13 California Forms of Pleading and Practice--Annotated § 140.10

§ 140.10 Definitions

[1] Contract and Agreement

The Civil Code defines a contract as an agreement to do or not to do a particular thing [*Civ. Code § 1549*; *Breckinridge v. Crocker (1889) 78 Cal. 529, 536, 21 P. 179]*. Generally, however, "agreement" has a wider meaning than "contract":

- An *agreement* is a manifestation of mutual assent by two or more persons to one another, which may be made by words or by any other conduct, including silence [*see Stevens v. Dillon (1946) 74 Cal. App. 2d 178, 182, 168 P.2d 492]*.
- A *contract* is an enforceable agreement that satisfies the requirements for a contract [*see Civ. Code § 1550*; § 140.20] and creates an obligation or duty, for the breach of which the law supplies a remedy to the party to whom the obligation or duty is owed [*see Scott v. Security Title Ins. & Guar. Co. (1937) 9 Cal. 2d 606, 614, 72 P.2d 143*; *Ulwelling v. Crown Coach Corp. (1962) 206 Cal. App. 2d 96, 137 138, 23 Cal. Rptr. 631]*.

[2] Oral or Written Contract

All contracts may be oral except those that are specifically required by statute to be in writing [*Civ. Code § 1622*; *see, e.g., Fam. Code § 1611* (premarital agreements); former *Civ. Code § 5134* (marriage settlement agreements executed before 1986, *see Fam. Code § 1503*)]. A

contract may be partly oral and partly written [*Griffith v. Bucknam (1947) 81 Cal. App. 2d 454, 458 184 P.2d 179]*.

In an action based on a contract, the court may apply various rules distinguishing oral contracts and written contracts, for example:

- The limitation period generally is two years for an action based on an oral contract [*Code Civ. Proc. § 339(1)*] or four years for an action based on a written contract [*Code Civ. Proc. § 337(a)*], but there are exceptions [*see, e.g.*, *Com. Code § 2725* (period may be from one year to four years for action on contract for sale of goods, whether oral or written)]. For further discussion, see *Ch. 345, Limitation of Actions*.

- The statute of frauds may be pleaded in defense against enforcement of a contract listed in the statute, if the contract is oral and no note or memorandum of the contract is in writing and subscribed by the defendant or his or her agent [*see, e.g.*, *Civ. Code § 1624*; *Prob. Code § 21700* (contract to make will or not to revoke will)]. For a form for an affirmative defense based on the statute of frauds, *see § 140.143*; for further discussion and forms, see *Ch. 530, Statute of Frauds*.

- The parol evidence rule generally may be raised to preclude evidence of the terms of a written contract, other than the writing [*see Code Civ. Proc. § 1856*; for discussion of the parol evidence rule, see *§ 140.31*].

For forms for complaints for breach of a written contract, *see §§ 140.101–140.103*, *140.105*; for a form for a complaint for breach of an oral contract, *see § 140.104*.

[3] Executory or Executed Contract

An executory contract is one that, to some extent, remains to be performed, whereas an executed contract is one that has been fully performed [*Civ. Code § 1661*; *Mather v. Mather (1944) 25 Cal. 2d 582, 586 587, 154 P.2d 684]*. There must be complete performance by both

parties for the contract to be executed; performance on only one side is not sufficient [*Smith v. Parlier Winery, Inc. (1935) 7 Cal. App. 2d 357, 360, 46 P.2d 170]*.

[4] Unilateral or Bilateral Contract

A bilateral contract comprises an exchange of promises made by both parties, while a unilateral contract is a promise made by one party in exchange for an expected act or forbearance, which the other party subsequently does or forbears to do, with knowledge of the promise [*see Davis v. Jacoby (1934) 1 Cal. 2d 370, 378, 34 P.2d 1026]*. A unilateral contract sometimes is described in terms of offer and acceptance; the promise is an offer, which the other party may accept by doing, or forbearing to do, a specified act [*Asmus v. Pacific Bell (2000) 23 Cal. 4th 1, 14–15, 96 Cal. Rptr. 2d 179, 999 P.2d 71* (after employer modified its unilaterally adopted policy, employees' continued employment constituted acceptance of offer of modified unilateral contract); *Newberger v. Rifkind (1972) 104 Cal. Rptr. 663* (continuing in employment was acceptance of employer's implied offer of unilateral contract consisting of right to exercise stock option); *Tetrick v. Sloan (1959) 170 Cal. App. 2d 540, 546 547, 339 P.2d 613* (offer to pay broker's commission for selling particular real estate generally required acceptance by act of selling real estate)]. For discussion of offer and acceptance generally, *see § 140.22[3]*, *[4]*.

[5] Express or Implied Contract

[a] In General

A contract is either express or implied [*Civ. Code § 1619*]. The terms of an express contract are stated in words [*Civ. Code § 1620*], whereas the existence and terms of an implied contract are manifested by conduct [*Civ. Code § 1621*;*Bell v. Superior Court (1989) 215 Cal. App. 3d 1103, 1108,263 Cal. Rptr. 787*; *McGough v. University of San Francisco (1989) 214 Cal. App. 3d 1577, 1584, 263 Cal. Rptr. 404*; *see Mitsui O.S.K.*

Lines v. Dynasea Corp. (1999) 72 Cal. App. 4th 208, 212–213, 85 Cal. Rptr. 2d 1 (no implied contract that defendant agreed to pay freight charges for shipment)]. For example, if one party does not rely on the explicit words by which the parties agreed, but instead considers that a course of conduct, which may include various oral representations, has created a reasonable expectation of a certain performance, then failure to receive that performance gives rise to a cause of action for breach of an implied-in-fact contract [*Foley v. Interactive Data Corp. (1988) 47 Cal. 3d 654, 675, 254 Cal. Rptr. 211, 765 P.2d 373*; *McGough v. University of San Francisco (1989) 214 Cal. App. 3d 1577, 1584 1585, 263 Cal. Rptr. 404*; *Wilkerson v. Wells Fargo Bank (1989) 212 Cal. App. 3d 1217, 1225 n.2, 261 Cal. Rptr. 185*; *see Scott v. Pacific Gas & Electric Co. (1995) 11 Cal. 4th 454, 463–464, 46 Cal. Rptr. 2d 427, 904 P.2d 834*; *Kawasho Internat. (U.S.A.), Inc. v. Lakewood Pipe Service, Inc. (1983) 152 Cal. App. 3d 785, 789 791, 201 Cal. Rptr. 640]*. For an allegation of a contract implied in fact to be used in a complaint for breach of contract, *see § 140.110*.

The essential elements of an implied-in-fact contract and an express contract are the same, namely, mutual assent and consideration [*McGough v. University of San Francisco (1989) 214 Cal. App. 3d 1577, 1584, 263 Cal. Rptr. 404*; *Chandler v. Roach (1957) 156 Cal. App. 2d 435, 440, 319 P.2d 776]*. Similarly, once the implied-in-fact contract is established, its terms stand on an equal footing with express terms [*Foley v. Interactive Data Corp. (1988) 47 Cal. 3d 654, 677, 254 Cal. Rptr. 211, 765 P.2d 373]*.

An essential difference between an implied contract and an express contract is the mode of proof [*Bell v. Superior Court (1989) 215 Cal. App. 3d 1103, 1108, 263 Cal. Rptr. 787]*. When the contract is implied, the party asserting the contract must prove conduct from which the court can infer the promise [*Foley v. Interactive Data Corp. (1988) 47 Cal. 3d 654, 677, 254 Cal. Rptr. 211, 765 P.2d 373*; *Youngman v. Nevada Irrigation Dist. (1969) 70 Cal. 2d 240, 246, 74 Cal. Rptr. 398, 449 P.2d 462*; *e.g.*, *Requa v. Regents of Univ. of Cal. (2012) 213 Cal. App. 4th 213, 227*–228, *152 Cal. Rptr. 3d 440* (allegations were

sufficient to plead cause of action based on implied contract)]. The court must determine, as a matter of fact, whether the parties acted in a manner that provides the necessary foundation for the implied contract. The plaintiff may introduce evidence of the parties' conduct, and the defendant may introduce evidence rebutting the inferences arising from that conduct or showing another explanation for it [*Foley v. Interactive Data Corp. (1988) 47 Cal. 3d 654, 677, 254 Cal. Rptr. 211, 765 P.2d 373]*.

[b] Implied-in-Fact or Implied-by-Law Contract

Implied contracts under *Civ. Code §§ 1619* and *1621* refer to implied-in-fact contracts that arise from the mutual agreement of the parties [*Iusi v. Chase (1959) 169 Cal. App. 2d 83, 87, 337 P.2d 79*; *see § 140.10[5][a]*]. Courts recognize contracts called "implied-by-law contracts" or "quasi-contracts" to prevent the unjust enrichment of one party, who has no intent, either express or implied, to pay or to make reimbursement for something of value received by that party. The law imposes an obligation to pay or reimburse because good conscience dictates that the party benefited should make the payment reimbursement [*Santa Clara County v. Robbiano (1960) 180 Cal. App. 2d 845, 848, 5 Cal. Rptr. 19*; *see Halperin v. Raville (1986) 176 Cal. App. 3d 765, 774, 222 Cal. Rptr. 350* (imposing liability to repay loan to family business on equitable ground when no express promise was made)].

The equitable doctrine of unjust enrichment applies where the plaintiff, while having no enforceable contract, nonetheless has conferred a benefit on the defendant, which the defendant has knowingly accepted in circumstances in which it would be inequitable for the defendant to retain the benefit without paying for its value. The phrase "unjust enrichment" does not describe a theory of recovery but describes the effect that would result from a failure to make restitution in circumstances where it is equitable to do so. Therefore, no particular form of pleading is necessary to invoke the doctrine of restitution, and a well-pleaded claim for breach of contract can be sufficient. While the measure of

damages for unjust enrichment is essentially restitution, that concept that has been expanded in modern jurisprudence to include, not only the restoration of something, but also compensation, reimbursement, indemnification, or reparation for benefits derived from, or for loss or injury caused to, another [*Dunkin v. Boskey (2000) 82 Cal. App. 4th 171, 195, 198, 98 Cal. Rptr. 2d 44*; *accord*, *Hernandez v. Lopez (2009) 180 Cal. App. 4th 932, 939, 103 Cal. Rptr. 3d 376* (*Dunkin* was dispositive in case that was "textbook example for application of the equitable doctrine of unjust enrichment"; plaintiff pleaded cause of action for breach of contract that fully raised all facts and circumstances in which equity could contemplate quasi-contractual remedy to prevent defendant from being unjustly enriched)].

As a general rule, a public entity cannot be sued on an implied-by-law contract or quasi-contract. The theory of recovery is based on quantum meruit and equitable theories of restitution, which are outweighed by the need to protect and limit a public entity's contractual obligations [*see* *Miller v. McKinnon (1942) 20 Cal. 2d 83, 88, 124 P.2d 34*; *Lundeen Coatings Corp. v. Department of Water & Power (1991) 232 Cal. App. 3d 816, 832 n.9, 283 Cal. Rptr. 551]*.

[6] Void or Voidable Contract

A *voidable* contract is one that is void as to one party, who has acted wrongly, but not void as to the other party, who has not acted wrongly, unless the innocent party elects to treat it as void. Thus, a voidable contract may be rendered a nullity at the option of an innocent party [*BGJ Associates, LLC v. Wilson (2003) 113 Cal. App. 4th 1217, 1226–1230, 7 Cal. Rptr. 3d 140* (oral joint venture agreement between attorney and client which was result of undue influence and violation of attorney's fiduciary duties was voidable; client did not ratify it by his conduct); *White Dragon Prods. v. Performance Guarantees, Inc. (1987) 196 Cal. App. 3d 163, 172, 241 Cal. Rptr. 745*; *Depner v. Joseph Zukin Blouses (1936) 13 Cal. App. 2d 124, 127, 56 P.2d 574]*.

A *void* contract is a nullity by operation of law. It cannot be given any effect, and it cannot be ratified by a party [*Durbin v. Hillman (1920) 50 Cal. App. 377, 379, 195 P. 274]*. A contract void because of illegality has no legal existence for any purpose, and it may not serve as the foundation of any action, either at law or in equity [*R.M. Sherman Co. v. W.R. Thomason, Inc. (1987) 191 Cal. App. 3d 559, 563, 236 Cal. Rptr. 577]*. However, one who is not a party to a contract does not have standing to seek to void it on public policy grounds [*Killian v. Millard (1991) 228 Cal. App. 3d 1601, 1605, 1607, 279 Cal. Rptr. 877* (plaintiffs sold interests in litigation to finance it; defendant had no standing to void those contracts)].

Determining whether a particular contract is void or merely voidable is not always easy [*see, e.g.*, *Asdourian v. Araj (1985) 38 Cal. 3d 276, 291–294, 211 Cal. Rptr. 703, 696 P.2d 95*; *White Dragon Prods. v. Performance Guarantees, Inc. (1987) 196 Cal. App. 3d 163, 172–173, 241 Cal. Rptr. 745]*. For forms for raising an affirmative defense of illegality, see *§§ 140.144*, *140.145*; for coverage of this issue in various contexts see *Ch. 215, Duress, Menace, Fraud, Undue Influence, and Mistake*, which discusses and includes forms for allegations related to the defenses to formation of a contract discussed in this chapter, and Ch. 490, *Rescission and Restitution*.

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§ 140.11 Forum Selection Clause

[1] Effect

The parties to a contract may agree contractually in advance on the forum for resolving disputes between them. A forum selection clause in a contract will be given effect unless it is unfair or unreasonable [*M/S Bremen v. Zapata Off-Shore Co. (1972) 407 U.S. 1, 15, 92 S. Ct. 1907, 32 L. Ed. 2d 513* (enforcing reasonable clause in international commercial transaction stipulating forum in England unless invalid for fraud or overreaching); *Richards v. Lloyd's of London (9th Cir. 1997) 135 F.3d 1289, 1294–1296* (applying *Bremen* and holding that antiwaiver provisions of Securities Act of 1933 and Securities Exchange Act of 1934 did not void contract's forum selection and choice of law provisions in international transaction); *Smith, Valentino & Smith, Inc. v. Superior Court (1976) 17 Cal. 3d 491, 495–496, 131 Cal. Rptr. 374, 551 P.2d 1206* (enforcement does not contravene policy favoring access to courts by resident plaintiffs if plaintiff has freely and voluntarily negotiated away that right); *Cal-State Business Products & Services, Inc. v. Ricoh (1993) 12 Cal. App. 4th 1666, 1678, 16 Cal. Rptr. 2d 417]*.

"Unreasonable" in this context means that the party challenging the forum-selection clause must establish one of the following facts [*Smith, Valentino & Smith, Inc. v. Superior Court (1976) 17 Cal. 3d 491, 494–496, 131 Cal. Rptr. 374, 551 P.2d 1206*; *Cal-State Business Products & Services, Inc. v. Ricoh (1993) 12 Cal. App. 4th 1666, 1679, 16 Cal. Rptr. 2d 417]*:

- The forum selected would be unavailable or unable to accomplish substantial justice;

- The forum selection clause is the result of overreaching or the unfair use of unequal bargaining power (*see* *§ 140.11[2][a]*); or
- The forum chosen by the parties would be seriously inconvenient for the trial of the particular action.

Neither inconvenience nor additional expense in litigating in the selected forum is part of the test of unreasonableness [*Smith, Valentino & Smith, Inc. v. Superior Court (1976) 17 Cal. 3d 491, 496, 131 Cal. Rptr. 374, 551 P.2d 1206*; *America Online, Inc. v. Superior Court (2001) 90 Cal. App. 4th 1, 15, 108 Cal. Rptr. 2d 699* (expense of litigating in Virginia rather than California should not be considered); *Furda v. Superior Court (1984) 161 Cal. App. 3d 418, 426–427, 207 Cal. Rptr. 646]*. However, the choice of forum must have some rational basis [*Furda v. Superior Court (1984) 161 Cal. App. 3d 418, 426, 427, 207 Cal. Rptr. 646*; *.e.g.*, *Cal-State Business Products & Services, Inc. v. Ricoh (1993) 12 Cal. App. 4th 1666, 1681–1682, 16 Cal. Rptr. 2d 417* (New York was major commercial center close enough to one party's domicile to have sufficient nexus for parties domiciled in New Jersey and California)].

A contractual *venue* selection clause, discussed in *§ 140.14*, differs from a forum selection clause in that venue selection is purely an intrastate issue involving the selection of a county in which to hold the trial, rather than the selection of a court from among different states or nations [*Alexander v. Superior Court (The Brix Group, Inc.) (2003) 114 Cal. App. 4th 723, 726–727, 8 Cal. Rptr. 3d 111*; *see* *Global Packaging, Inc. v. Superior Court (Epicor Software Corp.) (2011) 196 Cal. App. 4th 1623, 1633–1635, 127 Cal. Rptr. 3d 813* (contract provision purporting to make "venue" selection, which trial court misconstrued to be forum selection clause and then wrongly applied as consent to jurisdiction, was not in any way enforceable; court of appeal derided it as example of extremely sloppy drafting, which no court could be required to rectify through application of rules of interpretation)].

[2] Enforcement

[a] Fairness Test

Courts will enforce a forum selection clause in a contract entered into freely and voluntarily by parties who have negotiated at arms' length [*Smith, Valentino & Smith, Inc. v. Superior Court (1976) 17 Cal. 3d 491, 495–496, 131 Cal. Rptr. 374, 551 P.2d 1206*; *Cal-State Business Products & Services, Inc. v. Ricoh (1993) 12 Cal. App. 4th 1666, 1679, 16 Cal. Rptr. 2d 417]*. The parties entered into a forum selection clause freely and voluntarily if the party who is displeased with it had the power to walk away from the contract negotiations [*Cal-State Business Products & Services, Inc. v. Ricoh (1993) 12 Cal. App. 4th 1666, 1681, 16 Cal. Rptr. 2d 417]*.

Even if the forum selection clause is in a contract of adhesion and was not the subject of bargaining, the courts will enforce it if [*Carnival Cruise Lines, Inc. v. Shute (1991) 499 U.S. 585, 591–594, 111 S. Ct. 1522, 113 L. Ed. 2d 622, 633*; *Cal State Business Products & Services, Inc. v. Ricoh (1993) 12 Cal. App. 4th 1666, 1679, 16 Cal. Rptr. 2d 417*; *Furda v. Superior Court (1984) 161 Cal. App. 3d 418, 426, 207 Cal. Rptr. 646*; *Bos Material Handling, Inc. v. Crown Controls Corp. (1982) 137 Cal. App. 3d 99, 108, 186 Cal. Rptr. 740*; *see Hunt v. Superior Court (2000) 81 Cal. App. 4th 901, 908–909, 97 Cal. Rptr. 2d 215* (in dispute involving lease and guaranty, forum selection clause held not valid when it did not give notice that party was consenting to have California exercise personal jurisdiction)]:

- There is no evidence of unfair use of superior power to impose the contract on the other party; and
- The clause is within the reasonable expectations of the party against whom it is being enforced.

When a party has the option, under the terms of a forum selection clause, to litigate in more than one forum, and that party proceeds to litigate extensively in a particular forum—by filing a pleading for relief, conducting substantial discovery, and filing motions seeking

relief from the forum's court—that party may not then decide to enforce the right it otherwise would have had to compel the other party to litigate in a different forum. Such circumstances make enforcement of the forum selection clause unfair as a matter of law [*Trident Labs, Inc. v. Merrill Lynch Commercial Fin. Corp. (2011) 200 Cal. App. 4th 147, 157, 132 Cal. Rptr. 3d 551]*.

[b] Conflict With Public Policy

A forum selection clause that is valid as a matter of contract law could be statutorily unenforceable as a matter of overriding public policy. Sometimes the conflict is readily apparent [*e.g.*, *Vita Planning & Landscape Architecture, Inc. v. HKS Architects, Inc. (2015) 240 Cal. App. 4th 763, 774–777, 192 Cal. Rptr. 3d 838* (*Code Civ. Proc. § 410.42* barred enforcement of forum selection clause: "This case presents the very situation section 410.42 was designed to prevent: one where a California subcontractor performs work in California but is forced to litigate its dispute out of state, in a forum with laws unfavorable to the subcontractor.")]. In other cases the conflict is less obvious. For example, in a case in which a forum selection clause designated Virginia as the jurisdiction in which all disputes arising out of the relationship would be litigated, the court held that because one of the causes of action sought class-action relief under the Consumers Legal Remedies Act [*Civ. Code § 1750 et seq.*], which voids any waiver of rights under the Act as contrary to public policy, enforcement of the clause would be the functional equivalent of a contractual waiver and thus was prohibited under California law [*America Online, Inc. v. Superior Court (2001) 90 Cal. App. 4th 1, 15, 108 Cal. Rptr. 2d 699* (also concluding that because Virginia law did not allow consumer lawsuits to be brought as class actions, rights of California class members would be diminished if they were required to litigate in Virginia)]. For additional discussion of such cases, see *Ch. 323, Jurisdiction: Personal Jurisdiction, Inconvenient Forum, and Appearances, § 323.34[7]*.

[c] Clause in Contract for Ocean Passage

Forum selection clauses on cruise tickets are governed by federal admiralty law. They are not invalid simply because they are not negotiated and are found in form ticket contracts, at least when the passenger does not claim lack of notice of the clause and evidence does not support a finding that the chosen forum is inconvenient [*Carnival Cruise Lines, Inc. v. Shute (1991) 499 U.S. 585, 590, 595, 111 S. Ct. 1522, 113 L. Ed. 2d 622, 629, 632–633, 634* (clause does not violate 46 U.S.C. App. § 183c)].

However, when the ticket is purchased in California and there is an issue regarding the consumer's notice of a forum selection clause, the courts will determine the issue in accordance with *Civ. Code §§ 1550*, *1565*, and *1580*, which would make such a clause unenforceable as to any plaintiff who did not have sufficient notice of the clause before entering into the contract. Absent notice, mutual consent would be lacking [*see Carnival Cruise Lines, Inc. v. Superior Court (1991) 234 Cal. App. 3d 1019, 1026–1027, 286 Cal. Rptr. 323* (on remand from United States Supreme Court, state court of appeal again remanded for factual determinations regarding notice)].

[3] Challenge to Enforcement of Clause

A defendant seeking to challenge the plaintiff's choice of forum on the basis of a forum selection clause may move to dismiss or stay the action because of inconvenient forum [*see Code Civ. Proc. §§ 410.30*, *418.10*]. In an ordinary (*i.e.*, noncontractually based) challenge to the forum in which the plaintiff initiated the action, the defendant's burden of proof is set forth by the statutory criteria of forum non conveniens and substantial justice [*Code Civ. Proc. §§ 410.30(a)*, *418.10(a)(2)*; *Stangvik v. Shiley, Inc. (1991) 54 Cal. 3d 744, 751, 1 Cal. Rptr. 2d 556, 819 P.2d 14*; *Cal-State Business Products & Services, Inc. v. Ricoh (1993) 12 Cal. App. 4th 1666, 1675–1678, 16 Cal. Rptr. 2d 417]*.

When a party moves under *Code Civ. Proc. §§ 410.30* and *418.10* for enforcement of a forum selection clause, the party opposing enforcement of the clause (generally the plaintiff) bears

the burden of proving that there are grounds for invalidating the contract provision [*Smith, Valentino & Smith, Inc. v. Superior Court (1976) 17 Cal. 3d 491, 496, 131 Cal. Rptr. 374, 551 P.2d 1206*; *Cal-State Business Products & Services, Inc. v. Ricoh(1993) 12 Cal. App. 4th 1666, 1680–1681, 16 Cal. Rptr. 2d 417]*. Because the plaintiff, by entering into a contract with a forum selection provision, has contracted away the right to the forum of preference, and the defendant is seeking to enforce the contract right to the preferred forum, the issues are whether the provision is reasonable and whether it was the result of overreaching or the use of unfair bargaining power [*Cal-State Business Products & Services, Inc. v. Ricoh (1993) 12 Cal. App. 4th 1666, 1678–1683, 16 Cal. Rptr. 2d 417*; *but see Lifeco Services Corp. v. Superior Court (1990) 222 Cal. App. 3d 331, 335, 271 Cal. Rptr. 385* (forum selection clause enforced on basis of reasonableness, but court also engaged in analysis of traditional forum non conveniens factors)]. If, however, recovery in an action is based on legislation that contains a statutory anti-waiver provision, the burden of proof may be shifted to the party seeking enforcement of the forum selection clause [*America Online, Inc. v. Superior Court (2001) 90 Cal. App. 4th 1, 10–11, 108 Cal. Rptr. 2d 699* (fact that claims were pleaded under Consumers Legal Remedies Act containing statutory anti-waiver provision mandated departure from general rule that places burden of proving unfairness or unreasonableness of forum selection clause on party opposed to its enforcement); *accord*, *Doe 1 v. AOL LLC (9th Cir. 2009) 552 F.3d 1077, 1083–1085*.

A plaintiff who is not a party to a contract will be bound by the contract's forum selection clause if (1) the third party is closely related to the contractual relationship, and (2) the contractual forum state provides a suitable alternative forum for the lawsuit [*Net2phone, Inc. v. Superior Court (2003) 109 Cal. App. 4th 583, 587* (private plaintiff which itself had suffered no injury but filed representative action under California's unfair competition law alleging that defendant's contractual provisions subjected its customers to unfair business practices was bound by contract providing that disputes would be subject to exclusive jurisdiction in New Jersey)]. However, a nonparty to the contract may not be entitled to

enforce a contractual forum selection clause on the basis of being "closely related to the contractual relationship" between the parties [*see, e.g.*, *Bancomer, S.A. v. Superior Court (1996) 44 Cal. App. 4th 1450, 1458–1461, 52 Cal. Rptr. 2d 435* (bank, designated in purchase agreement to establish trust through which interests in Mexico resort would be purchased, not entitled to enforce forum selection clause because it lacked standing as third-party beneficiary and was not "closely related to contractual relationship" between vendor and purchaser); *see also Berclain America Latina v. Baan Company N.V. (1999) 74 Cal. App. 4th 401, 407–409, 87 Cal. Rptr. 2d 745* (reversing order dismissing action based on forum selection clause when corporation was neither signatory nor third party beneficiary of agreement, and was not so closely related to signatory as to be entitled to assert forum selection clause)]. The key to the "closely related" test is whether the nonsignatories were close to the contractual relationship. Giving standing to all closely related entities honors general principles of judicial economy by making all parties closely allied to the contractual relationship accountable in the same forum, thereby abating a proliferation of actions and inconsistent rulings [*Bugna v. Fike (2000) 80 Cal. App. 4th 229, 233–236, 95 Cal. Rptr. 2d 161* (defendants, who were not signatories to contract, but who were closely related to contractual relationship by virtue of negotiating, evaluating, and putting together transactions under attack, held entitled to enforce forum selection clause)].

For discussion and forms related to the enforceability and enforcement of forum selection clauses and motions to dismiss or stay for inconvenient forum, see *Ch. 323, Jurisdiction: Personal Jurisdiction, Inconvenient Forum, and Appearances, § 323.34*.

§ 140.12 Implied Covenant of Good Faith and Fair Dealing

[1] In Every Contract

California law recognizes an implied covenant of good faith and fair dealing in every contract. However, breach of the covenant does not necessarily give rise to a cause of action [*Quigley v. Pet, Inc. (1984) 162 Cal. App. 3d 877, 889–890, 208 Cal. Rptr. 394]*. The covenant is to the effect that neither party to the contract will do anything deliberately to deprive the other of the benefits of the agreement [*Pasadena Live, LLC v. City of Pasadena (2004) 114 Cal. App. 4th 1089, 1092–1094, 8 Cal. Rptr. 3d 233* (allegation that defendant city breached implied covenant of good faith and fair dealing by preventing plaintiff entertainment production company from even submitting entertainment proposals for consideration adequately alleged breach of contract for amphitheater productions); *see Oracle Corp. v. Falotti (9th Cir. 2003) 319 F.3d 1106, 1111–1112* (compensation committee did not breach covenant of good faith and fair dealing under stock option agreement); *Quigley v. Pet, Inc. (1984) 162 Cal. App. 3d 877, 887–888, 887 n.2, 893–894, 893 n.5, 894 n.6, 208 Cal. Rptr. 394* (difference between contract standard and tort standard)].

A breach of the implied covenant of good faith and fair dealing involves something more than a breach of a contractual duty itself. It involves unfair dealing (which may or may not also constitute a breach of an express contract term) in the form of a conscious and deliberate act that unfairly frustrates the agreed common purpose of the contract and disappoints the reasonable expectations of the other party to the contract [*Celador Int'l Ltd. v. Walt Disney*

Co. (C.D. Cal. 2004) 347 F. Supp. 2d 846, 852, citing *Careau & Co. v. Security Pac. Bus. Credit, Inc. (1990) 222 Cal. App. 3d 1371, 1394, 272 Cal. Rptr. 387]*. If a claim for breach of the implied covenant of good faith and fair dealing does not go beyond the statement of a breach of the express contractual terms and seeks the same relief sought in a breach of contract claim, it is simply superfluous to the contract claim. However, a claim for breach of the implied covenant is separate and distinct from a contract claim in three situations: (1) if no contract claim is alleged; (2) if the plaintiff is seeking recovery in tort; and (3) if the plaintiff alleges that the defendant acted in bad faith to frustrate the benefits plaintiff was to receive under the contract [*Celador Int'l Ltd. v. Walt Disney Co. (C.D. Cal.2004) 347 F. Supp. 2d 846, 852*, citing *Careau & Co. v. Security Pac. Bus. Credit, Inc. (1990) 222 Cal. App. 3d 1371, 1395, 272 Cal. Rptr. 387*, *Guz v. Bechtel Nat'l, Inc. (2000) 24 Cal. 4th 317, 353 n. 18, 100 Cal. Rptr. 2d 352, 8 P.3d 1089]*.

The implied covenant does not create a fiduciary relationship; it merely affords a basis for redress for breach of contract [*see Wolf v. Superior Court (2003) 107 Cal. App. 4th 25, 30–31, 130 Cal. Rptr. 2d 860* (contingent entitlement to future compensation within control of one party did not, alone, give rise to fiduciary relationship)]. Without an express contractual relationship, a party cannot assert a cause of action for breach of the implied covenant [*Smith v. City and County of San Francisco (1990) 225 Cal. App. 3d 38, 49, 275 Cal. Rptr. 17* (statutory relationship between developer and city would not support cause of action for breach of implied covenant; promissory estoppel argument also failed); *Kim v. Regents of the University of California (2000) 80 Cal. App. 4th 160, 164–165, 95 Cal. Rptr. 2d 10* (civil service employee could not state cause of action for breach of contractual covenant of good faith and fair dealing, since public employment is held by statute rather than by contract)].

[2] Nature of Duty Imposed

The precise nature and extent of the duty imposed by this covenant depends on the contractual purposes [*Sheppard v. Morgan Keegan & Co. (1990) 218 Cal. App. 3d 61, 66–67, 266 Cal.*

Rptr. 784; *Ellis v. Chevron, U.S.A., Inc. (1988) 201 Cal. App. 3d 132, 139, 246 Cal. Rptr. 863*; *Mobil Oil Corp. v. Exxon Corp. (1986) 177 Cal. App. 3d 942, 949, 223 Cal. Rptr. 392* (judgment on pleadings usually improper when precise extent of duty imposed by covenant at issue)]. However, courts will not use the implied covenant of good faith and fair dealing to vary the terms on an unambiguous agreement or to override an express provision in a contract [*Carma Developers (Cal.), Inc. v. Marathon Development California, Inc. (1992) 2 Cal. 4th 342, 374–376, 6 Cal. Rptr. 2d 467, 826 P.2d 710* (termination of lease); *April Enterprises, Inc. v. KTTV (1983) 147 Cal. App. 3d 805, 816, 195 Cal. Rptr. 421]*. Further, courts will not apply the implied covenant when the contract is unambiguous and implication of the covenant is not needed to effectuate the parties' expressed desire for a binding agreement [*Storek & Storek, Inc. v. Citicorp Real Estate, Inc. (2002) 100 Cal. App. 4th 44, 55–58, 64, 122 Cal. Rptr. 2d 267* (covenant of good faith and fair dealing not implied so as to prohibit defendant lender from doing what it was expressly permitted to do under loan agreement—withhold loan funds when conditions precedent to its performance were not fulfilled to its satisfaction); *Third Story Music, Inc. v. Waits (1995) 41 Cal. App. 4th 798, 808–809, 48 Cal. Rptr. 2d 747* (corporation's promise to market music or refrain from doing so, at its election, was not subject to implied covenant of good faith and fair dealing)].

If a contract gives one party discretion to affect rights of the other party, this covenant imposes a duty to exercise that discretion in good faith and in accordance with fair dealing [*Cal. Lettuce Growers v. Union Sugar Co. (1955) 45 Cal. 2d 474, 484, 289 P.2d 785*; *Chen v. Paypal, Inc. (2021) 61 Cal. App. 5th 559, 570–572, 275 Cal. Rptr. 3d 767*; *Locke v. Warner Bros., Inc. (1997) 57 Cal. App. 4th 354, 363–364, 66 Cal. Rptr. 2d 921*; *Sheppard v. Morgan Keegan & Co. (1990) 218 Cal. App. 3d 61, 67, 266 Cal. Rptr. 784*; *Walter E. Heller Western, Inc. v. Tecrim Corp. (1987) 196 Cal. App. 3d 149, 161, 241 Cal. Rptr. 677]*. For example:

- A class of automobile buyers sued a corporation that financed the purchases, alleging breach of contract. The court held that the corporation breached the implied covenant of good faith and fair dealing by using a method of computing mandatory insurance

premiums and refunds (the so-called accelerated method) that was not objectively reasonable. In view of the sale agreement's silence on the issue of the premium refund method, a buyer legitimately could have expected that a different refund method (the pro-rata-by-time method) would be used [*Acree v. General Motors Acceptance Corp. (2001) 92 Cal. App. 4th 385, 393–396, 112 Cal. Rptr. 2d 99]*.

- A publisher's agreement with an author obligated the publisher to make a judgment as to the quality or literary merit of the author's work. The court held that the contract was not illusory because the publisher's duty to exercise its discretion was limited by its duty of good faith and fair dealing. The publisher was required to make its judgment in good faith and could not reject the manuscript for other unrelated reasons [*Chodos v. West Publishing Co., Inc. (9th Cir. 2002) 292 F.3d 992, 997]*.

- An agreement was negotiated for one party to acquire all of the shares of a corporation in exchange for a cash payment and a distribution of shares in a different corporation. A handwritten summary of the agreement stated that the acquiring party would determine the form and documentation of the acquisition "consistent with a stock and cash for stock acquisition." The court held that this delegation was valid because if the acquiring party drafted terms that were unfair or oppressive, or that deprived the other party of the benefit of the bargain, a court could reject them as a breach of the implied covenant of good faith and fair dealing [*Facebook, Inc. v. Pacific Nw. Software, Inc. (9th Cir. 2011) 2011 U.S. App. LEXIS 7430, at **6–7]*.

[3] Breach of Implied Covenant in Insurance Contract

In the context of insurance policies, a breach of the implied covenant of good faith and fair dealing may be the basis for a tort action [*see Comunale v. Traders & General Ins. Co. (1958) 50 Cal. 2d 654, 658, 328 P.2d 198*; for tort and contract actions, *see § 140.56[2]*, *see generally Ch. 308, Insurance, § 308.10* et seq.]. Courts that allow the cause of action in the context of insurance contracts emphasize the special relationship between the contracting parties,

characterized by elements of public interest, adhesion, and fiduciary responsibility [*see, e.g.*, *Egan v. Mutual of Omaha Ins. Co. (1979) 24 Cal. 3d 809, 820, 157 Cal. Rptr. 482, 598 P.2d 452, cert. denied, 445 U.S. 912 (1980)]*.

The special relationship test involves the following characteristics [*Foley v. Interactive Data Corp. (1988) 47 Cal. 3d 654, 690–691, 254 Cal. Rptr. 211, 765 P.2d 373*; *see Wallis v. Superior Court (1984) 160 Cal. App. 3d 1109, 1119, 207 Cal. Rptr. 123* (using five criteria instead of four)]:

- One of the parties to the contract enjoys a superior bargaining position to the extent of being able to dictate the terms of the contract;
- The purpose of the weaker party in entering into the contract is not primarily to profit but rather to secure an essential service or product, financial security, or peace of mind;
- The relationship of the parties is such that the weaker party places trust and confidence in the stronger party; and
- There is conduct on the part of the stronger party indicating an intention to frustrate the weaker party's enjoyment of the contract rights.

[4] Bad-Faith Denial of Existence of Contract

In 1995, the California Supreme Court ruled in *Freeman & Mills, Inc. v. Belcher Oil Co.* that tort recovery is precluded for breach of the implied covenant of good faith and fair dealing outside the insurance context, at least in the absence of an independent duty arising from principles of tort law *other than* the bad faith denial of the existence of, or liability under, the breached contract [*Freeman & Mills, Inc. v. Belcher Oil Co. (1995) 11 Cal. 4th 85, 102, 44 Cal. Rptr. 2d 420, 900 P.2d 669]*. The Court expressly overruled a 1984 case holding that a party to a contract may be subject to tort remedies when, in addition to breaching the contract, the party seeks to avoid liability by denying, in bad faith and without probable cause, that the contract exists [*Freeman & Mills, Inc. v. Belcher Oil Co. (1995) 11 Cal. 4th 85, 92, 44 Cal.*

Rptr. 2d 420, 900 P.2d 669; *Seaman's Direct Buying Service, Inc. v. Standard Oil Co. (1984) 36 Cal. 3d 752, 769–770, 206 Cal. Rptr. 354, 686 P.2d 1158]*. That cause of action was known as the tort of bad faith denial of the existence of a contract. The Court concluded that the former rule was no longer viable [*see* *Freeman & Mills, Inc. v. Belcher Oil Co. (1995) 11 Cal. 4th 85, 102–103, 44 Cal. Rptr. 2d 420, 900 P.2d 669]*. However, the Court emphasized that nothing in the *Freeman* opinion should be read as affecting existing precedent governing enforcement of implied contracts in insurance cases [*Freeman & Mills, Inc. v. Belcher Oil Co. (1995) 11 Cal. 4th 85, 103, 44 Cal. Rptr. 2d 420, 900 P.2d 669]*.

The Court's opinion in *Freeman* contained no statement regarding the effect of its decision on pending actions. It appears that the decision was fully retroactive and barred any pending claims based on the abrogated cause of action [*see* *Moradi-Shalal v. Fireman's Fund Ins. Companies (1988) 46 Cal. 3d 287, 305, 250 Cal. Rptr 116, 758 P.2d 58*; *Peterson v. Superior Court (1982) 31 Cal. 3d 147, 151–152, 181 Cal. Rptr. 784, 642 P.2d 1305]*.

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§ 140.13 Arbitration Clause and Service-of-Suit Clause

In a service-of-suit clause, a party agrees to submit to the personal jurisdiction of designated courts for specified purposes related to the contract. The purpose of such a clause is to ease the burdens that the beneficiary of the clause might otherwise encounter in trying to obtain service of process sufficient to establish personal jurisdiction over the other party (for instance, when the other party is not a citizen of the United States and has no presence in the United States). Generally, because of the public policy favoring arbitration in lieu of litigation, courts have tended to hold that a service-of-suit clause can co-exist in a contract along with an arbitration clause—that is, the two clauses will not be in conflict—as long as the service-of-suit clause can be interpreted as having been intended to facilitate enforcement of the arbitration clause. This is easily possible if the arbitration clause is qualified by an introductory phrase such as "Notwithstanding every other provision of this contract …" [*Boghos v. Certain Underwriters at Lloyd's of London (2005) 36 Cal. 4th 495, 502–503, 30 Cal. Rptr. 3d 787, 115 P.3d 68* (both clauses could operate in insurance contract when it was construed so that service-of-suit clause would allow insured to sue in court if insurer refused to arbitrate or refused to pay award)].

§ 140.14 Venue Selection Clause

With respect to where litigation involving a contract may be commenced, venue selection is purely an intrastate issue involving the selection of a county in which to hold the trial, whereas a *forum* selection clause, discussed in *§ 140.11*, chooses the court system of a particular state or nation [*Alexander v. Superior Court (The Brix Group, Inc.) (2003) 114 Cal. App. 4th 723, 726–727, 8 Cal. Rptr. 3d 111]*.

The fundamental rule is that insofar as a venue selection clause would lay venue in a county that is not permissible under the legislative scheme, the clause may not be given effect [*General Acceptance Corp. v. Robinson (1929) 207 Cal. 285, 289, 277 P. 1039* (venue selection clause in contract at issue would have laid venue in county that was impermissible under statutory venue scheme, and to that extent "the contract upon which this action was brought was void"); *Battaglia Enters. v. Superior Court (Yard House USA, Inc.) (2013) 215 Cal. App. 4th 309, 315, 154 Cal. Rptr. 3d 907*; *Alexander v. Superior Court (The Brix Group, Inc.) (2003) 114 Cal.App.4th 723, 731, 8 Cal. Rptr. 3d 111* ("[s]ince the venue statutes themselves declare the public policy of this state with respect [to] the proper court for an action, agreements fixing venue in some location other than that allowed by statute are a violation of that policy")]. When a permissible county is selected in a contract, and one of the parties commences an action on the contract in a different county that is also a permissible county, the venue selection clause generally should be enforced if the defendant seeks a change of venue to the county specified in the contract [*Battaglia Enters. v. Superior Court (Yard House USA, Inc.) (2013) 215 Cal. App. 4th 309, 318, 154 Cal. Rptr. 3d 907*

("[w]e conclude that where, as here, two sophisticated parties agree, pursuant to arm's length negotiations, to litigate an action in one of multiple statutorily permissible venues, they should be held to their agreement"); *see* *Arntz Builders v. Superior Court (County of Contra Costa) (2004) 122 Cal. App. 4th 1195, 1202 n.5, 19 Cal. Rptr. 3d 346* ("[t]here is some logic to the contention that the parties should be able to agree among statutorily permissible counties")].

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13 California Forms of Pleading and Practice--Annotated §§ 140.15–140.19

California Forms of Pleading and Practice--Annotated > Volume 13: Conspiracy thru Conversion-Chs. 126-159 > Chapter 140 CONTRACTS > PART II. LEGAL BACKGROUND > A. Definitions and Specific Provisions

§§ 140.15 –140.19 [Reserved]

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13 California Forms of Pleading and Practice--Annotated § 140.20

§ 140.20 Essential Elements

The following elements are essential to the existence of a contract [*Civ. Code § 1550*; *Schaefer v. Williams (1993) 15 Cal. App. 4th 1243, 1246, 19 Cal. Rptr. 2d 212* (promise by one party is not contract); *Marshall & Co. v. Weisel (1966) 242 Cal. App. 2d 191, 196, 51 Cal. Rptr. 183]*:

- Parties that are capable of contracting. Generally all persons are capable of contracting, except minors, persons of unsound mind, and persons deprived of civil rights [*Civ. Code § 1556*]. For discussion of a party incapable of contracting generally, *see § 140.21*; for discussion of void and voidable contracts made by persons of unsound mind, *see § 140.10[6]*; for discussion and forms relating to a minor's incapacity to contract, see *Ch. 365, Minors: Contract Actions*.
- The parties' consent [*see § 140.22*].
- A sufficient consideration [*see § 140.23*].
- A lawful object, which may be assumed as long as the contract is not specifically prohibited [*see generally, e.g.*, *Civ. Code § 1667 et seq.* (unlawful contracts)] and unless the defendant asserts illegality of the contract [*see § 140.24*].

§ 140.21 Person Incapable of Contracting

[1] Unsound Mind

[a] Contract Void

A person entirely without understanding or whose incapacity has been judicially determined and who has not been restored to reason has no power to make a contract of any kind. Any contract entered into by such a person is void, except that a person entirely without understanding is liable for the reasonable value of things furnished that are necessary for his or her support or the support of his or her family [*Civ. Code §§ 38*, *40*]. A person whose incapacity has been judicially determined is liable on a contract implied by law for the payment of necessaries. Whether an incompetent person can be liable on an express contract for necessaries appears unlikely [*Estate of Doyle (1932) 126 Cal. App. 646, 647, 14 P.2d 920]*.

The term "understanding" denotes not the act of understanding but the capacity or faculty of doing so. The expression "without understanding" denotes persons without that capacity. However, the expression should not be understood in its literal and extreme sense because even the most disabled person may have some degree of understanding. Instead, the expression as it applies to both executed and executory contracts, refers to a person entirely without the capacity to understand or comprehend such transactions [*Jacks v. Estee (1903) 139 Cal. 507, 511, 73 P. 247]*.

The statutory exception cannot be invoked by a person of sound mind who wants to avoid a contract with a person subsequently ascertained to be of unsound mind. *Civ. Code §§ 38, 40* are intended to protect only persons without the capacity to comprehend the nature and subject of a contract [*San Francisco Credit Clearing-House v. MacDonald (1912) 18 Cal. App. 212, 215, 122 P. 964*].

[b] Contract Voidable

A contract made by a person of unsound mind but not totally without understanding, before the person has been judicially determined to be without capacity, may be rescinded [*Civ. Code §§ 39(a), 1689(b)(7)*; *but see Saret-Cook v. Gilbert, Kelly, Crowley & Jennett (1999) 74 Cal. App. 4th 1211, 1225–1227, 88 Cal. Rptr. 2d 732* (even if plaintiff lacked contractual capacity because she was under influence of Demerol at time of executing agreement, she both ratified contract and accepted benefits under agreement)]. A person need not be incompetent to enter into every kind of contract to obtain rescission. The test is whether the person could deal with the subject matter of the contract sought to be rescinded, with a full understanding of his or her rights and the nature, purpose, and effect of what he or she did with respect to the particular transaction [*Walton v. Bank of California (1963) 218 Cal. App. 2d 527, 541, 32 Cal. Rptr. 856*].

The test of understanding varies from one contract to the next [*Smalley v. Baker (1968) 262 Cal. App. 2d 824, 832, 69 Cal. Rptr. 521*]. However, a rebuttable presumption affecting the burden of proof that a person is of unsound mind exists for purposes of rescission if the person is substantially unable to manage his or her own financial resources or resist fraud or undue influence [*Civ. Code § 39(b)*]. Substantial inability may not be proved solely by isolated incidents of negligence or imprudence [*Civ. Code § 39(b)*].

Incompetence is determined as of the time the contract was made. In addition, the right to rescind does not depend on knowledge of the disabled party's incompetence or fraud on

the part of the other party [*Weseman v. Latham (1957) 153 Cal. App. 2d 841, 846, 315 P.2d 364]*.

For a complaint for relief based on rescission of a contract as a result of incompetence before adjudication, see *Ch. 490, Rescission and Restitution*. For affirmative defenses based on various degrees of incapacity to contract, see *§§ 140.133–140.135*.

[c] Evidentiary Requirements

The Probate Code establishes evidentiary requirements relating to judicial determinations of capacity, including the capacity to contract [*see Prob. Code § 812* (application of rules)]. A determination that a person is of unsound mind or lacks the capacity to contract 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 or deficits and the decision or acts in question [*Prob. Code § 811(a)*]:

- Alertness and attention;
- Information processing;
- Thought processes; and
- Ability to modulate mood and effect.

There are specific statutory examples of what is sufficient to demonstrate impairment in each of these categories.

The court may consider such a deficit only if the deficit, by itself or in combination with other mental-function deficits, significantly impairs the person's ability to understand and appreciate the consequences of his or her actions with regard to the type of act or decision in question [*Prob. Code § 811(b)*]. The court may take into consideration the frequency, severity, and duration of periods of impairment [*Prob. Code § 811(c)*].

Diagnosis of a mental or physical disorder is insufficient by itself to support a determination that a person is of unsound mind or lacks the capacity to contract [*Prob.*

Code § 811(d); *see* *Prob. Code § 810(b)* (legislative findings and declarations in support of requirements specified in *Prob. Code § 811*)].

[2] Defendant Deprived of Civil Rights

Persons deprived of their civil rights are not capable of contracting [*Civ. Code § 1556*; *see* *Penal Code § 2600* (deprivation of state prisoners' civil rights)]. Any person deprived of civil rights may assert the defense of incapacity to contract, especially if the evidence shows that the party asserted the incapacity but the other party proceeded with the contract [*Rosman v. Cuevas (1959) 176 Cal. App. 2d Supp. 867, 869, 1 Cal. Rptr. 485*; *but cf.* *Jones v. Allen (1960) 185 Cal. App. 2d 278, 282–283, 8 Cal. Rptr. 316* (seller who sold automobile to convict whose civil rights had been suspended did not remain owner for purpose of imposing liability for personal injuries sustained by person hit by automobile driven by convict)].

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§ 140.22 Parties' Consent

[1] Consent Must Be Free

[a] Requirement

The consent of the parties must be freely given [*Civ. Code § 1565*]. Consent that is not free nevertheless is not absolutely void, but may be rescinded in the manner prescribed by the rules for rescission contained in *Civ. Code § 1688 et seq.* [*Civ. Code § 1566*]. For discussion and forms relating to rescission, see *Ch. 490, Rescission and Restitution*.

