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IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

SECOND APPELLATE DISTRICT

DIVISION SEVEN

DAIRY FARMERS OF AMERICA, INC., Plaintiff and Respondent, v. CACIQUE, INC., Defendant and Appellant.	B219840 (Los Angeles County Super. Ct. No. BC376889)

APPEAL from a judgment of the Superior Court of Los Angeles County. Amy Hogue, Judge. Affirmed.

Salmas Law Group, George C. Salmas, Michael R. Hambly; Horvitz & Levy, Barry R. Levy, Felix Shafir and Andrea A. Ambrose for Defendant and Appellant.

Manatt, Phelps & Phillips, Craig J. de Recat, Adam Pines; Greines, Martin, Stein & Richland, Robin Meadow, Cynthia E. Tobisman and Alana H. Rotter for Plaintiff and Respondent.

INTRODUCTION

Appellant Cacique, Inc., a cheese manufacturer, entered into an agreement to purchase all of its "Grade A" milk from Respondent Dairy Farmers of America, Inc. (DFA). On August 31, 2007, DFA filed a complaint alleging that Cacique breached the agreement by terminating the contract without sufficient notice.

Cacique filed a cross-complaint for breach of contract alleging that in 2004 DFA delivered a contaminated shipment of milk that caused a rancid batch of cheese. In its answer to DFA's complaint, Cacique also alleged that DFA breached the implied covenant of good faith and fair dealing by engaging in bad faith conduct during settlement negotiations regarding the 2004 incident, which provided a complete defense to DFA's contract claim.

The court dismissed Cacique's implied covenant defense, ruling that DFA's "alleged bad faith in the . . . negotiations that followed Cacique's [2004] claim for damages was not tied to any express or implied clause in the contract." However, during pre-trial hearings, the court suggested that, if proven, DFA's alleged bad faith negotiation tactics might support a defense under the theory of equitable estoppel. Cacique elected to assert an equitable estoppel defense and agreed to a bench trial.

After a five-week trial, the court issued a statement of decision ruling that: (1) Cacique had breached the milk purchase agreement by terminating the contract without adequate notice; (2) DFA was not estopped from asserting its contract claim because Cacique had failed to prove that DFA had engaged in bad faith conduct, and; (3) Cacique failed to establish its counter-claim because there was insufficient evidence that DFA delivered a contaminated batch of milk in 2004. The trial court awarded DFA approximately $12,500,000 in damages, plus pre-judgment interest.

On appeal, Cacique contends that the trial court erred in dismissing its implied covenant defense, and that it failed to properly calculate the damages from Cacique's breach of contract. We affirm.

FACTUAL AND PROCEDURAL BACKGROUND

A. Events Preceding Cacique's Breach of Contract Action

In 1993, Appellant Cacique, Inc., a cheese manufacturer, and Respondent DFA entered into a "Milk Purchase Agreement" (MPA) that required Cacique to purchase all of its "Grade A" milk from DFA.[1] The contract stated that all milk delivered under the contract had to "meet requirements of appropriate health authority for use as Grade 'A' milk for human consumption."

The purchase price of the milk was to be determined by the state-mandated milk price minimums set by the California Department of Agriculture. In addition, the parties agreed that DFA would "retain[] the right to impose a service charge on [Cacique] in excess of legal minimums, the actual amount shall be negotiated between [Cacique] and [DFA] from time to time." During the relevant time frame, the parties agreed that this service charge, which consisted of freight charges and other special service charges, would be 43 cents per 100 hundred pounds of milk.

The initial term of the parties' agreement was to begin on "April 1, 1993 and continue through March 30, 1997." Thereafter, the agreement was to "continue on a yearly basis, commencing on April 1 of each year unless either party terminates . . . ." The contract included a termination provision stating "[t]ermination may . . . be accomplished, to be effective April 1 of any year, by either party by delivery of written notice to the other party prior to October 1 of the preceding year."

The parties proceeded under this agreement "without any significant problems until early May 2004, when several Cacique customers complained that certain batches of [cheese] tasted and smelled rancid." Cacique investigated the matter and concluded that the rancid cheese had been caused by a contaminated shipment of milk that DFA

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[1] The original contracting entities were the State Dairy Association and the Cacique Cheese Company. DFA is the successor-in-interest to the State Dairy Association, and Cacique Cheese Company changed its name to Cacique, Inc. For simplicity's sake we will refer to the contracting parties as DFA and Cacique.

delivered on April 5, 2004. Cacique notified DFA of the problem and requested that it pay $338,296 for the costs incurred in manufacturing the rancid cheese. According to Cacique, DFA stated that it would look into whether its milk was the cause of the defective cheese and, "if the problem proved to be DFA's responsibility, DFA would make things right by paying the amount sought." From 2004-2007, the parties continued to investigate the cause of the rancid cheese. Although Cacique maintained that DFA's defective milk shipment was the cause of the problem, it chose not to terminate the MPA.

On May 10, 2007, the president of Cacique, Gilbert de Cardenas, called DFA and demanded immediate payment of $338,296. Although DFA never acknowledged that it was responsible for the rancid cheese incident, it offered to settle the matter in June of 2007 by paying the requested amount of $338,296 in 12 monthly payments. Cacique rejected the offer.

