement.

(1) *Lessor After Assignment or Sublease.* When a tenant assigns a *lease*, and the assignee agrees "to perform all of the terms" thereof, the agreement between the tenant and assignee is for the benefit of the *lessor*, and he or she may sue the assignee. (*Bank of America v. Moore* (1937) 18 C.A.2d 522, 524, 64 P.2d 460.) In *Hartman Ranch Co. v. Associated Oil Co.* (1937) 10 C.2d 232, 73 P.2d 1163, the same rule was applied to a *sublessee*. Defendant sublessee of oil land expressly agreed with its sublessors (the original lessee and his coowners) to perform the covenants of the parent lease. Plaintiff lessor sued for breach of the implied covenant to protect the land from drainage by adjacent wells. *Held*, defendant was liable. The sublessee is not in privity of estate with the lessor, and ordinarily not in privity of contract with him or her; hence, usually the lessor has no right of action against him or her. The same is true of an assignee after abandonment of possession. But when the assignee or sublessee has assumed the obligations by a promise to the lessee, the object of the assumption is to discharge the lessee's duty to the lessor, and the lessor is a creditor beneficiary of the agreement. (10 C.2d 244.) (See 12 Summary (10th), *Real Property*, §§539, 542.)

If the lessor has expressly agreed to a sublease the sublessee is a third-party beneficiary entitled to sue the lessor for breach of the implied covenant of quiet enjoyment. (*Marchese v. Standard Realty & Dev. Co.* (1977) 74 C.A.3d 142, 147, 141 C.R. 370, 12 Summary (10th), *Real Property*, §543.)

(2) *Creditors of Buyer of Business.* When a business is sold and the buyer assumes the liabilities of the seller's business, the creditors are beneficiaries of the assumption agreement. (*Dick v. Woolson* (1951) 106 C.A.2d 415, 419, 235 P.2d 119; *R.J. Cardinal Co. v. R.J. Ritchie* (1963) 218 C.A.2d 124, 135, 32 C.R. 545 [defendants orally agreed with S to pay S's indebtedness to plaintiff]; see *infra*, §700; cf. *Fruitvale Canning Co. v. Cotton* (1953) 115 C.A.2d 622, 625, 252 P.2d 953 [agreement showed no intent that buyer-promisor should pay].)

(3) *Mortgagee After Grant by Mortgagor.* When a mortgagor grants property and his or her grantee assumes the mortgage debt, the *mortgagee* could be deemed a creditor beneficiary. The earlier California cases applied the "equitable asset" or "subrogation" theory to this situation, and did not treat him or her as a third-party beneficiary. (See *Case v. Egan* (1922) 57 C.A. 453, 454, 207 P. 388.) But later decisions use language indicating that the question is still open. (See *Hartman Ranch Co. v. Associated Oil Co.*, *supra*, 10 C.2d 245; *Central Bank of Oakland v. Wells Fargo Bank* (1937) 18 C.A.2d 559, 561, 64 P.2d 465; Corbin §796, 797; 13 Williston 4th, §37:41 et seq.; 27 Cal. L. Rev. 497,

513; 6 *Hastings L. J.* 364; 55 *Am.Jur.2d* (1996 ed.), *Mortgages* §1121 et seq.; 4 *Summary* (10th), *Security Transactions in Real Property*, §107 et seq.)

(4) *Grantee of Debtor Who Assumes Debts.* < In >20th Century Cigarette Vendors v. Shaheen (1966) 241 C.A.2d 391, 50 C.R. 773, three persons in a joint venture to develop property borrowed money and made unsecured promissory notes to plaintiffs. They were unsuccessful, and conveyed their property to V, who orally agreed to pay their debts. *Held*, plaintiffs, creditor beneficiaries, were entitled to enforce the oral promise. The statute of frauds was not a bar, because the promise was made to the debtor (see *supra*, §374); hence, the right of the creditor beneficiaries was the same as one arising from a written assumption agreement. (241 C.A.2d 395.)

West's Key Number Digest, Landlord and Tenant k.208(2)

SUPPLEMENT: [This section is current through the latest supplement]

(3) *Mortgagee After Grant by Mortgagor.* See 9 Corbin (Rev. ed.), §45.1.



14 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XI. RIGHTS AND OBLIGATIONS OF THIRD PARTIES

A. Third-Party Beneficiaries.

4. Particular Beneficiaries Who May Enforce Agreement.

b. Prospective Beneficiary of Will.

1 Witkin Sum. Cal. Law Contracts § 698

[§ 698] Prospective Beneficiary of Will.

In *Buckley v. Gray* (1895) 110 C. 339, 42 P. 900, defendant attorney was employed by testator to draw a will in favor of plaintiff and others. Defendant negligently failed to perform his promise to secure the desired devise to plaintiff. *Held*, plaintiff was a mere incidental beneficiary, and had no remedy in either contract or tort. (110 C. 342, 346.) The *Buckley* rule was repudiated in *Biakanja v. Irving* (1958) 49 C.2d 647, 648, 320 P.2d 16, 6 Summary (10th), *Torts*, §1179. (See 65 A.L.R.2d 1363 [liability of one drawing invalid will].)

In *Lucas v. Hamm* (1961) 56 C.2d 583, 15 C.R. 821, 364 P.2d 685, 1 Cal. Proc. (4th), *Attorneys*, §322, although no actionable negligence was found, the court recognized that a tort action for negligence and a contract action as third-party beneficiary were both proper remedies of the intended beneficiary against the attorney draftsman. As to the latter theory, the opinion held that the fact that the performance is not to be rendered directly to the beneficiary does not make him "remote." The main purpose of the testator client in making the agreement with the attorney draftsman is to benefit the persons named in his will. Because this intent can be effectuated, in the event of breach, only by giving the beneficiaries a right of action, "we should recognize, as a matter of policy, that they are entitled to recover as third-party beneficiaries." (56 C.2d 590.)

SUPPLEMENT: [This section is current through the latest supplement]

Lucas case:

Cross-Reference: 1 Cal. Proc. (5th), *Attorneys*, §297.



15 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XI. RIGHTS AND OBLIGATIONS OF THIRD PARTIES

A. Third-Party Beneficiaries.

4. Particular Beneficiaries Who May Enforce Agreement.

c. Express Though Not Sole Beneficiary.

1 *Witkin Sum. Cal. Law Contracts* § 699

[§ 699] Express Though Not Sole Beneficiary.

The contract need not be *exclusively* for the benefit of the third party, i.e., he or she need not be the sole or the primary beneficiary. (*Montgomery v. Dorn* (1914) 25 C.A. 666, 672, 145 P. 148; *Stanton v. Santa Ana Sugar Co.* (1927) 84 C.A. 206, 209, 257 P. 907; *LeBallister v. Redwood Theatres* (1934) 1 C.A.2d 447, 448, 36 P.2d 827; *Walsh v. Walsh* (1940) 42 C.A.2d 282, 285, 108 P.2d 760 [property settlement agreement provided for payments to wife for support of minor children; child was held to be third-party beneficiary]; *Johnson v. Superior Court* (2000) 80 C.A.4th 1050, 1064, 95 C.R.2d 864, citing the text; see 17 *Am.Jur.2d* (2004 ed.), *Contracts* §446; 21 *A.L.R.2d* 1061, 1067 [enforcement by child of contract in consideration of naming child]; 34 *A.L.R.2d* 1357 [enforcement by child of parents' separation or property settlement agreement].)

An agreement between vendor and purchaser that expressly provides for the payment of a commission to a broker makes the broker a third-party beneficiary. (*Lundeen v. Nowlin* (1912) 20 C.A. 415, 417, 129 P. 474.) But the broker is not safe in relying upon mention of his or her commission in *escrow instructions*. In *Steinberg v. Buchman* (1946) 73 C.A.2d 605, 167 P.2d 207, the vendor employed plaintiff broker, who found defendant purchaser. The vendor signed escrow instructions that directed the purchaser to pay the price, taxes, and certain expenses, and also provided: "Pay to S. H. Steinberg, a licensed real estate broker ... as a commission the amount called for in agreement to be handed you by him." Defendant purchaser, in his separately signed escrow instructions, merely agreed to pay the price and his share of the incidental expenses. *Held*, defendant was not liable for the broker's commission, because the vendor's *directions* to defendant did not constitute a promise by *defendant*, and defendant's promise to pay the price and certain expenses to the *vendor* did not obligate him to pay any money to the broker. "Defendant did not, by the mere act of placing his signature beneath a specification of the things which he agreed to do, assume or join in the separate undertakings of [the vendor] which were set out in the latter's instructions. ... Defendant no more assumed an obligation for the payment of a commission to plaintiff than he assumed obligations to other creditors of [the vendor], such as the company which would write the policy of insurance, the holders of encumbrances on the property, etc. [The vendor's] direction to the escrow holder for the payment of the commission was expressly for plaintiff's benefit but it was in no sense a contract to which defendant was a party." (73 C.A.2d 608.)

SUPPLEMENT: [This section is current through the latest supplement]



16 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XI. RIGHTS AND OBLIGATIONS OF THIRD PARTIES

A. Third-Party Beneficiaries.

4. Particular Beneficiaries Who May Enforce Agreement.

d. Express Beneficiary Not Identified.

1. In General.

aa. Identification of Beneficiary.

1 Witkin Sum. Cal. Law Contracts § 700

[§ 700] Identification of Beneficiary.

It is not necessary that the contract identify or refer to the third party by name; that party may recover on it if he or she can show that he or she is one of a class of persons for whose benefit the contract was made. (*Garratt v. Baker* (1936) 5 C.2d 745, 748, 56 P.2d 225; *Bryan v. Banks* (1929) 98 C.A. 748, 756, 277 P. 1075; *Woodhead Lumber Co. v. E.G. Niemann Inv.* (1929) 99 C.A. 456, 459, 278 P. 913; *Shell v. Schmidt* (1954) 126 C.A.2d 279, 290, 272 P.2d 82 [veteran home purchasers held beneficiaries of contract between government and building contractor requiring conformity with plans and specifications]; *Spector v. National Pictures Corp.* (1962) 201 C.A.2d 217, 224, 20 C.R. 307; *Kaiser Engineers v. Grinnell Fire Protection Systems Co.* (1985) 173 C.A.3d 1050, 1055, 219 C.R. 626, citing the text; *Marina Tenants Assn. v. Deauville Marina Dev. Co.* (1986) 181 C.A.3d 122, 128, 226 C.R. 321, supra, §694, citing the text; *Steve Schmidt & Co. v. Berry* (1986) 183 C.A.3d 1299, 1313, 228 C.R. 689; *Alling v. Universal Mfg. Corp.* (1992) 5 C.A.4th 1412, 1440, 7 C.R.2d 718 [holder of patented technology was intended beneficiary of contract by which manufacturer purchased patent holder's license and promised to use its best efforts in developing the technology]; *Harper v. Wausau Ins. Co.* (1997) 56 C.A.4th 1079, 1086, 66 C.R.2d 64, 2 Summary (10th), *Insurance*, §304, citing the text; *Brinton v. Bankers Pension Services* (1999) 76 C.A.4th 550, 558, 90 C.R.2d 469 [in action against investment company to recover for unsuccessful investments, defendant was third-party beneficiary of settlement of class action in which plaintiff participated, where settlement defined released defendants to include principals of listed defendants and defendant was principal of one of those defendants]; see *Rest.2d, Contracts* §308 ["It is not essential to the creation of a right in an intended beneficiary that he be identified when a contract containing the promise is made"]; *Corbin* §781; 13 *Williston* 4th, §§37:27, 37:39; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §§436, 443; *BAJI*, No. 10.59 [third-party beneficiary contract]; *CACI*, No. 301 [third-party beneficiary].)

West's Key Number Digest, Contracts k.187(1)

SUPPLEMENT: [This section is current through the latest supplement]
See 9 *Corbin* (Rev. ed.), §44.8.



17 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XI. RIGHTS AND OBLIGATIONS OF THIRD PARTIES
A. Third-Party Beneficiaries.
4. Particular Beneficiaries Who May Enforce Agreement.
d. Express Beneficiary Not Identified.
1. In General.
bb. Illustrations.

1 Witkin Sum. Cal. Law Contracts § 701

[§ 701] Illustrations.

In *Bryan v. Banks* (1929) 98 C.A. 748, 277 P. 1075, a partnership had executed its promissory note. Later a corporation was formed, which took over the business and entered into a contract with the partners to assume the liabilities of the firm. *Held*, the holder of the note could sue the corporation. In other words, where a purchaser takes property under an agreement to pay off the indebtedness of the seller, the creditors of the seller, although not expressly mentioned, have a right to enforce it. (98 C.A. 756.) (See *Sherwood & Sherwood v. Gill & Lutz* (1918) 36 C.A. 707, 712, 173 P. 171; 7 Cal. L. Rev. 197.)

In *Woodhead Lumber Co. v. E.G. Niemann Inv.* (1929) 99 C.A. 456, 459, 278 P. 913, a contractor's surety bond, indemnifying the owner for loss suffered by nonperformance, was interpreted as being expressly for the benefit of materialmen. (See *Rexroth & Rexroth v. General Cas. Co. of America* (1966) 242 C.A.2d 363, 372, 51 C.R. 505 [subdivider's performance bond to county containing material and labor bond; laborers and materialmen entitled to sue surety]; cf. *Thode v. McAmis* (1950) 96 C.A.2d 833, 837, 216 P.2d 548 [distinguishing *Woodhead*, and holding that differently worded bond did not give materialman right to sue]; *Rest.3d, Suretyship and Guaranty* §69.)

In *Johnson v. Holmes Tuttle Lincoln-Mercury* (1958) 160 C.A.2d 290, 325 P.2d 193, defendant automobile dealer with a licensed insurance department sold a car to C, its salesman orally promising "full coverage" insurance. The insurance actually given protected the conditional seller's interest alone, and did not include public liability or property damage. Plaintiffs, injured in an accident, obtained judgments against C, which were unsatisfied, and then brought this action against defendant seeking damages for breach of the oral promise to insure. *Held*, judgment for plaintiffs affirmed. The statute that allows an injured third party to sue the insurer on an unsatisfied judgment (see 2 *Summary* (10th), *Insurance*, §301) makes the benefit of a policy available to the "creditor beneficiary tortfeasee." (160 C.A.2d 298.) Hence, the agreement between defendant and C was not solely for C's benefit, but "was intended to inure to the benefit of third persons who might be protected by a full coverage policy." (160 C.A.2d 300.) In other words, C, in seeking liability insurance, sought to protect himself by securing protection for the unknown third persons who might be injured.

In *COAC v. Kennedy Engineers* (1977) 67 C.A.3d 916, 136 C.R. 890, plaintiff was awarded the general contract to construct a water treatment plant for C District. C District had previously engaged defendants to prepare engineering plans and an environmental impact report (see 12 *Summary* (10th), *Real Property*, §832 et seq.). Plaintiff brought this action for damages against defendants, alleging that their contract with C District was for plaintiff's benefit; that defendants had breached it by first failing to provide an impact report and by later furnishing a defective report that did not comply with the statute; and that as a result of these breaches plaintiff suffered delays in construction. The lower court rendered judgment on demurrer because the complaint failed to allege that the contract was "expressly" for plaintiff's benefit (see C.C. 1559). *Held*, reversed.

(a) The complaint could be amended to allege that the contract was "expressly" for plaintiff's benefit (67 C.A.3d 919), and it was not necessary that plaintiff be named or identified in that contract (67 C.A.3d 920).

(b) Plaintiff was a creditor beneficiary of the contract between C District and defendants if defendants' performance would satisfy a duty owed by the District under its contract with plaintiff. (67 C.A.3d 919.) Under the latter contract, the District owed a legal duty not to hinder or delay performance (67 C.A.3d 920; see *infra*, §798); an impact report was essential to commencement of construction (67 C.A.3d 921, 922); and, unless otherwise provided in the contract, the responsibility for compliance with the statute is on the public agency (67 C.A.3d 922). "The District (respondents' promisee) was therefore subject to an implied covenant to provide an EIR as a necessary condition to appellant's performance of its contract. ... The District attempted to discharge this duty via its contract with respondents. It follows that appellant is a creditor beneficiary thereunder." (67 C.A.3d 922.) (See *Gunter v. Stockton* (1976) 55 C.A.3d 131, 141, 126 C.R. 690, 127 C.R. 602, 12 *Summary* (10th), *Real Property*, §612, citing the text [lease named corporation as occupant of premises, though not a formal party to the lease]; *Gilbert Financial Corp. v. Steelform Contracting Co.* (1978) 82 C.A.3d 65, 70, 145 C.R. 448; *Zigas v. Superior Court* (1981) 120 C.A.3d 827, 835, 837, 174 C.R. 806 [holding plaintiffs direct beneficiaries under standard of *Shell v. Schmidt*, *supra*, §819, and distinguishing *Martinez v. Socoma Cos.* *supra*, §691]; *Zakaria v. Lincoln Property Co.* (1986) 185 C.A.3d 500, 508, 229 C.R. 669 [following *Zigas*].)

SUPPLEMENT: [This section is current through the latest supplement]

See *Performance Plastering v. Richmond Amer. Homes of Calif.* (2007) 153 C.A.4th 659, 667, 63 C.R.3d 537 [subcontractor's liability insurer was third-party beneficiary of subcontractor's settlement agreements with general contractor and thus had standing to sue general contractor for breach of agreements, even though subcontractor was suspended as corporation and agreements were voidable; because agreements released and discharged subcontractor and its insurers, insurer was member of class for whose benefit agreements were made, although they did not mention insurer by name].



18 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law XI. RIGHTS AND OBLIGATIONS OF THIRD PARTIES

A. Third-Party Beneficiaries.

4. Particular Beneficiaries Who May Enforce Agreement.

d. Express Beneficiary Not Identified.

2. Collective Labor Agreement.

1 *Witkin Sum. Cal. Law Contracts* § 702

[§ 702] Collective Labor Agreement.

An employee-member of a labor union is entitled to sue as a third party beneficiary of a collective labor agreement between an employer and the union. (See *Sublett v. Henry's Turk & Taylor Lunch* (1942) 21 C.2d 273, 275, 131 P.2d 369; *Division of Labor Law Enforcement, Dept. of Industrial Relations v. Dennis* (1947) 81 C.A.2d 306, 309, 183 P.2d 932.) And, where the agreement broadly refers to "employees," even a *nonunion* employee may be deemed within the class entitled to rights thereunder. (*Leahy v. Smith* (1955) 137 C.A.2d Supp. 884, 885, 290 P.2d 679 [plaintiff holding "work permit" card of union held entitled to sue on agreement].) (See *Lewis v. Benedict Coal Corp.* (1960) 361 U.S. 459, 80 S.Ct. 489, 493, 4 L.Ed.2d 442, 446 [action by trustees of union welfare fund against corporate employer]; *Reynolds Elec. & Engineering Co. v. Work. Comp. App. Bd.* (1966) 65 C.2d 429, 433, 55 C.R. 248, 421 P.2d 96, 2 Summary (10th), *Workers' Compensation*, §112; *Chicago Bridge & Iron Co. v. Industrial Acc. Com.* (1964) 226 C.A.2d 309, 318, 38 C.R. 57, 2 Summary (10th), *Workers' Compensation*, §112 [contract between union and employer had same legal effect on employee's workers' compensation as though made directly with the employer]; Corbin §§781, 782; 13 Williston 4th, §37:29; 48A Am.Jur.2d (1994 ed.), *Labor and Labor Relations* §3237 et seq.; 8 U.C.L.A. L. Rev. 222.)

West's Key Number Digest, Contracts k.597, 599

SUPPLEMENT: [This section is current through the latest supplement]

See 9 Corbin (Rev. ed.), §§44.3, 44.8; 48B Am.Jur.2d (2005 ed.), *Labor and Labor Relations* §2418 et seq.



19 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XI. RIGHTS AND OBLIGATIONS OF THIRD PARTIES

A. Third-Party Beneficiaries.

4. Particular Beneficiaries Who May Enforce Agreement.

d. Express Beneficiary Not Identified.

3. Beneficiary Not in Existence When Contract Formed.

1 Witkin Sum. Cal. Law Contracts § 703

[§ 703] Beneficiary Not in Existence When Contract Formed.

In *Gourmet Lane v. Keller* (1963) 222 C.A.2d 701, 35 C.R. 398, a lessor leased seven food-dispensing concessions to seven lessees in a market. The lessees agreed to form an association to maintain the dining area and to be governed by majority decisions as to details. They formed plaintiff association, and then incorporated it, for that purpose. Defendant, a lessee and shareholder-member of plaintiff, refused to pay his agreed weekly share of expenses. *Held*, plaintiff corporation could sue as a third party beneficiary to enforce the obligation. It was more than an incidental beneficiary; the whole reason for its creation was the efficient maintenance of the dining area according to majority rule. Hence, though plaintiff was not a creditor-beneficiary (not a creditor of promisee-lessor), it was a donee-beneficiary; i.e., the purpose of the promisees in obtaining creation of the entity was to confer on the beneficiary a right against the promisor-lessees. (222 C.A.2d 704.)

SUPPLEMENT: [This section is current through the latest supplement]



20 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law XI. RIGHTS AND OBLIGATIONS OF THIRD PARTIES

A. Third-Party Beneficiaries.

5. Rescission or Modification.

a. In General.

1 Witkin Sum. Cal. Law Contracts § 704

[§ 704] In General.

(1) *Restatement 2d.* The Restatement states that, in the absence of a contract term limiting their power, the promisor and promisee "retain power to discharge or modify the duty by subsequent agreement." (*Rest.2d, Contracts §311(1)*, (2).) The power terminates, however, when the beneficiary, before receiving notification of the discharge or modification, "materially changes his position in justifiable reliance on the promise or brings suit on it or manifests assent to it at the request of the promisor or promisee." (*Rest.2d, Contracts §311(3)*.) And if the promisee receives consideration for an attempted discharge or modification that is ineffective against the beneficiary, "the beneficiary can assert a right to the consideration so received." (*Rest.2d, Contracts §311(4)*.) (See Corbin §813 et seq.; 13 Williston 4th, §37:57 et seq.; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §§450, 451; 6 *Hastings L. J.* 370; 97 *A.L.R.2d* 1262 [mutual rescission or release of contract as affecting rights of third-party beneficiary].)

(2) *Unilateral Rescission.* "The principles governing rescission of third-party beneficiary contracts are those applicable to the rescission of contracts generally." Hence, there may be rescission not only by mutual consent but by unilateral notice based on statutory grounds. (*R.J. Cardinal Co. v. R.J. Ritchie* (1963) 218 *C.A.2d* 124, 149, 32 *C.R.* 545, citing the text.)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Restatement 2d.* See 9 Corbin (Rev. ed.), §46.2.

(3) (*New*) *Rescission by Third-Party Beneficiary.* Rescission is unavailable to a third-party beneficiary of a contract. (*Schauer v. Mandarin Gems of Calif.* (2005) 125 *C.A.4th* 949, 959, 23 *C.R.3d* 233 [C.C. 1559 grants third-party beneficiary right to enforce contract, not rescind it, and C.C. 1689 limits its grant of rescission rights to contracting parties].)



21 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law XI. RIGHTS AND OBLIGATIONS OF THIRD PARTIES

A. Third-Party Beneficiaries.

5. Rescission or Modification.

b. California Law.

1 Witkin Sum. Cal. Law Contracts § 705

[§ 705] California Law.

(1) *Earlier California Cases.* The California decisions (apart from life insurance cases; see 2 *Summary* (10th), *Insurance*, §72) originally did not distinguish between creditor and donee beneficiaries. Moreover, they proceeded on the peculiar theory that the contract is, as to any third party beneficiary, merely an *offer*; that the offer must be accepted by *bringing an action*; and that until the third party beneficiary brings the action, the contract may be rescinded by the parties. (*More v. Hutchinson* (1921) 187 C. 623, 625, 203 P. 97; *K. Lundeen Corp. v. Barlow* (1932) 120 C.A. 391, 394, 7 P.2d 1102; *Hillside Packing Assn. v. Cowles* (1937) 20 C.A.2d 26, 30, 66 P.2d 451; see *Garratt v. Baker* (1936) 5 C.2d 745, 748, 56 P.2d 225 [plaintiff beneficiary need not plead that contract has not been rescinded; rescission is a matter of defense]; 12 *Cal. L. Rev.* 328; 27 *Cal. L. Rev.* 497, 503, 519.)

(2) *Present California Rule.* Later California cases appear to approve or follow the general rule that the beneficiary's change of position alone will protect him or her against rescission. (See *Central Bank of Oakland v. Wells Fargo Bank* (1937) 18 C.A.2d 559, 565, 64 P.2d 465 [doubting correctness of rule that action must be brought to "accept" the "offer"]; *Silveyra v. Harper* (1947) 82 C.A.2d 761, 766, 187 P.2d 83 [rescission cannot retroactively cut off rights of beneficiary resulting from change of position in reliance on promise]; *Dick v. Woolson* (1951) 106 C.A.2d 415, 419, 235 P.2d 119 [promisor may rescind until creditor-beneficiary has acted in reliance]; *Riley v. Riley* (1953) 118 C.A.2d 11, 15, 256 P.2d 1056 [stating that contract may be rescinded before accepted or acted upon by beneficiary]; *Griffin v. Williamson* (1955) 137 C.A.2d 308, 317, 290 P.2d 361 [same; rescission effective]; *Mitchell v. Marklund* (1965) 238 C.A.2d 398, 406, 47 C.R. 756; *Levy v. Bellmar Enterprises* (1966) 241 C.A.2d 686, 689, 50 C.R. 842; 18 *Hastings L. J.* 423.)

In *Bass v. John Hancock Mut. Life Ins. Co.* (1974) 10 C.3d 792, 112 C.R. 195, 518 P.2d 1147, the court, referring to the cases suggesting that the beneficiary must ordinarily signify his or her acceptance of the "offer," held them inapplicable to this case, involving a *self-executing* plan of automatic coverage for all employees. "Under these circumstances, acceptance of Ford's 'offer' would have been an idle and unnecessary act." (10 C.3d 797, footnote 3.)

SUPPLEMENT: [This section is current through the latest supplement]



22 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law XI. RIGHTS AND OBLIGATIONS OF THIRD PARTIES

- A. Third-Party Beneficiaries.
- 5. Rescission or Modification.
- c. Distinction: Plaintiff Promisee.

1 Witkin Sum. Cal. Law Contracts § 706

[§ 706] Distinction: Plaintiff Promisee.

Sometimes a person appears superficially to be outside the direct contractual relationship and therefore entitled to recover only as a third party beneficiary before the parties rescind; but, on analysis, the party is a promisee with a direct right to sue.

In *Weber v. Dobyys* (1961) 193 C.A.2d 402, 14 C.R. 103, plaintiff real estate broker found purchasers for defendants' property, and an "Acceptance" of an exchange agreement was signed by defendants and plaintiff, under which defendants agreed to pay a commission upon the "execution of this agreement by all parties hereto." Later, the deal was abandoned by defendants and the purchasers, and defendants contended that plaintiff's right was terminated by rescission. *Held*, plaintiff was entitled to recover. This was not a third party beneficiary contract; defendants entered into two contracts--one with the purchasers, and one with plaintiff to pay for his services in procuring the exchange. (193 C.A.2d 407.) And the agreement with plaintiff was not conditioned on performance by the purchasers.

The court observed that cases have sometimes used the third-party beneficiary rationale in dealing with brokers' commission claims where no broker relationship was involved. The distinction is that (a) where the person sued is not the one who employed the broker, the broker, not being a contracting party, can only recover as a third party beneficiary; but (b) where the person sued did employ and agree to pay the broker, the broker can sue as a promisee. (193 C.A.2d 408.)

In *MacDonald v. California-Western States Life Ins. Co.* (1962) 203 C.A.2d 440, 21 C.R. 659, the California Department of Veterans Affairs contracted to sell D and his wife a residence, and D, as agreed, took out a life insurance policy with defendant, payable to the department, to secure any unpaid balance of the price on his death. On D's death leaving a balance due of \$ 13,089, defendant denied liability on the ground of fraud of D. The court found against defendant on this issue, but defendant further claimed that it had the right to cancel the policy with consent of the department, because plaintiff, D's widow, was only a third-party donee beneficiary, whose rights could be terminated by rescission effected by the promisor and promisee prior to suit. *Held*, this theory, that defendant and the department could mutually rescind after the death of the veteran, was unsound. D and his wife were actual parties to the insurance plan; they were obligated by the purchase contract to procure the insurance, and they were promisees of the insurer's promise to pay benefits and of the department's promise to use them in discharge of the debt. (203 C.A.2d 452.)

SUPPLEMENT: [This section is current through the latest supplement]



23 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law XI. RIGHTS AND OBLIGATIONS OF THIRD PARTIES

B. Assignment.

1. In General.

a. Nature of Assignment.

1 Witkin Sum. Cal. Law Contracts § 707

[§ 707] Nature of Assignment.

Assignment is a term that may comprehensively cover the *transfer* of title to any kind of property. (See C.C. 1039; *Commercial Discount Co. v. Cowen* (1941) 18 C.2d 610, 614, 116 P.2d 599 [term construed to mean transfer of title, not possession]; and see generally Corbin §856 et seq.; 29 Williston 4th, §74:1 et seq.; 6 Am.Jur.2d (1999 ed.), *Assignments* §1 et seq.; 2B Am.Jur. Legal Forms 2d (2003 ed.), §25:1 et seq.; 2A Am.Jur. P.P. Forms (2000 ed.), *Assignments*, §1 et seq.; Cal. Civil Practice, 3 Business Litigation, §26:1 et seq.; Cal. Transactions Forms, 3 Business Transactions §16:1 et seq.; BAJI, No. 10.96.) In its narrower sense, however, it refers to the transfer of a nonnegotiable chose in action. (*Estate of Beffa* (1921) 54 C.A. 186, 189, 201 P. 616; see 29 Williston 4th, §74:1 et seq.; 12 *Hastings L. J.* 397; 2 U.C.L.A. L. Rev. 303; 6 Am.Jur.2d (1999 ed.), *Assignments* §1.)

Most of the common law restrictions on assignability were eliminated by the provisions of the Civil Code. (See *infra*, §732.) And the former rule that the test of assignability was *survivability* (see *Farmland Irr. Co. v. Dopplmaier* (1957) 48 C.2d 208, 222, 308 P.2d 732) became obsolete in 1961, when restrictions on survivability of causes of action were eliminated. (See 3 Cal. Proc. (4th), *Actions*, §67.)

The Second Restatement, Chapter 15, commences its comprehensive coverage with §316 on its scope:

"(1) In this Chapter, references to assignment of a right or delegation of a duty or condition, to the obligee or obligor of an assigned right or delegated duty, or to an assignor or assignee, are limited to rights, duties, and conditions arising under a contract or for breach of a contract."

"(2) The statements in this Chapter are qualified in some respects by statutory and other rules governing negotiable instruments and documents, relating to interests in land, and affecting other classes of contracts."

West's Key Number Digest, *Assignments* k.1

SUPPLEMENT: [This section is current through the latest supplement]

See C.E.B., *Law of Contracts* §7.2 et seq.; 9 Corbin (Rev. ed.), §47.3 et seq; 6 Am.Jur.2d (2008 ed.), *Assignments* §1 et seq. *Elimination of restrictions on survivability of causes of action:*

Cross-Reference: 3 Cal. Proc. (5th), Actions, §15.



24 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law XI. RIGHTS AND OBLIGATIONS OF THIRD PARTIES

B. Assignment.

1. In General.

b. Classification of Assignments.

1 Witkin Sum. Cal. Law Contracts § 708

[§ 708] Classification of Assignments.

As to *subject matter*, an assignment may be of either a bilateral contract (infra, §712 et seq.) or a chose in action (infra, §720 et seq.). With reference to the *purpose*, *extent*, and *effect* of assignments, they may be classified as follows:

(1) Total or partial assignment. (See *Rest.2d, Contracts* §326; Corbin §889; 29 Williston 4th, §74:72; infra, §§732, 733.)

(2) Assignment as security. (See *St. Paul Fire & Marine Ins. Co. v. James I. Barnes Const. Co.* (1963) 59 C.2d 691, 692, 31 C.R. 52, 381 P.2d 932; *First Nat. Bank of Stockton v. Pomona Tile Mfg. Co.* (1947) 82 C.A.2d 592, 602, 186 P.2d 693; 4 Cal. Proc. (4th), *Pleading*, §110; on assignments under Division 9 of the Uniform Commercial Code, see U.C.C. 9109, 9401, 9403, 9404, 9405, 9406, 9408, 9409, 9514; 4 *Summary* (10th), *Secured Transactions in Personal Property*, §21 et seq.)

(3) Assignment for collection. (See *Macri v. Carson Tahoe Hosp.* (1966) 247 C.A.2d 63, 65, 55 C.R. 276; C.E.B., 2 Debt Collection Practice 2d, §11.21 et seq.; 4 Cal. Proc. (4th), *Pleading*, §109.)

(4) Assignment for benefit of creditors. (See infra, §§710, 711.)

(5) Assignment as gift. (See *Rest.2d, Contracts* §332; Corbin §909 et seq.; 29 Williston 4th, §74:63 et seq.; 13 *Summary* (10th), *Personal Property*, §136 et seq.)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Total or partial assignment.* See 9 Corbin (Rev. ed.), §50.4.

(2) *Assignment as security.*

Cross-Reference: 4 Cal. Proc. (5th), *Pleading*, §129.

(3) *Assignment for collection.*

Cross-Reference: 4 Cal. Proc. (5th), *Pleading*, §128.

(5) *Assignment as gift*. See 9 Corbin (Rev. ed.), §48.1.



25 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law XI. RIGHTS AND OBLIGATIONS OF THIRD PARTIES

B. Assignment.

1. In General.

c. Requisites of Assignment.

1 Witkin Sum. Cal. Law Contracts § 709

[§ 709] Requisites of Assignment.

An assignment may be made *orally* in every case except those in which a writing is expressly required by statute. (C.C. 1052; see *Ralph v. Anderson* (1921) 187 C. 45, 47, 200 P. 940 [claim for damages for injury to automobile]; *McGown v. Dalzell* (1925) 72 C.A. 197, 201, 236 P. 941; *Brown v. Patella* (1938) 24 C.A.2d 362, 364, 75 P.2d 119 [promissory note]; *Norton v. Consolidated Fisheries* (1953) 120 C.A.2d 86, 90, 260 P.2d 617 [claims of commercial fishermen for price or value of catch; assignee is competent witness to prove assignment]; *Rest.2d, Contracts* §324.) (On statutory requirement of writing for assignment of wages, see *infra*, §724; on invalidity of oral *gift* of chose in action unaccompanied by delivery, see 13 *Summary* (10th), *Personal Property*, §136.)

While no particular form is required, it "must be a manifestation to another person by the owner of the right indicating his intention to transfer, without further action or manifestation of intention, the right to such other person, or to a third person." (*Cockerell v. Title Ins. & Trust Co.* (1954) 42 C.2d 284, 291, 267 P.2d 16 [evidence held insufficient to show effective assignment]; *Greco v. Oregon Mut. Fire Ins. Co.* (1961) 191 C.A.2d 674, 683, 12 C.R. 802 [assignment of fire insurance policy by owner-vendor to purchaser in escrow held established by inference and implication from the evidence]; *Sunburst Bank v. Executive Life Ins. Co.* (1994) 24 C.A.4th 1156, 1164, 29 C.R.2d 734 [in insolvency proceeding against corporation that sold bond contracts to two banks that then failed, evidence was insufficient to establish that FDIC, which, as receiver, assigned the contracts to successor banks, also assigned its priority as creditor to those banks]; see *Rest.2d, Contracts* §324; Corbin §879; 29 Williston 4th, §74:4; 6 *Am.Jur.2d* (1999 ed.), *Assignments* §113 et seq.)

Assent of the assignee to an assignment for consideration is not required. (See *Rest.2d, Contracts* §327.) (On gift assignment and right to disclaim, see 13 *Summary* (10th), *Personal Property*, §136.)

West's Key Number Digest, Assignments k.31

SUPPLEMENT: [This section is current through the latest supplement]
See 9 Corbin (Rev. ed.), §47.7; 6 *Am.Jur.2d* (2008 ed.), *Assignments* §82 et seq.



26 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law XI. RIGHTS AND OBLIGATIONS OF THIRD PARTIES

B. Assignment.

1. In General.

d. Assignment for Benefit of Creditors.

1. In General.

1 Witkin Sum. Cal. Law Contracts § 710

[§ 710] In General.

(1) *Nature of Assignment.* An assignment for benefit of creditors is a widely used method by which an insolvent debtor transfers his or her assets in trust to an assignee, who liquidates them and distributes the proceeds to the creditors. (See 6 *Am.Jur.2d* (1999 ed.), *Assignments for Benefit of Creditors* §1 et seq.; 2B *Am.Jur. Legal Forms* 2d (2003 ed.), §26:1 et seq.; 2B *Am.Jur. P.P. Forms* (2000 ed.), *Assignments for Benefit of Creditors*, §1 et seq.; 8 *A.L.R.3d* 903 [effect of debtor's transfer of assets to representative of creditors in absence of express agreement releasing claims]; on priority wage claims, see *Dunlop v. Tremayne* (1965) 62 *C.2d* 427, 431, 42 *C.R.* 438, 398 *P.2d* 774, 3 *Summary* (10th), *Agency and Employment*, §403.)

(2) *Repeal of Former California Statutory Procedure.* Former C.C. 3448 et seq. provided a statutory method of making these assignments as an alternative to the common law method. The Law Revision Commission, pointing out that the statutory procedure was rarely used, recommended its repeal. (See 15 *Cal. Law Rev. Com. Reports* 1117.) The recommendation was followed by the 1980 Legislature, which repealed former C.C. 3448 et seq., and made conforming changes in other statutes by deleting references to statutory assignments. (See 12 *Pacific L. J.* 312.)

(3) *Common Law Assignments Now Sole Method.* The common law assignment by simple transfer in trust, almost invariably used in place of the cumbersome statutory procedure, is now the only method recognized by California decisions. (See *Jarvis v. Webber* (1925) 196 *C.* 86, 98, 236 *P.* 138; *Brainard v. Fitzgerald* (1935) 3 *C.2d* 157, 158, 44 *P.2d* 336; *Bumb v. Bennett* (1958) 51 *C.2d* 294, 299, 333 *P.2d* 23; *First Nat. Bank Stockton v. Pomona Tile Mfg. Co.* (1947) 82 *C.A.2d* 592, 607, 186 *P.2d* 693; *Vollstedt Kerr Lumber Co. v. Production Homes* (1955) 130 *C.A.2d* 507, 510, 279 *P.2d* 615; *Mechanics Bank of Richmond v. Rosenberg* (1962) 201 *C.A.2d* 419, 423, 20 *C.R.* 202; *Credit Managers Assn. v. National Independent Business Alliance* (1984) 162 *C.A.3d* 1166, 1170, 209 *C.R.* 119; 36 *Cal. L. Rev.* 586; 45 *Cal. L. Rev.* 66; 47 *Cal. L. Rev.* 595; 6 *U.C.L.A. L. Rev.* 573.)

The validity and effectiveness of a common law assignment were reaffirmed in *Bumb v. Bennett*, *supra*. The members of an insolvent partnership executed an assignment of all the partnership property to plaintiff as assignee for the benefit of the partnership creditors, and he accepted on May 29 at 9 a.m. On the same day at 12:17 p.m. defendants, representing certain unsecured creditors, levied an attachment on the partnership real property. *Held*, the assignment

was valid and had priority over the attachment, and plaintiff was entitled to quiet title. The court decided the following issues raised by defendants:

First, "common-law assignments of both personalty and realty are permitted by our laws." (51 C.2d 299.)

Second, despite failure to comply with the general statutory provisions on recordation of conveyances, the assignment, like an unrecorded deed, is good against a mere attaching creditor. (51 C.2d 299.)

Third, the assignment was not rendered invalid by the proviso that secured creditors would be required to surrender the security held by them in order to participate. Even if this provision were to be held void as against a nonconsenting secured creditor, defendants (representing unsecured creditors) and consenting secured creditors were in no position to raise the objections. And the fact that the proviso limited the assignment to a particular class of creditors rather than creditors generally was not an objection, for a preference is not illegal under our law; i.e., an insolvent debtor may pay one or more of his or her creditors to the exclusion of others (C.C. 3432). "We can see no reason why he may not do the same thing by way of a transfer in trust where there is no basis for contending that the transfer is in fraud of creditors." (51 C.2d 300, disapproving early cases contra.) (See 47 Cal. L. Rev. 595; 6 U.C.L.A. L. Rev. 585.)

(4) *Assignment Terminates Lien*. C.C.P. 493.010 et seq. (a) define a "general assignment for the benefit of creditors"; (b) provide that this assignment terminates a lien pursuant to attachment or temporary protective order if the lien was created within 90 days prior to the assignment; and (c) establish the procedure for obtaining release of the attached property. (See 6 Cal. Proc. (4th), *Provisional Remedies*, §§189, 190.)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Nature of Assignment*. See *Sherwood Partners v. EOP-Marina Business Center, L.L.C.* (2007) 153 C.A.4th 977, 981, 62 C.R.3d 896, citing the text [assignee for benefit of commercial tenant's creditors did not assume underlying contractual obligations in written lease between tenant and landlord and thus was not liable for attorneys' fees and costs pursuant to lease in connection with failed action to recover security deposit from landlord]; 6 Am.Jur.2d (2008 ed.), *Assignments for Benefit of Creditors* §1 et seq.(4) *Assignment Terminates Lien*.

Cross-Reference: 6 Cal. Proc. (5th), *Provisional Remedies*, §§188, 189.



27 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law XI. RIGHTS AND OBLIGATIONS OF THIRD PARTIES

B. Assignment.

1. In General.

d. Assignment for Benefit of Creditors.

2. Conformity With Federal Statutes.

1 Witkin Sum. Cal. Law Contracts § 711

[§ 711] Conformity With Federal Statutes.

In 1982, several amendments were made and a new statute was added to bring California law on assignment for benefit of creditors into conformity with federal bankruptcy law. (See *14 Pacific L. J.* 496.)

(1) *11 U.S.C.*, §547 generally permits a bankruptcy trustee to avoid transfers that prefer certain creditors if they are made within 90 days of filing the bankruptcy petition. If the creditor is an "insider" and has reason to believe that the debtor is insolvent at the time of the transfer, transfers occurring between 90 days and 1 year of filing are voidable (*11 U.S.C.*, §547(b)(4)). (See *9B Am.Jur.2d* (1999 ed.), *Bankruptcy* §1912 et seq.) *C.C.P.* 1800, which gives the assignee of a general assignment for the benefit of creditors the right to recover preferential transfers, a right that formerly extended only to transfers made within 90 days before the assignment, was amended to define "insider" and to make a similar extension of time (from 90 days to 1 year before assignment) for preferential transfers to a creditor who is an insider with reason to know of the assignor's insolvency. (See *Credit Managers' Assn. v. Brubaker* (1991) 233 C.A.3d 1587, 1594, 285 C.R. 417 [rejecting contention that loan made to assignor by its chief executive officer was within exception to *C.C.P.* 1800 for payment made and debt incurred in ordinary course of business].)

(2) Federal bankruptcy law provides for an automatic stay on certain steps that might otherwise be taken against the bankrupt or his or her estate, including "any act to obtain possession of property of the estate" (*11 U.S.C.*, §362(a)(3)). This serves to prevent termination of a lease during windup of the bankruptcy estate. (See *9B Am.Jur.2d* (1999 ed.), *Bankruptcy* §1567 et seq.) C.C. 1954.1 was added to make similar provision for the assignee in a general assignment for the benefit of creditors to occupy the assignor's leased business premises for up to 90 days, assuming timely payment of the rent, notwithstanding any clauses in the lease permitting termination upon assignment or insolvency of the lessee.

(3) Former C.C. 3439.09 (now C.C. 3439.07), which gives standing to complain of a fraudulent conveyance to a creditor with respect to whom the conveyance was fraudulent, was amended to extend the same right to an assignee of a general assignment for the benefit of creditors.

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Preferential transfers:* See *Central Virginia Community College v. Katz* (2006) 546 U.S. 356, 126 S.Ct. 990, 994,

163 *L.Ed.2d* 945, 952 [adversary proceeding brought by Chapter 11 trustee to set aside alleged preferential transfers that debtor had made to state agencies was not barred by agencies' sovereign immunity]; *Haberbush v. Charles & Dorothy Cummins Family Ltd. Partnership* (2006) 139 *C.A.4th* 1630, 1635, 43 *C.R.3d* 814 [C.C.P. 1800 is not preempted by federal Bankruptcy Code]; *Credit Managers Assn. of Calif. v. Countrywide Home Loans* (2006) 144 *C.A.4th* 590, 598, 50 *C.R.3d* 259 [same]; 42 *U.S.F. L. Rev.* 383 [Bankruptcy Clause and state sovereignty]; 9*B Am.Jur.2d* (2006 ed.), *Bankruptcy* §2105 et seq.

(2) *Automatic Stay*: See 9*B Am.Jur.2d* (2006 ed.), *Bankruptcy* §1719 et seq.



28 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law XI. RIGHTS AND OBLIGATIONS OF THIRD PARTIES

B. Assignment.

2. Assignment of Contracts.

a. Contracts Ordinarily Assignable.

1 Witkin Sum. Cal. Law Contracts § 712

[§ 712] Contracts Ordinarily Assignable.

Whether a contract is assignable depends upon its nature and terms. Ordinarily, either a bilateral or unilateral contract is assignable unless it calls for some personal quality of the promisor, or unless it expressly or impliedly negatives the right to assign.

Thus, in *La Rue v. Groezinger* (1890) 84 C. 281, 24 P. 42, there was a contract for the sale and delivery of all grapes of a certain quality that the seller was to raise on a certain vineyard for 10 years. The seller sold the land and assigned the contract to plaintiff, who gathered the next crop and tendered it to the buyer. The buyer refused to accept it, and plaintiff sold the crop elsewhere and sued for the loss sustained. *Held*, the contract was assignable and he could recover. (84 C. 283.) (See *Farmland Irr. Co. v. Dopplmaier* (1957) 48 C.2d 208, 222, 308 P.2d 732 [patent license agreement]; *Rest.2d, Contracts* §317(2); *Rest.3d, Suretyship and Guaranty* §13(1) [suretyship contract assignable]; 12 *Hastings L. J.* 397; 2 *U.C.L.A. L. Rev.* 311; 5 *U.C.L.A. L. Rev.* 337; 6 *Am.Jur.2d* (1999 ed.), *Assignments* §17 et seq.; 2B *Am.Jur. Legal Forms* 2d (2003 ed.), §25:31 et seq.; *Cal. Civil Practice*, 3 Business Litigation, §26:5 et seq.; 66 *A.L.R.2d* 606 [assignability of licensee's rights under licensing contract]; cf. *U.C.C.* 2210(2) [assignments may be made except "as otherwise provided in Section 9406."]. (On *U.C.C.* 9406, see 4 *Summary* (10th), *Secured Transactions in Personal Property*, §§163, 164.)

Although an *offer* can be accepted only by the person to whom it is made (see *supra*, §180), an *option*, which is a contract to keep the offer open (see *supra*, §168), is assignable. (See *Tatum v. Levi* (1931) 117 C.A. 83, 89, 3 P.2d 963.)

West's Key Number Digest, Assignments k.4 et seq.

SUPPLEMENT: [This section is current through the latest supplement]

See CACI, No. 326 [Assignment Contested]; CACI, No. 327 [Assignment Not Contested]; 6 *Am.Jur.2d* (2008 ed.), *Assignments* §15 et seq.



29 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law XI. RIGHTS AND OBLIGATIONS OF THIRD PARTIES

B. Assignment.

2. Assignment of Contracts.

b. Contracts Not Assignable.

1. Contractual Provision Against Assignment.

aa. Nature and Effect.

1 Witkin Sum. Cal. Law Contracts § 713

[§ 713] Nature and Effect.

The contract may expressly provide that it is not to be assigned, or it may contain equivalent provisions; in either case it cannot be assigned. (*Henkel Corp. v. Hartford Acc. & Indem. Co. (2003) 29 C.4th 934, 943, 129 C.R.2d 828, 62 P.3d 69* [no benefits were assigned to successor corporation under liability policies, because insurance contracts contained no-assignment clause, and defendant insurers did not consent to assignment]; *Quemetco v. Pacific Auto. Ins. Co. (1994) 24 C.A.4th 494, 501, 29 C.R.2d 627* [insurance policy did not pass from predecessor to successor corporation upon sale of assets, where policy contained clause requiring insurer's consent to assignment, this consent was not given, and assignment would increase insurer's risk]; see *La Rue v. Groezinger (1890) 84 C. 281, 283, 24 P. 42*; *Rest.2d, Contracts §317(2)(c)*; *Rest.3d, Suretyship and Guaranty §13(1)(c)*; *Corbin §§872, 873*; *29 Williston 4th, §74:39*; *6 Am.Jur.2d (1999 ed.), Assignments §21 et seq.*; *5A Am.Jur. Legal Forms 2d (2004 ed.), §68:129*; *2A Am.Jur. P.P. Forms (2000 ed.), Assignments, §17*; *12 Hastings L. J. 403*; *37 A.L.R.2d 1251* [validity of anti-assignment clause].)

In *Thomas v. Thomas (1961) 192 C.A.2d 771, 13 C.R. 872*, defendant ex-husband was entitled to certain pension payments as an employee of S Co., and plaintiff ex-wife sought to garnish them for overdue spousal support. The plan contract provided that "[t]he interest of any employee ... shall be nonassignable whether by voluntary or involuntary assignment or by operation of law." *Held*, the pension payments were not subject to garnishment. The court took note of both the policy in favor of free transferability and the policy in favor of contract clauses, and of statutory provisions protecting retirement benefits from claims of creditors. (*192 C.A.2d 780.*) (See *70 Harv. L. Rev. 498.*)

However, in spite of a stipulation that prohibits voluntary assignment, the contract may nevertheless be performed by the administrator of the promisor if it is of a type that ordinarily survives. (*California Packing Corp. v. Lopez (1929) 207 C. 600, 603, 279 P. 664*; see *infra*, §838.) And the Commercial Code repudiates the traditional rule and makes ineffective a prohibition against assignment in a contract between an account debtor and an assignor. (U.C.C. 9406(d); see *4 Summary (10th), Secured Transactions in Personal Property, §164.*)

The rule that consent to assignment may not be arbitrarily withheld was adopted by the California Supreme Court for *commercial leases*, in an opinion stressing the modern view that a lease is a contract, and that a discretionary power

conferred on a party must be exercised in good faith and in accordance with fair dealing. (See *Kendall v. Ernest Pestana* (1985) 40 C.3d 488, 500, 220 C.R. 818, 709 P.2d 837, 12 Summary (10th), *Real Property*, §551 et seq.)

West's Key Number Digest, Assignments k.18

SUPPLEMENT: [This section is current through the latest supplement]

See 9 Corbin (Rev. ed.), §§49.9, 49.10; 6 *Am.Jur.2d* (2008 ed.), *Assignments* §19 et seq.



30 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
XI. RIGHTS AND OBLIGATIONS OF THIRD PARTIES

B. Assignment.

2. Assignment of Contracts.

b. Contracts Not Assignable.

1. Contractual Provision Against Assignment.

bb. Waiver by Promisee.

1 Witkin Sum. Cal. Law Contracts § 714

[§ 714] Waiver by Promisee.

The contractual provision is generally regarded as for the benefit of one of the contracting parties; e. g., the obligor-promisor may refuse to perform to an assignee of the promisee, or the obligee-promisee may object to receiving performance from an assignee. But as between the assignor and the assignee, the assignment is valid. The assignee gets the usual rights against the assignor, and the obligor-promisor may recognize the assignment (waive objection thereto) by performing to the assignee instead of to the original promisee. And this performance will discharge his or her duty, i.e., the promisee-assignor, after assigning, cannot object to the assignee's receiving the benefits of the assignment. (See *Johnston v. Landucci* (1942) 21 C.2d 63, 67, 130 P.2d 405; *E-P Constructors v. Peterson Tractor Co.* (1961) 192 C.A.2d 518, 523, 13 C.R. 569.)

Similarly, the obligee-promisee may waive the provision by subsequent dealings with the assignee after knowledge of the assignment; e.g., a lessor may accept rent from the assignee. (*Buchanan v. Banta* (1928) 204 C. 73, 76, 266 P. 547; see *Trubowitch v. Riverbank Canning Co.* (1947) 30 C.2d 335, 342, 182 P.2d 182, *infra*, §715.)

SUPPLEMENT: [This section is current through the latest supplement]



31 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law XI. RIGHTS AND OBLIGATIONS OF THIRD PARTIES

B. Assignment.

2. Assignment of Contracts.

b. Contracts Not Assignable.

1. Contractual Provision Against Assignment.

cc. Formal or Technical Assignment.

1 Witkin Sum. Cal. Law Contracts § 715

[§ 715] Formal or Technical Assignment.

In *Trubowitch v. Riverbank Canning Co.* (1947) 30 C.2d 335, 182 P.2d 182, Pan Am. Corp. contracted to buy goods from defendant seller. Subsequently Pan Am. Corp. was dissolved, its assets were assigned to plaintiffs as its sole stockholders, and they carried on the business as Pan Am. Co., a partnership, with no change in management or personnel. In this suit based on breach of contract by the seller, defendant relied on the nonassignability clause in the contract. The court upheld plaintiffs' right to sue on two familiar grounds (see *supra*, §714, and *infra*, §716) but added a third, less familiar and more controversial reason: "[I]f an assignment results merely from a change in the legal form of ownership of a business, its validity depends upon whether it affects the interests of the parties protected by the nonassignability of the contract." (30 C.2d 344.) The court then pointed out that the shareholders who continued the business were personally liable to the creditors of the corporation, including any party to a contract with the corporation; that the interest of the seller herein was solely in receiving the contract price of the goods; and that it could not be adversely affected by this assignment.

Despite this practical and realistic approach, which is similar to that used in *Haldor v. Beebe* (1945) 72 C.A.2d 357, 366, 164 P.2d 568, *infra*, §719, the opinion does not adequately consider two troublesome questions: (a) If a clause prohibiting assignment is enforceable only when it affects the interests of a party invoking it, is it possible to predict, with any certainty, that the prohibiting clause will be binding? The conclusion, as indicated by the court's reasoning, depends upon the particular circumstances of each case. (b) The court said that to require the action to be brought by the dissolved corporation instead of by its assignees (the partners) would be to require compliance with "a shallow formality." (30 C.2d 346.) This is, in effect, a holding that the corporate entity may be disregarded for equitable reasons, *by the shareholders themselves*, a proposition for which there is both support and dissent in California decisions. (See 9 *Summary* (10th), *Corporations*, §18.)

SUPPLEMENT: [This section is current through the latest supplement]



32 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law XI. RIGHTS AND OBLIGATIONS OF THIRD PARTIES

B. Assignment.

2. Assignment of Contracts.

b. Contracts Not Assignable.

1. Contractual Provision Against Assignment.

dd. Assignment of Money Due or To Become Due.

1 Witkin Sum. Cal. Law Contracts § 716

[§ 716] Assignment of Money Due or To Become Due.

In spite of a stipulation against assignment of the *contract*, an assignment may be made of the *money due or to become due under it*. (*Butler v. San Francisco Gas & Elec. Co.* (1914) 168 C. 32, 41, 141 P. 818.) And *money damages for breach* of the contract may be assigned. One theory is that, on breach (or anticipatory breach) of the contract, the nonassignability clause ceases to bind the other party, because that party may then elect his or her remedy of damages for breach, and the assignment will be treated as a transfer of an accrued cause of action. (See *Trubowitch v. Riverbank Canning Co.* (1947) 30 C.2d 335, 339, 182 P.2d 182, *supra*, §715; U.C.C. 2210(2); Corbin §872; 29 Williston 4th, §74:39; 6 Am.Jur.2d (1999 ed.), *Assignments* §36, 33; 12 *Hastings L. J.* 397.)

There is some conflict as to the validity of an express prohibition or restriction on the assignment of money due. (See 19 Cal. L. Rev. 207; U.C.C. 2210(2).) But in *Fairbanks v. Crump Irr. & Supply Co.* (1930) 108 C.A. 197, 205, 291 P. 629, the court expressed the opinion that this type of provision should be given effect. And this dictum (in accord with the view of Williston and Corbin) was followed in *Parkinson v. Caldwell* (1954) 126 C.A.2d 548, 552, 272 P.2d 934: "[W]here appropriate language is used, assignments of money due under contracts may be prohibited." (See *Thomas v. Thomas* (1961) 192 C.A.2d 771, 779, 13 C.R. 872, *supra*, §713 [following *Fairbanks* and *Parkinson*]; *Benton v. Hofmann Plastering Co.* (1962) 207 C.A.2d 61, 67, 24 C.R. 268 [same]; Corbin §872; 29 Williston 4th, §74:39; 6 Am.Jur.2d (1999 ed.), *Assignments* §21 et seq.)

West's Key Number Digest, Assignments k.18

SUPPLEMENT: [This section is current through the latest supplement]

Effect of stipulation against assignment of contract: See 9 Corbin (Rev. ed.), §§49.9, 49.10; 6 Am.Jur.2d (2008 ed.), *Assignments* §31.

Effect of prohibition or restriction on assignment of money due: See 9 Corbin (Rev. ed.), §§49.9, 49.10; 6 Am.Jur.2d (2008 ed.), *Assignments* §19 et seq.



33 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
XI. RIGHTS AND OBLIGATIONS OF THIRD PARTIES

B. Assignment.

2. Assignment of Contracts.

b. Contracts Not Assignable.

2. Statutory Prohibition of Assignment.

1 Witkin Sum. Cal. Law Contracts § 717

[§ 717] Statutory Prohibition of Assignment.

Violation of a statute prohibiting assignment presents a more difficult question than violation of a contractual provision (*supra*, §713). Does the violation of the statute render the assignment *wholly void for illegality*, or will the purpose of the statute be examined, and, consistent with it, the assignment upheld as between the assignor and assignee?

In *O'Neill v. O'Malley* (1946) 75 C.A.2d 821, 171 P.2d 907, defendant veteran contracted to buy land from the Veterans' Welfare Board, the contract containing the statutory prohibition against assignment without written consent of the board. With consent of the board, defendant assigned to his wife; without consent of the board, his wife assigned to him and herself as joint tenants; on her death, her executor claimed the property, contending that the second assignment was void. *Held*, the assignment was valid between the parties. The court said: "[I]f private individuals incorporated into their contract the exact language of the two statutes, under the Landucci case, such language would be interpreted to be for the sole benefit of the vendor and would in no way affect the validity of the assignment between the assignor and assignee. It would seem that that language when used in a statute should not be given a different meaning." (75 C.A.2d 826.) (See *Rosenthal v. Landau* (1949) 90 C.A.2d 310, 313, 202 P.2d 810 [veteran's contract to buy land from Veterans' Welfare Board; following *O'Neill*].)

In *Recovery Oil Co. v. Van Acker* (1947) 79 C.A.2d 639, 180 P.2d 436, an oil lease from the federal Government, not assignable without consent of the Secretary of the Interior, was held enforceable by the assignee against the assignor. "These and similar laws and regulations against assignments have been before the courts numerous times. It is the established rule that they are for the benefit and protection of the government. Their prohibition can only be raised by the sovereign." (79 C.A.2d 641.)

The right of a person to a state lottery prize is not assignable, except that the payment of a prize may be assigned under specified circumstances. (*Govt.C. 8880.325.*) (For other aspects of the statutory prohibition of assignments, see C.C. 2985.1 et seq. [regulating assignment of real property sales contracts, and prohibiting assignment of these contracts without transfer of the property]; *Burchell v. Strube* (1955) 43 C.2d 828, 834, 279 P.2d 1 [upholding *Prob.C. 11604*, authorizing probate court to set aside assignment by heir if grossly unfair or unreasonable]; *Saso v. Furtado* (1951) 104 C.A.2d 759, 763, 232 P.2d 583 [newly enacted statutory prohibition against transfer of liquor license without consent of

licensing agency held nonretroactive]; Corbin §857; 29 Williston 4th, §74:20 et seq.; 6 *Am.Jur.2d* (1999 ed.), *Assignments* §94; on the federal Anti-Assignment Act, 41 U.S.C., §15, relating to contracts with the United States, and exceptions thereto, see *United States v. Shannon* (1952) 342 U.S. 288, 72 S.Ct. 281, 283, 96 L.Ed. 321, 326; 65 *Harv. L. Rev.* 1448; 12 *A.L.R.2d* 460 [transfers or assignments within federal anti-assignment statutes]; 6 *Am.Jur.2d* (1999 ed.), *Assignments* §95 et seq.)

SUPPLEMENT: [This section is current through the latest supplement]

Assignability of lottery prize: See *Stone Street Capital, LLC v. California State Lottery Com.* (2008) 165 C.A.4th 109, 117, 80 C.R.3d 326 [Govt.C. 8880.325, which prohibits assignment of lottery prize except under specified circumstances, prevails over conflicting provisions of U.C.C. 9406(f), which defines "accounts" to include lottery payments and purports to invalidate statutes that prohibit assignment of accounts].

Other aspects of prohibition: See 9 Corbin (Rev. ed.), §47.9; 6 *Am.Jur.2d* (2008 ed.), *Assignments* §72 et seq.



34 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
XI. RIGHTS AND OBLIGATIONS OF THIRD PARTIES

B. Assignment.

2. Assignment of Contracts.

b. Contracts Not Assignable.

3. Contract Personal in Character.

aa. General Rule and Test.

1 Witkin Sum. Cal. Law Contracts § 718

[§ 718] General Rule and Test.

If the contract calls for the skill, credit, or other personal quality of the promisor, it is neither assignable nor survivable, and the test is the same as that discussed in connection with performance (*infra*, §838). In this type of case, the performance received from the assignee is essentially different from that contracted for. (See *La Rue v. Groezinger* (1890) 84 C. 281, 285, 24 P. 42; *Coykendall v. Jackson* (1936) 17 C.A.2d 729, 731, 62 P.2d 746 [contract for personal services]; *Teel v. Bank of Eureka* (1941) 42 C.A.2d 807, 809, 110 P.2d 78 [contract by grantee of property to support grantor]; cf. *Fenn v. Pickwick Corp.* (1931) 117 C.A. 236, 241, 4 P.2d 215 [if contract calls for performance that is only personal in part, it is assignable when personal portion has been performed]; and see *Rest.2d, Contracts* §318, Comment c; Corbin §865; 29 Williston 4th, §74:10 et seq.; 6 *Am.Jur.2d* (1999 ed.), *Assignments* §28 et seq.; 2A *Am.Jur. P.P. Forms* (2000 ed.), *Assignments*, §13.)

Even if the contract contains a formal clause stating that it inures to the benefit of, and is binding on, heirs, assigns, etc., this recital of assignability is not binding. The intention of the parties, gathered from its terms, may still show that it calls for a purely personal obligation. (*Davis v. Basalt Rock Co.* (1951) 107 C.A.2d 436, 444, 237 P.2d 338 [upholding trial court's construction of peculiar provisions of contract, in light of conditions under which it was executed, as not intending that defendant should perform to any but original parties].)

West's Key Number Digest, *Assignments* k.19

SUPPLEMENT: [This section is current through the latest supplement]
See 9 Corbin (Rev. ed.), §§49.1, 49.2; 6 *Am.Jur.2d* (2008 ed.), *Assignments* §26 et seq.



35 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law XI. RIGHTS AND OBLIGATIONS OF THIRD PARTIES

B. Assignment.

2. Assignment of Contracts.

b. Contracts Not Assignable.

3. Contract Personal in Character.

bb. Contracts Held Assignable.

1 Witkin Sum. Cal. Law Contracts § 719

[§ 719] Contracts Held Assignable.

Usually, where credit is extended to a particular person in the purchase of property, the contract is considered personal in its nature; and if the buyer assigns his or her interest to someone else, the seller is not bound to abide by the credit provision. But in *Davies-Overland Co. v. Blenkiron* (1925) 71 C.A. 690, 236 P. 179, a conditional sales contract contained an express provision against assignment by the buyer of his interest in the property. He nevertheless transferred it, and the assignee tendered to the sellers the entire unpaid balance of the purchase price. *Held*, the sellers could not repossess, because they were not prejudiced in any way by the assignment. (71 C.A. 693.) (See *Walker v. Houston* (1932) 215 C. 742, 747, 12 P.2d 952.)

In *Murphy v. Luthy Battery Co.* (1925) 74 C.A. 68, 75, 239 P. 341, it was held that a contract to guarantee payments did not involve personal trust or confidence, and was assignable. Also, in *Thorpe v. Story* (1937) 10 C.2d 104, 118, 73 P.2d 1194, the court held that a guaranty on a corporate bond issue was assignable, and was effectively assigned by the transfer of the bond, though the guaranty was on a separate instrument and the assignee may have been ignorant of it.

In *Haldor v. Beebe* (1945) 72 C.A.2d 357, 164 P.2d 568, defendant moving picture director engaged a corporation to obtain professional employment for him and to advise and act for him in connection therewith, at a commission of 10% of all compensation received under the obtained employment. A 7-year contract was obtained; he paid commissions from 1936 to 1941, but refused to pay those subsequently due. It appeared that the corporation had entered into a partnership in 1938, then returned to the corporate form under a change of name, and that an interest in the contract had been assigned to the partnership and then back to the corporation. However, during the entire period C, the sole stockholder, controlled the corporation and partnership, and U, the employee who originally negotiated with defendant, handled all dealings involving his contract. *Held*, defendant was liable for the commissions. The brief discussion discloses three distinct grounds for the decision: (a) There was in fact *no assignment*; the purported assignments were "technical" and "non-effectual," for C, personally, always owned the contract. (72 C.A.2d 366.) (b) The assignment was immaterial because the sole performance--negotiation of the 7-year contract--was completed prior thereto, and no further services were to be performed by any assignee. (72 C.A.2d 368, concurring opinion.) (c) This was *not a personal services contract*, because it was made with a *corporation*, which cannot perform personal

functions. Hence, "it must have been in contemplation of the parties when the contract was signed that the services bargained for would be rendered by a human representative delegated to perform that duty by the corporation and subject to being succeeded, if occasion should arise, by one with proper qualifications." (72 C.A.2d 365.) The court added that, in this case, the same representative (U) continued to perform all the services. (See 20 So. Cal. L. Rev. 121, 136; and cf. *Trubowitch v. Riverbank Canning Co.* (1947) 30 C.2d 335, 344, 182 P.2d 182, supra, §715 [assignment resulting merely from change in legal form of ownership].)

SUPPLEMENT: [This section is current through the latest supplement]

See *Superbrace v. Tidwell* (2004) 124 C.A.4th 388, 402, 21 C.R.3d 404 [rights of holders of exclusive license to manufacture, market, and sell inventor's patented motorcycle products were not personal and were therefore assignable without inventor's consent, notwithstanding parties' friendship when entering into licensing contract; there was no personal aspect to inventor's retention of title to patents as security for payment, and holders were not sole persons capable of making and selling products].



36 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law XI. RIGHTS AND OBLIGATIONS OF THIRD PARTIES

B. Assignment.

3. Assignment of Choses in Action.

a. Rights Ordinarily Assignable.

1. In General.

1 Witkin Sum. Cal. Law Contracts § 720

[§ 720] In General.

The Civil Code defines a chose or thing in action as "a right to recover money or other personal property by a judicial proceeding." (C.C. 953.) Choses in action are assignable when they arise out of an *obligation* or out of the *violation of a right of property*. (C.C. 954, 1458; see *Baum v. Duckor, Spradling & Metzger* (1999) 72 C.A.4th 54, 65, 84 C.R.2d 703, *infra*, §729, quoting the text; Corbin §859; 29 Williston 4th, §74:2; 22 Cal. L. Rev. 456; 6 Am.Jur.2d (1999 ed.), *Assignments* §51 et seq.; Cal. Civil Practice, 3 Business Litigation, §26:9 et seq.; 2B Am.Jur. Legal Forms 2d (2003 ed.), §25:136 et seq.; 2A Am.Jur. P.P. Forms (2000 ed.), *Assignments*, §39 et seq.)

The following are illustrations of rights held assignable:

(1) A cause of action for breach of contract. (See *Trubowitch v. Riverbank Canning Co.* (1947) 30 C.2d 335, 339, 182 P.2d 182, *supra*, §715.)

(2) A right to recover money paid under a void contract. (*Rued v. Cooper* (1893) 109 C. 682, 692, 34 P. 98.)

(3) A cause of action for damages for conversion of personal property. (*Staley v. McClurken* (1939) 35 C.A.2d 622, 625, 96 P.2d 805.)

(4) A cause of action for damages to real property. (*Stapp v. Madera Canal & Irr. Co.* (1917) 34 C.A. 41, 46, 166 P. 823.)

(5) A cause of action for fraudulent destruction of the goodwill of a newspaper. (*Clark v. Leshner* (1956) 46 C.2d 874, 883, 299 P.2d 865.)

(6) A cause of action arising by subrogation of an insurance company to the rights of an employer who has become liable under the Workers' Compensation Act. (*Morris v. Standard Oil Co.* (1926) 200 C. 210, 214, 252 P. 605.)

(7) A right to contest a will. (*Estate of Clark* (1928) 94 C.A. 453, 460, 271 P. 542; cf. *Estate of Field* (1951) 38 C.2d 151, 154, 238 P.2d 578 [assignable and survivable].)

(8) A cause of action in favor of an injured person against an insurance company after judgment against an insured automobile owner. (*Bias v. Ohio Farmers Indem. Co. (1938) 28 C.A.2d 14, 16, 81 P.2d 1057.*)

(9) A cause of action by an insured against his or her insurance company for wrongful failure to settle with the injured party. (*Brown v. Guarantee Ins. Co. (1957) 155 C.A.2d 679, 693, 319 P.2d 69.*)

(10) A right of reentry or of possession for breach of condition subsequent. (C.C. 1046; see 12 *Summary* (10th), *Real Property*, §169.)

(11) A cause of action for equitable indemnity. (*Fleck v. Bollinger Home Corp. (1997) 54 C.A.4th 926, 932, 63 C.R.2d 407* [defendant improver of property, which had latent defect caused by former tortfeasor, could assign to plaintiff cross-complaint for indemnity brought under C.C.P. 337.15(c) before being found liable for damages].)

SUPPLEMENT: [This section is current through the latest supplement]
See 9 Corbin (Rev. ed.), §47.2; 6 *Am.Jur.2d* (2008 ed.), *Assignments* §44 et seq.



37 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law XI. RIGHTS AND OBLIGATIONS OF THIRD PARTIES

B. Assignment.

3. Assignment of Choses in Action.

a. Rights Ordinarily Assignable.

2. Distinctions.

1 Witkin Sum. Cal. Law Contracts § 721

[§ 721] Distinctions.

Several types of assignments are subject to qualification:

(1) The statutory right of an executor or administrator of an insolvent estate to sue to set aside a fraudulent conveyance for the benefit of creditors (*Prob.C. 9653(a)*) may be assigned, by consent of the probate court, provided that the recovery is made available to all creditors without discrimination. (*Webb v. Pillsbury (1943) 23 C.2d 324, 327, 144 P.2d 1* [assignment to sole creditor of estate].) (See *Michal v. Adair (1944) 66 C.A.2d 382, 388, 152 P.2d 490* [any creditor's cause of action to set aside a fraudulent conveyance is assignable].)

(2) It has been said that a cause of action for *fraud* is not itself assignable, but that where the *purchaser of property* has a claim against the vendor as a result of fraud in the sale, he or she may transfer the property to another and assign to him or her the incidental right to recover for the fraud. (*Wikstrom v. Yolo Fliers Club (1929) 206 C. 461, 463, 274 P. 959*; see *Swallow v. Tungsten Products Co. (1928) 205 C. 207, 219, 270 P. 366.*) In *Jackson v. Deauville Holding Co. (1933) 219 C. 498, 27 P.2d 643*, this exception was greatly extended. Several persons purchased club memberships under false representations, and assigned their claims to plaintiff, who sued and was permitted to recover the money paid. The court held that where property (including money) is obtained by fraud, the cause of action is assignable on the theory that it is for a violation of a right of property, under C.C. 954. (219 C. 502.) (See *Osuna v. Albertson (1982) 134 C.A.3d 71, 82, 184 C.R. 338*, citing the text [following *Wikstrom* and *Jackson*]; 22 *Cal. L. Rev.* 456.)

(3) Although a cause of action for a personal tort is not assignable (see *infra*, §727), a *judgment* obtained in the action may be assigned. (*Adams v. White Bus Line (1921) 184 C. 710, 712, 195 P. 389*; see 33 *A.L.R.4th* 82 [assignability of proceeds of claim for personal injury or death].) It has been pointed out, however, that this is true only where the judgment has become *final* prior to the assignment. If it has not, as where the case is pending on appeal, the assignor still has merely a claim for damages for the tort, which is not assignable. (*Pacific Gas & Elec. Co. v. Nakano (1939) 12 C.2d 711, 713, 87 P.2d 700.*) (See *Lab.C. 4900* [claim for workers' compensation not assignable before payment].)

SUPPLEMENT: [This section is current through the latest supplement]



38 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law XI. RIGHTS AND OBLIGATIONS OF THIRD PARTIES

B. Assignment.

3. Assignment of Choses in Action.

b. Assignment of Future Rights.

1. Expectancies.

1 Witkin Sum. Cal. Law Contracts § 722

[§ 722] Expectancies.

"A mere *possibility, not coupled with an interest*, cannot be transferred." (C.C. 1045.) This section would normally have the effect of preventing the assignment of the *expectant interest* of an heir. But it has been held that the assignment will be treated as a contract to assign, i.e., equity will compel a transfer to the assignee if the consideration is adequate and the contract is otherwise fair and reasonable. (*Estate of Garcelon* (1894) 104 C. 570, 584, 38 P. 414; *Estate of Edelman* (1905) 148 C. 233, 238, 82 P. 962; *Bridge v. Kedon* (1912) 163 C. 493, 496, 126 P. 149; *Bank of California v. Connolly* (1973) 36 C.A.3d 350, 366, 111 C.R. 468; see *Rest.2d, Contracts* §330(2); Corbin §874; 29 Williston 4th, §74:15 et seq.; 6 *Am.Jur.2d* (1999 ed.), *Assignments* §§14 et seq., 32, 36, 88 et seq.)

In *Bridge v. Kedon*, supra, defendant assigned to plaintiff as security for a debt his expectant interest in the estate of his mother, who was then living. Before the mother died, defendant went through bankruptcy, so that the debt itself was discharged. *Held*, the security was not discharged. The assignment created a "present equitable charge" that would be enforceable when the property came to the heir. (163 C. 496.) (See 1 *Cal. L. Rev.* 186; 5 *So. Cal. L. Rev.* 159.)

In *Kelly v. Kelly* (1938) 11 C.2d 356, 79 P.2d 1059, this theory was applied to the assignment of the interest of a beneficiary under a trust. Defendant husband, beneficiary of a spendthrift trust, assigned one-half of the property to which he might become entitled to plaintiff wife, as a property settlement. *Held*, on termination of the trust, she could sue for her share. The assignment did not transfer any property nor even create a charge thereon (because of the spendthrift provision), and the beneficiary took the property with a clear title. But the assignment was effective as a contract, and plaintiff could sue for breach, her recovery being the value of the property that he contracted to transfer to her. (11 C.2d 363.) (See *Cheek v. Farmers & Merchants Nat. Bank of Los Angeles* (1936) 14 C.A.2d 176, 178, 57 P.2d 1325 [ordinary trust, assignment by beneficiary held to create equitable charge]; *Chilwell v. Chilwell* (1940) 40 C.A.2d 550, 553, 105 P.2d 122 [property settlement agreement by husband to reinstate life insurance policy in favor of children held equitable assignment of proceeds to them]; *Critz v. Farmers Ins. Group* (1964) 230 C.A.2d 788, 799, 41 C.R. 401, 2 *Summary* (10th), *Insurance*, §261 [assignment of insured's potential cause of action treated as contract to assign]; 2 *A.L.R.3d* 1403 [renewal rights in copyright].)

In *McCafferty v. Gilbank* (1967) 249 C.A.2d 569, 57 C.R. 695, defendant S, to satisfy his obligation to plaintiff,

agreed to pay one-half of the net proceeds of a personal injury action he was bringing against a stranger. The action was settled, and drafts were made to defendant S and defendant G, his attorney. S and G cashed the drafts and S disappeared. Plaintiff then sued defendant G for conversion. *Held*, nonsuit reversed. The promise of S to pay out of the prospective fund was not an invalid present assignment of the cause of action but the creation of a valid equitable lien on ascertainable proceeds. (249 C.A.2d 575.)

West's Key Number Digest, Assignments k.6

SUPPLEMENT: [This section is current through the latest supplement]

See 9 Corbin (Rev. ed.), §§50.1, 50.2; 6 *Am.Jur.2d* (2008 ed.), *Assignments* §§12 et seq., 30, 70 et seq.



39 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XI. RIGHTS AND OBLIGATIONS OF THIRD PARTIES

B. Assignment.

3. Assignment of Choses in Action.

b. Assignment of Future Rights.

2. Rights Under Contract or Employment.

1 Witkin Sum. Cal. Law Contracts § 723

[§ 723] Rights Under Contract or Employment.

Where there is an *existing contract or employment*, money to become due or other rights to arise thereunder may be assigned. However, where the contract or employment is *not yet in existence*, there is some uncertainty. An assignment has been upheld where the contract was contemplated and subsequently executed. (See *H.D. Roosen Co. v. Pacific Radio Publishing Co.* (1932) 123 C.A. 525, 531, 11 P.2d 873; 21 Cal. L. Rev. 394.) But the general rule is that such an assignment is ineffective, except perhaps as a promise to assign. (See *Orkow v. Orkow* (1933) 133 C.A. 50, 51, 23 P.2d 781 [assignment of share of future earnings from literary productions to be written, not under present employment or contract, held void]; 22 Cal. L. Rev. 446; 2 U.C.L.A. L. Rev. 313.) (On assignment of wages or salary, see *infra*, §724 et seq.)

SUPPLEMENT: [This section is current through the latest supplement]



40 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law XI. RIGHTS AND OBLIGATIONS OF THIRD PARTIES

B. Assignment.

3. Assignment of Choses in Action.

c. Assignment of Wages.

1. Statutory Restrictions.

aa. Formal Requisites.

1 Witkin Sum. Cal. Law Contracts § 724

[§ 724] Formal Requisites.

An employee's right to wages is a chose in action and may be assigned. (See 6 *Am.Jur.2d* (1999 ed.), *Assignments* §74 et seq.; Cal. Transactions Forms, 3 Business Transactions §16:55 et seq.; 2B *Am.Jur. Legal Forms 2d* (2003 ed.), §25:2 et seq.; 2A *Am.Jur. P.P. Forms* (2000 ed.), *Assignments*, §52 et seq.)

Lab.C. 300 states a number of requisites for the validity of any assignment of, or order for, wages or salary, earned or to be earned.

(1) *Separate written instrument*: The assignment must be by a separate written instrument, signed by the employee, and *identifying specifically the transaction* to which the assignment relates.

(2) *Consent of spouse, parent, or guardian*: If the employee is married, the *written consent* of the other spouse must be *attached* to the instrument. (See *Lab.C. 97* [Labor Commissioner not bound by requirement].) If the employee is a minor, the written consent of a parent or guardian must be attached. If the employee is an adult or unmarried, his or her written statement of this fact must be attached.

(3) *Statement as to no other assignments by assignor*: The assignor's written statement, that no other assignment or order exists in connection with the same transaction or series of transactions, must be attached.

(4) *Filing copy with employer*: A copy of the instrument and attached statement, authenticated by a notary, must be filed with the employer, accompanied by an *itemized statement of the amount then due*; and the employer may make payments in reliance on the statements (adult or unmarried, no other assignment) without inquiry.

West's Key Number Digest, *Assignments* k.14, 15

SUPPLEMENT: [This section is current through the latest supplement]
See 6 *Am.Jur.2d* (2008 ed.), *Assignments* §64 et seq.



41 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law XI. RIGHTS AND OBLIGATIONS OF THIRD PARTIES

B. Assignment.

3. Assignment of Choses in Action.

c. Assignment of Wages.

1. Statutory Restrictions.

bb. Other Conditions.

1 Witkin Sum. Cal. Law Contracts § 725

[§ 725] Other Conditions.

In addition to the requirements of form, *Lab.C. 300* states the following conditions that govern the validity of the wage assignment or order:

(1) *Future wages*, i.e., those not yet earned, can only be assigned for *necessities of life*, to the person *directly furnishing them*, and only in the *amount needed* therefor. (See *Walker v. Rich* (1926) 79 C.A. 139, 144, 249 P. 56; *Orkow v. Orkow* (1933) 133 C.A. 50, 51, 23 P.2d 781; 5 So. Cal. L. Rev. 159.)

(2) The amount assigned may not exceed 50%.

(3) An assignment of *future wages* is revocable at any time, as is a *power of attorney* to assign or collect wages.

(4) No assignment of present or future wages can be made at all if the employee works interchangeably for several employers under a plan for payment at a central place, pursuant to *Lab.C. 204a*.

(5) The assignment is not valid if, at the time thereof, another assignment is subject to payment, and an earnings withholding order against the employee's wages is in force. (On earnings withholding order, see 8 *Cal. Proc.* (4th), *Enforcement of Judgment*, §232 et seq.)

SUPPLEMENT: [This section is current through the latest supplement]

(5) *Earnings withholding order:*

Cross-Reference: 8 *Cal. Proc.* (5th), *Enforcement of Judgment*, §241 et seq.



42 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law XI. RIGHTS AND OBLIGATIONS OF THIRD PARTIES

B. Assignment.

3. Assignment of Choses in Action.

c. Assignment of Wages.

2. Scope and Waiver of Restrictions.

1 Witkin Sum. Cal. Law Contracts § 726

[§ 726] Scope and Waiver of Restrictions.

In *Lande v. Jurisich* (1943) 59 C.A.2d 613, 139 P.2d 657, the court held that *Lab.C. 300* is to be liberally construed to carry out its purpose, and that, although technically a *lien* is not an "assignment" or "order" within the meaning of that statute and a contract imposing a lien on future wages might be permissible under C.C. 2883, it is nevertheless void unless it complies with *Lab.C. 300*. "[T]he Legislature obviously sought to reach every form of instrument which would result in the impounding of a wage earner's wages before he received them." (59 C.A.2d 619.) (Cf. *Lab.C. 97* [Labor Commissioner taking assignment of wage claim for collection is not subject to *Lab.C. 300*].)

The statutory language ("wages or salary") is intended to cover comprehensively all kinds of earnings, whether called wages, salary, fees, or compensation. (*Reynolds v. Reynolds* (1936) 14 C.A.2d 481, 484, 58 P.2d 660.) But by express provision, the section does not apply to *deductions* by the employer at the request of the employee for insurance premiums, taxes, contributions, or payment for goods or services furnished by the employer to the employee or his or her family at the employee's request. (*Lab.C. 300(g)*.)

The statute does not apply to an independent contractor. It was designed to protect wage earners and salaried workers, and neither its language nor its purpose calls for application to an assignment by an independent contractor of his or her earnings. (*Fitch v. Pacific Fidelity Life Ins. Co.* (1975) 54 C.A.3d 140, 146, 126 C.R. 445 [assignment by licensed insurance agent of commissions on policies sold].)

The assignment of future salary by a *public officer* is void, for reasons of public policy. But ordinary *public employees*, such as engineers and teachers hired by contract, may make valid assignments of future earnings, subject to the statutory restrictions. (*Kimball v. Ledford* (1936) 13 C.A.2d 602, 603, 57 P.2d 163.)

In a case arising under the former statute, where the assignment lacked written consent of the wife, it was held that the defects could be waived by failure to plead them, and that the wife might give her consent at any time, even after commencement of an action, and thus cure them. (*Berg v. Standard Light Co.* (1928) 89 C.A. 542, 544, 265 P. 369; see also *Mathewson v. Alderman* (1930) 107 C.A. 272, 275, 290 P. 317.)

SUPPLEMENT: [This section is current through the latest supplement]



43 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
XI. RIGHTS AND OBLIGATIONS OF THIRD PARTIES

B. Assignment.

3. Assignment of Choses in Action.

d. Nonassignable Rights.

1. Claims for Personal Wrongs.

1 Witkin Sum. Cal. Law Contracts § 727

[§ 727] Claims for Personal Wrongs.

Rights of action founded upon wrongs of a purely *personal* nature, such as slander, assault and battery, negligent personal injuries, and other torts to the person or reputation are not assignable. (*Wikstrom v. Yolo Fliers Club* (1929) 206 C. 461, 463, 274 P. 959; *Fifield Manor v. Finston* (1960) 54 C.2d 632, 639, 7 C.R. 377, 354 P.2d 1073, 13 Summary (10th), Equity, §188; Corbin §857; 6 Am.Jur.2d (1999 ed.), Assignments §63 et seq.; 22 Cal. L. Rev. 456; 76 A.L.R.2d 1286 [malicious prosecution]; 88 A.L.R. 2d 1153 [cause of action under civil rights statute]; 33 A.L.R.4th 82 [assignability of proceeds of claim for personal injury or death].)

C.C.P. 377.22, in the chapter dealing with survival (see 3 Cal. Proc. (4th), Actions, §67), provides that nothing in the chapter is to be construed as affecting the assignability of causes of action.

West's Key Number Digest, Assignments k.19

SUPPLEMENT: [This section is current through the latest supplement]
See 9 Corbin (Rev. ed.), §47.9; 6 Am.Jur.2d (2008 ed.), Assignments §55 et seq.

Cross-Reference: 3 Cal. Proc. (5th), Actions, §15.



44 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XI. RIGHTS AND OBLIGATIONS OF THIRD PARTIES

B. Assignment.

3. Assignment of Choses in Action.

d. Nonassignable Rights.

2. Statutory Penalty.

1 *Witkin Sum. Cal. Law Contracts* § 728

[§ 728] Statutory Penalty.

The right to recover a statutory penalty is not assignable. (*Esposti v. Rivers Bros.* (1929) 207 C. 570, 573, 279 P. 423; *Peterson v. Ball* (1931) 211 C. 461, 466, 296 P. 291; *Western Mortg. & Guaranty Co. v. Gray* (1932) 215 C. 191, 198, 8 P.2d 1016; see 36 *Am.Jur.2d* (2001 ed.), *Forfeitures and Penalties* §56.)

In applying this rule, a distinction must be made between statutory liability without reference to the actual damage sustained, the emphasis being on punishment (penalty), and such liability *measured by the loss sustained*, the object being compensation (remedial right). (*Agudo v. Monterey* (1939) 13 C.2d 285, 289, 89 P.2d 400 [right of action against county for damage caused by mob or riot (under former statute) held compensatory and assignable].)

SUPPLEMENT: [This section is current through the latest supplement]



45 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law XI. RIGHTS AND OBLIGATIONS OF THIRD PARTIES

B. Assignment.

3. Assignment of Choses in Action.

d. Nonassignable Rights.

3. Claim for Legal Malpractice.

1 Witkin Sum. Cal. Law Contracts § 729

[§ 729] Claim for Legal Malpractice.

(1) *In General.* The uniquely personal nature of legal services and the highly personal and confidential attorney-client relationship make the assignment of a cause of action for malpractice contrary to public policy. (*Goodley v. Wank & Wank* (1976) 62 C.A.3d 389, 395, 397, 133 C.R. 83.)

In *Goodley*, the court said: "The assignment of such claims could relegate the legal malpractice action to the market place and convert it to a commodity to be exploited and transferred to economic bidders who have never had a professional relationship with the attorney and to whom the attorney has never owed a legal duty, and who have never had any prior connection with the assignor or his rights. The commercial aspect of assignability of choses in action arising out of legal malpractice is rife with probabilities that could only debase the legal profession. The almost certain end result of merchandizing such causes of action is the lucrative business of factoring malpractice claims which would encourage unjustified lawsuits against members of the legal profession, generate an increase in legal malpractice litigation, promote champerty and force attorneys to defend themselves against strangers. The endless complications and litigious intricacies arising out of such commercial activities would place an undue burden on not only the legal profession but the already overburdened judicial system, restrict the availability of competent legal services, embarrass the attorney-client relationship and imperil the sanctity of the highly confidential and fiduciary relationship existing between attorney and client." (62 C.A.3d 397.)

In *Jackson v. Rogers & Wells* (1989) 210 C.A.3d 336, 258 C.R. 454, plaintiff attempted to bypass the rule against nonassignability of a claim for legal malpractice by allegations of fraud and breach of contract. The court, commenting on the "hybrid contract-tort nature" of legal malpractice claims (210 C.A.3d 342, 349), concluded that *Goodley* precluded assignment. (210 C.A.3d 343, noting that the weight of authority in other states follows the *Goodley* reasoning. "[I]f we were to uphold a characterization of these allegations as grounded in fraud rather than in classic attorney malpractice or negligence and thus assignable, we would be requiring a trial court to second-guess the attorney's professional evaluations communicated to the client and the strategic choices made in the past in a confidential relationship in which the current plaintiff had no part, and was in fact adversary to the attorney-client partnership. Such an attenuated theory of liability would lead to proof problems and would work mischief in the already busy field of legal malpractice litigation." (210 C.A.3d 346.)

In *Kracht v. Perrin, Gartland & Doyle* (1990) 219 C.A.3d 1019, 268 C.R. 637, Kracht filed an action in California against Hogue, an Oregon resident. Defendants, attorneys licensed in Oregon but not in California, assisted Hogue in preparing responses to discovery requests and in filing and serving the responses in California. As a result of deficiencies in the responses, allegedly caused by defendants' negligence, judgment was entered for Kracht, who then, as the judgment creditor of Hogue, obtained an order compelling Hogue to assign all choses in action that he held against defendants. As the assignee of the claims, Kracht filed the present malpractice action against defendants, but a demurrer was sustained, and the action was dismissed, on the ground that under California law legal malpractice claims are not assignable. *Held*, order of dismissal affirmed.

(a) The public policy concerns stated in *Jackson* and *Goodley* are violated by *any* assignment of malpractice claims, whether voluntary or (as here) involuntary. However, there are additional arguments against assignability involving involuntary transfer to the former adversary. "First, a suit could be filed, even though the former client (to whom the duty was owed) was entirely satisfied with the services and opposed the filing of a malpractice lawsuit. Second, a suit brought on a claim acquired by involuntary assignment, and against the client's wishes, places the attorney in an untenable position. He must preserve the attorney-client privilege (the client having done nothing to waive the privilege) while trying to show that his representation of the client was not negligent. Finally, a malpractice suit filed by the former adversary is 'fraught with illogic' ... and unseemly arguments: In the former lawsuit Kracht judicially averred and proved she *was entitled* to recover against Hogue; but in the malpractice lawsuit Kracht must judicially aver that, but for attorney's negligence, she *was not entitled* to have recovered against Hogue. Reduced to its essence, Kracht's argument in the malpractice action is 'To the extent I was not entitled to recover, I am now entitled to recover.' " (219 C.A.3d 1024.)

(b) Kracht contended that defendants' failure to obtain a California license transmuted their acts into the acts of mere laymen to which the nonassignability rule was inapplicable. But no authority was cited for the novel proposition that an attorney-client relationship between a licensed attorney and a resident of the licensing state is forfeited merely because the attorney also renders advice or services outside the borders of the licensing state. Although the fact that a foreign attorney lacks a California license may have specific consequences, such as the inability to appear formally in state courts, it does not denigrate the existence or fundamental attributes of a valid attorney-client relationship. Regardless of where he or she might travel, the attorney must still preserve the client's confidences, fulfill his or her fiduciary obligations, and render competent legal advice. (219 C.A.3d 1025.)

(2) *Bankruptcy*. In *Baum v. Duckor, Spradling & Metzger* (1999) 72 C.A.4th 54, 84 C.R.2d 703, plaintiff, a creditor of two corporations, brought a legal malpractice action against the corporations' legal counsel after plaintiff had become, in bankruptcy proceedings, the assignee and successor to the corporations' collective claims and rights under an agreement with bankruptcy trustees that was approved by the bankruptcy court. *Held*, judgment of dismissal affirmed.

(a) Many of the public policy concerns discussed in *Goodley*, *Jackson*, and *Kracht* are also of concern in the context of a bankruptcy trustee's purported assignment to creditors of a debtor corporation's potential legal malpractice claims against its former counsel. "The attorney-client relationship is unique and involves a highly confidential relationship even where the client is a corporation. An attorney owes all clients, including a corporate client, duties of undivided loyalty and diligence, among other fiduciary duties. A bankruptcy trustee's purported assignment to creditors of a debtor's legal malpractice chose in action, especially under circumstances in which the bankruptcy trustee has decided not to prosecute such a claim, could encourage unjustified lawsuits and the commercialization of claims condemned in *Goodley*." (72 C.A.4th 69.)

(b) Because of these policy concerns, the costs to the legal system of assigning legal malpractice claims in the bankruptcy context outweigh the benefits. "We thus hold that a legal malpractice claim belonging to the bankruptcy estate of a corporation may not be assigned by the trustee of that estate to a creditor of the corporation or any other person." (72 C.A.4th 69.)

(c) Federal law, which provides for the involuntary assignment of a debtor's legal malpractice claims to a

bankruptcy estate under 11 U.S.C., §541, does not invalidate any state law restrictions on the transfer. The nature and extent of the debtor's rights in property, and therefore of the estate's rights in the same property, are defined by state law, not bankruptcy law. (72 C.A.4th 70.) (See *Curtis v. Kellogg & Andelson* (1999) 73 C.A.4th 492, 503, 86 C.R.2d 536 [following *Baum*; bankruptcy trustee could not assign legal malpractice claim of bankrupt medical corporation to physician, even though he was sole owner of corporation, because, for legal purposes, corporation had separate rights and separate identity]; cf. *Office of Statewide Health Planning & Dev. v. Musick, Peeler & Garrett* (1999) 76 C.A.4th 830, 835, 90 C.R.2d 705 [Chapter 11 bankruptcy plan may provide for transfer of claim by operation of law from trustee to representative of bankruptcy estate, who is invested with ability to pursue claim, including one for legal malpractice, without assignment; distinguishing *Baum* and *Curtis*]; 31 West L.A. L. Rev. 25 [assignability of proceeds of claim for legal malpractice].)

SUPPLEMENT: [This section is current through the latest supplement]



46 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law XI. RIGHTS AND OBLIGATIONS OF THIRD PARTIES

B. Assignment.

4. Effect of Assignment.

a. Liabilities of Assignor.

1. Liability to Promisee.

1 Witkin Sum. Cal. Law Contracts § 730

[§ 730] Liability to Promisee.

Where the subject matter of the assignment (e.g., a bilateral contract) involves reciprocal rights and duties, the assignor may transfer the *benefits*, i.e., the assignor may transfer his or her rights, but cannot escape the *burden* of his or her obligation by a mere assignment. The assignor still remains liable to the promisee. Even if the assignee *assumes* the obligation, i.e., agrees to perform it, the assignor still remains secondarily liable as a surety or guarantor, unless the promisee releases him or her or the parties execute a complete novation. (C.C. 1457; *Cutting Packing Co. v. Packers Exchange of Calif.* (1890) 86 C. 574, 576, 25 P. 52; *Wiseman v. Sklar* (1930) 104 C.A. 369, 374, 285 P. 1081; *Fenn v. Pickwick Corp.* (1931) 117 C.A. 236, 241, 4 P.2d 215; *AICCO v. Insurance Co. of North America* (2001) 90 C.A.4th 579, 588, 595, 109 C.R.2d 359 [under C.C. 1457, insurer may not transfer liability obligations to another insurer without policyholders' consent; rule applies even when transfer is by operation of law]; see *Rest.2d, Contracts* §318(3) and Comment d; Corbin §§865, 866; 29 Williston 4th, §74:27 et seq.; 6 *Am.Jur.2d* (1999 ed.), *Assignments* §§165, 166; Cal. Civil Practice, 3 Business Litigation, §26:13 et seq.; 2A *Am.Jur. P.P. Forms* (2000 ed.), *Assignments*, §11; 2 *U.C.L.A. L. Rev.* 310.)

SUPPLEMENT: [This section is current through the latest supplement]

See 9 Corbin (Rev. ed.), §49.1 et seq.; 6 *Am.Jur.2d* (2008 ed.), *Assignments* §§129, 130.



47 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law XI. RIGHTS AND OBLIGATIONS OF THIRD PARTIES

B. Assignment.

4. Effect of Assignment.

a. Liabilities of Assignor.

2. Liability to Assignee.

1 Witkin Sum. Cal. Law Contracts § 731

[§ 731] Liability to Assignee.

At common law, the assignor impliedly warranted genuineness of and absence of defenses to the right assigned. (See *Jeffers v. Easton, Eldridge & Co.* (1896) 113 C. 345, 353, 45 P. 680 [assignment of lease carries with it warranty of title]; *Rest.2d, Contracts* §333; *Corbin* §904; 29 *Williston* 4th, §74:7 et seq.; 6 *Am.Jur.2d* (1999 ed.), *Assignments* §155 et seq.; 27 *Cal. L. Rev.* 477; 2 *U.C.L.A. L. Rev.* 317.)

Former C.C. 1774 limited the common law rule by providing that the seller of a written instrument purporting to bind anyone to the performance of an act only warranted that he or she had *no knowledge of defects*. (See *Sutro v. Rhodes* (1891) 92 C. 117, 124, 28 P. 98; *Mary Pickford Co. v. Bayly Bros.* (1939) 12 C.2d 501, 518, 86 P.2d 102.) Since repeal of C.C. 1774 in 1931, the common law implied warranties of genuineness, title, and validity have been recognized by the California courts. (See *Pickford Co. v. Bayly Bros.*, *supra* [upholding warranties implied under former Corporate Securities Act in pre-1931 transaction]; 27 *Cal. L. Rev.* 479.)

Warranties in commercial transactions within the scope of the Uniform Commercial Code are now governed by provisions of that Code:

- (1) *Commercial Paper*. (U.C.C. 3416, 3417, 4207; see 4 *Summary* (10th), *Negotiable Instruments*, §§49, 50, 103.)
- (2) *Documents of Title*. (U.C.C. 7507, 7508; see 4 *Summary* (10th), *Sales*, §54.)
- (3) *Goods Sold*. (U.C.C. 2312 et seq.; see 4 *Summary* (10th), *Sales*, §51 et seq.)
- (4) *Investment Securities*. (U.C.C. 8108, 8208; see 9 *Summary* (10th), *Corporations*, §139.)
- (5) *Letters of Credit*. (U.C.C. 5110; see 4 *Summary* (10th), *Negotiable Instruments*, §136 et seq.)

West's Key Number Digest, Assignments k.95

SUPPLEMENT: [This section is current through the latest supplement]

Implied warranty of genuineness and absence of defenses: See 9 Corbin (Rev. ed.), §51.9; 6 Am.Jur.2d (2008 ed.), Assignments §122 et seq. *Warranties in commercial transactions within scope of Uniform Commercial Code:*

(2) *Documents of Title.* In 2006, U.C.C. 7507 and 7508 were repealed and reenacted.



48 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law XI. RIGHTS AND OBLIGATIONS OF THIRD PARTIES

- B. Assignment.
- 4. Effect of Assignment.
 - b. Rights of Assignee.
 - 1. In General.
 - aa. Complete Assignment.

1 Witkin Sum. Cal. Law Contracts § 732

[§ 732] Complete Assignment.

Legal title passes to the assignee when a chose in action is transferred, even though the assignment is made only for collection. After notice of the assignment, performance by the obligor to the assignor does not extinguish the obligation. (*In re Kling* (1919) 44 C.A. 267, 270, 186 P. 152; see *Fricker v. Uddo & Taormina Co.* (1957) 48 C.2d 696, 701, 312 P.2d 1085; *Cohn v. Thompson* (1932) 128 C.A. Supp. 783, 787, 16 P.2d 364; Corbin §892 et seq.; 29 Williston 4th, §74:7 et seq.; 6 *Am.Jur.2d* (1999 ed.), *Assignments* §§144, 148 et seq., 156; 68 *A.L.R.3d* 360 [right of assignee of insurance policy to notice from insurer of premiums due].)

The assignee is the real party in interest and sues in his or her own name. (*Reios v. Mardis* (1912) 18 C.A. 276, 280, 122 P. 1091; see 4 *Cal. Proc.* (4th), *Pleading*, §108 et seq.) And a valid and effective assignment gives the assignee priority over creditors of the assignor. (*Rest.2d, Contracts* §341; see Corbin §882, 905; 29 Williston 4th, §74:55; 6 *Am.Jur.2d* (1999 ed.), *Assignments* §127 et seq.)

West's Key Number Digest, Assignments k.94, 95, 98

SUPPLEMENT: [This section is current through the latest supplement]

Passage of legal title to assignee: See 9 Corbin (Rev. ed.), §51.1 et seq.; 6 *Am.Jur.2d* (2008 ed.), *Assignments* §§108, 112 et seq.

Assignee is real party in interest:

Cross-Reference: 4 *Cal. Proc.* (5th), *Pleading*, §127 et seq.

Assignee's priority over assignor's creditors: See 9 Corbin (Rev. ed.), §47.8; 6 *Am.Jur.2d* (2008 ed.), *Assignments* §93 et seq.



49 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law XI. RIGHTS AND OBLIGATIONS OF THIRD PARTIES

- B. Assignment.
- 4. Effect of Assignment.
 - b. Rights of Assignee.
 - 1. In General.
 - bb. Partial Assignment.

1 Witkin Sum. Cal. Law Contracts § 733

[§ 733] Partial Assignment.

A partial assignment of a claim is unenforceable without the debtor's consent, and the assignee ordinarily has no legal standing to sue. The reason is that if the creditor were permitted to split up his or her claim into parts, the debtor might be subjected to the trouble and expense of numerous suits on each partial claim. (*Stein v. Cobb* (1940) 38 C.A.2d 8, 10, 100 P.2d 358.) But the substantive rights of the partial assignee are recognized and are enforceable by joinder of the partial assignor and any other partial assignees. (See *Martin v. Howe* (1922) 190 C. 187, 194, 211 P. 453; *Oxnard School Dist. v. Penn* (1933) 132 C.A. 763, 768, 23 P.2d 828; *D'Orazi v. Bank of Canton* (1967) 254 C.A.2d 901, 905, 62 C.R. 704; *Rest.2d, Contracts* §326; *Corbin* §889; 29 *Williston* 4th, §74:72 et seq.; 6 *Am.Jur.2d* (1999 ed.), *Assignments* §106 et seq., 132, 133; 2B *Am.Jur. Legal Forms* 2d (2003 ed.), §25:164 et seq.; 2 *U.C.L.A. L. Rev.* 316; 4 *Cal. Proc.* (4th), *Pleading*, §111.)

A bill of exchange or order for part of a fund, whether negotiable or nonnegotiable, does not of itself operate as an assignment to the payee. (*Guggenhime & Co. v. Lamantia* (1929) 207 C. 96, 98, 276 P. 995.) However, it will have this effect if accepted, i.e., assented to, by the drawee (the party to whom the order is directed). And even though there has been no express acceptance by the drawee, as between the drawer and payee it may be regarded in equity as an assignment if from the entire transaction this clearly appears to be their intention. (*Goldman v. Murray* (1912) 164 C. 419, 421, 129 P. 462; *Security Trust & Savings Bank of San Diego v. A.H. Frost Co.* (1932) 126 C.A. 94, 102, 14 P.2d 346; *Baumgarten v. California Pac. Title & Trust Co.* (1932) 127 C.A. 649, 657, 16 P.2d 332; *Oxnard School Dist. v. Penn*, *supra*; *Cannon v. Chapman* (1938) 24 C.A.2d 448, 452, 75 P.2d 522; *McKay v. Security-First Nat. Bank of Los Angeles* (1939) 35 C.A.2d 349, 352, 96 P.2d 376.)

SUPPLEMENT: [This section is current through the latest supplement]
Partial assignment is unenforceable:

See 9 *Corbin* (Rev. ed.), §50.4; 6 *Am.Jur.2d* (2008 ed.), *Assignments* §79 et seq. p

Cross-Reference: 4 *Cal. Proc.* (5th), *Pleading*, §130.



50 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law XI. RIGHTS AND OBLIGATIONS OF THIRD PARTIES

B. Assignment.

4. Effect of Assignment.

b. Rights of Assignee.

2. Incidental Rights Pass With Assignment.

1 Witkin Sum. Cal. Law Contracts § 734

[§ 734] Incidental Rights Pass With Assignment.

An assignment carries with it all rights of the assignor. (See C.C. 1084; Corbin §907; 29 Williston 4th, §§74:51, 74:52; 6 *Am.Jur.2d* (1999 ed.), *Assignments* §172 et seq.) Thus:

(1) Assignment of a note passes any incidental security, such as a mortgage or other lien. (C.C. 2936; *Adler v. Sargent* (1895) 109 C. 42, 48, 41 P. 799; *Union Supply Co. v. Morris* (1934) 220 C. 331, 338, 30 P.2d 394; see *Mitchell v. Shoreridge Oil Co.* (1938) 24 C.A.2d 382, 384, 75 P.2d 110 [assignment of debt carries with it mechanic's lien]; *Rest.2d, Contracts* §340(2).)

(2) Assignment by a lessee-sublessor of all "right, title and interest" in a lease is sufficient to transfer his or her interest in machinery previously installed by him or her in the premises. (*Root v. Burgeson* (1936) 8 C.2d 27, 28, 63 P.2d 293.)

(3) Assignment of a lease by a judgment debtor transfers title to each installment of rent as it accrues, leaving nothing that the judgment creditor can reach by garnishment. (*Hustead v. Superior Court* (1969) 2 C.A.3d 780, 789, 83 C.R. 26; 8 *Cal. Proc.* (4th), *Enforcement of Judgment*, §50.)

(4) Assignment of an option gives the assignee the right to recover a deposit paid by the assignor in the event of breach by the owner of the property. (*Tatum v. Levi* (1931) 117 C.A. 83, 89, 3 P.2d 963.)

(5) Where a lease contains a provision for attorneys' fees in case the lessor is forced to sue, the assignee of the lessor is entitled to the benefit of the provision. (*Adjustment Corp. v. Marco* (1929) 100 C.A. 338, 341, 279 P. 1006.)

(6) Assignment of a credit agreement between a finance company and a recreational vehicle dealer includes the personal guaranties of the dealer and his wife. (*Champion Home Builders Co. v. Sipes* (1990) 219 C.A.3d 1415, 1423, 269 C.R. 75.)

(7) Assignment of a judgment constitutes an assignment of the debt upon which it was based. (*North v. Evans* (1934) 1 C.A.2d 64, 67, 36 P.2d 133.)

In *Millner v. Lankershim Packing Co.* (1936) 13 C.A.2d 315, 318, 56 P.2d 1295, it was held that, although the assignment of a chattel mortgage passed the mortgagee's right to the property, it did not carry with it a right of action for a tort against the property (conversion) committed by a third person before the assignment.

But in *National Reserve Co. of America v. Metropolitan Trust Co.* (1941) 17 C.2d 827, 112 P.2d 598, it was held that an unlimited assignment of an investment certificate passed to the assignee an accrued cause of action for breach of the trust indenture securing the certificates. The court laid down the following test where a contract is assigned: If the cause of action can be asserted by the assignor independently of his or her continued ownership of the contract, and is not essential to continued enforcement of the contract, it does not pass; but (a) if the cause of action cannot be asserted apart from the contract, or (b) is essential to its adequate enforcement, or (c) the assignor is prevented by express provision in the contract from asserting the cause of action after assignment, the right to sue passes to the assignee. (17 C.2d 833.) (See *Emmons v. Barton* (1895) 109 C. 662, 666, 42 P. 303 [assignment of creditor's claim against estate passes right to set aside prior fraudulent conveyance by deceased debtor]; *Latimer v. Capay Valley Land Co.* (1902) 137 C. 286, 290, 70 P. 82 [assignment of contract carries accrued cause of action for rescission].)

SUPPLEMENT: [This section is current through the latest supplement]

See 9 Corbin (Rev. ed.), §49.1; 6 *Am.Jur.2d* (2008 ed.), *Assignments* §113 et seq. *Hustead case*:

Cross-Reference: 8 *Cal. Proc.* (5th), *Enforcement of Judgment*, §60.



51 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law XI. RIGHTS AND OBLIGATIONS OF THIRD PARTIES

B. Assignment.

4. Effect of Assignment.

b. Rights of Assignee.

3. Notice and Defenses of Obligor.

aa. In General.

1 Witkin Sum. Cal. Law Contracts § 735

[§ 735] In General.

The assignment merely transfers the interest of the assignor. The assignee "stands in the shoes" of the assignor, taking his or her rights and remedies, subject to *any defenses* that the *obligor* has against the assignor prior to notice of the assignment. (C.C. 1459; C.C.P. 368; see *Parker v. Funk* (1921) 185 C. 347, 352, 197 P. 83; *American Nat. Bank of San Francisco v. A.G. Sommerville* (1923) 191 C. 364, 370, 216 P. 376; *Reios v. Mardis* (1912) 18 C.A. 276, 279, 122 P. 1091; *Stern v. Sunset Road Oil Co.* (1920) 47 C.A. 334, 341, 190 P. 651; *Arp v. Blake* (1923) 63 C.A. 362, 366, 218 P. 773; *Bank of America v. Pacific Ready-Cut Homes* (1932) 122 C.A. 554, 560, 10 P.2d 478; *Berrington v. Williams* (1966) 244 C.A.2d 130, 135, 52 C.R. 772; *Royal Bank Export Finance Co. v. Bestways Distr. Co.* (1991) 229 C.A.3d 764, 768, 280 C.R. 355, quoting the text [assignment to bank of accounts owed to manufacturer by purchaser held subject to purchaser's defense that manufacturer's goods were not merchantable]; *Music Acceptance Corp. v. Lofing* (1995) 32 C.A.4th 610, 622, 39 C.R.2d 159 [assignment to finance company of consumer credit contract for purchase of piano was subject to purchaser's claims against seller for breach of implied warranty, remedy for which included cancellation of contract]; *Johnson v. Fresno* (2003) 111 C.A.4th 1087, 1096, 4 C.R.3d 475, citing the text [where county and county employee were sued for sexual harassment, county was dismissed with prejudice, and employee entered into stipulated judgment with plaintiff, county could not have raised its dismissal as defense had employee brought indemnification action, and likewise could not do so when indemnification action was brought by plaintiff as employee's assignee]; *Rest.2d, Contracts* §336; Corbin §892 et seq.; 29 Williston 4th, §74:47 et seq.; 6 *Am.Jur.2d* (1999 ed.), *Assignments* §§144, 148 et seq.; 2A *Am.Jur. P.P. Forms* (2000 ed.), *Assignments*, §§13, 17.) (On cutting off defenses under installment sales contract, see C.C. 1804.2, 4 *Summary* (10th), *Sales*, §281.)

The assignee can protect his or her right by giving *notice* to the obligor. On the other hand, payment or performance by the obligor to the assignor before this notice is a good defense against the assignee. (*Ornbaun v. First Nat. Bank* (1932) 215 C. 72, 76, 8 P.2d 470; *Mutual Bldg. & Loan Assn. of Long Beach v. Corum* (1936) 16 C.A.2d 212, 215, 60 P.2d 316; Corbin §890; 29 Williston 4th, §74:56 et seq.; 6 *Am.Jur.2d* (1999 ed.), *Assignments* §140 et seq.; 2B *Am.Jur. Legal Forms* 2d (2003 ed.), §25:174 et seq.; 2A *Am.Jur. P.P. Forms* 2002 ed.), *Assignments*, §12; cf. *Jones v. Martin* (1953) 41 C.2d 23, 28, 256 P.2d 905 [even after notice, assignee may lose his or her right by waiver or estoppel].)

If the debtor-obligor has a claim against his or her creditor-obligee that accrued *before* notice of assignment, the debtor-obligor may set it up by a cross-complaint in an action brought against him or her by the creditor's assignee. (*Hall & Co. v. Consolidated Packing Co.* (1942) 55 C.A.2d 651, 655, 131 C.2d 859.) Or, as in the case of a judgment debtor, he or she may bring an equitable action against the assignee to have the claim offset. (See *Harrison v. Adams* (1942) 20 C.2d 646, 649, 128 P.2d 9.) It has been held, however, that this right does not exist where the judgment debtor's claim was merely assigned to him or her for collection, for in this case the claims would not be mutual, and the judgment debtor would be attempting to use a claim assigned in a fiduciary capacity as an offset against his or her own personal debt. (*Harrison v. Adams*, *supra*; see 15 So. Cal. L. Rev. 364.)

A debtor may sometimes be entitled to cross-complain against an assignee on a cause of action that accrued *after* notice of assignment. Thus, in *Cohen v. Bonnell* (1936) 14 C.A.2d 38, 57 P.2d 1326, defendant debtor made a note and mortgage to N; the latter assigned to plaintiff assignee, who sued to foreclose. But N, the assignor, was indebted to defendant debtor on another secured note. The evidence showed chronologically that defendant debtor gave the assignor notice of default; plaintiff assignee gave defendant debtor notice of assignment; plaintiff brought this suit; defendant had a sale and obtained a deficiency judgment against the assignor. *Held*, defendant debtor could counterclaim this judgment against plaintiff assignee. (14 C.A.2d 39.)

Where a right is in litigation, if an assignment thereof is made by a party *pendente lite*, the assignee who takes with notice of the action does so subject to any judgment rendered against the assignor in the action, even though he or she is not made a party by substitution. (*Dougherty v. California Kettleman Oil Royalties* (1937) 9 C.2d 58, 84, 69 P.2d 155.)

West's Key Number Digest, Assignments k.99-

SUPPLEMENT: [This section is current through the latest supplement]

Assignee as subject to obligor's defenses against assignor before notice: See 9 Corbin (Rev. ed.), §51.1 et seq.; 6 *Am.Jur.2d* (2008 ed.), Assignments §§108, 112 et seq.

Effect of obligor's performance before notice: See 9 Corbin (Rev. ed.), §51.5, 51.6; 6 *Am.Jur.2d* (2008 ed.), Assignments §104 et seq.



52 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law XI. RIGHTS AND OBLIGATIONS OF THIRD PARTIES

B. Assignment.

4. Effect of Assignment.

b. Rights of Assignee.

3. Notice and Defenses of Obligor.

bb. Rights Under Executory Contract.

1 Witkin Sum. Cal. Law Contracts § 736

[§ 736] Rights Under Executory Contract.

The proposition that the assignee only takes subject to those defenses existing *prior to notice* of the assignment (see *supra*, §735) is not invariably true. If the assignment is of rights under an executory bilateral contract, and thereafter the assignor is guilty of a breach (or failure of consideration), the obligor has a good defense. This is made clear in *Bliss v. California Cooperative Producers* (1947) 30 C.2d 240, 181 P.2d 369, where the court quotes Williston as follows: "[P]ayment to the assignor or other defenses acquired by the debtor against the assignor after notice of the assignment are invalid, unless the defense, though acquired after notice, is based on a right of the defendant inherent in the contract by its terms. Thus if payments under an executory contract are assigned, the debtor may set up failure of the assignor to fulfill his part of the contract though such failure occurs after notice of the assignment, for the assignor cannot give another a larger right than he has himself." (30 C.2d 250.) (See Corbin §895; 29 Williston 4th, §74:56; 6 Am.Jur.2d (1999 ed.), *Assignments* §154.)

Another limitation on the rights of the assignee has been generally recognized: An assignment of money to become due to the assignor after he or she performs under an executory contract is subject to advances by the obligor to the assignor to enable the assignor to perform. But the burden is on the obligor to show this necessity. Thus, in *Fricker v. Uddo & Taormina Co.* (1957) 48 C.2d 696, 312 P.2d 1085, K agreed to grow and sell tomatoes to defendant canning company, and made an assignment ("crop order") to plaintiffs of \$ 4,074.91 for soil fumigant supplied on credit. After notice of this assignment, defendant advanced considerable sums to K for various purposes necessary to produce the crop. The court, however, after a careful analysis of the evidence, found that \$ 7,845 was advanced for unspecified purposes, including living expenses of K and his family. This sum had no priority over the assignment, and plaintiffs were therefore entitled to the amount assigned to them. (48 C.2d 701.)

SUPPLEMENT: [This section is current through the latest supplement]

See 9 Corbin (Rev. ed.), §50.1; 6 Am.Jur.2d (2008 ed.), *Assignments* §121.



53 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law XI. RIGHTS AND OBLIGATIONS OF THIRD PARTIES

- B. Assignment.
- 4. Effect of Assignment.
- b. Rights of Assignee.
- 4. Latent Equities.

1 Witkin Sum. Cal. Law Contracts § 737

[§ 737] Latent Equities.

A latent equity is an equity or defense held by some person other than the obligor. The rights of the assignee are subject to defenses or equities that could have been set up against the assignor by the *debtor* or *obligor*, but not to equities of *third persons* against the assignor. (See *Rest.2d, Contracts* §343; Corbin §900; 29 Williston 4th, §§74:53, 74:54; 6 *Am.Jur.2d* (1999 ed.), *Assignments* §153, 170.)

For example, D (debtor, obligor) owes C (creditor, obligee) a sum of money. X procures a transfer of the claim from C by fraud. X (assignor) assigns it to A (assignee), a bona fide purchaser without notice of the fraud. D, the obligor, had no defense, and must pay A, even if A subsequently learns of the fraud. C, the defrauded obligee, is a third person having a defense against X; i.e., he or she has a latent equity against the assignor; but only the equities of the obligor against the assignor may be set up against the assignee.

In *First Nat. Bank of Bridgeport v. Perris Irr. Dist.* (1895) 107 C. 55, 40 P. 45, a contractor built a pipe line for defendant, and then assigned to A Co. all claims due or to become due in payment. A Co. assigned to plaintiff bank, which immediately gave notice to defendant obligor. C Co. furnished materials to the contractor, for which it was not paid, but gave no notice to defendant until after the commencement of this action, in which it intervened. *Held*, the intervenor was a third party with a claim against the assignor; it therefore had a mere latent equity, and could not prevail against the assignee. (107 C. 62.)

SUPPLEMENT: [This section is current through the latest supplement]
See 9 Corbin (Rev. ed.), §51.8; 6 *Am.Jur.2d* (2008 ed.), *Assignments* §§120, 132.



54 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law XI. RIGHTS AND OBLIGATIONS OF THIRD PARTIES

B. Assignment.

4. Effect of Assignment.

b. Rights of Assignee.

5. Priorities Among Successive Assignees.

aa. In General.

1 Witkin Sum. Cal. Law Contracts § 738

[§ 738] In General.

(1) *In General.* Where there are successive assignments by an assignor of the same chose in action, it is necessary to determine which assignee has priority. The situation, substantially, is as follows: D, the debtor, owes money to C, the creditor. C assigns the claim to A1, the first assignee. Later C makes a second assignment of the same debt to A2, the second assignee. A2 then notifies D of the assignment. Which assignee is entitled to the money? Two important and conflicting rules have been developed to solve this problem.

(a) *Assignee first in time.* The so-called American rule, adopted by the Restatement, gives priority to the assignee first in time. The theory is that the *legal title* has passed from the assignor after the first assignment, and he or she has, legally, nothing further to assign. (See *Salem Trust Co. v. Manufacturers' Finance Co.* (1924) 264 U.S. 182, 44 S.Ct. 266, 270, 68 L.Ed 628, 634; *Rest.2d, Contracts* §342; Corbin §902; 29 Williston 4th, §§74:59, 74:60; 6 *Am.Jur.2d* (1999 ed.), *Assignments* §167 et seq.; 13 *Cal. L. Rev.* 141; 2 *U.C.L.A. L. Rev.* 316.)

(b) *First assignee to give notice.* The other rule prefers the first assignee to give notice, on the theory that the assignment of a chose in action is to be governed by equitable rules, and therefore, after the assignment to him or her, A1 should perfect the right by giving notice to the debtor, D. If the first assignee fails to do this, he or she leaves C with the power to deceive A2, an innocent party, by another assignment. The California courts follow the notice theory, holding that the assignee of a chose in action must do everything possible to secure possession or control of the subject matter of the assignment. Hence, he or she must give notice of the claim to the legal holder of the fund, which notice is, in the case of a chose in action, the equivalent of possession. If the subsequent assignee does this, he or she will prevail over a prior assignee, provided that the subsequent assignee has no notice of the first assignment. (C.C. 955.1(b) [as between bona fide assignees of same right for value without notice, assignee first giving written notice thereof has priority]; *Graham Paper Co. v. Pembroke* (1899) 124 C. 117, 120, 56 P. 627; *Widenmann v. Weniger* (1913) 164 C. 667, 673, 130 P. 421; *Smitton v. McCullough* (1920) 182 C. 530, 535, 189 P. 686; *Rogers v. Transamerica Corp.* (1939) 36 C.A.2d 233, 241, 97 P.2d 517; *Rosenblatt v. Credit Discount Co.* (1940) 37 C.A.2d 108, 109, 98 P.2d 747; Corbin §902; 29 Williston 4th, §§74:59, 74:60; 6 *Am.Jur.2d* (1999 ed.), *Assignments* §168; 17 *So. Cal. L. Rev.* 303; 2 *U.C.L.A. L. Rev.* 315.)

In *First Nat. Bank of Stockton v. Pomona Tile Mfg. Co.* (1947) 82 C.A.2d 592, 186 P.2d 693, the California notice rule was restated (though the first assignee to give notice was also the first in time). The second assignee's claim of priority on the ground that it had received a formal *legal* assignment, while the preferred claim was only an "implied" or "equitable" assignment (implied from conduct of the parties), was answered as follows: "But the modern view is that the law governing assignment of things in action having originated entirely in equity, priority between such assignments should be determined without regard to any distinction between legal and equitable titles." (82 C.A.2d 606.)

C.C. 955.1 is inapplicable to transfers or assignments of "transition property," as defined in *Pub.Util.C. 840*, or to transfers or assignments of "recovery property," as defined in *Pub.Util.C. 848*. (C.C. 955.1(d).)

(2) *Executory Contract for Sale of Land*. The foregoing rules apply, of course, only to the assignment of *choses in action* (personal property); an executory contract for the sale of land transfers an equitable interest in real property, and successive assignments of this type of contract are governed by the rules of recordation and bona fide purchase. (*Central Const. Co. v. Hartman* (1935) 7 C.A.2d 703, 707, 47 P.2d 484.) And statutes requiring recording or filing of any other instrument may also affect the validity (and therefore the priority) of an assignment. (See C.C. 955.1 [as amended in 1963 to exclude security interests subject to the rules set forth in the Uniform Commercial Code]; 27 So. Cal. L. Rev. 76; and see *infra*, §739.)

West's Key Number Digest, Assignments k.85; Equity k.60

SUPPLEMENT: [This section is current through the latest supplement]

(1) *In General*.

(a) *Assignee first in time*. See 9 Corbin (Rev. ed.), §51.10 et seq.; 6 *Am.Jur.2d* (2008 ed.), *Assignments* §131 et seq.

(b) *First assignee to give notice*. See 9 Corbin (Rev. ed.), §51.10 et seq.; 6 *Am.Jur.2d* (2008 ed.), *Assignments* §131 et seq.



55 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law XI. RIGHTS AND OBLIGATIONS OF THIRD PARTIES

B. Assignment.

4. Effect of Assignment.

b. Rights of Assignee.

5. Priorities Among Successive Assignees.

bb. Nonnotification Financing of Accounts Receivable.

1 Witkin Sum. Cal. Law Contracts § 739

[§ 739] Nonnotification Financing of Accounts Receivable.

(1) *Former Law.* A modification of the notice requirement in financing by assignment of *accounts receivable* was made in 1943 by the enactment of former C.C. 3017 et seq.

In place of notification of the debtor, the statute provided for *recording* a notice of intention to assign certain accounts. An assignment without this recordation was valid between the parties but not against present or future creditors without notice, or a subsequent purchaser or assignee of the account without notice.

The chief purpose of the law was to establish *priorities* among the *assignee and third persons*, and to protect the rights of the assignee in the event of the assignor's bankruptcy, without requiring notification of the debtor (which involves both business and legal disadvantages). The general rules governing rights of the *debtor* were unaffected; i.e., until notified of the assignment, he or she could *pay the assignor*, and he or she could set up against the assignee any cross-claim or defense existing prior to notice. (Former C.C. 3018.) (See generally *Smith v. Harris* (1954) 127 C.A.2d 311, 315, 273 P.2d 835; *Durkin v. Durkin* (1955) 133 C.A.2d 283, 291, 284 P.2d 185; *H.S. Mann Corp. v. Moody* (1956) 144 C.A.2d 310, 313, 301 P.2d 28; 33 Cal. L. Rev. 40, 96; 38 Cal. L. Rev. 308; 41 Cal. L. Rev. 333; 43 Cal. L. Rev. 71; 64 Harv. L. Rev. 62; 65 Harv. L. Rev. 627; 17 So. Cal. L. Rev. 303; 27 So. Cal. L. Rev. 75; 2 U.C.L.A. L. Rev. 316; 4 U.C.L.A. L. Rev. 471.) The second assignee in time whose notice of assignment was first filed was entitled to priority over the assignee first in time. (Former C.C. 3018; *Continental Bank v. Blethen* (1970) 7 C.A.3d 178, 182, 86 C.R. 485.)

(2) *Uniform Commercial Code.* The former statute was superseded by Division 9 of the Uniform Commercial Code. (On the effect of the Code on receivables financing generally, see 76 Harv. L. Rev. 1529; 8 U.C.L.A. L. Rev. 878, 973; for the principal priority rules under the Code, see U.C.C. 9322 ["first to file" and "first to perfect" rules]; 4 *Summary* (10th), *Secured Transactions in Personal Property*, §114 et seq.)

SUPPLEMENT: [This section is current through the latest supplement]



56 of 184 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law XI. RIGHTS AND OBLIGATIONS OF THIRD PARTIES

B. Assignment. 4. Effect of Assignment. c. Liability of Assignee.

1 Witkin Sum. Cal. Law Contracts § 740

[§ 740] Liability of Assignee.

(1) *In General.* The assignee ordinarily does not become bound to perform the obligations of the assignor by a mere acceptance of the assignment. (*Armstrong Co. v. Shell Co. of Calif.* (1929) 98 C.A. 769, 775, 277 P. 887; *Bruce v. Mieir* (1932) 120 C.A. 287, 290, 7 P.2d 1037; *Griffin v. Williamson* (1955) 137 C.A.2d 308, 315, 290 P.2d 361.) The assignee does become liable, however, by an express "assumption" or promise to perform, made to the assignor, which is enforceable by the creditor as a third-party beneficiary, provided that it appears to have been made *expressly* for his or her benefit. (See *Bruce v. Mieir*, *supra*; Corbin §§866, 906; 29 Williston 4th, §74:30 et seq.; 6 *Am.Jur.2d* (1999 ed.), *Assignments* §§161, 162; 2 *U.C.L.A. L. Rev.* 312; cf. U.C.C. 2210(5) [assignee is bound unless language or circumstances indicate otherwise].)

(2) *Acceptance of Benefits.* C.C. 1589 provides that the voluntary acceptance of the benefit of a transaction is equivalent to a *consent* to its obligations, where the facts are known or ought to be known to the person accepting. It was nevertheless urged against this implied liability of the assignee that C.C. 1559 (on third-party beneficiaries) permits only express beneficiaries to recover, and that C.C. 1589 applies only to parties to the original transaction. (See *Armstrong Co. v. Shell Co.*, *supra*, 98 C.A. 778; *Bruce v. Mieir*, *supra*, 120 C.A. 290; 18 *Cal. L. Rev.* 196; 12 *Hastings L. J.* 405.) Other cases took a different view. (See *Cutting Packing Co. v. Packers Exchange of Calif.* (1890) 86 C. 574, 577, 25 P. 52; *Robinson v. Rispin* (1917) 33 C.A. 536, 541, 165 P. 979; *Brady v. Fowler* (1920) 45 C.A. 592, 595, 188 P. 320.) In *Weidner v. Ziegler* (1933) 218 C. 345, 23 P.2d 515, the latter cases were approved. The court concluded that whether the assignee is to be bound depends upon the intent of the parties, and that his or her assumption of liability may be implied from acceptance of rights and privileges under the contract. (128 C. 350.) (See *Compton Inv. Co. v. Hart* (1934) 138 C.A. 224, 226, 31 P.2d 1049; *Citizens Suburban Co. v. Rosemont Dev. Co.* (1966) 244 C.A.2d 666, 676, 53 C.R. 551.)