An apparent consent is not real or free when obtained through duress, menace, fraud, undue influence, or mistake [*Civ. Code § 1567*]. Consent is deemed to have been obtained through one of these causes only when it would not have been given had the cause not existed [*Civ. Code § 1568*]. For discussion and forms relating to purported contracts tainted by such defects, see *Ch. 215, Duress, Menace, Fraud, Undue Influence, and Mistake*.

[b] Fraud in Inducement and Fraud in Execution or Inception

In the usual case of fraud involving an agreement, a party knows that he or she is signing, or otherwise entering into, an agreement, but his or her consent is induced by fraud. In that case, mutual assent is present, and a contract is formed, but by reason of the fraud, the contract is voidable. The party seeking to void the contract must rescind under the statutory and common law rules [*Village Northridge Homeowners Assn v. State Farm Fire Cas. Co.*

(2010) 50 Cal. 4th 913, 921, 931, 114 Cal. Rptr. 3d 280, 237 P.3d 598; *see Ch. 490, Rescission and Restitution*].

Occasionally, fraud goes to the execution or inception of the contract, so that a party does not intend to sign (or otherwise enter into) a contract; and in that case, there is no mutual assent to support a contract, and the purported contract is void [*e.g.*, *Jones v. Adams Fin. Servs. (1999) 71 Cal. App. 4th 831, 840, 84 Cal. Rptr. 2d 151* (loan documents, signed by elderly woman who was blind and suffered from dementia, were obtained through fraud in execution, without negligence on her part; purported loan contract therefore was void)]. Because it is void, the purported contract may be disregarded, without any necessity of taking steps toward rescission [*Village Northridge Homeowners Ass'n v. State Farm Fire & Cas. Co. (2010) 50 Cal. 4th 913, 921, 931, 114 Cal. Rptr. 3d 280, 237 P.3d 598* (insured, having obtained payment on claim and having executed settlement and release agreement with insurance company, could not sue on claim of fraud in inducement without first rescinding that agreement)].

[c] Effect of Fraud on Arbitration Provision

When a party to a contract containing an arbitration clause elects to resist arbitration and asserts fraud in the inducement or fraud in the execution, special procedural rules apply because an arbitration clause is considered to be separable from the contract. If the party asserts fraud in the *inducement* of the *contract generally*, the assertion is no bar to the arbitration of the contract. The separable arbitration clause is considered valid, and the parties must arbitrate whether the contract was induced by fraud (even though a finding of fraud in the inducement may result in rescission of the contract as a whole). However, if the party is asserting fraud in the inducement of the *arbitration clause specifically*, the assertion is to be resolved by the trial court, as it goes to the validity of the arbitration clause itself. An assertion of fraud in the *execution* of the entire agreement is not arbitrable under either state or federal law. If the entire contract is void ab initio because of fraud, the

parties have not agreed to arbitrate any controversy; therefore, an issue of fraud in the execution is to be resolved by the trial court, not by an arbitrator [*Brown v. Wells Fargo Bank, N.A. (2008) 168 Cal. App. 4th 938, 958, 85 Cal. Rptr. 3d 817*; *see generally Rosenthal v. Great Western Fin. Securities Corp. (1996) 14 Cal. 4th 394, 415–419, 58 Cal. Rptr. 2d 875, 926 P.2d 1061* (prescribing court's duty, in proceedings to compel arbitration, to determine existence and validity of arbitration agreement, as well as parties' respective burdens of proof); *Toal v. Tardif (2009) 178 Cal. App. 4th 1208, 1220–1222, 101 Cal. Rptr. 3d 97* (prescription, in *Rosenthal* opinion, of court's duty and parties' burdens of proof respecting existence of valid arbitration agreement, applies also to proceedings for confirmation of arbitration award; party's consent to arbitration agreement cannot be proved solely by evidence that party's attorney signed agreement on party's behalf); *see also Desert Outdoor Adver. v. Superior Court (Murphy) (2011) 196 Cal. App. 4th 866, 872–875, 127 Cal. Rptr. 3d 158* (fraud-in-execution claim was not successful when made by sophisticated and experienced business executive who admittedly signed attorney retention agreement without reading it, who could have easily seen arbitration clause, which was not hidden, and who would have understood it, since it was in plain language; attorney had no fiduciary responsibility, under those circumstances, to draw attention to arbitration clause); *accord*, *Mt. Holyoke Homes, L.P. v. Jeffer Mangels Butler & Mitchell, LLP (2013) 219 Cal. App. 4th 1299, 1309, 162 Cal. Rptr. 3d 597]*.

An assertion of fraud in the execution could relate solely to the *absence* of the arbitration clause in the contract signed by the party resisting arbitration. For instance, the parties might have executed what the party resisting arbitration believed to be duplicate originals in two languages (neither party being fluent in the other's language), the other party having provided both documents; however, the arbitration clause was missing in the version signed by the party resisting arbitration, who at the time could not have discovered this discrepancy, for lack of fluency in the other party's language. If, as often happens in consumer transactions particularly, negotiations did not even touch on an arbitration

clause, there would have been no reason to look for one in the resisting party's version of the contract. In such a case, a trial court could reasonably conclude that mutual assent to the arbitration clause did not exist, and the clause therefore must be void [*Ramos v. Westlake Servs. LLC (2015) 242 Cal. App. 4th 674, 686–690, 195 Cal. Rptr. 3d 34* ("Ramos reasonably relied on a Spanish translation of the English Contract that … [Westlake's predecessor] provided him and that did not include the arbitration agreement. Accordingly, mutual assent as to the arbitration agreement is lacking, it is void, and the trial court correctly denied Westlake's motion to compel arbitration.")].

For additional discussion, see *Ch. 32, Contractual Arbitration: Agreements and Compelling Arbitration, § 32.20[7][b]*.

[2] Mutuality

[a] Requirement

The consent of the parties must be mutual [*Civ. Code § 1565*]. Consent is not mutual unless the parties agree on the same thing in the same sense [*Civ. Code § 1580*; *see The Money Store v. Southern California Bank (2002) 98 Cal. App. 4th 722, 728, 120 Cal. Rptr. 2d 58* (lender's closing instructions to bank exhibited mutual consent); *Weddington Productions, Inc. v. Flick (1998) 60 Cal. App. 4th 793, 811*; *McClintock v. Robinson (1937) 18 Cal. App. 2d 577, 582, 64 P.2d 749]*.

[b] Objective Test

The mutuality of the parties' consent must be gathered from their words and acts, judged by a reasonable standard, which must manifest an intention to agree in regard to the matter in question. The real but unexpressed state of a party's mind on the subject is immaterial [*Brant v. California Dairies, Inc. (1935) 4 Cal. 2d 128, 133, 48 P.2d 13*; *Martinez v. BaronHr, Inc. (2020) 51 Cal. App. 5th 962, 967–970, 265 Cal. Rptr. 3d 523* (mutual assent

to arbitrate all disputes established by three explicit terms in signed contract, despite unexpressed subjective intention not to initial jury trial waiver); *Hilleary v. Garvin (1987) 193 Cal. App. 3d 322, 327, 238 Cal. Rptr. 247]*. Under this objective test, a "meeting of the minds" is unnecessary. A party may be bound even though that party misunderstood the terms of a proposed contract and actually had a different undisclosed intention [*Myers v. Carter (1963) 215 Cal. App. 2d 238, 241, 30 Cal. Rptr. 91]*.

On the other hand, a failure to reach a meeting of the minds on all material points prevents the formation of a contract even though the parties have orally agreed on some of the terms or have taken some action related to the alleged contract [*Banner Entertainment, Inc. v. Superior Court (1998) 62 Cal. App. 4th 348, 359, 72 Cal. Rptr. 2d 598*; *see Cheema v. L.S. Trucking, Inc. (2019) 39 Cal. App. 5th 1142, 1149–1150, 252 Cal. Rptr. 3d 606]*. Thus, when undisputed facts showed that there was no meeting of the minds as to the essential structure and operation of an alleged joint venture, as a matter of law there was no contract, even if there was agreement on some of the terms [*Bustamante v. Intuit, Inc. (2006) 141 Cal. App. 4th 199, 215, 45 Cal. Rptr. 3d 692]*.

[c] Unenforceable Promise Does Not Preclude Mutuality

A contract does not lack mutuality of consent if the promise of one of the parties is unenforceable or voidable because of a special privilege not expressly reserved in the promise but given by the law. Examples are the voidable contracts of minors and persons lacking mental capacity to contract [*Metropolitan Water Dist. v. Marquardt (1963) 59 Cal. 2d 159, 179, 28 Cal. Rptr. 724, 379 P.2d 28*; *see § 140.21*].

[3] Offer

[a] Definition

A contract is created by a proposal or offer by one party and an acceptance by the other [*Tuso v. Green (1924) 194 Cal. 574, 580–581, 229 P. 327]*. An offer is a promise that is in its terms conditional on an act, forbearance, or return promise to be given in exchange for the promise or its performance [Restatement of Contracts, § 24].

[b] Requirements

The offer must reach the offeree. The burden of ascertaining whether it did reach the offeree is on the offeror. Consequently, the offeror, merely by sending an offer, is not entitled to take for granted that the offeree received and accepted it [*American Bldg. Maintenance Co. v. Indemnity Ins. Co. (1932) 214 Cal. 608, 616, 7 P.2d 305]*.

An offer must be sufficiently definite, or must call for such definite terms in the acceptance, that the performance promised is reasonably certain. A contract is void if it is so uncertain and indefinite that the intention of the parties in material respects cannot be determined [*Weddington Productions, Inc. v. Flick (1998) 60 Cal. App. 4th 793, 811–812*; *Ladas v. California State Auto. Ass'n (1993) 19 Cal. App. 4th 761, 770, 23 Cal. Rptr. 2d 810*; for the effect of a contract being void, *see § 140.10[6]*]. For the purpose of deciding whether a pleading is sufficient to state a claim for breach of contract, an offer is sufficiently definite if, assuming acceptance, the terms of the contract provide a basis for determining the existence of a breach and for giving an appropriate remedy [*Bustamante v. Intuit, Inc. (2006) 141 Cal. App. 4th 199, 209, 45 Cal. Rptr. 3d 692*; *e.g.*, *Sateriale v. R.J. Reynolds Tobacco Co. (9th Cir. 2012) 697 F.3d 777, 789* (in connection with its "Camel Cash" customer rewards program, defendant was obligated to make reasonable quantities of rewards merchandise available during life of that program, but failed to make any merchandise available after a particular date, thereby rendering alleged breach readily discernible; fact that contract afforded defendant some discretion in performing did not compel conclusion that contract was too indefinite to be enforced; in view of all

allegations, courts in this case should conclude, at pleading stage, that some basis would emerge in trial for determining appropriate remedy)].

The California Supreme Court has held that a licensed auto dealer's newspaper advertisement for the sale of a particular vehicle at a specified price constituted an offer that was accepted by a customer's tender of the advertised price [*Donovan v. RRL Corp. (2001) 26 Cal. 4th 261, 271, 276, 109 Cal. Rptr. 2d 807, 27 P.3d 702* (construing offer in light of *Veh. Code § 11713.1(e)*, which states it is violation of Vehicle Code for dealer to fail to sell vehicle at advertised price)]. The Ninth Circuit, relying on the *Donovan* case, has held that under California law, the plaintiffs in a class action for breach of contract adequately alleged the existence of an offer to enter into a unilateral contract, whereby the defendant promised to provide rewards to customers who purchased Camel cigarettes, saved "Camel Cash" certificates from the packages, and redeemed those certificates in accordance with terms stated in merchandise catalogs that the defendant distributed to customers for that purpose [*Sateriale v. R.J. Reynolds Tobacco Co. (9th Cir. 2012) 697 F.3d 777, 787]*.

[c] Revocation Before Acceptance

The offeror may revoke an offer at any time before the offeree has communicated acceptance to the offeror, but not afterwards [*Civ. Code § 1586*; *Grieve v. Mullaly (1930) 211 Cal. 77, 79, 293 P. 619*; *see Ersa Grae Corp. v. Fluor Corp. (1991) 1 Cal. App. 4th 613, 622, 2 Cal. Rptr. 2d 288* (communication of revocation to offeror's agent did not revoke offer when agent did not notify offeree of revocation before offeree accepted); *see also CPI Builders, Inc. v. Impco Technologies, Inc. (2001) 94 Cal. App. 4th 1167, 1174, 114 Cal. Rptr. 2d 851* (offeror's communication of revocation to offeror's attorney did not revoke offer when offeror's attorney did not notify offeree's attorney of revocation before offeree accepted)]. The offeror may withdraw an offer that states that it will remain open for a given length of time at any time prior to acceptance unless based on a valuable

consideration [*Davies v. Langin (1962) 203 Cal. App. 2d 579, 584, 21 Cal. Rptr. 682*; for discussion of options supported by consideration, *see § 140.22[3][d]*.

An offer is revoked on the occurrence of any of the following events [*Civ. Code § 1587*]:

- The communication of a notice of revocation by the offeror to the other party in the manner prescribed by *Civ. Code §§ 1581* and *1583* (methods by which consent can be communicated and the time consent is deemed communicated) before the other party's acceptance has been communicated to the offeror [*Civ. Code § 1587(a)*; *Wilson v. White (1911) 161 Cal. 453, 462, 119 P. 895]*.
- The lapse of the time prescribed in the offer for its acceptance or, if no time is prescribed, the lapse of a reasonable time without communication of the acceptance [*Civ. Code § 1587(b)*; *Davies v. Langin (1962) 203 Cal. App. 2d 579, 584–585, 21 Cal. Rptr. 682]*.
- The failure of the offeree to fulfill a condition precedent to acceptance [*Civ. Code § 1587(c)*].
- The death or insanity of the offeror before acceptance [*Civ. Code § 1587(d)*; *Bard v. Kent (1942) 19 Cal. 2d 449, 451–452, 122 P.2d 8]*.

[d] Option Supported by Consideration

An option agreement is a unilateral contract that results when one party (the optionor) offers to do something when and if some condition is satisfied by the other party (the optionee), and consideration passes from the optionee to the optionor. Usually, the optionor's offer is to sell property to the optionee on specified terms within a specified period, and the condition is that the optionee must accept the offer—that is, exercise the option—within that period, and the consideration is the payment of money by the optionee [*Steiner v. Thexton (2010) 48 Cal. 4th 411*, 420–421, *106 Cal. Rptr. 3d 252, 226 P.3d 359*; *County of San Diego v. Miller (1975) 13 Cal. 3d 684, 688, 119 Cal. Rptr. 491, 532 P.2d*

139]. In some cases, the equitable doctrine of promissory estoppel can be applied to overcome the absence of normal consideration [*e.g.*, *A-C Co. v. Security Pac. Nat'l Bank (1985) 173 Cal. App. 3d 462, 472, 219 Cal. Rptr. 62*; *see § 140.23[8]*].

This kind of unilateral contract may be called an irrevocable option, or irrevocable offer, because the effect of the consideration is to transform what would otherwise be a mere offer, which could be revoked at any time prior to acceptance, into an offer that cannot be revoked as long as satisfaction of the specified condition remains in the optionee's power [*Steiner v. Thexton (2010) 48 Cal. 4th 411, 106 Cal. Rptr. 3d 252, 226 P.3d 359, 2010 Cal. LEXIS 1913, at *15–*25]*.

In the case of an irrevocable option to purchase real property, the effect of the optionee's satisfying the specified condition is to supplant the unilateral contract (the option agreement) with a bilateral contract for sale of the property by the optionor and purchase by the optionee [*Palo Alto Town & Country Village, Inc. v. BBTC Co. (1974) 11 Cal. 3d 494, 503–504, 113 Cal. Rptr. 705, 521 P.2d 1097]*.

An irrevocable option may be exercised against the optionor's successors following the optionor's death. Unless the option agreement provides to the contrary, an irrevocable option generally is assignable [*County of San Diego v. Miller (1975) 13 Cal. 3d 684, 688, 119 Cal. Rptr. 491, 532 P.2d 139]*.

[4] Acceptance

[a] Definition and Requirements

An acceptance of an offer is an expression of assent to the offered terms, made by the offeree in a manner requested or authorized by the offeror. Unless otherwise required by statute or by the terms of the offer [*see Schreiber v. Hooker (1952) 114 Cal. App. 2d 634, 639, 251 P.2d 55]*, an acceptance may be written or oral [*Riverside Fence Co. v. Novak (1969) 273 Cal. App. 2d 656, 661, 78 Cal. Rptr. 536]*. An acceptance, to be effective, must

comply with the terms of the offer in every respect, but it is not essential that the acceptance repeat the identical language [*Schreiber v. Hooker (1952) 114 Cal. App. 2d 634, 639, 251 P.2d 55*].

With respect to the procedure established by *Code Civ. Proc. § 998*, governing written offers to compromise a pending action, it has been held that both the policy of encouraging settlement and the desirability of maintaining certainty compel the conclusion that general contract principles should not apply to the determination of whether an offer has been rejected. Thus, in the absence of an unequivocal rejection of a *Code Civ. Proc. § 998* offer, the offer may be accepted by the offeree during the statutory period unless the offer has been revoked by the offeror [*Guzman v. Visalia Community Bank (1999) 71 Cal. App. 4th 1370, 1376–1377, 84 Cal. Rptr. 2d 581* (trial court erred in denying plaintiff's request to enforce defendant's *Code Civ. Proc. § 998* offer to compromise, since disparaging comment of plaintiff's counsel regarding that offer did not constitute a rejection)].

[b] Qualified Acceptance Is Rejection

The acceptance must be absolute and unqualified [*Civ. Code § 1585*; *King v. Stanley (1948) 32 Cal. 2d 584, 588, 197 P.2d 321*, *disapproved on other grounds*, *Patel v. Liebermensch (2008) 45 Cal. 4th 344, 351 n.4, 86 Cal. Rptr. 3d 366, 197 P.3d 177*]. A qualified acceptance is a new proposal [*Civ. Code § 1585*; *Ten Winkel v. Anglo Cal. Sec. Co. (1938) 11 Cal. 2d 707, 717, 81 P.2d 958*; *but see Com. Code § 2207* (expression of acceptance operates as acceptance even though additional or different terms are included)], and constitutes a rejection terminating the offer [*see Roth v. Malson (1998) 67 Cal. App. 4th 552, 557–559, 79 Cal. Rptr. 2d 226* (prospective buyer's response to seller's counteroffer was a counter-counteroffer rather than an acceptance, and no contract was formed)]. The new proposal (or counteroffer) must be accepted by the original offeror, now turned offeree, before a contract results [*Landberg v. Landberg (1972) 24 Cal. App. 3d 742, 750, 101 Cal. Rptr. 335*].

[c] Sealed Bid as Acceptance

Generally, a seller who solicits sealed bids is not bound to accept the highest bid submitted. However, if the seller manifests an intent to be bound by the highest bid submitted, the request or bid is an offer [*Carver v. Teitsworth (1991) 1 Cal. App. 4th 845, 851–852, 2 Cal. Rptr. 2d 446* (acceptance with following change manifested intent to be bound by highest bid: "Sale price to be determined by sealed bid(s) at price not less than $795,000, 2 PM. 9/12/88. Terms will not be renegotiated.")].

A sealed bid that states the price in terms of a formula, such as "$1,000 higher [or lower] than any other sealed bid received at the bid opening," is defective for uncertainty even if the price can be objectively determined [*Carver v. Teitsworth (1991) 1 Cal. App. 4th 845, 853, 2 Cal. Rptr. 2d 446]*. The problem with formula bids is not that they are uncertain, but that they are considered unfair, and thus void, because they defraud both the soliciting party and the sum-certain bidders. The fraud on the sum-certain bidders occurs because it renders their bids ineffective and guarantees the formula bidder's supremacy. The prospect of a formula bidder frightens away potential sum-certain bidders, which chills competition. Fraud on the soliciting party occurs if the formula bidder prevails at a price lower (for a purchase) or higher (for a sale) than actual competition would have produced. However, formula bidding is fully valid if the soliciting party expressly solicits relative bids or if relative bidding is objectively reasonable as being customary in the particular trade or industry [*Carver v. Teitsworth (1991) 1 Cal. App. 4th 845, 854–855, 2 Cal. Rptr. 2d 446* (reversing summary judgment for insufficiency of factual record, which contained no expert opinions regarding industry practice, although clearly sum-certain bidders were not aware that relative bid would be submitted)].

[d] When Acceptance Is Effective

Consent is deemed to be fully communicated between the parties as soon as the offeree puts an acceptance in the course of transmission to the offeror [*Civ. Code § 1583*; *see Civ. Code § 1582* (requiring conformity to conditions of proposal)].

[5] Communication of Consent or Acceptance

[a] Requirement

Generally, in order to constitute a contract, the acceptance of an offer must be communicated to the offeror [*Commercial Casualty Ins. Co. v. Industrial Acci. Com. (1953) 116 Cal. App. 2d 901, 907, 254 P.2d 954*; *see Civ. Code § 1565(3)*]. For discussion of acceptance of unilateral contracts as an exception to this rule, *see* [b], *below*.

If an offer prescribes any conditions concerning communication of its acceptance, the offeror is not bound unless the acceptance satisfies those conditions. However, when the offer prescribes no conditions, the offeree may use any reasonable and usual mode of accepting [*Civ. Code § 1582*]. That is, if the offer does not make a positive requirement or impose an absolute condition of a specified manner of acceptance but merely suggests a permitted manner, another method of acceptance is not precluded [*Estate of Crossman (1964) 231 Cal. App. 2d 370, 372, 41 Cal. Rptr. 800*; *see Palo Alto Town & Country Village, Inc. v. BBTC Co. (1974) 11 Cal. 3d 494, 498–500, 113 Cal. Rptr. 705, 521 P.2d 1097* (applying same principles to option)]. A personal messenger is not a "usual mode" of communication within the meaning of *Civ. Code § 1582*, which refers to the medium, not to the messenger [*Ersa Grae Corp. v. Fluor Corp. (1991) 1 Cal. App. 4th 613, 622–623, 2 Cal. Rptr. 2d 288]*.

[b] Unilateral Contracts

In the case of a unilateral contract, no notice of acceptance by performance is normally required [*Davis v. Jacoby (1934) 1 Cal. 2d 370, 378, 34 P.2d 1026*; for definition of

unilateral contract, *see* *§ 140.10[4]*]. An offer for a unilateral contract is accepted and the contract is formed when the offeree performs. However, the offeree is required to give notice of the performance to the offeror within a reasonable time. Without notice, the offeror may treat the offer as lapsed [*Harris v. Time, Inc. (1987) 191 Cal. App. 3d 465, 476, 236 Cal. Rptr. 471*; *see* *Skaggs-Stone, Inc. v. La Batt (1960) 182 Cal. App. 2d 142, 143–144, 5 Cal. Rptr. 882* (guaranty of obligation owed to creditor was enforceable only when creditor had notice of undertaking)].

[c] Modes of Communicating Consent or Acceptance

For the acceptance or consent to be effectively communicated, the offeree must perform some act or omission by which the offeree intends to communicate (or that necessarily tends to communicate) consent [*Civ. Code § 1581*]. Consent may be manifested by acts or conduct and need not necessarily be shown by a writing or express words [*Kritzer v. Citron (1950) 101 Cal. App. 2d 33, 39, 224 P.2d 808]*.

When acceptance is by mail, formation of the contract is complete when the letter of acceptance is posted. Delivery to the post office of an acceptance properly addressed and with correct postage operates as delivery to the person addressed at the place and time it is delivered to the post office [*Palo Alto Town & Country Village, Inc. v. BBTC Co. (1974) 11 Cal. 3d 494, 500–501, 113 Cal. Rptr. 705, 521 P.2d 1097*; *Gibbs v. American Savings & Loan Assn. (1990) 217 Cal. App. 3d 1372, 1376, 266 Cal. Rptr. 517]*. Delivery to a third person who is to deposit the acceptance in the mail is not effective for this purpose [*Gibbs v. American Savings & Loan Assn. (1990) 217 Cal. App. 3d 1372, 1376, 266 Cal. Rptr. 517]*. Even in the face of testimony that an acceptance was deposited in the mail on a certain date, another date on the postmark is sufficient evidence to support a judgment that the acceptance did not occur until the date of the postmark [*Gibbs v. American Savings & Loan Assn. (1990) 217 Cal. App. 3d 1372, 1375–1376, 266 Cal. Rptr. 517]*.

If an offer is accepted by telegram, the offer takes effect on its deposit for transmission [*Sam Finman, Inc. v. Rokuz Holding Corp. (1955) 130 Cal. App. 2d 758, 761, 279 P.2d 982]*.

For discussion of communicating consent or acceptance in the context of transactions on the internet [*see, e.g.*, *Long v. Provide Commerce, Inc. (2016) 245 Cal. App. 4th 855, 863–867, 200 Cal. Rptr. 3d 117* ("terms of use" hyperlinks were not sufficiently conspicuous to put reasonably prudent internet consumer on inquiry notice; plaintiff did not manifest his unambiguous assent to be bound by terms of use)], see *California Legal Forms, Ch. 57, Computer-Related and Internet Transactions, § 57.34[3]*.

Civ. Code §§ 1582 and *1583* apply to irrevocable options as well as to revocable offers. Absent any provisions in the option contract to the contrary, the exercise of an option becomes effective at the time written notice of acceptance is deposited in the mail [*Palo Alto Town & Country Village, Inc. v. BBTC Co. (1974) 11 Cal. 3d 494, 501, 113 Cal. Rptr. 705, 521 P.2d 1097*]. For discussion of revocation before acceptance, *see § 140.22[3][c]*; for discussion of irrevocable options, *see § 140.22 [3][d]*.

[d] Silence as Acceptance

Silence generally may not constitute an acceptance unless there is a relationship between the parties, a previous course of dealing pursuant to which silence would be understood as acceptance [*Southern Cal. Acoustics Co. v. C.V. Holder, Inc. (1969) 71 Cal. 2d 719, 722, 79 Cal. Rptr. 319, 456 P.2d 975*; *accord Adams v. Johns-Manville Corp. (9th Cir. 1989) 876 F.2d 702, 704* (applying California law; settlement procedures in class action provided course of conduct between parties requiring objection by party who intended not to accept settlement offer)], or unless the circumstances impose on the offeree a duty to speak [*Wold v. League of the Cross (1931) 114 Cal. App. 474, 479, 300 P. 57]*. Acceptance may be inferred from inaction in the face of a duty to act to reject a benefit, the retention of a benefit conferred, the past relations of the parties, or the offeror having given the offeree

reason to believe that acceptance would be manifested by silence [*Golden Eagle Ins. Co. v. Foremost Ins. Co. (1993) 20 Cal. App. 4th 1372, 1385–1387, 25 Cal. Rptr. 2d 242*; *see Durgin v. Kaplan (1968) 68 Cal. 2d 81, 91, 65 Cal. Rptr. 158, 436 P.2d 70]*.

Acceptance through silence can be said to be an application of the doctrine of equitable estoppel. A party invoking this doctrine must prove all of the following [*Adams v. Johns-Manville Corp. (9th Cir. 1989) 876 F.2d 702, 706–707* (applying California law)]:

- The party to be estopped was apprised of the facts;
- The party to be estopped intended his, her or its conduct to be acted on, or that party acted in such a way that the party asserting estoppel could reasonably believe that silence would constitute acceptance;
- The party asserting estoppel was ignorant of the actual facts; and
- The party asserting estoppel relied on the other's conduct to his, her, or its injury.

[e] Performance of Conditions or Acceptance of Consideration as Consent

Performance of the conditions of a proposal, or the acceptance of the consideration offered with a proposal, is an acceptance of the proposal [*Civ. Code § 1584*; *see Estate of Klauenberg (1973) 32 Cal. App. 3d 1067, 1070, 108 Cal. Rptr. 669]*. Additionally, in option contracts (*see* [3][d], *above*), although the usual contemplated method of accepting an option is by notice, a valid acceptance may be made by a tender of actual performance [*Riverside Fence Co. v. Novak (1969) 273 Cal. App. 2d 656, 661, 78 Cal. Rptr. 536]*. However, *Civ. Code § 1584*, stating that the acceptance of the consideration offered with a proposal is an acceptance of the proposal, can have no application unless the offeree has an opportunity to reject the consideration before it is conveyed. If the offeree has not had such an opportunity, he or she cannot be said to have accepted [*Desny v. Wilder (1956) 46 Cal. 2d 715, 739, 299 P.2d 257]*.

[f] New Contract Terms Posted on Web Site

In some situations the terms of a consumer service contract are posted on the service provider's web site, and that posting is the only source to which a customer can refer for those terms. If the service provider posts revised terms on the web site, an issue exists as to whether the modified contract is enforceable against an existing customer.

In this situation, the Ninth Circuit has concluded that such a party has no obligation to check the terms of the contract on a periodic basis in order to learn whether they have been changed by the service provider. The customer would not know when to check the web site for possible changes to the contract terms without being notified regarding how the contract had been changed. Even if the customer checked the contract every day for possible changes, an examination still would be cumbersome in the absence of such notice, because the customer would have to compare every word of the posted contract with the existing contract in order to detect whether it had changed. It is elementary that a party cannot unilaterally change the terms of a contract, but must obtain the other party's consent to do so. Presenting a revised contract amounts to nothing more than making an offer and does not bind the other party until it is accepted. Generally an offeree cannot actually assent to an offer unless the offeree knows of its existence. Even if the customer's continued use of the provided service could be considered assent, such assent can be inferred only after the customer has received proper notice of the proposed changes [*Douglas v. United States Dist. Court (9th Cir. 2007) 495 F.3d 1062, 1066–1067*; *see Stover v. Experian Holdings, Inc. (9th Cir. 2020) 978 F.3d 1082, 2020 U.S. LEXIS 33176, *10]*.

[6] Promise to Agree in Future

[a] In General

The general rule is that if an "essential element" of a promise is reserved for the future agreement of the parties, the promise gives rise to no legal obligation until the future agreement is made. The enforceability of a contract containing a promise to agree depends on the relative importance and the severability of the matter left to the future. It is a question of degree that 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 the enforcement of the remainder of the agreement unfair [*Coleman Engineering Co. v. North American Aviation, Inc. (1966) 65 Cal. 2d 396, 405, 55 Cal. Rptr. 1, 420 P.2d 713*; *see Com. Code § 2204(3)* (contract for sale of goods does not fail for indefiniteness when terms are left open, if parties intended to make contract and there is reasonably certain basis for giving appropriate remedy); *Kruse v. Bank of America (1988) 202 Cal. App. 3d 38, 59, 248 Cal. Rptr. 217* (when evidence clearly shows that only subject matter under consideration is left for further negotiation and agreement, no contract is formed; reason is not vagueness and indefiniteness but is simply absence of any terms)].

It is not unlawful or even unusual, however, for contracting parties to agree to cross certain bridges when they are reached [*see, e.g.*, *Herman v. County of Los Angeles (2002) 98 Cal. App. 4th 484, 487–488, 119 Cal. Rptr. 2d 691* (agencies' promise to reach mutual agreement on new placement of former police officers who did not pass review process did not void contract for failure to reach agreement on essential term)].

A minor possible ground of disagreement in an otherwise complete agreement will not render the agreement uncertain. If 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 enforced. The law does not favor the destruction of contracts because of uncertainty. Courts will construe agreements to carry into effect the reasonable intentions of the parties if they can be ascertained and are feasible [*Wong v. Di Grazia (1963) 60 Cal. 2d 525, 539, 35 Cal. Rptr. 241, 386 P.2d 817]*. A promise to agree in the future is unenforceable only

when the uncertainty or incompleteness prevents the court from knowing, with the aid of extrinsic evidence if necessary, what to enforce [*Okun v. Morton (1988) 203 Cal. App. 3d 805, 817, 819, 250 Cal. Rptr. 220]*.

One rule of interpretation is that a contract is to be given effect if possible. One court, in considering the term "based on" in an agreement that called for horse-race purses to be based on the previous year's pari-mutuel pools, noted that if "based on" meant "estimated," there would be something left for the parties to agree on, and the contract might be illusory; but if "based on" meant "equal to," there was sufficient certainty [*Horsemen's Benevolent & Protective Assn. v. Valley Racing Assn. (1992) 4 Cal. App. 4th 1538, 1558–1559, 6 Cal. Rptr. 2d 698* (trial court properly submitted matter to jury after admitting extrinsic evidence)].

[b] Intention to Execute Written Agreement

When the parties definitely agree on all of the essential terms of an agreement in a writing, there is a contract even though the parties intend that a formal writing will be executed later [*see Harris v. Rudin, Richman & Appel (1999) 74 Cal. App. 4th 299, 306–309, 87 Cal. Rptr. 2d 822* (distinguishing *Beck v. American Health Group Internat., Inc. (1989) 260 Cal. Rptr. 237*, discussed *below*, when signed letter purported to embody "essential terms" of agreement)]. On the other hand, when there is a manifest intention that the agreement is not to be complete until reduced to a formal writing to be executed, there is no contract until this is done [*Rennick v. O.P.T.I.O.N. Care, Inc. (9th Cir. 1996) 77 F.3d 309, 315–316*; *Banner Entertainment v. Superior Court (1998) 62 Cal. App. 4th 348, 357–358, 72 Cal. Rptr. 2d 598*; *Beck v. American Health Group Internat., Inc. (1989) 211 Cal. App. 3d 1555, 1562, 260 Cal. Rptr. 237*; *Duran v. Duran (1983) 150 Cal. App. 3d 176, 180, 197 Cal. Rptr. 497*; *Smissaert v. Chiodo (1958) 163 Cal. App. 2d 827, 830–831, 330 P.2d 98]*.

An agreement to agree that shows a manifest intention that the parties not be bound until they have finally agreed or until a final, formal agreement is executed will not support a cause of action for breach of contract or for specific performance [*Autry v. Republic Productions, Inc. (1947) 30 Cal. 2d 144, 151, 180 P.2d 888*; *Beck v. American Health Group Internat., Inc. (1989) 211 Cal. App. 3d 1555, 1563, 260 Cal. Rptr. 237]*. If an ambiguous written agreement to agree is incorporated into a complaint, or set forth *in haec verba*, and a party does not allege the meaning that party ascribes to it, the court will construe the language of the agreement on its face and as a whole to determine whether there is a manifest intention that the parties are already bound or that they will not be bound until a final, formal document is executed [*Beck v. American Health Group Internat., Inc. (1989) 211 Cal. App. 3d 1555, 1562, 260 Cal. Rptr. 237*; *Hillsman v. Sutter Community Hospitals (1984) 153 Cal. App. 3d 743, 749–750, 200 Cal. Rptr. 605]*.

[c] Contract to Negotiate an Agreement

One court has held that a contract to negotiate an agreement is distinguishable from a so-called "agreement to agree," and can be formed and breached just like any other contract [*see Copeland v. Baskin Robbins U.S.A. (2002) 96 Cal. App. 4th 1251, 1253, 117 Cal. Rptr. 2d 875* (parties agreed to purchase and sell ice cream manufacturing plant, and agreed to negotiate terms of second agreement for purchase and sale of ice cream manufactured at that plant)]. The court first stated that the contract to negotiate the terms of a second agreement, in this case for the purchase and sale of ice cream, was neither illegal or immoral pursuant to *Civ. Code § 1667*. The court further found that a contract to negotiate the terms of an agreement differs from a mere agreement to agree because failure to agree is not itself a breach of a contract to negotiate. A party will be liable only if a failure to reach ultimate agreement resulted from a breach of that party's obligation to negotiate or to negotiate in good faith [*Copeland v. Baskin Robbins U.S.A. (2002) 96 Cal. App. 4th 1251, 1257*].

The appropriate remedy for breach of a contract to negotiate is not damages for the injured party's lost profits under the prospective contact, but rather damages caused by the injured party's reliance on the agreement to negotiate. Reliance damages include plaintiff's out-of-pocket costs in conducting the negotiations, and any lost opportunity costs [*Copeland v. Baskin Robbins U.S.A. (2002) 96 Cal. App. 4th 1251, 1260–1264, 117 Cal. Rptr. 2d 875* (holding that defendant was entitled to summary judgment because it showed that plaintiff could not establish reliance damages); *see Ch. 177, Damages, § 177.140* et seq.].

End of Document

§ 140.23 Consideration

[1] In General

Consideration is an act or return promise, bargained for and given in exchange for a promise, which either gives a benefit to the promisor or imposes a burden on the promisee [*Civ. Code § 1605*; *Flojo Internat., Inc. v. Lassleben (1992) 4 Cal. App. 4th 713, 719, 6 Cal. Rptr. 2d 99*; *Peterson Tractor Co. v. State Board of Equalization (1962) 199 Cal. App. 2d 662, 670, 18 Cal. Rptr. 800]*. A promise alone, unsupported by consideration, is not enforceable and has no binding force [*Western Lith. Co. v. Vanomar Producers (1921) 185 Cal. 366, 369, 197 P. 103*; *see, e.g., O'Byrne v. Santa Monica-UCLA Medical Center (2002) 94 Cal. App. 4th 797, 808–810* (no consideration was given for medical staff bylaws adopted pursuant to *22 Cal. Code Reg. § 70703*; thus bylaws did not in and of themselves constitute contract between hospital and physician on its medical staff); *see also Kremen v. Cohen (9th Cir. 2003) 337 F.3d 1024, 1028–1029* (registrar of Internet domain name did not breach implied contract with registrant by assigning name to another party; no consideration was given for registration)].

Consideration is a necessary element of both express contracts and implied contracts [*Civ. Code § 1605*; *Grant v. Long (1939) 33 Cal. App. 2d 725, 737, 92 P.2d 940]*. However, the requirement of consideration applies only to executory contracts. After the contract is fully executed on both sides, the question of consideration becomes immaterial [*Schiffman v. Atlas Mill Supply, Inc. (1961) 193 Cal. App. 2d 847, 853, 14 Cal. Rptr. 708]*.

The existence of consideration does not depend on a benefit being conferred on the promisor. It is sufficient if the promisee must take on some burden of suffer some detriment, or gives a return promise to do so [*Brody v. Gabriel (1961) 193 Cal. App. 2d 644, 645, 14 Cal. Rptr. 539]*.

Generally it does not matter from whom the consideration moves or to whom it goes. If it is bargained for and given in exchange for a promise, the promise is not gratuitous. In one case, for example, the owner of a closely held corporation had relinquished ownership and control to the corporation's major supplier in return for forgiveness of a debt owed to the corporation and the right to royalties and commissions based on sales generated by the former owner as sales representative for the reorganized corporation. The corporation refused to pay commissions, claiming that it had not received any consideration. The court of appeal rejected the argument, characterizing the corporation as the promisor of the promise to pay royalties. The consideration received was the transfer of the corporate stock to the supplier, which was a detriment to the promisee, the former owner, and apparently of vital interest to the corporation [*Flojo Internat., Inc. v. Lassleben (1992) 4 Cal. App. 4th 713, 719, 6 Cal. Rptr. 2d 99]*.

[2] Element of Bargain or Agreed Exchange

The consideration for a promise must actually be bargained for and given in exchange for the promise [*Simmons v. California Institute of Technology (1949) 34 Cal. 2d 264, 272, 209 P.2d 581*; *Jara v. Suprema Meats, Inc. (2004) 121 Cal. App. 4th 1238, 1251, 18 Cal. Rptr. 3d 187* (promise by one shareholder to another not to vote for increased officer compensation without other's agreement was unenforceable gratuitous promise because it was not induced by, or given, to induce return promise or performance); *Passante v. McWilliam (1997) 53 Cal. App. 4th 1240, 1247–1249, 62 Cal. Rptr. 2d 298* (attorney who arranged loan could not enforce subsequent promise by grateful borrower to transfer stock to attorney)]. No act of an offeree can constitute consideration binding on the offeror unless the latter agrees to be bound in return [*Bard v. Kent (1942) 19 Cal. 2d 449, 452, 122 P.2d 8]*. The fact that the promisee relies

on the promise to the promisee's injury, or the promisor gains some advantage, does not establish consideration without the element of bargain or agreed exchange [*Meyer v. Glenmoor Homes, Inc. (1966) 246 Cal. App. 2d 242, 259, 55 Cal. Rptr. 502*].

[3] When Consideration Presumed

A written instrument is presumptive evidence of consideration [*Civ. Code § 1614*]. Thus, the plaintiff does not need to plead the existence and character of the consideration in a complaint for breach of contract if the pleading states that the contract was in writing [*Henke v. Eureka Endowment Asso. (1893) 100 Cal. 429, 433, 34 P. 1089]*, or if a written contract is set forth in full in the pleading [*Williams v. Hall (1889) 79 Cal. 606, 607, 21 P. 965]*.

The presumption of consideration under *Civ. Code § 1614* affects the burden of producing evidence, not the burden of proof [*Rancho Santa Fe Pharmacy, Inc. v. Seyfert (1990) 219 Cal. App. 3d 875, 884, 268 Cal. Rptr. 505]*. Once the court admits sufficient evidence to call into question the validity of the presumed fact, *i.e.*, consideration, the proponent of the written instrument has the burden of proving the presumed fact [*Rancho Santa Fe Pharmacy, Inc. v. Seyfert (1990) 219 Cal. App. 3d 875, 883*]. On the other hand, the burden of pleading and proving the lack of consideration is on the party seeking to avoid the contract on that ground [*Civ. Code § 1615*; *Blonder v. Gentile (1957) 149 Cal. App. 2d 869, 874, 309 P.2d 147]*. However, the presumption does not apply to a contract in which a different rule is expressly prescribed [*Toomy v. Dunphy (1890) 86 Cal. 639, 642, 25 P. 130]*, nor does it apply to ordinary letters [*Michaelian v. State Fund (1996) 50 Cal. App. 4th 1093, 1112, 58 Cal. Rptr. 2d 133*; *Foltz v. First Trust & Sav. Bank (1948) 86 Cal. App. 2d 59, 61, 194 P.2d 135]*.

The recital of a certain specific consideration in an agreement subscribed by both parties is a statement or admission of the parties that the consideration was received and is prima facie evidence to that effect [*Podesta v. Mehrten (1943) 57 Cal. App. 2d 66, 71, 134 P.2d 38]*. Nevertheless, the parties are not estopped by recitals in an agreement with respect to its consideration. A party may always show the true consideration or want of it by extrinsic

evidence for the purpose of avoiding a contract, even though the contract states facts that show a valuable consideration [*Royer v. Kelly (1916) 174 Cal. 70, 72, 161 P. 1148]*.

[4] Mutuality of Obligation Required

When the parties exchange promises as consideration in their attempt to contract, the promises must be mutual in obligation. Without mutuality of obligation, there is no consideration for the agreement, and no enforceable contract results.

The mutuality of obligation principle, however, applies only to bilateral contracts. In the unilateral contract context, there is no mutuality of obligation [*see Asmus v. Pacific Bell (2000) 23 Cal. 4th 1, 14–15, 96 Cal. Rptr. 2d 179, 999 P.2d 71* (rule governing termination of unilateral contracts is that once employer promisor determines it will terminate or modify contract, and provides its employees with reasonable notice of change, additional consideration is not required)].

For discussion of lack of mutuality of obligation as a defense to an action for breach of contract, see *§ 140.62[1]*.

[5] Ability of One Party to Terminate Contract

Courts generally hold that contracts permitting one party to withdraw at will, or permitting performance by one party as he or she pleases, lack consideration. However, a contract is not necessarily unenforceable if one party has the power to terminate the contract under certain conditions. For instance, the defense of lack of mutuality of obligation (*see § 140.62[1]*) generally does not apply if a party has the right to terminate the contract on the happening of certain contingencies beyond the party's control [*Vitagraph, Inc. v. Liberty Theatres Co. (1925) 197 Cal. 694, 701, 242 P. 709]*. The defense also does not apply when a party has a power of revocation, if the power is exercisable only on notice to the other party. In such a case the requirement of notice is a sufficient legal detriment to constitute consideration [*Mutz*

v. Wallace (1963) 214 Cal. App. 2d 100, 111, 29 Cal. Rptr. 170]. For discussion of termination of contracts generally, see *§ 140.47*.

[6] Requirements Contracts

[a] Validity in General

A contract that reserves in either party an option to deliver or to accept personal property, or to contract for a future delivery, and under which the quantity is dependent on the will, wish, want, or desire of the other party, is void for lack of consideration and mutuality. For discussion of defense of lack mutuality generally, see *§ 140.62[1]*. However, when a buyer agrees to buy what he or she needs or requires of a certain product, and the seller absolutely promises to sell, a contract is made. Such a contract imposes on the buyer the duty of buying what the buyer requires from the seller and on the seller the obligation to sell to the buyer at the contract price [*Ross v. Frank W. Dunne Co. (1953) 119 Cal. App. 2d 690, 698, 260 P.2d 104]*.

[b] Performance Conditional on Party's Satisfaction

Contracts making the duty of performance of one of the parties conditional on that party's satisfaction are enforceable. They are of two kinds [*see Mattei v. Hopper (1958) 51 Cal. 2d 119, 122–123, 126, 330 P.2d 625]*:

- Contracts in which the condition calls for satisfaction as to commercial value or quality, operative fitness, or mechanical utility are enforceable, since dissatisfaction cannot be claimed arbitrarily, unreasonably, or capriciously. Courts use the standard of the reasonable person in determining whether satisfaction has been received.
- Contracts containing satisfaction clauses involving fancy, taste, or judgment are nevertheless enforceable, even though the satisfaction of one party is dependent on a subjective standard, since the party's determination of dissatisfaction must be

made in good faith [*see, e.g.*, *Locke v. Warner Bros., Inc. (1997) 57 Cal. App. 4th 354, 364–365, 66 Cal. Rptr. 2d 921* (evidence raised triable issue of material fact as to whether movie studio had honest or good faith dissatisfaction with director's proposals under film development deal)].

One party's approval of the documents, or of preliminary title reports and inspections in real estate transactions, may be a condition precedent to that party's performance. If the party whose approval is required expressly and unequivocally disapproves, the contract is terminated and cannot be revived by later waiver of the condition [*Beverly Way Associates v. Barham (1990) 226 Cal. App. 3d 49, 51, 56, 276 Cal. Rptr. 240]*.

[7] Sufficiency of Consideration

[a] Intrinsic Value Not Counted

The sufficiency of the consideration supporting a promise does not depend on its intrinsic value. Generally, courts do not inquire into the real value of consideration as long as it is something of legally cognizable value. The determination as to the adequacy of the consideration in this regard is left to the parties at the time of contracting and should not be made by the court when one party attempts to enforce the contract [*see Schumm v. Berg (1951) 37 Cal. 2d 174, 185, 231 P.2d 39*; *Rice v. Brown (1953) 120 Cal. App. 2d 578, 582, 261 P.2d 565]*. However, this rule does not preclude a party from showing that the consideration had some value at least. Something that is completely worthless by any standard cannot constitute a valid consideration [*Louisville Title Ins. Co. v. Surety Title & Guar. Co. (1976) 60 Cal. App. 3d 781, 791, 132 Cal. Rptr. 63]*.

[b] Court's Power to Weigh Consideration

Whether sufficient consideration was received by a promisor is a question of fact [*Estate of Thomson (1913) 165 Cal. 290, 296, 131 P. 1045]*. In certain cases, courts have been given

the power by statute to consider relative values in weighing the sufficiency of consideration. These cases include agreements involving the rights of heirs, devisees, and legatees [Prob. Code § 1020.1; *Estate of Freeman (1965) 238 Cal. App. 2d 486, 489, 48 Cal. Rptr. 1]*.

Further, the courts may not enforce specific performance against a party to a contract unless that party has received adequate consideration [*Civ. Code § 3391*; *Morrill v. Everson (1888) 77 Cal. 114, 115–116, 19 P. 190*; for discussion of specific performance generally, see *Ch. 528, Specific Performance*]. In this context, "adequate" means a consideration that is fair and reasonable in the circumstances [*Chalmers v. Raras (1962) 200 Cal. App. 2d 682, 689, 19 Cal. Rptr. 531]*. In considering the circumstances, the court should determine the object to be obtained by the contract and the relationship of the parties [*Berkeley Lawn Bowling Club v. City of Berkeley (1974) 42 Cal. App. 3d 280, 290, 116 Cal. Rptr. 762]*.

[c] Sufficiency at Time of Making Contract

The courts determine the sufficiency of the consideration as of the time the parties entered into the contract, not in relation to a subsequent time [*Crail v. Blakely (1973) 8 Cal. 3d 744, 753, 106 Cal. Rptr. 187, 505 P.2d 1027]*. If there was sufficient consideration at the time the parties made the agreement, the fact that it subsequently diminished in value or became of no value does not relieve the promisor from liability on the promise [*Riverside Water Co. v. Jurupa Ditch Co. (1960) 187 Cal. App. 2d 538, 542, 9 Cal. Rptr. 742]*.