A month later, DFA sent a settlement agreement to de Cardenas offering a lump sum payment of $338,296 if Cacique would agree to continue using DFA as Cacique's exclusive milk supplier through March 31, 2009. In an email dated July 11, 2007, de Cardenas declined to sign the settlement, stating "the only thing that I will sign at this time is the endorsement part on the back of the check; once it clears the bank we will talk about the rest."

David Parrish, the CEO for DFA's Western Division, met with de Cardenas on August 16 to try to resolve the parties' differences. de Cardenas expected "that Mr. Parrish was going to bring a reimbursement check so they could talk about future business relations face to face." However, when Parrish arrived, he handed de Cardenas a written copy of the same settlement offer that Cacique had rejected on July 11, 2007, which de Cardenas promptly rejected.

The parties dispute what occurred next. Cacique contends that, after de Cardenas rejected the settlement, Parrish admitted that DFA had always known that it was responsible for the rancid cheese. Parrish allegedly told de Cardenas that "one of the milk tanker trucks that delivered DFA's milk to Cacique on April 5, 2004 had been used earlier that day to haul whey – a byproduct of cheesemaking." Parrish further stated that

the milk hauler failed to wash the tanker before re-filling it with milk, which contaminated the milk shipment.

DFA denies that Parrish told de Cardenas he "knew that the problem had resulted from whey in the milk, or that there had been any whey in the milk that DFA delivered on April 5, 2004." According to Parrish, he merely stated that residual whey was one possible cause of the defective cheese.

Several days after the August meeting, de Cardenas left a voicemail informing DFA that it was terminating the MPA effective September 1, 2007, and that from that date forward DFA's competitor, California Dairies, Inc. (CDI), would be fulfilling Cacique's milk needs. On August 24, Cacique provided a letter alleging that its termination of the contract was justified based on: (1) DFA's delivery of a contaminated load of milk in 2004, and (2) DFA's "disingenuous 'negotiations' regarding reimbursement it did not intend to make . . . [and] its withholding the truth regarding the factual background of the contaminated milk," which was intended to "deceive Cacique into delaying any decision regarding terminating its business relationship with DFA."

B. The Parties' Pleadings

On August 31, 2007, DFA filed a complaint alleging that Cacique's decision to stop accepting milk shipments as of September 1, 2007, breached a provision of the MPA stating that termination could only be accomplished by providing written notice by October 1, to become effective April 1 of the following year. DFA asserted that, under this provision, Cacique was required to continue purchasing its "Grade A" milk from DFA until March 31, 2008.

Cacique filed a counter-claim alleging that DFA had breached the MPA by "deliver[ing] contaminated milk" and engaging in "bad faith negotiating tactics." Cacique's complaint asserted that in April of 2004 it informed DFA that contaminated milk had resulted in a rancid batch of cheese and requested a reimbursement. According to the counter-complaint:

> The people at DFA responded that they wanted to conduct tests of the defective cheese and Cacique provided DFA with samples to test. Over the months that followed, DFA employees met with Cacique personnel, DFA sent [quality] control specialists to investigate, and the parties discussed the matter on the phone. Cacique was led to believe that if the problem proved to be DFA's responsibility, DFA would make things right by paying the amount sought.
>
> Discussions, meetings, and DFA testing went on for more than three years, during which time Cacique continued doing business with DFA. Throughout 2004, 2005, 2006 and the first half of 2007, DFA never acknowledged that it was responsible for the cheese defect problem. . . .
>
> On August 16, 2007, David Parrish . . . admitted that DFA was indeed responsible for the defective cheese as Cacique had long suspected.

The complaint further alleged that DFA's "delivery of contaminated milk was a material breach by DFA of the [MPA] that DFA has refused to cure. In addition, DFA's stringing Cacique along for years and bad-faith negotiating tactics breached the implied covenant of good faith and fair dealing."

Cacique also filed an answer to DFA's breach of contract claim that included a defense alleging that Cacique's "further performance under the [MPA] was excused by DFA's breaches of the Agreement consisting of DFA's delivery of contaminated milk (which DFA refused to cure) and DFA's bad-faith tactics that breached the implied covenant of good faith and fair dealing."

D. Dismissal of Breach of the Implied Covenant Defense

1. DFA's motion in limine regarding evidence of breach of the implied covenant of good faith and fair dealing

Prior to trial, DFA filed a motion in limine to exclude evidence regarding DFA's alleged breach of the implied covenant of good faith and fair dealing. DFA contended that neither the MPA nor the implied covenant imposed a duty to negotiate a resolution of an alleged breach of the contract. Thus, according to DFA, even if Cacique proved DFA acted in bad faith by failing to disclose that it knew its defective milk caused the rancid batch of cheese, such conduct did not constitute a breach of the implied covenant.

Cacique opposed the motion, arguing that "it was justified in canceling on short notice its milk purchase agreement with DFA" because "DFA[] breach[ed] . . . the implied covenant of good faith and fair dealing in the course of the parties' discussions to resolve a defective cheese incident—which culminated on August 16, 2007 when . . . DFA admitted that it had known for some time that a failure to wash a tanker truck (for which DFA was responsible) had caused the problem." Cacique further asserted that "lying about one's knowledge of responsibility for bad milk after the fact is a material breach of the implied covenant . . . to be honest in connection with enforcement of a contract. And that [ ] material breach excuses Cacique's performance."