In *Bergin v. van der Steen* (1951) 107 C.A.2d 8, 18, 236 P.2d 613, the court said: "The California rule appears somewhat narrower than the provision of the Restatement of Contracts ... that an assignee is held impliedly to undertake performance of the duties imposed by a contract merely by virtue of an assignment thereof. It is here held in conformance with section 1589, *supra*, that acceptance of the benefits of a transaction is equivalent to a consent to all the obligations thereby imposed." (See *Compton Inv. Co. v. Hart*, *supra*; *Jegen v. Berger* (1946) 77 C.A.2d 1, 6, 174 P.2d 489; *Pecarovich v. Becker* (1952) 113 C.A.2d 309, 315, 248 P.2d 123; *Fanning v. Yoland Productions* (1957) 150

*C.A.2d 444, 448, 310 P.2d 85; Bank of America v. McLaughlin (1957) 152 C.A.2d Supp. 911, 914, 313 P.2d 220; Gregers v. Peterson Ice Cream Co. (1958) 158 C.A.2d 746, 751, 323 P.2d 572; Recorded Picture Co. [Productions] Ltd. v. Nelson Entertainment (1997) 53 C.A.4th 350, 361, 61 C.R.2d 742 [subdistributor of movie was not subject to burdens of agreement between movie producer and distributor under C.C. 1589, where it only accepted benefit of its own contract with distributor and was not assignee of producer-distributor agreement]; NORCAL Mut. Ins. Co. v. Newton (2000) 84 C.A.4th 64, 82, 100 C.R.2d 683 [person who sought and accepted benefit of spouse's insurance policy in handling underlying medical malpractice suit, even though arguably not entitled to coverage under policy, was required to abide by policy's provision for arbitration of disputes; distinguishing *Recorded Picture Co.*]; *Melchior v. New Line Productions (2003) 106 C.A.4th 779, 787, 131 C.R.2d 347* [where original agreement between plaintiff author and assignor film production company had provided for payment to plaintiff of 2% of film's gross receipts, assignee was liable for this amount, even though original agreement was ineffectively modified so that the 2% was no longer due; unlike in *Recorded Picture Co.*, assignee was aware of original agreement]; cf. *Fruitvale Canning Co. v. Cotton (1953) 115 C.A.2d 622, 626, 252 P.2d 953* [no liability where assignee did not receive benefits].) (On requirement of a writing for assumption of mortgage debt by grantee of mortgagor, see *supra*, §400; on liabilities after assignment of lease, see 12 *Summary* (10th), *Real Property*, §538.)*

In *Heppler v. J.M. Peters Co. (1999) 73 C.A.4th 1265, 87 C.R.2d 497*, a construction defect case involving a residential development, the developer, as part of a global settlement, assigned its indemnification rights against nonsettling subcontractors to plaintiff homeowners. In the subsequent action by plaintiffs against the nonsettling subcontractors, the trial court entered a judgment that plaintiffs take nothing from three subcontractors whose contracts contained express indemnity clauses. The court also ordered plaintiffs, rather than the developer, to pay attorneys' fees, including fees incurred before the assignment, to those subcontractors. *Held*, affirmed.

Under the settlement agreement, the developer expressly assigned its right to attorneys' fees, but the agreement was silent as to a corresponding obligation to pay attorneys' fees. Nevertheless, considering the terms of the settlement agreement, C.C. 1589 obligated plaintiffs to pay the fees. By virtue of the assignment, plaintiffs became owners of the developer's indemnity rights and were completely in charge of the litigation. They chose to sue the nonsettling subcontractors, even though they had the option to settle with them without incurring attorneys' fees. Plaintiffs were primed to take the benefits of an award of attorneys' fees if they won; thus it was reasonable to infer that they were prepared to take the concomitant obligation to pay attorneys' fees if they lost. (*73 C.A.4th 1288*.)

(3) *Assignee of Lease*. The requirement of an express assumption of the contractual obligations of a *lease* in order to hold the assignee liable for the obligations applies only to the lease of real property. (See *Enterprise Leasing Corp. v. Shugart Corp. (1991) 231 C.A.3d 737, 745, 746, 282 C.R. 620* [rule of C.C. 1589, that assumption of obligations may be implied from acceptance of benefits under contract, applied to lease of computer system].)

West's Key Number Digest, Assignments k.105

SUPPLEMENT: [This section is current through the latest supplement]

(1) *In General*. *Express assumption*: See *El Escorial Owners' Assn. v. DLC Plastering (2007) 154 C.A.4th 1337, 1360, 65 C.R.3d 524; 9 Corbin (Rev. ed.), §49.6; 6 Am.Jur.2d (2008 ed.), Assignments §§127, 128*.

(2) *Acceptance of Benefits*. See *Thornburg v. Superior Court (2006) 138 C.A.4th 43, 54, 41 C.R.3d 156* [defendant that entered into agreement with hospital, under which it agreed to respond to patient requests for copies of their medical records, was subject to cost limitations for providing records imposed on hospitals by statute; having entered into agreement with hospital under which it accepted benefits, defendant, under C.C. 1589, was bound by hospital's statutory obligations]; *Matthau v. Superior Court (2007) 151 C.A.4th 593, 603, 60 C.R.3d 93* [neither "loan out" company used by actor before he died, nor actor's son who succeeded to actor's rights under his motion picture employment contracts, were subject, under C.C. 1589, to actor's arbitration agreement with talent agency; benefits that company and son accepted were from actor's employment contracts, not from his talent agency contract].



57 of 184 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XII. INTERPRETATION

A. In General.

1. Nature of Interpretation.

1 Witkin Sum. Cal. Law Contracts § 741

[§ 741] Nature of Interpretation.

Interpretation of a contract consists in ascertaining the meaning to be given to the expression of the parties. (See C.C. 1635 et seq.; *Rest.2d, Contracts* §200; 5 Corbin (Rev. ed.), §24.1 et seq.; 11 Williston 4th, §30:1 et seq.; *17A Am.Jur.2d* (2004 ed.), *Contracts* §328 et seq.; Cal. Civil Practice, 3 Business Litigation, §24:8 et seq.; 33 *Golden Gate L. Rev.* 105 [defining hospitality entities, such as "restaurant" or "hotel," in contracts]; 31 *Loyola L.A. L. Rev.* 557 [Contract Interpretation in California: Plain Meaning, Parol Evidence and Use of the "Just Result" Principle]; 31 *Southwestern U. L. Rev.* 725 [construction of term "best efforts"]; 25 *Thomas Jefferson L. Rev.* 167 [ambiguity and the law]; *BAJI*, No. 10.75 [interpretation]; *CACI*, No. 314 et seq. [civil jury instructions on interpretation].)

Where the language of a contract is clear and not absurd, it will be followed. (C.C. 1638; see *Pierce v. Merrill* (1900) 128 C. 464, 472, 61 P. 64; *Apra v. Aureguy* (1961) 55 C.2d 827, 830, 13 C.R. 177, 361 P.2d 897; *Estate of Wemyss* (1975) 49 C.A.3d 53, 59, 122 C.R. 134, citing the text.) But if the meaning is uncertain, the general rules of interpretation are to be applied. (C.C. 1637; see *Burns v. Peters* (1936) 5 C.2d 619, 623, 55 P.2d 1182; *infra*, §744 et seq.; *Wachs v. Wachs* (1938) 11 C.2d 322, 326, 79 P.2d 1085; *Pacific Indem. Co. v. California Elec. Works, Ltd.* (1938) 29 C.A.2d 260, 272, 84 P.2d 313; *Norton v. Farmers Auto. Inter-Ins. Exchange* (1940) 40 C.A.2d 556, 560, 105 P.2d 136.) When a contract is reduced to writing, the parties' intention is ascertained from the writing alone, if possible, subject to other provisions governing interpretation. (C.C. 1639.)

The trial court's determination of whether an ambiguity exists in a contract is a question of law, subject to independent review on appeal. The trial court's resolution of an ambiguity is also a question of law if no parol evidence is admitted or if the parol evidence is not in conflict. However, where the parol evidence is in conflict, the trial court's resolution of that conflict is a question of fact and must be upheld if supported by substantial evidence. Furthermore, when two equally plausible interpretations of the language of a contract may be made, parol evidence is admissible to aid in interpreting the agreement, thereby presenting a question of fact that precludes summary judgment if the evidence is contradictory. (*WYDA Associates v. Merner* (1996) 42 C.A.4th 1702, 1710, 50 C.R.2d 323; see *Waller v. Truck Ins. Exchange* (1995) 11 C.4th 1, 18, 44 C.R.2d 370, 900 P.2d 619, 2 *Summary* (10th), *Insurance*, §277 [interpretation of insurance policy is question of law]; *Unetco Industries Exchange v. Homestead Ins. Co.* (1997) 57 C.A.4th 1459, 1466, 67 C.R.2d 784 [determination as to whether particular matter falls within appraisal clause of insurance policy is question of law].)

In accordance with aforementioned rules governing trial court interpretation, appellate review of that court's interpretation of a contract or other writing is governed by three rules: (1) Where extrinsic evidence has been properly admitted and the evidence is in conflict, any reasonable construction by the trial judge will be upheld under the general rule of conflicting evidence. (2) Where no competent extrinsic evidence has been introduced, the interpretation is derived solely from the terms of the instrument, the question is one of law, and the appellate court will give the writing its own independent interpretation. (3) Where competent extrinsic evidence has been introduced but it is not in conflict, the trial judge's inferences from it are not binding on the appellate court; as in the second situation, *supra*, the appellate court will make an independent determination of the meaning. (See *Parsons v. Bristol Dev. Co.* (1965) 62 C.2d 861, 866, 44 C.R. 767, 402 P.2d 839; *Los Banos Gravel Co. v. Freeman* (1976) 58 C.A.3d 785, 791, 130 C.R. 180; *Medical Operations Management v. National Health Laboratories* (1986) 176 C.A.3d 886, 891, 222 C.R. 455; *New Haven Unified School Dist. v. Taco Bell Corp.* (1994) 24 C.A.4th 1473, 1483, 30 C.R.2d 469 [following *Parsons v. Bristol Dev. Co.*, *supra*, and holding that because interpretation did not turn on credibility of extrinsic evidence, it was function of appellate court]; *El Cajon v. El Cajon Police Officers' Assn.* (1996) 49 C.A.4th 64, 70, 56 C.R.2d 723 [following *Parsons*, and applying de novo review where evidence was undisputed and parties drew conflicting inferences]; *Los Angeles County Metropolitan Trans. Authority v. Shea-Kiewit-Kenny* (1997) 59 C.A.4th 676, 682, footnote 2, 69 C.R.2d 431, citing the text [following *Parsons*, and applying de novo review where extrinsic evidence was not in conflict]; *Morey v. Vannucci* (1998) 64 C.A.4th 904, 913, 75 C.R.2d 573 [following *Parsons*; interpretation of contract turned on assessment of conflicting extrinsic evidence, which trial court properly submitted to jury]; *Lange v. TIG Ins. Co.* (1998) 68 C.A.4th 1179, 1185, 81 C.R.2d 39, quoting the text; 9 Cal. Proc., 4th, Appeal, §374 et seq.)

Interpretation of a written instrument is solely a judicial function unless interpretation turns on the credibility of extrinsic evidence. (*De Guere v. Universal City Studios* (1997) 56 C.A.4th 482, 501, 65 C.R.2d 438, 6 Cal. Proc. (4th), *Proceedings Without Trial*, Supp., §60 [referee exceeded scope of reference by deciding issues of contract enforceability].)

SUPPLEMENT: [This section is current through the latest supplement]

See C.E.B., Law of Contracts §5.1 et seq.; 42 Cal. Western L. Rev. 321 [interpretation of gestational surrogacy contracts]; 28 California Lawyer 39 (January 2008) [construction of "best efforts" clause].

Unambiguous language controls: See *Dore v. Arnold Worldwide* (2006) 39 C.4th 384, 392, 46 C.R.3d 668, 139 P.3d 56 [employer's letter to employee contained no ambiguity in its specific creation of at-will employment; additional statements concerning "90 day assessment" and "annual review" neither expressly nor impliedly conferred right in employee to be terminated only for cause, and extrinsic evidence proffered by employee, even if credited, did not support contrary inference]. *Questions of law or fact in trial court:* See *Wolf v. Walt Disney Pictures & Television* (2008) 162 C.A.4th 1107, 1125, 76 C.R.3d 585 [author did not show conflict in extrinsic evidence regarding parties' intent as to author's right to royalties arising from sale of third-party licensee-manufactured merchandise at movie production company's venues, under contract assigning rights to novel's characters to production company, and thus issue of whether author was entitled to royalties for sales of such merchandise was matter of law for trial court, rather than factual question for jury].

Rules governing appellate review: See *California Nat. Bank v. Woodbridge Plaza LLC* (2008) 164 C.A.4th 137, 143, 78 C.R.3d 561 [trial court's interpretation of commercial lease was reviewed de novo rather than for substantial evidence, even though parties offered testimony of their differing interpretations of lease, where parties offered no evidence of their intent in negotiating or executing disputed paragraph, and there was no conflicting extrinsic evidence].

Cross-Reference: 9 Cal. Proc. (5th), Appeal, §380 et seq. *De Guere case:*

Cross-Reference: 6 Cal. Proc. (5th), *Proceedings Without Trial*, §66.

(*New*) *Ejusdem generis:* Under the principle of *ejusdem generis*, where specific words follow general words in a contract, the general words are construed to embrace only things similar in nature to those enumerated by the specific

words. (See *Nygard v. Uusi-Kerttula* (2008) 159 C.A.4th 1027, 1046, 72 C.R.3d 210 [phrase "any information, knowledge or data of the Company" was construed in light of kinds of protected information enumerated in following sentence].)



58 of 184 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XII. INTERPRETATION

A. In General.

2. General Application of Rules.

1 Witkin Sum. Cal. Law Contracts § 742

[§ 742] General Application of Rules.

"All contracts, whether public or private, are to be interpreted by the same rules, except as otherwise provided by this code." (C.C. 1635.) (On interpretation of public contracts, see *infra*, §991.)

Thus, although a surety or guarantor cannot be held beyond the express terms of his or her agreement, the contract is interpreted by application of the same rules as those applied to other contracts. (*United States Leasing Corp. v. DuPont* (1968) 69 C.2d 275, 284, 70 C.R. 393, 444 P.2d 65; *Cates Const. v. Talbot Partners* (1999) 21 C.4th 28, 39, 86 C.R.2d 855, 980 P.2d 407, 6 Summary (10th), *Torts*, §1592 [performance bond]; *Pacific Employers Ins. Co. v. Berkeley* (1984) 158 C.A.3d 145, 150, 204 C.R. 387, citing the text.) A standard form of *insurance policy* prescribed by *statute* is also governed by the ordinary rules of interpretation of contracts. (*Montrose Chemical Corp. v. Admiral Ins. Co.* (1995) 10 C.4th 645, 666, 42 C.R.2d 324, 913 P.2d 878; *Ruffino v. Queen Ins. Co.* (1934) 138 C.A. 528, 533, 33 P.2d 26, 883; *Mid-Century Ins. Co. v. Bash* (1989) 211 C.A.3d 431, 436, 259 C.R. 382, citing the text; on interpretation of insurance contracts generally, see 2 Summary (10th), *Insurance*, §48 et seq.) And a lease, although a conveyance, is also a contract, and the modern tendency is to construe it as such. (See *Medico-Dental Bldg. Co. of Los Angeles v. Horton & Converse* (1942) 21 C.2d 411, 418, 132 P.2d 457; *Kendall v. Ernest Pestana* (1985) 40 C.3d 488, 495, 220 C.R. 818, 709 P.2d 837; *Knox v. Wolfe* (1946) 73 C.A.2d 494, 499, 167 P.2d 3; 31 Cal. L. Rev. 338; 12 Summary (10th), *Real Property*, §517.)

West's Key Number Digest, Contracts k.143-

SUPPLEMENT: [This section is current through the latest supplement]

(*New*) *Judgment incorporating settlement agreement*: General contract principles are applied when interpreting a judgment incorporating a settlement agreement. (*Roden v. AmerisourceBergen Corp.* (2007) 155 C.A.4th 1548, 1561, 67 C.R.3d 26.)



59 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XII. INTERPRETATION

A. In General.

3. Distinctions.

1 Witkin Sum. Cal. Law Contracts § 743

[§ 743] Distinctions.

In addition to the general rules discussed in subsequent sections (*infra*, §744 et seq.), the courts sometimes apply special ones, e.g., interpretation against forfeiture (*infra*, §826); interpretation in favor of independent covenant rather than condition precedent (*infra*, §812; interpretation in favor of bilateral contract (*supra*, §106).

Rest.2d, Contracts §207, adds another special rule: "In choosing among the reasonable meanings of a promise or agreement or a term thereof, a meaning that serves the public interest is generally preferred." Comment a observes that this is a rule of legal effect as well as interpretation, and rests more on considerations of public policy than on the probable intention of the parties. "It has often been relied on to justify narrow construction of a grant of a public franchise or an agreement for a tax exemption." However, "[i]t does not prefer the interest of a governmental agency as a party to a contract; government contracts are likely to be construed against the government as the drafting party." (See 5 Corbin (Rev. ed.), §24.25; 11 Williston 4th, §32:17 et seq.)

Several substantive and procedural topics should be distinguished from interpretation:

- (1) Reformation. (See *supra*, §276 et seq.); 5 *Cal. Proc. (4th), Pleading*, §762.
- (2) Relief from mistake, and mistake preventing formation of contract. (See *supra*, §256 et seq.)
- (3) Implication (implied covenants and conditions). (See *infra*, §794 et seq.)
- (4) The parol evidence rule. (See 2 *Cal. Evidence (4th), Documentary Evidence*, §59.)
- (5) Admissibility of evidence to interpret. (See 2 *Cal. Evidence (4th), Documentary Evidence*, §74.)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Reformation*.

Cross-Reference: 5 *Cal. Proc. (5th), Pleading*, §806.



60 of 184 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XII. INTERPRETATION

B. Rules of Interpretation.

1. Intention of Parties: Objective Test.

1 Witkin Sum. Cal. Law Contracts § 744

[§ 744] Intention of Parties: Objective Test.

C.C. 1636 provides: "A contract must be so interpreted as to give effect to the *mutual intention* of the parties as it existed at the time of contracting, so far as the same is ascertainable and lawful." (See *First Nat. Bank of Redlands v. Bowers* (1903) 141 C. 253, 262, 74 P. 856; *Lemm v. Stillwater Land & Cattle Co.* (1933) 217 C. 474, 480, 19 P.2d 785; *Bergin v. van der Steen* (1951) 107 C.A.2d 8, 13, 236 P.2d 613; *Ticor Title Ins. Co. v. Rancho Santa Fe Assn.* (1986) 177 C.A.3d 726, 730, 223 C.R. 175; *Stevenson v. Oceanic Bank* (1990) 223 C.A.3d 306, 316, 272 C.R. 757, quoting the text; *American Star Ins. Co. v. Insurance Co. of the West* (1991) 232 C.A.3d 1320, 1330, 284 C.R. 45; *Lloyd's Underwriters v. Craig & Rush* (1994) 26 C.A.4th 1194, 1198, 32 C.R.2d 144; *Miscione v. Barton Dev. Co.* (1997) 52 C.A.4th 1320, 1325, 61 C.R.2d 280, 12 Summary (10th), *Real Property*, §677, quoting the text; *Shaw v. Regents of Univ. of Calif.* (1997) 58 C.A.4th 44, 54, 67 C.R.2d 850 [objective intent of university was to incorporate its patent policy into patent agreement with professor]; *Badie v. Bank of America* (1998) 67 C.A.4th 779, 803, 79 C.R.2d 273, *infra*, §801; *Atascadero v. Merrill Lynch* (1998) 68 C.A.4th 445, 473, 80 C.R.2d 329, 13 Summary (10th), *Trusts*, §150, citing the text; *Winograd v. American Broadcasting Co.* (1998) 68 C.A.4th 624, 632, 636, 80 C.R.2d 378, citing the text; *Citizens for Goleta Valley v. HT Santa Barbara* (2004) 117 C.A.4th 1073, 1076, 12 C.R.3d 249; *San Joaquin v. Work. Comp. App. Bd.* (2004) 117 C.A.4th 1180, 1184, 12 C.R.3d 406; *infra*, §846; cf. *Rest.2d, Contracts* §202(1) ["if the principal purpose of the parties is ascertainable it is given great weight"].)

The modern approach, however, is to avoid the terminology of "intention," and to look for *expressed* intent, under an objective standard. (See *Brant v. California Dairies* (1935) 4 C.2d 128, 133, 48 P.2d 13; *Blumenfeld v. R.H. Macy & Co.* (1979) 92 C.A.3d 38, 46, 154 C.R. 652, citing the text; *Mission Valley East v. Kern* (1981) 120 C.A.3d 89, 97, 174 C.R. 300, citing the text [deed construed as contract]; *Medical Operations Management v. National Health Laboratories* (1986) 176 C.A.3d 886, 893, 222 C.R. 455; *People v. R.J. Reynolds Tobacco Co.* (2003) 107 C.A.4th 516, 526, 529, 132 C.R.2d 151 [in settlement agreement, giving phrase "initial sponsored event" two different meanings was not prevented either by same meaning or last antecedent rules in view of agreement's overall objective]; *Roden v. Bergen Brunswick Corp.* (2003) 107 C.A.4th 620, 628, 132 C.R.2d 549 [defendant's postsettlement attempts to clarify settlement agreement were irrelevant when determining intent, or agreement's meaning, as of date offer was accepted]; *Founding Members of the Newport Beach Country Club v. Newport Beach Country Club* (2003) 109 C.A.4th 944, 955, 135 C.R.2d 505 [under objective standard, club regulation granting right to make first offer for purchase of club stock to organization "then in existence" was clear on its face, and extrinsic evidence showing that subjective intent was that right of first offer was to

be granted to founding members as group was inadmissible]; *Beard v. Goodrich* (2003) 110 C.A.4th 1031, 1039, 2 C.R.3d 160 [phrase "forgiveness or discharge of debt" in fee agreement between attorney and client did not include unrecovered and unliquidated claims, despite attorney's subjective belief to contrary, because reasonable person would not construe word "debt" to include unresolved, and possibly unfounded, claims]; 5 Corbin (Rev. ed.), §§24.5, 24.6, 24.31; 11 Williston 4th, §§31:4 et seq., 32:2; 17A Am.Jur.2d (2004 ed.), Contracts §336 et seq.; Cal. Transactions Forms, 1 Business Transactions §6:31; supra, §116.)

Similarly, it is said that the rules of interpretation of written contracts are for the purpose of ascertaining the meaning of the words used therein; evidence cannot be admitted to show intention independent of the instrument. (See *Barnhart Aircraft v. Preston* (1931) 212 C. 19, 22, 297 P. 20; *Brant v. California Dairies*, supra; *Sass v. Hank* (1951) 108 C.A.2d 207, 214, 238 P.2d 652; 2 Cal. Evidence (4th), Documentary Evidence, §75.)

However, if it is shown that the words were used to conceal rather than to express the true intent of the parties, the court will look through the form to the substance. Typical situations arise where an illegal object is concealed by apparently lawful terms (see supra, §435), and where the relationship of employment is concealed by terms suggestive of independent contract (see 3 Summary (10th), Agency and Employment, §42).

Another illustration appears in *Shafford v. Otto Sales Co.* (1953) 119 C.A.2d 849, 260 P.2d 269. Plaintiff broker was entitled to a 5% commission on any sales of coconut by defendant to B, a customer he had produced. To evade liability, defendant entered into a factor's agreement making B its selling agent; but invoices were subsequently sent to B as buyer of the coconut. Held, the factor's agreement could be shown, by evidence of the circumstances, to be a sham. "[M]ere verbal formulas, mere words and the ingenuity of contractual expression dreamed up by ingenious business men or their lawyers cannot be used to prevent a showing of the real nature of the transaction. It is substance and not form that controls." (119 C.A.2d 860.)

C.C. 1649 adds a special directive: If the terms of a promise are ambiguous or uncertain it must be interpreted "in the sense in which the promisor believed, at the time of making it, that the promisee understood it." This section permits testimony by the promisor or his or her authorized agent as to the promisor's belief. (*Kusmark v. Montgomery Ward & Co.* (1967) 249 C.A.2d 585, 591, 57 C.R. 678; *Western Camps v. Riverway Ranch Enterprises* (1977) 70 C.A.3d 714, 725, 138 C.R. 918; *Medical Operations Management v. National Health Laboratories*, supra, 176 C.A.3d 893.) And "when different constructions of a provision are otherwise equally proper, that is to be taken which is most favorable to the party in whose favor the provision was made." (C.C.P. 1864; see *Mitchell v. Exhibition Foods* (1986) 184 C.A.3d 1033, 1042, 229 C.R. 535.)

The Restatement (§201(2)) states that where the parties have attached different meanings to an agreement or term, it is interpreted in accordance with the meaning attached by one of them if, at the time the agreement was made: "(a) that party did not know of any different meanings attached by the other, and the other knew the meaning attached by the first party; or (b) that party had no reason to know of any different meaning attached by the other, and the other had reason to know the meaning attached by the first party."

West's Key Number Digest, Contracts k.147

SUPPLEMENT: [This section is current through the latest supplement]



61 of 184 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XII. INTERPRETATION

B. Rules of Interpretation.

2. Ordinary Words and Technical Language.

1 Witkin Sum. Cal. Law Contracts § 745

[§ 745] Ordinary Words and Technical Language.

"The words of a contract are to be understood in their *ordinary and popular sense*, rather than according to their strict legal meaning; unless *used* by the parties in a *technical sense*, or unless a *special meaning* is given to them by *usage*, in which case the latter must be followed." (C.C. 1644.) "*Technical words* are to be interpreted as usually understood by persons in the *profession or business* to which they relate, unless clearly used in a different sense." (C.C. 1645.) "The terms of a writing are presumed to have been used in their primary and general acceptance, but evidence is nevertheless admissible that they have a local, technical, or otherwise peculiar signification, and were so used and understood in the particular instance, in which case the agreement must be construed accordingly." (C.C.P. 1861.) (See *Rest.2d, Contracts* §203(3); 5 Corbin (Rev. ed.), §24.8; 11 Williston 4th, §§31:3, 31:9 et seq., 32:3, 32:4; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §356 et seq.; Cal. Transactions Forms, 1 Business Transactions §6:32; CACI, Nos. 315 [Interpretation--Meaning of Ordinary Words]; 316 [Interpretation--Meaning of Technical Words].)

Many cases apply these rules. (See *Higgins v. California Petroleum & Asphalt Co.* (1898) 120 C. 629, 631, 52 P. 1080; *California Canning Peach Growers v. Williams* (1938) 11 C.2d 221, 229, 78 P.2d 1154 [used in technical sense]; *Vandenberg v. Superior Court* (1999) 21 C.4th 815, 839, 88 C.R.2d 366, 982 P.2d 229, *infra*, §751; *Holliday v. Porter* (1934) 136 C.A. 480, 483, 29 P.2d 276; *Turner v. Metropolitan Life Ins. Co.* (1943) 56 C.A.2d 862, 865, 133 P.2d 859 ["children" in beneficiary clause of insurance policy held to include illegitimates, ordinary meaning]; *La Jolla Casa de Manana v. Hopkins* (1950) 98 C.A.2d 339, 347, 219 P.2d 871 ["duration" and "termination of the present war" given reasonable and usual meaning of VJ Day (end of hostilities) rather than Congressional declaration]; *Associated Lathing & Plastering Co. v. Louis C. Dunn* (1955) 135 C.A.2d 40, 47, 286 P.2d 825 [phrase "building into concrete" in cement contract given specialized meaning acquired in building trades]; *Beverly Hills Oil Co. v. Beverly Hills Unified School Dist.* (1968) 264 C.A.2d 603, 607, 70 C.R. 640 [meaning of word "rentals" in oil lease surrender clause taken from form in standard work on the subject]; *Sayble v. Feinman* (1978) 76 C.A.3d 509, 514, 142 C.R. 895; *Safeco Surplus Lines Co. v. Employer's Reinsurance Corp.* (1992) 11 C.A.4th 1403, 1408, 15 C.R.2d 58 [under ordinary usage, a "claim" is not made until party claimed against learns of the claim]; *Shell Oil Co. v. Winterthur Swiss Ins. Co.* (1993) 12 C.A.4th 715, 746, 15 C.R.2d 815, 2 Summary (10th), *Insurance*, §147; *Biancalana v. Fleming* (1996) 45 C.A.4th 698, 701, 53 C.R.2d 47 [ordinary and popular meaning of "additional" income tax in context of tax-deferred installment sale includes tax paid sooner rather than later]; *Republic Bank v. Marine Nat. Bank* (1996) 45 C.A.4th 919, 922, 53 C.R.2d 90 [phrase "incorporation by reference" is almost universally understood to mean inclusion, within body of document, of text that,

although physically separate from document, becomes as much part of document as if it had been typed in directly]; *Powers v. Dickson, Carlson & Campillo* (1997) 54 C.A.4th 1102, 1112, 63 C.R.2d 261, 1 Cal. Proc. (4th), Attorneys, Supp., §347 [ordinary meaning of provisions in attorney's retainer agreements requiring that "disputes arising out of or related to professional services" be resolved by arbitration encompassed professional malpractice claims and not merely fee disputes]; *Sierra Vista Regional Med. Center v. Bonta'* (2003) 107 C.A.4th 237, 245, 132 C.R.2d 9 [agreement calling for higher compensation for "inpatient services" provided by "Neonatal Intensive Care Unit" did not define these terms, but parties agreed to be governed by relevant regulations, and these regulations required certain services and a nurse-patient ratio of 1:2 or better].)

SUPPLEMENT: [This section is current through the latest supplement]

See *Butler v. Palos Verdes Estates* (2005) 135 C.A.4th 174, 181, 37 C.R.3d 199 [in interpreting deed restriction stating that no animals could be kept on city property, whether city "kept" wild peafowl by ranging them through management program required construing "kept" in its ordinary, not scientific, sense; thus, because peafowl had not been domesticated or subjected to city's control, possession, and ownership in ordinary sense of those terms, they were not "kept"].*Powers case:*

Cross-Reference: 1 Cal. Proc. (5th), Attorneys, §331.



62 of 184 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XII. INTERPRETATION

B. Rules of Interpretation.

3. Interpretation as a Whole.

a. Single Writing.

1 Witkin Sum. Cal. Law Contracts § 746

[§ 746] Single Writing.

"The whole of a contract is to be taken together, so as to give effect to every part, if reasonably practicable, each clause helping to interpret the other." (C.C. 1641.) "[W]here there are several provisions or particulars, such a construction is, if possible, to be adopted as will give effect to all." (C.C.P. 1858.) (See *Monroe v. Grolier Soc. of London* (1929) 208 C. 447, 451, 281 P. 604; *Lemm v. Stillwater Land & Cattle Co.* (1933) 217 C. 474, 480, 19 P.2d 785; *Ghirardelli v. Peninsula Properties Co.* (1940) 16 C.2d 494, 496, 107 P.2d 41; *Universal Sales Corp. v. California Press Mfg. Co.* (1942) 20 C.2d 751, 760, 128 P.2d 665; *Newby v. Anderson* (1950) 36 C.2d 463, 470, 224 P.2d 673; *Broome v. Broome* (1951) 104 C.A.2d 148, 157, 231 P.2d 171; *Sass v. Hank* (1951) 108 C.A.2d 207, 212, 215, 238 P.2d 652; *Rosen v. E.C. Losch Co.* (1965) 234 C.A.2d 324, 330, 44 C.R. 377; *Medical Operations Management v. National Health Laboratories* (1986) 176 C.A.3d 886, 893, 222 C.R. 455; *Sunniland Fruit v. Verni* (1991) 233 C.A.3d 892, 901, 284 C.R. 824; *Ellis v. McKinnon Broadcasting Co.* (1993) 18 C.A.4th 1796, 1803, 23 C.R.2d 80; *Titan Corp. v. Aetna Cas. & Surety Co.* (1994) 22 C.A.4th 457, 473, 471, 27 C.R.2d 476; *Brown v. California Pension Administrators & Consultants* (1996) 45 C.A.4th 333, 344, 52 C.R.2d 788; *Foothill Properties v. Lyon/Copley Corona Associates* (1996) 46 C.A.4th 1542, 1550, 54 C.R.2d 488; *Unetco Industries Exchange v. Homestead Ins. Co.* (1997) 57 C.A.4th 1459, 1466, 67 C.R.2d 784; *Atascadero v. Merrill Lynch* (1998) 68 C.A.4th 445, 473, 80 C.R.2d 329, 13 Summary (10th), Trusts, §150, citing the text; *The Ratcliff Architects v. Vanir Const. Management* (2001) 88 C.A.4th 595, 601, 106 C.R.2d 1 [construing contract as whole meant that only defendant, not third parties, had indemnification rights]; *Vahle v. Barwick* (2001) 93 C.A.4th 1323, 1328, 113 C.R.2d 793 [agreement releasing "all other persons"; other parts of release suggested that parties intended to release only other party and persons in privity with other party]; *Rest.2d, Contracts* §202(2); 5 Corbin (Rev. ed.), §24.21; 11 Williston 4th, §§32:5, 32:6; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §375 et seq.; Cal Transactions Forms, 1 Business Transactions §6:33; CACI, No. 317 [interpretation--construction of contract as a whole].)

West's Key Number Digest, Contracts k.143.5

SUPPLEMENT: [This section is current through the latest supplement]



63 of 184 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XII. INTERPRETATION

B. Rules of Interpretation.

3. Interpretation as a Whole.

b. Several Writings.

1 Witkin Sum. Cal. Law Contracts § 747

[§ 747] Several Writings.

"Several contracts relating to the same matters, between the same parties, and made as parts of substantially one transaction, are to be taken together." (C.C. 1642.) (See *Brewer v. Horst & Lachmund Co.* (1900) 127 C. 643, 647, 60 P. 418 [telegrams]; *Merkeley v. Fisk* (1919) 179 C. 748, 754, 178 P. 945; *Mayers v. Loew's* (1950) 35 C.2d 822, 827, 221 P.2d 26; *Cates Const. v. Talbot Partners* (1999) 21 C.4th 28, 39, 86 C.R.2d 855, 980 P.2d 407, 6 Summary (10th), Torts, §1592; *Torrey v. Shea* (1916) 29 C.A. 313, 316, 155 P. 820; *Hawes v. Lux* (1931) 111 C.A. 21, 23, 294 P. 1080; *Citizens Nat. Trust & Savings Bank of Los Angeles v. Arrowhead Springs Beverage Co.* (1932) 126 C.A. 550, 553, 14 P.2d 821; *Cadigan v. American Trust Co.* (1955) 131 C.A.2d 780, 784, 281 P.2d 332; *Berg Metals Corp. v. Wilson* (1959) 170 C.A.2d 559, 567, 339 P.2d 869; *Brown v. California Pension Administrators & Consultants* (1996) 45 C.A.4th 333, 344, 52 C.R.2d 788; *Brookwood v. Bank of America* (1996) 45 C.A.4th 1667, 1673, 53 C.R.2d 515; *Shaw v. Regents of Univ. of Calif.* (1997) 58 C.A.4th 44, 54, 67 C.R.2d 850 [patent agreement between teacher and university was contract that incorporated terms of patent policy in effect at time teacher was hired]; *Rest.2d, Contracts* §202(2); 5 Corbin (Rev. ed.), §24.21; 11 Williston 4th, §30:25 et seq.; 17A Am.Jur.2d (2004 ed.), *Contracts* §§379, 390; CACI, No. 313 [modification].)

The language of C.C. 1642, *supra*, has been somewhat broadened by construing it as a declaration of common law principles. It refers expressly to "several contracts," as parts of "substantially one transaction." Nevertheless, it has been held that the several writings need not each be contracts, and that they need not be executed on the same day or within any particular period of time. (*Cadigan v. American Trust Co.*, *supra*, 131 C.A.2d 786, 787; see *Biescar v. Czechoslovak-Patronat* (1956) 145 C.A.2d 133, 142, 302 P.2d 104 [contemporaneous contract may be looked at to determine intention of parties to deed]; *Pacific Employers Ins. Co. v. Berkeley* (1984) 158 C.A.3d 145, 150, 204 C.R. 387, citing the text.)

Nor is the statute limited to contracts signed by the same parties and identifying the same subject matter. It applies to "instruments," "papers," and "contracts," whether they expressly refer to each other or it appears from extrinsic evidence that they were executed as part of one transaction. (*Harm v. Frasher* (1960) 181 C.A.2d 405, 413, 5 C.R. 367.) (See *Lucas v. Quigley Motor Co.* (1961) 191 C.A.2d 152, 157, 12 C.R. 442, citing the text; *Goodman v. Community Savings & Loan Assn.* (1966) 246 C.A.2d 13, 20, 54 C.R. 456 [where deposit receipt and acceptance contained several terms important to plaintiff purchaser, these were part of the contract though left out of defendant vendor's escrow

instructions]; *Pacific Employers Ins. Co. v. Berkeley*, *supra*, 158 C.A.3d 150, citing the text.)

Where there is an inconsistency between two agreements, both of which are executed by all the parties, the later contract supersedes the former. (See *Frangipani v. Boecker* (1998) 64 C.A.4th 860, 863, 75 C.R.2d 407 [later escrow instructions superseded inconsistent provisions of earlier contract].)

SUPPLEMENT: [This section is current through the latest supplement]



64 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XII. INTERPRETATION

B. Rules of Interpretation.

4. Surrounding Circumstances.

1 Witkin Sum. Cal. Law Contracts § 748

[§ 748] Surrounding Circumstances.

"A contract may be explained by reference to the circumstances under which it was made, and the matter to which it relates." (C.C. 1647.) "For the proper construction of an instrument, the circumstances under which it was made, including the situation of the subject of the instrument, and of the parties to it, may also be shown, so that the judge be placed in the position of those whose language he is to interpret." (C.C.P. 1860.) (See *First Nat. Bank of Redlands v. Bowers* (1903) 141 C. 253, 261, 74 P. 856; *Payne v. Commercial Nat. Bank of Los Angeles* (1917) 177 C. 68, 72, 169 P. 1007; *Wachs v. Wachs* (1938) 11 C.2d 322, 326, 79 P.2d 1085 [circumstances held admissible to explain term "transaction" in contract for division of real estate commissions]; *Walsh v. Walsh* (1941) 18 C.2d 439, 443, 116 P.2d 62 [words "child or children" held ambiguous, might possibly be limited to minors or merely applied to relationship irrespective of age]; *Barham v. Barham* (1949) 33 C.2d 416, 423, 202 P.2d 289; *Mayers v. Loew's* (1950) 35 C.2d 822, 829, 221 P.2d 26; *Palma v. Leslie* (1935) 6 C.A.2d 702, 707, 45 P.2d 391; *Ross v. Pacific Mortg. & Guaranty Co.* (1936) 16 C.A.2d 672, 675, 61 P.2d 368 [phrase "by way of pledge," without statement that property pledged as security for a particular debt]; *Gibson v. De La Salle Institute* (1944) 66 C.A.2d 609, 619, 152 P.2d 774; *Wells v. Wells* (1946) 74 C.A.2d 449, 457, 169 P.2d 23; *Willson v. Niagara Duplicator Co.* (1948) 88 C.A.2d 63, 74, 198 P.2d 362; *MacIntyre v. Angel* (1952) 109 C.A.2d 425, 429, 240 P.2d 1047; *Lathrop v. Gauger* (1954) 127 C.A.2d 754, 762, 274 P.2d 730; *Wechsler v. Capitol Trailer Sales* (1963) 220 C.A.2d 252, 263, 33 C.R. 680 [interpretation of ambiguous provision]; *In re Marriage of Williams* (1972) 29 C.A.3d 368, 378, 105 C.R. 406; *Moss Dev. Co. v. Geary* (1974) 41 C.A.3d 1, 13, 115 C.R. 736; *General Motors Corp. v. Superior Court* (1993) 12 C.A.4th 435, 442, 15 C.R.2d 622 [circumstances surrounding release of "all persons, firms, and corporations" established its application to defendant corporation even though it was not specifically named therein]; *Los Angeles County Metropolitan Trans. Authority v. Shea-Kiewit-Kenny* (1997) 59 C.A.4th 676, 683, 69 C.R.2d 431 [meaning of "cause" in construction contract providing for termination for cause of member of dispute resolution board must be determined by circumstances of case and nature of contract]; *Morey v. Vannucci* (1998) 64 C.A.4th 904, 912, 75 C.R.2d 573, citing the text; *Atascadero v. Merrill Lynch* (1998) 68 C.A.4th 445, 474, 80 C.R.2d 329, 13 Summary (10th), Trusts, §150, citing the text; *Southern Pac. Trans. Co. v. Santa Fe Pac. Pipelines* (1999) 74 C.A.4th 1232, 1243, 88 C.R.2d 777 [circumstances surrounding formation of agreements by pipeline company to pay rent for easements on railroad right-of-way had to be considered on issue of valuation]; *Binder v. Aetna Life Ins. Co.* (1999) 75 C.A.4th 832, 850, 89 C.R.2d 540, quoting the text; *Wolf v. Superior Court* (2004) 114 C.A.4th 1343, 1350, 8 C.R.3d 649 [extrinsic evidence was admissible to prove that term "gross receipts" in royalty provision was susceptible to different meanings]; *Robert T. Miner, M.D. v. Tustin Ave. Investors, LLC* (2004)

116 C.A.4th 264, 271, 10 C.R.3d 178 [where lease contained renewal option and estoppel certificate stated that lease continued in effect, but indicated that there were no options available, plausible explanation was that certificate was intended to list only options not specified in lease]; *Rest.2d, Contracts* §202(1); 5 Corbin (Rev. ed.), §24.5 et seq.; 11 Williston 4th, §§32:7, 33:38 et seq.; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §351 et seq.; Cal. Transactions Forms, 1 Business Transactions §6:34.)

This rule of construction was formerly limited by the "plain meaning rule"; i.e., where the language of an integrated writing was clear, evidence of circumstances was inadmissible to establish a meaning contrary to the words used. The plain meaning rule was greatly criticized and later repudiated; now evidence of circumstances is admissible if relevant to prove a meaning of which the contractual language is "reasonably susceptible." (See 2 *Cal. Evidence* (4th), *Documentary Evidence*, §80 et seq.)

West's Key Number Digest, Contracts k.169

SUPPLEMENT: [This section is current through the latest supplement]

See *Falkowski v. Imation Corp.* (2005) 132 C.A.4th 499, 508, 33 C.R.3d 724 [language in stock options plans for employees of corporation that became wholly owned subsidiary of parent after merger, providing for cessation of options on "termination of employment," although ambiguous, was, considering surrounding circumstances, reasonably interpreted to terminate options when subsidiary was resold to third party; interpretation was consistent with purpose of attracting and retaining good employees].



65 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XII. INTERPRETATION
B. Rules of Interpretation.
5. Subsequent Conduct of Parties.

1 Witkin Sum. Cal. Law Contracts § 749

[§ 749] Subsequent Conduct of Parties.

Acts of the parties, subsequent to the execution of the contract and before any controversy has arisen as to its effect, may be looked to in determining the meaning. The conduct of the parties may be, in effect, a *practical construction* thereof, for they are probably least likely to be mistaken as to the intent. "This rule of practical construction is predicated on the common sense concept that 'actions speak louder than words.' Words are frequently but an imperfect medium to convey thought and intention. When the parties to a contract perform under it and demonstrate by their conduct that they knew what they were talking about the courts should enforce that intent." (*Crestview Cemetery Assn. v. Dieden* (1960) 54 C.2d 744, 754, 8 C.R. 427, 356 P.2d 171, 1 Cal. Proc. (4th), Attorneys, §219; see CACI, No. 318 [Interpretation--Construction by Conduct].)

Numerous cases apply this principle. (See *Universal Sales Corp. v. California Press Mfg. Co.* (1942) 20 C.2d 751, 761, 128 P.2d 665; *Bohman v. Berg* (1960) 54 C.2d 787, 795, 8 C.R. 441, 356 P.2d 185, supra, §145 [rule applied to determine basic certainty and enforceability of contract]; *Retsloff v. Smith* (1926) 79 C.A. 443, 452, 249 P. 886; *Tennant v. Wilde* (1929) 98 C.A. 437, 453, 277 P. 137; *Wells v. Wells* (1946) 74 C.A.2d 449, 457, 169 P.2d 23; *Kohn v. Kohn* (1950) 95 C.A.2d 708, 713, 214 P.2d 71; *John v. Marshall* (1951) 103 C.A.2d 172, 179, 229 P.2d 367; *Balian v. Rainey* (1952) 115 C.A.2d 10, 12, 251 P.2d 731; *Shafford v. Otto Sales Co.* (1953) 119 C.A.2d 849, 860, 260 P.2d 269; *Lawrence Block Co. v. Palston* (1954) 123 C.A.2d 300, 311, 266 P.2d 856; *Anchor Cas. Co. v. Surety Bond Savings & Loan Assn.* (1962) 204 C.A.2d 175, 184, 22 C.R. 278; *McManus v. Sequoyah Land Associates* (1966) 240 C.A.2d 348, 354, 49 C.R. 592; *Crawford v. Continental Cas. Co.* (1968) 261 C.A.2d 98, 102, 67 C.R. 641, citing the text [plaintiff insured, from 1948 to 1965, made 70 quarterly premium payments and twice paid delinquent quarterly payments to reinstate policy, without ever asserting that the policy only called for an annual premium in the specified amount]; *Automobile Salesmen's Union v. Eastbay Motor Car Dealers* (1970) 10 C.A.3d 419, 424, 89 C.R. 20; *Spott Electrical Co. v. Industrial Indem. Co.* (1973) 30 C.A.3d 797, 808, 106 C.R. 710, citing the text; *Davies Machinery Co. v. Pine Mountain Club* (1974) 39 C.A.3d 18, 26, 113 C.R. 784, citing the text; *Lix v. Edwards* (1978) 82 C.A.3d 573, 579, 147 C.R. 294, citing the text; *Oceanside 84, Ltd. v. Fidelity Fed. Bank* (1997) 56 C.A.4th 1441, 1449, 66 C.R.2d 487 [borrower under loan contract with bank acquiesced in bank's interpretation of contract, where it made payments for 5 years without objection based on that interpretation and failed to question bank's method of calculating interest]; *Atascadero v. Merrill Lynch* (1998) 68 C.A.4th 445, 474, 80 C.R.2d 329, 13 Summary (10th), Trusts, §150 citing the text; *Southern Pac. Trans. Co. v. Santa Fe Pac. Pipelines* (1999) 74 C.A.4th 1232, 1242, 88 C.R.2d 777 [conduct of

parties to agreements by pipeline company to pay rent for easements on railroad right-of-way had to be considered on issue of valuation]; *Fisher v. Allis-Chalmers Corp. Product Liab. Trust* (2002) 95 C.A.4th 1182, 1192, 116 C.R.2d 310 [successor corporation's construction of agreement to assume all liabilities, where construction occurred subsequent to entry into that agreement, could be used to show that agreement included plaintiff's product claim]; 5 Corbin (Rev. ed.), §24.16; 11 Williston 4th, §32:14; 17A Am.Jur.2d (2004 ed.), Contracts §354.)

In the *Automobile Salesmen's Union* case, supra, plaintiff union and defendant employers' association made a collective bargaining agreement. It contained a provision that, if the union obtained a more favorable contract with another employer in the area, the Eastbay Motor Car Dealers (employer) should have the option to adopt such contract. After the union had negotiated one such contract, several dealer members of the employers' association elected to adopt that contract for their salesmen, without objection from any of the parties. Some months later, the union saw dangers in this process and sought declaratory relief, insisting on the clear language of the provision, i.e., that only the association, for all the dealer members, could exercise such an election. The trial judge granted the judgment requested. *Held*, reversed. The conduct of the parties, for several months prior to the dispute, supported the interpretation that an individual dealer could exercise the option. And this practical construction, demonstrating what the contract meant to the parties, should prevail over the ordinary meaning of the words used. (10 C.A.3d 424.)

The Restatement (§202(4)), adopting the terminology of U.C.C. 2208, states the rule as follows: "Where an agreement involves repeated occasions for performance by either party with knowledge of the nature of the performance and opportunity for objection to it by the other, any course of performance accepted or acquiesced in without objection is given great weight in the interpretation of the agreement." But Comment g cautions that practical construction is not conclusive of meaning, and that conduct must be weighed in the light of the possible meanings of terms. However: "Where it is unreasonable to interpret the contract in accordance with the course of performance, the conduct of the parties may be evidence of an agreed modification or of a waiver by one party." (*Rest.2d, Contracts* §202, Comment g.)

An unusual application of the rule was made in *Doll v. Maravilas* (1947) 82 C.A.2d 943, 949, 187 P.2d 885, where the lessor and the lessee, by conduct, interpreted a provision in the lease, and this interpretation was held binding on an assignee of the lessor.

The rule that the conduct of the parties to a contract may be looked to in determining its meaning is not limited to the joint conduct of the parties. The practical interpretation of the contract by one party, evidenced by his or her words or acts, can be used against that party on behalf of the other party, even though the other party had no knowledge of those words or acts when they occurred and did not concur in them. (*Southern Calif. Edison Co. v. Superior Court* (1995) 37 C.A.4th 839, 851, 44 C.R.2d 227.)

SUPPLEMENT: [This section is current through the latest supplement]

Cases applying the principle: See *City of Hope Nat. Med. Center v. Genentech* (2008) 43 C.4th 375, 392, 75 C.R.3d 333, 181 P.3d 142 [evidence that biotechnology company concealed from medical research center information about patent licenses issued by company, after execution of contract in which center granted patents to company in exchange for royalties but before dispute arose about contract's meaning, was relevant and admissible to support claim that company breached contract]; *Cedars-Sinai Med. Center v. Shewry* (2006) 137 C.A.4th 964, 983, 41 C.R.3d 48, quoting the text [rule unsuccessfully urged by hospital seeking larger compensation for services provided]; *Jones v. P.S. Dev. Co.* (2008) 166 C.A.4th 707, 720, 82 C.R.3d 882, quoting the text [statements by contractor's project supervisor regarding contractor's duties under contracts were not inadmissible opinions on questions of law, and thus were properly considered in granting summary judgment in negligence action on basis that contractor had no duty to supervise subcontractor, because supervisor's explanation of duties under contract was given in context of his discharge of those duties].

Crestview Cemetery Assn. case:

Cross-Reference: 1 Cal. Proc. (5th), Attorneys, §193.U.C.C. 2208 was repealed in 2006.



66 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XII. INTERPRETATION

B. Rules of Interpretation.

6. Reasonable, Operative, and Lawful Interpretation.

a. General Rule.

1 Witkin Sum. Cal. Law Contracts § 750

[§ 750] General Rule.

"A contract must receive such an interpretation as will make it lawful, operative, definite, reasonable, and capable of being carried into effect, if it can be done without violating the intention of the parties." (C.C. 1643.) "An interpretation which gives effect is preferred to one which makes void." (C.C. 3541.) And *Rest.2d, Contracts §203(a)* states that "an interpretation which gives a reasonable, lawful, and effective meaning to all the terms is preferred to an interpretation which leaves a part unreasonable, unlawful or of no effect." (See 5 Corbin (Rev. ed.), §24.22; 11 Williston 4th, §32:11; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §§336 et seq., 346; on avoidance of forfeiture by interpretation, see *infra*, §826.)

Many cases invoke this rule against extraordinary or absurd interpretations, or those that make the contract illegal or unenforceable. (See *Robbins v. Pacific Eastern Corp.* (1937) 8 C.2d 241, 273, 65 P.2d 42; *Baine v. Continental Assur. Co.* (1942) 21 C.2d 1, 5, 129 P.2d 396; *Barham v. Barham* (1949) 33 C.2d 416, 422, 202 P.2d 289, *supra*, §626 [avoid illegality]; *Southern Surety Co. v. Bank of Lassen* (1931) 118 C.A. 149, 154, 4 P.2d 952; *Duntley v. Tutt* (1941) 48 C.A.2d 367, 370, 119 P.2d 804; *Thacker v. American Foundry* (1947) 78 C.A.2d 76, 82, 177 P.2d 322 [avoid illegality]; *Crillo v. Curtola* (1949) 91 C.A.2d 263, 272, 204 P.2d 941 [reasonable construction]; *Cox v. Hollywood Film Enterprises* (1952) 109 C.A.2d 320, 325, 240 P.2d 713; *Nissen v. Stovall-Wilcoxson Co.* (1953) 120 C.A.2d 316, 319, 261 P.2d 10 [construction against perpetual performance]; *Cain v. Hunter* (1958) 161 C.A.2d 808, 811, 327 P.2d 583 [reasonable construction]; *Zimco Restaurants v. Bartenders & Culinary Workers Union, Local 340, AFL-CIO* (1958) 165 C.A.2d 235, 238, 331 P.2d 789 [construction against perpetual performance]; *South Tahoe Gas Co. v. Hofmann Land Imp. Co.* (1972) 25 C.A.3d 750, 757, 102 C.R. 286 [contract interpreted as excluding illegal rate and including rate fixed in tariff rule]; *Service Employees Int. Union, Local 18, AFL-CIO v. American Bldg. Maintenance Co.* (1972) 29 C.A.3d 356, 359, 105 C.R. 564 [making contract operative]; *Moss Dev. Co. v. Geary* (1974) 41 C.A.3d 1, 11, 115 C.R. 736 [reasonable construction]; *Marin v. Assessment App. Bd.* (1976) 64 C.A.3d 319, 325, 328, 134 C.R. 349 [reasonable interpretation, avoiding harsh result]; *Masonite Corp. v. Pacific Gas & Elec. Co.* (1976) 65 C.A.3d 1, 10, 135 C.R. 170 [same]; *Sayble v. Feinman* (1978) 76 C.A.3d 509, 513, 142 C.R. 895; *Strong v. Theis* (1986) 187 C.A.3d 913, 919, 920, 232 C.R. 272 [reciprocal options of cotenants to purchase coowner's share construed as creating personal rights in order to avoid violation of rule against perpetuities]; *Binder v. Aetna Life Ins. Co.* (1999) 75 C.A.4th 832, 852, 89 C.R.2d 540, citing the text.)

Of course, if the intention is clearly expressed, the court will not rewrite the contract to avoid illegality. (*Bolen v.*

Parks (1957) 149 C.A.2d 460, 468, 308 P.2d 521.)

SUPPLEMENT: [This section is current through the latest supplement]

See *Poseidon Dev. v. Woodland Lane Estates, LLC* (2007) 152 C.A.4th 1106, 1115, 62 C.R.3d 59 [trial court's interpretation saved late charge provision from being unlawful penalty].



67 of 184 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XII. INTERPRETATION

B. Rules of Interpretation.

6. Reasonable, Operative, and Lawful Interpretation.

b. Rejecting or Supplying Words.

1 Witkin Sum. Cal. Law Contracts § 751

[§ 751] Rejecting or Supplying Words.

"If necessary to carry out the intention of a contract, words may be transposed, rejected, or supplied, to make its meaning more clear." (*Heidlebaugh v. Miller* (1954) 126 C.A.2d 35, 38, 271 P.2d 557.) In this case, a conditional sales contract (a commercial printed form) provided that, on default, the seller could sell "with or *with* notice." The sale was challenged for failure to give notice to the buyer. The court pointed to several provisions in the agreement reading "with or *without*," and held that the phrase in question was an inexplicable redundancy resulting from an obvious printer's error. Accordingly, the omitted letters "out" were supplied by interpretation.

In *Vandenbergh v. Davis* (1961) 190 C.A.2d 694, 12 C.R. 222, plaintiff executed a 3-year lease to defendant of the second floor of a 3-story building. The lease, prepared by a realtor, contained a lessor's covenant giving the lessee the "first refusal" to lease the third floor at not over \$ 100 monthly rental, and a right to occupy that floor until "lessor leases" it and "lessee has refused to lease same." Defendant took the position that he was not required to exercise his right of refusal until plaintiff actually signed a lease to a third party. Accordingly, he occupied the third floor for 2 years without paying rent. Meanwhile, plaintiff did have bona fide offers to lease, but defendant refused to allow the prospects to view the premises. *Held*, defendant was liable as a tenant at sufferance from the time he refused to rent. To avoid absurdity, the phrase "lessor leases" was construed as "layman's shorthand" for "has an offer to lease." (190 C.A.2d 698.)

Rest.2d, Contracts §204 states this rule as follows: "When the parties to a bargain sufficiently defined to be a contract have not agreed with respect to a term which is essential to a determination of their rights and duties, a term which is reasonable in the circumstances is supplied by the court." Comment a points out that supplying an omitted term "is not technically interpretation," but that the courts often speak of an "implied" term. Comment d adds that the process "has sometimes been disguised as a literal or a purposive reading of contract language directed to a situation other than the situation that arises." And it is sometimes said that the search is for the term the parties would have agreed to if the question had been brought to their attention. "But where there is in fact no agreement, the court should supply a term which comports with community standards of fairness and policy rather than analyze a hypothetical model of the bargaining process." (Comment d, *supra*.) (See C.C. 1655 ["Stipulations which are necessary to make a contract reasonable, or conformable to usage, are implied"]; 5 Corbin (Rev. ed.), §24.19; 11 Williston 4th, §31:5 et seq.; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §§373, 374; 73 *Cal. L. Rev.* 261 [Interactions Between Express and Implied Contract

Terms].)

SUPPLEMENT: [This section is current through the latest supplement]



68 of 184 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XII. INTERPRETATION

B. Rules of Interpretation.

6. Reasonable, Operative, and Lawful Interpretation.

c. Applicable Laws Become Part of Contract.

1 Witkin Sum. Cal. Law Contracts § 752

[§ 752] Applicable Laws Become Part of Contract.

All applicable laws and ordinances in existence when the agreement is made become a part thereof as fully as if incorporated by reference. (See *Calpetro Producers' Syndicate v. Charles M. Woods Co.* (1929) 206 C. 246, 252, 274 P. 65; *Silveira v. Ohm* (1949) 33 C.2d 272, 278, 201 P.2d 387 [crop lease held to be governed by C.C. 1935, requiring apportionment of rent when lease terminates before end of specified period]; *Bell v. Minor* (1948) 88 C.A.2d 879, 881, 199 P.2d 718 [lease made after rent control legislation enacted held subject to rental modification by wartime price stabilization agency]; *Masonite Corp. v. Pacific Gas & Elec. Co.* (1976) 65 C.A.3d 1, 8, 135 C.R. 170; *Bodle v. Bodle* (1978) 76 C.A.3d 758, 764, 143 C.R. 115; *Grubb v. Ranger Ins. Co.* (1978) 77 C.A.3d 526, 529, 143 C.R. 558; *Empire Fire & Marine Ins. Co. v. Bell* (1997) 55 C.A.4th 1410, 1415, 64 C.R.2d 749 [county ordinance requiring ambulance service to maintain insurance coverage and give advance notice of modification of coverage was incorporated into insurance policy]; *Miracle Auto Center v. Superior Court* (1998) 68 C.A.4th 818, 821, 80 C.R.2d 587 [interpretation of term "standard time," as used with respect to expiration of insurance policy, was governed by *Ins.C.* 460 and *Govt.C.* 6807 et seq., which, read together, provided that term meant time currently in use in state, whether Pacific standard time or daylight saving time]; *Corby v. Gulf Insurance Co.* (2004) 114 C.A.4th 1371, 1375, 8 C.R.3d 663 [bond issued to protect purchaser of uncompleted house if developer defaulted covered all purchaser's payments even though bond was issued after payments were made; terms of applicable statutes were incorporated into bond, and they made no distinction as to when payments were made]; 5 Corbin (Rev. ed.), §24.26; 11 Williston 4th, §30:19 et seq.; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §§371, 372.)

The rule favoring a lawful interpretation is often applied where legal performance is dependent upon compliance with governmental regulations; it will be presumed that the parties did not intend to perform except upon this compliance. (See *Fadel v. Slayman* (1948) 84 C.A.2d 6, 9, 189 P.2d 771 [contract to construct a building; held that parties contemplated obtaining War Production Board authorization and priority for materials]; *Fong v. Rossi* (1948) 87 C.A.2d 20, 22, 195 P.2d 854 [lease of premises where liquor was to be sold; held that lessor impliedly promised to transfer liquor licenses with approval of Board of Equalization as required by Alcoholic Beverage Control Act].)

In *Mulder v. Casho* (1964) 61 C.2d 633, 39 C.R. 705, 394 P.2d 545, plaintiff bought a used car from defendant dealer for \$ 125. The purchase instrument contained a "merger" clause excluding any terms not expressed, and stating that the car was sold "As Is" without warranty as to condition. Plaintiff was injured when the defective brakes failed to

work. At the trial she testified that, when considering purchase, she had a mechanic look at it, he suggested that the brakes needed adjusting, and defendant said he would do it. Defendant denied making the statement, but the jury, on submission of the special issue, found that he had made the agreement and breached it. *Held*, judgment on verdict for plaintiff, for \$ 35,000, affirmed. *Veh.C. 24007* provides that no dealer shall sell a new *or used* motor vehicle without testing and adjusting the brakes to conform with the Code and department regulations; and *Veh.C. 26453* requires that brakes be maintained "in good condition and in good working order." Under these statutes a dealer selling a used car for other than wrecking purposes "is required to make a reasonable inspection of the brake system," and to repair defective brakes. (61 C.2d 637.) The jury's verdict, though made on another legal theory (express oral agreement), did find the necessary fact establishing breach of the statutory duty that became a part of the contract. (61 C.2d 637.)

West's Key Number Digest, Contracts k.168

SUPPLEMENT: [This section is current through the latest supplement]

See *Castillo v. Express Escrow Co.* (2007) 146 C.A.4th 1301, 1308, 53 C.R.3d 485, citing the text [statute requiring escrow agent receiving written notification of dispute between parties to hold funds in escrow (*Health & Saf.C. 18035(f)*) was part of contract for purchase of mobilehome].



69 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XII. INTERPRETATION

B. Rules of Interpretation.

6. Reasonable, Operative, and Lawful Interpretation.

d. Effect of Change in Law: Old Law Governs.

1 Witkin Sum. Cal. Law Contracts § 753

[§ 753] Effect of Change in Law: Old Law Governs.

Laws enacted subsequent to the execution of an agreement are not deemed part of the agreement unless the language of the agreement clearly indicates that the parties intend to be bound by future laws. (*Swenson v. File* (1970) 3 C.3d 389, 393, 90 C.R. 580, 475 P.2d 852; *Equitable Bldg. & Loan Assn. v. Wolfangle* (1931) 111 C.A. 119, 123, 295 P. 388; see 11 Williston 4th, §30:23; 5 So. Cal. L. Rev. 62; on effect of statutory repeal on validity of illegal contract, see *supra*, §433; on distinction for insurance coverage, see 2 *Summary* (10th), *Insurance*, §54.) In other words, the parties are presumed to have had only *existing law* in mind. (*Swenson v. File, supra*, 3 C.3d 394.)

Thus, in *Swenson v. File, supra*, a partnership agreement made in 1960 contained a covenant restricting competition by a retiring partner within a 20-mile radius of any partnership office existing on the date of his or her retirement. In 1960, this provision was invalid to the extent that it went beyond the "city or town" limitation of *B. & P.C. 16602* (see *supra*, §585). In 1961, the statute was revised to permit countywide covenants, and a few weeks later defendant withdrew from the partnership and set up a business within the county. *Held*, the amendment did not apply, and the covenant was unenforceable. (3 C.3d 392.) (See *Roberts v. Pfefer* (1970) 13 C.A.3d 93, 97, 91 C.R. 308 [same; following *Swenson*]; *Torrance v. Work. Comp. App. Bd.* (1982) 32 C.3d 371, 379, 185 C.R. 645, 650 P.2d 1162 [applying qualification stated in *Swenson*: where language clearly indicates that parties intended to incorporate future changes in law].)

SUPPLEMENT: [This section is current through the latest supplement]



70 of 184 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XII. INTERPRETATION

B. Rules of Interpretation.

7. Inconsistency Between Parts of Contract.

1 *Witkin Sum. Cal. Law Contracts* § 754

[§ 754] Inconsistency Between Parts of Contract.

(1) *Specific Provisions Control*. Where general and specific provisions are inconsistent, the specific provision will control. (C.C.P. 1859; see *Continental Cas. Co. v. Phoenix Const. Co.* (1956) 46 C.2d 423, 431, 296 P.2d 801 [insurance policy; endorsement controls over body of policy]; *Kavruck v. Blue Cross of Calif.* (2003) 108 C.A.4th 773, 781, 134 C.R.2d 152 [trial court erred in granting summary judgment in breach of contract action to health insurer that changed policies so that premiums were no longer based on insureds' initial enrollment age but on their attained age at time of renewal where, while one portion of policies gave insurer general authority to modify premiums, another portion, specifically addressing entry age rating, could be reasonably understood to promise that rating would continue]; *Rest.2d, Contracts* §203(c) ["specific terms and exact terms are given greater weight than general language"]; 5 Corbin (Rev. ed.), §24.23; 11 Williston 4th, §32:15; 17A Am.Jur.2d (2004 ed.), *Contracts* §363.)

(2) *Main Purpose Controls*. The apparent *main purpose of the parties* is to be given effect. "Words in a contract which are wholly inconsistent with its nature, or with the main intention of the parties, are to be rejected." (C.C. 1653.) "Repugnancy in a contract must be reconciled, if possible, by such an interpretation as will give some effect to the repugnant clauses, subordinate to the general intent and purpose of the whole contract." (C.C. 1652.) (See C.C. 1648 ["[h]owever broad may be the terms of a contract, it extends only to those things concerning which it appears that the parties intended to contract"]; C.C. 1650 [[p]articular clauses of a contract are subordinate to its general intent]; *Anderson v. Badger* (1948) 84 C.A.2d 736, 742, 191 P.2d 768; 5 Corbin (Rev. ed.), §24.20; 11 Williston 4th, §32:9; 17A Am.Jur.2d (2004 ed.), *Contracts* §§350, 385.)

(3) *Written Parts Control Printed Parts*. Where inconsistent, written or typed parts control printed parts. "Where a contract is partly written and partly printed, or where part of it is written or printed under the special directions of the parties, and with a special view to their intention, and the remainder is copied from a form originally prepared without special reference to the particular parties and the particular contract in question, the written parts control the printed parts, and the parts which are purely original control those which are copied from a form. And if the two are absolutely repugnant, the latter must be so far disregarded." (C.C. 1651.) (See C.C.P. 1862 ["[w]hen an instrument consists partly of written words and partly of a printed form, and the two are inconsistent, the former controls the latter"]; U.C.C. 3114 ["[i]f an instrument contains contradictory terms, typewritten terms prevail over printed terms, handwritten terms prevail over both, and words prevail over numbers"]; *Rest.2d, Contracts* §203(d) ["separately negotiated or added terms are given greater weight than standardized terms or other terms not separately negotiated"]; 5 Corbin (Rev. ed.), §24.24;

11 Williston 4th, §32:13; 17A Am.Jur.2d (2004 ed.), Contracts §386.)

This rule is frequently applied. (See *Monson v. Fischer* (1931) 118 C.A. 503, 513, 5 P.2d 628; *Body-Steffner Co. v. Flotill Products Co.* (1944) 63 C.A.2d 555, 561, 147 P.2d 84; *Marks v. Rowley* (1951) 102 C.A.2d 619, 621, 228 P.2d 29; *Jackson v. Belmont* (1951) 108 C.A.2d 288, 290, 238 P.2d 1084; *Lawrence Block Co. v. Palston* (1954) 123 C.A.2d 300, 310, 266 P.2d 856; *Integrated v. Alec Fergusson Electrical Contractor* (1967) 250 C.A.2d 287, 294, 58 C.R. 503; *Welk v. Fainbarg* (1967) 255 C.A.2d 269, 275, 63 C.R. 127; *Gutzi Associates v. Switzer* (1989) 215 C.A.3d 1636, 1642, 264 C.R. 538.)

West's Key Number Digest, Contracts k.162

SUPPLEMENT: [This section is current through the latest supplement]



71 of 184 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XII. INTERPRETATION

B. Rules of Interpretation.

8. Usage and Custom as Aid to Interpretation.

a. In General.

1 Witkin Sum. Cal. Law Contracts § 755

[§ 755] In General.

(1) *What Constitutes Usage of Trade.* A usage is "habitual or customary practice" (*Rest.2d, Contracts §219*); and a usage of trade is one "having such regularity of observance in a place, vocation, or trade as to justify an expectation that it will be observed with respect to a particular agreement" (*Rest.2d, Contracts §222(1)*). (See U.C.C. 1205; *Binder v. Aetna Life Ins. Co.* (1999) 75 C.A.4th 832, 853, 89 C.R.2d 540, citing the text; 5 Corbin (Rev. ed.), §24.13; 12 Williston 4th, §34:1.)

(2) *Usage To Interpret Agreement.* Usage or custom may be looked to, both to explain the meaning of language and to imply terms, where no contrary intent appears from the terms of the contract. (C.C. 1655; see *Miller v. Germain Seed & Plant Co.* (1924) 193 C. 62, 69, 222 P. 817; *Ermolieff v. R.K.O. Radio Pictures* (1942) 19 C.2d 543, 550, 122 P.2d 3; *King v. Stanley* (1948) 32 C.2d 584, 589, 197 P.2d 321 [in contract for sale of real property, custom may properly determine details such as opening of escrow, furnishing of deeds and title insurance, prorating of taxes, etc.]; *Beneficial Fire & Cas. Ins. Co. v. Kurt Hitke & Co.* (1956) 46 C.2d 517, 525, 297 P.2d 428; *Oakdale Mercantile Co. v. Baer* (1932) 128 C.A. 350, 354, 17 P.2d 779; *May v. American Trust Co.* (1933) 135 C.A. 385, 391, 27 P.2d 101; *Dutton Dredge Co. v. United States Fidelity & Guaranty Co.* (1934) 136 C.A. 574, 578, 29 P.2d 316; *Body-Steffner Co. v. Flotill Products Co.* (1944) 63 C.A.2d 555, 558, 147 P.2d 84; *Correa v. Quality Motor Co.* (1953) 118 C.A.2d 246, 251, 257 P.2d 738 [in agency agreement to sell automobiles, custom of taking used cars as trade-ins held to establish this authority of agent]; *Verdugo Highlands v. Security Ins. Co. of New Haven* (1966) 240 C.A.2d 527, 532, 49 C.R. 736, citing the text [custom of excavating and grading contractors to create additional deposit areas for coverage of fill]; *Heggblade-Marguleas-Tenneco v. Sunshine Biscuit* (1976) 59 C.A.3d 948, 954, 131 C.R. 183 [applying U.C.C. 2202; *Varni Bros. Corp. v. Wine World* (1995) 35 C.A.4th 880, 889, 41 C.R.2d 740, quoting the text [evidence of custom and usage was admissible to prove that termination only for good cause was term of implied distribution agreements but was insufficient to raise triable issue of fact]; *Southern Pac. Trans. Co. v. Santa Fe Pac. Pipelines* (1999) 74 C.A.4th 1232, 1244, 88 C.R.2d 777 [in dispute over amount of rent owed by pipeline company for easements on railroad right-of-way, trade usage and custom had to be considered on issue of valuation]; cf. *Schubert v. Reich* (1948) 87 C.A.2d 268, 274, 196 P.2d 944 [contract to grade and process dates; custom held admissible on how dates are graded, but not on whether particular method should be used without extra charge]; see *Rest.2d, Contracts §222(3)*; 5 Corbin (Rev. ed.), §24.13 et seq.; 12 Williston 4th, §34:1 et seq.; 17A Am.Jur.2d (2004 ed.), *Contracts* §361; 21A Am.Jur.2d (1998), *Customs and*

Usages §1 et seq.; Cal. Transactions Forms, 1 Business Transactions §6:36; 12 *Cal. L. Rev.* 523; 23 *A.L.R.2d* 244, 334 [contracts dealing with literary and artistic rights]; 4 *Summary* (10th), *Sales*, §33; on drafting history of insurance policy provisions as interpretative material, see 2 *Summary* (10th), *Insurance*, §53.)

Usage can be invoked only to interpret, not to create, contractual terms. (*Peiser v. Mettler* (1958) 50 *C.2d* 594, 609, 328 *P.2d* 953; *Hanley v. Marsh & McLennan-J.B.F. Davis & Son, Ltd.* (1941) 46 *C.A.2d* 787, 797, 117 *P.2d* 69; *Rabin v. Craft* (1950) 100 *C.A.2d* 808, 811, 224 *P.2d* 843; *Santandrea v. Siltec Corp.* (1976) 56 *C.A.3d* 525, 528, 128 *C.R.* 629, citing the text.) But a reasonable usage may supply an omitted term or otherwise supplement an agreement. (*Rest.2d, Contracts* §221.)

(3) *Usage Cannot Change Rule of Law.* It has been said that usage cannot change a rule of law. (See *Hayward Tamkin & Co. v. Carpenteria Inv. Co.* (1968) 265 *C.A.2d* 617, 624, 71 *C.R.* 462; 12 *Williston* 4th, §§34:9, 34:10; 70 *Harv. L. Rev.* 553.) Hence, an instrument cannot be made negotiable by business custom, where it fails to conform to the provisions of the statute. (*American Nat. Bank of San Francisco v. A.G. Sommerville* (1923) 191 *C.* 364, 370, 216 *P.* 376.) The Restatement, however, makes this distinction: "If the rule of law is one which overrides contrary agreement, it also overrides usage; but if the law merely supplies a term in the absence of contrary agreement, usage can have the same effect as contrary agreement." (*Rest.2d, Contracts* §221, Comment c.)

(4) *Course of Dealing.* The Restatement, following U.C.C. 1205(1), states that a course of dealing between the parties, like a usage of trade, may determine the meaning of language or may annex an agreed but unstated term. (*Rest.2d, Contracts* §223 and Comment b.) (See 5 *Corbin* (Rev. ed.), §24.17; 12 *Williston* 4th, §34:14.)

West's Key Number Digest, Contracts k.175(.5)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *What Constitutes Usage of Trade.* In 2006, U.C.C. 1205 was redesignated U.C.C. 1303.

(2) *Usage To Interpret Agreement.* See 21A *Am.Jur.2d* (2008 ed.), *Customs and Usages* §1 et seq.



72 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XII. INTERPRETATION

B. Rules of Interpretation.

8. Usage and Custom as Aid to Interpretation.

b. Assent or Knowledge.

1 *Witkin Sum. Cal. Law Contracts* § 756

[§ 756] Assent or Knowledge.

For a custom to be operative, the parties must assent to it, or one party must know or have reason to know the other party intends it to govern, or it must be so generally known that a person should be aware of it. (See *Miller v. Germain Seed & Plant Co.* (1924) 193 C. 62, 69, 222 P. 817; *Lucke v. First Nat. Bank of Marysville* (1924) 193 C. 184, 190, 223 P. 547; *Latta v. Da Roza* (1929) 100 C.A. 606, 608, 280 P. 711, 281 P. 655; *Miller v. Stults* (1956) 143 C.A.2d 592, 603, 300 P.2d 312 [not admissible]; *Rest.2d, Contracts* §220.) Knowledge of a custom may be presumed from the fact that the custom is of general application in a particular industry. (*Pastorino v. Greene Bros.* (1949) 90 C.A.2d 841, 845, 204 P.2d 368; see *Watson Land Co. v. Rio Grande Oil Co.* (1943) 61 C.A.2d 269, 272, 142 P.2d 950 [knowledge of usage may be inferred from fact that party is engaged in trade or industry in which usage is common].)

SUPPLEMENT: [This section is current through the latest supplement]



73 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XII. INTERPRETATION

B. Rules of Interpretation.

9. Interpretation Against Party Causing Uncertainty.

1 Witkin Sum. Cal. Law Contracts § 757

[§ 757] Interpretation Against Party Causing Uncertainty.

"In cases of uncertainty not removed by the preceding rules, the language of a contract should be interpreted most strongly against the party who caused the uncertainty to exist." (C.C. 1654.) (See *Taylor v. J.B. Hill Co.* (1948) 31 C.2d 373, 374, 189 P.2d 258; *Ecco-Phoenix Elec. Corp. v. Howard J. White* (1969) 1 C.3d 266, 275, 81 C.R. 849, 461 P.2d 33; *Victoria v. Superior Court* (1985) 40 C.3d 734, 745, 747, 222 C.R. 1, 710 P.2d 833; *Glenn v. Bacon* (1927) 86 C.A. 58, 72, 260 P. 559; *Coast Mut. Bldg.-Loan Assn. v. Security Title Ins. & Guarantee Co.* (1936) 14 C.A.2d 225, 229, 57 P.2d 1392; *Earl Ranch, Ltd. v. Marchus* (1943) 60 C.A.2d 379, 383, 140 P.2d 891; *Basin Oil Co. of Calif. v. Baash-Ross Tool Co.* (1954) 125 C.A.2d 578, 595, 271 P.2d 122 [clause in sales contract purporting to exempt from liability construed against seller]; *Moss Dev. Co. v. Geary* (1974) 41 C.A.3d 1, 11, 115 C.R. 736 [rejecting rule when forfeiture would result]; *Federal Leasing Consultants v. Mitchell Lipsett Co.* (1978) 85 C.A.3d Supp. 44, 48, 150 C.R. 82, *infra*, §845 [applying rule]; *Howe v. American Baptist Homes of West* (1980) 112 C.A.3d 622, 628, 169 C.R. 418; *Sutherland v. Barclays Amer./Mortg. Corp.* (1997) 53 C.A.4th 299, 311, 61 C.R.2d 614 [mortgagee's oral statement that it will temporarily "stop" account is ambiguous as to when excused payments are due and arguably should be construed in favor of borrower]; *Badie v. Bank of America* (1998) 67 C.A.4th 779, 803, 79 C.R.2d 273; *Robert T. Miner, M.D. v. Tustin Ave. Investors, LLC* (2004) 116 C.A.4th 264, 270, 10 C.R.3d 178 [whether lease renewal provision was still operable in view of contradictory statements in estoppel certificate should be interpreted most strongly against landlord]; *Rest.2d, Contracts* §206 [interpretation "against the party who supplies the words or from whom a writing otherwise proceeds"]; 5 Corbin (Rev. ed.), §24.27; 11 Williston 4th, §32:12; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §343; CACI, No. 320 [Interpretation--Construction Against Drafter]; 4 *Summary* (10th), *Sales*, §91; on insurance applications, see 2 *Summary* (10th), *Insurance*, §62 et seq.)

"The rule that any ambiguities caused by the draftsman of the contract must be resolved against that party ... applies with peculiar force in the case of the *contract of adhesion*. Here the party of superior bargaining power not only prescribes the words of the instrument but the party who subscribes to it lacks the economic strength to change such language. Hence, any ambiguity in the contract should be resolved against the draftsman, and questions of doubtful interpretation should be construed in favor of the subscribing party." (*Neal v. State Farm Ins. Cos.* (1961) 188 C.A.2d 690, 695, 10 C.R. 781, *supra*, §323.) (See *Laux v. Freed* (1960) 53 C.2d 512, 524, 2 C.R. 265, 348 P.2d 873; *Gray v. Zurich Ins. Co.* (1966) 65 C.2d 263, 54 C.R. 104, 419 P.2d 168, 2 *Summary* (10th), *Insurance*, §51; *Spence v. Omnibus Industries* (1975) 44 C.A.3d 970, 975, 119 C.R. 171, *supra*, §327; on applicability of rule to insurance contracts, see 2

Summary (10th), *Insurance*, §62 et seq.; on adhesion contracts, see *supra*, §323 et seq.)

The rule is inapplicable, however, where it does not appear who caused the uncertainty or who was the "promisor" (*Union Oil Co. of Calif. v. Union Sugar Co.* (1948) 31 C.2d 300, 318, 188 P.2d 470; *San Joaquin v. Work. Comp. App. Bd.* (2004) 117 C.A.4th 1180, 1186, 12 C.R.3d 406 [contract is not automatically construed against drafter where it is result of negotiations]), or where the language is so clear that no uncertainty exists to be resolved by such construction (*Coit v. Jefferson Standard Life Ins. Co.* (1946) 28 C.2d 1, 11, 168 P.2d 163; *Young's Market Co. v. American Home Assur. Co.* (1971) 4 C.3d 309, 316, 93 C.R. 449, 481 P.2d 817). Moreover, the rule applies only as a tiebreaker when the other canons of construction fail to dispel the uncertainty. (*Pacific Gas & Elec. Co. v. Superior Court* (1993) 15 C.A.4th 576, 596, 19 C.R.2d 295; *Oceanside 84, Ltd. v. Fidelity Fed. Bank* (1997) 56 C.A.4th 1441, 1448, 66 C.R.2d 487.)

West's Key Number Digest, Contracts k.155

SUPPLEMENT: [This section is current through the latest supplement]

See *City of Hope Nat. Med. Center v. Genentech* (2008) 43 C.4th 375, 398, 75 C.R.3d 333, 181 P.3d 142 [fact that contract was arrived at by negotiation may make it difficult or even impossible for jury to determine which party caused particular contractual ambiguity to exist, but this added complexity does not make underlying rule irrelevant or inappropriate]; 13 A.L.R. Fed 2d 261 [application of patent ambiguity doctrine to federal Government contracts]. *Rule applies only when other canons of construction fail to dispel uncertainty:* See *California Nat. Bank v. Woodbridge Plaza LLC* (2008) 164 C.A.4th 137, 145, 78 C.R.3d 561 [in interpreting ambiguous lease, rule that language of contract should be interpreted most strongly against party who caused uncertainty to exist did not apply where court could resolve uncertainty using evidence of circumstances surrounding leases' execution].



74 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XII. INTERPRETATION

B. Rules of Interpretation.

10. Contracts Containing Medium of Payment in European Currency.

1 Witkin Sum. Cal. Law Contracts § 758

[§ 758] Contracts Containing Medium of Payment in European Currency.

C.C. 1663 provides rules for interpretation of contracts that are expressed in terms of European currencies that have been replaced by the single currency of the European Union, known as the "euro."

(1) *Definitions.*

(a) "Euro" means the currency of participating member states of the European Union that adopt a single currency in accordance with the Treaty on European Union signed February 7, 1992, as amended from time to time. (C.C. 1663(a)(1).)

(b) "Introduction of the euro" includes, but is not limited to, the implementation from time to time of economic and monetary union in member states of the European Union in accordance with the Treaty on European Union. (C.C. 1663(a)(2).)

(c) "ECU" or "European Currency Unit" means the currency basket that is from time to time used as the unit of account of the European community, as defined in a European Council Regulation. (C.C. 1663(a)(3).)

(2) *Rule of Interpretation.* If a subject or medium of payment of a contract, security, or instrument is the ECU or a currency that has been substituted or replaced by the euro, the euro shall be a commercially reasonable substitute and substantial equivalent that may be either tendered or used in determining the value of the ECU or currency, in each case at the conversion rate determined in accordance with regulations of the Council of the European Union. (C.C. 1663(b).)

The introduction of the euro, the tendering of euros in connection with an obligation in compliance with C.C. 1663(b), the determining of the value of an obligation in compliance with that provision, or the calculating or determining of the subject or medium of payment of a contract, security, or instrument with reference to an interest rate or other basis that has been substituted or replaced due to the introduction of the euro and that is a commercially reasonable substitute and substantial equivalent, may not have the effect of either (a) discharging or excusing performance under a contract, security, or instrument or (b) giving a party the right unilaterally to alter or terminate a contract, security, or instrument. (C.C. 1663(c).)

(3) *Agreements of Parties Controlling.* C.C. 1663 is subject to any agreements between parties with specific

reference to, or agreement regarding, the introduction of the euro. (C.C. 1663(d).)

(4) *Applicability of Statute to All Contracts.* C.C. 1663 applies to all contracts, securities, and instruments, including contracts with respect to commercial transactions, and may not be deemed to be displaced by another state law. (C.C. 1663(e).)

(5) *Effect of Statute on Other Currency Changes.* In the event of other currency changes, the provisions of C.C. 1663 with respect to the euro may not be interpreted as creating a negative inference or negative presumption regarding the validity or enforceability of contracts, securities, or instruments denominated in whole or part in those other currencies. (C.C. 1663(f).)

SUPPLEMENT: [This section is current through the latest supplement]



75 of 184 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

A. In General.

1. Discharge by Performance.

1 Witkin Sum. Cal. Law Contracts § 759

[§ 759] Discharge by Performance.

(1) *Full Performance*. "Full performance of an obligation, by the party whose duty it is to perform it, or by any other person on his behalf, and with his assent, if accepted by the creditor, extinguishes it." (C.C. 1473.) (See *Rest.2d, Contracts* §235(1); 13 Corbin (Rev. ed.), §67.3; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §524; Cal. Civil Practice, 3 Business Litigation, §24:51 et seq.; BAJI, No. 10.83 [discharge by performance]; CACI, No. 312 [substantial performance]; on performance of obligation to pay money by deposit in bank, see *infra*, §775.)

(2) *Partial Performance*. "A partial performance of an indivisible obligation extinguishes a corresponding portion thereof, if the benefit of such performance is voluntarily retained by the creditor, but not otherwise. If such partial performance is of such a nature that the creditor cannot avoid retaining it without injuring his own property, his retention thereof is not presumed to be voluntary." (C.C. 1477; see C.C. 1525, 2 *Cal. Proc.* (4th), *Jurisdiction*, §21 [encouraging part payment of undisputed amounts in order to channel actions into inferior courts]; *infra*, §950 et seq.)

(3) *Performance Under Reservation of Rights*. A party to a contract governed by the Commercial Code may perform under a reservation of rights; i.e., by use of words such as "without prejudice" or "under protest," he or she may perform, promise to perform, or assent to performance without thereby losing, through waiver or estoppel, any rights he or she may have with respect to a breach committed by the other contracting party. (U.C.C. 1207(a); see 2 Anderson 3d (1997 ed.) §2-207.1 et seq.; 6 *Am.Jur. P.P. Forms* (2002 ed.), *Commercial Code*, §1:36; 15 *Southwestern U.L. Rev.* 791; *infra*, §857.)

West's Key Number Digest, Contracts k.275

SUPPLEMENT: [This section is current through the latest supplement]

(2) *Partial Performance*.

Cross-Reference: 2 *Cal. Proc.* (5th), *Jurisdiction*, §22.(3) *Performance Under Reservation of Rights*. See C.E.B., *Law of Contracts* §8.2 et seq.; 2 *Lawrence's Anderson 3d* (2004 ed.), §2-207:1 et seq.

In 2006, U.C.C. 1207(a) was renumbered U.C.C. 1308(a) and amended without substantive change.



76 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

A. In General.

2. Demand of Performance.

1 Witkin Sum. Cal. Law Contracts § 760

[§ 760] Demand of Performance.

Where the contract contains an unconditional promise to perform at a fixed time, no demand is necessary to put the promisor in default. Suit may be brought at once. (*Danielson v. Neal* (1913) 164 C. 748, 750, 130 P. 716.) And if the contract calls for the *payment of money* owed by the promisor, no demand is necessary, because immediate payment is required. (C.C. 1657; see *Rottman v. Hevener* (1921) 54 C.A. 474, 483, 202 P. 329; *infra* §945.)

In other cases, a demand is usually necessary for the reason that it gives the promisor an opportunity to discharge his or her liability without the expense and inconvenience of litigation. (*Cox v. Delmas* (1893) 99 C. 104, 120, 33 P. 836; *Leonard v. Rose* (1967) 65 C.2d 589, 592, 55 C.R. 916, 422 P.2d 604; *Tisdale v. Bryant* (1918) 38 C.A. 750, 757, 177 P. 510; see 8 Corbin (Rev. ed.), §31.5; 23 Williston 4th, §§63:5, 63:6; 17A Am.Jur.2d (2004 ed.), *Contracts* §594.)

Sometimes the terms of the contract are such that demand by one party is a condition precedent to the obligation of the other to perform. If this is the case, the demand must be made within a reasonable time, or the statute of limitations will begin to run on the cause of action. (*Bass v. Hueter* (1928) 205 C. 284, 287, 270 P. 958; *Kaplan v. Reid Bros.* (1930) 104 C.A. 268, 272, 285 P. 868; *Woollomes v. Gomes* (1938) 26 C.A.2d 461, 465, 79 P.2d 728; see 3 Cal. Proc. (4th), *Actions*, §495 et seq.)

Where demand would be futile, as where the defendant has previously refused to perform, it is unnecessary. (*Goldberg v. Rempp* (1928) 95 C.A. 452, 455, 273 P. 63; *Cook v. Snyder* (1936) 16 C.A.2d 587, 591, 61 P.2d 53.)

SUPPLEMENT: [This section is current through the latest supplement]

Demand as condition precedent:

Cross-Reference: 3 Cal. Proc. (5th), *Actions*, §532 et seq.



77 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

A. In General.

3. Place of Performance.

1 Witkin Sum. Cal. Law Contracts § 761

[§ 761] Place of Performance.

Where no place of performance is specified, the debtor must ordinarily seek the creditor. (See C.C. 1488, 1489, *infra*, §771.) But this rule yields to specific provisions or reasonable inferences drawn from the contract. (See *Burr v. Western States Life Ins. Co.* (1931) 211 C. 568, 575, 296 P. 273; *Clark v. Policy-Holders Life Ins. Assn.* (1934) 138 C.A. 505, 507, 32 P.2d 653; 15 Williston 4th, §47:6; 17A Am.Jur.2d (2004 ed.), *Contracts* §469; 5A Am.Jur. Legal Forms 2d (2004 ed.), §68:98; 3 Cal. Proc. (4th), *Actions*, §§759 et seq., 773 et seq. [county where contract is to be performed as proper venue].)

SUPPLEMENT: [This section is current through the latest supplement]

Cross-Reference: 3 Cal. Proc. (5th), *Actions*, §§841 et seq.; 855 et seq.



78 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

A. In General.

4. Time of Performance.

a. Reasonable Time.

1 Witkin Sum. Cal. Law Contracts § 762

[§ 762] Reasonable Time.

If the contract does not specify the time of performance, and the act cannot be done "instantly" (see *infra*, §763), a reasonable time is allowed. (*Standard Box Co. v. Mutual Biscuit Co. (1909) 10 C.A. 746, 750, 103 P. 938; Fogler v. Purkiser (1932) 127 C.A. 554, 559, 16 P.2d 305; Ottney v. Finnie (1935) 5 C.A.2d 356, 362, 42 P.2d 714; Kuhn v. Valley Meat Co. (1937) 23 C.A.2d 25, 31, 72 P.2d 164; Estate of Baird (1943) 59 C.A.2d 303, 306, 138 P.2d 698* [though contract requires payment only when promisor's property is sold, performance is due within reasonable time]; *Consolidated World Inv. v. Lido Preferred Ltd. (1992) 9 C.A.4th 373, 381, 11 C.R.2d 524* [reasonable time is question of fact]; *Eidsmore v. RBB (1994) 25 C.A.4th 189, 198, 30 C.R.2d 357* [6-month period between execution of contract for purchase of "unique and exotic" car and arrival of vehicle was reasonable, considering limited nature of vehicle's production and distribution]; *House of Prayer: Renewal & Healing Center of Yuba City v. Evangelical Assn. for India (2003) 113 C.A.4th 48, 54, 7 C.R.3d 24* [under C.C. 1657 (*supra*, §760), where no time of performance was stated, reasonable time was implied]; *1 Corbin (Rev. ed.)*, §4.2; *17A Am.Jur.2d (2004 ed.)*, *Contracts* §466 et seq.)

In *Pitzer v. Wedel (1946) 73 C.A.2d 86, 165 P.2d 971*, the promise was to pay indebtedness "out of proceeds from the sale of crops" to be raised by the promisor. *Held*, this implied that performance would be made within a reasonable time; hence, the statute of limitations did not commence to run until the expiration of some reasonable period determined by the trial court (here, 4 years). (*73 C.A.2d 91.*)

A vendor may agree to sell property that he or she does not yet own, but this fact does not extend the time of performance. At the specified date, the vendor must tender a good deed, and while he or she is entitled to a reasonable time to *execute* a conveyance, he or she is not entitled to additional time to *acquire title*. (*Ellwood v. Niedermeyer (1936) 12 C.A.2d 699, 704, 56 P.2d 279.*)

In *Stockton v. Stockton Plaza Corp. (1968) 261 C.A.2d 639, 68 C.R. 266*, plaintiff city leased land adjacent to a redevelopment area, and defendant lessee agreed to construct improvements, conditional upon its obtaining financing. Defendant was unsuccessful in its attempt to obtain financing, and plaintiff city brought this action to terminate the lease for failure to perform. The lease gave the lessee the right to terminate if first mortgage financing was not available within 1 year; it was silent on the lessor's right to terminate. The lessee contended that it had an indefinite period, so long as it acted in good faith and was not insolvent. *Held*, C.C. 1657 governed: No time was specified, and, a reasonable

time having passed, plaintiff was entitled to terminate. (261 C.A.2d 642.)

West's Key Number Digest, Contracts k.282

SUPPLEMENT: [This section is current through the latest supplement]

See *Kotler v. PacifiCare of Calif.* (2005) 126 C.A.4th 950, 956, 24 C.R.3d 447 [in Lyme disease patient's breach of contract action against health care service plan, triable issue of fact remained, precluding summary judgment, whether 6-week wait for patient's appointment with specialist constituted breach of plan's implied-in-law obligation to provide patient timely treatment by infectious disease specialist].



79 of 184 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

A. In General.

4. Time of Performance.

b. Payment of Money.

1 Witkin Sum. Cal. Law Contracts § 763

[§ 763] Payment of Money.

The reasonable time rule (*supra*, §762) is subject to an exception where the act required is in its nature capable of being done instantly, e.g., the *payment of money*. In such case, it must be performed as soon as the obligation is ascertained; and, when the amount due is clear, the contract calls for immediate payment. (C.C. 1657.) (See *ShIPLEY Co. v. Rosemead Co.* (1929) 100 C.A. 706, 711, 280 P. 1017; 13 Corbin (Rev. ed.), §67.4; 28 Williston 4th, §72:2 et seq.; 17A Am.Jur.2d (2004 ed.), Contracts §480 et seq.; 60 Am.Jur.2d (2003 ed.), Payment §6 et seq.; 5A Am.Jur. Legal Forms 2d (2004 ed.), §68:93; 19A Am.Jur. P.P. Forms (1997 ed.), Payment, §31 et seq.; *supra*, §760.)

However, a promise to pay "when able" does not call for immediate performance, and the statute of limitations does not begin to run until the debtor becomes able to pay. (*Van Buskirk v. Kuhns* (1913) 164 C. 472, 474, 129 P. 587; see *infra*, §791; 3 Cal. Proc. (4th), Actions, §494) And where the time of payment is fixed with reference to an event that can never occur, a reasonable time is allowed. (*Bank of America v. Engleman* (1950) 101 C.A.2d 390, 394, 225 P.2d 597.)

SUPPLEMENT: [This section is current through the latest supplement]

See 19A Am.Jur. P.P. Forms (2007 ed.), Payment, §13 et seq.

Cross-Reference: 3 Cal. Proc. (5th), Actions, §531.



80 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

A. In General.

4. Time of Performance.

c. Time Specified and Extensions.

1 Witkin Sum. Cal. Law Contracts § 764

[§ 764] Time Specified and Extensions.

(1) *Time Specified*. When a contractual provision specifies the time for performance, that time will generally be given effect. (See 8 Corbin (Rev. ed.), §37.1; 15 Williston 4th, §46:2 et seq.; 17A Am.Jur.2d (2004 ed.), *Contracts* §§191, 466; on time of the essence, see 13 *Summary* (10th), *Equity*, §60.)

The usual rules governing computation of time apply. (See C.C. 10; 74 Am.Jur.2d (2001 ed.), *Time* §13 et seq.; 61 Proof of Facts 3d 325 [time as of essence in real estate contract]; 98 A.L.R.2d 1331 [inclusion or exclusion of first and last days for performance of act or event that must take place a certain number of days before a known future date]; 5 A.L.R.3d 584 [meaning of "year"]; 32 A.L.R.4th 8 [real estate contract; requirement that vendor give notice of time of performance after extension of original time of performance].)

The word "immediately" is usually construed to mean "within a reasonable time" under the circumstances. (*Integrated v. Alec Fergusson Electrical Contractor* (1967) 250 C.A.2d 287, 295, 58 C.R. 503 [duty to make progress payments to subcontractor].)

(2) *Statutory Extensions*. If a specified time of performance falls on a holiday, the law extends it to the next business day, although the debtor may perform on the holiday if he or she desires. (C.C. 11; see *Cheney v. Canfield* (1910) 158 C. 342, 347, 111 P. 92.) Holidays are Sundays and days specified as holidays in the Government Code. (C.C. 7.) (See C.C. 9 [optional bank holiday as defined in C.C. 7.1 is not a business day for any act to be performed by, at, or through a bank].)

Enlisted members of the National Guard called or ordered into active state service by the Governor for over 7 days may, by sending a copy of their orders to any *contract creditor*, secure an extension of the time required for the payment of *any contract obligation* for a period of 1 month for each month or fraction thereof in active state service. If the creditor refuses to grant the extension, a court order extending the time for payment may be secured. An enlisted member of the National Guard may also secure a stay of any administrative or judicial proceedings for a comparable period. (*Mil. & Vet.C.* 399.) (See 50 U.S.C. Appx, §501 et seq. [providing civil relief to persons in federal military service].)

West's Key Number Digest, Contracts k.299(1)

SUPPLEMENT: [This section is current through the latest supplement]

(2) *Statutory Extensions*. *Mil. & Vet.C. 399* was repealed in 2002. *Mil. & Vet.C. 400* et seq., added in 2002, provide specified protections for reservists and National Guard members who are called to active duty with respect to, among other things, contract obligations, court proceedings, rental agreements, taxes or assessments, and health or medical insurance.



81 of 184 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

A. In General.

5. Several Debts: Application of Payments.

a. Specification by Parties.

1 Witkin Sum. Cal. Law Contracts § 765

[§ 765] Specification by Parties.

(1) *Specification by Debtor.* Where a debtor owes several debts to a creditor, and makes a payment, he or she may specify the obligation to which it is to be applied. (C.C. 1479(One); see *Ray v. Borgfeldt* (1915) 169 C. 253, 261, 146 P. 679; *American Contractors Indemnity Co. v. Saladino* (2004) 115 C.A.4th 1262, 1272, 9 C.R.3d 835 [where surety is only liable for portion of obligation, principal debtor is entitled to designate how debtor's payments to original creditor should be applied]; *Rest.2d, Contracts* §258; 13 Corbin (Rev. ed.), §67.4; 28 Williston 4th, §72:2 et seq.; 60 *Am.Jur.2d* (2003 ed.), *Payment* §62 et seq.)

(2) *Specification by Creditor.* If the debtor does not specify, the creditor may. (C.C. 1479(Two); see *Goodwin v. Alston* (1952) 114 C.A.2d 713, 718, 250 P.2d 722; *Hollywood Wholesale Elec. Co. v. John Baskin* (1953) 121 C.A.2d 415, 429, 263 P.2d 665; *Rest.2d, Contracts* §259.) However, the creditor's bookkeeping applications under C.C. 1479 are not binding where the creditor is ignorant of the existence of two primary debtors owing different amounts. (*Orlopp v. Willardson* (1965) 232 C.A.2d 750, 755, 43 C.R. 125.) And where the direction is thwarted by intervening rights of a third party, the dilemma must be resolved on common law principles. (*Pike v. Tuttle* (1971) 18 C.A.3d 746, 753, 96 C.R. 403.)

(3) *Debtor's Consent to Application.* In *Ewing Irr. Products v. Rohnert Park Golf Course Corp.* (1973) 29 C.A.3d 862, 105 C.R. 812, a materialman, with knowledge of the source of funds, applied them to earlier jobs, under its standard bookkeeping practice. Both the owner and general contractor were aware of this practice, and no directions were given as to how the funds should be applied. *Held*, judgment for materialman affirmed. While generally knowledge of the source of the funds requires application of those funds to the job related to the source, here the owner and contractor consented to the funds being allocated to other jobs. (29 C.A.3d 868.) (See *Phillips Const. Co. v. Argonaut Ins. Co.* (1978) 77 C.A.3d 575, 580, 143 C.R. 671 [following *Ewing*].)

(4) *Distinction: Joint Check.* Where an owner or general contractor issues a joint check to a subcontractor and materialman, the drawer demonstrates the intent that the proceeds are to be divided among the payees to discharge obligations to them. C.C. 1479 is inapplicable, because it does not deal with *division* of funds among joint payees; it provides a method of *allocation of payments only after the division*. (*Post Bros. Const. Co. v. Yoder* (1977) 20 C.3d 1, 7, 141 C.R. 28, 569 P.2d 133; see 67 *Cal. L. Rev.* 641.)

West's Key Number Digest, Payment 41 et seq.

SUPPLEMENT: [This section is current through the latest supplement]



82 of 184 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

A. In General.

5. Several Debts: Application of Payments.

b. Statutory Rules.

1 Witkin Sum. Cal. Law Contracts § 766

[§ 766] Statutory Rules.

If neither party specifies otherwise within a reasonable time, the law (C.C. 1479(Three)) requires payment to be applied in the following order:

(1) Interest due. (See 13 Corbin (Rev. ed.), §67.4; 28 Williston 4th, §72:20.)

(2) Principal due.

(3) Obligations earliest to mature. (See *Jessup Farms v. Baldwin* (1983) 33 C.3d 639, 651, 654, 190 C.R. 355, 660 P.2d 813; *Hollywood Wholesale Elec. Co. v. John Baskin* (1953) 121 C.A.2d 415, 429, 263 P.2d 665; *Rest.2d, Contracts §260(2).*)

(4) Unsecured obligations. (See *Bank of America v. Kelsey* (1935) 6 C.A.2d 346, 353, 44 P.2d 617; *Rest.2d, Contracts §260(2)(b)(ii)*; 13 Corbin (Rev. ed.), §67.4.; 28 Williston 4th, §72:18.)

(5) Secured obligations. (See 28 Williston 4th, §72:18.)

These rules are not always strictly applied. Thus, where one obligation is better secured than another, the court may, under equitable principles, apply the payment first to extinguish the debt with the more precarious security. (See *Murdock v. Clarke* (1891) 88 C. 384, 392, 26 P. 601; *Bradner v. Woods* (1939) 30 C.A.2d 678, 681, 87 P.2d 69.)

In *Smith v. Renz* (1954) 122 C.A.2d 535, 265 P.2d 160, plaintiff executed an installment note for \$ 148,000 with payments of \$ 500 or more to be made on the first day of each month. A few months later, plaintiff made a payment of \$ 23,500, without designation of application, and then contended that this sum should be applied in satisfaction of the next 47 \$ 500 installments, thus obviating the necessity of any further payments for nearly 5 years. Rejecting this contention, the court said that "an excess payment made prior to or on one installment date is not effective to reduce the amount of or obviate the necessity of paying subsequent installments as they fall due according to the agreed schedule." (122 C.A.2d 539.) Here, the \$ 23,500 was in effect a payment of "\$ 500 or more"; it lessened the principal sum by that amount and consequently reduced the number of installments remaining to be paid. (See 89 A.L.R.3d 947 [excess of payment for one period as applicable to subsequent period under contract or mortgage providing for periodic

payments].)

SUPPLEMENT: [This section is current through the latest supplement]



83 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

A. In General.

6. Election of Alternative Modes of Performance.

1 Witkin Sum. Cal. Law Contracts § 767

[§ 767] Election of Alternative Modes of Performance.

In *Durgin v. Kaplan* (1968) 68 C.2d 81, 65 C.R. 158, 436 P.2d 70, D Company was a creditor of Poly Company. Defendant, principal shareholder and director of Poly, executed a continuing guaranty of its obligations. Poly filed a Chapter XI bankruptcy petition, and the court approved a plan for issuance of one share of common stock for each dollar of indebtedness, in full satisfaction of claims. D Company received these shares, but thereafter filed an action against defendant guarantor, contending that the stock was worthless. The jury returned a verdict for defendant, thereby necessarily finding that the value of the stock at least equaled that of the debt and extinguished the claim. But on appeal plaintiff invoked the provision in the guaranty agreement allowing it to reject the securities and demand cash. *Held*, acceptance of the stock was a binding election.

(a) *The statutes.* Under C.C. 2822, a creditor's acceptance of anything in partial satisfaction of an obligation of the principal reduces the guarantor's obligation in the same measure. And under C.C. 2839, actual payment of an obligation by the principal exonerates the guarantor. Hence, D Company's acceptance of stock equal in value to the debt executed the guaranty and terminated any contractual relationship. (68 C.2d 89.)

(b) *No waiver.* The guaranty did not contain any waiver of these sections. Moreover, "[w]e doubt the validity of such a provision in a contract of guaranty, which, contrary to public policy, could require a guarantor to pay the debt of his principal many times over before becoming exonerated." (68 C.2d 90, footnote 8.)

(c) *Silence as assent.* Plaintiff creditor, as offeree of alternative modes of performance, sought to treat its silence as both acceptance and rejection, subject to its ultimate choice unlimited as to time. It cannot do this: If it is to receive the benefit of appreciation in value of the stock, it must bear the risk of depreciation; if it wishes to protect against the risk, it must exercise the option of rejection before acquiring the opportunity for gain. In other words, this is one of the situations in which silence may constitute acceptance: "We believe, therefore, that plaintiff accepted the arrangement-proceeding stock within the meaning of section 2822 not only expressly, by choosing the value theory of recovery *at trial*, but impliedly as well, by remaining silent while accepting the benefits of the stock *after the Chapter XI proceeding*." (68 C.2d 91.)

In *Union Bank v. Ross* (1976) 54 C.A.3d 290, 126 C.R. 646, the court, referring to the *Durgin* opinion dictum on "no waiver," observed that "the courts have clearly held that a guarantor is permitted to waive his or her right by

contract to require the creditor to proceed against security provided by the principal debtor." (54 C.A.3d 294.)

SUPPLEMENT: [This section is current through the latest supplement]



84 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

A. In General.

7. Conditional Payment by Mailing Check.

1 Witkin Sum. Cal. Law Contracts § 768

[§ 768] Conditional Payment by Mailing Check.

In *Cornwell v. Bank of America* (1990) 224 C.A.3d 995, 274 C.R. 322, plaintiff made a payment on his deed of trust by mailing a check to defendant bank. Defendant asserted that it never received the check and never debited plaintiff's account; hence the payment had not been made. The trial judge gave summary judgment for defendant. *Held*, affirmed; the debtor bears the risk of loss for a check that goes astray in the mail.

(a) *C.C. 1476*. C.C. 1476 states that, if the creditor directs the debtor to perform in a particular manner, the obligation is extinguished by the performance in that manner, even though the creditor does not receive the benefit of that performance. (224 C.A.3d 998.) Plaintiff invoked the section by pointing to the loan payment coupon furnished by the bank, containing the words "Mail this coupon with check payable to Bank of America." However, these words do not legally amount to a specific direction to pay by mail: "Nothing in the coupon prevents the debtor from making payment in person at a local branch of the bank, or from using other available alternatives." (224 C.A.3d 1000.)

(b) *U.C.C. 3802 (now U.C.C. 3310)*. Plaintiff's contention is unsound for a more fundamental reason: Payment of a debt by an uncertified check or other negotiable instrument is a *conditional payment* that depends on the successful negotiation of the check by the creditor. (U.C.C. 3802 (now U.C.C. 3310); see 4 *Summary* (10th), *Negotiable Instruments*, §18. "Thus, even if the check was received by defendant, and lost by it, payment would not have been made. ... If the check was received by defendant and dishonored by plaintiff's bank, payment would still not have been made. While the parties may vary these rules by agreement, the payment coupon is not evidence of such an agreement here." (224 C.A.3d 1001.) (See *Nguyen v. Calhoun* (2003) 105 C.A.4th 428, 443, 129 C.R.2d 436 [where creditor did not direct that payment be made by mail, payment was not effective until received by creditor; following *Cornwell*].)

SUPPLEMENT: [This section is current through the latest supplement]



85 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

B. Tender.

1. Nature and Effect.

a. Offer of Performance.

1 Witkin Sum. Cal. Law Contracts § 769

[§ 769] Offer of Performance.

A tender is an offer of performance. "An obligation is extinguished by an offer of performance, made in conformity to the rules herein prescribed, and with intent to extinguish the obligation." (C.C. 1485.)

The tender, when properly made, has the effect of placing the other party in default if he or she refuses to accept it, and the party making the tender may rescind, or sue for breach of contract or for specific performance where this remedy is available. (See *Cates v. McNeil* (1915) 169 C. 697, 706, 147 P. 944; *Marshall v. Hilton* (1930) 209 C. 531, 534, 289 P. 165; *Weisenberg v. Hirschhorn* (1929) 97 C.A. 532, 533, 275 P. 997; 13 Corbin (Rev. ed.), §67.5 et seq.; 28 Williston 4th, §72:27; 17A Am.Jur.2d (2004 ed.), Contracts §597 et seq.; 74 Am.Jur.2d (2001 ed.), Tender §1 et seq.; 7A Am.Jur. P.P. Forms (2002 ed.), Contracts, §45; BAJI, No. 10.84 [tender].)

West's Key Number Digest, Contracts k.279(.5)

SUPPLEMENT: [This section is current through the latest supplement]
See C.E.B., Law of Contracts §8.13 et seq.



86 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

B. Tender.

1. Nature and Effect.

b. Effect on Incidents of Obligation.

1 Witkin Sum. Cal. Law Contracts § 770

[§ 770] Effect on Incidents of Obligation.

"An offer of payment or other performance, duly made, though the title to the thing offered be not transferred to the creditor, stops the running of interest on the obligation, and has the same effect upon its incidents as a performance thereof." (C.C. 1504.)

Thus, where money is due on an indebtedness, tender *discharges any lien* that is security for the debt, releases sureties, and stops the running of interest. (See *Loughborough v. McNevin* (1887) 74 C. 250, 254, 14 P. 369 [lien of pledge discharged]; *Leet v. Armbruster* (1904) 143 C. 663, 667, 77 P. 653; *Walsh v. Walsh* (1940) 42 C.A.2d 293, 295, 108 P.2d 768 [where valid tender of amount due was refused and action was brought on contract with attorneys' fee provision, no interest, costs, or attorneys' fees were recoverable]; *Hossom v. Long Beach* (1948) 83 C.A.2d 745, 750, 189 P.2d 787 [land sold for city taxes; owner made repeated efforts to redeem and pay delinquent amounts, but city tax collector refused to state amounts due; tax lien held discharged]; *Rose v. Hecht* (1949) 94 C.A.2d 662, 665, 211 P.2d 347 [stopping running of interest]; *Universal C.I.T. Credit Corp. v. Rater* (1963) 214 C.A.2d 493, 494, 29 C.R. 631 [extinguishes lien]; *Montano v. South Gate* (1970) 13 C.A.3d 446, 449, 91 C.R. 523; 74 Am.Jur.2d (2001 ed.), Tender §35 et seq.)

In *Montano*, on October 28, 1968, plaintiff minor received a \$ 65,000 judgment against defendant city for personal injuries, and filed a cost bill of \$ 794.10. On November 4, 1968, defendant city sent drafts for the judgment amount and the cost bill, with a covering letter offering to pay interest due for the few days between the time of judgment and time of receipt of the drafts. Plaintiff's counsel returned the drafts stating that the condition of the tender ("for the settlement" of the minor's judgment) was unacceptable because he intended to move for a new trial for inadequacy of damages. He made the motion, it was denied on January 21, 1969, and the trial judge approved the minor's claim and authorized satisfaction of the judgment in the amount awarded with interest until January 27, 1969 (\$ 1,154.90). *Held*, the interest award was unauthorized, and defendant was entitled to satisfaction of judgment in accordance with the original tender. Although acceptance of the tender would have resulted in a waiver of his motion for new trial, in rejecting it he assumed the risk of loss of interest during the time the motion was pursued. (13 C.A.3d 449.)

The early case of *Himmelmann v. Fitzpatrick* (1875) 50 C. 650, held that tender did not discharge the lien of a mortgage. (See 3 Cal. L. Rev. 336; 5 Cal. L. Rev. 78.) The more logical view followed in later cases has been that

tender does discharge the lien. (*Wiemeyer v. Southern Trust & Commerce Bank* (1930) 107 C.A. 165, 173, 290 P. 70 [real mortgage]; *Moskovitz v. LeFrancois* (1932) 121 C.A. 310, 314, 8 P.2d 1049 [chattel mortgage]; *Wagner v. Shoemaker* (1938) 29 C.A.2d 654, 657, 85 P.2d 229 [deed of trust]; see dicta in *Walker v. Houston* (1932) 215 C. 742, 746, 12 P.2d 952, and *Sondel v. Arnold* (1934) 2 C.2d 87, 89, 39 P.2d 793; cf. *Lichty v. Whitney* (1947) 80 C.A.2d 696, 699, 182 P.2d 582 [holder of second deed of trust made tender of amount due to holder of first deed of trust; first lien held discharged].)

An unaccepted tender will also discharge a security interest in personal property. (*Walker v. Houston*, supra.) And tender by a *purchaser* of property subject to a lien or other security interest, not a party to the note or obligation secured, has the same effect in discharging the lien or security interest as tender by the debtor. (*Walker v. Houston*, supra; see *Sondel v. Arnold*, supra.)

SUPPLEMENT: [This section is current through the latest supplement]



87 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

B. Tender.

1. Nature and Effect.

c. Requisites of Tender.

1 Witkin Sum. Cal. Law Contracts § 771

[§ 771] Requisites of Tender.

A tender must be of *full performance*, at a *proper time and place*, made by the *debtor or by some person on his or her behalf* and with the debtor's consent, to the *creditor or some person authorized* to receive or collect what is due, at a *place appointed by the creditor* or a place where the *person authorized can be found* (or, if he or she cannot be found, at any place within the state). (C.C. 1486, 1487, 1488, 1489, 1490, 1491.) (See *Gaffney v. Downey Savings & Loan Assn.* (1988) 200 C.A.3d 1154, 1165, 246 C.R. 421 [where creditor was not informed by debtor that two separate partial payments would be made, each payment was properly rejected as inadequate]; 13 Corbin (Rev. ed., §67.7; 28 Williston 4th, §72:29 et seq.; 17A Am.Jur.2d (2004 ed.), Contracts §599; 74 Am.Jur.2d (2001 ed.), Tender §6 et seq.; 82 A.L.R.3d 1178 [creditor's failure to disclose amount due as affecting debtor's tender of amount believed to be due]; 37 A.L.R.4th 286 [sufficiency of defaulting vendee's tender to redeem rights in purchased property].)

Compliance with the following requirements is essential to a valid tender:

(1) It must be *timely*: "Where an obligation fixes a time for its performance, an offer of performance must be made at that time, within reasonable hours, and not before nor afterwards." (C.C. 1490.) Thus, a *premature* tender is ineffective. (*James Talcott v. Gee* (1968) 266 C.A.2d 384, 388, 72 C.R. 168 [buyer under installment contract cannot put seller in default by tendering balance unless contract provides for right of prepayment]; *Waller v. Brooks* (1968) 267 C.A.2d 389, 394, 72 C.R. 228, citing the text.)

(2) It must be *unconditional*, except in cases where the debtor is entitled to the performance of a condition precedent or concurrent by the creditor. (C.C. 1494, 1498; see *Groobman v. Kirk* (1958) 159 C.A.2d 117, 123, 323 P.2d 867.) An unwarranted condition annexed to the offer is in effect a refusal to perform. (*Feagins v. Burton* (1929) 100 C.A. 7, 11, 279 P. 460; see *Bourdieu v. Baker* (1935) 6 C.A.2d 150, 158, 44 P.2d 587; *K. & M. v. LeCuyer* (1951) 107 C.A.2d 710, 717, 238 P.2d 28; *Wiener v. Van Winkle* (1969) 273 C.A.2d 774, 782, 78 C.R. 761, citing the text; *Still v. Plaza Marina Commercial Corp.* (1971) 21 C.A.3d 378, 385, 98 C.R. 414; *Klinger v. Realty World Corp.* (1987) 196 C.A.3d 1549, 1554, 242 C.R. 592 [offer to pay broker admittedly owed commission as full satisfaction of disputed claim involving another commission; not a valid tender]; BAJI, No. 10.84 [tender].) However, if the condition expressed is a proper one, the tender is effective. (See *Montano v. South Gate* (1970) 13 C.A.3d 446, 449, 91 C.R. 523, supra, §770 [settlement of judgment].)

(3) A tender must also be in *good faith*. (C.C. 1493.) So, if the party making the offer is actually unable or unwilling to perform, it is ineffectual. (C.C. 1495; see *Doak v. Bruson* (1907) 152 C. 17, 21, 91 P. 1001; *Allen v. Chatfield* (1916) 172 C. 60, 68, 156 P. 47; *Sondel v. Arnold* (1934) 2 C.2d 87, 90, 39 P.2d 793; *Dickey v. Kuhn* (1930) 106 C.A. 300, 304, 289 P. 242; *Karlsen v. American Savings & Loan Assn.* (1971) 15 C.A.3d 112, 118, 92 C.R. 851.)

(4) If the contract calls for the delivery of some specific thing, *actual production* of it at the time of tender is *not necessary*. The party must merely be able to produce it, and must do so when the offer is accepted. (C.C. 1496; see 3 *Cal. L. Rev.* 170.) Furthermore, an *offer in writing* to pay money or to deliver a written instrument or specific personal property is, if unaccepted, equivalent to *actual production* (C.C.P. 2074; *Gray v. Fred B. Neuhoff Co.* (1932) 124 C.A. 567, 582, 12 P.2d 1036; *California v. Agostini* (1956) 139 C.A.2d 909, 913, 294 P.2d 769.)

West's Key Number Digest, Contracts k.279(2)

SUPPLEMENT: [This section is current through the latest supplement]



88 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

B. Tender.

2. Waiver of Defects by Failure To Object.

a. In General.

1 Witkin Sum. Cal. Law Contracts § 772

[§ 772] In General.

(1) *Statutory Rule.* The person to whom the tender is made must specify any objections that he or she may have at that time, or defects in form or method are waived. (C.C.P. 2076; C.C. 1501; *Hind v. Oriental Products Co.* (1925) 195 C. 655, 665, 235 P. 438; *Peterson v. Gilbert* (1927) 83 C.A. 542, 546, 257 P. 140; *Strom v. Union Oil Co.* (1948) 88 C.A.2d 78, 83, 198 P.2d 347; *Bodem v. Friedman* (1949) 90 C.A.2d 225, 228, 202 P.2d 632; *Fidler v. Schiller* (1963) 212 C.A.2d 569, 574, 28 C.R. 48; *Riverside Fence Co. v. Novak* (1969) 273 C.A.2d 656, 662, 78 C.R. 536; 8 Corbin (Rev. ed.), §40.7; 13 Corbin (Rev. ed.), §67.7; 28 Williston 4th, §72:41 et seq.; 17A Am.Jur.2d (2004 ed.), *Contracts* §597 et seq.; 74 Am.Jur.2d (2001 ed.), *Tender* §4.)

(2) *Exception: Inability To Perform.* The waiver extends only to the objections that could be obviated by the person making the tender, and by the essential requisite of tender, which is the ability to perform. (C.C. 1501, 1495.) Hence, if the person making the tender is in fact unable to perform, failure by the other party to object is not a waiver. (*Allen v. Chatfield* (1916) 172 C. 60, 68, 156 P. 47; *Klein v. Markarian* (1917) 175 C. 37, 41, 165 P. 3; *Reuling v. Sergeant* (1949) 93 C.A.2d 241, 243, 208 P.2d 1046; see 4 Cal. L. Rev. 424.)

(3) *Distinction: Advance Notice Demanding Specific Tender.* In *Noyes v. Habitation Resources* (1975) 49 C.A.3d 910, 123 C.R. 261, a stipulated judgment against defendant required payment in monthly installments. Several payments were made by check, in accordance with the usual business practice; but, after some delays were encountered in collection, plaintiff's counsel advised defendant's counsel that future payments were to be made either in cash or by certified check. Some 3 weeks later defendant, after banking hours, tendered an uncertified check drawn by a third party on a Florida bank. Plaintiff refused the tender, declared a default, and obtained an order for execution. *Held*, this was proper. (a) The two statutes on waiver of objections (C.C. 1501, C.C.P. 2076, *supra*) deal with objections at the time of tender; their purpose is to prevent later surprise of the offeror with hidden objections. (49 C.A.3d 914.) (b) Here, the objection was made 3 weeks before the tender; and, although the statutes do not expressly provide for advance notice requiring specific tender, such notice fulfills the statutory purpose of allowing the debtor time to make a conforming tender if he or she chooses. (49 C.A.3d 914.) (See 82 A.L.R.3d 1199 [note on *Noyes* case: right of judgment creditor to demand that tender be in cash or by certified check].)

SUPPLEMENT: [This section is current through the latest supplement]

(2) *Exception: Inability To Perform.* See *McElroy v. Chase Manhattan Mortg. Corp.* (2005) 134 C.A.4th 388, 391, 36 C.R.3d 176 [bank's failure to respond to borrowers' tender did not waive bank's objections to form of tender, where "tender" was worthless bill].



89 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

B. Tender.

2. Waiver of Defects by Failure To Object.

b. Timely Correction of Mistake.

1 Witkin Sum. Cal. Law Contracts § 773

[§ 773] Timely Correction of Mistake.

An exception to the waiver rule was declared in *Sanguansak v. Myers* (1986) 178 C.A.3d 110, 223 C.R. 490. Plaintiff, by his attorney-in-fact S, executed a note and deed of trust on December 15, 1982, in favor of defendant, for \$ 57,000. The note contained a prepayment penalty of 6 months' unearned interest. After one payment was made in January, 1983, S brought a \$ 60,000 cashier's check to Great Western (defendant's collection agent) to pay off the loan. Great Western's employee accepted the check and gave S a receipt for \$ 57,085.50--the amount due on the note--and a refund check for \$ 2,914.50, but he neglected to charge the prepayment penalty of \$ 4,104. Thereafter, Great Western mailed notices to S's residence indicating that a balance of \$ 4,104 was owed, but S had left town and never received the notices. In June, 1983, defendant instituted foreclosure proceedings. Plaintiff obtained a temporary restraining order, but the trial judge eventually denied plaintiff's demand for an injunction against the trustee's sale. *Held*, affirmed.

(a) *Hind v. Oriental Products Co.* (1925) 195 C. 655, 665, 235 P. 438, *supra*, §772, and similar cases, rely on estoppel: "These cases generally arise either where a creditor has refused a tender without specifying his reasons for the refusal or where he has accepted a tender without informing the debtor that the tender is nonconforming." (178 C.A.3d 115.) C.C.P. 2076 and C.C. 1501 "are primarily intended to protect debtors/offers who perform or tender performance in good faith from harm by creditors/offerees who refuse to accept or intentionally fail to demand proper tender." (178 C.A.3d 116.)

(b) Here, defendant neither refused to accept nor *intentionally* failed to demand proper tender; the failure to obtain the prepayment penalty was the result of a mistake that the agent attempted to correct by immediately sending notice to plaintiff's attorney-in-fact. Defendant cannot be held responsible for the fact that there was no one at the address to receive the notice; and plaintiff, through his attorney-in-fact, knew or should have known of the defect in the tender, because the prepayment charge was clearly stated in the note. (178 C.A.3d 117, 118.)

(c) Defendant was not estopped to rely on the debt of \$ 4,104 with interest as a basis for foreclosure. At the time that the correct information had been sent to S, plaintiff had not as yet suffered any detriment, but could have satisfied the obligation and avoided foreclosure by a payment of the amount properly due. (178 C.A.3d 118.)

SUPPLEMENT: [This section is current through the latest supplement]



90 of 184 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

B. Tender.

3. Excuse of Tender Where Useless.

1 Witkin Sum. Cal. Law Contracts § 774

[§ 774] Excuse of Tender Where Useless.

Timely tender may be excused where the debtor is induced by conduct of the creditor to delay or neglect it. (C.C. 1511(3); see *Pierce v. Lukens* (1904) 144 C. 397, 400, 77 P. 996.) And no tender need be made at all if it would obviously be useless, as where the other party repudiates the contract and gives notice of his or her refusal to perform, or if the other party admits an inability to perform. (C.C. 1440, 1511(3), 1515; see *Hoppin v. Munsey* (1921) 185 C. 678, 685, 198 P. 398; *Ray Thomas v. Cowan* (1929) 99 C.A. 140, 146, 277 P. 1086; *Woods-Drury v. Superior Court* (1936) 18 C.A.2d 340, 348, 63 P.2d 1184; *Ratterree Land Co. v. Security First Nat. Bank* (1938) 26 C.A.2d 652, 657, 80 P.2d 102; *Enfield v. Huffman Motor Co.* (1953) 117 C.A.2d 800, 807, 257 P.2d 458; *Greenstone v. Claretian Theological Seminary, Claretville* (1959) 173 C.A.2d 21, 33, 343 P.2d 161 [defendant vendor notified plaintiff purchaser that it would not perform]; see 17A Am.Jur.2d (2004 ed.), *Contracts* §598; 74 Am.Jur.2d (2001 ed), *Tender* §4.)

This last rule was subjected to peculiar qualification in *Beeler v. American Trust Co.* (1946) 28 C.2d 435, 170 P.2d 439. In a prior action, plaintiff claimed that his absolute deed to defendant was only a mortgage, and tendered the amount due on the debt. He prevailed and the trial court determined that his tender stopped the running of *interest* on the debt until judgment (see *supra*, §770). Defendant appealed, still maintaining that the deed was absolute, but judgment was affirmed. Plaintiff then objected to paying interest after the judgment below and during the 41/2-year period on appeal, contending that the position of defendant on appeal constituted a continuation of the same repudiation of his rights as a mortgagor, and that a new tender of the debt, after the lower court judgment was rendered, would have been refused. *Held*, plaintiff was liable for the interest. His obviously correct appraisal of the futility of a new tender was rejected as "pure speculation," the court adding: "The only way in which appellant could have avoided or terminated his liability to pay interest during pendency of the appeal was to have made an actual tender." (28 C.2d 438.) The decision seems unsound, and its theory is obscure; the only explanation appears in the statement of a flat exception to the general rule that conduct or declarations of the other party may excuse tender: "an appeal is not classifiable as a declaration of position on the same basis to constitute a waiver of interest on a judgment as provided by law (*Code Civ. Proc.*, § 1033) nor does it dispense with the formality of tender to stop the interest running on the adjudicated obligation." (28 C.2d 439.)

West's Key Number Digest, Contracts k.279(.5)

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91 of 184 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

B. Tender.

4. Deposit in Bank Distinguished.

1 *Witkin Sum. Cal. Law Contracts* § 775

[§ 775] Deposit in Bank Distinguished.

"An obligation for the *payment of money is extinguished* by a due offer of payment, if the amount is immediately *deposited in the name of the creditor*, with some *bank or savings and loan association* within this state, of good repute, and *notice thereof is given to the creditor*." (C.C. 1500; see *Gaffney v. Downey Savings & Loan Assn. (1988) 200 C.A.3d 1154, 1167, 246 C.R. 421* [account requiring debtors' signatures before funds could be released to creditors did not satisfy requirement of C.C. 1500 that money deposited be unconditionally available to creditor].)

This section states a special rule where money is due, but it is not a rule of tender; it is rather a rule of complete performance. It is still possible to tender money called for under a contract without depositing it in the bank, and this tender will have the usual effect of placing the other party in default, discharging any lien or secondary liability, and stopping the running of interest. (See *supra*, §770.) In such a case, however, the ultimate obligation to pay the debt will still remain. In order to completely extinguish that obligation, it is necessary to deposit the money in a bank in accordance with the provisions of C.C. 1500. (*Marshall v. Hilton (1930) 209 C. 531, 534, 289 P. 165; Sheller v. Livingston (1914) 25 C.A. 572, 574, 144 P. 547; see Walker v. Houston (1932) 215 C. 742, 745, 12 P.2d 952; Hunt v. Mahoney (1947) 82 C.A.2d 540, 547, 187 P.2d 43; Magnus v. Morrison (1949) 93 C.A.2d 1, 3, 208 P.2d 407; Taliaferro v. Taliaferro (1956) 144 C.A.2d 109, 113, 300 P.2d 726.*)

SUPPLEMENT: [This section is current through the latest supplement]



92 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

C. Conditions and Covenants.

1. Nature and Distinctions.

a. Conditions.

1 Witkin Sum. Cal. Law Contracts § 776

[§ 776] Conditions.

A *condition* is a fact, the happening or nonhappening of which creates (condition precedent) or extinguishes (condition subsequent) a duty on the part of the promisor. If the promisor makes an absolute or unconditional promise, he or she is bound to perform when the time arrives; but if the promisor makes a *conditional promise*, he or she is bound to perform only if the condition precedent occurs, or is relieved from the duty if the condition subsequent occurs. The condition may be the happening of an *event*, or an *act* of a party. (See C.C. 1434, 1435; 8 Corbin (Rev. ed.), §30.1 et seq.; 13 Williston 4th, §38:1 et seq.; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §454 et seq.; BAJI, No. 10.80 [conditions precedent and subsequent]; CACI, No. 321 [existence of condition precedent disputed], CACI, No. 322 [occurrence of agreed condition precedent], CACI, No. 323 [waiver of condition precedent].)