[d] Moral Obligation as Consideration

In general, a moral obligation is not consideration for a contract. However, a moral obligation originating in some benefit conferred on the promisor or prejudice suffered by the promisee is consideration for a promise [*see Civ. Code § 1606*] if good and valuable consideration once existed [*Wilson v. Wilson (1960) 54 Cal. 2d 264, 271–272, 5 Cal. Rptr.*

317, 352 P.2d 725 (father's moral obligation of continued support of children after failure to perform property agreement made at time of divorce rested on legal duty to support children)].

For example, if a party once had a past legal obligation, but the remedy is now barred, *e.g.*, when a debt is barred by the statute of limitations or a discharge in bankruptcy or an original obligation is barred by the statute of frauds, a subsequent promise to pay is enforceable [*cf. Dow v. River Farms Co. (1952) 110 Cal. App. 2d 403, 410, 243 P.2d 95* (company's promise to pay plaintiff's husband for past services rendered was only promise to make gift and unenforceable because no past legal obligation existed)]. The subsequent promise is enforceable because, although the remedy to enforce the payment of the debt is gone or never existed, the moral obligation to pay remains [*Lambert v. Schmalz (1897) 118 Cal. 33, 35, 50 P. 13]*.

If there was no expectation of payment by either party when past services were rendered, a promise by the party receiving the services to pay the performing party is a mere promise to make a gift and not enforceable [*Passante v. McWilliam (1997) 53 Cal. App. 4th 1240, 1248–1249, 62 Cal. Rptr. 2d 298* (no consideration for directors' oral promise to provide corporation's attorney with stock interest in return for arranging financing when loan was arranged before stock was promised)].

[e] Promise to Perform Existing Duty

Consideration for an agreement is not adequate when it is a mere promise to perform what the promisor is already legally bound to do [*Grant v. Aerodraulics Co. (1949) 91 Cal. App. 2d 68, 75, 204 P.2d 683]*. For example, a promise of extra compensation for completion of a contract, made to a party who has the existing legal duty to perform the contract, is without consideration [*Bailey v. Breetwor (1962) 206 Cal. App. 2d 287, 291–292, 23 Cal. Rptr. 740]*.

However, the agreed consideration may consist almost wholly of a performance that is already required if some small additional performance is bargained for and given. Thus, if the bargained-for performance that is rendered includes something not within the requirements of an existing duty, the requirement of consideration is met [*House v. Lala (1963) 214 Cal. App. 2d 238, 243, 29 Cal. Rptr. 450]*.

[f] Relinquishment of Claimed Right

Relinquishment or forbearance of a claimed right is consideration for the creation of a new right, regardless of whether the claimed right actually was effective [*Walters v. Calderon (1972) 25 Cal. App. 3d 863, 873–874, 102 Cal. Rptr. 89]*. Examples include [*Booth v. Bond (1942) 56 Cal. App. 2d 153, 157, 132 P.2d 520]*:

- Cancellation of an existing debt.
- Release of security.
- Forbearance to sue (even though it subsequently appears that the forbearer might not have been successful in the suit).

Similarly, a promise given in consideration of the settlement or compromise of a dispute or controversy, the outcome of which is uncertain or doubtful, is supported by consideration [*see Baker v. Philbin (1950) 97 Cal. App. 2d 393, 397, 218 P.2d 119]*.

The determinative question is whether the purported right waived or relinquished was one the promisee could have urged in good faith and which presented some bona fide question of validity, however slight, rather than whether the right was legally valid and effective. If the right waived and relinquished was obviously worthless and ineffective, a promise to relinquish it would not constitute valid consideration [*Walters v. Calderon (1972) 25 Cal. App. 3d 863, 873–874, 102 Cal. Rptr. 89]*.

[8] Promissory Estoppel as Substitute for Consideration

[a] In General

Consideration is something bargained for and given in exchange for a promise. The promisee's performance is requested at the time the promisor makes the promise and the performance is bargained for. The absence of this bargained-for exchange would normally render a promise unenforceable. Nevertheless, a promisor may be bound under the doctrine of promissory estoppel when the following conditions exist [*Drennan v. Star Paving Co. (1958) 51 Cal. 2d 409, 413, 333 P.2d 757*; *US Ecology, Inc. v. State (2005) 129 Cal. App. 4th 887, 891, 908, 28 Cal. Rptr. 3d 894*; *Smith v. City and County of San Francisco (1990) 225 Cal. App. 3d 38, 48, 275 Cal. Rptr. 17*; *Sheppard v. Morgan Keegan & Co. (1990) 218 Cal. App. 3d 61, 67, 266 Cal. Rptr. 784*; *A-C Co. v. Security Pacific Nat. Bank (1985) 173 Cal. App. 3d 462, 474, 219 Cal. Rptr. 62]*:

- The promisor makes a promise that the promisor should reasonably expect to induce action or forbearance of a definite and substantial character on the part of the promisee;
- The promise does induce such action or forbearance;
- The promisor's breach of the promise was a substantial factor in causing injury to the promisee; and
- Injustice can be avoided only by enforcement of the promise.

The doctrine of promissory estoppel employs equitable principles to satisfy the requirement that consideration be given in exchange for the promise sought to be enforced [*Raedeke v. Gibraltar Sav. & Loan Asso. (1974) 10 Cal. 3d 665, 672, 111 Cal. Rptr. 693, 517 P.2d 1157]*.

[b] Elements

For the doctrine of promissory estoppel to apply, the plaintiff must establish that:

- The defendant made a promise—gave assurance, rather than merely engaged in preliminary discussions or negotiations—and the promise was clear and unambiguous in its terms [*Southern Cal. Acoustics Co. v. C.V. Holder, Inc. (1969) 71 Cal. 2d 719, 723, 79 Cal. Rptr. 319, 456 P.2d 975*; *Garcia v. World Savings, FSB (2010) 183 Cal. App. 4th 1031, 1044–1045, 107 Cal. Rptr. 3d 683* (mortgage lender's employee told borrowers in default that if they needed additional time, until specified date, for closing another loan in order to obtain funds for curing default, then employee would postpone foreclosure sale so as to permit borrowers to do that; such statement was sufficiently definite for trial court to determine scope of promise and lender's consequent obligation; fact that promise was conditioned on borrowers' needing additional time did not render it unenforceable or ambiguous)];

- The plaintiff's reliance on defendant's promise was reasonable [*see MacIsaac & Menke Co. v. Freeman (1961) 194 Cal. App. 2d 327, 335, 15 Cal. Rptr. 48*; *see also Joffe v. City of Huntington Park (2011) 201 Cal. App. 4th 492, 513, 134 Cal. Rptr. 3d 868* (complaint did not allege facts supporting reasonable reliance; trial court sustained demurrer without leave to amend; judgment of dismissal affirmed because there was no promissory estoppel as matter of law)];

- The plaintiff suffered substantial detriment as a result of the reliance on defendant's promise or representation [*see Garcia v. World Savings, FSB (2010) 183 Cal. App. 4th 1031, 1041–1044, 107 Cal. Rptr. 3d 683* (detrimental reliance was established by evidence that borrowers, whose residential mortgage loan was in default, were assured by lender's employee that foreclosure sale would be postponed until specified date if borrowers needed such postponement in order to cure default, and further evidence that borrowers, relying on that statement but ignorant that foreclosure sale had been concluded in spite of that statement, proceeded to obtain high-interest, high-cost loan secured by other property, which loan was closed by

that specified date and yielded funds sufficient to cure default); *Henry v. Weinman (1958) 157 Cal. App. 2d 360, 366–367, 321 P.2d 117]*; and

- Defendant's breach of the promise was a substantial factor in causing injury to the plaintiff [*US Ecology, Inc. v. State (2005) 129 Cal. App. 4th 887, 891, 908, 28 Cal. Rptr. 3d 894]*.

The existence of these elements is a question of fact [*Division of Labor Law Enforcement v. Transpacific Transp. Co. (1977) 69 Cal. App. 3d 268, 275–276, 137 Cal. Rptr. 855]*. In determining whether the plaintiff has adequately alleged a cause of action based on promissory estoppel, the court should look at the complaint as a whole, not solely at the allegations grouped together under a heading referencing promissory estoppel. The complaint is sufficient if each of the elements of promissory estoppel is alleged at some place [*West v. JPMorgan Chase Bank (2013) 214 Cal. App. 4th 780, 804–805, 154 Cal. Rptr. 3d 285]*.

As an illustration of the application of promissory estoppel, in the case of an employment contract, the court may estop an employer from terminating an employee before the start date, and without an opportunity to demonstrate the employee's ability to meet the job requirements, after the employee severs his or her former employment and moves across the country [*Sheppard v. Morgan Keegan & Co. (1990) 218 Cal. App. 3d 61, 67, 266 Cal. Rptr. 784]*.

The California Supreme Court has applied the doctrine of promissory estoppel in the public contract context, holding that the lowest responsible bidder that was wrongfully denied a public contract has a cause of action for monetary damages against the public entity. Those damages, however, included bid preparation costs but not lost profits [*Kajima/Ray Wilson v. Los Angeles MTA (2000) 23 Cal. 4th 305, 315–317, 96 Cal. Rptr. 2d 747]*.

[c] Equitable Estoppel

Evid. Code § 623 creates a related doctrine called "equitable estoppel." It provides that a party who has, by the party's own statement or conduct, intentionally and deliberately led another to believe a particular thing to be true and to act on that belief, may not, in litigation arising out of that statement or conduct, contradict it. The doctrine of equitable estoppel requires proof of four elements [*Hair v. State of California (1991) 2 Cal. App. 4th 321, 328–329, 2 Cal. Rptr. 2d 871]*:

- The party to be estopped must be apprised of the true facts;
- The party to be estopped must intend that his, her or its conduct be acted on, or must act so that the party asserting the estoppel had a right to believe that was the intent;
- The party asserting the estoppel must be ignorant of the true facts; and
- The party asserting the estoppel must rely on the conduct or statement to that party's injury.

An oral promise to make a will or not to revoke a will [*see generally Prob. Code § 21700* (statute of frauds), formerly section 150 (for contracts made in 1985–2000); *see also Civ. Code § 1624* before amendment by Stats. 1983, ch. 842, § 6 (for contracts made before 1985)] can be enforced by application of the equitable estoppel doctrine, whether the promisor is living [*Juran v. Epstein (1994) 23 Cal. App. 4th 882, 897, 28 Cal. Rptr. 2d 588]* or dead [*Estate of Housley v. Haywood (1997) 56 Cal. App. 4th 342, 349–351, 357–358, 65 Cal. Rptr. 2d 628]*. Furthermore, a party may be estopped from asserting the statute of limitations as a defense to an untimely action to enforce an oral promise to make a will [*Battuello v. Battuello (1998) 64 Cal. App. 4th 842, 847–848, 75 Cal. Rptr. 2d 548* (appellant alleged sufficient facts to come within doctrine of equitable estoppel to assertion of one-year statute of limitations set forth in *Code Civ. Proc. § 366.2*, which applied because promisor made inter vivos transfer of property covered by contract); *accord*, *McMackin v. Ehrheart (2011) 194 Cal. App. 4th 128, 142, 122 Cal. Rptr. 3d 902* (equitable estoppel applied to assertion of statute of limitations set forth in *Code Civ. Proc. § 366.3*

concerning claim, which arose from oral promise by decedent, of entitlement to life estate in decedent's house)].

The complaint in § 140.106[1] may be modified to allege breach of a contract arising from, and the terms of which are governed by, the defendant's conduct or statement. For an affirmative defense asserting equitable estoppel to establish discharge of an obligation, see *Ch. 385, Negotiable Instruments*.

[9] Failure of Consideration Based on Failure to Perform

[a] In General

Failure of consideration is the failure to perform a promise, the performance of which has been exchanged for performance by the other party. In all executory contracts the several promises of the parties constitute to each, reciprocally, the consideration of the contract. A failure to perform constitutes a failure of consideration, either partial or total, within the meaning of *Civ. Code § 1689* (grounds for rescission of contract) [*Bliss v. California Coop. Producers (1947) 30 Cal. 2d 240, 248–249, 181 P.2d 369*; for discussion of partial failure, *see* [b], *below*].

The other party may invoke the failure as a basis for rescinding or terminating the contract, provided the failure or refusal to perform constitutes a breach in such an essential particular as to justify rescission or termination. The right of the aggrieved party to claim release from obligations and thus to elect to terminate the contract depends on the gravity of the breach [*Taliaferro v. Davis (1963) 216 Cal. App. 2d 398, 411–412, 31 Cal. Rptr. 164]*.

Failure of consideration, however, does not vitiate the contract from the beginning. Until rescinded or terminated, a contract once in effect remains in effect. This principle rests on the distinction that failure of consideration is based not on facts existing at the time the mutual promises in a bilateral contract are made, but on some fact or contingency that

occurs between the time of the making of the contract and the action that results in the material failure of performance by one party [*Taliaferro v. Davis (1963) 216 Cal. App. 2d 398, 411, 31 Cal. Rptr. 164*].

For an affirmative defense based on failure of consideration, see *§ 140.148[1]*.

[b] Partial Failure of Consideration

A failure of a part of a lawful consideration nullifies that part. However, because the amount of consideration is irrelevant, the court may nevertheless enforce the promise if there remains a substantial consideration [*Del Riccio v. Photochart (1954) 124 Cal. App. 2d 301, 312, 268 P.2d 814*]. Although an insubstantial failure of consideration does not give the other party the right to rescind the contract, it can be a basis for damages [*Hofland v. Gustafson (1955) 132 Cal. App. 2d Supp. 907, 909*]. A partial failure of consideration resulting from the willful failure of a party to perform a material part of the contract is sufficient, however, to justify the other party's rescission [*Bonadelle Construction Co. v. Hernandez (1959) 169 Cal. App. 2d 396, 399, 337 P.2d 85*].

[c] Substantial Performance

Substantial performance means that [*Bonadelle Construction Co. v. Hernandez (1959) 169 Cal. App. 2d 396, 399, 337 P.2d 85*]:

- There has been no willful departure from the terms of the contract;
- There has been no omission of any of its essential parts; and
- The performing party has in good faith performed all of the substantive terms of the contract.

The doctrine of substantial performance assumes the existence of a binding contract [*Rosenaur v. Pacelli (1959) 174 Cal. App. 2d 673, 677, 345 P.2d 102*]. The rule as to what constitutes substantial performance is indefinite, and the question must be determined in

each case with reference to the existing facts and circumstances [*Bonadelle Construction Co. v. Hernandez (1959) 169 Cal. App. 2d 396, 399, 337 P.2d 85*]. The defects in performance must be easily remedied or compensated, so that the other party may get almost what the contract called for [*Posner v. Grunwald-Marx, Inc. (1961) 56 Cal. 2d 169, 187, 14 Cal. Rptr. 297, 363 P.2d 313*]. For further discussion, see *Ch. 104, Building Contracts*.

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§ 140.24 Illegal Contracts

[1] What Makes Contract Illegal

The consideration and the object of a contract—that is, the thing the party receiving the consideration agrees to do or not to do [*Civ. Code § 1595*]—must be lawful. If either the consideration or the object of the contract is unlawful, the contract is illegal and may be unenforceable [*McIntosh v. Mills (2004) 121 Cal. App. 4th 333, 344, 346, 17 Cal. Rptr. 3d 66*]. A contract is illegal if the object or consideration is any of the following [*Civ. Code §§ 1596*, *1607*, *1109* & *1667*; *Diosdado v. Diosdado (2002) 97 Cal. App. 4th 470, 474, 118 Cal. Rptr. 2d 494* (contract between husband and wife providing for liquidated damages for infidelity held contrary to public policy); *Homami v. Iranzadi (1989) 211 Cal. App. 3d 1104, 1109–1111, 260 Cal. Rptr. 6*; *Green v. Mt. Diablo Hospital Dist. (1989) 207 Cal. App. 3d 63, 71, 254 Cal. Rptr. 689*; *Bovard v. American Horse Enterprises, Inc. (1988) 201 Cal. App. 3d 832, 838, 247 Cal. Rptr. 340*; *see Vick v. Patterson (1958) 158 Cal. App. 2d 414, 417, 322 P.2d 548*]:

- Contrary to an express provision of law;
- Contrary to the policy of express law, even though not expressly prohibited; or
- Otherwise contrary to good morals.

Whether a contract is illegal or contrary to public policy is a question of law to be determined from the circumstances of each particular case [*Jackson v. Rogers & Wells (1989) 210 Cal.*

App. 3d 336, 349–350, 258 Cal. Rptr. 454; *Kallen v. Delug (1984) 157 Cal. App. 3d 940, 951, 203 Cal. Rptr. 879]*.

For affirmative defenses asserting illegality, see *§ 140.143* (contract contrary to an express provision of law) and § 140.145 (contract contrary to public policy or good morals).

[2] Contrary to Law or Public Policy

Generally, a contract that is against public policy or against the mandate of a statute is void and may not be made the foundation of any action, either in law or in equity [*McIntosh v. Mills (2004) 121 Cal. App. 4th 333, 344, 17 Cal. Rptr. 3d 66*; *Homami v. Iranzadi (1989) 211 Cal. App. 3d 1104, 1109–1111, 260 Cal. Rptr. 6*; *South Tahoe Gas Co. v. Hofmann Land Improvement Co. (1972) 25 Cal. App. 3d 750, 756, 102 Cal. Rptr. 286*]. In determining whether the subject of a given contract violates public policy, courts must rely on the state of law as it existed at the time the contract was made [*Bovard v. American Horse Enterprises, Inc. (1988) 201 Cal. App. 3d 832, 840 n.3, 247 Cal. Rptr. 340*; *Moran v. Harris (1982) 131 Cal. App. 3d 913, 918, 182 Cal. Rptr. 519*].

Such illegal contracts include the following agreements for the sharing of attorney's fees:

- A contract for fee sharing between an attorney and a nonlawyer [*McIntosh v. Mills (2004) 121 Cal. App. 4th 333, 344, 17 Cal. Rptr. 3d 66* (unenforceable as contrary to rule of professional conduct)].
- A contract for fee-sharing between attorneys not in compliance with Cal. Rules Prof. Conduct, former Rule 2-200 [*now see* Rule 1.5.1], which prohibits fee-sharing between attorneys who are not partners, except by written client consent [*see Chambers v. Kay (2002) 29 Cal. 4th 142, 162–163, 126 Cal. Rptr. 2d 536, 56 P.3d 645* (Rule 2-200 was approved to protect public and promote respect and confidence in legal profession, and fee-sharing agreements not in compliance with that rule therefore are unenforceable); *Reeve v. Meleyco (2020) 46 Cal. App. 5th 1092, 1098–1100, 260 Cal. Rptr. 3d 457*

(under former Rule 2-200, client's written acknowledgment that he received and understood attorney's letter regarding origin of referral fee did not constitute written consent to referral fee agreement; thus, agreement was unenforceable); *Margolin v. Shemaria (2000) 85 Cal. App. 4th 891, 903, 102 Cal. Rptr. 2d 502* (attorney who made case referral to another attorney had no viable contract for sharing of fees that complied with Rule 2-200); *but see Huskinson & Brown, LLP v. Wolf (2004) 32 Cal. 4th 453, 464, 9 Cal. Rptr. 3d 693, 84 P.3d 379* (law firm was barred from recovering under fee-sharing agreement with another firm, in absence of written client consent to agreement required by Rule 2-200, but was entitled to recover from other firm in quantum meruit for reasonable value of services rendered on client's behalf)].

Other kinds of contracts that are illegal as violating a statute or public policy include the following:

- An agreement by which an heir hunter obtains an assignment authorizing the heir hunter to select and pay for an attorney, if there is any element of legal representation included in the contract or assignment, such as the heir hunter's being empowered to control litigation involving the inheritance in question [*Estate of Molino (2008) 165 Cal. App. 4th 913, 923, 81 Cal. Rptr. 3d 512* (void as against public policy)].

- An agreement for an agent to be compensated for procuring performance engagements for a singer, if the agent does not meet licensing requirements in the Talent Agencies Act, *Lab. Code § 1700 et seq.* [*Yoo v. Robi (2005) 126 Cal. App. 4th 1089, 1103, 24 Cal. Rptr. 3d 740* (agent's contract was void; defense of illegality based on public policy was not waived by failure to include it as affirmative defense, since legality was challenged in petition to Labor Commissioner, who found contract illegal and void)].

- An agreement for the establishment of a plant in Iran to manufacture computer products to be sold in Iran [*Kashani v. Tsann Kuen China Enterprise, Ltd. (2004) 118 Cal. App. 4th 531, 537, 13 Cal. Rptr. 3d 174* (unenforceable as illegal and against public policy

because it violated U.S. presidential executive orders and implementing regulations excluding U.S. persons from transactions relating to supply of technology to Iran)].

- A contract between spouses providing for liquidated damages for infidelity [*Diosdado v. Diosdado (2002) 97 Cal. App. 4th 470, 474, 118 Cal. Rptr. 2d 494* (contrary to public policy underlying no-fault provisions for dissolution of marriage)].

- A sperm bank's agreement with potential parents precluding disclosure of a donor's identity and other information under all circumstances [*Johnson v. Superior Court (2000) 80 Cal. App. 4th 1050, 1065–1067, 95 Cal. Rptr. 2d 864* (contrary to public policy and unenforceable, as *Fam. Code § 7613* permits disclosure of insemination records under certain circumstances); *but see Dunkin v. Boskey (2000) 82 Cal. App. 4th 171, 189–190, 98 Cal. Rptr. 2d 44* (agreement by unmarried couple to grant male partner paternity rights to child conceived by artificial insemination was not against public policy, and served rather than contravened family law policies to legitimate children and provide for their support)].

- A confidentiality clause in a settlement agreement that prohibits a securities dealer's customer from discussing the dealer's misconduct with regulatory authorities [*Cariveau v. Halferty (2000) 83 Cal. App. 4th 126, 138, 99 Cal. Rptr. 2d 417* (void and unenforceable as violation of public policy set forth in securities laws and regulations)].

[3] Taint of Partial Illegality

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 [*Civ. Code § 1608*]. Similarly, if a contract has a single object and that object is unlawful, either in whole or in part, the entire contract is void [*Civ. Code § 1598*; *see Yoo v. Jho (2007) 147 Cal. App. 4th 1249, 1251, 1256, 55 Cal. Rptr. 3d 243* (in view of illegal object of contract for sale of business dealing in

counterfeit goods, trial court erred in entertaining action and in awarding any relief, including attorney's fees; also holding that if parties fail to raise issue of contract's illegality, trial court should raise it *sua sponte* when evidence reveals probable illegality); *Bovard v. American Horse Enterprises, Inc. (1988) 201 Cal. App. 3d 832, 838, 247 Cal. Rptr. 340* (refusing to enforce notes given to purchase company that manufactured jewelry and drug paraphernalia)]. For the legal effect of a void contract, see *§ 140.10[6]*.

However, if the contract is only partially illegal, these rules apply only when the court otherwise determines that the contract is not severable [*see Keene v. Harling (1964) 61 Cal. 2d 318, 320, 324, 38 Cal. Rptr. 513, 392 P.2d 273]*. Thus, if the transaction is of a nature that the good part of the consideration can be separated from what is bad, courts make void only what is against the law and let the rest stand [*Birbrower, Montalbano, Condon & Frank v. Superior Court (1998) 17 Cal. 4th 119, 137–138, 140, 70 Cal. Rptr. 2d 304, 949 P.2d 1*; *Keene v. Harling (1964) 61 Cal. 2d 318, 320, 324, 38 Cal. Rptr. 513, 392 P.2d 273]*.

If the contract has several distinct objects, at least one of which is lawful, the contract is valid and enforceable as to the lawful object, provided the lawful object is clearly severable from the rest [*Civ. Code § 1599*; *Birbrower, Montalbano, Condon & Frank v. Superior Court (1998) 17 Cal. 4th 119, 137–138, 140, 70 Cal. Rptr. 2d 304, 949 P.2d 1*; *Symcox v. Zuk (1963) 221 Cal. App. 2d 383, 389, 34 Cal. Rptr. 462]*. *Civ. Code § 1599* authorizes, but does not require, a court to sever the illegal object of a contract from the legal object. The decision whether to sever the illegal object of a contract is informed by equitable considerations [*Yoo v. Robi (2005) 126 Cal. App. 4th 1089, 1105, 24 Cal. Rptr. 3d 740*; *see, e.g., Baeza v. Superior Court (Castle & Cooke Cal., Inc.) (2011) 201 Cal. App. 4th 1214, 1230–1231, 135 Cal. Rptr. 3d 557* (no abuse of discretion in trial court's enforcement of contract provisions requiring notice to home builder and opportunity to repair, despite possibility that other provision, limiting damages recoverable by homeowners on construction defect claims, was unlawful); *Chiba v. Greenwald (2007) 156 Cal. App. 4th 71, 81–82, 67 Cal. Rptr. 3d 86* (trial court, in refusing to order severance, correctly found that agreement's lawful and unlawful objects were

inextricably intertwined and correctly disregarded plaintiff's attempt, in second amended complaint, to allege separate consideration for each object, which allegation was inconsistent with two previous iterations of complaint)].

The principle of severability is not necessarily to be applied strictly as codified in *Civ. Code § 1599*; that is, solely when a contract "has several distinct objects, of which one at least is lawful." It can be possible for a contract to have only one object, which is lawful when considered in view of the contract alone; yet a party's performance under the contract could be either lawful or unlawful, depending on the circumstances of that performance. In such a case, the contract may be upheld as to the lawful performance and invalidated as to the unlawful performance, and this result would not be inconsistent with the principle of severability in *Civ. Code § 1599* [*see Greenlake Capital, LLC v. Bingo Invs., LLC (2010) 185 Cal. App. 4th 731, 740, 111 Cal. Rptr. 3d 82]*. For example, a contract called for plaintiff to provide various financing related services, none of which necessarily required plaintiff to have any license, and plaintiff in fact had no license. After plaintiff performed, the obligor refused to pay plaintiff's fee on ground that plaintiff's performance required a real estate broker's license and the contract therefore was illegal under *Bus. & Prof. Code §§ 10131* and *10136*. The court concluded that the contract was subject to the principle of severability. It appeared that at the inception of the relationship, neither party intended the financing to take a form that would necessarily violate *Bus. & Prof. Code § 10136*. Thus, a disputed issue of fact existed as to whether any of the services provided fell within the scope of *Bus. & Prof. Code § 10131* and, if so, whether the agreement should be enforced to the extent it was not barred by *Bus. & Prof. Code § 10136* [*see Greenlake Capital, LLC v. Bingo Invs., LLC (2010) 185 Cal. App. 4th 731, 740, 111 Cal. Rptr. 3d 82]*.

[4] Exculpatory Contract

Any contract that has for its object, directly or indirectly, to exempt anyone from responsibility for any of the following is against the policy of the law [*Civ. Code § 1668*; *see*

SI 59 LLC v. Variel Warner Ventures, LLC (2018) 29 Cal. App. 5th 146, 148, 239 Cal. Rptr. 3d 788 (§ 1668 negates contractual clause exempting party from responsibility for fraud or statutory violation only when some or all elements of tort are concurrent or future events at time contract is signed); *Neubauer v. Goldfarb (2003) 108 Cal. App. 4th 47, 54–57, 133 Cal. Rptr. 2d 218*; *Farnham v. Superior Court (1997) 60 Cal. App. 4th 69, 73, 70 Cal. Rptr. 2d 85*; *Blankenheim v. E.F. Hutton & Co. (1990) 217 Cal. App. 3d 1463, 1472–1473, 266 Cal. Rptr. 593* (negligent misrepresentation as species of fraud within meaning of *Civ. Code § 1668*)]:

- The person's own fraud;
- The person's own willful injury to the person or property of another; or
- The person's own violation of law, whether willful or negligent.

The plain language of *Civ. Code § 1668* shows that its provisions apply to "[a]ll contracts" the object of which is, directly or indirectly, to exempt "anyone" from responsibility for his or her "own fraud, or willful injury to the person or property of another, or violation of law"; therefore, no exculpatory provision in any contract can be invoked by anyone who claims to have the benefit of the provision (whether or not the person is a party to the contract), in order to avoid the legal consequences of the person's own fraud, willful injury of another, or violation of law [*Manderville v. PCG&S Group, Inc. (2007) 146 Cal. App. 4th 1486, 1501–1502, 55 Cal. Rptr. 3d 59* (defendant real estate broker could not invoke any exculpatory provisions of standard form CAR contract of sale between plaintiff and broker's client, to avoid liability for broker's intentional misrepresentation to plaintiff)].

For example, an agreement exculpating a child care provider from its own negligence is void as against public policy [*Gavin W. v. YMCA of Metropolitan Los Angeles (2003) 106 Cal. App. 4th 662, 671–674, 131 Cal. Rptr. 2d 168* (finding that contract involved public interest under criteria enumerated in *Tunkl v. Regents of University of California (1963) 60 Cal. 2d 92, 32 Cal. Rptr. 33, 383 P.2d 441*); *see § 140.145*]. A contractual clause prohibiting any recovery of damages (but not equitable relief) for any violation of statutory or regulatory law not made

part of the parties' contractual obligations was held invalid under *Civ. Code § 1668* [*Health Net of Cal., Inc. v. Dept. of Health Servs. (2003) 113 Cal. App. 4th 224, 226–227, 234–236, 6 Cal. Rptr. 3d 235* (extending settled interpretation of § 1668 with respect to violations of statutory law, to cover regulatory violations; contract involved public interest under *Tunkl*)]. A waiver of corporate directors' and majority shareholders' fiduciary duties to a minority shareholder in a private close corporation has been held to be against public policy and a clause purporting to effect such a waiver in a buy-sell agreement was held void [*Neubauer v. Goldfarb (2003) 108 Cal. App. 4th 47, 54–57, 133 Cal. Rptr. 2d 218]*.

However, *Civ. Code § 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, and does not bar either contractual indemnity or insurance [*see Benedek v. PLC Santa Monica, LLC (2002) 104 Cal. App. 4th 1351, 1358–1359, 129 Cal. Rptr. 2d 197* (express language of unambiguous release of health club from all premises liability applied to personal injuries unrelated to exercise suffered by member; release of premises liability in consideration of permission to enter recreational facilities does not violate public policy); *Farnham v. Superior Court (1997) 60 Cal. App. 4th 69, 74–75, 70 Cal. Rptr. 2d 85* (contractual limitation on liability of corporate directors for defamation was not incompatible with public policy so as to violate *Civ. Code § 1668*)].

An agreement made in the context of sports or recreational programs or services, purporting to release anyone from liability for future gross negligence, generally is unenforceable as a matter of public policy [*City of Santa Barbara v. Superior Court (Janeway) (2007) 41 Cal. 4th 747, 776–777, 62 Cal. Rptr. 3d 527, 161 P.3d 1095*; *Eriksson v. Nunnink (2011) 191 Cal. App. 4th 826, 855–857, 120 Cal. Rptr. 3d 90* (triable issues of fact existed relating to whether defendant's conduct, as trainer in equestrian competition, was grossly negligent and therefore outside scope of release)].

For further discussion of the validity or invalidity of exculpatory agreements, see *§ 140.145[4]* and *Ch. 380, Negligence*.

In the case of a contract between two businesses having equal bargaining power, when the only question is which of them should bear the risk of economic loss in the event of a particular mishap that both parties recognize could ensue, there is no reason for the courts to intervene and remake the parties' agreement in the light of *Civ. Code § 1668* [*CAZA Drilling (California), Inc. v. TEG Oil & Gas U.S.A., Inc. (2006) 142 Cal. App. 4th 453, 475, 48 Cal. Rptr. 3d 271*]. However, a contract provision limiting consequential damages in commercial transactions may be tested for legality under *Com. Code § 2719(3)* [*see generally Ch. 500, Sales: Sales Under the Commercial Code*] rather than under *Civ. Code § 1668* [*Nunes Turfgrass, Inc. v. Vaughan-Jacklin Seed Co. (1988) 200 Cal. App. 3d 1518, 1538–1539, 246 Cal. Rptr. 823*].

[5] Superficial Legality

Even though a contract is legal on its face, a party may introduce evidence to establish its illegal character. If the substance of the transaction is illegal, it does not matter when or how the illegality is raised. Whether the evidence comes from one side or the other, it is fatal to the case [*Homami v. Iranzadi (1989) 211 Cal. App. 3d 1104, 1112, 260 Cal. Rptr. 6* (plaintiff not entitled to recover after testifying he had oral agreement with defendant to collect interest secretly to evade tax law)].

When the parties are *in pari delicto*, this rule may leave the defendant with an unexpected benefit for the transaction. Nevertheless, the courts do not apply the rule to correct injustice between the parties, but out of regard for a higher interest, *i.e.*, that of the public, whose welfare demands that the courts discourage these transactions. Knowing they will receive no help from the courts may be a deterrent making parties less likely to enter into illegal agreements [*Homami v. Iranzadi (1989) 211 Cal. App. 3d 1104, 1112–1113, 260 Cal. Rptr. 6*].

[6] When Illegal Contract Is Enforceable

[a] In General

A contract that is illegal because its object is contrary to common standards of morality ("malum in se") will not be enforced, but a contract that is illegal merely because its object is in violation of a statute ("malum prohibitum") may be enforceable, in spite of its illegality, by a party who is not in pari delicto [*McIntosh v. Mills (2004) 121 Cal. App. 4th 333, 344 n.10, 17 Cal. Rptr. 3d 66* (refusing enforcement); *see Wong v. Tenneco, Inc. (1985) 39 Cal. 3d 126, 136–138, 216 Cal. Rptr. 412, 702 P.2d 570* (refusing enforcement); *Shenson v. Fresno Meat Packing Co. (1950) 96 Cal. App. 2d 725, 731, 216 P.2d 156* (refusing enforcement); *see also California Physicians' Serv. v. Aoki Diabetes Research Inst. (2008) 163 Cal. App. 4th 1506, 1516–1517, 78 Cal. Rptr. 3d 646* (while health care provider's contract with service plan was illegal because it violated statutory prohibition on corporate practice of medicine, that prohibition is meant to protect patients, not service plans, and contract for provision of medical services by licensed professionals plainly is not malum in se; service plan would have been unjustly enriched if it had been allowed to retain benefit of services that provider bestowed on its subscribers without compensating provider, and contract therefore was enforceable to extent of compensating provider for services rendered; court did not discuss parties' relative culpability)].

Whether an illegal contract should be enforced, the extent of enforceability, and the kind of remedy the court should allow depend on a variety of factors, including the policy of the transgressed law, the kind of illegality, and the particular facts [*Asdourian v. Araj (1985) 38 Cal. 3d 276, 292, 211 Cal. Rptr. 703, 696 P.2d 95]*. For example, the court should not refuse to enforce the contract if the following conditions are met [*Wald v. TruSpeed Motorcars, LLC (2010) 184 Cal. App. 4th 378, 390–393, 108 Cal. Rptr. 3d 542* (car dealer subject to suit on unlicensed salesperson's claim for compensation pursuant to oral agreement); *Johnson v. Johnson (1987) 192 Cal. App. 3d 551, 557–558, 237 Cal. Rptr. 644* (resulting trust awarded); *Emmons, Williams, Mires & Leech v. State Bar (1970) 6 Cal. App. 3d 565, 569, 86 Cal. Rptr. 367* (attorney fee-sharing agreement enforced in favor of

bar association's attorney referral service); *Cain v. Burns (1955) 131 Cal. App. 2d 439, 442, 280 P.2d 888* (attorney fee-sharing agreement enforced in favor of relatively innocent private investigator who had performed work)]:

- The public policy underlying the statute, regulation, or rule will not be affected in view of the circumstances of the particular transaction;
- The public cannot be protected because the transaction has been completed;
- No serious moral turpitude is involved;
- The defendant is the one guilty of the greater moral fault; and
- The defendant would otherwise be unjustly enriched at the expense of the plaintiff.

Similarly, if the illegality of a bargain is due to facts of which one party is justifiably ignorant and the other party is not, the court may grant the ignorant party relief [*Tiedje v. Aluminum Taper Milling Co. (1956) 46 Cal. 2d 450, 454, 296 P.2d 554]*.

[b] Plaintiff in Class Protected by Law

If the policy of the law violated by the contract was designed for the plaintiff's protection, the court may enforce the contract. When the Legislature enacts a statute forbidding conduct to protect one class of persons from the activities of another, a member of the protected class may maintain an action for breach of contract, notwithstanding the fact that that party shared in the illegal transaction. The protective purpose of the legislation is realized by allowing the plaintiff who is not *in pari delicto* to maintain the action against the defendant who is within the class primarily to be deterred [*Lewis & Queen v. N.M. Ball Sons (1957) 48 Cal. 2d 141, 153, 308 P.2d 713]*.

[c] Unfairly Harsh Result

In some cases a statute making conduct illegal may provide for a fine or administrative discipline and exclude by implication the additional penalty involved in holding the illegal

contract unenforceable. In others, the forfeiture resulting from unenforceability is disproportionately harsh considering the nature of the illegality [*M. Arthur Gensler, Jr., & Associates, Inc. v. Larry Barrett, Inc. (1972) 7 Cal. 3d 695, 702–703, 103 Cal. Rptr. 247, 499 P.2d 503]*.

Courts may provide a remedy despite a contract's illegality if the wrong involved is *malum prohibitum* (wrong because prohibited by law) and not *malum in se* (wrong in itself). In the former case, courts will take notice of the circumstances and give relief if justice and equity require a restoration of money received by either party [*Smith v. Bach (1920) 183 Cal. 259, 263, 191 P. 14]*. The principle is usually applied to aid one not *in pari delicto* but to some extent involved in the illegality, who is comparatively less culpable [*South Tahoe Gas Co. v. Hofmann Land Improvement Co. (1972) 25 Cal. App. 3d 750, 758, 102 Cal. Rptr. 286]*.

[7] Secret Intent to Violate Law

A secret intent to violate the law, concealed in the mind of one party to an otherwise legal contract, does not enable that party to avoid the contract and escape liability under its terms [*Griffin v. Payne (1933) 133 Cal. App. 363, 373, 24 P.2d 370* (appellant unable to avoid margin contract despite intent to gamble on stock market when intent was not disclosed to brokers during time appellant was trading through them)]. In addition, a contract legal in itself is not rendered unenforceable by the fact that one of the parties knew that the other party intended, by means of the contract or the subject matter, to violate a law or public policy [*People v. Brophy (1942) 49 Cal. App. 2d 15, 30, 120 P.2d 946* (contract between appellant and telephone company was enforceable despite company's knowledge of appellant's use of telephones for illegal purposes)].

An agreement that is legal when standing by itself, but is merely a step intended for the accomplishment of an illegal object, is illegal. Thus, if the effect of the contract is to accomplish an unlawful purpose, the court will declare the agreement illegal regardless of the

intention of the parties [*Stockton Morris Plan Co. v. California Tractor & Equip. Corp. (1952) 112 Cal. App. 2d 684, 689–690, 247 P.2d 90*].

[8] Rescission and Restitution

The rule against enforcement of an unlawful contract should not defeat a party's claim for restitution after rescission of an unlawful contract, assuming that the money or property to be restored was lawfully in the claimant's possession when it was transferred pursuant to the contract, and assuming that the claimant's transfer of that money or property to the other party was not illegal at the time it occurred. Public policy favors the repudiation of unlawful contracts, and the principles of equity disfavor allowing unjust enrichment through forfeiture [*Kyablue v. Watkins (2012) 210 Cal. App. 4th 1288, 1295, 149 Cal. Rptr. 3d 156*]. For discussion of restitution claims generally, see *Ch. 490, Rescission and Restitution*.

[9] Non-Disparagement Clause in Consumer Contract

A contract or proposed contract for the sale or lease of consumer goods or services may not include a provision waiving the consumer's right to make any statement regarding the seller or lessor or its employees or agents, or concerning the goods or services [*Civ. Code § 1670.8(a)(1)*]. It is unlawful to threaten or to seek to enforce a provision made unlawful under *Civ. Code § 1670.8*, or to otherwise penalize a consumer for making any statement protected under that section [*Civ. Code § 1670.8(a)(2)*]. Any waiver of the provisions of *Civ. Code § 1670.8* is contrary to public policy, and is void and unenforceable [*Civ. Code § 1670.8(b)*].

A consumer or public prosecutor may recover a civil penalty for violation of *Civ. Code § 1670.8* [*Civ. Code § 1670.8(c)*, *(d)*]. The penalty is not an exclusive remedy and does not affect any other relief or remedy provided by law [*Civ. Code § 1670.8(e)*].

Civ. Code § 1670.8 does not prohibit or limit a person or business that hosts online consumer reviews or comments from removing a statement that is otherwise lawful to remove [*Civ. Code § 1670.8(e)*].

[10] Forced Concealment of Criminal Conduct or Sexual Harassment

Notwithstanding any other law, a provision in a contract or settlement agreement entered into after 2019 is void and unenforceable if the provision waives a party's right to testify in an administrative, legislative, or judicial proceeding concerning alleged criminal conduct or alleged sexual harassment on the part of the other party to the contract or settlement agreement, or on the part of the agents or employees of the other party, when the party whose testimony is sought has been required or requested to attend the proceeding pursuant to a court order, subpoena, or written request from an administrative agency or the Legislature [*Civ. Code § 1670.11*].

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§ 140.25 Unconscionable Contract

[1] Nature of Unconscionability

[a] Procedural and Substantive Unconscionability

Unconscionability generally includes the absence of meaningful choice on the part of one of the parties together with contract terms that unreasonably favor the other party [*Allan v. Snow Summit, Inc. (1996) 51 Cal. App. 4th 1358, 1376–1377, 59 Cal. Rptr. 2d 813*; *Carboni v. Arrospide (1991) 2 Cal. App. 4th 76, 82–83, 2 Cal. Rptr. 2d 845*; *West v. Henderson (1991) 227 Cal. App. 3d 1578, 1586, 278 Cal. Rptr. 570]*.

An unconscionable contract ordinarily involves both a procedural and a substantive element: (1) oppression or surprise due to unequal bargaining power, and (2) overly harsh or one-sided results [*Donovan v. RRL Corp. (2001) 26 Cal. 4th 261, 291–292, 109 Cal. Rptr. 2d 807, 27 P.3d 702* (citing *Armendariz*); *Armendariz v. Foundation Health Psychcare Servs. (2000) 24 Cal. 4th 83, 113–114, 99 Cal. Rptr. 745, 6 P.3d 669* (reversing order compelling arbitration in wrongful termination action brought under FEHA); *Chen v. Paypal, Inc. (2021) 61 Cal. App. 5th 559, 578–580, 275 Cal. Rptr. 3d 767* (reiterating that unconscionability involves more than bad bargain, hence courts' use of intensifiers such as "overly" harsh, "unduly" oppressive); *Dougherty v. Roseville Heritage Partners (2020) 47 Cal. App. 5th 93, 107, 260 Cal. Rptr. 3d 580* (arbitration agreement in care home admission documents held to be procedurally and substantively unconscionable); *Lopez v.*

Bartlett Care Center, LLC (2019) 39 Cal. App. 5th 311, 320–322 (arbitration agreement signed by daughter for nursing home resident found to be both procedurally and substantively unconscionable); *Crippen v. Central Valley RV Outlet, Inc. (2004) 124 Cal. App. 4th 1159, 1164*; *Villa Milano Homeowners Association v. Il Davorge (2000) 84 Cal. App 4th 819, 828–829, 102 Cal. Rptr. 2d 1* (arbitration clause contained in CC&Rs was unconscionable adhesion contract and unenforceable to the extent it applied to construction and design defect claims against developer who drafted, signed, and recorded CC&Rs)]. Both elements must appear to invalidate a contract or one of its individual terms. These elements, however, need not be present in the same degree. The more substantively oppressive the contract term, the less evidence of procedural unconscionability is required to conclude that the term is unenforceable, and vice versa [*Armendariz v. Foundation Health Psychcare Servs. (2000) 24 Cal. 4th 83, 114, 6 P.3d 669*; *Crippen v. Central Valley RV Outlet, Inc. (2004) 124 Cal. App. 4th 1159, 1164–1165, 22 Cal. Rptr. 3d 189*; *Freeman v. Wal-Mart Stores, Inc. (2003) 111 Cal. App. 4th 660, 669, 3 Cal. Rptr. 3d 860* (service fee on shopping card held not unconscionable); *Woodside Homes v. Superior Court (2003) 107 Cal. App. 4th 723, 730, 736, 132 Cal. Rptr. 2d 35* (low level of procedural unconscionability required high level of substantive unconscionability; agreements for judicial reference held enforceable)].

The party asserting unconscionability has the burden of proving both procedural and substantive unconscionability [*Swain v. LaserAway Medical Group, Inc. (2020) 57 Cal. App. 5th 59, 67, 270 Cal. Rptr. 3d 787* (plaintiff met burden of showing that arbitration agreement signed on electronic tablet before receiving laser hair removal treatment was procedurally and substantively unconscionable); *Crippen v. Central Valley RV Outlet, Inc. (2004) 124 Cal. App. 4th 1159, 1165, 22 Cal. Rptr. 3d 189*; *accord Walnut Producers of Cal. v. Diamond Foods, Inc. (2010) 187 Cal. App. 4th 634, 646–650, 114 Cal. Rptr. 3d 449* (class action waiver in agreement between walnut producers and buying corporation was not unconscionable because producers did not have inferior bargaining power, were not

compelled by circumstances to make that agreement, could not claim to have been surprised by class action waiver since that provision was not hidden or obscured in agreement, and could not show substantive unconscionability)].

"The procedural element focuses on two factors: oppression and surprise. Oppression arises from an inequality of bargaining power which results in no real negotiation and an absence of meaningful choice … . Surprise involves the extent to which the terms of the bargain are hidden in a 'prolix printed form' drafted by a party in a superior bargaining position" [*Crippen v. Central Valley RV Outlet, Inc. (2004) 124 Cal. App. 4th 1159, 1165, 22 Cal. Rptr. 3d 189*, quoting *Olsen v. Breeze, Inc. (1996) 48 Cal. App. 4th 608, 621, 55 Cal. Rptr. 2d 818*; *see, e.g.*, *Fisher v. MoneyGram International, Inc. (2021) 66 Cal. App. 5th 1084, 1089–1090, 281 Cal. Rptr. 3d 771* (finding arbitration provision unconscionable largely because it was hidden on back of money transfer order form in 6-point type, deemed virtually illegible)]. There is no general rule that a form contract is procedurally unconscionable. Rather, procedural unconscionability arises from the manner in which the contract is presented to the party in the weaker position [*Crippen v. Central Valley RV Outlet, Inc. (2004) 124 Cal. App. 4th 1159, 1165, 22 Cal. Rptr. 3d 189*; *accord*, *Lhotka v. Geographic Expeditions, Inc. (2010) 181 Cal. App. 4th 816, 824, 104 Cal. Rptr. 3d 844* (by showing that defendant presented its contract as both nonnegotiable and not different from contract that would be presented by any other provider of guided hiking expeditions, plaintiff established minimal level of oppression to justify finding of procedural unconscionability)].

No extrinsic evidence of procedural unconscionability is required if a great disparity of power can be inferred from the parties' relationship or from the contract itself [*Crippen v. Central Valley RV Outlet, Inc. (2004) 124 Cal. App. 4th 1159, 1165, 22 Cal. Rptr. 3d 189* (unconscionability could not be inferred from the relationship between a consumer and a motor home dealer)]. For example, oppression may be inferred in the employment context because generally only the most sought-after employees are in a position to refuse a job if

the employer requires an arbitration agreement [*Crippen v. Central Valley RV Outlet, Inc. (2004) 124 Cal. App. 4th 1159, 1165, 22 Cal. Rptr. 3d 189*; *see* *Armendariz v. Foundation Health Psychcare Servs., Inc. (2000) 24 Cal. 4th 83, 115, 99 Cal. Rptr. 2d 745*; *Subcontracting Concepts (CT), LLC v. DeMelo (2019) 34 Cal. App. 5th 201, 208, 245 Cal. Rptr. 3d 838* (finding arbitration clause in employment agreement both procedurally and substantively unconscionable); *O'Hare v. Municipal Res. Consultants (2003) 107 Cal. App. 4th 267, 283, 132 Cal. Rptr. 2d 116]*.

Surprise may be found if a contract merely refers to rules set forth in another source that the customer would have to see prior to signing in order to learn the full import of the contract [*Crippen v. Central Valley RV Outlet, Inc. (2004) 124 Cal. App. 4th 1159, 1165, 22 Cal. Rptr. 3d 189*; *see* *Harper v. Ultimo (2003) 113 Cal. App. 4th 1402, 1406, 7 Cal. Rptr. 3d 418* (contract unconscionable because it incorporated terms not attached and those terms both required arbitration and severely limited damages)].