At a pre-trial hearing on May 4, 2009, the trial court expressed doubt as to whether Cacique had properly alleged a breach of the implied covenant:

> The breach of implied covenant is doing something that prevents the other party from performing or getting the benefit of the performance. And here, the parties are performing up and down the line while this negotiations [*sic*] on the side breach is happening. I just don't see how that is a breach of the implied covenant of good faith and fair dealing.

The court continued: "I don't hear any [] defense of breach of implied covenant, good faith . . . . [¶] . . . just because you find out the other side lied to you about something that's essentially at this point collateral to the current contract doesn't mean you just up and breach. So I don't think that theory fits."

The trial court suggested, however, that the DFA's alleged bad faith conduct might support a defense under the doctrine of equitable estoppel:

> [i]f you look at equitable estoppel . . . you have evidence, I'm not saying you can prove it, but you have evidence to show that there was a concealment of a material fact with knowledge to Cacique with the intent that you'd act on it and that you acted on it. And you acted on it by renewing the contract [in 2005 and 2006]. And that when you found out, you know, you were justified in terminating. I mean that fits. . . .

The court later reiterated that DFA might "be estopped from recovering damages or terminating the 2007 contract because [Cacique was] in essence duped into either renewing or reinstating in the meantime;" "I think [Cacique] might be able to come up

with a viable . . . equitable estoppel theory, but that's up to them to decide. That's their choice or not."

2. The trial court's dismissal of Cacique's implied covenant defense

The following day, the court issued its written ruling granting DFA's motion to preclude the implied covenant of good faith and fair dealing defense, which the court treated "as a motion for judgment on the pleadings." As summarized by the court, Cacique alleged that "DFA knew from the start that it was responsible for supplying defective milk in April 2004 and its concealment of that knowledge materially violated the covenant of good faith and fair dealing implied in the [MPA] . . . . [¶] . . . In other words, the alleged bad faith was in connection with post-breach discussions including settlement discussions, between the parties."

The trial court concluded that any bad faith conduct by DFA in connection with post-breach discussions was not connected to any term in the contract:

> There is no provision in the [MPA] requiring DFA to automatically pay damages if Cacique claims that DFA delivered defective milk. There is likewise no provision in the contract requiring DFA to engage in good faith negotiations when Cacique accuses it of breach. Therefore, when Cacique demanded payment of damages caused by the allegedly defective milk, it was demanding a remedy at law, not the performance of any clause under the contract. DFA's alleged bad faith in the meetings and negotiations that followed Cacique's claim for damages are not tied to any express or implied clause in the contract.

The court ruled "as a matter of law, that Cacique's theory that DFA's alleged concealment of its responsibility for supplying defective milk after the alleged breach fails to state a claim for breach of the implied covenant of good faith and fair dealing under the [MPA]. Since Cacique has no viable claim for breach of the implied covenant on these facts, it has no viable defense of prior breach sufficient to excuse its performance under the Agreement."

However, the court chose not to exclude any evidence regarding DFA's alleged bad faith conduct, explaining "the evidence supporting Cacique's misguided implied covenant theory may be relevant to other claims and defenses in the action . . . ."

3. Further discussions regarding equitable estoppel

After the court issued its ruling, Cacique elected to proceed on the defense of equitable estoppel. The parties thereafter discussed what role, if any, a jury should have in deciding whether DFA was estopped from asserting its breach of contract claim. Although the trial court stated that it was responsible for deciding whether Cacique had established any equitable defense, it invited the parties to consider whether the jury should be permitted to make factual findings that would inform the court's decision. The court elected to postpone further discussions until the following day, and requested the parties to consider two options: to leave the equitable issues as a mini-court trial after the main trial or to let the jury decide the facts pertaining to equitable estoppel, after which the court would decide the remedy.

As soon as the court reconvened the following morning, counsel for Cacique announced that, based on the court's previous rulings, including its decision to dismiss the implied covenant defense, Cacique had decided to waive its right to a jury trial and elected to proceed by way of a bench trial. DFA agreed to a bench trial.

E. The Trial Court Finds in Favor of DFA

At the conclusion of a five week trial, the court ruled in favor of DFA on all counts. Specifically, the court ruled that: (1) DFA had established that Cacique terminated the contract without providing sufficient notice; (2) DFA was not estopped from asserting its contract claim because Cacique had failed to prove that DFA acted in bad faith during settlement negotiations, and; (3) Cacique had failed to establish that DFA breached the contract in 2004 because there was insufficient evidence establishing that DFA delivered contaminated milk in April of 2004, or that the milk had caused the rancid cheese.

In its "Summary and Evaluation of Pertinent Evidence," the trial court rejected Cacique's allegation that DFA had always known that its milk caused the rancid cheese. According to the court, the evidence showed DFA had consistently doubted Cacique's theory that defective milk caused the rancid cheese, and made repeated requests that

Cacique provide information substantiating its claim. The court further concluded that although Cacique was aware that DFA wanted substantiation, it refused to provide any such information. Instead, de Cardenas "expected DFA to take his word for it and to make good on Cacique's claim with no questions asked." DFA eventually attempted to settle the dispute because it realized that its relationship with Cacique was in jeopardy.

The court also rejected Cacique's contention that DFA had promised that it would pay for the rancid cheese. Although the court credited witness testimony that DFA said it would "take care" of the costs of the rancid cheese, it ruled that such statements did not "amount[] to [a] misrepresentation of fact inducing Cacique to delay cancellation." Instead, the court found that DFA always "qualified" such statements by "offering to take care of the problem *if its milk* was to blame."