A condition precedent is an *act* that must be performed or an uncertain *event* that must happen before the promisor's duty of performance arises. (C.C. 1436; see 8 Corbin (Rev. ed.), §30.7; 13 Williston 4th, §§38:7, 38:8; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §458; *infra*, §780 et seq.) (On conditions concurrent, see *infra*, §§792, 809 et seq.; on conditions subsequent, see *infra*, §793; for the new Restatement terminology, see *infra*, §779.)

A promise may be dependent upon the happening or performance of more than one condition. (See *Fenn v. Pickwick Corp.* (1931) 117 C.A. 236, 243, 4 P.2d 215; *Pearson v. McKinney* (1911) 160 C. 649, 655, 117 P. 919.) And before a promisee can require a promisor to perform, "he must fulfill all conditions precedent thereto imposed upon himself; and must be able and offer to fulfill all conditions concurrent so imposed upon him on the like fulfillment by the other party," except where the other party gives notice that he or she will not perform. (C.C. 1439; see *Dotson v. International Alliance of Theatrical Stage Employees & Moving Picture Machine Operators of United States & Canada, Local 162* (1949) 34 C.2d 362, 372, 210 P.2d 5 [action to compel admission to membership in labor union]; *Fenn v. Pickwick Corp.*, *supra*; 4 Cal. Proc. (4th), *Pleading*, §491.)

West's Key Number Digest, Contracts k.278(.5)

SUPPLEMENT: [This section is current through the latest supplement]

See *Hollister v. Monterey Ins. Co.* (2008) 165 C.A.4th 455, 500, 81 C.R.3d 72 [insurer's conduct harmed insured city by rendering it practically impossible, or at least unreasonably difficult, for city to comply with requirement that it enter

into replacement contract within 180 days in order to receive functional replacement value of fire-damaged building, as was required to estop insurer from relying on provision as defense to city's claim; so long as insurer refused to say whether it would honor claim for functional replacement benefits, city could not comply with the condition]; C.E.B., Law of Contracts §6.41 et seq.

Promisee must fulfill all conditions precedent:

Cross-Reference: 4 Cal. Proc. (5th), Pleading, §530.



93 of 184 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

C. Conditions and Covenants.

1. Nature and Distinctions.

b. Express and Implied Conditions.

1 Witkin Sum. Cal. Law Contracts § 777

[§ 777] Express and Implied Conditions.

With reference to their creation, conditions may be either (1) *express*, or (2) *implied*. Express conditions are those that are stated in the contract, and they are determined by the intention of the parties as disclosed in the agreement. (See *Schwab v. Bridge* (1915) 27 C.A. 204, 206, 149 P. 603; 8 Corbin (Rev. ed.), §30.10; 13 Williston 4th, §§38:11, 38:12; 17A Am.Jur.2d (2004 ed.), Contracts §454; BAJI, No. 10.80 [conditions precedent and subsequent]; CACI, No. 321 [existence of condition precedent disputed], CACI, No. 322 [occurrence of agreed condition precedent], CACI, No. 323 [waiver of condition precedent].) The words "provided" and "upon the condition" are appropriate methods of stating express conditions, but they do not necessarily have this effect, where the intention of the parties, gathered from the whole instrument, is otherwise. (*Diepenbrock v. Luiz* (1911) 159 C. 716, 718, 115 P. 743; see 8 Corbin (Rev. ed.), §31.1 et seq.; 13 Williston 4th, §38:16 et seq.; 17A Am.Jur.2d (2004 ed.), Contracts §455.)

A further distinction is made between conditions *implied in fact*, by interpretation of the agreement, and conditions *implied by law* irrespective of intent, to avoid injustice ("constructive conditions"). (See 8 Corbin (Rev. ed.), §30.11, 32.1 et seq.; 13 Williston 4th, §38:11; see also *Wal-Noon Corp. v. Hill* (1975) 45 C.A.3d 605, 611, 119 C.R. 646, 12 Summary (10th), Real Property, §618 [implied condition precedent: notice by lessee to lessor to make latter liable under his or her covenant to repair].)

SUPPLEMENT: [This section is current through the latest supplement]



94 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

C. Conditions and Covenants.

1. Nature and Distinctions.

c. Conditions and Covenants Distinguished.

1 Witkin Sum. Cal. Law Contracts § 778

[§ 778] Conditions and Covenants Distinguished.

A *covenant* is a *promise* to render some performance. The practical distinction between a condition and a covenant may be illustrated as follows: (1) If B agrees to render some performance to A, provided a condition happens, and the condition does not happen, A's *duty to perform is excused*, but A *cannot recover damages* from B. (2) On the other hand, if no condition is stated, and B merely makes a promise, his or her breach of covenant will give rise to a right of action for damages, but will not necessarily excuse A's performance. (3) However, if the condition is stated, and in addition B *promises that the condition will happen*, upon the failure of the condition to occur not only is A's duty excused, but A can also recover damages for the breach of covenant or promise. In brief, therefore, breach of covenant, or failure of a condition to happen, alone, merely excuses the other party's performance; breach of covenant, alone, merely gives the other party a right of action for damages; but the same fact or act may be both a condition and a promise, resulting in both an excuse of counterperformance and a right of action for damages. (See *Britschgi v. McCall* (1953) 41 C.2d 138, 144, 257 P.2d 977; *B.F. Schlesinger & Sons v. Kohler & Chase* (1930) 103 C.A. 195, 199, 284 P. 244; *Starr v. Davis* (1930) 105 C.A. 632, 634, 288 P. 706; 8 Corbin (Rev. ed.), §§30.12, 30.14; 13 Williston 4th, §§38:5, 38:13; 17A Am.Jur.2d (2004 ed.), *Contracts* §457; on the buyer's remedies for improper tender or delivery of goods, see U.C.C. 2601; 4 *Summary* (10th), *Sales*, §159 et seq.)

Thus, in *Britschgi v. McCall*, *supra*, defendants agreed to sell land "contingent upon the seller being able to eliminate the interest" of S, who held a lease with option to purchase. *Held*, this was a *condition precedent* to defendants' duty to convey, and there was no fault in their failure to fulfill it, for it was *not a covenant*. "An express condition precedent to performance by a party cannot be construed as imposing a duty on that party to fulfill the condition, where, as here, the language employed does not constitute an undertaking to do so." (41 C.2d 144.)

In *De La Falaise v. Gaumont-British Picture Corp.* (1940) 39 C.A.2d 461, 103 P.2d 447, plaintiff contracted to render services as an actress upon notification of the starting date of the picture. Defendant failed to notify, and was held liable in damages. The court erroneously stated that "failure to comply with conditions precedent" will sustain an action for damages. (39 C.A.2d 468.) The case may be explained on the theory that the court deemed the requirement of notification both a condition and a promise.

West's Key Number Digest, *Sales* 65

SUPPLEMENT: [This section is current through the latest supplement]
See C.E.B., Law of Contracts §6.32 et seq.



95 of 184 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

C. Conditions and Covenants.

1. Nature and Distinctions.

d. Restatement 2d.

1 Witkin Sum. Cal. Law Contracts § 779

[§ 779] Restatement 2d.

(1) *Terminology.* The traditional terms "condition precedent" and "condition subsequent" have caused confusion and are not used in the Restatement. The occurrence of an event that will extinguish a duty after performance has become due (condition subsequent) is subject to the rules on discharge, not to the rules on conditions; and conditions precedent are referred to simply as "conditions." (See Rest.2d, Contracts, Introductory Note, Vol. 2, p. 159; §224, Comment e, and Reporter's Note.)

(2) *Condition (Condition Precedent).* "A condition is an event, not certain to occur, which must occur, unless its non-occurrence is excused, before performance under a contract becomes due." (*Rest.2d, Contracts §§224, 225.*) An event may be made a condition either by agreement of the parties (e.g., "on condition that" or "if"), or by a term supplied by the court (often described as a "constructive" or "implied in law" condition; terms not used in the Restatement). (*Rest.2d, Contracts §226* and Comments a, b, c.)

(3) *Event That Terminates a Duty (Condition Subsequent).* *Rest.2d, Contracts §230* reads as follows:

(a) "Except as stated in Subsection (2), if under the terms of the contract the occurrence of an event is to terminate an obligor's duty of immediate performance or one to pay damages for breach, that duty is discharged if the event occurs."

(b) "The obligor's duty is not discharged if occurrence of the event (a) is the result of a breach by the obligor of his duty of good faith and fair dealing, or (b) could not have been prevented because of impracticability and continuance of the duty does not subject the obligor to a materially increased burden."

(c) "The obligor's duty is not discharged if, before the event occurs, the obligor promises to perform the duty even if the event occurs and does not revoke his promise before the obligee materially changes his position in reliance on it." (See Comment b, pointing out that the rule in Subsection (3) is sometimes expressed in terms of waiver or estoppel.)

SUPPLEMENT: [This section is current through the latest supplement]



96 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

C. Conditions and Covenants.

2. Conditions Precedent.

a. Performance of Act.

1. Vendor and Purchaser.

1 Witkin Sum. Cal. Law Contracts § 780

[§ 780] Vendor and Purchaser.

(1) *Act by Purchaser.* The most familiar example of an *act* as a condition is the requirement found in most installment contracts of sale of real or personal property, that all payments shall be made at the times specified before the *purchaser* may demand transfer of title. (*Major-Blakeney Corp. v. Jenkins* (1953) 121 C.A.2d 325, 331, 263 P.2d 655; *Nash v. Superior Court* (1978) 86 C.A.3d 690, 695, 698, 150 C.R. 394; 77 Am.Jur.2d (1997 ed.), *Vendor and Purchaser* §80; 78 A.L.R.3d 880 [sufficiency of purchaser's efforts to secure financing on which sale is contingent]; cf. 81 A.L.R.2d 1338 [purchaser's arrangements for financing]; see 13 *Summary* (10th), *Equity*, §60 et seq.)

(2) *Act by Vendor.* A typical vendor's duty is to clear defects and produce a marketable title as a condition precedent to the purchaser's obligation to pay. (See *Hill v. State Box Co.* (1952) 114 C.A.2d 44, 49, 249 P.2d 903; *Leiter v. Handelsman* (1954) 125 C.A.2d 243, 247, 270 P.2d 563; 77 Am.Jur.2d (1997 ed.), *Vendor and Purchaser* §123 et seq.; cf. *Sosin v. Richardson* (1962) 210 C.A.2d 258, 264, 26 C.R. 610 [sale conditional on default of loan and vendor's acquisition of the property by foreclosure].) And a subdivision owner may agree to recordation of a tract map as a condition precedent to a purchaser's duty to deposit the purchase price in escrow. (See *Rubin v. Fuchs* (1969) 1 C.3d 50, 54, 81 C.R. 373, 459 P.2d 925. (See also C.C. 1099 [vendor must deliver copy of termite inspection report (as prescribed by B. & P.C. 8519) when such report is required by the contract of sale or is a condition of financing]; 6 *Pacific L. J.* 381.)

West's Key Number Digest, Vendor and Purchaser k.93

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Act by Purchaser.* See 77 Am.Jur.2d (2006 ed.), *Vendor and Purchaser* §67.(2) *Act by Vendor.* See 77 Am.Jur.2d (2006 ed.), *Vendor and Purchaser* §86 et seq.



97 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

C. Conditions and Covenants.

2. Conditions Precedent.

a. Performance of Act.

2. Other Illustrations.

1 Witkin Sum. Cal. Law Contracts § 781

[§ 781] Other Illustrations.

The following cases illustrate the variety of conditions precedent that may be embodied in contracts:

(1) Defendant agreed to advance the money each Saturday to a contractor to carry on certain work; the weekly payment was held to be a condition precedent to the contractor's duty of further performance. (*Woodruff Co. v. Exchange Realty Co. (1913) 21 C.A. 607, 610, 132 P. 598.*)

(2) Defendant guaranteed an account of a third party, provided it was presented to him by a certain date; presentation within the time limit was held to be a condition precedent to his liability. (*Schwab v. Bridge (1915) 27 C.A. 204, 206, 149 P. 603.*)

(3) Defendant shipbuilder agreed to replace defective parts provided the vessel was brought to the shipyard; failure to comply with this condition precluded liability for the defects. (*Gonsalves v. Hodgson (1951) 38 C.2d 91, 99, 237 P.2d 656.*)

(4) Defendant audit company, after performing an audit for plaintiff in 1995, resigned and refused to conduct the 1996 audit because plaintiff had failed to perform its agreement to replace its securities attorney; replacement of the attorney was a condition precedent to defendant's duty to conduct the audit. (*Wiz Technology v. Coopers & Lybrand (2003) 106 C.A.4th 1, 12, 130 C.R.2d 263.*)

Demand of performance may also be a condition precedent. (See *supra*, §760.) And notice by a lessee to his lessor may be a condition precedent to the latter's liability under his covenant to repair. (*Wal-Noon Corp. v. Hill (1975) 45 C.A.3d 605, 611, 119 C.R. 646, 12 Summary (10th), Real Property, §618.*)

Private arbitration is governed by contract law, and parties may expressly agree that the right is subject to a condition precedent. Thus, when the parties have agreed that a *demand for arbitration* must be made within a certain time, that demand is a condition precedent that must be performed before the contractual duty arises. (*Platt Pac. v. Andelson (1993) 6 C.4th 307, 313, 24 C.R.2d 597, 862 P.2d 158; see 21 Pepperdine L. Rev. 1440 [Platt Pac.].*) (On

conditions precedent in insurance policies, see 2 *Summary* (10th), *Insurance*, §§66, 67.)

SUPPLEMENT: [This section is current through the latest supplement]



98 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

C. Conditions and Covenants.

2. Conditions Precedent.

b. Performance to Satisfaction of Third Person.

1 Witkin Sum. Cal. Law Contracts § 782

[§ 782] Performance to Satisfaction of Third Person.

If the parties agree that the sufficiency of performance is to be determined by some *third person*, e.g., an architect, that person's determination is conclusive in the absence of proof of fraud or mistake. (*Church v. Shanklin* (1892) 95 C. 626, 627, 30 P. 789; *City Street Imp. Co. v. Marysville* (1909) 155 C. 419, 427, 101 P. 308; *Brown v. Aguilar* (1927) 202 C. 143, 151, 259 P. 735; *Pacific Commercial Co. v. Greer* (1933) 129 C.A. 751, 756, 19 P.2d 543; see 8 Corbin (Rev. ed.), §31.11 et seq.; 13 Williston 4th, §38:21 et seq.; 17A Am.Jur.2d (2004 ed.), Contracts §634; 5A Am.Jur. Legal Forms 2d (2004 ed.), §67:167 et seq.; 7 A.L.R.3d 555 [contract for sale of goods]; on owner-architect-contractor relationships in general, see 47 Cal. L. Rev. 645.)

Of course, if there is actual satisfaction, the third party cannot arbitrarily refuse to furnish a required certificate to that effect. (*Coplew v. Durand* (1908) 153 C. 278, 281, 95 P. 38.)

West's Key Number Digest, Contracts k.282

SUPPLEMENT: [This section is current through the latest supplement]



99 of 184 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

C. Conditions and Covenants.

2. Conditions Precedent.

c. Performance to Satisfaction of Promisor.

1. Nature of Problem.

1 Witkin Sum. Cal. Law Contracts § 783

[§ 783] Nature of Problem.

Where a contract provides that performance must be satisfactory to the promisor, so that this becomes a condition precedent, and after performance the promisor claims to be dissatisfied with it, may the promisee recover on the ground that his or her performance would have satisfied a reasonable person? (See *Kadner v. Shields* (1971) 20 C.A.3d 251, 97 C.R. 742, *infra*, §788; *infra*, §784 et seq.)

This type of contract has been upheld against attack on the grounds of indefiniteness or lack of mutuality of obligation. (See *Mattei v. Hopper* (1958) 51 C.2d 119, 122, 330 P.2d 625; *Rodriguez v. Barnett* (1959) 52 C.2d 154, 160, 338 P.2d 907; *Melton v. Story* (1931) 113 C.A. 609, 612, 298 P. 1032; *Guntert v. Stockton* (1974) 43 C.A.3d 203, 209, 117 C.R. 601, *infra*, §788; *Larwin-Southern Calif. v. JGB Inv. Co.* (1979) 101 C.A.3d 626, 638, 640, 162 C.R. 52 [following *Mattei* and *Rodriguez*]; *Converse v. Fong* (1984) 159 C.A.3d 86, 90, 205 C.R. 242 [promise is not illusory and does not lack mutuality of obligation; citing *Mattei* and *Rodriguez*; 2 Corbin (Rev. ed.), §5.33; 8 Corbin (Rev. ed.), §§31.6, 31.7; 13 Williston 4th, §38:21 et seq.; 17A Am.Jur.2d (2004 ed.), *Contracts* §628.) But complications arise in attempting to enforce the promisor's obligation. The cases distinguish between two general types of contracts: those involving fancy, taste, or judgment, and those involving mechanical utility or operative fitness. (See *infra*, §784 et seq.)

Rest.2d, Contracts §228 states a preference for the objective standard (reasonable satisfaction): "When it is a condition of an obligor's duty that he be satisfied with respect to the obligee's performance or with respect to something else, and it is practicable to determine whether a reasonable person in the position of the obligor would be satisfied, an interpretation is preferred under which the condition occurs if such a reasonable person in the position of the obligor would be satisfied." Comments a and b explain that (1) to make the subjective standard of honest dissatisfaction applicable, the obligor must use clear language; but (2) if the agreement leaves no doubt that this is meant, the condition is not met if the obligor is honestly, even though unreasonably, dissatisfied. (See *infra*, §789.)

The simple provision that the buyer should pay for machinery "if this installation works properly" is not a satisfaction clause, and sufficiency of performance is determined by ordinary rules. (*Innes Food Equipment Co. v. Sanguinetti Fruit Co.* (1948) 85 C.A.2d 140, 144, 192 P.2d 83.)

SUPPLEMENT: [This section is current through the latest supplement]



100 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

C. Conditions and Covenants.

2. Conditions Precedent.

c. Performance to Satisfaction of Promisor.

2. Fancy, Taste, or Judgment.

aa. Good Faith Test.

1 Witkin Sum. Cal. Law Contracts § 784

[§ 784] Good Faith Test.

Where the contract involves matters of fancy, taste, or judgment, the promisor is the sole judge of his or her satisfaction. If the promisor asserts *in good faith* that he or she is not satisfied, there can be no inquiry into the reasonableness of the attitude. (*Tiffany v. Pacific Sewer Pipe Co.* (1919) 180 C. 700, 702, 182 P. 428; *Baker v. Kale* (1947) 83 C.A.2d 89, 93, 189 P.2d 57; *Pugh v. See's Candies* (1988) 203 C.A.3d 743, 766, 250 C.R. 195, citing the text; see 8 Corbin (Rev. ed.), §31.8; 13 Williston 4th, §38:21; 17A Am.Jur.2d (2004 ed.), Contracts §628 et seq.; 5A Am.Jur. Legal Forms 2d (2004 ed.), §68:182; 7A Am.Jur. P.P. Forms (2002 ed.), Contracts, §51.)

Traditional examples are employment contracts (see *infra*, §785), and agreements to paint a portrait, write a literary or scientific article, or produce a play or other live performance. (*Schuyler v. Pantages* (1921) 54 C.A. 83, 85, 201 P. 137.) (See *Leboire v. Royce* (1960) 53 C.2d 659, 672, 2 C.R. 745, 349 P.2d 513 [provision for reimbursement of percentage of attorneys' fees, not binding until "our written approval and consent"]; *San Bernardino Valley Water Dev. Co. v. San Bernardino Valley Mun. Water Dist.* (1965) 236 C.A.2d 238, 252, 45 C.R. 793 [whether plaintiff well drilling company produced new water not derived from existing watershed; but good faith dissatisfaction not proved]; 86 A.L.R.2d 200 [sale of goods]; on requirement of satisfactory *lease*, see *infra*, §786.)

Clauses involving satisfaction with respect to legal rights would seem ordinarily to be subject to the objective test of satisfaction of a reasonable person (*infra*, §787). But in *Baker v. Kale*, *supra*, a lessee contracted to sell a lease, and the buyer, to protect himself against trouble with the lessor, had a clause inserted in the contract reading: "provided that [buyer] is then *satisfied* the option to extend the lease has been legally exercised and is binding upon the lessor." The lessor falsely told the buyer that the lease was not valid, and the buyer refused to perform. *Held*, this was a case where *judgment* was involved, and personal dissatisfaction, in good faith, was enough. (83 C.A.2d 94.)

Other cases seemingly involving only objective factors to be governed by the reasonable person test (see *infra*, §787) have also been held subject to the rule of personal satisfaction. Thus, in *Hall v. Webb* (1924) 66 C.A. 416, 226 P. 403, the contract provided that one party had the right to withdraw water from a stream only so long as the other's supply was not lessened, and gave the latter the sole right to determine whether this lessening took place. *Held*, the

court could not go into the question of actual diminution. (66 C.A. 422.) And in *Van Demark v. California Home Extension Assn.* (1919) 43 C.A. 685, 185 P. 866, where a contract for the sale of real property contained an agreement by the vendor to buy it back if the purchaser should be "dissatisfied with the investment," it was held that personal dissatisfaction, independent of value or quality of the property, was controlling. The court pointed out, however, that the decision worked no hardship, because it merely accomplished, in effect, a rescission, each party receiving what had been given by him as consideration. (43 C.A. 689.)

The requirement of good faith was the decisive factor in *Locke v. Warner Bros.* (1997) 57 C.A.4th 354, 66 C.R.2d 921, where plaintiff sued defendant film studio for breach of a development deal. The deal had two basic components: First, defendant agreed to pay plaintiff \$ 250,000 per year for 3 years in exchange for her agreement to first submit to defendant any picture she was interested in developing, which defendant could then accept or reject within 30 days. Second, defendant agreed to pay plaintiff \$ 750,000 for a "pay or play" directing deal, under which defendant could either "play" plaintiff by using her services, or pay her the fee. Defendant paid plaintiff the guaranteed compensation of \$ 1.5 million and provided her with an office and an administrative assistant, but it never developed any of her proposed projects or hired her to direct a film. Plaintiff alleged that the deal was a sham because defendant never intended to accept any of her proposals or to use her as a director. *Held*, summary judgment for defendant reversed.

(a) The trial court erred in deferring entirely to what it characterized as defendant's "creative decision" in the handling of the development deal. If defendant acted in bad faith by categorically rejecting plaintiff's work and refusing to work with her, irrespective of the merits of her proposals, that conduct was not beyond the reach of the law, even if fancy, taste, or judgment was involved. (57 C.A.4th 363, 364, quoting the text.)

(b) That defendant paid plaintiff the guaranteed compensation under the agreement did not establish fulfillment of its contractual obligation. The value in the development deal was not merely the guaranteed payments, but also the opportunity to direct and produce films and earn additional sums, and most importantly, the opportunity to promote and enhance a career. Defendant was entitled to reject plaintiff's work based on its subjective judgment, and its creative decision in that regard is not subject to being second-guessed by a court. However, subjective dissatisfaction must be an honestly held dissatisfaction, and the evidence raised a triable issue as to whether defendant breached its agreement by not considering plaintiff's proposals on their merits. (57 C.A.4th 364.)

(c) Defendant argued that the implied covenant of good faith and fair dealing was inapplicable because, under *Carma Developers (Calif.) v. Marathon Dev. Calif.* (1992) 2 C.4th 342, 374, 6 C.R.2d 467, 826 P.2d 710, *infra*, §797, the covenant may not be read to prohibit a party from doing that which is expressly permitted by an agreement. Here, however, the agreement did not give defendant the express right to refrain from working with plaintiff. Rather, it gave defendant discretion with respect to developing plaintiff's projects. The implied covenant of good faith and fair dealing obligated defendant to exercise that discretion honestly and in good faith. (57 C.A.4th 365, distinguishing *Third Story Music v. Waits* (1995) 41 C.A.4th 798, 803, 48 C.R.2d 747, *infra*, §797.)

SUPPLEMENT: [This section is current through the latest supplement]



101 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

C. Conditions and Covenants.

2. Conditions Precedent.

c. Performance to Satisfaction of Promisor.

2. Fancy, Taste, or Judgment.

bb. Satisfactory Services.

1 Witkin Sum. Cal. Law Contracts § 785

[§ 785] Satisfactory Services.

An employment contract comes within the class of contracts involving matters of fancy, taste, or judgment. (See *Tiffany v. Pacific Sewer Pipe Co.* (1919) 180 C. 700, 705, 182 P. 428 [plaintiff hired as expert maker of glazed brick].) But where the evidence shows *no bona fide dissatisfaction*, and the discharge is for other reasons, the employee can recover. (*Seifert v. Arnold Bros.* (1934) 138 C.A. 324, 326, 31 P.2d 1059; *Coats v. General Motors Corp.* (1934) 3 C.A.2d 340, 348, 39 P.2d 838; see 8 Corbin (Rev. ed.), §31.8; 13 Williston 4th, §38:22; 27 Am.Jur.2d (2004 ed.), *Employment Relationship* §36; 17A Am.Jur. P.P. Forms (2000 ed.), Master and Servant, §34 et seq.)

The drastic effect of a satisfaction clause was avoided by construction in *Crillo v. Curtola* (1949) 91 C.A.2d 263, 204 P.2d 941. A 2-year employment contract to manage a restaurant was evidenced by a letter from defendant employer, accepted by plaintiff employee. It contained the statement: "It is understood, of course, that you will devote the time necessary to perform your duties diligently to the advantage and satisfaction of The Curtola Company." Plaintiff was discharged, and dissatisfaction with his services, in good faith, was established. Nevertheless, the trial court gave judgment for damages for wrongful discharge, and the judgment was upheld. The court reasoned that (a) because plaintiff gave up a good position to accept this employment, it would be unreasonable to interpret the contract as authorizing the employer to discharge him at any time if dissatisfied; and therefore (b) the trial judge properly concluded, from admissible extrinsic evidence, that the term "satisfaction" referred simply to the time to be devoted to his duties, and not to the nature of his performance. The court was also influenced by a finding that the dissatisfaction, though in good faith, was a result of defendants' own acts of *prevention* (failure to give plaintiff the authority called for by his contract). "Obviously, justice requires that the contract should be interpreted, if reasonably possible, so as not to permit defendants to create the situation that gave rise to their dissatisfaction, refuse to remedy such situation, and then fire plaintiff because they were 'dissatisfied'." (91 C.A.2d 271.)

West's Key Number Digest, Contracts k.282-

SUPPLEMENT: [This section is current through the latest supplement]



102 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

C. Conditions and Covenants.

2. Conditions Precedent.

c. Performance to Satisfaction of Promisor.

2. Fancy, Taste, or Judgment.

cc. Satisfactory Lease.

1 Witkin Sum. Cal. Law Contracts § 786

[§ 786] Satisfactory Lease.

In *Mattei v. Hopper* (1958) 51 C.2d 119, 330 P.2d 625, plaintiff real estate developer agreed to purchase defendant's land for a shopping center. The contract provided that the balance of the price was payable in 120 days, "[s]ubject to [the realtor] obtaining leases satisfactory to the purchaser." Before the end of the period defendant repudiated, on the theory that plaintiff's promise, as limited by the satisfaction clause, was illusory and hence did not constitute consideration for defendant's promise. *Held*, the contract was enforceable. In its careful examination of the effect of a satisfaction clause, the court made this distinction:

(a) The category of operative fitness, mechanical utility, or commercial value, with its reasonable person (objective) standard cannot be applied to a clause requiring a lease satisfactory to the lessor, because the factors are too numerous and varied: "Illustrative of some of the factors which would have to be considered in this case are the duration of the leases, their provisions for renewal options, if any, their covenants and restrictions, the amounts of the rentals, the financial responsibility of the lessees, and the character of the lessees' businesses." (51 C.2d 123.)

(b) The category of fancy, taste, or judgment does apply, but the promisor cannot escape his obligation without showing dissatisfaction in good faith. Because plaintiff is bound to perform if leases satisfactory to him (in the exercise of an honest judgment) are obtained, his promise is not illusory and is good consideration for defendant's promise. (51 C.2d 124.) (See *Rodriguez v. Barnett* (1959) 52 C.2d 154, 160, 338 P.2d 907 [*Mattei* reasoning applied to contract to buy land with provision allowing purchasers to withdraw if dissatisfied with the governmental subdivision map]; 2 Corbin (Rev. ed.), §5.33; 8 Corbin (Rev. ed.), §31.6; 47 Cal. L. Rev. 753; 47 A.L.R.2d 455 [land sale contract with provision that title must be satisfactory to purchaser].)

SUPPLEMENT: [This section is current through the latest supplement]



103 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

C. Conditions and Covenants.

2. Conditions Precedent.

c. Performance to Satisfaction of Promisor.

3. Mechanical Utility or Operative Fitness.

aa. In General.

1 Witkin Sum. Cal. Law Contracts § 787

[§ 787] In General.

A different rule governs satisfaction clauses in contracts involving mechanical utility or operative fitness. In this class, it is sufficient if the performance would be satisfactory to a *reasonable person*. Typical examples are building contracts (*Bryan Elevator Co. v. Law* (1916) 31 C.A. 204, 215, 160 P. 170; *Bruner v. Hegyi* (1919) 42 C.A. 97, 99, 183 P. 369; 44 A.L.R.2d 1114 [provision in private building and construction contract requiring work to be done to owner's satisfaction]), and contracts to furnish machinery (*Petrotta v. Gerson* (1929) 98 C.A. 507, 513, 277 P. 167; *Jones-McLaughlin v. Kelly* (1929) 100 C.A. 315, 321, 279 P. 1076; *Lyon v. Giannoni* (1959) 168 C.A.2d 336, 339, 335 P.2d 690). (See generally *Weisz Trucking Co. v. Emil R. Wohl Const.* (1970) 13 C.A.3d 256, 262, 91 C.R. 489, *infra*, §788 [arbitrary repudiation not permitted]; *Kadner v. Shields* (1971) 20 C.A.3d 251, 259, 97 C.R. 742, *infra*, §788; 8 Corbin (Rev. ed.), §31.8; 13 Williston 4th, §38:24; 13 Am.Jur.2d (2000 ed.), *Building and Construction Contracts*, §33 et seq.; 17A Am.Jur.2d (2004 ed.), *Contracts* §628 et seq.; 65 Proof of Facts 3d 513 [limitations on right to reject contractor's work under "satisfaction" clause in building contract]; 7A Am.Jur. P.P. Forms (2002 ed.), *Contracts*, §55.)

SUPPLEMENT: [This section is current through the latest supplement]



104 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

C. Conditions and Covenants.

2. Conditions Precedent.

c. Performance to Satisfaction of Promisor.

3. Mechanical Utility or Operative Fitness.

bb. Commercial Factors.

1 *Witkin Sum. Cal. Law Contracts* § 788

[§ 788] Commercial Factors.

In *Melton v. Story* (1931) 113 C.A. 609, 612, 298 P. 1032, a provision in a contract that bonds were to be purchased only if the appraisal of the property was satisfactory to the purchaser was held to require only the satisfaction of a reasonable person. And where an insurance policy provides for reinstatement after default, upon furnishing "satisfactory evidence" of insurability, evidence satisfactory to a *reasonable insurer* is all that is required. (*Kennedy v. Occidental Life Ins. Co.* (1941) 18 C.2d 627, 634, 117 P.2d 3 [disapproving contrary statement in *Greenberg v. Continental Cas. Co.* (1938) 24 C.A.2d 506, 515, 75 P.2d 644]; see *Collins v. Vickter Manor* (1957) 47 C.2d 875, 882, 306 P.2d 783 ["Seller to furnish satisfactory soil compaction report" on building site]; *Ryman v. American Nat. Ins. Co.* (1971) 5 C.3d 620, 634, 96 C.R. 728, 488 P.2d 32 [following *Kennedy*].)

In *Weisz Trucking Co. v. Emil R. Wohl Const.* (1970) 13 C.A.3d 256, 91 C.R. 489, defendant contractor contracted with plaintiff subcontractor for construction work. The subcontract required plaintiff to furnish a bond "in a form and by a company acceptable to the Contractor." Plaintiff furnished a bond that defendant said was unacceptable because of the financial rating of the surety company. Defendant then terminated the subcontract and plaintiff sued. The evidence on the financial condition of the surety was conflicting. The trial judge denied plaintiff's request for specific findings on whether defendant acted in good faith and reasonably, concluded that the satisfaction condition had not been performed, and gave judgment for defendant. *Held*, reversed. The court found no authority directly in point, but was persuaded by cases involving workers' skills and insurability to apply the standard of reasonableness. (13 C.A.3d 263.) Because the evidence was conflicting, the reversal was for the purpose of permitting the lower court to make a finding on that issue.

This issue was reexamined and clarified in *Kadner v. Shields* (1971) 20 C.A.3d 251, 97 C.R. 742. Plaintiff purchasers contracted to buy a new home from defendant vendor for \$ 225,000. The contract was contained in escrow instructions with U.C.B. as escrow agent. The instructions called for the purchasers' assumption of a \$ 124,000 note and first deed of trust to Home Savings and Loan Assn., and a \$ 30,000 note and second deed of trust to defendant vendor for the balance. They also contained the following clause added by the purchasers' attorney: "The terms and conditions of the existing first encumbrance are subject to the written approval of the buyer within seven days after a copy thereof is delivered to the buyer." Plaintiffs deposited \$ 10,000 of the required \$ 71,000 down payment; but, on receipt of the

note and deed of trust they wrote U.C.B. stating their disapproval of two provisions: (a) an acceleration clause on default in performance, and (b) a prepayment penalty clause calling for additional interest. They then made a demand for return of their deposit, which defendant vendor refused. Two months after making of the original contract, plaintiffs purchased a \$ 165,000 house with a smaller down payment, smaller monthly payments, and a smaller note and deed of trust containing identical default-acceleration and prepayment-penalty interest clauses. Then they sued for a declaratory judgment of rescission and defendant vendor cross-complained for damages for breach. The trial judge applied the subjective individual judgment test and found good faith dissatisfaction. *Held*, judgment for plaintiffs reversed.

(a) *Satisfaction clause as condition precedent*. There was no express language to the effect that the agreement was contingent on the purchasers' approval. Accordingly, defendant vendor contended that it was not a condition precedent, and that the clause merely gave the purchasers the election to reject the Home deed of trust and find other financing. However, the language and the surrounding circumstances justified the conclusion that a condition precedent to the existence of the contract was created. (20 C.A.3d 258.)

(b) *Tests of dissatisfaction*. There is no clear line of demarcation between the two tests; the difference is one of degree. As Williston says, "in most cases, it is out of the question to decide upon which side of the line a given case falls until the highest court has passed upon the case." And Corbin observes that, although the classification is "serviceable," "there are many cases in which it renders no service whatever." (20 C.A.3d 259.)

(c) *Objective standard preferred*. In the absence of explicit statement, the law prefers the less arbitrary standard of the reasonable man. (20 C.A.3d 263, citing Williston, Corbin and the Restatement, and criticizing the contrary law of *Van Demark v. California Home Extension Assn.* (1919) 43 C.A. 685, 185 P. 866, supra, §784.) And where "factors of commercial value or factors of financial concern are involved" the objective test is generally applied. (20 C.A.3d 264.)

(d) *Objective standard applied*. The two clauses of the deed of trust must be looked at not in isolation but in their transactional setting: "They are in a security device which is one of a number issued by a major financing entity supplying the funds for the development of a tract of luxury homes. Such security device is, in a sense, akin to a product put out by a large concern which is an integral part of a transaction entered into by the litigating parties. It is not the original negotiation of a personality tailored security arrangement." (20 C.A.3d 267.) So viewed, there is nothing of personal taste involved, but only "a matter of commercial practice and competitive action among the large financing institutions." (20 C.A.3d 267, 268.)

(e) *Burden of proof*. Normally the burden of proof is on the party who seeks to enforce the other party's duty of performance, and on that theory the vendor would have to prove the occurrence of the condition precedent (reasonable man's satisfaction). (20 C.A.3d 268.) The vendor's argument that this is not a typical condition precedent over which he has control, and that the burden should be on the purchaser to prove dissatisfaction, is unsupported by authority. (20 C.A.3d 270.)

(f) *Burden of going forward*. The initial burden, however, should shift to the purchaser on a prima facie showing by the vendor of the unreasonableness of the dissatisfaction. (20 C.A.3d 271.) And defendant vendor met that burden. He did not offer the most persuasive evidence, i.e., the general practice of loan companies to insist on these standard provisions. (20 C.A.3d 271.) But he did show that a reasonable person would have accepted these common clauses; that the deed of trust involved in their new purchase contained the same clauses; and that the instrument that they disapproved also contained a due-on-sale clause, to which they did not object. "If this is not unreasonable, there is a good basis for saying that the default-acceleration clause is not unreasonable." (20 C.A.3d 271.)

In *Guntert v. Stockton* (1974) 43 C.A.3d 203, 117 C.R. 601, plaintiff leased waterfront business property from defendant city. The lease contained a clause permitting termination by the city lessor on 18 months' notice, if the city "received and agreed to accept a bona fide offer or proposal to develop the demised premises." The clause further stated: "The determination as to the validity of said offer or proposal and the economic feasibility and the ability to adequately finance said development shall be at the sole discretion of said City Council." The city accepted an offer

from C Land Co. and gave notice of termination. *Held*, plaintiff was entitled to an injunction against termination.

(a) The trial judge correctly construed the contract, in the light of extrinsic evidence of the preliminary negotiations, as calling for the objective "reasonable man" standard in passing on acceptability of a development proposal. (43 C.A.3d 211, 213.) The "sole discretion" language does not necessarily imply arbitrary power. (43 C.A.3d 213.)

(b) The evidence supported the finding of unreasonableness in the city's action: C Land Co. had misrepresented its ability to obtain financing; the city manager believed that it did not have such ability; and neither the city nor the city manager made any inquiry into the feasibility of the proposal. (43 C.A.3d 210.) These findings, supported by the evidence, justified the conclusion that the city's action was unreasonable and arbitrary. (43 C.A.3d 216.)

West's Key Number Digest, Contracts k.282

SUPPLEMENT: [This section is current through the latest supplement]



105 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

C. Conditions and Covenants.

2. Conditions Precedent.

c. Performance to Satisfaction of Promisor.

3. Mechanical Utility or Operative Fitness.

cc. Explicit Satisfaction Clause.

1 Witkin Sum. Cal. Law Contracts § 789

[§ 789] Explicit Satisfaction Clause.

Most authorities agree that, even in contracts involving only mechanical utility, a provision that clearly calls for performance to the satisfaction of the promisor is enforceable; in other words, that the entire distinction may be avoided by sufficiently emphatic and unequivocal language in the contract. (See *Tiffany v. Pacific Sewer Pipe Co.* (1919) 180 C. 700, 702, 182 P. 428; *Van Demark v. California Home Extension Assn.* (1919) 43 C.A. 685, 689, 185 P. 866, supra, §784; *Hall v. Webb* (1924) 66 C.A. 416, 422, 226 P. 403, supra, §784; *Kadner v. Shields* (1971) 20 C.A.3d 251, 262, 97 C.R. 742, supra, §788; *Rest.2d, Contracts* §228, Comments a, b; 8 Corbin (Rev. ed.), §§31.6, 31.8; 13 Williston 4th, §38:24.)

SUPPLEMENT: [This section is current through the latest supplement]



106 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

C. Conditions and Covenants.

2. Conditions Precedent.

c. Performance to Satisfaction of Promisor.

4. Rejection of Condition Terminates Contract.

1 Witkin Sum. Cal. Law Contracts § 790

[§ 790] Rejection of Condition Terminates Contract.

In *Beverly Way Associates v. Barham* (1990) 226 C.A.3d 49, 276 C.R. 240, plaintiff buyer contracted to buy real property from defendant seller. The contract contained a provision entitled "Approval by Buyer of Inspection and Documents," stating that the buyer had 28 business days after receipt of specified papers, including a certified survey of the property, to inspect and approve them as a condition of his obligation to close escrow. Defendant furnished the papers, and within the 28-day period plaintiff wrote a letter to defendant rejecting the land survey, mainly on the ground that an electrical room constructed on one of the garage parking spaces reduced these spaces to a number below that shown on the tract map. Later, however, the buyer informed the seller that it waived its objections and was ready to proceed to close escrow. *Held*, rejection of the "satisfaction" condition precedent terminated the contract.

(a) "Under the California rule, the holder of a formal option loses the right to exercise it once it has communicated a formal rejection, and this is so even though the purported exercise occurs within the time specified in the option agreement." (226 C.A.3d 55, citing *Landberg v. Landberg* (1972) 24 C.A.3d 742, 101 C.R. 335, *supra*, §170.) "If anything, the situation of a party who has a power to approve or disapprove a condition precedent and also exercises it by disapproval, presents an a fortiori case." (226 C.A.3d 55.)

(b) "Except for the judicial gloss that the power of rejection must be exercised reasonably, the party having the power to approve or reject is in the same position as a contract offeree. It is hornbook law that an unequivocal rejection by an offeree, communicated to the offeror, terminates the offer; even if the offeror does no further act, the offeree cannot later purport to accept the offer and thereby create enforceable contractual rights against the offeror." (226 C.A.3d 55, citing the text.)

(c) Hence, the buyer's rejection of the survey, communicated to the seller, terminated the contract and left the buyer with no power to create obligations against the seller by a later waiver of its objections and acceptance of the proffered documentation. (226 C.A.3d 56.)

SUPPLEMENT: [This section is current through the latest supplement]



107 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

C. Conditions and Covenants.

2. Conditions Precedent.

d. Event as Condition.

1 *Witkin Sum. Cal. Law Contracts* § 791

[§ 791] Event as Condition.

The following are examples of events as conditions precedent:

(1) An obligation to pay money from funds to accrue from a certain source, e.g., the net profits of a business, is conditioned upon the making of profits. (*Lynch v. Keystone Consol. Mining Co.* (1912) 163 C. 690, 697, 126 P. 968; *Parsons v. Bristol Dev. Co.* (1965) 62 C.2d 861, 868, 44 C.R. 767, 402 P.2d 839; *Carpenter v. Elmer R. Sly Co.* (1930) 109 C.A. 539, 546, 293 P. 162; *Martin v. Martin* (1935) 5 C.A.2d 591, 593, 43 P.2d 314; *Draper v. Patterson* (1958) 156 C.A.2d 606, 608, 319 P.2d 694; *Jeschke v. Lamarr* (1965) 234 C.A.2d 506, 511, 44 C.R. 416; see 8 Corbin (Rev. ed.), §30.15; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §482; 3 *Cal. Proc.* (4th), *Actions*, §494.)

(2) A promise to pay a sum "when able" is conditioned upon ability to pay. (*Van Buskirk v. Kuhns* (1913) 164 C. 472, 474, 129 P. 587; *Horacek v. Smith* (1948) 33 C.2d 186, 191, 199 P.2d 929; *Maurer v. Bernardo* (1931) 118 C.A. 290, 294, 5 P.2d 36; 8 Corbin (Rev. ed.), §31.3; 4 *Williston* 4th, §8:32; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §485; 3 *Cal. Proc.* (4th), *Actions*, §494.)

(3) Entitlement to vacation, under a collective bargaining agreement, is conditioned upon active employment with the company on a certain date. (*Division of Labor Law Enforcement v. Standard Coil Products Co.* (1955) 136 C.A.2d Supp. 919, 923, 288 P.2d 637.)

(4) The right to compensation may be conditioned on some event. Thus, in *Van Norden v. Metson* (1946) 75 C.A.2d 595, 171 P.2d 485, a contract provided for a special additional percentage fee to an engineer preparing a case for arbitration, payable "after the arbitration is completed." Through no fault of the engineer, the contemplated arbitration never took place, and the claim was successfully prosecuted by action. *Held*, because the event (arbitration) did not occur, the special fee was not recoverable. (75 C.A.2d 598.) (See *Peterson v. Montgomery Holding Co.* (1949) 89 C.A.2d 890, 893, 202 P.2d 365 [real estate broker's authorization to obtain tenant for future building on defendant's property; provision that commission payable when owner executed contract for construction of the building]; *Cochran v. Ellsworth* (1954) 126 C.A.2d 429, 439, 272 P.2d 904 [real estate broker's authorization to sell, commission payable "in the event of consummation of the sale," first payment "at the close of escrow"].)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Obligation to pay money from certain source:*

Cross-Reference: 3 *Cal. Proc.* (5th), *Actions*, §531.

(2) *Promise to pay:*

Cross-Reference: 3 *Cal. Proc.* (5th), *Actions*, §531.



108 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XIII. PERFORMANCE
C. Conditions and Covenants.
3. Conditions Concurrent.

1 Witkin Sum. Cal. Law Contracts § 792

[§ 792] Conditions Concurrent.

(1) *In General.* Conditions concurrent are conditions precedent that are mutually dependent, and are to be performed at the same time. (C.C. 1437; see C.C. 1439, 1498; 8 Corbin (Rev. ed.), §§30.8, 32.4; 13 Williston 4th, §38:8; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §459; 69 Proof of Facts 3d 99 [real estate purchaser not ready, willing, and able to make payment due at closing].)

In the ordinary contract for the sale of real property, delivery of the deed and payment of the purchase price or last installation thereon are concurrent conditions, and there must be performance or *tender* thereof by one party to put the other in default. (*Griesemer v. Hammond* (1912) 18 C.A. 535, 538, 123 P. 818; *Monnette v. Title Guarantee & Trust Co.* (1939) 30 C.A.2d 428, 433, 86 P.2d 848; *Caspar Lumber Co. v. Stowell* (1940) 37 C.A.2d 58, 61, 98 P.2d 744; *Lifton v. Harshman* (1947) 80 C.A.2d 422, 433, 182 P.2d 222; *Brant v. Bigler* (1949) 92 C.A.2d 730, 733, 208 P.2d 47; *Lamont v. Ball* (1949) 93 C.A.2d 291, 293, 209 P.2d 9; *Thein v. Sticha* (1949) 93 C.A.2d 295, 300, 209 P.2d 13; *Katemis v. Westerlind* (1953) 120 C.A.2d 537, 545, 261 P.2d 553; *Groobman v. Kirk* (1958) 159 C.A.2d 117, 123, 323 P.2d 867; *Diamond v. Huenergardt* (1959) 175 C.A.2d 214, 220, 346 P.2d 37 [obligation of purchaser to deposit money and seller to deposit instruments in escrow]; cf. *Callisch v. Farnham* (1948) 83 C.A.2d 427, 431, 188 P.2d 775 [option to purchase land, provision that vendor should have 90 days after purchaser's election in which to perfect title; held, delivery of deed clearly not condition concurrent with exercise of option]; see 77 *Am.Jur.2d* (1997 ed.), *Vendor and Purchaser* §§75, 76, 77.)

The same is true of delivery of goods and payment of the price in sales of personal property. (U.C.C. 2507, 2511; see 4 *Summary* (10th), *Sales*, §155; cf. *Patty v. Berryman* (1949) 95 C.A.2d 159, 169, 212 P.2d 937 [where buyer knows seller merely has right to acquire goods, seller allowed reasonable time after buyer's payment to acquire them].)

Thus, the only important difference between a concurrent condition and a condition precedent is that the condition precedent must happen or be performed before the other duty arises, while a *tender* of performance is sufficient in the case of a condition concurrent. (See *Groobman v. Kirk*, *supra*, 159 C.A.2d 123.)

(2) *Failure of Both Parties To Perform.* In *Pittman v. Canham* (1992) 2 C.A.4th 556, 3 C.R.2d 340, plaintiff contracted to buy real estate from defendant for \$ 250,000. By a designated date, plaintiff was to deposit in escrow a specified sum of money, a note, and a deed of trust; and defendant was to deposit therein a recorded deed. Although

both the contract and escrow instructions provided that time was of the essence, as of the closing date neither party had tendered the required performance. Approximately 5 months later, defendant, ignoring plaintiff's demand for performance, sold the property to another person for \$ 600,000, and plaintiff sued for breach of contract. *Held*, judgment for defendant affirmed.

(a) Plaintiff argued that a failure of both contracting parties to perform concurrent conditions does not automatically terminate the contract, but rather that one party must tender performance before the other party is in default. This is incorrect. "The failure of both parties to perform concurrent conditions during the time for performance results in a discharge of both parties' duty to perform. Thus, where the parties have made time the essence of the contract, at the expiration of time without tender by either party, both parties are discharged." (2 C.A.4th 559.) This was the case here, and hence neither party could hold the other in default and no cause of action to enforce the contract ever arose. (2 C.A.4th 560.)

(b) The same paragraph of the escrow instructions making time of the essence also directed the escrow holder, if closing did not occur on the closing date and no demand for cancellation was made, to close the escrow when the parties had complied with the instructions. This provision merely instructed the escrow holder not to cancel escrow on its own initiative, but to close only if the parties voluntarily and mutually decided to perform. Construing the provision as giving either party the unilateral right to demand performance after the time for performance had passed would render meaningless the parties' agreement that time was of the essence. (2 C.A.4th 560.) (See *Pittman, Ninety Nine Investments, Ltd. v. Overseas Courier Service (Singapore) Private, Ltd.* (2003) 113 C.A.4th 1118, 1134, 6 C.R.3d 891 [under facts, seller was required to fulfill escrow obligations *before* buyer's was required to deposit funds]; *Galdjie v. Darwish* (2003) 113 C.A.4th 1331, 1340, 7 C.R.3d 178, quoting the text [failure of either party to perform on closing date did not discharge contract, because seller waived time provision and buyer's failure to later tender loan funds was due to seller's failure to place termite report in escrow].)

West's Key Number Digest, Contracts k.225

SUPPLEMENT: [This section is current through the latest supplement]

(1) *In General.* See 77 Am.Jur.2d (2006 ed.), *Vendor and Purchaser* §62 et seq.



109 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XIII. PERFORMANCE
C. Conditions and Covenants.
4. Conditions Subsequent.

1 Witkin Sum. Cal. Law Contracts § 793

[§ 793] Conditions Subsequent.

A condition subsequent is one referring to a future event, upon the happening of which the obligation of the other party ceases. (C.C. 1438; see 8 Corbin (Rev. ed.), §§30.7, 39.1 et seq.; 13 Williston 4th, §38:9; 17A Am.Jur.2d (2004 ed.), Contracts §464.) This type of condition is unusual, and frequently a condition subsequent in form may be interpreted as precedent in fact. (See 8 Corbin (Rev. ed.), §§30.7, 39.1 et seq.; 13 Williston 4th, §38:9; 17A Am.Jur.2d (2004 ed.), Contracts §464.) (On ineffectiveness of oral conditions subsequent under parol evidence rule, see *Fontana v. Upp* (1954) 128 C.A.2d 205, 208, 275 P.2d 164; 2 Cal. Evidence (4th), Documentary Evidence, §105; on provisions cutting down the period of limitation, and notice of claim clauses, see *supra*, §679.)

The following are illustrations of provisions construed to be conditions subsequent:

- (1) An inventor owned patent rights that he agreed to transfer to a corporation with the provision that it should manufacture and sell at least 5,000 of the products each year, and, upon failure to do so, the rights should be reassigned. (*Lowe v. Copeland* (1932) 125 C.A. 315, 321, 13 P.2d 522.)
- (2) A purchaser of land signed a note for the balance of the price, with the provision that its payment was dependent upon performance by the vendor of a separate agreement, under which the vendor was to cultivate, plant, and care for the land for 6 years. (*Ebbert v. Mercantile Trust Co. of Calif.* (1931) 213 C. 496, 501, 2 P.2d 776.)
- (3) An employment contract for a definite period was made terminable upon sale of the employer's business or the employee's entry into military service. (*Hartman v. San Pedro Commercial Co.* (1944) 66 C.A.2d 935, 936, 153 P.2d 212.)
- (4) Operation of a municipal electric system was made terminable if the utility corporation established or maintained for a designated period electric rates higher than those charged by a municipally owned electric system in a neighboring city. (*Vernon v. Southern Calif. Edison Co.* (1961) 191 C.A.2d 378, 387, 12 C.R. 701.)
- (5) A member of a charitable corporation providing homes for retired persons deposited his funds with the corporation; the member agreed that in the event of his death, the balance of his account would be paid to the Endowment Fund of the corporation. (*Symmonds v. Pacific Homes* (1964) 224 C.A.2d 507, 511, 36 C.R. 725, 14

Summary (10th), *Wills and Probate*, §106.)

(6) An employment contract required that the employee obtain a security clearance prior to commencement of work. (*Reynolds Elec. & Engineering Co. v. Work. Comp. App. Bd.* (1966) 65 C.2d 429, 434, 55 C.R. 248, 421 P.2d 96, 2 *Summary* (10th), *Workers' Compensation*, §112; *Chicago Bridge & Iron Co. v. Industrial Acc. Com.* (1964) 226 C.A.2d 309, 317, 38 C.R. 57, 2 *Summary* (10th), *Workers' Compensation*, §112.)

(7) A stipulated settlement of a disciplinary action between a dentist and the executive director of the Board of Dental Examiners, effective upon acceptance by the dentist, was to be of no force and effect should the board fail or refuse to adopt the stipulation when submitted to the board for consideration. (*Frankel v. Board of Dental Examiners* (1996) 46 C.A.4th 534, 550, 54 C.R.2d 128, citing the text.)

In *Ransom v. Penn Mut. Life Ins. Co.* (1954) 43 C.2d 420, 274 P.2d 633, decedent applied for life insurance and paid the first premium in full. While an additional medical examination was pending, he was killed. Defendant insurer denied liability, relying on a clause that stated, in substance, that if the first premium was paid the insurance should be in force, provided that the company was satisfied of the insured's acceptability at the date of the application, and that if not so satisfied, no insurance should be in force until delivery of the policy. The company contended that acceptability was a condition precedent to the existence of the contract. But the court held that the ambiguous clause, reasonably and fairly construed, was a condition subsequent; i.e., a contract of insurance arose on payment of the premium, subject to termination upon dissatisfaction with the risk. "There is an obvious advantage to the company in obtaining payment of the premium when the application is made, and it would be unconscionable to permit the company, after using language to induce payment of the premium at that time, to escape the obligation which an ordinary applicant would reasonably believe had been undertaken by the insurer." (43 C.2d 425.) (See *Thompson v. Occidental Life Ins. Co.* (1973) 9 C.3d 904, 911, 109 C.R. 473, 513 P.2d 353 [following *Ransom*]; *Brunt v. Occidental Life Ins. Co. of Calif.* (1963) 223 C.A.2d 179, 183, 35 C.R. 492 [same].)

SUPPLEMENT: [This section is current through the latest supplement]



110 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

C. Conditions and Covenants.

5. Implied Conditions and Covenants.

a. In General.

1. Nature and Purpose.

1 Witkin Sum. Cal. Law Contracts § 794

[§ 794] Nature and Purpose.

"Stipulations which are necessary to make a contract *reasonable*, or conformable to *usage*, are implied, in respect to matters concerning which the contract manifests no contrary intention." (C.C. 1655.) "All things that in law or usage are considered as *incidental* to a contract, or as *necessary to carry it into effect*, are implied therefrom, unless some of them are expressly mentioned therein, when all other things of the same class are deemed to be excluded." (C.C. 1656.) (See *Farmers & Merchants' Nat. Bank of Los Angeles v. Bailie* (1934) 138 C.A. 143, 149, 32 P.2d 157; *Mainieri v. Magnuson* (1954) 126 C.A.2d 426, 429, 272 P.2d 557; 8 Corbin (Rev. ed.), §30.10; 13 Williston 4th, §38:11; 15 Williston 4th, §48:1 et seq.; 17A Am.Jur.2d (2004 ed.), Contracts §368; 20 Am.Jur.2d (1995 ed.), Covenants, Conditions, and Restrictions §29; 29 U.C. Davis L. Rev. 971 [implied obligations in contractual relations between student-athletes and colleges].)

SUPPLEMENT: [This section is current through the latest supplement]
See 20 Am.Jur.2d (2005 ed.), Covenants, Conditions, and Restrictions §36 et seq.



111 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

C. Conditions and Covenants.

5. Implied Conditions and Covenants.

a. In General.

2. Strict Test.

1 Witkin Sum. Cal. Law Contracts § 795

[§ 795] Strict Test.

It has been said that implied conditions and covenants are *not favored*: "(1) the implication must arise from the language used or it must be indispensable to effectuate the intention of the parties; (2) it must appear from the language used that it was so clearly within the contemplation of the parties that they deemed it unnecessary to express it; (3) implied covenants can only be justified on the grounds of legal necessity; (4) a promise can be implied only where it can be rightfully assumed that it would have been made if attention had been called to it; (5) there can be no implied covenant where the subject is completely covered by the contract." (*Cousins Inv. Co. v. Hastings Clothing Co.* (1941) 45 C.A.2d 141, 149, 113 P.2d 878.)

A similar view was expressed in *Walnut Creek Pipe Distributors v. Gates Rubber Co. Sales Div.* (1964) 228 C.A.2d 810, 815, 39 C.R. 767: "The courts cannot make better agreements for parties than they themselves have been satisfied to enter into or rewrite contracts because they operate harshly or inequitably. It is not enough to say that without the proposed implied covenant, the contract would be improvident or unwise or would operate unjustly. Parties have the right to make such agreements. The law refuses to read into contracts anything by way of implication except upon grounds of obvious necessity." (See *Stockton Dry Goods Co. v. Girsh* (1951) 36 C.2d 677, 680, 227 P.2d 1; *Lippman v. Sears, Roebuck & Co.* (1955) 44 C.2d 136, 142, 280 P.2d 775, *infra*, §806; *Cabana Nutria v. The Way* (1958) 163 C.A.2d 485, 487, 329 P.2d 590; *Hinckley v. Bechtel Corp.* (1974) 41 C.A.3d 206, 211, 116 C.R. 33; *Kessler v. General Cable Corp.* (1979) 92 C.A.3d 531, 541, 155 C.R. 94, citing the text; *Pacific Gas & Elec. Co. v. Superior Court* (1993) 15 C.A.4th 576, 609, 19 C.R.2d 295 [where gas purchase contract provided for minimum payments even if no gas was purchased, there was no implied covenant obligating purchaser to take enough gas to avoid damage to the wells]; *Ben-Zvi v. Edmar Co.* (1995) 40 C.A.4th 468, 473, 47 C.R.2d 12, 3 *Summary* (10th), *Agency and Employment*, §204 [no implied covenant in contract giving exclusive distribution rights in Israel for product manufactured in California that distributor was required to reside in Israel]; *Third Story Music v. Waits* (1995) 41 C.A.4th 798, 804, 48 C.R.2d 747, *infra*, §797 [unnecessary to imply covenant of good faith to protect enforceability of contract or otherwise to effectuate clear and obvious intent of parties]; 21 *So. Cal. L. Rev.* 36 [rule applicable to government contracts]; *infra*, §976 et seq.)

In *Walnut Creek*, plaintiff, by a written contract terminable on 30 days' notice by either party, became a distributor of defendant's products. After several years, defendant exercised its right to cancel. Plaintiff had on hand a large amount

of plastic pipe purchased because of a strike, and contended that defendant was bound by an implied covenant to repurchase or give credit for this unused stock on hand. *Held*, judgment for plaintiff reversed. The court followed *Cousins Inv. Co. and Stockton Dry Goods Co., supra*, and distinguished *Milton v. Hudson Sales Corp. (1957) 152 C.A.2d 418, 313 P.2d 936*, *infra*, §805, on the ground that there, because of the dealer's expected investment in organization, the manufacturer's implied promise was legally necessary to prevent frustration of the contractual purpose. (228 C.A.2d 816.) Here, the exercise of the right of cancellation by either party could be substantially detrimental to the other, and the possibility of loss in disposition of the merchandise was a risk assumed by plaintiff. (228 C.A.2d 817.) And the implied covenant of fair dealing was inapplicable because there was no finding of bad faith or unfairness. (228 C.A.2d 817.) (See *Cherry v. Home Savings & Loan Assn. (1969) 276 C.A.2d 574, 580, 81 C.R. 135*, quoting *Walnut Creek* and citing the text.)

West's Key Number Digest, Contracts k.168

SUPPLEMENT: [This section is current through the latest supplement]



112 of 184 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law
XIII. PERFORMANCE
C. Conditions and Covenants.
5. Implied Conditions and Covenants.
a. In General.
3. Liberal Test.

1 Witkin Sum. Cal. Law Contracts § 796

[§ 796] Liberal Test.

The conventional view of *Cousins Inv. Co. v. Hastings Clothing Co. (1941) 45 C.A.2d 141, 149, 113 P.2d 878*, and similar cases, *supra*, §795, was recognized in *Addiego v. Hill (1965) 238 C.A.2d 842, 48 C.R. 240*, but the court also proceeded to declare and follow a far more liberal rule: "The modern trend of the law is to favor the enforcement of contracts and, if feasible, to carry out the intentions of the parties. Neither law nor equity requires that every term and condition be set forth in a contract. The usual and reasonable terms found in similar contracts may be considered, unexpressed provisions of the contract may be inferred from the writing, external facts may be relied upon, and custom and usage may be resorted to in an effort to supply a deficiency if it does not alter or vary the terms of the agreement." (*238 C.A.2d 846.*)

The facts, which the court characterized as "a classic situation" for implying a covenant, involved a preemption agreement by shareholders in a close corporation, giving the other shareholders a prior right to purchase shares "on the same terms" as any outside purchaser. Defendants negotiated with J to sell their shares for \$ 125,000, payable by J's transfer of his equity of \$ 105,000 in an undertaking business, and a 2-year 6% note for the balance. Plaintiffs offered \$ 125,000 in cash. *Held*, a literal interpretation would permit frustration of the object of any preemption agreement by a capricious offer; hence the "same terms" phrase "can, in good conscience, only mean that where an offer to purchase is made by a third party in terms of a unique interest or commodity, an offer of the cash equivalent by an original incorporator is acceptable." (*238 C.A.2d 847.*) (See *Yuba v. Central Valley Nat. Bank (1971) 20 C.A.3d 109, 113, 97 C.R. 369*, citing the text [implied to avoid forfeiture]; *Frankel v. Board of Dental Examiners (1996) 46 C.A.4th 534, 545, 54 C.R.2d 128* [implication in stipulated settlement of disciplinary action between dentist and Board of Dental Examiners' executive director that parties agreed to submit stipulation to board for consideration and to give board reasonable time to act on it was fairly drawn from stipulation and parties' correspondence concerning it; quoting *Addiego*].)

In *Walker v. Occidental Life Ins. Co. (1967) 67 C.2d 518, 63 C.R. 45, 432 P.2d 741*, W, an employee, had a group insurance policy issued in 1936. It contained a required provision (*Ins.C. 10209*) that it could be converted to an individual policy within 31 days after termination of employment. W was suspended from his job in April 1961, termination for cause was later announced by his employer, and negotiations ended in a settlement in November. When

he sought to exercise his conversion option, the insurer notified him that the 31-day period had expired. After his death, plaintiff widow sued to enforce the policy. *Held*, judgment for defendant insurer reversed. The conversion option was a valuable property right, and it would be of dubious value if the employee were not entitled to notification of termination of his employment. Hence, the duty of the insurer to give timely notice should be implied, to make the contract "reasonable" (C.C. 1655). (67 C.2d 523.) (See *Hinckley v. Bechtel Corp.* (1974) 41 C.A.3d 206, 213, 116 C.R. 33 [distinguishing *Walker* on ground that employee was not in doubt as to termination date].)

SUPPLEMENT: [This section is current through the latest supplement]



113 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

C. Conditions and Covenants.

5. Implied Conditions and Covenants.

a. In General.

4. Effect of Express Covenant.

1 Witkin Sum. Cal. Law Contracts § 797

[§ 797] Effect of Express Covenant.

A covenant will not be implied against express terms or to supply a term on a matter as to which the contract is intentionally silent. (*Foley v. Euless* (1931) 214 C. 506, 511, 6 P.2d 956; *Tanner v. Title Ins. & Trust Co.* (1942) 20 C.2d 814, 824, 129 P.2d 383; *Taylor v. National Supply Co. of Calif.* (1936) 12 C.A.2d 557, 563, 56 P.2d 263.) As stated in *Carma Developers (Calif.) v. Marathon Dev. Calif.* (1992) 2 C.4th 342, 374, 6 C.R.2d 467, 826 P.2d 710: "We are aware of no reported case in which a court has held the covenant of good faith may be read to prohibit a party from doing that which is expressly permitted by an agreement. On the contrary, as a general matter, implied terms should never be read to vary express terms." (See *Third Story Music v. Waits* (1995) 41 C.A.4th 798, 803, 48 C.R.2d 747 [quoting *Carma Developers*].)

Implied covenants may, however, coexist with express covenants where they relate to different subjects. In *Hartman Ranch Co. v. Associated Oil Co.* (1937) 10 C.2d 232, 73 P.2d 1163, an oil lease required drilling of one well each year. Defendant sublessee assumed its obligations and performed this express covenant, but also drilled on adjoining property, draining oil from the land of plaintiff lessor. *Held*, defendant was liable for breach of implied covenant. Covenants are ordinarily implied to use reasonable diligence to explore and discover oil, and thereafter to protect from drainage by adjacent wells. Unless clearly so intended, express covenants as to *development* (e.g., to drill a specific number of wells) do not negative the implied covenant to drill additional wells to protect the land from drainage. (10 C.2d 240.) But leaving open the question whether this duty would exist to protect from drilling, the covenant should certainly be implied where the drainage is by acts of the defendant on other land. (10 C.2d 241.)

In *Storek & Storek v. Citicorp Real Estate* (2002) 100 C.A.4th 44, 122 C.R.2d 267, plaintiffs, investors in a real estate development project, entered into an agreement whereby defendant lender would supply funds to complete the project. However, the agreement provided that defendant was obligated to make disbursements only if the project budget was "in balance," i.e., the undisbursed amount of the loan was not less than the amount required to pay all expenses in connection with completion of the construction improvements. To assist defendant in making this determination, the agreement also provided that plaintiffs were required to submit along with its monthly requests for disbursements a current project budget and evidence satisfactory to defendant that the leasing criteria had been met. When defendant quit making disbursements, plaintiffs sued on several causes of action, including breach of contract and

breach of the implied covenant of good faith and fair dealing. The first trial ended in a hung jury, and thereafter plaintiffs dismissed the cause for breach of the express terms of the loan agreement. In the second trial, which was brought only for breach of the implied covenant, the jury was instructed that defendant's determination whether the project budget was in balance should be evaluated for both reasonableness and good faith. Judgment was for plaintiffs. *Held*, reversed; the "good faith" portion of the aforementioned instruction was erroneous.

(a) Every contract imposes upon each party a duty of good faith and fair dealing in the performance of the contract such that neither party can do anything that will have the effect of destroying or injuring the right of the other party to receive the fruits of the contract. However, the California Supreme Court has clarified that an implied covenant of good faith and fair dealing cannot contradict the express terms of a contract. Thus, the parties may, by express provisions of the contract, grant the right to engage in the very acts and conduct that would otherwise have been forbidden by an implied covenant of good faith and fair dealing. This principle means that if, by the express provisions of the contract, the defendant was given the right to do what it did, there can be no breach. (100 C.A.4th 55, citing *Carma Developers*.)

(b) When a party is given absolute discretion by express contract language, the courts will imply a covenant of good faith and fair dealing to limit that discretion in order to create a binding contract and avoid a finding that the promise is illusory. However, when the contract is supported by adequate consideration regardless of the discretionary power, there is no need to impose a covenant of good faith in order to create mutuality. Thus, the courts are not at liberty to imply a covenant directly at odds with a contract's express grant of discretionary power except in those relatively rare instances when reading the provision literally would, contrary to the parties' clear intention, result in an unenforceable, illusory agreement. (100 C.A.4th 57, citing *Third Story Music v. Waits*.)

(c) Defendant contended that *Carma Developers* and *Third Story Music* are controlling, because defendant, too, had absolute discretion under the loan agreement to refrain from making loan disbursements. This contention is inaccurate. Under the plain language of the loan agreement, defendant's obligation to make the loan disbursements was not *discretionary*; defendant's obligation was *conditional* upon the fulfillment of a *condition precedent*, namely, defendant's satisfaction that the project budget was in balance. (100 C.A.4th 58.)

(d) When the promisor has the power to make a purely subjective decision as to satisfaction, that decision must be made in good faith, but the courts will not examine its reasonableness. Conversely, when the promisor's satisfaction is evaluated under an objective test, the validity of the promisor's decision of satisfaction or dissatisfaction rests only on the reasonableness of the decision; the courts will not examine good faith. (100 C.A.4th 59, citing *Guntert v. Stockton* (1974) 43 C.A.3d 203, 117 C.R. 601, *supra*, §788.) The present contract involves a commercial transaction and is subject to the objective test. It is to be distinguished from the contract in *Locke v. Warner Bros.* (1997) 57 C.A.4th 354, 66 C.R.2d 921, *supra*, §784, where a subjective test was used for determining a movie studio's satisfaction as to matters of artistic merit. (100 C.A.4th 60.)

(e) Here, defendant owed no duty of good faith in determining whether the conditions precedent to its performance had been fulfilled. The loan agreement was a freely negotiated contract entered into by sophisticated business entities. Under the terms of that contract, expressly agreed to by plaintiffs, defendant's obligation to disburse the loan funds was conditional on its objectively reasonable determination that the project budget was in balance. No obligation to act in good faith can be implied to contradict or limit that express condition precedent. No inquiry into good faith can be made. Thus, it was error to instruct that defendant was required to act reasonably *and in good faith* in determining whether the loan was or was not out of balance. Defendant was required only to act reasonably, and consequently, the only available challenge to defendant's determination that the project budget was not in balance was one to the reasonableness of that determination. However, this challenge is to the express terms of the contract, and the cause of action based on this theory was dismissed. There is therefore no need to analyze whether defendant's determination was in fact objectively reasonable. For the same reason, there is also no need to decide whether defendant's actions excused the condition precedent. (100 C.A.4th 61.) (See *Bergum v. Weber* (1955) 136 C.A.2d 389, 394, 288 P.2d 623; *Milton v. Hudson Sales Corp.* (1957) 152 C.A.2d 418, 427, 313 P.2d 936, *infra*, §805; *Harrison v. Cook* (1963) 213 C.A.2d 527, 530, 531, 29 C.R. 269; 4 Santa Clara Lawyer 110 [critical note on *Harrison*].)

SUPPLEMENT: [This section is current through the latest supplement]

See *Wolf v. Walt Disney Pictures & Television* (2008) 162 C.A.4th 1107, 1121, 76 C.R.3d 585 [movie production company's agreement with author for rights to novel's characters, stating that company could license characters to third parties as it "saw fit," granted company unfettered discretion to license characters, such that implied covenant of good faith and fair dealing was not enforceable to limit company's right to enter into licensing agreements for which it received no monetary compensation; implied term directly at odds with express contractual grant of unfettered discretion would not be enforced].



114 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

C. Conditions and Covenants.

5. Implied Conditions and Covenants.

b. Good Faith and Fair Dealing.

1. In General.

aa. Nature of Covenant.

1 Witkin Sum. Cal. Law Contracts § 798

[§ 798] Nature of Covenant.

If the cooperation of the other party is necessary for successful performance of an obligation, a promise to give that cooperation and not to do anything that prevents realization of the fruits of performance will often be implied. This is sometimes referred to as an implied covenant of good faith and fair dealing.

"There is implied in every contract a covenant by each party not to do anything which will deprive the other parties thereto of the benefits of the contract. ... This covenant not only imposes upon each contracting party the duty to refrain from doing anything which would render performance of the contract impossible by any act of his own, but also the duty to do everything that the contract presupposes that he will do to accomplish its purpose." (*Harm v. Frasher* (1960) 181 C.A.2d 405, 417, 5 C.R. 367.) (See *Universal Sales Corp. v. California Press Mfg. Co.* (1942) 20 C.2d 751, 771, 128 P.2d 665; *Nelson v. Abraham* (1947) 29 C.2d 745, 751, 177 P.2d 931; *California Lettuce Growers v. Union Sugar Co.* (1955) 45 C.2d 474, 484, 289 P.2d 785; *Carma Developers (Calif.) v. Marathon Dev. Calif.* (1992) 2 C.4th 342, 371, 6 C.R.2d 467, 826 P.2d 710, supra, §797; *Brawley v. Crosby Research Foundation* (1946) 73 C.A.2d 103, 112, 166 P.2d 392; *Orton v. Embassy Realty Associates* (1949) 91 C.A.2d 434, 438, 205 P.2d 427; *Matzen v. Horwitz* (1951) 102 C.A.2d 884, 892, 228 P.2d 841; *Bergum v. Weber* (1955) 136 C.A.2d 389, 392, 288 P.2d 623; *Automatic Vending Co. v. Wisdom* (1960) 182 C.A.2d 354, 358, 6 C.R. 31, supra, §230; *Kenworthy v. California* (1965) 236 C.A.2d 378, 383, 46 C.R. 396, citing the text; *McWilliams v. Holton* (1967) 248 C.A.2d 447, 451, 56 C.R. 574; *Foley v. U. S. Paving Co.* (1968) 262 C.A.2d 499, 506, 68 C.R. 780; *Milstein v. Security Pac. Nat. Bank* (1972) 27 C.A.3d 482, 486, 103 C.R. 16, citing the text; *Spindle v. Travelers Ins. Cos.* (1977) 66 C.A.3d 951, 958, 136 C.R. 404; *Zurn Engineers v. California* (1977) 69 C.A.3d 798, 833, 138 C.R. 478, citing the text; *Southern Calif. Dist. Council, Assemblies of God v. Shepherd of the Hills Evangelical Lutheran Church* (1978) 77 C.A.3d 951, 956, 144 C.R. 46; *Schoolcraft v. Ross* (1978) 81 C.A.3d 75, 80, 146 C.R. 57, 4 Summary (10th), *Security Transactions in Real Property*, §84, citing the text; *Nystrom v. First Nat. Bank of Fresno* (1978) 81 C.A.3d 759, 767, 146 C.R. 711, quoting the text; *Vale v. Union Bank* (1979) 88 C.A.3d 330, 336, 151 C.R. 784, citing the text; *April Enterprises v. KTTV* (1983) 147 C.A.3d 805, 816, 818, 195 C.R. 421, citing the text; *Third Story Music v. Waits* (1995) 41 C.A.4th 798, 802, 48 C.R.2d 747; *Locke v. Warner Bros.* (1997) 57 C.A.4th 354, 365, 66 C.R.2d 921, supra, §784; *PMC v. Porthole Yachts, Ltd.* (1998) 65 C.A.4th 882, 889, 76

C.R.2d 832; Charpentier v. Los Angeles Rams Football Co. (1999) 75 C.A.4th 301, 313, 89 C.R.2d 115; Storek & Storek v. Citicorp Real Estate (2002) 100 C.A.4th 44, 122 C.R.2d 267, supra, §797; Corbin §§570, 571; 15 Williston 4th, §48:1, 48:2; 17A Am.Jur.2d (2004 ed.), Contracts §369; 18 California Lawyer 64 (August 1998) ["best efforts" clauses as related to implied covenant of good faith and fair dealing]; 47 Hastings L. J. 585 [proposed standards for evaluating when covenant of good faith and fair dealing has been violated]; 29 Loyola L.A. L. Rev. 1059 [good faith and fair dealing in international trade]; 27 Pacific L. J. 37 [bad faith in performance and enforcement of contract as abuse of rights]; 37 U.S.F. L. Rev. 257 [problems in applying implied covenant of good faith performance]; on implied covenant of good faith under the Uniform Commercial Code, see U.C.C. 1203; on implied covenant of good faith in insurance policies, see 2 Summary (10th), Insurance, §239 et seq.)

Being of universal prevalence, the implied covenant of good faith and fair dealing does not create a fiduciary relationship. (*Wolf v. Superior Court (2003) 107 C.A.4th 25, 31, 130 C.R.2d 860.*)

West's Key Number Digest, Contracts k.168

SUPPLEMENT: [This section is current through the latest supplement]

Implied covenant of good faith under Uniform Commercial Code: In 2006, U.C.C. 1203 was redesignated U.C.C. 1304.



115 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

C. Conditions and Covenants.

5. Implied Conditions and Covenants.

b. Good Faith and Fair Dealing.

1. In General.

bb. Restatement 2d.

1 Witkin Sum. Cal. Law Contracts § 799

[§ 799] Restatement 2d.

"Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement."
(*Rest.2d, Contracts §205.*)

Good faith *performance* is explained in Comment d: "Subterfuges and evasions violate the obligation of good faith in performance even though the actor believes his conduct to be justified. But the obligation goes further: bad faith may be overt or may consist of inaction, and fair dealing may require more than honesty. A complete catalogue of types of bad faith is impossible, but the following types are among those which have been recognized in judicial decisions: evasion of the spirit of the bargain, lack of diligence and slacking off, willful rendering of imperfect performance, abuse of a power to specify terms, and interference with or failure to cooperate in the other party's performance."

Good faith in *enforcement* is explained in Comment e: The obligation extends to the assertion, settlement, and litigation of contract claims and defenses. It is violated by dishonest conduct "such as conjuring up a pretended dispute, asserting an interpretation contrary to one's own understanding, or falsification of facts. It also extends to dealing which is candid but unfair, such as taking advantage of the necessitous circumstances of the other party to extort a modification of a contract for the sale of goods without legitimate commercial reason. ... Other types of violation have been recognized in judicial decisions: harassing demands for assurances of performance, rejection of performance for unstated reasons, willful failure to mitigate damages, and abuse of a power to determine compliance or to terminate the contract."

SUPPLEMENT: [This section is current through the latest supplement]



116 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

C. Conditions and Covenants.

5. Implied Conditions and Covenants.

b. Good Faith and Fair Dealing.

1. In General.

bb. Breach.

1 Witkin Sum. Cal. Law Contracts § 800

[§ 800] Breach.

Breach of the covenant of good faith and fair dealing gives rise to a *contract action* (see cases cited supra, 798, and infra, §803 et seq.) or, in limited contexts, a *tort action* with the tort measure of compensatory damages and the right to recover punitive damages (3 *Cal. Proc.* (4th), *Actions*, Supp., §166A; 2 *Summary* (10th), *Insurance*, §240 et seq.). (See 73 *Cal. L. Rev.* 1291; 39 *Hastings L. J.* 483 [argument that employee abusing special position of trust should be liable in tort for breach of covenant of good faith and fair dealing]; 27 *Loyola L.A. L. Rev.* 483 [history and decline of tort action for breach of covenant]; 21 *Santa Clara L. Rev.* 1111; 55 *A.L.R.4th* 1026 [bank's liability for breach]; BAJI, No. 10.38 [implied covenant of good faith and fair dealing--damages for breach]; CACI, No. 2331 [breach of the implied obligation of good faith and fair dealing--failure or delay in payment--essential factual Elements].) The covenant can be breached by objectively unreasonable conduct (see infra, §801), regardless of the actor's motive. (*Badie v. Bank of America* (1998) 67 *C.A.4th* 779, 796, 79 *C.R.2d* 273.)

The prerequisite for any action for breach of this covenant is the existence of a contractual relationship between the parties, because the covenant is an implied term in the contract. *Smith v. San Francisco* (1990) 225 *C.A.3d* 38, 49, 275 *C.R.* 17.

SUPPLEMENT: [This section is current through the latest supplement]

Cross-Reference: 3 *Cal. Proc.* (5th), *Actions*, §171.



117 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

C. Conditions and Covenants.

5. Implied Conditions and Covenants.

b. Good Faith and Fair Dealing.

1. In General.

cc. Objectively Reasonable Conduct as Essence of Covenant.

1 Witkin Sum. Cal. Law Contracts § 801

[§ 801] Objectively Reasonable Conduct as Essence of Covenant.

The essence of the good faith covenant is *objectively reasonable conduct*. When a party has the unilateral right to change the terms of a contract, it does not act in an objectively reasonable manner when it attempts to recapture a foregone opportunity by adding an entirely new term that has no bearing on any subject, issue, right, or obligation addressed in the original contract and that was not within the reasonable contemplation of the parties when the contract was entered into. This is particularly true when the new term deprives the other party of the right to a jury trial and the right to select a judicial forum for dispute resolution. (*Badie v. Bank of America* (1998) 67 C.A.4th 779, 796, 79 C.R.2d 273 [change of terms provision in bank's account agreements did not permit bank to add alternative dispute resolution (ADR) clause to agreements by sending customers unilateral notice in form of "bill stuffer" insert with monthly account statements, where original agreements did not show intent to contract concerning ADR].)

SUPPLEMENT: [This section is current through the latest supplement]



118 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

C. Conditions and Covenants.

5. Implied Conditions and Covenants.

b. Good Faith and Fair Dealing.

1. In General.

dd. No Implied Covenant To Negotiate in Good Faith.

1 Witkin Sum. Cal. Law Contracts § 802

[§ 802] No Implied Covenant To Negotiate in Good Faith.

The implied covenant of good faith and fair dealing is limited to assuring compliance with the *express terms* of the contract, and cannot be extended to create obligations not contemplated by the contract. Hence, in the absence of a specific agreement imposing an obligation of good faith bargaining, "[t]he fact that parties commence negotiations looking to a contract, or to the amendment of an existing contract, does not by itself impose any duty on either party not to be unreasonable or not to break off negotiation, for any reason or for no reason." (*Racine & Laramie, Ltd. v. Department of Parks & Recreation* (1992) 11 C.A.4th 1026, 1034, 14 C.R.2d 335.)

SUPPLEMENT: [This section is current through the latest supplement]

See *McClain v. Octagon Plaza, LLC* (2008) 159 C.A.4th 784, 798, 71 C.R.3d 885 [alleged misrepresentations that shopping center landlord made as to size of proposed leased space in negotiations with tenant over lease did not violate implied covenant of good faith and fair dealing, as covenant did not require landlord to negotiate in good faith, but rather only required landlord to operate in good faith in performance of contract; following *Racine & Laramie, Ltd. v. Department of Parks & Recreation* (1992) 11 C.A.4th 1026, 14 C.R.2d 335, text, p. 895.]



119 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

C. Conditions and Covenants.

5. Implied Conditions and Covenants.

b. Good Faith and Fair Dealing.

2. Building Contract.

1 Witkin Sum. Cal. Law Contracts § 803

[§ 803] Building Contract.

In a building or other construction contract, the owner impliedly promises that the contractor will be permitted to proceed with construction without interference by the owner. (*Gray v. Bekins* (1921) 186 C. 389, 395, 199 P. 767; *Shea v. Los Angeles* (1935) 6 C.A.2d 534, 536, 45 P.2d 221; *Hensler v. Los Angeles* (1954) 124 C.A.2d 71, 82, 268 P.2d 12 [implied covenant that owner will furnish selected site of operations].) And a builder who accepts a subcontractor's bid for part of the work may be held to have impliedly promised to commence construction within a reasonable time. (*Stark v. Shaw* (1957) 155 C.A.2d 171, 177, 317 P.2d 182 [plaintiff roofer's bid of \$ 355,000 for 936 homes].)

SUPPLEMENT: [This section is current through the latest supplement]



120 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

C. Conditions and Covenants.

5. Implied Conditions and Covenants.

b. Good Faith and Fair Dealing.

3. Real Estate Broker's Contract.

1 Witkin Sum. Cal. Law Contracts § 804

[§ 804] Real Estate Broker's Contract.

In *Torelli v. J.P. Enterprises* (1997) 52 C.A.4th 1250, 61 C.R.2d 76, plaintiff broker, T, had a listing agreement to sell certain property, and he produced a buyer, M, who made an offer that included a commission provision for plaintiff. Defendant seller, J, then made a counteroffer that also included a commission for plaintiff, but before it could be accepted, it expired. The buyer and seller then commenced negotiating on their own and reached an agreement that was similar to the counteroffer, minus the commission. Plaintiff sued to recover his commission. *Held*, summary judgment for defendant reversed. Emphasizing that defendant had benefited from plaintiff's services, the court said:

"[J]ust because the seller was not at fault for the nonacceptance of the counteroffer does not mean the seller could, with impunity, breach its *existing* contract to pay a commission to the broker. As adumbrated in *Coulter*, and made express many times thereafter, every contract has an implied covenant not to do anything which injures the right of the other party to receive the benefits of the agreement. Having made an agreement to pay Torelli a commission which was memorialized in the counteroffer, J.P. Enterprises could not thereafter, consistent with the implied covenant of good faith, make a deal with the buyer on substantially the same terms as it contemplated in the counteroffer without paying Torelli the agreed commission. The omission of a provision for Torelli's commission in the final agreement was the functional equivalent of a with-fault repudiation of the entire sale. While no writing may have expressly prohibited J.P. Enterprises from entering into direct negotiations with the Melstroms, the implied covenant of good faith meant that J.P. Enterprises still had no right to use those negotiations to deprive Torelli of his commission for having found the Melstroms in the first place." (52 C.A.4th 1257, citing *Coulter v. Howard* (1927) 203 C. 17, 262 P 751.)

SUPPLEMENT: [This section is current through the latest supplement]



121 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

C. Conditions and Covenants.

5. Implied Conditions and Covenants.

b. Good Faith and Fair Dealing.

4. Manufacturer's Exculpatory Clause.

1 Witkin Sum. Cal. Law Contracts § 805

[§ 805] Manufacturer's Exculpatory Clause.

In *Milton v. Hudson Sales Corp.* (1957) 152 C.A.2d 418, 313 P.2d 936, plaintiff dealer charged that defendant corporation deliberately and with intent to injure him refused to deliver automobiles in sufficient quantities to meet his resale needs. Defendant relied on the contract provision that it "shall in no event be liable ... for any loss or damage because of failure ... to ship or fill such order, regardless of any express or implied provision to the contrary in this agreement." *Held*, judgment for damages affirmed. In view of provisions of the lengthy contract specifying excuses for performance based on impossibility or impracticability, and other provisions giving defendant the right to terminate the dealer's franchise for cause, the exculpatory clause was characterized as ambiguous, and construed as not giving a complete excuse for nonperformance in bad faith. In other words, the clause "was an excuse for nonperformance to be exercised bona fide, not a privilege to repudiate." (152 C.A.2d 429, quoting leading federal case.)

Thus, the court interpreted the franchise contract as containing an implied promise by the dealer to buy and resell, and a correlative promise by the manufacturer to supply his needs except where in good faith it asserts a reasonable excuse. The extremely practical approach of the court is highlighted by the following excerpt: "The contention that Hudson's discretion was complete is not in accord with common sense or the facts of business life. Milton was expected to put a sizable investment into his selling organization. Milton had a compelling obligation to buy cars. If he did not buy them his franchise would be canceled and his investment lost. Under such circumstances why would the distributor desire to retain the privilege of withholding deliveries if the circumstances permitted the filling of orders? Milton's claim is that Hudson's actions were wholly unwarranted, that is, in bad faith. Hudson replies that its actions do not have to be justified. Would any businessman enter into such an arrangement if he understood its implications? Of course not." (152 C.A.2d 432.) (See 10 *Hastings L. J.* 99.)

West's Key Number Digest, Contracts k.2168

SUPPLEMENT: [This section is current through the latest supplement]



122 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

C. Conditions and Covenants.

5. Implied Conditions and Covenants.

b. Good Faith and Fair Dealing.

5. Obligation To Remain in Business.

1 Witkin Sum. Cal. Law Contracts § 806

[§ 806] Obligation To Remain in Business.

The implication of a *promise to remain in business*, in "output" or "requirements" contracts and percentage leases, is the subject of many confusing decisions. The majority refuse to imply the covenant.

Thus, in *Cousins Inv. Co. v. Hastings Clothing Co. (1941) 45 C.A.2d 141, 113 P.2d 878*, defendant's lease provided for a rental of 51/2% of gross income, with a \$ 4,000 monthly minimum. Plaintiff lessor informed defendant that a new tenant would replace him upon expiration, and defendant found other quarters and vacated 2 months before that date, paying the \$ 4,000 minimum for the period. Plaintiff sued to recover the estimated percentage rental, claiming violation of an implied covenant by defendant to remain in business. *Held*, no covenant should be implied. The lease was drawn by an expert, and was presumably intentionally silent on this point; also, it is generally held that where the percentage rental provision is coupled with a substantial minimum payment, there is no implied covenant that the lessee will continue in business throughout the term. (45 C.A.2d 149.) (See *Stockton Dry Goods Co. v. Girsh (1951) 36 C.2d 677, 680, 227 P.2d 1* [lease of space in department store for shoe business; no implied covenant that lessor would not open its own shoe department]; *Langenberg v. Guy (1926) 77 C.A. 664, 688, 247 P. 621* [contract to hire another to perform work of certain type as business of promisor *requires*; no implied obligation on promisor to remain in business]; *Masciotra v. Harlow (1951) 105 C.A.2d 376, 380, 233 P.2d 586* [following *Cousins*].)

A few decisions find additional facts sufficient to support the implication. In *Lippman v. Sears Roebuck & Co. (1955) 44 C.2d 136, 280 P.2d 775*, the court pointed out that, although a mere statement of the purposes for which premises are leased does not imply a lessee's covenant to engage in or continue that use, such a covenant may be implied where the rental is based on a percentage of sales. (44 C.2d 144.) In *Cousins* and *Masciotra*, no covenant was implied because the lease called for a substantial and adequate minimum payment. In this case, the evidence showed that the lessor had remodeled the building at considerable expense in contemplation of the lease; that the specified minimum monthly payments were far below any reasonable return; and that the contemplated rental was based upon the lessee's retail sales. Accordingly, where the lessee opened a store at another location and paid only the minimum to plaintiff lessor, damages were awarded for breach of the implied covenant. (44 C.2d 146.) (See *Gaspar v. United Milk Producers (1944) 62 C.A.2d 546, 551, 144 P.2d 867* [defendant employer agreed to buy stock from plaintiff employee if latter discharged; defendant's going out of business constituted a discharge of plaintiff].)

In *College Block v. Atlantic Richfield Co.* (1988) 206 C.A.3d 1376, 254 C.R. 179, involving a 20-year lease to operate a gasoline station, the rent was based on a percentage of the gasoline delivered, with the provision that plaintiff lessor was to receive a minimum of \$ 1,000 per month. After defendant lessee ceased operation and paid the minimum rent for the remaining 39 months of the lease, plaintiff sued to recover the additional rent he would have received had defendant remained in business (approximately \$ 2,250 per month). Based on a ruling that, as a matter of law, there was an implied covenant requiring defendant to remain in business for the entire lease period, the trial judge entered judgment for plaintiff. *Held*, reversed; further evidence was required before this covenant could be implied.

(a) Various provisions in the lease suggested that the parties contemplated continued operation of the business: (1) The rent provision did not set a minimum payment irrespective of whether the property was utilized as a service station, but rather irrespective of the number of gallons delivered. (2) An anticompetition clause prevented plaintiff from operating a station on other property it owned, while another clause limited defendant's use of the property to that of a service station. These clauses were inconsistent with an implied right on the part of defendant to cease operation whenever it desired. (206 C.A.3d 1381.)

(b) Defendant's contention that there was no implied covenant of continued operation was based on two provisions: one allowing it to remove all structures from the property, and the other giving it the "privilege" of erecting structures required for operation of a service station. However, when viewed in conjunction with the rest of the lease, the former provision was an obvious recognition of defendant's right to upgrade the station, as needed. And the "privilege" granted by the latter provision could not be interpreted as allowing defendant to cease operation, because that action would completely frustrate the purpose of the lease. (206 C.A.3d 1382, distinguishing *Hicks v. Whelan Drug Co.* (1955) 131 C.A.2d 110, 280 P.2d 104; and *Masciotra v. Harlow*, *supra*.)

(c) If both parties contemplate continued operation, a covenant of continued operation will be implied in a lease containing a specified minimum rent plus a percentage, when the minimum is *not substantial*. Hence, before ruling, as a matter of law, that a covenant of continued operation would be implied in this case, the trial judge must find that the \$ 1,000 guaranteed minimum was not substantial and did not provide plaintiff with a fair return on its investment. (206 C.A.3d 1383.)

SUPPLEMENT: [This section is current through the latest supplement]



123 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

C. Conditions and Covenants.

5. Implied Conditions and Covenants.

b. Good Faith and Fair Dealing.

6. Lessor's Obligation To Keep Other Tenants.

1 Witkin Sum. Cal. Law Contracts § 807

[§ 807] Lessor's Obligation To Keep Other Tenants.

In *Cordonier v. Central Shopping Plaza Associates* (1978) 82 C.A.3d 991, 147 C.R. 558, a franchisor of restaurants leased space in a shopping center from defendant lessor. The lease provided that the term would not commence until the lessor entered into 20-year leases with a chain department store, chain supermarket, and chain drugstore. This was done, and a franchisee subleased from the franchisor and opened a restaurant. However, during the term of the sublease, the department store and drugstore ceased operations. After 2 years, plaintiffs, the franchisor and franchisee, brought this action for damages. *Held*, a cause of action was stated. Under the reasoning of *Lippman v. Sears Roebuck & Co.* (1955) 44 C.2d 136, 280 P.2d 775, *supra*, §806, an implied covenant could arise to require the lessor to use good faith to insure continuing use and occupancy by major tenants for the 20-year term of the master lease. (82 C.A.3d 1000, 1002.)

SUPPLEMENT: [This section is current through the latest supplement]



124 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

C. Conditions and Covenants.

5. Implied Conditions and Covenants.

b. Good Faith and Fair Dealing.

7. Other Examples.

1 Witkin Sum. Cal. Law Contracts § 808

[§ 808] Other Examples.

(1) *Employee's Incentive Contract*. The implied covenant of good faith and fair dealing prohibits both parties to an employment contract from doing anything that will injure the rights of the other to receive the benefits of the agreement. (*Foley v. U. S. Paving Co. (1968)* 262 C.A.2d 499, 505, 68 C.R. 780 [employee's incentive contract violated by defendant corporation employer where it siphoned off benefits through device of increasing salaries of its two principal officers who were sole stockholders].)

(2) *License*. Where a contract gave an exclusive license to develop, exploit, and commercialize an invention, the licensee was bound by an implied covenant to make its best efforts to produce and sell the licensed product. (*Brawley v. Crosby Research Foundation (1946)* 73 C.A.2d 103, 112, 166 P.2d 392.) (See 43 A.L.R.4th 1182 [duty of publisher with regard to distribution and promotion of book].)

(3) *Physician's Contract*. An implied covenant of good faith and fair dealing was violated where defendant agreed to take over plaintiff's practice and devote his talents to its interests during plaintiff's military service, and defendant took plaintiff's practice with him on termination of the contract. (*Matzen v. Horwitz (1951)* 102 C.A.2d 884, 892, 228 P.2d 841.)

(4) *Sales Agreement*. Where a transaction involved a sale by three different sellers to one buyer and each seller agreed that the buyer's obligation was contingent on performance by all three sellers, each seller impliedly promised the other two that he would do nothing to prevent performance. (*Harm v. Frasher (1960)* 181 C.A.2d 405, 417, 5 C.R. 367.)

In contracts to purchase automobiles on credit, plaintiff purchasers agreed to maintain insurance, but if they did not, insurance could be purchased by defendant finance company at plaintiffs' expense. In the event that plaintiffs later purchased insurance, the premiums for the insurance previously purchased by defendant were to be refunded. Although the sales agreements were silent as to the method of refund, the implied covenant of good faith and fair dealing required that the pro rata by time method, rather than the accelerated method, be employed, because the former was the method customarily employed by defendant and because required notices expressly stated that the pro rata method would be used. (*Acree v. General Motors Acceptance Corp. (2001)* 92 C.A.4th 385, 393, 112 C.R.2d 99.)

(5) *Lease*. Where a lease provided that the lessee would be given possession when the occupying tenant vacated the premises, the lessor violated the implied covenant when he permitted the tenant and his successors to remain in possession. (*McWilliams v. Holton* (1967) 248 C.A.2d 447, 451, 56 C.R. 574.) Where an event producer's lease of a city amphitheater envisioned future productions, it was a breach of the covenant of good faith and fair dealing for the city to bar the producer from submitting any proposals for such productions. (*Pasadena Live, LLC v. Pasadena* (2004) 114 C.A.4th 1089, 1093, 8 C.R.3d 233.)

(6) *Partnership or Joint Venture*. Where a seller and a buyer of a machine entered into a cooperative arrangement for its development and marketing, the seller violated the covenant of good faith and fair dealing by withholding information from the buyer regarding manufacture, sale, and patent application of an improved machine. (*Universal Sales Corp. v. California Press Mfg. Co.* (1942) 20 C.2d 751, 771, 128 P.2d 665.)

(7) *Deed of Trust*. The implied covenant was violated by the beneficiary of a deed of trust that gave it the right either to apply fire insurance proceeds to the indebtedness or to release them to the trustor, where the beneficiary refused to release the proceeds even though they were not needed to protect its security. (*Schoolcraft v. Ross* (1978) 81 C.A.3d 75, 80, 146 C.R. 57, 4 Summary (10th), *Security Transactions in Real Property*, §84.)

(8) *Wrongful Termination of Employment*. Wrongful discharge of an employee may be a violation of the implied covenant of good faith and fair dealing, giving rise to a contract action for breach. (See *Gray v. Superior Court* (1986) 181 C.A.3d 813, 819, 820, 821, 226 C.R. 570; 3 Summary (10th), *Agency and Employment*, §239 et seq.); on repudiation of a tort action for wrongful termination, see *Foley v. Interactive Data Corp.* (1988) 47 C.3d 654, 254 C.R. 211, 765 P.2d 373, 3 Summary (10th), *Agency and Employment*, §271.)

(9) *Funeral Services*. In every contract for funeral services, there is an implied covenant that the services will be conducted with dignity and respect toward the family members for whose benefit the services are performed. (*Wilson v. Houston Funeral Home* (1996) 42 C.A.4th 1124, 1133, 50 C.R.2d 169 [allegations that decedent's family was falsely imprisoned when defendant's limousine took them to bank to cash check instead of to burial site, that defendant retained decedent's body at mortuary and refused to perform burial until payment was made, and that limousine driver engaged in unprofessional conduct stated cause of action for breach of contract].)

SUPPLEMENT: [This section is current through the latest supplement]



125 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

C. Conditions and Covenants.

6. Implied (Constructive) Concurrent Conditions.

a. General Rule for Agreed Exchange.

1 Witkin Sum. Cal. Law Contracts § 809

[§ 809] General Rule for Agreed Exchange.

In bilateral contracts, where performance by one party is in *exchange* for performance by the other, and the duties are to be performed or can be performed at the *same time and place*, the law will ordinarily imply *concurrent conditions* (or "dependent covenants"), making each party's obligation dependent upon performance or tender of performance by the other. (See *McDorman v. Moody* (1942) 50 C.A.2d 136, 142, 122 P.2d 639; 8 Corbin (Rev. ed.), §32.1 et seq.; 14 Williston 4th, §43:1 et seq.; 15 Williston 4th, §§43:17 et seq., 44:1 et seq.)

Thus, in installment contracts for the sale of land, the vendor may sue for any installment; the purchaser's promise to pay it is an independent covenant. But when the last installment is due, the payment thereof and the tender of a deed are concurrent conditions. (*Boone v. Templeman* (1910) 158 C. 290, 297, 110 P. 947; *Bank of America v. Ries* (1932) 128 C.A. 75, 78, 16 P.2d 1018; see *supra*, §792.) The same is true of an installment contract for the sale of personal property. (*McDorman v. Moody*, *supra*.)

Even where the defendant's payment of an installment is an independent obligation, if the time for the plaintiff's performance arrives and the plaintiff fails to perform, the obligations become concurrently conditional. (*Jozovich v. Central Calif. Berry Growers Assn.* (1960) 183 C.A.2d 216, 225, 6 C.R. 617.)

Covenants in *leases*, as a result of policies developed in the law of landlord and tenant, were formerly regarded as exceptional; but later decisions and statutes apply the doctrine of constructive conditions to them. (See 12 *Summary* (10th), *Real Property*, §§667, 672, 673; see also Rest.2d, Property §§7.1, 7.2, 13.1, 13.2.)

West's Key Number Digest, Sales 151

SUPPLEMENT: [This section is current through the latest supplement]



126 of 184 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

C. Conditions and Covenants.

6. Implied (Constructive) Concurrent Conditions.

b. Exception: Performances Due at Different Times.

1 Witkin Sum. Cal. Law Contracts § 810

[§ 810] Exception: Performances Due at Different Times.

Where the promises are to be performed at different times, they are generally deemed independent covenants and not concurrent conditions. Thus, in *Starr v. Davis* (1930) 105 C.A. 632, 288 P. 706, plaintiff sold his business to defendant, covenanting not to engage in a similar business for 2 years, and defendant gave a note for the price, payable in 1 year. In a suit on the note, defendant set up plaintiff's breach of covenant. *Held*, plaintiff could recover, despite violation of his covenant; the promises were independent. (105 C.A. 634.) (See 8 Corbin (Rev. ed.), §32.5.)

Similarly, in *Kaupke v. LeMoore Canal & Irr. Co.* (1937) 20 C.A.2d 554, 67 P.2d 407, plaintiff irrigation district agreed to deliver water to defendant continuously under a certain schedule and to protect his water rights from interference, and defendant agreed to pay assessments when levied. *Held*, the obligations were independent, and defendant could not set up an asserted breach by plaintiff as a bar to an action on the assessments. (20 C.A.2d 557.)

Some contractual obligations of a vendor may not be concurrent conditions; e.g., the obligation to furnish title insurance cannot take place until after recordation of the deed, because it insures the purchaser's title; and the obligation to furnish termite clearance may not arise while the transaction is still contingent on the buyer's obtaining a loan. (*Fogarty v. Saathoff* (1982) 128 C.A.3d 780, 786, 180 C.R. 484.)

West's Key Number Digest, Sales k.85

SUPPLEMENT: [This section is current through the latest supplement]



127 of 184 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

C. Conditions and Covenants.

6. Implied (Constructive) Concurrent Conditions.

c. Restatement 2d.

1 Witkin Sum. Cal. Law Contracts § 811

[§ 811] Restatement 2d.

(1) *Terminology.* The Second Restatement treatment of this subject employs a different terminology and a more detailed analysis. The former heading of "promises for an agreed exchange" is now "performances to be exchanged under an exchange of promises." The term "concurrent conditions" is not used; promises are not classified as "independent" or "dependent"; and the term "failure of performance" is substituted for "failure of consideration." (Rest.2d, Contracts, Reporter's Note, Vol. 2, p. 195; §231, Reporter's Note; §237, Comment a, and Reporter's Note.)

(2) *Criterion for Determining When Performances Are To Be Exchanged.* "Performances are to be exchanged under an exchange of promises if each promise is at least part of the consideration for the other and the performance of each promise is to be exchanged at least in part for the performance of the other." (Rest.2d, Contracts §231.)

(3) *Presumption That Performances Are To Be Exchanged.* "Where the consideration given by each party to a contract consists in whole or in part of promises, all the performances to be rendered by each party taken collectively are treated as performances to be exchanged under an exchange of promises, unless a contrary intention is clearly manifested." (Rest.2d, Contracts §232.)

(4) *Performance at One Time or in Installments.* Rest.2d, Contracts §233, based on Unif.Com.C. §2-307, reads as follows:

(a) "Where performances are to be exchanged under an exchange of promises, and the whole of one party's performance can be rendered at one time, it is due at one time, unless the language or the circumstances indicate the contrary."

(b) Where only a part of one party's performance is due at one time under Subsection (a), "if the other party's performance can be so apportioned that there is a comparable part that can also be rendered at that time, it is due at that time, unless the language or the circumstances indicate the contrary."

(5) *Order of Performance.* Rest.2d, Contracts §234, reads as follows:

(a) "Where all or part of the performances to be exchanged under an exchange of promises can be rendered

simultaneously, they are to that extent due simultaneously, unless the language or the circumstances indicate the contrary."

(b) Except to the extent stated in Subsection (a), "where the performance of only one party under such an exchange requires a period of time, his performance is due at an earlier time than that of the other party, unless the language or the circumstances indicate the contrary."

Comment b explains: "Cases in which simultaneous performance is possible under the terms of the contract can be grouped into five categories: (1) where the same time is fixed for the performance of each party; (2) where a time is fixed for the performance of one of the parties and no time is fixed for the other; (3) where no time is fixed for the performance of either party; (4) where the same period is fixed within which each party is to perform; (5) where different periods are fixed within which each party is to perform. The requirement of simultaneous performance applies to the first four categories. The requirement does not apply to the fifth category, even if simultaneous performance is possible, because in fixing different periods for performance the parties must have contemplated the possibility of performance at different times under their agreement. Therefore in cases in the fifth category the circumstances show an intention contrary to the rule stated" in Subsection (a).

(6) *Effect of Failure To Offer Performance.* "Where all or part of the performances to be exchanged under an exchange of promises are due simultaneously, it is a condition of each party's duties to render such performance that the other party either render or, with manifested present ability to do so, offer performance of his part of the simultaneous exchange." (*Rest.2d, Contracts* §238.)

(7) *Failure Justified by Nonoccurrence of Condition.* A party's failure to render or offer performance may affect the other party's duties even though failure is justified by the nonoccurrence of a condition, unless the other party assumed the risk that he or she would have to perform in spite of the failure. (*Rest.2d, Contracts* §239.)

(8) *Promise Conditional on Fortuitous Event.* The promise *received by* a party assuming the risk of performance despite a justifiable failure of the bargained for performance due to nonoccurrence of a condition is sometimes described as "aleatory," i.e., a promise expressly conditioned on the happening of a fortuitous event. (See *Rest.2d, Contracts* §232, Comment c; §239, Comment b.) The party whose performance is so conditioned cannot elect to refuse to perform because of the other party's breach, unless he or she states the intention to do so *before* being adversely affected by the occurrence of the condition or a material change in the probability of its occurrence. (*Rest.2d, Contracts* §379.)

SUPPLEMENT: [This section is current through the latest supplement]



128 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

C. Conditions and Covenants.

- 6. Implied (Constructive) Concurrent Conditions.
- d. Construction in Favor of Independent Covenant.

1 Witkin Sum. Cal. Law Contracts § 812

[§ 812] Construction in Favor of Independent Covenant.

To hold that promises are dependent, i.e., concurrently conditional, sometimes leads to inequitable results, the plaintiff in default being denied any recovery for the defendant's breach. In these cases, the courts will, to avoid forfeitures, attempt to construe them as independent.

Thus, in *Musto v. Grosjean* (1929) 208 C. 453, 281 P. 1022, defendant purchased lands, signing notes and a mortgage for the balance of the price. The vendor-mortgagee agreed to do street work and build a railway spur track by a certain date, failing which defendant was authorized to do the work and credit the cost on the indebtedness, or otherwise recover from the vendor. Plaintiff, assignee of the vendor-mortgagee, sued to foreclose the mortgage, and defendant set up the defense of failure to perform the work. *Held*, the promises of the parties were independent covenants; the option given the defendant to do the work and credit the cost on the note indicated that they did not intend that the mortgagee's performance should be a condition precedent to any recovery by him. (208 C. 460.)

In *Richardson v. Hislop* (1930) 109 C.A. 440, 293 P. 168, an agreement gave plaintiff the exclusive right to sell defendants' entire output of tiles. The parties executed a novation, providing for the release of defendants upon giving certain properties and making certain payments to plaintiff. Plaintiff later sued, alleging that defendants failed to perform, and contending that the original sales agreement was still in force and entitled him to commissions thereunder. *Held*, plaintiff could recover only ordinary damages for defendants' default. Defendants' promises were simply covenants, there being nothing in the new agreement to show that the parties intended the delivery of property and payments to be a condition precedent to the discharge of the old agreement. (109 C.A. 449.) (See *Streicher v. Heimburge* (1928) 205 C. 675, 684, 272 P. 290; *Starr v. Davis* (1930) 105 C.A. 632, 634, 288 P. 706, *supra*, §810; *Division of Labor Law Enforcement, Dept. of Industrial Relations v. Ryan Aeronautical Co.* (1951) 106 C.A.2d Supp. 833, 835, 236 P.2d 236; *Verdier v. Verdier* (1955) 133 C.A.2d 325, 334, 284 P.2d 94 [property settlement agreement; wife entitled to recover support payments despite breach of covenant not to molest]; *Enos v. Foster* (1957) 155 C.A.2d 152, 155, 317 P.2d 670 [lease covenant for apportionment of part of condemnation award to lessee and lessee's unperformed covenant to erect building]; 8 Corbin (Rev. ed.), §30.14; 13 Williston 4th, §§38:5, 38:13; 17A Am.Jur.2d (2004 ed.), Contracts §462.)

The Restatement also favors an interpretation that will avoid a forfeiture: "In resolving doubts as to whether an

event is made a condition of an obligor's duty, and as to the nature of such an event, an interpretation is preferred that will reduce the obligee's risk of forfeiture, unless the event is within the obligee's control or the circumstances indicate that he has assumed the risk." (*Rest.2d. Contracts §227(1)*).

SUPPLEMENT: [This section is current through the latest supplement]



129 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

C. Conditions and Covenants.

7. Failure of Consideration as Discharge of Duty.

a. Theory of Constructive Condition.

1 Witkin Sum. Cal. Law Contracts § 813

[§ 813] Theory of Constructive Condition.

In bilateral contracts for an agreed exchange, where one party has materially failed to perform his or her promise, or there has been a material delay in the performance, the other party's duty to perform is discharged, even though the first party's default was excusable (as by impossibility) and therefore not a breach that would justify an action for damages.

Failure of consideration thus operates as a sort of implied (constructive) condition, and the doctrine rests upon the theory that it is unjust to compel one party to perform when, for any reason, that party does not receive the other party's performance. (See C.C. 1689(b)(2), (b)(4) [rescission for failure of consideration]; *Walker v. Harbor Business Blocks Co.* (1919) 181 C. 773, 781, 186 P. 356; *Madera Canal & Irr. Co. v. Arakelian* (1930) 103 C.A. 592, 597, 284 P. 971; *Rest.2d, Contracts* §237 [stating the rule in terms of "failure of performance"]; 13 Corbin (Rev. ed.), §68.4 et seq.; 15 Williston 4th, §44:50; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §648 et seq.; 3 California Affirmative Defenses (2004 ed.), §57:1 et seq.; BAJI, No. 10.82 [failure of consideration].)

West's Key Number Digest, Contracts k.260

SUPPLEMENT: [This section is current through the latest supplement]
See 3 California Affirmative Defenses §57:1 et seq.



130 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

C. Conditions and Covenants.

7. Failure of Consideration as Discharge of Duty.

b. Materiality of Failure of Consideration.

1. In General.

1 Witkin Sum. Cal. Law Contracts § 814

[§ 814] In General.

Material failure of consideration discharges the other party's duty; slight or partial failure may not have this effect. (See *Wylar v. Feuer* (1978) 85 C.A.3d 392, 404, 149 C.R. 626.) The court will consider such factors as extent of performance or preparation and good faith of the defaulting party, the hardship on him or her of a termination of the contract, the adequacy of damages to compensate the other party for the default, etc. (See *Rest.2d, Contracts §241*; 8 Corbin (Rev. ed.), §36.5 et seq.; 15 Williston 4th, §44:55 et seq.; 21 A.L.R.2d 1247 [employer's right of termination due to employee's illness or physical incapacity]; BAJI, No. 10.82 [failure of consideration].)

SUPPLEMENT: [This section is current through the latest supplement]



131 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

C. Conditions and Covenants.

7. Failure of Consideration as Discharge of Duty.

b. Materiality of Failure of Consideration.

2. Delay in Performance.

1 *Witkin Sum. Cal. Law Contracts* § 815

[§ 815] Delay in Performance.

Delay in performance is a material failure of consideration only if *time is of the essence*, i.e., if prompt performance is, by the express language of the contract or by its very nature, a vital matter. (See C.C. 1492; *Henck v. Lake Hemet Water Co.* (1937) 9 C.2d 136, 143, 69 P.2d 849 [time held not of the essence]; *Katemis v. Westerlind* (1953) 120 C.A.2d 537, 543, 261 P.2d 553; *Leiter v. Handelsman* (1954) 125 C.A.2d 243, 251, 270 P.2d 563; *Jozovich v. Central Calif. Berry Growers Assn.* (1960) 183 C.A.2d 216, 227, 6 C.R. 617 [contract to construct machine for use in seasonal industry, time expressly of the essence]; *Johnson v. Alexander* (1976) 63 C.A.3d 806, 813, 134 C.R. 101, citing the text [time not specified]; *Rest.2d, Contracts* §242; 8 Corbin (Rev. ed.), §37.1 et seq.; 15 Williston 4th, §46:1 et seq.; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §§466, 471 et seq.; cf. *Becker v. Becker* (1950) 36 C.2d 324, 326, 223 P.2d 479 [delay held unreasonable]; see also 13 *Summary* (10th), *Equity*, §70.)

SUPPLEMENT: [This section is current through the latest supplement]



132 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

C. Conditions and Covenants.

7. Failure of Consideration as Discharge of Duty.

c. Prospective Failure of Consideration.

1 Witkin Sum. Cal. Law Contracts § 816

[§ 816] Prospective Failure of Consideration.

It is also a defense where, before performance is due, a party repudiates the agreement, or it appears that the performance will not take place because of impossibility, illegality, insolvency, or similar cause. (See *Bliss v. California Cooperative Producers* (1947) 30 C.2d 240, 248, 250, 181 P.2d 369 [discussing failure of consideration as a defense, and describing insolvency and voluntary bankruptcy as both a failure of consideration and a breach]; *Ogren v. Inner Harbor Land Co.* (1927) 83 C.A. 197, 200, 256 P. 607; *Charles B. Webster Real Estate v. Rickard* (1971) 21 C.A.3d 612, 616, 98 C.R. 559, citing the text [death of principal discharges all executory obligations under agency contract]; *Rest.2d, Contracts* §268; 13 Corbin (Rev. ed.), §68.4 et seq.; 15 Williston 4th, §§43:17 et seq., 44:50.)

West's Key Number Digest, Contracts k.260-

SUPPLEMENT: [This section is current through the latest supplement]



133 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

C. Conditions and Covenants.

7. Failure of Consideration as Discharge of Duty.

d. Effect of Defendant's Prior Breach.

1 *Witkin Sum. Cal. Law Contracts* § 817

[§ 817] Effect of Defendant's Prior Breach.

A defendant's duty is discharged by failure of consideration regardless of his or her lack of knowledge of it, and even though the defendant has also been guilty of a breach. The reason is that the plaintiff, having failed to perform on his or her part, suffers no legal injury by the defendant's breach. (See *Rest.2d, Contracts* §254(1).)

Moreover, failure of consideration will extinguish an *accrued right of action*. Thus, if a contract to sell is made under which the buyer is to pay the price some time before title is to pass, upon nonpayment the seller has a right of action. But if, at the time for the seller's performance he or she does not or cannot perform, the failure of consideration on the seller's part cuts off the accrued right of action, for otherwise he or she would collect the price from the buyer in one suit, and the latter would then sue and recover it back. (See 13 Corbin (Rev. ed.), §68.5; 15 Williston 4th, §43:2; on distinguishable *executed sale*, where title passes, see 4 *Summary* (10th), *Sales*, §22.)

SUPPLEMENT: [This section is current through the latest supplement]



134 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

C. Conditions and Covenants.

7. Failure of Consideration as Discharge of Duty.

e. Substantial Performance.

1. Nature of Doctrine.

1 Witkin Sum. Cal. Law Contracts § 818

[§ 818] Nature of Doctrine.

At common law, recovery under a contract for work done was dependent upon *complete* performance, although hardship might be avoided by permitting recovery in *quantum meruit*. The prevailing doctrine today, which finds its application chiefly in building contracts, is that *substantial performance* is sufficient, and justifies an action on the contract, although the other party is entitled to a reduction in the amount called for by the contract, to compensate for the defects. What constitutes substantial performance is a question of fact, but it is essential that there be no wilful departure from the terms of the contract, and that the defects be such as may be easily remedied or compensated, so that the promisee may get practically what the contract calls for. (See *Connell v. Higgins* (1915) 170 C. 541, 556, 150 P. 769; *Thomas Haverty Co. v. Jones* (1921) 185 C. 285, 289, 197 P. 105; *Brown v. Aguilar* (1927) 202 C. 143, 147, 259 P. 735; *Posner v. Grunwald-Marx* (1961) 56 C.2d 169, 186, 14 C.R. 297, 363 P.2d 313, quoting the text; *Lowy v. United Pac. Ins. Co.* (1967) 67 C.2d 87, 92, 60 C.R. 225, 429 P.2d 577; *Division of Labor Law Enforcement, Dept. of Industrial Relations v. Ryan Aeronautical Co.* (1951) 106 C.A.2d Supp. 833, 836, 236 P.2d 236; *Roseleaf Corp. v. Radis* (1953) 122 C.A.2d 196, 204, 264 P.2d 964; *Shell v. Schmidt* (1958) 164 C.A.2d 350, 355, 330 P.2d 817, *infra*, §819; *Patrick J. Ruane v. Parker* (1960) 185 C.A.2d 488, 503, 8 C.R. 379; *U. S. Industries v. Edmond J. Vadnais, General Contractor* (1969) 270 C.A.2d 520, 526, 76 C.R. 44; *Tolstoy Const. Co. v. Minter* (1978) 78 C.A.3d 665, 671, 672, 143 C.R. 570, citing the text [doctrine held inapplicable]; *Kossler v. Palm Springs Dev., Ltd.* (1980) 101 C.A.3d 88, 101, 161 C.R. 423, citing the text; 8 Corbin (Rev. ed.), §36.1 et seq.; 15 Williston 4th, §44:51 et seq.; 13 Am.Jur.2d (2000 ed.), *Building and Construction Contracts* §46 et seq.; 17A Am.Jur.2d (2004 ed.), *Contracts* §616 et seq.; 40 U.C.L.A. L. Rev. 1587 [The Substantial Compliance Doctrine in Tax Law: Equity vs. Efficiency].) (On whether parties may expressly contract for exact performance, and thus render the doctrine inapplicable, see 37 Cal. L. Rev. 498.)

*West's Key Number Digest, Contracts k.294***SUPPLEMENT:** [This section is current through the latest supplement]See *Murray's Iron Works v. Boyce* (2008) 158 C.A.4th 1279, 1291, 71 C.R.3d 317, quoting the text.



135 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

C. Conditions and Covenants.

7. Failure of Consideration as Discharge of Duty.

e. Substantial Performance.

2. Illustrations.

1 *Witkin Sum. Cal. Law Contracts* § 819

[§ 819] Illustrations.

In the following cases, the performance rendered was found to constitute substantial performance:

Thomas Haverty Co. v. Jones (1921) 185 C. 285, 292, 197 P. 105 [contract price for construction of plumbing, steam-heating, and ventilation plant was \$ 27,332.66, cost of building about \$ 186,000; departures reduced value of building by \$ 2,180.88].

Brown v. Aguilar (1927) 202 C. 143, 146, 259 P. 735 [contract price of \$ 3,000 for construction of garage; "such slight changes as were made in the specifications" were made by owner through her architect].

Lowy v. United Pac. Ins. Co. (1967) 67 C.2d 87, 92, 60 C.R. 225, 429 P.2d 577 [contractor completed 98% of contracted excavation and grading work but was prevented by developers from completing performance].

The doctrine was held inapplicable in *Shell v. Schmidt* (1958) 164 C.A.2d 350, 330 P.2d 817. The contractor built a \$ 12,000 house, deliberately deviating from the specifications in regard to sheathing material of the exterior walls, one instead of two floor furnaces, and use of sheet rock for interior walls instead of gypsum lath and plaster. The cost of reconstruction was found to be \$ 3,950. Defendant's excuse was that the substitutions, although intentional, were made in good faith and resulted in a building equally as good as that called for by the specifications. The court held, however, that there cannot be substantial performance where, as here, the deviations were not trivial but *major*, and where, despite the asserted "good faith," they were *intentional*. (164 C.A.2d 355.) (See *Tolstoy Const. Co. v. Minter* (1978) 78 C.A.3d 665, 673, 143 C.R. 570 [quoting Corbin: "The performance rendered may be held to be less than substantial by reason of the accumulation of many defects, any one of which standing alone would be minor in character"].) (See 14 Williston 4th, §42:4; 15 Williston 4th, §44:54 et seq.)

SUPPLEMENT: [This section is current through the latest supplement]

See *Murray's Iron Works v. Boyce* (2008) 158 C.A.4th 1279, 1290, 71 C.R.3d 317 [evidence was sufficient to support finding that decorative ironworks manufacturer substantially completed contract with homeowner before manufacturer's president instructed crew not to complete second coat of filling and caulking; president testified that main work was

completed and that manufacturer later completed minor work on punch list, homeowner testified that he was completely satisfied with work done up to that point, and jury could have concluded that filling and caulking was so trivial that manufacturer could have fixed it very easily].



136 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

C. Conditions and Covenants.

8. Excuse of Conditions.

a. Repudiation.

1 Witkin Sum. Cal. Law Contracts § 820

[§ 820] Repudiation.

A condition precedent may in some situations be excused, and the plaintiff permitted to enforce the defendant's duty despite failure of the condition to happen. (See *infra*, §821 et seq.)

If, e.g., the defendant repudiates his or her own promise, the plaintiff need not attempt the useless act of performance of a condition such as tender. (See C.C. 1440, *supra*, §774; *Thomas v. Cowan* (1929) 99 C.A. 140, 146, 277 P. 1086; *Rest.2d, Contracts* §255; Corbin §975 et seq.; 13 Williston 4th, §39:37 et seq.; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §§688, 689; BAJI, No. 10.81 [excuse of condition].) And the condition in a fire or theft insurance policy, requiring proof of loss within a specified period, may be excused by the insurer's denial of all liability under the policy. (See *Olson v. Standard Marine Ins. Co.* (1952) 109 C.A.2d 130, 137, 240 P.2d 379; 2 *Summary* (10th), *Insurance*, §317.)

Where a contract contains an arbitration clause, and one party repudiates the entire agreement as having no binding force, the injured party has these elections: (1) He or she may insist on arbitration and defend against an action by the repudiator on the ground that arbitration is a condition precedent, or he or she may obtain a stay or order to arbitrate. (2) The injured party may, changing his or her position in reliance on the repudiation, bring an action on the contract, and it is then too late for the repudiator to retract and insist on arbitration. (*Bertero v. Superior Court* (1963) 216 C.A.2d 213, 220, 30 C.R. 719.)

West's Key Number Digest, Specific Performance k.97(1)

SUPPLEMENT: [This section is current through the latest supplement]



137 of 184 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

C. Conditions and Covenants.

8. Excuse of Conditions.

b. Prevention of Satisfaction of Condition.

1. General Rule.

1 Witkin Sum. Cal. Law Contracts § 821

[§ 821] General Rule.

A person cannot take advantage of his or her own act or omission to escape liability; if the person *prevents or makes impossible* the performance or happening of a condition precedent, the condition is excused. (*Pacific Venture Corp. v. Huey* (1940) 15 C.2d 711, 717, 104 P.2d 641; *Bewick v. Mecham* (1945) 26 C.2d 92, 99, 156 P.2d 757; *Carl v. Eade* (1927) 81 C.A. 356, 358, 253 P. 750, *infra*, §822; *Thomas v. Cowan* (1929) 99 C.A. 140, 145, 277 P. 1086; *Crillo v. Curtola* (1949) 91 C.A.2d 263, 271, 204 P.2d 941, *supra*, §785; *Overton v. Vita-Food Corp.* (1949) 94 C.A.2d 367, 371, 210 P.2d 757; *Unruh v. Smith* (1954) 123 C.A.2d 431, 437, 267 P.2d 72; *Rains v. Arnett* (1961) 189 C.A.2d 337, 347, 11 C.R. 299; *Green v. Linn* (1962) 210 C.A.2d 762, 767, 26 C.R. 889, *infra*, §822; *Stone v. Carpenter* (1963) 211 C.A.2d 491, 496, 27 C.R. 203; *General Ins. Co. v. Commerce Hyatt House* (1970) 5 C.A.3d 460, 468, 85 C.R. 317; *Jacobs v. Tenneco West* (1986) 186 C.A.3d 1413, 1417, 1418, 231 C.R. 351 [discussing *Rest.2d, Contracts* §245, and *Rains v. Arnett, supra*]; see *Rest.2d, Contracts* §245; 8 Corbin (Rev. ed.), §§40.17, 40.18; 13 Williston 4th, §39:3 et seq.; 3 California Affirmative Defenses (2004 ed.), §59:1 et seq.; BAJI, No. 10.81 [excuse of condition].)

Of course, if the contract expressly allows the defendant's act that prevents performance of the condition, the plaintiff has no cause for complaint, because he or she has assumed the risk. (See *Kline v. Johnson* (1953) 121 C.A.2d Supp. 851, 854, 263 P.2d 494 [real estate broker's agreement providing that, on forfeiture, commission limited to half of down payment; no recovery where no down payment].)

SUPPLEMENT: [This section is current through the latest supplement]

See 3 California Affirmative Defenses §59:1 et seq.



138 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

C. Conditions and Covenants.

8. Excuse of Conditions.

b. Prevention of Satisfaction of Condition.

2. Illustrations.

1 *Witkin Sum. Cal. Law Contracts* § 822

[§ 822] Illustrations.

Where an owner connives with an architect and the latter arbitrarily refuses a certificate of completion, or where the owner fails to appoint an architect at all, the condition of an architect's certificate is excused. (*Thomas Haverty Co. v. Jones* (1921) 185 C. 285, 296, 197 P. 105.)

Where the defendant's promise to pay money is conditioned on an event within his or her own control, the defendant may be liable despite the nonhappening of the event, if he or she prevents it from happening. Thus, in *Carl v. Eade* (1927) 81 C.A. 356, 253 P. 750, defendant vendor agreed to pay a real estate agent a commission out of a sum of money to be received from the purchaser, but later accepted a quitclaim deed from the purchaser, instead of the money. *Held*, the condition of receipt of money from the purchaser was excused, and the vendor was liable for the commission. (81 C.A. 359.)

In *Orton v. Embassy Realty Associates* (1949) 91 C.A.2d 434, 205 P.2d 427, plaintiffs, in October 1945, sold to defendants all the capital stock of a real estate corporation. The contract provided that the price would be increased in stated amounts if plaintiffs procured for defendants a suitable lessee of the corporation's property before September 1946. In June 1946, defendants sold the land. *Held*, plaintiffs could recover damages for breach. Under the provision, defendants impliedly agreed to hold the property available for lease until September 1946, and by resale of the property they effectively prevented plaintiffs from performing the condition. (91 C.A.2d 438.)

In *Zogarts v. Smith* (1948) 86 C.A.2d 165, 194 P.2d 143, plaintiffs transferred their interest in a partnership to defendants, the other partners, in consideration of a promise to pay the price *out of profits* of the business. Defendants also agreed personally to pay the old firm debts. Instead, they allowed the new firm to assume the debts, with the result that its credit was impaired, it failed, and the business was liquidated. *Held*, defendants were liable for the price, despite the fact that the condition (making of profits) had not occurred, for their own voluntary act made fulfillment of that condition impossible. (86 C.A.2d 170.)

In *Green v. Linn* (1962) 210 C.A.2d 762, 26 C.R. 889, a real estate broker's contract specified that the sale of property of a partnership in dissolution was subject to court approval. Plaintiff broker negotiated the sale and defendant

principal petitioned for approval, but then defendant stipulated in court that the deal be disapproved and a sale to another purchaser approved. *Held*, it was bad faith and a breach of contract to persuade the court to accept the stipulation, and the condition was excused. (210 C.A.2d 767.)

SUPPLEMENT: [This section is current through the latest supplement]



139 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

C. Conditions and Covenants.

8. Excuse of Conditions.

c. Waiver of Condition.

1. General Rule.

1 Witkin Sum. Cal. Law Contracts § 823

[§ 823] General Rule.

A condition may be *waived*; i.e., the party whose duty is *dependent* upon the other party's performance of a condition may make his or her duty *independent*, binding the party to perform unconditionally. (See *17A Am.Jur.2d* (2004 ed.), *Contracts* §638.)