A provision is substantively unconscionable if it is so one-sided as to "shock the conscience" or imposes harsh or oppressive terms [*24 Hour Fitness, Inc. v. Superior Court (1998) 66 Cal. App. 4th 1199, 1213, 78 Cal. Rptr. 2d 533]*. Those concepts—harshness, oppression, and "shocking to the conscience"—are not synonymous with "unreasonable." Basing an unconscionability determination on the unreasonableness of a contract provision would inject an inappropriate level of judicial subjectivity into the analysis [*Morris v. Redwood Empire Bancorp (2005) 128 Cal. App. 4th 1305, 1322, 27 Cal. Rptr. 3d 797]*. With a concept as nebulous as "unconscionability" it is important that a court not intervene to change contract terms that the parties have agreed to, merely because the court believes the terms are unreasonable; rather, the terms must "shock the conscience" [*American Software, Inc. v. Ali (1996) 46 Cal. App. 4th 1386, 1391, 54 Cal. Rptr. 2d 477]*.

In the context of an arbitration agreement, the agreement is unconscionable unless there is a "modicum of bilaterality" in the arbitration remedy [*O'Hare v. Municipal Resource Consultants (2003) 107 Cal. App. 4th 267, 273–274, 132 Cal. Rptr. 2d 116* (citing

Armendariz; finding mandatory arbitration provision procedurally and substantively unconscionable); *Flores v. Transamerica Homefirst, Inc. (2001) 93 Cal. App. 4th 846, 853–855, 113 Cal. Rptr. 2d 376* (citing *Armendariz*; finding arbitration provisions procedurally and substantive unconscionable); *Armendariz v. Foundation Health Psychcare Servs. (2000) 24 Cal. 4th 83, 117, 6 P.3d 669]*. The kind of arbitration provision that is so one-sided as to be substantively unconscionable is one that, rather than providing a neutral forum for dispute resolution, actually provides a strong disincentive for the weaker party to pursue any claim in any forum [*Lhotka v. Geographic Expeditions, Inc. (2010) 181 Cal. App. 4th 816, 825, 104 Cal. Rptr. 3d 844* (arbitration provision "guaranteed that plaintiffs could not possibly obtain anything approaching full recompense for their harm" because maximum recovery was limited to price plaintiffs paid for hiking expedition, remedy was restricted to mediation and arbitration in city far from plaintiffs' home, plaintiffs were required to share cost of mediation and to indemnify defendant for defense costs if plaintiffs sued instead of pursuing arbitration, and defendant was not subject to reciprocal limitation on recovery or reciprocal indemnification obligation)].

Another kind of substantively unconscionable provision in the context of an arbitration agreement occurs when the party imposing arbitration mandates a post-arbitration proceeding, either judicial or arbitral, wholly or largely to its benefit at the expense of the party on which the arbitration is imposed [*Little v. Auto Stiegler (2003) 29 Cal. 4th 1064, 1072–1074, 1076, 130 Cal. Rptr. 2d 892, 63 P.3d 979* (finding provision in mandatory employment arbitration agreement that permitted either party to appeal arbitration award of more than $50,000 to second arbitrator to be unconscionable, but concluding that provision could be severed and rest of agreement enforced)].

The courts have recognized that there is a sliding scale or a balancing relationship between the two elements of unconscionability. The greater the degree of unfair surprise or unequal bargaining power, the less the degree of substantive unconscionability required to annul the contract, and vice versa [*Davis v. Kozak (2020) 53 Cal. App. 5th 897, 905, 267 Cal.*

Rptr. 3d 927; *Crippen v. Central Valley RV Outlet, Inc. (2004) 124 Cal. App. 4th 1159, 1165, 22 Cal. Rptr. 3d 189*; *Harper v. Ultimo (2003) 113 Cal. App. 4th 1402, 1406, 7 Cal. Rptr. 3d 418* (finding arbitration provision in construction contract to be both procedurally and substantively unconscionable); *Marin Storage & Trucking, Inc. v. Benco Contracting and Engineering, Inc. (2001) 89 Cal. App. 4th 1042, 1056, 107 Cal. Rptr. 2d 645* (in light of low level of procedural unfairness in adhesion contract containing indemnity clause, greater degree of substantive unfairness than that shown was required before contract could be found substantively unconscionable)]. Because procedural unconscionability must be measured on a sliding scale with substantive unconscionability, it is necessary not only to determine whether procedural unconscionability exists but also, and more important, to ascertain in what degree it may exist [*Morris v. Redwood Empire Bancorp (2005) 128 Cal. App. 4th 1305, 1319, 27 Cal. Rptr. 3d 797]*.

These rules are intended to make it possible for the courts to police explicitly against the contracts or clauses they find to be unconscionable. In the past, such policing has been accomplished largely by adverse construction of language, manipulation of the rules of offer and acceptance, or determinations that the clause is contrary to public policy or to the dominant purpose of the contract. Now, under these rules, a court may pass directly on the unconscionability of the contract or a particular clause and make a conclusion of law as to its unconscionability. The basic test is whether, in light of the general background and the needs of the particular case, the clauses involved are so one-sided as to be unconscionable under the circumstances existing at the time of the making of the contract. The principle is one of prevention of oppression and unfair surprise, without disturbance of the allocation of risks because of superior bargaining power [Legislative Committee Comment to *Civ. Code § 1670.5*].

For discussion of unconscionability as a defense to an action for breach of contract, see *§ 140.64*.

[b] Unenforceable Contract of Adhesion

A contract of adhesion is a standardized contract imposed and drafted by the party of superior bargaining strength. It relegates to the subscribing party only the opportunity to adhere to the contract or reject it [*Stirlen v. Supercuts, Inc. (1997) 51 Cal. App. 4th 1519, 1533–1534, 60 Cal. Rptr. 2d 138]*. A court will not enforce a contract of adhesion if it is unduly oppressive or unconscionable or if its terms are not within the reasonable expectation of the weaker or adhering party [*Pardee Construction Company v. Superior Court (2002) 100 Cal. App. 4th 1081, 1086–1087, 123 Cal. Rptr. 2d 288* (real estate purchase agreements requiring all disputes to be submitted to judicial reference were adhesive contracts fatally infected with procedural and substantive unconscionability); *Allan v. Snow Summit, Inc. (1996) 51 Cal. App. 4th 1358, 1375–1376, 59 Cal. Rptr. 2d 813*; *Graham v. Scissor-Tail, Inc. (1981) 28 Cal. 3d 807, 820, 171 Cal. Rptr. 604, 623 P.2d 165*; *Izzi v. Mesquite Country Club (1986) 186 Cal. App. 3d 1309, 1317–1318, 231 Cal. Rptr. 315*; *see Armendariz v. Foundation Health Psychcare Services, Inc. (2000) 24 Cal. 4th 83, 113–114, 99 Cal. Rptr. 2d 745, 6 P.3d 669* (reversing order compelling arbitration in wrongful termination action brought under FEHA); *Villa Milano Homeowners Assn. v. IL Davorge (2000) 84 Cal. App. 4th 819, 835–836, 102 Cal. Rptr. 2d 1* (arbitration clause contained in CC&Rs was unconscionable adhesion contract and unenforceable to extent it applied to construction and design defect claims against developer who drafted, signed, and recorded CC&Rs)].

Use of a standardized form does not of itself make a contract an unconscionable adhesion contract. Even if a contract is adhesive, the court applies a sliding scale. There must be some showing of substantive unconscionability [*Soltani v. Western & Southern Life Insurance Co. (9th Cir. 2001) 258 F.3d 1038, 1042–1045* (holding that employment contract provision shortening limitations period for wrongful termination action to six months was not unconscionable); *see Epstein v. Vision Service Plan (2020) 56 Cal. App. 5th 223, 228, 270 Cal. Rptr. 3d 239* (although arbitration provision in form agreement was

procedurally unconscionable in minor respects, plaintiff failed to establish substantive unconscionability); *Diaz v. Sohnen Enterprises (2019) 34 Cal. App. 5th 126, 131–132, 245 Cal. Rptr. 3d 827* (trial court's finding that arbitration contract was adhesive was not sufficient to demonstrate that agreement was unenforceable; record contained no evidence of surprise or sharp practices indicating substantive unconscionability)]. The test for unconscionability is whether the stronger party has disappointed the reasonable expectations of the other party [*Coon v. Nicola (1993) 17 Cal. App. 4th 1225, 1234, 1235, 21 Cal. Rptr. 2d 846]*. Adhesion, however, is not a prerequisite for unconscionability [*Harper v. Ultimo (2003) 113 Cal. App. 4th 1402, 1406, 7 Cal. Rptr. 3d 418* (finding arbitration provision in construction contract to be both procedurally and substantively unconscionable)]. For discussion of interpretation of contracts of adhesion, see *§ 140.32[12][c]*.

[2] Facts Indicating Unconscionability

[a] Arbitration Clause in Contract

An arbitration clause in an employment contract may be unconscionable according to the mores and business practices of the time and place of execution, if the contract provides the employer more rights and greater remedies than would otherwise be available and concomitantly deprives employees of significant rights and remedies they would normally enjoy, when the contract is considered in light of the commercial context in which it operates and the legitimate needs of the parties at the time the parties entered into it [*Stirlen v. Supercuts, Inc. (1997) 51 Cal. App. 4th 1519, 1542, 60 Cal. Rptr. 2d 138*; *see Bolter v. Superior Court (2001) 87 Cal. App. 4th 900, 910–911* ("place and manner" arbitration clauses in franchise agreement found unconscionable and clearly severable from remainder of agreement)]. Further, the Federal Arbitration Act [*9 U.S.C. § 1 et seq.*] would not preclude a court from finding that the arbitration clause was unconscionable and

unenforceable [*Stirlen v. Supercuts, Inc. (1997) 51 Cal. App. 4th 1519, 1552, 60 Cal. Rptr. 2d 138]*, as long as enforcement of the unconscionability rules would not interfere with fundamental attributes of arbitration [*Sonic-Calabasas A, Inc. v. Moreno (2013) 57 Cal. 4th 1109, 1124–1125, 163 Cal. Rptr. 3d 269, 311 P.3d 184*; *see also OTO, L.L.C. v. Kho (2019) 8 Cal. 5th 111, 251 Cal. Rptr. 3d 714, 447 P.3d 680* (even if litigation-like arbitration procedure may be acceptable substitute for *Berman* wage-dispute hearing in other circumstances, oppressive circumstances at issue involving high degree of procedural unconscionability rendered arbitration agreement unenforceable)].

However, an arbitration clause is not necessarily unconscionable simply because it is in an employment agreement, even though an employee seldom has as much bargaining power as the employer [*see* [d], *below*]. An arbitration clause can be enforceable by the employer if it is written so that an employee would understand it, and the employee in fact read it before signing the agreement, and if the clause neither gives greater power to the employer nor deprives the employee alone of important rights [*see Roman v. Superior Court (Flo-Kem, Inc.) (2009) 172 Cal. App. 4th 1462, 1470–1476, 92 Cal. Rptr. 3d 153* (arbitration clause, which employee initialed, was in short agreement and applied to "all disputes" relating to employee's employment; clause did not reserve any rights solely to employer, did not impose undue limitation on discovery by employee, and did not limit administrative remedies available to employee under state law); *see also Alvarez v. Altamed Health Services Corp. (2021) 60 Cal. App. 5th 572, 589, 596, 274 Cal. Rptr. 3d 802* (arbitration provisions in employment agreement contained only limited procedural unconscionability and only one substantively unconscionable provision, which was severable pursuant to severability clause); *Torrecillas v. Fitness Internat., LLC (2020) 52 Cal. App. 5th 485, 488–489, 266 Cal. Rptr. 3d 181* (arbitration provisions in employment agreement contained little or no procedural or substantive unconscionability; employer advised employee to seek legal advice before signing and employee had opportunity to negotiate terms); *but cf., e.g., Olvera v. El Pollo Loco, Inc. (2009) 173 Cal. App. 4th 447,*

455–457, 93 Cal. Rptr. 3d 65 (employer's attempt to force arbitration of employees' claims failed because purported agreement to arbitrate was based on procedurally and substantively unconscionable contents of employee manual)].

An arbitration agreement might contain a provision that, in so many words, does nothing more than restate existing law. If, as a practical matter, that provision might usually favor the party in the stronger bargaining position, it would not *unreasonably* favor that party—that party would have the benefit of the underlying law in any event—and therefore such a provision would not render the agreement unconscionable [*see Baltazar v. Forever 21, Inc. (2016) 62 Cal. 4th 1237, 1241, 1247–1248, 200 Cal. Rptr. 3d 7, 367 P.3d 6* (employer-employee arbitration agreement provided that if claim proceeded to arbitration, either party could seek preliminary injunctive relief in court; that provision did no more than restate existing law in *Code Civ. Proc. § 1281.8(b)*, wherefore that provision did not unreasonably favor employer and did not render agreement unconscionable)].

In *Armendariz v. Foundation Health Psychcare Services, Inc.*, a pre-employment arbitration "agreement" was found to be one-sided and thus unconscionable and unenforceable when it (1) contained limitations on remedies that the employee could obtain, (2) contained oppressive cost provisions requiring the employee to bear expenses that he or she would not be required to bear if the action could be brought in court, and (3) inherently favored the employer without some reasonable justification for that lack of mutuality. The California Supreme Court stated that such multiple defects indicated a systematic effort to impose arbitration on an employee not simply as an alternative to litigation, but as an inferior forum that works to the employer's advantage. Because courts are unable to cure this unconscionability through severance or restriction and are not permitted to cure it through reformation and augmentation, they must void the entire agreement [*Armendariz v. Foundation Health Psychcare Services, Inc. (2000) 24 Cal. 4th 83, 124–125, 99 Cal. Rptr. 2d 745, 6 P.3d 669* (reversing order compelling arbitration in wrongful termination action brought under FEHA); *see Cabatit v. Sunnova Energy Corp.*

(2020) 60 Cal. App. 5th 317, 325, 274 Cal. Rptr. 3d 720 (significant procedural unconscionability combined with unjustifiable one-sidedness of arbitration clause supported trial court's exercise of discretion to deny enforcement); *Ali v. Daylight Transport, LLC (2020) 59 Cal. App. 5th 462, 481–482, 273 Cal. Rptr. 3d 544* (arbitration clause had moderate level of procedural unconscionability and three substantively unconscionable terms; there was no single provision court could strike to remove unconscionability from agreement); *Davis v. Kozak (2020) 53 Cal. App. 5th 897, 918, 267 Cal. Rptr. 3d 927* (arbitration agreement with low level of procedural unconscionability but high degree of substantive unconscionability with multiple defects including lack of mutuality held to be unenforceable); *Davis v. TWC Dealer Group Inc. (2019) 41 Cal. App. 5th 662, 674–675, 254 Cal. Rptr. 3d 443* (arbitration agreement was both procedurally and substantively unconscionable, with fine-print terms, lack of mutuality, three inconsistent arbitration provisions, and provisions that violated public policy); *Subcontracting Concepts (CT), LLC v. DeMelo (2019) 34 Cal. App. 5th 201, 208, 245 Cal. Rptr. 3d 838* (finding arbitration clause in non-native English speaker's employment agreement to be both procedurally and substantively unconscionable; agreement was so permeated with unconscionability that severance was not possible); *Ramos v. Superior Court (2018) 28 Cal. App. 5th 1042, 1069, 239 Cal. Rptr. 3d 679* (provisions in law partnership arbitration agreement that required plaintiff to pay half the costs of arbitration, to pay her own attorney's fees, restricted ability of arbitrators to override judgment of partnership, and confidentiality clause were unconscionable; agreement was void as court could not strike those clauses to cure unconscionability); *Zullo v. Superior Court (Inland Valley Publ'g Co.) (2011) 197 Cal. App. 4th 477, 487–488, 127 Cal. Rptr. 3d 461* (same: employer's arbitration policy, stated in employment handbook, was procedurally unconscionable because it was contract of adhesion and no arbitration rules were attached; it was substantively unconscionable because it was one-sided and harsh; severance was not appropriate because no single provision could be struck to remove unconscionability of

policy that applied only to employees); *Pinedo v. Premium Tobacco Stores, Inc. (2000) 85 Cal. App. 4th 774, 780–781* (affirming order denying arbitration in action brought under FEHA); *see also Blake v. Ecker (2001) 93 Cal. App. 4th 728, 740–743, 113 Cal. Rptr. 2d 422* (citing principles set forth in *Armendariz* and remanding case to trial court to determine whether *Armendariz* applied to make parties' arbitration agreement unenforceable)]. This same reasoning was used by a federal court in determining that an employment contract provision requiring 10 days written notice to the employer as a prerequisite to filing suit was unenforceable. The court found that, as in *Armendariz*, the effect of the provision was to maximize employer advantage without reasonable justification for that arrangement. The failure to comply with the provision deprived an employee of a judicial forum and its concomitant rights [*Soltani v. Western & Southern Life Insurance Co. (9th Cir. 2001) 258 F.3d 1038, 1045–1047]*.

In another case, in which arbitration provisions in a reverse mortgage agreement were found to be both procedurally and substantively unconscionable, the court followed *Armendariz* in refusing to sever the invalid arbitration provisions. Because it was faced with an arbitration agreement in which no single provision could be stricken to remove the unconscionable taint, the court affirmed the trial court's order denying the lender's motion to compel arbitration [*Flores v. Transamerica Homefirst, Inc. (2001) 93 Cal. App. 4th 846, 857–858, 113 Cal. Rptr. 2d 376]*. Similarly, in a case in which the court found the provisions of an arbitration agreement between a securities corporation and its sales personnel to be both substantively and procedurally unconscionable, the court cited *Armendariz* in holding that the arbitration agreement was unenforceable. Because the contract was permeated with unconscionability and illegality, the court could not cure it by removing the offending provisions [*Mercuro v. Superior Court (2002) 96 Cal. App. 4th 167, 184–186*; *see also Bakersfield College v. California Community College Athletic Assn. (2019) 41 Cal. App. 5th 753, 769–770, 254 Cal. Rptr. 3d 470* (procedural unconscionability coupled with substantive unconscionability rendered arbitration

agreement so permeated by unconscionability that it could be saved, if at all, only by reformation beyond court's authority; citing *Mercuro*)].

An investment company's standard-form customer account agreement requiring customers to arbitrate disputes before a panel of three arbitrators from the Judicial Arbitration and Mediation Service and prohibiting consolidation or joinder of claims was so prohibitively expensive as to be unconscionable. The investment company's failure in court to offer a justification or explanation for requiring three arbitrators instead of one demonstrated that these provisions were included deliberately for the improper purpose of discouraging or preventing customers from vindicating their rights. Because these provisions could not be severed, the arbitration provisions in their entirety were unenforceable [*Parada v. Superior Court (Monex Deposit Co.) (2009) 176 Cal. App. 4th 1554, 1586–1587, 98 Cal. Rptr. 3d 743*].

In a case involving a mandatory preemployment arbitration agreement in which a provision permitting either party to appeal an arbitration award of more than $50,000 to a second arbitrator was found unconscionable under *Armendariz,* the court concluded that the offending provision could be severed. Unlike the agreement in *Armendariz,* this contract involved only a single provision that was unconscionable, and no contract reformation was required [*Little v. Auto Stiegler (2003) 29 Cal. 4th 1064, 1072–1074, 1076, 130 Cal. Rptr. 2d 892, 63 P.3d 979]*.

A one-sided arbitration clause may have attributes of a contract of adhesion and yet not be unconscionable on its face. In that case, the court may uphold the clause against a claim of unconscionability. However, application of the clause could raise issues of fraud and waiver [*Engalla v. Permanente Medical Group, Inc. (1997) 15 Cal. 4th 951, 984–986, 64 Cal. Rptr. 2d 843, 938 P.2d 903* (arbitration requirement in group medical plan)].

An arbitration provision in an attorney's retainer agreement was held to be enforceable when the initial retainer agreement and amendment did not constitute an adhesion contract. The clients did not enter into a standardized contract with the attorney on a take it or leave

it basis, the retainer agreement and amendment were negotiated and individualized agreements, and the clients possessed the freedom to employ the attorney of their choice and bargain for the terms of their choice [*Powers v. Dickson, Carlson & Campillo (1997) 54 Cal. App. 4th 1102, 1110, 63 Cal. Rptr. 2d 261*].

An arbitration provision in a comprehensive contracting service agreement between an insurer and a hospital was held to be enforceable when evidence of unconscionability presented by the hospital included only a declaration from its attorney who had no personal involvement with negotiation of the service agreement, and two newspaper articles containing quotes from an officer of the hospital on the reasons for filing the lawsuit. None of this material was competent evidence sufficient to establish unconscionability as a defense to mandatory arbitration [*Coast Plaza Doctors Hospital v. Blue Cross of California (2000) 83 Cal. App. 4th 677, 687–689, 99 Cal. Rptr. 2d 809* (neither procedural nor substantive unconscionability found)].

[b] Prices of Consumer Goods and Services

Facts to be considered in determining whether a price is unconscionable are [*Perdue v. Crocker National Bank (1985) 38 Cal. 3d 913, 926–927, 216 Cal. Rptr. 345, 702 P.2d 503*; *Carboni v. Arrospide (1991) 2 Cal. App. 4th 76, 82–83, 2 Cal. Rptr. 2d 845* (interest rate of 200 percent per year unenforceable on loan exempt from usury law); *see Civ. Code § 1670.5*]:

- The basis and justification for the price charged.
- The price paid by other similarly situated consumers in similar transactions.
- The inconvenience imposed on the party charging the price.
- The true value of the goods or services.
- The absence of meaningful choice on the part of the party being charged the price.

• Whether deceptive practices are involved.

Although it is unlikely a court would find a price set by a freely competitive market unconscionable, the market price set by an oligopoly is not immune from scrutiny [*Perdue v. Crocker National Bank (1985) 38 Cal. 3d 913, 927, 216 Cal. Rptr. 345, 702 P.2d 503]*.

The "oppression" element of procedural unconscionability requires lack of meaningful alternative sources of the goods or services in question [*Shadoan v. World Savings & Loan Assn. (1990) 219 Cal. App. 3d 97, 102–103, 268 Cal. Rptr. 207*; *Dean Witter Reynolds, Inc. v. Superior Court (1989) 211 Cal. App. 3d 758, 768, 259 Cal. Rptr. 789]*. On the other hand, the existence of consumer choice only decreases the extent of procedural unconscionability. It does not negate the oppression or obligate courts to enforce the challenged provision regardless of the extent of substantive unfairness. The existence of consumer choice is relevant, but it is not determinative of the entire issue of procedural unconscionability. Except in unusual circumstances—such as when the consumer is highly sophisticated and the challenged provision does not undermine important public policies—the use of a contract of adhesion establishes a minimal degree of procedural unconscionability notwithstanding the availability of market alternatives [*Gatton v. T-Mobile USA, Inc. (2007) 152 Cal. App. 4th 571, 583–585, 61 Cal. Rptr. 3d 344* ("In sum, there are provisions so unfair or contrary to public policy that the law will not allow them to be imposed in a contract of adhesion, even if theoretically the consumer had an opportunity to discover and use an alternate provider for the goods or services involved")].

[c] Class Action Waiver in Consumer Contract

The California Supreme Court held in 2005 that "when … [a class action/class arbitration] waiver is found in a consumer contract of adhesion in a setting in which disputes between the contracting parties predictably involve small amounts of damages, and when it is alleged that the party with the superior bargaining power has carried out a scheme to deliberately cheat large numbers of consumers out of individually small sums of money,

then … the waiver becomes in practice the exemption of the party 'from responsibility for [its] own fraud, or willful injury to the person or property of another.' (*Civ. Code, § 1668*.) Under these circumstances, such waivers are unconscionable under California law and should not be enforced" [*Discover Bank v. Superior Court (2005) 36 Cal. 4th 148, 162–163, 30 Cal. Rptr. 3d 76, 113 P.3d 1100*]. The court also held that the Federal Arbitration Act [*9 U.S.C. § 1 et seq.*; see *Ch. 32, Contractual Arbitration: Agreements and Compelling Arbitration*] does not preempt California law in this respect [*Discover Bank v. Superior Court (2005) 36 Cal. 4th 148, 153, 30 Cal. Rptr. 3d 76, 113 P.3d 1100*].

Subsequently the U.S. Supreme Court abrogated the *Discover Bank* rule insofar as it applies to class-*arbitration* provisions (as opposed to class action *litigation*), holding that it is preempted by the Federal Arbitration Act [*AT&T Mobility LLC v. Concepcion (2011) 563 U.S. 333, 131 S. Ct. 1740, 179 L. Ed. 2d 742, 751, 756, 759* ("class arbitration, to the extent it is manufactured by *Discover Bank* rather than consensual, is inconsistent with the FAA"), *rev'g Laster v. AT&T Mobility LLC (9th Cir. 2009) 584 F.3d 849*; *see American Express Co. v. Italian Colors Restaurant (2013) 570 U.S. 228, 133 S. Ct. 2304, 186 L. Ed. 2d 417, 423, 427* (FAA does not permit courts to invalidate contractual waiver of class arbitration on ground that plaintiff's cost of individually arbitrating federal statutory claim exceeds potential recovery; "Truth to tell, our decision in *AT&T Mobility* all but resolves this case")]. That holding also implicitly abrogated other decisions based on the *Discover Bank* rule, or in accord with it, in numerous California cases [*see, e.g.*, *Arguelles Romero v. Superior Court (AmerCredit Fin. Servs.) (2010) 184 Cal. App. 4th 825, 838–839, 109 Cal. Rptr. 3d 289* (court is required to consider, when *Discover Bank* factors are not all present in case involving class action waiver, whether facts might still compel conclusion that class action waiver is unconscionable); *Gatton v. T-Mobile USA, Inc. (2007) 152 Cal. App. 4th 571, 588, 61 Cal. Rptr. 3d 344* (class action/class arbitration waiver in cell phone service contract was directly within scope of *Discover Bank* rule); *Cohen v. DirecTV, Inc. (2006) 142 Cal. App. 4th 1442, 1451–1453, 48 Cal. Rptr. 3d 813* (application of *Discover Bank*

rule to class action waiver in satellite TV customer agreement; summaries of other cases); *Klussman v. Cross Country Bank (2005) 134 Cal. App. 4th 1283, 1298–1300, 36 Cal. Rptr. 3d 728* (trial court correctly ruled that class action waiver in consumer contract of adhesion governed by Delaware law could not be enforced in action under Consumers Legal Remedies Act and California's unfair competition law); *Aral v. Earthlink, Inc. (2005) 134 Cal. App. 4th 544, 557, 36 Cal. Rptr. 3d 229* (waiver of class-wide arbitration in contract for consumer DSL Internet service); *Independent Ass'n of Mailbox Ctr. Owners, Inc. v. Superior Court (2005) 133 Cal. App. 4th 396, 410–411, 34 Cal. Rptr. 3d 659* (ban on class wide arbitration under franchise agreement may be unenforceable in appropriate case); *see also Szetela v. Discover Bank (2002) 97 Cal. App. 4th 1094, 1101–1102, 118 Cal. Rptr. 2d 862]* as well as cases from the Ninth Circuit [*e.g.*, *Omstead v. Dell, Inc. (9th Cir. 2010) 594 F.3d 1081, 1086* (under California law, choice-of-law provision electing Texas law, in computer manufacturer's consumer contract, was unenforceable; class action waiver was unconscionable under *Discover Bank* rule and could not be severed, rendering entire arbitration provision unenforceable); *Shroyer v. New Cingular Wireless Servs. (9th Cir. 2007) 498 F.3d 976, 988–993* (there is no conflict between *Discover Bank* rule and Federal Arbitration Act sufficient to support conclusion of implicit preemption); *Douglas v. United States Dist. Court (9th Cir. 2007) 495 F.3d 1062*; *Nagrampa v. MailCoups, Inc. (9th Cir. 2006) 469 F.3d 1257*; *see also Ting v. AT&T (9th Cir. 2003) 319 F.3d 1126]*.

In the wake of the *AT&T Mobility* case, the United States Supreme Court held that the Federal Arbitration Act does not permit courts to invalidate a contractual waiver of class arbitration on the ground that the cost of individually arbitrating a federal statutory claim would exceed the potential recovery [*American Express Co. v. Italian Colors Restaurant (2013) 570 U.S. 228, 133 S. Ct. 2304, 186 L. Ed. 2d 417, 423, 427]*. The court explicitly noted, however, that the result might be different if an arbitration provision required a party to pay "filing and administrative fees attached to arbitration that are so high as to make access to the forum impracticable" [*American Express Co. v. Italian Colors*

Restaurant (2013) 570 U.S. 228, 133 S. Ct. 2304, 186 L. Ed. 2d 417, 426]. In a case "present[ing] exactly that situation," the Ninth Circuit held that an arbitration policy imposed on employees was unconscionable under California law, and that the California law on unconscionability was not preempted by the FAA in that situation; therefore, the trial court correctly denied the employer's motion to compel arbitration [*Chavarria v. Ralphs Grocery Co. (9th Cir. 2013) 733 F.3d 916, 926–927* ("[i]n this case, administrative and filing costs, even disregarding the cost to prove the merits, effectively foreclose pursuit of the claim")].

[d] Class Action Waiver in Employment Contract

The United States Supreme Court has held that agreements between employers and employees that provide for individualized arbitration proceedings, rather than class or collective action procedures, are enforceable as written [*Epic Sys. Corp. v. Lewis (2017) — U.S. —, 138 S. Ct. 1612, 1619, 200 L. Ed. 2d 889]*. The Court found that the Federal Arbitration Act [*see 9 U.S.C. § 1 et seq.*] instructs federal courts to enforce arbitration agreements according to their terms, including terms providing for individualized proceedings, and cited its decision in *American Express Co. v. Italian Colors* in which it noted that the Act requires courts to rigorously "enforce arbitration agreements according to their terms, including terms that specify with whom the parties choose to arbitrate their disputes and the rules under which that arbitration will be conducted" [*Epic Sys. Corp. v. Lewis (2017) — U.S. —, 138 S. Ct. 1612, 1621, 200 L. Ed. 2d 889*; *see American Express Co. v. Italian Colors Restaurant (2013) 570 U.S. 228, 233, 133 S. Ct. 2304, 186 L. Ed. 2d 417, 423, 427*, discussed in [c], *above*; *see also Ch. 32, Contractual Arbitration: Agreements and Compelling Arbitration*]. The Act's savings clause [*see 9 U.S.C. § 2*] did not save the employees' defense regarding the NLRA rendering the waivers illegal; the savings clause recognizes only defenses that apply to "any" contract and offers no refuge

for defenses that apply only to arbitration [*Epic Sys. Corp. v. Lewis (2017) — U.S. —, 138 S. Ct. 1612, 1622–1623, 200 L. Ed. 2d 889*.

[3] No Ground for Affirmative Relief

Regardless of the status or identity of the plaintiff making the claim of unconscionability, *Civ. Code § 1670.5* does not support an affirmative cause of action. However, a cause of action may exist under some other statute; for example:

- An affirmative cause of action may exist under the Consumers Legal Remedies Act [*see, e.g.*, *Civ. Code §§ 1770(a)(19)*, *1780*], discussed in *Ch. 504, Sales: Consumers Legal Remedies Act*, based on the use of unconscionable provisions in consumer contracts [*Dean Witter Reynolds, Inc. v. Superior Court (1989) 211 Cal. App. 3d 758, 766, 259 Cal. Rptr. 789]*.

- Use of unconscionable contract provisions might support affirmative relief or injunctive relief under *Bus. & Prof. Code § 17200 et seq.*, discussed in *Ch. 565, Unfair Competition, § 565.10* et seq., on the theory that use of such provisions constituted a deceptive or unfair business practice [*Dean Witter Reynolds, Inc. v. Superior Court (1989) 211 Cal. App. 3d 758, 772–775, 259 Cal. Rptr. 789]*.

- If the contested term is a liquidated damages provision in a consumer contract, *Civ. Code § 1671(d)* provides affirmative relief to a party who has paid sums in accordance with an invalid provision to the extent the sums paid exceed the other party's actual damages [*Beasley v. Wells Fargo Bank (1991) 235 Cal. App. 3d 1383, 1398–1401*, *disapproved on other grounds*, *Olson v. Automobile Club of So. Cal. (2008) 42 Cal. 4th 1142, 1153 n.6*]. Liquidated damages provisions are discussed in *Ch. 177, Damages*.

[4] Court Will Hear Evidence

It is proper for the court to hear evidence on these questions. This evidence is for the court's consideration, not the jury's. The court must decide whether a particular contract or clause is unconscionable [*see* Legislative Committee Comment to *Civ. Code § 1670.5*]. The critical juncture for determining whether a contract is unconscionable is the moment it was entered into by the parties. The issue is not whether it is unconscionable in light of subsequent events [*Civ. Code § 1670.5*; *see American Software, Inc. v. Ali (1996) 46 Cal. App. 4th 1386, 1391, 54 Cal. Rptr. 2d 477]*.

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§ 140.26 Electronic Contracts and Signatures

[1] In General

With the advent of the Internet and other advances in technology, agreements are frequently negotiated and finalized by electronic communication methods such as fax, e-mail, or Internet websites. Agreements formed in this matter are not "written" or "signed" within the traditional meanings of those terms. In recognition of the changes in the way agreements are formed and preserved, both California and the federal government have enacted legislation validating electronic documents and electronic signatures. In California, the governing statute is the Uniform Electronic Transactions Act (UETA) [*Civ. Code § 1633.1 et seq.*]. Nearly all other states also have enacted UETA. The federal counterpart is the Electronic Signatures in Global and National Commerce Act (E-SIGN) [*Pub. L. No. 106-229*, tit. 1, 2 (June 30, 2000); *15 U.S.C. § 7001 et seq.*]. For a discussion of the relationship between the state and federal statutes, see *§ 140.26[3][b]*.

[2] California Transactions

[a] Application of Uniform Act

In California, UETA applies (with some specified exceptions) to electronic records and electronic signatures relating to a "transaction"—that is, an action or set of actions occurring between two or more persons relating to the conduct of business, commercial, or

governmental affairs [*Civ. Code § 1633.3(a)*; *see* Civ. Code § 1633.2(o) (definition of "transaction"); *see also* Civ. Code §§ 1633.2(a)–(n), *1633.3(b)–(d), (f)* (other definitions; exceptions)]. UETA is to be construed and applied so as to facilitate electronic transactions consistent with other applicable law; to be consistent with reasonable practices concerning electronic transactions and with the continued expansion of those practices; and to effectuate the general purpose to make uniform the law with respect to the subject of UETA among states enacting it [*Civ. Code § 1633.6*].

Numerous specific statutory exclusions from UETA exist [*see Civ. Code § 1633.3(b), (c)*]. The broadest exclusions include the following:

- Transactions subject to a law governing the creation and execution of wills, codicils, or testamentary trusts [*Civ. Code § 1633.3(b)(1)*].
- Transactions subject to Division 1 of the Commercial Code, except *Com. Code §§ 1206* and *1306* [*Civ. Code § 1633.3(b)(2)*].
- Transactions subject to Division 3 (negotiable instruments), 4 (bank deposits and collections), 5 (letters of credit), 8 (investment securities), 9 (secured transactions), or 11 (funds transfers) of the Commercial Code [*Civ. Code § 1633.3(b)(3)*].
- Transactions subject to any law requiring that specifically identifiable text or disclosures in a record or portion of a record be separately signed or initialed [*Civ. Code § 1633.3(b)(4)*]. However, this exclusion does not apply to transactions subject to *Civ. Code §§ 1677* or *1678*, relating to liquidated damages in real property sales contracts, or *Code Civ. Proc. § 1298*, relating to arbitration provisions in real property sales contracts.

UETA specifically does apply to electronic records and electronic signatures relating to transactions conducted by a person licensed, certified, or registered pursuant to the Alarm Company Act [*see Bus. & Prof. Code § 7590 et seq.*] for purposes of activities authorized

in connection with installation agreements [*Civ. Code § 1633.3(g)*; *see* *Bus. & Prof. Code § 7599.54*].

Although transactions excluded from UETA are not subject to its provisions, they still may be conducted by electronic means if that can be done under any other applicable law [*Civ. Code § 1633.3(f)*].

[b] Effect of Electronic Contract or Signature

Under UETA, a record or signature may not be denied legal effect or enforceability solely because it is in electronic form. A contract may not be denied legal effect or enforceability solely because an electronic record was used in its formation. If a law requires a record to be in writing, an electronic record satisfies the law. If a law requires a signature, an electronic signature satisfies the law [*Civ. Code § 1633.7*; *see* *Civ. Code § 1633.2 (d)*, *(g)*, *(h)* (definitions of "contract" and "electronic record" and "electronic signature"; for purposes of UETA, "digital signature" as defined in *Gov. Code § 16.5(d)* is type of electronic signature)]. In a case evaluating, under common law, the validity of an e mail sent prior to enactment of the UETA, a federal court held that the e mail, signed with a party's name, satisfied the statute of frauds, assuming that a binding oral agreement existed and that the e mail included all of the material terms of that agreement [*Lamle v. Mattel, Inc. (Fed. Cir. 2005) 394 F.3d 1355, 1362–1363]*.

Evidence of a record or signature may not be excluded in a proceeding solely because it is in electronic form [*Civ. Code § 1633.13*].

[c] Effect of Uniform Act on Parties

UETA does not *require* that a record or signature be created, generated, sent, communicated, received, stored, or otherwise processed or used, by electronic means or in electronic form [*Civ. Code § 1633.5(a)*].

Moreover, UETA applies only to a transaction between parties each of whom has agreed to conduct the transaction by electronic means. Whether the parties agree to conduct a transaction by electronic means is determined from the context and surrounding circumstances, including the parties' conduct. Except for a separate and optional agreement the primary purpose of which is to authorize a transaction to be conducted by electronic means, 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. An agreement to conduct a transaction by electronic means 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 statutory rules may not be varied by agreement [*Civ. Code § 1633.5(b)*].

A party that agrees to conduct a transaction by electronic means 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 by electronic means, the buyer may refuse to conduct further transactions regarding the goods or services by electronic means. These statutory rules may not be varied by agreement [*Civ. Code § 1633.5(c)*].

Except as otherwise provided in UETA, the effect of any of its provisions may be varied by agreement. The presence in certain provisions of UETA 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 [*Civ. Code § 1633.5(d)*].

[d] Attribution of Electronic Contract or Signature to Party

An electronic record or electronic signature is attributable to a person if it was the act of the person. The act of the person may be shown in any manner, including a showing of the efficacy of any security procedure applied to determine the person to whom the electronic

record or electronic signature was attributable [*Civ. Code § 1633.9(a)*; *e.g.*, *Espejo v. Southern Cal. Permanente Med. Group (2016) 246 Cal. App. 4th 1047, 1061–1062, 201 Cal. Rptr. 3d 318* (description of facts that, in this case, satisfied requirements to establish that electronic signature on document was "the act of" plaintiff and therefore provided necessary evidence to authenticate document); *but see Bannister v. Marinidence Opco, LLC (2021) 64 Cal. App. 5th 541, 544–545, 279 Cal. Rptr. 3d 112* (substantial evidence supported trial court's conclusion that employer failed to prove that employee electronically signed arbitration agreement; it did not establish that she was assigned unique, private username and password such that she alone could have signed agreement); *Fabian v. Renovate America, Inc. (2019) 42 Cal. App. 5th 1062, 1067–1070, 255 Cal. Rptr. 3d 695* (affirming trial court's finding that party did not carry its burden to establish authenticity of electronic signature on contract)]. The effect of an electronic record or electronic signature attributed to a person under the foregoing rules 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 [*Civ. Code § 1633.9(b)*].

[e] Other Effects of Uniform Act

UETA also provides rules affecting the following aspects of transactions subject to it:

- Providing, sending, or delivering information "in writing" to another person, and the posting, displaying, or formatting of such information [*see Civ. Code § 1633.8*].
- Making changes, and dealing with errors, in electronic records [*see Civ. Code § 1633.10*].
- Notarizing an electronic signature, and signing under penalty of perjury [*see Civ. Code § 1633.11*].

- Complying with legal requirements to retain specified types of records [*see Civ. Code § 1633.12*].
- Conducting wholly automated transactions [*see Civ. Code § 1633.14*].
- Sending and receiving electronic records related to a transaction [*see Civ. Code § 1633.15*].
- Using electronic means to send a notice of a right to cancel [*see Civ. Code § 1633.16*].
- Prohibiting state agents from interfering with the use of electronic signatures [*see Civ. Code § 1633.17*].

[3] Interstate and International Transactions

[a] Effect of Electronic Contract or Signature

The federal E-SIGN Act applies to any transaction in or affecting interstate or foreign commerce [*see 15 U.S.C. § 7001(a)*]. Under E-SIGN, notwithstanding any statute, regulation, or other rule of law, a signature, contract, or other record relating to a transaction affecting interstate or foreign commerce may not be denied legal effect, validity, or enforceability solely because it is in electronic form, and a contract relating to such a transaction may not be denied legal effect, validity, or enforceability solely because an electronic signature or electronic record was used in its formation [*15 U.S.C. § 7001(a)*; *see 15 U.S.C. § 7006* (definitions)]. The term "transaction" means an action, or a set of actions, relating to the conduct of business, consumer, or commercial affairs between two or more persons, including any of the following types of conduct [*15 U.S.C. § 7006(13)*]:

- The sale, lease, exchange, licensing, or other disposition of personal property (including goods and intangibles) or services (or any combination of these actions).
- The sale, lease, exchange, or other disposition (or any combination of these actions) of any interest in real property.

The E-SIGN requirements do not limit, alter, or otherwise affect any requirement imposed by a statute, regulation, or rule of law, other than a requirement that contracts or other records be written, signed, or in nonelectronic form [*15 U.S.C. § 7001(b)(1)*].

However, E-SIGN does not require any to agree to use or accept electronic records or electronic signatures (except a governmental agency, with respect to a record other than a contract to which it is a party) [*15 U.S.C. § 7001(b)(2)*].

[b] Effect of State Laws

State law, regulation, or other rule of law may modify, limit, or supersede the provisions of *15 U.S.C. § 7001* [discussed in [a], *above*] with respect to state law in the following cases [*15 U.S.C. § 7002(a)*]:

- The law or regulation in question constitutes an enactment of UETA as approved and recommended for enactment in all the states by the National Conference of Commissioners on Uniform State Laws in 1999, except that any exception to the scope of UETA enacted by a state [*see, e.g., Civ. Code § 1633.3(b)(4), (c)* (California exceptions)] is preempted to the extent that the exception is inconsistent with the regulatory provisions of E-SIGN. In other words, UETA controls in states that have enacted it, and individual state modifications of UETA that are inconsistent with E-SIGN are preempted.

- The law or regulation is question specifies alternative procedures or requirements for the use and/or acceptance of electronic records or signatures to establish the legal effect, validity, or enforceability of contracts, if these procedures or requirements are consistent with E-SIGN.

UETA has been enacted in most states, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands. New York has an equivalent law [*see 15 U.S.C. § 7002(a)(2)*; *see also https://www.ncsl.org/research.aspx*].

In addition, state law may not require or accord greater legal status or effect to the implementation or application of a specific technology or technical specification for performing the functions of creating, storing, generating, receiving, communicating, or authenticating electronic records or electronic signatures [*15 U.S.C. § 7002(a)(2)(A)(ii)*; *see* *15 U.S.C. § 7002(a)(1)*]. States also are not permitted to circumvent the regulatory provisions of E-SIGN through the imposition of nonelectronic delivery methods under section 8(b)(2) of UETA [*15 U.S.C. § 7002(c)*; *see* *Civ. Code § 1633.8(b)(2)*].

In a few other specified circumstances, state law will supersede E-SIGN requirements [*see* *15 U.S.C. § 7003*]. Specifically, the requirement to give effect to an electronic contract or signature does not apply to a contract or other record to the extent it is governed by any of the following state laws [*15 U.S.C. § 7003(a)*]:

- A statute, regulation, or other rule of law governing the creation and execution of wills, codicils, or testamentary trusts.
- A statute, regulation, or other rule of law governing adoption, divorce, or other matters of family law.
- The Uniform Commercial Code, other than section 1 206 (presumptions), Article 2 (sales of goods), and Article 2A (personal property leases) [*see* *Com. Code §§ 1206*, *2101 et seq.*, *10101 et seq.*].

The requirement to give effect to an electronic signature or record also does not apply to court documents (such as orders, notices, briefs and pleadings); notices of cancellation or termination of utility services; specified notices in connection with default, acceleration, repossession, foreclosure, eviction, or right to cure under a credit agreement secured by, or a rental agreement for, an individual’s primary residence; cancellation of health or life insurance benefits; product recall notices [*15 U.S.C. § 7003(b)(2)*]; and any document required to accompany any transportation or handling of toxic or dangerous materials [*15 U.S.C. § 7003(b)(3)*].

California Forms of Pleading and Practice--Annotated

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§§ 140.27 –140.29 [Reserved]

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§ 140.30 Governing Law

[1] General Rule Absent Choice of Law Provision

Generally, a contract is interpreted in accordance with the law and usage of the place at which it is to be performed, or, if it does not indicate a place of performance, according to the law and usage of the place at which it was made [*Civ. Code § 1646*; *see, e.g.*, *Shannon-Vail Five Inc. v. Bunch (9th Cir. 2001) 270 F.3d 1207, 1210* (finding that since Nevada was place of performance of loan contract, Nevada law should be applied; analyzing Restatement (Second) of Conflicts to reach same result)]. The parties may provide in the contract for their choice of a different law, however [*see* [3], *below*].

[2] Contract Involving $250,000 or More Specifying California Law

The parties to any contract, agreement, or undertaking, contingent or otherwise, relating to a transaction involving in the aggregate not less than $250,000, may agree that California law will govern their rights and duties in whole or in part, whether the contract, agreement, or undertaking, or the transaction, bears a reasonable relation to California, and even if the transaction would otherwise be covered by *Com. Code § 1301(a)* (requiring reasonable connection to California and another state or country, to uphold choice of law provision) [*Civ. Code § 1646.5*; *see* *Code Civ. Proc. § 410.40* (jurisdiction and venue over foreign corporation or resident pursuant to choice of law provision in contract involving not less than $1,000,000)].

However, this rule does not apply to any of the following contracts, agreements, or undertakings [*Civ. Code § 1646.5*]:

- A contract for labor or personal services.
- A contract relating to any transaction primarily for personal, family, or household purposes.
- Any other contract to the extent provided in *Com. Code § 1301(b)*. The latter section lists Commercial Code sections that override a choice of law provision in situations involving creditors' rights against goods sold, leases, bank deposits and collections, letters of credit, bulk sales, investment securities, and perfection of security interests.

[3] Enforceability of Choice of Law Provision

[a] Adoption of Restatement Approach

In determining the enforceability of arm's length contractual choice of law provisions, California courts must apply the principles set forth in Restatement 2d of Conflict of Laws section 187, which reflects a strong policy favoring enforcement of such provisions [*Nedlloyd Lines B.V. v. Superior Court (1992) 3 Cal. 4th 459, 464–465, 11 Cal. Rptr. 2d 330, 834 P.2d 1148*; *see* *Washington Mutual Bank v. Superior Court (2001) 24 Cal. 4th 906, 927–928, 103 Cal. Rptr. 2d 320, 15 P.3d 1071* (trial court erred in certifying class in multi-state class action without first determining effect of choice of law agreements at issue: choice of law issues must be resolved as part of certification process)].

This discussion (in § 140.30[3]) concerns contract provisions by which the parties choose between the law of California and the law of another state or of a foreign country; this discussion does not concern a provision purporting to choose between California law and federal law. When a valid federal law governs an issue that a state law purports also to govern, the state law is preempted to the extent of any conflict with the federal law, and no

choice of law expressed in a contract can change that result [*DIRECTV, Inc. v. Imburgia (2015) 577 U.S. 47, 136 S. Ct. 463, 193 L. Ed. 2d 365, 375* (California appellate court's interpretation of arbitration agreement's reference to California law was preempted by Federal Arbitration Act because court did not place arbitration contracts on equal footing with all other contracts, thus failing to give due regard to federal policy favoring arbitration), *rev'g Imburgia v. DIRECTV, Inc. (2014) 225 Cal. App. 4th 338, 170 Cal. Rptr. 3d 190, and implicitly aff'g Murphy v. DirecTV, Inc. (9th Cir. 2013) 724 F.3d 1218, 1228]*.

[b] Determining Reasonable Basis for Parties' Choice

To apply the principles of Restatement 2d of Conflict of Laws section 187, the court first must determine that either (1) the chosen state has a substantial relationship to the parties or their transaction or (2) there is some other reasonable basis for the parties' choice of law. However, in making this inquiry, the court should be aware of the following possible exceptions [*Nedlloyd Lines B.V. v. Superior Court (1992) 3 Cal. 4th 459, 465, 11 Cal. Rptr. 2d 330, 834 P.2d 1148]*.

- There may be an exception when a choice of law issue arises from a contract subject to the Uniform Commercial Code, which provides that, with specified exceptions, when a transaction bears a reasonable relation to California and also to another state or nation, the parties may agree that the law either of California or of the other state or nation will govern their rights and duties. Failing such an agreement, the Commercial Code applies to transactions bearing an appropriate relation to California [*Com. Code § 1301*].
- A different result might obtain under subdivision (1) of Restatement 2d of Conflict of Laws section 187, which appears to allow the parties in some circumstances to specify the law of a state that has no relation to the parties or their transaction

[*Nedlloyd Lines B.V. v. Superior Court (1992) 3 Cal. 4th 459, 465 n.4, 11 Cal. Rptr. 2d 330, 834 P.2d 1148]*.