The court also discredited de Cardenas's testimony that he decided to "end[] the relationship" after discovering that "Parrish had concealed the 'real reason' for the defective cheese for three years." As summarized by the court, de Cardenas testified that, during the August 16 meeting, "Parrish told him, with a smirk, that DFA knew all along what caused the April 2004 problem and that the problem was a dirty tanker truck contaminated with whey."

The court provided several reasons why de Cardenas's testimony did not "add up." First, the court noted that "[a]t all points prior to the August 16 meeting, Parrish behaved as a reasonable businessman attempting to make an evidence-based decision." The court explained that, "[m]easured against this course of conduct before the August 16, 2007 meeting and his logical and calm demeanor at trial, it is difficult to imagine that Parrish would have behaved as de Cardenas described. . . . A reasonable businessman like Parrish would not have thrown away the relationship he was working to preserve by making an impulsive smart aleck remark."

Second, the evidence showed that, shortly after the rancid cheese was discovered in 2004, the parties had investigated and dispelled the "theory that DFA hauled milk in a whey-contaminated tanker." Specifically, Cacique had verified that the hauling company DFA used to deliver the allegedly contaminated milk in 2004 did not haul whey. Thus,

according to the court, "by August 16, 2007, de Cardenas had known for years that whey contamination could not have been the 'real reason' for the rancid cheese."

Third, the court was persuaded by evidence showing that Cacique had begun negotiating into a milk contract with CDI before the August 16 meeting with Parrish took place. A former president of CDI testified that in May of 2007, Cacique approached CDI about supplying its raw milk and requested that CDI draft a purchase agreement. The witness further testified that, during a two hour meeting on June 12, 2007, de Cardenas was personally involved in negotiating the terms of the CDI milk purchase agreement. The court concluded that such evidence demonstrated that Cacique intended to replace DFA as its milk supplier long before the August 16 meeting with Parrish.

In addition to rejecting Cacique's allegation that DFA engaged in bad faith settlement negotiations, the court found that there was insufficient evidence "to prove that DFA supplied nonconforming milk on April 5, 2004 or that the milk DFA delivered caused the cheese to turn rancid." Although Cacique introduced test results allegedly showing that DFA's milk was contaminated with elevated levels of bacteria, the court found that there was substantial evidence at trial questioning the "reliability of th[ose] tests." After weighing the evidence, the court concluded that it could not "find [by a] preponderance of the evidence that the April 5 delivery breached an installment of the MPA let alone the entire agreement."

Based on its factual findings, the court ruled that "Cacique breached the MPA by giving notice on August 21, 2007 that it was prematurely terminating the MPA and refusing to accept further deliveries as of September 1, 2007." It further ruled that Cacique's breach could not be excused because the Appellant had failed to show that DFA breached the agreement in 2004 or engaged in any bad faith conduct that estopped DFA from pursuing its claims.

After holding further proceedings on damages, the court awarded DFA approximately $12.5 million plus prejudgment interest.

Cacique filed a timely appeal of the judgment, arguing that: (1) the trial court erred in dismissing its defense based on a breach of the implied covenant of good faith and fair dealing, and (2) the trial court erred in calculating DFA's damages.

DISCUSSION

A. The Trial Court Did Not Err in Dismissing Cacique's Implied Covenant Defense

1. Standard of review

"In an appeal from a motion granting judgment on the pleadings, we accept as true the facts alleged in the complaint and review the legal issues de novo. 'A motion for judgment on the pleadings, like a general demurrer, tests the allegations of the complaint or cross-complaint, supplemented by any matter of which the trial court takes judicial notice, to determine whether plaintiff or cross-complainant has stated a cause of action. [Citation.]" (*Angelucci v. Century Supper Club* (2007) 41 Cal.4th 160, 166.) "'We consider evidence outside the pleadings which the trial court considered without objection. [Citation.]' [Citation.]" (*Burnett v. Chimney Sweep* (2004) 123 Cal.App.4th 1057, 1065.)

2. The implied covenant does not impose an independent duty to negotiate an alleged breach of a contract in good faith

Cacique argues that DFA breached the implied covenant when it "negotiated with Cacique in bad faith over whether DFA breached the [MPA] 'by providing sub-Grade A milk' to Cacique." In its appellate brief, Cacique describes these alleged "bad faith negotiating tactics" as follows:

> DFA knew from the start that it supplied sub-Grade A milk to Cacique in 2004 and concealed this knowledge while the parties sought to resolve whether DFA had delivered contaminated milk in breach of the agreement and whether DFA would compensate Cacique for this breach.

Therefore, the issue we must determine is whether the covenant of good faith implied a term in the MPA requiring the parties to engage in good faith negotiations regarding any alleged breach of the contract.[2]

"Every contract contains an implied covenant of good faith and fair dealing providing that no party to the contract will do anything that would deprive another party of the benefits of the contract. [Citations.]" (*Digerati Holdings, LLC v. Young Money Entertainment, LLC* (2011) 194 Cal.App.4th 873, 885 (*Digerati Holdings*).) The covenant "exists merely to prevent one contracting party from unfairly frustrating the other party's right to receive the benefits of the agreement actually made. [Citation.] The covenant thus cannot '"be endowed with an existence independent of its contractual underpinnings."' [Citation.] It cannot impose substantive duties or limits on the contracting parties beyond those incorporated in the specific terms of their agreement." (*Guz v. Bechtel National, Inc*. (2000) 24 Cal.4th 317, 349-350 (*Guz*) [italics omitted].)