The waiver may be an *express statement*, or it may be *implied*, as where the party entitled to certain performance accepts partial or defective performance. (See *Kellogg v. Snell* (1928) 93 C.A. 717, 721, 270 P. 232; *Lowe v. Copeland* (1932) 125 C.A. 315, 321, 13 P.2d 522; *Bardeen v. Commander Oil Co.* (1940) 40 C.A.2d 341, 347, 104 P.2d 875; *Panno v. Russo* (1947) 82 C.A.2d 408, 412, 186 P.2d 452; *Bell v. Minor* (1948) 88 C.A.2d 879, 882, 199 P.2d 718; *Wesley N. Taylor Co. v. Russell* (1961) 194 C.A.2d 816, 828, 15 C.R. 357; *Sosin v. Richardson* (1962) 210 C.A.2d 258, 264, 26 C.R. 610; *Spellman v. Dixon* (1967) 256 C.A.2d 1, 5, 63 C.R. 668 [must be unconditional]; *Doryon v. Salant* (1977) 75 C.A.3d 706, 712, 142 C.R. 378; *Rest.2d, Contracts* §246; 8 Corbin (Rev. ed.), §40.1 et seq.; 13 Williston 4th, §39:17; 14 Williston 4th, §40:1 et seq.; Cal. Civil Practice, 3 Business Litigation, §32:18; 7A Am.Jur. P.P. Forms (2002 ed.), *Contracts*, §110; *17A Am.Jur.2d* (2004 ed.), *Contracts* §638 et seq.; 80 Proof of Facts 3d 193 [owner's waiver of stipulation in private building contract that alterations or extras must be authorized in writing]; BAJI, No. 10.81 [excuse of condition]; CACI, No. 323 [waiver of condition precedent].) (On insurer's acceptance of defaulted premium payment as affecting liability for loss occurring during default period, see 7 A.L.R.3d 414.)

There can be no waiver of "a material part of the agreed exchange"; i.e., the party entitled to performance cannot by a mere declaration or other acts, unsupported by consideration, give up the entire benefit of the contract. Thus, a buyer may waive conditions relating to time and place of delivery, but not the right to receive the goods; and a seller may waive a right to prior payment and deliver the goods first, but cannot by a mere waiver give up the right to receive the price. (See *Rest.2d, Contracts* §84(1) and Comment c; 8 Corbin (Rev. ed.), §40.2.) To relinquish the entire obligation of performance, some recognized form of discharge is necessary, e.g., release, accord and satisfaction, or novation. (See *infra*, §946 et seq.)

West's Key Number Digest, Estoppel k.71

SUPPLEMENT: [This section is current through the latest supplement]



140 of 184 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

C. Conditions and Covenants.

8. Excuse of Conditions.

c. Waiver of Condition.

2. Illustrations.

1 Witkin Sum. Cal. Law Contracts § 824

[§ 824] Illustrations.

Familiar examples of waiver are:

(1) Acceptance of late payments in an installment contract for the sale of land or a conditional sale of goods, waiving the provision that "time is of the essence." (*Boone v. Templeman* (1910) 158 C. 290, 295, 110 P. 947; *Redd v. Garford Motor Truck Co.* (1928) 205 C. 245, 247, 270 P. 447; *Galdjie v. Darwish* (2003) 113 C.A.4th 1331, 1343, 7 C.R.3d 178; see 13 *Summary* (10th), *Equity*, §61.)

(2) Waiver of a lessee's breach of condition by the landlord's acceptance of rent. (*Kern Sunset Oil Co. v. Good Roads Oil Co.* (1931) 214 C. 435, 440, 6 P.2d 71; see 12 *Summary* (10th), *Real Property*, §669.)

(3) Employer's waiver of condition of 20 years' service as basis for employee's pension. (*Sessions v. Southern Calif. Edison Co.* (1941) 47 C.A.2d 611, 619, 118 P.2d 935.)

(4) Agency to sell: waiver of condition calling for sale of certain units within 90-day period. (*Fuller v. Mann* (1932) 119 C.A. 568, 572, 6 P.2d 999.)

In *Noel v. Dumont Builders* (1960) 178 C.A.2d 691, 3 C.R. 220, plaintiffs desired to sell their old home and build a new one. They contracted with defendant builder for construction, subject to the condition precedent of sale of their old home. They delayed the sale in order to have a place to live, but approved plans, authorized construction, and made changes. They also signed a deposit receipt for the new home. Later, they attempted to rescind and recover their deposit on the ground that they had not sold their old home. *Held*, judgment for plaintiffs reversed; their conduct constituted a waiver of the condition. (178 C.A.2d 696.)

However, after notice of breach and election to sell under a trust deed, acceptance by the beneficiary of a small sum as *partial payment* on the interest or principal will not constitute a waiver of the default. (*Harris v. Whittier Bldg. & Loan Assn.* (1936) 18 C.A.2d 260, 268, 63 P.2d 840.) And the plaintiffs' payments on account will not be held to constitute a waiver of the defendant's delay in performance when accompanied by protests. (*Wilkinson & Co. v.*

McKinley (1948) 84 C.A.2d 100, 105, 190 P.2d 35.)

West's Key Number Digest, Vendor and Purchaser 95(2)

SUPPLEMENT: [This section is current through the latest supplement]



141 of 184 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

C. Conditions and Covenants.

8. Excuse of Conditions.

c. Waiver of Condition.

3. Retraction of Waiver.

1 Witkin Sum. Cal. Law Contracts § 825

[§ 825] Retraction of Waiver.

A waiver may be retracted until the other party materially *changes his or her position*, in reliance upon it. In other words, though waiver is usually defined as an "intentional relinquishment of a known right," the relinquishment of a contractual right, to be binding, generally requires an additional showing of (1) *consideration*, or (2) *election of one of two inconsistent rights*, or (3) *estoppel*. So, where there is no consideration, and there has been no choice between inconsistent rights, the waiver, express or implied, may be retracted until the other party's reliance thereon creates an estoppel. (See *Rest.2d, Contracts* §84(2) and Comment (f); 8 Corbin (Rev. ed.), §40.13; 13 Williston 4th, §39:20; cf. U.C.C. 2209(5) [other party's reliance must result in "material change of position"].)

In *Tas-T-Nut Co. v. Continental Nut Co.* (1954) 125 C.A.2d 351, 270 P.2d 43, defendant seller initially delayed arbitration by dilatory steps, but plaintiff buyer did not unequivocally elect to treat this conduct as an implied repudiation of the arbitration clause. It was only after defendant reasserted its right to arbitration that plaintiff abandoned its own right to do so and instituted a court action. *Held*, arbitration was a condition precedent to plaintiff's right to sue. At the time of defendant's dilatory actions, plaintiff could have elected to acquiesce in the abandonment of arbitration. (125 C.A.2d 355.) Having failed to do so, plaintiff's right to elect was lost, and defendant was free to retract its waiver and insist on arbitration. (125 C.A.2d 358.) (Cf. *Local 659, I.A.T.S.E. v. Color Corp. of America* (1956) 47 C.2d 189, 194, 302 P.2d 294 [arbitration clause in collective labor agreement held waived by repudiation and acceptance thereof by employer].)

SUPPLEMENT: [This section is current through the latest supplement]



142 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

C. Conditions and Covenants.

8. Excuse of Conditions.

d. Condition Involving Forfeiture.

1. Construction To Avoid.

1 Witkin Sum. Cal. Law Contracts § 826

[§ 826] Construction To Avoid.

Forfeitures are not favored; hence a contract, and conditions in a contract, will if possible, be *construed* to avoid a forfeiture. (C.C. 1442; see *Ballard v. MacCallum* (1940) 15 C.2d 439, 444, 101 P.2d 692; *Bittinger v. New York Life Ins. Co.* (1941) 17 C.2d 834, 841, 112 P.2d 621 ["This is particularly true of insurance contracts"]; *Universal Sales Corp. v. California Press Mfg. Co.* (1942) 20 C.2d 751, 771, 128 P.2d 665; *Petrovich v. Arcadia* (1950) 36 C.2d 78, 84, 222 P.2d 231; *Alpha Beta Food Markets v. Retail Clerks Union Local 70* (1955) 45 C.2d 764, 771, 291 P.2d 433; *Milovich v. Los Angeles* (1941) 42 C.A.2d 364, 373, 108 P.2d 960; *Smith v. Baker* (1950) 95 C.A.2d 877, 883, 241 P.2d 94; *Yamanishi v. Bleily & Collishaw* (1972) 29 C.A.3d 457, 462, 105 C.R. 580; *Moss Dev. Co. v. Geary* (1974) 41 C.A.3d 1, 11, 115 C.R. 736; 8 Corbin (Rev. ed.), §39.10; 13 Williston 4th, §38:13; 14 Williston 4th, §42:1 et seq.; 17A Am.Jur.2d (2004 ed.), Contracts §§545, 546; 74 A.L.R.3d 187 [construction of no damages for delay clause].)

In *Hawley v. Orange County Flood Control Dist.* (1963) 211 C.A.2d 708, 27 C.R. 478, plaintiff contracted to build a sewer line. The work was substantially delayed because of defendant district's failure to promptly correct a mistake in its plans, and as a result a cave-in occurred, necessitating repair work of the reasonable value of \$ 3,000. In this action for breach, a nonsuit was granted on the ground that the contract contained a "no damage for delay clause" that authorized only an extension of time but no damages. *Held*, reversed. The clause had the effect of imposing a forfeiture; such a clause is strictly construed, particularly when prepared by the party seeking to impose it; and this is so even though that party is a governmental agency. (211 C.A.2d 713.) Here, the trial judge found that defendant was guilty of "unreasonable delay," and whether the clause was intended to prevent recovery was a factual question calling for a consideration of all the circumstances. A nonsuit was improper, because the evidence could have supported a factual conclusion that the parties did not contemplate refusal to reimburse the contractor for extra expense resulting from the acts and omissions of defendant. (211 C.A.2d 717.)

SUPPLEMENT: [This section is current through the latest supplement]



143 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

C. Conditions and Covenants.

8. Excuse of Conditions.

d. Condition Involving Forfeiture.

2. Excuse of Condition or Equitable Relief.

1 *Witkin Sum. Cal. Law Contracts* § 827

[§ 827] Excuse of Condition or Equitable Relief.

Where the provision requiring a forfeiture is express and cannot be avoided by construction, the court may, in a proper case, excuse the condition or give *equitable relief* against its enforcement. (See C.C. 3275, 3369; *Ebbert v. Mercantile Trust Co.* (1931) 213 C. 496, 499, 2 P.2d 776; *Hopkins v. Woodward* (1932) 216 C. 619, 621, 15 P.2d 499; *O'Morrow v. Borad* (1946) 27 C.2d 794, 800, 167 P.2d 483; *Brant v. Bigler* (1949) 92 C.A.2d 730, 734, 208 P.2d 47; *Wagner v. Shapona* (1954) 123 C.A.2d 451, 462, 267 P.2d 378; *Rest.2d, Contracts* §229 [court may excuse condition "unless its occurrence was a material part of the agreed exchange"]; §271 [impracticability as excuse if occurrence is not material part of agreed exchange]; 8 Corbin (Rev. ed.), §40.3; 13 Williston 4th, §39:15; 14 Williston 4th, §42:1 et seq.; 13 *Summary* (10th), *Equity*, §§20 et seq., 62; and see *Ballard v. MacCallum* (1940) 15 C.2d 439, 444, 101 P.2d 692 [distinguishing doctrines of construction and excuse or equitable relief].) (On the similar rule authorizing the court to refuse enforcement of an "unconscionable" provision, see C.C. 1670.5, *supra*, §330.)

West's Key Number Digest, Contracts k.309(1)

SUPPLEMENT: [This section is current through the latest supplement]

See *Root v. American Equity Specialty Ins. Co.* (2005) 130 C.A.4th 926, 948, 30 C.R.3d 631 [insured attorney was entitled to be equitably excused from condition precedent that he report malpractice suit against him within policy period, where attorney heard only ambiguous report of client's suit 3 days before policy expired, he learned reliably of suit 2 days after policy expired and reported suit immediately, and he was not given opportunity to buy extended reporting endorsement].



144 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

D. Impossibility, Impracticability, and Frustration of Purpose.

1. In General.

a. Nature of Excuse and California Statutes.

1 Witkin Sum. Cal. Law Contracts § 828

[§ 828] Nature of Excuse and California Statutes.

The excuse of impossibility is covered in several Code sections:

"A condition in a contract, the fulfillment of which is impossible or unlawful ... , or which is repugnant to the nature of the interest created by the contract, is void." (C.C. 1441.)

"The object of a contract must be lawful when the contract is made, and possible and ascertainable by the time the contract is to be performed." (C.C. 1596.)

Performance is excused "[w]hen it is prevented or delayed by an irresistible, superhuman cause, or by the act of public enemies of this state or of the United States." (C.C. 1511(2); see *Pub.Contr.C. 7105(a)*, (b), *infra*, §992.)

In the early law, "act of God" ("vis major," "force majeure") was regarded as the principal impossibility defense. (See *Pope v. Farmers' Union & Milling Co.* (1900) 130 C. 139, 141, 62 P. 384; *Mathes v. Long Beach* (1953) 121 C.A.2d 473, 477, 263 P.2d 472; 14 Corbin (Rev. ed.), §74.1 et seq.; 1 *Am.Jur.2d*, *Act of God* (1994 ed.), §1 et seq.; 14 *Am.Jur.2d* (2000 ed.), *Carriers* §544 et seq.; 5A *Am.Jur. P.P. Forms* (1998 ed.), *Carriers*, §164; *Cal. Civil Practice*, 3 *Business Litigation*, §24:62 et seq.; 2 *California Affirmative Defenses* (2004 ed.), §30:1 et seq.; 3 *California Affirmative Defenses* (2004 ed.), §60:1 et seq.; 1 *Proof of Facts* 143 [act of God]; 7 *Cal. L. Rev.* 115; 64 *Harv. L. Rev.* 462; 20 *Hastings L. J.* 1393; *BAJI*, No. 10.81 [excuse of condition].)

This excuse has greatly declined in practical importance as other grounds caused by human agency have been commonly recognized. (See *Rest.2d*, *Contracts* §261, *infra*, §829; 14 Corbin (Rev. ed.), §74.1 et seq.; 14 *Williston* 4th, §43:11 et seq.; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §655 et seq.; 24 *Proof of Facts* 2d 269 [impossibility of performing contract]; 26 *Hastings L. J.* 2151 [The Economic Implication of the Doctrine of Impossibility]; 84 *A.L.R.2d* 12 [modern status of rules]; *infra*, §838 et seq.)

SUPPLEMENT: [This section is current through the latest supplement]

See 5A *Am.Jur. P.P. Forms* (2008 ed.), *Carriers*, §161; 2 *California Affirmative Defenses* §30:1 et seq.; 3 *California Affirmative Defenses* §60:1 et seq.; 1 *Am.Jur.2d* (2005 ed.), *Act of God* §1 et seq.; 102 *Proof of Facts* 3d 401

[impossibility of performing contract], superseding 24 Proof of Facts 2d 269, text, p. 917.



145 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XIII. PERFORMANCE
D. Impossibility, Impracticability, and Frustration of Purpose.
1. In General.
b. Restatement 2d.

1 Witkin Sum. Cal. Law Contracts § 829

[§ 829] Restatement 2d.

Rest.2d, Contracts §261, entitled "Discharge by Supervening Impracticability," reads as follows:

"Where, after a contract is made, a party's performance is made impracticable without his fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made, his duty to render that performance is discharged, unless the language or the circumstances indicate the contrary."

The Second Restatement consolidates the subjects of impracticability and frustration of purpose, substituting the term "impracticability" for "impossibility" as better expressing the extent of the increased burden required. It rejects the notion of an "implied term" of the contract, and "adopts the central notion" of U.C.C. 2615 of "a contingency the non-occurrence of which was a basic assumption on which the contract was made," in dealing with both impracticability and frustration. (*Rest.2d, Contracts §261*, Reporter's Note.)

The new approach is explained in Restatement 2d, Contracts, Volume 2, Chapter 11, p. 309, Introductory Note:

(1) An obligor who does not wish to undertake strict contract liability may contract for a lesser obligation by various clauses (e.g., "best efforts," right to cancel, or limitation of damages for breach). But even where he has not limited his obligation by agreement, the court may grant relief: "An extraordinary circumstance may make performance so vitally different from what was reasonably to be expected as to alter the essential nature of that performance." (Introductory Note, p. 309.)

(2) Three distinct grounds for discharge of the obligor's duty must be distinguished (Introductory Note, p. 310):

First, the obligor may claim that some circumstance has made his or her own performance impracticable. (§§261, 262, 263, 264.)

Second, the obligor may claim that some circumstance has so destroyed the value to him or her of the other party's performance as to frustrate his or her own purpose in making the contract. (§265.)

Third, the obligor may claim that he or she will not receive the agreed exchange for his or her own performance

because some circumstance has discharged the obligee's duty on the ground of either impracticability or frustration. (§§237, 267.)

(3) Usually, the impracticability or frustration occurs after the contract is made ("supervening"; §261); but it may have already existed at the time of contracting ("existing"; §266), and the results in each case are substantially the same. The rules on mistake may also be available to the obligor on the basis of existing impracticability or frustration. (Introductory Note, p. 310.)

(4) The effect of the doctrine is to relieve the obligor of his or her duty because the contract, having been made on a different "basic assumption," is regarded as not covering the case. In some cases, a party who has already partly performed may recover for what he or she has done under the rule on part performances as agreed equivalents (§240), or the party may be entitled to restitution or expenses incurred in reliance on the contract (§§272, 377). (Introductory Note, p. 311.)

(5) In determining whether the nonoccurrence of an event was a basic assumption, the court will look at all circumstances, including the terms of the contract. "The fact that the event was unforeseeable is significant as suggesting that its non-occurrence was a basic assumption. However, the fact that it was foreseeable, or even foreseen, does not, of itself, argue for a contrary conclusion, since the parties may not have thought it sufficiently important a risk to have made it a subject of their bargaining. Another significant factor may be the relative bargaining positions of the parties and the relative ease with which either party could have included a clause." (Introductory Note, p. 311.)

SUPPLEMENT: [This section is current through the latest supplement]



146 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

D. Impossibility, Impracticability, and Frustration of Purpose.

1. In General.

c. Subjective and Objective Impossibility.

1 Witkin Sum. Cal. Law Contracts § 830

[§ 830] Subjective and Objective Impossibility.

The defense is *impossibility "in the nature of things"* (C.C. 1597); i.e., the impossibility must be in the nature of the thing to be done ("objective impossibility"), and not in the inability of the promisor to do it. (See *Sample v. Fresno Flume & Irr. Co.* (1900) 129 C. 222, 227, 61 P. 1085; *Wilson v. Alcatraz Asphalt Co.* (1904) 142 C. 182, 188, 75 P. 787; *Hensler v. Los Angeles* (1954) 124 C.A.2d 71, 83, 268 P.2d 12 ["One who binds himself to a contract which cannot be performed without the consent or cooperation of a third person is not relieved of liability because of his inability to secure the required consent or cooperation"]; cf. *Rest.2d, Contracts* §261, Comment e [terms "objective" and "subjective" not used; "the rationale is that a party generally assumes the risk of his own inability to perform his duty"].)

Hence, mere unforeseen difficulty or expense does not constitute impossibility and ordinarily will not excuse performance. (See *Wilmington Trans. Co. v. O'Neil* (1893) 98 C. 1, 5, 32 P. 705; *Carlson v. Sheehan* (1910) 157 C. 692, 697, 109 P. 29; *Aristocrat Highway Displays v. Stricklin* (1945) 68 C.A.2d 788, 790, 157 P.2d 880; *Palo & Dodini v. Oakland* (1947) 79 C.A.2d 739, 746, 180 P.2d 764; *McCulloch v. Liguori* (1948) 88 C.A.2d 366, 370, 199 P.2d 25; *Paramount Pictures v. Sparling* (1949) 93 C.A.2d 768, 771, 209 P.2d 968; *Caron v. Andrew* (1955) 133 C.A.2d 402, 407, 284 P.2d 544; 14 Corbin (Rev. ed.), §74.1; 30 Williston 4th, §77:23.) (On strikes and labor disputes as excusing performance, see 8 Corbin (Rev. ed.), §31.4; 8 Corbin (Rev. ed.), §31.4; 14 Corbin (Rev. ed.), §§74.7, 75.8; 14 U.C. Davis L. Rev. 669 [Unif.Com.C. §2-615 and strikes].)

Thus, in *Kennedy v. Reece* (1964) 225 C.A.2d 717, 37 C.R. 708, defendant, an experienced water well driller, agreed to drill a well to a depth of 400 feet. He quit at 270 feet when he encountered rock. However, the evidence showed that the rock was brittle and could be pierced at a moderate increase in cost (\$ 5 per foot as against contract price of \$ 3.50); hence, judgment for plaintiff was affirmed. (225 C.A.2d 724.)

In *Oosten v. Hay Haulers Dairy Employees & Helpers Union* (1955) 45 C.2d 784, 291 P.2d 17, defendant creamery contracted to buy plaintiff's milk. Plaintiff had a dispute with defendant labor union, and the creamery's union employees, fearing reprisals from defendant union, refused to take plaintiff's milk. The contract provided an excuse in case of "strike, lockout, or other labor trouble" which rendered performance impossible. *Held*, plaintiff was entitled to damages for breach of contract. The provision merely stated a general principle of contract law, and it was necessary for defendant to show affirmatively that performance was impossible despite the exercise of skill, diligence, and good faith.

Here, the trial judge was justified in concluding that there was only a vague threat of adverse action by the other union, and that defendant creamery was under no pressure except a desire not to antagonize that union. (45 C.2d 789.)

However, "modern cases recognize as a defense not only objective impossibility in the true sense, but also impracticability due to excessive and unreasonable difficulty or expense." (*Christin v. Superior Court* (1937) 9 C.2d 526, 533, 71 P.2d 205.) (See *supra*, §829; *infra*, §842.)

West's Key Number Digest, Contracts k.309(1)

SUPPLEMENT: [This section is current through the latest supplement]



147 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

D. Impossibility, Impracticability, and Frustration of Purpose.

1. In General.

d. Complete Impossibility or Impracticability.

1. Promisor's Duty Discharged.

1 Witkin Sum. Cal. Law Contracts § 831

[§ 831] Promisor's Duty Discharged.

(1) If the impossibility exists at the time the agreement is made, no duty, i.e., no binding contract, *arises*. (*Dairy Food Store v. Alpert* (1931) 116 C.A. 670, 672, 3 P.2d 61; see *Rest.2d, Contracts* §266; 14 Corbin (Rev. ed.), §74.13; *supra*, §258.) However, if it occurs *after* the making of the agreement, the duty of the promisor is discharged; i.e., his or her performance is excused. (C.C. 1511; *H. Hackfeld & Co. v. Castle* (1921) 186 C. 53, 57, 198 P. 1041; see *Rest.2d, Contracts* §261; 14 Corbin (Rev. ed.), §§74.1, 74.13.)

(2) Where the promisor reasonably *apprehends* impossibility or serious danger to life or health, he or she may be excused from commencing performance, and in some situations may be wholly discharged. (See 14 Corbin (Rev. ed.), §75.3; 30 Williston 4th, §77:68.)

(3) Impossibility arising before performance is due will discharge the promisor's duty even though he or she has already committed an *anticipatory breach*. But where the time for performance arrives and the promisor commits an *actual breach*, subsequent impossibility is not a complete excuse, though it will limit the damages recoverable if the impossibility would have occurred anyway. (See 14 Corbin (Rev. ed.), §75.9; 30 Williston 4th, §77:50.)

SUPPLEMENT: [This section is current through the latest supplement]



148 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

D. Impossibility, Impracticability, and Frustration of Purpose.

1. In General.

d. Complete Impossibility or Impracticability.

2. Promisee Excused.

1 Witkin Sum. Cal. Law Contracts § 832

[§ 832] Promisee Excused.

Because the promisor may not be held, the other party may ordinarily rescind an executory contract for failure of consideration. (See *Rest.2d, Contracts* §§237, 267; *supra*, §813.)

Thus, in *Ogren v. Inner Harbor Land Co. (1927) 83 C.A. 197, 256 P. 607*, the vendor had agreed to sell land, but condemnation proceedings against him resulted in his losing title. *Held*, the purchaser could recover prior payments on the purchase price. (*83 C.A. 199.*) (See *Riff v. Mayhew (1949) 90 C.A.2d 712, 717, 203 P.2d 812* [where impossibility of performance by seller results in failure of consideration, buyer may recover purchase money previously paid into escrow].)

The foregoing general rule is subject to an exception where a party has by law, or by the nature or terms of the contract, *assumed the risk of loss*. (See *Rest.2d, Contracts* §267; 14 Corbin (Rev. ed.), §74.15; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §665.)

Thus, where a contract for the sale of goods requires or authorizes the seller only to arrange for shipment, the risk of loss passes to the buyer when the goods are duly delivered to the carrier for shipment; and the seller may recover the price even if the goods are never delivered to the buyer. (U.C.C. 2509(1)(a); see 4 *Summary* (10th), *Sales*, §199.) (On the risk in sales of real property after destruction or condemnation, see 13 *Summary* (10th), *Equity*, §§175, 176.)

SUPPLEMENT: [This section is current through the latest supplement]



149 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

D. Impossibility, Impracticability, and Frustration of Purpose.

1. In General.

e. Temporary and Partial Impossibility.

1. Suspension of Duty.

1 Witkin Sum. Cal. Law Contracts § 833

[§ 833] Suspension of Duty.

Temporary impossibility usually *suspends* the obligation to perform during the time it exists. (See *Rest.2d, Contracts* §269; 14 Corbin (Rev. ed.), §76.7; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §662.)

Thus, *an embargo* suspends the seller's duty to deliver goods until it is lifted. (*United States Trading Corp. v. Newmark Grain Co.* (1922) 56 C.A. 176, 186, 205 P. 29.) And the duty of a surety on a bail bond to deliver the accused for arraignment is suspended during the period of the accused's incarceration, if he or she is subsequently arrested and held in custody elsewhere. (*People v. Meyers* (1932) 215 C. 115, 118, 8 P.2d 837.) (See *Bergin v. van der Steen* (1951) 107 C.A.2d 8, 16, 236 P.2d 613 ["Where performance of a contract after a temporary suspension does not impose a substantially greater burden upon such promisor his duty is suspended only during the period his performance was hindered and he must thereafter perform".]) (On the right of an employee to recover wages for a period of temporary disability, see 5 *Stanf. L. Rev.* 30.)

West's Key Number Digest, Contracts k.309(1)

SUPPLEMENT: [This section is current through the latest supplement]

See *Maudlin v. Pacific Decision Sciences Corp.* (2006) 137 C.A.4th 1001, 1017, 40 C.R.3d 724, citing the text [on remand, trial court must determine whether obligated party had sufficient funds and whether any deficiency was temporary, thereby merely suspending duty to pay, or whether, without fault of obligated party, deficiency had become sufficiently permanent to excuse further payments].



150 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

D. Impossibility, Impracticability, and Frustration of Purpose.

1. In General.

e. Temporary and Partial Impossibility.

2. Discharge of Duty.

1 Witkin Sum. Cal. Law Contracts § 834

[§ 834] Discharge of Duty.

(1) *Partial impossibility* ordinarily discharges the duty only to the extent thereof. (See *Rest.2d, Contracts §270*; *17A Am.Jur.2d (2004 ed.), Contracts §662*.)

(2) *Temporary impossibility of indefinite duration* will sometimes be sufficiently permanent to justify termination of the contract. (*Autry v. Republic Productions (1947) 30 C.2d 144, 148, 155, 180 P.2d 888*, *infra*, §840; *20th Century Lites v. Goodman (1944) 64 C.A.2d Supp. 938, 945, 149 P.2d 88*; see *Rest.2d, Contracts §269*; 14 Corbin (Rev. ed.), §76.7; *17A Am.Jur.2d (2004 ed.), Contracts §662*.)

(3) Where a promisor partly performs and his or her further duty is discharged by impossibility, the promisor may ordinarily, in the absence of contrary provision in the contract, recover the value of his or her part performance. (See *Rest.2d, Contracts §272(1)*; 14 Corbin (Rev. ed.), §78.6 *et seq.*; *17A Am.Jur.2d (2004 ed.), Contracts §685*.)

(4) Where the promise is to do one of two or more things, in the *alternative*, and one becomes unlawful or impossible, the contract will usually be interpreted to impose a duty to do the act that is possible. In other words, impossibility in an alternative contract ordinarily destroys merely the freedom of choice. (C.C. 1451; see *Rosenthal v. Perkins (1898) 123 C. 240, 243, 55 P. 804*; *Rest.2d, Contracts §261*, Comment f; 14 Corbin (Rev. ed.), §74.17; *17A Am.Jur.2d (2004 ed.), Contracts §663*.)

SUPPLEMENT: [This section is current through the latest supplement]



151 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

D. Impossibility, Impracticability, and Frustration of Purpose.

1. In General.

e. Temporary and Partial Impossibility.

3. Apportionment of Performances.

1 Witkin Sum. Cal. Law Contracts § 835

[§ 835] Apportionment of Performances.

A special form of *partial* impossibility occurs where the promisor owes performance under separate contracts to several promisees, but cannot perform in full to all. May the promisor prefer one promisee or must he or she perform ratably to all, i.e., apportion performance equally among them?

The First Contracts Restatement stated the apportionment rule, and the section was followed in *Akins v. Riverbank Canning Co.* (1947) 80 C.A.2d 868, 183 P.2d 86. Defendant canning company had contracts to buy the tomato crops of various growers, and to supply them with boxes for shipping. A shortage of boxes developed, and defendant furnished adequate amounts to some growers but not to plaintiffs. *Held*, defendant was liable for the loss of plaintiffs' crop. The court said: "Here the parties by virtue of the peculiar nature of the contracts and the type of activity involved, obviously contemplated that similar contracts would be made with other growers. Each of such contracts constituted part of an over-all plan known to all the growers, none of whom could reasonably believe that if future circumstances should prevent the complete performance of all the contracts he would be entitled to preferential treatment under his agreement or that the cannery at its own choosing might discriminate against him in favor of others. Under the circumstances herein it would be as manifestly unfair to compel defendant to carry out in full its contract with plaintiffs to the exclusion of all others as it would be to allow defendant to carry out its contracts with some of the other growers and to escape its obligation to plaintiffs by proof of only a partial impossibility of performance." (80 C.A.2d 873.)

The rule was again applied in *Yuba v. Mattoon* (1958) 160 C.A.2d 456, 325 P.2d 162. Plaintiff leased 300 acres of rice land to defendant for a rental of 20% of the crop proceeds and a minimum of \$ 2,500. Defendant also rented 200 acres from others. A government order limited his total farming acreage, and he elected to allow plaintiff's land to remain idle and farm the other leased land. *Held*, plaintiff could have recovered damages for failure to farm a proportionate amount of its land and account for the proceeds; and, in this action for the minimum rental--a smaller sum--judgment for plaintiff was affirmed. (160 C.A.2d 458.) (See *Rest.2d, Contracts §272*, Comment c and Reporter's Note; 14 Corbin (Rev. ed.), §75.10; 17A *Am.Jur.2d* (2004 ed.), *Contracts §662*.)

SUPPLEMENT: [This section is current through the latest supplement]



152 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

D. Impossibility, Impracticability, and Frustration of Purpose.

1. In General.

f. Provision Requiring Notice of Intent.

1 Witkin Sum. Cal. Law Contracts § 836

[§ 836] Provision Requiring Notice of Intent.

In *Peter Kiewit Sons' Co. v. Pasadena City Junior College Dist. of Los Angeles* (1963) 59 C.2d 241, 28 C.R. 714, 379 P.2d 18, a construction contract provided for a \$ 25 liquidated damage deduction for each day's delay beyond the specified period for performance, except where an extension was granted, for causes beyond the contractor's control, on written application to the architect and owner. A number of delays occurred by reason of matters beyond the contractor's control, but as to some he did not request extensions of time, and defendant claimed the right to deduct. *Held*, there was no such right. Under C.C. 1511, delay caused by the conduct of the creditor (which includes an owner) is excusable despite an express stipulation to the contrary (see *supra*, §§821, 822), and a contract provision requiring an application for extension of time would contravene the statutory policy. Contrary language in *Roberts v. Security Trust & Savings Bank* (1925) 196 C. 557, 238 P. 673, and *Suhr v. Metcalfe* (1917) 33 C.A. 59, 164 P. 407, was disapproved. (59 C.2d 245.)

The 1965 Legislature abrogated the foregoing holding by the following addition to C.C. 1511(1): "[T]he parties may expressly require in a contract that the party relying on the provisions of this paragraph give *written notice* to the other party or parties, *within a reasonable time* after the occurrence of the event excusing performance, of an *intention to claim an extension of time* or of an *intention to bring suit* or of *any other similar or related intent*, provided the requirement of such notice is reasonable and just." (See *General Ins. Co. v. Commerce Hyatt House* (1970) 5 C.A.3d 460, 470, 85 C.R. 317 [amendment affected substantive rights and could not be retroactively applied to contract made prior to enactment].)

West's Key Number Digest, Contracts k.309(1)

SUPPLEMENT: [This section is current through the latest supplement]



153 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

D. Impossibility, Impracticability, and Frustration of Purpose.

1. In General.

g. Contract Provision To Shift Risk.

1 Witkin Sum. Cal. Law Contracts § 837

[§ 837] Contract Provision To Shift Risk.

The parties may make special provision for adjustment of rights in the event of impossibility arising from any cause. (See C.C. 1511(2); *Rest.2d, Contracts* §261, Comment c.)

Thus, in *Mathes v. Long Beach* (1953) 121 C.A.2d 473, 263 P.2d 472, defendant city's street improvement contract provided that, if federal regulations stopped the improvement, plaintiff contractor would accept as full compensation a proportionate payment for work completed, and the reasonable value of work on uncompleted items. *Held*, the provision was valid. "Instead of impinging upon, this clause recognized and protected substantial rights of the city, the property owners affected, and the contractor." (121 C.A.2d 477.) (See *Govt.C. 4410, 4411, 4412*, recognizing propriety of these clauses; *Dahlgren v. Walsh* (1916) 173 C. 27, 32, 158 P. 748 [special contract term for apportionment of loss from fire or earthquake]; 30 Williston 4th, §77:126; 54 *Harv. L. Rev.* 106; 85 *A.L.R.3d* 1085 [construction contract provision excusing delay caused by "severe weather"]; *supra*, §837.)

SUPPLEMENT: [This section is current through the latest supplement]



154 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

D. Impossibility, Impracticability, and Frustration of Purpose.

2. Events Constituting Impossibility or Impracticability.

a. Death or Incapacity of Promisor.

1 Witkin Sum. Cal. Law Contracts § 838

[§ 838] Death or Incapacity of Promisor.

If the promisor dies before completing the performance, the liability of his or her estate is determined by the nature of the contract. If it is *personal*, calling for services such as those of an author, painter, lawyer, physician, or other person possessing special skill or ability, it is ordinarily discharged by the death of the person who was to render them. (See *Carver v. Fitzsimmons* (1935) 5 C.A.2d 320, 325, 42 P.2d 1066; *Farnon v. Cole* (1968) 259 C.A.2d 855, 858, 66 C.R. 673; *Charles B. Webster Real Estate v. Rickard* (1971) 21 C.A.3d 612, 618, 98 C.R. 559; *Rest.2d, Contracts* §262; 14 Corbin (Rev. ed.), §75.1 et seq.; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §§670, 671; 3 *Summary* (10th), *Agency and Employment*, §205.)

But if the work or services are of such a character that they may be as well performed by others, or where the contract by its terms shows that performance by others was contemplated, the obligation will survive the death and bind the administrator or executor of the promisor. A building contract is of this type. (*Estate of Burke* (1926) 198 C. 163, 167, 244 P. 340; *Didier v. American Cas. Co. of Reading, Pennsylvania* (1968) 261 C.A.2d 742, 750, 68 C.R. 217; 14 Corbin (Rev. ed.), §75.1 et seq.; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §670 et seq.)

A peculiar distinction was drawn in *Central Contra Costa Sanitary Dist. v. National Surety Corp.* (1952) 112 C.A.2d 61, 246 P.2d 150. G's bid on a sanitary disposal system for plaintiff district provided, pursuant to requirements, that the successful bidder would enter into a nonassignable contract within 10 days. G died on the day of notification that his bid was accepted, without having executed a contract. The district accepted a higher bid, and, in this suit for the difference, recovery was denied. The ordinary rule that a building contract does not call for special skill and is not discharged by death was held inapplicable here because (a) the proposal contemplated the execution of a formal contract by the successful bidder himself, and (b) the specifications expressly prohibited assignment of the contract. Hence, death excused both the execution of the contract and its performance. (112 C.A.2d 68.)

West's Key Number Digest, Contracts k.311

SUPPLEMENT: [This section is current through the latest supplement]



155 of 184 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

D. Impossibility, Impracticability, and Frustration of Purpose.

2. Events Constituting Impossibility or Impracticability.

b. Operation of Law.

1 *Witkin Sum. Cal. Law Contracts* § 839

[§ 839] Operation of Law.

(1) *Governmental Acts*. Performance is excused where prevented "by the operation of law," in spite of any stipulation to the contrary. (C.C. 1511(1).) (See *National Pavements Corp. of Calif. v. Hutchinson Co.* (1933) 132 C.A. 235, 238, 22 P.2d 534; *Rest.2d, Contracts* §264; 14 Corbin (Rev. ed.), §76.1 et seq.; 30 Williston 4th, §77:55 et seq.; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §677 et seq.) (For requirement of notice of intent, see *supra*, §836.)

Thus, where a prisoner on bail was arrested in another county, and later released and ordered by the court to leave the state, the surety's obligation was held discharged; the acts of state officers constituted prevention both by operation of law and by act of the promisee (the state, to which the surety owed performance). (*People v. Meyers* (1932) 215 C. 115, 117, 8 P.2d 837.) (On effect of government price ceilings on obligations of seller and buyer, see 66 *Harv. L. Rev.* 354.)

(2) *Prevention by Private Litigant Not an Excuse*. The California cases apply the above rule only to *governmental* interference, such as results from the passage of a statute or ordinance making the contemplated performance illegal, or from a condemnation proceeding brought by the state or other public agency. Prevention by court order or process obtained by a *private* litigant, as in the case of an injunction or attachment obtained against the promisor by some third party, is not considered an excuse. (*Klauber v. San Diego Street Car Co.* (1892) 95 C. 353, 357, 30 P. 555; *Sample v. Fresno Flume & Irr. Co.* (1900) 129 C. 222, 227, 61 P. 1085; *Union Contracting & Paving Co. v. Campbell* (1905) 2 C.A. 534, 535, 84 P. 305; *Irwindale Citrus Assn. v. Semler* (1943) 60 C.A.2d 318, 324, 140 P.2d 716; *Webster v. Southern Calif. First Nat. Bank* (1977) 68 C.A.3d 407, 415, 137 C.R. 293, quoting the text.)

In *Webster*, plaintiff, assignee of the holder of notes given by the seller of a bar and restaurant, brought an action against several parties including defendant bank, alleging that the bank had unlawfully disbursed escrow funds without paying the notes. The bank's answer was that, in a prior unrelated action, the court had ordered it to make the payments to others. *Held*, this was not a defense. (a) In California, prevention by a court order in private litigation is not an excuse. (68 C.A.3d 415.) (b) Moreover, the orders in the prior case were made on stipulation. Having consented to the orders and affirmatively participated in initiating them, it could not contend that it was compelled by legal authority to act contrary to its legal duties under the escrow. (68 C.A.3d 416.)

SUPPLEMENT: [This section is current through the latest supplement]



156 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

D. Impossibility, Impracticability, and Frustration of Purpose.

2. Events Constituting Impossibility or Impracticability.

c. Act of Public Enemy and War.

1 Witkin Sum. Cal. Law Contracts § 840

[§ 840] Act of Public Enemy and War.

Prevention by act of public enemies of this state or of the United States is an excuse, unless a contrary stipulation is made. (C.C. 1511(2); see 14 Corbin (Rev. ed.), §76.1 et seq.; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §§682, 683, 693 et seq.)

World War II created a number of situations involving the distinction between difficulty and impossibility, and the determination of the effect of temporary impossibility.

Thus, if a person agreed to construct a building, and the war made materials or labor scarce or totally unavailable by reason of priority regulations, a problem of true impossibility or its equivalent--extraordinary difficulty--arose. But if the promisor should reasonably have foreseen the conditions, and failed to make express provision in the contract for an excuse based thereon, he or she assumed the risk of nonperformance. Thus, in *McCulloch v. Liguori* (1948) 88 C.A.2d 366, 199 P.2d 25, defendant, in February 1946, agreed to construct and lease a building to plaintiff by May 1946. He delayed the commencement of construction until priority regulations made it either impossible or extremely difficult to obtain materials. *Held*, the risk was assumed and he was liable in damages; "the fact that the parties contracted in view of the conditions as they existed at the time of the execution of the contract, and the delay of defendants and their contractor in immediately protecting themselves against the probable change in conditions, deprives them of any legal grounds for not fulfilling their contract." (88 C.A.2d 371.) (See *Glens Falls Indem. Co. v. Perscallo* (1950) 96 C.A.2d 799, 802, 216 P.2d 567.)

In *Autry v. Republic Productions* (1947) 30 C.2d 144, 180 P.2d 888, plaintiff, a movie actor, made a contract with defendant producer in 1938, for 1 year, with options that carried the term to March 1945; he volunteered for military service in July 1942, and was still in the army when the contract term expired. In such a situation, a controversy may arise over the subsequent refusal of the employer to take the employee back for the unperformed services, or, as here, over the subsequent unwillingness of the employee to serve. The general principles of law applicable to this type of case, and discussed in the superseded opinion of the court of appeal, were well settled: (a) The war service in the beginning gave the employee the defense of *temporary impossibility*, suspending his duty, and, if the impossibility was of short duration, the duty of performance thereafter revived. (b) If, however, the impossibility persisted for so long a time as to result in a substantially increased burden on the promisor, beyond the contemplation of the parties, the duty

was completely discharged. (30 C.2d 149.) The Supreme Court reached its decision on a construction of a special modifying agreement made in 1942 and did not, therefore, find it necessary to determine the impossibility defense. (30 C.2d 151.) In a strong dictum, however, the court declared that equitable considerations should govern the attempted revival of personal service contracts interrupted by war, and that the passage of time may place a serious handicap on an artist who is called upon to render delayed performance of the contract for a compensation fixed before the great decrease in the purchasing value of the dollar. (See 30 C.2d 149, 155.) Thus, the implication of the opinion appears to be that, in a case not involving any special agreement, a substantial period of war service would ordinarily have the effect of complete, and not merely temporary, impossibility. (See 35 Cal. L. Rev. 581; 19 So. Cal. L. Rev. 439; 21 So. Cal. L. Rev. 197.)

SUPPLEMENT: [This section is current through the latest supplement]



157 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

D. Impossibility, Impracticability, and Frustration of Purpose.

2. Events Constituting Impossibility or Impracticability.

d. Destruction or Nonexistence of Subject Matter.

1 Witkin Sum. Cal. Law Contracts § 841

[§ 841] Destruction or Nonexistence of Subject Matter.

Where a contract requires the transfer of a *specific thing*, the destruction or nonexistence of that thing makes the performance impossible "in the nature of things" (C.C. 1597), and performance is excused. And even though performance is possible, if it appears that the parties contracted in *contemplation of the continued existence* of a thing, so that, reasonably construed, the contract requires that thing to be in existence, its destruction or such impairment as makes it unavailable excuses the promisor, unless he or she has in the contract assumed the risk of its destruction. (See *Charpentier v. Los Angeles Rams Football Co.* (1999) 75 C.A.4th 301, 311, 89 C.R.2d 115 [although season ticket holder could have understood contract tendered by football team to have promised right to renew seats for games played at local stadium, once team moved, there was no local seat available to purchase, and his contractual rights left with team]; *Rest.2d, Contracts* §263; U.C.C. 2613, 2614; 14 Corbin (Rev. ed.), §75.4 et seq.; 30 Williston 4th, §77:78 et seq.; 17A Am.Jur.2d (2004 ed.), *Contracts* §673; *infra*, §842.)

The following are illustrations: A contract to manufacture goods in a particular factory is discharged by the destruction of the factory; a contract to do work on a specific building is discharged by the destruction of the building; a contract to carry goods by a particular ship is discharged by the loss of the ship; a contract to ship goods on a certain line of steamers is discharged by the discontinuance of that line. (See discussion, *H. Hackfeld & Co. v. Castle* (1921) 186 C. 53, 57, 198 P. 1041.)

West's Key Number Digest, Contracts k.309(2)

SUPPLEMENT: [This section is current through the latest supplement]



158 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

D. Impossibility, Impracticability, and Frustration of Purpose.

2. Events Constituting Impossibility or Impracticability.

e. Extraordinary Difficulty and Expense.

1 Witkin Sum. Cal. Law Contracts § 842

[§ 842] Extraordinary Difficulty and Expense.

Mere unforeseen *difficulty or expense* does not constitute impossibility and ordinarily is not an excuse. (See *supra*, §830.) But modern cases allow the defense of impossibility when performance is *impracticable* because of *excessive and unreasonable difficulty or expense*. (*People v. Meyers* (1932) 215 C. 115, 119, 8 P.2d 837; *Christin v. Superior Court* (1937) 9 C.2d 526, 533, 71 P.2d 205; *Schmeltzer v. Gregory* (1968) 266 C.A.2d 420, 424, 72 C.R. 194, citing the text; *Rest.2d*, Contracts §261, Comment d; see 14 Corbin (Rev. ed.), §74.7; 17A Am.Jur.2d (2004 ed.), Contracts §647; U.C.C. 2615, 2616; 54 Harv. L. Rev. 108; 4 U.C.L.A. L. Rev. 122; 23 U.S.F. L. Rev. 379 [Three Propositions About Impracticability].)

In *Mineral Park Land Co. v. Howard* (1916) 172 C. 289, 156 P. 458, defendant, building a bridge, contracted to take all gravel he needed from pits on plaintiff's land. After some performance, he refused to take any more on the ground that the rest was under water, and that the expense of removal and drying would be over 10 times as great as originally contemplated. *Held*, further performance on his part was excused; the extraordinary increase made the taking of the gravel impracticable, and was equivalent to its total absence, i.e., to the nonexistence of the subject matter. (172 C. 293.)

In *Vernon v. Los Angeles* (1955) 45 C.2d 710, 290 P.2d 841, a contract allowed plaintiff city to discharge its sewage through defendant city's sewer system for a specified price. The state enjoined defendant's dumping in the bay, and defendant was forced to build more expensive facilities. Plaintiff refused to pay anything more than the original contract sums and sued for specific performance and damages for defendant's refusal to handle its sewage. *Held*, defendant's performance was excused, under the theory of the *Howard* case, for the parties had contemplated the availability of disposal facilities the cost of which would not be completely disproportionate to those which originally existed. (45 C.2d 717.)

The decision in *Vernon* was criticized on two main grounds: (1) No showing appeared of the extent of the increased cost, and it is doubtful whether it approached the ratio (over 10 times) of the *Howard* case. (4 U.C.L.A. L. Rev. 122.) (2) There was neither impossibility nor impracticability of performance, for the disposal plant was operating and would necessarily continue to operate; hence, in practical effect, the defendant was not excused from performance but was enabled to demand additional consideration for a continuation of the same, more expensive performance. (*Dissent*, 45

C.2d 725.)

SUPPLEMENT: [This section is current through the latest supplement]



159 of 184 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

D. Impossibility, Impracticability, and Frustration of Purpose.

3. Frustration of Purpose.

a. Nature of Defense.

1 Witkin Sum. Cal. Law Contracts § 843

[§ 843] Nature of Defense.

A modern excuse for performance, not always clearly distinguished from true impossibility, is the *frustration of the object or effect* of the contract: Where the parties assume that a certain object or effect will be attained, and this becomes impossible, performance by the injured party is excused. In these cases there is no true impossibility of performance, but the *value of counterperformance* is substantially lessened or destroyed. The defense has sometimes been explained on the theory of implied conditions and failure of consideration. (See *La Cumbre Golf & Country Club v. Santa Barbara Hotel Co.* (1928) 205 C. 422, 425, 271 P. 476, *infra*, §845; *Johnson v. Atkins* (1942) 53 C.A.2d 430, 431, 127 P.2d 1027; *Brown v. Yoshio* (1943) 58 C.A.2d 190, 193, 136 P.2d 29; *20th Century Lites v. Goodman* (1944) 64 C.A.2d Supp. 938, 940, 149 P.2d 88; *Dorn v. Goetz* (1948) 85 C.A.2d 407, 410, 193 P.2d 121, *infra*, §846; *Rest.2d, Contracts* §265, *infra*, §844; 14 Corbin (Rev. ed.), §74.2; 30 Williston 4th, §77:94 et seq.; 27 *Cal. L. Rev.* 460; 12 *Hastings L. J.* 432; 43 *Hastings L.J.* 1 [Mistake, Frustration, and the Windfall Principle of Contract Remedies]; 2 *Stanf. L. Rev.* 588; 13 *Stanf. L. Rev.* 833; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §651 et seq.; 3 California Affirmative Defenses (2004 ed.), §58:1 et seq.; 89 *A.L.R.3d* 329 [inability to obtain license, permit, or charter required for tenant's business as defense to enforcement of lease].) (On the distinction between defenses of impossibility and frustration of purpose, see *Autry v. Republic Productions* (1947) 30 C.2d 144, 148, 180 P.2d 888, *supra*, §840.)

In *Dorn v. Goetz*, *supra*, the court quoted Williston as follows: "Performance remains entirely possible, but the whole value of the performance to one of the parties at least, and the basic reason recognized as such by *both* parties, for entering into the contract has been destroyed by a supervening and unforeseen event. This does not operate primarily as an excuse for the promisor, the performance of whose promise has lost its value, but as a failure of consideration for the promise of the other party, not in a literal sense it is true, since the performance bargained for can be given, but in substance, because the performance has lost its value." (85 C.A.2d 410, 411.)

West's Key Number Digest, Contracts k.310

SUPPLEMENT: [This section is current through the latest supplement]
See 3 California Affirmative Defenses §58:1 et seq.



160 of 184 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

D. Impossibility, Impracticability, and Frustration of Purpose.

3. Frustration of Purpose.

b. Restatement 2d.

1 Witkin Sum. Cal. Law Contracts § 844

[§ 844] Restatement 2d.

Rest.2d, Contracts §265 reads as follows:

"Where, after a contract is made, a party's principal purpose is substantially frustrated without his fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made, his remaining duties to render performance are discharged, unless the language or the circumstances indicate the contrary."

Comment a discusses the requirements of discharge of duty:

"First, the purpose that is frustrated must have been a principal purpose of that party in making the contract. It is not enough that he had in mind some specific object without which he would not have made the contract. The object must be so completely the basis of the contract that, as both parties understand, without it the transaction would make little sense."

"Second, the frustration must be substantial. It is not enough that the transaction has become less profitable for the affected party or even that he will sustain a loss. The frustration must be so severe that it is not fairly to be regarded as within the risks that he assumed under the contract."

"Third, the non-occurrence of the frustrating event must have been a basic assumption on which the contract was made. This involves essentially the same sorts of determinations that are involved under the general rule on impracticability. The foreseeability of the event is here, as it is there, a factor in that determination, but the mere fact that the event was foreseeable does not compel the conclusion that its non-occurrence was not such a basic assumption."

SUPPLEMENT: [This section is current through the latest supplement]



161 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

D. Impossibility, Impracticability, and Frustration of Purpose.

3. Frustration of Purpose.

c. Illustrations.

1. Doctrine Applied.

1 Witkin Sum. Cal. Law Contracts § 845

[§ 845] Doctrine Applied.

In *La Cumbre Golf & Country Club v. Santa Barbara Hotel Co.* (1928) 205 C. 422, 271 P. 476, defendant hotel company agreed to pay a certain monthly sum to plaintiff country club for golf privileges for its guests. The hotel burned. The lower court found that the parties had contemplated the continued existence of the hotel in making the contract. *Held*, further payment was excused. (205 C. 425.) (See *Johnson v. Atkins* (1942) 53 C.A.2d 430, 431, 127 P.2d 1027 [buyer's obligations under contract for sale of goods to be shipped to a foreign country excused when authorities of that country cancelled permission for entry].)

The effect of war conditions limiting the business of a lessee has frequently been urged as a ground for termination of the lease. This situation arose, e.g., where a building was leased for a certain business, but war regulations practically prohibited the business. There was no impossibility; the lessor could still keep the lessee in possession, the lessee could still pay the rent, and all other covenants could be performed, but the purpose of the contract, a profitable business enterprise, was not realizable. The modern view applies the doctrine of commercial frustration where the fortuitous destruction of the value of the tenancy was not contemplated by the parties and was not reasonably foreseeable. (See discussion, *Lloyd v. Murphy* (1944) 25 C.2d 48, 52, 153 P.2d 47; 31 Cal. L. Rev. 445; 17 So. Cal. L. Rev. 173; 18 So. Cal. L. Rev. 304; and see *20th Century Lites v. Goodman* (1944) 64 C.A.2d Supp. 938, 940, 149 P.2d 88 [lease of neon advertising sign; governmental blackout order frustrating primary purpose justified termination].)

In *Federal Leasing Consultants v. Mitchell Lipsett Co.* (1978) 85 C.A.3d Supp. 44, 150 C.R. 82, A Co. was the manufacturer of an electronic burglar alarm system operated on certain radio frequencies. It solicited defendant to obtain its system and recommended plaintiff as the financing agency. Plaintiff leased the system to defendant, under an agreement providing for title in plaintiff lessor and monthly rental payable by defendant lessee. A year later, the federal district court enjoined the use of this equipment because it interfered with secret government radio frequencies. Defendant then sought to rescind the lease and plaintiff sued to recover the remaining payments. *Held*, judgment for defendant lessee affirmed.

(a) The frustrating event, which totally destroyed the value of the leased equipment, was not reasonably foreseeable; and, had the controversy arisen in a direct transaction between A Co. and defendant, defendant's

performance would clearly have been excused. (85 C.A.3d Supp. 47.)

(b) Plaintiff contended that there was no frustration of the purpose of *its* contract; i.e., the consideration for defendant lessee's obligation was the *financing*, not the utilization of the equipment. This contention is unsound: The purpose of the transaction was to give defendant a functioning burglar alarm system; and, in the absence of an express agreement to the contrary, it cannot be assumed that plaintiff and defendant agreed to a lease of a system that could not be used. (85 C.A.3d Supp. 49.)

(c) A provision in the lease, that the lessee waived any claims against the lessor for improper installation or unsatisfactory operation of the equipment, did not preclude the defense of commercial frustration. The agreement, on plaintiff's form, must be construed against plaintiff; and, so construed, the exculpatory clause refers to an unsatisfactory *condition* of the *equipment*, not to an unsatisfactory *situation* brought about by an independent agency rendering otherwise satisfactory equipment inoperable. (85 C.A.3d Supp. 48, 49.)

SUPPLEMENT: [This section is current through the latest supplement]



162 of 184 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XIII. PERFORMANCE

D. Impossibility, Impracticability, and Frustration of Purpose.

3. Frustration of Purpose.

c. Illustrations.

2. Defense Rejected.

1 *Witkin Sum. Cal. Law Contracts* § 846

[§ 846] Defense Rejected.

In *Dorn v. Goetz* (1948) 85 C.A.2d 407, 193 P.2d 121, plaintiffs, in February 1946, contracted to sell their old home to defendants for \$ 13,000. The contract recited that they were about to build a new home, and that the time of conveyance could not therefore be definitely fixed but would be later set by notice. Shortly thereafter, the Veterans' Emergency Housing Act was passed, preventing plaintiffs for some time from commencing construction. Despite defendants' willingness to excuse the delay and accept late performance, plaintiffs brought this action for declaratory relief on the theory that their performance was excused by frustration. *Held*, they remained bound. The *object* of the contract was the sale and purchase of the old home, and there was no frustration of this object; the building of the new home was merely an event that would determine the *time of performance*. (85 C.A.2d 413.)

In *San Joaquin Light & Power Corp. v. Costaloupes* (1929) 96 C.A. 322, 274 P. 84, defendant operated a factory, and agreed to purchase electric power from plaintiff for 3 years at a certain minimum rate. The factory burned down, and defendant refused to take or pay for any more power. *Held*, the contract contained an unequivocal obligation on the part of defendant to pay the specified sum whether he used power or not, and there was nothing in the instrument to indicate that the parties contracted upon the implied condition that the factory would remain in existence. (96 C.A. 326.) This decision seems unsound and inconsistent with the modern rule. (For other examples of refusal to apply the doctrine to ordinary contracts, see *Law v. San Francisco Gas & Elec. Co.* (1914) 168 C. 112, 118, 142 P. 52; *Montaldo v. Hires Bottling Co.* (1943) 59 C.A.2d 642, 648, 139 P.2d 666 [collective labor agreement with local union held still binding on employer after American Federation of Labor suspended union's charter].)

In *FPI Dev. v. Nakashima* (1991) 231 C.A.3d 367, 282 C.R. 508, plaintiffs obtained an option to purchase Earp's option to purchase a golf course. Plaintiffs assigned their right to defendants in return for a promissory note. Defendants' assertion that their right was worthless (and their performance excused) was based on the theory that Earp would refuse to perform because plaintiffs had breached their contract with him by failing to pursue development of the property and not obtaining written consent to the assignment. *Held*, defendants' right was not worthless.

(a) The fact that plaintiffs were in breach of their agreement with Earp did not amount to a frustration of purpose that would, in itself, render defendants' right worthless. (231 C.A.3d 398.)

(b) Although plaintiffs' breach would be material to the defense of frustration of purpose if it were related to Earp's refusal to perform or repudiation, or to a demonstration that defendants' ability to exercise plaintiffs' option was likely to be prevented because of the prospect of such conduct by Earp, the evidence indicated that Earp intended to perform his promise to sell the option, even assuming that he had the right to refuse to do so. (231 C.A.3d 399.)

In lease cases, the lessee must show that the risk of the frustrating event was not reasonably foreseeable, and that the value of counterperformance is almost totally destroyed. If the event was foreseeable and the contract is silent on it, the lessee, like any other promisor, is deemed to have assumed the risk; and if the tenancy remains valuable though less profitable, the lessee remains bound. Thus, in *Lloyd v. Murphy* (1944) 25 C.2d 48, 153 P.2d 47, the lease, made after the National Defense Act, was for the sole purpose of selling new automobiles. But when the war cut down sales, the lessors waived the restriction on use and subletting, and offered a reduction in rent. *Held*, the lessees remained liable. (a) The automobile industry was already anticipating war priorities, and the lessees could have foreseen the development when making the lease. (b) Some sales, and other profitable uses of the property, including subletting, were still possible. The court emphasized the confusion that might result from excusing the lessee in varying situations of alleged "substantial frustration" amounting merely to less profitable conditions for doing business. (25 C.2d 55.) (See *Glenn R. Sewell Sheet Metal v. Loverde* (1969) 70 C.2d 666, 676, 75 C.R. 889, 451 P.2d 721, 12 Summary (10th), *Real Property*, §635; *Grace v. Croninger* (1936) 12 C.A.2d 603, 605, 55 P.2d 940 [lease for saloon and cigar store; obligation survived Prohibition Act, because some uses still possible]; *Davidson v. Goldstein* (1943) 58 C.A.2d Supp. 909, 911, 136 P.2d 665 [lessee's tire business restricted, but repair, retreading, and battery business still profitable]; *Brown v. Oshiro* (1945) 68 C.A.2d 393, 396, 156 P.2d 976 [Japanese lessee of hotel claimed that governmental World War II internment order deprived him of benefits of lease, but held liable where evidence showed non-Japanese tenants available].)

A strict and debatable application of the test of foreseeability resulted in a refusal to allow the defense in *Gold v. Salem Lutheran Home Assn.* (1959) 53 C.2d 289, 1 C.R. 343, 347 P.2d 687. N was 84 years old. He applied for admission to defendant nonprofit home for the aged, and under its rules was admitted for a trial period of 2 months (August 1 to October 1), on payment of \$ 130 per month. In September, the directors agreed to accept him and a contract was drawn and dated October 1, 1956. But N signed it on September 25, delivered a check for \$ 8,500 the same day, and defendant's officers also signed it that day or the next day. On September 27, N suffered a stroke, from which he died on September 28. *Held*, his executors were not entitled to recover the money. The frustrating event--death--was reasonably foreseeable; death may always come tomorrow, particularly in a man of advanced age; and each party here assumed the risk of variation of the life span from that predicted by the mortality tables. (53 C.2d 291.) The opinion generalizes the holding as follows: A life care contract is not subject to cancellation or recovery of money paid on death of the beneficiary before performance is to commence, because the consideration is defendant's promise to furnish care for the remainder of life, and there is no failure of consideration. (53 C.2d 291.)

A strong dissent argued that: (a) The contract provided that N would become a life member on October 1, 1956; before that time, the by laws of the home prohibited a permanent annuity relationship, and he was still a probationary member. (b) Execution of the contract did not terminate the probationary period; the board had no power to end it, and did not intend to do so, for N's request for a refund on his probationary board and room payment was refused on the ground that he was not entitled to it. (c) An antenuptial contract is subject to an implied condition that both parties be alive at the intended date of marriage; and a doctor must return an advance fee to a patient if the latter through no fault of his or her own is incapable of accepting services on the day of performance. "The case at bar is clearly analogous. The purpose contemplated by both parties was the creation--and the maintenance--of a relationship. All contractual duties were discharged when fortuitous events prevented the creation of that relationship." (53 C.2d 294.) (See, critical of the result, 12 *Hastings L. J.* 432; on validity and construction of life care contracts generally, see 44 *A.L.R.3d* 1174.)

West's Key Number Digest, Contracts k.310

SUPPLEMENT: [This section is current through the latest supplement]



163 of 184 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XIV. BREACH

A. In General.

1. Nature of Breach.

1 Witkin Sum. Cal. Law Contracts § 847

[§ 847] Nature of Breach.

The *wrongful*, i.e., the unjustified or unexcused, failure to perform a contract is a *breach*. (See *Rest.2d, Contracts* §235(2); *Corbin* §943 et seq.; 23 *Williston* 4th, §63:1 et seq.; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §699 et seq.; *Cal. Civil Practice*, 3 *Business Litigation*, §24:66 et seq.; 7A *Am.Jur. P.P. Forms* (2002 ed.), *Contracts*, §57 et seq.; 33 *San Diego L. Rev.* 137 [negligent performance of contract as "economic negligence"]; 44 *U.C.L.A. L. Rev.* 1513 [Efficiency Concerns in Breach of Multilateral Contracts]; 47 *U.C.L.A. L. Rev.* 859 [Consequentialism, Promissory Obligation, and the Theory of Efficient Breach]; 35 *A.L.R.5th* 285 [liability for breach of farming lease or contract]; 36 *Proof of Facts* 3d 373 [liability for breach of employment severance agreement]; *BAJI*, No. 10.85 [breach--essential elements]; *CACI*, No. 300 [essential factual elements]; *CACI*, No. 303 [breach of contract--essential factual elements].) Where the nonperformance is legally justified, or excused, there may be a failure of consideration, but not a breach. (See *supra*, §813.)

Ordinarily, a breach is the result of an intentional act, but *negligent performance* may also constitute a breach, giving rise to alternative contract and tort actions. (See 3 *Cal. Proc.* (4th), *Actions*, §§158, 159; 6 *Summary* (10th), *Torts*, §1179.) (On faulty workmanship or materials as breach of implied warranty in contract for labor and materials, see 4 *Summary* (10th), *Sales*, §53.)

The state is liable for breach in the same manner as an individual. (*Souza & McCue Const. Co. v. Superior Court* (1962) 57 *C.2d* 508, 510, 20 *C.R.* 634, 370 *P.2d* 338; see *infra*, §997.)

West's Key Number Digest, *Contracts* k.310

SUPPLEMENT: [This section is current through the latest supplement]
See *C.E.B., Law of Contracts* §8.66 et seq.; *CACI*, No. 300 [breach of contract].

Negligent performance may constitute breach:

Cross-Reference: 3 *Cal. Proc.* (5th), *Actions*, §§162, 163.



164 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIV. BREACH

A. In General.

2. Plaintiff's Freedom From Fault.

1 Witkin Sum. Cal. Law Contracts § 848

[§ 848] Plaintiff's Freedom From Fault.

The plaintiff must be free from substantial default in order to avail himself or herself of the remedies for the defendant's breach. Hence, the plaintiff must plead and prove performance or tender on his or her part or an excuse for performance. (See *Fenn v. Pickwick Corp.* (1931) 117 C.A. 236, 243, 4 P.2d 215; *Pry Corp. of America v. Leach* (1960) 177 C.A.2d 632, 639, 2 C.R. 425 [defendant, cross-complaining for breach of contract, held not entitled to recovery where evidence showed breach of conditions precedent]; *Kenworthy v. California* (1965) 236 C.A.2d 378, 394, 46 C.R. 396 [plaintiff contractor insolvent, dilatory, and never in position to perform]; 17A Am.Jur.2d (2004 ed.), *Contracts* §600; 63 Harv. L. Rev. 1064; 4 Cal. Proc. (4th), *Pleading*, §491 et seq.)

A conditional right to terminate for breach may be lost by wrongful conduct of the injured party. In *Mad River Lumber Sales v. Willburn* (1962) 205 C.A.2d 321, 22 C.R. 918, defendant owner gave plaintiff lumber company the right to log her land. The contract provided that neither party could terminate for breach without giving the other 15 days' notice and an opportunity to remedy the breach. Defendant sent a notice of breach to plaintiff; but, prior thereto, defendant had placed a chain across the road to the land, preventing any attempt by plaintiff to remedy the breach. *Held*, the contract was not terminated, since defendant's wrongful act was the cause of the failure of plaintiff to perform. (205 C.A.2d 324.)

SUPPLEMENT: [This section is current through the latest supplement]

See *Wall Street Network, Ltd. v. New York Times Co.* (2008) 164 C.A.4th 1171, 1181, 80 C.R.3d 6 [newspaper, sued by assignee of internet marketing company for breach of contract and misrepresentation, following termination of agreement under which marketing company was to solicit subscribers to newspaper, was entitled to summary judgment, because assignee could not establish that marketing company had performed under agreement].

Cross-Reference: 4 Cal. Proc. (5th), *Pleading*, §530 et seq.



165 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIV. BREACH

B. Kinds of Breach.

1. Nonperformance of Covenant.

a. General Rule.

1 Witkin Sum. Cal. Law Contracts § 849

[§ 849] General Rule.

The unjustified failure to perform a material promise or covenant, where the contract is entire, is a breach. (*Sterling v. Gregory* (1906) 149 C. 117, 121, 85 P. 305; *Los Angeles Gas & Elec. Co. v. Amalgamated Oil Co.* (1909) 156 C. 776, 781, 106 P. 55; *Woodard v. Glenwood Lumber Co.* (1915) 171 C. 513, 522, 153 P. 951.) (On breach of a liability insurance contract, see 2 *Summary* (10th), *Insurance*, §250.)

It has occasionally been said that nonperformance of a *condition* is a breach. (See *Glock v. Howard & Wilson Colony Co.* (1898) 123 C. 1, 16, 55 P. 713; *Woodruff Co. v. Exchange Realty Co.* (1913) 21 C.A. 607, 610, 132 P. 598; *De La Falaise v. Gaumont-British Picture Corp.* (1940) 39 C.A.2d 461, 468, 103 P.2d 447; *McManus v. Bendlage* (1947) 82 C.A.2d 916, 924, 187 P.2d 854.) But this language is mistakenly applied to nonperformance of a condition that is nothing more than a condition, because nonperformance under these circumstances only excuses the counterperformance. (See *Rest.2d, Contracts* §225(3) and Comment d.) An examination of the facts of these cases shows that the condition involved was also a *promise*. (See *supra*, §776.)

Repudiation is not a necessary element of actual breach. If performance is not yet due, repudiation may constitute an anticipatory breach (see *infra*, §863); but, when performance is due, it is the failure to perform that constitutes the breach, irrespective of the presence or absence of repudiation. (*Robinson v. Raquet* (1934) 1 C.A.2d 533, 542, 36 P.2d 821.) However, repudiation accompanying a partial breach will make it total (see *infra* §§852, 858); and repudiation may amount to prevention (see *infra*, §851).

West's Key Number Digest, Contracts k.315

SUPPLEMENT: [This section is current through the latest supplement]



166 of 184 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XIV. BREACH

B. Kinds of Breach.

1. Nonperformance of Covenant.
- b. Building Contract: Installment.

1 Witkin Sum. Cal. Law Contracts § 850

[§ 850] Building Contract: Installment.

A building contract usually provides for payment by the owner to the contractor in installments as the work progresses. Sometimes the owners fail to pay a particular installment when it becomes due. One view has been that the delay is only a temporary *excuse* for performance: The contractor may stop work until the progress payment is received, but he or she must resume work when paid, unless the delay is so unreasonably long as to amount to a *material* breach or failure of consideration, in which case it gives rise to the usual remedies of rescission or damages.

The California cases have taken a different approach. Although the failure to pay an installment is not such a breach as to justify a suit for damages, the contractor may *rescind* and recover the *reasonable value of work already done*. (See *Barris v. Atlas Rock Co. (1931) 118 C.A. 606, 610, 5 P.2d 670.*) This rule is somewhat inconsistent, for if the delay is not serious it should not justify termination of the contract, but if it is serious and wrongful, it constitutes a breach for which an action for damages is proper. (See *Big Boy Drilling Corp. v. Etheridge (1941) 44 C.A.2d 114, 120, 111 P.2d 953.*) And the rule was questioned in *Integrated v. Alec Fergusson Electrical Contractor (1967) 250 C.A.2d 287, 297, 58 C.R. 503*. The court declared that the better rule calls for more than a slight deviation in time or amount of payments to justify rescission; there must be a "substantial" failure to comply with the contract.

An action for damages will lie if, in addition to the failure to make a timely payment, (1) there is some act of prevention or hindrance by the owner; or (2) there is a repudiation of the contract by the owner; or (3) the contract makes the timely payment of each installment an *express condition precedent* to the further duty of performance by the contractor. (See *Big Boy Drilling Corp. v. Etheridge, supra.*)

SUPPLEMENT: [This section is current through the latest supplement]



167 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIV. BREACH

B. Kinds of Breach.

2. Prevention of Other Party's Performance.

1 Witkin Sum. Cal. Law Contracts § 851

[§ 851] Prevention of Other Party's Performance.

Prevention or hindrance of the other party's performance operates not only as an excuse for the performance (C.C. 1511(1); *Taylor v. Sapritch* (1940) 38 C.A.2d 478, 481, 101 P.2d 539; *supra*, §821), but is also a breach, giving that party the affirmative remedies for breach. (*Alderson v. Houston* (1908) 154 C. 1, 11, 96 P. 884; *Crawford v. Pioneer Box Co.* (1930) 105 C.A. 760, 768, 288 P. 694; *Woodruff v. Adams* (1933) 134 C.A. 490, 494, 25 P.2d 529; *Unruh v. Smith* (1954) 123 C.A.2d 431, 437, 267 P.2d 52; *Sloan v. Stearns* (1955) 137 C.A.2d 289, 295, 290 P.2d 382; *Corbin* §947; 23 Williston 4th, §63:26; 17A Am.Jur.2d (2004 ed.), *Contracts* §700; 3 California Affirmative Defenses (2004 ed.), §59:1 et seq.)

Thus, in *Crawford v. Pioneer Box Co.*, *supra*, plaintiff agreed to cut timber on defendant's land. After some performance, defendant wrote him to stop cutting until further notice. *Held*, this was a breach; plaintiff's possibility of performance depended on his entry on the land, and the order to stop was, in practical effect, a prevention of his entry. (105 C.A. 768.)

Where a real estate broker has an *exclusive right to sell*, and the owner, in violation thereof, sells by himself or herself or through another broker, the first broker may recover the agreed commission without showing that he or she has an available purchaser. The action is not one to recover compensation for performance, but is for damages for breach, the owner's acts having prevented the first broker's performance. (*Wright v. Vernon* (1947) 81 C.A.2d 346, 347, 183 P.2d 908.)

Repudiation may amount to prevention; "[a]ny conduct or declaration of a promisor evincing a clear intention to treat his contract as no longer binding is a legal prevention of performance." (*Alphonzo E. Bell Corp. v. Listle* (1946) 74 C.A.2d 638, 645, 169 P.2d 462 [lessor of oil lease wrongfully declared forfeiture, demanded possession, and brought suit to cancel lease].)

West's Key Number Digest, Contracts k.314

SUPPLEMENT: [This section is current through the latest supplement]
See 3 California Affirmative Defenses §59:1 et seq.



168 of 184 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XIV. BREACH

B. Kinds of Breach.

3. Total and Partial Breach.

1 Witkin Sum. Cal. Law Contracts § 852

[§ 852] Total and Partial Breach.

Any breach, total or partial, that causes a measurable injury, gives the injured party a right to *damages as compensation therefor*. (See *Borgonovo v. Henderson* (1960) 182 C.A.2d 220, 231, 6 C.R. 236, quoting the text; *Rest.2d, Contracts* §236; Corbin §948; 23 Williston 4th, §63:1; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §699.) The important question, however, is whether a particular breach will also give the injured party the right to refuse further performance on his or her own part, i.e., to *terminate the contract*. The test is whether the breach is *material*, and a *total or complete* breach is of course material and a grounds for termination by the injured party. (See 21 *U.C. Davis L. Rev.* 1073 [A New Look at Material Breach in the Law of Contracts]; BAJI, No. 10.86 [total/partial breach]; CACI, No. 303 [breach of contract--essential factual elements].)

Whether a *partial* breach is material depends on the importance or seriousness thereof and the probability of the injured party getting substantial performance. (See *Superior Motels v. Rinn Motor Hotels* (1987) 195 C.A.3d 1032, 1052, 241 C.R. 487 [breach of antireceivership clause in lease held material]; *Linden Partners v. Wilshire Linden Associates* (1998) 62 C.A.4th 508, 531, 73 C.R.2d 708 [misrepresentation by seller of office with respect to amount of one subtenant's monthly rental, although only partial breach, was material and thus gave plaintiff buyers right to seek damages]; *Rest.2d, Contracts* §242; Corbin §946; 23 Williston 4th, §63:3; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §§704, 705.) The following are the principal situations and applicable rules:

(1) Even a slight breach at the *outset* of the performance may justify termination, for it indicates future difficulty in obtaining performance, and termination at that time is not so serious in its effect upon the wrongdoer. (See *Associated Lathing & Plastering Co. v. Louis C. Dunn* (1955) 135 C.A.2d 40, 50, 286 P.2d 825.)

(2) After considerable performance, a slight breach that does not go "to the root" of the contract will not justify termination. (See *Karz v. Department of Professional Vocational Standards* (1936) 11 C.A.2d 554, 557, 54 P.2d 35 [contract to construct building; owner's breach of special incidental agreement to pay for extras was not ground for rescission by contractor]; *Axis Petroleum Co. v. Taylor* (1941) 42 C.A.2d 389, 397, 108 P.2d 978.)

(3) If the promisor's partial breach is accompanied by or followed by his or her repudiation, it is treated as a total breach. (*Gold Mining & Water Co. v. Swinerton* (1943) 23 C.2d 19, 29, 142 P.2d 22.) (See *Rest.2d, Contracts* §243(2) and Comment b; *infra*, §858.)

(4) The buyer's partial breach of an exclusive requirements contract may justify termination by the seller even though the seller has a market for all his or her production and suffers no financial loss. "The fact that defendant might have sold its product elsewhere under the fortuitous circumstances here prevailing does not minimize the materiality of plaintiff's violation of its fundamental obligation under the contract; nor should it affect defendant's right to insist on receiving from plaintiffs the crucial benefit flowing to it under its bargain. To embrace the validity of such an argument would give rise to an anomalous result. On this theory, plaintiffs might have refused all performance by abstaining from submitting any requirements to defendant, yet, despite a total breach, could urge it was of insufficient materiality to warrant termination simply because defendant had another market for its total product. It would create the absurd effect of binding defendant to a contract in which plaintiffs' obligation is illusory and chimerical, while permitting plaintiff in willful default to make capital of his own wrong." (*Wilson v. Corrugated Kraft Containers* (1953) 117 C.A.2d 691, 696, 256 P.2d 1012.)

West's Key Number Digest, Contracts k.319

SUPPLEMENT: [This section is current through the latest supplement]

See *Brawley v. J.C. Interiors* (2008) 161 C.A.4th 1126, 1134, 74 C.R.3d 832, citing the text [finding that each party breached contract, and that each party is entitled to damages for other's breach, is legally permissible; proper procedure is to offset jury's damages award findings against each other, and, if there has been settlement, to apply settlement credit to any net amount of damages nonsettling defendant would have been liable for if there had been no settlement].



169 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIV. BREACH

C. Effect of Breach.

1. Remedies for Breach.

a. Available Remedies.

1 Witkin Sum. Cal. Law Contracts § 853

[§ 853] Available Remedies.

A breach, even if *material*, does not automatically *discharge* the contract; it excuses the injured party's performance, and gives him or her the election of certain remedies. (See generally *Whitney Inv. Co. v. Westview Dev. Co.* (1969) 273 C.A.2d 594, 602, 78 C.R. 302, citing the text; *Metcalf General Contractor v. Earl Erne* (1963) 212 C.A.2d 689, 693, 28 C.R. 382; *Rest.2d, Contracts* §344 et seq.; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §707; 61 *So. Cal. L. Rev.* 630 [when breach is more efficient than performance as promised].)

These remedies are:

(1) *Rescission and Restitution*. (See *Alder v. Drudis* (1947) 30 C.2d 372, 384, 182 P.2d 195, *infra*, §854; *Block v. D.W. Nicholson Corp.* (1947) 77 C.A.2d 739, 745, 176 P.2d 739; *Crofoot Lumber v. Thompson* (1958) 163 C.A.2d 324, 331, 329 P.2d 302; Corbin §1102 et seq.; 26 Williston 4th, §68:1 et seq.; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §524 et seq.; C.E.B., *Breach of Contract Remedies* §5.55 et seq.; C.E.B., 1 *Real Property Remedies and Damages* 2d, Chap. 1; 79 *Harv. L. Rev.* 1307; 57 *So. Cal. L. Rev.* 723; 67 *So. Cal. L. Rev.* 1465; 3 *Cal. Proc.* (4th), *Actions*, §201; 4 *Cal. Proc.* (4th), *Pleading*, §502 et seq.; *infra*, §930 et seq.)

(2) *Damages*. (See *Sobelman v. Maier* (1927) 203 C. 1, 9, 262 P. 1087; *Royer v. Carter* (1951) 37 C.2d 544, 546, 233 P.2d 539; *Coughlin v. Blair* (1953) 41 C.2d 587, 597, 262 P.2d 305; *King Features Syndicate v. KMTR Radio Corp.* (1938) 29 C.A.2d 247, 249, 84 P.2d 322; Corbin §990 et seq.; 24 Williston 4th, §64:1 et seq.; 22 *Am.Jur.2d* (2003 ed.), *Damages* §44 et seq.; C.E.B., *Breach of Contract Remedies* §4.1 et seq.; C.E.B., 1 *Real Property Sales Transactions* 3d, §4.128, 4.131 et seq.; C.E.B., 1 *Real Property Remedies and Damages* 2d, Chaps. 3, 4; *infra*, §869 et seq.; 4 *Summary* (10th), *Sales*, §188 et seq.; 4 *Cal. Proc.* (4th), *Pleading*, §476 et seq.)

(3) *Specific Performance*. (See Corbin §1136 et seq.; 25 Williston 4th, §67:1 et seq.; C.E.B., *Breach of Contract Remedies* §5.1 et seq.; C.E.B., 1 *Real Property Sales Transactions* 3d, §§4.130, 4.136; C.E.B., 1 *Real Property Remedies and Damages* 2d, Chap. 5; 4 *Summary* (10th), *Sales*, §216; 13 *Summary* (10th), *Equity*, §§24, 25; 5 *Cal. Proc.* (4th), *Pleading*, §740 et seq.)

(4) *Injunction*. In a few situations, an injunction will lie to prevent breach of a contract. (See *Smith v. Mendonsa*

(1952) 108 C.A.2d 540, 544, 238 P.2d 1039; 42 Am.Jur.2d (2000 ed.), *Injunctions* §124 et seq.; C.E.B., *Breach of Contract Remedies* §5.35 et seq.; 6 Cal. Proc. (4th), *Provisional Remedies*, §308 et seq.; 5 Cal. Proc. (4th), *Pleading*, §778 et seq.)

(5) *Declaratory Relief*. The remedy of declaratory relief is often used, either alone or with a demand for other relief. (See *Alder v. Drudis*, *supra*, 30 C.2d 382; 22A Am.Jur.2d (2003 ed.), *Declaratory Judgments* §14 et seq.; C.E.B., *Breach of Contract Remedies* §5.40 et seq.; 5 Cal. Proc. (4th), *Pleading*, §805 et seq.)

(6) *Ejectment or Quiet Title*. Where a purchaser defaults in installment payments on a contract for the sale of real property, the vendor may treat this as a repudiation of the contract and a divestment of the equitable estate in the land. Hence, he or she may sue in ejectment or to quiet title. (*Paap v. Von Helmholt* (1960) 185 C.A.2d 823, 828, 8 C.R. 568 [trial judge properly charged defendant purchasers with reasonable rental value during period of unlawful holding over, and credited them with payments and improvements]; *Kudokas v. Balkus* (1972) 26 C.A.3d 744, 753, 103 C.R. 318; see C.E.B., 1 Real Property Remedies and Damages 2d, Chaps. 7, 10; *infra*, §901 et seq.)

(7) *Tort Action*. In some cases, the breach of contract may be the result of negligence or other wrongful conduct, and an alternative remedy in tort is recognized. (See *Buxbom v. Smith* (1944) 23 C.2d 535, 548, 145 P.2d 305, 5 Summary (10th), *Torts*, §747; 6 Summary (10th), *Torts*, §§1089, 1179, 1180; 3 Cal. Proc. (4th), *Actions*, §141 et seq.)

West's Key Number Digest, Contracts k.321

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Rescission and Restitution*. See C.E.B., *Law of Contracts* §11.46 et seq.

Cross-References: 3 Cal. Proc. (5th), *Actions*, §206; 4 Cal. Proc. (5th), *Pleading*, §541 et seq.

(2) *Damages*. See 11 Corbin (Rev. ed.), §55.1 et seq.; C.E.B., *Law of Contracts* §10.1 et seq.; C.E.B., 1 Real Property Sales Transactions 4th, §§4.141, 4.144 et seq.

Cross-References: 4 Cal. Proc. (5th), *Pleading*, §515 et seq. (3) *Specific Performance*. See C.E.B., *Law of Contracts* §11.7 et seq.

Cross-Reference: 5 Cal. Proc. (5th), *Pleading*, §784 et seq.

(4) *Injunction*. See C.E.B., *Law of Contracts* §11.2 et seq.

Cross-References: 6 Cal. Proc. (5th), *Provisional Remedies*, §305 et seq.; 5 Cal. Proc. (5th), *Pleading*, §822 et seq.

(5) *Declaratory Relief*. See C.E.B., *Law of Contracts* §11.40 et seq.

Cross-Reference: 5 Cal. Proc. (5th), *Pleading*, §849 et seq.

(7) *Tort Action*. See C.E.B., *Law of Contracts* §10.30 et seq.

Cross-Reference: 3 Cal. Proc. (5th), *Actions*, §146 et seq.



170 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIV. BREACH

C. Effect of Breach.

1. Remedies for Breach.

b. Binding Election.

1 Witkin Sum. Cal. Law Contracts § 854

[§ 854] Binding Election.

(1) *In General.* The remedies listed in the preceding section are usually alternative and inconsistent, and call for an election by the injured party. (See *Alder v. Drudis* (1947) 30 C.2d 372, 384, 182 P.2d 195; *Oliver v. Campbell* (1954) 43 C.2d 298, 302, 273 P.2d 15; *Alphonzo E. Bell Corp. v. Listle* (1946) 74 C.A.2d 638, 644, 169 P.2d 462; *Ely v. Bottini* (1960) 179 C.A.2d 287, 296, 3 C.R. 756; *Whitney Inv. Co. v. Westview Dev. Co.* (1969) 273 C.A.2d 594, 602, 78 C.R. 302; 19 *Hastings L. J.* 1233; on conduct constituting binding election, see *Rest.2d, Contracts* §378; 3 *Cal. Proc.* (4th), *Actions*, §174 et seq.)

In *Jozovich v. Central Calif. Berry Growers Assn.* (1960) 183 C.A.2d 216, 6 C.R. 617, plaintiff contracted to produce a special type of berry freezing machine for defendant. Because of the unsatisfactory working of the first product, defendant did not make an installment payment of some \$ 10,000 due on April 1. Plaintiff nevertheless continued to work on the machine, but never completed a satisfactory product in the time defendant allowed him to meet the needs of the season. Plaintiff sued and was awarded both the installment payment and quasi-contract recovery of certain parts furnished or their value. *Held*, reversed. "[A]n aggrieved party may not simultaneously pursue inconsistent procedures for relief. In the case of breach of contract, he may treat the agreement as alive and effective, suing for damages for breach, or he may assume the contract dead and proceed to obtain restitution. But damages and restitution constitute alternative remedies and an election to pursue one is a bar to invoking the other." (183 C.A.2d 229.)

In *Alder v. Drudis*, *supra*, plaintiffs, in one cause of action, asked for declaratory relief, and the decision held that they were entitled to the remedy of specific restitution of unique personal property, although their pleadings sought damages also on inconsistent theories with respect to the termination and the continued existence of the contract. (See 30 C.2d 387.) The case suggests the possibility that sometimes, where prior acts have not amounted to an election, the action itself need not be an election, if a cause of action for declaratory relief is added; the court may then give whatever remedy is appropriate. (See 30 C.2d 382.)

(2) *Distinction.* In an action under C.C. 1692 based on rescission, the plaintiff may obtain both restitution and damages, provided that duplicate or inconsistent items are not included. (See *infra*, §936.)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *In General.*

Cross-Reference: 3 *Cal. Proc.* (5th), *Actions*, §179 et seq.



171 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIV. BREACH

C. Effect of Breach.

1. Remedies for Breach.

c. Contract Provisions.

1 Witkin Sum. Cal. Law Contracts § 855

[§ 855] Contract Provisions.

(1) *In General.* The contract may specify particular remedies to be available in the event of a breach, in addition to or in substitution for those otherwise afforded by law. (See Corbin §1227; *17A Am.Jur.2d* (2004 ed.), *Contracts* §709; 32 *A.L.R.3d* 377 [right to rely on arbitration clause after breach or repudiation of underlying contract]; on contractual modification or limitation of statutory remedies for breach of sales contract, see 4 *Summary* (10th), *Sales*, §218.)

(2) *Exclusive Remedy.* An intent to limit the injured party's remedies to the one specified in the contract must be clearly indicated. In *Nelson v. Spence* (1960) 182 C.A.2d 493, 6 C.R. 312, defendants represented and warranted to plaintiff that they had the exclusive right to sell peat produced by G, and gave plaintiff the right to rescind within 1 year if the warranty proved untrue. The warranty was untrue and plaintiff sued for damages. *Held*, citing the text, the usual elections were available to plaintiff. The language referring to rescission ("option" and "may") indicated no intention to make that remedy exclusive. (182 C.A.2d 498.) (See U.C.C. 2719(1)(b) [remedy is optional unless expressly agreed to be exclusive]; 84 *A.L.R.2d* 322 [contractual provision as to remedy as excluding other remedies].)

On the other hand, in *B.C. Richter Contracting Co. v. Continental Cas. Co.* (1964) 230 C.A.2d 491, 41 C.R. 98, a subcontract contained a clause providing that in the event of dispute the subcontractor must nevertheless proceed with the work. *Held*, this was in effect an advance waiver of the right to rescind after partial performance, and made the action for damages for breach the exclusive remedy. (230 C.A.2d 500.) (See *Michel & Pfeffer v. Oceanside Properties* (1976) 61 C.A.3d 433, 442, 132 C.R. 179 [building contract, provision making extension of time sole remedy of subcontractor for delay].)

(3) *Nullification on Breach.* A provision in a contract that upon breach it shall become "null and void" is to be interpreted as optional with the injured party, and the forfeiture takes place only upon his or her election. It does not mean that the defaulting party can bring the contract to an end by refusing to perform. "That language means that by a violation of the terms of the contract the rights of the party violating it cease, and as to that party and to that extent, the agreement becomes void and of no effect ... but the contract is nevertheless kept in force so as to protect the rights of the innocent party and to enforce the obligations of the delinquent party." (*Central Oil Co. of Los Angeles v. Southern Refining Co.* (1908) 154 C. 165, 166, 97 P. 177; see *Bank of America v. Moore* (1937) 18 C.A.2d 522, 526, 64 P.2d 460; *Felton Chemical Co. v. Superior Court* (1939) 33 C.A.2d 622, 626, 92 P.2d 684; *Norins Realty Co. v. Hoytt* (1943)

61 C.A.2d 194, 199, 142 P.2d 353.)

SUPPLEMENT: [This section is current through the latest supplement]



172 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIV. BREACH

C. Effect of Breach.

2. Waiver of Breach.

a. Effect of Waiver.

1 Witkin Sum. Cal. Law Contracts § 856

[§ 856] Effect of Waiver.

Instead of treating the breach as a termination of the contract, the injured party may *waive* it, i.e., elect to treat the contract as still alive, remaining ready and able to perform on his or her part, and limiting the remedy to compensation for the breach. (See *Romano v. Rockwell Int. (1996) 14 C.4th 479, 489, 59 C.R.2d 20, 926 P.2d 1114, 3 Cal. Proc. (4th), Actions, Supp.*, §492, citing the text [employee who was notified of wrongful intended termination in future could continue to rely on employment contract until actual termination]; *McMillan Process Co. v. Brown (1939) 33 C.A.2d 279, 285, 91 P.2d 613* [statute of limitations does not run until election to treat breach as termination]; *B.C. Richter Contracting Co. v. Continental Cas. Co. (1964) 230 C.A.2d 491, 500, 41 C.R. 98*; 8 Corbin (Rev. ed.), §40.4; 13 Williston 4th, §39:35; *17A Am.Jur.2d (2004 ed.)*, *Contracts* §713; Cal. Civil Practice, 3 Business Litigation, §32:21 et seq.; 45 Proof of Facts 2d 177 [insurer's waiver of insured's breach of cooperation clause]; BAJI, No. 10.88 [waiver of breach]; CACI, No. 336 [affirmative defense--waiver].)

West's Key Number Digest, Contracts k.316(1)

SUPPLEMENT: [This section is current through the latest supplement]

Romano case:

Cross-Reference: 3 Cal. Proc. (5th), *Actions*, §528.



173 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIV. BREACH

C. Effect of Breach.

2. Waiver of Breach.

b. Acts Constituting Waiver.

1 Witkin Sum. Cal. Law Contracts § 857

[§ 857] Acts Constituting Waiver.

(1) *Acceptance of Further Performance.* The waiver need not be an express statement; it may result where the injured party continues to perform, with knowledge of the other's breach, and where he or she accepts further performance from the guilty party after the breach. (*Boone v. Templeman* (1910) 158 C. 290, 295, 110 P. 947; *Kern Sunset Oil Co. v. Good Roads Oil Co.* (1931) 214 C. 435, 440, 6 P.2d 71; *Spiegelman v. Metropolitan Life Ins. Co.* (1937) 21 C.A.2d 299, 301, 68 P.2d 1006 [negotiations recognizing continued validity of contract]; *Leiter v. Eltinge* (1966) 246 C.A.2d 306, 317, 54 C.R. 703; see 8 Corbin (Rev. ed.), §40.4; 13 Williston 4th, §39:35; 17A Am.Jur.2d (2004 ed.), Contracts §714; 60 Proof of Facts 3d 445 [circumstances establishing waiver of strict compliance with real estate contract]; BAJI, No. 10.88 [waiver of breach]; CACI, No. 336 [affirmative defense--waiver].)

On the other hand, acceptance by an owner of a contractor's defective performance and payment therefor do not constitute a waiver of the breach where the defects are latent or the owner has no reasonable means of ascertaining them prior to payment. (*Banducci v. Frank T. Hickey* (1949) 93 C.A.2d 658, 662, 209 P.2d 398.) (See 66 A.L.R.2d 570 [partial payment on private building or construction contract as waiver of defects].)

(2) *Exception: Continuing Covenant.* Where the defendant's obligation is a *continuing covenant*, e.g., to cut timber or conduct other operations, each day's failure is a new breach. Hence, despite previous waivers, the plaintiff may at any time assert a new breach. (*Woodard v. Glenwood Lumber Co.* (1915) 171 C. 513, 523, 153 P. 951; see 13 Williston 4th, §39:35.)

SUPPLEMENT: [This section is current through the latest supplement]



174 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIV. BREACH

C. Effect of Breach.

3. Election To Treat Partial Breach as Total.

1 Witkin Sum. Cal. Law Contracts § 858

[§ 858] Election To Treat Partial Breach as Total.

In *Coughlin v. Blair* (1953) 41 C.2d 587, 262 P.2d 305, defendants sold a residential lot to plaintiffs, agreeing to pave an access road and install gas and electricity connections on their own adjoining land.

(a) In May 1949, the time for performance, nothing had been done. But plaintiffs continued to urge performance. Hence the rule applied that "even if a breach is total, the injured party may treat it as partial, unless the wrongdoer has repudiated the contract. The circumstances of each case determine whether the injured party may treat a breach of contract as total." (41 C.2d 598.)

(b) In May 1950, plaintiffs filed this action, thereby giving notice of their election to treat the partial breach as total. "Although defendants had not expressly repudiated the contract, their conduct clearly justified plaintiffs' belief that performance was either unlikely or would be forthcoming only when it suited defendants' convenience. Plaintiffs were not required to endure that uncertainty or to await that convenience and were therefore justified in treating defendants' nonperformance as a total breach of the contract." (41 C.2d 599.)

(c) For reasons not fully disclosed (but possibly because the paving and installations fulfilled obligations to other lot purchasers or made other unsold lots more salable), defendants, after suit was brought, went ahead and finally performed. *Held*, they were not entitled to a credit for this performance. "Plaintiffs did not urge performance after the complaint was filed, and they could not prevent it. By commencing the action they fully and fairly informed defendants that instead of performance they sought money damages for the value of defendants' promise. Unless plaintiffs indicated that they were again willing to treat the breach as partial, the remedial rights provided by law were substituted for the rights under the contract. Thereafter defendants were absolved from all duties under the contract to furnish improvements. Subsequent work to that end would not be performance of a contract then existent but would be entirely voluntary. If prompted by defendants' self-interest in the sale of other lots, such gratuitous benefit, wholly speculative on the record, would not constitute unjust enrichment to plaintiffs. Parties who have totally breached a contract cannot force performance on the injured parties." (41 C.2d 602.)

The *Coughlin* case was followed in *Sackett v. Spindler* (1967) 248 C.A.2d 220, 229, 56 C.R. 435, where defendant buyer's repeated delays in tendering the balance due under a contract for the sale of stock were held to justify plaintiff's treating the breach as total, despite defendant's frequently expressed willingness to perform.

SUPPLEMENT: [This section is current through the latest supplement]



175 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIV. BREACH

C. Effect of Breach.

4. Breach of Severable Versus Entire Contract.

a. Severable Contract.

1 Witkin Sum. Cal. Law Contracts § 859

[§ 859] Severable Contract.

(1) *In General.* A severable or divisible contract is one in which two or more separate partial performances on each side are agreed to be exchanged for partial performances on the other side. The failure to perform one severable part does not bar recovery for performance of another part. (*Agnifili v. Lagna* (1928) 204 C. 262, 267, 267 P. 705; *Lowy v. United Pac. Ins. Co.* (1967) 67 C.2d 87, 91, 60 C.R. 225, 429 P.2d 577 [construction contract, work in two phases, consideration apportioned; held severable, and nonperformance under second did not preclude recovery for performance under first]; *Waybright v. Meek* (1928) 90 C.A. 13, 17, 265 P. 370; *Filet Menu v. C.C.L. & G.* (2000) 79 C.A.4th 852, 860, 94 C.R.2d 438.) (See 8 Corbin (Rev. ed.), §§35.8, 35.9; 15 Williston 4th, §45:1 et seq.; 17A Am.Jur.2d (2004 ed.), *Contracts* §626.)

(2) *Defrauding Party May Not Enforce Parts of Contract Not Induced by Fraud.* In *Filet Menu*, plaintiff printing and design business sued a restaurant owner and its officer for breach of a contract to purchase restaurant supplies. Defendants cross-complained, alleging fraud and other misconduct, premised on misrepresentations made in connection with the contract. Plaintiffs contended that the contract was divisible, because it provided for delivery of different things at different times, with the consideration apportioned. The trial court refused to submit a special verdict form to the jury requiring it to determine whether the contract between the parties was divisible, and if so, which portions were induced by fraud and which were not. Following a special jury verdict, the trial court entered judgment for defendants on both the complaint and cross-complaint. *Held*, affirmed.

(a) A distillation of the rules established under *Rest.2d, Contracts* §240 and the commentaries on divisible contracts highlights several principles germane to resolving the issue under consideration here: First, a divisible contract is still one contract, subject to the same governing rules as applicable to indivisible contracts, with the exception that to avoid forfeitures, the concept of divisibility permits a breaching party to recover the consideration allocated to the portions of the divisible contract that he or she has performed. Second, a party breaching a divisible contract cannot enforce any portions that he or she has not performed. Third, if a party has materially breached any portion of a divisible contract, the aggrieved party is excused from further performance of all uncompleted portions of the contract. (79 C.A.4th 861.)

(b) Because a divisible contract is still only a single contract, the customary rules regarding contract formation apply. Those rules provide that a contract induced by fraud renders the *entire* agreement voidable, permitting the

aggrieved party to defend a suit on the contract by objecting to its enforcement because it was procured or induced by fraud. Because the jury here found that the contract was induced by misrepresentations made with the intent to defraud defendants, the contract, whether divisible or not, was voidable. Any other conclusion would be anomalous, because even a party simply breaching a divisible portion of a contract could not enforce its unperformed portions that he or she did not breach. Similarly, a party who has defrauded another into entering a portion of a divisible contract cannot enforce the other parts not so induced. (79 C.A.4th 861.)

(c) *Simmons v. California Institute of Technology* (1949) 34 C.2d 264, 209 P.2d 581, *infra*, §934, does not support plaintiff's claim that it can enforce the divisible portions of the contract that may not have been induced by fraud. That case did not involve a *defrauding party* seeking to enforce a portion of a divisible contract. Rather, it involved an *aggrieved party* being permitted to rescind only the fraudulently induced portion of the agreement while retaining the benefit of the balance of the agreement. It does not suggest that the wrongdoer would have that same option. (79 C.A.4th 863.)

(d) Cases holding that the legal portions of divisible contracts that are partially illegal may be enforced are not applicable here. That rule is premised on the principle that illegal contracts violate public policy considerations. Thus, once the illegal portion of a divisible contract is eliminated, there is no interest in refusing to enforce the balance of the agreement to which the parties knowingly agreed. A contract procured by fraud, on the other hand, implicates the private interests of the parties. There is an element of wrongdoing by one of the parties to the other, which cannot be undone by simply excising the fraudulently induced portion of the agreement. (79 C.A.4th 864.)

West's Key Number Digest, Contracts k.171

SUPPLEMENT: [This section is current through the latest supplement]



176 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIV. BREACH

C. Effect of Breach.

4. Breach of Severable Versus Entire Contract.

b. Entire Contract.

1 Witkin Sum. Cal. Law Contracts § 860

[§ 860] Entire Contract.

An entire contract is one in which all of the performances are common and interdependent, and any material breach justifies termination by the other party. (See *Los Angeles Gas & Elec. Co. v. Amalgamated Oil Co.* (1909) 156 C. 776, 779, 106 P. 55; *Moore v. Fellner* (1958) 50 C.2d 330, 341, 325 P.2d 857 [attorney's contract held severable]; *Lessing v. Gibbons* (1935) 6 C.A.2d 598, 608, 45 P.2d 258 [employment contract held entire]; *Stewart v. Claudius* (1937) 19 C.A.2d 349, 352, 65 P.2d 933 [contract to pay tuition to school proprietor for school year, although in installments, is entire; and balance may be collected where student is dismissed before completing year's work]; *Jozovich v. Central Calif. Berry Growers Assn.* (1960) 183 C.A.2d 216, 222, 6 C.R. 617, supra, §854 [contract for installation of complete functioning machine, held entire, despite provision for installment payments]; 8 Corbin (Rev. ed.), §§35.8, 35.9; 15 Williston 4th, §45:1 et seq.; 17A Am.Jur.2d (2004 ed.), Contracts §558; 10 Hastings L. J. 203; 6 U.C.L.A. L. Rev. 315.)

Ordinarily, where there is a purchase of different things at different prices at the same time, the contract will be severable as to each thing. But if the taking of the whole is rendered essential by the nature of the subject matter or by the act of the parties, it will be considered entire. (See generally *Sterling v. Gregory* (1906) 149 C. 117, 119, 85 P. 305; *Goorberg v. Western Assur. Co.* (1907) 150 C. 510, 515, 89 P. 130; *Los Angeles Gas & Elec. Co. v. Amalgamated Oil Co.*, supra; *Law v. San Francisco Gas & Elec. Co.* (1914) 168 C. 112, 117, 142 P. 52; *Lewis v. Shell Oil Co.* (1933) 220 C. 80, 83, 29 P.2d 413; *Benchley v. Durkee Famous Foods* (1933) 128 C.A. 604, 608, 17 P.2d 1020.)

In *Los Angeles Gas & Elec. Co. v. Amalgamated Oil Co.*, supra, plaintiff contracted to buy from defendant all the crude oil needed in its business for a 5-year period, at a certain price, monthly payments apportioned to oil delivered. Plaintiff did not order all its needs from defendant, but contended that the agreement was severable into monthly sales, and that its violation as to any prior months, while ground for recovery of damages, did not constitute a complete breach justifying termination. Held, the contract was entire and defendant could terminate it for breach. Defendant seller had to hold itself in readiness to supply all the buyer's needs, and to permit the buyer to secure particular installments elsewhere would deprive the seller of substantial benefits. (156 C. 779.) (See, on installment sales, U.C.C. 2612(3) [entire contract is breached if nonconformity or default of installment substantially impairs the value of the whole contract]; 4 Summary (10th), Sales, §160; 8 Corbin (Rev. ed.), §35.1 et seq.; 14 Williston 4th, §43:5 et seq.; 15 Williston 4th, §45:18; 17A Am.Jur.2d (2004 ed.), Contracts §411; 41 Cal. L. Rev. 715.)

SUPPLEMENT: [This section is current through the latest supplement]



177 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIV. BREACH

D. Anticipatory Breach.

1. Nature of Anticipatory Breach.

1 Witkin Sum. Cal. Law Contracts § 861

[§ 861] Nature of Anticipatory Breach.

An actual breach does not take place until the time for performance has arrived; but there may be a *total breach* by "anticipatory repudiation," usually called *anticipatory breach*. (See *Gold Mining & Water Co. v. Swinerton* (1943) 23 C.2d 19, 29, 142 P.2d 22 [distinguishing actual and anticipatory breach]; *Taylor v. Johnston* (1975) 15 C.3d 130, 137, 123 C.R. 641, 539 P.2d 425, citing the text; Corbin §959 et seq.; 23 Williston 4th, §63:28 et seq.; 17A Am.Jur.2d (2004 ed.), *Contracts* §716 et seq.; 3 Proof of Facts 2d 429 [anticipatory repudiation of contract for sale of goods]; 31 Stanf. L. Rev. 69 ["Anticipatory Repudiation" and the Temporal Element of Contract Law: An Economic Inquiry into Contract Damages in Cases of Prospective Nonperformance]; 1 A.L.R.4th 527 [what constitutes anticipatory repudiation of sales contract under Unif.Com.C. §2-610]; 34 A.L.R.5th 651 [anticipatory breach with respect to horse breeding contracts]; BAJI, No. 10.87 [actual and anticipatory breach]; CACI, No. 324 [anticipatory breach].)

The Restatement covers the subject under the heading of "Effect of Prospective Non-Performance." (See *Rest.2d, Contracts* §250 et seq.)

A repudiation at the time performance is due is not an anticipatory breach; it is an actual breach, and the statute of limitations begins to run at once. (*Fox v. Dehn* (1974) 42 C.A.3d 165, 171, 173, 116 C.R. 786.)

The doctrine has no application where executory covenants remain unperformed by a promisor. In *Vitagraph v. Liberty Theatres Co. of Calif.* (1925) 197 C. 694, 242 P. 709, plaintiff producer agreed to deliver six films to defendant exhibitor, for \$ 300 apiece. Defendant accepted numbers 1 and 2, returned numbers 3 and 4, and repudiated as to numbers 5 and 6. Plaintiff sued for the entire price. *Held*, plaintiff could not recover the price of numbers five and six, for it made no tender of these films or showing of ability to perform. (197 C. 700.)

The doctrine was formerly held inapplicable to a lease; i.e., the lessor could bring periodic actions for rent but he or she could not recover rent not yet due on a theory of anticipatory breach. (See 12 *Summary* (10th), *Real Property*, §690.) Damages for breach of a lease are now authorized by statute. (See C.C. 1951.2; 12 *Summary* (10th), *Real Property*, §694 et seq.)

West's Key Number Digest, Contracts k.313(1)

SUPPLEMENT: [This section is current through the latest supplement]

Executory covenants that remain unperformed: See *Central Valley General Hosp. v. Smith* (2008) 162 C.A.4th 501, 519, 75 C.R.3d 771 [existence of executory covenants that hospital did not perform, before treating as anticipatory breach medical group's purported repudiation of letter of intent giving hospital option to purchase rural health clinics from medical group, did not bar hospital from pursuing damages claim based on anticipatory breach]. *Correction:* Page 949, third full paragraph, *Vitagraph v. Liberty Theatres Co. of Calif.* (1925) 197 C. 694, 242 P. 709, does not broadly hold that the doctrine of anticipatory breach has no application where executory covenants remained unperformed.



178 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIV. BREACH

D. Anticipatory Breach.

2. Effect of Anticipatory Breach.

1 *Witkin Sum. Cal. Law Contracts* § 862

[§ 862] Effect of Anticipatory Breach.

If the statements or conduct of the promisor amount to anticipatory repudiation (*supra*, §861; *infra*, §863 et seq.), the injured party has an election of remedies:

(1) He or she may treat the repudiation as an anticipatory breach and exercise the available remedies *immediately*. (See *Atkinson v. District Bond Co.* (1935) 5 C.A.2d 738, 743, 43 P.2d 867; *Winegar v. Gray* (1962) 204 C.A.2d 303, 308, 22 C.R. 301; *Daum v. Superior Court* (1964) 228 C.A.2d 283, 287, 39 C.R. 443; *Mayo v. Pacific Project Consultants* (1969) 1 C.A.3d 1013, 1018, 82 C.R. 117, *infra*, §863; Corbin §960; 23 Williston 4th, §63:31; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §729 et seq.; BAJI, No. 10.87 [actual and anticipatory breach]; CACI, No. 324 [anticipatory breach].)

(2) The injured party may *wait* until the time of performance and exercise his or her remedies for actual breach. (See *Guerrieri v. Severini* (1958) 51 C.2d 12, 18, 330 P.2d 635; *Brewer v. Simpson* (1960) 53 C.2d 567, 593, 2 C.R. 609, 349 P.2d 289; *Taylor v. Johnston* (1975) 15 C.3d 130, 137, 123 C.R. 641, 539 P.2d 425 ["if the injured party disregards the repudiation and treats the contract as still in force, ... then the repudiation is nullified and the injured party is left with his remedies, if any, invocable at the time of performance"]; *Ross v. Tabor* (1921) 53 C.A. 605, 613, 200 P. 971; *Crane v. East Side Canal & Irr. Co.* (1935) 6 C.A.2d 361, 367, 44 P.2d 455; *Trypucko v. Clark* (1983) 142 C.A.3d Supp. 1, 7, 191 C.R. 165; Corbin §989; 23 Williston 4th, §63:31; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §732.)

If the injured party waits, the statute of limitations does not begin to run on this cause of action until the time when performance is due, i.e., until there is an actual breach. (See *Brewer v. Simpson*, *supra*; *Romano v. Rockwell Int.* (1996) 14 C.4th 479, 489, 59 C.R.2d 20, 926 P.2d 1114, 3 Cal. Proc. (4th), *Actions*, Supp., §492, citing the text [statute of limitations in action for wrongful termination did not begin to run until employee was actually terminated, even though he was notified of intended termination more than 2 years earlier]; *Ross v. Tabor*, *supra*; Corbin §989; 51 *Am.Jur.2d* (2000 ed.), *Limitation of Actions* §165.) (On the duty to mitigate damages, which may sometimes in practical effect deprive the injured party of the benefits of election, see *infra*, §920.)

Although an anticipatory breach or repudiation of a contract by one party allows the injured party to sue for damages without performing or offering to perform his or her own obligations, that party cannot recover damages without presenting evidence sufficient to establish that, but for the breach, he or she was ready, willing, and able to

perform as required by the contract. (*Ersa Grae Corp. v. Fluor Corp.* (1991) 1 C.A.4th 613, 627, 2 C.R.2d 288; *Solano v. Vallejo Redevelopment Agency* (1999) 75 C.A.4th 1262, 1277, 90 C.R.2d 41 [substantial evidence showed ability to perform; citing *Ersa*].)

SUPPLEMENT: [This section is current through the latest supplement]

Romano case:

Cross-Reference: 3 Cal. Proc. (5th), Actions, §528.



179 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIV. BREACH

D. Anticipatory Breach.

3. Methods of Committing Anticipatory Breach.

a. Express Repudiation.

1 Witkin Sum. Cal. Law Contracts § 863

[§ 863] Express Repudiation.

If the promisor *expressly repudiates* the contract by an unequivocal refusal to perform, he or she is guilty of an anticipatory breach. (See *Jeppi v. Brockman Holding Co.* (1949) 34 C.2d 11, 18, 206 P.2d 847; *Bomberger v. McKelvey* (1950) 35 C.2d 607, 613, 220 P.2d 729; *Freedman v. The Rector, Wardens & Vestrymen of St. Matthias Parish of Los Angeles* (1951) 37 C.2d 16, 19, 230 P.2d 629; *Guerrieri v. Severini* (1958) 51 C.2d 12, 19, 330 P.2d 635; *Winegar v. Gray* (1962) 204 C.A.2d 303, 308, 22 C.R. 301; *McWilliams v. Holton* (1967) 248 C.A.2d 447, 452, 56 C.R. 574; *Thornton v. Victor Meat Co.* (1968) 260 C.A.2d 452, 476, 67 C.R. 887, citing the text [employee's refusal to be bound to work certain days; treated as similar to employee's statement that he or she is quitting]; *Rest.2d, Contracts* §250(a); U.C.C. 2610; Corbin §973; 23 Williston 4th, §§63:45, 63:46; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §723; BAJI, No. 10.87 [actual and anticipatory breach]; CACI, No. 324 [anticipatory breach].)

In *Nemanick v. Christensen* (1948) 87 C.A.2d 844, 197 P.2d 785, plaintiff, employed by defendants under a contract for a term of years, had a dispute over a minor detail of performance and declared, "I am quitting." Although he did proceed promptly to comply with defendants' directions concerning the matter in dispute, defendants hired his successor the following day. *Held*, the evidence warranted the jury's verdict for defendants, based on the determination of fact that plaintiff's statement was an unequivocal repudiation. (87 C.A.2d 846.)

In *Mayo v. Pacific Project Consultants* (1969) 1 C.A.3d 1013, 82 C.R. 117, plaintiff landowner gave notice of rescission of his joint venture contract with defendant developer, and brought suit for damages and to quiet title. Defendant cross-complained for the value of services rendered. The trial judge found that plaintiff's rescission was without legal cause and gave judgment for defendant on his cross-complaint. *Held*, affirmed. The notice of rescission and the suit by plaintiff constituted a repudiation of the agreement, and defendant's cross-complaint was an election to treat the repudiation as a breach. (1 C.A.2d 1017.)

But to have this effect the repudiation must be clear, positive, and unequivocal, and it may be found as a fact that the statements of the promisor did not amount to an anticipatory breach. (See *California Canning Peach Growers v. Harris* (1928) 91 C.A. 654, 656, 267 P. 572; *Wilton v. Clarke* (1938) 27 C.A.2d 1, 3, 80 P.2d 141; *Hertz Driv-Ur-Self Stations v. Schenley Distilleries Corp.* (1953) 119 C.A.2d 754, 758, 260 P.2d 93 [request for revision of contract terms]; *Martinez v. Scott Specialty Gases* (2000) 83 C.A.4th 1236, 1247, 100 C.R.2d 403 [employer's issuance of new personnel

handbook, along with declaration that prior personnel handbooks and employment policies were superseded, did not expressly repudiate prior handbook's arbitration provisions]; *Rest.2d, Contracts* §250, Comment b.)

West's Key Number Digest, Contracts k.313(2)

SUPPLEMENT: [This section is current through the latest supplement]

See *In re Marriage of Burkle* (2006) 139 C.A.4th 712, 749, 43 C.R.3d 181 [wife's filing of dissolution petition asserting invalidity of postmarital agreement, which parties had executed while prior dissolution proceeding was in abeyance, constituted unequivocal repudiation of agreement, excusing husband's performance pending determination of validity of agreement].



180 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIV. BREACH

D. Anticipatory Breach.

3. Methods of Committing Anticipatory Breach.

b. Implied Repudiation.

1 Witkin Sum. Cal. Law Contracts § 864

[§ 864] Implied Repudiation.

An anticipatory breach will also result from an *implied repudiation*, where the promisor *puts it out of his or her power to perform*. (See *Zogarts v. Smith* (1948) 86 C.A.2d 165, 172, 194 P.2d 143, *supra*, §822; *Solano v. Vallejo Redevelopment Agency* (1999) 75 C.A.4th 1262, 1275, 90 C.R.2d 41 [conduct of redevelopment agency in reaching funding limit by paying off school district's bonds constituted implied anticipatory breach, because it rendered substantial performance under capital improvements contract impossible]; cf. *Martinez v. Scott Specialty Gases* (2000) 83 C.A.4th 1236, 1248, 100 C.R.2d 403 [issuance of new personnel handbook, along with declaration that prior handbooks and employment policies were superseded, did not impliedly repudiate prior handbook's arbitration provisions, where there was no evidence that arbitration under old agreement was no longer possible]; see also *Rest.2d, Contracts* §250(b); Corbin §984; 23 Williston 4th, §63:49; 17A Am.Jur.2d (2004 ed.), *Contracts* §725; BAJI, No. 10.87 [actual and anticipatory breach]; CACI, No. 324 [anticipatory breach].)

Thus, where a vendor agrees to sell land to a purchaser, and prior to the time specified for delivery of the deed he or she conveys to a third party without notice of the rights of the purchaser, this is a repudiating act that puts it out of the power of the vendor to perform. (See *Am-Cal Inv. Co. v. Sharlyn Estates* (1967) 255 C.A.2d 526, 538, 63 C.R. 518 [defendant vendor guilty of anticipatory breach, although judgment for plaintiff purchaser reversed because he failed to show his own ability to perform].)

However, there is no implied repudiation unless the promisor actually puts it out of his or her power to perform. (*Taylor v. Johnston* (1975) 15 C.3d 130, 139, 123 C.R. 641, 539 P.2d 425, citing the text.) Thus, if a transfer to a third party is made subject to the rights of the purchaser, or under such other conditions as will protect these rights, there is no anticipatory breach. (*Brimmer v. Salisbury* (1914) 167 C. 522, 531, 140 P. 30; see *Crane v. East Side Canal & Irr. Co.* (1935) 6 C.A.2d 361, 368, 44 P.2d 455; 2 Cal. L. Rev. 326.) And there is no anticipatory breach where the seller merely permits a foreclosure sale of the property prior to the time fixed for the conveyance, for he or she may redeem. (*Lloyd v. Locke-Paddon Land Co.* (1935) 5 C.A.2d 211, 214, 42 P.2d 367; see *Seeburg v. El Royale Corp.* (1942) 54 C.A.2d 1, 7, 128 P.2d 362.)

Cases involving *actual* breach should be distinguished. In *Darr v. Clevelin Realty Corp.* (1939) 33 C.A.2d 500, 92 P.2d 475, at the time the purchaser paid the last installment on the price the vendor had divested itself of title. Hence,

the vendor was in default at the time performance was due. The court rejected the contention that the vendor was entitled to a reasonable time to execute the conveyance, pointing out that a vendor may have a reasonable time to prepare and deliver a *deed*, but not to *acquire title*. (33 C.A.2d 504.) (See *supra*, §762.)

Bankruptcy of the promisor is equivalent in effect to anticipatory breach in one respect: The promisee with a money claim may prove the bankruptcy, though performance is not yet due. However, the trustee in bankruptcy has a reasonable time to *elect to perform* the bankrupt promisor's contract; and, if he or she does, there is no anticipatory breach and the claim is not provable. If the trustee rejects the contract, the result is a breach. (See *Rest.2d, Contracts* §250, Comment c; Corbin §§967, 985; 14 Williston 4th, §§43:29, 43:30; 23 Williston 4th, §63:50; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §726.)

SUPPLEMENT: [This section is current through the latest supplement]

See *Central Valley General Hosp. v. Smith* (2008) 162 C.A.4th 501, 516, 75 C.R.3d 771 [party to contract does not lose right to treat implied repudiation of contract as anticipatory breach by failing to seek damages immediately after learning of events that constitute implied repudiation; damages can be sought until repudiation is nullified by injured party disregarding repudiation and treating contract as still in force, together with repudiating party retracting repudiation prior to time of performance].



181 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law

XIV. BREACH

D. Anticipatory Breach.

3. Methods of Committing Anticipatory Breach.

c. Restatement 2d.

1 Witkin Sum. Cal. Law Contracts § 865

[§ 865] Restatement 2d.

(1) *Failure To Give Assurance of Performance. Rest.2d, Contracts §251* adopts for all contracts the sales doctrine of assurance of performance set forth in the Uniform Commercial Code (U.C.C. 2609, 4 *Summary* (10th), *Sales*, §170). The Restatement section reads as follows:

(a) "Where reasonable grounds arise to believe that the obligor will commit a breach by non-performance that would of itself give the obligee a claim for damages for total breach under § 243, the obligee may demand adequate assurance of due performance and may, if reasonable, suspend any performance for which he has not already received the agreed exchange until he receives such assurance."

(b) "The obligee may treat as a repudiation the obligor's failure to provide within a reasonable time such assurance of due performance as is adequate in the circumstances of the particular case." (See 48 *So. Cal. L. Rev.* 1358 [argument that sales doctrine should be extended to all contracts]; 37 *A.L.R.5th* 459 [what constitutes "reasonable grounds for insecurity" justifying demand for adequate assurance of performance under Unif.Com.C. §2-609].)

(2) *Effect of Insolvency. Rest.2d, Contracts §252(1)* states a similar rule of assurance for an obligor's insolvency: "Where the obligor's insolvency gives the obligee reasonable grounds to believe that the obligor will commit a breach under the rule stated in § 251, the obligee may suspend any performance for which he has not already received the agreed exchange until he receives assurance in the form of performance itself, an offer of performance, or adequate security." (See 13 *Corbin* (Rev. ed.), §68.6; 14 *Williston* 4th, §§43:29, 43:30.)

SUPPLEMENT: [This section is current through the latest supplement]



182 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIV. BREACH

D. Anticipatory Breach.

4. Retraction or Waiver of Repudiation.

1 Witkin Sum. Cal. Law Contracts § 866

[§ 866] Retraction or Waiver of Repudiation.

A repudiation may be nullified by a retraction of the statement before the injured party materially changes his or her position in reliance on it or brings suit. (See *Guerrieri v. Severini* (1958) 51 C.2d 12, 19, 330 P.2d 635; *Crown Products Co. v. California Food Products Corp.* (1947) 77 C.A.2d 543, 551, 175 P.2d 861; *Rest.2d, Contracts* §256(1); Corbin §980; 23 Williston 4th, §63:57 et seq.) However, the retraction must be clear and unequivocal. In *Pichignau v. Paris* (1968) 264 C.A.2d 138, 70 C.R. 147, defendant repudiated plaintiff's 5-year employment contract, then offered inferior employment terminable at will for dissatisfaction. *Held*, with these new conditions, the retraction was insufficient. (264 C.A.2d 142.)

The injured party does not waive the repudiation by urging performance. (See *Rest.2d, Contracts* §257; U.C.C. 2610(b); Corbin §981; 23 Williston 4th, §63:53; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §718.) But a repudiation is nullified where the other party disregards it and treats the contract as still in force. (*Cook v. Nordstrand* (1948) 83 C.A.2d 188, 195, 188 P.2d 282 [vendor's oral statement that she would not perform, followed by purchaser's acts in attempting to complete escrow transaction].)

West's Key Number Digest, Contracts k.316(1)

SUPPLEMENT: [This section is current through the latest supplement]



183 of 184 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XIV. BREACH

D. Anticipatory Breach.

5. Unilateral Contract Exception.

a. Theory of Exception.

1 Witkin Sum. Cal. Law Contracts § 867

[§ 867] Theory of Exception.

There can be no anticipatory breach of a unilateral contract, whether it was originally unilateral or became so by one party's complete performance. The theory is that in bilateral contracts where one party repudiates, it is unfair to compel the injured party to continue performance or maintain readiness to perform on his or her part up to the time when the promisor's performance is due; but in unilateral contracts the injured party has already performed, and he or she does not suffer any unreasonable loss by merely waiting until the time of counterperformance before bringing suit. (See 23 Williston 4th, §63:28; *17A Am.Jur.2d* (2004 ed.), *Contracts* §720.)

Corbin criticizes this view, asserting that a promisor is required not only to perform his or her promise when it is due but also to forbear from repudiating it prior to that time. Breach of this duty to forbear is a proper basis for allowing an action for anticipatory breach of a bilateral or unilateral contract. (See Corbin §959 et seq.) But California courts, taking note of this criticism, nevertheless find the illogical distinction justifiable on policy grounds. (See *Minor v. Minor* (1960) 184 C.A.2d 118, 125, 7 C.R. 455, *infra*, §868; *Diamond v. University of Southern Calif.* (1970) 11 C.A.3d 49, 54, 89 C.R. 302, footnote 4, *infra*, §868.)

SUPPLEMENT: [This section is current through the latest supplement]



184 of 184 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XIV. BREACH

D. Anticipatory Breach.

5. Unilateral Contract Exception.

b. Illustrations.

1 Witkin Sum. Cal. Law Contracts § 868

[§ 868] Illustrations.

In *Minor v. Minor* (1960) 184 C.A.2d 118, 122, 7 C.R. 455, prior to an uncontested divorce decree, defendant husband contracted to pay plaintiff wife \$ 10,000, \$ 1,000 down and \$ 175 in monthly installments, in consideration of her waiver of alimony. He immediately defaulted in the initial \$ 1,000 installment and in monthly payments. Plaintiff sued for the total \$ 10,000. *Held*, citing the text, she was entitled only to the installments due. (184 C.A.2d 123.)

Answering Corbin's criticism (see *supra*, §867) that this rule results in giving judgment for future installments to one who has not yet performed and in denying it to a party whose full performance entitles him or her to better consideration, the court declared that the consequences of changing rules applicable to the enormously expanded installment contract field were too serious to warrant a reevaluation of the doctrine. (184 C.A.2d 126.)

In *Diamond v. University of Southern Calif.* (1970) 11 C.A.3d 49, 89 C.R. 302, plaintiff's class action complaint, for some 600 persons, alleged that defendant sold economy season football tickets to its games with a promise that the buyer would have an option to buy a Rose Bowl ticket if defendant's team were selected to play there. Defendant's team was selected and defendant first refused to perform its promise; but after plaintiff filed this action, it did offer performance. Plaintiff appealed from a judgment for defendant, merely to vindicate his right to attorneys' fees. *Held*, judgment affirmed; the action was premature. When defendant repudiated its promise, the contract was unilateral, i.e., the ticket holders had fully performed, and nothing remained but defendant's performance. (11 C.A.3d 53, citing the text.) (On insurance cases, see 2 *Summary* (10th), *Insurance*, §73.)

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1 of 175 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XV. DAMAGES

A. In General.

1. Nature of Remedy.

1 Witkin Sum. Cal. Law Contracts § 869

[§ 869] Nature of Remedy.

The basic object of damages is *compensation*, and in the law of contracts the theory is that the party injured by breach should receive as nearly as possible the equivalent of the benefits of performance. (See C.C. 3300; U.C.C. 1106(1); *Christensen v. Slawter* (1959) 173 C.A.2d 325, 330, 343 P.2d 341, *infra*, §900; *Brandon & Tibbs v. George Kevorkian Accountancy Corp.* (1990) 226 C.A.3d 442, 455, 277 C.R. 40, citing the text; *Lisec v. United Airlines* (1992) 10 C.A.4th 1500, 1503, 11 C.R.2d 689, quoting the text; *Rest.2d, Contracts* §346(1); Corbin §§992, 1002; 24 Williston 4th, §§64:1, 64:2; 22 *Am.Jur.2d, Damages* (2003 ed.) §§1 et seq., 24, 25; C.E.B., Attorney's Guide to Damages 2d, §1.1 et seq.; Cal. Civil Practice, 3 Business Litigation, §§24:73 et seq., 24:86 et seq., 24:97 et seq.; 61 *Harv. L. Rev.* 116; 38 *Hastings L. J.* 417 [Private Advantage and Public Power: Reexamining the Expectation and Reliance Interests in Contract Damages]; 54 *Hastings L. J.* 1335 [expectation damages]; CACI, No. 359 [present cash value of future damages], CACI, No. 361 [plaintiff may not recover duplicate contract and tort damages].) (On causation, see *infra*, §870; on foreseeability, see *infra*, §871; on reasonableness, see *infra*, §874; on elements of recovery, see *infra*, §879 et seq.; on mitigating damages, see *infra*, §914 et seq.; on particular contracts, see *infra*, §898 et seq.; 3 *Summary* (10th), *Agency and Employment*, §266 [employment contract]; 4 *Summary* (10th), *Sales*, §19 [contract of sale].)

West's Key Number Digest, Damages k.1

SUPPLEMENT: [This section is current through the latest supplement]

U.C.C. 1106(1) was repealed in 2006. The provision discussed in the text is now in U.C.C. 1305(a).

See 11 Corbin (Rev. ed.), §§55.3, 55.4.



2 of 175 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XV. DAMAGES

A. In General.

2. Causation.

1 Witkin Sum. Cal. Law Contracts § 870

[§ 870] Causation.

It is essential to establish a causal connection between the breach and the damages sought. (C.C. 3300 [compensation for detriment "proximately caused thereby"]; see *Westwater v. Grace Church* (1903) 140 C. 339, 342, 73 P. 1055; *Reliance Acceptance Corp. v. Hooper-Holmes Bureau* (1934) 139 C.A. 607, 613, 34 P.2d 762; *Southall v. Security Title Ins. & Guarantee Co.* (1952) 112 C.A.2d 321, 323, 246 P.2d 74; *Metzenbaum v. R.O.S. Associates* (1986) 188 C.A.3d 202, 213, 232 C.R. 741 [broker's loss of commission when client secured loan from another party held caused by broker's inability to negotiate a loan, instead of by client's breach]; *Bruckman v. Parliament Escrow Corp.* (1987) 190 C.A.3d 1051, 1063, 235 C.R. 813 [escrow agent's failure to perform, as substantial factor causing collapse of escrow, entitled vendor to recover resulting damages, even though other factors may have contributed to collapse]; *Postal Instant Press v. Sealy* (1996) 43 C.A.4th 1704, 1709, 51 C.R. 365, *infra*, §913, citing the text; *Vu v. California Commerce Club* (1997) 58 C.A.4th 229, 233, 68 C.R.2d 31 [no causal connection between gamblers' losses at card games and cheating by other players]; *National Med. Trans. Network v. Deloitte & Touche* (1998) 62 C.A.4th 412, 435, 72 C.R.2d 720; *St. Paul Fire & Marine Ins. Co. v. American Dynasty Surplus Lines Ins. Co.* (2002) 101 C.A.4th 1038, 1061, 124 C.R.2d 818, citing the text [no causal connection between subcontractor's alleged failure to provide liability policy insuring general contractor and any expense incurred by general contractor, where there proved to be no coverage under policy]; Corbin §997; 24 Williston 4th, §64:13; 22 *Am.Jur.2d* (2003 ed.), *Damages* §§302, 303; 4 *Cal. Proc.* (4th), *Pleading*, §501.)