The fact that one of the parties resides in another state gives the parties a reasonable ground for choosing that state's law [*Nedlloyd Lines B.V. v. Superior Court (1992) 3 Cal. 4th 459, 467, 11 Cal. Rptr. 2d 330, 834 P.2d 1148*; *Hughes Electronics Corp. v. Citibank Delaware (2004) 120 Cal. App. 4th 251, 258, 15 Cal. Rptr. 3d 244]*. The same should be true when there is an intended third-party beneficiary of the contract, and that person resides in the chosen state [*ABF Capital Corp. v. Berglass (2005) 130 Cal. App. 4th 825, 835, 30 Cal. Rptr. 3d 588]*.

If the court cannot determine that there is a reasonable basis for the parties' choice, that is the end of the inquiry, and the court need not enforce the parties' choice of law [*Nedlloyd Lines B.V. v. Superior Court (1992) 3 Cal. 4th 459, 465, 11 Cal. Rptr. 2d 330, 834 P.2d 1148]*.

[c] Testing for Conflict With Fundamental Policy

If the court determines that the parties' choice of law was reasonable [*see § 140.30[3][b]*], 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 must enforce the parties' choice of law [*Nedlloyd Lines B.V. v. Superior Court (1992) 3 Cal. 4th 459, 465, 11 Cal. Rptr. 2d 330, 834 P.2d 1148*; *e.g.*, *IBM v. Bajorek (9thCir. 1999) 191 F.3d 1033, 1041–1042* (New York law, chosen in stock-option agreement); *Washington Mutual Bank v. Superior Court (2001) 24 Cal. 4th 906, 917, 103 Cal. Rptr. 2d 320, 15 P.3d 1071* ("California … has no public policy against the enforcement of choice-of-law provisions contained in contracts of adhesion where they are otherwise appropriate."); *Brinkley v. Monterey Fin. Servs. (2015) 242 Cal. App. 4th 314, 328–329, 196 Cal. Rptr. 3d 1 (Washington law)*; *Guardian Savings & Loan Ass'n v. MD Assocs. (1998) 64 Cal. App. 4th 309, 323, 75 Cal. Rptr. 2d 151 (Texas law)]*.

There are no bright-line rules for determining what is or is not contrary to a fundamental policy of California [*Discover Bank v. Superior Court (2006) 134 Cal. App. 4th 886, 893, 36 Cal. Rptr. 3d 456*, *disapproved on other ground*, *AT&T Mobility LLC v. Concepcion (2011) 563 U.S. 333, 131 S. Ct. 1740, 179 L. Ed. 2d 742, 759* (*see* discussion in *§ 140.25[2][c]*)]. The absence of a fundamental conflict of laws could be due simply to the absence of any conflict [*see, e.g.*, *Gerdlund v. Electronic Dispensers International (1987) 190 Cal. App. 3d 263, 269–270, 235 Cal. Rptr. 279* (Nevada law was reasonable choice; there was no conflict with California policy since California's parol evidence rule was same as Nevada rule)]. Or it could be due to the absence of a fundamental policy that would be affected. For instance, California law allows contracting parties to shorten or extend limitation periods; thus, California has no discernible fundamental policy that would be thwarted by enforcing a choice of law provision for the application of another state's limitation period [*ABF Capital Corp. v. Berglass (2005) 130 Cal. App. 4th 825, 836, 30 Cal. Rptr. 3d 588]*.

In determining whether another state's law conflicts with the fundamental policy of California, it would be error for the court to isolate the differences between an applicable California law and the other state's comparable law and then determine whether the isolated differences in the two states' laws reflect a fundamental policy. This approach would lead the court to consider each portion of the compared laws separately, which would minimize the impact of any deviation from the requirements of the California law. It is erroneous because it fails to consider the California law as an integrated whole, the particular parts of which reinforce each other [*Brack v. Omni Loan Co., Ltd. (2008) 164 Cal. App. 4th 1312, 1325, 80 Cal. Rptr. 3d 275* (choice of Nevada law, in consumer loan contract of adhesion, conflicted with fundamental policy expressed in Financing Law, *Fin. Code § 22000 et seq.*)].

In some cases, application of a choice of law provision can cause a non-California party to receive less protection under the non-California law than if California law were applied.

California public policy should not be offended by that result if it is caused by the party who is adversely affected—if, for example, the choice of law provision is in a standard form contract drafted by that party (who thus freely chose the non-California law), and the non-California law has an adverse effect on that party, in the case in question, solely because of that party's voluntary acts taken without due regard for the effect of that law. For example, California public policy was not offended when a Pennsylvania crane company's form contract, which chose Pennsylvania law, gave the company less protection after the company voluntarily delivered a crane to a California contractor under circumstances making Pennsylvania law disadvantageous for the crane company, a result that the company could have avoided [*Maxim Crane Works, L.P. v. Tilbury Constructors (2012) 208 Cal. App. 4th 286, 294–295, 145 Cal. Rptr. 3d 406]*.

There may be an occasional case in which California is the forum, and the parties have chosen the law of another state, but the law of yet a third state, rather than California's law, would apply but for the parties' choice. In that situation, the California court will look to the fundamental policy of the third state in determining whether to enforce the parties' choice of law [*Nedlloyd Lines B.V. v. Superior Court (1992) 3 Cal. 4th 459, 465 n.5, 11 Cal. Rptr. 2d 330, 834 P.2d 1148]*.

[d] Resolving Fundamental Conflict of Laws

When there is a fundamental conflict with California law, the court then must 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 will not be enforced, for the obvious reason that in such a case the California court should decline to enforce a law contrary to California's fundamental policy [*Nedlloyd Lines B.V. v. Superior Court (1992) 3 Cal. 4th 459, 465, 11 Cal. Rptr. 2d 330, 834 P.2d 1148]*. For example:

- California's strong policy expressed in *Bus. & Prof. Code § 16600*, prohibiting covenants not to compete, determined the enforceability of a noncompetition agreement in an employment contract, which provided that Maryland law would govern contract disputes [*Application Group Inc. v. Hunter Group, Inc. (1998) 61 Cal. App. 4th 881, 900–902, 72 Cal. Rptr. 2d 73*; *see Scott v. Snelling & Snelling, Inc. (N.D. Cal. 1990) 732 F. Supp. 1034, 1039–1041* (*Bus. & Prof. Code § 16600* would control as to validity of noncompetition clause in franchise agreement that was to be governed by Pennsylvania law)].

- The parties' choice of Colorado law allowing an interest rate that would be usurious under California law could not be enforced [*Mencor Enterprises, Inc. v. Hets Equities Corp. (1987) 190 Cal. App. 3d 432, 441, 235 Cal. Rptr. 464]*.

Otherwise, the parties' choice of law should be enforced. For example, California's interest in enforcing the policy underlying *Code Civ. Proc. § 580b*, which prohibits a deficiency debt or judgment in certain cases of foreclosing a lien, was not materially greater than a Texas policy of ensuring that the justified expectations of the parties would be met [*Guardian Savings & Loan Ass'n v. MD Assocs. (1998) 64 Cal. App. 4th 309, 323, 75 Cal. Rptr. 2d 151]*.

[4] Application of Choice of Law Provision in Tort Action

Generally, a clause referring to all disputes "arising under or growing out of this agreement" is considered broader than one stating only that "this agreement shall be governed by and construed in accordance with the law of" a specified jurisdiction. The California Supreme Court narrowly held that a provision of the first kind required a cause of action for breach of fiduciary duty to be determined in accordance with the foreign law specified in the choice of law provision. Whatever fiduciary duties the parties had toward each other arose out of their contractual obligations to each other [*Nedlloyd Lines B.V. v. Superior Court (1992) 3 Cal. 4th*

459, 469–472, 11 Cal. Rptr. 2d 330, 834 P.2d 1148 (majority shareholder's duty to corporation)].

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§ 140.31 Parol Evidence Rule

[1] Elements

[a] Writing Intended as Final Expression of Agreement

The parol evidence rule generally prohibits the introduction of any extrinsic evidence, whether oral or written, to vary, alter, or augment the terms of an integrated written contract. The rule is codified in *Civ. Code § 1625* and *Code Civ. Proc. § 1856* [*Casa Herrera, Inc. v. Beydoun (2004) 32 Cal. 4th 336, 343, 9 Cal. Rptr. 3d 97, 83 P.3d 497*; *see Kanno v. Marwit Capital Partners II, L.P. (2017) 18 Cal. App. 5th 987, 999–1000, 227 Cal. Rptr. 3d 334]*.

The execution of a contract in writing, whether the law requires it to be written or not, supersedes all of the negotiations or stipulations concerning its subject matter that preceded or accompanied the execution of the contract [*Civ. Code § 1625*].

Terms set forth in a writing intended by the parties as a final expression of their agreement with respect to the terms included in the writing may not be contradicted by evidence of any previous agreement or of a contemporaneous oral agreement [*Code Civ. Proc. § 1856(a)*; *see Com. Code § 2202* (virtually identical rule applicable to contracts for sales of goods)]. The parties may explain or supplement the terms in such an agreement by evidence of consistent additional terms, unless the writing is intended as a complete and exclusive statement of the terms of the agreement [*Code Civ. Proc. § 1856(b)*; *see § 140.31[1][b]*].

The parol evidence rule does not, however, prohibit the introduction of extrinsic evidence to explain the meaning of a written contract if the meaning urged is one to which the written contract terms are reasonably susceptible [*Casa Herrera, Inc. v. Beydoun (2004) 32 Cal. 4th 336, 343, 9 Cal. Rptr. 3d 97, 83 P.3d 497]*. Extrinsic evidence is admissible to explain ambiguities or to give meaning and content to words used in the agreement, as long as that evidence does not vary or contradict the written terms of the agreement [*Blackburn v. Charnley (2004) 117 Cal. App. 4th 758, 766, 11 Cal. Rptr. 3d 885*; *see Code Civ. Proc. 1856(e)*]. Evidence admitted to explain an agreement may include evidence of a course of dealing, usage of trade, or course of performance [*Code Civ. Proc. 1856(c)*; *Employers Reins. Co. v. Superior Court (2008) 161 Cal. App. 4th 906, 911, 923–924, 74 Cal. Rptr. 3d 733* (course-of-performance evidence is admissible only to interpret contract under which parties were performing; it is not relevant to interpret any other contract between same parties, even if both contracts involved same subject); *see United States Cellular Inv. Co. v. GTE Mobilnet, Inc. (9th Cir. 2002) 281 F.3d 929, 937–938* (course of performance of partnership agreement demonstrated that partners did not intend that corporate partner's transfers of stock would trigger anti-transfer provisions); *see also Com. Code § 2202* (virtually identical rule applicable to contracts for sales of goods)].

[b] Writing Intended as Final and Complete Agreement

As codified in *Code Civ. Proc. 1856(a)*, the parol evidence rule precludes only evidence to contradict the terms of a written agreement that the parties intended to be their final agreement on those terms. It does not preclude evidence of consistent additional terms relating to the same subject matter unless the parties intended the agreement to be not only the final expression of their agreement but also their complete and exclusive statement of the terms of their agreement on the subject matter [*Code Civ. Proc. 1856(b)*; *see Com. Code § 2202* (virtually identical rule applicable to contracts for sales of goods)].

[c] Determination of Parties' Intention

The trial court determines whether the parties intended the writing to be a final expression of their agreement with respect to the terms included in it and whether the writing is intended also as a complete and exclusive statement of the terms of the agreement [*Code Civ. Proc. § 1856(d)*; *see* *Banco Do Brasil, S.A. v. Latian, Inc. (1991) 234 Cal. App. 3d 973, 1001, 285 Cal. Rptr. 870*, *disapproved on other grounds in* *Riverisland Cold Storage, Inc. v. Fresno-Madera Production Credit Assn. (2013) 5 Cal. 4th 1169, 1182, 151 Cal. Rptr. 3d 93, 291 P. 3d 316* (whether rule applies to exclude evidence of any collateral oral agreements is question of law to be determined by court); *see also* *Wang v. Massey Chevrolet (2002) 97 Cal. App. 4th 856, 872–873, 876, 118 Cal. Rptr. 2d 770* (citing *Banco Do Brasil* in determining that parol evidence rule barred evidence of oral misrepresentations when lease was not reasonably susceptible to interpretation consistent with those representations)].

[d] Integrity of Writing or Validity of Agreement

When a party puts a mistake or imperfection of the writing in issue by the pleadings, the parol evidence rule does not preclude taking evidence relevant to that issue [*Code Civ. Proc. § 1856(e)*; *see* *Pacific State Bank v. Greene (2003) 110 Cal. App. 4th 375, 388–389, 1 Cal. Rptr. 3d 739* (loan guarantor's declaration regarding which loan she intended to guarantee raised triable issue of fact concerning mutual mistake defense in bank's action to recover on several loans)].

When the validity of the agreement is in dispute, the parol evidence rule does not preclude taking evidence relevant to that issue [*Code Civ. Proc. § 1856(f)*; *Lewis & Queen v. N.M. Ball Sons (1957) 48 Cal. 2d 141, 148, 308 P.2d 713* (rule does not preclude evidence that contract lawful on its face is in fact part of illegal transaction); *Homami v. Iranzadi (1989) 211 Cal. App. 3d 1104, 1112, 260 Cal. Rptr. 6]*.

[e] Circumstances of Making Agreement

The parol evidence rule does not preclude taking evidence of the circumstances in which the agreement was made or to which it relates, as defined in *Code Civ. Proc. § 1860* [*Code Civ. Proc. § 1856(g)*], which states that for the proper construction of an instrument, the parties may show the circumstances in which it was made, including the situation of the subject of the instrument and of the parties to it, so that the judge may be placed in the position of those whose language the judge is to interpret [*Code Civ. Proc. § 1860*].

In addition, the parol evidence rule does not preclude taking evidence to explain an extrinsic ambiguity, or otherwise to interpret the terms of the agreement [*Code Civ. Proc.§ 1856(g)*; *see, e.g.*, *Kavruck v. Blue Cross of California (2003) 108 Cal. App. 4th 773, 782–784, 134 Cal. Rptr. 2d 152* (insured was entitled to submit parol evidence to support interpretation of ambiguous health insurance policy term); *Darling v. Controlled Environments Construction, Inc. (2001) 89 Cal. App. 4th 1221, 1234–1235, 108 Cal. Rptr. 2d 213* (parol evidence rule did not bar extrinsic evidence introduced to assist court in ascertaining parties' intent regarding ambiguity of floor flatness standard in structural concrete subcontract); *Neverkovec v. Fredericks (1999) 74 Cal. App. 4th 337, 350–353, 87 Cal. Rptr. 2d 856* (parol evidence rule did not bar extrinsic evidence introduced by third party regarding intent of parties to release)].

The parol evidence rule also does not preclude taking evidence to establish illegality or fraud [*Code Civ. Proc.§ 1856(g)*]; and when fraudulent inducement is the issue, the parol evidence rule does not preclude evidence relevant to that issue [*Code Civ. Proc.§ 1856(f)* (no preclusion of evidence when "the validity of the agreement is the fact in dispute"); *see generally* *Riverisland Cold Storage, Inc. v. Fresno Madera Production Credit Assn. (2013) 55 Cal. 4th 1169, 1182, 151 Cal. Rptr. 3d 93, 291 P.3d 316*, *overruling* *Bank of Am. v. Pendergrass (1935) 4 Cal. 2d 258, 263, 48 P.2d 659* (which had limited fraud exception to parol evidence rule); *Julius Castle Restaurant, Inc. v. Payne (2013) 216 Cal. App. 4th 1423, 1440–1442, 157 Cal. Rptr. 3d 839* (explanation of *Riverisland Cold Storage* holding

and its effect)]. For example, in a case in which a guarantor claimed that she agreed to guarantee a single loan but that a bank employee's misrepresentations led her to sign guaranty agreements covering four loans, the court of appeal held that evidence of factual misstatements was admissible to show mistake or fraud pursuant to the statutory exceptions to the parol evidence rule [*Pacific State Bank v. Greene (2003) 110 Cal. App. 4th 375, 378–379, 396, 1 Cal. Rptr. 3d 739]*.

[2] Rule of Substantive Law

The parol evidence rule is a rule of substantive law, not a rule of evidence [*Casa Herrera, Inc. v. Beydoun (2004) 32 Cal. 4th 336, 343, 9 Cal. Rptr. 3d 97, 83 P.3d 497*; *Estate of Gaines (1940) 15 Cal. 2d 255, 264, 100 P.2d 1055*; *Alling v. Universal Manufacturing Corp. (1992) 5 Cal. App. 4th 1412, 1433, 7 Cal. Rptr. 2d 718*; *Banco Do Brasil, S.A. v. Latian, Inc. (1991) 234 Cal. App. 3d 973, 1000, 285 Cal. Rptr. 870*, *disapproved on other grounds in Riverisland Cold Storage, Inc. v. Fresno-Madera Production Credit Assn. (2013) 5 Cal. 4th 1169, 1182, 151 Cal. Rptr. 3d 93, 291 P. 3d 316]*. It does not preclude evidence for reasons ordinarily requiring exclusion, such as the low probative value of the evidence or a policy against admitting it. Instead, the rule states simply that, as a matter of substantive law, the act of embodying the complete terms of an agreement in a writing, called integration, becomes the contract of the parties. Extrinsic evidence of their agreement, no matter how persuasive, is precluded because it cannot serve to prove what the agreement was; that is determined as a matter of law to be the writing itself [*Riley v. Bear Creek Planning Committee (1976) 17 Cal. 3d 500, 508–509, 131 Cal. Rptr. 381, 551 P.2d 1213*; *Alling v. Universal Manufacturing Corp. (1992) 5 Cal. App. 4th 1412, 1434, 7 Cal. Rptr. 2d 718*; *Banco Do Brasil, S.A. v. Latian, Inc. (1991) 234 Cal. App. 3d 973, 1000, 285 Cal. Rptr. 870*, *disapproved on other grounds in Riverisland Cold Storage, Inc. v. Fresno-Madera Production Credit Assn. (2013) 5 Cal. 4th 1169, 1182, 151 Cal. Rptr. 3d 93, 291 P. 3d 316*; *Marani v. Jackson (1986) 183 Cal. App. 3d 695, 701, 228 Cal. Rptr. 518]*.

In a case in which a court resolved an action for breach of contract and fraud in favor of a defendant by applying the parol evidence rule, and the defendant thereafter filed a malicious prosecution action against the plaintiffs in the underlying action, the California Supreme Court held that the termination of the underlying action based on the parol evidence rule satisfied the favorable termination element of a malicious prosecution claim [*Casa Herrera, Inc. v. Beydoun (2004) 32 Cal. 4th 336, 339, 349, 9 Cal. Rptr. 3d 97, 83 P.3d 497]*.

PRACTICE TIP:

Possibility of Action for Fraud in Lieu of Action for Breach of Contract. A party may not be able to prove a cause of action for breach of contract based on an oral misrepresentation that contradicts a written integrated agreement. However, the party may be able to prove a tort cause of action for fraud based on fraudulent concealment if the party was induced to enter into the written, integrated agreement by the other party's intentional failure to disclose material facts that party had a duty to disclose [*see Marketing West, Inc. v. Sanyo Fisher (USA) Corp. (1992) 6 Cal. App. 4th 603, 612–614, 7 Cal. Rptr. 2d 859]*. This strategy is discussed in *Ch. 269, Fraud and Deceit*.

[3] Integration and Susceptibility

[a] Determination That Agreement Is Integrated

The parties may not use parol evidence to add to or vary the terms of a written contract if they have agreed that it is an "integrated agreement," that is, a complete and final embodiment of the terms of their agreement [*Masterson v. Sine (1968) 68 Cal. 2d 222, 225, 65 Cal. Rptr. 545, 436 P.2d 561*; *Bionghi v. Metropolitan Water District of Southern California (1999) 70 Cal. App. 4th 1358, 1364, 83 Cal. Rptr. 2d 388* (extrinsic evidence

offered by plaintiff to show that contract required good cause for termination was inadmissible when agreement included integration clause); *SDC/Pullman Partners v. Tolo Inc. (1997) 60 Cal. App. 4th 37, 53–54, 70 Cal. Rptr. 2d 62*; *Alling v. Universal Manufacturing Corp. (1992) 5 Cal. App. 4th 1412, 1434, 7 Cal. Rptr. 2d 718*; *Wagner v. Glendale Adventist Medical Center (1989) 216 Cal. App. 3d 1379, 1385, 265 Cal. Rptr. 412]*. Whether a written agreement is integrated depends on the parties' intent, which the court must determine by considering relevant extrinsic evidence that explains but does not flatly contradict the writing [*Stevenson v. Oceanic Bank (1990) 223 Cal. App. 3d 306, 316, 272 Cal. Rptr. 757]*. The crucial issue in determining whether the agreement is integrated is whether the parties intended their writing to serve as the exclusive embodiment of their agreement. The resolution of this question involves examining the instrument itself as well as collateral agreements and circumstances at the time of the writing, and the subject matter, nature, and object of the contract [*Masterson v. Sine (1968) 68 Cal. 2d 222, 225–226, 65 Cal. Rptr. 545, 436 P.2d 561*; *Williams v. Atria Las Posas (2018) 24 Cal. App. 5th 1048, 1051–1052, 235 Cal. Rptr. 3d 341*; *Wedeck v. Unocal Corp. (1997) 59 Cal. App. 4th 848, 862–863, 69 Cal. Rptr. 2d 501*; *Wagner v. Glendale Adventist Medical Center (1989) 216 Cal. App. 3d 1379, 1385–1386, 265 Cal. Rptr. 412*; *McLain v. Great American Ins. Companies (1989) 208 Cal. App. 3d 1476, 1484, 256 Cal. Rptr. 863*; *Marani v. Jackson (1986) 183 Cal. App. 3d 695, 702, 228 Cal. Rptr. 518]*.

An appellate court is not bound by the trial court's determination of whether a written agreement is integrated. The appellate court may review the evidence de novo [*Banco Do Brasil, S.A. v. Latian, Inc. (1991) 234 Cal. App. 3d 973, 1001, 285 Cal. Rptr. 870*, *disapproved on other grounds in Riverisland Cold Storage, Inc. v. Fresno-Madera Production Credit Assn. (2013) 5 Cal. 4th 1169, 1182, 151 Cal. Rptr. 3d 93, 291 P. 3d 316]*, unless the decision rests on evidence that is contradictory or from which conflicting inferences may be drawn, in which case the sufficiency-of-the-evidence standard applies [*see Sunniland Fruit, Inc. v. Verni (1991) 233 Cal. App. 3d 892, 897, 284 Cal. Rptr. 824]*.

[b] Factors to Be Considered

In determining integration, factors the court should consider include [*Stevenson v. Oceanic Bank (1990) 223 Cal. App. 3d 306, 316, 272 Cal. Rptr. 757*; *McLain v. Great American Ins. Companies (1989) 208 Cal. App. 3d 1476, 1484, 256 Cal. Rptr. 863*; *Marani v. Jackson (1986) 183 Cal. App. 3d 695, 702, 228 Cal. Rptr. 518*; *Mobil Oil Corp. v. Rossi (1982) 138 Cal. App. 3d 256, 266, 187 Cal. Rptr. 845]*:

- The language and completeness of the written agreement;
- Whether it contains an integration clause;
- The terms of the alleged oral agreement and whether it might contradict those in the writing;
- Whether the oral agreement might naturally be made as a separate agreement or, conversely, involves terms that would more naturally have been included in the writing; and
- Whether the jury might be misled by the introduction of parol evidence.

[c] Previous Agreements

If the contract provides that there are no previous understandings or agreements not contained in the writing, it may express the parties' intention to nullify antecedent understandings or agreements. However, the court must examine such collateral agreements themselves to determine whether the parties intended that the subjects of negotiation with which the contract deals were to be included in, excluded from, or otherwise affected by, the writing [*Masterson v. Sine (1968) 68 Cal. 2d 222, 225–226, 65 Cal. Rptr. 545, 436 P.2d 561* (repudiating face-of-document rule requiring court to determine from face of instrument whether contract appeared to be complete agreement)].

[d] Partial Integration

Integration may be partial. The parties may intend a writing as a final expression of their agreement with respect to a particular subject matter or term, but not as a final expression of their entire agreement [*Founding Members of Newport Beach Country Club v. Newport Beach Country Club, Inc. (2003) 109 Cal. App. 4th 944, 953–954, 135 Cal Rptr. 2d 505* (concluding that part of contract regarding right of first offer of sale was integrated); *see Kanno v. Marwit Capital Partners II, L.P. (2017) 18 Cal. App. 5th 987, 991–992, 227 Cal. Rptr. 3d 334* (written agreements were at most partial integrations; oral agreement, the terms of which did not contradict written agreements, was therefore enforceable); *Banning Ranch Conservancy v. Superior Court (City of Newport Beach) (2011) 193 Cal. App. 4th 903, 914–916, 123 Cal. Rptr. 3d 348* (so-called framework retainer agreement for attorney's services could be construed independently based on contract language because competent extrinsic evidence was not in conflict); *Wallis v. Farmers Group, Inc. (1990) 220 Cal. App. 3d 718, 730, 269 Cal. Rptr. 299*, *disapproved on other grounds*, *Dore v. Arnold Worldwide, Inc. (2006) 39 Cal. 4th 384, 394 n.2*; *Wagner v. Glendale Adventist Medical Center (1989) 216 Cal. App. 3d 1379, 1385, 265 Cal. Rptr. 412]*. If only part of the agreement is integrated, the parol evidence rule applies to that part of the agreement; the parties may use extrinsic evidence to prove nonintegrated elements [*Wallis v. Farmers Group, Inc. (1990) 220 Cal. App. 3d 718, 730, 269 Cal. Rptr. 299*, *disapproved on other grounds*, *Dore v. Arnold Worldwide, Inc. (2006) 39 Cal. 4th 384, 394 n.2*; *but see Harden v. Maybelline Sales Corp. (1991) 230 Cal. App. 3d 1550, 1555–1556, 282 Cal. Rptr. 96* (disagreeing with *Wallis* regarding application of parol evidence rule to employment applications)].

[e] Provisional Receipt of Evidence

To determine whether parol evidence is admissible, the court must provisionally receive all evidence offered relating to the intention of parties, the circumstances surrounding the

making of the agreement, and the proffered collateral agreement [*Gerdlund v. Electronic Dispensers International (1987) 190 Cal. App. 3d 263, 270, 235 Cal. Rptr. 279]*. The following guidelines may apply:

- A contract provision that states that the contract supersedes all previous agreements between parties is not conclusive of integration. The court must examine the collateral agreement itself to determine whether the agreement was integrated [*Gerdlund v. Electronic Dispensers International (1987) 190 Cal. App. 3d 263, 270–271, 235 Cal. Rptr. 279]*.
- A standardized form drafted by one party is less likely to reflect an integrated agreement than a document drafted specifically to memorialize the parties' transaction [*see McLain v. Great American Ins. Companies (1989) 208 Cal. App. 3d 1476, 1485, 256 Cal. Rptr. 863]*.
- A document that fails to address significant aspects of the agreement is not likely to be integrated [*see McLain v. Great American Ins. Companies (1989) 208 Cal. App. 3d 1476, 1485, 256 Cal. Rptr. 863* (employment application that made no mention of salary or position not integrated agreement)].

[f] Admission of Evidence

The court should exclude parol evidence of oral collateral agreements only if the collateral agreements directly contradict the writing and the jury is likely to be misled [*Masterson v. Sine (1968) 68 Cal. 2d 222, 227, 65 Cal. Rptr. 545, 436 P.2d 561]*. Phrased another way, parol evidence is admissible if the agreement is susceptible of the meaning urged by the party offering the evidence [*SDC/Pullman Partners v. Tolo Inc. (1997) 60 Cal. App. 4th 37, 53–54, 70 Cal. Rptr. 2d 62*; *McLain v. Great American Ins. Companies (1989) 208 Cal. App. 3d 1476, 1483, 1485–1486, 256 Cal. Rptr. 863*; *see Pacific Gas & E. Co. v. G.W. Thomas Drayage etc. Co. (1968) 69 Cal. 2d 33, 37, 69 Cal. Rptr. 561, 442 P.2d 641*;

Bionghi v. Metropolitan Water District of Southern California (1999) 70 Cal. App. 4th 1358, 1364–1366, 83 Cal. Rptr. 2d 388 (extrinsic evidence offered by plaintiff did not show that contract language was reasonably susceptible to interpretation that added requirement of good cause for termination and thus was inadmissible); *United States Cellular v. GTE Mobilnet, Inc. (9th Cir. 2002) 281 F.3d 929, 938–939* (district court did not abuse discretion in excluding extrinsic evidence supporting plaintiff's construction of agreement's anti-transfer provisions because provisions were not fairly susceptible to that construction)].

Whether the court admits the evidence involves a determination of the credibility of the evidence and whether, considering the circumstances of the parties, the agreement is one that might naturally be made as a separate agreement [*see Riley v. Bear Creek Planning Committee (1976) 17 Cal. 3d 500, 509, 131 Cal. Rptr. 381, 551 P.2d 1213*; *Masterson v. Sine (1968) 68 Cal. 2d 222, 227–228, 65 Cal. Rptr. 545, 436 P.2d 561*; *FPI Development, Inc. v. Nakashima (1991) 231 Cal. App. 3d 367, 388, 282 Cal. Rptr. 508*; *cf. Com. Code § 2202*, Comment 3 (court should exclude evidence of additional terms only if they certainly would be included in document)]. If the court concludes that it would not have been natural for the parties to make an alleged collateral oral agreement, the court should nevertheless permit parol evidence of such an agreement if the court is convinced that the unnatural negotiation actually happened in the case [*see Masterson v. Sine (1968) 68 Cal. 2d 222, 228 n.1, 65 Cal. Rptr. 545, 436 P.2d 561]*.

[g] Issue of Law or Fact

California courts disagree on whether the issue of integration, *i.e.*, whether the parties intended a writing as a final, complete, and exclusive statement of their agreement, is a question of law or of fact. The primary significance of whether integration is a question of law or fact is the standard applicable on review. If it is a question of law, the trial court's decision is subject to plenary review as long as the foundational extrinsic evidence is not in

conflict. In some cases, the result will be the same whether the appellate court applies a substantial evidence test or makes its own determination [*see, e.g.*, *Esbensen v. Userware Internat., Inc. (1992) 11 Cal. App. 4th 631, 638 n.4, 14 Cal. Rptr. 2d 93]*.

The First District and Fourth District Courts of Appeal have held that integration is a question of law [*see Esbensen v. Userware Internat., Inc. (1992) 11 Cal. App. 4th 631, 638 n.4, 14 Cal. Rptr. 2d 93*; *Alling v. Universal Manufacturing Corp. (1992) 5 Cal. App. 4th 1412, 1434, 7 Cal. Rptr. 2d 718*; *Malmstrom v. Kaiser Aluminum & Chemical Corp. (1986) 187 Cal. App. 3d 299, 314, 231 Cal. Rptr. 820*; *Brawthen v. H & R Block, Inc. (1972) 28 Cal. App. 3d 131, 137, 104 Cal. Rptr. 486]*. The Second District has held that it is a question of fact [*Mobil Oil Corp. v. Handley (1978) 76 Cal. App. 3d 956, 961, 143 Cal. Rptr. 321]*.

The Third District Court of Appeal treats integration as a mixed question of law and fact. The Third District permits a limited weighing of the evidence by the trial court for the purpose of keeping "incredible" evidence of an oral understanding from the jury. Analysis of integration involves three steps [*FPI Development, Inc. v. Nakashima (1991) 231 Cal. App. 3d 367, 391, 392, 282 Cal. Rptr. 508]*:

- Determining what happened.
- Selecting the applicable rules of law.
- Applying the rules to the facts.

Only if the evidence bearing on the first step (what happened) presents a conflict will the trial court weigh evidence. Necessarily, the court should not weigh evidence on a motion for summary judgment.

[4] Invocation of Rule by Stranger to Contract

Before 1978, *Code Civ. Proc. § 1856* limited application of the parol evidence rule to the parties to the contract and their representatives and successors in interest. Case law interpreted

this limitation to make the rule inapplicable to actions involving a stranger to the contract. In 1978, *Code Civ. Proc. § 1856* was amended to remove the limiting language. The California Supreme Court has not yet addressed the issue. However, one court of appeal concluded that the amendment was a deliberate substantive change, and the parol evidence rule applies in actions involving a stranger to a contract [*Kern County Water Agency v. Belridge Water Storage Dist. (1993) 18 Cal. App. 4th 77, 86, 22 Cal. Rptr. 2d 354*; *see also Neverkovec v. Fredericks (1999) 74 Cal. App. 4th 337, 350, n.8, 87 Cal. Rptr. 2d 856* (citing *Kern*)]. The effect is to preclude the introduction of evidence of terms contradicting a writing even though the action is between a party to the contract and a stranger.

California Forms of Pleading and Practice--Annotated

End of Document

§ 140.32 Rules of Interpretation

[1] Uniformity of Rules

Courts must interpret all contracts, public or private, by the same rules, except as otherwise provided by the Civil Code [*Civ. Code § 1635*; *see* *National Marble Co. v. Bricklayers & Allied Craftsmen (1986) 184 Cal. App. 3d 1057, 1067, 229 Cal. Rptr. 653* (language of contract, if clear and explicit, governs its interpretation)].

[2] Purpose to Give Effect to Parties' Intention

A court must interpret a contract to give effect to the mutual intention of the parties as the intention existed at the time of contracting, as far as that is ascertainable and lawful [*Civ. Code § 1636*; *Int'l Bhd of Teamsters Local 396 v. NASA Servs. (9th Cir. 2020) 957 F.3d 1038, 1045, 1049–1050* (district court erred in reading contract language to conclude that language was ambiguous as to whether it was condition precedent to formation or performance); *Revitch v. DIRECTV, LLC (9th Cir. 2020) 977 F.3d 713, 717–718* (although arbitration agreement existed between plaintiff and AT&T Mobility "and affiliates," absurd result would result from interpreting agreement to require arbitration with any entity such as defendant satellite TV company that was acquired by AT&T years after plaintiff signed agreement); *Roden v. Bergen Brunswig Corporation (2003) 107 Cal. App. 4th 620, 625, 633, 132 Cal. Rptr. 2d 549* (trial court did not err in interpreting judgment encapsulating section 998 settlement agreement concerning retirement benefits); *People v. R.J. Reynolds Tobacco Co. (2003) 107 Cal. App. 4th 516, 525, 132 Cal. Rptr. 2d 151* (trial court did not err in interpreting terms of master

settlement limiting outdoor tobacco advertising); *De Anza Enterprises v. Johnson (2002) 104 Cal. App. 4th 1307, 1314–1315, 1318, 128 Cal. Rptr. 2d 749* (examination of joint venturers' contract terms, in context of document as a whole and surrounding circumstances, led to conclusion that parties intended to fix purchase price by mutual agreement or appraisal, leaving date to follow as matter of course); *Stevenson v. Oceanic Bank (1990) 223 Cal. App. 3d 306, 316, 272 Cal. Rptr. 757*; *United States Cellular v. GTE Mobilnet, Inc. (9th Cir. 2002) 281 F.3d 929, 934–936* (finding no genuine issue of material fact as to proper construction of anti-transfer provisions in partnership agreement, because intent of parties as expressed in plain language of partnership agreement was not to restrict legitimate sale of stock of corporate partner)]. To ascertain the intention of the parties, if it is doubtful, the court must apply statutory rules [*Civ. Code § 1637*; *see § 140.32[3]–[19]*].

[3] Contract Language Governs

[a] Rule and Exception

The language of a contract governs its interpretation, if the language is clear and unambiguous and does not involve absurdity [*Civ. Code § 1638*; *Gilkyson v. Disney Enterprises, Inc. (2021) 66 Cal. App. 5th 900, 916, 281 Cal. Rptr. 3d 539*; *Hewlett-Packard Co. v. Oracle Corp. (2021) 65 Cal. App. 5th 506, 530–531, 280 Cal. Rptr. 3d 21*; *Appalachian Ins. Co. v. McDonnell Douglas Corp. (1989) 214 Cal. App. 3d 1, 11, 262 Cal. Rptr. 716*; *National Marble Co. v. Bricklayers & Allied Craftsmen (1986) 184 Cal. App. 3d 1057, 1067, 229 Cal. Rptr. 653]*. This interpretation, even though it involves what might properly be called questions of fact, is essentially a judicial function to be exercised according to the generally accepted canons of interpretation unless the interpretation turns on the credibility of extrinsic evidence [*Parsons v. Bristol Development Co. (1965) 62 Cal. 2d 861, 865, 44 Cal. Rptr. 767, 402 P.2d 839*; *Oceanside 84, Ltd. v. Fidelity Federal Bank (1997) 56 Cal. App. 4th 1441*; *Canadian Ins. Co. v. Ehrlich (1991) 229 Cal. App. 3d 383,*

391–392, 280 Cal. Rptr. 141; *Greater Middleton Assn. v. Holmes Lumber Co. (1990) 222 Cal. App. 3d 980, 989, 271 Cal. Rptr. 917*; *Appalachian Ins. Co. v. McDonnell Douglas Corp. (1989) 214 Cal. App. 3d 1, 11, 262 Cal. Rptr. 716*; *Moss Dev. Co. v. Geary (1974) 41 Cal. App. 3d 1, 9, 115 Cal. Rptr. 736*; *see Sanchez v. Bally's Total Fitness Corporation (1998) 68 Cal. App. 4th 62, 69, 79 Cal. Rptr. 2d 902* (health club release and assumption of risk provision was clear, explicit, and comprehensible in itself and when considered with entire agreement and thus plaintiff's cause of action for negligence was barred by terms of agreement)].

[b] Judicial Function

When there is no extrinsic evidence or when the extrinsic evidence is uncontradicted, the interpretation of a written instrument is solely a judicial function [*Greater Middleton Assn. v. Holmes Lumber Co. (1990) 222 Cal. App. 3d 980, 989–990, 271 Cal. Rptr. 917*; *Northridge Hospital Foundation v. Pic 'N' Save No. 9, Inc. (1986) 187 Cal. App. 3d 1088, 1095*; *see Crow Winthrop Dev. Ltd. Pshp. v. Jamboree LLC (9th Cir. 2001) 241 F.3d 1121, 1124* (court may interpret contract without recourse to extrinsic evidence if contract terms are unambiguous)]. When conflicting inferences may be drawn from extrinsic evidence that is not in conflict, the court must interpret the contract [*Medical Operations Management, Inc. v. National Health Laboratories, Inc. (1986) 176 Cal. App. 3d 886, 891–892, 895, 222 Cal. Rptr. 455]*.

In general, when a dispute arises over the meaning of contract language, the first question the court must decide is whether the language is "reasonably susceptible" to the interpretation urged by a party. If not, the issue is concluded [*Foster-Gardner, Inc. v. National Union Fire Insurance Company (1998) 18 Cal. 4th 857, 879–880, 77 Cal. Rptr. 2d 107, 959 P.2d 265* (use of word "suit" in insurance policies was not ambiguous; reasonable interpretation of that term is "lawsuit," that is, court proceeding initiated by filing of complaint, and construction which included pre-complaint notices was not

reasonable); *Oceanside 84, Ltd. v. Fidelity Federal Bank (1997) 56 Cal. App. 4th 1441, 1448*; *So. Cal. Edison Co. v. Superior Court (1995) 37 Cal. App. 4th 839, 847–848, 44 Cal. Rptr. 2d 227*; *see Consolidated World Investments, Inc. v. Lido Preferred, Ltd. (1992) 9 Cal. App. 4th 373, 379, 11 Cal. Rptr. 2d 524]*. The court can determine whether the contract is reasonably susceptible to the party's interpretation from the language of the contract [*So. Cal. Edison Co. v. Superior Court (1995) 37 Cal. App. 4th 839, 848, 44 Cal. Rptr. 2d 227*; *see United Teachers of Oakland v. Oakland Unified Sch. Dist. (1977) 75 Cal. App. 3d 322, 330, 142 Cal. Rptr. 105*; *see also § 140.32[6]*], or from extrinsic evidence of the parties' intent [*Oceanside 84, Ltd. v. Fidelity Federal Bank (1997) 56 Cal. App. 4th 1441, 1448*; *So. Cal. Edison Co. v. Superior Court (1995) 37 Cal. App. 4th 839, 848, 44 Cal. Rptr. 2d 227*; *see Winet v. Price (1992) 4 Cal. App. 4th 1159, 1165, 6 Cal. Rptr. 2d 554]*.

When a dispute about the meaning of contract language arises on a demurrer, and the complaint alleges the existence of extrinsic evidence in support of the plaintiff's interpretation, the court is still required to determine whether the contract language is reasonably susceptible to the plaintiff's interpretation. The court is not obliged to overrule the demurrer simply because the complaint alleges the existence of extrinsic evidence in support of that interpretation. On the contrary, the court may determine that the contract is not reasonably susceptible to the meaning alleged in the complaint, and in that situation the court may properly sustain the demurrer without leave to amend [*George v. Automobile Club of S. Cal. (2011) 201 Cal. App. 4th 1112, 1127–1128, 135 Cal. Rptr. 3d 480]*.

If the court decides the language is reasonably susceptible to the interpretation urged, the court moves to the second question; that is, what the parties intended the language to mean [*So. Cal. Edison Co. v. Superior Court (1995) 37 Cal. App. 4th 839, 847–848, 44 Cal. Rptr. 2d 227*; *see Winet v. Price (1992) 4 Cal. App. 4th 1159, 1165, 6 Cal. Rptr. 2d 554]*.

[c] Admissibility of Extrinsic Evidence

The paramount consideration in the interpretation of contracts is the mutual intention of the parties at the time of the contracting, as far as it is ascertainable and lawful [*Western Camps, Inc. v. Riverway Ranch Enterprises (1977) 70 Cal. App. 3d 714, 723, 138 Cal. Rptr. 918*; *see Civ. Code § 1636*]. The test of admissibility of extrinsic evidence to explain the meaning of a written instrument is not whether the instrument appears to the court to be plain and unambiguous on its face, but whether the offered evidence is relevant to prove a meaning to which the language is reasonably susceptible [*Founding Members of Newport Beach Country Club v. Newport Beach Country Club, Inc. (2003) 109 Cal. App. 4th 944, 955–956, 961, 135 Cal Rptr. 2d 505* (country club's governing regulation was not reasonably susceptible to interpretation urged by club's members); *General Motors Corp. v. Superior Court (1993) 12 Cal. App. 4th 435, 441, 15 Cal. Rptr. 2d 622* (release); *Horsemen's Benevolent & Protective Assn. v. Valley Racing Assn. (1992) 4 Cal. App. 4th 1538, 1559, 6 Cal. Rptr. 2d 698*; *Murphy Slough Assn. v. Avila (1972) 27 Cal. App. 3d 649, 653, 104 Cal. Rptr. 136]*.

The court must ascertain and give effect to this intention by determining what the parties meant by the words they used. The meaning of particular words or groups of words varies with the verbal context and surrounding circumstances and purposes in view of the linguistic education and experience of the users and hearers or readers. A word has no meaning apart from these factors [*Pacific Gas & E. Co. v. G.W. Thomas Drayage etc. Co. (1968) 69 Cal. 2d 33, 38, 69 Cal. Rptr. 561, 442 P.2d 641]*. Even if one assumes that words standing alone mean one thing, when the parties have demonstrated by their actions that to them those words mean something different, the court must enforce the meaning and intention of the parties [*Corwin v. Los Angeles Newspaper Service Bureau, Inc. (1978) 22 Cal. 3d 302, 314, 148 Cal. Rptr. 918, 583 P.2d 777]*.

[d] Use of Extrinsic Evidence

Extrinsic evidence is admissible to explain the meaning of a written instrument when the offered evidence is relevant to prove a meaning to which the language of the instrument is reasonably susceptible in the light of all of the circumstances that reveal the sense in which the writer used the words [*Pacific Gas & E. Co. v. G.W. Thomas Drayage etc. Co. (1968) 69 Cal. 2d 33, 40, 69 Cal. Rptr. 561, 442 P.2d 641*; *Southern Pacific Transportation Company v. Santa Fe Pacific Pipelines Inc. (1999) 74 Cal. App. 4th 1232, 1241–1242, 88 Cal. Rptr. 2d 777*; *Oakland-Alameda County Coliseum, Inc. v. Oakland Raiders, Ltd. (1988) 197 Cal. App. 3d 1049, 1057, 243 Cal. Rptr. 300]*. Extrinsic evidence is not admissible to add to, detract from, or vary the terms of a written contract [*Pacific Gas & E. Co. v. G.W. Thomas Drayage etc. Co. (1968) 69 Cal. 2d 33, 39, 69 Cal. Rptr. 561, 442 P.2d 641*; *Oakland-Alameda County Coliseum, Inc. v. Oakland Raiders, Ltd. (1988) 197 Cal. App. 3d 1049, 1058, 243 Cal. Rptr. 300*; *Gerdlund v. Electronic Dispensers International (1987) 190 Cal. App. 3d 263, 272, 235 Cal. Rptr. 279*; *see Crow Winthrop Dev. Ltd. Pshp. v. Jamboree LLC (9th Cir. 2001) 241 F.3d 1121, 1124* (court may interpret contract without recourse to extrinsic evidence if contract terms are unambiguous)]. For example, in a case in which independent contractor insurance agents sought to use parol evidence to interpret a contract's termination provision to show that it required good cause, the court of appeals held that *Pacific Gas,* cited *above,* clearly prohibited such an attempt to graft a good cause requirement onto the termination provision's plain language allowing termination at will [*Appling v. State Farm Mut. Auto. Ins. Co. (9th Cir. 2003) 340 F.3d 769, 777–779* (affirming district court's holding that there was no genuine issue of material fact as to meaning of termination provision)]. Nevertheless, the court must first determine these terms before it can decide whether a party is offering extrinsic evidence for a prohibited purpose [*Pacific Gas & E. Co. v. G.W. Thomas Drayage etc. Co. (1968) 69 Cal. 2d 33, 39, 69 Cal. Rptr. 561, 442 P.2d 641*; *Oakland-Alameda County Coliseum, Inc. v. Oakland Raiders, Ltd. (1988) 197 Cal. App. 3d 1049, 1058, 243 Cal. Rptr. 300]*.

Rational interpretation requires at least a preliminary consideration of all credible evidence offered to prove the intention of the parties [*Pacific Gas & E. Co. v. G.W. Thomas Drayage etc. Co. (1968) 69 Cal. 2d 33, 39–40, 69 Cal. Rptr. 561, 442 P.2d 641*]. Therefore, the trial court must provisionally receive any proffered extrinsic evidence that is relevant to show whether the contract is reasonably susceptible of a particular meaning. It is reversible error for a trial court to refuse to consider such extrinsic evidence on the basis of the trial court's own conclusion that the language of the contract appears to be clear and unambiguous on its face [*Morey v. Vannucci (1998) 64 Cal. App. 4th 904, 912, 75 Cal. Rptr. 2d 573*; *e.g.*, *Halicki Films v. Sanderson Sales & Mktg. (9th Cir. 2008) 547 F.3d 1213, 1223* (in absence of indication in record that trial court considered certain proffered documents, although court was specifically asked to do so and court mentioned other proffered documents, appellate court had to assume that trial court did not consider documents not mentioned; failure to consider that evidence was reversible error: "The court was required to use the extrinsic evidence to aid in its interpretation of the contract.")].

If the court decides, after considering this evidence, that the language of a contract, in the light of all of the circumstances, is fairly susceptible of either one of the two proposed interpretations, extrinsic evidence relevant to prove either of those meanings is admissible [*Pacific Gas & E. Co. v. G.W. Thomas Drayage etc. Co. (1968) 69 Cal. 2d 33, 37, 39–40, 69 Cal. Rptr. 561, 442 P.2d 641* (overruling "plain meaning" rule that no parol evidence admissible to interpret writing clear on its face if no ambiguity or uncertainty asserted); *Oakland-Alameda County Coliseum Authority v. Golden State Warriors, LLC (2020) 53 Cal. App. 5th 807, 817–818, 267 Cal. Rptr. 3d 799* (based on consideration of extrinsic evidence, finding that it was fully plausible to interpret word "terminates" to include termination by nonrenewal); *Wolf v. Superior Court (2004) 114 Cal. App. 4th 1343, 1346, 1350–1351, 8 Cal. Rptr. 3d 649* (trial court erred in finding that term "gross receipts" in author's royalty contract meant only cash and in rejecting expert extrinsic evidence that, in

entertainment context, term meant both money and value of other consideration received); *Southern Pacific Transportation Company v. Santa Fe Pacific Pipelines Inc. (1999) 74 Cal. App.4th 1232, 1245–1246, 88 Cal. Rptr. 2d 777* (trial court committed reversible error in rejecting almost all exhibits and refusing to interpret agreements to determine formula for establishing rent or to consider extrinsic evidence pertinent to issue)]. This rule allows extrinsic evidence of the parties' understanding and intended meaning of the words used in their written agreement and is unconcerned with extrinsic collateral agreements [*Brawthen v. H & R Block, Inc. (1972) 28 Cal. App. 3d 131, 136, 104 Cal. Rptr. 486]*.