The MPA does not include any term that requires the parties to negotiate alleged breaches of the agreement. Nor does it contain any provision describing how the parties are to resolve disputes that arise under their agreement. Instead, the contract states only that Cacique will purchase all of its milk from DFA, that such milk must meet the requirements of "Grade A" milk for human consumption, the price of the milk, the date

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[2] DFA argues that we need not decide whether Cacique properly alleged a breach of the implied covenant because, following a five-week bench trial, the court found no evidence indicating that DFA engaged in bad faith conduct during the parties' settlement negotiations. Thus, according to DFA, even if the trial court erred in dismissing the implied covenant defense, the error was harmless because the trial court rejected the factual allegations necessary to substantiate the defense. Cacique, however, argues that we cannot rely on the trial court's findings because Cacique was entitled to have a jury, rather than the court, decide the implied covenant issue. Although Cacique acknowledges that it waived its right to a jury, it contends that it did so only after the court had dismissed the implied covenant defense and suggested that Cacique proceed under an equitable defense, which had to be decided by the court. We need not resolve these issues because we conclude that the trial court did not err in dismissing the implied covenant defense.

on which payment must be made and the necessary prerequisites for terminating the agreement.

When a contract does not include a provision requiring the parties to negotiate about a specific subject matter, the implied covenant cannot be read into the contract to create an obligation that they do so. For example, in *Racine& Laramie, Ltd. v. Department of Parks & Recreation* (1992) 11 Cal.App.4th 1026, 1031 (*Racine*), plaintiff and defendant entered into discussions to modify an existing concession contract to permit the sale of alcohol. After negotiations broke down, plaintiff filed a complaint alleging that defendant had breached the implied covenant by acting "arbitrarily" during the contract modification negotiations. (*Id*. at p. 1030.) Plaintiff argued that "once a negotiation [between two parties operating under a contract] has been undertaken there is an obligation implied in law to negotiate in good faith." (*Id*. at p. 1032.)

The appellate court rejected the plaintiff's claim, ruling that the implied covenant was inapplicable because "[t]here existed no express contractual obligation here to negotiate a modification of the concession contract." (*Racine*, *supra*, 11 Cal.App.4th at p. 1032.) The court explained that "the implied covenant is limited to assuring compliance with the express terms of the contract, and cannot be extended to create obligations not contemplated in the contract." (*Ibid*.) Thus, "[t]he fact that parties commence negotiations looking to . . . the amendment of an existing contract, does not by itself impose any duty on either party not to be unreasonable or not to break off the negotiations, for any reason or for no reason." (*Id*. at p. 1035.) Subsequent decisions have followed *Racine's* reasoning, ruling that "[w]hen two parties, under no compulsion to do so, engage in negotiations to form or modify a contract neither party has any obligation to continue negotiating or to negotiate in good faith. . . . Only when the parties are under a contractual compulsion to negotiate does the covenant of good faith and fair dealing attach . . . ." (*Copeland v. Baskin Robbins U.S.A.* (2002) 96 Cal.App.4th 1251, 1259; *Los Angeles Equestrian Center, Inc. v. City of Los Angeles* (1993) 17 Cal.App.4th 432, 447 [rejecting implied covenant claim where agreement contained "no express

contractual obligation . . . to negotiate a modification of the type of concession granted by the contract"].)

Although this case does not involve "pre-contractual" negotiations or negotiations to modify an existing agreement, the logic of *Racine* applies equally to claims predicated on an alleged failure to negotiate a resolution of a breach of the existing contract. Had the parties intended to use a specific dispute resolution mechanism, they were free to include those terms in the contract. They elected not to do so and the implied covenant "cannot be imposed to create a contract different from the one the parties negotiated for themselves." (*Locke v. Warner Bros., Inc.* (1997) 57 Cal.App.4th 354, 360-361; see also *Racine, supra,* 11 Cal.App.4th at p. 1032 ["covenant is limited to assuring compliance with the express terms of the contract, and cannot be extended to create obligations not contemplated in the contract"].)

If we were to accept Cacique's theory, every party to a contract would be required to negotiate in good faith any dispute that might constitute a breach of that agreement. We are aware of no authority suggesting that the covenant of good faith imposes such a broad obligation. At least one other jurisdiction has expressly rejected such a conclusion. (See, e.g., *State Street Bank and Trust Co. v. Inversiones Errazuriz Limitada* (S.D.N.Y 2002) 246 F.Supp.2d 231, 242 ["Nor does the covenant apply to settlement negotiations, extensions, or modifications of the existing contract"].)[3]

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[3] Cacique alleges that its position is supported by Restatement (Second) of Contracts, section 205, comment (e) which is entitled "good faith in enforcement." Comment (e) states that "good faith and fair dealing extends to the assertion, settlement and litigation of contract claims and defenses. . . . The obligation is violated by dishonest conduct such as conjuring up a pretended dispute, asserting an interpretation contrary to one's own understanding, or falsification of facts." The illustrations accompanying comment (e) involve situations where a party attempts to enforce provisions of the contract on false pretenses. Although California has adopted the language of Restatement section 205 (See Cal. U. Com. Code, § 1304; *Carma Developers (Cal.), Inc. v. Marathon Development Cal., Inc.* (1992) 2 Cal.4th 342, 371), Cacique has failed to cite any California authority that has adopted or applied comment (e)'s interpretation of that section. Even if we were to assume that California law follows comment (e), we do not believe the comment would apply here. Comment (e) merely reflects that the implied