West's Key Number Digest, *Damages* k.21

SUPPLEMENT: [This section is current through the latest supplement]

See *Haley v. Casa Del Rey Homeowners Assn.* (2007) 153 C.A.4th 863, 870, 63 C.R.3d 514 [jury instruction providing that "the failure of the defendants was a substantial factor in causing damage to the plaintiffs" did not improperly require finding of substantial, as opposed to nominal, damages to condominium unit owners, but rather only required finding that condominium homeowners association's breach of contract with unit owners was substantial factor in causing damage]; *Thompson Pac. Const. v. Sunnyvale* (2007) 155 C.A.4th 525, 541, 66 C.R.3d 175 [city was not entitled, on its breach of implied covenant of good faith and fair dealing cross-claim in contractor's breach of contract action, to award of damages in exact amount of disputed payments withheld from contractor for contractor's failure to perform, because award did not reflect damages caused by bad faith conduct but by failure to perform]; *Ventura v.*

Channel Islands Marina (2008) 159 C.A.4th 615, 627, 71 C.R.3d 762 [breach of ground lease by county, as lessor of harbor property, by opposing marina tenant's attempts to obtain permits to remove improvements at termination of lease was not cause of tenant's loss for improvements to property, thus precluding tenant's recovery for loss of improvements, because regulation promulgated after lease was executed prohibited removal of improvements]; 11 Corbin (Rev. ed.), §55.1. *Cross-Reference:* 4 Cal. Proc. (5th), *Pleading*, §540.



3 of 175 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XV. DAMAGES

A. In General.

3. Foreseeability.

a. Rule of Hadley v. Baxendale.

1 Witkin Sum. Cal. Law Contracts § 871

[§ 871] Rule of Hadley v. Baxendale.

(1) *The Hadley Case*. In *Hadley v. Baxendale* (1854) 9 Ex. 341, 156 Eng. Rep. R. 145, the court announced the doctrine still generally accepted as a limitation on damages recoverable for breach of contract: First, *general* damages are ordinarily confined to those that would *naturally arise* from the breach, or that might have been *reasonably contemplated or foreseen* by both parties, at the time they made the contract, as the *probable result* of the breach. Second, if *special circumstances* cause some *unusual injury*, *special damages* are not recoverable therefor unless the circumstances were *known or should have been known* to the guilty party at the time he or she entered into the contract. The requirement of *knowledge or notice* as a prerequisite to the recovery of special damages is based on the theory that a party does not and cannot assume limitless responsibility for all consequences of a breach, and that at the time of contracting, he or she must be advised of the facts concerning special harm that might result therefrom, in order that the party may determine whether or not to accept the risk of contracting. (See *Martin v. U-Haul Co. of Fresno* (1988) 204 C.A.3d 396, 409, 251 C.R. 17, quoting the text; *Brandon & Tibbs v. George Kevorkian Accountancy Corp.* (1990) 226 C.A.3d 442, 455, 277 C.R. 40, citing the text; Corbin §1006 et seq.; 24 Williston 4th, §64:14; 22 Am.Jur.2d (2003 ed.), *Damages* §§304, 308 et seq.; 80 Cal. L. Rev. 563; 61 Harv. L. Rev. 117; 63 Harv. L. Rev. 1068; 23 So. Cal. L. Rev. 398; 61 So. Cal. L. Rev. 1125; 51 Stanf. L. Rev. 1547; 51 Stanf. L. Rev. 1591; 51 Stanf. L. Rev. 1615; 45 U.C.L.A. L. Rev. 1005, 1070; BAJI, No. 10.90 [general damages/breach of contract], BAJI, No. 10.92 [special damages/breach of contract]; CACI, No. 350 [introduction to contract damages], CACI, No. 351 [special damages]; on requirement of knowledge or notice, see *Nielsen v. Farrington* (1990) 223 C.A.3d 1582, 1588, 273 C.R. 312, *infra*, §905, quoting the text.)

(2) *California Code*. "For the breach of an obligation arising from contract, the measure of damages, except where otherwise expressly provided by this code, is the amount which will compensate the party aggrieved for *all the detriment proximately caused thereby*, or which, in the ordinary course of things, *would be likely to result therefrom*." (C.C. 3300.)

Despite differences in language, it has been held that this section incorporates the limiting rule of *Hadley v. Baxendale*, applicable unless some other statute expressly covers the situation. (See *Mitchell v. Clarke* (1886) 71 C. 163, 164, 11 P. 882; *Hunt Bros. Co. v. San Lorenzo Water Co.* (1906) 150 C. 51, 56, 87 P. 1093; *Overstreet v. Merritt* (1921) 186 C. 494, 503, 200 P. 11; *Christensen v. Slawter* (1959) 173 C.A.2d 325, 334, 343 P.2d 341, *infra*, §900;

Sabraw v. Kaplan (1962) 211 C.A.2d 224, 227, 27 C.R. 81, infra, §872, citing the text; *Automatic Poultry Feeder Co. v. Wedel* (1963) 213 C.A.2d 509, 513, 28 C.R. 795, infra, §872; *Mendoyoma v. Mendocino* (1970) 8 C.A.3d 873, 879, 87 C.R. 740, quoting the text; *Glendale Fed. Savings & Loan Assn. v. Marina View Heights Dev. Co.* (1977) 66 C.A.3d 101, 123, 125, 135 C.R. 802, infra, §909, citing the text; *Ericson v. Playgirl* (1977) 73 C.A.3d 850, 854, 140 C.R. 921, infra, §912; 5 Cal. Proc. (4th), *Pleading*, §§896, 897.) (For an argument that late California cases upholding recovery of lost profits have made *Hadley v. Baxendale* obsolete, see 9 U.S.F. L. Rev. 415.)

(3) *Restatement 2d. Rest.2d, Contracts* §351 states the rule in conformity with the language of U.C.C. 2714(1) and 2715(2)(a) as follows:

"(1) Damages are not recoverable for loss that the party in breach did not have reason to foresee as a probable result of the breach when the contract was made."

"(2) Loss may be foreseeable as a probable result of a breach because it follows from the breach (a) in the ordinary course of events, or (b) as a result of special circumstances, beyond the ordinary course of events, that the party in breach had reason to know."

"(3) A court may limit damages for foreseeable loss by excluding recovery for loss of profits, by allowing recovery only for loss incurred in reliance, or otherwise if it concludes that in the circumstances justice so requires in order to avoid disproportionate compensation."

West's Key Number Digest, Damages k.127

SUPPLEMENT: [This section is current through the latest supplement]

(1) *The Hadley Case*. See 11 Corbin (Rev. ed.), §56.1 et seq.(2) *California Code*.

Cross-Reference: 5 Cal. Proc. (5th), *Pleading*, §§943, 944.



4 of 175 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XV. DAMAGES

A. In General.

3. Foreseeability.

b. Illustrations.

1. No Special Circumstances Shown.

1 Witkin Sum. Cal. Law Contracts § 872

[§ 872] No Special Circumstances Shown.

Application of the foreseeability and notice tests produces varied results, depending upon the strictness or liberality with which the court looks at the showing of notice in the particular case.

Thus, in *Hunt Bros. Co. v. San Lorenzo Water Co.* (1906) 150 C. 51, 87 P. 1093, the complaint alleged that defendant water company had agreed to install water pipes and a fire hydrant, and to supply water in a certain volume for plaintiff's premises. No time was specified for completion of the work, but after some months plaintiff protested the delay and defendant promised to commence work immediately. Nothing was done, however, prior to a fire that destroyed much of plaintiff's business property. *Held*, no cause of action was stated. The contract was not for the continuance of an established water service, nor did it call for commencement of the service at a particular time; consequently there was no showing that the defendant knew that plaintiff relied upon performance of the contract for protection of the premises from fire. (150 C. 57.)

Similarly, in *Mitchell v. Clarke* (1886) 71 C. 163, 11 P. 882, defendant failed to deliver money to plaintiff's creditor, and plaintiff was sued and his goods were sold at a forced sale. *Held*, general damages, consisting of the sum to be delivered, were recoverable; but the special loss was not, there being no proof that defendant was aware of plaintiff's insolvency and the probability of suit. (71 C. 165.)

In *Sabraw v. Kaplan* (1962) 211 C.A.2d 224, 27 C.R. 81, through plaintiff contractor's fault, a building that he knew was intended by defendant to be used as a drugstore was completed more than 4 months late. Defendant had paid a salary, or "draw," during that period to a pharmacist, who was his partner. In plaintiff's action to foreclose a mechanic's lien, defendant cross-complained for recovery of lost profits and the amount of the salary or drawing account. *Held*, the evidence was insufficient to sustain the trial court's award of damages for the salary paid the pharmacist. There was no showing that it was reasonably foreseeable that a pharmacist's services would be needed prior to completion of the building or that it would be difficult to engage a pharmacist except by employing him or her at that time. Nor was it foreseeable that defendant would enter into a partnership agreement with a third party and make advances during the delay in construction. (211 C.A.2d 227.)

In *Automatic Poultry Feeder Co. v. Wedel* (1963) 213 C.A.2d 509, 28 C.R. 795, plaintiff had an agreement with a third party to raise turkeys. He purchased feeding machinery from defendant manufacturer, the use of which caused the death of several thousand turkeys. Plaintiff sued for damages for breach of warranty, and also sought recovery of a bonus that the third party would have paid if the mortality of his flocks was 10% or below. *Held*, the bonus was not recoverable. Although defendant was aware of the third-party contract, there was no showing that it had notice or knowledge of the bonus provisions. (213 C.A.2d 514.)

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5 of 175 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XV. DAMAGES

A. In General.

3. Foreseeability.

b. Illustrations.

2. Special Circumstances Shown.

1 *Witkin Sum. Cal. Law Contracts* § 873

[§ 873] Special Circumstances Shown.

In *Morello v. Growers Grape Products Assn.* (1947) 82 C.A.2d 365, 186 P.2d 463, the seller failed to deliver brandy, which the buyer had already contracted to resell, and no other brandy was obtainable on the market. *Held*, the buyer's loss of profits could be proved as general damages. (82 C.A.2d 375.)

In *McCulloch v. Liguori* (1948) 88 C.A.2d 366, 199 P.2d 375, involving a lessor's breach of an agreement to lease a store, the difference between the agreed rental and the rental value of the term was held recoverable as general damages, and the amount paid by the lessee for storage of equipment until other premises were obtained was held recoverable as special damages. (88 C.A.2d 375.)

In *Henderson v. Oakes-Waterman Builders* (1941) 44 C.A.2d 615, 112 P.2d 662, defendant contracted to build a house according to specifications, in 45 days, for \$ 2,500, which was paid in advance. Later, he abandoned the job, leaving an unfinished building with inferior materials. *Held*, plaintiff's right was not limited to return of the \$ 2,500 paid, but he could recover the cost of demolition and reconstruction, so as to obtain the house defendant contracted to build; and he could also recover loss of the rental value from the end of the specified time to the time of reconstruction, which item was entirely independent of the contract. (44 C.A.2d 617.)

In *Coughlin v. Blair* (1953) 41 C.2d 587, 262 P.2d 305, defendants sold a residential lot to plaintiffs for \$ 14,000, defendants agreeing to pave a road and install electricity and gas within a year. In this action after total breach by defendants, damages awards were upheld as follows:

(a) *General damages.* If the work were to be done entirely on the property of the plaintiffs, the proper measure would be the reasonable cost to plaintiffs of completing it. But where, as here, the improvements are to be made on the property of the defendants, the injured party cannot do the work alone, and damages will consist of the difference in value of the property with and without the promised performance. Hence, the court properly awarded \$ 9,500, the difference between the market value of the property on the date performance was due and the value it would have had at that time if the contract had been performed. (41 C.2d 600.)

(b) *Special damages*. Plaintiffs were properly awarded two items of special damages: the value of the use of the lot and the amount of the increase in construction costs. These losses were clearly foreseeable by defendants as a result of nonperformance. But the special damages were allowable only up to the time when plaintiffs, by filing their complaint, elected to treat the breach as total. The court erred in allowing them up to the time of trial for, after plaintiffs' election, defendants were neither obligated to perform nor entitled to do so, and any loss of use or increased cost of construction after that time was the fault of plaintiffs. In effect, the trial court was attempting to give the equivalent of interest, which was improper because the damages were not certain. (41 C.2d 604.) (See *Rakish v. Valerga* (1954) 125 C.A.2d 274, 277, 270 P.2d 50 [reciting general damages rule of *Coughlin*,]; *Glendale Fed. Savings & Loan Assn. v. Marina View Heights Dev. Co.* (1977) 66 C.A.3d 101, 124, 135 C.R. 802 [same].)

In *Mack v. Hugh W. Comstock Associates* (1964) 225 C.A.2d 583, 37 C.R. 466, defendant C, a general contractor, constructed a home for plaintiffs, and defendant B, a subcontractor, installed a radiant heating system. Both defendants made express warranties of merchantable quality and fitness for the proposed use. The home was completed in 1956, leaks developed in each succeeding year through 1962, and efforts by defendants to repair proved unsuccessful. In October 1962, plaintiffs replaced the system. In this action for damages, *held*, judgment for defendants on demurrer reversed.

(a) The contract was for labor and materials, not a sale; but the cause of action and measure of damages for breach of implied warranty are the same. And the liability need not be viewed as purely contractual or purely delictual, for the measure of damages for breach is substantially identical with that for negligence. (225 C.A.2d 587.) The court also took notice of the modern view that in consumer transactions, as distinguished from mercantile transactions, recovery is best measured by the tort yardstick allowing recoupment for all damages proximately resulting from the breach. (225 C.A.2d 587.)

(b) Consequential damages were also recoverable. It was foreseeable that leaks in water pipes in the floor could result in damage to floors, woodwork, and contents of the rooms, making the house temporarily unlivable. These items and the reasonable expense entailed thereby were proper consequential damages. (225 C.A.2d 587.)

Other instructive cases are *Overstreet v. Merritt* (1921) 186 C. 494, 503, 200 P. 11; *Grupe v. Glick* (1945) 26 C.2d 680, 688, 160 P.2d 832; *Grosse v. Petersen* (1916) 30 C.A. 482, 486, 158 P. 511; *Ross v. Frank W. Dunne Co.* (1953) 119 C.A.2d 690, 700, 260 P.2d 104; *Christensen v. Slawter* (1959) 173 C.A.2d 325, 335, 343 P.2d 341, *infra*, §900.) (See 5 Cal. Proc. (4th), *Pleading*, §897.)

SUPPLEMENT: [This section is current through the latest supplement]
Other instructive cases:

Cross-Reference: 5 Cal. Proc. (5th), *Pleading*, §944.



6 of 175 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XV. DAMAGES

A. In General.

4. Reasonableness.

a. Unconscionable or Oppressive Damages.

1 Witkin Sum. Cal. Law Contracts § 874

[§ 874] Unconscionable or Oppressive Damages.

C.C. 3359 provides: "Damages must, in all cases, be reasonable, and where an obligation of any kind appears to create a right to unconscionable and grossly oppressive damages, contrary to substantial justice, no more than reasonable damages can be recovered."

In *Avery v. Fredericksen & Westbrook (1944) 67 C.A.2d 334, 154 P.2d 41*, defendant contractor paid \$ 25 per acre (which was found to be the total value of the land) for the privilege of removing sand from plaintiff's land, promising to level off the property when finished. On defendant's failure to perform, plaintiff asked for \$ 10,400 damages, representing the cost of restoring the land to its original condition. *Held*, damages were limited to \$ 87.50, the market value of 3 1/2 acres from which the sand was taken. (*67 C.A.2d 336.*) (See *Postal Instant Press v. Sealy (1996) 43 C.A.4th 1704, 1713, 51 C.R. 365*, *infra*, §913 [award to franchisor of lost future royalty and advertising fees after termination of franchise agreement for franchisee's failure to timely pay some past royalty and advertising fees would result in unreasonable, unconscionable, and oppressive damages]; *53 Harv. L. Rev. 138; 61 Harv. L. Rev. 117, 154.*)

SUPPLEMENT: [This section is current through the latest supplement]



7 of 175 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XV. DAMAGES

A. In General.

4. Reasonableness.

b. Damages Exceeding Value of Performance.

1 Witkin Sum. Cal. Law Contracts § 875

[§ 875] Damages Exceeding Value of Performance.

"Except as expressly provided by statute, no person can recover a greater amount in damages for the breach of an obligation, than he could have gained by the full performance thereof on both sides." (C.C. 3358; see *Caminetti v. Pacific Mut. Life Ins. Co. (1943) 23 C.2d 94, 107, 142 P.2d 741*; *Avery v. Fredericksen & Westbrook (1944) 67 C.A.2d 334, 336, 154 P.2d 41*, supra, §874.) The proviso in C.C. 3358 was added in 1977 in conjunction with the revised liquidated damages law (supra, §533 et seq.).

However, where another established rule of damages applies, it will apparently govern even though the result in the particular case is contrary to the theory of C.C. 3358. For example, under U.C.C. 2708(1) the measure of damages for nonacceptance or repudiation by a buyer is the difference between the unpaid contract price and the market price at the time and place for tender. (See 4 *Summary* (10th), *Sales*, §188.) In *Rice v. Schmid (1941) 18 C.2d 382, 115 P.2d 498*, decided under a similar provision of the former Sales Act, plaintiff seller agreed to furnish flour, as instructed by defendant buyer, and the buyer repudiated. Plaintiff sued for the difference between the contract price and the market price at the time the goods should have been accepted. *Held*, this was proper, even though he had made a separate contract with a manufacturer to obtain his flour at a higher rate than the market price at the time of breach. (*18 C.2d 387*.)

Similarly, in *Pelletier v. Eisenberg (1986) 177 C.A.3d 558, 567, 223 C.R. 84*, plaintiff artist brought an action against defendant art gallery, consignee of paintings that were destroyed in a fire. *Held*, the proviso in C.C. 3358 applied. Under C.C. 1738(c), an art consignee is absolutely liable for the loss of fine art, regardless of the terms of the consignment contract; i.e., C.C. 1738(c) "recognizes that the destruction of fine art results in peculiar losses ... normally arising from a failure to perform other types of obligation." (*177 C.A.3d 568*.)

Obviously, C.C. 3358 cannot be applied in the absence of a showing as to what the performance by both parties would have been. In *Benard v. Walkup (1969) 272 C.A.2d 595, 77 C.R. 544, Cal. Proc. (4th), Attorneys*, §335, plaintiff sued attorney S for failure to file a personal injury action within the limitations period, and was awarded stipulated damages of \$ 7,500 as the amount that would have been recovered in the suit against the tortfeasor. S argued that the amount of the contingent fee he would have received should have been deducted. *Held*, the award was proper; there was no way of ascertaining the actual damages plaintiff would have recovered had S fully performed. (*272 C.A.2d 605*.)

SUPPLEMENT: [This section is current through the latest supplement]

Benard case:

Cross-Reference: 1 *Cal. Proc.* (5th), *Attorneys*, §313.



8 of 175 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XV. DAMAGES

A. In General.

5. Punitive Damages.

a. No Award in Contract Case.

1 Witkin Sum. Cal. Law Contracts § 876

[§ 876] No Award in Contract Case.

C.C. 3294, providing for exemplary or punitive damages, refers to breach of an obligation "not arising from contract." Hence, punitive damages are never recoverable for breach of contract, no matter how wilful or malicious, except where the wrongful act is also a tort. (See *Jones v. Kelly* (1929) 208 C. 251, 254, 280 P. 942; *Haigler v. Donnelly* (1941) 18 C.2d 674, 680, 117 P.2d 331; *Croghan v. Metz* (1956) 47 C.2d 398, 405, 303 P.2d 1029; *Frazier v. Metropolitan Life Ins. Co.* (1985) 169 C.A.3d 90, 106 224 C.R. 883; *Ilkhchooyi v. Best* (1995) 37 C.A.4th 395, 412, 45 C.R.2d 766 [motive of party breaching contract has no bearing on scope of damages recoverable]; *Rest.2d, Contracts* §355; *Corbin* §1077; 24 Williston 4th, §64:2; 22 *Am.Jur.2d* (2003 ed.), *Damages* §574 et seq.; 70 *Harv. L. Rev.* 531; 29 *Loyola L.A. L. Rev.* 1071 [Punitive and Compensatory Contract Damages: A Comparative Study of UCC, Chinese, and International Law].)

In *Chelini v. Nieri* (1948) 32 C.2d 480, 196 P.2d 915, defendant mortician was employed to prepare the body of plaintiff's mother for burial. Knowing of plaintiff's intention to move the body to a vault at some future date, he promised to furnish a hermetically sealed casket, and to embalm the body in such a manner that it would "keep almost forever." Defendant knew that this promise could not be performed. Less than 2 years later the body, on examination, was found to be decomposed. In this action, plaintiff recovered judgment for (a) \$ 10,000 compensatory damages for physical suffering and disability resulting from the shock of discovery, and (b) \$ 900 exemplary damages pursuant to an instruction to the jury that they might award them if the breach of contract was wilful. *Held*, the award of compensatory damages was proper (*Westervelt v. McCullough* (1924) 68 C.A. 198, 228 P. 734, *infra*, §885), but the instruction and award of exemplary damages were in conflict with the rule that punitive damages cannot be awarded for a mere breach of contract. The court pointed out that the evidence would have supported the verdict for exemplary damages on the theory of the tort of *fraud*, consisting of a promise made without intention to perform; but there was neither a *proper pleading* of this additional cause of action, nor the presentation of the issue to the jury at the trial. (32 C.2d 487.) (See *Myers Bldg. Industries, Ltd. v. Interface Technology* (1993) 13 C.A.4th 949, 956, 17 C.R.2d 242 [where special verdict contained only finding of breach of contract, no punitive damages could be awarded despite evidence of fraud and jury instruction thereon].)

In *Frazier v. Metropolitan Life Ins. Co.*, *supra*, plaintiff brought an action against defendant insurer for breach of the implied covenant of good faith and fair dealing in failing to pay a death benefit under an insurance policy. In order to avoid the statute of limitations on a tort action, she pleaded one cause of action in contract; and in order to obtain tort

damages for emotional distress, she pleaded another cause of action in tort. But she also, under the tort cause, asked for punitive damages. *Held*, punitive damages could not be recovered. The court recognized the inconsistency of accepting the tort aspect of the action for compensatory damages and rejecting it for punitive damages, and gave the following explanation for its decision: "Here, pure logic must give way to the strict statutory prohibition of section 3294 and case authority interpreting the statute, as punitive damages in California are based upon this statute alone; and it is the statutory language which controls. ... "[T]he very words of section 3294 permit punitive damages only for breach of an obligation *not arising from contract*." (169 C.A.3d 107.)

West's Key Number Digest, Damages k.89(2)

SUPPLEMENT: [This section is current through the latest supplement]

See *Power Standards Lab v. Federal Express Corp.* (2005) 127 C.A.4th 1039, 1046, 26 C.R.3d 202, quoting the text [carrier case; punitive damages were extracontractual and were preempted by federal law]; 11 Corbin (Rev. ed.), §59.1.



9 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XV. DAMAGES

A. In General.

5. Punitive Damages.

b. Where Breach Is Also a Tort.

1 Witkin Sum. Cal. Law Contracts § 877

[§ 877] Where Breach Is Also a Tort.

In a number of situations involving contractual obligations, the injured party has the election of alternative contract or tort actions, and punitive damages may be recovered in causes of action in contract and tort. (See 3 *Cal. Proc.* (4th), *Actions*, §139 et seq.; 6 *Summary* (10th), *Torts*, §1730.) The following are examples:

(1) *Fraud*. See *Horn v. Guaranty Chevrolet Motors* (1969) 270 C.A.2d 477, 484, 75 C.R. 871 [rescission for fraud; recovery of amount paid, costs and expenses, and punitive damages]; cf. *Ward v. Taggart* (1959) 51 C.2d 736, 743, 336 P.2d 534, 6 *Summary* (10th), *Torts*, §1713 [where money is obtained by fraud, quasi-contract action for restitution is outside the scope of statutory limitation--"not arising from contract"].)

(2) *Insurer's bad faith*. See *Neal v. Farmers Ins. Exchange* (1978) 21 C.3d 910, 923, 148 C.R. 389, 582 P.2d 980; *Egan v. Mutual of Omaha Ins. Co.* (1979) 24 C.3d 809, 822, 169 C.R. 691, 620 P.2d 141; *Fletcher v. Western Nat. Life Ins. Co.* (1970) 10 C.A.3d 376, 401, 89 C.R. 78 [insurer's bad faith refusal to make payments under disability policy, together with threatening communications to insured to induce him to surrender policy or disadvantageously settle nonexistent dispute; punitive damages awarded against insurer and its claim supervisor]; 7 *Cal. Western L. Rev.* 496 [*Fletcher*]; 47 A.L.R.3d 314 [same]; 2 *Summary* (10th), *Insurance*, §239 et seq.)

The former tort action for bad faith denial of the existence of a contract was repudiated and the decision creating the action, *Seaman's Direct Buying Service v. Standard Oil Co.* (1984) 36 C.3d 752, 206 C.R. 354, 686 P.2d 1158, was overruled by *Freeman & Mills v. Belcher Oil Co.* (1995) 11 C.4th 85, 44 C.R.2d 420, 900 P.2d 669, 3 *Cal. Proc.* (4th), *Actions*, §166.

SUPPLEMENT: [This section is current through the latest supplement]

Alternative contract or tort actions:

Cross-Reference: 3 *Cal. Proc.* (5th), *Actions*, §144 et seq.

Former tort action for bad faith denial of contract:

1 Witkin Sum. Cal. Law Contracts § 877

Cross-Reference: 3 Cal. Proc. (5th), Actions, §170.



10 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XV. DAMAGES

A. In General.

6. Nominal Damages.

1 Witkin Sum. Cal. Law Contracts § 878

[§ 878] Nominal Damages.

For a breach causing no substantial damage, or where the damages were not foreseeable or not clearly ascertainable, only *nominal damages* (an insignificant sum) can be given. (C.C. 3360; see *Kenyon v. Western Union Tel. Co.* (1893) 100 C. 454, 457, 35 P. 75; *Sweet v. Johnson* (1959) 169 C.A.2d 630, 632, 337 P.2d 499; *Ericson v. Playgirl* (1977) 73 C.A.3d 850, 859, 140 C.R. 921, *infra*, §912; *Rest.2d, Contracts* §346(2); Corbin §1001; 24 Williston 4th, §64:6; 22 *Am.Jur.2d* (2003 ed.), *Damages* §8 et seq.; 61 *Harv. L. Rev.* 118; CACI, No. 360 [nominal damages].)

SUPPLEMENT: [This section is current through the latest supplement]
See 11 Corbin (Rev. ed.), §55.10.



11 of 175 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XV. DAMAGES

B. Particular Elements of Recovery.

1. Loss of Profits or Benefits.

a. Requirement of Certainty.

1 Witkin Sum. Cal. Law Contracts § 879

[§ 879] Requirement of Certainty.

(1) *In General.* C.C. 3301 states that "No damages can be recovered for a breach of contract which are *not clearly ascertainable* in both their nature and origin."

Subject to this limitation, the injured party may recover for the profits or benefits that he or she would have obtained by performance if the injured party can establish them with reasonable certainty. (See *Rest.2d, Contracts* §352, and Comment b; Corbin §§1020, 1022; 24 Williston 4th, §64:9 et seq.; 22 *Am.Jur.2d* (2003 ed.), *Damages* §§317 et seq., 328 et seq., 448 et seq.; 46 *Harv. L. Rev.* 696; 61 *Harv. L. Rev.* 121; 64 *Harv. L. Rev.* 317; 52 *So. Cal. L. Rev.* 1727 [Lost Profits in the Uniform Commercial Code]; 67 *So. Cal. L. Rev.* 1573 [Averting the New Business' Battle To Prove Lost Profits: A Reintroduction of the Traditional Reasonable Certainty Rule as Penalty Default]; 9 *U.S.F. L. Rev.* 415 [analysis of all California cases on lost profits]; 17 *A.L.R.2d* 1379 [loss of business resulting from resale of unwholesome food or beverages furnished by another]; 24 *A.L.R.2d* 1008, 1011 [measure of damages for buyer's breach of contract to purchase article from dealer or manufacturer's agent]; 28 *A.L.R.2d* 591 [recovery by contractor or artisan, suing for breach of warranty, of damages for loss of goodwill occasioned by use in business of unfit materials]; 41 *A.L.R.2d* 1414 [breach of covenant for quiet enjoyment in lease]; 3 *A.L.R.3d* 689 [overhead expense as recoverable element of damages]; 54 *A.L.R.3d* 324 [damages for wrongful termination of automobile dealership contracts]; BAJI, No. 10.91 [general damages/loss of profits], BAJI, No. 12.57 [fraud and deceit--damages--benefit of the bargain rule]; CACI, No. 352 [loss of profits--no profits earned], CACI, No. 353 [loss of profits--some profits earned], CACI, No. 1924 [damages--benefit of the-bargain rule].)

(2) *Illustrations.* The nature of the requirement for certainty was carefully examined in *Noble v. Tweedy* (1949) 90 C.A.2d 738, 203 P.2d 778. Defendant lessors gave plaintiffs a 10-year lease on certain property, further covenanting to erect an additional building. On the lessors' failure to perform this covenant, plaintiffs sued and were awarded, as the present value of their prospective damages, the difference in rental value of the existing property and the promised property (\$ 75 per month). Defendants objected that the award gave the lessees a speculative windfall, because it might develop that they would not be entitled to occupancy for the full term, and suggested that, instead of a lump sum, plaintiffs be given a reduction in rent of \$ 75 per month. *Held*, the award was proper. Reasonable, not mathematical, certainty, is required for an award of damages; and where there is no uncertainty as to the *fact* of future damages, it is no objection to recovery that the *amount* cannot be exactly determined, or is subject to contingencies. The court added:

"The possibilities of a breach by plaintiffs, or insolvency, or of destruction of the building, are wholly speculative and fanciful. It is clear that an award of damages could not be *granted* upon the basis of anticipated future injuries or other events as purely hypothetical as these; and it follows by way of analogy, that they likewise do not constitute a sufficient basis for *denying* a recovery for damages which are otherwise reasonably certain to be sustained." (90 C.A.2d 746.)

In *Mann v. Jackson* (1956) 141 C.A.2d 6, 296 P.2d 120, defendants agreed to build a wire-assembling machine to produce wire at a minimum rate of 3,000 feet an hour. The machine was defective and never produced salable wire. Plaintiffs recovered: (a) The difference between the value of the machine delivered and the amount paid for it, and the expense of trying to make it work (concededly proper). (b) The difference between the cost of producing wire by their ordinary manual method and the cost (which would have been less) if the machine had worked as agreed. The court's theory was that the working experience of the business afforded a reasonable method of determining the loss. (141 C.A.2d 11.)

Other illustrations are numerous. (See *Shoemaker v. Acker* (1897) 116 C. 239, 245, 48 P. 62 [defendant "cannot wholly escape on account of the difficulty which his own wrong has produced of devising a perfect measure of damages"]; *Grupe v. Glick* (1945) 26 C.2d 680, 688, 160 P.2d 832 [retail dealer may recover for loss of profits on prospective resales, where defendant wholesaler breached warranty of quality]; *Hacker Pipe & Supply Co. v. Chapman Valve Mfg. Co.* (1936) 17 C.A.2d 265, 267, 61 P.2d 944 ["It is sufficient that it be shown as a reasonable probability that the profits would have been earned except for the breach"]; *O'Hare v. Peacock Dairies* (1938) 26 C.A.2d 345, 359, 79 P.2d 433 [defendant contracted to take all milk produced by plaintiffs for 10 years, but after 4 years defendant repudiated and plaintiffs then stopped production and sold herd; prospective profits for remainder of contract term were not recoverable because plaintiffs made it impossible to compute future damages with certainty]; *Monroe v. Owens* (1946) 76 C.A.2d 23, 30, 172 P.2d 110 [approving quotation from A.L.R.: "Uncertainty as to the fact is fatal to recovery, but not uncertainty as to the amount"]; *Morello v. Growers Grape Products Assn.* (1947) 82 C.A.2d 365, 375, 186 P.2d 463 [seller's failure to deliver, buyer's loss of profits on prospective resales]; *Allen v. Gardner* (1954) 126 C.A.2d 335, 340, 272 P.2d 99 ["The law only requires that some reasonable basis of computation be used, and will allow damages so computed even if the result reached is only an approximation"]; *Mahoney v. Founders' Ins. Co.* (1961) 190 C.A.2d 430, 436, 12 C.R. 114 [only reasonable certainty is required where promisor has created the difficulty by his or her breach]; *Fisher v. Hampton* (1975) 44 C.A.3d 741, 747, 118 C.R. 811, citing the text; *Guntert v. Stockton* (1976) 55 C.A.3d 131, 152, 126 C.R. 690, 127 C.R. 602, 12 Summary (10th), Real Property, §612; *GHK Associates v. Mayer Group* (1990) 224 C.A.3d 856, 873, 274 C.R. 168; *Brandon & Tibbs v. George Kevorkian Accountancy Corp.* (1990) 226 C.A.3d 442, 456, 457, 458, 277 C.R. 40; *DuBarry Int. v. Southwest Forest Industries* (1991) 231 C.A.3d 552, 562, 282 C.R. 181, citing the text; *Al-Husry v. Nilsen Farms Mini-Market* (1994) 25 C.A.4th 641, 651, 31 C.R.2d 28, *infra*, §888; *Arntz Contracting Co. v. St. Paul Fire & Marine Ins. Co.* (1996) 47 C.A.4th 464, 489, 54 C.R.2d 888 [lost profit from impaired bonding capacity not inherently speculative]; *Shade Foods v. Innovative Products Sales & Marketing* (2000) 78 C.A.4th 847, 888, 93 C.R.2d 364 [lost profits were recoverable in bad faith action against insurer, where evidence supported conclusion that insurer's denial of coverage forced insured out of business and damages were not speculative]; *Copeland v. Baskin Robbins U.S.A.* (2002) 96 C.A.4th 1251, 117 C.R.2d 875, *supra*, §148 [lost profits from breach of contract to negotiate agreement were unrecoverable because of uncertainty].)

West's Key Number Digest, Damages k.40(2)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *In General.* See *Toscano v. Greene Music* (2004) 124 C.A.4th 685, 695, 21 C.R.3d 732, *Supp.*, *supra*, §246 [lost future earnings were too speculative in at-will employment setting]; 11 Corbin (Rev. ed.), §§56.16, 56.19.



12 of 175 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XV. DAMAGES

B. Particular Elements of Recovery.

1. Loss of Profits or Benefits.

b. Established and New Businesses.

1. Giving Up Established Business.

1 Witkin Sum. Cal. Law Contracts § 880

[§ 880] Giving Up Established Business.

If the plaintiff gives up an established business or profession to enter into new activities by contract with the defendant, on breach the plaintiff may recover the profit or earnings he or she would have made by remaining in the former business or profession. (See *Overstreet v. Merritt* (1921) 186 C. 494, 505, 200 P. 11 [emphasizing bad faith on defendant's part].)

SUPPLEMENT: [This section is current through the latest supplement]



13 of 175 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XV. DAMAGES

B. Particular Elements of Recovery.

1. Loss of Profits or Benefits.

b. Established and New Businesses.

2. Future Profits From Existing Business.

1 Witkin Sum. Cal. Law Contracts § 881

[§ 881] Future Profits From Existing Business.

In *Hoag v. Jenan* (1948) 86 C.A.2d 556, 195 P.2d 451, the court, quoting from a New Jersey case, contrasted the rule against recovery of prospective profits from a *new* business (infra, §882) with the rule allowing recovery where the business is established: "In the one case, the success of the business usually depends upon a variety of circumstances, and the outcome is therefore too uncertain to provide a tangible basis for computation; while in the other, past experience has demonstrated the success of the enterprise and provides a reasonably certain basis for the calculation of plaintiff's probable loss consequent upon the breach." (86 C.A.2d 564.)

In *Hoag*, plaintiff lessee, a garageman, sought damages for defendant lessor's failure to perform his promise to construct and lease an annex to plaintiff's premises. *Held*, plaintiff was entitled to recover for loss of profits resulting from his inability to handle available increased business because of lack of space. (86 C.A.2d 563, 564.) (See *Jegen v. Berger* (1946) 77 C.A.2d 1, 16, 174 P.2d 489 [sale of defective laundry machinery, buyer's loss of prospective profits from new customers he was forced to turn away]; *Phalanx Air Freight v. National Skyway Freight Corp.* (1951) 104 C.A.2d 771, 776, 232 P.2d 510 [future profits and value of goodwill of recently established business not yet operating at profit, difficult to estimate but recoverable]; *Guntert v. Stockton* (1976) 55 C.A.3d 131, 152, 126 C.R. 690, 127 C.R. 602, 12 Summary (10th), *Real Property*, §612; *Burnett & Doty Dev. Co. v. Phillips* (1978) 84 C.A.3d 384, 389, 148 C.R. 569; 64 Harv. L. Rev. 319.)

West's Key Number Digest, Damages k.40(2)

SUPPLEMENT: [This section is current through the latest supplement]



14 of 175 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XV. DAMAGES

B. Particular Elements of Recovery.

1. Loss of Profits or Benefits.
- b. Established and New Businesses.
3. Future Profits From New Business.

1 Witkin Sum. Cal. Law Contracts § 882

[§ 882] Future Profits From New Business.

If the anticipated profits were not to come from an established business or profession, but from a new business to be established, the difficulty of estimating them has generally led the courts to classify the damages as uncertain and speculative, and to deny recovery. (See *California Press Mfg. Co. v. Stafford Packing Co.* (1923) 192 C. 479, 485, 221 P. 345; *Alder v. Drudis* (1947) 30 C.2d 372, 382, 182 P.2d 195 [breach of contract to promote and develop invention]; *Gibson v. Hercules Mfg. Co.* (1927) 80 C.A. 689, 702, 252 P. 780; *Handley v. Guasco* (1958) 165 C.A.2d 703, 711, 332 P.2d 354; *MacMorris Sales Corp. v. Kozak* (1968) 263 C.A.2d 430, 443, 69 C.R. 719; *Fisher v. Hampton* (1975) 44 C.A.3d 741, 748, 118 C.R. 811, citing the text; *Resort Video, Ltd. v. Laser Video* (1995) 35 C.A.4th 1679, 1697, 42 C.R.2d 136 [evidence of lost profits of newly established business producing resort promotional videos failed to provide degree of certainty necessary to support jury award]; 46 *Harv. L. Rev.* 696; 64 *Harv. L. Rev.* 319; 8 *U.S.F. L. Rev.* 431; 55 *A.L.R.4th* 507 [recovery of anticipated lost profits of new business: post-1965 cases].)

However, even where the business is a new one, damages are recoverable if a satisfactory showing is made. (*Mahoney v. Founders' Ins. Co.* (1961) 190 C.A.2d 430, 436, 12 C.R. 114.)

SUPPLEMENT: [This section is current through the latest supplement]

In *Lewis Jorge Const. Management v. Pomona Unified School Dist.* (2004) 34 C.4th 960, 22 C.R.3d 340, 102 P.3d 257, plaintiff contractor and defendant school district entered into a contract to construct school improvements. Four months later, defendant declared plaintiff in default for failing to meet the completion date, terminated the contract, and made a successful demand on plaintiff's surety to hire another contractor to complete the contract under plaintiff's performance bond. Plaintiff then brought a breach of contract action and alleged that, as a result of defendant's breach, plaintiff's bonding capacity had been reduced. As damages, plaintiff sought to recover the lost profits that it would have earned on future, unidentified construction contracts that it allegedly would have been awarded had its bonding capacity not been impaired. *Held*, the potential profits were not recoverable.

(a) *General damages.*

(1) The Court of Appeal, concluding that the future profits were a proper item of general damages, reasoned that

defendant was aware of the bonding requirements and thus should have known that its breach, and subsequent resort to another contractor to complete the work, would result in plaintiff's bonding capacity being reduced to a level so low that it would be unable to successfully bid on future public contracts. Indeed, damages measured by lost future profits have been upheld for breach of a construction contract when the breaching party's conduct prevented the other side from undertaking performance, i.e., when the lost profits that were unearned involved the very contract that had been breached. However, lost profits from collateral transactions (as is involved here) as a measure of general damages for breach of contract are usually limited to contracts involving crops, goods intended for resale, or an agreement creating an exclusive sales agency, because in such cases the likelihood of lost profits from a related or derivative transaction is so obvious that the breaching party must be deemed to have contemplated them when the contract was entered into. With respect to construction contracts, there is no California authority upholding lost profit damages under the facts presented, and a Montana case taking the contrary view has not been followed in a published opinion outside Montana in the 33 years since it was decided. (34 C.4th 970.)

(2) *Arntz Contracting Co. v. St. Paul Fire & Marine Ins. Co.* (1996) 47 C.A.4th 464, 54 C.R.2d 888, is the only California decision upholding damages for a contractor's lost profits on future contracts that it did not win because its bonding capacity was impaired, but that decision arose not, as here, from a construction contract, but from a contract to provide future bonding. Because the contract was one for future bonding, it was entirely within the contemplation of the surety that its breach of the contract would preclude the contractor from bidding on and being awarded major projects. Thus, the lost profits on those projects were properly general damages, for they were the direct and immediate fruits of the surety's breach of the contract to provide bonding. (34 C.4th 973.)

(3) Here, it cannot be said that the parties' bargain included plaintiff's potential profits on future construction projects that it had not been awarded. Full performance by defendant would have provided plaintiff with full payment of the contract price, and the projected profit was limited by the contract price and plaintiff's costs of performance. In other words, if plaintiff's bid accurately predicted its costs, the benefit of its contractual bargain for profits was capped by whatever net profit it had assumed in setting its bid price. *Warner Const. Corp. v. Los Angeles* (1970) 2 C.3d 285, 85 C.R. 444, 466 P.2d 996, did not, as argued by plaintiff, hold that potential profits lost from future contracts are general damages that naturally flow from a breach of a construction contract. At most, it acknowledged that to recover profits lost on future contracts the plaintiff contractor must prove their occurrence and extent. (34 C.4th 973.)

(b) *Special damages.*

(1) Lost profits, if recoverable, are more commonly special, rather than general, damages and are subject to various limitations. Thus, not only must special damages be pleaded with particularity, but they must also be proven to be certain both as to their occurrence and extent, albeit not with mathematical precision. Although plaintiff did not plead its lost future profits as special damages, the issue of their availability as special damages was presented to the jury, and at oral argument defendant expressly stated that it was not relying on that pleading omission. (34 C.4th 975.)

(2) Although a few sister state cases have held that a contractor suing for breach of contract may recover as special damages any profits it might have earned on other unawarded construction contracts, such damages are more frequently denied by other state courts as too speculative. Also, there are numerous federal decisions to similar effect. These cases bar recovery of profits lost on future contracts not because the amount of the lost profits is speculative or remote, but because their occurrence is uncertain. California, likewise, has not upheld as special damages a contractor's unearned profits after breach of a construction contract, not even in *S.C. Anderson v. Bank of America* (1994) 24 C.A.4th 529, 30 C.R.2d 286, where the lost profits claim was for a sum certain and flowing from a particular project that the contractor would likely have won as the low bidder. In contrast, the lost profits that plaintiff claimed it would have made on future construction projects were uncertain and speculative. (34 C.4th 976.)

(3) At trial, plaintiff presented evidence that its bonding capacity was reduced by its surety after defendant's termination of the contract. But plaintiff did not establish that when the contract was formed the defendant could have reasonably contemplated that its breach would probably lead to a reduction of plaintiff's bonding capacity by its surety,

which in turn would adversely affect plaintiff's ability to obtain future contracts. Indeed, the evidence disclosed that plaintiff's bonding agent, who had obtained the construction bonds from a particular agency, anticipated that the agency's suspension of plaintiff's bonding capacity would only be temporary. (34 C.4th 977.)

(4) Evidence at trial established that defendant's terminating a contract might or might not cause the contractor's surety to reduce plaintiff's bonding capacity. As defendant pointed out at oral argument, when it signed the contract it did not know what plaintiff's balance sheet showed or what criteria plaintiff's surety ordinarily used to evaluate a contractor's bonding limits. Absent such knowledge, the profits that plaintiff claimed it would have made on future, unawarded contracts were not actually foreseen nor reasonably foreseeable. "Hence they are unavailable as special damages for the breach of this contract." (34 C.4th 977.)



15 of 175 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XV. DAMAGES

B. Particular Elements of Recovery.

2. Plaintiff's Expenditures.

1 Witkin Sum. Cal. Law Contracts § 883

[§ 883] Plaintiff's Expenditures.

Another measure of contract damages is the amount of the plaintiff's expenditures, together with the reasonable value of his or her own services, in preparation and performance in reliance on the contract. This type of recovery is frequently sought or awarded where, because of uncertainty or difficulty of proof or other reason, the plaintiff is unable to establish a claim for lost profits. (See *Cederberg v. Robison* (1893) 100 C. 93, 97, 34 P. 625; *Grosse v. Petersen* (1916) 30 C.A. 482, 486, 158 P. 511; *Blair v. Brownstone Oil & Refining Co.* (1917) 35 C.A. 394, 396, 170 P. 160; *Patty v. Berryman* (1949) 95 C.A.2d 159, 172, 212 P.2d 937; *Walpole v. Prefab Mfg. Co.* (1951) 103 C.A.2d 472, 489, 230 P.2d 36; *Rest.2d, Contracts* §349; *Corbin* §1031; 24 Williston 4th, §66:14 et seq.; 63 Harv. L. Rev. 1068; 64 Harv. L. Rev. 324; 23 So. Cal. L. Rev. 398; 17 A.L.R.2d 1300 [expenditures incurred in preparation for performance]; 3 A.L.R.3d 689 [overhead expense]; BAJI, No. 12.56 [fraud and deceit--damages--out of pocket rule]; CACI, No. 1923 [damages--out of pocket Rule]; on recovery of reliance damages in action for breach of contract to negotiate an agreement, see *Copeland v. Baskin Robbins U.S.A.* (2002) 96 C.A.4th 1251, 117 C.R.2d 875, supra, §148.)

Where an insurer breaches its policy obligation and fails to defend a suit against the insured, the insured can recover litigation expenses and attorneys' fees incurred in defending the suit. (*Arenson v. National Auto. & Cas. Ins. Co.* (1957) 48 C.2d 528, 537, 310 P.2d 961, 2 Summary (10th), *Insurance*, §297; *Lowell v. Maryland Cas. Co.* (1966) 65 C.2d 298, 302, 54 C.R. 116, 419 P.2d 180; *California v. Pacific Indem. Co.* (1998) 63 C.A.4th 1535, 1551, 75 C.R.2d 69; 44 Am.Jur.2d (2003 ed.), *Insurance* §§1406, 1407; 4 A.L.R.3d 270 [attorneys' fees incurred in litigation with third person].) The same is true where the insurer violates the covenant of good faith and fair dealing by unreasonable refusal to pay a claim, and the insured brings an action to recover the benefits. (See *Brandt v. Superior Court* (1985) 37 C.3d 813, 817, 818, 819, 210 C.R. 211, 693 P.2d 796, 7 Cal. Proc. (4th), *Judgment*, §149.)

West's Key Number Digest, Damages k.45

SUPPLEMENT: [This section is current through the latest supplement]
See 11 Corbin (Rev. ed.), §57.3.

Brandt case:

Cross-Reference: 7 Cal. Proc. (5th), *Judgment*, §154.



16 of 175 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XV. DAMAGES

B. Particular Elements of Recovery.

3. Mental or Physical Suffering.

a. Traditional Rule Against Recovery.

1 Witkin Sum. Cal. Law Contracts § 884

[§ 884] Traditional Rule Against Recovery.

Ordinarily, damages are not recoverable for *mental suffering* resulting from a breach of contract. (See *Westwater v. Grace Church* (1903) 140 C. 339, 341, 73 P. 1055; *Mack v. Hugh W. Comstock Associates* (1964) 225 C.A.2d 583, 588, 37 C.R. 466, *supra*, §873 [no recovery for mental suffering or humiliation caused by defective heating system damaging interior of home]; *O'Neil v. Spillane* (1975) 45 C.A.3d 147, 159, 119 C.R. 245, citing the text [applying same rule to action based on undue influence and constructive fraud]; *Sawyer v. Bank of America* (1978) 83 C.A.3d 135, 139, 145 C.R. 623; *Rest.2d, Contracts* §353; *Corbin* §1076; 24 Williston 4th, §64:7; 38 *Am.Jur.2d* (1999 ed.), *Fright, Shock, and Mental Disturbance* §20; 49 *Cal. L. Rev.* 758; 5 *Cal. Western L. Rev.* 88; 61 *Harv. L. Rev.* 141; 70 *Harv. L. Rev.* 532; 20 *U.C. Davis L. Rev.* 57 [Emotional Distress Damages and Breach of Contract: A New Approach]; 37 *A.L.R.2d* 538, 543 [insurer's failure or delay in making payments due under contract]; 88 *A.L.R.2d* 1367 [breach of contract to furnish goods]; 7 *A.L.R.4th* 1178 [recovery for mental pain, absent independent physical injury, consequent upon breach of building contract].) This rule, as well as that which denies punitive damages for breach of contract (see *supra*, §876), is occasionally blunted by a showing that the defendant's refusal to perform was a breach of the implied covenant of good faith, thereby giving the plaintiff a tort remedy in some circumstances. (See *supra*, §876; *infra*, §885.)

In *Sawyer v. Bank of America*, *supra*, plaintiff farmer, a long-time customer of defendant bank, financed his purchases of vehicles through defendant's local branch. He relied on an oral agreement that the bank would renew his vehicle insurance if he did not, but in one instance, as a result of clerical error, the bank failed to renew insurance on a pickup truck. The truck was damaged by fire and plaintiff incurred repair costs of \$ 2,005.90, but defendant refused his demands for payment of this sum, offering instead a compromise payment of \$ 1,000. He brought this action and received a jury verdict and judgment for (a) the amount of the loss as actual damages, \$ 5,000 as general damages for emotional distress, and (b) \$ 15,000 as punitive damages. *Held*, judgment modified to limit the recovery to the actual damages.

The court said: "[I]t is not a tort for a contractual obligor to dispute his liability under the contract. Rather, the tort of breach of an implied covenant of good faith and fair dealing consists in bad faith action, extraneous to the contract, with the motive intentionally to frustrate the obligee's enjoyment of contract rights. ... We have found no authority recognizing tort liability resting solely on the basis of an obligor's resistance to an assertion of contract liability." (83 C.A.3d 139.)

In *Selden v. Dinner* (1993) 17 C.A.4th 166, 21 C.R.2d 153, plaintiff (Selden) elected to undergo a preventive mastectomy, and defendant (Dinner) agreed to perform the reconstructive surgery. On the day scheduled for both procedures (July 25), defendant cancelled the surgery, claiming that an argument with the hospital concerning the need to have the surgery monitored by another plastic surgeon had left him too upset to operate. The trial judge ruled that plaintiff could not recover damages for emotional distress as an element of her breach of contract claim. *Held*, this was correct. Distinguishing *Ross v. Forest Lawn Memorial Park* (1984) 153 C.A.3d 988, 203 C.R. 468, *infra*, §886, and *Windeler v. Scheers Jewelers* (1970) 8 C.A.3d 844, 88 C.R. 39, *infra*, §885, the court said:

"Dinner's obligation to meet the professional standard of care is critical in considering the measure of Selden's contract damages because we are unwilling to create a substantial incentive which conflicts with that obligation. If, as the record strongly suggests, the standard of care required that Dinner cancel Selden's surgery on July 25 because of his emotional state, holding him liable for emotional distress damages on a breach of contract theory would create a powerful financial incentive to act below the standard of care. In refusing to create such an incentive, we note that our Supreme Court has consistently found that where they conflict, the public concerns which are articulated in our system of tort law must prevail over the private interests embodied in contracts." (17 C.A.4th 173.) (See *Erlich v. Menezes* (1999) 21 C.4th 543, 552, 558, 87 C.R.2d 886, 981 P.2d 978, 6 Summary (10th), *Torts*, §1037 [home construction contract; mere negligent breach of contract is not sufficient to support damages in tort for mental distress, nor may those damages be included as consequential or special damages for breach of contract]; *Dunkin v. Boskey* (2000) 82 C.A.4th 171, 193, 98 C.R.2d 44, 10 Summary (10th), *Parent and Child*, §206 [unmarried woman's breach of contract in which she granted man paternity, visitation, and custody rights to child conceived by artificial insemination with anonymous donor did not give rise to damages for mental and emotional suffering and distress allegedly resulting from man's loss of relationship, custody, visitation, and parental rights as to child].)

Recovery has also been denied for injury to the name, character, or personal reputation of the injured party. (*Walpole v. Prefab Mfg. Co.* (1951) 103 C.A.2d 472, 489, 230 P.2d 36 [manufacturer's breach of agreement to sell to plaintiff retailer, who was unable to fill orders from buyers]; *Frangipani v. Boecker* (1998) 64 C.A.4th 860, 865, 75 C.R.2d 407 [award for damage to plaintiffs' credit was not permissible, because it would be in nature of recovery for damage to reputation].)

West's Key Number Digest, Damages k.56

SUPPLEMENT: [This section is current through the latest supplement]
See 11 Corbin (Rev. ed.), §59.1.



17 of 175 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XV. DAMAGES

B. Particular Elements of Recovery.

3. Mental or Physical Suffering.

b. Recovery Allowed.

1. Physical Injury and Emotional Distress.

1 Witkin Sum. Cal. Law Contracts § 885

[§ 885] Physical Injury and Emotional Distress.

Where the breach of contract causes physical suffering or illness, recovery is appropriate. (See *Rest.2d, Contracts* §353, Comment a; *Corbin* §1076; 24 *Williston* 4th, §64:7; 38 *Am.Jur.2d* (1999 ed.), *Fright, Shock, and Mental Disturbance* §21; 17 *A.L.R.2d* 936 [wrongful eviction].)

Thus, in *Westervelt v. McCullough* (1924) 68 C.A. 198, 228 P. 734, there was a breach of an agreement to furnish a home, the ouster resulting in illness. The court said: "Whenever the terms of a contract relate to matters which concern directly the comfort, happiness, or personal welfare of one of the parties, or the subject matter of which is such as directly to affect or move the affection, self-esteem, or tender feelings of that party, he may recover damages for physical suffering or illness proximately caused by its breach." (68 C.A. 208.)

In *Windeler v. Scheers Jewelers* (1970) 8 C.A.3d 844, 88 C.R. 39, plaintiff contracted with defendant jeweler to reset stones from six old rings into a new ring, emphasizing their sentimental value as mementos of her deceased husband, and her desire to make the new one an heirloom for her daughter. Defendant negligently sent the rings to a fabricator by ordinary insured mail, not registered, and they were lost. Plaintiff sued for their value, and for damages for personal injuries, testifying that she suffered headaches, loss of sleep, pain in her arms and shoulders, and general nervousness. A jury awarded her \$ 4,000 for personal injuries and \$ 1,436 for property loss damage. *Held*, affirmed.

(a) The bailment was a contractual relationship, and negligence of the bailee in relation to the subject matter was a breach of contract. (8 C.A.3d 850.)

(b) Emotional distress may be a foreseeable result of breach of contract: "[W]here a person contracts, upon a sufficient consideration, to do a particular thing, the failure to do which may result in physical suffering or illness on the part of the other contracting party, he is presumed to have contracted with reference to the payment of damages for such injury or illness in the event such damages accrue by reason of a breach of contract on his part." (8 C.A.3d 851.)

(c) Here, the special circumstance known to both parties at the time of contracting was the nature of the rings and their sentimental value. Hence, the jury was entitled to give damages not only for the loss but "for physical suffering or

illness proximately resulting from such loss." (8 C.A.3d 852.)

SUPPLEMENT: [This section is current through the latest supplement]
See 11 Corbin (Rev. ed.), §59.1.



18 of 175 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XV. DAMAGES

B. Particular Elements of Recovery.

3. Mental or Physical Suffering.

b. Recovery Allowed.

2. Emotional Distress a Likely Result.

aa. Mishandling of Corpse.

1 Witkin Sum. Cal. Law Contracts § 886

[§ 886] Mishandling of Corpse.

Damages for physical suffering and emotional distress have been allowed in actions arising from a mortician's breach of contract relating to the disposition of a body. (See *Chelini v. Nieri* (1948) 32 C.2d 480, 481, 196 P.2d 915, *supra*, §876; *Cohen v. Groman Mortuary* (1964) 231 C.A.2d 1, 3, 41 C.R. 481 [funeral service was conducted with wrong body; court discusses causes of action in contract and tort for physical suffering of various relatives who sued mortician]; *Saari v. Jongordon Corp.* (1992) 5 C.A.4th 797, 803, 7 C.R.2d 82 [*Christensen v. Superior Court* (1991) 54 C.3d 868, 2 C.R.2d 79, 820 P.2d 181, 5 *Summary* (10th), *Torts*, §460, did not affect right to recover damages for emotional distress for breach of mortuary contracts]; *Wilson v. Houston Funeral Home* (1996) 42 C.A.4th 1124, 50 C.R.2d 169, *supra*, §808 [emotional distress resulting from mortuary's breach of covenant to provide appropriate and dignified burial service]; *Rest.2d, Contracts* §353, Comment a; 42 A.L.R.4th 1059 [liability of cemetery in connection with conducting or supervising burial services]; 53 A.L.R.4th 360 [liability of undertaker in connection with transportation, burial, or safeguarding of body]; 53 A.L.R.4th 394 [liability for improper manner of reinterment]; 54 A.L.R.4th 901, 927 [mental anguish or emotional distress damages for breach of contract for burial and funeral-related services]; 28 *Proof of Facts* 3d 319 [proof of cemetery's liability in interring body].)

In *Allen v. Jones* (1980) 104 C.A.3d 207, 211, 163 C.R. 445, the complaint alleged that plaintiff made an oral agreement with defendant mortician to cremate the body of plaintiff's brother and ship the remains to Illinois; and that, as a result of defendant's negligence, the package arrived empty and plaintiff suffered emotional distress. *Held*, on the authority of *Chelini v. Nieri*, *supra*, and out-of-state cases, a cause of action was stated: The contract so affects the vital concerns of the individual that severe mental distress is a foreseeable result of breach. (104 C.A.3d 211, 212.) (For the holding on recovery for emotional distress without physical injury or illness, see 6 *Summary* (10th), *Torts*, §1022.)

In *Ross v. Forest Lawn Memorial Park* (1984) 153 C.A.3d 988, 994, 203 C.R. 468, plaintiff mother alleged the following: she contracted with defendant for the funeral services and burial of her 17-year-old daughter; she advised defendant that she wanted everything private, with only family members and invited guests present; her daughter had been a "punk rocker," and defendant agreed to use all reasonable means to prevent her daughter's former associates from disrupting the private services; many punk rockers did attend the services and burial in shocking costumes, used liquor

and drugs, and were physically and verbally abusive to the family and guests; defendant agreed to guard the grave, but the next day plaintiff discovered that the flowers and surface had been disturbed by the punk rockers; plaintiff requested permission to hire a private guard for the original grave overnight until the body could be moved, and the permission was first granted and then retracted. *Held*, reversing judgment on demurrer, causes of action were stated.

(a) Under *Health & Saf.C. 7100*, the right to control the disposition of remains vests in the parent where there is no surviving spouse or child (right to control remains now vests initially in agent under power of attorney for health care given that right; see 13 *Summary* (10th), *Personal Property*, §5); and the right of disposition includes the right to be free from interference with its exercise, including the right to determine the time, manner, and place of burial. Hence, plaintiff had a right to have private services that excluded certain of her daughter's acquaintances. (153 *C.A.3d* 994.)

(b) The contract by its nature put defendant on notice that a breach would result in mental suffering by plaintiff, and damages for emotional distress were recoverable under *Chelini, supra*, *Cohen, supra*, and other decisions (*infra*, §887). (153 *C.A.3d* 995.)

(c) Recovery was also proper under the allegations of failure to guard the grave (153 *C.A.3d* 995, 996) and retracting the permission to hire a private guard (153 *C.A.3d* 997).

West's Key Number Digest, Damages k.50.10

SUPPLEMENT: [This section is current through the latest supplement]



19 of 175 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XV. DAMAGES

B. Particular Elements of Recovery.

3. Mental or Physical Suffering.

b. Recovery Allowed.

2. Emotional Distress a Likely Result.

bb. Other Acts.

1 Witkin Sum. Cal. Law Contracts § 887

[§ 887] Other Acts.

Recovery for purely mental and emotional suffering has been allowed where the breach was intentional. In *Leavy v. Cooney* (1963) 214 C.A.2d 496, 29 C.R. 580, plaintiff, prosecutor in the celebrated case of *Chessman v. Superior Court* (1958) 50 C.2d 835, 330 P.2d 225, consented to appear without compensation in a sound motion picture to be made by defendant C. It was expressly understood that the picture was to be shown only on television. Defendant C nevertheless contracted with defendant S for its exhibition in theatres, and it was so exhibited. *Held*, a verdict for \$ 7,500 compensatory damages against C was proper. C had been advised that plaintiff had never profited by a case in which he had participated and that he feared that display in a theatre would convey the impression that he had. Hence, the parties had contemplated the damage--humiliation and embarrassment--suffered. (214 C.A.2d 500.)

In *Wynn v. Monterey Club* (1980) 111 C.A.3d 789, 168 C.R. 878, plaintiff sued defendant licensed card clubs, alleging that his wife was a known compulsive gambler; that she incurred substantial gambling debts in defendants' establishments; that plaintiff and defendants then agreed that plaintiff would satisfy the debts in exchange for defendants' promise to deny plaintiff's wife access to the clubs and check cashing privileges; that nevertheless, after a period of a year the wife gambled again, suffering heavy losses; and that, as a result of defendants' intentional or negligent breach of the contract, plaintiff's marriage was destroyed, and he suffered emotional distress. *Held*, summary judgment for defendants reversed. After holding that the contract was a lawful means to prevent harm to both spouses and hence not violative of public policy (111 C.A.3d 798), the court decided the damages issue which the parties had not raised. Citing *Westervelt v. McCullough* (1924) 68 C.A. 198, 228 P. 734, *supra*, §885, and *Leavy, supra*, contract cases, and recent tort cases, the court said: "[T]he contract was a lawful contract which by its nature put the defendants on notice that a breach thereof would result in emotional and mental suffering by the plaintiff as well as other forms of compensable damage." (111 C.A.3d 801.)

Cases involving bad faith breach by an insurer, giving rise to alternative tort and contract actions, furnish another illustration of recovery, although the plaintiff usually elects the tort action. These cases are discussed at length in 2 *Summary* (10th), *Insurance*, §239 et seq.

Some jurisdictions have upheld recovery for breach of contract in extreme situations. (See *Rest.2d, Contracts* §353, Comment a; 5 Corbin §1076; 24 Williston 4th, §64:7; 38 *Am.Jur.2d* (1999 ed.), *Fright, Shock, and Mental Disturbance* §§21, 22; 49 *Cal. L. Rev.* 760; 5 *Cal. Western L. Rev.* 91; 17 *A.L.R.2d* 938 [wrongful eviction]; 61 *A.L.R.3d* 922 [breach of contract of sale of real property]; 99 *A.L.R.3d* 303 [physician's breach of contract to achieve particular result or cure]; 7 *A.L.R.4th* 1178 [breach of contract or warranty in connection with construction of home or other building]; 52 *A.L.R.4th* 826 [breach of contract to lend money]; 54 *A.L.R.4th* 901 [breach of service contract].)

SUPPLEMENT: [This section is current through the latest supplement]
See 11 Corbin (Rev. ed.), §59.1.



20 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XV. DAMAGES

B. Particular Elements of Recovery.

4. Interest.

a. Where Interest Is Allowed.

1. General Rule.

1 Witkin Sum. Cal. Law Contracts § 888

[§ 888] General Rule.

(1) *In General.* "Every person who is entitled to recover damages certain, or capable of being made certain by calculation, and the right to recover which is vested in him upon a particular day, is entitled also to recover interest thereon from that day, except during such time as the debtor is prevented by law, or by the act of the creditor from paying the debt." (C.C. 3287(a); see *Rest.2d, Contracts* §354 and Comments a, b; Corbin §1046; 25 Williston 4th, §66:110 et seq.; 22 *Am.Jur.2d* (2003 ed.), *Damages* §467; C.E.B., *Attorney's Guide to Damages* 2d, §1.20; 61 *Harv. L. Rev.* 136; 5 *U.C.L.A. L. Rev.* 262; 4 *A.L.R.2d* 1388 [breach of contract for sale of commodity; interest recoverable]; 25 *A.L.R.2d* 951 [rights as between vendor and vendee under land contract with respect to interest]; 60 *A.L.R.3d* 487 [prejudgment interest on builder's recovery in action for breach of construction contract]; 94 *A.L.R.3d* 583 [measure of damages in action for breach of warranty of title to personal property under Unif.Com.C. §2-714]; *infra*, §889 et seq.)

Formerly, interest prior to judgment could not be awarded against the state, a county, municipality, or other political subdivision. (See *Abbott v. Los Angeles* (1958) 50 *C.2d* 438, 466, 326 *P.2d* 484; *Imperiale v. San Francisco* (1954) 128 *C.A.2d* 277, 282, 275 *P.2d* 569.) Amendments in 1955 and 1959 abolished this rule, and C.C. 3287(a) is now expressly applicable to "the state or any county, city, city and county, municipal corporation, public district, public agency, or any political subdivision of the state." (See *Benson v. Los Angeles* (1963) 60 *C.2d* 355, 364, 33 *C.R.* 257, 384 *P.2d* 649; *Mass v. Board of Education of San Francisco Unified School Dist.* (1964) 61 *C.2d* 612, 624, 39 *C.R.* 739, 394 *P.2d* 579, 8 *Cal. Proc.* (4th), *Extraordinary Writs*, §214; *Tripp v. Swoap* (1976) 17 *C.3d* 671, 683, 131 *C.R.* 789, 552 *P.2d* 749, *infra*, §890; *Olson v. Cory* (1983) 35 *C.3d* 390, 401, 197 *C.R.* 843, 673 *P.2d* 720, *infra*, §895; *Currie v. Work. Comp. App. Bd.* (2001) 24 *C.4th* 1109, 1115, 104 *C.R.2d* 392, 17 *P.3d* 749, 9 *Cal. Proc.* (4th), *Administrative Proceedings*, Supp., §46A [generally, back pay awards are "damages" for purposes of C.C. 3287, which applies to awards made by administrative agencies such as Workers' Compensation Appeals Board, and nothing in *Lab.C.* 132a (discriminatory termination for filing claims) was meant to preclude that interest]; *Adler v. Pasadena* (1964) 229 *C.A.2d* 518, 524, 40 *C.R.* 373; *Austin v. Board of Retirement* (1989) 209 *C.A.3d* 1528, 1532, 258 *C.R.* 106, [discussing *Olson v. Cory*, and *Tripp v. Swoap*].)

(2) *Interaction of Rule Allowing Prejudgment Interest and Rule Limiting Compensatory Damages to Benefit of Bargain.* In *Al-Husry v. Nilsen Farms Mini-Market* (1994) 25 *C.A.4th* 641, 31 *C.R.2d* 28, an action for breach of a

contract for the sale of a mini-market, plaintiff purchasers recovered both compensatory damages, as well as prejudgment interest on their \$ 100,000 escrow deposit. Defendants argued that this gave plaintiffs a double recovery. *Held*, the award of both compensatory damages and prejudgment interest was proper.

(a) The rule allowing a nondefaulting buyer to recover prejudgment interest on an amount deposited into escrow is necessary so that a defaulting seller will not have an incentive to retain an advance payment, reaping interest thereon during litigation and until entry of judgment. (25 C.A.4th 648.)

(b) There is no conflict between this rule and the rule that the nondefaulting party's damages are limited to the benefit of his or her bargain. The latter rule is governed by a separate Chapter of the Civil Code (C.C. 3300-3360), a provision of which states that the damages prescribed therein are *exclusive* of interest (C.C. 3357). And C.C. 3287(a), which is in another chapter dealing with prejudgment interest, provides that persons entitled to recover compensatory damages are "entitled also" to recover interest thereon. Thus, under this statutory scheme, the right to recover damages based on the benefit of the bargain does not limit the right to recover prejudgment interest. (25 C.A.4th 649.)

(3) *Dispute as to Title Does Not Prevent Assessment of Interest*. In *Cheng v. California Pac. Bank* (1999) 76 C.A.4th 274, 90 C.R.2d 401, plaintiff, a dissenting shareholder in a bank conversion transaction, sued for declaratory relief requesting a determination that he was entitled to immediate payment of the appraised value of his shares in defendant bank, plus interest from the date of his demand for payment. Defendant deposited the value of the shares with the court, but challenged plaintiff's ownership of the shares and his right to prejudgment interest. The trial court granted summary judgment for plaintiff, finding that there was no dispute that he was entitled to the funds and awarding prejudgment interest. *Held*, affirmed.

Defendant argued that prejudgment interest is only due when the amount is vested on a particular day, and that, because plaintiff's share certificates carried forged endorsements, defendant was prevented from paying him until clear title was established. However, the existence of a dispute as to title does not prevent the assessment of prejudgment interest. Even if plaintiff was not the rightful owner, the money never belonged to defendant, and it was not entitled to retain it during the alleged dispute. Once plaintiff agreed with the appraisal of the shares and issued his demand for payment, he became entitled to payment of a specified amount, "capable of being made certain by calculation" as provided by C.C. 3287(a). (76 C.A.4th 278.) (See *infra*, §890.)

(4) *Prejudgment Interest Authorized in Proceeding To Confirm Arbitration Award*. A successful party to arbitration is entitled to postaward, prejudgment interest under C.C. 3287(a), because he or she is entitled to "recover damages certain" within the meaning of the statute on the date the arbitrator renders the award. (See *Britz v. Alfa-Laval Food & Dairy Co.* (1995) 34 C.A.4th 1085, 1106, 40 C.R.2d 700, 6 Cal. Proc. (4th), *Proceedings Without Trial*, §510; *Pierotti v. Torian* (2000) 81 C.A.4th 17, 26, 96 C.R.2d 553.)

(5) *Time To Request Interest Award*. A request for an award of prejudgment interest must be made in the trial court before entry of judgment; it cannot be made for the first time on appeal. At the latest, a request may be sought as part of a motion for new trial pursuant to C.C.P. 657, on the ground of excessive or inadequate damages. (See *North Oakland Med. Clinic v. Rogers* (1998) 65 C.A.4th 824, 829, 76 C.R.2d 743 [request for interest in cost bill after judgment was inappropriate and violated defendants' right to notice and opportunity for hearing].)

(6) *Lack of Express Authorization*. The lack of express authorization for interest in a statute that provides for an award does not prevent the recovery of interest on the award. (*Utility Audit Co. v. Los Angeles* (2003) 112 C.A.4th 950, 958, 5 C.R.3d 520 [provision requiring interest would be redundant in view of C.C. 3287; citing *Currie, supra*].)

West's Key Number Digest, Damages k.68

SUPPLEMENT: [This section is current through the latest supplement]

(1) *In General*. See *Shewry v. Begil* (2005) 128 C.A.4th 639, 646, 27 C.R.3d 209 [Department of Health Services was

entitled to prejudgment interest in its successful action for reimbursement from estate of deceased patient who received Medi-Cal benefits while she was resident at skilled nursing facility; court rejected argument that prejudgment interest was not recoverable on statutory claim]; 11 Corbin (Rev. ed.), §57.18.

Mass case:

Cross-Reference: 8 Cal. Proc. (5th), *Extraordinary Writs*, §214.

Currie case:

Cross-Reference: 9 Cal. Proc. (5th), *Administrative Proceedings*, §62.(4) *Prejudgment Interest Authorized in Proceeding To Confirm Arbitration Award*. See *Solano v. Lionsgate Corp.* (2005) 126 C.A.4th 741, 753, 24 C.R.3d 362 [in arbitration of county's breach of contract action against contractor, prevailing county was entitled to prejudgment interest on penalty award, even though there were no "damages," but only as of date of final award; prior to that, penalties awarded were not "certain," as issues remained to be resolved].

Britz case:

Cross-Reference: 6 Cal. Proc. (5th), *Proceedings Without Trial*, §556.



21 of 175 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XV. DAMAGES

B. Particular Elements of Recovery.

4. Interest.

a. Where Interest Is Allowed.

2. Liquidated Sum Due.

1 Witkin Sum. Cal. Law Contracts § 889

[§ 889] Liquidated Sum Due.

The first situation (C.C. 3287(a), "damages certain") is where the amount of money due is litigated. (See *Calhoun v. Huntington Park First Savings & Loan Assn.* (1960) 186 C.A.2d 451, 462, 9 C.R. 479; *Leaf v. Phil Rauch* (1975) 47 C.A.3d 371, 375, 120 C.R. 749 [amount fixed by terms of contract]; *Clark Equipment Co. v. Mastelotto* (1978) 87 C.A.3d 88, 98, 150 C.R. 797 [plaintiff secured party entitled to deficiency judgment, amount of which was fixed when valid sale of collateral was made]; Corbin §1046; 25 Williston 4th, §66:110 et seq.; 22 *Am.Jur.2d* (2003 ed.), *Damages* §§467, 471; 61 *Harv. L. Rev.* 136; 5 *U.C.L.A. L. Rev.* 262.)

Specific provision is made for interest on a liquidated claim "based on contract or statute of the State of California" where the claim is made by any public entity against any other public entity or by any person against a public agency. Interest is payable at the rate of 6% from the 61st day after the public entity or person "files a liquidated claim known or agreed to be valid when filed pursuant to such statute or contract, and such claim is due and payable." (*Govt.C.* 926.10.)

A state agency that fails to pay a person an undisputed payment or refund due is liable for interest on the undisputed amount. (*Govt.C.* 926.19.)

SUPPLEMENT: [This section is current through the latest supplement]
See 11 Corbin (Rev. ed.), §57.18.



22 of 175 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XV. DAMAGES

B. Particular Elements of Recovery.

4. Interest.

a. Where Interest Is Allowed.

3. Damages Ascertainable by Calculation.

1 *Witkin Sum. Cal. Law Contracts* § 890

[§ 890] Damages Ascertainable by Calculation.

Even though the demand is not for a specific sum, interest may be recovered where the damages are "capable of being made certain by calculation." (C.C. 3287(a); see *Coleman Engineering Co. v. North Amer. Aviation* (1966) 65 C.2d 396, 407, 55 C.R. 1, 420 P.2d 713; *Shell Chemical Corp. v. Owl Transfer Co.* (1959) 173 C.A.2d Supp. 796, 804, 344 P.2d 108; *Worthington Corp. v. El Chicote Ranch Properties* (1967) 255 C.A.2d 316, 322, 63 C.R. 203, quoting the text; *West v. Holstrom* (1968) 261 C.A.2d 89, 97, 67 C.R. 831; *Foley v. U. S. Paving Co.* (1968) 262 C.A.2d 499, 507, 68 C.R. 780; *Esgro Central v. General Ins. Co.* (1971) 20 C.A.3d 1054, 1060, 98 C.R. 153; *Leaf v. Phil Rauch* (1975) 47 C.A.3d 371, 375, 120 C.R. 749; *People v. Southern Pac. Co.* (1983) 139 C.A.3d 627, 641, 188 C.R. 913, citing the text; *Corbin* §1046; 25 Williston 4th, §66:110 et seq.; 22 *Am.Jur.2d* (2003 ed.), *Damages* §§467, 471.) Where there is no factual dispute as to the amount, but only a legal dispute as to liability, the certainty requirement is satisfied. (*Olson v. Cory* (1983) 35 C.3d 390, 402, 197 C.R. 843, 673 P.2d 720; *National Farm Workers Service Center v. M. Caratan* (1983) 146 C.A.3d 796, 809, 194 C.R. 617; *Shell Oil Co. v. National Union Fire Ins. Co. of Pittsburgh, PA* (1996) 44 C.A.4th 1633, 1651, 52 C.R.2d 580 [even though plaintiff proposed three different measures of damages, all of which were in dispute, damages were "certain" under C.C. 3287(a), because only *legal* determination was necessary to fix them; citing *Olson v. Cory, supra*]; *Children's Hosp. & Med. Center v. Bonta'* (2002) 97 C.A.4th 740, 772, 118 C.R.2d 629 [hospitals sought reimbursement for overpayments made under Medicare program; although plaintiffs put forth two methods of calculating damages, damages were capable of being made certain by calculation, because methods did not conflict (second method only augmented first), and neither required reliance on disputed cost figures].)

Damages are "certain," e.g., where the amount may be ascertained by reference to market value. (*Bare v. Richman & Samuels of New York* (1943) 60 C.A.2d 413, 419, 140 P.2d 895.) It is immaterial that the parties are in dispute as to the agreed price or amount of work done; the necessary certainty depends on what the court decides as to the liability and determinability. (*AnSCO Const. Co. v. Ocean View Estates* (1959) 169 C.A.2d 235, 239, 337 P.2d 146.)

In *Charlton v. Pan Amer. World Airways* (1953) 116 C.A.2d 550, 254 P.2d 128, plaintiff sued on a contract calling for salary "plus all traveling and living expenses," and was given judgment for these expenses, with interest. The amount due was capable of calculation by defendant at the end of the period of employment, all items were supported by vouchers, and subtraction of any duplicated amounts could just as readily be done on receipt of the expense account

as at the trial. (116 C.A.2d 554.)

In *Esgro Central v. General Ins. Co.*, *supra*, plaintiff corporations were concessionaires at stores that were burned and looted during a riot. They were awarded damages against defendant insurer on separate policies covering loss from fire and loss due to business interruption, but interest was denied. *Held*, (a) interest was recoverable on the fire loss policy; defendant's denial of *liability* did not make damages uncertain within the meaning of C.C. 3287(a). (20 C.A.3d 1060.) And they were fixed or determinable even though the recovery exceeded plaintiffs' proof of loss and was less than the amount sought in the complaint. (20 C.A.3d 1062.) (b) Interest was properly denied on the business interruption policy, for coverage was admitted and the contested issue was the extent of the damage. The loss was dependent upon such matters as a projection of plaintiffs' earnings and the permissible duration of the interruption of the business, and a jury determination, on conflicting evidence, was required. (20 C.A.3d 1063.)

In *KGM Harvesting Co. v. Fresh Network* (1995) 36 C.A.4th 376, 42 C.R.2d 286, after plaintiff grower breached its contract to sell a specified quantity of lettuce at a set price to defendant, defendant refused to pay for lettuce it had already received and purchased lettuce on the open market to satisfy its obligations to a customer. Plaintiff sued for the balance due on its invoices, and defendant cross-complained for the additional cost it incurred to obtain substitute lettuce. The trial judge gave a net award to defendant and also awarded prejudgment interest commencing 30 days before trial. *Held*, prejudgment interest award reversed with directions to award prejudgment interest from an earlier date just after defendant had provided plaintiff with information needed to calculate defendant's damages.

The damages were certain or capable of being made certain, within the meaning of C.C. 3287(a), at that earlier time. The test for recovery of prejudgment interest is whether a party actually knows the amount of damages owed the other party, or could have computed that amount from reasonably available information. If the party does not know or cannot readily compute the damages, the claimant must supply a statement and supporting data so that the other party can ascertain the damages. Here, defendant did exactly that when it supplied plaintiff with a document listing all lettuce purchases, purchase order numbers, bin numbers, and price information. An error of approximately 5.5% in the original calculations made by defendant's controller did not make the damages uncertain. (36 C.A.4th 391, 392.) (See *Maurice L. Bein v. Housing Authority* (1958) 157 C.A.2d 670, 686, 321 P.2d 753.)

In *Tripp v. Swoap* (1976) 17 C.3d 671, 131 C.R. 789, 552 P.2d 749, plaintiff's application for disability benefits under the statutory welfare program was denied. In this proceeding in administrative mandamus, the superior court ordered defendant director to pay the benefits retroactively with interest. *Held*, affirmed. (a) The statute under which benefit determinations were reviewable did not specifically authorize interest, but the failure to mention it does not preclude an award if another statute allows it. (b) C.C. 3287(a), the general statute, applies. Under the test of *Mass v. Board of Education of San Francisco Unified School Dist.* (1964) 61 C.2d 612, 624, 39 C.R. 739, 394 P.2d 579, the state has a legal obligation to furnish welfare benefits to eligible persons; benefits are set by fixed payment schedules, hence are capable of being made certain by calculation; the right to payment vests on a particular day; and the same public policy supporting an award of retroactive benefits favors an award of interest. (17 C.3d 683.) *Luna v. Carleson* (1975) 45 C.A.3d 670, 673, 119 C.R. 711, holding this interest not recoverable, is disapproved. (17 C.3d 685.)

Tripp, was followed in *Todd Shipyards Corp. v. Los Angeles* (1982) 130 C.A.3d 222, 226, 181 C.R. 652, holding that a municipal taxpayer who received a refund for an overpayment of business taxes was entitled to recover interest. (See dissent, 130 C.A.3d 227, 231, arguing that the policy considerations in the areas of wages, pensions, welfare benefits, and wrongful discharge of teachers involved express contractual obligations, not involved in this case.)

West's Key Number Digest, Damages k.68-

SUPPLEMENT: [This section is current through the latest supplement]
See 11 Corbin (Rev. ed.), §57.18.



23 of 175 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XV. DAMAGES

B. Particular Elements of Recovery.

4. Interest.

a. Where Interest Is Allowed.

4. Defendant With Unliquidated Offset.

1 Witkin Sum. Cal. Law Contracts § 891

[§ 891] Defendant With Unliquidated Offset.

Interest may be given on the balance due under a liquidated claim notwithstanding the fact that the defendant debtor claims an unliquidated offset. (*Hansen v. Covell* (1933) 218 C. 622, 629, 24 P.2d 772; *Leaf v. Phil Rauch* (1975) 47 C.A.3d 371, 376, 120 C.R. 749; see 5 U.C.L.A. L. Rev. 268.)

Thus, "when a plaintiff sues for a liquidated sum and the defendant establishes an offsetting claim based upon defective workmanship or defective performance of the same contract by the plaintiff, the amount of the former is to be offset against the latter *as of the due date of the original debt* and only the balance bears interest." (*Burgermeister Brewing Corp. v. Bowman* (1964) 227 C.A.2d 274, 285, 38 C.R. 597, supra, §232.) In this case, where there was a refusal to perform (wrongful termination), the same rule was held applicable; i.e., if defendant was entitled to an offset, plaintiff was never entitled to more than the net amount, and defendant was justified in withholding payment even though the amount of his offset had not then been judicially determined. (227 C.A.2d 285.)

SUPPLEMENT: [This section is current through the latest supplement]

See *Great Western Drywall v. Roel Const. Co.* (2008) 166 C.A.4th 761, 767, 83 C.R.3d 235 [even if trial court awarded property damages to general contractor for subcontractor's damage to work of another subcontractor under negligence theory as opposed to breach of contract theory, general contractor was entitled to set off its entire award against award of prejudgment interest to subcontractor on subcontractor's breach of contract claim, where general contractor's damages arose entirely from subcontractor's deficient performance of contract].



24 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XV. DAMAGES

B. Particular Elements of Recovery.

4. Interest.

b. Damages Not Ascertainable by Calculation.

1. Traditional Rule of Denial.

1 Witkin Sum. Cal. Law Contracts § 892

[§ 892] Traditional Rule of Denial.

If the damages are neither certain nor capable of being made certain by calculation, interest is denied. "[I]nterest is not allowable where the damages depend upon no fixed standard and cannot be made certain except by accord, verdict or decree." (*Lineman v. Schmid* (1948) 32 C.2d 204, 211, 195 P.2d 408 [action by seller for breach of a contract to buy flour; interest denied on ground that there was no reasonably ascertainable market value, and damages were awarded on conflicting evidence]; see *Coughlin v. Blair* (1953) 41 C.2d 587, 604, 262 P.2d 305; *Axell v. Axell* (1952) 114 C.A.2d 248, 256, 250 P.2d 182; *Conderback v. Standard Oil Co.* (1966) 239 C.A.2d 664, 690, 48 C.R. 901; *Macomber v. California* (1967) 250 C.A.2d 391, 401, 58 C.R. 393 [reasonable value of contractor's extra work]; *Distefano v. Hall* (1968) 263 C.A.2d 380, 387, 69 C.R. 691; *Abrams v. Motter* (1970) 3 C.A.3d 828, 846, 83 C.R. 855; *Esgro Central v. General Ins. Co.* (1971) 20 C.A.3d 1054, 1062, 98 C.R. 153; *Elliano v. Assurance Co. of America* (1975) 45 C.A.3d 170, 182, 119 C.R. 653; *Nicholson-Brown v. San Jose* (1976) 62 C.A.3d 526, 534, 133 C.R. 159; *Chesapeake Industries v. Togova Enterprises* (1983) 149 C.A.3d 901, 906, 197 C.R. 348; *Rest.2d, Contracts* §354, Comment c; *Corbin* §1048; 25 *Williston* 4th, §66:110 et seq.; 22 *Am.Jur.2d* (2003 ed.), *Damages* §§468, 471; 61 *Harv. L. Rev.* 136; 5 *U.C.L.A. L. Rev.* 266; but see *infra*, §893.)

In *Chesapeake Industries v. Togova Enterprises*, *supra*, defendant Togova leased property to plaintiff Chesapeake for 10 years. In the event of breach, section 14 of the lease gave lessor Togova the election to relet the premises and hold lessee Chesapeake liable for any deficiency. Chesapeake vacated the premises with over 3 years remaining on the lease and Togova relet. After the term ended, Chesapeake brought an action for an accounting of rents received from the reletting, seeking to recover any excess over what Togova would have received under the lease. Togova cross-complained, alleging that there was a deficiency, the exact amount of which would be determined by an accounting to be prepared. The trial judge concluded that Chesapeake owed Togova the net deficit figure of \$ 34,830.04 and also awarded Togova prejudgment interest of \$ 16,367.13. Chesapeake appealed only from the portion of the judgment awarding prejudgment interest. *Held*, reversed.

(a) "There are two lines of authority which instruct us in the proper award of prejudgment interest under section 3287, subdivision (a). First, interest traditionally has been denied on unliquidated claims because of the general equitable principle that a person who does not know what sum is owed cannot be in default for failure to pay. ... The

second line of authority advances the countervailing policy that injured parties should be compensated for the loss of the use of their money during the period between the assertion of a claim and the rendition of judgment. ... This policy has been implemented through a generally liberal construction of 'certainty' under section 3287." (149 C.A.3d 906.) "The injured party's right to prejudgment interest is further protected by the rule that the legal interest allowable under section 3287 cannot be defeated by setting up an unliquidated counterclaim as an offset." (149 C.A.3d 907.)

(b) "These competing policy considerations have led the courts to focus on the *defendant's* knowledge about the amount of the plaintiff's claim. The fact that the plaintiff or some omniscient third party knew or could calculate the amount is not sufficient. The test we glean from prior decisions is: did the *defendant* actually know the amount owed or from reasonably available information could the defendant have computed that amount. Only if one of those two conditions is met should the court award prejudgment interest." (149 C.A.3d 907.)

(c) Here, Chesapeake would be liable for prejudgment interest only if it knew or could have calculated the amount of the deficit, and there was no such showing:

(1) In their cross-claims for an accounting, both Chesapeake and Togova asserted that they did not know and could not calculate the amount of Chesapeake's liability under section 14 of the lease; and a number of cases hold that where an accounting is required interest is not allowed. (149 C.A.3d 908.)

(2) Togova stated in its cross-complaint that it did not know the exact amount due but believed it to exceed \$ 115,000; i.e., even though it had sole discretion to relet and make repairs and alterations, as well as full access to information of the costs incurred, it did not know the exact amount. When considered with other factors such as the large discrepancy between the amount claimed and the amount awarded by the judgment, it must be concluded that the sum due was not calculable by *Chesapeake*. (149 C.A.3d 909, 910.)

(3) Chesapeake could not ascertain the amount of its indebtedness because the records were in possession of Togova and the information--a statement of the account with supporting data--was not furnished to *Chesapeake*. (149 C.A.3d 912.) (See *Polster v. Swing* (1985) 164 C.A.3d 427, 435, 210 C.R. 567 [stating and applying *Chesapeake's* tests].)

SUPPLEMENT: [This section is current through the latest supplement]

See *Jamison v. Jamison* (2008) 164 C.A.4th 714, 721, 79 C.R.3d 561 [landowners were not entitled to prejudgment interest on owelty award after partition of parcels held as tenants in common, where award required trial court to determine values of various parcels, and trial court was presented with conflicting evidence of those values; award was not certain, or capable of being made certain by calculation, before judgment].



25 of 175 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XV. DAMAGES

B. Particular Elements of Recovery.

4. Interest.

b. Damages Not Ascertainable by Calculation.

2. Discretionary Award.

aa. In General.

1 Witkin Sum. Cal. Law Contracts § 893

[§ 893] In General.

(1) *In General.* In an equity case, the court is said to have a broad discretion to grant or withhold interest. (See *Leonard v. Huston* (1954) 122 C.A.2d 541, 549, 265 P.2d 566; 5 U.C.L.A. L. Rev. 269.)

The 1967 Legislature expanded this discretion to cover any kind of action, by dividing C.C. 3287 into two parts. Subdivision (a) is the former section, providing for the recovery of interest on a liquidated sum due. (See *supra*, §§888, 890.) Subdivision (b), added, reads as follows: "Every person who is entitled under any judgment to receive damages based upon a cause of action in contract where the claim was *unliquidated*, may also recover interest thereon from *a date prior to the entry of judgment* as the court may, in its *discretion*, fix, but in *no event earlier* than the date the *action was filed*." (See *A & M Produce Co. v. FMC Corp.* (1982) 135 C.A.3d 473, 495, 186 C.R. 114; *Rest.2d, Contracts* §354(2) and Comment d.)

A & M Produce Co. v. FMC Corp., *supra*, found the following factors sufficient to support the trial judge's decision upholding an award: (a) Over 7 years passed between the time of complaint and judgment. (b) The award of 7% to plaintiff does not penalize defendant for litigating a bona fide dispute; it is merely a recognition of an additional amount of damage incurred by plaintiff as a result of defendant's breach of warranty. (c) "Were the judicial process devoid of transaction costs," plaintiff would have been entitled to reimbursement at the outset; and defendant cannot complain that these transaction costs have essentially allowed it to borrow over \$ 325,000 from plaintiff for 7 years at 7%, for the trial judge could take cognizance of higher market interest rates during this period. (d) Plaintiff's offer to settle the case at the outset furnishes additional support for the trial judge's decision; defendant's refusal placed the prejudgment interest amount at risk. (135 C.A.3d 496, 497.)

C.C. 3287(b) permits a discretionary award only where the cause of action is "in contract." In *George v. Double-D Foods* (1984) 155 C.A.3d 36, 201 C.R. 870, the action was in quantum meruit, i.e., quasi-contract (see *infra*, §1029), to recover the reasonable value of services. However, statutes relating to claims arising upon contract have been applied to quasi-contractual obligations (see *supra*, §103), and "for most purposes, an action to recover the reasonable value of services is considered an action on the contract." (155 C.A.3d 47.) Hence C.C. 3287(b) was properly applied. (155

C.A.3d 47.) (See Zalk v. General Expiration (1980) 105 C.A.3d 786, 795, 164 C.R. 647.)

(2) *Applicability of C.C. 3287(b) to Public Entities.* In *Lewis C. Nelson & Sons v. Clovis Unified School Dist.* (2001) 90 C.A.4th 64, 108 C.R.2d 715, plaintiff corporation sued defendant school district, and the jury found in favor of plaintiff. The trial judge awarded plaintiff prejudgment interest, even though the damages were unliquidated and defendant was a public entity. *Held*, this was proper.

(a) C.C. 3287(a) allows recovery of prejudgment interest from a defendant, *including from a public entity*, if the damages are liquidated. If the cause of action is in contract, C.C. 3287(b) affords the trial judge the discretion to award this interest, even though the damages are unliquidated. However, this subsection does not mention public entities, and thus the issue here, which is one of first impression, is whether C.C. 3287(b) applies to public entities. (90 C.A.4th 67.)

(b) The distinction between the two subsections of C.C. 3287 has to do with the nature of the damages, i.e., liquidated or unliquidated, for which prejudgment interest may be awarded, not with the identity of the defendant against whom the interest may be awarded. Admittedly, the Legislature did not make it clear that the public entity provision of subsection (a) was to carry over to subsection (b), but given the minimal legislative history, which confirms that the limited purpose of subdivision (b) was to establish a limited exception to the general rule prohibiting prejudgment interest in unliquidated damages cases, there is nothing to indicate a legislative intention to exempt public entities from liability for prejudgment interest on unliquidated claims. Moreover, C.C. 3287(a) provides that this "section," not subsection, applies to the recovery of interest from public entities. (90 C.A.4th 71.)

(c) When C.C. 3287(b) was enacted, the term "every person" in C.C. 3287(a) had already expanded to include public entities. Because it is presumed that the Legislature, in enacting a new provision, intended to leave the law as it stands, it is reasonable to conclude that if the Legislature had meant to exclude public agencies from liability under subsection (b), it would have expressly said so. (90 C.A.4th 72.)

(d) The purpose of prejudgment interest is to compensate the plaintiff for loss of use of his or her money. "If fairness demands that plaintiffs with liquidated claims against public agencies should have protection against the loss of use of money, fairness equally demands that plaintiffs with unliquidated claims against public agencies should have some of the same protection." (90 C.A.4th 72.)

West's Key Number Digest, Damages k.68

SUPPLEMENT: [This section is current through the latest supplement]

Correction: Page 986, end of first full paragraph, "*Zalk v. General Expiration*" should be "*Zalk v. General Exploration*".



26 of 175 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XV. DAMAGES

B. Particular Elements of Recovery.

4. Interest.

b. Damages Not Ascertainable by Calculation.

2. Discretionary Award.

bb. Jury Cannot Decide Issue.

1 Witkin Sum. Cal. Law Contracts § 894

[§ 894] Jury Cannot Decide Issue.

The discretion to be exercised (*supra*, §893) is that of the judge; it is error to allow the jury to decide the issue. (See *Esgro Central v. General Ins. Co.* (1971) 20 C.A.3d 1054, 1064, 98 C.R. 153; *George v. Double-D Foods* (1984) 155 C.A.3d 36, 47, 201 C.R. 870.)

The court in *George*, explains why the error is highly prejudicial: "Judicial discretion must be guided and controlled by fixed legal principles; it is to be exercised impartially toward the end of substantial justice in accord with the spirit of the law. ... In other words, judicial discretion is an objective discretion." (155 C.A.3d 48.) "In contrast, a jury's discretion often is necessarily subjective in nature, circumscribed only by the stricture that the jury may not indulge in uncertain conjecture or speculation. ... While a jury's discretion in awarding interest is to be exercised considering all the particular circumstances of the case ... , it is reasonably probable the jury's subjective view of the circumstances will differ from the judge's objective assessment of the requirements of substantial justice. Placing the issue of the propriety of an interest award within the power of the jury deprived defendant of its right to judicial objectivity." (155 C.A.3d 48.)

SUPPLEMENT: [This section is current through the latest supplement]



27 of 175 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XV. DAMAGES

B. Particular Elements of Recovery.

4. Interest.

c. Debtor Prevented by Law.

1 Witkin Sum. Cal. Law Contracts § 895

[§ 895] Debtor Prevented by Law.

In *Olson v. Cory* (1983) 35 C.3d 390, 197 C.R. 843, 673 P.2d 720, plaintiff judges and judicial pensioners had previously established their right to salary and pension increases under *Govt.C. 68203* (*Olson v. Cory* (1980) 27 C.3d 532, 178 C.R. 568, 636 P.2d 532 [*Olson v. Cory I*]). In the present action they claimed interest on the amounts due, naming as defendants the State Controller and the Los Angeles County Auditor-Controller. The court first held that the certainty requirement of C.C. 3287(a) was satisfied (see *supra*, §888), and then examined defendants' contention that recovery was precluded by the statutory proviso--"except during such time as the debtor is prevented by law ... from paying the debt." *Held*, the exception was inapplicable and interest was recoverable.

(a) The state, not the Controller, is the "debtor," and the state is subject to claims for interest under C.C. 3287(a). The only "law" involved was the 1976 amendment to *Govt.C. 68203*, held unconstitutional in *Olson v. Cory I*; and "it would be anomalous to hold that legislation voluntarily promulgated by the debtor itself constitutes a 'law' by which the debtor is 'prevented' from fulfilling its overriding obligations." (35 C.3d 403, 404.) The Controller suggested that to exclude a constitutionally defective statute as the source of a "prevented-by-law" defense may put him in the untenable position of foreseeing what that determination will be. But the holding that the state is obligated to make the payments does not imply that the Controller, during the period prior to final judicial determination of unconstitutionality, could have been compelled to do so. (35 C.3d 404.)

(b) Defendants also contended that plaintiffs were not entitled to interest on the increases in judicial pensions because those pensions were payable entirely out of the Judges' Retirement Fund. But nothing in the wording of C.C. 3287 suggests that the right to recover interest from the state varies in accordance with the particular fund out of which the underlying obligation was payable. (35 C.3d 406, disapproving statements in prior Court of Appeal decisions.)

(c) The county-auditor defendants contended that the increases in municipal court salaries were county obligations "prevented by law" before *Olson v. Cory I*. *Sonoma County Organization of Public Employees v. Sonoma* (1979) 23 C.3d 296, 152 C.R. 903, 591 P.2d 1, 8 Summary (10th), *Constitutional Law*, §1288, is distinguishable: The debts involved in that case were created by contracts independently entered into by the counties; here the municipal judges' salary claims were based wholly on state statutes, and the increases constituted a contract between the judges and the state. (35 C.3d 406, 407.) "Since the salaries are prescribed exclusively by the Legislature, the Legislature's 1976

amendment of section 68203, insofar as held inoperative in *Olson v. Cory I*, cannot be deemed a 'law' that prevented counties from paying the municipal court judicial salary claims." (35 C.3d 407.)

SUPPLEMENT: [This section is current through the latest supplement]



28 of 175 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XV. DAMAGES

B. Particular Elements of Recovery.

4. Interest.

d. Rate of Interest.

1 Witkin Sum. Cal. Law Contracts § 896

[§ 896] Rate of Interest.

(1) *Rate Stipulated.* "Any legal rate of interest stipulated by a contract remains chargeable after a breach thereof, as before, until the contract is superseded by a verdict or other new obligation." (C.C. 3289(a); see *Hitz v. First Interstate Bank* (1995) 38 C.A.4th 274, 44 C.R.2d 890, supra, §541 [in class action challenging bank's late and overlimit fees charged on credit card accounts, calculation of bank's actual damages resulting from late payment and overlimit breaches so as to deduct them from plaintiffs' recovery denied bank its full contract rate of interest authorized by C.C. 3289(a)].)

For purposes of C.C. 3289, "the rate of the contracted finance charge shall be the legal rate of interest stipulated by a retail installment contract" (see C.C. 1801 et seq.; 4 *Summary* (10th), *Sales*, §278). (C.C. 3289.5.)

(2) *Rate Not Specified.* "If a contract entered into after January 1, 1986, does not stipulate a legal rate of interest, the obligation shall bear interest at a rate of 10 percent per annum after a breach." (C.C. 3289(b).)

West's Key Number Digest, Damages k.68

SUPPLEMENT: [This section is current through the latest supplement]

(2) *Rate Not Specified.* See *Ohio Cas. Ins. Co. v. Garamendi* (2006) 137 C.A.4th 64, 83, 39 C.R.3d 758 [proper rate of interest awarded on outstanding assessments imposed by California's FAIR Plan Association against insurers who had withdrawn from California insurance market was 7%, in accordance with constitutional provision on interest; case was not an action for breach of contract, and thus higher rate of 10% was not justified]; *Teachers' Retirement Bd. v. Genest* (2007) 154 C.A.4th 1012, 1044, 65 C.R.3d 326 [whether contract claim is liquidated or unliquidated, prejudgment interest may be recovered from state or public entity; thus, Teachers' Retirement Board, which was successful in its constitutional impairment of contract challenge to legislation reducing state's obligation to fund Supplemental Benefit Maintenance Account by specified amount, was entitled to prejudgment interest at 10%, rather than 7%]; *Wolf v. Walt Disney Pictures & Television* (2008) 162 C.A.4th 1107, 1131, 76 C.R.3d 585 [prejudgment interest rate of 7%, applicable to contracts entered into prior to 1986, applied to judgment for author, in his breach of contract action against movie production company arising from 1983 agreement for rights to novel's characters and from 1989 settlement agreement that amended and supplemented 1983 agreement, where 1983 agreement provided basis for author's claims at

trial].



29 of 175 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XV. DAMAGES

B. Particular Elements of Recovery.

5. Attorneys' Fees.

1 Witkin Sum. Cal. Law Contracts § 897

[§ 897] Attorneys' Fees.

(1) *In General.* The contract may contain a provision for the recovery of attorneys' fees as damages in the event of a breach and suit. This provision is commonly found in promissory notes, conditional sales agreements, deeds of trust, mortgages, leases, and building contracts. (See 7 *Cal. Proc.* (4th), *Judgment*, §157 et seq.; for statutory extension of contract right to prevailing party whether he or she is specified in the contract or not, see C.C. 1717, 7 *Cal. Proc.* (4th), *Judgment*, §162 et seq.)

(2) *Expense of Previous Litigation.* Where, as a result of the *tort* of the defendant, the plaintiff has been required to defend his or her interest by bringing or defending an action against a third person, the plaintiff may recover as damages the expense of the previous litigation, including attorneys' fees. (See 6 *Summary* (10th), *Torts*, §1656.) The same rule was applied to an action for breach of contract in *De La Hoya v. Slim's Gun Shop* (1978) 80 *C.A.3d Supp.* 6, 146 *C.R.* 68. Plaintiff bought a handgun from defendant dealer; neither party knew that the gun had been stolen. The police arrested plaintiff, and he engaged an attorney who successfully defended him against criminal charges. Plaintiff then brought this action for damages for breach of warranty of title, and was awarded judgment for the price of the gun and attorneys' fees. *Held*, affirmed; the general American rule permits recovery in this situation (80 *C.A.3d Supp.* 10), and the Uniform Commercial Code (U.C.C. 2714, 2715; see 4 *Summary* (10th), *Sales*, §203) does not preclude it. (80 *C.A.3d Supp.* 12.)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *In General.*

Cross-References: 7 *Cal. Proc.* (5th), *Judgment*, §165 et seq.; 7 *Cal. Proc.* (5th), *Judgment*, §170 et seq.



30 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XV. DAMAGES

C. Particular Kinds of Contracts.

1. Sale of Land: Breach by Vendor.

a. Former Limited Rule.

1 Witkin Sum. Cal. Law Contracts § 898

[§ 898] Former Limited Rule.

When a vendor breached a contract to sell and convey a good title to real property, C.C. 3306 formerly followed the English rule, denying compensation for the loss of the bargain unless there was "bad faith." Without bad faith, the purchaser could only obtain *reimbursement*; i.e., he or she could recover the payments on the price and the expense of examining the title and preparing papers, with interest. (See *Carpenter v. Froloff* (1939) 30 C.A.2d 400, 406, 86 P.2d 691; *Wheeler v. Oppenheimer* (1956) 140 C.A.2d 497, 501, 295 P.2d 128; 61 Harv. L. Rev. 146; 63 Harv. L. Rev. 909.)

"Bad faith" was a question of fact (*Engasser v. Jones* (1948) 88 C.A.2d 171, 176, 198 P.2d 546), and the burden of proof was on the purchaser. (See *Wilson v. Rosenkranz* (1931) 112 C.A. 511, 513, 297 P. 44; *Robertson v. Bogert* (1955) 130 C.A.2d 639, 645, 279 P.2d 572.) But it was not necessary to prove fraud: refusal to perform without just cause was enough. (See *Shaw v. Union Escrow & Realty Co.* (1921) 53 C.A. 66, 69, 200 P. 25 [bad faith found]; *Kaufman v. Bell* (1928) 89 C.A. 610, 611, 265 P. 317 [bad faith established where defendant relied on inability to obtain wife's signature, but previously gave various false excuses, and joined with wife in deed to a third party]; *Snook v. Netherby* (1954) 124 C.A.2d 797, 801, 269 P.2d 195, 3 Summary (10th), *Agency and Employment*, §155 [bad faith of vendor's agent cannot be imputed to personally innocent vendor]; *Kahn v. Lischner* (1954) 128 C.A.2d 480, 490, 275 P.2d 539 [vendor deliberately refused to perform because he saw opportunity to make better deal]; *Mercer v. Lemmens* (1964) 230 C.A.2d 167, 173, 40 C.R. 803 [deliberate refusal to recognize plaintiffs' preemptive right to purchase at lower price]; *Brandolino v. Lindsay* (1969) 269 C.A.2d 319, 325, 75 C.R. 56 [deliberate repudiation]; *Collins v. Marvel Land Co.* (1970) 13 C.A.3d 34, 42, 91 C.R. 291 [sufficient pleading]; 5 Santa Clara Lawyer 164; cf. *Hamaker v. Bryan* (1918) 178 C. 128, 129, 172 P. 391 [instruction that "any unlawful or unjustifiable refusal to comply with their agreement" was bad faith held erroneous].)

The rule applied in some tort cases, that reliance on the advice of counsel may negative bad faith or malice, was held applicable in a case brought under C.C. 3306. (*Fox v. Aced* (1957) 49 C.2d 381, 385, 317 P.2d 608.)

West's Key Number Digest, Vendor and Purchaser k.351(1)

SUPPLEMENT: [This section is current through the latest supplement]



31 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XV. DAMAGES

C. Particular Kinds of Contracts.

1. Sale of Land: Breach by Vendor.

b. Revised Statutes.

1 Witkin Sum. Cal. Law Contracts § 899

[§ 899] Revised Statutes.

(1) *Bad Faith Requirement Eliminated.* In 1983, the Legislature deleted the requirement of bad faith (see *supra*, §898), and C.C. 3306 now reads as follows:

"The detriment caused by the breach of an agreement to convey an estate in real property, is deemed to be the price paid, and the expenses properly incurred in examining the title and preparing the necessary papers, the difference between the price agreed to be paid and the value of the estate agreed to be conveyed at the time of the breach, the expenses properly incurred in preparing to enter upon the land, consequential damages according to proof, and interest." (See *15 Pacific L. J.* 674; C.E.B., Attorney's Guide to Damages 2d, §2.2 et seq.; C.E.B., 1 Real Property Sales Transactions 3d, §4.128; C.E.B., 1 Real Property Remedies and Damages 2d, §4:11; 52 Proof of Facts 3d 429 [real estate purchaser's rights and remedies where seller is unable to convey marketable title]; *94 A.L.R.3d 1091* [recovery for mistake as to amount of land conveyed]; *97 A.L.R.3d 1220* [recovery for removal of part of property before conveyance]; *28 A.L.R.4th 1078* [recovery for increased mortgage interest costs]; BAJI No. 10.94 [measure of damages--sale of land]; CACI, No. 356 [buyer's damages for breach of contract for sale of real property].)

(2) *Benefit of the Bargain.* The cases in which bad faith was found under the former statute illustrate the recovery of damages consisting of the difference between the contract price and the market value at the time of breach. (See *supra*, §898); *Nelson v. Fernando Nelson & Sons* (1936) 5 C.2d 511, 55 P.2d 859; *11 A.L.R.3d 719* [recovery for loss of profits from contemplated sale or use of land, where vendor fails or refuses to convey].)

This rule should not ordinarily be applied to breach of an option to buy property that was never exercised. (See *Schmidt v. Beckelman* (1960) 187 C.A.2d 462, 470, 9 C.R. 736.)

Baran v. Goldberg (1948) 86 C.A.2d 506, 194 P.2d 765, reaches an unusual result. Defendant vendor deliberately refused to convey land, and plaintiff sued for specific performance or damages. *Held*: (a) Specific performance was properly denied on the ground of inadequacy of consideration, determined from conflicting evidence; (b) damages were properly denied on the ground that there was no showing of any difference between the market value and contract price, because plaintiff had alleged that the agreed price was at all times the "fair and reasonable value." (86 C.A.2d 511.) In other words, the relatively formal allegation of adequacy of consideration, essential to a complaint for specific

performance, was given the effect of a conclusive admission that plaintiff was not damaged by the breach. (See 5 *Cal. Proc.* (4th), *Pleading*, §755.)

Fair market value is determined at the time of the *breach*, rather than at the time of *trial*. (*Reese v. Wong* (2001) 93 C.A.4th 51, 55, 112 C.R.2d 669 [language in *Stewart Dev. Co. v. Superior Court* (1980) 108 C.A.3d 266, 166 C.R. 450, 3 *Cal. Proc.* (4th), *Actions*, §379, supporting "time of trial" standard was limited to determining amount of undertaking where *lis pendens* has been expunged and does not apply to *contract* actions merely because of expungement].)

(3) *Prejudgment Interest*. In *Rifkin v. Achermann* (1996) 43 C.A.4th 391, 50 C.R.2d 661, plaintiff sued the owners of real property for breach of a contract to sell their property. The trial court ruled for plaintiff and awarded damages, including prejudgment interest on the damages measured by the property's fair market value on the date of breach less the purchase price. *Held*, affirmed, but remanded for recalculation of interest award.

The words "and interest" at the end of C.C. 3307 (seller's remedies; see *infra*, §901), as added by a 1983 amendment, appear to recognize a right to prejudgment interest on damages measured by the difference between the contract price and market value. C.C. 3306 (buyer's remedies; see *supra*) was similarly amended, and because the two statutes relate to the same subject, the import of the amendment as to C.C. 3307 is authority for a similar interpretation of C.C. 3306. However, C.C. 3306 does not establish an independent basis for prejudgment interest. Rather, the phrase "and interest" should be read as referring to the generally applicable provisions of C.C. 3287 (see *supra*, §893). Under C.C. 3287(b), the court has discretionary authority to award prejudgment interest where damages are "based upon a cause of action in contract." However, the statute provides that interest may not run from a date "earlier than the date the action was filed," and the trial court erred by awarding interest from the date of breach instead of from the date the action was filed. (43 C.A.4th 394.)

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Bad Faith Requirement Eliminated*. See C.E.B., 1 Real Property Sales Transactions 4th, §4.144.

(2) *Benefit of the Bargain*. See *Horning v. Shilberg* (2005) 130 C.A.4th 197, 206, 29 C.R.3d 717 [lost profits could not be measured by difference between contract price and price at which property was sold to another party approximately 13 months after breach].

Effect of allegation of adequacy of consideration:

Cross-Reference: 5 *Cal. Proc.* (5th), *Pleading*, §799.

Stewart Dev. Co. case:

Cross-Reference: 3 *Cal. Proc.* (5th), *Actions*, §405.



32 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XV. DAMAGES

C. Particular Kinds of Contracts.

1. Sale of Land: Breach by Vendor.

c. Delay in Conveyance.

1 Witkin Sum. Cal. Law Contracts § 900

[§ 900] Delay in Conveyance.

The usual measure of damages for delay in conveyance by the vendor is the reasonable rental value of the property. (*Lifton v. Harshman* (1949) 90 C.A.2d 180, 183, 202 P.2d 858.) Special damages are recoverable if they were within the reasonable contemplation of the parties when making the contract. (*Christensen v. Slawter* (1959) 173 C.A.2d 325, 334, 343 P.2d 341.) (See generally 25 Williston 4th, §66:83; 22 Am.Jur.2d (2003 ed.), *Damages* §69 et seq.; 74 A.L.R.2d 578 [measure of vendee's recovery in action for vendor's delay in conveying real property].)

In *Christensen v. Slawter*, *supra*, defendant owner of a subdivision agreed to sell 30 lots to plaintiff speculative building contractor, possession to be given in installments of 10, construction to commence promptly, and payments to be made in installments. Because the purchase was to be financed by a construction loan and the proceeds of resale to homeowners, and the contractor had a crew to be kept continually at work, time was made of the essence. Defendant, not in bad faith, but without legal justification, delayed conveyance of 13 lots by some 4 months, causing plaintiff certain losses from the work stoppage. *Held*, plaintiff was entitled to recover these losses as damages for delay under the general rule of C.C. 3300 (*supra*, §871).

(a) C.C. 3306, 3306a and 3307, considered together, present a legislative scheme to establish rules for failure to convey, not delay in conveyance, for delay in delivery of the deed is not a breach of the covenant to convey. (173 C.A.2d 331.)

(b) Damages for delay under C.C. 3300 are not precluded by acceptance of a deed. The specific performance cases are persuasive: Where a purchaser is finally able to compel conveyance, he or she is also allowed to recover damages for the delay in performance. The same rule should govern where the purchaser obtains a tardy conveyance without the necessity of seeking specific performance. (173 C.A.2d 333.)

(c) The requirement of foreseeability (*supra*, §871) is met here: the special purpose of buying the land--speculative building of homes, the time schedule known, and time expressly of the essence and necessary for the construction loan and effective use of working crews. (173 C.A.2d 334.)

SUPPLEMENT: [This section is current through the latest supplement]



33 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XV. DAMAGES

C. Particular Kinds of Contracts.

2. Sale of Land: Breach by Purchaser.

a. Excess of Contract Price Over Market Value.

1. Measure of Damages.

1 Witkin Sum. Cal. Law Contracts § 901

[§ 901] Measure of Damages.

(1) *In General.* If the purchaser defaults, the vendor may recover for the loss of his or her bargain and consequential damages. "The detriment caused by the breach of an agreement to purchase an estate in real property is deemed to be the excess, if any, of the amount which would have been due to the seller under the contract over the value of the property to him or her, consequential damages according to proof, and interest." (C.C. 3307.)

The "value of the property" is ordinarily the market value, i.e., the best price obtainable from a buyer, at the date of breach. (See *Royer v. Carter* (1951) 37 C.2d 544, 549, 233 P.2d 539, *infra*, §902; *Honey v. Henry's Franchise Leasing Corp.* (1966) 64 C.2d 801, 805, 52 C.R. 18, 415 P.2d 833; *Employees' Participating Assn. v. Pine* (1949) 91 C.A.2d 299, 301, 204 P.2d 965; *Crummer v. Zalk* (1967) 248 C.A.2d 794, 797, 57 C.R. 185; *Barton v. White Oak Realty* (1969) 271 C.A.2d 579, 585, 76 C.R. 587; *Abrams v. Motter* (1970) 3 C.A.3d 828, 841, 83 C.R. 855; *Kudokas v. Balkus* (1972) 26 C.A.3d 744, 753, 103 C.R. 318; Corbin §1098A; 25 Williston 4th, §66:79 *et seq.*; 48 Cal. L. Rev. 755; 61 Harv. L. Rev. 148; C.E.B., Attorney's Guide to Damages 2d, §2.9 *et seq.*; C.E.B., 1 Real Property Sales Transactions 3d, §§4.128, 4.131 *et seq.*; C.E.B., 1 Real Property Remedies and Damages 2d, §4:29 *et seq.*; BAJI, No. 10.95 [measure of damages--purchase of land]; CACI, No. 357 [seller's damages for breach of contract to purchase real property].)

Loss of bargain damages should be calculated on an all-cash-to-seller basis. Thus, where the purchase price is based partly on cash payment and partly on the amount of a promissory note, the amount of the note must be converted to its cash value. This conversion usually involves a discount of the note, based on such factors as the terms of the note and the value of the real property securing it, the amount of prior encumbrances, and the extent of the risks of economic changes during the term of the note, changes in interest rates, and foreclosure expenses. (*Abrams v. Motter, supra*, 3 C.A.3d 841.)

(2) *Specific Performance.* C.C. 3307 does not preclude the remedy of specific performance: In *BD Inns v. Pooley* (1990) 218 C.A.3d 289, 266 C.R. 815, defendant Pooley agreed to buy a motel being built by plaintiff BD Inns, and, after escrow instructions had been signed, defendant cancelled the sale. Plaintiff sued for specific performance and damages for breach; the trial judge denied breach of contract relief but ordered defendant Pooley, as an individual, to specifically perform by paying the purchase price plus interest. The judgment then provided that if payment was not

made within 30 days, the property was to be sold, and defendant was to pay plaintiff the difference between the contract price plus interest and the ultimate sales price. *Held*, judgment for specific performance affirmed.

(a) Defendant contended that C.C. 3307 provides the vendor with an adequate remedy at law, thereby precluding specific performance (see 13 *Summary* (10th), *Equity*, §24). But the legislative history makes it clear that the Legislature intended to expand the damages available for breach of real property contract, and not to eliminate the seller's alternative remedy of specific performance. (218 C.A.3d 296.)

(b) Plaintiff also sought compensation for operating losses and loss of income. Upholding the trial judge's denial of this compensation, the court said:

"In California the compensation which may be awarded incident to a decree of specific performance is not for a breach of contract and is not legal damages. The complainant affirms the contract and asks that it be performed. Since the time for performance has passed, the court relates that performance back to that date, by treating the parties as if the change in ownership had taken place at that time. Thus the buyer is entitled to the rents and profits from the time the contract should have been performed, and the seller is entitled to an offset for the interest on the purchase money which he would have received had the contract been performed. The process is more like an accounting between the parties than an assessment of damages." (218 C.A.3d 298, quoting *Hutton v. Gliksberg* (1982) 128 C.A.3d 240, 180 C.R. 141, 13 *Summary* (10th), *Equity*, §27.)

(3) *Prejudgment Interest*. The words "and interest" at the end of C.C. 3307, as added by a 1983 amendment, appear to recognize the right to prejudgment interest on damages, measured by the difference between the contract price and market value. (See *Rifkin v. Achermann* (1996) 43 C.A.4th 391, 396, 50 C.R.2d 661, *supra*, §899.)

(4) *Liquidated Damages*. The limitations of C.C. 3307 do not apply to land sale contracts containing a valid liquidated damages provision under C.C. 1675 (residential property) or C.C. 1676 (other real property). (Law Rev. Com. Comment to C.C. 1675, 1676; see *supra*, §544 et seq.)

West's Key Number Digest, Vendor and Purchaser k.330-

SUPPLEMENT: [This section is current through the latest supplement]

(1) *In General*. See 11 Corbin (Rev. ed.), §60.12; C.E.B., 1 Real Property Sales Transactions 4th, §4.141.



34 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XV. DAMAGES

C. Particular Kinds of Contracts.

2. Sale of Land: Breach by Purchaser.

a. Excess of Contract Price Over Market Value.

2. Resale Price as Evidence.

1 Witkin Sum. Cal. Law Contracts § 902

[§ 902] Resale Price as Evidence.

The vendor cannot, as in the case of personal property (C.C. 3353), resell to a third person and recover the difference between the contract price and the resale price. (*Royer v. Carter (1951) 37 C.2d 544, 550, 233 P.2d 539*; see *C.C.P. 580b* ["No deficiency judgment shall lie in any event after any sale of real property or an estate for years therein for failure of the purchaser to complete his or her contract of sale"].)

If the vendor does resell, the resale price is relevant only as evidence of the market value at the time of breach. In *Royer*, plaintiff vendor agreed to sell property for \$ 24,000. Defendant purchaser paid \$ 1,000 down and defaulted. Plaintiff resold for \$ 18,500 and the trial court gave him damages equal to the difference between contract price and resale price, plus expenses incurred in connection with the first sale, less the down payment. The evidence, however, was that the value of property at the time of breach was at least \$ 22,500, the market having declined thereafter. *Held*, reversed for retrial of the issue of damages; the trial court should have made an adjustment for the decline in the market. (*37 C.2d 548*.)

A concurring opinion argues that in determining market value at the time of breach the resale price later should be considered; i.e., the estimate must take into account the fact that some time will elapse before the vendor can find another purchaser. "The value to the seller on the date of breach should be the price obtainable on an offering of the property on that date with allowance for a reasonable time within which to find a purchaser. Certainly the seller who does not breach his contract should not have to anticipate a breach by the contracting purchaser nor should such a seller have to stand all or any part of the loss necessarily flowing from the purchaser's breach. Thus, if the price finally obtained in a falling market is the best price which reasonably could be procured, with due diligence, on an offering made as of the date of breach, the value to the seller as of such date would be no more than the price actually obtained." (*37 C.2d 552*.)

SUPPLEMENT: [This section is current through the latest supplement]



35 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XV. DAMAGES

C. Particular Kinds of Contracts.

2. Sale of Land: Breach by Purchaser.

b. Consequential Damages.

1. In General.

1 Witkin Sum. Cal. Law Contracts § 903

[§ 903] In General.

(1) *In General.* C.C. 3307 originally made no reference to consequential damages, but the 1983 amendment expressly covers them. (See *supra*, §901.) Even prior to the amendment, however, expenses necessarily incurred by the vendor in an effort to realize the benefit of his or her bargain were held to be recoverable.

In *Royer v. Carter* (1951) 37 C.2d 544, 233 P.2d 539, *supra*, §902, the court pointed out that C.C. 3307 is designed to assure the vendor the benefit of the bargain, and that the purchaser's breach may make it necessary to incur additional expense to realize that benefit. "Given the rule that the value of the property to the seller under section 3307 is ordinarily the market value at the time of the breach injustice could result if the vendor were not allowed to recover damages for additional expenses caused him by the vendee's breach. Thus in a case where the property is sold at the market value and that value remains constant until after the breach, and the property is then resold at the same price, the vendor could recover no damages under section 3307. He would be forced to pay, however, in addition to the expenses of the first sale, the expenses of the resale. When such additional expenses are the natural consequence of the breach, they may be recovered in addition to those provided for in section 3307." (37 C.2d 550.)

The court added that the expenses of the first sale to defendant should not be allowed. These would have been incurred had the contract been *performed*, and to recover them would place the vendor in a better position than if there had been no breach (C.C. 3358; see *supra*, §875). (37 C.2d 551.) (See *Barton v. White Oak Realty* (1969) 271 C.A.2d 579, 585, 76 C.R. 587.)

(2) *Specific Expenses.* In *Nielsen v. Farrington* (1990) 223 C.A.3d 1582, 273 C.R. 312, a sale of property that was to have occurred in 1986 did not occur until 1987 due to defendant buyer's breach, and plaintiff seller had to pay an additional \$ 5,435 in taxes as a result of a new tax law that went into effect in 1987. *Held*, it was error to include this amount in the award of consequential damages.

(a) Increased taxes are recoverable only if the defaulting party has actual or constructive knowledge of special circumstances at the time the contract is entered into. There is no evidence that the tax law that went into effect in 1987 was known to or contemplated by the parties when the contract was entered into in 1985. (223 C.A.3d 1588.)

(b) Plaintiff argued that defendant was liable for the increased taxes because, when the contract was modified to allow defendant until August 16, 1986, to perform, he was then informed of the necessity of closing in 1986 to avoid adverse tax consequences. This argument is without merit; it was plaintiff's inability to resell the property in 1986, instead of defendant's failure to close by August 16, that caused the increase in taxes. (223 C.A.3d 1589.)

(c) Although plaintiff's inability to resell the property in 1986 arguably was caused by defendant's refusal to cancel escrow, this refusal, by itself, did not establish a breach of contract. (223 C.A.3d 1589.)

Types of consequential damages that have been recognized as proper include: expenses incurred in preparation for resale of the property (*Abrams v. Motter* (1970) 3 C.A.3d 828, 850, 83 C.R. 855); expenses incurred in resale (*Kudokas v. Balkus* (1972) 26 C.A.3d 744, 755, 103 C.R. 318); and loss of a walnut crop on the vendor's land that could not be marketed (*Wade v. Lake County Title Co.* (1970) 6 C.A.3d 824, 830, 86 C.R. 182). (See *Askari v. R & R Land Co.* (1986) 179 C.A.3d 1101, 1107, 225 C.R. 285; C.E.B., 1 Real Property Sales Transactions 3d, §§4.128, 4.131 et seq.; C.E.B., 1 Real Property Remedies and Damages 2d, §4:43 et seq.; 17 A.L.R.2d 1300, 1353 [recovery, in breach of contract action, of expenditures incurred in preparation for performance].)

West's Key Number Digest, Vendor and Purchaser k.330

SUPPLEMENT: [This section is current through the latest supplement]

(2) *Specific Expenses*. See C.E.B., 1 Real Property Sales Transactions 4th, §4.141.



36 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XV. DAMAGES

C. Particular Kinds of Contracts.

2. Sale of Land: Breach by Purchaser.

b. Consequential Damages.

2. Rental Value.

1 Witkin Sum. Cal. Law Contracts § 904

[§ 904] Rental Value.

In *Kudokas v. Balkus* (1972) 26 C.A.3d 744, 103 C.R. 318, plaintiff vendor sold a motel to defendants on an installment contract. Defendants took possession November 1, 1965, and defaulted September 13, 1967. Plaintiff declared the contract terminated, but defendants refused to surrender possession until removed by a court-appointed receiver on October 24, 1969. Plaintiff sought recovery of rental value as an element of damages. *Held*:

(a) Plaintiff could not recover rental value for the period of defendants' legal possession. During this period, the purchaser takes the risk of a decline in capital value, relieving the vendor of that risk. If the vendor elects to rescind and restore payments, he or she might recover the value; but "[t]his lawsuit manifests an election to treat the property as though it had been sold, not rented. In arguing for rental value in addition or as an alternative to 'benefit of the bargain,' plaintiff would treat the property as though it had *not* been sold." (26 C.A.3d 754.)

(b) Rental value could be recovered, however, for the period of illegal possession, i.e., from September 13, 1967 (the date of breach) until October 24, 1969 (when the receiver took possession for plaintiff vendor). The reason is that at the time of breach, when value is the measure of damages, the vendor is presumed free to use or dispose of the property. If the purchaser wrongfully retains possession, the vendor should have additional damages in the amount necessary to give him or her the benefit of the bargain--here, the rental value. (26 C.A.3d 754.)

SUPPLEMENT: [This section is current through the latest supplement]



37 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XV. DAMAGES

C. Particular Kinds of Contracts.

2. Sale of Land: Breach by Purchaser.

b. Consequential Damages.

3. Credit for Higher Resale Price.

1 Witkin Sum. Cal. Law Contracts § 905

[§ 905] Credit for Higher Resale Price.

In *Smith v. Maddy* (1983) 146 C.A.3d 129, 194 C.R. 42, plaintiff vendors agreed to sell a residence to defendant purchasers for \$ 205,000, and defendants defaulted. Within a few days thereafter plaintiffs contracted to sell the property to others for \$ 215,000 and the sale followed promptly. Plaintiffs then sued defendants for breach of the first sales contract. There were no "benefit of the bargain" damages under C.C. 3307 because the resale price established the value of the property at the time of breach as in excess of the contract price; but the trial judge awarded consequential damages of \$ 2,648.34 under C.C. 3300 for costs of insurance, gardening, property taxes, utilities, and encumbrance interest payments incurred between the default and the resale. *Held*, defendants were entitled to credit against these consequential damages the increase in proceeds from the subsequent resale.

(a) In *Abrams v. Motter* (1970) 3 C.A.3d 828, 846, 83 C.R. 855, *supra*, §901, the court recognized that a vendor's continued ownership after a purchaser's default may have a "use" value that should be offset against expenses of the continuing ownership. And the line of cases beginning with *Freedman v. The Rector, Wardens & Vestrymen of St. Matthias Parish of Los Angeles* (1951) 37 C.2d 16, 230 P.2d 629, 13 Summary (10th), *Equity*, §63, established the principle that the vendor should not be unjustly enriched as a result of the purchaser's default. (146 C.A.3d 132.) Moreover, C.C. 3358 directly prohibits recovery of a greater amount in damages for breach than could have been gained by full performance (see *supra*, §875). (146 C.A.3d 133.) Thus, the vendor should not be permitted to receive a windfall at the purchaser's expense: "We discern no reason to deprive the defaulting purchaser of benefitting from a higher price on resale after continued ownership by seller while crediting the purchaser ... with the value of the use to the seller during continued ownership." (146 C.A.3d 133.)

(b) Where the resale at a higher price occurs at a considerable time after the breach, the vendor may show a lower property value at the moment of breach as well as increased costs of continuing ownership. However, the immediate resale in this case established the value of the property at the time of breach: "Realistically, the vendors here had sold their property to defendants at a price lower than the then value of the real estate." (146 C.A.3d 133.)

(c) The vendor has an obligation to resell promptly in order to obtain consequential damages, and the resale price may fix the property value for C.C. 3307 damages. There is therefore no separateness in the original sale and

subsequent resale transactions, and the increased resale price gave the vendors a \$ 10,000 increment that absorbed the \$ 2,648.34 in increased costs of continuing ownership. (146 C.A.3d 133.) (See *Spurgeon v. Drumheller* (1985) 174 C.A.3d 659, 664, 220 C.R. 195 [citing *Smith v. Maddy* on this point]; *Askari v. R & R Land Co.* (1986) 179 C.A.3d 1101, 1107, 1112, 225 C.R. 285 [discussing and applying *Maddy* holding].)

The opposite result was reached in *Nielsen v. Farrington* (1990) 223 C.A.3d 1582, 273 C.R. 312, where plaintiff agreed to sell certain property in the city of Redlands to defendant for \$ 180,000. After defendant breached the contract, the city condemned the property, and approximately 13 months after the breach, paid \$ 180,000 for it. Defendant argued that in awarding plaintiff \$ 7,334.68 as consequential damages, the trial judge erred in refusing to offset the \$ 18,000 in commissions that plaintiff "saved" when the property was sold to the city. *Held*, there was no error.