[e] Procedure for Admitting Extrinsic Evidence

When the proponent of extrinsic evidence urges a particular interpretation of a contract, the court, outside the presence of the jury, must permit the parties to introduce, conditionally or subject to a motion to strike, all available evidence on the issue of the meaning to be given to the written instrument. If the evidence has the effect of imparting to the written instrument a meaning to which the instrument is not readily susceptible, the court will strike the extrinsic evidence. The jury is involved only if the court makes three determinations [*Equitable Life Assurance Society v. Berry (1989) 212 Cal. App. 3d 832, 838, 260 Cal. Rptr. 819]*:

- The wording of the instrument is reasonably susceptible of the interpretation urged by the proponent of the extrinsic evidence;
- The extrinsic evidence is relevant to prove the proposed meaning; and
- The credibility of the proponent's parol evidence is disputed.

[4] Objective Manifestation Governs

The law imputes to a person the intention corresponding to the reasonable meaning of his or her language, acts, and conduct [*H.S. Crocker Co., Inc. v. McFaddin (1957) 148 Cal. App. 2d*

639, 643, 307 P.2d 429]. In construing the mutual intention of the parties, the objective, outward manifestation of mutual consent generally governs [*Winet v. Price (1992) 4 Cal. App. 4th 1159, 1166, 6 Cal. Rptr. 2d 554]*. If the objective manifestations are sufficient to establish a contract, the parties' subjective intentions or beliefs are wholly immaterial. In other words, when a person who can read and understand an instrument signs it, in the absence of fraud or imposition, that person is bound by its contents and is estopped from saying that its provisions are contrary to his or her intentions or understandings [*Estate of Wilson (1976) 64 Cal. App. 3d 786, 802, 134 Cal. Rptr. 749]*.

[5] Contract Fails to Express Parties' Intentions

When, through fraud, mistake, or accident, a written contract fails to express the real intention of the parties, the court must regard their intention and disregard the erroneous parts of the writing [*Civ. Code § 1640*]. Extrinsic evidence is admissible to show that the writing does not contain the real contract between the parties [*Pasqualetti v. Galbraith (1962) 200 Cal. App. 2d 378, 381, 19 Cal. Rptr. 323*; *see Trident Center v. Connecticut General Life Ins. (9th Cir. 1988) 847 F.2d 564, 568–570]*.

The parties may show by extrinsic evidence that a writing was not intended as a final act because it was not to become effective until a condition occurred; that is, the existence or efficacy of the instrument as a contract depends on a condition precedent, not inconsistent with its terms [*Louis Lesser Enterprises, Ltd. v. Roeder (1962) 209 Cal. App. 2d 401, 410, 25 Cal. Rptr. 917]*. In addition, the parties may introduce extrinsic evidence to show that they never intended a writing to constitute a contract [*Martindell v. Bodrero (1967) 256 Cal. App. 2d 56, 62, 63 Cal. Rptr. 774]*, or that they never, in fact, reached an agreement [*Earp v. Nobmann (1981) 122 Cal. App. 3d 270, 288, 175 Cal. Rptr. 767* (disapproved on other grounds in *Silberg v. Anderson (1990) 50 Cal. 3d 205, 212, 266 Cal. Rptr. 638, 786 P.2d 365*)]. The burden of overcoming the presumption that a correctly executed contract correctly

expresses the intention of the parties rests on the party seeking to avoid its plain terms [*Taff v. Atlas Assur. Co. (1943) 58 Cal. App. 2d 696, 702, 137 P.2d 483*].

[6] Construction by the Parties

When a contract is ambiguous or uncertain, the practical construction placed on the contract by the parties, before any controversy arose as to its meaning, affords one of the most reliable means of determining the intent of the parties [*Bohman v. Berg (1960) 54 Cal. 2d 787, 795, 8 Cal. Rptr. 441, 356 P.2d 185*; *Oceanside 84, Ltd. v. Fidelity Federal Bank (1997) 56 Cal. App. 4th 1441, 1449*; *Kennecott Corp. v. Union Oil Co. (1987) 196 Cal. App. 3d 1179, 1189–1190, 242 Cal. Rptr. 403*]. If the parties perform without objection under a contract the terms of which appear to be indefinite, they have indicated that its terms were sufficiently certain so they, at least, could perform it [*Bohman v. Berg (1960) 54 Cal. 2d 787, 795–796, 8 Cal. Rptr. 441, 356 P.2d 185*; *Epic Commc'ns, Inc. v. Richwave Tech., Inc. (2015) 237 Cal. App. 4th 1342, 1356, 188 Cal. Rptr. 3d 844*; *Okun v. Morton (1988) 203 Cal. App. 3d 805, 819, 250 Cal. Rptr. 220*]. The principle of practical construction applies only to acts performed under the contract before any dispute arose [*Warner Constr. Corp. v. City of Los Angeles (1970) 2 Cal. 3d 285, 296–297, 85 Cal. Rptr. 444, 466 P.2d 996*; *Okun v. Morton (1988) 203 Cal. App. 3d 805, 819, 250 Cal. Rptr. 220*].

[7] Words Interpreted in Ordinary Sense

[a] General Rule

The words of a contract are to be understood in their ordinary and popular sense, rather than according to any strict legal meaning [*Beck v. American Health Group Internat., Inc. (1989) 211 Cal. App. 3d 1555, 1562, 260 Cal. Rptr. 237*; *Salton Bay Marina, Inc. v. Imperial Irrigation Dist. (1985) 172 Cal. App. 3d 914, 931, 218 Cal. Rptr. 839*], unless the parties used the words in a technical sense or gave them a special meaning by usage, in

which case the latter must be followed [*Civ. Code § 1644*; *Appalachian Ins. Co. v. McDonnell Douglas Corp. (1989) 214 Cal. App. 3d 1, 11, 262 Cal. Rptr. 716*; *Achen v. Pepsi-Cola Bottling Co. (1951) 105 Cal. App. 2d 113, 120, 233 P.2d 74*; *see Northridge Hospital Foundation v. Pic 'N' Save No. 9, Inc. (1986) 187 Cal. App. 3d 1088, 1095 n.4, 232 Cal. Rptr. 329*]. For example, courts will not give the disjunctive "or" will its ordinary meaning but may read it as "and" when that construction is necessary to carry out the obvious intent of the parties as gleaned from the context in which they used the word [*Kelly v. William Morrow & Co. (1986) 186 Cal. App. 3d 1625, 1630–1632, 231 Cal. Rptr. 497]*.

Courts interpret technical words as usually understood by persons in the profession or business to which they relate, unless clearly used in a different sense [*Civ. Code § 1645*].

[b] Custom and Trade Usage

Although courts ordinarily construe words in a contract according to their plain, ordinary, popular, or legal meaning, if, in reference to the subject matter of the contract, particular expressions have acquired a different meaning by trade usage, and both parties are engaged in that trade, courts will deem the parties to the contract to have used them according to their different and peculiar sense as shown by the trade usage [*see, e.g.*, *Texas Instruments, Inc. v. Tessera, Inc. (Fed. Cir. 2000) 231 F.3d 1325, 1331* (in patent case, term "litigation" in governing law clause of license agreement was found to include International Trade Commission proceedings); *Wolf v. Superior Court (2004) 114 Cal. App. 4th 1343, 1346, 1354–1355, 8 Cal. Rptr. 3d 649* (trial court erred in finding that term "gross receipts" in author's royalty contract meant only cash and in rejecting expert extrinsic evidence that, in context of entertainment industry, term meant both money and value of other consideration received when not otherwise limited or defined by contract)]. Parol evidence is admissible to establish the trade usage even though the words in their ordinary or legal meaning are

entirely unambiguous [*Beneficial Fire & Cas. Ins. Co. v. Kurt Hitke & Co. (1956) 46 Cal. 2d 517, 525–526, 297 P.2d 428]*.

Generally, if there is a custom in an industry, courts deem those engaged in that industry to have contracted in reference to that practice unless the contrary appears from the other terms of the contract. The prevailing industry custom binds those engaged in the business even if there is no specific proof that the particular party to the litigation knew of the custom. The industry practice becomes a part of the contract, and the evidence of the custom is admissible to supply a missing term or to aid in interpretation if it does not alter or vary the terms of the contract [*Midwest Television, Inc. v. Scott, Lancaster, Mills & Atha, Inc. (1988) 205 Cal. App. 3d 442, 451, 252 Cal. Rptr. 573]*.

[c] Party Not Engaged in Industry

A party to a contract not engaged in the industry is not bound by a custom or usage unless that party had actual knowledge of it, or it is so general or well-known in the community as to give rise to the presumption of that knowledge. For example, courts do not presume that customs of special trades and local usages limited to certain communities are known to all persons. In such a case, one who is not engaged in the trade or occupation that employs the usage relied on may be bound, but proof of actual knowledge of the usage is necessary unless it is so commonly accepted that the public is presumed to recognize its existence [*see Peiser v. Mettler (1958) 50 Cal. 2d 594, 608, 328 P.2d 953]*. In addition, custom and usage cannot change a rule of law and thus cannot override positive statutory law [*Hayward Tamkin & Co. v. Carpenteria Inv. Co. (1968) 265 Cal. App. 2d 617, 623–624, 71 Cal. Rptr. 462* (custom and usage did not create duty on part of limited partners when governing statute stated that limited partners would not be bound by obligations of partnership); *see Corp. Code § 15903.03* (liability of limited partner; formerly section 15632 of California Revised Limited Partnership Act and section 15501 of Uniform Limited Partnership Act, both repealed effective January 1, 2010)].

[8] Implied Terms

[a] Test of Necessity

Stipulations necessary to make a contract reasonable or conformable to usage are deemed implied in respect to matters concerning which the contract manifests no contrary intention [*Civ. Code § 1655*]. All things in law or usage considered as incidental to a contract or necessary to carry it into effect are implied by the contract, unless some of them are expressly mentioned in the contract, in which case all other things of the same class are deemed excluded [*Civ. Code § 1656*; *Addiego v. Hill (1965) 238 Cal. App. 2d 842, 846, 48 Cal. Rptr. 240]*.

In an effort to remedy a deficiency, if it does not alter or vary the terms of the agreement, the court may [*Frankel v. Board of Dental Examiners (1996) 46 Cal. App. 4th 534, 545, 54 Cal. Rptr. 2d 128*; *Addiego v. Hill (1965) 238 Cal. App. 2d 842, 846, 48 Cal. Rptr. 240]*:

- Consider the usual and reasonable terms found in similar contracts;
- Infer unexpressed provisions of the contract from the writing;
- Rely on external facts; and
- Resort to custom and usage.

[b] Limitation on Finding Implied Terms

The law generally does not favor implied terms in contracts because they interfere with the right of the parties to freely set the contractual terms. A court's authority to infer a term in a contract is subject to the following limitations [*Lippman v. Sears, Roebuck & Co. (1955) 44 Cal. 2d 136, 142,145, 280 P.2d 775*; *Frankel v. Board of Dental Examiners (1996) 46 Cal. App. 4th 534, 545–546, 54 Cal. Rptr. 2d 128*; *City of Glendale v. Superior Court (1993) 18 Cal. App. 4th 1768, 1778, 23 Cal. Rptr. 2d 305]*:

- The implied term must arise from the language used or it must be indispensable to effectuate the intention of the parties;
- It must appear from the language used that the implied term was so clearly within the contemplation of the parties that they deemed it unnecessary to express;
- Implied terms can be justified only on the ground of legal necessity;
- A promise can be deemed to be implied only when it can be rationally assumed that it would have been expressly made if attention had been called to it; and
- There can be no implied term when the subject is completely covered by the contract.

[c] Covenant of Good Faith and Fair Dealing

Every contract contains an implied covenant of good faith and fair dealing that neither party will do anything to deprive the other of the benefits of the contract [*Merritt v. J.A. Stafford Co. (1968) 68 Cal. 2d 619, 626, 68 Cal. Rptr. 447, 440 P.2d 927*; *Sheppard v. Morgan Keegan & Co. (1990) 218 Cal. App. 3d 61, 66, 266 Cal. Rptr. 784*; *Ellis v. Chevron, U.S.A., Inc. (1988) 201 Cal. App. 3d 132, 139, 246 Cal. Rptr. 863]*. For purposes of traditional contract remedies, this covenant imposes on each party not only the duty to refrain from doing anything to render performance of the contract impossible, but also the duty to do everything the contract presupposes that party will do to accomplish the purpose of the contract [*Pasadena Live, LLC v. City of Pasadena (2004) 114 Cal. App. 4th 1089, 1092–1094, 8 Cal. Rptr. 3d 233* (allegation that defendant city breached implied covenant of good faith and fair dealing by preventing plaintiff entertainment production company from even submitting entertainment proposals for consideration adequately alleged breach of contract for amphitheater productions); *Floystrup v. City of Berkeley Rent Stabilization Bd. (1990) 219 Cal. App. 3d 1309, 1318, 268 Cal. Rptr. 898*; *Corson v. Brown Motel Investments, Inc. (1978) 87 Cal. App. 3d 422, 427, 151 Cal. Rptr. 385*; *Harm v. Frasher*

(1960) 181 Cal. App. 2d 405, 417, 5 Cal. Rptr. 367]. For discussion of the covenant, see *§ 140.12*.

[9] Entire Contract to Be Given Effect

The whole of a contract is to be taken together, so as to avoid internal conflict in its provisions and to give effect to every part, if reasonably practicable, each clause helping to interpret the other [*Civ. Code § 1641*; *Int'l Bhd of Teamsters Local 396 v. NASA Servs. (9th Cir. 2020) 957 F.3d 1038, 1046, 1049–1050* (applying California law); *Trident Center v. Connecticut General Life Ins. (9th Cir. 1988) 847 F.2d 564, 566–567* (applying California law); *Moore v. Wood (1945) 26 Cal. 2d 621, 630, 160 P.2d 772*; *ITV Gurney Holding v. Gurner (2017) 18 Cal. App. 5th 22, 30, 226 Cal. Rptr. 3d 496*; *Zubia v. Farmers Ins. Exchange (1993) 14 Cal. App. 4th 790, 797, 18 Cal. Rptr. 2d 65*; *Gutzi Associates v. Switzer (1989) 215 Cal. App. 3d 1636, 1642, 264 Cal. Rptr. 538*; *Appalachian Ins. Co. v. McDonnell Douglas Corp. (1989) 214 Cal. App. 3d 1, 12, 262 Cal. Rptr. 716*; *see Code Civ. Proc. § 1858*]. Thus, the meaning of the contract is not determined by isolating one term used by the parties and defining it without reference to other language of the contract [*Moore v. Wood (1945) 26 Cal. 2d 621, 630, 160 P.2d 772]*.The meaning of the words used must be determined from a reading of the entire contract [*Rodriguez v. Barnett (1959) 52 Cal. 2d 154, 160, 338 P.2d 907]*. Even if one provision of the contract is clear and explicit, that portion alone does not govern its interpretation [*Alperson v. Mirisch Co. (1967) 250 Cal. App. 2d 84, 90, 58 Cal. Rptr. 178]*.

However, if construing every provision of the contract would be obviously repugnant to the intention of the parties or would lead to some other inconvenience or absurdity, the court will not construe the contract that way [*Transamerica Ins. Co. v. Sayble (1987) 193 Cal. App. 3d 1562, 1566, 239 Cal. Rptr. 201]*. The court will interpret the contract to give effect to the contract's main apparent purpose [*Harris v. Klure (1962) 205 Cal. App. 2d 574, 578, 23 Cal. Rptr. 313]*.

[10] Resolving Ambiguities

[a] Trial Court's Procedure

When the meaning of words used in a contract is disputed, the trial court engages in a three-step process. First, the court provisionally receives any proffered extrinsic evidence that is relevant to prove a meaning to which the language of the contract is reasonably susceptible. If, in light of the extrinsic evidence, the language is reasonably susceptible to the interpretation urged, the extrinsic evidence is then admitted to aid the court in its role in interpreting the contract. When there is no material conflict in the extrinsic evidence, the trial court interprets the contract as a matter of law. This is true even when conflicting inferences may be drawn from the undisputed extrinsic evidence or when the extrinsic evidence renders the contract terms susceptible to more than one reasonable interpretation. If, however, there is a conflict in the extrinsic evidence, the factual conflict is to be resolved by the jury [*Wolf v. Walt Disney Pictures & Television (2008) 162 Cal. App. 4th 1107, 1126–1127, 76 Cal. Rptr. 3d 585*; *Brown v. Goldstein (2019) 34 Cal. App. 5th 418, 432–433, 246 Cal. Rptr. 3d 161]*.

[b] General Words Following Specific Words

When general words follow the enumeration of particular classes of persons or things, the court will construe the general words as applicable only to persons or things of the same general nature or class as those enumerated. This rule is based on the belief that if the writer had intended the general words to be used in their unrestricted sense, he or she would not have mentioned the particular things or class of things that would in that event be mere surplusage. The words "other" or "any other" following an enumeration of particular classes should be read as "other such like" or to include others "of like kind or character" [*Fiske v. Niagra Fire Ins. Co. (1929) 207 Cal. 355, 357, 278 P. 861*; *Lawrence v. Walzer & Gabrielson (1989) 207 Cal. App. 3d 1501, 1506, 256 Cal. Rptr. 6*; *Scally v.*

Pacific Gas & Electric Co. (1972) 23 Cal. App. 3d 806, 819, 100 Cal. Rptr. 501]. For example, an agreement to arbitrate disputes regarding "fees, costs, or any other aspect of" the parties' relationship only required arbitration of financial matters similar to disputes regarding fees and costs, but did not require arbitration of other breaches of their contract [*Lawrence v. Walzer & Gabrielson (1989) 207 Cal. App. 3d 1501, 1506, 256 Cal. Rptr. 6]*.

[c] Interpretation of Ambiguities With Reference to Entire Contract

The court must interpret an ambiguous clause with reference to the entire contract [*Medical Operations Management, Inc. v. National Health Laboratories, Inc. (1986) 176 Cal. App. 3d 886, 893, 222 Cal. Rptr. 455* (also considering evidence as to negotiations, letter of intent, and drafting history)]. If two clauses of an agreement appear to be in direct conflict, the court must reconcile those clauses so as to give effect to the whole instrument. In construing an agreement in this manner, the court will consider no term uncertain or ambiguous if its meaning can be ascertained by fair inference from the terms of the agreement [*Ellis v. McKinnon Broadcasting Co. (1993) 18 Cal. App. 4th 1796, 1802, 23 Cal. Rptr. 2d 80*; *see* [11], *below*, for further discussion of reconciling inconsistent provisions].

[d] Ambiguity Must Relate to Particular Case

The court must construe language in a contract in the context of the instrument as a whole (*see* [9], *above*), and in the circumstances of the particular case. The court cannot find language ambiguous in the abstract. There can be no ambiguity unrelated to application of the instrument to the particular facts of a case [*Bay Cities Paving & Grading, Inc. v. Lawyers' Mutual Ins. Co. (1993) 5 Cal. 4th 854, 867, 21 Cal. Rptr. 2d 691, 855 P.2d 1263]*.

[e] On Demurrer

At the demurrer stage, as long as the complaint does not place a clearly erroneous construction on the provisions of the contract, the court must accept the plaintiff's construction of an ambiguous contract as correct [*Aragon-Haas v. Family Security Ins. Services, Inc. (1991) 231 Cal. App. 3d 232, 239, 282 Cal. Rptr. 233*; *Marina Tenants Assn. v. Deauville Marina Development Co. (1986) 181 Cal. App. 3d 122, 128, 132, 226 Cal. Rptr. 321]*.

[11] Reconciling Inconsistent Provisions

[a] General and Specific Provisions

When general and specific provisions of a contract deal with the same subject matter, the specific provision, if inconsistent with the general provision, controls [*Continental Cas. Co. v. Zurich Ins. Co. (1961) 57 Cal. 2d 27, 35, 17 Cal. Rptr. 12, 366 P.2d 455]*. When the two provisions do not conflict, the court will give both effect [*Powers v. Superior Court (1987) 196 Cal. App. 3d 318, 321–322, 242 Cal. Rptr. 55* (specific language in waiver and release did not conflict with general exculpatory language used in related rental agreement, and both provisions were effective)].

On the other hand, the court will reject specific words in a contract which are wholly inconsistent with its nature, or with the main intention of the parties [*Civ. Code § 1653*; *see, e.g.*, *Safeco Ins. Co. v. Robert S. (2001) 26 Cal. 4th 758, 766, 110 Cal. Rptr. 2d 844* (insurance policy's illegal act exclusion could not reasonably be given meaning under established rules of construction of contracts and was thus rejected as invalid)].

[b] Written and Printed Provisions

If a contract is partly written and partly printed, or if 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 purely original parts control those copied from a form. If the two are absolutely repugnant, the court must disregard the latter to that extent [*Civ. Code § 1651*; *Gutzi Associates v. Switzer (1989) 215 Cal. App. 3d 1636, 1642, 264 Cal. Rptr. 538*; *American City Bank v. Zetlen (1967) 253 Cal. App. 2d 548, 553, 61 Cal. Rptr. 311]*.

The word "written" in *Civ. Code § 1651* includes "typewritten" [*Continental Cas. Co. v. Phoenix Constr. Co. (1956) 46 Cal. 2d 423, 431, 296 P.2d 801]*. Thus, the court must give a typewritten provision effect even when it is totally contrary to printed text [*Gutzi Associates v. Switzer (1989) 215 Cal. App. 3d 1636, 1642–1643, 264 Cal. Rptr. 538]*.

[12] Interpretation Against Party Causing Uncertainty

[a] General Rule

In cases of uncertainty not removed by the statutory rules of construction [*see generally Civ. Code § 1635 et seq.*], the court should interpret the language of a contract most strongly against the party who caused the uncertainty [*Civ. Code § 1654*; *see Taylor v. J.B. Hill Co. (1948) 31 Cal. 2d 373, 374, 189 P.2d 258*; *Badie v. Bank of America (1999) 67 Cal. App. 4th 779, 801, 79 Cal. Rptr. 2d 273* (interpreting provision in original credit account agreements that bank could change any "term, condition, service or feature" of account, which was ambiguous as to whether bank could impose alternative dispute resolution clause); *Powers v. Dickson, Carlson & Campillo (1997) 54 Cal. App. 4th 1102, 1112, 63 Cal. Rptr. 2d 261*; *Gutzi Associates v. Switzer (1989) 215 Cal. App. 3d 1636, 1641–1643, 264 Cal. Rptr. 538*; *Lawrence v. Walzer & Gabrielson (1989) 207 Cal. App. 3d 1501, 1507, 256 Cal. Rptr. 6*; *Ellis v. Chevron, U.S.A., Inc. (1988) 201 Cal. App. 3d 132, 138, 246 Cal. Rptr. 863]*. For example, in a case involving a Chapter 11 debtor's bankruptcy plan, the Ninth Circuit held that the lower courts correctly concluded that ambiguous language in the plan regarding discharge of "gap period" interest on taxes owed

to the IRS should be construed against the debtor/drafter [*Miller v. United States (9th Cir. 2004) 363 F.3d 999, 1006]*. For purposes of this principle, uncertainty or ambiguity means doubtfulness, doubtfulness of meaning, duplicity, indistinctness, or uncertainty of meaning of an expression used in a written instrument, want of clearness or definiteness. It denotes language difficult to comprehend or distinguish, and of doubtful import [*Royal Neckwear Co. v. Century City, Inc. (1988) 205 Cal. App. 3d 1146, 1153, 252 Cal. Rptr. 810*; *Estate of Black (1962) 211 Cal. App. 2d 75, 85, 27 Cal. Rptr. 418]*.

For example, a lease that obligates the lessor to repair a roof is not ambiguous even though it also provides that the lessor is not liable for any consequential damages suffered by the tenant as a result of the lessor's failure to make the repairs. Nor is there ambiguity in a lease that obligates the tenants to pay for common area costs, including security, but allows the landlord to determine what level of security is appropriate [*Royal Neckwear Co. v. Century City, Inc. (1988) 205 Cal. App. 3d 1146, 1153, 252 Cal. Rptr. 810]*. However, a guaranty agreement including a waiver of the limitation period to the extent permitted by law is not ambiguous so as to require construction against the drafter when the only ambiguity was in the statute describing the permissible extent of waiver [*California First Bank v. Braden (1989) 216 Cal. App. 3d 672, 675–676, 264 Cal. Rptr. 820]*.

[b] When Rule Applies

This rule is to be applied only when an uncertainty has not been removed by other rules of construction [*Oceanside 84, Ltd. v. Fidelity Federal Bank (1997) 56 Cal. App. 4th 1441, 1448–1449*; *Jacobson v. Simmons Real Estate (1994) 23 Cal. App. 4th 1285, 1293, 28 Cal. Rptr. 2d 699*, *disapproved on other grounds* in *Trope v. Katz (1995) 11 Cal. 4th 274, 292, 45 Cal. Rptr. 2d 241, 902 P.2d 259*]. This principle of interpretation is sometimes referred to as *contra proferentem*, and is not applicable to ambiguous language that was the product of joint drafting efforts [*Mitchell v. Exhibition Foods, Inc. (1986) 184 Cal. App. 3d 1033, 1042, 229 Cal. Rptr. 535*; *see Western Bagel Co., Inc. v. Superior Court (2021) 66 Cal.*

App. 5th 649, 668, 281 Cal. Rptr. 3d 329 (FAA preempted applying contra proferentem rule and required construction of any ambiguity in favor of binding arbitration)]. In dealing with ambiguous form contracts, courts apply this principle by interpreting the contract to have the meaning that a reasonable person in the position of the party with less bargaining power would expect [*Hurd v. Republic Ins. Co. (1980) 113 Cal. App. 3d 250, 253, 169 Cal. Rptr. 675]*.

[c] Contract of Adhesion

"Contract of adhesion" refers to a standardized contract prepared entirely by one party for acceptance by the other. Because of a great disparity in bargaining power between the parties, a contract of adhesion embodies an offer the second party must accept or reject on a "take it or leave it" basis, without an opportunity to bargain and under such conditions that the party accepting (or adhering to) the offer cannot obtain the desired product or service except by acquiescing to the form agreement [*Steven v. Fidelity & Casualty Co. (1962) 58 Cal. 2d 862, 882, 27 Cal. Rptr. 172, 377 P.2d 284*; *see Flores v. Transamerica Homefirst, Inc. (2001) 93 Cal. App. 4th 846, 853–854, 113 Cal. Rptr. 2d 376* (finding arbitration agreement to be procedurally unconscionable contract of adhesion when undisputed facts showed it was imposed on plaintiffs on "take it or leave it" basis); *Powers v. Dickson, Carlson & Campillo (1997) 54 Cal. App. 4th 1102, 1110, 63 Cal. Rptr. 2d 261* (attorney's retainer agreement was not contract of adhesion when clients did not enter into standardized contract on take it or leave it basis, retainer agreement and amendment were negotiated and individualized agreements, and clients had freedom to employ attorney of choice and bargain for terms of choice)]. The fact that a form contract is standardized does not itself establish the adhesive character of the contract. The determinative criteria are [*Powers v. Dickson, Carlson & Campillo (1997) 54 Cal. App. 4th 1102, 1110, 63 Cal. Rptr. 2d 261* (attorney retainer agreement not contract of adhesion); *Izzi v. Mesquite*

Country Club (1986) 186 Cal. App. 3d 1309, 1317–1318, 231 Cal. Rptr. 315; *Parr v. Superior Court (1983) 139 Cal. App. 3d 440, 444, 188 Cal. Rptr. 801]*:

- The relative bargaining powers of the parties;
- Whether the adhering party was free to negotiate for alteration of the printed terms of the proffered agreement; and
- The availability of the product or service from other sources.

The court will not enforce a contract of adhesion or an adhesive provision against the weaker or "adhering" party if the contract or provision does not fall within the reasonable expectations of the weaker party or an ordinary person in that party's position. Among the factors that strongly affect the court's assessment of whether the contract was within the reasonable expectation of the adhering party are notice and the extent to which the contract affects the public interest [*Allan v. Snow Summit, Inc. (1996) 51 Cal. App. 4th 1358, 1375–1376, 59 Cal. Rptr. 2d 813]*. The court also will not enforce an adhesive contract or provision if, considered in its context, the contract is unduly oppressive or unconscionable [*Perdue v. Crocker National Bank (1985) 38 Cal. 3d 913, 925, 216 Cal. Rptr. 345, 702 P.2d 503*; *Marin Storage & Trucking, Inc. v. Benco Contracting and Engineering, Inc. (2001) 89 Cal. App. 4th 1042, 1052, 107 Cal. Rptr. 2d 645* (although standardized contract could be considered contract of adhesion, that finding merely begins inquiry of whether particular provision within contract should be denied enforcement because it defeats expectations of weaker party or is unduly oppressive or unconscionable); *Stirlen v. Supercuts, Inc. (1997) 51 Cal. App. 4th 1519, 1530, 60 Cal. Rptr. 2d 138*; *Parr v. Superior Court (1983) 139 Cal. App. 3d 440, 445, 188 Cal. Rptr. 801*; *Holmes v. City of Los Angeles (1981) 117 Cal. App. 3d 212, 217, 172 Cal. Rptr. 589]*. For discussion of unconscionable contracts, see *§ 140.25*.

An exculpatory adhesion contract will be unenforceable if it violates public policy [*see Tunkl v. Regents of University of California (1963) 60 Cal. 2d 92, 98–101, 32 Cal. Rptr.*

33, 383 P. 2d 441 (enumerating factors indicating public policy violation); *see also YMCA of Metropolitan Los Angeles v. Superior Court (1997) 55 Cal. App. 4th 22, 27–28, 63 Cal. Rptr. 2d 612* (provision by which participants in Senior Program released YMCA for personal injury arising from YMCA's negligence exhibited none of coercive aspects typically found in adhesion contract)].

Certain rules of interpretation apply with particular force to contracts of adhesion, such as the rule that an ambiguity caused by the drafter or promisor must be resolved against that party. The party of superior bargaining power prescribes the words of the instrument. The party who subscribes to it lacks the economic strength to change that language. Hence, any ambiguity in the contract should be resolved against the drafter, and questions of doubtful interpretation should be construed in favor of the subscribing party [*Neal v. State Farm Ins. Cos. (1961) 188 Cal. App. 2d 690, 695, 10 Cal. Rptr. 781*; *Badie v. Bank of America (1999) 67 Cal. App. 4th 779, 803–804, 79 Cal. Rptr. 2d 273* (interpreting provision in original credit account agreements that bank could change any "term, condition, service or feature" of account, which was ambiguous as to whether bank could impose alternative dispute resolution clause)].

An arbitration clause in an employment contract may be part of a contract of adhesion, even if the employee is a successful and sophisticated corporate executive, if the employee had no realistic ability to modify the terms of the employment contract. Experienced but legally unsophisticated business people may be unfairly surprised by unconscionable contract terms [*Stirlen v. Supercuts, Inc. (1997) 51 Cal. App. 4th 1519, 1533–1534, 60 Cal. Rptr. 2d 138]*. A basic question respecting an agreement to submit to future arbitration is whether the arbitrators, in lieu of a court, may decide threshold issues such as whether the parties have a valid arbitration agreement, or are bound by a given arbitration clause, and whether an arbitration clause in a concededly binding contract applies to a given controversy. The California Supreme Court has found two "long-established interpretive principles" helpful. First, under state law as under federal law, when the allocation of a

matter to arbitration or the courts is uncertain, California courts will resolve all doubts in favor of arbitration; all else being equal, this presumption tips the scales in favor of allocating the arbitration availability question to the arbitrator. Second, ambiguities in a written agreement are to be construed against the drafter [*Civ. Code § 1654*; *Sandquist v. Lebo Auto., Inc. (2016) 1 Cal. 5th 233, 247–248, 205 Cal. Rptr. 3d 359, 376 P.3d 506* ("[T]here is no dispute that the arbitration clauses were part of contracts of adhesion drafted by Lebo Automotive and imposed as conditions of employment. … [*Civ. Code § 1654*] applies equally to the construction of arbitration provisions. Where the drafter of a form contract has prepared an arbitration provision whose application to a particular dispute is uncertain, ordinary contract principles require that the provision be construed against the drafter's interpretation and in favor of the nondrafter's interpretation"; citations omitted)].

[d] Insurance Policy

It does not matter whether or not insurance policies are labeled adhesive, because the canons of construction governing insurance contracts are well established and have independent vitality even though the applicable principles undoubtedly grew out of contracts of adhesion [*Equitable Life Assurance Society v. Berry (1989) 212 Cal. App. 3d 832, 837, 260 Cal. Rptr. 819]*. For discussion of principles of interpretation of insurance contracts, see *Ch. 308, Insurance*.

[13] Several Instruments Taken Together

Several contracts relating to the same matters, between the same parties, and made as parts of substantially one transaction, are to be taken together [*Civ. Code § 1642*; *Boyd v. Oscar Fisher Co. (1989) 210 Cal. App. 3d 368, 378, 258 Cal. Rptr. 473*; *Housing Authority v. Monterey Senior Citizen Park (1985) 164 Cal. App. 3d 348, 353–354, 210 Cal. Rptr. 497*; *Nevin v. Salk (1975) 45 Cal. App. 3d 331, 338, 119 Cal. Rptr. 370*; *but see Stevenson v. Oceanic Bank*

(1990) 223 Cal. App. 3d 306, 317–318, 272 Cal. Rptr. 757 (loan agreement and guaranty separate; term from loan agreement not to be incorporated into guaranty agreement if it would be inconsistent with specific term of guaranty agreement)]. The term "contract" as used in *Civ. Code § 1642* is descriptive only of a writing and actually refers to an "instrument" [*Harm v. Frasher (1960) 181 Cal. App. 2d 405, 413, 5 Cal. Rptr. 367]*. Whether the parties intended several writings to cover one transaction is generally a question of fact [*Boyd v. Oscar Fisher Co. (1989) 210 Cal. App. 3d 368, 378, 258 Cal. Rptr. 473*; *BMP Property Development v. Melvin (1988) 198 Cal. App. 3d 526, 531, 243 Cal. Rptr. 715*; *Nevin v. Salk (1975) 45 Cal. App. 3d 331, 338, 119 Cal. Rptr. 370]*.

The general principle of joint construction of several instruments as one agreement is applicable regardless of whether they expressly refer to each other or it appears from extrinsic evidence that they were executed as a part of one transaction [*Harm v. Frasher (1960) 181 Cal. App. 2d 405, 413, 5 Cal. Rptr. 367*; *accord Holguin v. Dish Network LLC (2014) 229 Cal. App. 4th 1310, 1320–1321, 178 Cal. Rptr. 3d 100* (both circumstances applied and supported trial court's reference to singular "contract" in jury instructions)]. This principle also applies regardless of whether each of the several instruments was signed by all or only by some of the parties to the transaction [*Harm v. Frasher (1960) 181 Cal. App. 2d 405, 414, 5 Cal. Rptr. 367]*, or whether the written instruments were executed contemporaneously [*Mayers v. Loew's, Inc. (1950) 35 Cal. 2d 822, 827, 221 P.2d 26]* or at different times [*Boyd v. Oscar Fisher Co. (1989) 210 Cal. App. 3d 368, 378, 258 Cal. Rptr. 473*; *BMP Property Development v. Melvin (1988) 198 Cal. App. 3d 526, 531–532, 243 Cal. Rptr. 715* (loan agreement and exchange agreement single transaction even though closed through separate escrows); *Nevin v. Salk (1975) 45 Cal. App. 3d 331, 338, 119 Cal. Rptr. 370]*.

[14] Incorporation by Reference

A written agreement may incorporate other written agreements by expressly referring to them. In the event of incorporation of other agreements by reference, the court must consider and

construe as one the original agreement and those referred to [*Holbrook v. Fazio (1948) 84 Cal. App. 2d 700, 701, 191 P.2d 123*]. For the terms of another document to be incorporated into the document executed by the parties, the following conditions must be satisfied [*Kleveland v. Chicago Title Ins. Co. (2006) 141 Cal. App. 4th 761, 765* (arbitration clause in title insurance policy was not incorporated by reference into preliminary title report and so was not binding on insured because arbitration was not mentioned in that report and report referred to policy that was different from what was actually issued by insurer); *Baker v. Aubry (1989) 216 Cal. App. 3d 1259, 1264*; *Richards v. Merrill Lynch, Pierce, Fenner & Smith, Inc. (1976) 64 Cal. App. 3d 899, 904 n.3, 135 Cal. Rptr. 26*; *cf. Chan v. Drexel Burnham Lambert, Inc. (1986) 178 Cal. App. 3d 632, 636–641, 223 Cal. Rptr. 838* (reference and availability were insufficient)]:

- The reference must be clear and unequivocal;
- The reference must be called to the attention of the other party;
- The other party must consent to it; and
- The terms of the incorporated document must be known or easily available to the contracting parties.

The contract need not recite that it "incorporates" another document, so long as it "guides" the reader to the incorporated document [*Shaw v. Regents (1997) 58 Cal. App. 4th 44, 53–54, 67 Cal. Rptr. 2d 850* (patent agreement signed by university professor incorporated patent policy in effect at time agreement was executed)]. Documents that are not contracts may be incorporated into a contract [*Shaw v. Regents (1997) 58 Cal. App. 4th 44, 55, 67 Cal. Rptr. 2d 850* (holding that university's patent policy was incorporated into employment agreement)].

[15] Supportive Interpretation

The court must give a contract susceptible to different interpretations an interpretation that will make the contract lawful, operative, definite, reasonable, and capable of being carried into effect, if the court can give it that construction without violating the intention of the parties

[*Civ. Code § 1643*; *see* *Apra v. Aureguy (1961) 55 Cal. 2d 827, 831, 13 Cal. Rptr. 177, 361 P.2d 897*; *City of Los Angeles v. Superior Court (1959) 51 Cal. 2d 423, 437, 333 P.2d 745*; *Strong v. Theis (1986) 187 Cal. App. 3d 913, 919–921, 232 Cal. Rptr. 272* (construction to avoid violating rule against perpetuities)]. The court must avoid an interpretation that will make a contract extraordinary, harsh, unjust, or inequitable, or that would result in an absurdity [*Citizens for Goleta Valley v. HT Santa Barbara (2004) 117 Cal. App. 4th 1073, 1076–1077, 12 Cal. Rptr. 3d 249* (developer's interpretation of settlement agreement rejected by court when it defeated reasonable expectations of parties and would lead to absurd results); *Ticor Title Ins. Co. v. Rancho Santa Fe Assn. (1986) 177 Cal. App. 3d 726, 730, 223 Cal. Rptr. 175*; *Howe v. American Baptist Homes of the West, Inc. (1980) 112 Cal. App. 3d 622, 627, 169 Cal. Rptr. 418*; *see* *Northridge Hospital Foundation v. Pic 'N' Save No. 9, Inc. (1986) 187 Cal. App. 3d 1088, 1095*]. For example, because every contract in California has an implied covenant of good faith and fair dealing, the court properly interpreted a noncompetition clause in a lease to include additions to the shopping center to which it related; to do otherwise would violate the implied covenant [*Edmond's of Fresno v. MacDonald Group, Ltd. (1985) 171 Cal. App. 3d 598, 605–608, 217 Cal. Rptr. 375]*. For discussion of the implied covenant of good faith and fair dealing, see *§ 140.12*.

This rule of construction is based on a policy that favors carrying out the parties' intentions by enforcing their contract and disfavors holding contracts unenforceable for uncertainty [*Hennefer v. Butcher (1986) 182 Cal. App. 3d 492, 500–501, 227 Cal. Rptr. 318]*.

[16] Incorporation of Existing Law

As a general rule, all applicable laws in existence when the parties enter into a contract are presumed to be known to the parties and form a part of the contract as if the contract expressly referred to them and incorporated them in its terms [*California First Bank v. Braden (1989) 216 Cal. App. 3d 672, 675–676, 264 Cal. Rptr. 820* (distinction between ambiguity in contract, which would require interpretation against drafter, and ambiguity in statute, which does not);

Century 21 Region V., Inc. v. Pondoff Realty, Inc. (1988) 203 Cal. App. 3d Supp. 11, 15; *Grubb v. Ranger Ins. Co. (1978) 77 Cal. App. 3d 526, 529, 143 Cal. Rptr. 558*; *People v. Wilshire Ins. Co. (1976) 61 Cal. App. 3d 51, 58, 132 Cal. Rptr. 19]*. Existing law includes court decisions interpreting statutes [*California Ass'n of Highway Patrolmen v. Department of Personnel Admin. (1986) 185 Cal. App. 3d 352, 364, 229 Cal. Rptr. 729]*. The parties can agree originally to incorporate subsequent changes in the law or can reexecute their agreement to accomplish that purpose [*Swenson v. File (1970) 3 Cal. 3d 389, 394–395, 90 Cal. Rptr. 580, 475 P.2d 852]*.

Applying this principle, the court can interpret an agreement that might otherwise be unclear or ambiguous without resort to other rules of interpretation. For example, a franchise agreement that was the subject of a dispute with respect to escrow income and required the franchisee to pay the franchisor a percentage of its gross income derived from "all transactions requiring a real estate license" was not ambiguous when construed with regard to the relevant licensing law, which allowed the franchisee to operate its escrow services without an escrow license if it had a real estate license. In light of the applicable law, the income from escrow services clearly had to be included in gross income for purposes of computing the amount due to the franchisor [*Century 21 Region V., Inc. v. Pondoff Realty, Inc. (1988) 203 Cal. App. 3d Supp. 11, 14–15*].

When a contract fails to include a provision that a statutory or administrative mandate specifies must be included in such a contract, the contract is to that extent unlawful; but since a court is bound to interpret a contract in a way that makes it lawful if that is possible [*Civ. Code § 1643*; *see § 140.32[15]*], a court may read the contract as including that required provision [*West v. JPMorgan Chase Bank (2013) 214 Cal. App. 4th 780, 797–798, 154 Cal. Rptr. 3d 285*; *accord*, *Corvello v. Wells Fargo Bank (9th Cir. 2013) 728 F. 3d 878, 884]*.

[17] Question of Law

Issues of contract interpretation are questions of law for the trial court, not for a referee under *Code Civ. Proc. § 639(a)* [*De Guere v. Universal City Studios, Inc. (1997) 56 Cal. App. 4th 482, 501, 65 Cal. Rptr. 2d 438*; *Parsons v. Bristol Development Co. (1965) 62 Cal. 2d 861, 865, 44 Cal. Rptr. 767, 402 P.2d 839]*. Similarly, issues of contract enforceability, such as whether an agreement is a contract of adhesion and if so, whether it is enforceable, are equitable issues to be resolved by the trial court rather than a referee [*De Guere v. Universal City Studios, Inc. (1997) 56 Cal. App. 4th 482, 501, 65 Cal. Rptr. 2d 438*; *see Westlye v. Look Sports (1993) 17 Cal. App. 4th 1715, 1735–1737, 22 Cal. Rptr. 2d 781]*.

[18] Appellate Court's Role in Interpreting Contract

Interpretation of a written instrument generally presents a question of law for the appellate court to determine anew [*Parsons v. Bristol Development Co. (1965) 62 Cal. 2d 861, 865, 44 Cal. Rptr. 767, 402 P.2d 839*; *Curry v. Moody (1995) 40 Cal. App. 4th 1547, 1552–1553, 48 Cal. Rptr. 2d 627*; *Equitable Life Assurance Society v. Berry (1989) 212 Cal. App. 3d 832, 840, 260 Cal. Rptr. 819*; *Boyd v. Oscar Fisher Co. (1989) 210 Cal. App. 3d 368, 378, 258 Cal. Rptr. 473* (dealership agreement and invoices taken as one contract); *Northridge Hospital Foundation v. Pic 'N' Save No. 9, Inc. (1986) 187 Cal. App. 3d 1088, 1099*], when it does not depend on conflicting evidence. When extrinsic evidence was offered in the trial court, the reviewing court is not bound by the trial court's interpretation if the extrinsic evidence is incompetent, uncontradicted, not in conflict, not substantial, or inconsistent with the only interpretation to which the agreement is reasonably susceptible [*Stevenson v. Oceanic Bank (1990) 223 Cal. App. 3d 306, 315, 272 Cal. Rptr. 757*; *Greater Middleton Assn. v. Holmes Lumber Co. (1990) 222 Cal. App. 3d 980, 989–990, 271 Cal. Rptr. 917*; *Broffman v. Newman (1989) 213 Cal. App. 3d 252, 257, 261 Cal. Rptr. 532]*. When the extrinsic evidence itself is not in conflict, but the inferences that may be drawn from it are, the appellate court is required to make its own de novo interpretation of the meaning of the agreement [*Okun v. Morton (1988) 203 Cal. App. 3d 805, 816, 250 Cal. Rptr. 220*; *Malmstrom v. Kaiser Aluminum &*

Chemical Corp. (1986) 187 Cal. App. 3d 299, 315, 231 Cal. Rptr. 820; *Medical Operations Management, Inc. v. National Health Laboratories, Inc. (1986) 176 Cal. App. 3d 886, 893, 222 Cal. Rptr. 455]*.

In the absence of extrinsic evidence, the appellate court must accept the trial court's interpretation of a written instrument if that interpretation is reasonable, if it is one of two or more reasonable constructions of the instrument, or if it is equally tenable with the appellate court's interpretation. The appellate court still has a duty to interpret the instrument, but it must determine that the trial court's interpretation is erroneous before it may properly reverse the judgment [*Parsons v. Bristol Development Co. (1965) 62 Cal. 2d 861, 866, 44 Cal. Rptr. 767, 402 P.2d 839]*. Similarly, when the trial court properly admits evidence to interpret an ambiguous contract, the appellate court must uphold any reasonable interpretation by the trial court, although the appellate court is not bound by the trial court's finding of ambiguity if it is based on incompetent evidence [*Aviointeriors SpA v. World Airways, Inc. (1986) 181 Cal. App. 3d 908, 915, 226 Cal. Rptr. 527*; *Heston v. Farmers Ins. Group (1984) 160 Cal. App. 3d 402, 410, 206 Cal. Rptr. 585*; *Robinson v. Nevada Irrigation Dist. (1980) 101 Cal. App. 3d 760, 769–770, 161 Cal. Rptr. 863]*.

[19] Effect of Factual Statements in Written Contract

Written contracts often contain material factual statements that are attributable to one party and are accepted as true by the other party when the contract was made. If the reliant party eventually discovers that such a factual statement was significantly untrue, that party may be able to assert, on a theory of fraud, a claim for damages or a right to rescind the contract [*see Ch. 269, Fraud and Deceit*; *Ch. 490, Rescission and Restitution*], or a defense to an action for breach of the contract [*see Ch. 215, Duress, Menace, Fraud, Undue Influence, and Mistake*], assuming that both actionable misrepresentation and justifiable reliance can be proven [*see, e.g.*, *McClain v. Octagon Plaza, LLC (2008) 159 Cal. App. 4th 784, 792–794, 71 Cal. Rptr. 3d 885* (shopping mall lease exaggerated square footage of lessee's commercial space and total

square footage of mall on which rent and lessee's share of common-area expenses were to be computed under lease)].

When fraud can be shown, the culpable party is precluded from invoking any provision in the contract by way of exculpation, such as a stipulation or waiver by the reliant party, since any such provision is void by statute [*see* *Civ. Code § 1668* (any contract having as its object, directly or indirectly, to exempt any person from responsibility for that person's own fraud, whether willful or negligent, is "against the policy of the law"); § 140.24[4]]. Therefore, a provision stating that one party "acknowledges" or otherwise stipulates that some material factual statement by the other party is true, or that one party "agrees to" or otherwise purportedly accepts a fact-based situation of the other party's making, which does not comport with reality, is unenforceable when fraud exists [*see, e.g.*, *McClain v. Octagon Plaza, LLC (2008) 159 Cal. App. 4th 784, 794–796, 71 Cal. Rptr. 3d 885* (commercial lease stated that lessee "acknowledged" having investigated suitability of mall space for lessee's business use, when in fact lessor obstructed all investigative efforts while giving assurance that lessee could rely on lessor's exaggerated statement as to square footage)].

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13 California Forms of Pleading and Practice--Annotated §§ 140.33–140.39

§§ 140.33 –140.39 [Reserved]

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§ 140.40 Obligation Extinguished by Performance

[1] Acceptance of Performance

Generally, full performance of an obligation, either by the party whose duty it is to perform or by anyone else on that party's behalf and with that party's assent, if accepted by the party entitled to performance, extinguishes the obligation [*Civ. Code § 1473*].