Moreover, we fail to see how DFA's alleged refusal to negotiate in good faith "deprive[d] . . . [Cacique] of the benefits of the contract. [Citations.]" (*Digerati Holdings*, *supra*, 194 Cal.App.4th at p. 885), which was to receive "Grade A" milk at an agreed upon price. (See *ibid*. ["The scope of conduct prohibited by the implied covenant depends on the purposes . . . of the contract"]; *Guz*, *supra*, 24 Cal.4th at pp. 349-350 [covenant exists merely to prevent one contracting party from unfairly frustrating the other party's right to receive the benefits of the agreement actually made"].) Cacique has never alleged that DFA's negotiation tactics caused Cacique to receive contaminated milk shipments. Indeed, Cacique admits that, following the 2004 incident, Cacique continued to receive milk from DFA that met all the requirements of the contract.

Cacique, however, contends that the implied covenant applies because DFA's bad faith negotiation deprived it of two "benefits" of the contract: (1) the "right to enforce the Agreement to receive compensation for the nonconforming" 2004 milk shipment, and (2) the right to terminate the contract. More specifically, Cacique theorizes that, by falsely promising to pay for the defective cheese, DFA induced Cacique not to exercise its right to enforce or terminate the contract.

With regard to Cacique's first argument, Cacique has not demonstrated that DFA's alleged negotiation tactics "deprived . . . [Cacique] of the right to enforce the Agreement to receive compensation for [the] nonconforming" milk shipment in 2004. At trial, Cacique asserted a cross-claim seeking $338,298 based on DFA's delivery of "sub-Grade A [milk] that caused batches of [cheese] to spoil prematurely." The trial court found that

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covenant may apply to dishonest actions that deprive the party of the benefits of the agreement. This might occur, for example, if a party asserts a breach knowing that no breach has occurred, or if a party rejects goods on grounds that it knows to be false. In those situations, the implied covenant would apply because, although the express terms of the contract might not prohibit such conduct, the false enforcement activity would necessarily deprive a party of the benefits of the contract. Here, however, based on Cacique's allegations, DFA chose not to negotiate in good faith after Cacique attempted to enforce the contract and, while doing so, continued to otherwise provide Cacique with the benefits of the agreement. Under these circumstances, nothing in comment (e) supports a finding that the parties here had a duty to negotiate, or negotiate in good faith, a claim asserting that it has breached the contract.

"Cacique . . . has failed to prove, by a preponderance of evidence, that DFA delivered substandard milk on April 5, 2004 in breach of the MPA, or that DFA's delivery caused Cacique to suffer any damages." Cacique has not appealed that portion of the court's ruling. Therefore, contrary to Cacique's assertion, it was not denied an opportunity to enforce the contract for the alleged 2004 breach; it asserted that exact claim in this litigation, but failed to prove it.

We also reject the contention that Cacique was "deprived of the benefits of the contract" because DFA's alleged promise to settle the 2004 cheese incident induced Cacique not to terminate the MPA at an earlier date. As explained above, the purpose the contract was to receive "Grade A" milk at a specified price, and DFA otherwise consistently complied with those requirements. In effect, Cacique asserts that the implied covenant is breached whenever an unfulfilled collateral promise induces a party to remain in a contractual relationship. The case law makes clear, however, that the covenant is intended only to assure compliance "with the express terms of the contract." (*Racine, supra*, 11 Cal.App.4th at p. 1032.) Thus, a promise that is not itself required by the express terms of the contract cannot be deemed a breach of the implied covenant merely because it induces the other party to remain in that contract. Here, the contract did not require DFA to negotiate or settle alleged breaches of the MPA. Therefore, its extra-contractual promise to do so cannot be transformed into a breach of the implied covenant merely because it allegedly caused Cacique to remain in that contract.

Although DFA's alleged misconduct does not support a claim under the implied covenant, that did not preclude Cacique from asserting equitable defenses predicated on that same conduct. "[M]islead[ing]" or "unfair tactics" in the negotiation or enforcement of a contract may give rise to equitable claims regardless of whether such conduct qualified as a breach of the implied covenant. For example, in *Price v. Wells Fargo Bank* (1989) 213 Cal.App.3d 465, the plaintiff argued that a bank violated the implied covenant by refusing to restructure a loan. The court rejected the theory, explaining:

> The implied covenant does not impose any affirmative duty of moderation in the enforcement of legal rights. The equitable doctrines of estoppel or

> waiver may, of course, bar unfair tactics in the enforcement of agreements, but appellants have not raised any such equitable defenses.

(*Id*. at p. 479.) Similarly, in *Racine*, *supra*, 11 Cal.App.4th 1026, the court ruled that while the implied covenant did not require a party to negotiate a modification of an existing agreement, it noted that "in the course of [contract] negotiations it is possible for a party to so mislead another by promises or representations, upon which the second party detrimentally relies, as to bring into play the concept of promissory estoppel." (*Id*. at p. 1035.)