(a) Ordinarily, the seller must establish the value of the property at the time of the breach in order to recover "benefit of the bargain" damages (*supra*, §901). However, because plaintiff here was seeking only consequential damages, defendant had the burden of establishing the property's value at the time of breach in order to obtain an offset from any consequential damages. Defendant failed to meet this burden. (223 C.A.3d 1587, footnote 5.)

(b) Defendant's reliance on *Smith v. Maddy*, *supra*, is misplaced. That decision allowed an offset for the seller's gain on resale after first determining that the resale price established the value of the property at the time of the breach. However, because the value of the property on the date of the breach was unknown here (because the resale did not occur until 13 months later), it is impossible to determine whether plaintiff suffered any "benefit of the bargain" damages. Hence, the trial judge was not required to determine whether "benefit of the bargain" damages should be based simply on the difference between the contract price and the value of the property on the date of the breach, or whether the commission should be deducted from the contract price before measuring that difference. (223 C.A.3d 1587.)

SUPPLEMENT: [This section is current through the latest supplement]



38 of 175 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XV. DAMAGES

C. Particular Kinds of Contracts.

2. Sale of Land: Breach by Purchaser.

c. Retention of Downpayment.

1 Witkin Sum. Cal. Law Contracts § 906

[§ 906] Retention of Downpayment.

In *Royer v. Carter* (1951) 37 C.2d 544, 233 P.2d 539, supra, §902, the contract provided that if the purchaser failed to pay the balance or complete the purchase, the vendor at his option could retain the prior payments "as the consideration for the execution of this agreement by the seller." Defendant contended that the vendor elected this remedy by retaining the \$ 1,000 downpayment, and lost the remedy of action for damages. *Held*, there was no election. Independent of the contract provision, plaintiff had an alternative right to retain the downpayment as a setoff against actual damages; she informed defendant of her intention to hold him liable for actual damages; hence, retention of the downpayment was consistent with the choice of either remedy, and this justified the trial court finding that the deposit was retained to apply on damages sustained by the breach. (37 C.2d 547.) (On restitution of prior payments to relieve against forfeiture, see 13 *Summary* (10th), *Equity*, §62.) (On validity of provisions for retention of the downpayment as liquidated damages under the Revised Liquidated Damages Law, see supra, §544 et seq.)

SUPPLEMENT: [This section is current through the latest supplement]



39 of 175 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XV. DAMAGES

C. Particular Kinds of Contracts.

3. Agreement To Give Quitclaim Deed.

1 Witkin Sum. Cal. Law Contracts § 907

[§ 907] Agreement To Give Quitclaim Deed.

Where there is a breach of an agreement to give a *quitclaim deed*, the minimum detriment is deemed to be the expenses of quieting title and making entry on the property, including reasonable *attorneys' fees*, to be fixed by the court in the quiet title action. (C.C. 3306a.)

West's Key Number Digest, Vendor and Purchaser k.351(1)

SUPPLEMENT: [This section is current through the latest supplement]



40 of 175 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XV. DAMAGES

C. Particular Kinds of Contracts.

4. Agreement To Pay Money.

1 Witkin Sum. Cal. Law Contracts § 908

[§ 908] Agreement To Pay Money.

C.C. 3302 provides that the "detriment caused by the breach of an obligation to pay *money only*, is deemed to be the amount due by the terms of the obligation, with interest thereon." (See 25 Williston 4th, §66:96; 22 *Am.Jur.2d* (2003 ed.), *Damages* §§81, 82; Harv. L. Rev. 157.)

This limiting rule does not apply where there are other obligations as well. In *Venturi v. Zurich General Acc. & Liab. Co.* (1936) 14 *C.A.2d* 89, 57 *P.2d* 1002, judgments were recovered against plaintiff for damages as a result of an automobile collision. Defendant, his insurance carrier, defended at the trial, but refused to pay the judgments, or to appeal or furnish bonds. Execution was levied on plaintiff's business, forcing him into bankruptcy. *Held*, plaintiff could recover damages suffered by the loss of his property, business, and credit, and he was not limited merely to recovery of the amount of the judgments in the tort action, which defendant should have paid. (14 *C.A.2d* 90.)

Where a contract calls for payment in a particular foreign currency, the obligee assumes the risks of its fluctuation or even complete devaluation by action of the foreign sovereign. (*Sternberg v. West Coast Life Ins. Co.* (1961) 196 *C.A.2d* 519, 523, 16 *C.R.* 546 [insurance policy payable in Shanghai Taels Sycee, which became valueless]; see 25 Williston 4th, §66:96; 22 *Am.Jur.2d* (2003 ed.), *Damages* §§83, 84; BAJI, No. 10.93 [damages--obligation to pay money only]; CACI, No. 355 [obligation to pay money only].)

SUPPLEMENT: [This section is current through the latest supplement]



41 of 175 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XV. DAMAGES

C. Particular Kinds of Contracts.

5. Building Construction Contract.

a. Breach by Contractor.

1 Witkin Sum. Cal. Law Contracts § 909

[§ 909] Breach by Contractor.

It is generally held that damages for a contractor's defective or incomplete construction of a building may be measured by either (1) the cost of reconstruction or completion, or (2) the difference in value between the building as constructed and as it should have been constructed. (See *Erlich v. Menezes* (1999) 21 C.4th 543, 561, 87 C.R.2d 886, 981 P.2d 978, 6 Summary (10th), Torts, §1037 [damages for defective construction of house are limited to cost of repairs, including lost use or relocation expenses, or diminution of value; damages for mental distress are not recoverable]; Corbin §1089 et seq.; 24 Williston 4th, §66:14 et seq.; 3 Am.Jur.2d, *Building and Construction Contracts* (2000 ed.), §84 et seq.; Cal. Civil Practice, 2 Real Property Litigation, §9:1 et seq.; 93 Am.Jur. Trials 405 [representing community association in condominium construction litigation]; 6 A.L.R.3d 1394 [nonliability of contractor where loss or damage is due to contractee's defective plans and specifications]; 40 A.L.R.4th 110 [recovery of punitive damages for contractor's breach]; 41 A.L.R.4th 131 [cost of construction or difference in value as proper measure]; CACI, No. 354 [owner's/lessee's damages for breach of contract to construct improvements on real property]; on contractor's liability for labor cost overruns or completion delays, see *Superior Gunite v. Ralph Mitzel* (2004) 117 C.A.4th 301, 311, 12 C.R.3d 423 [sub-subcontractor was not entitled to recover for labor cost overruns in breach of contract action against general contractor, inasmuch as sub-subcontractor was not in privity with general contractor; subcontractor had assigned its claims to sub-subcontractor, but only contract claim that subcontractor had against general contractor was false start claim]; 67 Proof of Facts 3d 339 [liability of contractor for delay in completion of building or construction project]; 16 A.L.R.3d 1252 [prime contractor's liability to subcontractor for delay in performance].)

In *Shell v. Schmidt* (1958) 164 C.A.2d 350, 330 P.2d 817, supra, §819, defendant building contractor intentionally deviated in several major respects from the specifications for a \$ 12,000 house. On the issue of damages, he contended that the resulting structure was good, that the cost of reconstruction (\$ 3,950) was disproportionately high, and that therefore the measure of damages should be the mere difference in value between the house as built and as it should have been built. Held, the proper measure under C.C. 3300 was the cost of reconstruction to make the work conform to the contract. The court reviewed the authorities at length, noting that some courts apply the difference in value rule where a substantial part of the work would have to be *undone*. Here, however, the defendant would merely have to do *additional work* at not too great an expense. Corbin's statement of the cost rule was approved: "Without question, the contract breaker should pay the cost of construction and completion in accordance with his contract unless he proves

affirmatively and convincingly that such construction and completion would involve an unreasonable economic waste." (164 C.A.2d 359.)

In *Glendale Fed. Savings & Loan Assn. v. Marina View Heights Dev. Co.* (1977) 66 C.A.3d 101, 135 C.R. 802, plaintiff lender contracted with defendant developer to sell land and lend money to improve the land. On defendant's default, plaintiff foreclosed on its deed of trust, purchased the property at a nonjudicial sale, and brought this action for damages. The trial judge found that at the time of contracting the market value of the land exceeded the amount of the loan, but at the date of foreclosure the market value was \$ 9.3 million while the secured indebtedness was over \$ 10 million. Judgment was accordingly rendered for plaintiff, and both parties appealed. The court, affirming the judgment, set forth a number of rules on damages for breach of a construction contract.

(a) Where the work is to be done *on the property of the plaintiff owner*, the measure of damages is ordinarily the reasonable cost to the plaintiff of completing the work, not the difference between the value of the property and its value had the improvements been constructed. (66 C.A.3d 123, citing *Shell v. Schmidt*, *supra*.)

(b) A different rule applies where improvements are to be made *on property not owned by the injured party*. Because the injured party is unable to complete the work himself or herself, the proper measure is the difference in value of the property with and without the promised performance. (66 C.A.3d 124, citing *Coughlin v. Blair* (1953) 41 C.2d 587, 262 P.2d 305, *supra*, §873.)

(c) Where a mortgagee has made a loan for the construction of improvements on the mortgaged property and has required a surety bond guaranteeing completion of the improvements, recovery is limited to the injury to the mortgagee's security interest, measured by the difference between the value of the property with and without the completed improvements. (66 C.A.3d 124.) Although plaintiff mortgagee became the owner at the foreclosure sale, damages under C.C. 3300 are ordinarily confined to those that might have been reasonably contemplated at the time of contracting. (66 C.A.3d 125, citing the text.)

(d) Where the measure of damages turns on the value of property, the normal standard is market value; and the principles governing ascertainment of market value are the same as those applicable to the valuation of property in eminent domain proceedings. (66 C.A.3d 141.) The accepted definition, as stated in *Sacramento R. Co. v. Heilbron* (1909) 156 C. 408, 409, 104 P. 979, is "the highest price estimated in terms of money which the land would bring if exposed for sale in the open market, with reasonable time allowed in which to find a purchaser, buying with knowledge of all of the uses and purposes to which it was adapted and for which it was capable." (66 C.A.3d 141, citing *Abrams v. Motter* (1970) 3 C.A.3d 828, 841, 83 C.R. 855, *supra*, §901.)

(e) The rule in eminent domain that market value assumes the highest price obtainable on a sale for cash or its equivalent rather than on terms logically follows from the fact that the condemner is required to pay cash, not a downpayment with balance payable on terms; and the same is true of a judgment for damages, for the judgment debtor must pay the amount of the award in cash. (66 C.A.3d 142, 144.)

SUPPLEMENT: [This section is current through the latest supplement]

See 11 Corbin (Rev. ed.), §60.1 et seq. *Correction:* Page 1003, paragraph (d), line 5, "*Sacramento R. Co. v. Heilbron*" should be "*Sacramento Southern R. Co. v. Heilbron*".



42 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XV. DAMAGES

C. Particular Kinds of Contracts.

5. Building Construction Contract.

b. Breach by Owner.

1 Witkin Sum. Cal. Law Contracts § 910

[§ 910] Breach by Owner.

In *C. Norman Peterson Co. v. Container Corp.* (1985) 172 C.A.3d 628, 218 C.R. 592, defendant CCA, owner of a paper mill, contracted with plaintiff CNP for a modernization project consisting of enlargement of the building and installation of new machinery. The contract called for completion by CNP in 18 months, and payment by CCA of the actual net cost of the work, not exceeding \$ 4,789,000, plus a fee of \$ 300,000. CNP completed the work on time, and was paid \$ 5,544,500; but CNP contended that, as a result of numerous errors in design and changes in plan made by CCA, it was entitled to recover its total costs, without being limited by the original contract amount. The trial judge made findings of both breach and abandonment by CCA, and gave judgment in favor of CNP for \$ 2,898,687.47 with interest, representing CNP's total costs expended plus overhead and profit, less receipts. *Held*, affirmed.

(a) CCA, relying on traditional contract theories, argued that completion of performance was inconsistent with a finding that the contract had been abandoned. However, in cases dealing with construction contracts, it has been held that where an owner imposes on the contractor so large a number of changes that it can be said that the scope of the work has been altered, an abandonment of contract may be found. In such a situation, the contractor, with the approval and expectation of the owner, may complete the project; i.e., although the *contract* may be abandoned, the *work* is not. (72 C.A.3d 640.)

(b) Here, there were hundreds of changes, many significant; and the contract requirement of written change orders was ignored during most of the project period. The trial judge was justified in concluding that there was an abandonment implied from acts of the parties. (172 C.A.3d 641, 642.)

(c) The rescission cases treating abandonment and breach as incompatible are distinguishable: They were primarily concerned with preventing double recovery by obtaining both restitution through rescission and additional damages by alleging breach. Here, no suggestion was made that CNP received a double recovery under the judgment. (172 C.A.3d 642, 643.) The evidence showed material breaches by CCA, including failure to inform CNP that it would substantially reengineer and redesign the paper mill while the project was under way; providing CNP with plans that were both erroneous and extremely late in issuance; and delay of 10 to 29 months in payment of \$ 500,000 retention money. These and other breaches were actually the precipitating cause of abandonment of the construction contract and of the subsequent implicit understanding by the parties to proceed with the project on a quantum meruit basis. (172 C.A.3d

643, 644.)

(d) The contract cost maximum at the time of its execution was \$ 4,789,000 (plus the \$ 300,000 fee); a later change order revised the figure upwards to \$ 5,937,114. The trial judge found that CNP's expenditures and the reasonable value of its services was \$ 8,194,713.02, and based its award on this figure. The judge concluded that the changes ordered by CCA caused such a loss of productivity and increased cost of performance that the contract maximum was inapplicable. This conclusion was proper. (172 C.A.3d 646.)

(e) The contention that the total cost method of measuring damages is disfavored is based on cases in which the contractor did not offer specific evidence of causation by showing ordinary costs and then the increased costs resulting from the alleged breach. Here CNP was unable to keep accurate cost records due to the many errors and omissions in the drawings and the numerous and complex orally directed changes in work during the critical period. It was therefore appropriate for the judge to employ the total cost method because there was no better proof available. (172 C.A.3d 646, 647.)

(f) CNP, in its cross-appeal, contended that the judge erred in not awarding it the costs of borrowing resulting from CCA's wrongful withholding of money due. The judge, in his notice of intended decision, stated that no allowance was made for inflation, and this was correct. "We are aware of no California *contract case* in which damages were awarded to compensate for the effects of inflation or the costs of borrowing money." (172 C.A.3d 650.)

In addition to abandonment, *Amelco Elec. v. Thousand Oaks* (2002) 27 C.4th 228, 115 C.R.2d 900, 38 P.3d 1120, infra, §1000, dealt with whether plaintiff contractor had presented sufficient evidence to warrant instructing the jury on the *total cost* method of measuring damages in plaintiff's action against defendant city for breach of a contract to do the electrical work involved in the construction of a civic arts plaza. During the 2-year construction process, plaintiff submitted many requests for change orders, most of which were denied. After completion of the project, plaintiff filed a claim for costs allegedly resulting from the noncaptured costs of the change orders. The jury was instructed on the total cost method of measuring damages, even though plaintiff, although maintaining daily records of its work activities, was unable to produce documentation of instances in which performance of a work directive or change order was delayed or interfered with by defendant's actions. The trial judge entered judgment for plaintiff, and the Court of Appeal affirmed. *Held*, reversed.

(a) Defendant does not argue that total cost recovery is never appropriate against a public agency, only that this damages theory is inappropriate here. For this reason, "we do not determine whether total cost damages are ever appropriate in a breach of public contract case, but rather whether the theory for such damages was in this case properly submitted to the jury." Also, defendant does not challenge the jury's finding of breach of contract; rather, it challenges only the manner in which damages were calculated. (27 C.4th 242.)

(b) Under the total cost method, which is generally disfavored, damages are determined by subtracting the contract amount from the total cost of performance. Before this method may be used, the trial court bears the initial responsibility of determining the following: (1) the impracticality of proving actual losses directly; (2) whether the plaintiff's bid was reasonable; (3) whether plaintiff's actual costs were reasonable; and (4) whether plaintiff had no responsibility for the added costs. (27 C.4th 243.) The total cost method is not a substitution for causation, and hence the costs must be tied to the defendant's fault. (27 C.4th 244.)

(c) Here, plaintiff failed to adduce evidence to satisfy the fourth element of the preceding four-part test. A corollary of this element is that the contractor must demonstrate that the defendant, and no one else, is responsible for the additional costs. Although the jury here was instructed that it could find a breach of contract on several theories, plaintiff never attempted to demonstrate how a particular alleged breach caused certain damages. Rather, it conceded that no effort was made to distinguish those inefficiencies that were plaintiff's and those believed to be the responsibility of defendant. Nor did plaintiff demonstrate *when* any particular breach occurred. Instead, it sought to recover all costs over the life of the contract if the jury found, at any undetermined point, that the contract had been breached. (27 C.4th

245.)

(d) Plaintiff also asserted that "if we fail to uphold the total cost method here, '[p]ublic entities [will] be motivated to change, mismanage and disrupt problem projects as much as possible to make it impossible for a contractor to determine the separate cost of each distinct change.'" Here, plaintiff has simply failed to demonstrate that it was not possible to determine these corporate costs. (27 C.4th 248.)

Under the foregoing principles, the following instruction was held erroneous: " 'If you find that the City breached or abandoned the contract, then Amelco is entitled to recover the reasonable value of the work performed by it less the payments made by the City, and less any costs incurred by Amelco which are not fairly attributable to the City.' " (27 C.4th 247.) (See 22 *Pacific L. J.* 1185 [total cost method of calculating damages]; 52 *A.L.R.4th* 712 [contractor's right to recover equipment leasing expense]; 64 Proof of Facts 3d 471 [sufficiency of authorization for extra work under private building contract]; 67 Proof of Facts 3d 339 [liability of owner for delay in completion of building or construction project].)

West's Key Number Digest, Implied and Constructive Contracts k.111

SUPPLEMENT: [This section is current through the latest supplement]

See *Lewis Jorge Const. Management v. Pomona Unified School Dist.* (2004) 34 C.4th 960, 965, 22 C.R.3d 340, 102 P.3d 257, Supp., supra, §882 [damages for breach of construction contract do not include potential profits lost on future contracts that contractor does not win when, as consequence of property owner's breach, contractor's surety reduces contractor's bonding capacity]; 124 *A.L.R.5th* 375 ["total cost method (or approach)" and "modified total cost method (or approach)" to proving damages].



43 of 175 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XV. DAMAGES

C. Particular Kinds of Contracts.

6. Works of Improvement Contracts.

1 Witkin Sum. Cal. Law Contracts § 911

[§ 911] Works of Improvement Contracts.

Under legislation enacted in 1995, failure to make payments under contracts for works of improvement entered into on or after January 1, 1996, may result in the imposition of penalties in lieu of interest payments.

(1) *Private Works of Improvement.* In a written contract for private works of improvement, the contracting party and the design professional may agree to a late payment penalty in lieu of any interest otherwise due, provided the terms of the penalty are specifically set forth in the contract. (C.C. 3319(a).)

(2) *Public Works of Improvement.* In a contract for public works of improvement, the public agency must make certain progress payments to the prime design professional which, in turn, must make progress payments to each subconsultant design professional, although up to 150% of an amount due that is disputed in good faith may be withheld. (C.C. 3320(a), 3321(a).) If any amount is wrongfully withheld or is not timely paid, the respective design professionals are entitled to a penalty of 1/2% per month for the amount improperly withheld, in lieu of any interest otherwise due. In an action for collection of the amounts withheld, the prevailing party is entitled to reasonable attorneys' fees and costs. (C.C. 3320(b), 3321(b).)

(3) *Definitions.* The following definitions apply:

(a) A "design professional" means a licensed architect, a registered professional engineer, or a licensed land surveyor. (C.C. 3319(d)(2), 3320(f)(2), 3321(e)(2).)

(b) A "prime design professional" means a design professional with a written contract directly with the public agency. (C.C. 3320(f)(3), 3321(e)(3).)

(c) A "subconsultant design professional" means a design professional with a written contract with a prime design professional. (C.C. 3321(e)(4).)

(4) *Penalty in Addition to Liens.* The penalty is in addition to the design professionals' liens under C.C. 3081.1 et seq., mechanics' liens under C.C. 3109 et seq., and stop notices for private and public works under C.C. 3156 et seq. (C.C. 3319(b), 3320(c), 3321(c).)

(5) *Construction Loan Funds Excluded.* None of the rights or obligations between the parties apply to construction loan funds held by a lender under a construction loan agreement. (C.C. 3319(c), 3320(e), 3321(d).)

(6) *Certain State Agency Contracts Excluded.* The provisions relating to the rights and obligations between public agencies and prime design professionals are inapplicable to state agency contracts subject to Govt.C. 927.6 (penalty for failure of state agency to submit correct claim schedule). (C.C. 3320(d).)

SUPPLEMENT: [This section is current through the latest supplement]



44 of 175 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XV. DAMAGES

C. Particular Kinds of Contracts.

7. Actor's Contract for Publicity.

1 Witkin Sum. Cal. Law Contracts § 912

[§ 912] Actor's Contract for Publicity.

In *Ericson v. Playgirl* (1977) 73 C.A.3d 850, 140 C.R. 921, plaintiff was an actor whose picture had previously appeared in the centerfold of defendant's magazine "Playgirl." He agreed that defendant could repeat the picture on the cover of the annual edition of "Best of Playgirl" along with pictures of five other persons. Due to an editorial mix-up, the picture did not appear, and plaintiff brought this action for damages for the loss of publicity. Based on testimony of the value to an entertainer of a picture on the cover of a national magazine, the trial judge awarded plaintiff damages of \$ 12,500. *Held*, judgment modified to reduce amount to \$ 300 as nominal damages.

(a) *Nature of action.* This was not a tort action for invasion of privacy, but an action for breach of contract (the breach being admitted). Hence, (1) the damages must be clearly ascertainable and reasonably certain; and (2) the tort rule that when calculation of the fact and amount of damages has been made difficult by defendant's wrong the court may adopt means to right the wrong does not apply. (73 C.A.3d 854.)

(b) *Reasonably certain damages for loss of publicity.* In cases of refusal to continue an advertising contract, recovery has been allowed, with damages assessed at the market value of the advertising, less the agreed contract price. (73 C.A.3d 855.)

(c) *Principles applied to contract of performing artist.*

(1) For publicity to be of value and result in custom, it must relate to the specific aspect of the human activity involved. "It follows that damages for loss of publicity in breach of contract must be tied to loss of publicity for some particular event, such as a musical concert or a prize fight, or loss of publicity for some continuing activity, such as the conduct of a specific business at a specific location or the practice of a particular skill or art." (73 C.A.3d 856.) Thus, where a performing artist's employment contract is breached, he or she may recover not only for loss of salary but for loss of publicity resulting from the denial of the opportunity to appear in public in the artist's professional capacity. (73 C.A.3d 857, citing *Colvig v. RKO General* (1965) 232 C.A.2d 56, 42 C.R. 473, 3 Summary (10th), *Agency and Employment*, §125.) But in the cases allowing recovery, "the lost publicity grew out of the loss of the artist's exercise of his or her profession, i.e., loss of the opportunity to act, to broadcast, to sing, to conduct an orchestra, to entertain; or resulted from the loss of credit to the artist for professional services connected with a particular work, i.e., a script, play, musical composition, design, production, and the like. ... Damages for the loss of this publicity does not present

insuperable difficulties in calculation, for the artist's future earnings can be directly correlated to his box office appeal or to his known record of successes." (73 C.A.3d 857.)

(2) Plaintiff does not bring himself within this rule. "His situation is comparable to that of an actor who hopes to obtain wide publicity by cutting the ribbon for the opening of a new resort-hotel complex, by sponsoring a golf or tennis tournament, by presenting the winning trophy at the national horse show, or by acting as master of ceremonies at a televised political dinner. Each of these activities may generate wide publicity that conceivably could bring the artist to the attention of patrons and producers of his art and thus lead to professional employment. Yet none of it bears any relation to the practice of his art. Plaintiff's argument, in essence, is that for an actor all publicity is valuable, and the loss of any publicity as a result of breach of contract is compensable. Carried to this point, we think his claim for damages becomes wholly speculative." (73 C.A.3d 858.)

(d) *Nominal damages where actual damages impossible to assess.* Because there was admittedly a breach of contract, but the actual damages, if any, are speculative and conjectural, plaintiff is entitled only to nominal damages (see supra, §878). These may be set by analogy to C.C. 3344, providing statutory damages of \$ 300 for unauthorized use of a person's name or likeness (see 5 Summary (10th), *Torts*, §681 et seq.). (73 C.A.3d 859.) (See 96 A.L.R.3d 437 [recovery by writer, artist, or entertainer for loss of publicity or reputation resulting from breach of contract].)

SUPPLEMENT: [This section is current through the latest supplement]



45 of 175 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XV. DAMAGES

C. Particular Kinds of Contracts.

8. Franchise Agreement.

1 Witkin Sum. Cal. Law Contracts § 913

[§ 913] Franchise Agreement.

In *Postal Instant Press v. Sealy* (1996) 43 C.A.4th 1704, 51 C.R. 365, plaintiff franchisor terminated a 20-year franchise agreement after 13 years and then sued defendant franchisee for breach of contract for failure to timely pay past royalties and advertising fees. The trial court awarded damages to plaintiff, not only for the unpaid past royalties and fees, but also for future lost royalties and advertising fees that plaintiff claimed it would have received during the remaining term of the franchise agreement had it not been terminated. *Held*, reversed, insofar as the judgment awarded expectancy damages in the form of future lost profits, and affirmed in all other respects.

(a) Defendant's failure to timely pay *past* royalties and advertising fees was not a "proximate" or "natural and direct" cause of plaintiff's loss of *future* royalties and advertising fees.

(1) Under general contract principles, when one party breaches a contract the other party ordinarily is entitled to damages sufficient to make that party "whole." This includes future profits that the breach prevented the nonbreaching party from earning, but the lost future profits must be "proximately caused" by the specific breach. (43 C.A.4th 1708.)

(2) Here, there is a "natural and direct" causal connection between defendant's breaches and the loss of past royalty payments. But defendant's failure to timely make the past royalty payments is not a "natural and direct" cause of plaintiff's failure to receive future royalty payments. Plaintiff could have remained entitled to those future royalties for the full term of the franchise contract, even if it sued to collect the past payments, if it had not terminated the franchise agreement. (43 C.A.4th 1710.)

(3) Several California cases have awarded lost future profits in other contexts, but in none of these was the defendant's breach a mere failure to pay money owed for past performance. Instead they involved total failures to perform at all. (43 C.A.4th 1711.)

(b) Even if defendant's breach caused plaintiff to lose some future royalty payments, an award of lost future profits would result in damages that are unreasonable, unconscionable, and oppressive.

(1) Under C.C. 3359, damages must be reasonable, and where an obligation appears to create a right to unconscionable and grossly oppressive damages, contrary to substantial justice, no more than reasonable damages can

be recovered. This limitation applies to contract as well as tort damages. (43 C.A.4th 1714.)

(2) Some courts and commentators have stressed that the bargaining disparity between franchisors and franchisees is so great that franchise agreements exhibit many of the attributes of an adhesion contract and some of the terms of those contracts may be unconscionable. The "lost future profits" award here dramatically expands the already enormous bargaining gap between the parties. (43 C.A.4th 1715.)

(3) Plaintiff argued that it was entitled to recover for lost future profits because the failure to timely make royalty payments constituted a "material breach," which, in turn, entitled plaintiff to terminate the contract and collect the "benefit of the bargain," including all the future royalty fees it could expect to receive. But, even if the agreement were construed to call for an award of "lost future royalty payments," such an award would be "excessive" and "unconscionable" and "oppressive" within the meaning of C.C. 3359. (43 C.A.4th 1717.)

(c) Although there are compelling reasons for reversing the "lost future profits" award here, the holding is limited. "We are not holding a trial court can never appropriately award *some* 'lost future profits' to a franchisor. In a future case, the breach may be of a type which directly causes the franchisor to lose future profits independent of the franchisor's own termination of the franchise agreement. Furthermore, the amount of the award may be of a size which is neither 'excessive' nor 'oppressive' nor 'disproportionate to the loss.' What we do hold, however, is that a 'lost future profits' award to a franchisor must satisfy all of these conditions--just as would such an award to any other party. Furthermore, we conclude the franchisor-franchisee relationship introduces some special considerations in determining whether the conditions are met. ... [T]hose considerations include the lengthy term of such agreements, the franchisor's power to terminate the franchise and substitute a new franchisee, and the typical imbalance between the parties." (43 C.A.4th 1718.) (See 25 Western State L. Rev. 117 [Emasculating Goliath: Did *Postal Instant Press v. Sealy* Strike an Unfair Blow at the Franchising Industry?]; 40 A.L.R.5th 57 [damages for wrongful termination of franchise other than automobile dealership contracts].)

SUPPLEMENT: [This section is current through the latest supplement]



46 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XV. DAMAGES

D. Mitigating Damages.

1. In General.

1 Witkin Sum. Cal. Law Contracts § 914

[§ 914] In General.

A party injured by a breach of contract is required to do everything reasonably possible to mitigate his or her own loss and thus reduce the damages for which the other party has become liable. (See *Johnson v. Comptoir etc. (1955) 135 C.A.2d 683, 689, 288 P.2d 151*; *Sackett v. Spindler (1967) 248 C.A.2d 220, 238, 56 C.R. 435*; *Spurgeon v. Drumheller (1985) 174 C.A.3d 659, 665, 220 C.R. 195*, citing the text; *Rest.2d, Contracts §350* [Avoidability as a Limitation on Damage]; Corbin §1039 et seq.; 24 Williston 4th, §64:27; U.C.C. 2706, 2712; 22 *Am.Jur.2d (2003 ed.)*, *Damages §351* et seq.; 2 California Affirmative Defenses (2004 ed.), §36:1 et seq.; 12 *Hastings L. J. 215*; CACI, No. 358 [mitigation of damages].)

The Restatement observes that there is no "duty" to mitigate damages, because the injured party incurs no liability for failure to act: "The amount of loss that he could reasonably have avoided by stopping performance, making substitute arrangements or otherwise is simply subtracted from the amount that would otherwise have been recoverable as damages." (*Rest.2d, Contracts §350*, Comment b.)

Although there is no "duty" to mitigate, mitigation costs may be included in a damages award, as illustrated by *Brandon & Tibbs v. George Kevorkian Accountancy Corp. (1990) 226 C.A.3d 442, 277 C.R. 40*, which involved the breach of a contract to operate defendants' accounting practice as a joint venture. Following a sale of the practice to plaintiff accounting corporation, the trial judge awarded plaintiff damages for lost profits for the 5 years from the date of defendants' breach to the date of final judgment (reduced by the contractual purchase price), plus the expenses incurred in mitigation, i.e., the 3 years of losses that plaintiff suffered in starting a new practice. *Held*, the trial judge was correct in including the mitigation costs, but he erred in not subtracting therefrom the profits made by plaintiff from its new business during the last 2 years of the 5-year period. (*226 C.A.3d 463*.)

The doctrine of mitigation of damages gives rise to two rules: (1) No recovery for avoidable loss (*infra*, §915); (2) recovery for loss suffered when reasonable efforts to avoid have been unsuccessful (*infra*, §916).

West's Key Number Digest, Contracts k.59

SUPPLEMENT: [This section is current through the latest supplement]

See 11 Corbin (Rev. ed.), §57.11 et seq.; 2 California Affirmative Defenses §36:1 et seq.



47 of 175 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XV. DAMAGES

D. Mitigating Damages.

2. No Recovery for Avoidable Loss.

1 *Witkin Sum. Cal. Law Contracts* § 915

[§ 915] No Recovery for Avoidable Loss.

The plaintiff *cannot recover* for harm that he or she could have foreseen and avoided by reasonable effort and without undue expense. (See *Henrici v. South Feather Land & Water Co.* (1918) 177 C. 442, 449, 170 P. 1135 [rule applied where plaintiff refused to pay excessive price for irrigation water, allowing his crops and trees to die, instead of saving them by slight expenditures]; *Schmidt v. New Plastic Corp.* (1956) 144 C.A.2d Supp. 849, 851, 301 P.2d 131; *Spurgeon v. Drumheller* (1985) 174 C.A.3d 659, 665, 220 C.R. 195, citing the text; *Rest.2d, Contracts* §350(1) [loss that could have been avoided "without undue risk, burden or humiliation"]; Corbin §1039; 24 Williston 4th, §64:27; 61 Harv. L. Rev. 131; 33 San Diego L. Rev. 175 [Living Without the Avoidable Consequences Doctrine in Contract Remedies]; 33 A.L.R.2d 511 [buyer's use or attempted use of article known to be defective as affecting damages recoverable for breach of warranty].)

In *Spurgeon v. Drumheller, supra*, plaintiffs, in need of money to start a business, agreed to sell their home to defendants on May 1, 1982, for \$ 385,000. The sale was subject to two existing deeds of trust held by a state-chartered savings institution. The escrow bank demanded that defendant complete a financial questionnaire, and defendant cancelled the agreement. Plaintiffs filed suit for breach of contract on July 2, 1982, and relisted the property for sale for \$ 365,000; but in November 1982, they removed the property from the market and continued to live in the home. This latter act was explained by testimony of plaintiff husband that plaintiffs had obtained other funds for the business, had no further need for cash, and intended to retain the property as their residence. The trial judge gave plaintiffs judgment for loss of bargain damages with interest and expenses. *Held*, reversed.

(a) Because no loss of bargain damages are available to a vendor if there is a resale at the same or a higher price (see *supra*, §901), the law requires that the vendor exercise diligence to make a resale within the shortest time possible. Under these circumstances, removal of the property from the market for reasons unrelated to its marketability constituted a failure to mitigate damages. (174 C.A.3d 665, citing the text.)

(b) No reported case has involved the situation presented here of an increase in value by the time of trial (\$ 350,000 at time of breach, \$ 380,000 at time of trial) but without an actual resale. "One reason for the absence of such decisions may very likely be that vendors who do not resell during a rising market recognize they have an increased increment in their net worth ... and have thus wiped out loss of bargain damages resulting from the earlier buyer's breach of contract." (174 C.A.3d 665.)

SUPPLEMENT: [This section is current through the latest supplement]
See 11 Corbin (Rev. ed.), §57.11.



48 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XV. DAMAGES

D. Mitigating Damages.

3. Reasonable Effort To Avoid Loss Required.

a. General Rule.

1 Witkin Sum. Cal. Law Contracts § 916

[§ 916] General Rule.

"The injured party is not precluded from recovery ... to the extent that he has made reasonable but unsuccessful efforts to avoid loss." (*Rest.2d, Contracts §350(2)*; see *W.C. Cook & Co. v. White Truck & Transfer Co. (1932) 124 C.A. 721, 727, 13 P.2d 549* [cost of reconditioning damaged goods]; *Sackett v. Spindler (1967) 248 C.A.2d 220, 239, 56 C.R. 435*; *Corbin §1039*; *22 Am.Jur.2d (2003 ed.), Damages §§367, 368.*) Thus, the injured party need not engage in impractical or unreasonable efforts to minimize damages. (See *Rest.2d, Contracts §350(2)* and Comment g; *Corbin §1039*; *24 Williston 4th, §64:27*; *22 Am.Jur.2d (2003 ed.), Damages §§344 et seq., 367, 368, 378 et seq.*)

Thus, in *Dutra v. Cabral (1947) 80 C.A.2d 114, 181 P.2d 26*, defendant breached his promise to furnish water for crops. *Held*, plaintiff was not under a duty to procure other water where the expense and effort would have been unreasonably great in proportion to the damages sustained. (*80 C.A.2d 122.*)

In *Crown Products Co. v. California Food Products Corp. (1947) 77 C.A.2d 543, 175 P.2d 861*, defendant seller, under a contract to sell 300,000 gallons of vinegar at 71/2 cents per gallon, improperly demanded 10 cents. After suit was filed, it made a strategic "tender" of 2,700 gallons at the contract price. *Held*, plaintiff was justified in refusing this offer made in bad faith. The court declared that, although the buyer might sometimes be called upon to pay the seller a higher price by way of minimizing damages (see *Henrici v. South Feather Land & Water Co. (1918) 177 C. 442, 449, 170 P. 1135*, *supra*, §915), "such duty does not extend to the compulsion of accepting at even the contract price less than the quantity specified in the contract where, as here, the circumstances show that there was no intention to deliver the balance, at least where suit is filed before such imperfect tender." (*77 C.A.2d 551.*) (See *Vitagraph v. Liberty Theatres Co. (1925) 197 C. 694, 699, 242 P. 709* [burden of proof on defendant]; *Schultz v. Lakeport (1936) 5 C.2d 377, 384, 54 P.2d 1110* [no duty where impracticable]; *Guerrieri v. Severini (1958) 51 C.2d 12, 23, 330 P.2d 635*; *Eubanks v. Milton G. Cooper & Son (1945) 68 C.A.2d 366, 372, 156 P.2d 775*; *Jegen v. Berger (1946) 77 C.A.2d 1, 11, 174 P.2d 489* [whether injured party acted reasonably is question of fact]; *Camrosa County Water Dist. v. Southwest Welding & Mfg. Co. (1975) 49 C.A.3d 951, 955, 123 C.R. 93.*)

West's Key Number Digest, Contracts k.62(1)

SUPPLEMENT: [This section is current through the latest supplement]

See 11 Corbin (Rev. ed.), §57.11.



49 of 175 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XV. DAMAGES

D. Mitigating Damages.

3. Reasonable Effort To Avoid Loss Required.

b. Employee.

1. Other Employment Must Be Comparable.

1 Witkin Sum. Cal. Law Contracts § 917

[§ 917] Other Employment Must Be Comparable.

(1) *In General.* If an employer breaches the employment contract, the employee may recover as damages the amount he or she would have received under the contract less the amount the employee earned or might have earned from other employment. (See 3 *Summary* (10th), *Agency and Employment*, §267.) But the employee does not have to accept work of a different character from that covered by the contract; hence, the employer seeking a reduction in damages by reason of other employment opportunities "must show that the other employment was comparable, or substantially similar, to that of which the employee has been deprived." (*Parker v. Twentieth Century-Fox Film Corp.* (1970) 3 C.3d 176, 182, 89 C.R. 737, 474 P.2d 689; see *Gregg v. McDonald* (1925) 73 C.A. 748, 757, 239 P. 373; *Smetherham v. Laundry Workers' Union* (1941) 44 C.A.2d 131, 139, 111 P.2d 948; *Crillo v. Curtola* (1949) 91 C.A.2d 263, 275, 204 P.2d 941; *Mayer v. Multistate Legal Studies* (1997) 52 C.A.4th 1428, 1436, 61 C.R.2d 336 [employer did not meet its burden of showing how much plaintiff manager could have made in comparable field by showing instead how much manager in unrelated field made]; Rest.2d, *Agency* §455, Comment d; 22 *Am.Jur.2d* (2003 ed.), *Damages* §362 et seq.; 22 *A.L.R.3d* 1057 [reasonable alternative employment for discharged teacher]; 44 *A.L.R.3d* 629 [nature of alternative employment that employee must accept to minimize damages for wrongful discharge]; cf. *Gonzales v. International Assn. of Machinists* (1963) 213 C.A.2d 817, 822, 29 C.R. 190 [plaintiff wrongfully expelled from defendant union; available jobs not within his special skills and lacked protection of union membership].)

In *Billetter v. Posell* (1949) 94 C.A.2d 858, 211 P.2d 621, plaintiff employee, with a contract for \$ 75 per week salary and a \$ 500 yearly bonus, quit when her salary was cut to \$ 55 per week, despite defendant employer's offer to give her \$ 60 per week. In holding that defendant was not entitled to a credit for the amount offered, the court made this distinction: (a) An employee wrongfully discharged must, to minimize damages, accept his or her employer's offer of reemployment where this can be done without prejudice to the employee's rights under the contract; e.g., where the offer of reemployment is at the same rate of compensation, or where it is expressly understood that acceptance of the offer will not be deemed a waiver of the breach or a modification of the contract. (b) However, "[w]hen a person is employed for a definite period of time at an agreed rate of wages and is wrongfully discharged before the expiration of the period for which he was employed, he may refuse his former employer's offer of reemployment at less wages than were stipulated in the original contract of employment when acceptance of such offer would amount to a modification

of the original contract or to a waiver of his right to recover according to its terms." (94 C.A.2d 860.)

In the *Parker* case, supra, plaintiff, a well-known actress, contracted with defendant to play the lead in a film musical entitled "Bloomer Girl" for a minimum guaranteed compensation of \$ 750,000. Defendant decided not to produce the picture, and, "to avoid any damage" to plaintiff, offered her the lead in a western drama at the same compensation and under a contract identical in most respects to the earlier one. Plaintiff did not accept this offer and sued for the agreed compensation. *Held*, summary judgment for plaintiff affirmed. (a) The offered employment was different: The substitute film was a drama rather than a musical; it would be filmed on location in Australia rather than in Los Angeles; and it would not utilize plaintiff's talents as a dancer. (3 C.3d 183.) (b) It was also *inferior*, for the first contract reserved to plaintiff a right of approval of the director and screenplay, and the second did not. (3 C.3d 184.) (See dissent, arguing that the criteria should not be restricted to "different" and "inferior," and that "reasonableness" of the refusal should be considered, 3 C.3d 184.)

(2) *Employee Must Make Effort To Retain New Employment*. Comparable employment must not only be secured, but must also be *retained*. In *Stanchfield v. Hamer Toyota* (1995) 37 C.A.4th 1495, 44 C.R.2d 565, plaintiff employee brought an action against defendant car dealership for breach of an employment contract. Plaintiff had found comparable employment at another car dealership only a few days after being wrongfully terminated by defendant, but was fired for good cause from the new position 2 months later. After a directed verdict for plaintiff, the jury awarded damages, but plaintiff appealed, contending that the trial judge erred in changing BAJI, No. 10.16, on mitigation of damages, to provide that an employee damaged by breach of an employment contract has a duty to minimize the loss by making a reasonable effort to find "and retain" comparable employment. *Held*, affirmed.

No case has analyzed what is meant by the duty to mitigate in this situation. However, considering the basic principles underlying the mitigation rule, a jury, in deciding the reasonableness of a wrongfully discharged employee's efforts to mitigate damages, may properly take into account that employee's failure to retain comparable employment once it has been secured. The crux of the mitigation rule is that, while the compensation to which the employee would have been entitled for the unexpired period of the contract affords a *prima facie* measure of damages, the employee's actual damage is the amount the employee is out of pocket by reason of the wrongful discharge. Therefore, where the jury determines that the employee was fired from a substantially similar position for cause, any amount the employee with reasonable effort could have earned by retaining that employment should be deducted from the amount of damages that otherwise would have been awarded under the terms of the original employment agreement. (37 C.A.4th 1502, 1503.) (See BAJI, No. 10.16 [breach of employment contract--employee's duty to mitigate damages], which was revised in 1996 in accordance with this case.)

SUPPLEMENT: [This section is current through the latest supplement]



50 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XV. DAMAGES

D. Mitigating Damages.

3. Reasonable Effort To Avoid Loss Required.

b. Employee.

2. Public Employees.

1 *Witkin Sum. Cal. Law Contracts* § 918

[§ 918] Public Employees.

The suggestion appears in earlier cases that the duty to mitigate damages does not apply to public employees because their rights and responsibilities are governed by statute rather than contract. This view, contrary to the weight of authority (see 22 *A.L.R.3d* 1047, 1057 [schoolteacher's damages for wrongful discharge]), was repudiated in *California School Employees Assn. v. Personnel Com.* (1973) 30 *C.A.3d* 241, 249, 106 *C.R.* 283: "[W]e hold that a wrongfully discharged public employee has a duty to mitigate damages." (See *Carroll v. Civil Service Com.* (1973) 31 *C.A.3d* 561, 564, 107 *C.R.* 557 [following *School Employees*]; *Currier v. Roseville* (1975) 50 *C.A.3d* 499, 504, 123 *C.R.* 314 [leaving open question whether *public officers*, as distinguished from civil service employees, are free from the requirement]; *Martin v. Santa Clara Unified School Dist.* (2002) 102 *C.A.4th* 241, 255, 125 *C.R.2d* 337 [teacher who was charged with various drug offenses, had charges dismissed after completion of diversion program and retained teaching credentials while charges were pending was entitled to back pay while on compulsory leave, reduced by amount she might have earned from available comparable work].)

West's Key Number Digest, Contracts k.62(4)

SUPPLEMENT: [This section is current through the latest supplement]



51 of 175 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XV. DAMAGES

D. Mitigating Damages.

3. Reasonable Effort To Avoid Loss Required.

b. Employee.

3. Employer's Offer of Reinstatement.

1 Witkin Sum. Cal. Law Contracts § 919

[§ 919] Employer's Offer of Reinstatement.

In *Carroll v. Civil Service Com.* (1973) 31 C.A.3d 561, 107 C.R. 557, plaintiff, a discharged public employee, spent 147 days in jail for public drunkenness. In his action for reinstatement and back pay, defendant county contended that he was not entitled to recovery for that period, because he was not ready, able, and willing to perform. *Held*, the defense was not available, for there was no offer by defendant employer to permit him to perform. The court said:

"Thus the concept of being ready, willing and able to perform the duties of the position must necessarily be qualified by making the duty mutual, that is, that the employer also be ready and willing to perform by offering reinstatement to the employee. Until the employer does so, the employee is not required to stand by in readiness during the entire period of the discharge or suspension. To hold the employee is required to stand idly by in readiness to perform would run counter to the concept of duty to mitigate by making reasonable effort to seek other similar employment since an employee thereby would be unable to accept other employment for any substantial period." (31 C.A.3d 567.)

SUPPLEMENT: [This section is current through the latest supplement]



52 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XV. DAMAGES

D. Mitigating Damages.

4. After Repudiation or Anticipatory Breach.

a. Duty To Mitigate.

1 Witkin Sum. Cal. Law Contracts § 920

[§ 920] Duty To Mitigate.

Where the defendant commits an anticipatory breach, the injured party, in theory, may elect to wait and treat the contract as binding until the time when the defendant's performance is due. (See *supra*, §862.) But where the result of waiting and continuing his or her own performance is to enhance damages, the duty to mitigate them arises and limits the plaintiff's election. "It is the general rule in California and in practically all other jurisdictions that either party to an executory contract has the power to stop performance of the contract by giving notice or direction to that effect, subjecting himself to liability for damages, and upon receipt of such notice the other party cannot continue to perform and recover damages based on full performance. ... This is an application of the principle that a plaintiff must mitigate damages so far as he can without loss to himself. ... The reason for this rule is twofold: Ordinarily a plaintiff is interested only in the profit he will make from his contract, and if he receives this he obtains the full benefit of his bargain; on the other hand, performance by the plaintiff might be useless to the defendant, although he would have to pay the entire contract price if the plaintiff were permitted to perform, and this would inflict damage on the defendant without benefit to the plaintiff." (*Bomberger v. McKelvey* (1950) 35 C.2d 607, 613, 220 P.2d 729.)

Thus, in *Richardson v. Davis* (1931) 116 C.A. 388, 2 P.2d 860, defendant agreed to pay plaintiff \$ 65 per month for display advertising for a 2-year period, and after a few months repudiated the agreement. Plaintiff continued the display for the full period, and sued for the contract price. Held, recovery was limited to damages only, and plaintiff could not enhance them by continuing to perform after notice of repudiation. (116 C.A. 391.) (See *Atkinson v. District Bond Co.* (1935) 5 C.A.2d 738, 745, 43 P.2d 867; U.C.C. 2610(c); 4 *Summary* (10th), Sales, §171; Corbin §1053; 22 *Am.Jur.2d* (2003 ed.), *Damages* §§351, 359; 12 *Hastings L. J.* 216.)

West's Key Number Digest, Contracts k.62(4)

SUPPLEMENT: [This section is current through the latest supplement]

See 11 Corbin (Rev. ed.), §57.25.



53 of 175 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XV. DAMAGES

D. Mitigating Damages.

4. After Repudiation or Anticipatory Breach.

b. Exceptions.

1 Witkin Sum. Cal. Law Contracts § 921

[§ 921] Exceptions.

The duty to stop performance after repudiation (see *supra*, §920) is subject to several exceptions, e.g., (1) where the plaintiff is not interested solely in the profit from the agreement but must proceed with the work to fulfill other obligations or accomplish other purposes; (2) where the plaintiff's performance has reached a point where completion might diminish rather than enhance damages; or (3) where damages would be an inadequate remedy and specific performance would lie. (*Bomberger v. McKelvey* (1950) 35 C.2d 607, 614, 220 P.2d 729, *supra*, §920; see U.C.C. 2610(c), 2704; 4 *Summary* (10th), Sales, §184; Corbin §1053; 22 *Am.Jur.2d* (2003 ed.), Damages §359; 12 *Hastings L. J.* 216.)

In *Bomberger*, it was agreed that plaintiffs would wreck and salvage an old building on land that they sold to defendants, for which defendants would pay a certain sum. Defendants wrongfully notified plaintiffs not to proceed. But plaintiffs had planned to use the salvaged material (scarce and under war priorities) in performance of a contract to construct a new building for a third party, and, accordingly, they continued performance and sued for the agreed sum. *Held*, they were entitled to recover. (35 C.2d 615.)

SUPPLEMENT: [This section is current through the latest supplement]
See 11 Corbin (Rev. ed.), §57.25.



54 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XV. DAMAGES

E. Deduction for Benefits Received.

1. In General.

1 Witkin Sum. Cal. Law Contracts § 922

[§ 922] In General.

The damages recoverable may sometimes be subject to deductions for benefits received. (See Corbin §1038; 22 *Am.Jur.2d* (2003 ed.), *Damages* §§383, 385.) In other words, the collateral source rule (6 *Summary* (10th), *Torts*, §1631 et seq.), which prevents deduction, is not applicable in contract cases. (*Plut v. Fireman's Fund Ins. Co.* (2000) 85 C.A.4th 98, 107, 102 C.R.2d 36; *Bramalea Calif. v. Reliable Interiors* (2004) 119 C.A.4th 468, 472, 14 C.R.3d 302 [because collateral source rule was not applicable, real estate developer could not recover attorney fees against subcontractor, where fees had been paid by developer's insurer].) Thus, in *Pfaff v. Fair-Hipsley* (1965) 232 C.A.2d 274, 42 C.R. 624, defendant terminated plaintiff's contract to log land and deliver timber. *Held*, it was error, in awarding damages, to fail to deduct the compensation received from other work during the period for which recovery was given. (232 C.A.2d 281.)

This principle applies where a wrongfully dismissed teacher sues for back salary: Earnings from other regular employment are deductible. (*Mass v. Board of Education* (1964) 61 C.2d 612, 627, 39 C.R. 739, 394 P.2d 579 [holding, however, that defendant board failed to sustain its burden of pleading and proof of the offsetting compensation].)

It also applies to actions by other agents or employees who sue for damages for breach of the employment contract by wrongful termination. (See *Erler v. Five Points Motors* (1967) 249 C.A.2d 560, 562, 57 C.R. 516; 24 Williston 4th, §§66:4, 66:7 et seq.) (On pleading the defense, see *Erler v. Five Points Motors*, *supra*, 249 C.A.2d 568; 5 *Cal. Proc.* (4th), *Pleading*, §§1003, 1026.)

The defense may be waived. In *De Angeles v. Roos Bros.* (1966) 244 C.A.2d 434, 52 C.R. 783, defendant employer relied on its right to discharge plaintiff, and for this reason deliberately chose at the trial not to emphasize plaintiff's skill and trade connections. *Held*, this strategy was a waiver of the issue of other employment as a basis for deduction, and it could not be raised on appeal. (244 C.A.2d 442.)

SUPPLEMENT: [This section is current through the latest supplement]
See 11 Corbin (Rev. ed.), §57.10.

Application of principle in actions by agents or employees:

Cross-Reference: 5 *Cal. Proc.* (5th), *Pleading*, §§1076, 1100.



55 of 175 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XV. DAMAGES

E. Deduction for Benefits Received.

2. Distinction: Deduction for Tax Benefits.

1 Witkin Sum. Cal. Law Contracts § 923

[§ 923] Distinction: Deduction for Tax Benefits.

In *DePalma v. Westland Software House* (1990) 225 C.A.3d 1534, 276 C.R. 214, plaintiff physician purchased computer hardware and software from defendant supplier for \$ 50,009.40, and defendant promised that the equipment could be used for accounting and billing purposes. The equipment did not function as promised, and plaintiff sued for breach of contract. At the trial, defendant proffered evidence of plaintiff's tax returns to show that plaintiff had received investment tax credits and/or depreciation allowances for the purchase, and argued that these tax benefits should be considered as an offset to any compensatory damages award. Plaintiff objected that the proffered evidence was irrelevant, and the trial judge sustained the objection. *Held*, affirmed.

(a) Defendant contended that the trial judge had erroneously applied the *collateral source* rule established for tort actions to a breach of contract. This contention is unsound: That rule precludes reduction of tort damages by receipt of *payment* from an independent source (see 6 *Summary* (10th), *Torts*, §1631); defendant here seeks reduction of the damages by a claim of offset for *income tax* credits, and there is no precedent for that offset. (225 C.A.3d 1539.)

(b) California damage statutes on breach of contract damages are silent on the question of whether tax benefits should be considered; but the decisions of this state and other states consistently hold that tax consequences should not be considered as offsets. (225 C.A.3d 1540.) There are three reasons for this conclusion:

(1) The federal "tax benefit rule" cancels out most windfalls to plaintiffs. This rule allows the Government to recapture past tax benefits awarded to a taxpayer if in a later year an event occurs that changes the basis or is fundamentally inconsistent with the premise on which the deduction was initially based. (225 C.A.3d 1541.) Thus, in the present case, when plaintiff receives his damages award, the rule will most likely cancel out any tax benefits that he may have received. (225 C.A.3d 1542.)

(2) Even if there were no tax benefit rule, estimating tax benefits is speculative, time-consuming, and confusing. (225 C.A.3d 1544.) And *Ev.C.* 352 gives the trial judge discretion to exclude evidence if its probative value is substantially outweighed by the probability that its admission will necessitate undue consumption of time or create a substantial danger of confusing the issues.

"In applying the criteria set forth in *Evidence Code* section 352 to evidence of tax consequences, we observe the

following: (1) such evidence would only be useful in those few instances when the tax rate changed; (2) even the most accurate predictions of the tax consequences would result in mere approximations. ... On the other side of the scale, trial judges and juries would be subjected to complicated, time consuming and confusing processes which would be required to admit and consider such minimally relevant evidence. Consequently it appears to us any reasonable judge would rule against the admission of such evidence under *Evidence Code section 352* We agree and would affirm that exercise of discretion." (225 C.A.3d 1545.)

(3) Even if the evidence were admissible under *Ev.C. 352*, public policy calls for its rejection: (a) There is deterrent value against breaching a contract if contracting parties know that they must compensate the other party in full; and the courts, as participants in an already overloaded court system, have a stake in discouraging breach. (225 C.A.3d 1545.) (b) Tax benefits should be received by only those for whom the government intended them. "In the present case, if respondent received an investment tax credit for purchasing the computer system, it was because the government was encouraging the purchase of such systems by conferring credits. For this court to rule such a subsidy should now in effect be taken from respondent and credited to appellant would be at odds with the purpose of the credit; it would be tantamount to awarding appellant government funding to subsidize his breach of contract." (225 C.A.3d 1545.)

SUPPLEMENT: [This section is current through the latest supplement]



56 of 175 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law
XVI. DISCHARGE
A. Methods of Discharge.

1 Witkin Sum. Cal. Law Contracts § 924

[§ 924] Methods of Discharge.

The ordinary method by which contractual obligations are discharged is *performance* (supra, §759 et seq.). The effect of *conditions* (supra, §776 et seq.), *impossibility* (supra, §828 et seq.), and *breach* (supra, §847 et seq.) has also been considered. Other methods of discharge include *termination* or *cancellation*, *rescission*, *release*, *accord and satisfaction*, *novation*, *modification*, and *account stated*. (See Rest.2d, Contracts, Introductory Note, Vol. 2, Chapter 12, p. 361; 3 Corbin (Rev. ed.), §67.1 et seq.; 28 Williston 4th, §72:1 et seq.; 17A Am.Jur.2d (2004 ed.), Contracts §§500 et seq., 524 et seq.; infra, §925 et seq.)

Bankruptcy may result in a discharge on the theory of failure of consideration or anticipatory breach (supra, §§813 et seq., 861 et seq.). (On discharge of judgment by bankruptcy, see 43 Stanf. L. Rev. 99 [analysis of contract excuses and bankruptcy discharge]; 8 Cal. Proc. (4th), Enforcement of Judgment, §486 et seq.)

A contract may also be discharged by expiration of the term of the agreement. (See *Beatty Safway Scaffold v. Skrable* (1960) 180 C.A.2d 650, 654, 4 C.R. 543.)

SUPPLEMENT: [This section is current through the latest supplement]
Bankruptcy may result in discharge:

Cross-Reference: 8 Cal. Proc. (5th), Enforcement of Judgment, §514 et seq.



57 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XVI. DISCHARGE
B. Termination and Cancellation.
1. In General.

1 Witkin Sum. Cal. Law Contracts § 925

[§ 925] In General.

(1) *Occurrence and Effect.* " 'Termination' occurs when either party pursuant to a power created by agreement or law puts an end to the contract otherwise than for its breach. On 'termination' all obligations which are still executory on both sides are discharged but any right based on prior breach or performance survives." (U.C.C. 2106(3); see *Martter v. Byers* (1946) 75 C.A.2d 375, 380, 171 P.2d 101; *Grant v. Aerodraulics Co.* (1949) 91 C.A.2d 68, 75, 204 P.2d 683 ["To 'terminate' a contract ... means to abrogate so much of it as remains unperformed, thereby doing away with the existing agreement upon the terms and with the consequences agreed upon"]; 13 Corbin (Rev. ed.), §73.2; Cal. Civil Practice, 3 Business Litigation, §29:1 et seq.; 5A Am.Jur. Legal Forms 2d (2004 ed.), §68:231; 27 *Pacific L. J.* 37 [abusive terminations of contracts].)

" 'Cancellation' occurs when either party puts an end to the contract for breach by the other and its effect is the same as that of 'termination' except that the canceling party also retains any remedy for breach of the whole contract or any unperformed balance." (U.C.C. 2106(4); see *Sanborn v. Ballanfonte* (1929) 98 C.A. 482, 488, 277 P. 152, *infra*, §926; *Rest.2d, Contracts* §274; 13 Corbin (Rev. ed.), §73.2; 30 Williston 4th, §75:1 et seq.; 13 *Am.Jur.2d* (2000 ed.), *Cancellation of Instruments* §1 et seq.; 5A Am.Jur. Legal Forms 2d (2004 ed.), §68:234 et seq.; on cancellation of insurance policies, see 2 *Summary* (10th), *Insurance*, §219 et seq.)

(2) *Contract With Physician Advocating for Medically Appropriate Health Care.* It is against public policy to terminate an employment or other contractual relationship with a physician where the termination is principally due to the physician's advocating for medically appropriate health care consistent with that degree of learning and skill ordinarily possessed by reputable physicians practicing according to the applicable legal standard of care. No person may terminate, retaliate against, or otherwise penalize a physician for that advocacy, nor may any person prohibit, restrict, or in any way discourage a physician from communicating information to a patient in furtherance of medically appropriate health care. (*B. & P.C. 2056(c)*; see 25 *Pacific L. J.* 410.) (On prohibition against provisions in health care service plan contracts that interfere with ability of physicians to communicate with patients regarding their health care, see *B. & P.C. 2056.1*, 2 *Summary* (10th), *Insurance*, §127.)

West's Key Number Digest, Cancellation of Instruments k.1

SUPPLEMENT: [This section is current through the latest supplement]



58 of 175 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XVI. DISCHARGE

B. Termination and Cancellation.

2. Rescission Distinguished.

1 *Witkin Sum. Cal. Law Contracts* § 926

[§ 926] Rescission Distinguished.

"A contract is extinguished by its rescission." (C.C. 1688.) Cancellation abrogates so much of the contract as remains unperformed; future obligations are terminated, but all prior accrued rights remain and are enforceable. (See *supra*, §925.) Rescission not only terminates further liability but restores the parties to their former position by requiring each to return whatever he or she received as consideration under the contract, or, where specific restoration cannot be had, its value. (*Barrera v. State Farm Mut. Auto. Ins. Co.* (1969) 71 C.2d 659, 663, 79 C.R. 106, 456 P.2d 674, footnote 3, 2 Summary (10th), Insurance, §311; *Young v. Flickinger* (1925) 75 C.A. 171, 174, 242 P. 516; *Sanborn v. Ballanfonte* (1929) 98 C.A. 482, 488, 277 P. 152; *Larsen v. Johannes* (1970) 7 C.A.3d 491, 501, 86 C.R. 744; 58 Cal. L. Rev. 274 [*Barrera*].)

Because of the decided difference in effect between cancellation and rescission, an important problem of construction is presented by notices or agreements that purport to terminate the contract. (*Pico Citizens Bank v. Tafco* (1962) 201 C.A.2d 131, 136, 19 C.R. 905, quoting the text.) Thus, in *Sanborn v. Ballanfonte*, *supra*, a notice given by a lessor to defaulting lessees under an oil lease that all their rights "are terminated and ended" was held to be a *cancellation*, and the lessor was permitted thereafter to recover accrued royalties that were due him at the time. (98 C.A. 488.) (See *Pacific Coast Engineering Co. v. Detroit Fidelity & Surety Co.* (1931) 214 C. 384, 388, 5 P.2d 888; *Winter v. Kitto* (1929) 100 C.A. 302, 310, 279 P. 1024; *Martinelli v. Hogrefe* (1932) 123 C.A. 438, 442, 11 P.2d 412; cf. U.C.C. 2720 [expressions of "cancellation" or "rescission" not construed as renunciation of claim for damages for prior breach unless that intention clearly appears].)

In *Evans v. Rancho Royale Hotel Co.* (1952) 114 C.A.2d 503, 250 P.2d 283, plaintiff agreed to buy building lots for construction of apartments. An escrow was opened, plaintiff and paid the agent \$ 1,375 and deposited the balance of the price and her share of the expenses (\$ 12,420). Subsequently the title search disclosed deed restrictions to single-family dwellings, attempts by defendant to obtain their removal failed, and the parties signed cancellation instructions, under which defendant returned the above sums and agreed to pay all escrow charges. Then plaintiff brought the present action for damages for false representations by defendant that the lots could be used for multiple dwellings. Her demand was for \$ 2,500 expended for plans and specifications, \$ 140 paid as a deposit on kitchen units, and \$ 240 paid for rental of living quarters to use during construction. *Held*, no recovery; the contract was cancelled on terms acceptable to both parties, and, although damages were not discussed, it is presumed that the parties waived all claims and made a complete settlement of the controversy. (114 C.A.2d 508.)

The decision seems highly questionable. (1) The court's observation that the claim for fraud "arises out of and is based upon the breach of the contract of sale" (*114 C.A.2d 508*) is contrary to settled law: A tort cause of action for damages for fraud in the inducement of a contract is distinct from a right of action for breach. (See 3 *Cal. Proc. (4th), Actions*, §148.) (2) The cancellation agreement, silent on the matter of fraud, should not have been construed as a waiver of that cause of action.

SUPPLEMENT: [This section is current through the latest supplement]

Action for fraud in inducement of contract:

Cross-Reference: 3 *Cal. Proc. (5th), Actions*, §152.



59 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XVI. DISCHARGE
C. Rescission by Mutual Consent.
1. Mutual Consent.

1 Witkin Sum. Cal. Law Contracts § 927

[§ 927] Mutual Consent.

An executory bilateral contract may be rescinded by the mutual consent of the parties. (C.C. 1689(a) ["[a] contract may be rescinded if all the parties thereto consent"]; see U.C.C. 2720; *Rest.2d, Contracts* §283 [Agreement of Rescission]; 13 Corbin (Rev. ed.), §67.8; 29 Williston 4th, §73:15 et seq.; *17A Am.Jur.2d (2004 ed.)*, *Contracts* §535 et seq.; Cal. Civil Practice, 3 Business Litigation, §§30:6, 30:7; Cal. Transactions Forms, 3 Business Transactions §17:1 et seq.; 3 California Affirmative Defenses (2004 ed.), §61:1 et seq.; C.E.B., 1 Real Property Remedies and Damages 2d, §1.9; 5A Am.Jur. Legal Forms 2d (2004 ed.), §§68:229, 68:238; 7A Am.Jur. P.P. Forms (2002 ed.), *Contracts*, §127 et seq.)

Although consent may be oral or manifested by conduct (see *infra*, §928), it must be mutual. (*Pennel v. Pond Union School Dist. (1973) 29 C.A.3d 832, 837, 105 C.R. 817* [evidence failed to support finding of rescission by consent].)

West's Key Number Digest, *Contracts* k.252

SUPPLEMENT: [This section is current through the latest supplement]
See 3 California Affirmative Defenses §61:1 et seq.



60 of 175 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XVI. DISCHARGE

C. Rescission by Mutual Consent.

2. Written, Oral, or Manifested by Conduct.

1 Witkin Sum. Cal. Law Contracts § 928

[§ 928] Written, Oral, or Manifested by Conduct.

(1) *Formal Writing*. The parties to a formal contract should if possible make their intent clear by an unambiguous writing. (See *Evans v. Rancho Royale Hotel Co.* (1952) 114 C.A.2d 503, 508, 250 P.2d 283, supra, §926 [written instructions canceling real estate escrow for title defect, construed as precluding an action for damages for fraud]; *Larsen v. Johannes* (1970) 7 C.A.3d 491, 499, 86 C.R. 744 [agreement quoted in full]; U.C.C. 2720; Cal. Transactions Forms, 3 Business Transactions §17:5 et seq.; 5A Am.Jur. Legal Forms 2d (2004 ed.), §68:238; 7A Am.Jur. P.P. Forms (2002 ed.), Contracts, §132.)

(2) *Writing Unnecessary*. The consent need not be written, though the contract is in writing, but may be oral or manifested by conduct. (*Treadwell v. Nickel* (1924) 194 C. 243, 258, 228 P. 25; *Klein Norton Co. v. Cohen* (1930) 107 C.A. 325, 331, 290 P. 613; see *Holmes v. Robarts* (1929) 102 C.A. 53, 56, 282 P. 519; *Thompson v. Municipal Bond Co.* (1937) 23 C.A.2d 402, 411, 73 P.2d 274; *Morrow v. Coast Land Co.* (1938) 29 C.A.2d 92, 107, 84 P.2d 301; *Lohn v. Fletcher Oil Co.* (1940) 38 C.A.2d 26, 30, 100 P.2d 505; *Tucker v. Schumacher* (1949) 90 C.A.2d 71, 75, 202 P.2d 327; *Grant v. Aerodraulics Co.* (1949) 91 C.A.2d 68, 75, 204 P.2d 683; *Jura v. Sunshine Biscuits* (1953) 118 C.A.2d 442, 447, 258 P.2d 90; *Kane v. Sklar* (1954) 122 C.A.2d 480, 482, 265 P.2d 297; *Breakers Holding Co. v. Josebra Co.* (1954) 122 C.A.2d 741, 746, 265 P.2d 938; 13 Corbin (Rev. ed.), §67.8; 29 Williston 4th, §§73:21, 73:22; 17A Am.Jur.2d (2004 ed.), Contracts §§538, 540.)

The statement in *Mulrooney v. Pietro* (1947) 79 C.A.2d 311, 314, 180 P.2d 62, that "an oral agreement to rescind a written contract is ineffectual unless such oral agreement is consummated," is "opposed to the otherwise uniform rule of California decisions." (*Grant v. The Aerodraulics Co.*, supra, 91 C.A.2d 75.)

Even a contract required by law to be written, as is one to purchase real estate, may be abandoned by mutual oral agreement. (*San Roque Properties v. Pierce* (1937) 18 C.A.2d 379, 380, 63 P.2d 1198; *Martin v. Butter* (1949) 93 C.A.2d 562, 565, 209 P.2d 636.)

(3) *Implied Rescission by Later Contract*. There may be an implied rescission by a later *inconsistent contract* between the parties, but if the second differs only in terms and has the same legal effect, it is considered merely a ratification of the first, and they are construed together. (*Thomson v. Leak* (1933) 135 C.A. 544, 548, 27 P.2d 795; see 13 Corbin (Rev. ed.), §67.8; 29 Williston 4th, §73:15 et seq.; 17A Am.Jur.2d (2004 ed.), Contracts §539.)

SUPPLEMENT: [This section is current through the latest supplement]



61 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XVI. DISCHARGE
C. Rescission by Mutual Consent.
3. Consideration.

1 *Witkin Sum. Cal. Law Contracts* § 929

[§ 929] Consideration.

Although ordinarily *consideration* is as necessary for a discharge as for the creation of a contract (see *supra*, §202), this presents no difficulty when neither party has fully performed or has been discharged. "The promise of one party to forego his rights under the contract is sufficient consideration for the promise of the other party to forego his rights." (*Jura v. Sunshine Biscuits* (1953) 118 C.A.2d 442, 447, 258 P.2d 90, quoting Williston; see *Sass v. Hank* (1951) 108 C.A.2d 207, 215, 238 P.2d 652 ["such consideration is present here in the form of the mutual cancellation of executory contractual rights"]; *Rest.2d, Contracts* §283, Comment a; 29 Williston 4th, §73:15 et seq.; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §537.)

West's Key Number Digest, Contracts k.252

SUPPLEMENT: [This section is current through the latest supplement]



62 of 175 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XVI. DISCHARGE

D. Rescission by Injured Party.

1. Nature of Remedy.

a. Equitable Action Abolished.

1 Witkin Sum. Cal. Law Contracts § 930

[§ 930] Equitable Action Abolished.

(1) *Former Law.* The Civil Code originally provided for rescission by a party (C.C. 1689) and also for an action to have a rescission adjudged (former C.C. 3406). Failure to observe this distinction sometimes resulted in the erroneous statements that an action was necessary for rescission (*Doud v. Jackson* (1929) 102 C.A. 213, 219, 283 P. 107), and that a suit to recover the consideration was an action "for equitable relief" (*Stone v. Superior Court* (1931) 214 C. 272, 273, 4 P.2d 777). Later cases made it clear that a party having the right to rescind could accomplish a completed rescission by taking the steps specified in C.C. 1691. (*Philpott v. Superior Court* (1934) 1 C.2d 512, 523, 36 P.2d 635; *McCall v. Superior Court* (1934) 1 C.2d 527, 535, 36 P.2d 642 [overruling *Stone*]; *Leland v. Craddock* (1947) 83 C.A.2d 84, 88, 187 P.2d 803; *Karapetian v. Carolan* (1948) 83 C.A.2d 344, 350, 188 P.2d 809; see 21 Cal. L. Rev. 130; 23 Cal. L. Rev. 638; 36 Cal. L. Rev. 606.)

(2) *Statutory Revision of 1961.* Pursuant to a recommendation of the Law Revision Commission, the *equitable action* to have a rescission adjudged was *abolished* in 1961, and the statutes now deal solely with *unilateral rescission* by notice and offer to restore the consideration. (See *Runyan v. Pacific Air Industries* (1970) 2 C.3d 304, 312, 85 C.R. 138, 466 P.2d 682, *infra*, §936; *Paularena v. Superior Court* (1965) 231 C.A.2d 906, 913, 42 C.R. 366; Cal. Civil Practice, 3 Business Litigation, §30:8 et seq.; Cal. Transactions Forms, 3 Business Transactions §17:1 et seq.; 3 California Affirmative Defenses (2004 ed.), §62:1 et seq.; C.E.B., 1 Real Property Remedies and Damages 2d, §1.10 et seq.; 19 *Hastings L. J.* 1248.)

West's Key Number Digest, Contracts k.257

SUPPLEMENT: [This section is current through the latest supplement]

(2) *Statutory Revision of 1961.* See *Nmsbpcslldhb v. Fresno* (2007) 152 C.A.4th 954, 963, 61 C.R.3d 425 [if rescission action seeking to recover something other than consideration paid was equitable action prior to 1961 amendments, "it is an equitable action today"]; 3 California Affirmative Defenses §62:1 et seq.



63 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XVI. DISCHARGE

D. Rescission by Injured Party.

1. Nature of Remedy.

b. Rescission by Party in Default.

1 Witkin Sum. Cal. Law Contracts § 931

[§ 931] Rescission by Party in Default.

A party who has failed to perform a dependent covenant cannot rescind for the other party's *breach or failure of consideration*. (*Fairchild-Gilmore-Wilton Co. v. Southern Refining Co.* (1910) 158 C. 264, 273, 110 P. 951; *Joshua Tree Townsite Co. v. Joshua Tree Land Co.* (1950) 100 C.A.2d 590, 596, 224 P.2d 85; *Nelson v. Spence* (1960) 182 C.A.2d 493, 499, 6 C.R. 312, citing the text; see 26 Williston 4th, §68:30; 17A Am.Jur.2d (2004 ed.), *Contracts* §555; cf. *Kulawitz v. Pacific Woodenware & Paper Co.* (1944) 25 C.2d 664, 669, 155 P.2d 24 [defaulting lessee permitted to rescind]; 18 So. Cal. L. Rev. 295.)

But a party may rescind, notwithstanding some default, in two situations:

(1) Where the covenants are *independent* and the obligations so unrelated that failure to perform one does not excuse performance of the other. (*American-Hawaiian Engineering & Const. Co. v. Butler* (1913) 165 C. 497, 516, 133 P. 280.) (For rule of construction in favor of independent covenant, see *supra*, §812.)

(2) Where the ground of rescission is *fraud*; e.g., a purchaser of property on an installment contract may rescind for fraud in inducing the sale, though he or she has not made all the required payments. (*Eade v. Reich* (1932) 120 C.A. 32, 38, 7 P.2d 1043.)

SUPPLEMENT: [This section is current through the latest supplement]



64 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XVI. DISCHARGE

D. Rescission by Injured Party.

1. Nature of Remedy.

c. When Rescission Is Unnecessary.

1 Witkin Sum. Cal. Law Contracts § 932

[§ 932] When Rescission Is Unnecessary.

In some situations, the purported contract is regarded as *void* and may be disregarded without taking the procedural steps of rescission. (See *Meyer v. Haas* (1899) 126 C. 560, 563, 58 P. 1042, *supra*, §299 [fraud in the inception]; *Orton v. Privett* (1927) 202 C. 754, 757, 262 P. 713 [total failure of consideration]; *Backus v. Sessions* (1941) 17 C.2d 380, 390, 110 P.2d 51 [lack of mental capacity]; *Estrada v. Alvarez* (1952) 38 C.2d 386, 388, 240 P.2d 278 [illegality]; *Charles Brown & Sons v. White Lunch Co.* (1928) 92 C.A. 457, 461, 268 P. 490 [uncertainty or lack of mutuality of obligation].) (On distinction between rescission and disaffirmance by minor, see *supra*, §31.)

SUPPLEMENT: [This section is current through the latest supplement]



65 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XVI. DISCHARGE

D. Rescission by Injured Party.

1. Nature of Remedy.

d. Executed Contract.

1 Witkin Sum. Cal. Law Contracts § 933

[§ 933] Executed Contract.

In *Engle v. Farrell* (1946) 75 C.A.2d 612, 171 P.2d 588, plaintiff purchasers agreed to buy land from defendants, paid the price, and received a deed. Thereafter they discovered defendants' fraud, served notice of rescission and brought this action for recovery of the price. In answer to defendant's contention that rescission is not an available remedy where the contract is *executed*, the court said that C.C. 1689 makes no distinction between executory and executed contracts, and that to "deny the right of rescission merely because the perpetrator of the fraud had been able to conceal the misrepresentations until after the deed had been delivered would not only be absurd but would in effect add to *section 1689 of the Civil Code*, a provision which the legislators did not enact." (75 C.A.2d 618.) (See *Shapiro v. Sutherland* (1998) 64 C.A.4th 1534, 1551, 76 C.R.2d 101, citing the text [if case for rescission of real estate purchase is proved, purchaser must rescind the contract of purchase with relocation management service, and not grant deed signed by former owner when it transferred property to that service]; 4 *Summary* (10th), *Sales*, §§181, 193 [Uniform Commercial Code allows either buyer or seller to cancel executed sale].)

The court did not discuss the California cases holding that the *vendor-grantor* cannot rescind a *deed* for failure of consideration on the part of the purchaser. (See 12 *Summary* (10th), *Real Property*, §262.) The distinction between an action to rescind a contract and to rescind a deed seems inconsequential, for in each case the rescission is really directed at that *contract of purchase and sale*, the deed being merely the instrument by which the vendor performs. Nor does there appear to be any rational basis for different treatment of (1) contracts of sale of personal and real property, after title has passed; (2) rescission sought by the buyer or grantee and rescission sought by the seller or grantor; and (3) rescission based on fraud and rescission based on failure of consideration. (See *Schultz v. Contra Costa* (1984) 157 C.A.3d 242, 247, 203 C.R. 760, *supra*, §268, quoting the text [tax sale and deed held subject to rescission for unilateral mistake of purchaser].)

SUPPLEMENT: [This section is current through the latest supplement]



66 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XVI. DISCHARGE

D. Rescission by Injured Party.

1. Nature of Remedy.

e. Severable Contract.

1 Witkin Sum. Cal. Law Contracts § 934

[§ 934] Severable Contract.

Ordinarily, the aggrieved party must rescind the *whole* contract; he or she cannot repudiate the undesirable parts and affirm the rest. "The theory underlying such a rule is that retention of only the benefits of the transaction amounts to unjust enrichment and binds the parties to a contract which they did not contemplate." (*Simmons v. California Institute of Technology* (1949) 34 C.2d 264, 275, 209 P.2d 581; see *Howell v. Courtesy Chevrolet* (1971) 16 C.A.3d 391, 404, 94 C.R. 33; *IMO Dev. Corp. v. Dow Corning Corp.* (1982) 135 C.A.3d 451, 458, 185 C.R. 341; 17A Am.Jur.2d (2004 ed.) Contracts §533.)

However, if the contract is *severable*, a total rescission of a severable part may be proper. (*Simmons v. California Institute of Technology*, *supra*; *Howell v. Courtesy Chevrolet*, *supra*; see 17A Am.Jur.2d (2004 ed.), Contracts §533; cf. *Filet Menu v. C.C.L. & G.* (2000) 79 C.A.4th 852, 863, 94 C.R.2d 438, *supra*, §859 [even if contract is divisible, *defrauding party* may not enforce parts of contract that were not induced by fraud, because wrongdoer does not have option of enforcing rest of agreement; distinguishing *Simmons*].) (On entire and severable contracts, see *supra*, §§859, 860.)

West's Key Number Digest, Contracts k.273

SUPPLEMENT: [This section is current through the latest supplement]



67 of 175 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law
XVI. DISCHARGE
D. Rescission by Injured Party.
2. Grounds for Rescission.

1 Witkin Sum. Cal. Law Contracts § 935

[§ 935] Grounds for Rescission.

The grounds for rescission are stated in C.C. 1689(b), with cross-references to other specific statutes. (See *19 Hastings L. J.* 1249; *4 Cal. Proc. (4th), Pleading*, §505 et seq.; and see generally *17A Am.Jur.2d (2004 ed.)*, *Contracts* §547 et seq.; *52 Proof of Facts 3d* 429 [real estate purchaser's rights and remedies where seller is unable to convey marketable title].) They are as follows:

(1) "If the consent of the party rescinding, or of any party jointly contracting with him, was given by *mistake*, or obtained through *duress*, *menace*, *fraud*, or *undue influence*, exercised by or with the connivance of the party as to whom he rescinds, or of any other party to the contract jointly interested with such party." (C.C. 1689(b)(1).) (On mistake, see *supra*, §268 et seq.; on duress, see *supra*, §309 et seq.; on menace, see *supra*, §311; on fraud, see *supra*, §285 et seq.; on undue influence, see *supra*, §316 et seq.)

(2) "If the *consideration* for the obligation of the rescinding party fails, in whole or in part, through the *fault* of the party as to whom he rescinds." (C.C. 1689(b)(2).) (See *supra*, §813 et seq.)

(3) "If the *consideration* for the obligation of the rescinding party becomes entirely *void* from any cause." (C.C. 1689(b)(3).) (See *supra*, §216 et seq.)

(4) "If the *consideration* for the obligation of the rescinding party, before it is rendered to him, *fails in a material respect from any cause*." (C.C. 1689(b)(4).) (See *supra*, §813 et seq.)

(5) "If the contract is *unlawful* for causes which do not appear in its terms or conditions, and the parties are not equally at fault." (C.C. 1689(b)(5).) (See *supra*, §438 et seq.)

(6) "If the *public interest* will be prejudiced by permitting the contract to stand." (C.C. 1689(b)(6).) (See *supra*, §452.)

(7) "Under the circumstances provided for in Sections 39, 1533, 1566, 1785, 1789, 1930 and 2314 of this code, Section 2470 of the Corporations Code, *Sections 331, 338, 359, 447, 1904 and 2030 of the Insurance Code* or *any other statute* providing for rescission." (C.C. 1689(b)(7); see *supra*, §55 [C.C. 39]; *infra*, §961 [C.C. 1533]; *supra*, §285 [C.C. 1566]; *2 Summary* (10th), *Insurance*, §224 [Ins.C. 331]; *13 Summary* (10th), *Personal Property*, §191 [C.C. 1930]; *3*

Summary (10th), *Agency and Employment*, §143 [C.C. 2314]; 4 *Summary* (10th), *Sales*, §180 [U.C.C. provisions superseding C.C. 1785, 1789]; 9 *Summary* (10th), *Corporations*, §140 [U.C.C. provisions superseding Corp.C. 2470].)

SUPPLEMENT: [This section is current through the latest supplement]

Where grounds are stated:

Cross-Reference: 4 *Cal. Proc.* (5th), *Pleading*, §544 et seq.



68 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XVI. DISCHARGE

D. Rescission by Injured Party.

3. Nature and Scope of Relief.

a. Alternative Remedies.

1. In General.

1 Witkin Sum. Cal. Law Contracts § 936

[§ 936] In General.

(1) *Affirmative or Defensive Relief.* "When a contract has been rescinded in whole or in part, any party to the contract may seek relief based upon such rescission by (a) bringing an *action* to recover any *money or thing* owing to him by any other party to the contract as a consequence of such rescission or for *any other relief* to which he may be entitled under the circumstances or (b) asserting such rescission by way of *defense or cross-complaint*." (C.C. 1692; see *Modoc Mineral & Oil Co. v. Cal-Vada Drilling & Exploration Co.* (1965) 236 C.A.2d 868, 873, 46 C.R. 508; *Nelson v. Sperling* (1969) 270 C.A.2d 194, 195, 76 C.R. 481; 4 Cal. Proc. (4th), *Pleading*, §502 et seq.)

(2) *Restitution and Damages.* "A claim for damages is not inconsistent with a claim for relief based upon *rescission*. The aggrieved party shall be awarded complete relief, including *restitution* of benefits, if any, conferred by him as a result of the transaction and any *consequential damages* to which he is entitled; but such relief shall not include *duplicate or inconsistent* items of recovery." (C.C. 1692; see *Runyan v. Pacific Air Industries* (1970) 2 C.3d 304, 310, 85 C.R. 138, 466 P.2d 682; *Leaf v. Phil Rauch* (1975) 47 C.A.3d 371, 377, 120 C.R. 749 [consequential damages and interest]; *Arthur L. Sachs v. Oceanside* (1984) 151 C.A.3d 315, 322, 198 C.R. 483; 3 Cal. Proc. (4th), *Actions*, §177; on restitution, see *infra*, §937.)

Thus, a party who attempts to rescind a contract and does so ineffectively may thereafter sue for damages. Or, in the same action, a party may seek rescission, or alternatively damages in the event rescission is not possible. (*Walters v. Marler* (1978) 83 C.A.3d 1, 16, 147 C.R. 655.) But, as expressly stated in the statute, duplicate or inconsistent items are not recoverable. (See *McCoy v. West* (1977) 70 C.A.3d 295, 138 C.R. 660, *infra*, §938.)

(3) *Relief Where Rescission Not Accomplished.* "If in an action or proceeding a party seeks relief based upon rescission and the court determines that the contract *has not been rescinded*, the court may grant any party to the action *any other relief* to which he may be entitled under the circumstances." (C.C. 1692.)

West's Key Number Digest, Contracts k.265, 266

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Affirmative or Defensive Relief.*

Cross-Reference: 4 Cal. Proc. (5th), *Pleading*, §541 et seq.

(2) *Restitution and Damages.* In *Akin v. Certain Underwriters at Lloyd's London (2006) 140 C.A.4th 291, 44 C.R.3d 284*, plaintiff had two homeowners insurance policies with defendants, and she filed a claim alleging that water leaks caused damage to her home. However, defendants denied her claims and rescinded her policies. After a contractual limitations period had run, plaintiff sued under C.C. 1692, for improper rescission, seeking damages for delayed payment and nonpayment of benefits under the policies, exposure to unnecessary health risks, other related losses, mental and emotional distress, and punitive damages. *Held*, judgment for defendants on demurrer affirmed. Contract damages, such as those sought, are not recoverable in a rescission action.

(a) When a party has been injured by a breach of contract and either lacks the ability or the desire to keep the contract alive, the injured party can choose between two alternative remedies: (1) The party can treat the contract as rescinded and recover damages resulting from the rescission; or (2) the party can treat the contract as repudiated by the other party and recover damages to which he or she would have been entitled had the other party not breached the contract or prevented performance. "An action for rescission is based on the disaffirmance of the contract and an action for damages for breach of contract is based on its affirmance." (140 C.A.4th 296.)

(b) Although C.C. 1692 allows the aggrieved party to recover "consequential damages," that term refers to damages that would restore the parties to their original positions. Indeed, the very purpose of rescission is to restore the parties to the position that they would have been in had they not entered the contract. On the other hand, the award given in an action for damages compensates the aggrieved party for the loss of his or her "expectational" interest, i.e., the benefit of the bargain that full performance would have brought. In the context of an insurance case, an action for damages for breach of contract may entitle the aggrieved party to payment of benefits under the policies. However, an action for rescission only permits the aggrieved party to the return of his or her premiums and whatever else may be required to restore the parties to the status quo. (140 C.A.4th 298.)

(c) Because plaintiff seeks to retain the benefits of the contract, i.e., payment of benefits under the policies, she has elected to affirm the contract. In short, based on her allegations, plaintiff sued for breach of contract, and, based on the aforementioned principles, she cannot recover contract damages in an action for "improper rescission." (140 C.A.4th 298.)

Cross-Reference: 3 Cal. Proc. (5th), *Actions*, §182.



69 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law

XVI. DISCHARGE

D. Rescission by Injured Party.

3. Nature and Scope of Relief.

a. Alternative Remedies.

2. Restitution.

1 *Witkin Sum. Cal. Law Contracts* § 937

[§ 937] Restitution.

(1) *General Rule.* The successful plaintiff is entitled to restitution, i.e., to recovery of the consideration that he or she gave and any other compensation necessary to make him or her whole. (See *Lobdell v. Miller* (1952) 114 C.A.2d 328, 343, 250 P.2d 357; *Utemark v. Samuel* (1953) 118 C.A.2d 313, 315, 257 P.2d 656; *Crofoot Lumber v. Thompson* (1958) 163 C.A.2d 324, 331, 329 P.2d 302; *Rest.2d, Contracts* §370 et seq.; Corbin §1102 et seq.; 26 Williston 4th, §68:7 et seq.; 17A Am.Jur.2d (2004 ed.), *Contracts* §588.)

In *Utemark v. Samuel*, *supra*, plaintiff purchasers bought land worth \$ 10,000 on contract, and improved it with buildings. Defendant vendors refused to convey, and plaintiffs were given judgment for rescission, but the award was merely for purchase price payments, taxes, etc., and the present value of the improvements (\$ 6,650). *Held*, they were entitled to receive the *cost* of the improvements (over \$ 12,000).

The court cited Williston for the governing rule, that the purchaser may recover what he or she has paid "and also what he has expended in improvements on the land and not merely the increased value of the land by virtue of the improvement. That is, the law should impose on the wrongdoing defendant a duty to restore the plaintiff's former status, not merely to surrender any enrichment or benefit that he may unjustly hold or have received; though if the market value or, in the absence of a market value, the benefit to the defendant of what has been furnished exceeds the cost or value to the plaintiff, there is no reason why recovery of this excess should not be allowed." (118 C.A.2d 316.)

Defendants relied on the section providing that, on adjudging rescission, the court "may require the party to whom such relief is granted to make any compensation to the other which justice may require." (118 C.A.2d 315.) (See *infra*, §938.) But in the absence of bad faith or improvidence in making the improvements, the equities are in favor of the innocent plaintiffs, and they, rather than the wrongdoing defendant, should be restored to their former position. (118 C.A.2d 316, 317.)

(2) *Action by Building Contractor.* In cases in which a building contractor is limited to, or chooses the remedy of, rescission and restitution, the measure of recovery has given rise to some conflict. Ordinarily, a plaintiff after rescission may recover the reasonable value of his or her labor and materials, i.e., the cost to the plaintiff; but occasionally this

may be greater than the sums specified in the contract as payments for that portion of the work. Some authorities have contended that the contract provisions limit the amount recoverable; others that, after rescission, the contract cannot govern at all and recovery may be had irrespective of its terms. (See Corbin §1112; 23 *Cal. L. Rev.* 313; 7 *So. Cal. L. Rev.* 338.)

SUPPLEMENT: [This section is current through the latest supplement]



70 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XVI. DISCHARGE

D. Rescission by Injured Party.

3. Nature and Scope of Relief.

b. Conditions of Rescission Relief.

1 Witkin Sum. Cal. Law Contracts § 938

[§ 938] Conditions of Rescission Relief.

"If in an action or proceeding a party seeks relief based upon rescission, the court may require the party to whom such relief is granted to make any *compensation to the other* which justice may require and may otherwise in its judgment *adjust the equities* between the parties." (C.C. 1692; see *Runyan v. Pacific Air Industries* (1970) 2 C.3d 304, 319, 85 C.R. 138, 466 P.2d 682, supra, §936; *Hedging Concepts v. First Alliance Mortg. Co.* (1996) 41 C.A.4th 1410, 1422, 49 C.R.2d 191 [even if rescission were proper, where parties had actual contract with contingent-compensation term and contingency failed, justice did not require that plaintiff receive any compensation, nor were there any equities to be adjusted, under C.C. 1692]; 7 Cal. Proc. (4th), *Judgment*, §27.)

The codified principles precluding recovery of duplicate or inconsistent items (supra, §936) and authorizing adjustment of the equities (C.C. 1692, supra) were applied to rescission for a vendor's fraud in *McCoy v. West* (1977) 70 C.A.3d 295, 138 C.R. 660. McCoy, owner of a moving and storage business, sold it to W and M on an installment contract. W and M took possession, operated the business for some months, and then gave notice of rescission for fraud. The trial judge held that the rescission was effective and that W and M were entitled to the return of their downpayment and installment payments. He also concluded, however, that McCoy was entitled to an offset in the amount of the reasonable rental value of the business property while the buyers were in possession. *Held*, judgment for the offset reversed.

(a) The general rule supports the vendor's position in the usual case; but the vendor's right is not absolute, and he or she will not be permitted to retain an unjust benefit as a result of the rescission. (70 C.A.3d 301, 302.)

(b) The rule applicable here is set forth in the *Restatement of Restitution*, §157: The innocent purchaser is entitled to pay either the reasonable rental value or the profits, if any, from operation of the business, whichever is less. "In this way the guilty vendor, the one more at fault, bears the loss, if any, resulting from a failure to use the subject matter profitably." (70 C.A.3d 303.)

(c) The record contained no evidence that the business was profitable, and W's uncontradicted testimony was that it was operated at a loss. (70 C.A.3d 303.)

(d) "[W]here, as here, the vendor of a business enterprise existing for the purpose of making a profit sells the business to a buyer under a contract of sale, and thereafter the contract of sale is rescinded on the grounds of the vendor's fraud, the vendor is not entitled to receive the reasonable rental value for the vendee's use of the business without proof that the vendee's profits equalled or exceeded the reasonable rental value. We further hold that absent such proof, the guilty vendor is at most entitled to the profits, if any, the vendee may have made in the operation of the business during the period that the vendee was in possession thereof." (70 C.A.3d 303.)

SUPPLEMENT: [This section is current through the latest supplement]
Compensation to other party:

Cross-Reference: 7 Cal. Proc. (5th), *Judgment*, §27.



71 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XVI. DISCHARGE

D. Rescission by Injured Party.

4. Waiver of Right To Rescind.

1 *Witkin Sum. Cal. Law Contracts* § 939

[§ 939] Waiver of Right To Rescind.

(1) *Acts or Conduct Constituting Waiver.* The injured party may lose his or her right to rescind by failure to give timely notice (see *infra*, §940), or by conduct (such as retention of benefits) indicating an election to affirm the contract. (See *Neet v. Holmes* (1944) 25 C.2d 447, 458, 154 P.2d 854; *Pearson Candy Co. v. Waits* (1946) 27 C.2d 615, 620, 165 P.2d 674; *Hogan v. Anthony* (1921) 52 C.A. 158, 165, 198 P. 47; *Eustace v. Lynch* (1941) 43 C.A.2d 486, 491, 111 P.2d 372; *Panno v. Russo* (1947) 82 C.A.2d 408, 411, 186 P.2d 452 [waiver found]; *LeClerc v. Michael* (1948) 88 C.A.2d 700, 702, 199 P.2d 343 [treating contract as binding after full knowledge of facts is waiver]; *Esau v. Briggs* (1948) 89 C.A.2d 427, 437, 201 P.2d 25 [waiver is question of fact; no waiver found]; *Mayer v. Northwood Textile Mills* (1951) 105 C.A.2d 406, 409, 233 P.2d 657 [same]; *Soon v. Beckman* (1965) 234 C.A.2d 33, 36, 44 C.R. 190, 13 *Summary* (10th), *Equity*, §13; *Saret-Cook v. Gilbert, Kelly, Crowley & Jennett* (1999) 74 C.A.4th 1211, 1225, 88 C.R.2d 732 [party could not rescind where she ratified agreement during time when there was no evidence of lack of capacity, continued to accept benefits under agreement, and delayed attempt to rescind to prejudice of other parties]; 17A *Am.Jur.2d* (2004 ed.), *Contracts* §§534, 572; 57 *Proof of Facts* 3d 287 [proof of circumstances establishing purchaser's waiver of right to rescind real estate contract]; 1 *So. Cal. L. Rev.* 290; 4 *Summary* (10th), *Sales*, §167.)

(2) *Where No Waiver Results.* Retention of benefits does not amount to a waiver where the injured party had no knowledge of the facts giving rise to the right to rescind. (*Union Pac. R. Co. v. Zimmer* (1948) 87 C.A.2d 524, 532, 197 P.2d 363 [following federal cases; release of claim for personal injuries executed under mistake as to seriousness of injuries; offer to restore consideration made over a year later].) And the right is not waived when the acts constituting the alleged waiver were induced by fraud. (*Channell v. Anthony* (1976) 58 C.A.3d 290, 304, 129 C.R. 704.)

An ambiguous time limitation in a contract was denied effect as a waiver in *Osborne v. Cal-Am Financial Corp.* (1978) 80 C.A.3d 259, 145 C.R. 584. Plaintiff seller sued defendant buyer for damages for breach of contract to buy a 34-unit apartment building for \$ 295,000. During the escrow period, defendant discovered that the seller had been guilty of material misrepresentations of net income, and refused to perform. Defendant was obviously entitled to rescind (80 C.A.3d 266), but plaintiff seller relied on a provision in the deposit receipt (substantially repeated in the escrow instructions) stating, "Buyer has seven days to verify income and expenses." *Held*, this provision was not a waiver of the right to rescind. (a) The statement was lacking in any indication of the time when the 7-day period was to begin to run; and, if interpreted to mean from the signing of the contract, it would constitute a wholly unreasonable waiver of the right of rescission. (80 C.A.3d 267.) (b) The proper construction of the provision would limit it to misrepresentations

marginally material or genuinely ambiguous. (80 C.A.3d 268.)

West's Key Number Digest, Contracts k.262

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Acts or Conduct Constituting Waiver*. See *Gill v. Rich* (2005) 128 C.A.4th 1254, 1264, 1265, 28 C.R.3d 52

[members of insolvent interindemnity trust created to provide indemnity and defense to physician members could not rescind contract with trust on grounds that trustees committed fraud, because (a) members had accepted contract's protection, and (b) rescission and release of members' liability for assessments would harm other members who had relied upon all members to fulfill their contractual obligations, as well as patients who had malpractice claims].



72 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XVI. DISCHARGE

D. Rescission by Injured Party.

5. Procedure.

a. Notice of Rescission.

1 Witkin Sum. Cal. Law Contracts § 940

[§ 940] Notice of Rescission.

"Subject to Section 1693, to effect a rescission a party to the contract must, promptly upon discovering the facts which entitle him to rescind if he is free from duress, menace, undue influence or disability and is aware of his right to rescind: (a) Give *notice of rescission* to the party as to whom he rescinds." (C.C. 1691; see *Golem v. Fahey* (1961) 191 C.A.2d 474, 476, 13 C.R. 63; 17A Am.Jur.2d (2004 ed.), *Contracts* §568; Cal. Transactions Forms, 3 Business Transactions §§17:38, 17:39, 17:57 et seq.; 5A Am.Jur. Legal Forms 2d (2004 ed.), §68:239; 7A Am.Jur. P.P. Forms (2002 ed.), *Contracts*, §128; 3 Cal. Proc. (4th), *Actions*, §201; 4 Cal. Proc. (4th), *Pleading*, §503.)

It need not be in any particular form, but must simply indicate the intention of the party rescinding to treat the contract as ended. (*McNeese v. McNeese* (1923) 190 C. 402, 405, 213 P. 36.) Moreover, a statement in the notice of certain grounds for rescission does not prevent the party from thereafter relying upon different and proper grounds. (*Hull v. Ray* (1931) 211 C. 164, 167, 294 P. 700.)

The former strict requirement of timeliness of notice has been relaxed (see *infra*, §945), and the pleading itself may serve as the notice (see *infra*, §944).

West's Key Number Digest, *Contracts* k.271

SUPPLEMENT: [This section is current through the latest supplement]

Steps to effect rescission:

Cross-References: 3 Cal. Proc. (5th), *Actions*, §206; 4 Cal. Proc. (5th), *Pleading*, §542.



73 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law

XVI. DISCHARGE

D. Rescission by Injured Party.

5. Procedure.

b. Offer To Restore Consideration.

1 Witkin Sum. Cal. Law Contracts § 941

[§ 941] Offer To Restore Consideration.

The party seeking rescission must "[r]estore to the other party *everything of value* which he has received from him under the contract or *offer to restore* the same *upon condition* that the other party do likewise, unless the latter is *unable or positively refuses to do so*." (C.C. 1691(b); see *Fairchild v. Western Sec. Corp.* (1917) 176 C. 742, 743, 169 P. 363; *Vice v. Thacker* (1947) 30 C.2d 84, 91, 180 P.2d 4 [offer on condition that other party do likewise]; *King v. Mortimer* (1951) 37 C.2d 430, 433, 233 P.2d 4; *Paxson v. Margulis-Stulman Co.* (1932) 127 C.A. 94, 97, 15 P.2d 191; *Dreiske v. Los Angeles Inv. Sec. Corp.* (1936) 13 C.A.2d 59, 61, 56 P.2d 299; *Papenfus v. Webb Products Co.* (1938) 24 C.A.2d 559, 563, 75 P.2d 631; *Burgess v. Security-First Nat. Bank* (1941) 44 C.A.2d 808, 820, 113 P.2d 298; *Beeler v. Beeler* (1954) 125 C.A.2d 41, 43, 269 P.2d 949; *Rest.2d, Contracts* §384; Corbin §1114; 26 Williston 4th, §68:24 et seq.; 17A Am.Jur.2d (2004 ed.), *Contracts* §574 et seq.; Cal Transactions Forms, 3 Business Transactions §17:55; 5A Am.Jur. Legal Forms 2d (2004 ed.), §68:240; 7A Am.Jur. P.P. Forms (2002 ed.), *Contracts*, §128; *infra*, §§942, 943 [when prior restoration is unnecessary], §944 [pleading as offer], §945 [delay in restoration]; 4 Cal. Proc. (4th), *Pleading*, §503.)

West's Key Number Digest, Contracts k.266-

SUPPLEMENT: [This section is current through the latest supplement]

See *Myerchin v. Family Benefits* (2008) 162 C.A.4th 1526, 1535, 76 C.R.3d 816 [plaintiff who accepted settlement money from defendant could not effectuate rescission of settlement agreement without returning entire consideration received].

Cross-Reference: 4 Cal. Proc. (5th), *Pleading*, §542.



74 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law

XVI. DISCHARGE

D. Rescission by Injured Party.

5. Procedure.

c. When Prior Restoration Is Unnecessary.

1. In General.

1 Witkin Sum. Cal. Law Contracts § 942

[§ 942] In General.

The requirement of a restoration of, or an offer to restore, the consideration (see *supra*, §941), as an essential element of rescission, has been criticized. (See 36 *Cal. L. Rev.* 610.) It is, moreover, subject to the following exceptions:

(1) Where nothing of value was received by the plaintiff. (C.C. 1691(b) [must restore "everything of value"]; *Rosemead Co. v. Shipley Co.* (1929) 207 C. 414, 421, 278 P. 1038; *Simmons v. California Institute of Technology* (1949) 34 C.2d 264, 275, 209 P.2d 581; *Dunn v. Stringer* (1940) 41 C.A.2d 638, 646, 107 P.2d 411; *Esau v. Briggs* (1948) 89 C.A.2d 427, 436, 201 P.2d 25; see *Rest.2d, Contracts* §384(2)(a).)

(2) Where the plaintiff received merely the individual promissory note or uncashed check of the defendant. (*Weger v. Rocha* (1934) 138 C.A. 109, 116, 32 P.2d 417.)

(3) Where the plaintiff is entitled to keep what he or she has received in any event, so that the defendant could not possibly be injuriously affected by a failure to restore. (*Matteson v. Wagoner* (1905) 147 C. 739, 743, 82 P. 436; *Shaffer v. Security Trust & Savings Bank* (1935) 4 C.A.2d 707, 715, 41 P.2d 948; *Auclair v. Auclair* (1946) 72 C.A.2d 791, 799, 165 P.2d 527 [rescission of property settlement agreement between husband and wife]; *Sime v. Malouf* (1949) 95 C.A.2d 82, 111, 212 P.2d 946, 213 P.2d 788.)

(4) Where an accounting or showing of facts independent of the contract itself is necessary to ascertain the respective obligations of the parties; in this situation, an offer to refund such sum as the court may decree is sufficient. (*California Farm & Fruit Co. v. Schiappa-Pietra* (1907) 151 C. 732, 739, 91 P. 593; *Zeller v. Milligan* (1925) 71 C.A. 617, 626, 236 P. 349; *Elrod-Oas Home Bldg. Co. v. Mensor* (1932) 120 C.A. 485, 489, 8 P.2d 171.)

(5) Where, without the plaintiff's fault, restoration has become impossible, and the court may by its decree fully adjust the equities between the parties. (*Carruth v. Fritch* (1950) 36 C.2d 426, 430, 224 P.2d 702; *Stegeman v. Vandeventer* (1943) 57 C.A.2d 753, 761, 135 P.2d 186; *Farina v. Bevilacqua* (1961) 192 C.A.2d 681, 685, 13 C.R. 791; see *Rest.2d, Contracts* §384(2)(b).)

(6) Where the offer would be futile, as where the defendant is unable or refuses to rescind, or it is certain that the offer of restoration will be refused. (C.C. 1691(b); *Egan v. Parks* (1931) 111 C.A. 415, 420, 295 P. 866; *Elrod-Oas Home Bldg. Co. v. Mensor, supra*, 120 C.A. 489.)

(7) Special exceptions are recognized where rescission itself is unnecessary (see *supra*, §932) and where the plaintiff seeks specific restitution (see *infra*, §943).

SUPPLEMENT: [This section is current through the latest supplement]



75 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XVI. DISCHARGE

D. Rescission by Injured Party.

5. Procedure.

c. When Prior Restoration Is Unnecessary.

2. Specific Restitution Without Prior Offer.

1 *Witkin Sum. Cal. Law Contracts* § 943

[§ 943] Specific Restitution Without Prior Offer.

If the plaintiff, entitled to rescission for the defendant's breach or fraud, seeks not the money value of his or her prior performance but rather the specific recovery of land or personal property transferred pursuant to the contract, the plaintiff *need not offer to restore* the consideration previously received. The court itself, by its judgment, will provide for restoration by making the decree of specific restitution *conditional* upon return of the consideration. (See *Rest.2d, Contracts* §372; 63 *Harv. L. Rev.* 1464.)

This rule was applied in *Alder v. Drudis* (1947) 30 *C.2d* 372, 182 *P.2d* 195, where plaintiffs delivered models of an invention to defendants, under an agreement for development and promotion, and defendants paid them \$ 5,000. Later, defendants committed a breach, and plaintiffs brought this action. *Held*, plaintiffs were entitled to the return of the models, without prior notice of rescission or offer to restore, but conditioned upon their return of the \$ 5,000. The court said: "The purpose of restitution as a remedy for breach is the restoration of the *status quo ante* as far as is practicable, and in the absence of qualifying circumstances, the plaintiff must return any consideration he has received in order to obtain specific restitution. While there is no literal rescission of the contract, the result reached by the restitutionary remedy approximates that reached by rescission. It is not necessary that plaintiff should have made an offer to return the consideration, but the decree for specific restitution may be made conditional upon such return." (30 *C.2d* 384.)

The rule of *Alder v. Drudis*, *supra*, was codified in 1961. (See C.C. 1692, *supra*, §936 [party may recover "any money or thing"]; C.C. 1693, *infra*, §945 [conditional judgment authorized].)

SUPPLEMENT: [This section is current through the latest supplement]



76 of 175 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XVI. DISCHARGE

D. Rescission by Injured Party.

5. Procedure.

d. Pleading as Notice or Offer.

1 Witkin Sum. Cal. Law Contracts § 944

[§ 944] Pleading as Notice or Offer.

Prior notice of rescission and an offer to restore the consideration received were formerly essential to maintenance of an action for rescission. (See *McCall v. Superior Court* (1934) 1 C.2d 527, 535, 36 P.2d 642; *Zeller v. Milligan* (1925) 71 C.A. 617, 626, 236 P. 349; *Holcomb v. Long Beach Inv. Co.* (1933) 129 C.A. 285, 297, 19 P.2d 31; 19 Cal. L. Rev. 424; 23 Cal. L. Rev. 638; 36 Cal. L. Rev. 612.)

The action for rescission has been abolished (see *supra*, §930) and, although the traditional requirements of notice and offer to restore remain (see *supra*, §940 et seq.), *prior* notice and offer are no longer essential: "When notice of rescission has not otherwise been given or an offer to restore the benefits received under the contract has not otherwise been made, the *service of a pleading* in an action or proceeding that seeks relief based on rescission *shall be deemed to be such notice or offer or both.*" (C.C. 1691; see 19 *Hastings L. J.* 1255; 4 *Cal. Proc.* (4th), *Pleading*, §503.) (On effect of delay, see *infra*, §945.)

West's Key Number Digest, Contracts k.271

SUPPLEMENT: [This section is current through the latest supplement]

Prior notice and offer not essential:

Cross-Reference: 4 *Cal. Proc.* (5th), *Pleading*, §542.



77 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XVI. DISCHARGE

D. Rescission by Injured Party.

5. Procedure.

e. Delay in Notice or Offer.

1 *Witkin Sum. Cal. Law Contracts* § 945

[§ 945] Delay in Notice or Offer.

(1) *Former Law: Promptness as Condition of Right.* Some cases held under former C.C. 1691(1) that prompt notice of rescission was a condition of the substantive right to rescind, and that the right could be lost by mere excessive delay, without any showing of prejudice from the delay. (See *Estrada v. Alvarez* (1952) 38 C.2d 386, 391, 240 P.2d 278; *Stevens v. Bryson* (1933) 135 C.A. 684, 687, 27 P.2d 932; *Clanton v. Clanton* (1942) 52 C.A.2d 550, 556, 126 P.2d 639; *Sogg v. Harvey* (1955) 134 C.A.2d 116, 121, 285 P.2d 104.)

Other cases treated the requirement of promptness as merely an application of the equitable doctrine of *laches*. Under this doctrine *mere delay*, even though considerable in time, did not preclude rescission unless there was change of position or some other prejudice suffered by the other party, or an attempt by the plaintiff to speculate on the advantages of affirmance or rescission. (See *Rottman v. Rottman* (1921) 55 C.A. 624, 631, 204 P. 46; *Sherratt v. Hellman Commercial Trust & Savings Bank* (1931) 112 C.A. 542, 545, 297 P. 582; *Esau v. Briggs* (1948) 89 C.A.2d 427, 438, 201 P.2d 25 [delay of 5 months held insufficient to bar action where no injury to defendant shown]; cf. *Williams v. Marshall* (1951) 37 C.2d 445, 455, 235 P.2d 372 [no artificial rule on what lapse of time will bar relief; see dissent]; *Ulrich v. San Jacinto Estates* (1952) 109 C.A.2d 648, 649, 241 P.2d 262 [following *Williams*]; *Lobdell v. Miller* (1952) 114 C.A.2d 328, 339, 341, 250 P.2d 357 [same].)

(2) *New Rule of Laches.* Promptness is no longer a condition of the right, and rescission may be denied only for *laches*. This rule is stated in C.C. 1693 as follows:

(a) *Delay in notice:* "When relief based upon rescission is claimed in an action or proceeding, such relief shall not be denied because of delay in giving notice of rescission unless such delay has been *substantially prejudicial* to the other party."

(b) *Delay in restoration:* "A party who has received benefits by reason of a contract that is subject to rescission and who in an action or proceeding seeks relief based upon rescission shall not be denied relief because of a delay in restoring or in tendering restoration of such benefits before judgment unless such delay has been *substantially prejudicial* to the other party; but the court may make a *tender of restoration a condition of its judgment*."

(3) *Excuses for Delay*. Mere knowledge of the facts over a long period of time is not conclusive, unless the facts are such as to put a reasonable person upon inquiry as to his or her *legal right* to rescind. (*Hannah v. Steinman* (1911) 159 C. 142, 153, 112 P. 1094.) And delay will not be fatal where it results from indulgence granted to the defaulting party (*Moresco v. Foppiano* (1936) 7 C.2d 242, 246, 60 P.2d 430; *Crofoot Lumber v. Thompson* (1958) 163 C.A.2d 324, 333, 329 P.2d 302), or occurs pending negotiations for a settlement (*Williams v. Marshall, supra*, 37 C.2d 456; *Switzler v. Klein & Co.* (1928) 94 C.A. 410, 417, 271 P. 367; *Sherratt v. Hellman Commercial Trust & Savings Bank, supra*; *Mobley v. Richfield Oil Corp.* (1942) 53 C.A.2d 406, 412, 128 P.2d 105; see C.C. 1691, *supra*, §940).

West's Key Number Digest, Contracts k.271

SUPPLEMENT: [This section is current through the latest supplement]



78 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XVI. DISCHARGE

E. Release.

1. Validity and Effect.

1 Witkin Sum. Cal. Law Contracts § 946

[§ 946] Validity and Effect.

(1) *Consideration or Writing.* "An obligation is extinguished by a release therefrom given to the debtor by the creditor, upon a new consideration, or *in writing, with or without new consideration.*" (C.C. 1541; see *Cohn v. Bugas* (1974) 42 C.A.3d 381, 390, 116 C.R. 810, citing the text; *Rest.2d, Contracts* §284; 13 Corbin (Rev. ed.), §67.9 et seq.; 29 Williston 4th, §73:1 et seq.; 66 Am.Jur.2d, *Release* (2001 ed.) §1 et seq.; Cal. Civil Practice, 3 Business Litigation, §24:65; Cal. Transactions Forms, 3 Business Transactions §18:65 et seq.; 2 California Affirmative Defenses (2004 ed.), §42:1 et seq.; 21B Am.Jur. P.P. Forms (2001 ed.), *Release*, §1 et seq.) (On release of joint debtors, see *supra*, §111; on release of joint tortfeasors, see 5 *Summary* (10th), *Torts*, §70 et seq.; on contract not to sue, see *Rest.2d, Contracts* §285.)

The provision that a written release requires no consideration changes the common law. (See *Weddle v. Heath* (1931) 211 C. 445, 455, 295 P. 832; *Crow v. P.E.G. Const. Co.* (1957) 156 C.A.2d 271, 277, 319 P.2d 47; 47 Cal. L. Rev. 87.)

(2) *Mutual Assent.* The writing must expressly show the intent to extinguish the obligation. (*Golden West Credit & Adjustment Co. v. Wilson* (1932) 119 C.A. 627, 636, 7 P.2d 345.) And it must be free from invalidating causes such as mistake, fraud, and undue influence. (See *Chung v. Johnston* (1954) 128 C.A.2d 157, 163, 274 P.2d 922 [fraud]; *Tarpy v. San Diego* (2003) 110 C.A.4th 267, 276, 1 C.R.3d 607 [release given to county veterinary clinic was not coerced, where clinic's refusal to offer payment options or to waive impound fee was consistent with county regulations; also, release was not against public policy because it was given to get reduced impound fees]; 42 Cal. L. Rev. 161; *supra*, §§260, 297, 316; *infra*, §947.) (On release executed by person while incarcerated, see 86 A.L.R.3d 1230; on voidableness of release, 8 *Proof of Facts* 2d 617.)

A written release takes effect immediately upon its signing and delivery by the maker (releasor); it is immaterial that the consideration has not yet been paid, and the signature of the party released is not essential. (*Hofland v. Gustafson* (1955) 132 C.A.2d Supp. 907, 909, 282 P.2d 1039.)

Absent fraud, deception, misrepresentation, duress, or undue influence, a person who signs a release on the mere unspoken belief that it does not encompass certain claims, despite express language to the contrary, may not later rely on the unspoken intention not to waive those claims in order to escape the effect of the release. (See *Skrbina v. Fleming*

Cos. (1996) 45 C.A.4th 1353, 1367, 53 C.R.2d 481 [former employee's discrimination claim was barred by release given to employer in exchange for severance benefits, despite assertion that he never intended to abandon discrimination claims, where employee admitted reading release and signing it "willingly"]; *Bardin v. Lockheed Aeronautical Systems Co.* (1999) 70 C.A.4th 494, 504, 82 C.R.2d 726 [former employee's action against employer for allegedly providing false information to prospective new employer was barred by blanket release, despite assertion that she did not intend to release employer from liability for alleged acts and did not understand that release did so; following *Skrbina*.)]

West's Key Number Digest, Release k.38

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Consideration or Writing*. See 2 California Affirmative Defenses §42:1 et seq.



79 of 175 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XVI. DISCHARGE

E. Release.

2. General Release of Unknown Claims.

a. Statutory Prohibition.

1 Witkin Sum. Cal. Law Contracts § 947

[§ 947] Statutory Prohibition.

A *general release* does not extend to claims that the creditor does not know or suspect to exist in his or her favor at the time of executing the release, which if known by the creditor would have materially affected the settlement with the debtor. (C.C. 1542; see *O'Meara v. Haiden* (1928) 204 C. 354, 358, 268 P. 334; *Backus v. Sessions* (1941) 17 C.2d 380, 385, 110 P.2d 51; *Sime v. Malouf* (1949) 95 C.A.2d 82, 109, 212 P.2d 946, 213 P.2d 788; *Chung v. Johnston* (1954) 128 C.A.2d 157, 163, 274 P.2d 922; *In re Mission Ins. Co.* (1995) 41 C.A.4th 828, 837, 48 C.R.2d 209 [settlement agreement between Insurance Commissioner and insurer was valid even though parties agreed to abide by Supreme Court decision not yet rendered, where insurer waived rights under C.C. 1542]; 66 *Am.Jur.2d* (2001 ed.), Release §22; 30 *Cal. L. Rev.* 111; 32 *Cal. L. Rev.* 101; 42 *Cal. L. Rev.* 164; 71 *A.L.R.2d* 82 [avoidance of release on ground of fraud as to injuries]; 13 *A.L.R.4th* 686 [avoidance of release on ground of mistake as to injuries].)

In *Backus v. Sessions*, *supra*, a release was made by an injured person while in a semiconscious condition. Later, after recovery of his faculties, he cashed the draft received as consideration. *Held*, the original release was wholly void; the act of cashing the draft was not a "ratification" of it as to any claim for injury to his eye, which was then unknown to him. (17 C.2d 385.) (See 42 *Cal. L. Rev.* 166.)

West's Key Number Digest, Contracts k.31

SUPPLEMENT: [This section is current through the latest supplement]

See *Butler v. Vons Cos.* (2006) 140 C.A.4th 943, 947, 45 C.R.3d 151 [employee's release agreement with his employer, after resolution of altercation that employee had with coemployee, was ambiguous as to its scope for purposes of employee's subsequent and distinct claim against employer for employment discrimination]; *Perez v. Uline* (2007) 157 C.A.4th 953, 958, 68 C.R.3d 872 [release that former employee signed at termination complied with C.C. 1542, text, p. 1041, although release did not refer to that section, where employee understood he was releasing claims arising under all statutes agreement referred to, even those he did not understand; nothing in statute requires that it be designated in release or specifically waived]. (New) *Release by victim of fraud*: A party who is fraudulently induced to enter into a contract cannot be deprived of the well-recognized option to affirm the contract and sue for damages for fraud (see text, §285) simply because the contract contains a release of unknown claims. (*Persson v. Smart Inventions* (2005) 125 C.A.4th 1141, 1152, 23 C.R.3d 335 [through concealment of successful new product, plaintiff was induced to sell his

corporate shares; release applied to liability of any kind, known or unknown].)



80 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XVI. DISCHARGE

E. Release.

2. General Release of Unknown Claims.

b. Routine Waiver Invalid.

1 Witkin Sum. Cal. Law Contracts § 948

[§ 948] Routine Waiver Invalid.

(1) *Former Law Permitting Waiver.* The protection of C.C. 1542 (see supra, §947) was largely nullified by decisions holding that no public policy is involved and that therefore the statute may be waived by a recital in the release. (See *Berry v. Struble* (1937) 20 C.A.2d 299, 303, 66 P.2d 746; *Kostick v. Swain* (1953) 116 C.A.2d 187, 194, 253 P.2d 531.)

In *Kostick*, plaintiff was in an automobile collision, and his physician concluded that his injuries were mild cerebral concussion and abrasions with no physical impairments. He signed a release for \$ 215, no one mentioning unknown injuries. The release provided that the "nature, extent and result of the injuries and/or damage sustained by me are not now all known or anticipated, but I nevertheless desire to settle and compromise said claim in full." Also, "I hereby release," etc., all claims including "RESULTS OF INJURIES WHICH ARE UNKNOWN TO ME AND UNANTICIPATED BY ME." (116 C.A.2d 189.) Shortly thereafter he suffered pains, and X-rays showed a fractured vertebra and other serious injuries that kept him hospitalized for weeks, in a brace for 6 months, and unable to work for a year, all clearly the result of the accident. *Held*, the release was binding and constituted a waiver of any claim based on C.C. 1542. C.C. 1542 was of no aid to plaintiff because "he did not give a 'general release' for the settlement, but specific words were used with reference to unknown or unanticipated results of his injury. ... When appellant accepted the \$ 215 he knew exactly what he was giving for it. Therefore he made no mistake. ... [W]here the parties involved in an action for negligence expressly and intentionally settle for unknown injuries the release given by the claimant is incontestable." (116 C.A.2d 194.) This reasoning seems unsound: Despite the carefully chosen language, the writing was in effect a general release of unknown claims that C.C. 1542 was designed to prevent. (See 42 Cal. L. Rev. 167.)

(2) *Rule Abrogated.* Routine advance waiver is no longer possible. In *Casey v. Proctor* (1963) 59 C.2d 97, 28 C.R. 307, 378 P.2d 579, plaintiff's car was struck by defendant's negligently driven car. Four days later, plaintiff filled out an accident report for his collision insurer, answering "no" to the question concerning personal injuries. This report was sent to defendant's insurer, which sent a draft for property damage accompanied by a release with the warning "Caution! Read Before Signing." Plaintiff kept the release 9 days, then signed and returned it. Two months later, he sought medical attention, and serious personal injuries were discovered, with \$ 3,000 of estimated special damages and considerable pain. In this action for personal injuries, defendant set up the release, which covered "known and unknown bodily injuries." *Held*, judgment on directed verdict for defendant reversed.

(a) The cases holding that the protection of C.C. 1542 can be nullified by a simple reference to claims for unknown injuries misconstrue the statute. (59 C.2d 109, citing the text.) Under those cases, California, one of the few states to have a special statutory protection of releasers from unintended releases, in fact affords them less protection than the majority of other states provide by judicial decision. (59 C.2d 109.) *Berry v. Struble*, *supra*, was accordingly disapproved on this point. (59 C.2d 110.)

This does not mean that settlements for unknown claims cannot be made, but only that the mere recital in the release will not have that effect; the question is one of fact whether the releaser actually intended to discharge such claims. "If the evidence, independent of the words of the release, indicates that the parties have consciously contracted in reference to unknown claims, the release is, of course, binding." (59 C.2d 110.)

(b) Independent of C.C. 1542, the existence of unknown injuries affords grounds for rescission, under the facts of this case; it is a question of fact whether the parties actually intended to discharge unknown liabilities, with various factors stressed by the courts:

"If these factors be applied to the instant case, it is clear that under the rule prevailing in the majority of jurisdictions there is substantial evidence to support a holding that plaintiff may avoid the release. Here, no consideration was paid for personal injuries, there were no negotiations leading to the settlement, the risk of the existence of unknown injuries was never discussed, there is substantial evidence that plaintiff's belief that he had not suffered personal injuries was reasonable, and there is little doubt as to defendant's liability." (59 C.2d 113.) (See *DuBois v. Sparrow* (1979) 92 C.A.3d 290, 296, 154 C.R. 717 [following *Casey v. Proctor*]; *Leaf v. San Mateo* (1980) 104 C.A.3d 398, 411, 163 C.R. 711 [same]; 13 A.L.R.4th 686 [avoidance of release of personal claim on ground of mistake as to nature and extent of injuries].) (For an enforceable release knowingly made, see *Carmichael v. Industrial Acc. Com.* (1965) 234 C.A.2d 311, 315, 44 C.R. 470.)

(3) *Distinction: No Public Policy Involved.* The rule of *Casey v. Proctor*, *supra*, was declared for personal injury releases, and is grounded on public policy. No such policy applies to a commercial transaction, and a release in such a transaction is valid under general law. (See *Larsen v. Johannes* (1970) 7 C.A.3d 491, 506, 86 C.R. 744 [landowners' release of architect]; *Winet v. Price* (1992) 4 C.A.4th 1159, 1169, 6 C.R.2d 554 [client's release of attorney in settlement of attorney's action to recover legal fees; *distinguishing Casey v. Proctor*]; *San Diego Hospice v. San Diego* (1995) 31 C.A.4th 1048, 1053, 37 C.R.2d 501 [land purchaser's release of seller with respect to future claims of contamination of land was intended to cover eventuality of unknown source of contamination and included express waiver of protections under C.C. 1542].)

SUPPLEMENT: [This section is current through the latest supplement]



81 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XVI. DISCHARGE

E. Release.

3. Release by Person Admitted to Medical Facility.

1 Witkin Sum. Cal. Law Contracts § 949

[§ 949] Release by Person Admitted to Medical Facility.

B. & P.C. 6152(b), covering patients and outpatients of a clinic or health facility, creates a presumption of fraud where the release is made without time for deliberate consideration: "A general release from a liability claim obtained from any person during the period of the first physical confinement, whether as an inpatient or outpatient, in a clinic or health facility, as defined in *Sections 1203 and 1250 of the Health and Safety Code*, as a result of the injury alleged to have given rise to the claim and primarily for treatment of the injury, is presumed fraudulent if the release is executed within 15 days after the commencement of confinement or prior to release from confinement, whichever occurs first." (See *9 Pacific L. J. 681.*)

SUPPLEMENT: [This section is current through the latest supplement]



82 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XVI. DISCHARGE

F. Accord and Satisfaction.

1. In General.

a. Nature of Accord and Satisfaction.

1 Witkin Sum. Cal. Law Contracts § 950

[§ 950] Nature of Accord and Satisfaction.

"An accord is an *agreement* to accept, in extinction of an obligation, something *different from or less than* that to which the person agreeing to accept is entitled." (C.C. 1521.) "*Acceptance*, by the creditor, of the *consideration of an accord* extinguishes the obligation, and is called *satisfaction*." (C.C. 1523.) In other words, an accord substitutes a *new executory contract* for a previously existing contract or debt, the usual purpose being to settle a claim at a lesser amount. (*B. & W. Engineering Co. v. Beam* (1913) 23 C.A. 164, 170, 137 P. 624; *Moving Picture Machine Operators Union v. Glasgow Theaters* (1970) 6 C.A.3d 395, 402, 86 C.R. 33; see *Rest.2d, Contracts* §281; 13 Corbin (Rev. ed.), §69.1 et seq.; 29 Williston 4th, §73:27 et seq.; 1 *Am.Jur.2d, Accord and Satisfaction* (1994 ed.) §1 et seq.; Cal. Civil Practice, 3 Business Litigation, §31:1 et seq.; Cal. Transactions Forms, 3 Business Transactions §18:102 et seq.; 3 California Affirmative Defenses (2004 ed.), §63:1 et seq.; 1 Proof of Facts 65; 1 *Am.Jur. Legal Forms* 2d (1999 ed.), §4:1 et seq.; 1 *Am.Jur. P.P. Forms* (2003 ed.), Accord and Satisfaction, §1 et seq.; 59 *A.L.R.5th* 665 [conveyance or surrender of property as accord and satisfaction of contract obligation].)

Because an accord is an executory contract, it must be based upon a valid *consideration*. (*Shortell v. Evans-Ferguson Corp.* (1929) 98 C.A. 650, 654, 277 P. 519; see *Moving Picture Machine Operators Union v. Glasgow Theaters, supra*, 6 C.A.3d 403 ["there must be a bona fide dispute between the parties"].)

Intent of the parties to make a final settlement is a question of fact for the jury. (*Conderback v. Standard Oil Co.* (1966) 239 C.A.2d 664, 680, 682, 48 C.R. 901; see *In re Marriage of Thompson* (1996) 41 C.A.4th 1049, 1058, 48 C.R.2d 882, citing the text [no evidence of intent to settle obligation where debtor tendered check in mistaken belief he was paying total amount owed, he did not inform creditor that tender was in settlement of all claims, and he did not relay to creditor express condition that acceptance of check would constitute full payment of obligation].)

West's Key Number Digest, Accord and Satisfaction k.1

SUPPLEMENT: [This section is current through the latest supplement]

See 1 *Am.Jur.2d* (2005 ed.), *Accord and Satisfaction* §1 et seq.; 3 California Affirmative Defenses §63:1 et seq.



83 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XVI. DISCHARGE

F. Accord and Satisfaction.

1. In General.

b. Effect of Accord.

1 Witkin Sum. Cal. Law Contracts § 951

[§ 951] Effect of Accord.

The old obligation remains in force until the new contract is performed by satisfaction, i.e., when the creditor accepts the new consideration. (C.C. 1522; *Moving Picture Machine Operators Union v. Glasgow Theaters* (1970) 6 C.A.3d 395, 403, 86 C.R. 33; see *Rest.2d, Contracts §281(2)*; 13 Corbin (Rev. ed.), §69.4; 29 Williston 4th, §73:32.) Hence, in an action brought by the creditor on the old obligation, the debtor cannot plead an *executory accord* as a bar, but he or she can so plead an *accord and satisfaction*. (*Silvers v. Grossman* (1920) 183 C. 696, 699, 192 P. 534; *Blumer v. Madden* (1932) 128 C.A. 22, 26, 16 P.2d 319; see 13 Corbin (Rev. ed.), §69.4; 29 Williston 4th, §§73:33, 73:34; 12 Cal. L. Rev. 411; 17 Cal. L. Rev. 160, note 21.) (On debtor's right to equitable relief where he or she has not breached the accord, but is sued on the original obligation, see 13 Corbin (Rev. ed.), §69.4; 29 Williston 4th, §73:35; on remedies for breach of an accord, see 94 A.L.R.2d 504.)

Its executory character is what distinguishes the accord from a novation (*infra*, §961). "[A] novation extinguishes one obligation by accepting for it another, that is, the creditor agrees to accept the second promise for his existing claim. But this is not true of an accord. Here it is not the new promise that is accepted in lieu of the existing claim, but the performance of that new promise." (*Gardiner v. Gaither* (1958) 162 C.A.2d 607, 620, 329 P.2d 22.)