If there is joint liability for an obligation, performance by one of the several parties jointly liable extinguishes the liability of all [*Civ. Code § 1474*; *Wax v. Infante (1983) 145 Cal. App. 3d 1029, 1030 n.2, 194 Cal. Rptr. 14* (obligation for penalty assessed against defendants and their attorney satisfied when attorney paid penalty)].

Performance of an obligation for the delivery of money only is called "payment" [*Civ. Code § 1478*]. For discussion of extinguishment of an obligation to pay money, see [2], *below*; for an affirmative defense alleging payment, see *§ 140.138*.

[2] Obligation to Pay Money

[a] Tender of Check or Note

Unless the parties agree otherwise, if the obligee takes a certified check, cashier's check, or teller's check in payment of an obligation, the obligation is discharged to the extent of the amount of the check [*Com. Code § 3310(a)*]. Unless the parties agree otherwise, and except as provided in *Com. Code § 3310(a)*, if the obligee takes a note or an uncertified

check in payment of an obligation, the obligation is suspended to the extent of the amount of the check or note [*Com. Code § 3310(b)*].

In the case of an uncertified check, suspension continues until dishonor of the check or until it is paid or certified. Payment or certification of the check results in discharge of the obligation to the extent of the amount of the check [*Com. Code § 3310(b)(1)*; *Navrides v. Zurich Ins. Co. (1971) 5 Cal. 3d 698, 706, 97 Cal. Rptr. 309, 488 P.2d 637*; *Hale v. Bohannon (1952) 38 Cal. 2d 458, 467, 241 P.2d 4*; *Cornwell v. Bank of America (1990) 224 Cal. App. 3d 995, 1000–1001, 274 Cal. Rptr. 322]*.

In the case of a note, suspension continues until dishonor of the note or until it is paid. Payment of the note results in discharge of the obligation to the extent of the payment [*Com. Code § 3310(b)(2)*]. If the check or note is dishonored and the obligee of the obligation for which the instrument was taken is the person entitled to enforce the instrument, the obligee may enforce either the instrument or the obligation [*Com. Code § 3310(b)(3)*; *see Com. Code § 3310(b)(4)*, *(c)*].

[b] Lost Instrument

Unless the parties agree otherwise, and except as provided in *Com. Code § 3310(a)*, if the obligee is the person entitled to enforce the instrument but no longer has possession of it because it was lost, stolen, or destroyed, the obligation may not be enforced to the extent of the amount payable on the instrument. To that extent the obligee's rights against the obligor are limited to enforcement of the instrument [*Com. Code § 3310(b)(4)*].

[c] Creditor's Direction

If a creditor or any one of two or more joint creditors at any time directs the debtor to perform the obligation in a particular manner, the obligation is extinguished by performance in that manner, even though the creditor does not receive the benefit of that performance [*Civ. Code § 1476*]. This rule applies only to a creditor's direction regarding

the manner of transmission, not to a direction to pay something other than what was originally bargained for [*Cober v. Connolly (1942) 20 Cal. 2d 741, 744, 128 P.2d 519*]. If the creditor directs payment by mail, and the debtor mails the money but it is lost in transit, the obligation is satisfied even though the creditor does not receive the benefit. However, the creditor's provision to the debtor of self-addressed envelopes and payment coupons that state, "Detach and mail with payment" and "Mail this coupon with check payable to (the creditor)," does not amount to a direction to make payments by mail when the creditor also accepts payments by other methods, such as in its offices and by wire transfers or automated teller networks [*Cornwell v. Bank of America (1990) 224 Cal. App. 3d 995, 999, 274 Cal. Rptr. 322*].

"Direct" as used in *Civ. Code § 1476* refers to a single method of payment and is inapplicable without a specific direction to pay only in that manner. A creditor will not be held to have "directed" all methods of payment that it makes available [*Cornwell v. Bank of America (1990) 224 Cal. App. 3d 995, 1000, 274 Cal. Rptr. 322*].

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§ 140.41 Obligation Extinguished by Offer or Tender of Performance

[1] Offer or Tender Generally

An obligation is extinguished by an offer or tender of performance by the debtor, or by someone on the debtor's behalf and with the debtor's assent, with the intent to extinguish the obligation [*Civ. Code §§ 1485*, *1487*]. The offer or tender must be made to the party entitled to performance or to someone authorized by that party to receive performance [*see Civ. Code § 1488*; *Hoover v. Wolfe (1914) 167 Cal. 337, 342, 139 P. 794*; *Barnes v. Osgood (1930) 103 Cal. App. 730, 734, 284 P. 975]*. When properly made, the offer or tender has the effect of putting the other party in default if the party refuses to accept it [*Still v. Plaza Marina Commercial Corp. (1971) 21 Cal. App. 3d 378, 385, 98 Cal. Rptr. 414]*.

[2] Conditions for Valid Offer or Tender

[a] Full Performance

To be effective, an offer or tender of performance must be for full performance. An offer or tender of partial performance has no effect [*Civ. Code § 1486*; *Still v. Plaza Marina Commercial Corp. (1971) 21 Cal. App. 3d 378, 385, 98 Cal. Rptr. 414]*. Moreover, the offer or tender must be made in good faith, and in the manner most likely to benefit the creditor in the circumstances [*Civ. Code § 1493*; *K & M, Inc. v. Le Cuyer (1951) 107 Cal. App. 2d 710, 717, 238 P.2d 28]*.

[b] Unconditional

An offer of performance must be free from any conditions the creditor is not already bound to perform [*Civ. Code § 1494*; *Gaffney v. Downey Savings & Loan Assn. (1988) 200 Cal. App. 3d 1154, 1165, 1168, 246 Cal. Rptr. 421*; *Still v. Plaza Marina Commercial Corp. (1971) 21 Cal. App. 3d 378, 385, 98 Cal. Rptr. 414*; *see Klinger v. Realty World Corp. (1987) 196 Cal. App. 3d 1549, 1553–1554, 242 Cal. Rptr. 592* (*Civ. Code § 1494* applied to continue accrual of prejudgment interest)]. An unwarranted condition annexed to an offer is, in effect, a refusal to perform [*Steelduct Co. v. Henger-Seltzer Co. (1945) 26 Cal. 2d 634, 646, 160 P.2d 804]*.

[c] Present Ability to Perform

An offer or tender of performance has no effect if the person making it is not able and willing to perform according to the offer [*Civ. Code § 1495*; *Allen v. Chatfield (1916) 172 Cal. 60, 68, 156 P. 47]*. Even if the necessity of an offer or tender of performance is eliminated, such as by repudiation of the contract, ability to perform must be proved at trial to enforce the other party's obligation when that is an issue [*see McDorman v. Moody (1942) 50 Cal. App. 2d 136, 141, 122 P.2d 639]*.

A thing to be delivered need not be actually produced on an offer or tender of performance, unless the other party accepts the offer or tender [*Civ. Code § 1496*]. An offer in writing to pay a particular sum of money or to deliver a written instrument or specific personal property is, if not accepted, equivalent to the actual production and tender of the money, instrument, or property [*Code Civ. Proc. § 2074*; *State of California v. Agostini (1956) 139 Cal. App. 2d 909, 913, 294 P.2d 769*; for discussion of offer or tender of payment of money generally, see [5], *below*].

[3] Time for Offer or Tender

[a] No Time Fixed—Implication of Reasonable Time

When the contract is silent as to the time for delivery or performance, the court will imply a reasonable time for performance [*Civ. Code § 1657*; *Walnut Creek Pipe Distributors, Inc. v. Gates Rubber Co. (1964) 228 Cal. App. 2d 810, 816, 39 Cal. Rptr. 767*; *compare Resolution Trust Corporation v. First American Bank (9th Cir. 1998) 155 F.3d 1126, 1128* (California law implying "reasonable time" term was inapplicable when agreement was not silent as to time but rather gave careful consideration to time requirements)]. What is "reasonable" is a question of fact [*Palmquist v. Palmquist (1963) 212 Cal. App. 2d 322, 331, 27 Cal. Rptr. 744]*. The offer or tender may be made at any time after it is due and before the debtor, on a reasonable demand, has refused to perform [*Civ. Code § 1491*]. However, if the performance is in its nature capable of being done instantaneously, *e.g.*, the payment of money only (*see* [5], *below*), it must be performed immediately once the thing to be done has been exactly ascertained [*Civ. Code § 1657*; *Shipley Co. v. Rosemead Co. (1929) 100 Cal. App. 706, 711, 280 P. 1017]*.

When delay in performance is capable of exact and entire compensation, and time has not been expressly declared to be of the essence of the obligation, an offer or tender of performance, accompanied by an offer of compensation, may be made at any time after it is due, but without prejudice to any rights acquired by the creditor or by any other person in the meantime [*Civ. Code § 1492*; *Benedict v. Calkins (1937) 19 Cal. App. 2d 416, 419, 65 P.2d 831]*. The general rule of equity is that time is not of the essence of a contract unless it clearly appears from the terms of the contract, in the light of all the circumstances, that it was the intention of the parties [*Henck v. Lake Hemet Water Co. (1937) 9 Cal. 2d 136, 143, 69 P.2d 849]*.

[b] Time Fixed by Contract

If a contract fixes a time for performance, the offer or tender must be made [*Civ. Code § 1490*]:

- At that time;
- Within reasonable hours; and
- Not before or after.

[c] Premature Offer or Tender

A premature offer or tender of performance is not valid [*Waller v. Brooks (1968) 267 Cal. App. 2d 389, 394, 72 Cal. Rptr. 228]*.

[4] Place for Offer or Tender

If the contract does not expressly stipulate a place of performance, the court will find the contract performable in the place at which the circumstances viewed in the light of pertinent code provisions indicate the parties expected or intended it to be performed [*Hale v. Bohannon (1952) 38 Cal. 2d 458, 466–467, 241 P.2d 4* (issue of fact)]. The place of performance for the payment of a debt, in the absence of an agreement or stipulation to the contrary, is either the place of the creditor's residence or business, if the creditor has one, or wherever else the creditor may be found. Under ordinary circumstances, it is the duty of the debtor to seek the creditor for the purpose of making payment [*Civ. Code §§ 1488*, *1489*; *Hale v. Bohannon (1952) 38 Cal. 2d 458, 466–467, 241 P.2d 4]*.

In the absence of an express provision to the contrary, an offer or tender of performance may be made, at the option of the debtor, at any of the following locations [*Civ. Code § 1489*]:

- At any place appointed by the creditor;
- Wherever the creditor can be found;
- At the creditor's residence or place of business, when it can, with reasonable diligence, be found within California, if the creditor cannot, with reasonable diligence, be found within California, and within a reasonable distance from the residence or place of business, or if the creditor evades the debtor; or

• If that cannot be done, at any place within California.

[5] Offer of Payment of Money

An obligation for the payment of money is extinguished by an offer or tender of payment, if the debtor [*Civ. Code § 1500*; *Taliaferro v. Taliaferro (1956) 144 Cal. App. 2d 109, 113, 300 P.2d 726, cert. denied, 352 U.S. 971 (1957)]*:

• Immediately deposits the amount in the name of the creditor;

• At a bank of deposit or savings and loan association within California of good repute; and

• Gives notice to the creditor.

Civ. Code § 1500 does not prescribe the mode of tender, but, rather, delineates a method of extinguishing an obligation [*Sayward v. Houghton (1898) 119 Cal. 545, 550, 51 P. 853, 52 P. 44]*.

For a deposit under *Civ. Code § 1500* to constitute valid tender, the money deposited must be unconditionally available to the creditor. An account set up so that the creditor cannot withdraw from it without the debtor's signature does not amount to tender [*Gaffney v. Downey Savings & Loan Assn. (1988) 200 Cal. App. 3d 1154, 1167, 246 Cal. Rptr. 421]*. For an affirmative defense based on tender and deposit pursuant to *Civ. Code § 1500*, see *§ 140.139*.

[6] Objections

[a] Required on Tender

To allow the obligor to remedy defects in the tender, the obligee must, at that time, specify any objection. Otherwise, the objection is deemed waived [*Civ. Code § 1501*; *Code Civ. Proc. § 2076*; *see Riverside Fence Co. v. Novak (1969) 273 Cal. App. 2d 656, 661–662, 78 Cal. Rptr. 536]*.

[b] Permissible Subjects of Objection

Objections to the mode of an offer or tender may cover not only what is offered, but also the conditions of the offer [*Kofoed v. Gordon (1898) 122 Cal. 314, 321–323, 54 P. 1115*]. If the objection is to an amount of money, the terms of an instrument, or an amount or kind of property, the obligee must specify the amount, terms, or kind required; otherwise the obligee is precluded from objecting afterward [*Noyes v. Habitation Resources, Inc. (1975) 49 Cal. App. 3d 910, 913–914, 123 Cal. Rptr. 261*].

[c] Effect of Generally Recognized Business Usage or Course of Dealings Between Parties

Because of generally recognized business usage or the course of dealing between the parties, the obligor may have reason to believe that tender in a medium other than that prescribed by law will be acceptable. If the obligee refuses it, insisting on legal tender, the obligee must give the obligor a reasonable time to make a valid tender. The more technical the objection to the tender, the more reasonable the inference from slight evidence that the obligee waived the objection [*Hunt v. Mahoney (1947) 82 Cal. App. 2d 540, 547, 187 P.2d 43*].

[d] Failure to Object

Failure to object to a tender does not waive a defect that, if specified, could not have been cured by the obligor [*Klein v. Markarian (1917) 175 Cal. 37, 41, 165 P. 3*; *Roven v. Miller (1959) 168 Cal. App. 2d 391, 399, 335 P.2d 1035*]. In addition, failure to object to a premature offer does not render the performance immediately due or waive the right to object to a subsequent offer made at maturity [*Allen v. Chatfield (1916) 172 Cal. 60, 68, 156 P. 47*].

[7] Offer or Tender Not Required When Futile

An offer or tender of performance is not necessary when the conduct and declarations of the other party show that the offer or tender would be unavailing or when the person who should have made the offer or tender is induced not to by an act of the other party naturally tending to have that effect, at or before the time the performance or offer or tender may be made [*Civ. Code § 1511(3)*; *Hoppin v. Munsey (1921) 185 Cal. 678, 685, 198 P. 398*; *United California Bank v. Maltzman (1974) 44 Cal. App. 3d 41, 52, 118 Cal. Rptr. 299]*.

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§ 140.42 Demand for Performance

[1] When Required

When one party has an unconditional duty to perform an act, the other party is not required to demand performance before commencing an action for breach of contract. The action itself is the only demand necessary [*Danielson v. Neal (1913) 164 Cal. 748, 750, 130 P. 716*; *McDonald v. Filice (1967) 252 Cal. App. 2d 613, 623, 60 Cal. Rptr. 832]*.

If the promisor does not have an unconditional duty to perform and the contract does not specify a time for performance, the promisee must make a demand for performance within a reasonable time after it can lawfully be made [*Woollomes v. Gomes (1938) 26 Cal. App. 2d 461, 465, 79 P.2d 728]*, to put the promisor in default. For discussion of conditional performance generally, *see § 140.44*. The primary object of the demand is to enable the promisor to perform the obligation or otherwise discharge the liability without being subject to the inconvenience and expense of litigation [*Tisdale v. Bryant (1918) 38 Cal. App. 750, 757, 177 P. 510]*. However, if a demand for performance would be futile, the demand need not be made, since the law does not require idle acts [*Cook v. Snyder (1936) 16 Cal. App. 2d 587, 591, 61 P.2d 53]*. For example, if the delay has operated to the detriment of the promisee to so as to render the delayed performance valueless, and the promisor was charged with knowledge of the special circumstances, the promisee need not demand performance [*Leonard v. Rose (1967) 65 Cal. 2d 589, 592–593, 55 Cal. Rptr. 916, 422 P.2d 604]*.

[2] Effect on Running of Statute of Limitations

A demand for performance may be considered a preliminary requirement to the beginning of an action or a condition precedent to a right. If it is a preliminary requirement to an action, the statute of limitations begins to run when a right has fully accrued. However, if the demand is an integral part of a cause of action, the statute does not run until the demand is made [*Woollomes v. Gomes (1938) 26 Cal. App. 2d 461, 465, 79 P.2d 728]*.

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§ 140.43 Performance of Alternative Obligations

A party whose obligation requires the performance of alternative acts has the right to select which act to perform unless the terms of the obligation provide otherwise [*Civ. Code § 1448*; *San Bernardino Valley Water Dev.Co. v. San Bernardino Valley Mun. Water Dist. (1965) 236 Cal. App. 2d 238, 247, 45 Cal. Rptr. 793]*. The party must select an alternative in its entirety, unless the other party otherwise consents [*see Civ. Code § 1450*].

The selecting party must give notice of the selection within the time fixed by the terms of the obligation. If the terms of the obligation do not fix a time, the selecting party must give notice before the time the obligation ought to be performed; otherwise the right of selection passes to the other party [*Civ. Code § 1449*; *Norris v. Harris (1860) 15 Cal. 226, 258]*. The obligation becomes absolute only on the making of a selection by either party [*see Norris v. Harris (1860) 15 Cal. 226, 258]*.

If one of the alternative acts is unlawful or becomes unlawful or impossible to perform, the court will interpret the obligation as though the other stood alone [*Civ. Code § 1451*; *Rosenthal v. Perkins (1898) 123 Cal. 240, 243, 55 P. 804]*.

§ 140.44 Performance of Conditional Obligation

[1] In General

The performance of a contractual obligation is conditional when the rights or duties of a party depend on the occurrence of an uncertain event [*Civ. Code § 1434*; *Riess v. Murchison (9th Cir. 1964) 329 F.2d 635, 643*, *after remand*, *503 F.2d 999 (1974)]*. Parties may insert in their contracts whatever legal conditions they desire [*Cavanaugh v. Casselman (1891) 88 Cal. 543, 549, 26 P. 515]*. These conditions may be precedent[*see* [4], *below*], subsequent [*see* [5], *below*], or concurrent [*Civ. Code § 1435*; *see* [6], *below*].

The breach of an important condition may excuse the other party from performance [*Civ. Code § 1439*; *see, e.g.*, *Wiz Technology, Inc. v. Coopers & Lybrand LLP (2003) 106 Cal. App. 4th 1, 11–14, 130 Cal. Rptr. 2d 263* (auditor's resignation was justified by client's breach of material condition which required hiring different securities counsel)].

[2] Condition and Covenant Distinguished

A condition is a fact or event that creates no right or duty, but merely limits or modifies a contractual duty or right. The nonoccurrence of a condition can prevent the existence of a duty in the other party, but it cannot create any remedial rights and duties unless one party has promised that it will occur [*see Civ. Code § 1582*].

On the other hand, a promise or covenant is an expression of intention that the promisor will render some future performance and an assurance of its rendition to the promisee. The

nonfulfillment of a promise, unlike a condition, is a breach of contract and creates in the other party a right to damages.

Whether a provision constitutes a condition or a covenant is determined from the whole document, its purpose, and the intention of the parties [*Pacific Allied v. Century Steel Products (1958) 162 Cal. App. 2d 70, 80,327 P.2d 547]*. When it is doubtful whether words create a promise or an express condition, the court interprets the words as creating a promise. Such an interpretation protects both parties and avoids having a slight failure to perform wholly destroy all rights under the contract [*Division of Labor Law Enforcement, Dep't of Industrial Relations v. Ryan Aeronautical Co. (1951) 106 Cal. App. 2d Supp. 833, 836*].

[3] Express and Implied Conditions

An express condition is a condition by agreement of the parties, expressed in definite language when the parties make the contract. A condition is implied when the parties make promises by expressing an intention that a fact or event should be a condition of their legal duty without putting it into words [*see Sosin v. Richardson (1962) 210 Cal. App. 2d 258, 264, 26 Cal. Rptr. 610]*.

[4] Condition Precedent

[a] Definition

A condition precedent is a condition to be performed before a right dependent on it accrues or an act dependent on it is to be performed [*Civ. Code § 1436*]. For example, the parties create a condition precedent by agreeing that a third person is to determine performance of the contract [*see Lucas v. Quigley Motor Co. (1961) 191 Cal. App. 2d 152, 155, 12 Cal. Rptr. 442]*, or that one party must perform to the satisfaction of the other party before the approving party has a duty to perform [*see Mattei v. Hopper (1958) 51 Cal. 2d 119, 122–*

123, 330 P.2d 625; *see also* *Locke v. Warner Bros., Inc. (1997) 57 Cal. App. 4th 354, 363–364, 66 Cal. Rptr. 2d 921]*.

[b] Not Favored by Law

The law does not favor conditions precedent. Courts are disinclined to construe the stipulations of a contract as conditions precedent unless compelled by the language of the contract, because such a construction prevents the court from doing justice for the parties according to the equities of the case [*Front St., Mission & Ocean R.R. Co. v. Butler (1875) 50 Cal. 574, 577*; *Colaco v. Cavotec SA (2018) 25 Cal. App. 5th 1171, 1183, 236 Cal. Rptr. 3d 542*; *Frankel v. Board of Dental Examiners (1996) 46 Cal. App. 4th 534, 550, 54 Cal. Rptr. 2d 128]*. However, parties to a contract may agree that any matter is a condition precedent [*see* *Int'l Bhd. of Teamsters Local 396 v. NASA Servs. (9th Cir. 2020) 957 F.3d 1038, 1043, 1049–1050* (finding that contract contained condition precedent to formation that was both ascertainable and lawful)]. If the words used in the contract are so precise, express, and strong that such an interpretation of the contract finding such an intention is the only one compatible with the terms employed, the court must give effect to the declared intention of the parties [*Schwab v. Bridge (1915) 27 Cal. App. 204, 207, 149 P. 603]*.

[c] Approval of Agreement by Others

Generally, an agreement subject to the approval of the board of directors of one of the contracting parties or of some third person is not unenforceable as illusory. Unless a reasonable person would have understood that the agreement was not effective when signed, approval is a condition precedent to the party's duty to perform, not a condition precedent to the formation of the contract [*Jacobs v. Freeman (1980) 104 Cal. App. 3d 177, 187, 189–190, 163 Cal. Rptr. 680*; for discussion of formation of enforceable contracts generally, *see* *§ 140.20* et seq.].

The condition of approval and the implied covenant of good faith and fair dealing (*see § 140.12*) give rise to a duty on the part of the party whose performance is conditioned on approval to submit the contract to the board or other person for approval, as well as a duty on the part of the board or other person to decide whether to approve the contract [*Moreland Development Co. v. Gladstone Holmes, Inc. (1982) 135 Cal. App. 3d 973, 977–978, 186 Cal. Rptr. 6*; *Jacobs v. Freeman (1980) 104 Cal. App. 3d 177, 190, 163 Cal. Rptr. 680]*.

Failure to submit the contract for approval is a breach of contract. For discussion of breach of contract generally, *see § 140.50* et seq. If approval would have been given if sought, failure to seek approval excuses the condition of approval and the party whose performance was conditioned on approval must perform [*Jacobs v. Tenneco West, Inc. (1986) 186 Cal. App. 3d 1413, 1417–1418, 231 Cal. Rptr. 351* (decree of specific performance proper on trial court's finding that approval would have been given if sought)]. If approval would not have been given if sought, failure to seek approval is excused, and the party whose performance was conditioned on approval need not perform. This excuse for nonperformance is a kind of affirmative defense. The party who did not submit the contract for approval has the burden of proving that the board of directors or other person, acting in good faith, would not have approved the contract if the party had submitted it for approval in a timely manner [*Jacobs v. Tenneco West, Inc. (1986) 186 Cal. App. 3d 1413, 1418–1419, 231 Cal. Rptr. 351]*.

[d] Payment From Particular Fund

A contract may limit an obligation to pay sums by prescribing payment out of a specified fund or from a specified source. The existence of the fund is a condition precedent to the obligation of payment. If, through no fault of the promisor, the fund does not exist, the promisor will not be obligated to pay [*Sunniland Fruit, Inc. v. Verni(1991) 233 Cal. App. 3d 892, 899, 284 Cal. Rptr. 824*; *Jeschke v. Lamarr (1965) 234 Cal. App. 2d 506, 511, 44*

Cal. Rptr. 416; *but see* *Wm. R. Clarke Corp. v. Safeco Ins. Co. (1997) 15 Cal. 4th 882, 888–896, 64 Cal. Rptr. 2d 578, 938 P.2d 372* (in subcontractor's action against surety on general contractor's payment bond, "pay if paid" provision in subcontract did not create condition precedent to subcontractor's contractual right to receive payment from general contractor; provision was not valid as waiver of subcontractor's mechanic's lien rights); *see also* *Capital Steel Fabrications v. Mega Construction Co. (1997) 58 Cal. App. 4th 1049, 1062, 58 Cal. App. 4th 1049, 68 Cal. Rptr. 2d 672* (holding that *Clarke* applies to a public works project when there is no pending action against the governmental entity)].

Simple identification of a particular pool of money as a source of payment does not limit or preclude recovery from other sources when the pool fails to materialize, unless the agreement expressly so states [*Sunniland Fruit, Inc. v. Verni (1991) 233 Cal. App. 3d 892, 900, 284 Cal. Rptr. 824* (fact that advance would be "deducted" from grower's profits did not condition duty to repay advance on existence of profits)].

When the duty to pay is conditioned on the existence of a specific fund, the promisee must allege and prove that the condition has been satisfied [*Draper v. Patterson (1958) 156 Cal. App. 2d 606, 608–609, 319 P.2d 694* (complaint insufficient for failing to allege that defendant made profit from crops off land in question)].

[5] Condition Subsequent

A condition subsequent is a future event, on the happening of which the obligation will become no longer binding on the other party if the other party chooses to avail himself, herself or itself of the condition [*Civ. Code § 1438*; *Frankel v. Board of Dental Examiners (1996) 46 Cal. App. 4th 534, 550, 54 Cal. Rptr. 2d 128]*. An example of a condition subsequent is an agreement that the transfer of patent rights to a company is subject to the condition that the company thereafter must manufacture and sell at least 5,000 patented devices each year, otherwise, on demand, the patent rights must be reassigned [*Lowe v. Copeland (1932) 125 Cal. App. 315, 318, 321, 13 P.2d 522]*.

The intent to create a condition subsequent must appear expressly or by clear implication. However, no precise words are necessary [*Lowe v. Copeland (1932) 125 Cal. App. 315, 321, 13 P.2d 522]*.

[6] Concurrent Conditions

Concurrent conditions are conditions that are mutually dependent and are to be performed at the same time [*Civ. Code § 1437*; *Groobman v. Kirk (1958) 159 Cal. App. 2d 117, 123, 323 P.2d 867]*. In a bilateral contract (*see § 140.10[4]*), although performances are not necessarily to be rendered at the same time, the performance of one promise is the agreed exchange for the other promise [*see McDorman v. Moody (1942) 50 Cal. App. 2d 136, 142, 122 P.2d 639]*. As a result, and since the law does not favor conditions precedent, whenever possible the courts construe promises in a bilateral contract as mutually dependent and concurrent conditions [*Rubin v. Fuchs (1969) 1 Cal. 3d 50, 53–54, 81 Cal. Rptr. 373, 459 P.2d 925]*. Conditions precedent are discussed in *§ 140.44[4]*.

The only important difference between a concurrent condition and a condition precedent is that the condition precedent must be performed before another duty arises, while a tender of performance is sufficient to cause another duty to arise in the case of concurrent conditions. The failure of both parties to perform concurrent conditions during the time for performance does not leave the contract open for an indefinite period so that either party may tender performance at that party's leisure [*Pittman v. Canham (1992) 2 Cal. App. 4th 556, 559, 3 Cal. Rptr. 2d 340]*. The failure of both parties to perform concurrent conditions results in a discharge of both parties' duty to perform. Thus, when a contract makes time of the essence, if the time expires without tender by either party, both parties are discharged from their obligations under the contract [*Pittman v. Canham (1992) 2 Cal. App. 4th 556, 559–560, 3 Cal. Rptr. 2d 340*; *see Rutherford Holdings, LLC v. Plaza Del Rey (2014) 223 Cal. App. 4th 221, 228–230, 166 Cal. Rptr. 3d 864* (real property seller failed to tender deed and buyer failed to tender purchase price, which were concurrent conditions, and therefore neither party

could argue that other party's failure to perform in that respect was breach of contract, but instead each such duty to perform was discharged; however, aggrieved party was entitled to allege that other party breached contract by failing to satisfy some different condition)].

[7] Excuse of Condition

Courts will sometimes excuse conditions, allowing one party to enforce the contract even though the condition has not been satisfied. For example, if the obligee gives notice to the obligor before the obligor is in default, that the obligee will not perform the obligation, and does not retract that notice before the time performance is due, the obligor is entitled to enforce the obligation without previously performing or offering to perform any obligation in favor of the defaulting obligee [*Civ. Code § 1440*; *see* *Tatum v. Ackerman (1905) 148 Cal. 357, 360, 83 P. 151]*.

If a condition is solely for the benefit of one party, the condition and the implied covenant of good faith and fair dealing give rise to the duty on the part of that party to do everything the contract presupposes that party will do to accomplish its purpose [*Jacobs v. Freeman (1980) 104 Cal. App. 3d 177, 188–189, 163 Cal. Rptr. 680]*. When the party to be benefitted by performance of the condition tries in good faith to satisfy the condition but is unable to do so, that party has an option not to consummate the transaction. Thus, a party may waive a condition precedent solely for that party's benefit [*Crescenta Valley Moose Lodge v. Bunt (1970) 8 Cal. App. 3d 682, 687, 87 Cal. Rptr. 428*; *see* *Wyler Summit Partnership v. Turner Broadcasting (9th Cir. 1998) 135 F.3d 658, 662–664* (holding that plaintiff stated claim for breach of contract based on its alleged waiver of installment payment provision for "percentage compensation" for profits from film "Ben Hur"); *Wyler Summit Partnership v. Turner Broadcasting (9th Cir. 2000) 235 F.3d 1184, 1191–1192* (trial court erred in granting summary judgment to studio on issue of waiver when genuine issue of material fact existed regarding whether installment provision originally was included in contract for sole benefit of director)].

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§ 140.45 Impossibility of Performance

[1] In General

[a] Impossible or Impracticable

At common law, the determination that a contract was impossible to perform was limited to literal or physical impossibility of performance [*Kennedy v. Reece (1964) 225 Cal. App. 2d 717, 724, 37 Cal. Rptr. 708]*. The common law rule still applies to the extent that a party may not escape a voluntarily assumed contractual obligation merely because performance would be more expensive or more difficult than contemplated when the agreement was executed [*Butler v. Nepple (1960) 54 Cal. 2d 589, 599, 6 Cal. Rptr. 767, 354 P.2d 239]*.

However, modern cases recognize something as legally impossible when it is impracticable, that is, when it can be done only at an excessive and unreasonable cost [*Mineral Park Land Co. v. Howard (1916) 172 Cal. 289, 293, 156 P. 458]*. The defense of impossibility may be based on impracticability when it is due to excessive and unreasonable difficulty or expense [*Christin v. Superior Court (1937) 9 Cal. 2d 526, 533, 71 P.2d 205*; *see In re Marriage of Benjamins (1994) 26 Cal. App. 4th 423, 432 n.3, 31 Cal. Rptr. 2d 313* (general contract principles applied to dissolution settlement agreement)]. Nevertheless, facts that make performance more difficult or expensive than the parties anticipated do not constitute a ground for the defense of impracticability unless

they are of the gravest importance [*Kennedy v. Reece (1964) 225 Cal. App. 2d 717, 725, 37 Cal. Rptr. 708]*.

A party invoking the impossibility defense must show that reasonable efforts were used to surmount the obstacles that prevented performance [*McCalden v. California Library Ass'n (9th Cir. 1990) 955 F.2d 1214, 1219*, *cert. denied, 504 U.S. 957 (1992)]*.

For an affirmative defense based on impossibility, see *§ 140.137*.

[b] Objective Test

If performance of a contract is possible, failure to perform is not an excuse for nonperformance, but is instead a breach even if the obligor may have become wholly unable to perform. If what is agreed to be done is possible and lawful, it must be done. If a party expressly undertakes to do a thing lawful in itself, and not necessarily impossible in all circumstances, but does not do it, that party must pay damages, even if the performance was rendered impracticable or even impossible by an unforeseen cause for which no provision was made and over which the party had no control but against which the party might have provided in the contract [*Kennedy v. Reece (1964) 225 Cal. App. 2d 717, 725, 37 Cal. Rptr. 708]*.

The impossibility must attach to the nature of the thing to be done and not to the inability of the promisor to do it. For example, failure of the defendant to obtain permission to divert traffic from an old bypass road in time for the plaintiff to proceed with the contract to construct new roads did not excuse performance on the grounds of impossibility, when the defendant was able to get consent later and might have arranged for the diversion at the date required by using greater diligence or better planning [*Hensler v. City of Los Angeles (1954) 124 Cal. App. 2d 71, 83, 268 P.2d 12]*. A party cannot assert the defense of impossibility if that party has placed performance of the contract beyond that party's control by a voluntary act [*Pacific Venture Corporation v. Huey (1940) 15 Cal. 2d 711,*

717, 104 P.2d 641; *Lortz v. Connell (1969) 273 Cal. App. 2d 286, 290–291, 78 Cal. Rptr. 6]*.

[2] Extreme Hardship

A party cannot assert a defense of impossibility based on extreme hardship if the party has received the full consideration or if circumstances have not entirely destroyed the purpose that both parties had in mind. There is no impossibility of performance when one party rendered services as agreed and nothing remains for the other party to do but pay the agreed compensation [*Browne v. Fletcher Aviation Corp. (1945) 67 Cal. App. 2d 855, 862, 155 P.2d 896* (no impossibility of performance and plaintiff test pilot permitted to recover full contract price under contract to test gliders manufactured by defendant for Air Force, when gliders were delivered, accepted, and paid for in amount satisfactory to defendant even though tests by plaintiff lasted only three hours instead of projected 10 hours)].

[3] Destruction of Thing or Death of Party

If performance depends on the existence of a given thing, and existence was assumed as the basis of the agreement, performance is excused to the extent the thing ceases to exist or is nonexistent [*Mineral Park Land Co. v. Howard (1916) 172 Cal. 289, 292, 156 P. 458]*. Similarly, when one party engages another to render personal services for a specified period, the obligor's death or incapacity before the end of the agreed time terminates the contract if the terms of the contract and the surrounding circumstances indicate that each party relied on personal skills, talents, or characteristics that no one other than the other contracting party could provide [*Farnon v. Cole (1968) 259 Cal. App. 2d 855, 858, 66 Cal. Rptr. 673*; *Cazares v. Saenz (1989) 208 Cal. App. 3d 279, 284–286, 256 Cal. Rptr. 209* (when partner in two-person law firm was appointed to bench, association agreement was discharged, and attorney associated with firm did not have to work with other partner)].

If the existence of a particular person is necessary for performance, incapacity making performance impracticable is sufficient to discharge the contract [Restatement (Second) of Contracts § 262 (1979)]. This rule does not apply if the services may be as well performed by others or if the contract by its terms shows that performance by others was contemplated [*Howard v. Adams (1940) 16 Cal. 2d 253, 258, 105 P.2d 971]*.

[4] Interference by Operation of Law

Performance may be excused by operation of law if the passage of a statute or ordinance makes the contemplated performance illegal or a condemnation proceeding brought by the state or a public agency prevents performance. 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 a third person, is not an excuse for nonperformance, however [*see Civ. Code § 1511(1)*; *Webster v. Southern Cal. First National Bank (1977) 68 Cal. App. 3d 407, 415–416, 137 Cal. Rptr. 293]*. Laws or other governmental acts that only make performance unprofitable or more difficult or expensive also do not excuse the duty to perform a contractual obligation [*Lloyd v. Murphy (1944) 25 Cal. 2d 48, 55, 153 P.2d 47]*.

A court holding may also have the effect of making performance impossible and therefore excused. For example, the lessee under an equipment lease, *i.e.*, a financing agreement in lease form, may be excused from making payments when, in a turn of events not reasonably foreseeable by either party when the agreement was made, the equipment became unusable because of a federal court order requiring that it be rendered inoperable, operation of the equipment having been found to unlawfully interfere with operation of other similar equipment by the federal government [*see Federal Leasing Consultants, Inc. v. Mitchell Lipsett Co. (1978) 85 Cal. App. 3d Supp. 44, 47–49*]. The court applied the commercial frustration doctrine [*see § 140.46*].

[5] Act of God or Public Enemy

Performance may be excused by an irresistible, superhuman cause or by an act of God [*Civ. Code § 1511(1)*; *Sun Oil Co. v. Union Drilling etc. Co. (1929) 208 Cal. 114, 120, 280 P. 535]*. For a discussion and forms relating to an act of God, see *Ch. 10, Act of God*.

Performance is also excused when prevented or delayed by the act of public enemies of California or of the United States, unless the parties have expressly agreed to the contrary [*Civ. Code § 1511(2)*; *but see U.S. Trading Corp. v. Newmark G. Co. (1922) 56 Cal. App. 176, 186–187, 205 P. 29* (railroad embargo to continue for indefinite time suspended but did not discharge performance of contract for shipment of goods)].

[6] Temporary Impossibility

Temporary impossibility of a character that, if it should become permanent, would discharge a promisor's entire contractual duty, operates as a permanent discharge if performance after the impossibility ceases would impose a substantially greater burden on the promisor. Otherwise, the duty is suspended while the impossibility exists [*Autry v. Republic Productions, Inc. (1947) 30 Cal. 2d 144, 149, 180 P.2d 888*; *see G.W. Andersen Construction Co. v. Mars Sales (1985) 164 Cal. App. 3d 326, 336–337, 210 Cal. Rptr. 409* (building moratorium temporary impossibility suspending contractor's performance duty but not defendant's duty to make down payment required by contract)].

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§ 140.46 Frustration of Purpose

The doctrine of frustration applies when performance remains possible but the fundamental reason of both parties for entering into the contract has been frustrated by an unanticipated supervening circumstance, destroying substantially the value of performance by the party standing on the contract [*Cutter Laboratories, Inc. v. Twining (1963) 221 Cal. App. 2d 302, 314–315, 34 Cal. Rptr. 317]*. A promisor without fault in causing the frustration, who is harmed by it, is discharged from performance unless a contrary intention appears [*Dorn v. Goetz (1948) 85 Cal. App. 2d 407, 411, 193 P.2d 121]*.

The defense of frustration is available only when the frustration is substantial. It is not enough that the transaction will be less profitable than originally anticipated or even that one party will sustain a loss. The frustration must be so severe that it is not fairly regarded as within the risks assumed by that party under the contract [*FPI Development, Inc. v. Nakashima (1991) 231 Cal. App. 3d 367, 399, 282 Cal. Rptr. 508*; *Nieman v. Peterson (1978) 86 Cal. App. 3d Supp. 14, 19*].

The doctrine of frustration is akin to the doctrine of impossibility of performance, since both developed from the commercial necessity of excusing performance in cases of extreme hardship. However, frustration is not a form of impossibility [*Lloyd v. Murphy (1944) 25 Cal. 2d 48, 53–54, 153 P.2d 47]*. Frustration more properly relates to the consideration for performance [*Autry v. Republic Productions, Inc. (1947) 30 Cal. 2d 144, 148, 180 P.2d 888]*.

The question is whether the equities of the case, considered in the light of sound public policy, require placing the risk of disruption or complete destruction of the contract equilibrium on the

defendant or the plaintiff in the circumstances of the case. The answer depends on whether an unanticipated circumstance, the risk of which should not be fairly thrown on the promisor, has made performance vitally different from what was reasonably to be expected. The court must examine the circumstances surrounding the formation of the contract to determine whether it can fairly infer that the risk of the event causing the alleged frustration was not reasonably foreseeable. If it was foreseeable, the contract should have provided for it. The absence of a provision gives rise to an inference that the parties assumed the risk [*Lloyd v. Murphy (1944) 25 Cal. 2d 48, 53–54, 153 P.2d 47]*. Of course, if the parties have contracted with reference to the frustrating event or have contemplated the risks arising from it, they may not invoke the doctrine of frustration to escape their obligations [*Glenn R. Sewell Sheet Metal, Inc. v. Loverde (1969) 70 Cal. 2d 666, 676, 75 Cal. Rptr. 889, 451 P.2d 721*; *U.S. Roofing, Inc. v. Credit Alliance Corp. (1991) 228 Cal. App. 3d 1431, 1448 n.10, 279 Cal. Rptr. 533* (doctrine inapplicable because crane defect foreseeable as demonstrated by lease disclaimer provision)].

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§ 140.47 Termination of Contract

[1] In General

The parties may terminate an executory contract, wholly or in part, by mutual consent at any stage of performance. Termination means doing away with the existing agreement and leaving the parties in their respective positions at the time of termination. It differs from rescission, one result of which is to restore the parties to their former positions [*Sanborn v. Ballanfonte (1929) 98 Cal. App. 482, 487–488, 277 P. 152]*. The parties may terminate a written contract by an oral agreement, whether executed or not [*Grant v. Aerodraulics Co. (1949) 91 Cal. App. 2d 68, 75, 204 P.2d 683]*.

[2] Contractual Provision for Termination

[a] Enforceability and Effect

If a contract provides that a party may terminate it at that party's option, the party is not liable after termination for further transactions under the contract. However, obligations that accrued before termination are not affected [*Merrill v. Continental Assurance Co. (1962) 200 Cal. App. 2d 663, 670, 19 Cal. Rptr. 432]*.

A provision giving one party an option to terminate on substantial notice need not be supported by consideration different from consideration supporting the entire agreement [*Millgee Investment Co. v. Friedrich (1967) 254 Cal. App. 2d 802, 805, 62 Cal. Rptr. 730]*.

The express term of the contract is not shortened or affected by the termination clause

unless a party exercises the option to terminate under the clause in the manner prescribed by the contract [*Kuffel v. Seaside Oil Co. (1970) 11 Cal. App. 3d 354, 368, 90 Cal. Rptr. 209]*.

Once a party exercises an option to terminate a contract, the contract is extinguished and discharged. The other party cannot thereafter revive it through an offer to perform an act, the nonperformance of which gave rise to the option to terminate [*Siegel v. Lewis (1946) 74 Cal. App. 2d 86, 91, 168 P.2d 50]*.

When a contract provides that either party may terminate it without cause by giving notice a specified number of days before termination, a party who terminates the contract without notice or on shorter notice than required breaches the contract. Damages for breach are limited to those that could have accrued during the period of the required notice [*see Civ. Code § 3358*; *Martin v. U-Haul Co. of Fresno (1988) 204 Cal. App. 3d 396, 410–411, 251 Cal. Rptr. 17]*.

[b] Necessity for Cause or Good Faith

The implied covenant of good faith and fair dealing [*see § 140.12*] may supply a requirement of good cause for termination if the contract is silent or ambiguous on that subject. However, courts will not interpret the implied covenant to add a requirement of good cause when the written contract expressly provides that it may be terminated at will or for any reason on notice [*Gerdlund v. Electronic Dispensers International (1987) 190 Cal. App. 3d 263, 277–278, 235 Cal. Rptr. 279* (contract with nonemployee sales representative)].

Similarly, no tort cause of action arises for termination of a contract pursuant to a notice provision unless a special relationship exists between the parties to the contract [*Martin v. U-Haul Co. of Fresno (1988) 204 Cal. App. 3d 396, 412–415, 251 Cal. Rptr. 17* (no special relationship: equipment rental dealership); *Premier Wine & Spirits v. E. & J. Gallo Winery (9th Cir. 1988) 846 F.2d 537, 540* (applying California law in diversity action; no

special relationship: wine distributorship); *see* *Abrahamson v. NME Hospitals, Inc. (1987) 195 Cal. App. 3d 1325, 1329–1330, 241 Cal. Rptr. 396* (no tort even if termination pursuant to notice provision was motivated by refusal of independent contractor physician to condone poor practices in healing arts)].

The court may receive parol evidence of industry custom and the circumstances surrounding formation of the contract on the issue of whether a provision for termination by either party after notice includes the requirement that termination must be for poor performance that remains uncorrected after notice [*Jack Rowe Assoc., Inc. v. Fisher Corp. (9th Cir. 1987) 833 F.2d 177, 181–183*, *after remand, 936 F.2d 578 (1991)* (applying California law to require retrial: distributorship agreement); *see* *Esbensen v. Userware Internat., Inc. (1992) 11 Cal. App. 4th 631, 636–640, 14 Cal. Rptr. 2d 93* (parol evidence admissible regarding oral understanding of grounds for termination of employment contract that was only partially integrated)].

Even when termination amounts to a breach of the contract because done on less notice than required by the contract, it does not constitute tortious denial of the existence of the contract [*Martin v. U-Haul Co. of Fresno (1988) 204 Cal. App. 3d 396, 412, 251 Cal. Rptr. 17]*. For discussion of tortious denial of the existence of a contract, see *§ 140.12[4]*.

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§§ 140.48 –140.49 [Reserved]

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13 California Forms of Pleading and Practice--Annotated § 140.50

§ 140.50 In General

[1] Definition

A breach of contract is a party's unjustified or unexcused nonperformance of a contractual duty the party is required to immediately perform. A breach may be total or partial [*see § 140.51*]. It may consist of [*see Sackett v. Spindler (1967) 248 Cal. App. 2d 220, 227, 56 Cal. Rptr. 435]*:

- Failure to perform acts promised;
- Prevention or hindrance of performance; or
- Repudiation of the promise.

A party cannot actually breach a contract until the time specified for performance has arrived [*Taylor v. Johnston (1975) 15 Cal. 3d 130, 137, 123 Cal. Rptr. 641, 539 P.2d 425]*. However, the court may treat repudiation of a promise as anticipatory breach [*see § 140.54*].

When the contract unambiguously provides what are the circumstances in which a party may be deemed to be in breach of the contract, then that provision will control a determination of whether that party's breach has occurred [*Silverado Modjeska Recreation & Park Dist. v. County of Orange (2011) 197 Cal. App. 4th 282, 312–314, 128 Cal. Rptr. 3d 772* (contract defined breach by either party as failure to perform any obligation after receipt of other party's written notice of breach, sent by prepaid certified mail or by courier, and recipient's failure to cure within 30 days after receipt of that notice; no such notice was given, and therefore trial court wrongly ruled that allegedly culpable party was in breach of contract)].

When a contract is expressly renewable for a fixed term at a party's option, but subject to the condition that renewal will depend on the parties reaching agreement about something essential to the contract (such as the nature and amount of security that one party will provide for that party's performance) in the renewal term, there is no breach of contract in the event that, after the option to renew is exercised, the parties fail to reach agreement on that essential something. After the original term ends, even if the parties continue to do business with each other as before, their conduct does not imply that the contract continues in existence. Therefore, if their negotiations regarding that essential something eventually come to naught, neither party can be liable for breach of contract [*Warner Bros. Int'l TV Distrib. v. Golden Channels Co. (9th Cir. 2008) 522 F.3d 1060, 1070*].

[2] Accrual of Cause of Action

A cause of action based on breach of contract accrues at the time of the breach. In the case of a personal performance contract, breach of the obligation to pay occurs at the time the other party completes the required performance [*E.O.C. Ord, Inc. v. Kovakovich (1988) 200 Cal. App. 3d 1194, 1203, 246 Cal. Rptr. 456]*.

[3] Effect

Any breach, total or partial, that causes a measurable injury gives the aggrieved party a right to damages as compensation for the breach [*Borgonovo v. Henderson (1960) 182 Cal. App. 2d 220, 231, 6 Cal. Rptr. 236]*. The breach may consist of a defective performance as well as an absence of performance [*Linden Partners v. Wilshire Linden (1998) 62 Cal. App. 4th 508, 531–532, 73 Cal. Rptr. 2d 708]*. If there is a total breach of the contract, the plaintiff may sue for all consequential damages, general and special. Any subsequent action for additional damages could be successfully opposed by a plea of res judicata; thus, the plaintiff's injury is necessarily permanent.

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§ 140.51 Partial Breach

[1] Effect

If the breach is partial only, the aggrieved party may recover damages for nonperformance only to the time of trial and may not recover damages for anticipated future nonperformance. Even if a breach is total, the aggrieved party may treat it as partial, unless the wrongdoer repudiated the contract [*Coughlin v. Blair (1953) 41 Cal. 2d 587, 598–599, 262 P.2d 305]*.

[2] Determination of Partial Breach

Whether a breach of contract is total or partial depends on its materiality and ordinarily is a question of fact [*Whitney Inv. Co. v. Westview Dev. Co. (1969) 273 Cal. App. 2d 594, 601, 78 Cal. Rptr. 302*; for discussion of materiality of breach, *see § 140.52*]. The circumstances of each case determine whether the aggrieved party may treat a breach of contract as total. If the aggrieved party has fully performed his, her or its obligations under a bilateral contract, courts usually treat a breach as partial unless it appears that performance of the agreement is unlikely and the aggrieved party may be protected only by the recovery of damages for the value of the promise [*Coughlin v. Blair (1953) 41 Cal. 2d 587, 599, 262 P.2d 305]*.