In this case, the trial court invited Cacique to demonstrate that DFA's bad faith negotiations conduct precluded it from asserting its contract claim under the doctrine of equitable estoppel, the "essence" of which "is that the party to be estopped has by false language or conduct led another to do that which he would not otherwise have done and as a result thereof that he has suffered injury." (*In re Lisa R.* (1975) 13 Cal.3d 636, 645.) Although Cacique elected to pursue that defense at trial, the court found no credible evidence indicating that DFA had engaged in false or misleading conduct.[4]

[4] Cacique also argues that, in addition to violating the implied covenant read into every contract in California, DFA's alleged bad faith conduct constituted a violation of California Uniform Commercial Code section 1304, which codifies the implied covenant and "expands the concept . . . by imposing this obligation on every 'duty' as well as every contract within the Commercial Code." (Cal. Code com., West's Ann. Cal. U. Com. Code, § 1304 [formerly § 1203].) As discussed above, there was no provision in the MPA requiring the parties to negotiate disputes arising under the contract. Moreover, Cacique has failed to identify any section of the Commercial Code that imposes such an obligation on parties to a commercial contract. As such there was no duty to negotiate in good faith under section 1304.

B. Cacique Has Failed to Show That the Trial Court Erred in Calculating Damages

1. Factual and procedural background

a. Background facts regarding damages

The California Department of Food and Agriculture sets a mandatory minimum price for different classes of "Grade A" milk, which is recalculated every month. Because the price of milk is regulated, "the main negotiating points in contracts between [milk] co-ops like DFA and handlers . . . like Cacique are freight charges and service charges that the handlers agree to pay in addition to the regulated prices for milk." Under the MPA, Cacique was obligated to pay the state-mandated minimum price applicable to "class 4b" "Grade A" milk (milk to be used in cheese products), plus a service charge of 43 cents per 100 pounds of milk.

The trial court explained in its statement of decision that because the price of milk is regulated, Cacique's breach of the MPA would, under normal market conditions, expose it to only limited liability:

> [Cacique's] decision to terminate the MPA on short notice . . . would not, in ordinary market conditions, expose Cacique to substantial damages for any alleged breach. Assuming that DFA found other handlers to buy its milk, Cacique's exposure for breach of contract was six months of service and freight charges, most of which would be recouped under the more favorable contract with CDI.[5]

However, during the relevant damages period, which, per the parties' stipulation, ran from September 1, 2007 until March 31, 2008, California experienced an oversupply of milk. As explained by the court, "[w]hereas, in the past California dairy farmers had been able to sell their entire production at the state regulated prices, the dearth of California handlers in late 2007 and early 2008 forced dairies to dump milk or sell it at greatly distressed prices." Despite its reasonable attempts to resell the milk that Cacique had contracted to purchase, DFA was only able to sell a portion of that milk at the state

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5 The evidence showed that the milk purchase agreement that Cacique entered into with CDI utilized a lower "service charge" than DFA's agreement, which saved Cacique $400,000 in the first six months of the contract period.

mandated-minimum price.[6] DFA was forced to sell the remainder of the milk at "distressed prices" to entities that were not subject to California's Grade "A" price minimums, including out of state vendors and farmers who intended to use the milk for purposes other than human consumption. In addition, DFA was forced to dump significant quantities of milk.

The trial court ruled that, although it was unfortunate that "market conditions were not ordinary during the damage period," the "Commercial Code and the law of contracts [required] Cacique to bear[] the responsibility for the damages caused by its breach of the MPA."

b. Parties' arguments regarding damages calculations

At trial, DFA only sought damages for the portion of milk that Cacique should have purchased, which was later sold by DFA at "distressed" prices. To establish the relevant volume of "distressed milk" for which Cacique was responsible, DFA introduced two categories of data: (1) the total amount of milk that Cacique purchased from CDI during each month of the damages period, and (2) the amount of "distressed milk" DFA sold during each month of the damages period. DFA argued that it was entitled to damages for the lower of those two figures, which are shown below:

September 2007	Gallons Cacique purchased from CDI:	21,476,459
	Gallons DFA sold at distressed prices:	9,152,559
	Gallons for which DFA sought damages:	9,152,559
October 2007	Gallons Cacique purchased from CDI:	24,633,934
	Gallons DFA sold at distressed prices:	14,224,876
	Gallons for which DFA sought damages:	14,224,876
November 2007	Gallons Cacique purchased from CDI:	19,475,605
	Gallons DFA sold at distressed prices:	14,184,342
	Gallons for which DFA sought damages:	14,184,342
December 2007	Gallons Cacique purchased from CDI:	17,633,509

[6] The trial court ruled that DFA made reasonable attempts to mitigate its damages by, among other things, attempting to sell Cacique's unpurchased milk to other entities.

	Gallons DFA sold at distressed prices:	30,318,503
	Gallons for which DFA sought damages:	17,633,509
January 2008	Gallons Cacique purchased from CDI:	20,785,713
	Gallons DFA sold at distressed prices:	35,834,329
	Gallons for which DFA sought damages:	20,785,713
February 2008	Gallons Cacique purchased from CDI:	20,719,435
	Gallons DFA sold at distressed prices:	33,753,193
	Gallons for which DFA sought damages:	20,719,435
March 2008	Gallons Cacique purchased from CDI:	22,272,219
	Gallons DFA sold at distressed prices:	46,116,198
	Gallons for which DFA sought damages:	22,272,219

As demonstrated by the figures above, DFA argued that it was entitled to damages on all its distressed milk sales in months where the volume of milk that Cacique purchased from CDI was greater than the amount of milk that DFA sold at distressed prices (September, October and November 2007). For those months, DFA argued that damages should be calculated by determining the difference between the amount received for the distressed milk and the amount that would have been received from Cacique under the MPA.