SUPPLEMENT: [This section is current through the latest supplement]



84 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XVI. DISCHARGE

F. Accord and Satisfaction.

2. Check Sent in Payment of Disputed Claim.

a. Disputed Debt.

1. In General.

1 Witkin Sum. Cal. Law Contracts § 952

[§ 952] In General.

(1) *Potter Rule*. A writing is not essential to an accord and satisfaction; it may be *implied*. Hence, where there is an *honest dispute* as to the amount due on an obligation, if the debtor sends a certain sum on the express condition that acceptance of it will constitute full payment, and the creditor so understands the transaction, acceptance by the creditor is an accord and satisfaction, even though he or she notifies the debtor that it is received only on account. (*B. & W. Engineering Co. v. Beam* (1913) 23 C.A. 164, 173, 137 P. 624; *Russell v. Riley & Peterson* (1927) 82 C.A. 728, 735, 256 P. 577; *Everhardy v. Union Finance Co.* (1931) 115 C.A. 460, 466, 1 P.2d 1024; *Wallace v. Crawford* (1937) 21 C.A.2d 394, 405, 69 P.2d 455; *Robertson v. Robertson* (1939) 34 C.A.2d 113, 117, 93 P.2d 175.)

The rule was restated in *Potter v. Pacific Coast Lumber Co. of Calif.* (1951) 37 C.2d 592, 597, 234 P.2d 16, as follows: "[W]here a claim is disputed or unliquidated and the tender of a check or draft in settlement thereof is of such character as to give the creditor notice that it must be accepted 'in full discharge of his claim' or not at all, the retention and use of such check or draft constitute an accord and satisfaction ... and it is immaterial that the 'creditor protests against accepting the tender in full payment' ... for in such case 'the law permits but two alternatives, either reject or accept in accordance with the condition.' " (See *Connecticut Printers v. Gus Kroesen* (1982) 134 C.A.3d 54, 60, 184 C.R. 436; 13 Corbin (Rev. ed.), §70.2; 29 Williston 4th, §73:44 et seq.; 1 Am.Jur.2d (1994 ed.), *Accord and Satisfaction* §16 et seq.; 1 Am.Jur. Legal Forms 2d (1999 ed.), §4:16 et seq.; 1 Am.Jur. P.P. Forms (2003 ed.), *Accord and Satisfaction*, §11; 42 A.L.R.4th 12 [status of rule that acceptance of check purporting to be final settlement of disputed amount constitutes accord and satisfaction].)

(2) *Rejection of Potter Rule*. The "two alternatives" approach of *Potter* was abrogated in 1987 by the enactment of C.C. 1526. Under the new statute, the creditor may retain the check as partial discharge of the obligation. (See 19 *Pacific L. J.* 672.) However, C.C. 1526 is in direct conflict with U.C.C. 3311, which was added in 1992 as part of the revised Article 3, entitled Negotiable Instruments. With some minor variations to reflect modern business conditions, U.C.C. 3311 restates the *Potter* common law approach. (See Official Comment to U.C.C. 3311.)

U.C.C. 3311 is covered in 4 *Summary* (10th), *Negotiable Instruments*, §19. The provisions of C.C. 1526 are set forth below.

(a) *General Rule: No Accord and Satisfaction.* If the debtor tenders a check or draft as full discharge of a disputed or unliquidated claim, "and the words 'payment in full' or other words of similar meaning are notated on the check or draft," acceptance does not constitute an accord and satisfaction if (1) the creditor protests by deleting the notation, or (2) the acceptance was inadvertent or without knowledge of the notation. (C.C. 1526(a).)

(b) *Exceptions.*

(1) *Composition or Extension Agreement.* Acceptance of the check or draft constitutes an accord and satisfaction if it is tendered under a composition or extension agreement between the debtor and his or her creditors, all creditors of the same class are treated the same, and the creditor receives the check or draft with knowledge of the restriction. (C.C. 1526(b).)

(2) *Release.* Acceptance of a check or draft constitutes an accord and satisfaction when it is issued in conjunction with a release of a claim. (C.C. 1526(c); on release, see *infra*, §946 et seq.)

(c) *Conclusive Presumption of Knowledge.* In two situations, the creditor is conclusively presumed to have knowledge of the restriction: (1) when he or she has executed a written consent to a composition or extension agreement prior to receipt of the check or draft (C.C. 1526(b)(1)), and (2) when the creditor has been given written notice, not less than 15 nor more than 90 days prior to receipt of the check or draft, that it will be tendered with a restrictive endorsement thereon and that acceptance and cashing will constitute an accord and satisfaction (C.C. 1526(b)(2)).

The notice requirement may be satisfied by mailing it to the address shown for the creditor on the debtor's books or to such other address the creditor may designate in writing. (C.C. 1526(d).) (See 33 *Loyola L.A. L. Rev.* 1 [Satisfaction Not Guaranteed: California's Conflicting Law on the Use of Accord and Satisfaction Checks]; 20 Thomas Jefferson L. Rev. 97 [Full Payment Condition Checks--California Statutory Conflict].)

A federal district court, concluding that the two provisions are in irreconcilable conflict, held that effect must be given to U.C.C. 3311, the later enacted statute. (*Director's Guild of America v. Harmony Pictures* (1998) 32 *F. Supp.2d* 1184, 1190.) *Woolridge v. J.F.L. Elec.* (2002) 96 C.A.4th Supp. 52, 59, 117 *C.R.2d* 771, 4 *Summary* (10th), *Negotiable Instruments*, §19, agreed with this approach.

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Potter Rule.* See 1 *Am.Jur.2d* (2005 ed.), *Accord and Satisfaction* §16 et seq.; 1 *Am.Jur.* Legal Forms 2d (2007 ed.), *Accord and Satisfaction*, §4:17 et seq.



85 of 175 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XVI. DISCHARGE

F. Accord and Satisfaction.

2. Check Sent in Payment of Disputed Claim.

a. Disputed Debt.

2. Sending Amount Due.

1 Witkin Sum. Cal. Law Contracts § 953

[§ 953] Sending Amount Due.

The accord and satisfaction doctrine applies even though the debtor sends only the amount concededly due. Thus, in *Potter v. Pacific Coast Lumber Co. of Calif.* (1951) 37 C.2d 592, 234 P.2d 16, supra, §952, plaintiff contracted to sell three loads of lumber to defendant. Defendant, relying on a custom calling for a particular method of charging freight, and asserting that some lumber failed to meet specifications, paid the three invoices with checks in amounts less than the charge, deducting the allegedly excess freight and other items. The explanatory vouchers attached to the checks contained the printed notation: "Payment of sight draft attached hereto is accepted in full settlement of account stated below." *Held*, plaintiff's cashing of the checks was an accord and satisfaction. "While there is some conflict in the authorities on whether the payment of the conceded part of the claim is a good accord and satisfaction if received in discharge of the whole ... , it is the majority view, as well as the 'tendency of the later cases,' to 'sustain the discharge where there is a dispute as to any part of the claim made by the creditor, although the payment is only the smaller amount which was conceded by the debtor to be due.' " (37 C.2d 602.) (On the revised law, see supra, §952.)

SUPPLEMENT: [This section is current through the latest supplement]



86 of 175 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XVI. DISCHARGE

F. Accord and Satisfaction.

2. Check Sent in Payment of Disputed Claim.

a. Disputed Debt.

3. Rule Unaffected by U.C.C. 1207.

1 *Witkin Sum. Cal. Law Contracts* § 954

[§ 954] Rule Unaffected by U.C.C. 1207.

In *Connecticut Printers v. Gus Kroesen* (1982) 134 C.A.3d 54, 184 C.R. 436, defendant debtor sent a check to plaintiff creditor with a notation, "This check represents payment in full for all obligations owed by ... Kroesen." Plaintiff creditor wrote on the check "Payment accepted without prejudice and subject to final determination of amount due," and deposited it. In this action for an additional sum allegedly due and owing as interest, plaintiff contended that U.C.C. 1207 changed the accord and satisfaction rule as to checks laid down in *Potter v. Pacific Coast Lumber Co. of Calif.* (1951) 37 C.2d 592, 597, 234 P.2d 16, supra, §952. *Held*, the *Potter* rule still governs in situations where there is a bona fide dispute.

(a) U.C.C. 1207, dealing with contracts generally, authorizes performance with a "reservation of rights." (See 4 *Summary* (10th), *Sales*, §19.) Authorities elsewhere are divided on whether this provision of the Uniform Code changes the prevailing rule on accord and satisfaction. (134 C.A.3d 58, 59.)

(b) U.C.C. 1103, providing that unless displaced by particular provisions of the Code the principles of law supplement the Code (see 4 *Summary* (10th), *Sales*, §12), indicates the correct rule: U.C.C. 1207 does not explicitly displace, and therefore does not abrogate, the *Potter* rule. (134 C.A.3d 60; see 21 *Loyola L.A. L. Rev.* 81 [extent to which U.C.C. 1207 has altered common law doctrine of accord and satisfaction].)

U.C.C. 1207 was amended in 1992 to specifically provide that it does not apply to an accord and satisfaction. (U.C.C. 1207(b).)

SUPPLEMENT: [This section is current through the latest supplement]
In 2006, U.C.C. 1207(b) was renumbered U.C.C. 1308(b).



87 of 175 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XVI. DISCHARGE

F. Accord and Satisfaction.

2. Check Sent in Payment of Disputed Claim.

a. Disputed Debt.

4. Distinction: No Debtor and Creditor Relationship.

1 Witkin Sum. Cal. Law Contracts § 955

[§ 955] Distinction: No Debtor and Creditor Relationship.

Where the parties are not merely debtor and creditor, the doctrine of accord and satisfaction may not be applied. Thus, an agent who has funds belonging to his or her principal cannot send less than is due as payment in full, and claim that an accord and satisfaction has resulted from acceptance thereof. (*Egan v. Crowther* (1925) 74 C.A. 674, 679, 241 P. 900.)

SUPPLEMENT: [This section is current through the latest supplement]



88 of 175 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law
XVI. DISCHARGE

F. Accord and Satisfaction.

2. Check Sent in Payment of Disputed Claim.

b. Good Faith and Assent.

1 Witkin Sum. Cal. Law Contracts § 956

[§ 956] Good Faith and Assent.

The evidence must show that the check was sent as a final settlement of the claim. If this condition is not expressed, there is no basis for implying an accord and satisfaction. (See *Lapp-Gifford Co. v. Muscoy Water Co.* (1913) 166 C. 25, 32, 134 P. 989; *Work v. Associated Almond Growers* (1929) 102 C.A. 232, 236, 282 P. 965; *Owens v. Noble* (1946) 77 C.A.2d 209, 215, 175 P.2d 241; *Dietl v. Heisler* (1961) 188 C.A.2d 358, 363, 10 C.R. 587 [jury found against accord and satisfaction].)

A bona fide dispute in good faith must likewise be shown. If a debtor who *definitely* owes a certain sum sends a smaller sum with the accompanying statement that it is intended as full payment, the creditor may accept it because it is due, but his or her mere acceptance does not amount to an accord and satisfaction. (*Lapp-Gifford Co. v. Muscoy Water Co.*, *supra*; *Berger v. Lane* (1923) 190 C. 443, 448, 213 P. 45; *Thompson v. Williams* (1989) 211 C.A.3d 566, 572, 259 C.R. 518 [good faith dispute between attorneys concerning amount of referral fee].) Thus, in *Southern Calif. Disinfecting Co. v. Lomkin* (1960) 183 C.A.2d 431, 7 C.R. 43, a fraudulent employee who stole customer lists owed plaintiff employer \$ 130 on an overdrawn account. He sent a check for this amount "in full payment of all claims against me." *Held*, this did not bar the claim for damages of which plaintiff was unaware when he cashed the check. (183 C.A.2d 440.)

The elements of dispute and assent are questions of fact. (See *Owens v. Noble*, *supra* [evidence held to show that neither party considered the check a final settlement]; *Sanford Co. v. Cory Glass Coffee Brewer Co.* (1948) 85 C.A.2d 724, 729, 194 P.2d 127 [summary judgment denied]; *Moore v. Satir* (1949) 92 C.A.2d 809, 812, 207 P.2d 835 [evidence held to show dispute and acceptance of check as payment in full]; *Kelly v. Bohannon Organization* (1953) 119 C.A.2d 787, 792, 260 P.2d 646 [evidence supported jury's implied finding of no dispute]; *California Metal Enameling Co. v. Waddington* (1977) 74 C.A.3d 391, 395, 141 C.R. 443 [evidence of subsequent discussions held to raise triable issue of fact as to whether cashing of check effected final settlement]; *Zuckerman v. Pacific Savings Bank* (1986) 187 C.A.3d 1394, 1405, 232 C.R. 458 [assent not established where creditor's written notice of amount due was result of computer error, and debtor's check for that amount was returned]; *BII Finance Co. v. U-States Forwarding Services Corp.* (2002) 95 C.A.4th 111, 126, 115 C.R.2d 312 [in dispute between defendant carrier and plaintiff, who was shipper's assignee, over carrier's misdelivery to buyer, buyer's partial payment to plaintiff was not satisfaction of plaintiff's claim under bills of lading, where evidence showed that acceptance of money by plaintiff was only to mitigate damages]; cf. *Potter*

v. Pacific Coast Lumber Co. of Calif. (1951) 37 C.2d 592, 598, 601, 234 P.2d 16, supra, §952 [trial court's finding against accord and satisfaction held without support in the evidence].) (On revised law, see supra, §952.)

A bona fide dispute is unnecessary where there is a written acceptance of part performance. (See *Petroleum Collections v. Sulser (1968) 265 C.A.2d Supp. 976, 979, 70 C.R. 537*, infra, §960.)

West's Key Number Digest, Accord and Satisfaction k.4

SUPPLEMENT: [This section is current through the latest supplement]



89 of 175 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XVI. DISCHARGE

F. Accord and Satisfaction.

2. Check Sent in Payment of Disputed Claim.

c. Retention of Check Without Cashing.

1 Witkin Sum. Cal. Law Contracts § 957

[§ 957] Retention of Check Without Cashing.

An accord and satisfaction results where a check is cashed, or certified, or retained for an unreasonable length of time without protest. (See C.C. 1505; *Conde v. Dreisam Gold Mining Co. (1906) 3 C.A. 583, 588, 86 P. 825; 42 A.L.R.4th 95* [certification]; *42 A.L.R.4th 117* [retention].)

But no such result follows where the creditor gives prompt notice of refusal to accept it as payment in full. Thus, in *Besco Enterprises v. Carole (1969) 274 C.A.2d 42, 78 C.R. 645*, defendant owed plaintiff \$ 9,347.40 at the termination of their business relationship. Defendant sent plaintiff an uncertified check for \$ 2,370.88, together with a letter stating that it was in full payment, with an accounting. Plaintiff promptly replied by letter stating that the accounting was incorrect, and "we are holding your check ... as we cannot accept this check as presented." (*274 C.A.2d 43.*) Plaintiff neither returned nor offered to return the check. Defendant did not request its return, and did not inform plaintiff either that it was being kept covered or that payment was stopped. *Held*, there was no accord and satisfaction, and plaintiff was entitled to recover the full amount of its claim. Where notice of a refusal is given, the creditor has no duty to return the check without a demand from the debtor. (*274 C.A.2d 45.*) (On the revised law, see *supra*, §952.)

West's Key Number Digest, Accord and Satisfaction k.3(3)

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90 of 175 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XVI. DISCHARGE

F. Accord and Satisfaction.

2. Check Sent in Payment of Disputed Claim.

d. Where Coerced Settlement Illegal.

1 Witkin Sum. Cal. Law Contracts § 958

[§ 958] Where Coerced Settlement Illegal.

In *Sierra & San Francisco Power Co. v. Universal Elec. & Gas Co.* (1925) 197 C. 376, 387, 241 P. 76, the claim of accord and satisfaction was rejected where it would have resulted in payments to a utility in violation of law.

This case was followed in *Reid v. Overland Machined Products* (1961) 55 C.2d 203, 10 C.R. 819, 359 P.2d 251. Plaintiff was employed by defendant to sell on commission. After some sales defendant terminated the contract and sent him a check for \$ 792.14, endorsed "payment in full," which plaintiff received and did not return. *Held*, this was not an accord and satisfaction, and plaintiff could maintain the action for commissions. *Lab.C. 206* defines wages to include commissions, and provides that in a wage dispute the employer must pay without condition all sums conceded due, leaving to the employee any remedies that he or she otherwise had. (See 3 *Summary* (10th), *Agency and Employment*, §397.) Hence, the employer may not withhold wages to coerce settlement of the disputed balance. (55 C.2d 207.) (On the revised law, see *supra*, §952.)

SUPPLEMENT: [This section is current through the latest supplement]



91 of 175 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XVI. DISCHARGE

F. Accord and Satisfaction.

3. Written Acceptance of Part Performance.

a. Rule and Theory.

1 Witkin Sum. Cal. Law Contracts § 959

[§ 959] Rule and Theory.

"Part performance of an obligation, either before or after a breach thereof, when expressly accepted by the creditor in writing, in satisfaction, or rendered in pursuance of an agreement in writing for that purpose, though without any new consideration, extinguishes the obligation." (C.C. 1524; see 1 *Am.Jur.2d* (1994 ed.), *Accord and Satisfaction* §29; 1 *Am.Jur. P.P. Forms* (2003 ed.), *Accord and Satisfaction*, §12 et seq.)

This section, like that covering release (C.C. 1541, *supra*, §946), effects a change in the common law, and the result of the two sections is that, irrespective of consideration, a writing may be sufficient to extinguish an obligation. However, in the case of a release, the obligation is at once extinguished by the writing; but in the case of an agreement to accept part performance, which is a form of accord and satisfaction, *the performance must be rendered*. (See *Petroleum Collections v. Sulser* (1968) 265 *C.A.2d Supp.* 976, 977, 70 *C.R.* 537, *infra*, §960.)

Although C.C. 1524 applies to any *obligation*, and a judgment is clearly an obligation, several early cases held that part payment of a judgment will not be a satisfaction thereof, even if expressly accepted in writing. (See *Siddall v. Clark* (1891) 89 *C.* 321, 323, 26 *P.* 829; *Cantrall v. Waterman* (1924) 70 *C.A.* 184, 187, 232 *P.* 997.) These decisions overlooked C.C. 1524, and the correct rule was declared in *Schwartz v. California Claim Service, Ltd.* (1942) 52 *C.A.2d* 47, 54, 125 *P.2d* 883. (See *Blumer v. Madden* (1932) 128 *C.A.* 22, 26, 16 *P.2d* 319.) It should also be noted that *C.C.P.* 724.010 permits a *satisfaction of judgment* by acceptance of a lesser sum in full satisfaction, but requires certain formalities, such as entry in the register. (See *C.C.P.* 724.020 et seq.; 8 *Cal. Proc.* (4th), *Enforcement of Judgment*, §379 et seq.)

C.C. 1524 is not a limitation on C.C. 1521, 1522, or 1523. Hence, an acceptance of part performance where the claim or debt is in dispute is sufficient to discharge the obligation; but *where there is no dispute*, acceptance must be in pursuance of an express agreement in writing. (*B. & W. Engineering Co. v. Beam* (1913) 23 *C.A.* 164, 175, 137 *P.* 624; *General Motors Acceptance Corp. v. Brown* (1934) 2 *C.A.2d* 646, 650, 38 *P.2d* 482; see *supra*, §950 et seq.)

West's Key Number Digest, Accord and Satisfaction k.7(1)

SUPPLEMENT: [This section is current through the latest supplement]

See 1 *Am.Jur.2d* (2005 ed.), *Accord and Satisfaction* §29.

Satisfaction of judgment:

Cross-Reference: 8 *Cal. Proc.* (5th), *Enforcement of Judgment*, §387 et seq.



92 of 175 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law
XVI. DISCHARGE

- F. Accord and Satisfaction.
3. Written Acceptance of Part Performance.
b. Check Containing Written Release.

1 Witkin Sum. Cal. Law Contracts § 960

[§ 960] Check Containing Written Release.

The general rule that acceptance of a check is not an accord and satisfaction unless there is a bona fide dispute (*supra*, §952 et seq.) does not apply where the lesser amount is expressly accepted in *writing as satisfaction*. In other words, C.C. 1524 and 1541 govern where there is a written acceptance of the part performance or a release of any further obligations. And there is no need for a separate document: A statement on the check that the payee-creditor releases the debtor from any claims or liability is a sufficient writing, and endorsement and cashing of the check is an acceptance of the part performance in discharge of the debt. (*Petroleum Collections v. Sulser* (1968) 265 C.A.2d Supp. 976, 979, 70 C.R. 537.)

SUPPLEMENT: [This section is current through the latest supplement]



93 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XVI. DISCHARGE
G. Novation.
1. Nature and Effect.

1 Witkin Sum. Cal. Law Contracts § 961

[§ 961] Nature and Effect.

Novation is the *substitution* by agreement of a new obligation for an existing one, with intent to *extinguish the latter*. (C.C. 1530, 1532.) The substitution may be (1) of a *new obligation* between the *same parties*; or (2) of *new parties*, either new debtor or new creditor. (C.C. 1531.) (See generally *Beckwith v. Sheldon* (1913) 165 C. 319, 323, 131 P. 1049; *Colley v. Chowchilla Nat. Bank* (1927) 200 C. 760, 769, 255 P. 188; *Alexander v. Angel* (1951) 37 C.2d 856, 860, 236 P.2d 561; *Eckhart v. Brown* (1939) 34 C.A.2d 182, 187, 93 P.2d 212; *Ehrenreich v. Shelton* (1963) 213 C.A.2d 376, 378, 28 C.R. 855; *People v. Metcalf* (1978) 79 C.A.3d 1, 8, 144 C.R. 657; *Rest.2d, Contracts* §§279, 280; 13 Corbin (Rev. ed.), §71.3 et seq.; 30 Williston 4th, §76:1 et seq.; 58 *Am.Jur.2d, Novation* (2002 ed.) §1 et seq.; Cal. Civil Practice, 3 Business Litigation, §27:1 et seq.; Cal. Transactions Forms, 3 Business Transactions §17:122 et seq.; 3 California Affirmative Defenses (2004 ed.), §64:1 et seq.; 9 Proof of Facts 2d 159 [novation of contract by substitution of debtors]; 18B *Am.Jur. P.P. Forms* (1997 ed.), Novation, §1 et seq.; 61 *A.L.R.2d* 755 [creditor's acceptance of obligation of third person as constituting novation]; CACI, No. 337 [affirmative defense--novation].)

The Restatement distinguishes between a "substituted contract" made by the same parties (*Rest.2d, Contracts* §279), and a "novation"--a substituted contract that includes a new party (*Rest.2d, Contracts* §280).

A novation completely *extinguishes* the original obligation, and a failure to perform the new one does not revive the old. (*Beckwith v. Sheldon*, supra, 165 C. 323; *Alexander v. Angel*, supra, 37 C.2d 862; *Richardson v. Hislop* (1930) 109 C.A. 440, 451, 293 P. 168; *Wells Fargo Bank v. Bank of America* (1995) 32 C.A.4th 424, 431, 38 C.R.2d 521, quoting the text.) But a special exception to this rule is stated in C.C. 1533: When a creditor accepts the obligation of a *third person* or an order upon a third person (e.g., a promissory note or bill of exchange) in satisfaction of a debt, the creditor may *rescind* the acceptance if (1) the debtor prevents the third person from fulfilling the obligation or from complying with the order; or (2) at the time the obligation or order is received, the third person is insolvent, and this fact is unknown to the creditor; or (3) before the creditor can with reasonable diligence present the order to such third person, the latter becomes insolvent.

West's Key Number Digest, Novation k.1

SUPPLEMENT: [This section is current through the latest supplement]

See 3 California Affirmative Defenses §64:1 et seq.; 18C *Am.Jur. P.P. Forms* (2006 ed.), Novation, §1 et seq.



94 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XVI. DISCHARGE

G. Novation.

2. Requisites.

a. In General.

1 Witkin Sum. Cal. Law Contracts § 962

[§ 962] In General.

(1) *Written, Oral, or Implied.* A novation is subject to the general rules governing contracts. (C.C. 1532.)

No particular form is required; it may be written, oral, or implied from conduct where the intent appears sufficiently clear. This is so even where the original contract is in writing. (*Producers Fruit Co. v. Goddard* (1925) 75 C.A. 737, 755, 243 P. 686; *Tucker v. Schumacher* (1949) 90 C.A.2d 71, 74, 202 P.2d 327; see 30 Williston 4th, §§76:11, 76:12; 58 Am.Jur.2d (2002 ed.), *Novation* §§11, 12.)

In *Chiarello v. Axelson* (1938) 25 C.A.2d 157, 76 P.2d 731, a contract provided that either party could assign it to a corporation to be formed by him, and then be relieved of liability if the corporation assumed the obligations. *Held*, upon formation of the corporation and its express assumption, defendant was discharged, despite plaintiff's refusal to consent, for the consent was embodied in the terms of the original contract. (25 C.A.2d 159.)

(2) *Consideration.* A novation requires consideration. However, where a new debtor is substituted for an old one, the release of the old debtor is sufficient consideration for the new debtor's promise. (*Manfre v. Sharp* (1930) 210 C. 479, 481, 292 P. 465; *Wells Fargo Bank v. Bank of America* (1995) 32 C.A.4th 424, 432, 38 C.R.2d 521, citing the text; see 13 Corbin (Rev. ed.), §71.3; 30 Williston 4th, §76:20 et seq.; 58 Am.Jur.2d (2002 ed.), *Novation* §16.)

(3) *Validity of New Contract.* It is sometimes said that an essential element of a novation is the *validity* of the new contract. (See *Pearsall v. Henry* (1908) 153 C. 314, 317, 95 P. 154, 159; *Young v. Benton* (1913) 21 C.A. 382, 384, 131 P. 1051; *Rest.2d, Contracts* §279, Comment b; 30 Williston 4th, §76:20 et seq.; 58 Am.Jur.2d (2003 ed.), *Novation* §§9, 10.) But in *Producers Fruit Co. v. Goddard*, *supra*, the parties to a written contract substituted an oral agreement that was not to be performed within a year. After 2 years, defendant refused to perform further, and plaintiff sued for breach of the original written contract, the terms of which had not yet run. Although the second contract was unenforceable under the statute of frauds, the court held that it was effective to discharge the first. (75 C.A. 755.) Such a result would appear sometimes to be contrary to the intent of the parties, and hence inconsistent with the theory of novation. (See 14 Cal. L. Rev. 408.)

SUPPLEMENT: [This section is current through the latest supplement]



95 of 175 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XVI. DISCHARGE

G. Novation.

2. Requisites.

b. Intent and Assent.

1 Witkin Sum. Cal. Law Contracts § 963

[§ 963] Intent and Assent.

A novation requires an intent to substitute a new obligation, terminating the old one. (*Blumer v. Madden* (1932) 128 C.A. 22, 24, 16 P.2d 319; *Columbia Cas. Co. v. Lewis* (1936) 14 C.A.2d 64, 71, 57 P.2d 1010; *Ayoob v. Ayoob* (1946) 74 C.A.2d 236, 250, 168 P.2d 462; *Davies Machinery Co. v. Pine Mountain Club* (1974) 39 C.A.3d 18, 24, 113 C.R. 784, citing the text [new arrangement for manner of payment under the contract held only a modification]; *Wade v. Diamond A Cattle Co.* (1975) 44 C.A.3d 453, 457, 118 C.R. 695, citing the text [intent not found]; *Meadows v. Grimsgaard* (1985) 175 C.A.3d 475, 483, 221 C.R. 22 [intent merely to modify]; *Paykar Const. v. Spilat Const. Corp.* (2001) 92 C.A.4th 488, 494, 111 C.R.2d 863 [in suit by subcontractor against general contractor and owners, subcontractor's acceptance of promissory note in lieu of owners' original debt did not, as matter of law, compel conclusion that subcontractor also intended to extinguish amount owed by contractor, in absence of any evidence showing that subcontractor intended to extinguish obligation]; see 30 Williston 4th, §76:12; 58 *Am.Jur.2d* (2002 ed.), *Novation* §12 et seq.; 18B *Am.Jur. P.P. Forms* (1997 ed.), *Novation*, §18.)

Thus, where one party is indebted to another, and the creditor takes his promissory note for the sum owed, this does not discharge the original debt unless the parties expressly so agree, or unless such intention is clearly indicated. (*Merchants Nat. Bank v. Bentel* (1913) 166 C. 473, 477, 135 P. 25; *Western Fuel Co. v. Stanford G. Lewald Co.* (1922) 190 C. 25, 26, 210 P. 419; *Cahn v. California Wrecking Co.* (1937) 9 C.2d 617, 619, 71 P.2d 1113; *First Nat. Bank v. Corcoran* (1930) 105 C.A. 116, 121, 286 P. 1105; see *Easton v. Ash* (1941) 18 C.2d 530, 535, 116 P.2d 433 [acceptance by mortgagee of new note and mortgage as renewal of or substitution for existing note and mortgage does not itself extinguish the original]; *Baer v. Associated Life Ins. Co.* (1988) 202 C.A.3d 117, 124, 248 C.R. 236 [defendant assigned policies to second insurer; insured's submission of claims to second insurer was not assent to novation because he had no effective alternative]; *Howard v. Amador* (1990) 220 C.A.3d 962, 978, 269 C.R. 807 [12th amendment to mineral lease, by which lessee surrendered right to mine lignite, but retained other rights, failed to show intent to extinguish original contract required for novation]; 61 *A.L.R.2d* 755 [creditor's acceptance of obligation of third party as constituting novation].)

In *Garthofner v. Edmonds* (1946) 74 C.A.2d 15, 167 P.2d 789, supra, §218, the court, relying on general language from various authorities to the effect that a novation is a new contract to which *all the parties* must agree, came to an unrealistic conclusion. The first contract was to pay plaintiff a sum lent to a husband and wife. The husband died, and

the wife made the second agreement with plaintiff creditor to cancel the old obligation and pay the debt individually. *Held*, this was not a valid novation, for there were three parties to the original agreement, and one of them, the husband, did not and could not consent. (74 C.A.2d 20.) The case was complicated, and the holding confused, by the unusual fact that the third person or new debtor (the wife) was also an original debtor. *Garthofner* was disapproved on this point in *Alexander v. Angel* (1951) 37 C.2d 856, 864, 236 P.2d 561, where the court followed the Restatement rule that the assent of the original debtor to a beneficial arrangement is presumed, though he or she may disclaim. (See generally *Rest.2d, Contracts* §280, Comment d; 13 Corbin (Rev. ed.), §71.3; 30 Williston 4th, §76:11 et seq.; 58 Am.Jur.2d (2002 ed.), *Novation* §13 et seq.)

West's Key Number Digest, Novation k.7

SUPPLEMENT: [This section is current through the latest supplement]
See 18C Am.Jur. P.P. Forms (2006 ed.), *Novation*, §§2, 12 et seq.



96 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XVI. DISCHARGE
H. Modification or Alteration.
1. In General.

1 Witkin Sum. Cal. Law Contracts § 964

[§ 964] In General.

Modification is a change in the obligation by a modifying agreement, which requires mutual assent, and must ordinarily be supported by consideration. (*American Bldg. Maintenance Co. v. Indemnity Ins. Co.* (1932) 214 C. 608, 615, 7 P.2d 305; *Harvey v. DeGarmo* (1933) 129 C.A. 487, 492, 18 P.2d 971; see *Shea v. Household Bank (SB)* (2003) 105 C.A.4th 85, 88, 129 C.R.2d 387 [where credit card holder announced that he refused to accept arbitration clause amendment and stopped using his card, failure to pay balance and cancel account did not constitute consent to modification]; 13 Corbin (Rev. ed.), §71.1 et seq.; 17A Am.Jur.2d (2004 ed.), *Contracts* §507 et seq.; Cal. Civil Practice, 3 Business Litigation, §27:25 et seq.; Cal. Transactions Forms, 3 Business Transactions §17:82 et seq.; 3 California Affirmative Defenses (2004 ed.), §65:1 et seq.; C.E.B., 1 Real Property Remedies and Damages 2d, §2.1 et seq.; 47 Cal. L. Rev. 92; 12 Hastings L. J. 390; 23 Hastings L. J. 1549; 42 U.C.L.A. L. Rev. 1315 [negative option offer in consumer service contract as modification of existing contract]; BAJI, No. 10.69 [modification]; CACI, No. 313 [modification].)

There are, however, several exceptions to the requirement of consideration:

(1) *Errors* in a contract may be corrected, and omissions supplied, without a new consideration. So where an exclusive agency to sell petroleum products was given to defendant, which did not specify the discount on a new type of gasoline, a modification stating the discount was binding. In such a situation, the consideration for the original contract supports the agreement as modified. (*Texas Co. v. Todd* (1937) 19 C.A.2d 174, 185, 64 P.2d 1180.)

(2) *An executed contract* cannot be attacked for lack of consideration, and the same is true of a modifying agreement. Thus, a modification of a lease by reduction of rent was held binding as to all rent received at the reduced figure, on the theory that the contract was executed as to those payments. (*Julian v. Gold* (1931) 214 C. 74, 79, 3 P.2d 1009; see 20 Cal. L. Rev. 552; 5 So. Cal. L. Rev. 245; see *infra*, §968.)

(3) *A contract not in writing* may be modified *in writing* without a new consideration. (C.C. 1697; see 47 Cal. L. Rev. 92; see *infra*, §967.)

(4) *A contract for the sale of goods* may be modified without consideration: "An agreement modifying a contract within this division needs no consideration to be binding." (U.C.C. 2209(1).)

Rest.2d, Contracts §89 dispenses with consideration in three situations:

"A promise modifying a duty under a contract not fully performed on either side is binding (a) if the modification is *fair and equitable* in view of *circumstances not anticipated* by the parties when the contract was made; or (b) to the extent provided *by statute*; or (c) to the extent that *justice requires* enforcement in view of *material change of position* in reliance on the promise."

Comment b points out that subdivision (a), *supra*, requires *an objectively demonstrable reason* for seeking a modification, and adds: "The same result ... is sometimes reached on the ground that the original contract was 'rescinded' by mutual agreement and that new promises were then made which furnished consideration for each other. That theory is rejected here because it is fictitious when the 'rescission' and new agreement are simultaneous, and because if logically carried out it might uphold unfair and inequitable modifications."

West's Key Number Digest, Contracts k.236

SUPPLEMENT: [This section is current through the latest supplement]
See 3 California Affirmative Defenses §65:1 et seq.



97 of 175 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XVI. DISCHARGE

H. Modification or Alteration.

2. Former Law on Oral Modification.

1 Witkin Sum. Cal. Law Contracts § 965

[§ 965] Former Law on Oral Modification.

(1) *General Rule Against Oral Modification of Written Contract.* C.C. 1698 formerly provided that "[a] contract in writing may be altered by a contract in writing, or by an executed oral agreement, and not otherwise." Thus, if the original contract was written, regardless of whether or not it was of a type within the statute of frauds, the modifying agreement ordinarily had to comply with two requirements: consideration (see *supra*, §964), and writing. (See *Harvey v. DeGarmo* (1933) 129 C.A. 487, 492, 18 P.2d 971; *Smith v. Parlier Winery* (1935) 7 C.A.2d 357, 359, 46 P.2d 170; *Battaglia v. Winchester Dried Fruit Co.* (1939) 32 C.A.2d 436, 90 P.2d 111; *Walther v. Occidental Life Ins. Co.* (1940) 40 C.A.2d 160, 163, 104 P.2d 551; 12 *Hastings L. J.* 391; 23 *Hastings L. J.* 1549; for criticisms of the writing requirement, see 44 *Cal. L. Rev.* 158 and 4 *Hastings L. J.* 59; for the revised C.C. 1698, see *infra*, §966 et seq.)

(2) *Exception: Executed Oral Agreement.* Under C.C. 1698, an executed oral agreement could alter a written contract. (See *Julian v. Gold* (1931) 214 C. 74, 76, 3 P.2d 1009; *Fuller v. Mann* (1932) 119 C.A. 568, 573, 6 P.2d 999; *Taylor v. Taylor* (1940) 39 C.A.2d 518, 521, 103 P.2d 575; *Estate of Morrison* (1945) 68 C.A.2d 280, 285, 156 P.2d 473; *Keeble v. Brown* (1954) 123 C.A.2d 126, 129, 266 P.2d 569; *Eluschuk v. Chemical Engineers Termite Control* (1966) 246 C.A.2d 463, 469, 471, 54 C.R. 711; 51 *Cal. L. Rev.* 1000; 12 *Hastings L. J.* 391; 23 *Hastings L. J.* 1554; 13 *Stanf. L. Rev.* 828; U.C.C. 2209, *supra*, §964.)

(3) *Agreement Performed on One Side.* Ordinarily, an executed oral agreement is one fully performed on *both sides*. (See *supra*, §101.) But in *D.L. Godbey & Sons Const. Co. v. Deane* (1952) 39 C.2d 429, 246 P.2d 946, decided on demurrer, defendant under a written contract agreed to pay plaintiff for cement work at a certain rate per cubic foot. Before performance began, both parties thought that the payment provision was ambiguous and orally modified it. Plaintiff furnished cement under the modified agreement, but defendant refused to pay the increased amount due. *Held*, the complaint was sufficient; where, as here, there was consideration for the oral modification, execution by the party relying on the modification is enough. (39 C.2d 433.) (See 40 *Cal. L. Rev.* 599; 4 *Hastings L. J.* 59; 23 *Hastings L. J.* 1559.)

The *Godbey* decision greatly liberalized the exception to C.C. 1698, and was criticized as a dangerous undermining of the protection against fraud, which the statute was designed to afford. (See dissent, 39 C.2d 434; 40 *Cal. L. Rev.* 601, 602.) It was also pointed out that, in the prior cases involving execution on one side only, the modification called for a markedly different kind of performance. In this case, plaintiff performed the same work; the consideration was merely

the substitution of the new obligations of both parties under the modifying agreement; hence, the claim of increased compensation would rest entirely on oral evidence. (See 40 Cal. L. Rev. 601.)

Despite these criticisms, the *Godbey* rule was consistently followed. (See *Raedeke v. Gibraltar Savings & Loan Assn.* (1974) 10 C.3d 665, 673, 111 C.R. 693, 517 P.2d 1157; *Healy v. Brewster* (1967) 251 C.A.2d 541, 551, 59 C.R. 752; *Weber v. Jorgensen* (1971) 16 C.A.3d 74, 81, 93 C.R. 668;) And the revised law adopts part of the *Godbey* rule. (See *infra*, §968.)

SUPPLEMENT: [This section is current through the latest supplement]



98 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XVI. DISCHARGE

H. Modification or Alteration.

3. Revised Law.

a. Purpose of Revision.

1 Witkin Sum. Cal. Law Contracts § 966

[§ 966] Purpose of Revision.

The original section on oral modification (former C.C. 1698, *supra*, §965) was subjected to a number of judicially declared exceptions (see *supra*, §965). The Law Revision Commission recommended that a new C.C. 1698 be enacted to cover the rule as applied by the courts, and the proposed legislation was adopted in 1976. It was made expressly prospective: The provisions of former C.C. 1697 and 1698 govern contracts made prior to the effective date of the statute (April 9, 1976). (Stats. 1976, Chap. 109, §5.) (See *8 Pacific L. J. 194.*)

SUPPLEMENT: [This section is current through the latest supplement]



99 of 175 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XVI. DISCHARGE

H. Modification or Alteration.

3. Revised Law.

b. Modification of Contract Not in Writing.

1 Witkin Sum. Cal. Law Contracts § 967

[§ 967] Modification of Contract Not in Writing.

"A contract not in writing may be modified in any respect by *consent of the parties, in writing, without a new consideration*, and is extinguished thereby to the extent of the modification." (C.C. 1697; see BAJI, No. 10.69 [modification]; CACI, No. 313 [modification].)

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100 of 175 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XVI. DISCHARGE

H. Modification or Alteration.

3. Revised Law.

c. Modification of Written Contract.

1 Witkin Sum. Cal. Law Contracts § 968

[§ 968] Modification of Written Contract.

(1) *By Written Contract.* C.C. 1698(a), continuing the former rule (supra, §965), states that "[a] contract in writing may be modified by a contract in writing."

If a contract requires that modifications be in writing, this provision may be waived when the modification conforms to the parties' intent. (See *Biren v. Equality Emergency Med. Group* (2002) 102 C.A.4th 125, 141, 125 C.R.2d 325 [contract required written approval to any billing contractor change, but oral modification said that only oral approval was needed; modification conformed to prior practice of orally approving billing contractor changes].)

(2) *By Executed Oral Agreement.* C.C. 1698(b), also continuing the former rule (supra, §965), states that "[a] contract in writing may be modified by an oral agreement to the extent that the oral agreement is executed by the parties." (See *Coldwell Banker & Co. v. Pepper Tree Office Center Associates* (1980) 106 C.A.3d 272, 280, 165 C.R. 51; 8 *Pacific L. J.* 196.)

(3) *By Oral Agreement and New Consideration.* C.C. 1698(c) codifies in part the holding of *D.L. Godbey & Sons Const. Co. v. Deane* (1952) 39 C.2d 429, 246 P.2d 946, supra, §965: "Unless the contract otherwise expressly provides, a contract in writing may be modified by an oral agreement supported by new consideration." But the *Godbey* requirement of execution by the party relying on the modification was not carried over in the new section. (Law Rev. Com. Comment to C.C. 1698); 8 *Pacific L. J.* 196.) (See *Coldwell Banker & Co. v. Pepper Tree Office Center Associates*, supra, 106 C.A.3d 280; *Beggerly v. Gbur* (1980) 112 C.A.3d 180, 190, 169 C.R. 166 [oral modification ineffective where no new consideration]; 10 *Williston 4th*, §29:41 et seq.)

C.C. 1698(c) further states that "[t]he statute of frauds (Section 1624) is required to be satisfied if the contract as modified is within its provisions." This provision is, of course, subject to the exceptions that take a contract out of the statute, e.g., part performance. (Law Rev. Com. Comment to C.C. 1698.)

West's Key Number Digest, Contracts k.236

SUPPLEMENT: [This section is current through the latest supplement]



101 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XVI. DISCHARGE

H. Modification or Alteration.

3. Revised Law.

d. Other Rules Unaffected.

1 Witkin Sum. Cal. Law Contracts § 969

[§ 969] Other Rules Unaffected.

(1) *In General.* C.C. 1698(d) states that "[n]othing in this section precludes in an appropriate case the application of rules of law concerning estoppel, oral novation and substitution of a new agreement, rescission of a written contract by an oral agreement, waiver of a provision of a written contract, or oral independent collateral contracts." In other words, C.C. 1698 does not affect related principles of law. (Law Rev. Com. Comment.) Thus, although the parties may expressly preclude executory oral modifications (C.C. 1698(c), *supra*, §968), oral modification may be valid under the doctrines recognized in C.C. 1698(d). (Law Rev. Com. Comment.) (For illustrations, see *infra*, this section; on oral novation, see *supra*, §962; on oral rescission, see *supra*, §928.)

(2) *Independent Collateral Contract.* An invalid oral modification must be distinguished from a new and valid *independent contract*. (See *Lacy Mfg. Co. v. Gold Crown Mining Co.* (1942) 52 C.A.2d 568, 577, 126 P.2d 644 [independent contract upheld].) In *Walther v. Occidental Life Ins. Co.* (1940) 40 C.A.2d 160, 104 P.2d 551, the court applied the strict and somewhat questionable test based on the *subject matter*. Plaintiff was employed by written contract to sell life, accident, and health insurance, and later an oral agreement was made authorizing him to sell "group insurance." In denying recovery for commissions under the latter authorization, the court said that group insurance was a form of life insurance and therefore was a subject within the scope of the original contract; consequently the oral agreement was not independent, but an attempted oral modification of the original contract. (40 C.A.2d 164.)

(3) *Waiver of Condition.* In some situations, the modification may be upheld as a *waiver of condition*. (See *Bardeen v. Commander Oil Co.* (1940) 40 C.A.2d 341, 347, 104 P.2d 875; *supra*, §823.) But in *Battaglia v. Winchester Dried Fruit Co.* (1939) 32 C.A.2d 436, 90 P.2d 111, plaintiff seller relied upon an oral agreement to extend time for performance, which was properly held invalid under C.C. 1698. The court rejected the contention that it was a waiver of condition, because no pleading, proof, or finding had been made on that theory. (32 C.A.2d 437.)

(4) *Estoppel.* A few decisions, viewing C.C. 1698 as a statute of frauds, have held a party estopped by his or her representations to set up the defense against the other party who relied on them. (See *Wade v. Markwell & Co.* (1953) 118 C.A.2d 410, 421, 258 P.2d 497; *Wagner v. Shapona* (1954) 123 C.A.2d 451, 456, 267 P.2d 378; *Wagner v. Glendale Adventist Med. Center* (1989) 216 C.A.3d 1379, 1388, 1391, 265 C.R. 412 [recognizing that written contract may be modified by contrary oral representations or conduct that induce reliance thereon by other party, but holding

evidence insufficient to establish such a modification].)

(5) *Sale of Goods*. Modification of an agreement for sale of goods is governed by the special provisions of U.C.C. 2209, as amended in 1975 to restore the official text of Unif.Com.C. §2-209. (See 4 *Summary* (10th), *Sales*, §40.)

SUPPLEMENT: [This section is current through the latest supplement]



102 of 175 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XVI. DISCHARGE

H. Modification or Alteration.

4. Unauthorized Alteration.

a. Obligations Discharged.

1 Witkin Sum. Cal. Law Contracts § 970

[§ 970] Obligations Discharged.

"The *intentional* destruction, cancellation, or *material alteration* of a written contract, by a party entitled to any benefit under it, or with his consent, extinguishes all the executory obligations of the contract in his favor, against the parties who do not consent to the act." (C.C. 1700; see *Bishop v. Rainboldt* (1947) 79 C.A.2d 568, 572, 180 P.2d 416; *Rosenberg v. C.W. Clarke Co.* (1962) 200 C.A.2d 178, 184, 19 C.R. 191; *Moving Picture Machine Operators Union v. Glasgow Theaters* (1970) 6 C.A.3d 395, 406, 86 C.R. 33; *Rest.2d, Contracts* §286; 13 Corbin (Rev. ed.), §73.2; 30 Williston 4th, §75:4 et seq.; 4 *Am.Jur.2d* (1995 ed.), *Alteration of Instruments* §1 et seq.; 3 California Affirmative Defenses (2004 ed.), §66:1 et seq.)

The absence of a fraudulent purpose is unimportant if the alteration is material. (*California Savings & Commercial Bank v. Wheeler* (1931) 216 C. 742, 746, 16 P.2d 737.) Where one party signs an incomplete instrument containing blanks as to essential matters, and the other without authority fills them in, this is a material alteration under C.C. 1700. (*Budd v. Hough* (1929) 100 C.A. 103, 106, 279 P. 1074; cf. *Rest.2d, Contracts* §286(1) and Comment (a) [alteration must be both material and fraudulent].) (See 13 Corbin (Rev. ed.), §73.2; 30 Williston 4th, §75:14.)

Moreover, the Evidence Code provides that the party producing a *writing* as genuine, which appears to have been altered after its execution in a part material to the dispute, must satisfactorily account for this appearance or alteration by showing either lack of fault on his or her part or that the alteration did not change the meaning of the instrument. If the party fails to do so, he or she *cannot offer the writing in evidence*. (*Ev.C. 1402*; see *King v. Tarabino* (1921) 53 C.A. 157, 165, 199 P. 890; 10 *Cal. L. Rev.* 162; 2 *Cal. Evidence* (4th), *Documentary Evidence*, §6.)

West's Key Number Digest, Contracts k.246

SUPPLEMENT: [This section is current through the latest supplement]

See 4 *Am.Jur.2d* (2007 ed.), *Alteration of Instruments* §1 et seq.; 3 California Affirmative Defenses §66:1 et seq.



103 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XVI. DISCHARGE

H. Modification or Alteration.

4. Unauthorized Alteration.

b. Alterations Not Affecting Contract.

1 Witkin Sum. Cal. Law Contracts § 971

[§ 971] Alterations Not Affecting Contract.

(1) The test of *materiality* is whether the alteration makes any change in the meaning or legal effect of the contract. If it does not, the instrument may still be enforced. (*Consolidated Loan Co. v. Harman* (1957) 150 C.A.2d 488, 491, 310 P.2d 450 [substitution of name of one obligee for class in which it was included].)

(2) Express or implied *ratification* of the altered instrument will give it full validity, as where notice of the alteration is brought to the attention of the party affected, and he or she makes no objection. (*Houk v. Williams Bros., Ltd.* (1943) 58 C.A.2d 573, 579, 137 P.2d 737; *Leboire v. Black* (1948) 84 C.A.2d 260, 262, 190 P.2d 634; *Consolidated Loan Co. v. Harman, supra*, 150 C.A.2d 493; see *Rest.2d, Contracts* §287; 13 Corbin (Rev. ed.), §73.2; 30 Williston 4th, §75:11.)

(3) *Spoilation*, i.e., unauthorized alteration by a third person or by an agent acting beyond the scope of authority, does not prevent enforcement of the agreement as originally written. Thus, in *Bumb v. Bennett* (1958) 51 C.2d 294, 333 P.2d 23, an assignee for the benefit of the creditors of a partnership, after accepting the written assignment, drew lines through the word "net" in the sentence giving him 10% of all "net funds" coming into his possession. Although this was a material alteration affecting the interests of all parties by a purported increase in the assignee's compensation, the assignment itself was not rendered void. (51 C.A.2d 303.)

SUPPLEMENT: [This section is current through the latest supplement]



104 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
 XVI. DISCHARGE
 I. Account Stated.
 1. Nature and Effect.

1 Witkin Sum. Cal. Law Contracts § 972

[§ 972] Nature and Effect.

Parties transacting business with each other, and keeping accounts of their transactions and items of indebtedness, may come to an *agreement upon the amount of the final balance due* from one to the other. This agreement is an *account stated*, a new and independent executory contract. The items in the original accounts are merged in the account stated. No right of action remains as to these items, and they are not subjects for inquiry in the action on the account stated, except where it is alleged that there was fraud or mistake, etc., in the stating of the account. (*Gardner v. Watson* (1915) 170 C. 570, 574, 150 P. 994; *Young v. LoPresti* (1928) 95 C.A. 79, 82, 272 P. 310; *Budd v. Hough* (1929) 100 C.A. 103, 106, 279 P. 1074; *Shapiro v. Equitable Life Assur. Soc.* (1946) 76 C.A.2d 75, 90, 172 P.2d 725; *Crofts & Anderson v. Johnson* (1950) 101 C.A.2d 418, 422, 225 P.2d 594; *Fogarty v. McGuire* (1959) 170 C.A.2d 405, 409, 338 P.2d 992; *Zinn v. Bright Co.* (1969) 271 C.A.2d 597, 76 C.R. 663, *infra*, §975; *Gleason v. Klammer* (1980) 103 C.A.3d 782, 786, 163 C.R. 483; *Maggio v. Neal* (1987) 196 C.A.3d 745, 753, 241 C.R. 883, citing the text; see *Rest.2d, Contracts* §282; 13 Corbin (Rev. ed.), §72.1 et seq.; 29 Williston 4th, §73:55 et seq.; 1 *Am.Jur.2d* (1994 ed.), *Accounts and Accounting* §24 et seq.; Cal. Civil Practice, 3 Business Litigation, §35:22 et seq.; Cal. Transactions Forms, 3 Business Transactions §18:115 et seq.; 11 *Cal. L. Rev.* 12.)

An account stated need not cover all the dealings or claims between the parties; there may be a partial settlement and account stated as to some of the transactions. (*California Milling Corp. v. White* (1964) 229 C.A.2d 469, 477, 40 C.R. 301.)

The Second Restatement makes the following distinction: (1) An account stated is a manifestation of assent to a stated sum as an accurate "computation." (2) If the agreement involves a *compromise*, the rules on novation and accord and satisfaction apply. (*Rest.2d, Contracts* §282, Comment a and Reporter's Note; see 13 Corbin (Rev. ed.), §72.4.)

West's Key Number Digest, Account Stated k.1

SUPPLEMENT: [This section is current through the latest supplement]

See 1 *Am.Jur.2d* (2005 ed.), *Accounts and Accounting* §26 et seq. *Correction:* Page 1062, line 14 of section, "*Zinn v. Bright Co.*" should be "*Zinn v. Fred R. Bright Co.*"



105 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XVI. DISCHARGE

I. Account Stated.

2. Requisites.

1 *Witkin Sum. Cal. Law Contracts* § 973

[§ 973] Requisites.

(1) The parties must have had at least one previous transaction; the statement cannot create a liability where none existed before. (*Bennett v. Potter* (1919) 180 C. 736, 745, 183 P. 156; *Trafton v. Youngblood* (1968) 69 C.2d 17, 26, 69 C.R. 568, 442 P.2d 648 [attorney sought to unilaterally determine his fee by sending itemized statement]; *Hemenover v. Lynip* (1930) 107 C.A. 356, 360, 290 P. 1089; see 6 A.L.R.2d 113, 122 [previous debtor and creditor relationship as condition of account stated].)

(2) An account stated cannot supersede an existing *specialty*, such as a written contract or promissory note, for the written instrument involves no uncertainty in the sum due, and is higher evidence of the debt. (*Rio Linda Poultry Farms v. Fredericksen* (1932) 121 C.A. 433, 435, 9 P.2d 262.)

(3) It need not be in writing, unless its nature is such as to bring it within the *statute of frauds*. In that case, as where the payment is not to be made within a year, a writing is required. (*Mitchell v. Fleming* (1926) 77 C.A. 241, 245, 246 P. 152; *Truestone v. Simi West Industrial Park II* (1984) 163 C.A.3d 715, 726, 209 C.R. 757.)

SUPPLEMENT: [This section is current through the latest supplement]



106 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law

XVI. DISCHARGE

I. Account Stated.

3. Agreement Implied.

a. Creditor's Statement and Debtor's Assent.

1 Witkin Sum. Cal. Law Contracts § 974

[§ 974] Creditor's Statement and Debtor's Assent.

The agreement need not be express, but may be implied from the circumstances; so ordinarily, where the creditor renders the statement, and the debtor fails to object within a reasonable time, the open account is superseded by the account stated. (*California Bean Growers' Assn. v. Williams* (1927) 82 C.A. 434, 442, 255 P. 751; cf. *Maggio v. Neal* (1987) 196 C.A.3d 745, 753, 241 C.R. 883 [no evidence that debtor knew of debt or that creditor was maintaining account; debtor failed to respond to creditor's statements on advice of attorney]; see *Rest.2d, Contracts §282(1)* and Comment b.)

However, if this intention does not appear, as where statements are sent periodically and business between the parties is continued, there is no account stated. (*American Fruit Growers v. Jackson* (1928) 203 C. 748, 751, 265 P. 926.) And where objection is made to the statement of the account, or the evidence fails to show acknowledgment of a definite and fixed sum, the implied assent is lacking and there is no account stated. (*Hansen v. Fresno Jersey Farm Dairy Co.* (1934) 220 C. 402, 408, 31 P.2d 359; *Petrosino v. Wakefield* (1934) 138 C.A. 336, 342, 31 P.2d 1056; *Hallford v. Baird* (1938) 27 C.A.2d 384, 392, 80 P.2d 1040; *Hill v. Security First Nat. Bank* (1939) 33 C.A.2d 164, 167, 91 P.2d 133.)

West's Key Number Digest, Account Stated k.7

SUPPLEMENT: [This section is current through the latest supplement]



107 of 175 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law

XVI. DISCHARGE

I. Account Stated.

3. Agreement Implied.

b. Debtor's Statement and Creditor's Assent.

1 Witkin Sum. Cal. Law Contracts § 975

[§ 975] Debtor's Statement and Creditor's Assent.

In the usual situation, the creditor renders a statement and the debtor acquiesces. (See *supra*, §974.) However, an account stated may also result where the debtor renders the statement, and the creditor assents.

Thus, in *Levy v. Prinzmetal* (1955) 134 C.A.2d Supp. 919, 286 P.2d 1023, the creditor sent a bill with a certain credit, the debtor paid it by a check marked "in full," and later the creditor challenged the credit and sought to recover that additional sum. *Held*, the rule works both ways, i.e., the *acceptance of payment* by the creditor without objection results in an account stated. (134 C.A.2d Supp. 922.) (See 46 A.L.R.3d 1325 [account stated based upon check or note tendered in payment of debt].)

Similarly, in *Zinn v. Fred R. Bright Co.* (1969) 271 C.A.2d 597, 76 C.R. 663, defendant employer owed employee K a bonus, and drew a check to K for \$ 3,045.73, indicating that purpose. The check bore the printed notation "If not cashed in 60 days this check is void." For some unexplained reason, K never cashed it, and it was found in his papers on his death. The underlying debt, an oral agreement to pay a bonus for services, was barred by the 2-year statute of limitations. Plaintiff administrator therefore sued on the theory of an account stated, with its 4-year statute. *Held*, judgment for plaintiff affirmed. (a) The delivery of the check with its recital was a rendering of an account. (271 C.A.2d 600.) (b) The evidence supported the inference of implied assent by K, the creditor. Although he did not cash the check, he kept it without raising any objection to its correctness; the court could conclude that the inference of agreement outweighed the contrary inference arising from failure to present the check for payment. (271 C.A.2d 601.) (See *Truestone v. Simi West Industrial Park II* (1984) 163 C.A.3d 715, 726, 209 C.R. 757.)

SUPPLEMENT: [This section is current through the latest supplement]



108 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XVII. GOVERNMENT CONTRACTS

A. In General.

1. Scope and Treatment of Subject.

1 Witkin Sum. Cal. Law Contracts § 976

[§ 976] Scope and Treatment of Subject.

The tremendous increase in governmental contracting, state and federal, has focused attention on some special problems not usually encountered in dealing with private individuals. (For general discussions, see C.E.B., 1 *Construction Contracts & Disputes* 3d, §4.1 et seq.; 56 *Am.Jur.2d* (2000 ed.), *Municipal Corporations, Counties, and Other Political Subdivisions* §440 et seq.; 65 *Am.Jur.2d* (2001 ed.), *Public Works and Contracts* §1 et seq.; Cal. Civil Practice, 3 Business Litigation, §39:1 et seq.; 20C *Am.Jur. P.P. Forms* (1998 ed.), *Public Works and Contracts*, §1 et seq.; 1 *San Diego L. Rev.* 88; on representing a government contractor, see 14 *Am.Jur. Trials* 437; on validity of law requiring employment of residents by public works contractors, see 36 *A.L.R.4th* 941.)

Although no attempt is made in this work to explore the ramifications of the subject in depth, significant California decisions and law notes are collected on such topics as challenged contracts, mutual assent, bids and bidders, interpretation, excuses for nonperformance, modification, disputes, termination and renegotiation, and liability of the Government. (See *infra*, §981 et seq.)

West's Key Number Digest, Municipal Corporations k.226

SUPPLEMENT: [This section is current through the latest supplement]

See C.E.B., 1 *Construction Contracts, Defects, and Litigation*, §6.1 (replacing C.E.B., *Construction Contracts and Disputes* 3d); 20C *Am.Jur. P.P. Forms* (2008 ed.), *Public Works and Contracts*, §1 et seq.



109 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XVII. GOVERNMENT CONTRACTS

A. In General.

2. Public Contract Code.

a. In General.

1 Witkin Sum. Cal. Law Contracts § 977

[§ 977] In General.

(1) *Enactment.* The Public Contract Code was enacted in 1981. It originally consisted of the State Contract Act (*Pub.Contr.C. 10100* et seq., formerly *Govt.C. 14250* et seq.), but substantial material, from the Government Code as well as from numerous other codes, was added in 1982, 1983, and 1984. (For a listing of the former code provisions and their disposition in the Public Contract Code, see West's Annotated California Codes, Public Contract, p. 1 et seq.) The new Code is for the most part a reorganization and recodification of the former provisions. (See West's Annotated California Codes, Public Contract, p. 11 et seq.)

(2) *Purpose.* Placing all public contract law in one code was done to make that law "clearer and easier to find." (*Pub.Contr.C. 100.*) In addition, *Pub.Contr.C. 100* accomplishes the following objectives:

(a) "To clarify the law with respect to competitive bidding requirements."

(b) "To ensure full compliance with competitive bidding statutes as a means of protecting the public from misuse of public funds."

(c) "To provide all qualified bidders with a fair opportunity to enter the bidding process, thereby stimulating competition in a manner conducive to sound fiscal practices."

(d) "To eliminate favoritism, fraud, and corruption in the awarding of public contracts."

Public contract law should be "efficient and the product of the best of modern practice and research." (*Pub.Contr.C. 101.*) Moreover, to encourage competition and aid public officials in efficient administration, the public contract law for similar work performed for similar agencies "should be uniform" (*Pub.Contr.C. 102*; see *San Diego Service Authority for Freeway Emergencies v. Superior Court* (1988) 198 C.A.3d 1466, 1470, 244 C.R. 440 [*Pub.Contr.C. 102* held not to state general policy requiring freeway emergency service authority to engage in competitive bidding, where enabling legislation did not contain this requirement].)

(3) *Scope.* The Code "is the basis of contracts between most public entities in this state and their contractors and subcontractors." With regard to *charter cities*, the Code applies in the absence of an express exemption or a city charter

provision or ordinance that conflicts with the relevant Code provision. (*Pub.Contr.C. 1100.7.*)

SUPPLEMENT: [This section is current through the latest supplement]



110 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XVII. GOVERNMENT CONTRACTS

A. In General.

2. Public Contract Code.

b. Organization.

1 Witkin Sum. Cal. Law Contracts § 978

[§ 978] Organization.

The "General Provisions" of the Public Contracts Code (Division 2) are organized into the following Parts and Chapters:

Part 1. Administrative Provisions. (Chap. 1, Definitions [§1100 et seq.]; Chap. 1.6, Electronic Transmissions [§§1600, 1601]; Chap. 2, Responsive Bidders [§2000 et seq.]; Chap. 2.5, Certification of Minority and Women Business Enterprises [§2050 et seq.]; Chap. 3, Formation [§§3300, 3400, 3410]; Chap. 4, Subletting and Subcontracting [§4100 et seq.]; Chap. 5, Relief of Bidders [§5100 et seq.]; Chap. 6, Awarding of Contracts [§6100 et seq.]; Chap. 7, Contract Clauses [§7100 et seq.]; Chap. 9, Claims and Disputes [§9201 et seq.].)

Part 2. Contracting by State Agencies. (Chap. 1, State Contract Act [§10100 et seq.]; Chap. 1.5, California Taxpayer and Shareholder Protection Act of 2003 [§§10286, 10287]; Chap. 2, State Acquisition of Goods and Services [§10290 et seq.]; Chap. 2.1, University of California Competitive Bidding [§10500 et seq.]; Chap. 2.5, California State University Contract Law [§10700 et seq.]; Chap. 3, Acquisition of Information Technology Goods and Services [§12100 et seq.]; Chap. 3.5, Acquisition of Telecommunications Goods and Services [§§12120, 12121]; Chap. 3.6, The Alternative Protest Pilot Project [§12125 et seq.]; Chap. 4, State Assistance for Recycling Markets [§12150 et seq.]; Chap. 5, Recycled Product Procurement by the Legislature [§12300 et seq.]; Chap. 6, Environmentally Preferable Purchasing [§12400 et seq.]; Chap. 10, Claims and Disputes [§19100 et seq.].)

Part 3. Contracting by Local Agencies. (Chap. 1, Local Agency Public Construction Act [§20100 et seq.]; Chap. 1.5, Water District Acts [§20930 et seq.]; Chap. 2, Bidding on *Public Contracts* [§21000 et seq.]; Chap. 2.5, Emergency Contracting Procedures [§22050]; Chap. 3, Acquisition of Electronic Data Processing [§22101 et seq.].)

Part 4. Arbitration of Public Works Contract Claims. (§§22200; 22201.)

Part 5. Withheld Contract Funds. (§22300.)

Part 5.5. The Year 2000 Problem Vendor Compliance and Information Practices Policy. (§22350 et seq.)

West's Key Number Digest, Municipal Corporations k.227

SUPPLEMENT: [This section is current through the latest supplement]

Part 2. Contracting by State Agencies. Assistance for recycling markets: *Pub.Contr.C. 12150* et seq. were repealed in 2005.



111 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
XVII. GOVERNMENT CONTRACTS
A. In General.
3. State Contracts Register.

1 Witkin Sum. Cal. Law Contracts § 979

[§ 979] State Contracts Register.

(1) *In General.* The 1985 Legislature added a Chapter to the Government Code (*Govt.C. 14825 et seq.*) requiring the Department of General Services to publish, at least twice a month, the California State Contracts Register, describing the contracts *proposed by the state*. (*Govt.C. 14825, 14825.1.*) The Department may adopt rules and regulations effectuating the Chapter (*Govt.C. 14829.1*), and state agencies must develop procedures to ensure that proposed contract opportunities are published in the Register (*Govt.C. 14827*).

The Department must offer copies of the Register for sale at a price not to exceed the amount necessary to cover expenses. (*Govt.C. 14829.*) Furthermore, it *may* make the register available to the general public electronically through a computer-accessed service. (*Govt.C. 14825.1.*)

(2) *Contracts Covered.* "Contract" refers to "an agreement entered into by a state agency for services, which term shall be construed to include contracts for construction or alteration of state-owned real property." (*Govt.C. 14825.*)

(3) *Exemptions.* The Chapter does not cover contracts for entertainment by district agricultural associations or for their fair-related events, except that summaries of types of fair-related events must be published in the Register at least twice a year. (*Govt.C. 14825.*)

The Department may exempt a state agency from advertising in the Register where the contract is "necessary for the immediate preservation of life or state property" and is with another agency, and where the director determines that the exemption is in the state's best interests. (*Govt.C. 14827.3.*) Also, the Department may exempt any class of contract if to do so is in the state's best interests. (*Govt.C. 14827.3.*)

The exemptions must be published prominently in each issue of the Register. (*Govt.C. 14827.3.*)

(4) *Content of Register.* In addition to information deemed appropriate by the Department, the Register must include all of the following: (a) Contract identification number. (b) A description of the contract to be performed. (c) All deadlines for submitting bid proposals or other required steps in the contract process, including the location and estimated duration of the contract where appropriate. (d) Any eligibility requirements and preferences. (e) Department, name, and telephone number of the person or persons to contact for further bid and submittal information. (*Govt.C.*

14825.1.)

Each state agency must furnish the required information in time for its publication to give potential bidders at least 10 working days' notice prior to the bid opening date. (*Govt.C. 14827.2.*)

(5) *Additional Information.* To broaden subcontracting opportunities for small businesses, agencies must furnish interested parties with the names and addresses of firms to whom requests for proposals or invitations to bid are to be issued with respect to contracts for \$ 100,000 or more. (*Govt.C. 14826.*)

The names of contractors awarded contracts and contract procedures and requirements must be furnished by contracting agencies to the department, which must maintain the information for review by interested parties. (*Govt.C. 14828.*)

(6) *Effect of Noncompliance.* A state agency may not award a contract unless notice thereof has first been published in the Register. (*Govt.C. 14827.1.*) Nor may it release invitations for bid or requests for proposals prior to publication in the Register of the required information (see *supra*). (*Govt.C. 14827.2.*)

SUPPLEMENT: [This section is current through the latest supplement]



112 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XVII. GOVERNMENT CONTRACTS
A. In General.
4. Unauthorized Contract.

1 Witkin Sum. Cal. Law Contracts § 980

[§ 980] Unauthorized Contract.

(1) *No Constitutional or Statutory Authority.* A public agency is not liable on a contract unless the agency was authorized by the Constitution or statute to incur the obligation; any unauthorized contract is void. (*Air Quality Products v. California* (1979) 96 C.A.3d 340, 349, 157 C.R. 791.)

In *Air Quality Products*, it was alleged that defendant State Air Resources Board breached a contract with plaintiff manufacturer binding the board (a) to compel installation of plaintiff's exhaust emission device in vehicles in California and (b) not to change its emission standards or previous decisions. *Held*, judgment for defendant on demurrer affirmed. Neither *Health & Saf.C. 39603(a)*, authorizing the board to contract for services necessary for the performance of its powers and duties, nor *Health & Saf.C. 39703*, empowering the board to award contracts for air pollution research projects, authorized the contract in question. (96 C.A.3d 349.) And no authority could be found in the board's general power, under *Health & Saf.C. 39600*, to do any act necessary for the proper execution of its powers and duties. (96 C.A.3d 350.)

(2) *Statute Requiring Prescribed Method.* When a statute limits a city's power to make certain contracts to a certain prescribed method and impliedly prohibits any other method, a contract that does not conform to the prescribed method is void and no implied liability can arise. (*South Bay Senior Housing Corp. v. Hawthorne* (1997) 56 C.A.4th 1231, 1235, 66 C.R.2d 99 [contract with general law city for lease of land for housing development was unenforceable unless signed by mayor in accordance with *Govt.C. 40601, 40602*]; *G.L. Mezzetta v. American Canyon* (2000) 78 C.A.4th 1087, 1093, 93 C.R.2d 292 [oral contract with general law city was unenforceable, because, when read together, *Govt.C. 40602* and city ordinances required contracts to be in writing and signed by mayor or city manager].)

(3) *Statute Requiring Written Contract.* When interpreting statutes that generally call for written contracts, but do not require that every contract, without exception, be in writing, the general purpose of the statutory scheme, as well as the consequences of alternative interpretations, may be used as guides. (See *Orange v. San Diego County Employees Retirement Assn.* (2002) 103 C.A.4th 45, 52, 126 C.R.2d 405 [oral option contract was enforceable even though not in writing, as generally required, where it furthered statutory purpose, involved no expenditure of city funds, and was to city's benefit; distinguishing *G.L. Mezzetta*].)

(4) *Contracts With Expatriate Corporations.* Unless certain conditions are met, state agencies are prohibited from

contracting with publicly held "expatriate corporations," that is, U.S.-based companies that have moved to tax haven countries, but only in name and on paper and without substantial business activities in the country of reincorporation. (*Pub.Contr.C. 10286, 10286.1.*) The legislative intent is to protect shareholder rights and to prevent these corporations from obtaining an unfair advantage, by avoiding their fair share of taxes, when competing for state contracts. (See *Stats. 2003, Chap. 657, §1.*)

(5) *Contracts To Purchase Personalty From Seller Lacking Permit or Registration.* A state agency may not contract to purchase tangible personal property from a vendor, contractor, or one of its affiliates, unless that vendor or contractor and all of its affiliates that make sales for delivery into California are holders of a California seller's permit or certificate of registration issued by the state Board of Equalization (see 9 *Summary* (10th), *Taxation*, §367). An exception is provided where the executive director of the agency, or his or her designee, makes a written finding that the contract "is necessary to meet a compelling state interest." (*Pub.Contr.C. 10295.1.*)

(6) *Contracts With Suppliers Discriminating Against Employees With Domestic Partners.* A state agency may not enter into a contract to acquire goods or services in the amount of \$ 100,000 or more with a contractor who, in providing benefits, discriminates between employees with spouses and employees with domestic partners, or discriminates between the domestic partners and spouses of those employees. Certain exceptions and exemptions are provided. Every state contract to acquire goods or services must contain a statement by the contractor certifying compliance with these provisions. (*Pub.Contr.C. 10295.3.*)

West's Key Number Digest, Municipal Corporations k.246

SUPPLEMENT: [This section is current through the latest supplement]

(2) *Statute Requiring Prescribed Method.* See *Katsura v. San Buenaventura* (2007) 155 C.A.4th 104, 108, 65 C.R.3d 762 [contractor could not recover in quantum meruit against city where work was not authorized in writing as required; citing *G.L. Mezzetta v. American Canyon* (2000) 78 C.A.4th 1087, 93 C.R.2d 292, text, p. 1069]. (5) *Contracts To Purchase Personalty From Seller Lacking Permit or Registration.* *Pub.Contr.C. 10295.1* was amended in 2005 to change "may" to "shall."



113 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XVII. GOVERNMENT CONTRACTS
A. In General.
5. Challenged Contract.

1 Witkin Sum. Cal. Law Contracts § 981

[§ 981] Challenged Contract.

Pub.Contr.C. 5110 governs the effect of entry into a public works contract that has been challenged.

(1) *Entry into Contract Authorized.* When a project for the construction, alteration, repair, or improvement of a structure, building, or road, or other improvement is competitively bid and the intended or actual award of the contract is challenged, the contract may be entered into pending final determination of the challenge. (*Pub.Contr.C. 5110(a).*)

(2) *Compensation of Contractor on Determination of Invalidity.* If the contract is later determined to be invalid due to a defect or defects in the competitive bidding process caused solely by the public entity, the contractor is entitled to be paid the reasonable cost, specifically excluding profit, of the labor, equipment, materials, and services furnished by the contractor prior to the date of that determination. The following conditions must be met:

(a) The contractor proceeded with the project based on a good faith belief that the contract was valid. (*Pub.Contr.C. 5110(a)(1).*)

(b) The public entity has reasonably determined that the work performed is satisfactory. (*Pub.Contr.C. 5110(a)(2).*)

(c) Contractor fraud did not occur in obtaining or performing the contract. (*Pub.Contr.C. 5110(a)(3).*)

(d) The contract does not otherwise violate statutory or constitutional limitations. (*Pub.Contr.C. 5110(a)(4).*) (See *Marshall v. Pasadena Unified School Dist. (2004) 119 C.A.4th 1241, 1259, 15 C.R.3d 344* [conditions of *Pub.Contr.C. 5110(a)* met in school district construction contract].)

In no event, however, may payment to the contractor exceed either (a) the contractor's costs as included in its bid plus the cost of any approved change orders or (b) the amount of the contract less profit at the time the contract is determined to be invalid. (*Pub.Contr.C. 5110(b).*)

(3) *Remedies Against Contractor Not Affected.* This statute does not affect any protest and legal proceedings, whether contractual, administrative, or judicial, to challenge the award of the public works contract and enforce competitive bidding laws, or any rights under *C.C.P. 337.1* or *337.15* (see *3 Cal. Proc. (4th), Actions, §§557, 558*), relating to limitations on actions to recover damages from construction of improvements. (*Pub.Contr.C. 5110(c).*)

SUPPLEMENT: [This section is current through the latest supplement]
(3) *Remedies Against Contractor Not Affected.*

Cross-Reference: 3 *Cal. Proc.* (5th), *Actions*, §606 et seq.



114 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XVII. GOVERNMENT CONTRACTS
A. In General.
6. Mutual Assent.

1 Witkin Sum. Cal. Law Contracts § 982

[§ 982] Mutual Assent.

Many cases deal with issues of mutual assent and enforceability of the agreement. (See *Housing Authority v. Los Angeles* (1952) 38 C.2d 853, 869, 243 P.2d 515 [mandamus issued to compel city to perform acts under agreement with Housing Authority]; *Santa Monica Unified School Dist. v. Persh* (1970) 5 C.A.3d 945, 952, 85 C.R. 463 [contract unenforceable against school district because not ratified by district's board as required by statute]; *First Street Plaza Partners v. Los Angeles* (1998) 65 C.A.4th 650, 661, 76 C.R.2d 626 [no contract was formed between city and development partnership where procedural requirements of city charter, including signature by mayor, approval by city council, and approval as to form by city attorney, had not been met]; *Transdyn/Cresci JV v. San Francisco* (1999) 72 C.A.4th 746, 753, 85 C.R.2d 512 [competitively bid contract for public work is awarded at time public entity accepts bid, and public official's duty to execute contract is ministerial; mandamus lies to compel official to sign contract, absent legal grounds for rescission]; 45 Cal. L. Rev. 363 [contracting with state without meeting civil service requirements]; 3 A.L.R.3d 864 [revocation prior to execution of contract, of vote or decision of public body awarding contract].)

A governmental subdivision may be bound by implied contract in the absence of a statutory prohibition against these arrangements. Hence, general provisions giving an irrigation district power to enter into contracts of employment give it power to make implied agreements. (*Youngman v. Nevada Irr. Dist.* (1969) 70 C.2d 240, 246, 74 C.R. 398, 449 P.2d 462.) (See 37 Stanf. L. Rev. 1367 [implied contracts with federal agencies].)

SUPPLEMENT: [This section is current through the latest supplement]



115 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XVII. GOVERNMENT CONTRACTS
A. In General.

7. (New) Restriction on Use of Private Contractors.

1 Witkin Sum. Cal. Law Contracts § 982A

[§ 982A] (New) Restriction on Use of Private Contractors.

Cal. Const., Art. VII, establishes the state's merit-based civil service (see 3 *Summary* (10th), *Agency and Employment*, §17 et seq.). The courts had interpreted this provision as an implied limitation on the use of private contractors that was intended to protect the civil service from political patronage appointments. (*Consulting Engineers & Land Surveyors of Calif. v. Professional Engineers in Calif. Government* (2007) 42 C.4th 578, 581, 67 C.R.3d 485, 169 P.3d 903.) However, Proposition 35, which was passed by the electorate in November 2000, removed the Article VII-based restrictions on contracting with private entities for architectural and engineering services by the State of California (see Cal. Const., Art. XXII). Accordingly, *Consulting Engineers & Land Surveyors of Calif.* held that a provision of a memorandum of understanding between the state and a state employee union that restricted the use of private contractors for architectural and engineering services by public agencies fatally conflicted with Proposition 35. (42 C.4th 580.)

(a) Proposition 35 impliedly repealed various statutory regulations on private contracting when it removed the constitutional restriction from which those statutes were derived. (42 C.4th 586.)

(b) Proposition 35 granted all three branches of government, legislative, executive, and judicial, the authority to contract with private entities for architectural and engineering services unimpeded by constitutional restrictions. (42 C.4th 587.)

(c) Proposition 35 did not endorse an improper shift of policymaking powers from the legislative branch to executive branch agencies. Rather, it recognized that there had been a policy determination, made by a constitutionally empowered legislative entity, i.e., the electorate acting through its initiative power, to permit those agencies to contract free of constitutionally derived limitations. (42 C.4th 587.) (See *Consulting Engineers & Land Surveyors of Calif. v. California Dept. of Trans.* (2008) 167 C.A.4th 1457, 1462, 84 C.R.3d 900 [statutes requiring that Department of Transportation employees perform certain work in construction of highway high-occupancy vehicle lane using design-build process violated constitutional provision authorizing governmental entities to contract with qualified private entities for architectural and engineering services for all public works of improvement, and in design-build project for public work of improvement, Legislature lacked authority to dictate that state employees be used for architectural and engineering services].)

SUPPLEMENT: [This section is current through the latest supplement]



116 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XVII. GOVERNMENT CONTRACTS
B. Bids and Bidders.
1. In General.

1 Witkin Sum. Cal. Law Contracts § 983

[§ 983] In General.

(1) *Competitive Bidding*. The Public Contract Code contains many provisions establishing competitive bidding procedures to ensure the awarding of contracts to the lowest responsible bidder. (See, e.g., *Pub.Contr.C. 10160* et seq. [state projects], *Pub.Contr.C. 10300* et seq. [state procurement of goods and services], *Pub.Contr.C. 10500* et seq. [University of California projects], *Pub.Contr.C. 22000* et seq. [local projects]; on requirement that bidder comply with affirmative action programs, see *Pub.Contr.C. 2000*; on requirement of purchase of information technology goods and services, see *Pub.Contr.C. 12100* et seq.; on statutes making offer or bid irrevocable, see supra, §164; on denial of reformation where bid based on mistake, see supra, §278; on illegality of contract entered into without competitive bidding, see supra, §647; on invalidity of ratification where contract let without competitive bidding, see 3 *Summary* (10th), *Agency and Employment*, §140.)

(2) *Standardized Questionnaire and Financial Statement for Prospective Bidders*. With certain exceptions, a public entity may require prospective bidders to complete a standardized questionnaire and financial statement for use in rating bidders on their qualifications to bid. The questionnaires and financial statements must be verified under oath, but they are not public records. A public entity may also establish a process for prequalifying prospective bidders and for bidders to dispute their proposed prequalification rating. (*Pub.Contr.C. 20101*.)

(3) *Noncollusion Affidavit*. The bidder on a public works contract must execute a noncollusion affidavit and submit it with the bid. (*Pub.Contr.C. 7106*.)

(4) *Damages Sustained by Second Lowest Bidder*. The second lowest bidder, and those in a contractual relationship with it, may recover damages resulting from its bid being rejected due to the successful bidder's violation of the duty to provide unemployment insurance or workers' compensation insurance. (*Pub.Contr.C. 19102, 20104.70*; on damages recoverable when contract misawarded to second lowest bidder, see infra, §987.)

(5) *Employment of Undocumented Aliens*. No state agency or department may award a public works contract to a bidder or contractor who, in the preceding 5 years, has been convicted of violating a state or federal law involving employment of undocumented aliens. Further, a bidder or contractor so convicted is ineligible to bid for a public contract. (*Pub.Contr.C. 6101*.)

(6) *Emergencies*. A procedure has been established to allow a public agency, in an emergency, to repair or replace a public facility without requesting bids on the work. (*Pub.Contr.C. 1102, 20113, 22050*; see *Marshall v. Pasadena Unified School Dist.* (2004) 119 C.A.4th 1241, 1258, 15 C.R.3d 344 [school district's terminating of construction contract, followed by awarding that contract to second company without public bidding, did not constitute "emergency"; decision to terminate was for district's own convenience, rather than sudden, unexpected occurrence, posing clear and imminent danger requiring prompt action, as required by statute].)

(7) *Bidding Over Internet*. "Any public entity" is authorized to adopt methods and procedures to receive bids on public works or other contracts over the Internet, but only if no bid can be opened before the bid deadline and all bids can be verified as authentic. (*Pub.Contr.C. 1601*.)

(8) *Bidding Preference for Public Transit Contractors Retaining Existing Employees*. An awarding authority letting a public transit service contract out to bid must give a prescribed percentage preference to a bidder who agrees to retain qualified employees of the prior contractor to perform the same or similar work. (*Lab.C. 1070 et seq.*)

(9) *Reverse Auctions*. The Department of General Services is authorized to utilize reverse auctions for the acquisition of goods, services, and information technology. A "reverse auction" is defined as a competitive online solicitation process in which vendors compete against each other online in real time in an open and interactive environment. The process is disallowed for bidding on state agency construction contracts under the State Contract Act (see *supra*, §§977, 978). (*Pub.Contr.C. 10290.3, 12101.7*.)

(10) *Commentary*. Commentary with respect to bids and bidders has been extensive. (See, e.g., 61 *Cal. L. Rev.* 552 ; 5 *Pacific L. J.* 152; 23 *Pepperdine L. Rev.* 378; 38 *Santa Clara L. Rev.* 205 [Bid Imperfections in California Public Contracting: Carving Out a Good Faith Exception to the Void Contract Rule]; 10 *Stanf. L. Rev.* 441 [problem of withdrawn bid]; 27 *A.L.R.2d* 917 [differences in character or quality of materials, articles, or work as affecting acceptance of bid]; 53 *A.L.R.2d* 498 [determination of amount involved within statutory provision requiring contracts involving sums exceeding specified amount to be let to lowest bidder]; 15 *A.L.R.3d* 733 [personal service contracts as outside bidding requirements]; 81 *A.L.R.3d* 979 [competitive bidding requirement as applicable to contract for public utility]; 40 *A.L.R.4th* 968 [waiver of bidding required for government construction contracts]; 52 *A.L.R.4th* 186 [state's authority to reject bids]; 89 *A.L.R.4th* 587 [validity of statute or ordinance giving local contractors percentage preference in determining lowest bid]; 49 *A.L.R.5th* 747 [authority of state, municipality, or other governmental entity to accept late bids for public works contracts].)

West's Key Number Digest, Municipal Corporations k.234

SUPPLEMENT: [This section is current through the latest supplement]

(1) *Competitive Bidding*. See *Arnold v. California Exposition & State Fair* (2004) 125 C.A.4th 498, 505, 22 C.R.3d 790 [harness racing contract was not governed by competitive bidding requirements of Public Contract Code, where contract did not involve services to be rendered to state, but rather, was more in nature of lease agreement that allowed commercial business operator to use state facilities to generate revenue]; *Zumbrun Law Firm v. California Legislature* (2008) 165 C.A.4th 1603, 1616, 82 C.R.3d 525 [projects in legislative domain are outside State Contract Act, because Act embraces projects within jurisdiction of Department of General Services and other departments in executive branch; thus, projects involving vehicle barriers around entrances to Capitol were not subject to competitive bidding, even though funds were transferred to Architecture Revolving Fund and Department of General Services had authority to pay monies for construction, because projects involved Legislature's power to construct facilities to protect its members].(7) *Bidding Over Internet*. *Pub.Contr.C. 1601* was subdivided in 2007. The provision discussed in the text is now in *Pub.Contr.C. 1601(a)(1)*.



117 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XVII. GOVERNMENT CONTRACTS
B. Bids and Bidders.
2. Seals and Security.

1 Witkin Sum. Cal. Law Contracts § 984

[§ 984] Seals and Security.

Numerous provisions in the Public Contract Code require all bids, including bids for construction work, to be submitted under sealed cover and accompanied by cash, a cashier's or certified check made payable to the applicable entity, or a bidder's bond executed by an admitted surety insurer and made payable to the entity. (See *Pub.Contr.C.* 20107, 20111, 20129, 20189, 20192, 20201.5, 20204.3, 20214, 20224.5, 20234, 20242, 20251.5, 20262, 20274, 20284, 20294, 20305, 20314, 20322, 20332, 20342, 20352, 20374, 20392.5, 20405, 20413, 20471.5, 20483, 20501, 20512, 20522, 20532, 20551.5, 20564.5, 20584.5, 20602.5, 20624, 20633.5, 20642.5, 20651, 20674, 20685.5, 20688.25, 20694.5, 20724, 20737, 20752.2, 20761.5, 20784, 20804.5, 20832.5, 20843.5, 20867, 20893.5, 20916.5, 20929; and see *Pub.Util.C.* 130232.)

SUPPLEMENT: [This section is current through the latest supplement]
Pub.Contr.C. 20685.5 was renumbered *Pub.Contr.C.* 20683 in 2005.



118 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XVII. GOVERNMENT CONTRACTS
B. Bids and Bidders.
3. Use of Negotiation Process.

1 Witkin Sum. Cal. Law Contracts § 985

[§ 985] Use of Negotiation Process.

The Department of General Services is authorized to use a negotiation process in contracting for goods, services, information technology, and telecommunications. (*Pub.Contr.C. 6611(a).*) The department must find that one or more of the following conditions exist:

(1) The business need or purpose of the procurement or contract can be further defined as a result of a negotiation process. (*Pub.Contr.C. 6611(a)(1).*)

(2) The business need or purpose of the procurement or contract is known by the department, but a negotiation process may identify different types of solutions to fulfill this business need or purpose. (*Pub.Contr.C. 6611(a)(2).*)

(3) The complexity of the purpose or need suggests that a bidder's costs to prepare and develop a solicitation response are extremely high. (*Pub.Contr.C. 6611(a)(3).*)

(4) The business need or purpose of the procurement or contract is known by the department, but negotiation is necessary to ensure that the department is receiving the best value or the most cost-efficient goods, services, information technology, and telecommunications. (*Pub.Contr.C. 6611(a)(4).*)

When it is in the best interests of the state, the department may negotiate amendments to the terms and conditions, including scope of work, of existing contracts for goods, services, information technology, and telecommunications, whether or not the original contract was the result of competition. (*Pub.Contr.C. 6611(b).*)

The department must establish the procedures and guidelines for the negotiation process, including the methodology of evaluating a bid. These may include provisions that authorize the department to receive supplemental bids after the initial bids are opened and specifying circumstances under which supplemental bids may be received. (*Pub.Contr.C. 6611(c).*)

These provisions become inoperative on July 1, 2006, and, as of January 1, 2007, are repealed, unless later otherwise provided. (*Pub.Contr.C. 6611(d).*)

SUPPLEMENT: [This section is current through the latest supplement]

Date of repeal: *Pub.Contr.C. 6611(d)*, specifying the date of automatic repeal, was repealed in 2005. It was replaced by a statute having the same designation and stating that an unsuccessful bidder has no right to protest the results of the negotiating process, but may, as a remedy, file a petition for a writ of mandamus.



119 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XVII. GOVERNMENT CONTRACTS
B. Bids and Bidders.
4. Substantial or Excused Compliance.

1 *Witkin Sum. Cal. Law Contracts* § 986

[§ 986] Substantial or Excused Compliance.

Substantial compliance with competitive bidding requirements is sufficient if the deviation therefrom is inconsequential. (See *Menefee v. Fresno* (1985) 163 C.A.3d 1175, 1178, 210 C.R. 99 [bid was valid even though bid form was not signed on appropriate line, where form was otherwise complete and signed at other locations, and where accompanying bond was properly signed]; *National Identification Systems v. State Bd. of Control* (1992) 11 C.A.4th 1446, 1453, 15 C.R.2d 257 [substantial conformance to call for bids may be accepted if variance is inconsequential]; *Ghilotti Const. Co. v. Richmond* (1996) 45 C.A.4th 897, 905, 53 C.R.2d 389 [award of construction project to lowest bidder did not violate public policy, because 5.5% deviation from contract specifications limiting subcontracting to 50% of total bid was inconsequential and there was no showing of unfair competitive advantage; distinguishing *Valley Crest Landscape v. City Council of Davis* (1996) 41 C.A.4th 1432, 49 C.R.2d 184].) However, a substantial compliance claim is sometimes rejected on the ground that the deviation is consequential. (See *Valley Crest Landscape v. City Council of Davis*, *supra*, 41 C.A.4th 1440 [low bidder's noncompliance with bid specification as to percentage of work to be performed by subcontractors, and subsequent changes in bid to achieve compliance, were not inconsequential irregularities that could be waived, because waiver would have given bidder unfair advantage by allowing withdrawal of bid without forfeiting bond]; *MCM Const. v. San Francisco* (1998) 66 C.A.4th 359, 373, 78 C.R.2d 44 [power to waive immaterial deviations from bid specifications is permissive, not mandatory; in any event, city was without power to waive bidder's failure to list dollar amount of work to be performed by subcontractors, because waiver would have given bidder unfair advantage by allowing withdrawal of bid without forfeiting bond].)

In other cases, a substantial compliance claim is irrelevant, because the circumstances may *excuse* compliance with the bidding requirements. (See *Meakin v. Steveland* (1977) 68 C.A.3d 490, 498, 137 C.R. 359 [sale of city's vacated street to developers who were the only potential purchasers and were willing to pay the full appraised value of land]; *Shea-Kaiser-Lockheed-Healy v. Department of Water & Power* (1977) 73 C.A.3d 679, 684, 140 C.R. 884 [competitive bidding requirements for purchase contract apply only to procedure by which price of goods is set; they have no application to determination of damages for breach of contract]; *Graydon v. Pasadena Redevelopment Agency* (1980) 104 C.A.3d 631, 636, 164 C.R. 56 ["where competitive proposals work an incongruity and are unavailing as affecting the final result, or where competitive proposals do not produce any advantage, or where it is practically impossible to obtain what is required and to observe such form, competitive bidding is not applicable"]; *Construction Industry Force Account Council v. Delta Wetlands* (1992) 2 C.A.4th 1589, 1594, 4 C.R.2d 43 [work to be performed by reclamation

district's own employees held not subject to competitive bidding requirements]; *Associated Builders & Contractors, Golden Gate Chapter v. Contra Costa Water Dist.* (1995) 37 C.A.4th 466, 470, 471, 43 C.R.2d 600 [water district operating under provisions of Water Code was not required to award construction contract to lowest qualified responsible bidder and could lawfully impose union labor clause in solicitation for bids]; *Construction Industry Force Account Council v. Amador Water Agency* (1999) 71 C.A.4th 810, 814, 84 C.R.2d 139 [Pub.Contr.C. 21451, providing that improvement contracts with estimated cost exceeding \$ 12,500 must be let to lowest responsible bidder, applied only when water agency chose to contract for particular project costing more than \$ 12,500 and did not compel agency to enter into contract for those projects; statute did not create "force account limit" (statutory ceiling on value of public works projects that local agency may perform without competitive bidding)].

SUPPLEMENT: [This section is current through the latest supplement]



120 of 175 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law
XVII. GOVERNMENT CONTRACTS

B. Bids and Bidders.

5. Damages Recoverable When Contract Misawarded to Second Lowest Bidder.

1 Witkin Sum. Cal. Law Contracts § 987

[§ 987] Damages Recoverable When Contract Misawarded to Second Lowest Bidder.

In *Kajima/Ray Wilson v. Los Angeles County Metropolitan Trans. Authority* (2000) 23 C.4th 305, 96 C.R.2d 747, 1 P.3d 63, plaintiff, the lowest responsible bidder on a public construction contract, sued defendant agency after it awarded the bid to the second lowest bidder. The trial court found that plaintiff had not received the proper credit in order to meet defendant's disadvantaged business enterprise participation goal and entered judgment for plaintiff, including damages for his bid preparation costs and for lost profits. *Held*, reversed as to the damages awarded.

(a) Because injunctive relief was no longer available, plaintiff had a cause of action for monetary damages based on a promissory estoppel theory. There is no statutory bar to that remedy, and allowing recovery of some measure of damages once injunctive relief is no longer effectively available furthers the purposes of the competitive bidding laws by encouraging proper challenges to misawarded public contracts by the most interested parties and by deterring government misconduct. When a public entity solicits bids, it represents, consistent with the statutory mandate, that if the contract is awarded, it will be awarded to the lowest responsible bidder. In reliance on this representation or requirement, a bidder incurs costs preparing and submitting a bid. If its bid is the lowest, and it is a responsible bidder, but the contract is awarded to a higher bidder, the elements of a promissory estoppel cause of action are established. (23 C.4th 313.)

(b) Plaintiff was entitled to recover damages for its bid preparation costs, but not for lost profits. At the time the bid was submitted, plaintiff had reasonably incurred bid preparation costs in reliance on the representation that if the contract was awarded, it would be awarded to the lowest responsible bidder. However, because defendant was authorized to reject all bids, plaintiff did not know at that point whether the contract would even be awarded. Nor, because of the secrecy of the bidding process, did plaintiff know whether it was indeed the lowest responsible bidder. Given these uncertainties, which are inherent in competitive bidding, bid preparation costs, not lost profits, were the only costs reasonably incurred. Moreover, the lowest bid could turn out to be an unprofitable one, as any miscalculation or unanticipated rise in costs could erode or even extinguish the bidder's profit margin. Awarding plaintiff the profits it would have earned on the contract would be vastly disproportionate to the losses actually sustained as a result of its detrimental reliance and would be necessarily speculative. (23 C.4th 315.)

(c) The competitive bidding statutes exist for the benefit of property holders and taxpayers, and not for the benefit or enrichment of bidders. They should be so construed and administered as to accomplish that purpose fairly and

reasonably with sole reference to the public interest. As a practical matter, in benefiting the public by requiring fairness in evaluating and accepting bids, and thereby increasing competition, the competitive bidding laws also benefit bidders. However, the general public does not benefit by allowing a disappointed bidder to recover lost profits; rather, permitting recovery of lost profits unduly punishes the tax-paying public while providing an unfair windfall to bidders like plaintiff for efforts that they did not make and risks that they did not take. Neither the doctrine of estoppel nor any other equitable principle may be invoked against a governmental body where it would operate to defeat the effective operation of a policy adopted to protect the public. (23 C.4th 316.) (See *Rubino v. Lolli* (1970) 10 C.A.3d 1059, 1063, 89 C.R. 320 [lowest responsible bidder does not have damage action against public entity or its officers who accept higher bid]; *Swinerton & Walberg Co. v. Inglewood-Los Angeles County Civic Center Authority* (1974) 40 C.A.3d 98, 103, 114 C.R. 834, supra, §251 [right of action for damages for rejection of lowest bid may be based on theory of promissory estoppel]; *Universal By-Products v. Modesto* (1974) 43 C.A.3d 145, 152, 117 C.R. 525 [discretion to reject low bid]; 65 A.L.R.4th 93 [low bidder's monetary relief against governmental entity for nonaward of contract].)

SUPPLEMENT: [This section is current through the latest supplement]



121 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XVII. GOVERNMENT CONTRACTS
B. Bids and Bidders.
6. Unlicensed Bidders.

1 Witkin Sum. Cal. Law Contracts § 988

[§ 988] Unlicensed Bidders.

It is a misdemeanor to submit a bid to a public agency without having a license, unless the bidder is exempted from the licensing requirement or the job is a state project involving federal funds. (*B. & P.C. 7028.15(a)*; see *23 Pacific L. J. 550*.)

Unless one of the joint venture exceptions applies (see *B. & P.C. 7028.15(c)*, (d)), any bid submitted to a public agency by an unlicensed contractor must be considered nonresponsive and must be rejected by the public agency. Contracts awarded to, and purchase orders issued to, unlicensed contractors are void. (*B. & P.C. 7028.15(e)*.)

Before awarding a bid, the agency must verify that the contractor was properly licensed. The registrar of contractors may issue a citation to any public employee or officer who knowingly awards a contract or issues a purchase order to an unlicensed contractor. (*B. & P.C. 7028.15(e)*.) However, a public employee or officer may not be issued a citation if the employee, officer, or employing agency contacted the Contractors' State License Board to verify the license status of any person or contractor and the board failed to respond within 3 business days. (*B. & P.C. 7028.15(g)*.)

SUPPLEMENT: [This section is current through the latest supplement]



122 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XVII. GOVERNMENT CONTRACTS
B. Bids and Bidders.
7. Relief From Bid.

1 Witkin Sum. Cal. Law Contracts § 989

[§ 989] Relief From Bid.

A bidder submitting a bid to a state or local public entity may obtain relief from a mistake therein, either by (1) the consent of the awarding authority or (2) an action to recover his or her forfeited bid security. (*Pub.Contr.C. 5100, 5101(a).*) (On amount of bid security and its forfeiture if successful bidder fails to execute a contract, see *Pub.Contr.C. 10167, 10181, 10765, 10781, 21003, 22002.*)

Pub.Contr.C. 5103 requires written notice within 5 days after opening of the bids, specifying in detail how the mistake occurred and showing that it was material and was not due to an error in judgment or to carelessness in inspecting the site or in reading the plans or specifications. (See *A & A Electric v. King* (1976) 54 C.A.3d 457, 463, 465, 126 C.R. 585 [no relief where bidder failed to give written notice or any detailed information; neither actual nor substantial compliance]; *Balliet Bros. Const. Corp. v. Regents of Univ. of Calif.* (1978) 80 C.A.3d 321, 326, 328, 145 C.R. 498 [bidder not required to allege and prove actual forfeiture under its bid bond; sufficient to show mistake, its cause, and timely notice]; *Cal-Air Conditioning v. Auburn Union School Dist.* (1993) 21 C.A.4th 655, 667, 26 C.R.2d 703 [school district had jurisdiction to hear contractor's claim that he had listed wrong subcontractor in bid proposal, where contractor had substantially, if not literally, complied with notice requirements of *Pub.Contr.C. 4107.5*]; *Emma Corp. v. Inglewood Unified School Dist.* (2004) 114 C.A.4th 1018, 1025, 8 C.R.3d 213 [where school district, after being informed that low bidder wished to withdraw bid because of innocent mistake, deliberately mislead bidder from timely complying with withdrawal statutes, it was estopped from enforcing contract]; 12 Proof of Facts 2d 697 [contractor's failure to exercise ordinary care in preparing bid]; 2 A.L.R.4th 991 [right of bidder to rescind for bidder's own mistake or that of his or her employee]; on unilateral mistake in contractor's bid, see *supra*, §267.) (On requirement of public record documenting reasons for mistake where relief is granted by consent, see *Pub.Contr.C. 5101(b)*; 17 *Pacific L. J.* 792.)

A builder who claims a mistake or forfeits his or her bid security is prohibited from participating in further bidding on the project of which the mistake was claimed or security forfeited. (*Pub.Contr.C. 5105; Colombo Const. Co. v. Panama Union School Dist.* (1982) 136 C.A.3d 868, 875, 186 C.R. 463 [plaintiff's rebid was barred by *Pub.Contr.C. 5105* where evidence established that, despite modification, second bid was on same project].)

SUPPLEMENT: [This section is current through the latest supplement]

Pub.Contr.C. 5103 was amended in 2005 to specify that the notice must be given within 5 *working* days, excluding

Saturdays, Sundays, and state holidays.

See *Diede Const. v. Monterey Mechanical Co.* (2004) 125 C.A.4th 380, 386, 22 C.R.3d 763 [statutes providing bid relief upon timely notice to public agency did not apply to mistaken bid submitted by subcontractor, but only to mistake in bid actually submitted by general contractor; permitting general contractor to withdraw bid whenever any subcontractor has made mistake that is minor in relation to total construction cost would threaten to impede timely and efficient administration of public works projects].



123 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XVII. GOVERNMENT CONTRACTS
B. Bids and Bidders.
8. Miscellaneous Issues.

1 *Witkin Sum. Cal. Law Contracts* § 990

[§ 990] Miscellaneous Issues.

A number of other issues involving competitive bidding procedures have arisen. (See *Inglewood-Los Angeles County Civic Center Authority v. Superior Court* (1972) 7 C.3d 861, 867, 103 C.R. 689, 500 P.2d 601 ["relative superiority" test inappropriate in determining the "lowest responsible bidder"]; *Domar Elec. v. Los Angeles* (1994) 9 C.4th 161, 36 C.R.2d 521, 885 P.2d 934, 8 Summary (10th), *Constitutional Law*, §993 [city's requirement that bidders undertake good faith efforts in compliance with subcontractor outreach program as part of competitive bid process did not violate city charter]; *Associated Builders & Contractors, Golden Gate Chapter v. San Francisco Airports Com.* (1999) 21 C.4th 352, 365, 87 C.R.2d 654, 981 P.2d 499, 3 Summary (10th), *Agency and Employment*, §347 [prehire agreement between airports commission and building and trades council designed to resolve labor disputes, which was made condition for bidders on airport project, did not violate either local or state competitive bidding law; agreement did not bar or substantially discriminate against class of contractors and it furthered legitimate governmental interest consistent with that law]; *Palo & Dodini v. Oakland* (1947) 79 C.A.2d 739, 745, 180 P.2d 764 [award to successful bidder creates contract without execution of formal agreement]; *Charles L. Harney v. Durkee* (1951) 107 C.A.2d 570, 575, 237 P.2d 561 [statutory power of municipality to reject all bids]; *Steele v. Jannsen* (1985) 171 C.A.3d 79, 83, 217 C.R. 152 [purchase of portable classrooms held subject to bidding procedures for procurement of materials, supplies, and equipment (*Pub.Contr.C.* 10290 et seq.), rather than to State Contract Act's (*Pub.Contr.C.* 10100 et seq.) bidding procedure for construction "projects"]; *Taylor Bus Service v. San Diego Bd. of Education* (1987) 195 C.A.3d 1331, 1343, 241 C.R. 379 [bidder determined to be nonresponsive, as opposed to nonresponsible, held entitled to notice and chance to submit materials, but not to hearing]; *Konica Business Machines U.S.A. v. Regents of Univ. of Calif.* (1988) 206 C.A.3d 449, 457, 253 C.R. 591 [contract set aside where successful bidder's failure to meet specifications gave it prohibited competitive advantage, and other bidders were not told of right to deviate from specifications]; *Boydston v. Napa Sanitation Dist.* (1990) 222 C.A.3d 1362, 1368, 272 C.R. 458 [sanitation district's lease of land to farmer for utilization of reclaimed water and sludge was public contract subject to competitive bidding requirements]; *Domar Elec. v. Los Angeles* (1995) 41 C.A.4th 810, 820, 48 C.R.2d 822, 8 Summary (10th), *Constitutional Law*, §993 [outreach program did not violate *Pub.Contr.C.* 2000 or Equal Protection Clause of U.S. Const., Fourteenth Amendment]; *Monterey Mechanical Co. v. Sacramento Regional County Sanitation Dist.* (1996) 44 C.A.4th 1391, 1400, 52 C.R.2d 395 [sanitation district abused its discretion in rejecting contractor's bid for failure to demonstrate good faith effort to comply with affirmative action goals as measured by district's written criteria, since *Pub.Contr.C.* 2000(b) contains exclusive criteria for assessing good faith efforts to satisfy those goals]; *M & B Const. v. Yuba County Water Agency*

(1999) 68 C.A.4th 1353, 1359, 81 C.R.2d 231 [under B. & P.C. 7059(b) [awarding authority may select from among license categories in deciding which classifications should be permitted to bid].)

SUPPLEMENT: [This section is current through the latest supplement]

See *D.H. Williams Const. v. Clovis Unified School Dist.* (2007) 146 C.A.4th 757, 765, 53 C.R.3d 345 [Subletting and Subcontracting Fair Practices Act, Contractors' State License Law, and defendant school district's bid package did not require bidders on public contract to list only subcontractors who were licensed at time of bid, such that bidder listing unlicensed subcontractor could be summarily rejected as not responsive]; *Imagistics Int. v. Department of General Services* (2007) 150 C.A.4th 581, 589, 59 C.R.3d 18 [because state agency's bid protest regulation did not grant protest coordinator any discretion to accept late filing, but instead specifically called for forfeiture of protest for noncompliance, doctrine of substantial compliance was inapplicable]; *Titan Elec. Corp. v. Los Angeles Unified School Dist.* (2008) 160 C.A.4th 188, 203, 72 C.R.3d 570 [substitution of subcontractor substantially complied with statutory procedure, although hearing at which school district approved of replacement took place after work was finished, not before as required by *Pub.Contr.C.* 4107; replacement was contacted after subcontractor notified general contractor that it would not return to work, general contractor specified proposed replacement to district before replacement began work, hearing was postponed at request of parties, and no bid shopping or bid peddling occurred in substitution].



124 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XVII. GOVERNMENT CONTRACTS
C. Interpretation.

1 *Witkin Sum. Cal. Law Contracts* § 991

[§ 991] Interpretation.

Contracts of the state or its agencies and other governmental bodies are interpreted in the same manner and under the same rules of construction as private contracts. (See *Brown v. Sebastopol* (1908) 153 C. 704, 709, 96 P. 363; *M.F. Kemper Const. Co. v. Los Angeles* (1951) 37 C.2d 696, 704, 235 P.2d 7; *Hensler v. Los Angeles* (1954) 124 C.A.2d 71, 78, 268 P.2d 12; *Oberg v. Los Angeles* (1955) 132 C.A.2d 151, 158, 281 P.2d 591; *Hawley v. Orange County Flood Control Dist.* (1963) 211 C.A.2d 708, 713, 27 C.R. 478 [forfeiture clause construed against governmental agency that drafted it]; *Los Angeles Equestrian Center v. Los Angeles* (1993) 17 C.A.4th 432, 445, 21 C.R.2d 313; on interpretation generally, see *supra*, §741 et seq.)

Contracts with the federal Government are also subject to the same general rules (see *Priebe & Sons v. United States* (1947) 332 U.S. 407, 68 S.Ct. 123, 125, 126, 92 L.Ed. 32, 38), but applicable federal statutes and regulations prevail over state laws and decisions (*Kauffman v. Kauffman* (1949) 93 C.A.2d 808, 811, 210 P.2d 29; see 4 Santa Clara Lawyer 96 [Armed Services Procurement Regulations as having force of law]).

SUPPLEMENT: [This section is current through the latest supplement]
See 13 *A.L.R. Fed* 2d 261 [application of patent ambiguity doctrine to federal Government contracts].



125 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XVII. GOVERNMENT CONTRACTS
D. Excuses for Nonperformance.

1 *Witkin Sum. Cal. Law Contracts* § 992

[§ 992] Excuses for Nonperformance.

The typical excuses for nonperformance are recognized. (See *M.F. Kemper Const. Co. v. Los Angeles* (1951) 37 C.2d 696, 702, 235 P.2d 7, supra, §267 [mistake]; *Central Contra Costa Sanitary Dist. v. National Surety Corp.* (1952) 112 C.A.2d 61, 67, 246 P.2d 150, supra, §838 [discharge of public works contract by death of contractor]; *Mathes v. Long Beach* (1953) 121 C.A.2d 473, 477, 263 P.2d 472, supra, §837 [impossibility clause].) (On failure to comply with statutory requirement such as competitive bidding as a defense in an action on quasi-contract, see supra, §647.)

With respect to construction contracts of public agencies, *Pub.Contr.C.* 7105(a) and 7105(b)(2) limit to 5% of the contracted price the contractor's responsibility for the cost of any repair or restoration necessitated by specified acts of God, i.e., earthquakes in excess of 3.5 on the Richter scale and tidal waves. (See 6 *Pacific L. J.* 172.)

SUPPLEMENT: [This section is current through the latest supplement]



126 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XVII. GOVERNMENT CONTRACTS
E. Modification.

1 Witkin Sum. Cal. Law Contracts § 993

[§ 993] Modification.

Government contracts usually contain a *changes* clause giving the government or the contractor authority to modify the contract. (See *Pub.Contr.C. 7105(d)(1)* [local public agencies; contracts not awarded on basis of competitive bidding may be modified by consent of parties]; *Govt.C. 11010.5(a)* [same authority for state agencies]; *Pub.Contr.C. 7105(d)(2)* [local public agencies; contracts awarded on basis of competitive bidding may be modified if so provided in contract or by provision of law]; *Govt.C. 11010.5(b)* [same authority for state agencies]; *Pub.Contr.C. 10227* [every contract must provide that state may make changes in plans and specifications]; *Pub.Contr.C. 20136* [specifying methods for changing local public entity contracts]; *Pub.Contr.C. 7101* [providing for payment to contractor of 50% of net savings in construction costs as determined by public entity; 60% for projects under supervision of transportation entities that reduce traffic congestion during construction].) (For cases and commentary, see *Boomer v. Abbott* (1953) 121 C.A.2d 449, 464, 263 P.2d 476; *Hensler v. Los Angeles* (1954) 124 C.A.2d 71, 80, 268 P.2d 12 [changes clause properly applied in interest of more satisfactory accomplishment of project; cannot be invoked to justify omission of integral part of work, as excuse from obligation of counterperformance]; 47 Cal. L. Rev. 105; 36 So. Cal. L. Rev. 323 [delays caused by modifications]; 1 San Diego L. Rev. 94 [changes clause]; 8 Santa Clara Lawyer 210 [defective pricing statute]; 1 A.L.R.3d 1273 [effect of provision that alterations or extras must be ordered in writing].)

Another provision that may be encountered in government contracts is the *changed conditions* clause. This provides for an adjustment in the contractor's compensation in the event unforeseeable or changed conditions increase or decrease costs. (See *Pub.Contr.C. 7105(c)* [state and local public entities may make changes to comply with environmental standards enacted after execution of the contract]; 65 Am.Jur.2d (2001 ed.), *Public Works and Contracts* §179 et seq.; 1 San Diego L. Rev. 93; 56 A.L.R.4th 1042 [construction and effect of "changed conditions" clause in public works or construction contract with state or its subdivisions].)

West's Key Number Digest, Municipal Corporations k.252-

SUPPLEMENT: [This section is current through the latest supplement]

See *Condon-Johnson & Associates v. Sacramento Mun. Util. Dist.* (2007) 149 C.A.4th 1384, 1393, 57 C.R.3d 849 [disclaimers in contract between utility district and contractor that made contractor responsible for determining subsurface conditions violated statute requiring change order when subsurface conditions materially differed from those "indicated" in contract, where contract included soil-boring information intended to acquaint bidder with information needed to assess costs, thereby "indicating" subsurface conditions]; 9 A.L.R. Fed 2d 565 ["cardinal change" doctrine in

federal contracts law]; *15 A.L.R. Fed 2d 273* [validity, construction, and effect of economic price adjustment (EPA) clauses in federal contracts].



127 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XVII. GOVERNMENT CONTRACTS
F. Disputes Clause.
1. Federal Law.

1 Witkin Sum. Cal. Law Contracts § 994

[§ 994] Federal Law.

Federal government contracts often contain a disputes clause that provides a method for settling differences between the parties. (See *United States v. Moorman* (1950) 338 U.S. 457, 70 S.Ct. 288, 290, 94 L.Ed. 256, 259; *United States v. Wunderlich* (1951) 342 U.S. 98, 72 S.Ct. 154, 155, 96 L.Ed. 113, 115; 67 *Harv. L. Rev.* 217.)

Wunderlich involved a standard disputes clause in a federal contract that made the decision of the contracting officer on a dispute concerning a question of fact final. The Court held that, under the clause, review of the officer's decision was limited to actual fraud. But the rule was nullified by the Wunderlich Act (41 U.S.C., §321, 322), making the contracting officer's decision under such a clause final unless it is "fraudulent or capricious or arbitrary or so grossly erroneous as necessarily to imply bad faith, or is not supported by substantial evidence." (On the Wunderlich Act and the operation of federal boards of contract appeals, see *United States v. Bianchi & Co.* (1963) 373 U.S. 709, 83 S.Ct. 1409, 10 L.Ed.2d 652; *United States v. Utah Const. & Mining Co.* (1966) 384 U.S. 394, 86 S.Ct. 1545, 16 L.Ed.2d 642; *United States v. Grace & Sons* (1966) 384 U.S. 424, 86 S.Ct. 1539, 16 L.Ed.2d 662; 8 *Corbin* (Rev. ed.), §31.14; 75 *Harv. L. Rev.* 1645; 1 *San Diego L. Rev.* 89; 33 *So. Cal. L. Rev.* 403.)

SUPPLEMENT: [This section is current through the latest supplement]



128 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XVII. GOVERNMENT CONTRACTS
F. Disputes Clause.
2. California Law.

1 Witkin Sum. Cal. Law Contracts § 995

[§ 995] California Law.

(1) *Review of Arbiter's Decision.* The object of the Wunderlich Act (supra, §994) was achieved in California by judicial decision. In *Clack v. California* (1969) 275 C.A.2d 743, 80 C.R. 274, plaintiff, assignee of a state contractor, sued for damages for breach of a contract for a highway construction project, alleging defective plans, misrepresentation of project conditions, and unjustified change orders. Defendant State relied on §9(f) of the Standard Specifications of the Division of Highways, a part of the contract, providing for settlement of disputed contract items by the state highway engineer, whose determination was made conclusive "except in the case of gross error." The engineer had denied plaintiff's claim, and the issue on appeal was whether plaintiff had sufficiently pleaded "gross error." *Held*, judgment on the pleadings for defendant reversed; though defective in form, a cause of action could be stated. The state's position, that "gross error" necessarily means fraud or bad faith, is untenable; the term also covers arbitrariness and gross mistake. (275 C.A.2d 746.) And the "substantial evidence rule" of appellate review and judicial review of administrative determinations should be applied:

"The engineer's decision may entail interpretation of the contract language or specifications, application of a rule of law, or of a contract interpretation, to agreed facts; or a resolution of disputed facts. Whatever his honesty, any of these decisions may be so groundless that no impartial, *reasoning* arbiter would agree with it. An action is arbitrary when it is based on no more than the will or desire of the decision-maker and not supported by a fair or substantial reason. ... In the context of fact-finding, arbitrariness characterizes the decision when it lacks substantial support in the evidence." (275 C.A.2d 747.)

In *Macomber v. California* (1967) 250 C.A.2d 391, 58 C.R. 393, plaintiff agreed to remodel a building for the state. The contract provided that claims for additional sums based on changes in specifications should be submitted to the state architect, whose determination would be conclusive "except in the case of gross error." The state architect, with full knowledge of serious errors in plans and many subsequent adjustments required of plaintiff, nevertheless rejected his claim. *Held*, "gross error" includes failure to exercise honest judgment, arbitrary action, and gross mistake; hence his determination was not binding. (250 C.A.2d 398.) (See *Boomer v. Abbott* (1953) 121 C.A.2d 449, 460, 263 P.2d 476 [disputes clause making arbiter's rulings final did not include rulings protested under clause requiring protest of rulings deemed unfair]; *Zurn Engineers v. California* (1977) 69 C.A.3d 798, 823, 138 C.R. 478 [applying substantial evidence rule]; 8 *Pacific L. J.* 533 [extensive critique of California procedures and proposal for a Public Contract Adjudications Act]; 32 *So. Cal. L. Rev.* 22 [effect on rights of subcontractor].)

(2) *Arbiter's Decision Denying Due Process.* In *Zurn Engineers v. California*, *supra*, the court held that failure of the engineer to advise the contractor in advance of the factual material on which he intended to rely so as to offer an opportunity for refutation or supplementation was "a procedural error of due process magnitude." (69 C.A.3d 833.) Accordingly, the judgment was reversed with directions to enter judgment requiring the engineer to reconsider the claims. (69 C.A.3d 838.)

(3) *Sole Arbiter Provision Invalid.* C.C. 1670 states that "Any dispute arising from a construction contract with a public agency, which contract contains a provision that one party to the contract or one party's agent or employee shall decide any disputes arising under that contract, *shall be resolved* by submitting the dispute to *independent arbitration*, if mutually agreeable, otherwise by *litigation* in a court of competent jurisdiction." (See 10 Pacific L. J. 300 [suggesting that, to avoid unconstitutional impairment of the obligation of contract, the new statute should be applied prospectively only, i.e., to contracts made on or after January 1, 1979].) (On arbitration provisions, see *Pub.Contr.C. 10240* et seq. [covering disputes under State Contract Act]; *Pub.Contr.C. 22200, 22201* [permitting state public works contracts not subject to State Contract Act to contain provision making Act's arbitration provisions applicable].)

(4) *List of Arbitrators.* *Pub.Contr.C. 10240.3* provides that if the parties cannot agree on the arbitrator, either party may petition the superior court to appoint one from the panel of arbitrators certified by the Public Works Contract Arbitration Committee. (See *Brutoco Engineering & Const. v. Superior Court* (2003) 107 C.A.4th 1326, 1330, 132 C.R.2d 866 [*Pub.Contr.C. 10240.3*, as construed to require trial court to nominate, or at least eventually to appoint, only arbitrators on list approved by arbitration committee, is enforceable].)

(5) *Other Statutes Involving Claims and Disputes.* *Pub.Contr.C. 19100* deals with the conditions and time limits for commencement of an action or proceeding against a public entity; *Pub.Contr.C. 7100* nullifies contract clauses making a contractor's acceptance of payment a waiver of claims against the public entity, but permits clauses requiring a release of claims associated with undisputed amounts for which the contractor accepts payment, with disputed contract claims in specified amounts to be excluded from operation of the release; *Pub.Contr.C. 9201* permits a public entity to compromise or settle a contract claim at any time.

The public entity must include provisions in a public works contract for timely notification of the contractor of a third-party claim. The entity is entitled to recover reasonable costs incurred in providing the notice. (*Pub.Contr.C. 9201(b), (c).*)

SUPPLEMENT: [This section is current through the latest supplement]



129 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XVII. GOVERNMENT CONTRACTS
G. Termination and Renegotiation.

1 Witkin Sum. Cal. Law Contracts § 996

[§ 996] Termination and Renegotiation.

Standard provisions in most public works contracts permit the government or contractor to terminate or renegotiate the contract under specified conditions. (See *Pub.Contr.C. 7105(d)* [local public agencies; specifying methods of termination of contracts awarded, and not awarded, on basis of competitive bidding, and allowing termination for environmental considerations]; *Govt.C. 11010.5* [same for state agencies]; *66 Harv. L. Rev. 47, 270*; *1 San Diego L. Rev. 96*; *27 So. Cal. L. Rev. 496*; *37 So. Cal. L. Rev. 452.*) (On clause in contracts of the federal Government permitting termination for convenience, see *7 Pepperdine L. Rev. 711*; on racial discrimination in termination for convenience or default, see *54 So. Cal. L. Rev. 823.*)

West's Key Number Digest, Municipal Corporations k.252-

SUPPLEMENT: [This section is current through the latest supplement]

See *12 A.L.R. Fed 2d 551* [recovery awardable to government contractor on termination of contract for convenience].



130 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XVII. GOVERNMENT CONTRACTS
H. Government's Liability.
1. In General.

1 Witkin Sum. Cal. Law Contracts § 997

[§ 997] In General.

The liability of the Government under a public works contract is usually the same as the liability of a party to a private contract. (See *Souza & McCue Const. Co. v. Superior Court* (1962) 57 C.2d 508, 510, 20 C.R. 634, 370 P.2d 338; *E. H. Morrill Co. v. California* (1967) 65 C.2d 787, 791, 56 C.R. 479, 423 P.2d 551 [allegations of complaint came within *Souza*]; *Salinas v. Souza & McCue Const. Co.* (1967) 66 C.2d 217, 223, 57 C.R. 337, 424 P.2d 921 [*Souza* case tried on contractor's cross-complaint]; *Bilardi Const. v. Spencer* (1970) 6 C.A.3d 771, 774, 86 C.R. 406; *Western Title Guaranty Co. v. Sacramento & San Joaquin Drainage Dist.* (1965) 235 C.A.2d 815, 820, 45 C.R. 578; *Healy v. Brewster* (1967) 251 C.A.2d 541, 550, 59 C.R. 752; 55 Cal. L. Rev. 119; 70 Proof of Facts 3d 97 [liability of government agency for improperly granting bid award]; 79 Harv. L. Rev. 1307 [restitution]; cf. 23 Hastings L. J. 874 [quasi-contractual liability of public entity].) (On "sovereign act" doctrine as special defense of federal government where its acts make performance of contract more burdensome, see 78 Harv. L. Rev. 1491; 1 San Diego L. Rev. 88; 8 Stanf. L. Rev. 284.)

West's Key Number Digest, Municipal Corporations k.256

SUPPLEMENT: [This section is current through the latest supplement]



131 of 175 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law
XVII. GOVERNMENT CONTRACTS

H. Government's Liability.

2. Implied Warranty, Misrepresentation, or Concealment.

1 Witkin Sum. Cal. Law Contracts § 998

[§ 998] Implied Warranty, Misrepresentation, or Concealment.

A provision in the contract that the bidder has examined or must examine the site cannot excuse active misrepresentation or concealment of conditions by the governmental agency. (*Morrill Co. v. California* (1967) 65 C.2d 787, 792, 56 C.R. 479, 423 P.2d 551 [disapproving contrary implication in *A. Teichert & Son v. California* (1965) 238 C.A.2d 736, 48 C.R. 225]; *Salinas v. Souza & McCue Const. Co.* (1967) 66 C.2d 217, 223, 57 C.R. 337, 424 P.2d 921; *Warner Const. Corp. v. Los Angeles* (1970) 2 C.3d 285, 294, 85 C.R. 444, 466 P.2d 996; *Welch v. California* (1983) 139 C.A.3d 546, 555, 558, 188 C.R. 726 [following *Warner Const. Corp.*]; *Howard Contracting v. G.A. MacDonald Const. Co.* (1998) 71 C.A.4th 38, 55, 83 C.R.2d 590 [contract provision requiring contractor's compliance with requirements of project permits did not absolve city from liability for concealment and nondisclosure of relevant information, even though it was disclosed in permits, where provision did not specifically direct bidders to examine permits and no reason compelled them to do so]; see 55 Cal. L. Rev. 119 [Morrill]; 6 Pepperdine L. Rev. 407 [implied warranty where contractor uses federal Government design specifications]; 86 A.L.R.3d 182 [duty of public authority to disclose information to contractor].)

On the other hand, where the governmental agency makes statements honestly and only as suggestions, with warnings to the contractor to satisfy itself as to conditions, there is no basis for reliance, and the *Souza* rule of breach of implied warranty is inapplicable: "When there is no misrepresentation of factual matters within the state's knowledge or withholding of material information, and when both parties have equal access to information as to the nature of the tests which resulted in the state's findings, the contractor may not claim in the face of a pertinent disclaimer that the presentation of the information, or a reasonable summary thereof, amounts to a warranty of the conditions that will actually be found." (*Wunderlich v. California* (1967) 65 C.2d 777, 786, 56 C.R. 473, 423 P.2d 545.) (See 55 Cal. L. Rev. 119; 7 Santa Clara Lawyer 265 [Wunderlich and Teichert].)

Silence alone, without misleading half-truths or concealment, is not a basis for governmental liability. (*Wiechmann Engineers v. California* (1973) 31 C.A.3d 741, 751, 107 C.R. 529 [distinguishing *Warner* and following *Wunderlich*]; *Jasper Const. v. Foothill Junior College Dist.* (1979) 91 C.A.3d 1, 10, 12, 153 C.R. 767 [same; must be affirmative misrepresentation or concealment of material facts].)

SUPPLEMENT: [This section is current through the latest supplement]

See *Thompson Pac. Const. v. Sunnyvale* (2007) 155 C.A.4th 525, 551, 66 C.R.3d 175 [contractor of public works who,

acting reasonably, was misled by incorrect plans and specifications issued by public authorities as basis for bids and who, as result, submitted bid that was lower than he would have otherwise made could recover in contract action for extra work or expenses necessitated by conditions being other than as represented].*Correction:* Page 1086, line 3 of section, "*Morrill Co. v. California*" should be "*E.H. Morrill Co. v. California*".



132 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XVII. GOVERNMENT CONTRACTS
H. Government's Liability.
3. Contractual Terms Limiting Liability.

1 Witkin Sum. Cal. Law Contracts § 999

[§ 999] Contractual Terms Limiting Liability.

Contractual terms by which a government attempts to limit its liability take various forms. A typical provision is one limiting the government's liability for the contract price to a special fund. In *Bilardi Const. v. Spencer* (1970) 6 C.A.3d 771, 774, 86 C.R. 406, the court held that such a provision did not bar a contractor's recovery against a city for *breach of contract* even though there was insufficient money in the special fund to pay the damages awarded. See 40 A.L.R.4th 998 [on amount of appropriation as limitation on government's liability for breach of contract].

Another standard contract clause was involved in *United States v. Seckinger* (1970) 397 U.S. 203, 90 S.Ct. 880, 25 L.Ed.2d 224. It provided that defendant contractor was "responsible for all damages to persons or property that occur as a result of his fault or negligence." A contractor's employee was injured and recovered against the United States under the Federal Tort Claims Act. The United States sought indemnification from the contractor. *Held*, the clause made the contractor liable only for its own negligence and not the negligence of the Government. The Government, therefore, was entitled to recover from the contractor only on the basis of comparative negligence. (90 S.Ct. 887, 25 L.Ed.2d 235.)

By statute, a contract provision limiting the Government's liability for unreasonable delays for which it is responsible to an extension for the delay may not be construed to preclude the recovery of damages by the contractor. Furthermore, the Government may not require that this statutory provision be waived, altered, or limited, and any action of this nature is void. (*Pub.Contr.C. 7102*; see *Howard Contracting v. G.A. MacDonald Const. Co.* (1998) 71 C.A.4th 38, 49, 83 C.R.2d 590 [contract clause purporting to exempt city from liability for delay damages was unenforceable under *Pub.Contr.C. 7102*, where delays were caused by city and were unreasonable and not within contemplation of parties; charter status of city did not exempt it from application of statute].)

Govt.C. 6508.1 provides that if a joint powers agency (JPA) is not one of the parties to the joint powers agreement but is a public entity, commission, or board *constituted pursuant to the agreement*, the debts, liabilities, and obligations of the agency are those of the parties to the agreement, *unless the agreement specifies otherwise*. (See *Tucker Land Co. v. California* (2001) 94 C.A.4th 1191, 1197, 114 C.R.2d 891 [agreement specifying that constituent members of JPA were not liable for its debts].)

West's Key Number Digest, Municipal Corporations k.256

SUPPLEMENT: [This section is current through the latest supplement]



133 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XVII. GOVERNMENT CONTRACTS

H. Government's Liability.

4. Abandonment Theory Not Applicable Against Public Entity.

1 Witkin Sum. Cal. Law Contracts § 1000

[§ 1000] Abandonment Theory Not Applicable Against Public Entity.

In *Amelco Elec. v. Thousand Oaks* (2002) 27 C.4th 228, 115 C.R.2d 900, 38 P.3d 1120, supra, §910, the question presented was: whether a public entity is liable under an abandonment theory to a contractor when it makes numerous changes to the contract work, and these changes allegedly make it difficult and more costly to perform the contract because of delay, interference with the work of other trades, and other problems not captured in the price of the executed change orders. Defendant city solicited bids for electrical work to be performed in the construction of a civic arts plaza. Plaintiff contractor submitted the lowest bid and was awarded the contract. During the construction process, defendant furnished over a thousand sketches to clarify or change the original contract drawings, 248 of which affected the electrical cost. As a result, plaintiff requested 221 change orders, but only received 32. At trial, plaintiff claimed that the project involved many sketches that were difficult to work with and that the scheduling of the various contractors' work became more difficult because of the changes. After denial of two requests for a change order concerning a particular work directive, plaintiff, alleging (a) abandonment and (b) breach of contract (see supra, §910), filed the present suit to recover costs allegedly resulting from the noncaptured costs of the change orders. The trial judge entered judgment for plaintiff on both theories, and the Court of Appeal affirmed. *Held*, reversed.