§ 140.52 Materiality

The materiality of a breach does not depend necessarily on the amount of money involved [*Associated Lathing & Plastering Co. v. Louis C. Dunn, Inc. (1955) 135 Cal. App. 2d 40, 51, 286 P.2d 825* (subcontractor's failure to install hangers was material breach even though cost of installing hangers was only $3,500 and total contract was for $140,000)]. In determining the materiality of a failure to fully perform a promise, the court should consider the following factors [*Whitney Inv. Co. v. Westview Dev. Co. (1969) 273 Cal. App. 2d 594, 602, 78 Cal. Rptr. 302*; *see Magic Carpet Ride LLC v. Rugger Investment Group, L.L.C. (2019) 41 Cal. App. 5th 357, 360, 254 Cal. Rptr. 3d 213*; *Sackett v. Spindler (1967) 248 Cal. App. 2d 220, 229, 56 Cal. Rptr. 435]*:

- The extent to which the aggrieved party will obtain the substantial benefit that party could have reasonably anticipated;
- The extent to which the aggrieved party may be adequately compensated in damages for lack of complete performance;
- The extent to which the party failing to perform has partly performed or made preparations for performance;
- The extent of the hardship on the party failing to perform, if the court terminates the contract;
- The willful, negligent, or innocent behavior of the party failing to perform;
- The extent of uncertainty that the party failing to perform will perform the remainder of the contract; and

- The timing of the breach (a slight breach at the outset may justify termination whereas a like breach later in performance may be insubstantial).

Whether a particular breach is material is usually a question of fact. The timing of a breach is a relevant consideration in determining its materiality. A slight breach at the outset may justify rescission, while a similar breach later in performance may be insubstantial [*Whitney Inv. Co. v. Westview Dev. Co. (1969) 273 Cal. App. 2d 594, 601–602, 78 Cal. Rptr. 302]*.

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§ 140.53 Entire Contract or Severable Provisions

A factor for consideration in the breach of an executory contract is whether the terms of the contract are entire or severable [*Big Boy Drilling Corp., Ltd. v. Etheridge (1941) 44 Cal. App. 2d 114, 119, 111 P.2d 953]*. If a contract is divisible and severable so that both parties may fully perform without affecting subsequent performance or right of performance as to the remainder, and a breach occurs as to the severable part, the aggrieved party may treat that part as abandoned and recover the money paid on the severable part [*San Diego Constr. Co. v. Mannix (1917) 175 Cal. 548, 554, 166 P. 325]*.

However, if a contract is entire, a repudiation of a part is a repudiation of it all. The aggrieved party has the right to consider the breach of a part as a breach of the entire contract and discontinue performance on the entire contract. The aggrieved party is discharged from the satisfaction of any conditions on his, her or its part [*De Prosse v. Royal Eagle Distilleries Co. (1902) 135 Cal. 408, 411, 67 P. 502]*.

§ 140.54 Anticipatory Breach

[1] Treatment as Actual Breach

California recognizes the rule of anticipatory breach. The promisee may treat the promisor's definite and unconditional repudiation of the contract, communicated to the promisee, as a breach of the contract creating an immediate right of action, even though the repudiation takes place long before the time prescribed for the promised performance and before conditions specified in the contract have been satisfied [*Daum Development Corp. v. Yuba Plaza, Inc. (1970) 11 Cal. App. 3d 65, 73–74, 89 Cal. Rptr. 458*, *disapproved on other grounds* in *Ninety Five Ten v. Crain (1991) 231 Cal. App. 3d 36, 40–41, 282 Cal. Rptr. 141*; *see Civ. Code § 1440*; *see also Mobil Oil Exploration & Producing Southeast, Inc. v. United States (2000) 530 U.S. 604, 120 S. Ct. 2423, 147 L.Ed. 2d 528, 534* (obligor's statement to obligee indicating that obligor will breach an important contractual promise, thereby substantially impairing the value of the contract, constituted repudiation of contract and plaintiffs were entitled to restitution whether or not repudiated contracts ultimately would have produced financial gain)].

[2] Requirements

[a] Repudiation Before Performance Due

An essential element of anticipatory breach is that the promisor expressly or implicitly repudiate the promise before the promisor's performance is due [*Taylor v. Johnston (1975)*

15 Cal. 3d 130, 137, 123 Cal. Rptr. 641, 539 P.2d 425]. The promisee may then treat the repudiation as a breach. However, the promisor may retract the repudiation up to the time performance is due, as long as the promisee has not made a detrimental change in position in reliance on the repudiation [*Guerrieri v. Severini (1958) 51 Cal. 2d 12, 19, 330 P.2d 635]*.

[b] Bilateral Contract

The contract must be bilateral [*Taylor v. Johnston (1975) 15 Cal. 3d 130, 137, 123 Cal. Rptr. 641, 539 P.2d 425*; *see § 140.10[4]*]. The doctrine of anticipatory breach by repudiation does not apply to contracts that are unilateral in their inception or that have become so by complete performance by one party. The theory underlying this rule is that a plaintiff who has no future obligations to perform is not prejudiced by having to wait for the arrival of the defendant's time for performance to sue for breach [*Harris v. Time, Inc. (1987) 191 Cal. App. 3d 449, 457, 237 Cal. Rptr. 584*; *Diamond v. University of So. California (1970) 11 Cal. App. 3d 49, 53–54, 89 Cal. Rptr. 302]*.

[3] Remedies

When the promisor repudiates the contract, the aggrieved promisee may elect a remedy [*Taylor v. Johnston (1975) 15 Cal. 3d 130, 137, 123 Cal. Rptr. 641, 539 P.2d 425*; *see Mobil Oil Exploration & Producing Southeast, Inc. v. United States (2000) 530 U.S. 604, 120 S. Ct. 2423, 147 L.Ed. 2d 528, 534* (oil companies sought restitution—rather than damages for breach of contract—of initial payments made to federal government after government repudiated lease contracts)]:

- Treat the repudiation as an anticipatory breach and immediately seek damages for breach of contract, terminating the contractual relation between the parties; or
- Treat the repudiation as an empty threat, wait until the time for performance arrives, and exercise remedies for actual breach if a breach does in fact occur at that time.

Treating repudiation as an anticipatory breach may enable the aggrieved party to pursue remedies apart from a suit for damages. For instance, if the aggrieved party normally would be entitled to mechanic's lien rights, a lien would have to be recorded within a specified time "after the contractor completes the direct contract" [*Civ. Code § 8412*]. A contract is complete for purposes of commencing the recordation period when all work under the contract has been performed or excused, or has been otherwise discharged, as when the aggrieved party elects to treat repudiation of the contract as an anticipatory breach [*Howard S. Wright Constr. Co. v. BBIC Investors, LLC (2006) 136 Cal. App. 4th 228, 241–243, 38 Cal. Rptr. 3d 769*].

If the aggrieved party disregards the repudiation and treats the contract as still in force, and the repudiating party retracts the repudiation before performance, the repudiation is nullified, and the aggrieved party is left with the remedies, if any, invocable at the time of performance [*Taylor v. Johnston (1975) 15 Cal. 3d 130, 137–138, 123 Cal. Rptr. 641, 539 P.2d 425*]. However, the aggrieved party's manifest purpose to allow or require performance by the promisor in spite of the repudiation does not nullify its effect as a breach, or prevent the repudiation from excusing satisfaction of conditions and from discharging the duty to render a return performance. Although the effect of repudiation may be nullified, it operates until nullified, not only as a breach but also as a continuing excuse of conditions and as a continuing justification of the promisee's failure to perform a return promise, even though the promisee indicated a willingness to forgive the repudiation [*Guerrieri v. Severini (1958) 51 Cal. 2d 12, 19–20, 330 P.2d 635*; *see Civ. Code § 1440*; *but see Ersa Grae Corp. v. Fluor Corp. (1991) 1 Cal. App. 4th 613, 625, 2 Cal. Rptr. 2d 288* (promisor who sues for damages must still prove ability to perform)]. Therefore, the promisee's option to treat the repudiation as an anticipatory breach, and seek damages for breach of contract [*Taylor v. Johnston (1975) 15 Cal. 3d 130, 137, 123 Cal. Rptr. 641, 539 P.2d 425*], remains viable unless and until the repudiation is nullified [*Central Valley Gen. Hosp. v. Smith (2008) 162 Cal. App. 4th 501, 519, 75 Cal. Rptr. 3d 771* (promisee is entitled to sue immediately for damages but is not required to make that election immediately after promisor's anticipatory breach)].

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§ 140.55 Action for Damages After Breach

[1] Elements

The essential elements of a cause of action for damages for breach of contract are [*Reichert v. General Ins. Co. (1968) 68 Cal. 2d 822, 830, 69 Cal. Rptr. 321, 442 P.2d 377*; *Acoustics, Inc. v. Trepte Constr. Co. (1971) 14 Cal. App. 3d 887, 916, 92 Cal. Rptr. 723]*:

- The contract [*see § 140.20* et seq.], which the court will need to construe [*see § 140.30* et seq.] to assess the other elements of the cause of action;
- Plaintiff's performance or excuse for nonperformance [*see § 140.55[2]*];
- Defendant's breach; and
- The resulting damages to the plaintiff [*see § 140.55[3]*].

The plaintiff has the burden of proof on each of the above elements [*e.g.*, *Sonic Manufacturing Technologies, Inc. v. AAE Systems, Inc. (2011) 196 Cal. App. 4th 456, 464–466, 126 Cal. Rptr. 3d 301* (plaintiff failed to carry burden to prove breach; correct disposition of case was to enter judgment for defendant)].

[2] Plaintiff's Ability to Perform

To be entitled to a judgment for damages for breach of contract, the plaintiff must prove that but for the defendant's breach, the plaintiff would have had the ability to perform [for performance of contract generally, *see § 140.40* et seq.]. This requirement usually arises after the defendant has repudiated or anticipatorily breached a contract [*see § 140.54*]. The plaintiff

does not have to allege readiness or willingness to perform, but must prove ability to perform [*Ersa Grae Corp. v. Fluor Corp. (1991) 1 Cal. App. 4th 613, 625, 2 Cal. Rptr. 2d 288* (in action based on real estate sale, plaintiff did not have to actually form consortium or obtain financing to prove ability to perform); *McDorman v. Moody (1942) 50 Cal. App. 2d 136, 140–141, 122 P.2d 639]*.

[3] Causal Connection Between Breach and Damages

Damages are not presumed to flow from the fact that a party breached a contract. The plaintiff must establish the causal connection between the breach and the damages sought [*see Civ. Code § 3300*; for damages in breach of contract actions generally, *see § 140.56[3]*].

The fact that the defendant breached a contract by repudiating it or obtaining performance elsewhere is not sufficient to infer the plaintiff's damages. The plaintiff is relieved of the duty to perform, but must still prove damages. For example, if the plaintiff's performance is impossible, the plaintiff cannot prove that damages flowed from the breach, and the defendant is entitled to judgment [*Metzenbaum v. R.O.S. Associates (1986) 188 Cal. App. 3d 202, 211–214, 232 Cal. Rptr. 741]*. In the context of a franchise relationship, a franchisee's failure to make past royalty payments is not a proximate or "natural and direct" cause of the franchisor's failure to receive future royalty payments [*see Postal Instant Press, Inc. v. Sealy (1996) 43 Cal. App. 4th 1704, 1713, 51 Cal. Rptr. 2d 365]*.

On the other hand, the defendant's breach need not be the sole cause of the plaintiff's damages. Under the substantial factor test, the defendant may be liable for all the plaintiff's damages even though other factors contributed. The plaintiff need not show the proportional contribution of the defendant's breach among the several factors causing injury. For example, a seller sued an escrow company for negligence and breach of contract based on the escrow company's failure to forward preliminary title reports or any demand, and the court found the escrow company liable to the seller for attorney's fees and litigation expenses incurred in the buyer's specific-performance suit against the seller. The court reasoned that the escrow

company's failure to perform its duties with reasonable care and dispatch was a substantial factor in the collapse of the escrow, which resulted in the seller's damages [*Bruckman v. Parliament Escrow Corp. (1987) 190 Cal. App. 3d 1051, 1060–1061, 1063–1064, 235 Cal. Rptr. 813]*. For discussion and forms applying theories of implied contractual indemnity to this type of situation, see *Ch. 300, Indemnity and Contribution, § 300.30* et seq.

[4] Demand for Damages

A demand for damages is unnecessary when the defendant has an unconditional duty to perform an act or pay a sum of money [*Bryson v. McCone (1898) 121 Cal. 153, 158, 53 P. 637*; *McDonald v. Filice (1967) 252 Cal. App. 2d 613, 623, 60 Cal. Rptr. 832]*. When the contract calls for the payment of money at a certain time and the breach consists of the debtor's refusal to pay, the creditor's failure to make a demand at the place named does not discharge the debt. However, the debtor may plead it as a defense to the recovery of costs or interest if the defendant establishes the ability and willingness to pay the debt when due [*Rottman v. Hevener (1921) 54 Cal. App. 474, 483–484, 202 P. 329]*.

The court will award interest as damages only from the date of a demand or from the date of filing suit if there has been no previous demand [*see Civ. Code § 3287*; *KGM Harvesting Co. v. Fresh Network (1995) 36 Cal. App. 4th 376, 391, 42 Cal. Rptr. 2d 286* (test for recovery of prejudgment interest under *Civ. Code § 3287(a)* is whether defendant either actually knows amount of damages owed plaintiff or could have computed that amount from reasonably available information)]. An award of prejudgment interest is not automatic; a request for interest must be made in the trial court. Furthermore, requests for prejudgment interest under *Civ. Code § 3287* by a successful plaintiff must be made by way of motion prior to entry of judgment, or the request must be made in the form of a motion for new trial no later than the time allowed for filing such a motion [*North Oakland Medical Clinic v. Rogers (1998) 65 Cal. App. 4th 824, 829–831, 76 Cal. Rptr. 2d 743* (when damages were awarded but no interest was included in verdict, and neither court nor jury had determined whether damages were

liquidated or unliquidated, rule was applied retroactively to plaintiffs who never sought prejudgment interest as part of damages and sought interest at last minute as part of order awarding costs)].

For discussion of interest on damages generally, see *§ 140.56[3][e]*.

[5] Application of Government Claims Act

Gov. Code § 810 et seq., commonly known as the Government Claims Act, applies to a claim for damages based on breach of a contract by the state or a local public entity [*City of Stockton v. Superior Court (2007) 42 Cal. 4th 730, 734, 737–740, 68 Cal. Rptr. 3d 295, 171 P.3d 20*]. Therefore, "all claims for money or damages against the state … on express contract" and all such claims against a local public entity are required to be presented in accordance with a prescribed procedure, not later than one year after the accrual of the cause of action [*Gov. Code §§ 905*, *905.2(b)(3)*, *911.2(a)*]. No suit for money or damages may be brought against the state or local public entity "on a cause of action for which a claim is required to be presented in accordance with … [the prescribed procedure] until a written claim therefor has been presented to the public entity and has been acted upon … or has been deemed to have been rejected" [*Gov. Code § 945.4*]. For discussion of the claim procedure [*see generally Gov. Code § 900 et seq.*] and related forms, see *Ch. 464, Public Entities and Officers: California Government Claims Act*.

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§ 140.56 Remedies for Breach

[1] Choice of Remedies

[a] Action for Damages, Specific Performance, or Rescission

If a breach of contract is sufficiently material, the aggrieved party has the option to withhold future performance and rescind the contract. An aggrieved party who has the option of rescission has the choice of the following three remedies [*see Michaelian v. Elba Land Co. (1926) 76 Cal. App. 541, 557, 245 P. 476*; *accord*, *Munoz v. MacMillan (2011) 195 Cal. App. 4th 648, 661–662, 124 Cal. Rptr. 3d 664* (existence of tenant's option to seek restitution after landlord breached lease did not eliminate tenant's alternative right to seek damages)]:

- An action for damages [*see § 140.56[3]*];
- A suit in equity for specific performance [*e.g.*, *Michaelian v. Elba Land Co. (1926) 76 Cal. App. 541, 557, 245 P. 476*; *see generally Ch. 528, Specific Performance*]; or
- An action for rescission and restitution [*see generally Ch. 490, Rescission and Restitution*].

For discussion of the factors for determining whether a breach is material, see *§ 140.52*.

With rescission, the aggrieved party may seek return of any consideration furnished before the rescission, less offsets for any benefits retained, or, if what was furnished cannot be returned, *e.g.*, labor, the aggrieved party may recover in quantum meruit for the value of

the performance before rescission [*Civ. Code §§ 1691*, *1692*; *C. Norman Peterson Co. v. Container Corp. of America (1985) 172 Cal. App. 3d 628, 642–644, 218 Cal. Rptr. 592* (quantum meruit recovery after mutual abandonment following breach); *B.C. Richter Contracting Co. v. Continental Cas. Co. (1964) 230 Cal. App. 2d 491, 499–500, 41 Cal. Rptr. 98]*.

[b] Action for Declaratory Relief or Injunction

If a dispute arises about the parties' respective rights and duties under the contract, but there has been no breach, the appropriate action may be for declaratory relief [*Code Civ. Proc. § 1060*; *Supervalu, Inc. v. Wexford Underwriting Managers, Inc. (2009) 175 Cal. App. 4th 64, 96 Cal. Rptr. 3d 316* (there is no requirement that declaratory judgment must resolve particular claim; only requirement for declaratory relief action is existence of actual controversy relating to legal rights and duties of parties to contract); *Bertero v. National General Corp. (1967) 254 Cal. App. 2d 126, 135, 62 Cal. Rptr. 714*; *see generally Ch. 182, Declaratory Relief*]. In addition, if the contract would be specifically enforceable, the aggrieved party may bring suit for an injunction [*Civ. Code § 3423(e)*; *Code Civ. Proc. § 526(a)(1)*; *see generally Ch. 303, Injunctions*]. An action for injunction does not waive the plaintiff's right to assert a claim for damages in a subsequent action [*Ahlers v. Smiley (1912) 163 Cal. 200, 206, 124 P. 827]*.

[c] Effect of Contractual Stipulation for Equitable Relief

As a general matter, if the parties have stipulated in the contract as to the nature or amount of a remedy, it is proper for the trial court to honor the parties' agreement unless the court finds that to do so would be contrary to a rule of law or public policy. In determining the lawfulness of a stipulation that contemplates an equitable remedy, the court should take into account the special nature of equitable remedies. Given their extraordinary nature, equitable remedies usually are unavailable when the remedy at law is adequate, as when

damages are quantifiable. A court must reject a stipulation contemplating an equitable remedy that is contrary to law or public policy, as in a case in which the evidence shows that an aggrieved party actually has an adequate remedy at law; otherwise, the court should honor the parties' agreement and enforce the stipulation [*DVD Copy Control Assn. v. Kaleidescape, Inc. (2009) 176 Cal. App. 4th 697, 725726, 97 Cal. Rptr. 3d 856*]. In other words, the fact that the parties' contract allowed for injunctive relief is not controlling; "injunction is an equitable remedy, which may be denied notwithstanding the parties' contractual stipulation if the remedy at law is adequate" [*Grail Semiconductor, Inc. v. Mitsubishi Elec. & Elecs. USA, Inc. (2014) 225 Cal. App. 4th 786, 801, 170 Cal. Rptr. 3d 581]*.

[2] Tort Remedies

[a] No Tort Recovery for Breach in Violation of Public Policy

Outside the employment context [*see* *Tameny v. Atlantic Richfield Co. (1980) 27 Cal. 3d 167, 164 Cal. Rptr. 839, 610 P.2d 1330* (employee fired for refusing to engage in illegal pricing practices)], no tort cause of action arises for breach of contract in violation of public policy [*Harris v. Atlantic Richfield Co. (1993) 14 Cal. App. 4th 70, 82, 17 Cal. Rptr. 2d 649* (franchisee's claim that franchisor's refusal to make repairs as promised was in retaliation for franchisee's reporting underground gasoline leaks to authorities and failing to comply with defendant's pricing policies); *Abrahamson v. NME Hospitals, Inc. (1987) 195 Cal. App. 3d 1325, 1329–1330, 241 Cal. Rptr. 396* (termination of physician's independent-contractor agreement, according to its terms, because of refusal to condone allegedly improper healing practices); *see* *Premier Wine & Spirits v. E. & J. Gallo Winery (9th Cir. 1988) 846 F.2d 537, 540]*. For discussion of this cause of action in the employment context, see *Ch. 249, Employment Law: Termination and Discipline*.

[b] Cause of Action for Negligence

The plaintiff may combine a contract cause of action with one for negligence in an appropriate case [for combining contract and tort causes of action in a single action generally, *see* *§ 140.56[2][e]*]. A cause of action for negligence may be based on the negligent performance of an implied obligation arising from the contract [*see, e.g.*, *North American Chemical Co. v. Superior Court (1997) 59 Cal. App. 4th 764, 775–776, 69 Cal. Rptr. 2d 466* (packaging and shipping contract imposed duty to reasonably and carefully perform contractual obligations; negligent performance of contractual obligation give rise to action in tort)]. The four-year limitation of *Code Civ. Proc. § 337(a)* governs an action based on negligent performance and breach of contract [*Bruckman v. Parliament Escrow Corp. (1987) 190 Cal. App. 3d 1051, 1057–1058, 235 Cal. Rptr. 813*; *cf. Hensley v. Caietti (1993) 13 Cal. App. 4th 1165, 1169, 16 Cal. Rptr. 2d 837* (complaint alleged only cause of action for attorney malpractice, with no mention of contract between attorney and client, so court applied one-year limitation of *Code Civ. Proc. § 340.6* to bar action)]. For further discussion, see *Ch. 380, Negligence*.

[c] Claim for Emotional Distress

The breach of a contract may give rise to damages for mental suffering or emotional distress when either the breach is of such a kind that serious emotional disturbance was a particularly likely result, or the express object of the contract is the mental and emotional well-being of one of the contracting parties [*Erlich v. Menezes (1999) 21 Cal. 4th 543, 558, 559, 87 Cal. Rptr. 2d 886, 981 P.2d 978* (breach of contract to build plaintiff's house is not "particularly likely" to result in "serious emotional disturbance"); *e.g.*, *Plotnik v. Meihaus (2012) 208 Cal. App. 4th 1590, 1601–1602, 146 Cal. Rptr. 3d 585* (settlement agreement in action between neighbors contained mutual restraint provision intended to protect against such harassing, vexing, and annoying activity as defendant subsequently pursued; verdict for plaintiff in action for breach of settlement agreement was correct); *see*

also *Ross v. Forest Lawn Memorial Park (1984) 153 Cal. App. 3d 988, 992–996, 203 Cal. Rptr. 468* (cemetery agreed to keep burial service private and to protect grave from vandalism); *Wynn v. Monterey Club (1980) 111 Cal. App. 3d 789, 799–801, 168 Cal. Rptr. 878* (gambling club agreed to exclude plaintiff's gambling-addicted wife and not to cash her checks); *Windeler v. Scheers Jewelers (1970) 8 Cal. App. 3d 844, 851–852, 88 Cal. Rptr. 39* (bailee of heirloom jewelry knew that it had great sentimental value for plaintiff)]. For further discussion, see *Ch. 177, Damages, § 177.79[1]*.

The plaintiff also may allege intentional infliction of emotional distress [*see*, *e.g.*, *Rulon-Miller v. International Business Machines Corp. (1984) 162 Cal. App. 3d 241, 254–255, 208 Cal. Rptr. 524*; *Wallis v. Superior Court (1984) 160 Cal. App. 3d 1109, 1119–1120, 207 Cal. Rptr. 123]*. For a general discussion of the tort of infliction of emotional distress, see *Ch. 362, Mental Suffering and Emotional Distress*.

[d] Other Torts Involving Contracts

- For discussion of torts arising out of the specific contractual relationship of employer and employee, see *Ch. 349, Employment Law: Termination and Discipline*.
- For discussion of the torts of misrepresentation and deceit, which may be applicable in contractual relationships, see *Ch. 269, Fraud and Deceit*.
- For discussion of torts based on business contracts, see *Ch. 565, Unfair Competition*.

[e] Combining Tort and Contract Causes of Action

[i] In General

A plaintiff may want to allege a tort cause of action in a complaint alleging a breach of contract to increase the number of possible counts on which to base remedies and to increase the total amount of damages by recovering punitive damages. Contract damages are limited to the amount that will compensate the plaintiff for all of the

detriment proximately caused by the breach [*Civ. Code § 3300*]. Punitive damages are not available for breach of contract, no matter how willful or malicious the defendant's conduct, except when the wrongful act is also a tort [*see Civ. Code § 3294(a)*; *Quigley v. Pet, Inc. (1984) 162 Cal. App. 3d 877, 887, 208 Cal. Rptr. 394*; for discussion of the preclusion of punitive damages in contract actions generally, *see § 140.56[3][c]*].

Tort damages may include compensation for all detriment caused by the tort [*see Civ. Code § 3333*], plus punitive damages if the plaintiff pleads and proves statutory prerequisites [*see Civ. Code § 3294(a)*]. However, the plaintiff must exercise care in alleging a tort cause of action in a complaint alleging breach of a contract other than an insurance contract, as a result of the Supreme Court's 1995 holding discussed in *§ 140.12[3]* [*see Freeman & Mills, Inc. v. Belcher Oil Co. (1995) 11 Cal. 4th 85, 44 Cal. Rptr. 2d 420, 900 P.2d 669]*. For general discussion of the issues involved in awarding damages in tort and contract actions, see *Ch. 177, Damages*.

[ii] Contract Statute of Limitations

An action for breach of the covenant of good faith and fair dealing [*see § 140.12[1]*] sounds both in tort and in contract. The plaintiff is allowed to make an election. Unless and until the plaintiff makes an irrevocable election, the plaintiff is not estopped to rely on the contract theory and is entitled to the benefit of the four-year statute of limitations [*see Code Civ. Proc. § 337(a)*] governing actions on written contracts [*Krieger v. Nick Alexander Imports, Inc. (1991) 234 Cal. App. 3d 205, 220–221, 285 Cal. Rptr. 717*; *Frazier v. Metropolitan Life Ins. Co. (1985) 169 Cal. App. 3d 90, 102–103, 214 Cal. Rptr. 883]*.

The statute of limitations begins to run on the occurrence of the last element necessary to the cause of action, which in contract actions is generally the breach. The discovery rule may extend accrual of the cause of action until the plaintiff discovers or reasonably should discover the existence of the cause of action [*see El Pollo Loco, Inc. v. Hashim*

(9th Cir. 2003) 316 F.3d 1032, 1038–1040 (discovery rule applied to toll statute of limitations in contract claim when fraudulent misrepresentations were asserted in conjunction with contract claim)]. However, the discovery rule applies only when a statutory scheme or a fiduciary relationship between the parties imposes a duty to disclose [*Krieger v. Nick Alexander Imports, Inc. (1991) 234 Cal. App. 3d 205, 221–222, 285 Cal. Rptr. 717* (evidence did not establish special relationship, so discovery rule was inapplicable and even contract action was barred)].

[iii] Attorney's Fees

A broad enough attorney's fee provision in a contract will support an award of attorney's fees to a prevailing party under *Civ. Code § 1717* (discussed in *Ch. 174, Costs and Attorney's Fees*), even if only tort causes of action go to the jury. However, the tort causes of action must arise from the contract [*Xuereb v. Marcus & Millichap, Inc. (1992) 3 Cal. App. 4th 1338, 1342–1345, 5 Cal. Rptr. 2d 154* (causes of action for negligence, breach of fiduciary duty, concealment, and misrepresentation arising from real estate purchase agreement)]. When a plaintiff before trial has voluntarily dismissed an action asserting both tort and contract claims arising from a contract containing a broadly worded attorney fee provision, *Civ. Code § 1717* bars recovery of attorney fees incurred in defending contract claims. That section, however, does not bar recovery of attorney fees incurred in defending tort or other *noncontract* claims. Whether attorney fees incurred in the noncontract claims are recoverable after a pretrial dismissal depends upon the terms of the contractual attorney fee provision [*Santisas v. Goodin (1998) 17 Cal. 4th 599, 602, 608, 71 Cal. Rptr. 2d 830, 951 P.2d 399]*. In one case, it was held that defendant was not the prevailing party for purposes of recovery of attorney fees incurred in defending noncontract causes of action when the plaintiffs obtained their litigation objective through settlement with other defendants [*Silver v. Boatwright Home Inspection, Inc. (2002) 97 Cal. App. 4th 443, 446, 118 Cal. Rptr. 2d*

475]. In a case in which a defendant who was not a party to a contract was sued for breach of that contract and various related tort and statutory causes of action, the court held that defendant could not recover attorney's fees incurred in defending the noncontract causes of action when the plaintiff had filed a voluntary dismissal with prejudice [*Topanga and Victory Partners, LLP v. Toghia (2002) 103 Cal. App. 4th 775, 778, 127 Cal. Rptr. 2d 104]*. For further discussion of attorney's fees, see *Ch. 174, Costs and Attorney's Fees*.

[3] Contract Damages

[a] Measure of Damages

Unless a statute otherwise specifically provides, the proper measure of damages for the breach of a contract is the amount that will compensate the plaintiff for all the detriment proximately caused by the breach or that, in the ordinary course of things, would be likely to result from the breach [*Civ. Code § 3300*; *see Robinson Helicopter Company, Inc. v. Dana Corporation (2004) 34 Cal. 4th 979, 992–993, 22 Cal. Rptr. 3d 352, 102 P. 3d 268* (scope of contract remedy assumes that the parties can negotiate the risk of loss occasioned by a breach; accordingly courts enforce those obligations each party voluntarily assumes and award only those benefits they expected to receive)]. The plaintiff may not recover damages unless they are clearly ascertainable in both their nature and origin [*Civ. Code § 3301*; *see, e.g., Vestar Development v. General Dynamics Corporation (9th Cir. 2001) 249 F.3d 958, 961–962* (action for breach of agreement to negotiate was properly dismissed when only damages sought were lost profits, which could not be proved with reasonable certainty as required by *Civ. Code § 3301*)].

Damages must be reasonable. If 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 may be recovered [*Civ. Code § 3359*; *Coughlin v. Blair (1953) 41 Cal. 2d 587, 600, 262 P.2d 305]*.

Generally, the measure of damages for breach of contract includes only lost profits and prejudgment interest [*Burnett & Doty Development Co. v. Phillips (1978) 84 Cal. App. 3d 384, 389–392, 148 Cal. Rptr. 569]*. Nevertheless, courts have construed *Civ. Code §§ 3300* and *3301* to allow recovery of damages for emotional distress and mental suffering in a breach of contract action if, from the particular subject matter of the contract and in the contemplation of the parties, mental suffering or emotional distress was a foreseeable and contemplated result of its breach [*Rogoff v. Grabowski (1988) 200 Cal. App. 3d 624, 633, 246 Cal. Rptr. 185*; *Wynn v. Monterey Club (1980) 111 Cal. App. 3d 789, 799–801, 168 Cal. Rptr. 878]*.

For further discussion of damages in contract actions, see *Ch. 177, Damages, § 177.140* et seq.

[b] Limitation on Damages

Except as expressly provided by statute, a plaintiff may not recover a greater amount in damages for the breach of an obligation than that plaintiff could have gained by full performance on both sides [*Civ. Code § 3358*; *see Martin v. U-Haul Co. of Fresno (1988) 204 Cal. App. 3d 396, 409–411, 251 Cal. Rptr. 17* (damages for breach of contract with termination option limited to damages that could potentially accrue during period of notice required to terminate)]. However, the court cannot apply this rule if the parties cannot show what the performance would have been. In that case, the court must make an estimate of damages rather than an actual computation. The party whose wrongful conduct rendered ascertainment of damages difficult cannot complain because the court estimated damages [*Benard v. Walkup (1969) 272 Cal. App. 2d 595, 605–606, 77 Cal. Rptr. 544]*.

[c] Punitive Damages

A plaintiff may not recover punitive or exemplary damages in an action for breach of contract [*Civ. Code § 3294*]. For discussion of combining tort causes of action with contract causes of action, see *§ 140.56[2]*.

[d] Minimizing Damages

Although aggrieved by a breach of contract, the plaintiff is required to do everything reasonably possible to minimize the loss and reduce the damages for which the defendant is liable. The plaintiff may not recover damages for detriment that could have been avoided by reasonable effort and without undue expense. The question of whether the plaintiff acted reasonably in mitigating damages is one of fact [*Sackett v. Spindler (1967) 248 Cal. App. 2d 220, 238–239, 56 Cal. Rptr. 435]*.

[e] Interest on Damages

[i] When Allowed

Every person who is entitled to recover damages certain, or capable of being made certain by calculation, whose right to recover is vested on a particular day, is entitled also to recover interest from that day, except for a period during which the debtor is prevented by law, or by the act of the creditor, from paying the debt [*Civ. Code § 3287(a)*]. Every person who is entitled under any judgment to receive damages based on a cause of action in contract when the claim was unliquidated may also recover interest from a date before the entry of judgment, which the court, in its discretion, may fix, but in no event earlier that the date the action was filed [*Civ. Code § 3287(b)*].

Requests for prejudgment interest under *Civ. Code § 3287* by a successful plaintiff must be made by way of motion prior to entry of judgment, or the request must be made in the form of a motion for new trial no later than the time allowed for filing such a motion [*North Oakland Medical Clinic v. Rogers (1998) 65 Cal. App. 4th 824, 829–*

831, 76 Cal. Rptr. 2d 743 (when damages were awarded but no interest was included in verdict, and neither court nor jury had determined whether damages were liquidated or unliquidated, rule was applied retroactively to plaintiffs who never sought prejudgment interest as part of damages and sought interest at last minute as part of order awarding costs)].

A legal rate of interest to which the parties agreed in the contract remains chargeable after a breach, as before, until the contract is superseded by a verdict or another new obligation [*Civ. Code § 3289(a)*; *Howard v. American Nat'l Fire Ins. Co. (2010) 187 Cal. App. 4th 498, 538, 115 Cal. Rptr. 3d 42* (contract rate applies until contract is superseded by judgment); *see Civ. Code § 3289.5* (retail installment contracts governed by *Civ. Code § 1801 et seq.*)]. If a contract does not stipulate a legal rate of interest, the obligation bears interest at the rate of 10 percent per year after breach [*Civ. Code § 3289(b)*; *see Mark McDowell Corp. v. LSM 128 (1989) 214 Cal. App. 3d 1427, 1431–1433* (if rate of interest specified in contract is usurious, *Civ. Code § 3289(b)* allows recovery of interest at 10 percent per year from date of breach); *but see Howard v. American Nat'l Fire Ins. Co. (2010) 187 Cal. App. 4th 498, 538, 115 Cal. Rptr. 3d 42* (prejudgment interest rate is 7 percent per year if contract was entered into on or before January 1, 1986, and does not specify lower interest rate)]. "Contract," as used in *Civ. Code § 3289(b)*, does not include a note secured by a deed of trust on real property [*Civ. Code § 3289(b)*].

[ii] When Precluded

Accepting payment of the whole principal waives all claim to interest [*Civ. Code § 3290*; *see San Francisco Unified School Dist. v. San Francisco Classroom Teachers Assn. (1990) 222 Cal. App. 3d 146, 150, 272 Cal. Rptr. 38* (*Civ. Code § 3290* applies only to interest as damages, not to postjudgment interest; thus, cashing check in satisfaction of judgment does not waive claim to postjudgment interest)].

An offer of payment stops the running of interest on an obligation. However, an offer to pay part of an amount owed does not stop the running of prejudgment interest if conditioned on the creditor's dropping a demand for other sums claimed [*see Civ. Code §§ 1494*, *1504*; *Klinger v. Realty World Corp. (1987) 196 Cal. App. 3d 1549, 1553–1554, 242 Cal. Rptr. 592]*. Tender and deposit of the amount owing pursuant to *Civ. Code § 1500* also stops the running of interest [*Klinger v. Realty World Corp. (1987) 196 Cal. App. 3d 1549, 1554 n.2, 242 Cal. Rptr. 592]*. For an affirmative defense alleging tender and deposit, see *§ 140.139*.

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§ 140.57 Waiver of Breach

The aggrieved party may waive a breach of contract. For example, an aggrieved party waives a breach by continued performance without a claim of breach [*A.B.C. Distrib. Co. v. Distillers Distrib. Corp. (1957) 154 Cal. App. 2d 175, 187, 316 P.2d 71]*. Waiver does not require actual subjective intent to waive a given right, but may result from conduct that, according to its natural import, is so inconsistent with the intent to enforce the right in question as to induce a reasonable belief that the aggrieved party has relinquished the right [*see Rubin v. Los Angeles Fed. Sav. & Loan Ass'n. (1984) 159 Cal. App. 3d 292, 298, 205 Cal. Rptr. 455* (detrimental reliance not necessarily element of waiver but only of estoppel)]. Thus, whether specific conduct constitutes a waiver is a question of fact.

In continuing obligation contracts, a waiver of a breach up to a certain time does not necessarily preclude the promisee from asserting a subsequent breach [*Bowman v. Santa Clara County (1957) 153 Cal. App. 2d 707, 713, 315 P.2d 67]*. The court will determine whether the waiver occurred late enough to preclude a breach.

For an affirmative defense based on waiver of the breach, see *§ 140.136*.

§ 140.58 Breach by Corporation—Effect of Business Judgment Rule

The common law business judgment rule, which insulates from court intervention those management decisions made by the board in good faith in what the directors believe is the corporation's best interest, does not override a contractual grant of discretion to a corporation's board of directors. In other words, the business judgment rule does not allow the board of directors to rewrite a contract so as to expand the board's own contractual discretionary authority and go outside the range of actions authorized by the contract, thus diminishing the contractual rights and protections given to the other party. However, if a court determines that the board acted *within* the range of the discretionary authority granted by the contract, the board's exercise of that discretionary authority is reviewable subject to the business judgment rule [*Scheenstra v. California Dairies, Inc. (2013) 213 Cal. App. 4th 370, 388–389, 153 Cal. Rptr. 3d 21* (board of directors of nonprofit agricultural cooperative association breached association's obligation, under supply contract with dairy farming members, to implement any milk-supply management program equitably, uniformly, and on basis of representative years of production; business judgment rule did not shield association from liability)].

13 California Forms of Pleading and Practice--Annotated § 140.59

§ 140.59 [Reserved]

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13 California Forms of Pleading and Practice--Annotated § 140.60

§ 140.60 Party's Lack of Ability to Contract

The following defenses may be asserted to an action for breach of contract based on a party's lack of ability to contract, making the contract void or voidable:

- The party is a minor [*see Ch. 365, Minors: Contract Actions*].
- The party is of unsound mind [*see § 140.21[1]*].
- The party has been deprived of civil rights [*see § 140.21[2]*].

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§ 140.61 Lack of Parties' Consent

[1] Revocation of Offer

The offeror may revoke an offer at any time before the offeree communicates acceptance to the offeror, but not afterward [*Civ. Code § 1586*; *Grieve v. Mullaly (1930) 211 Cal. 77, 79, 293 P. 619*; *see Ersa Grae Corp. v. Fluor Corp. (1991) 1 Cal. App. 4th 613, 622, 2 Cal. Rptr. 2d 288* (communication of revocation to offeror's agent did not revoke offer when agent did not notify offeree of revocation before offeree accepted); *see also CPI Builders, Inc. v. Impco Technologies, Inc. (2001) 94 Cal. App. 4th 1167, 1174, 114 Cal. Rptr. 2d 851* (offeror's communication of revocation to offeror's attorney did not revoke offer when offeror's attorney did not notify offeree's attorney of revocation before offeree accepted)]. The result of the offeror's revocation before acceptance is that no contract results. For discussion of revocation of an offer before acceptance, see *§ 140.22[3][c]*; for discussion of options supported by consideration constituting irrevocable offers, see *§ 140.22[3][d]*.

[2] Other Defenses Based on Lack of Consent

The following defenses may also be raised in an action for breach of contract, based on lack of consent:

- Consent was not freely given [*see § 140.22[1]*].
- Consent was not mutual [*see § 140.22[2]*].

- No contract was formed because the agreement was a promise or promises to agree in the future [*see* *§ 140.22[6]*].

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§ 140.62 Lack of Consideration

[1] No Mutuality of Obligation

In the case of a bilateral contract [*see* *§ 140.10[4]*], in which promises are exchanged as consideration, the promises must be mutual in obligation, that is, both parties must have assumed some legal obligation. Without this mutuality of obligation, the agreement lacks consideration, and the parties have not created an enforceable contract. If one of the promises leaves the promisor free to perform or to withdraw from the agreement at will, the promise is illusory and provides no consideration [*Mattei v. Hopper (1958) 51 Cal. 2d 119, 122, 330 P.2d 625*].

This issue can arise in the context of an adhesive arbitration agreement (such as one imposed on employees by the employer). Under both federal law pursuant to the Federal Arbitration Act [*9 U.S.C. § 1 et seq.*] and California law, if the stronger party has an unrestricted right to amend, modify, or terminate the arbitration agreement at any time, that right can render the agreement illusory—regardless of whether that party has exercised the unilateral right to amend, modify, or terminate the agreement, since it is the *ability to do so* that matters. However, the arbitration agreement is not illusory if the unilateral right to amend, modify, or terminate the agreement is restricted, either by express language or by terms implied under the covenant of good faith and fair dealing, so that a contract change cannot affect any claim that has accrued, or of which the stronger party has knowledge, as of the effective date of the change [*see generally* *Peleg v. Neiman Marcus Group, Inc. (2012) 204 Cal. App. 4th 1425, 1461–1466, 140 Cal. Rptr. 3d 38*].

The defense of lack of mutuality of obligation [*see § 140.23[4]*] does not apply if either party has performed. The defense applies only to executory contracts and not to executed contracts or to unilateral contracts in general [*see Asmus v. Pacific Bell (2000) 23 Cal. 4th 1, 14–15, 96 Cal. Rptr. 2d 179, 999 P.2d 71* (mutuality of obligation principle requiring new consideration for contract termination applies to bilateral contracts only); *Mutz v. Wallace (1963) 214 Cal. App. 2d 100, 109, 29 Cal. Rptr. 170*; *Anchor Cas. Co. v. Surety Bond Sav. & L. Ass'n (1962) 204 Cal. App. 2d 175, 182–183, 22 Cal. Rptr. 278]*. For an affirmative defense asserting the lack of consideration, see *§ 140.142[1]*.

[2] Other Defenses Based on Lack of Consideration

Other defenses based on lack of consideration include:

- One party's ability to terminate the contract [*see § 140.23[5]*].
- One party's obligation to perform conditional on party's approval [requirements contract; *see § 140.23[6]*].
- Insufficient consideration [*see § 140.23[7]*].

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§ 140.63 Illegal Contract

The consideration and the object of a contract, that is, the thing that the party receiving the consideration agrees to do or not to do [*Civ. Code § 1595*], must be lawful. That a contract is illegal is a defense to an action for its breach [*see, e.g.*, *Civ. Code §§ 1596*, *1607*, *1677*;*Homami v. Iranzadi(1989) 211 Cal. App. 3d 1104, 1109–1111, 260 Cal. Rptr. 6*; *Green v. Mt. Diablo Hospital Dist. (1989) 207 Cal. App. 3d 63, 71, 254 Cal. Rptr. 689*; *Bovard v. American Horse Enterprises, Inc. (1988) 201 Cal. App. 3d 832, 838, 247 Cal. Rptr. 340*; *see Vick v. Patterson (1958) 158 Cal. App. 2d 414, 417, 322 P.2d 548]*. For discussion of illegal contracts generally, see *§ 140.24*.

§ 140.64 Unconscionable Contract

If a court, as a matter of law, finds a contract or any clause of a contract to have been unconscionable at the time it was made, the court may do any of the following [*Civ. Code § 1670.5(a)*; *see, e.g.*, *Blake v. Ecker (2001) 93 Cal. App. 4th 728, 743–745, 113 Cal. Rptr. 2d 422* (remanding case to trial court to determine whether parties' arbitration agreement was unenforceable; agreement itself expressly provided for severance of provisions that resulted in plaintiff's claim of unconscionability)]:

- Refuse to enforce the contract [*see, e.g.*, *Dennison v. Rosland Capital LLC (2020) 47 Cal. App. 5th 204, 213, 260 Cal. Rptr. 3d 675* (finding arbitration agreement procedurally and substantively unconscionable and refusing to sever terms and rewrite agreement); *Lange v. Monster Energy Co. (2020) 46 Cal. App. 5th 436, 455, 260 Cal. Rptr. 3d 35* (arbitration agreement in employment agreement was permeated with too high a degree of unconscionability for severance to rehabilitate); *Bakersfield College v. California Community College Athletic Assn. (2019) 41 Cal. App. 5th 753, 769–770, 254 Cal. Rptr. 3d 470* (arbitration agreement was so permeated by unconscionability that it could be saved, if at all, only by reformation beyond court's authority); *Crippen v. Central Valley RV Outlet, Inc. (2004) 124 Cal. App. 4th 1159, 1164, 22 Cal. Rptr. 3d 189*; *Abramson v. Juniper Networks, Inc. (2004) 115 Cal. App. 4th 638, 668, 9 Cal. Rptr. 3d 422* (finding entire arbitration agreement in employment contract to be void and unenforceable; because illegality and unconscionability permeated agreement, objectionable terms could not be severed); *O'Hare v. Municipal Resource Consultants (2003) 107 Cal. App. 4th 267, 279,*

132 Cal. Rptr. 2d 116 (because unconscionability permeated entire agreement, severance was not appropriate); *Pardee Construction Company v. Superior Court (2002) 100 Cal. App. 4th 1081, 1086–1087, 123 Cal. Rptr. 2d 288* (trial court properly denied home builder's motion for appointment of judicial referee when real estate purchase agreements requiring all disputes to be submitted to judicial reference were adhesive contracts fatally infected with procedural and substantive unconscionability); *Flores v. Transamerica Homefirst, Inc. (2001) 93 Cal. App. 4th 846, 857–858, 113 Cal. Rptr. 2d 376* (arbitration provisions in reverse mortgage agreement found to be both procedurally and substantively unconscionable; court refused to sever invalid provisions because no single provision could be stricken to remove the unconscionable taint, and lender therefore could not compel arbitration)];

- Enforce the remainder of the contract without the unconscionable clause [*see* *Crippen v. Central Valley RV Outlet, Inc. (2004) 124 Cal. App. 4th 1159, 1164, 22 Cal. Rptr. 3d 189*; *Little v. Auto Stiegler (2003) 29 Cal. 4th 1064, 1072–1074, 1076, 130 Cal. Rptr. 2d 892, 63 P.3d 979* (finding provision in mandatory employment arbitration agreement that permitted either party to appeal arbitration award of more than $50,000 to second arbitrator to be unconscionable, but concluding that provision could be severed and rest of agreement enforced); *McManus v. CIBC World Markets Corp. (2003) 109 Cal.App. 4th 76, 101–102, 134 Cal. Rptr. 2d 446* (unconscionable provisions requiring employee's payment of fees could be severed from arbitration agreements); *Bolter v. Superior Court (2001) 87 Cal. App. 4th 900, 910–911, 104 Cal. Rptr. 2d 888* (unconscionable place and manner clauses in arbitration agreement regarding forum selection, consolidation restrictions, and damages limitations found clearly severable from remainder agreement)]—even when the practical result of severing the unconscionable provision and enforcing the remainder of the contract is to leave the parties in the same position as if the contract remained intact [*e.g.*, *Serpa v. California Surety Investigations, Inc. (2013) 215 Cal. App. 4th 695, 710, 155 Cal. Rptr. 3d 506* (severing unconscionable provision for

attorney's fees and enforcing remainder of arbitration agreement "yields the same result as if the agreement was simply interpreted … [without severance]. That is, each party will be responsible for his, her and its own attorney fees … ."")]; or

• Limit the application of any unconscionable clause so as to avoid an unconscionable result.

When a party claims or it appears to the court that all or any part of a contract may be unconscionable, the court must give the parties a reasonable opportunity to present evidence regarding the contract's commercial setting, purpose, and effect, to aid the court in making its determination [*Civ. Code § 1670.5(b)*]. For discussion of unconscionable contracts, see *§ 140.25*; for an affirmative defense based on unconscionability, see *§ 140.146*.

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§ 140.65 Defenses Related to Performance

The following defenses are related to legally cognizable excuses for nonperformance:

- Failure of consideration based on failure to perform [for discussion, *see* *§ 140.23[9]*; for an affirmative defense, *see* *§ 140.148*].
- Impossibility or impracticability of performance [for discussion of the defense, *see* *§ 140.45*; for an affirmative defense based on impossibility, *see* *§ 140.137[1]*].
- Frustration of purpose [*see* *§ 140.46*].
- Termination of contract [*see* *§ 140.47*].

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§ 140.66 Defenses Related to Breach

The defendant may raise as an affirmative defense to an action for damages based on breach of contract, the plaintiff's waiver of the breach. For discussion, see *§ 140.57*; for an affirmative defense, see *§ 140.136*.

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§§ 140.67 –140.79 [Reserved]