(a) Background.

(1) In general, if a public contract is declared void, a contractor may not be paid for the work performed under that contract. Also, a contractor cannot recover on a quantum meruit theory for work performed beyond the contractual requirements. (27 C.4th 229.)

(2) In California, the Courts of Appeal have concluded that *private* parties may abandon a contract when they fail to follow change order procedures and when the final product differs substantially from the original. (27 C.4th 235.) A contract is abandoned " 'when an owner imposes upon the contractor an excessive number of changes such that it can fairly be said that the scope of the work under the original contract has been altered.' " (27 C.4th 236, quoting *C. Norman Peterson Co. v. Container Corp. of America* (1985) 172 C.A.3d 628, 218 C.R. 592, supra, §910.)

(3) Plaintiff argued that the abandonment doctrine is coextensive with the "cardinal change" theory, under which the federal Court of Claims has historically recognized government breach of contract liability. This argument is without merit. When a contract is abandoned, it is set aside, and the plaintiff can then recover the reasonable costs for

all of its work. On the other hand, a cardinal change constitutes a material breach of contract, and the plaintiff may recover breach of contract damages for the different work. Moreover, because the jury in this case was never instructed on the cardinal change theory, the question whether that theory applies in California is not reached. (27 C.4th 238.)

(b) *Analysis.*

(1) The notion of the parties abandoning a public works contract, with its strict statutory requirements, is anomalous. General cities such as defendant are statutorily required to award public contracts in excess of \$ 5,000 to the lowest responsible bidder. In other words, a defendant lacks the authority to contract with a plaintiff for a quantum meruit payment free from any of the prior contract's restraints, and the *court* is also without authority to abrogate the bidding statute and make a new contract that the parties themselves are powerless to make. (27 C.4th 239.)

(2) Competitive bidding statutes are enacted for the benefit of property holders and taxpayers and not for the benefit or enrichment of bidders. Thus, these statutes should be so construed and administered as to accomplish this purpose fairly and reasonably with sole reference to the public interest. It is difficult, however, to ascertain how the general public benefits by allowing a contractor to claim abandonment of the public works contract following completion of the work, and recover for the reasonable value of its work. Indeed, just the opposite seems true: permitting recovery would appear to unduly punish the tax-paying public. (27 C.4th 239.)

(3) Under plaintiff's approach, a certain number of changes may be permissible, but at some indeterminate point, the next requested change makes the number "excessive," the competitively bid contract is set aside, and the contractor recovers on a quantum meruit basis from the beginning of the project onward. This vague definition fails to provide any meaningful guidance as to when that line has been crossed. Thus, public entities would not receive the timely notice of claims necessary to allow them to make project management, budget, or procedural adjustments during the course of construction. Rather, because the contractor would not need to demonstrate at what point the contract was abandoned, it would be permitted to wait until a project was completed before giving notice of "too many" changes, thus creating intolerable uncertainty in the budgeting and financing of construction projects. (27 C.4th 240.)

(4) Allowing contractors to recover in quantum meruit for the actual, as opposed to the bid cost of a project, would encourage them to bid unrealistically low with the hope of prevailing on an abandonment claim based on the numerous changes inherent in any large public works project. Moreover, if abandonment is recognized as a theory of recovery for public works, the possibility of significant monetary gain alone may encourage frivolous litigation and further expend public resources. Finally, prudence is always warranted whenever courts fashion damages remedies in an area governed by an extensive statutory scheme. (27 C.4th 240.)

(5) *Pub.Contr.C. 7105*, providing for the compensation payable under a public works contract, refers only to "termination, amendment, or modification." Plaintiff thus contended that this statute was not meant to apply to abandonment. However, under the abandonment doctrine, the original contract is set aside and the contractor is paid for the reasonable cost for its work. It is thus difficult to understand how such a radical change is not a "modification" or "termination" subject to *Pub.Contr.C. 7105*. (27 C.4th 241.)

(6) C.C. 3262, pertaining to mechanics liens, was amended in 1993 to specify that the release required for a contractor to receive progress payments does not affect the parties' contractual rights, including any right based upon *abandonment* or the right of the undersigned to recover compensation for labor, services, and material that were not covered by the progress payment. Asserting that this statute is applicable to both private and public contracts, plaintiff contended that it evidenced a legislative intent that abandonment claims were not inconsistent with the statutory competitive scheme that it had created. Although it is not clear what the Legislature intended in amending this statute, it is unlikely that it meant to recognize the abandonment doctrine for public works as well as private contracts. Such a conclusion, i.e., one overturning decades of case law regarding the unavailability of quantum meruit recovery against a public entity, would no doubt be more prominently featured than by simply amending a sample form regarding mechanic's liens. (27 C.4th 241.)

(7) Plaintiff also asserted that a defendant is liable for a *breach* of its agreement in the same manner as a private party. This is correct, and in this case the jury found that defendant had breached its contract. However, recovery for a specific breach, with its requirements for causation and damages, is far different from abandonment, in which an entire competitively bid contract is set aside. (27 C.4th 242.)

One justice, citing *C. Norman Peterson Co. v. Container Corp.*, *supra*, dissented on the grounds that it has long been the rule in California that a contractor has a remedy when the defendant creates so many changes that the original contract has been altered, and that public contracts, in this respect, are to be treated the same as private contracts. (27 C.4th 248.) (See *Sehulster Tunnels/Pre-Con v. Traylor Brothers/Obayashi Corp.* (2003) 111 C.A.4th 1328, 1343, 4 C.R.3d 655 [suit by subcontractor against contractor that had public works contract with city; *Amelco Elec.* not extended to subcontract between private parties even where subcontract is for materials and services destined to be part of other party's performance under public works contract].)

SUPPLEMENT: [This section is current through the latest supplement]



134 of 175 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law XVII. GOVERNMENT CONTRACTS I. Miscellaneous Provisions.

1 Witkin Sum. Cal. Law Contracts § 1001

[§ 1001] Miscellaneous Provisions.

The following sources are among the many that may be consulted on other special provisions in government contracts and statutes either authorizing or requiring them:

- (1) *Remedies of governmental subcontractor.* (See 2 *Lincoln L. Rev.* 1 [stop notice]; 32 *So. Cal. L. Rev.* 1.)
- (2) *Bonds and liabilities of surety.* (See 42 U.S.C., §1594 [Capehart Housing Act bonds]; 40 U.S.C., §1331 et seq. [Miller Act bonds]; *United States for Benefit of Sherman v. Carter* (1957) 353 U.S. 210, 77 S.Ct. 793, 1 L.Ed.2d 776 [Miller Act bond]; *B.C. Richter Contracting Co. v. Continental Cas. Co.* (1964) 230 C.A.2d 491, 497, 41 C.R. 91 [Capehart Housing Act bond]; *Union Asphalt v. Planet Ins. Co.* (1994) 21 C.A.4th 1762, 1764, 27 C.R.2d 371 [C.C. 3267 does not preclude third-tier subcontractors and material suppliers from bringing action on payment bond]; *National Technical Systems v. Superior Court* (2002) 97 C.A.4th 415, 426, 118 C.R.2d 465 [surety may be compelled to pay statutory penalty incurred by general contractor on municipal project]; 7 Am.Jur. Trials 279 [Miller Act litigation]; 69 A.L.R.2d 1046 [surety's liability for obligee's attorneys' fees under provisions of performance bond of public contractor or subcontractor]; 70 A.L.R.2d 1370 [surety's liability on bid bond for public works].)
- (3) *Penalty provisions in contracts made during national emergencies.* (See *Priebe & Sons v. United States* (1947) 332 U.S. 407, 68 S.Ct. 123, 92 L.Ed. 32; 21 *So. Cal. L. Rev.* 400.)
- (4) *Statutory prohibition against assignment.* (See *supra*, §717.)
- (5) *Liquidated damages.* (See *Pub.Contr.C.* 10226; *Govt.C.* 53069.85; *Bilardi Const. v. Spencer* (1970) 6 C.A.3d 771, 786, 86 C.R. 406; *Nomellini Const. Co. v. California* (1971) 19 C.A.3d 240, 244, 96 C.R. 682; *Silva & Hill Const. Co. v. Employers Mut. Liab. Ins. Co.* (1971) 19 C.A.3d 914, 918, 97 C.R. 498.)
- (6) *Government limited to usual remedies for breach.* (See *People v. Barenfeld* (1962) 203 C.A.2d 166, 177, 21 C.R. 501, *supra*, §449.) (On federal government's right to damages for delay, see 10 *Santa Clara Lawyer* 2.)
- (7) *The Subletting and Subcontracting Fair Practices Act* (*Pub.Contr.C.* 4100 et seq.), designed to prevent bid shopping and peddling, requires the prime contractor to list all proposed subcontractors in his or her bid. (See *Merco Const. Engineers v. Los Angeles Unified School Dist.* (1969) 274 C.A.2d 154, 164, 79 C.R. 23; *Coast Pump Associates v. Tyler Corp.* (1976) 62 C.A.3d 421, 424, 133 C.R. 88; *C.L. Smith Co. v. Roger Ducharme* (1977) 65 C.A.3d 735, 747,

135 C.R. 483; *R.M. Sherman Co. v. W.R. Thomason* (1987) 191 C.A.3d 559, 563, 236 C.R. 577, supra, §437; *E.F. Brady Co. v. M.H. Golden Co.* (1997) 58 C.A.4th 182, 190, 67 C.R.2d 886; *MCM Const. v. San Francisco* (1998) 66 C.A.4th 359, 370, 78 C.R.2d 44.)

(8) *The California Buy American Act* (Govt.C. 4300 et seq.), requiring bidders to agree to use materials produced in the United States, was held unconstitutional as an interference with the exclusive federal power over foreign affairs. (*Bethlehem Steel Corp. v. Board of Commrs.* (1969) 276 C.A.2d 221, 227, 80 C.R. 800 [see footnote 8, pointing out that federal Act, serving as equalizer rather than complete embargo, is valid]; 107 A.L.R.5th 673 [validity and application of state "Buy American" Acts].)

(9) *Debarment and suspension of contractors.* (See 27 *Hastings L. J.* 793 [due process considerations].)

(10) *Assignment of antitrust causes of action.* A person entering into a public works contract or submitting a bid must agree to assign to the public agency "all rights, title, and interest in and to all causes of action" under Section 4 of the Clayton Act (see supra, §569) or under the Cartwright Act (see supra, §591). (*Pub.Contr.C.* 7103.5(b), 7103.5(c).) In the event of a recovery, the assignor is entitled to reimbursement for actual legal costs, and to any portion of the recovery attributable to overcharges paid by the assignor and not passed on to the public body as part of the bid price. (*Govt.C.* 4553.) If the public agency has not been injured by the violation or declines to sue, the injured assignor may demand reassignment, and the public agency must reassign within 1 year from the demand. (*Govt.C.* 4554.) (See 10 *Pacific L. J.* 366.)

(11) *Contracts for architectural, landscape architectural, engineering, environmental, land surveying, and construction project management services.* (See *Govt.C.* 4525 et seq.; 6 *Pacific L. J.* 390.)

State agencies entering into contracts under *Govt.C.* 4525 et seq. must follow specified procedures for negotiating fees and executing contracts for the professional consulting services of private architectural, engineering, land surveying, environmental, or construction project management firms. (*Govt.C.* 4526.5, *Pub.Contr.C.* 6106.)

Under Proposition 35, the Fair Competition and Taxpayer Savings Act, restrictions on government contracting for architectural and engineering services in the private sector are lifted, and the state and all other governmental entities are allowed to contract with qualified private entities for architectural and engineering services for all public works. (Cal. Const., Art. XXII, §1.) Nothing in Cal. Const., Art. VII, §1 (forbidding private contracts for work that civil service can perform "adequately and competently") may be construed to limit, restrict, or prohibit governmental entities from contracting with private entities for the performance of architectural or engineering services. (Cal. Const., Art. XXII, §2.) (See *Govt.C.* 4529.10 et seq. [implementing legislation under Act].)

(12) *Substitution of securities for money withheld to ensure performance.* (See *Pub.Contr.C.* 22300.)

(13) *Contracts for professional and technical services.* (See *Govt.C.* 14130 et seq.; *Professional Engineers in Calif. Government v. Department of Trans.* (1997) 15 C.4th 543, 568, 63 C.R.2d 467, 936 P.2d 473; on performance of public work by independent contractors, see 3 *Summary* (10th), *Agency and Employment*, §19.)

(14) *Affirmative action in awarding contracts for professional bond services.* (See *Govt.C.* 16850 et seq. [minorities and women]; *Mil. & Vet.C.* 999.1 [disabled veterans]; cf. *Connerly v. State Personnel Bd.* (2001) 92 C.A.4th 16, 49, 112 C.R.2d 5 [Govt.C. 16850 through 16857, with exception of first sentence of 16855, are unconstitutional].)

(15) *Affirmative action in awarding contracts for labor, services, materials, or equipment.* (See *Mil. & Vet.C.* 999.2 [disabled veterans]; *Pub.Contr.C.* 10115 et seq. [minorities and women; held unconstitutional as violative of equal protection by federal court, as stated in *Barlow v. Davis* (1999) 72 C.A.4th 1258, 1262, 85 C.R.2d 752]; *Pub.Contr.C.* 2050 et seq. [certification procedure for minority, women, and disadvantaged business enterprises].)

(16) *Preference to small businesses in awarding contracts for construction, procurement of goods, or delivery of*

services. (See *Govt.C. 14835* et seq. [state agencies]; *Pub.Contr.C. 2002* [local agencies].)

(17) *The Truth in Negotiations Act* (10 U.S.C., §2306a) requires contractors to submit cost and pricing data and certify its accuracy. (See 20 *Loyola L.A. L. Rev.* 597.)

(18) *The State Assistance for Recycling (STAR) Markets Act of 1989* is designed to ensure the procurement and use of recycled resources by state agencies. (See *Pub.Contr.C. 12150* et seq.)

(19) *The Target Area Contract Preference Act* is designed to give preference to California-based companies submitting bids for state contract in excess of \$ 100,000 to be performed at worksites in distressed areas by persons with high risk of unemployment. (See *Govt.C. 4530* et seq.)

(20) *Preference on construction contracts for California companies as against nonresident contractors.* (See *Pub.Contr.C. 6107*; 24 *Pacific L. J.* 1039.)

(21) *Contract provision requiring antigraffiti technology* for project erected in area vulnerable to graffiti. (See *Pub.Contr.C. 7109*.)

(22) *Mandatory acceptance of bid of minority, women, and disabled veteran business enterprise utilization plan*, where contract involves materials, supplies, or equipment, including electronic data processing goods and services. (See *Pub.Contr.C. 10115.15*.)

(23) *Procurement contracts to specify that no equipment, materials, supplies, or apparel or its laundering furnished to state* may be produced by, or with benefit of, forced labor, convict labor, indentured labor, or abusive forms of child labor or exploitation of children in sweatshop labor. (See *Pub.Contr.C. 6108*.)

(24) *The Child Support Compliance Act of 1998* requires state contracts in excess of \$ 100,000 to contain acknowledgments by contractor (a) of state policy regarding importance of child and family support obligations, and (b) that it is complying with all earnings assignment orders. (See *Pub.Contr.C. 7110*.)

(25) *Local public entity, charter city, or charter county may not require bidder to assume responsibility for completeness and accuracy of architectural or engineering plans and specifications* on public works projects, except on clearly designated design build projects. (See *Pub.Contr.C. 1104*.)

(26) *Contract with state for legal services over specified amount* must certify that contracting law firm will make good faith effort to provide prescribed pro bono legal services. (See *B. & P.C. 6072*, operative January 1, 2003.)

(27) *Penalty in civil action.* On receipt of a progress payment, the contractor, within a specified time, must pay the subcontractor for the work performed by the subcontractor, but may withhold a certain amount over which a good faith dispute exists. Failure to comply constitutes a cause for disciplinary action and also subjects the contractor to a penalty of 2% of the amount due per month. (*B. & P.C. 7108.5*; see *Tesco Controls v. Monterey Mechanical Co. (2004) 122 C.A.4th 1467, 1489, 19 C.R.3d 646* [electrical supplier on city public works project became subcontractor entitled to penalty payment for late payment by contractor, at point contractor terminated subcontractor, and supplier finished work under oral contract with contractor].) While the statute does not state whether the subcontractor can recover the 2% penalty in a disciplinary proceeding before the Contractors' State Licensing Board or in a civil action, it would be inconsistent with the statute's legislative history if recovery were not allowed in *either* proceeding. (*Morton Engineering & Const. v. Patscheck (2001) 87 C.A.4th 712, 715, 104 C.R.2d 815*.)

SUPPLEMENT: [This section is current through the latest supplement]

(2) *Bonds and liabilities of surety.* (See *Electrical Electronic Control v. Los Angeles Unified School Dist. (2005) 126 C.A.4th 601, 611, 24 C.R.3d 316* [if public entity fails to determine whether surety on payment bond is admitted surety insurer, and to investigate bond's sufficiency, subcontractors who are unable to recover against insufficient bond have

cause of action against public entity].)(7) *The Subletting and Subcontracting Fair Practices Act*. (See *Golden State Boring & Pipe Jacking v. Orange County Water Dist.* (2006) 143 C.A.4th 718, 728, 49 C.R.3d 447 [where subcontractor whose subbid was part of general contractor's winning bid refused to sign subcontract incorporating its gratuitous, unilateral offer to obtain performance bond, which offer was included in subbid submitted in response to informal, unwritten invitation for subbids, there was statutory ground for general contractor's request seeking removal of subcontractor]; *Affholder v. Mitchell Engineering* (2007) 153 C.A.4th 510, 520, 63 C.R.3d 121 [prime contractor was not liable for failing to grant subcontract to tunneling subcontractor originally listed in its sewer and roadway project bid to sanitation district, even though district accepted bid with subcontractor listed, where district subsequently granted change order that eliminated need for tunneling work].)(11) *Contracts for architectural, landscape architectural, engineering, environmental, land surveying, and construction project management services*. (See *Professional Engineers in Calif. Government v. Kempton* (2007) 40 C.4th 1016, 1037, 56 C.R.3d 814, 155 P.3d 226 [Proposition 35 repealed prior law under Constitution and statutes restricting state's authority to contract with private architects and engineers; initiative and ballot materials indicated intent to supersede prior law, and initiative's provisions could not be reconciled with prior law].)(18) *The State Assistance for Recycling (STAR) Markets Act of 1989*. *Pub.Contr.C.* 12150 et seq. were repealed in 2005.(28) *(New) Subcontractor's entitlement to statutory penalties*. (See *Alpha Mechanical, Heating & Air Conditioning v. Travelers Cas. & Surety Co. of America* (2005) 133 C.A.4th 1319, 1337, 35 C.R.3d 496 [subcontractor was required to present evidence showing contractor's lack of good faith in its belief that dispute over damage caused by subcontractor justified withholding sums due subcontractor].)

(29) *(New) Penalty in civil action*. (See *S&S Cummins Corp. v. West Bay Builders* (2008) 159 C.A.4th 765, 778, 780, 71 C.R.3d 828 [statutory 2% per month charge on retention proceeds that general contractor withheld from electrical subcontractor on school construction project was not compounded on monthly basis and did not continue to accrue after entry of judgment].)

(30) *(New) California Disabled Veteran Business Enterprise Program*. (See *Niles Freeman Equipment v. Joseph* (2008) 161 C.A.4th 765, 780, 74 C.R.3d 690 [Department of General Services has administrative power to determine whether entity has violated Disabled Veteran Business Enterprise (DVBE) rules by fraudulently pursuing state contract as DVBE, and to suspend that entity from participating in state contracts; no finding of violation by court or other entity is required].)

(31) *(New) Darfur Contracting Act*. (See *Pub.Contr.C.* 10475 et seq., added in 2008.)

(32) *(New) Special bidding procedures for waste and recycling facilities*. (See *Pub.Contr.C.* 20193 et seq., added in 2008.)*Correction*: Page 1095, line 6 of paragraph (27), citation for *Tesco Controls* case should be (2004) 124 C.A.4th 780, 802, 21 C.R.3d 751.



135 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XVIII. SURETY CONTRACTS
A. In General.

1 Witkin Sum. Cal. Law Contracts § 1002

[§ 1002] In General.

A surety or guarantor (there is no distinction between the two terms) is "one who promises to answer for the debt, default, or miscarriage of another, or hypothecates property as security therefor." (C.C. 2787; see *Rest. 3d, Suretyship and Guaranty §1*.) Generally, a suretyship obligation must be in writing and signed by the surety. (C.C. 2793; on original obligations not requiring a writing, see C.C. 2794.) A continuing guaranty is one relating to a future liability of the principal, under successive transactions, which either continues the principal's liability or from time to time renews it after it has been satisfied. (C.C. 2814; see *Rest.3d, Suretyship and Guaranty §16*; on revocation of a continuing guaranty, see C.C. 2815.) A person may become a surety even without the knowledge or consent of the principal. (C.C. 2788.)

"Unless notice of acceptance is expressly required, an offer to become a surety may be accepted by acting upon it, or by acceptance upon other consideration. An absolute suretyship obligation is binding upon the surety without notice of acceptance." (C.C. 2795; on nonnecessity to show acceptance by creditor of ostensible principal as surety, see C.C. 2832; see *Rest. 3d, Suretyship and Guaranty §8*.)

Where a suretyship obligation is entered into at the same time with the original obligation, or with the acceptance of the original obligation by the creditor, and forms with that obligation a part of the creditor's consideration, no other consideration need exist. In all other cases, there must be a consideration distinct from that of the original obligation. (C.C. 2792; see *Rest. 3d, Suretyship and Guaranty §9*.)

In an assumption of liability as surety in connection with a contract whose terms are not then settled, it is implied that the contract's terms will be such as will not expose the surety to greater risks than he or she would incur under those terms that are most common in similar contracts at the place where the principal contract is to be performed. (C.C. 2799; on other rules of interpretation involving suretyship contracts specifically, see C.C. 2800 et seq.; on rules of interpretation generally, see C.C. 2837 ["same rules are to be observed as in the case of other contracts"].)

Even though a creditor recovers a judgment against a surety, the latter still occupies the relation of surety. (C.C. 2838.) However, an arbitration award rendered against a principal alone is not an award against his or her surety. (C.C. 2855.)

The surety's obligation must be neither larger in amount nor in other respects more burdensome than that of the

principal; and if it exceeds it, it is reducible in proportion to the principal obligation. (C.C. 2809.)

SUPPLEMENT: [This section is current through the latest supplement]



136 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XVIII. SURETY CONTRACTS
B. Rights of Sureties.

1 Witkin Sum. Cal. Law Contracts § 1003

[§ 1003] Rights of Sureties.

A surety may compel the principal to perform the obligation when due. (C.C. 2846; see Rest 3d, Suretyship and Guaranty §18.) Moreover, if a surety satisfies the principal obligation, or any part thereof, whether with or without legal proceedings, the principal is bound to reimburse what the surety has disbursed, including necessary costs and expenses; but the surety has no claim for reimbursement against other persons, though they may have been benefited by his or her act. (C.C. 2847; see *Rest. 3d, Suretyship and Guaranty* §22.) (On waiver of suretyship rights and defenses, see C.C. 2856.)

Upon satisfying the obligation of the principal, a surety is entitled to enforce every remedy that the creditor then has against the principal to the extent of reimbursing what the surety has expended, and also to require all the co-sureties to contribute thereto, without regard to the order of time in which they became such. (C.C. 2848.) Whenever property of a surety is hypothecated with property of the principal, the surety is entitled to have the property of the principal first applied to the discharge of the obligation. (C.C. 2850.)

A surety may require the creditor to proceed against the principal, or to pursue any other remedy in the creditor's power that the surety cannot pursue, and that would lighten the surety's burden; and if the creditor neglects to do so, the surety is exonerated to the extent to which the surety is thereby prejudiced. (C.C. 2845; on exoneration of sureties, see *infra*, §1004.)

SUPPLEMENT: [This section is current through the latest supplement]

See *Amwest Surety Ins. Co. v. Patriot Homes* (2005) 135 C.A.4th 82, 86, 37 C.R.3d 195 [general indemnity agreements between surety and real estate developers covered all bonds, including appeal bond, and therefore defendants breached indemnity contract by not paying judgment against them or indemnifying surety after they lost their appeal in underlying action; agreement repeatedly stated that it applied to all bonds, notwithstanding that its terms were provided by statute].



137 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XVIII. SURETY CONTRACTS
C. Liability of Sureties.

1 Witkin Sum. Cal. Law Contracts § 1004

[§ 1004] Liability of Sureties.

"A suretyship obligation is to be deemed unconditional unless its terms import some condition precedent to the liability of the surety." (C.C. 2806; see *Rest. 3d, Suretyship and Guaranty* §32 et seq.) Hence, a surety who has assumed liability for payment or performance is liable to the creditor immediately upon the principal's default, and without demand or notice. (C.C. 2807.) Where the surety's liability is conditional, it is commensurate with that of the principal, and the surety is not entitled to notice of the default of the principal, unless he or she is unable, by the exercise of reasonable diligence, to acquire information of the default, and the creditor has actual notice thereof. (C.C. 2808.)

A surety is liable, notwithstanding any mere *personal disability* of the principal, though the disability be such as to make the contract void against the principal; but the surety is not liable if for any other reason there is no liability upon the part of the principal at the time of the execution of the contract, or the liability of the principal thereafter ceases, unless the surety has assumed liability with knowledge of the existence of the defense. Where the principal is not liable because of mere personal disability, recovery back by the creditor of any res that formed all or part of the consideration for the contract will have the effect upon the liability of the surety that is attributed to the recovery back of such a res under the law of sales generally. (C.C. 2810.)

Any party required to give a bond undertaking or other obligation may agree with his or her surety for the deposit of any money and assets for which the surety is responsible with a bank, savings bank, safe deposit, or trust company authorized to do business as such, or other depository approved by the court (if the deposit is otherwise proper) for the safekeeping of the money and assets and in a manner designed to prevent the withdrawal of any or all of the money and assets without the written consent of the surety, or an order of court, made on such notice to the surety as the court may direct. An agreement authorizing withdrawal may not in any manner release, or change the liability of, the principal or surety as established by the terms of the bond. (C.C. 2811.)

SUPPLEMENT: [This section is current through the latest supplement]



138 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XVIII. SURETY CONTRACTS
D. Right to Benefit of Securities.

1 Witkin Sum. Cal. Law Contracts § 1005

[§ 1005] Right to Benefit of Securities.

A surety is entitled to the benefit of every security for the performance of the principal obligation held by the creditor, or by a co-surety at the time of entering into the contract of suretyship, or acquired by him or her afterwards, whether the surety was aware of the security or not. (C.C. 2849.) A creditor is entitled to the benefit of everything that a surety has received from the debtor by way of security for the performance of the obligation, and may, upon the maturity of the obligation, compel the application of this security to its satisfaction. (C.C. 2854.)

SUPPLEMENT: [This section is current through the latest supplement]



139 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XVIII. SURETY CONTRACTS
E. Exoneration of Sureties.

1 Witkin Sum. Cal. Law Contracts § 1006

[§ 1006] Exoneration of Sureties.

"A surety is exonerated, except so far as he or she may be indemnified by the principal, if by any act of the creditor, without the consent of the surety the original obligation of the principal is altered in any respect, or the remedies or rights of the creditor against the principal, in respect thereto, in any way impaired or suspended." (C.C. 2819; see *Rest. 3d, Suretyship and Guaranty* §39 et seq.) However, an agreement by a creditor to accept from the principal debtor a sum less than the balance owed on the original obligation, without the prior consent of the surety and without any other change to the underlying agreement between the creditor and principal debtor, does not exonerate the surety for the lesser sum agreed upon by the creditor and principal debtor. (C.C. 2822(b).) Moreover, that a promise by a creditor is for any cause void, or voidable at his or her option, does not prevent the creditor from altering the obligation or suspending or impairing the remedy within the meaning of C.C. 2819, supra. (C.C. 2820.) The rescission of an agreement altering the original obligation of a debtor, or impairing the remedy of a creditor, does not restore the liability of a surety who has been exonerated by the agreement. (C.C. 2821.)

"The acceptance, by a creditor, of anything in *partial satisfaction* of an obligation, reduces the obligation of a surety thereof, in the same measure as that of the principal, but does not otherwise affect it. However, if the surety is liable upon only a portion of an obligation and the principal provides partial satisfaction of the obligation, the principal may designate the portion of the obligation that is to be satisfied." (C.C. 2822(a); see *Rest. 3d, Suretyship and Guaranty* §§3, 36.)

Performance of the principal obligation or an offer of performance duly made exonerates a surety. (C.C. 2839.) However, a surety is not exonerated (1) by mere delay on the part of a creditor to proceed against the principal or to enforce any other remedy (C.C. 2823), or (2) by the discharge of his or her principal by operation of law, without the intervention or omission of the creditor (C.C. 2825).

"A surety, who has been indemnified by the principal, is liable to the creditor to the extent of the indemnity, notwithstanding that the creditor, without the assent of the surety, may have modified the contract or released the principal." (C.C. 2824.)

SUPPLEMENT: [This section is current through the latest supplement]

See *Central Bldg., LLC v. Cooper* (2005) 127 C.A.4th 1053, 1060, 26 C.R.3d 212 [by agreeing to modification of guaranty agreement, guarantor waived right of exoneration under C.C. 2819].



140 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XIX. UNUSUAL TYPES OF CONTRACTS
A. Organic Law of Association.

1 *Witkin Sum. Cal. Law Contracts* § 1007

[§ 1007] Organic Law of Association.

The relationship of unincorporated associations, such as labor unions and fraternal or professional societies, with their members, is contractual: The *contract* consists of the *constitution and bylaws* of the association. (See *Mandraccio v. Bartenders Union* (1953) 41 C.2d 81, 85, 256 P.2d 927; *Harris v. National Union of Marine Cooks & Stewards* (1950) 98 C.A.2d 733, 736, 221 P.2d 136; *Bernstein v. Alameda-Contra Costa Med. Assn.* (1956) 139 C.A.2d 241, 253, 293 P.2d 862; *Jost v. Communications Workers of America* (1970) 13 C.A.3d Supp. 7, 10, 91 C.R. 722; 6 *Am.Jur.2d* (1999 ed.), *Associations and Clubs* §§3, 21, 22.)

These contracts, however, are usually confined to the relationship between the individual and the association, and do not impose obligations on one member to another. (See *Scott v. Lee* (1962) 208 C.A.2d 12, 15, 24 C.R. 824.)

West's Key Number Digest, Contracts k.7

SUPPLEMENT: [This section is current through the latest supplement]
See 6 *Am.Jur.2d* (2008 ed.), *Associations and Clubs* §§2, 20, 21.



141 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XIX. UNUSUAL TYPES OF CONTRACTS
B. Corporation Charter.

1 Witkin Sum. Cal. Law Contracts § 1008

[§ 1008] Corporation Charter.

A corporation charter is a contract protected by the constitutional guarantee against impairment, but subject to the state's constitutional reserved power. (See 8 *Summary* (10th), *Constitutional Law*, §1281; 9 *Summary* (10th), *Corporations*, §2.) And the relationship of corporation and shareholder is contractual; the contract is contained in the articles, bylaws, and applicable statutes. (*In re Mayellen Apartments* (1955) 134 C.A.2d 298, 304, 285 P.2d 943; see 18A *Am.Jur.2d* (2004 ed.), *Corporations* §156 et seq.)

The bylaws are also a contract among the shareholders. (*Casady v. Modern Metal Spinning & Mfg. Co.* (1961) 188 C.A.2d 728, 732, 10 C.R. 790, 13 *Summary* (10th), *Equity*, §47.)

SUPPLEMENT: [This section is current through the latest supplement]



142 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XIX. UNUSUAL TYPES OF CONTRACTS
C. Federal Grant.

1 Witkin Sum. Cal. Law Contracts § 1009

[§ 1009] Federal Grant.

"The acceptance of a federal grant under terms and conditions authorized by Congress creates a binding contract."
(*McDonald v. Stockton Metropolitan Transit Dist.* (1973) 36 C.A.3d 436, 441, 111 C.R. 637 [federal Government has authority to enforce its rights against transit district under such contract, and private person is not entitled to seek performance by petition for mandamus].)

West's Key Number Digest, Contracts k.7

SUPPLEMENT: [This section is current through the latest supplement]



143 of 175 DOCUMENTS

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CHAPTER I - Contracts

Witkin Summary of California Law
XIX. UNUSUAL TYPES OF CONTRACTS
D. Published University Regulations.

1 Witkin Sum. Cal. Law Contracts § 1010

[§ 1010] Published University Regulations.

An unsuccessful action for breach of contract, based on an insufficiently pleaded claim that scheduled lectures and normal academic credit were not received, produced the following statement of a contract rule: "The basic legal relation between a student and a private university or college is contractual in nature. The catalogues, bulletins, circulars, and regulations of the institution made available to the matriculant become a part of the contract." (*Zumbrun v. University of Southern Calif. (1972) 25 C.A.3d 1, 10, 101 C.R. 499.*) (See 19 Cal. Western L. Rev. 467 [Challenging Educational Fee Increases, Program Termination and Deterioration, and Misrepresentation of Program Quality: The Legal Rights and Remedies of Students]; 51 A.L.R.3d 1003 [liability of college to student enrolled in course terminated prior to completion]; 46 A.L.R.5th 581 [liability of private school or educational institution for breach of contract arising from provision of deficient educational instruction]; 47 A.L.R.5th 1 [liability of private school or educational institution for breach of contract arising from expulsion or suspension of student].)

SUPPLEMENT: [This section is current through the latest supplement]

See *Kashmiri v. Regents of Univ. of Calif. (2007) 156 C.A.4th 809, 823, 67 C.R.3d 635* [contract law applied to students' claims against state university regarding university's increase in various student fees, where fee dispute did not require inquiry into nuances of educational processes and theories, but rather required objective assessment; citing *Zumbrun v. University of Southern Calif. (1972) 25 C.A.3d 1, 101 C.R. 499*, text, p. 1100].



144 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XIX. UNUSUAL TYPES OF CONTRACTS
E. Unconfirmed Arbitration Award.

1 Witkin Sum. Cal. Law Contracts § 1011

[§ 1011] Unconfirmed Arbitration Award.

An arbitration award that has not been confirmed or vacated "has the same force and effect as a contract in writing between the parties to the arbitration." (*C.C.P. 1287.6*; see *Walter v. National Indem. Co. (1970) 3 C.A.3d 630, 634, 83 C.R. 803* [award becomes asset of recipient's estate if he or she dies]; 21 Williston 4th, §57:128 et seq.)

The purpose of the quoted language is to make clear that arbitration awards of this type are binding as contracts even after the time for seeking their confirmation has expired. (*Doyle v. Giuliani (1965) 62 C.2d 606, 609, 43 C.R. 697, 401 P.2d 1*, supra, §49; on judgment on an arbitration award as a contract, see supra, §115.)

West's Key Number Digest, Contracts k.7

SUPPLEMENT: [This section is current through the latest supplement]



145 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law XIX. UNUSUAL TYPES OF CONTRACTS F. Regulated Forms.

1 Witkin Sum. Cal. Law Contracts § 1012

[§ 1012] Regulated Forms.

In recent years, a number of statutes have been enacted that specify the form of certain contracts or regulate their provisions. The general purpose of these statutes is to protect the public from overreaching by persons whose economic power or technical knowledge make bargaining on an equal footing virtually impossible. (For a similar judicial approach to contracts of adhesion, see *supra*, §323.)

The statutes cover a variety of matters. The following list indicates the subjects of some of the more important of these statutes and indicates where in this work they are discussed:

- (1) *Legibility*. (See *supra*, §123; 2 *Summary* (10th), *Insurance*, §32.)
- (2) *Motor vehicle sales*. (See 4 *Summary* (10th), *Sales*, §241 et seq.)
- (3) *Swimming pool sales*. (See 4 *Summary* (10th), *Sales*, §293.)
- (4) *Health and dance services*. (See 4 *Summary* (10th), *Sales*, §362.)
- (5) *Retail installment sales*. (See 4 *Summary* (10th), *Sales*, §272 et seq.).
- (6) *Miscellaneous consumer protection matters*. (See 4 *Summary* (10th), *Sales*, §295 et seq.)
- (7) *Door-to-door sales*. (See 4 *Summary* (10th), *Sales*, §329 et seq.)
- (8) *Automobile liability insurance policies*. (See 2 *Summary* (10th), *Insurance*, §162 et seq.)
- (9) *Fire insurance policies*. (See 2 *Summary* (10th), *Insurance*, §§131, 132; 4 *Summary* (10th), *Security Transactions in Real Property*, §82 et seq.)
- (10) *Automobile repairs*. (See 4 *Summary* (10th), *Sales*, §332.)
- (11) *Farm machinery repairs*. (See 4 *Summary* (10th), *Sales*, §332.)
- (12) *Professional malpractice insurance*. (See *Ins.C. 11580.01* [requiring notice that coverage is limited to claims

made while policy is in force]; 6 *Pacific L. J.* 336.)

(13) *Health care service plans.* (See *Health & Saf.C. 1340* et seq. [extended regulation and enforcement by Commissioner of Corporations]; *Schmidt v. Foundation Health* (1995) 35 *C.A.4th* 1702, 1714, 42 *C.R.2d* 172 [*Health & Saf.C. 1340* et seq. and related administrative regulations prohibit broker of health care service plans from offering commission rebates to clients]; *California Med. Assn. v. Aetna U.S. Healthcare of Calif.* (2001) 94 *C.A.4th* 151, 158, 114 *C.R.2d* 109 [nonwaiver clause of *Health & Saf.C. 1371* did not preclude health plan from delegating to intermediaries duty to make payments to doctors providing services to plan's enrollees; nonwaiver clause simply meant that time limits had to be observed even when payment obligations have been delegated].)

(14) *Invention development services.* (See *B. & P.C. 22370* et seq., [requiring various provisions including notice of right to cancel, and statement that customer's potential patent rights may be adversely affected by any attempt to commercialize idea or invention prior to filing patent application]; 7 *Pacific L. J.* 307.)

(15) *Earthquake insurance.* (See *Ins.C. 10081* et seq. [requiring that, before issuance of any residential property insurance policy, insured be offered opportunity to obtain earthquake insurance].)

(16) *Spanish translation of commercial contract.* (See *supra*, §124.)

SUPPLEMENT: [This section is current through the latest supplement]



146 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XX. QUASI-CONTRACTS AND RESTITUTION
A. In General.
1. Nature of Restitution.

1 Witkin Sum. Cal. Law Contracts § 1013

[§ 1013] Nature of Restitution.

The right to restitution or quasi-contractual recovery is based upon *unjust enrichment*. Where a person obtains a *benefit* that he or she may not *justly retain*, the person is unjustly enriched. The quasi-contract, or contract "implied in law," is an *obligation* (not a true contract; see *supra*, §103) created by the law without regard to the intention of the parties, and is designed to restore the aggrieved party to his or her former position by return of the thing or its equivalent in money. (See *Philpott v. Superior Court* (1934) 1 C.2d 512, 517, 36 P.2d 635; *McCall v. Superior Court* (1934) 1 C.2d 527, 531, 36 P.2d 642; *Ghirardo v. Antonioli* (1996) 14 C.4th 39, 51, 57 C.R.2d 687, 924 P.2d 996, 4 Summary (10th), *Security Transactions in Real Property*, §215; *Petersen v. Lyders* (1934) 139 C.A. 303, 305, 33 P.2d 1030; *Branche v. Hetzel* (1966) 241 C.A.2d 801, 807, 51 C.R. 188, quoting the text; *Kossian v. American Nat. Ins. Co.* (1967) 254 C.A.2d 647, 651, 62 C.R. 225, *infra*, §1016; *First Nationwide Savings v. Perry* (1992) 11 C.A.4th 1657, 1662, 15 C.R.2d 173, *infra*, §1023; *Maglica v. Maglica* (1998) 66 C.A.4th 442, 449, 78 C.R.2d 101, quoting the text; *Lectrodryer v. SeoulBank* (2000) 77 C.A.4th 723, 726, 91 C.R.2d 881 [bank was unjustly enriched when it refused to honor prepaid letter of credit and retained funds after allowing letter to expire]; *California Med. Assn. v. Aetna U.S. Healthcare of Calif.* (2001) 94 C.A.4th 151, 170, 114 C.R.2d 109, citing the text [where health care plan delegated payment obligation to intermediaries who were then required to reimburse doctors who had furnished services to plan's enrollees, plan was not unjustly enriched even though it would benefit from intermediaries' actions]; *Desert Healthcare Dist. v. PacifiCare FHP* (2001) 94 C.A.4th 781, 786, 114 C.R.2d 623 [same]; *Rest., Restitution §1; Rest.2d, Contracts §4*, Comment b; 1 Corbin (Rev. ed.), §1.20.; 1 Williston 4th, §1:6; 83 Cal. L. Rev. 1191 [liability based on unjust enrichment]; 19 *Hastings L. J.* 991 [symposium on restitution, with extensive bibliography]; 36 *Loyola L.A. L. Rev.* 777 [symposium on restitution]; 66 *Am.Jur.2d* (2001 ed.), *Restitution and Implied Contracts §1 et seq.*; Cal. Civil Practice, 3 Business Litigation, §34:1 et seq.)

However, "[t]he mere fact that a person benefits another is not of itself sufficient to require the other to make restitution therefor." (*Rest., Restitution §1*, Comment c; see *Marina Tenants Assn. v. Deauville Marina Dev. Co.* (1986) 181 C.A.3d 122, 134, 226 C.R. 321.)

Restitution may also be awarded in contract actions, where it often follows rescission (which typically applies only in contract actions). However, restitution is also available as a remedy to redress statutory violations. And in a statutory action, rescission is not a prerequisite to granting restitution. (*People v. Beaumont Inv. Ltd.* (2003) 111 C.A.4th 102, 132, 3 C.R.3d 429 [in unfair competition law action involving leases that violated particular ordinance, it was not

necessary to rescind leases before ordering restitution for unfair competition]; on rescission, see *supra*, §930 et seq.)

The cause of action, just as one based on true contract, is *assignable* and provable in bankruptcy. (*Rest., Restitution* §§5, 149.)

West's Key Number Digest, Implied and Constructive Contracts k.4

SUPPLEMENT: [This section is current through the latest supplement]

See *Ajaxo v. E*Trade Group* (2005) 135 C.A.4th 21, 54, 37 C.R.3d 221 [in action by developer of wireless stock trading technology against Internet stock trading company for breach of mutual nondisclosure agreement, evidence of money saved by trading company when it breached agreement amply demonstrated that trading company was unjustly enriched by breach, and owed restitution to developer]; 1 Williston 4th (2007 ed.), §1:6; C.E.B., Law of Contracts §11.66 et seq.



147 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XX. QUASI-CONTRACTS AND RESTITUTION
A. In General.
2. Practical Distinctions.

1 Witkin Sum. Cal. Law Contracts § 1014

[§ 1014] Practical Distinctions.

The distinction between rights of action based upon contract and quasi-contract may be of importance in the determination of a number of substantive and procedural rights and defenses:

(1) The *statute of frauds* applies to true contracts only. (*Mayborne v. Citizens Trust & Savings Bank* (1920) 46 C.A. 178, 190, 188 P. 1034; *First Nationwide Savings v. Perry* (1992) 11 C.A.4th 1657, 1670, 15 C.R.2d 173, citing the text.)

(2) The defendant's *lack of capacity* may be a defense to contractual liability, e.g., where the defendant is a minor or incompetent; but this does not bar quasi-contractual recovery against him or her. (See *Rest., Restitution* §139; *Estate of Doyle* (1932) 126 C.A. 646, 647, 14 P.2d 920 [recovery for reasonable value of necessities furnished an incompetent person]; *Dorris v. Crowder* (1938) 26 C.A.2d 49, 51, 78 P.2d 1039.)

(3) The accrual and period of the *statute of limitations* may be different. (See *Long v. Rumsey* (1938) 12 C.2d 334, 342, 84 P.2d 146; 3 Cal. Proc. (4th), *Actions*, §§480, 507 et seq., 599 et seq.)

(4) In an action in quasi-contract to recover for money or benefits conferred under mistake, a *demand* is ordinarily a necessary prerequisite, for the defendant is entitled to reasonable time after notice of the facts to make restitution. (*Mitchell v. California-Pac. Title Ins. Co.* (1926) 79 C.A. 45, 52, 248 P. 1035; *Rest., Restitution* §63; 15 Cal. L. Rev. 64.)

(5) However, for the purposes of awarding prejudgment interest, an action in quasi-contract is one "based upon a cause of action in contract" within the meaning of C.C. 3287(b), and interest may be allowed. (See *supra*, §893.) Also, prejudgment interest may be allowed from the time the duty to make restitution arose, if the action is to recover a definite sum of money paid under mistake or wrongfully withheld. (*Rest., Restitution* §156; see *Petersen v. Lyders* (1934) 139 C.A. 307, 309, 33 P.2d 1030.)

SUPPLEMENT: [This section is current through the latest supplement]

(3) *Statute of limitations*:

Cross-Reference: 3 Cal. Proc. (5th), *Actions*, §§514, 546 et seq., 656 et seq.

(6) *(New) Damages versus restitution:* Restitution differs from damages in that the latter is designed to put the injured party in as good a position as he or she would have occupied had the contract been fully performed, while the purpose of restitution is to require the wrongdoer to restore what he or she has received and thus put the injured party in as good a position as that occupied before the contract was made. (*Ajaxo v. E*Trade Group* (2005) 135 C.A.4th 21, 56, 37 C.R.3d 221.)



148 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
XX. QUASI-CONTRACTS AND RESTITUTION
A. In General.
3. Restatement of Restitution.

1 Witkin Sum. Cal. Law Contracts § 1015

[§ 1015] Restatement of Restitution.

The Restatement of Restitution, which covers *quasi-contracts* and *constructive trusts*, was published in 1937, with California Annotations in 1940. It goes beyond the usual scope of quasi-contracts by including restitutionary rights enforceable in equitable proceedings, and the right to follow property or its proceeds by means of constructive trust, equitable lien, or subrogation. But it does not cover the following: (1) Restitution on breach of or nonperformance of contract or trust (treated in Restatements of Contracts and Trusts). (2) Actions on a judgment. (3) Actions based on duty to pay money created by custom or statute. (See Notes, Rest., Restitution, pp. 1-4, 595.)

The "Underlying Principles" set forth at page 11 of the Restatement may be invoked where no specific provision is found. (See *Kossian v. American Nat. Ins. Co.* (1967) 254 C.A.2d 647, 651, 62 C.R. 225, *infra*, §1016; *First Nationwide Savings v. Perry* (1992) 11 C.A.4th 1657, 1670, 15 C.R.2d 173, citing the text.)

SUPPLEMENT: [This section is current through the latest supplement]



149 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XX. QUASI-CONTRACTS AND RESTITUTION
A. In General.
4. Unjust Enrichment Alone.

1 *Witkin Sum. Cal. Law Contracts* § 1016

[§ 1016] Unjust Enrichment Alone.

One of the "Underlying Principles" of the Restatement is that "[a] person who has been unjustly enriched at the expense of another is required to make restitution to the other." (*Rest., Restitution* §1; see *66 Am.Jur.2d* (2001 ed.), *Restitution and Implied Contracts* §9.) This is in harmony with the opening sentence: "The Restatement of this Subject deals with situations in which one person is accountable to another on the ground that otherwise he would unjustly benefit or the other would unjustly suffer loss." (*Rest., Restitution*, p. 1.) Where the facts do not come within a specific section, a court may base recovery on this underlying principle or even the opening sentence.

Thus, in *Kossian v. American Nat. Ins. Co.* (1967) 254 C.A.2d 647, 62 C.R. 225, defendant held a deed of trust on R's hotel. After a fire, R engaged plaintiff to remove debris for \$ 18,900, and plaintiff did the work. R became a bankrupt, the trustee abandoned the premises and any interest in the insurance policies, and R assigned his interest in them to defendant. Defendant made its claim against the insurers for \$ 160,000, including \$ 18,000 as the estimated cost of removing debris. The insurers paid defendant a compromise figure of \$ 135,620. Plaintiff then sought restitution of the value of his work or such part of it as the insurers paid defendant. *Held*, judgment for defendant reversed.

(a) Defendant had no relationship with plaintiff, and did not induce him to enter into the contract. Hence, if defendant, on foreclosure of its trust deed, had simply taken the property improved by plaintiff's efforts, the benefit received would not have been unjust enrichment. (254 C.A.2d 649, citing *Griffith Co. v. Hofues* (1962) 201 C.A.2d 502, 19 C.R. 900, *infra*, §1020.)

(b) Here, however, defendant claimed from the insurers the value of work done by plaintiff. Defendant would be unjustly enriched if indemnified twice for the same loss, while plaintiff lost the benefit of his labor and materials. Hence, plaintiff was entitled to reimbursement out of the insurance proceeds paid defendant. On retrial, the court could determine what part (if only part) of the settlement covered debris clearance costs, and plaintiff could recover *pro tanto*. (254 C.A.2d 651.)

West's Key Number Digest, Implied and Constructive Contracts k.3

SUPPLEMENT: [This section is current through the latest supplement]



150 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XX. QUASI-CONTRACTS AND RESTITUTION
B. Defenses to Quasi-Contract Actions.

1 Witkin Sum. Cal. Law Contracts § 1017

[§ 1017] Defenses to Quasi-Contract Actions.

The following are the defenses most commonly asserted by the defendant in an action for restitution:

- (1) Benefit voluntarily conferred. (See *infra*, §1020.)
- (2) No benefit conferred on the defendant. (See *infra*, §1018.)
- (3) Money paid under mistake actually discharged a valid debt or released a valid claim. (See *infra*, §1025.)
- (4) Plaintiff, seeking recovery for money paid under mistake, had assumed the risk of the mistake by entering into a compromise or settlement. (See *Rest., Restitution* §11.) But negligence of the plaintiff is ordinarily not a bar to recovery for mistake, because the defendant is only being compelled to make restitution to the extent of the benefit received. (See *Rest., Restitution* §59.)
- (5) Plaintiff's wrongful conduct. Thus, where a contract or transaction is seriously illegal, and the plaintiff is *in pari delicto*, quasi-contractual recovery is denied. (See *Rest., Restitution* §140; *Shenson v. Fresno Meat Packing Co.* (1950) 96 C.A.2d 725, 732, 216 P.2d 156; *supra*, §§436, 438 et seq.)
- (6) Plaintiff's failure to restore consideration or to reimburse defendant for beneficial expenditures, in situations where this is required. (See *Rest., Restitution*, §§65, 66, 67, 158, 159; 12 *Summary* (10th), *Real Property*, §458 et seq.)
- (7) Defendant's *status* is sometimes a defense; e.g., where he or she is a bona fide purchaser. (See *Rest., Restitution* §§13, 14, 22, 123.) And where the defendant is a governmental body, e.g., a municipality, which cannot be liable unless there has been strict compliance with the statutory requirements such as competitive bidding or form of contract, quasi-contract recovery will be denied. (See *supra*, §647; and see generally, on quasi-contractual liability of municipality, 47 *Harv. L. Rev.* 1143.)
- (8) Defendant's *change of position* or other change in circumstances making restitution inequitable. (See *Rest., Restitution* §§60, 142, 143; *Doyle v. Matheron* (1957) 148 C.A.2d 521, 522, 306 P.2d 913; *Bank of America v. Sanati* (1992) 11 C.A.4th 1079, 1084, 14 C.R.2d 615, citing the text.)/sec

SUPPLEMENT: [This section is current through the latest supplement]



151 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XX. QUASI-CONTRACTS AND RESTITUTION
C. Necessity of Benefit to Defendant.
1. Benefit Ordinarily Required.

1 Witkin Sum. Cal. Law Contracts § 1018

[§ 1018] Benefit Ordinarily Required.

In the usual case, the loss suffered by the plaintiff is roughly equivalent to a benefit received by the defendant, as where money is paid or property transferred under fraud or mistake. (See *Rest.*, *Restitution* §1.) And ordinarily quasi-contractual recovery depends upon the defendant's receiving some benefit. (See *Rotea v. Izuel* (1939) 14 C.2d 605, 611, 95 P.2d 927; *Rowell v. Crow* (1949) 93 C.A.2d 500, 503, 209 P.2d 149 [plaintiff architect prepared plans for building far exceeding cost limit set by client in their agreement, and plans were not used except for purpose of obtaining bids]; *Major-Blakeney Corp. v. Jenkins* (1953) 121 C.A.2d 325, 340, 263 P.2d 655; *Truestone v. Simi West Industrial Park II* (1984) 163 C.A.3d 715, 724, 209 C.R. 757; *Lauriedale Associates, Ltd. v. Wilson* (1992) 7 C.A.4th 1439, 1449, 9 C.R.2d 774 [condominium directors who failed to collect adequate assessments were not entitled to restitution from unit owners, who were persons harmed thereby]; *Unilogic v. Burroughs Corp.* (1992) 10 C.A.4th 612, 627, 12 C.R.2d 741, citing the text; *Dunkin v. Boskey* (2000) 82 C.A.4th 171, 196, 98 C.R.2d 44, 10 Summary (10th), *Parent and Child*, §206, citing the text [unmarried woman's breach of contract in which she granted man paternity, visitation, and custody rights to child conceived by artificial insemination with anonymous donor gave rise to damages for economic loss suffered by man under unjust enrichment theory, but woman was entitled to offset to extent her conduct conferred incidental benefit on man's economic interest that was harmed]; *Hirsch v. Bank of America* (2003) 107 C.A.4th 708, 721, 132 C.R.2d 220 [unjust enrichment cause was stated based on banks' unjustified charging of excessive fees to title companies, when fees were passed through to plaintiff landowners; banks received financial advantage--excessive fees--that they unjustly retained at expense of plaintiffs, who absorbed coverage]; 28 Cal. L. Rev. 528 [*Rotea*]; 21 Cal. Western L. Rev. 149 [quasi-contract in churning cases (stockbroker's excessive sale of securities); problems with limiting client's recovery to broker's commissions]; 66 Am.Jur.2d (2001 ed.), *Restitution and Implied Contracts* §§13, 14.)

In *Young v. Bank of California* (1948) 88 C.A.2d 184, 198 P.2d 543, plaintiff, a real estate broker, unsuccessfully sought a written authorization from defendant vendor, but nevertheless proceeded on defendant's oral assurance that it would pay his commission. Defendant eventually completed the sale itself. *Held*, plaintiff had no right to sue in contract, the statute of frauds being a bar; and no quasi-contractual recovery was possible because plaintiffs had not consummated the sale and hence had not conferred any benefits on defendant. (88 C.A.2d 187.) (On whether a contract may validly provide against quasi-contractual recovery by a promisor whose performance does not exactly meet the terms of the contract, see 37 Cal. L. Rev. 503.)

A subcontractor in no direct contractual relationship with a property owner ordinarily cannot recover from the owner for benefits conferred on the property. (*Rogers v. Whitson* (1964) 228 C.A.2d 662, 673, 39 C.R. 849; see 62 A.L.R.3d 288 [right of subcontractor who has dealt only with primary contractor to recover against property owner in quasi-contract]; *Truestone v. Simi West Industrial Park II*, *supra*.)

For a benefit to be conferred, it is not essential that money be paid directly to the recipient by the party seeking restitution. Further, a transferee with knowledge of the circumstances surrounding the unjust enrichment may be obligated to make restitution. (*Solano v. Vallejo Redevelopment Agency* (1999) 75 C.A.4th 1262, 1277, 90 C.R.2d 41 [action for unjust enrichment brought by county against city arising from redevelopment agency's payments to retire city school district's bonds using money contractually earmarked for county; agency's payments resulted in benefit to city in amount at least equal to sum agency failed to pay county, and because of agency's payments, development fees generated in part of city where school was located went to city instead of being used to develop school].)

West's Key Number Digest, Implied and Constructive Contracts k.16

SUPPLEMENT: [This section is current through the latest supplement]

See *Peterson v. Cellco Partnership* (2008) 164 C.A.4th 1583, 1593, 80 C.R.3d 316 [unlicensed cellular phone insurance seller did not retain benefit at expense of customers, as would support customers' unjust enrichment claim, absent allegation that customers could have bought same policy elsewhere for lower price; customers received benefit of bargain, having obtained bargain for insurance at bargain for price].



152 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
Copyright (c) 2010 By B.E. Witlin Article Sixth Testamentary Trust

CHAPTER I - Contracts

Witkin Summary of California Law
XX. QUASI-CONTRACTS AND RESTITUTION
C. Necessity of Benefit to Defendant.
2. Exceptions.

1 Witkin Sum. Cal. Law Contracts § 1019

[§ 1019] Exceptions.

In some situations, the defendant may be liable for loss although he or she receives *no benefit at all*, e.g.:

(1) Where the defendant is an innocent agent who sells goods that his or her principal has converted. (*Swim v. Wilson* (1891) 90 C. 126, 129, 27 P. 33; *Rest., Restitution* §128, Comment f; see 3 *Summary* (10th), *Agency and Employment*, §201.)

(2) Where an agent obtains money by fraud or mistake and pays it over to his or her principal with knowledge of the plaintiff's right of restitution. (*Millsap v. National Funding Corp.* (1943) 57 C.A.2d 772, 781, 135 P.2d 407; *Rest., Restitution* §143, Comment c; *Rest.2d.*, *Agency* §339, Comment f; see 3 *Summary* (10th), *Agency and Employment*, §203.)

(3) Where the defendant is a wilful wrongdoer. (*Rest., Restitution* §151; see *Elliott v. Elliott* (1964) 231 C.A.2d 205, 210, 41 C.R. 686, 13 *Summary* (10th), *Trusts*, §323.)

(4) Where the services are requested. (See dissent in *Coleman Engineering Co. v. North Amer. Aviation* (1966) 65 C.2d 396, 419, 55 C.R. 1, 420 P.2d 713, *supra*, §155; *Earhart v. Low Co.* (1979) 25 C.3d 503, 515, 158 C.R. 887, 600 P.2d 1344, *infra*, §1039; *Rest., Restitution* §1, Comment b ["benefit" includes performance of services "at the request of the other"].)

SUPPLEMENT: [This section is current through the latest supplement]



153 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XX. QUASI-CONTRACTS AND RESTITUTION
D. Benefits Voluntarily Conferred: Officiousness.
1. General Rule.

1 Witkin Sum. Cal. Law Contracts § 1020

[§ 1020] General Rule.

An important limitation on quasi-contractual recovery is found in the rule that one who confers benefits on another *officiously*, i.e., by unjustified interference in the other's affairs, is not entitled to restitution. It must ordinarily appear that the benefits were conferred by *mistake, fraud, coercion, or request*; otherwise, though there is enrichment, it is not unjust. (*Rest., Restitution* §§2, 112; see *Shelley v. Board of Trade of San Francisco* (1927) 87 C.A. 344, 349, 262 P. 403 [plaintiff voluntarily made payment under agreement unenforceable because consideration was *past*, but no mistake or duress; held voluntary payment, not recoverable]; *Myers v. Calipatria* (1934) 140 C.A. 295, 299, 35 P.2d 377; 74 Harv. L. Rev. 817, 1073 [European law]; 87 Harv. L. Rev. 1409 [The Self-Serving Intermeddler]; 66 Am.Jur.2d (2001 ed.), *Restitution and Implied Contracts* §§14, 44; 22 A.L.R.5th 800 [landowner's alleged unjust enrichment based on adjoining landowner's work on commonly used highway, street, or bridge]; cf. 74 Cal. L. Rev. 85 [proposal that nonprofessional rescuer injured during successful nonnegligent rescue be entitled to recover out-of-pocket expenses from rescuer].)

It is even more obvious that, where the plaintiff acts in performance of his or her own duty or in protection or improvement of the plaintiff's own property, any incidental benefit conferred on the defendant is not unjust enrichment. (See *Rest., Restitution* §106 [no right to contribution]; *Major-Blakeney Corp. v. Jenkins* (1953) 121 C.A.2d 325, 341, 263 P.2d 655 [citing *Rest., Restitution* §106]; cf. *Griffith Co. v. Hofues* (1962) 201 C.A.2d 502, 506, 19 C.R. 900 [plaintiff did paving work on property under express contract with N, believing N the owner when he was only purchaser who ultimately defaulted; defendant owner not liable]; *California Med. Assn. v. Aetna U.S. Healthcare of Calif.* (2001) 94 C.A.4th 151, 174, 114 C.R.2d 109, citing the text [no grounds existed for quasi-contractual action where performance of express contract served to benefit third party].)

In *Dinosaur Dev. v. White* (1989) 216 C.A.3d 1310, 265 C.R. 525, plaintiff and defendants owned adjoining parcels of unimproved property that were landlocked, i.e., lacking access to and from the nearest thoroughfare for vehicular traffic. Plaintiff applied to the county development department for approval of a subdivision map for construction of three single-family residences with an access road from the thoroughfare to the center of plaintiff's property. Defendants successfully demanded that the department require, as a condition of approval of the map, that plaintiff ensure access to defendants' property; but they refused to pay any part of the cost. Plaintiff then brought this action seeking recovery for the increased value of defendants' property as a result of compliance with the condition, and for the costs to plaintiff of improvements benefiting defendants. Held, judgment for defendants on demurrer affirmed.

(a) The complaint, in essence, sought restitution based on unjust enrichment. But the mere fact that a person benefits another is not of itself sufficient to require restitution: "It must ordinarily appear that the benefits were conferred by *mistake, fraud, coercion or request*; otherwise, though there is enrichment, it is not unjust." (216 C.A.3d 1316, quoting the text.)

(b) Plaintiff argued that there was a request from defendants routed through the department, but there was no direct request to plaintiff, and plaintiff acted for its own benefit in improving its property. (216 C.A.3d 1316.)

(c) Plaintiff also contended that there was coercion from the department, in that it acted solely in response to defendants and in such a manner as to benefit no one but defendants. But the department's conduct did not constitute coercion: the Government may impose conditions on the grant of permits or privileges, and these conditions do not amount to compulsion, because the property owner remains free either to accept or reject them. (216 C.A.3d 1318.)

"Viewed from this perspective, the issue of whether defendants have been benefited at plaintiff's expense must be subordinated to the cold hard fact of governmental power that has been deployed to safeguard defendants' right of access to the nearest public thoroughfare. ... Once that power is conceded, the question of precisely how or by whom it is triggered becomes irrelevant. ... If plaintiff complies with the Department's condition for approval of the subdivision, defendants will benefit. But because the benefit will be incidental to plaintiff's proposed development, it will not be unjust enrichment requiring defendants to make restitution." (216 C.A.3d 1319.)

West's Key Number Digest, Implied and Constructive Contracts k.39

SUPPLEMENT: [This section is current through the latest supplement]



154 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XX. QUASI-CONTRACTS AND RESTITUTION
D. Benefits Voluntarily Conferred: Officiousness.
2. Exception: Performing Defendant's Duty.

1 Witkin Sum. Cal. Law Contracts § 1021

[§ 1021] Exception: Performing Defendant's Duty.

An exception is recognized where the plaintiff acts for the *protection* of the defendant; e.g., he or she performs the defendant's common law or statutory duty to supply necessities to a child or spouse. (*Rest., Restitution* §112, Comment b, §113; Family. C. 3950; *Davis v. Fyfe* (1930) 107 C.A. 281, 282, 290 P. 468; 66 Am.Jur.2d (2001 ed.), *Restitution and Implied Contracts* §§14, 44.) Similarly, recovery is allowed for necessities furnished to an incompetent person for the support of the incompetent person or his or her family. (C.C. 38; *Rest., Restitution* §113; see *Estate of Doyle* (1932) 126 C.A. 646, 647, 14 P.2d 920; *Dorris v. Crowder* (1938) 26 C.A.2d 49, 51, 78 P.2d 1039 [plaintiff attorney appointed by judge to represent defendant, an insane person, in murder trial, held entitled to recover reasonable value of services, though defendant had attempted to decline the offer of counsel and pleaded guilty]; *Estate of O'Donnell* (1948) 85 C.A.2d 1, 12, 192 P.2d 94 [incompetent's estate liable for reasonable value of services rendered in locating him as missing heir].)

This exception was held inapplicable in *Union of Amer. Physicians & Dentists v. Santa Clara* (1983) 149 C.A.3d 45, 196 C.R. 602, where emergency medical services were provided by plaintiff physicians to indigents allegedly eligible for county services under Welf.C. 17000. Plaintiffs' claim against a county must rest on more than principles of restitution; the claim must be specifically authorized by statute, and this was not. If a county fails to perform its duty, the remedy is not to impose liability for individual claims, but to seek mandamus to compel the county to fulfill its obligations to the class of indigents intended to be benefited by Welf.C. 17000. (149 C.A.3d 50, 53.)

Where the plaintiff *mistakenly* satisfies some obligation of the defendant, e.g., if the plaintiff believes that he or she is the owner of property or liable for obligations imposed upon it, and pays money in taxes or in discharge of a lien upon it, the unjust enrichment of the defendant seems clear, for the defendant would have had to make the payment himself or herself. Hence, the Restatement allows recovery. (*Rest., Restitution* §§43, 54.) But California denies it, holding that the plaintiff is a mere volunteer unless he or she is forced to pay to protect some interest of his or her own. (*McMillan v. O'Brien* (1934) 219 C. 775, 780, 29 P.2d 183; *Dinkins v. Lamb* (1951) 108 C.A.2d 175, 179, 238 P.2d 630; see 13 *Summary* (10th), *Equity*, §186.)

SUPPLEMENT: [This section is current through the latest supplement]



155 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XX. QUASI-CONTRACTS AND RESTITUTION
E. Benefits Conferred Under Mistake or Fraud.
1. Payment of Money.
a. General Rule.

1 *Witkin Sum. Cal. Law Contracts* § 1022

[§ 1022] General Rule.

A person who *pays money* under the mistaken belief that he or she is under a duty to do so may recover it. (See *Burckard v. Smith* (1926) 80 C.A. 104, 107, 251 P. 663; *Wenzler v. Municipal Court* (1965) 235 C.A.2d 128, 133, 45 C.R. 54, 8 Cal. Proc. (4th), *Extraordinary Writs*, §79; *Rest., Restitution* §16; Corbin (Rev. ed.), §28.49; 19 *Hastings L. J.* 993 [restitution of distributions by fiduciary to which recipient was not entitled]; 11 *U.C.L.A. L. Rev.* 653 [mistake and unjust enrichment]; 66 *Am.Jur.2d* (2001 ed.), *Restitution and Implied Contracts*, §19 et seq.; 7 Cal. Civil Practice, 3 Business Litigation, §34:9 et seq.; BAJI, No. 10.70 [money had and received]; and see *infra*, §1042, on restitution where express contract fails.) (On change of position as a defense, see *Doyle v. Matheron* (1957) 148 C.A.2d 521, 523, 306 P.2d 913; *First Savings & Loan Assn. v. Bank of America* (1970) 4 C.A.3d 393, 395, 84 C.R. 532.)

Thus, if the plaintiff pays the purchase price of property, and it develops that the defendant had no title or interest therein, the payment is recoverable. (*Mitchell v. California-Pac. Title Ins. Co.* (1926) 79 C.A. 45, 50, 248 P. 1035; see *Rest., Restitution* §24; cf. 57 *A.L.R.2d* 350 [right of tenant to recover rentals previously paid to one mistakenly believed to be owner of property].) (On recovery by bank of money paid out to customer by mistake, see 10 *A.L.R.4th* 524.)

The same is true where money is obtained by false representations as to its intended use. (*Long v. Harrison* (1931) 113 C.A. 321, 322, 298 P. 148; *Berg v. King-Cola* (1964) 227 C.A.2d 338, 342, 38 C.R. 655 [inducement by false representation of fiduciary]; *Rest., Restitution* §28.) (On possible recovery by Government against public officer receiving money by breach of fiduciary obligations ("sale of influence"), see 37 *So. Cal. L. Rev.* 550.)

In *Pioneer Title Ins. Co. v. Guttman* (1959) 175 C.A.2d 116, 345 P.2d 577, plaintiff title company's escrow agent mistakenly paid defendant vendors money, without making a certain deduction for third persons giving a quitclaim deed. After unsuccessful attempts to gain reimbursement from defendants, plaintiff paid the third party and brought this action for money expended on behalf of defendants. *Held*, plaintiff had a legal obligation as escrow holder to pay, defendants were unjustly enriched, and recovery was proper. (175 C.A.2d 119.)

Under the modern view, both in contract and quasi-contract actions recovery may be had for payment under mistake of law as well as mistake of fact. (See *First Savings & Loan Assn. v. Bank of America*, *supra*, 4 C.A.3d 395; *Bridges v. Cal-Pac. Leasing Co.* (1971) 16 C.A.3d 118, 124, 93 C.R. 796; 7 Corbin (Rev. ed.), §28.49; 19 *Hastings L. J.*

1225; on contract actions, see *supra*, §272 et seq.)

However, where the plaintiff and the defendant are equally to blame, or equally innocent, for the mistake under which the money was paid, restitution is not available if the payee has altered his or her position. (*American Psychometric Consultants v. Work. Comp. App. Bd.* (1995) 36 C.A.4th 1626, 1647, 43 C.R.2d 254 [restitution denied to workers' compensation carriers for payments of medical-legal fees to medical lien claimants more than 2 years earlier, even though claimants submitted bills without complying with Workers' Compensation Act, where carriers were equally chargeable with knowledge of changes in law and paid bills without protest and after negotiating reductions in them].) (On reimbursement of medical-legal expenses under Workers' Compensation Act, see 2 *Summary* (10th), *Workers' Compensation*, §§273, 274.)

West's Key Number Digest, Implied and Constructive Contracts k.6

SUPPLEMENT: [This section is current through the latest supplement]
Wenzler case:

Cross-Reference: 8 *Cal. Proc.* (5th), *Extraordinary Writs*, §80.



156 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XX. QUASI-CONTRACTS AND RESTITUTION
E. Benefits Conferred Under Mistake or Fraud.
1. Payment of Money.
b. Mistaken Reconveyance of Deed of Trust.

1 Witkin Sum. Cal. Law Contracts § 1023

[§ 1023] Mistaken Reconveyance of Deed of Trust.

In *First Nationwide Savings v. Perry* (1992) 11 C.A.4th 1657, 15 C.R.2d 173, the court held that the beneficiary of a deed of trust could recover from a nonassuming grantee of a purchase money deed of trust, where the trustee mistakenly reconveyed the deed of trust and the grantee sold the property and obtained its proceeds.

In 1983, Madden borrowed \$ 146,000 from plaintiff, First Nationwide Savings (FNS), for the purchase of a single-family residence. The note was secured by a deed of trust in which Madden conveyed for the benefit of FNS a power of sale of the residence. Madden subsequently sold the property, and the purchaser took it subject to FNS's deed of trust.

In January 1986, a trustee's sale was held under the nonjudicial foreclosure of a deed of trust junior to the FNS deed of trust, and Sunrise Trust purchased the property subject to the FNS deed of trust. In May 1986, the trustee on the FNS deed of trust mistakenly executed a reconveyance. Hence, when Sunrise subsequently sold the property, FNS did not receive any of the proceeds of the sale.

FNS sued Madden on the theory of unjust enrichment, and the trial judge gave judgment for Madden on demurrer. *Held*, reversed.

(a) *Unjust enrichment cause of action.*

(1) The fact that one person benefits another is not, by itself, sufficient to require restitution. The person receiving the benefit is required to make restitution only if, under the circumstances, it is unjust for him or her to retain it. Policy considerations may dictate that the person making the mistake assume the risk of the error; and restitution may be denied against an innocent transferee or beneficiary, if the innocent transferee or beneficiary has changed his or her position after the transaction. (11 C.A.4th 1663.)

(2) "By contrast, a transferee with knowledge of the circumstances giving rise to an unjust enrichment claim may be obligated to make restitution." (11 C.A.4th 1663.) Accordingly, Sunrise's knowledge is an important consideration in determining the validity of FNS's unjust enrichment claim. (11 C.A.4th 1663.)

(b) *Purchase money deed of trust*. Sunrise argued that, under security transactions law, FNS could not recover the difference between the debt and sale proceeds if the purchase money deed of trust had been foreclosed, and that the same rule prevents FNS from stating a claim for unjust enrichment. This reasoning is unsound:

(1) The difference between the debt and the foreclosure proceeds is not at stake; there can be no foreclosure, because the lien on the property has been extinguished. And any unjust enrichment recovery could not exceed the property value. (11 C.A.4th 1664.)

(2) Equitable principles may outweigh the reasons for prohibiting deficiency judgments, and in appropriate circumstances an action for unjust enrichment can be stated against a nonassuming grantee under a purchase money deed of trust. (11 C.A.4th 1665.)

(c) *California Fed. Bank v. Matreyek distinguished*. In *California Fed. Bank v. Matreyek* (1992) 8 C.A.4th 125, 10 C.R.2d 58, *infra*, §1025, the plaintiff made the mistake; here the trustee was responsible. In that case, the borrowers did not know about the mistake; here the borrowers did know. In that case, the recipient of the benefit gave consideration in exchange for obtaining the advantage; here no such consideration was given. (11 C.A.4th 1667.)

(d) *Sunrise's knowledge*. If Sunrise should not have known about the reconveyance, and should not have realized that it was not entitled to all of the sale proceeds, it would not necessarily be unjust to permit it to retain those proceeds. FNS did not allege this knowledge, but it should be given an opportunity to amend its complaint to allege it. (11 C.A.4th 1669.) (See *Ghirardo v. Antonioli* (1996) 14 C.4th 39, 51, 57 C.R.2d 687, 924 P.2d 996, 4 Summary (10th), *Security Transactions in Real Property*, §215 [citing *First Nationwide Savings*, and holding that real property seller who, through mistake of fact, understated amount of payoff demand to purchasers for satisfaction of promissory note underlying deed of trust and, upon payment of demand, reconveyed deed, could recover amount omitted from demand on principles of unjust enrichment].)

SUPPLEMENT: [This section is current through the latest supplement]



157 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XX. QUASI-CONTRACTS AND RESTITUTION
E. Benefits Conferred Under Mistake or Fraud.

1. Payment of Money.

c. Payment of Support Due to Mistaken Belief of Biological Fatherhood.

1 Witkin Sum. Cal. Law Contracts § 1024

[§ 1024] Payment of Support Due to Mistaken Belief of Biological Fatherhood.

In *McBride v. Boughton* (2004) 123 C.A.4th 379, 20 C.R.3d 115, plaintiff, having been told by B that he was the father of her child, agreed to support B and the child for approximately 1 year and then to act as caretaker when B returned to work. When the child was about 21/2 years old, B announced that she was moving to San Francisco with the child and that plaintiff's visitation would be limited to two weekends per month. Plaintiff then filed a paternity proceeding seeking custody of the child, but paternity tests done in connection with that proceeding excluded plaintiff as the biological father. After abandoning his efforts to seek custody, plaintiff instituted the present action against B and D (the alleged biological father) seeking money damages and claiming, as an issue of first impression, that defendants had been unjustly enriched by his payment of support for B and the child. Having sustained defendants' demurrer, the trial judge entered judgment dismissing the complaint. *Held*, affirmed.

(a) *Nagy v. Nagy* (1989) 210 C.A.3d 1262, 258 C.R. 787, 5 Summary (10th), *Torts*, §792, and *Richard P. v. Superior Court* (1988) 202 C.A.3d 1089, 249 C.R. 246, 6 Summary (10th), *Torts*, §792, held that a man who paid support as a result of being told by a child's mother that he was the biological father could not recover general damages for the emotional impact of the mother's conduct. However, *Richard P.* expressly declined to foreclose the possibility that a man in this position might be able to recover, on an equitable theory for reimbursement such as unjust enrichment, actual out-of-pocket costs incurred in supporting another man's child. "Thus, this case calls upon us to decide the question we noted, but left open, in *Richard P.*" (123 C.A.4th 387.)

(b) The unjust enrichment doctrine focuses on the unjust nature of the enrichment. Accordingly, restitution will be denied where application of the doctrine would involve a violation or frustration of the law or opposition to public policy. Here, two of the most fundamental public policies of this state, i.e., the enforcement of parents' obligations to support their children, and the protection of children's interest in the stability of their family relationships, preclude requiring B to make restitution to plaintiff based on his claim of unjust enrichment. Under the circumstances presented here, granting plaintiff the right to restitution from the child's biological parents, who retain responsibility for her support, would give priority to plaintiff's desire to be made financially whole, to the potential detriment of the child's ongoing needs. (123 C.A.4th 389.) "More importantly, at least from the child's perspective, by *declining* to recognize an unjust enrichment claim, we create a *disincentive* for an unmarried man to form a parental bond with a child if the bond is likely to be severed upon the child's proving to be another man's genetic offspring. The potential emotional and

psychic costs to the child of such a rupture are far more significant than any financial injury a grown man might suffer from mistakenly supporting another man's child for a temporary period." (123 C.A.4th 390.)

(c) Holding that it is not unjust enrichment for a mother to retain child support that she has received serves an important public policy by sending the message to unmarried putative fathers that they should verify their paternity at an early stage if there is any doubt about the matter. (123 C.A.4th 391.)

(d) Determining whether B was unjustly enriched would involve inquiring into the very subjects which *Nagy and Richard P.* held that public policy requires courts to avoid. Issues of this type include (1) the extent to which plaintiff's expenditures exclusively benefited the child, rather than B personally, and if so, the effect of that fact on the equities of plaintiff's restitution claim against B and D; (2) if restitution is owed, whether its amount should be reduced by the value of any benefit, emotional or financial, that plaintiff received from his relationship with the child; and (3) how, if at all, the equities of plaintiff's restitution claim may be affected by his decision to end his relationship with the child rather than pursuing any rights he may have had under *Family C. 7611(d)* (proving natural father status by receiving child into home and openly holding out child as his; see 10 *Summary* (10th), *Parent and Child*, §39). (123 C.A.4th 391.)

(e) *Dunkin v. Boskey* (2000) 82 C.A.4th 171, 196, 98 C.R.2d 44, 10 *Summary* (10th), *Parent and Child*, §206, which allowed the plaintiff to recover under an unjust enrichment theory, damages for economic loss caused by breach of a contract granting the plaintiff parental rights to a child to be conceived through artificial insemination, is distinguishable. The equities favored the plaintiff in *Dunkin* because he had voluntarily agreed to assume a support responsibility that he would not otherwise have had, in exchange for the opportunity to enjoy a parental relationship that was later unilaterally severed by the child's mother, in breach of her agreement. Here, by contrast, plaintiff supported the child in the belief that he was her biological father (thus making it his legal responsibility to do so), without taking any steps to ascertain whether or not this was actually the case. On these facts, the equities fall in the child's favor, and her interest in defendants' continuing ability to support her trumps plaintiff's interest in obtaining restitution. Moreover, in *Dunkin*, the plaintiff was aware from the start that the child whom he agreed to support would not be biologically his, and his claim against the child's mother was not based on any misrepresentation to the contrary. Rather, his claim was based on the mother's breach of an express contractual promise to treat him as the child's father. Here, however, plaintiff alleges that he agreed to support the child merely because B told him that the child was biologically his, and having found out that this was untrue, he is now asking the court to imply a quasi-contract giving rise to a right of restitution in his favor. "For the reasons of public policy that we have already discussed, we decline to do so." (123 C.A.4th 394.)

SUPPLEMENT: [This section is current through the latest supplement]



158 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XX. QUASI-CONTRACTS AND RESTITUTION
E. Benefits Conferred Under Mistake or Fraud.
1. Payment of Money.
d. Satisfaction of Own Obligation.

1 Witkin Sum. Cal. Law Contracts § 1025

[§ 1025] Satisfaction of Own Obligation.

If the money is paid in satisfaction of an obligation actually owed by the plaintiff, he or she is obviously not entitled to restitution even though the performance was induced by mistake or fraud. (See *Rest., Restitution* §60.) And the same is true where the payment is made on a debt that is unenforceable by reason of the statute of frauds, statute of limitations, or a discharge in bankruptcy. (See *Rest., Restitution* §61.)

In *California Fed. Bank v. Matreyek* (1992) 8 C.A.4th 125, 10 C.R.2d 58, defendants obtained a loan from plaintiff bank containing a prepayment penalty provision. Plaintiff assigned the loan to a national mortgage association, under an agreement requiring plaintiff to continue to service the loan and to collect and pay to the national association a prepayment penalty in the event of an early payoff. Defendants, relying on plaintiff's incorrect but good faith advice that they would incur no prepayment penalty, paid off the loan and obtained substitute financing at a lower rate of interest. As a result of its mistake, plaintiff was required to pay to the national association a prepayment penalty of nearly \$ 654,000. When defendants refused to repay this amount, plaintiff brought this action for unjust enrichment and equitable subrogation. *Held*, judgment for defendants on demurrer affirmed.

(a) *Defendants were not unjustly enriched.* For plaintiff to be entitled to restitution, it must establish that it conferred upon defendants a benefit that it would be unjust for them to retain. Plaintiff clearly conferred a benefit upon defendants by sparing them the expense of the prepayment penalty. (8 C.A.4th 132, citing *Sanguansak v. Myers* (1986) 178 C.A.3d 110, 223 C.R. 490, *supra*, §773.) However, for the following reasons, retention of the benefit would not be unjust:

First, by repaying the loan earlier than they were required to do, thereby sparing plaintiff from any risk of loss and freeing up the funds for other purposes, defendants gave valuable consideration for plaintiff's promise to forgo the prepayment penalty. (8 C.A.4th 133.)

Second, had plaintiff not agreed to forgo the prepayment penalty, defendants would have had no reason to refinance and repay the loan early, because the amount of the prepayment penalty exceeded the net economic benefit to defendants of refinancing. (8 C.A.4th 133.)

Third, there was no allegation that defendants engaged in any impropriety or that they knew of plaintiff's mistake and took unfair advantage. Defendants specifically asked plaintiff whether they could pay early without incurring the prepayment penalty. Hence, as between the parties, plaintiff was in a superior position to know whether it would insist on collecting the penalty, and defendants were entitled to rely on plaintiff's response. (8 C.A.4th 134.)

Fourth, the status quo cannot be restored. In repaying the loan early, defendants entered into substitute financing with another lender. If plaintiff were to recover the penalty from defendants, that amount would erase any benefit to defendants from the refinancing, while plaintiff would still retain the benefit of the early payoff of the loan. Under these circumstances recovery by plaintiff would be inequitable. (8 C.A.4th 134.)

(b) *Plaintiff not entitled to equitable subrogation.* The doctrine of equitable subrogation applies where a person, not acting as a mere volunteer or intruder, pays another person's debt that in equity should have been discharged by the latter. Here, however, plaintiff did not pay a debt for which defendants were primarily liable. By repaying the principal and accrued interest, defendants performed fully, and plaintiff agreed to and accepted that repayment as indicated by its cancellation of the note and the issuance of a reconveyance. Hence, when plaintiff subsequently paid the prepayment penalty to the national association, it acted to fulfill its own obligation to the association, not to satisfy defendants' debt, which had been extinguished. (8 C.A.4th 134.)

SUPPLEMENT: [This section is current through the latest supplement]



159 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XX. QUASI-CONTRACTS AND RESTITUTION
E. Benefits Conferred Under Mistake or Fraud.
1. Payment of Money.
e. Satisfaction of Invalid but Honest Claim.

1 *Witkin Sum. Cal. Law Contracts* § 1026

[§ 1026] Satisfaction of Invalid but Honest Claim.

Where the payment was in satisfaction of an honest claim, advanced in good faith, restitution may be denied even though the claim was actually unenforceable. (See *Rest., Restitution* §45; cf. *Rest., Restitution* §§46, 47; 45 *Harv. L. Rev.* 336; for an analogous rule on compromise of a disputed claim as consideration for a promise, see *infra*, §§211, 215.)

Thus, fees paid under a statute, voluntarily and without protest, were held not to be recoverable when the statute was subsequently declared unconstitutional. (*Wingerter v. San Francisco* (1901) 134 C. 547, 548, 66 P. 730; *Campbell v. Rainey* (1932) 127 C.A. 747, 750, 16 P.2d 310.)

West's Key Number Digest, Implied and Constructive Contracts k.61-

SUPPLEMENT: [This section is current through the latest supplement]



160 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XX. QUASI-CONTRACTS AND RESTITUTION
E. Benefits Conferred Under Mistake or Fraud.
1. Payment of Money.
f. Satisfaction of Third Person's Obligation.

1 Witkin Sum. Cal. Law Contracts § 1027

[§ 1027] Satisfaction of Third Person's Obligation.

The general principle allowing quasi-contractual recovery to one who performs a duty that he or she does not owe is subject to another exception based on the equitable doctrine of bona fide purchase. If the defendant receives money or property for value without fraud or notice of the circumstance that a third person and not the plaintiff was liable therefor, both parties are innocent and the plaintiff is not entitled to restitution. (See *Rest., Restitution* §§13, 14.)

Thus, in *Hilliard v. Bank of America* (1951) 102 C.A.2d 730, 228 P.2d 327, C (a car thief or transferee from a thief), borrowed \$ 1,000 from defendant bank, gave a note and chattel mortgage on the car, and then sold it to plaintiff dealer for \$ 1,250. Plaintiff, to clear the title, paid defendant bank the mortgage debt and later sold the car to W. When the true owner discovered the car, plaintiff was forced to reimburse him for its value (\$ 1,400) in order to make W's title good. Thereafter, plaintiff sought to recover from defendant bank the amount paid to clear the mortgage. *Held*, no restitution. The mortgage was invalid (because C had no title to the car) but the debt was good and enforceable by the bank against C. Hence, when plaintiff paid the bank its good debt, the bank was not unjustly enriched. Both parties were mistaken, but both were equally innocent, and plaintiff had no more right to restitution than if he had paid C the money directly and C had then paid the bank. (102 C.A.2d 733.)

The defense of "discharge for value" (*Rest., Restitution* §14) "arises where there is a preexisting liquidated debt or lien owed to the beneficiary by the originator of the payment. If the originator or some third party erroneously gives the beneficiary funds at the originator's request, and the beneficiary in good faith believes the funds have been submitted in full or partial payment of that preexisting debt or lien and is unaware of the originator's or third party's mistake, the originator or third party will not be entitled to seek repayment from the beneficiary of the erroneously submitted funds." (*Bank of America v. Sanati* (1992) 11 C.A.4th 1079, 1084, 14 C.R.2d 615, citing the text), and *Hilliard*.)

SUPPLEMENT: [This section is current through the latest supplement]



161 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XX. QUASI-CONTRACTS AND RESTITUTION
E. Benefits Conferred Under Mistake or Fraud.
1. Payment of Money.
g. Gambling Losses.

1 Witkin Sum. Cal. Law Contracts § 1028

[§ 1028] Gambling Losses.

Illegal *gambling* gives rise to two kinds of problems of contract and quasi-contract:

(1) The *winner* cannot enforce the loser's promise to pay the gambling debt, because the contract is based on an illegal consideration. (See *supra*, §630.)

(2) The *loser* cannot recover the money that he or she has lost. (See *Wallace v. Openhanded* (1946) 73 C.A.2d 25, 26, 165 P.2d 709; 38 Am.Jur.2d (1999 ed.), *Gambling* §215 et seq.)

A few states with special statutes follow the qualification that, if the winner *cheats*, the loser is not *in pari delicto*, and is entitled to quasi-contractual recovery on the theory of money paid under mistake or fraud. (See 39 A.L.R.2d 1213 [recovery of money or property lost through cheating or fraud in gambling or game].) But California denies recovery in all cases because of public policy against the activity. (*Wallace v. Openhanded, supra*, 73 C.A.2d 28 ["where money or property is lost in a transaction between the parties which is prohibited by law, neither of the parties has standing in a court of law or equity to recover his losses"]; *Bradley v. Doherty* (1973) 30 C.A.3d 991, 994, 106 C.R. 725 [court cannot distinguish between degrees of turpitude of persons knowingly engaged in illegal gambling].)

In *Kelly v. First Astri Corp.* (1999) 72 C.A.4th 462, 84 C.R.2d 810, plaintiff, who banked a blackjack game at an *Indian reservation casino*, sued to recover gambling losses against managers and employees of the casino who allegedly used marked cards. The trial court granted summary judgment for defendants. *Held*, affirmed.

(a) California has a strong, long-standing public policy against judicial resolution of civil claims arising out of gambling contracts or transactions. This public policy, absent a statutory right to bring gambling claims, applies to both actions for recovery of gambling losses and actions to enforce gambling debts. (72 C.A.4th 476, discussing numerous cases and declining to follow *Crockford's Club Ltd. v. Si-Ahmed* (1988) 203 C.A.3d 1402, 250 C.R. 728, *supra*, §89, to extent it is contrary.)

(b) Here, plaintiff's losses occurred while he was "banking" games of twenty-one at the casino and he "banked" those games by collecting from the losers and paying the winners, such that he had a stake in each hand. On these

undisputed material facts, plaintiff's action is barred as a matter of law and strong public policy. (72 C.A.4th 488.) Further, the claims are barred whether the games of blackjack in which plaintiff participated as "banker" were proscribed games of twenty-one within the meaning of P.C. 330 (defining illegal gaming), or whether they were lawful under federal statutory law governing gaming on *California Indian lands*. (72 C.A.4th 490.)

(c) Plaintiff's claims are also barred under the *in pari delicto* doctrine. The form of blackjack in which he and defendants participated at the casino is proscribed by P.C. 330 if played in California, even if the playing of that game at the Indian casino were lawful under federal Indian gaming law. In any event, under the Indian Gaming Regulatory Act (25 U.S.C., §2701 et seq.), the game is, in fact, illegal on California Indian lands because it is illegal in California. Under the *in pari delicto* doctrine, neither courts of law nor courts of equity will aid or assist a plaintiff to recover money lost in a gambling game that is prohibited by law, regardless of where it is played and even if the loss resulted from cheating, absent a statute authorizing recovery of the gambling losses. (72 C.A.4th 490.)

SUPPLEMENT: [This section is current through the latest supplement]

See 87 Proof of Facts 3d 347 [enforceability of international gambling debts].*Correction:* Page 1120, lines 2 and 9, "*Wallace v. Openhanded*" should be "*Wallace v. Opinham*".



162 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XX. QUASI-CONTRACTS AND RESTITUTION
E. Benefits Conferred Under Mistake or Fraud.
2. Services Rendered.

1 *Witkin Sum. Cal. Law Contracts* § 1029

[§ 1029] Services Rendered.

Recovery for services rendered another under mistake depends upon different principles from those discussed in the preceding section. Money or property received can usually be returned; services cannot. And, while the plaintiff may suffer if not compensated for the services, the defendant may likewise suffer if compelled to pay for services not requested or desired. Hence, the situations in which recovery is permitted are narrowly restricted. Generally speaking, some fault on the part of the defendant is necessary to make him or her liable for the value of the unwanted services; e.g., fraud or innocent material misrepresentation, or acceptance of the services after knowledge of the mistake without attempting to inform plaintiff of it. (See *Rest., Restitution* §§40, 41, 42; *Wal-Noon Corp. v. Hill* (1975) 45 C.A.3d 605, 611, 119 C.R. 646, 12 Summary (10th), *Real Property*, §618 [no recovery by lessee for cost of repairs made, based on lessor's covenant to repair, where lessor was not notified and had no opportunity to object]; 66 *Am.Jur.2d* (2001 ed.), *Restitution and Implied Contracts* §50.) (On recovery where services are performed at request of the defendant, see *infra*, §1036 et seq.)

As in the case of money paid, there can be no restitution for services performed in satisfaction of an existing enforceable obligation, or one barred by the statute of frauds, limitations, or bankruptcy, etc. (*Rest., Restitution* §§60, 61.)

West's Key Number Digest, Implied and Constructive Contracts k.30 et seq.

SUPPLEMENT: [This section is current through the latest supplement]



163 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XX. QUASI-CONTRACTS AND RESTITUTION

F. Benefits Conferred Under Coercion.

1. In General.

a. Rule and Situations.

1 Witkin Sum. Cal. Law Contracts § 1030

[§ 1030] Rule and Situations.

Benefits, such as payment of money or transfer of property, conferred under duress, undue influence, or any other form of coercion, may ordinarily be recovered in a quasi-contract action. In other words, coercion has the same effect, in giving rise to a right of restitution, as fraud. (*Rest., Restitution §70.*) (See *66 Am.Jur.2d (2001 ed.), Restitution and Implied Contracts §113 et seq.*)

The Restatement sets forth three broad classes of situations giving rise to a right of restitution on the theory of coercion:

- (1) Institution or threat of legal or administrative proceedings. (*Rest., Restitution §71 et seq.*)
- (2) Discharge by the plaintiff of a duty also owed by another; the plaintiff may be entitled to indemnity or contribution. (*Rest., Restitution §76 et seq.*; see *13 Summary (10th), Equity, §178 et seq.*)
- (3) Satisfaction by the plaintiff of a duty owed by another where this is done to protect the plaintiff's property. (*Rest., Restitution §103 et seq.*)

SUPPLEMENT: [This section is current through the latest supplement]



164 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XX. QUASI-CONTRACTS AND RESTITUTION
F. Benefits Conferred Under Coercion.

1. In General.

b. Duress and Illegal Business Compulsion.

1 Witkin Sum. Cal. Law Contracts § 1031

[§ 1031] Duress and Illegal Business Compulsion.

A narrow theory of duress, confining it to unlawful acts, as distinguished, e.g., from breach or threat of breach of contract, is usually applied in the cases dealing with contractual consent. (See *supra*, §315.) A more liberal view has developed in late cases dealing with quasi-contract, and some of the later contract cases (*supra*, §314).

As the court observed in *Lewis v. Fahn* (1952) 113 C.A.2d 95, 99, 247 P.2d 831, *infra*, §1032: "[D]uress is to be tested, not by the nature of the threats, but rather by the state of mind induced thereby in the victim. The means used to produce that condition, the age, sex, state of health, and mental characteristics of the alleged injured party, are all evidentiary, merely, of the ultimate fact in issue, of whether such person was bereft of the free exercise of his will power. ... His resisting power, under all the circumstances of the situation, and not any arbitrary standard, is to be considered in determining whether there was duress." And the opinion adds: "A reading of the California cases of later vintage leads us to believe that the relaxed and modern rule of the *subjective* test of duress ... is the controlling rule in California and particularly is this so we think in respect of that form of duress with which we are here concerned and which has sometimes been termed 'illegal business compulsion.' " (113 C.A.2d 100.) (See *Leeper v. Beltrami* (1959) 53 C.2d 195, 203, 1 C.R. 12, 347 P.2d 12, *infra*, §1032 ["[u]nder modern law duress is not limited to threats against the person. It may also consist of threats to business or property interests"]; 66 Am.Jur.2d (2001 ed.), *Restitution and Implied Contracts* §§122, 123; 40 Cal. L. Rev. 425; cf. *Fuhrman v. California Satellite Systems* (1986) 179 C.A.3d 408, 426, 225 C.R. 140 [recognizing theory of recovery but holding it inapplicable where plaintiff never paid any money but sued in tort for damages for emotional distress].)

SUPPLEMENT: [This section is current through the latest supplement]



165 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XX. QUASI-CONTRACTS AND RESTITUTION
F. Benefits Conferred Under Coercion.
2. Legal Proceedings Without Probable Cause.
a. Suit or Threat of Suit.

1 *Witkin Sum. Cal. Law Contracts* § 1032

[§ 1032] Suit or Threat of Suit.

Recovery in quasi-contract may be based upon a benefit conferred under threat or institution of a suit on an unjustified claim. (See 66 *Am.Jur.2d* (2001 ed.), *Restitution and Implied Contracts* §§124, 125.)

Thus, in *Steffen v. Refrigeration Discount Corp.* (1949) 91 *C.A.2d* 494, 205 *P.2d* 727, defendant mortgagee held three notes and mortgages on three pieces of property. On default of plaintiff mortgagor, defendant invoked the acceleration clause, claimed interest unearned and not due, and threatened foreclosure. Plaintiff, to avoid foreclosure, sold one piece of property and obtained refinancing on the others, and to release the properties from the mortgages (so as to consummate the sale and refinancing) *paid the excessive claims*. In this action to recover the excessive payments, defendant contended that they were voluntary because plaintiff could have litigated the merits of the claims before paying. *Held*, the payments were made under "illegal business compulsion," for no prospective purchaser or lender would have waited through the period of litigation. (91 *C.A.2d* 497, 498.) (On illegal business compulsion, see *supra*, §1031.)

In *McNichols v. Nelson Valley Bldg. Co.* (1950) 97 *C.A.2d* 721, 218 *P.2d* 789, the complaint alleged that plaintiff had a deal pending in escrow to purchase property by exchanging 10 of his own lots. Defendants, fraudulently claiming a partnership with him, filed a complaint for dissolution, recorded a *lis pendens*, and thus clouded his title. When the escrow holder refused to furnish title insurance, plaintiff yielded to defendants' demand to convey four of the lots worth \$ 6,000. *Held*, a cause of action for duress or business compulsion was stated. (97 *C.A.2d* 723, 724.)

In *Lewis v. Fahn* (1952) 113 *C.A.2d* 95, 247 *P.2d* 831, plaintiffs were in possession under a lease, by the terms of which the rental was stated as \$ 725 per month, but only \$ 575 until the lessees completed remodeling to be done by them. Nevertheless, under defendant lessors' threat to cancel the lease and evict them, plaintiffs paid the full rental of \$ 725 before the remodeling. This suit was to recover the money paid. *Held*, a cause of action was stated. "Indeed, given an unlawful demand, a threat of groundless litigation unless the unlawful demand be met presents a situation where courts should not too readily listen to a claim by the party extorting the payment that his victim ought to have been a braver man and should have resisted his attack. ... Of course it is difficult to see how this compulsion could have persisted to the degree necessary to make out payment under duress over the long period of time involved, and many other difficulties of proof can easily be foreseen. But it cannot be said that proof is impossible when we remember the

sensitiveness of credit arrangements to attacks upon business, and the disastrous results that even an unjustified attack upon the very basis and foundation of a business not strongly organized may have." (113 C.A.2d 101.)

In *Leeper v. Beltrami* (1959) 53 C.2d 195, 1 C.R. 12, 347 P.2d 12, the complaint alleged the following facts: Plaintiff wife was liable for a \$ 10,000 bail bond, and execution was threatened on her home. Defendants B and S, falsely plotting to make her pay a \$ 10,150 mortgage debt that had already been satisfied, filed suit to foreclose the mortgages (on Sacramento and Sutter ranch properties), and filed lis pendens against both properties. As a result, plaintiff could not sell the Sutter ranch for \$ 18,000 (title clouded and defendants refused to withdraw claims), and was forced to sell the Sacramento ranch for \$ 10,760, a third of its value, to S. *Held*, judgment on demurrer reversed. One who falsely clouds title to real property, and then seeks some consideration to remove the cloud, is guilty of a wrongful act and may be compelled to restore the consideration. (53 C.2d 203.)

The court examined and rejected the following defenses:

(a) Defendants were merely seeking the legal remedy of foreclosure of a mortgage. But the complaint alleged that B and S knew that the claim was false, and legal prosecution of the false claim was duress. (53 C.2d 204.)

(b) Defendants' acts were not the proximate cause of plaintiff's injuries because the threat of execution was from a third person. But the primary cause of the payment was defendants' false claim; the other factors merely created the situation that made the pressing of the false claim successful. (53 C.2d 204.)

(c) Plaintiff could have allowed her home to be sold, then contested defendants' foreclosure suit. But to allow one's home to be sold at a foreclosure sale is not necessarily a reasonable alternative; hence under the allegations of the complaint, plaintiff had no reasonable alternative. (53 C.2d 204, 205.)

(d) Plaintiff paid the money to defendants in settlement of the suit and the judgment was res judicata. But any judgment by consent or of dismissal can be attacked by a showing of extrinsic fraud, and "[d]uress is a species of fraud." (53 C.2d 205.)

West's Key Number Digest, Implied and Constructive Contracts k.36

SUPPLEMENT: [This section is current through the latest supplement]



166 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XX. QUASI-CONTRACTS AND RESTITUTION
F. Benefits Conferred Under Coercion.
2. Legal Proceedings Without Probable Cause.
b. Enforcement or Threatened Enforcement of Judgment.

1 *Witkin Sum. Cal. Law Contracts* § 1033

[§ 1033] Enforcement or Threatened Enforcement of Judgment.

A payment made pursuant to enforcement or threatened enforcement of an invalid or reversed judgment is another common basis of quasi-contract recovery. (See *Levy v. Drew* (1935) 4 C.2d 456, 459, 50 P.2d 435; *Pentz v. Kuppinger* (1973) 31 C.A.3d 590, 594, 107 C.R. 540 [judgment obtained from Mexican court by extrinsic fraud]; *Rest., Restitution* §§72(2), 73, 74; cf. *Wake Dev. Co. v. O'Leary* (1931) 118 C.A. 131, 135, 4 P.2d 802 [payment to release property from improper execution, in order to carry through a sale].)

SUPPLEMENT: [This section is current through the latest supplement]



167 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XX. QUASI-CONTRACTS AND RESTITUTION
F. Benefits Conferred Under Coercion.
3. Other Illustrations of Recovery.

1 *Witkin Sum. Cal. Law Contracts* § 1034

[§ 1034] Other Illustrations of Recovery.

In *Young v. Hoagland* (1931) 212 C. 426, 298 P. 996, plaintiff stockholder, to avoid forced sale of his stock, paid an illegal assessment. *Held*, his payment was not voluntary and he could recover. The court approved the rule that "where, by reason of the peculiar facts a reasonably prudent man finds that in order to preserve his property or protect his business interests it is necessary to make a payment of money which he does not owe and which in equity and good conscience the receiver should not retain, he may recover it." (212 C. 431.) (See 40 *Cal. L. Rev.* 425.)

In *Millsap v. National Funding Corp.* (1943) 57 C.A.2d 772, 135 P.2d 407, an employee turned notary fees collected over to her employer under threat of discharge. *Held*, this was "illegal business compulsion," and the payments were recoverable. (57 C.A.2d 781.) (But cf. *Marshall v. Packard-Bell Co.* (1951) 106 C.A.2d 770, 236 P.2d 201, *infra*, §1035 [employer had right to discharge at any time, and threat to do what one has power to do is not coercion].)

The right to restitution of money paid under an invalid tax or assessment is comprehensively regulated by statute, and is considered elsewhere. (See 9 *Summary* (10th), *Taxation*, §284 et seq.)

SUPPLEMENT: [This section is current through the latest supplement]



168 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XX. QUASI-CONTRACTS AND RESTITUTION
F. Benefits Conferred Under Coercion.
4. Cases Denying Recovery.

1 *Witkin Sum. Cal. Law Contracts* § 1035

[§ 1035] Cases Denying Recovery.

In *Western Gulf Oil Co. v. Title Ins. & Trust Co.* (1949) 92 C.A.2d 257, 206 P.2d 643, over a period of 208 days plaintiff, lessee under an oil lease, disputed the lessor's right to certain payments, but nevertheless made them after the lessor threatened forfeiture of the lease. Then the lessee sued to recover the payments. *Held*, the payments were voluntary, for plaintiff could have sued immediately for a declaration of rights under C.C.P. 1060, and could have asked for temporary relief from forfeiture pending the action. Though the correctness of the result is debatable, the case stands for little in view of the observation that whether the plaintiff acted reasonably in making the payments was a question of fact for the trial court. (92 C.A.2d 266.)

In *Draper v. Grant* (1949) 91 C.A.2d 566, 205 P.2d 399, petitioner pleaded guilty in an inferior court and paid a fine though the crime was beyond the jurisdiction of the court; he then sought *mandamus* against the judge and city treasurer to compel return of the money. After properly holding that the extraordinary writ did not lie, the court made the dubious suggestion that even in a proper action recovery would be "problematical," apparently because the payment was voluntary, under mistake of law. (91 C.A.2d 571.) It is difficult to see how payment of a fine, to escape an illegal jail sentence, is "voluntary."

In *Brahs v. Katcher* (1951) 106 C.A.2d 657, 235 P.2d 619, defendant owed an apparently disputed balance of \$ 3,000 on a contract of sale, after having given several dishonored drafts. Plaintiff phoned from the district attorney's office stating that he could prosecute but would rather collect the money. Defendant paid. *Held*, there was no duress. To render the payment involuntary and recoverable, "there must be an actual or threatened exercise of power possessed or supposed to be possessed by the party receiving payment. ... The threat must be clear and direct. It is not sufficient that a threat might possibly be inferred." (106 C.A.2d 659.) Here, the testimony at most showed a statement of power possessed, rather than a threatened exercise of it. (106 C.A.2d 659.)

In *Marshall v. Packard-Bell Co.* (1951) 106 C.A.2d 770, 236 P.2d 201, plaintiff, distributor for defendant, alleged that he agreed to and did contribute a percentage of his monthly billings to an advertising fund for the company's products, under threat of loss of his exclusive distributorship. *Held*, he could not recover the money paid. Defendant had the right to terminate his distributorship contract at any time, and "it does not constitute duress or coercion to threaten to do that which a party has a legal right to do." (106 C.A.2d 774.)

In *Reynolds v. San Francisco* (1975) 53 C.A.3d 99, 125 C.R. 673, plaintiff paid a filing fee of \$ 346.05 as a candidate for municipal court judge. Thereafter, the California Supreme Court held the fee requirement unconstitutional (see 7 *Summary* (10th), *Constitutional Law*, §261), and he sued for a refund. *Held*, he was not entitled. The fee was paid without protest; i.e., there was no compulsion by governmental authorities, but only a mistaken belief of plaintiff that the law was valid. (53 C.A.3d 102.)

SUPPLEMENT: [This section is current through the latest supplement]



169 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XX. QUASI-CONTRACTS AND RESTITUTION
G. Services Performed at Request.
1. Theory of Recovery.

1 Witkin Sum. Cal. Law Contracts § 1036

[§ 1036] Theory of Recovery.

Where one person renders services to another from which the latter derives benefit, ordinarily an obligation arises to pay their reasonable value. The California courts have permitted recovery on *implied contract* or *quantum meruit* for services rendered, without always clearly indicating whether the contract was implied in fact or implied in law. In general, however, it would seem that whenever there is an *invalid or unenforceable express contract*, and recovery is nevertheless allowed, the basis of the recovery is *quasi-contractual*. (See *Rotea v. Izuel* (1939) 14 C.2d 605, 608, 95 P.2d 927; *Bogan v. Wiley* (1946) 72 C.A.2d 533, 536, 164 P.2d 912; *Murdock v. Swanson* (1948) 85 C.A.2d 380, 383, 193 P.2d 81 [services and goods furnished]; *Shive v. Barrow* (1948) 88 C.A.2d 838, 844, 199 P.2d 693 [services and money furnished]; *Drvol v. Bant* (1960) 183 C.A.2d 351, 356, 7 C.R. 1 [services for decedent in reliance on promise to devise home, will denied probate; recovery in quantum meruit]; *Beley v. Municipal Court* (1979) 100 C.A.3d 5, 8, 160 C.R. 508, *infra*, §1042, citing the text; 66 *Am.Jur.2d* (2001 ed.), *Restitution and Implied Contracts* §38 et seq.; Cal. Civil Practice, 3 Business Litigation, §34:21 et seq.; BAJI, No. 10.71 [reasonable value of services (quantum meruit)]; and see generally 12 *Hastings L. J.* 408 [breach of oral contract to perform services in exchange for compensation by will].) (On restitution for life salvage at sea, see 30 *Hastings L. J.* 227, 240; on quasi-contractual recovery for services rendered in a nonmarital relationship, see *Marvin v. Marvin* (1976) 18 C.3d 660, 134 C.R. 815, 557 P.2d 106, 11 *Summary* (10th), *Community Property*, §275; on statute of limitations, see 3 *Cal. Proc.* (4th), *Actions*, §§480, 508, 509.)

The uncertainty in classification is increased by decisions treating the "existence of an implied contract" as "a question of fact for the trial court." In *Medina v. Van Camp Sea Food Co.* (1946) 75 C.A.2d 551, 171 P.2d 445, the United States Government, when war was declared, requisitioned defendants' fishing boats. The fish in defendants' boats were loaded on plaintiff's boats and delivered to canneries, which paid defendants. Defendants then refused to compensate plaintiff for the reasonable cost of transporting the fish, contending that they (defendants) had acted under compulsion of law, without freedom to accept or reject the services, and hence no contract could be implied. *Held*, under the facts, the trial court properly concluded that defendants did have freedom of choice, and judgment for plaintiff should accordingly be affirmed. (75 C.A.2d 555, 556.) But the opinion does not clearly indicate whether the decision rests on contract implied in fact or quasi-contract.

For purposes of recovery in quantum meruit, although there must be a benefit to the defendant from the services rendered, the reasonable value of the services may not be measured by the amount of the benefit. (See *Maglica v. Maglica* (1998) 66 C.A.4th 442, 449, 78 C.R.2d 101, citing the text [action by woman for services rendered to business

of man she had cohabited with for 20 years; jury instruction that value of services could be measured by benefit received by defendant improperly allowed jury to value services as having bought plaintiff de facto ownership interest in business, even though defendant never agreed to transfer any interest in his business to plaintiff[.]

West's Key Number Digest, Implied and Constructive Contracts k.34

SUPPLEMENT: [This section is current through the latest supplement]

Invalid or unenforceable contract: Where a written agreement or licensure is required, a party may not recover in quantum meruit for that which cannot be recovered on a contract. (*Castillo v. Barrera* (2007) 146 C.A.4th 1317, 1328, 53 C.R.3d 494) [alleged manager of professional boxer, who did not have license to manage as required by Boxing Act and whose contract was oral instead of written, was not entitled to recover, by means of quantum meruit, compensation for any managerial services he performed for boxer; to allow recovery under these circumstances would subvert purpose of Boxing Act and supporting regulations].

Statute of limitations:

Cross-Reference: 3 Cal. Proc. (5th), Actions, §§514, 547, 548.



170 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XX. QUASI-CONTRACTS AND RESTITUTION
G. Services Performed at Request.
2. Intention To Compensate.

1 Witkin Sum. Cal. Law Contracts § 1037

[§ 1037] Intention To Compensate.

To entitle the plaintiff to recover, the circumstances must be such as to warrant the inference that it was the expectation of *both parties* during the time that the services were rendered that compensation should be made. Proof may be made that they were actually intended to be gratuitous; or special circumstances such as kinship may be shown, from which it may sometimes be inferred that no payment was contemplated. (See *Mayborne v. Citizens Trust & Savings Bank* (1920) 46 C.A. 178, 187, 188 P. 1034 [*invalid will*, left by party to whom the services were rendered, admissible in evidence to show the intention to compensate]; *Shaad v. Hazelton* (1948) 72 C.A.2d 860, 865, 165 P.2d 517 [married daughter performed services for mother, with whom she and her husband and child lived; presumed gratuitous]; *Rest., Restitution* §107; 7 Cal. L. Rev. 357; 21 A.L.R.3d 30 [price for services fixed in contract unenforceable under statute of frauds admissible for purpose of proving that services were not gratuitous]; 92 A.L.R.3d 726 [establishment of "family" relationship to raise presumption that services were rendered gratuitously, as between persons living in same household but not related by blood or affinity]; 94 A.L.R.3d 552 [recovery for services rendered by persons living in apparent relation of husband and wife without express agreement for compensation]; BAJI, No. 10.71 [reasonable value of services (quantum meruit)].)

SUPPLEMENT: [This section is current through the latest supplement]



171 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XX. QUASI-CONTRACTS AND RESTITUTION
G. Services Performed at Request.
3. Necessity of Benefit.

1 Witkin Sum. Cal. Law Contracts § 1038

[§ 1038] Necessity of Benefit.

It has been suggested that recovery may be allowed for services requested, regardless of whether the defendant is actually benefited. (See dissent in *Coleman Engineering Co. v. North Amer. Aviation* (1966) 65 C.2d 396, 419, 55 C.R. 1, 420 P.2d 713, supra, §155; BAJI, No. 10.71 [reasonable value of services (quantum meruit)].)

But where there is no request for the particular acts, there can be no recovery without benefit. Thus, in *Palmer v. Gregg* (1967) 65 C.2d 657, 56 C.R. 97, 422 P.2d 985, decedent asked plaintiff to come from her home in Palm Springs to Los Angeles to take care of him. *Held*, (a) she could recover for the reasonable value of her services as practical nurse and housekeeper, but (b) she could not recover for the expense she incurred for the services of a gardener to take care of her Palm Springs home while she was away. (65 C.2d 661.) (See *Day v. Alta Bates Med. Center* (2002) 98 C.A.4th 243, 248, 119 C.R.2d 606 [attorney representing client in unsuccessful malpractice action brought quantum meruit action against hospital where client had been treated, asserting that he had performed services for defendant in connection with lien it had filed against malpractice action; attorney established neither that defendant requested services nor that it benefited from them]; 55 Cal. L. Rev. 1167.)

West's Key Number Digest, Implied and Constructive Contracts k.16

SUPPLEMENT: [This section is current through the latest supplement]



172 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XX. QUASI-CONTRACTS AND RESTITUTION
G. Services Performed at Request.
4. Services to Third Person.

1 Witkin Sum. Cal. Law Contracts § 1039

[§ 1039] Services to Third Person.

In *Rotea v. Izuel* (1939) 14 C.2d 605, 95 P.2d 927, plaintiff, at the request of decedent, rendered services to decedent's sister, for which decedent orally agreed to pay. Recovery was denied. The court declared that, where services are performed for a third person to whom the defendant or decedent owes a legal duty of support (e.g., child or spouse), the right to restitution arises, but that, in the absence of this legal duty, there is no unjust enrichment. (14 C.2d 608.) (See *McClenahan v. Keyes* (1922) 188 C. 574, 580, 206 P. 454; *Zumwalt v. Schwarz* (1931) 112 C.A. 734, 736, 297 P. 608; 66 Am.Jur.2d (2001 ed.), *Restitution and Implied Contracts* §43; 34 A.L.R.3d 176 [medical services].)

This view was criticized on the theory that pecuniary benefit to the defendant personally should not be the test, and that it should be sufficient that the defendant obtain from the plaintiff some performance that he or she expressly requested. (See 28 Cal. L. Rev. 528; dissent in *Coleman Engineering Co. v. North Amer. Aviation* (1966) 65 C.2d 396, 419, 55 C.R. 1, 420 P.2d 713, *supra*, §155.) (See BAJI, No. 10.71 [reasonable value of services (quantum meruit)].)

The limitations of *Rotea v. Izuel*, *supra*, were repudiated in *Earhart v. Low Co.* (1979) 25 C.3d 503, 158 C.R. 887, 600 P.2d 1344. Plaintiff contractor and defendant landowner entered into negotiations for construction of a mobilehome park, partly on land owned by defendant and partly on land owned by P (which defendant intended to buy). The construction contract did not become binding because of unfulfilled conditions (defendant to obtain financing, plaintiff to secure a bond). However, in order to keep a permit alive for the construction on P's land, defendant requested that plaintiff commence performance. Plaintiff did so, and after a week's work submitted a progress bill. Defendant refused to pay, revealing that he had signed a construction contract with another firm. In this action in quantum meruit, the trial judge gave judgment for plaintiff, but limited the recovery to the reasonable value of the work done on defendant's land. As to the work done on P's land, the judge, considering himself bound by *Rotea*, denied any recovery. *Held*, reversed.

(a) *Reexamination of Rotea holding.* The result reached in *Rotea* was understandable in the light of the mutual exchange of familial support; but the broad statement that the satisfaction of obtaining compliance with one's request will not support recovery has been criticized as harsh, and the requirement of "direct benefit" to the defendant has been described as purely "historical." (25 C.3d 510.) Moreover, the Restatement of Restitution (§1, Comment b) recognizes that performance of services at another's request may itself constitute "benefit." (25 C.3d 511.)

(b) *Later cases.* Two later Court of Appeal decisions support the Restatement view. (25 C.3d 511, citing *Bodmer v.*

Turnage (1951) 105 C.A.2d 475, 233 P.2d 157, and *Williams v. Dougan* (1959) 175 C.A.2d 414, 346 P.2d 241.) And Chief Justice Traynor, dissenting in *Coleman Engineering, supra*, argued that the "benefit" limitation was unconscionable and should be abandoned. (25 C.3d 512, 513.)

(c) *Analogous contract doctrines.* Several parallel contract doctrines support this view: part performance to satisfy the statute of frauds, estoppel to set up the statute of frauds, and promissory estoppel. (25 C.3d 514.)

(d) *Conclusion.* In view of the equitable considerations underlying these doctrines, "compensation for a party's performance should be paid by the person whose request induced the performance." (25 C.3d 515.) Two justices joined in a dissent, criticizing the result, and arguing that the majority's rule is too broad. (25 C.3d 516.)

SUPPLEMENT: [This section is current through the latest supplement]



173 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XX. QUASI-CONTRACTS AND RESTITUTION
H. Waiver of Tort.
1. In General.

1 Witkin Sum. Cal. Law Contracts § 1040

[§ 1040] In General.

A tort normally gives rise to an action for damages; but in certain situations, where the defendant *acquires benefits* by his or her wrongful act, the plaintiff may "waive the tort," i.e., elect to sue in quasi-contract for restitution instead of for damages. The following are illustrations:

(1) *Conversion*. The action may be brought as for goods sold and delivered. (*Corey v. Struve* (1915) 170 C. 170, 172, 149 P. 48; *Bank of America v. Hill* (1937) 9 C.2d 495, 499, 71 P.2d 258; *Armstrong v. Kubo & Co.* (1928) 88 C.A. 331, 336, 263 P. 365; *Glantz v. Freedman* (1929) 100 C.A. 611, 614, 280 P. 704; *Shahood v. Cavin* (1957) 154 C.A.2d 745, 748, 316 P.2d 700; *H. Russell Taylor's Fire Prevention Service v. Coca Cola Bottling Corp.* (1979) 99 C.A.3d 711, 719, 160 C.R. 411; *Rest., Restitution* §128 and Note, p. 522; see 3 Cal. Proc. (4th), Actions, §160; 4 Cal. Proc. (4th), Pleading, §517.)

In California, the action for the value of the goods will lie regardless of whether they have been sold and converted into money. (*Los Angeles Drug Co. v. Superior Court* (1936) 8 C.2d 71, 74, 63 P.2d 1124.) (See *Fredericksen v. Harney* (1962) 199 C.A.2d 189, 194, 195, 18 C.R. 562, citing the text [dictum that materialman whose property was tortiously incorporated in structure could waive tort and enforce mechanic's lien].)

(2) *Wrongful Occupation of Real Property*. The action may be brought for the reasonable value of the use. (*Taggart v. Shepherd* (1932) 122 C.A. 755, 758, 10 P.2d 808; *Samuels v. Singer* (1934) 1 C.A.2d 545, 554, 36 P.2d 1098, 37 P.2d 1050; *Meyer v. Parobek* (1953) 119 C.A.2d 509, 513, 259 P.2d 948.) (On denial of restitution where tort remedy is adequate, see *infra*, §1041.)

(3) *Wrongful Appropriation of Literary Property*. The same theory is applied to an action by the creator of a literary or dramatic property against one wrongfully appropriating it. The tort of plagiarism may be waived, and quasi-contract recovery given in the amount of the reasonable value of the property. (See *Weitzenkorn v. Lesser* (1953) 40 C.2d 778, 256 P.2d 947; *Desny v. Wilder* (1956) 46 C.2d 715, 734, 299 P.2d 257; *Fink v. Goodson-Todman Enterprises, Ltd.* (1970) 9 C.A.3d 996, 1013, 88 C.R. 679; 27 So. Cal. L. Rev. 124, 290; 4 U.C.L.A. L. Rev. 524, 547; 23 A.L.R.2d 244 [infringement of literary and artistic rights in connection with motion pictures, radio, and television].)

(4) *Fraud*. Where the defendant has been enriched by his or her fraud, recovery may be had in the amount of the

unjust enrichment, and exemplary damages may also be awarded, in a quasi-contract action. (*Ward v. Taggart* (1959) 51 C.2d 736, 743, 336 P.2d 534, 6 Summary (10th), *Torts*, §1713; see *Arcturus Mfg. Corp. v. Rork* (1961) 198 C.A.2d 208, 210, 17 C.R. 758 [recovery of secret profits fraudulently made by agent]; *Haurat v. Superior Court* (1966) 241 C.A.2d 330, 334, 50 C.R. 520 [same].) (For discussions of *Ward*, see 48 Cal. L. Rev. 342; 11 Hastings L. J. 183; 12 Stanf. L. Rev. 270; 7 U.C.L.A. L. Rev. 147; on recovery of profit from tortfeasor, see 19 Hastings L. J. 1071.)

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(1) *Conversion*.

Cross-References: 3 Cal. Proc. (5th), *Actions*, §164; 4 Cal. Proc. (5th), *Pleading*, §556.



174 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XX. QUASI-CONTRACTS AND RESTITUTION
H. Waiver of Tort.
2. Where Tort Remedy Is Adequate.

1 *Witkin Sum. Cal. Law Contracts* § 1041

[§ 1041] Where Tort Remedy Is Adequate.

Restitution under this theory (*supra*, §1040) is denied where there is an adequate tort remedy. In *Ramona Manor Convalescent Hosp. v. Care Enterprises* (1986) 177 C.A.3d 1120, 225 C.R. 120, plaintiff, a prospective lessee of a nursing home, sued defendants, the holdover operating lessees of the home, for intentional interference with prospective economic advantage. (See 5 *Summary* (10th), *Torts*, §741.) The jury, contrary to the judge's instruction, returned special verdicts on both the tort and unjust enrichment theories, by including in the unjust enrichment award profits earned by defendants during the period of wrongful possession. *Held*, this was error.

(a) The Restatement of Restitution (§129) states that "A person who tortiously has taken possession of another's land without the other's consent is not thereby under a duty of restitution to the other for its value or use." The Comment explains: "The liability of a trespasser or of a dispossessor in an action of tort ... is normally as great as would exist if an action for restitution were allowed, since the person entitled to possession is entitled not only to be given possession if he does not have it, but also to damages for the deprivation, which ordinarily are determined by the value of the use of the land during the unlawful occupation, and in addition to damages for any harm done to the land." (177 C.A.3d 1139.)

(b) Thus, restitution may be allowed in some situations where there has been no tort, but it is not allowed in cases of wrongful dispossession of land, because the remedy of tort damages is adequate. "This, of course, is fully consistent with the general principle of equity that equitable relief will not be afforded when the plaintiff's remedies at law are adequate." (177 C.A.3d 1140.) Here, plaintiff can obtain full redress for its loss of profits under its tort cause of action. (177 C.A.3d 1140.)

SUPPLEMENT: [This section is current through the latest supplement]



175 of 175 DOCUMENTS

Witkin Summary of California Law, Tenth Edition
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CHAPTER I - Contracts

Witkin Summary of California Law
XX. QUASI-CONTRACTS AND RESTITUTION
I. Restitution Where Contract Fails.

1 Witkin Sum. Cal. Law Contracts § 1042

[§ 1042] Restitution Where Contract Fails.

There are a number of situations in which one who has paid money or given other consideration under a contract that turned out to be void, voidable, or otherwise ineffective may have restitution:

(1) Money paid may be recovered where the *consideration has wholly failed*. (*Richter v. Union Land & Stock Co.* (1900) 129 C. 367, 373, 62 P. 39; *Mahony v. Standard Gas Engine Co.* (1921) 187 C. 399, 405, 202 P. 146.)

(2) Money paid may be recovered after rescission for fraud, failure of consideration, illegality, etc. (*Philpott v. Superior Court* (1934) 1 C.2d 512, 518, 36 P.2d 635; *Longway v. Newbery* (1939) 13 C.2d 603, 608, 91 P.2d 110; *Fontaine v. Lacassie* (1918) 36 C.A. 175, 178, 171 P. 812; *Fitzhugh v. University Realty Co.* (1920) 46 C.A. 198, 200, 188 P. 1023; *Landry v. Marshall* (1966) 243 C.A.2d 170, 176, 177, 52 C.R. 119; *Porter v. Arthur Murray* (1967) 249 C.A.2d 410, 424, 57 C.R. 554; see *Rest.2d, Contracts* §§375, 376; 18 Cal. L. Rev. 75; 81 A.L.R.2d 587 [recovery of money paid in reliance on unenforceable promise to accept bill of exchange]; 33 A.L.R.3d 397 [right to recover back payments made under contract violating competitive bidding statute]; 74 A.L.R.3d 637 [recovery of money paid to unlicensed person required by law to have occupational or business license or permit to make contract]; *supra*, §§438, 937.) Recovery may be denied, however, if the contract is illegal and the parties are equally in the wrong. (See *supra*, §436.)

(3) A minor may disaffirm a voidable express contract for his or her services and recover their reasonable value. (*Abdullah v. Abdullah* (1920) 50 C.A. 115, 119, 194 P. 511; see *supra*, §31.)

(4) Where a contract between an employer and his or her employee is void for uncertainty, or unenforceable by reason of the statute of frauds, the employee may sue for the value of services rendered, as if the express contract had never been made. (*Brown v. Crown Gold Milling Co.* (1907) 150 C. 376, 383, 89 P. 86.)

(5) Where a valid express contract for services lacks a definite provision for compensation, the reasonable value of the services may be recovered. (*Elconin v. Yalen* (1929) 208 C. 546, 548, 282 P. 791.) The same is true where services are performed for a consideration that turns out to be impossible of performance or unenforceable; e.g., shares in a corporation that cannot be issued because of lack of a permit. (*McGillycuddy v. Los Verjels Land & Water Co.* (1931) 213 C. 145, 147, 2 P.2d 19, *supra*, §420.)

(6) The reasonable value of services and materials may be recovered despite technical violation of a regulatory statute. Thus, in *Beley v. Municipal Court* (1979) 100 C.A.3d 5, 160 C.R. 508, plaintiff building contractor performed services and furnished materials in remodeling defendants' home. However, the contract was subject to the home solicitation contract statute, and did not contain the required notice giving the buyer the right to cancel within 3 days (see 4 Summary (10th), Sales, §329). Defendants' right to cancel was therefore extended indefinitely, and they exercised it after the work was substantially completed and sought to retain the benefits conferred without any payment. *Held*, although by reason of violation of the statute plaintiff could not recover on the express building contract, there was nothing improper about the contract or the performance under it; hence, he was entitled to recover in quantum meruit for the reasonable value of the improvements. (100 C.A.3d 8.) (See *Gardiner Solder Co. v. SupAlloy Corp.* (1991) 232 C.A.3d 1537, 1543, 284 C.R. 206 [out-of-state manufacturer was entitled to restitution for goods supplied to purchaser, even though contract was voidable on ground that manufacturer had not qualified to do business in California]; cf. *Louis Luskin & Sons v. Samovitz* (1985) 166 C.A.3d 533, 537, 212 C.R. 612, 4 Summary (10th), Sales, §330 [recovery denied where, contrary to owner's instructions, contractor began work immediately after contract was signed and had completed significant portion within 3-day cancellation period]; on owner's right to recover for services or materials expended on own real property in reliance on unenforceable contract for its sale or rental, see 64 A.L.R.3d 1191.)

(7) A party who improves the property of another in the performance of a contract that he or she later breaches may recover the reasonable value of the services, but not the increased value of the property. In *Lesny Dev. Co. v. Kendall* (1985) 164 C.A.3d 1010, 210 C.R. 890, involving a contract to sell undeveloped land, plaintiff purchaser fulfilled its obligation to obtain approval of its tentative tract map, but breached the contract in other respects. Plaintiff was awarded damages of \$ 60,000 as compensation for the increase in the property's value due to its efforts, and \$ 18,750 as the reasonable value of the 250 hours it allegedly expended in obtaining approval of the tract map. *Held*, this was error.

(a) Under the applicable principles of unjust enrichment, plaintiff was entitled to recover only "its reasonable costs or the reasonable value to it of its services, not the increase in value to the property that may have resulted from its services." (164 C.A.3d 1021.) Although there are no cases directly on point, plaintiff's position is similar to that of a person who improves the property of another under the reasonable, but mistaken, belief that he or she is the owner or is under an obligation to do so. Under *Rest., Restitution* §42, such an improver is entitled to recover the lesser of the value of the services or the resulting increase in the value of the property. (164 C.A.3d 1022.)

(b) In order to recover the value of its services, plaintiff was required to show that the services benefited defendant sellers, i.e., that they were expended in satisfying the contractual obligation of obtaining approval of the tentative tract map. (164 C.A.3d 1021.) However, the evidence established that only 50 of the 250 hours were expended for this purpose; the rest were used on projects that would benefit plaintiff had it acquired the property, and are not recompensable. (164 C.A.3d 1023.) Hence, plaintiff's recovery must be reduced to \$ 4,690, i.e., 50 hours of service at \$ 75 per hour, plus the \$ 940 plaintiff paid for the application for approval of the map. (164 C.A.3d 1025, footnote 2.)

West's Key Number Digest, Implied and Constructive Contracts k.4

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