For the remainder of the damages period (December 2007 to March 2008), the total volume of DFA's "distressed milk" sales was higher than the amount of milk that Cacique purchased from CDI. For each such month, DFA sought damages on the volume of milk that Cacique purchased from CDI. However, because DFA received different prices for distressed milk that it sold to different vendors, the court had to determine how to calculate which distressed milk sales should be attributed to Cacique for the purposes of calculating damages.

DFA argued that for months where its distressed milk sales exceeded the volume of milk Cacique purchased from CDI, damages should be calculated by "attribut[ing] [DFA's] least profitable [distressed milk] sales to Cacique." In other words, it sought the difference between the amount received for the "least profitable" distressed milk and the amount that would have been received for that distressed milk under the MPA. For

example, in the month of March 2008, although DFA sold over 45 million gallons of distressed milk, it argued that it was entitled to the difference between the total amount received on the least profitable 22,272,219 gallons of distressed milk (which reflects the amount Cacique purchased from CDI that month), and the amount it would have received for that milk under the MPA.

Cacique, however, argued that DFA's damages were governed by California Uniform Commercial Code section 2708, subdivision (1), which states that "'the measure of damages for nonacceptance or repudiation by the buyer is the difference between the market price at the time and place for tender and the unpaid contract price.'" Cacique asserted that the term "market price" should be interpreted to mean the state-regulated mandatory minimum for "Grade A" milk, which was the same price stated in the MPA. Thus, according to Cacique, DFA's damages were limited solely to "DFA's lost service charges and freight charges that Cacique would have paid on top of the state-mandated prices," which Cacique calculated to total approximate $1.2 million.[7]

c. Trial court's damages calculation

Although the trial court agreed with Cacique's argument that DFA's damages were governed by California Uniform Commercial Code section 2708, subdivision (1), it did not agree that the state-mandated minimum price was the relevant "market price" for milk that DFA was required to sell at distressed prices as the result of Cacique's breach. The court also rejected DFA's contention that the market price should be derived from their "least profitable" distressed milk sales:

> The court takes issue with DFA's calculation of damages to the extent that it attributes its least profitable post-breach sales to Cacique. Cacique was not the only source of DFA's surplus milk during the damage [period]. . . . [DFA] would have had some amount of oversupply even if Cacique had not breached. It is obviously impossible to segregate Cacique's milk from the other milk produced by DFA during the damage period. Since there is no

[7] In addition, Cacique argued that (1) a portion of the damages were unforeseeable because they were caused by unanticipated fluctuations in the milk supply, and (2) DFA failed to take reasonable efforts to mitigate its losses. The trial court rejected both arguments and Cacique has not appealed those findings.

> way to segregate the "Cacique" distressed milk from any other distressed milk, Cacique's responsibility for damages should be based on DFA's average sale price for all distressed milk sold during the damage period rather than on the lowest prices.

Thus, the trial court concluded that, for the purposes of California Uniform Commercial Code, section 2708, the relevant "market price" was the average price at which DFA had sold its distressed milk during the damages period. Utilizing this calculation, the court awarded DFA approximately $12.5 million plus prejudgment interest.

2. The trial court did not err in determining the market price

Cacique argues that the trial court erred when it ruled that the appropriate "market price" was the average price at which DFA sold its "distressed milk." The parties do not dispute any facts regarding this issue, only whether the trial court properly interpreted the meaning of the phrase "market price" under the circumstances of this case. This is a question of law that we review de novo. (See generally *Franke v. BAM Bld. Co* (2009) 172 Cal.App.4th 224, 232 (*Franke*) [for purposes of reviewing damages, appellate court "independently review[s] the application of a statute to undisputed facts"]; *Kelly v. CB&I Constructors, Inc*. (2009) 179 Cal.App.4th 442, 455.)

The term "market price," as used in section 2708, subdivision (1), has been defined to mean "the price or value of the article as established or shown by sales in the way of ordinary business; the price at which goods are freely offered in the market to all the world." (*Sacket v. Spindler* (1967) 248 Cal.App.2d 220, 236.) Cacique contends that, applying that definition here, the trial court's "market price" was erroneous because it did not include the large volume of milk that DFA offered "to the world" at the state-mandated minimum price.

Cacique proposes two methods that, in its view, properly state the relevant market price. First, it contends that "in a market heavily regulated by the government such as that for milk, the California state-regulated price (which is set once a month) should be deemed the 'market price' for purposes of section 2708(a)." Alternatively, it asserts that the "market price" should have been determined by "a weighted average of all DFA sales

– i.e., sales at the state minimum prices . . . and dispositions below those minimums." Given that DFA sold a vast majority of its milk to customers who were contracted to purchase the product at the state-mandated minimum price, this "weighted average" would be very close to the state mandated-minimum price.[8]

The problem with Cacique's argument is that DFA only sought damages for milk that it was forced to sell at distressed prices as the result of Cacique's breach; it did not seek damages for milk that Cacique should have purchased, but was later resold by DFA to third-parties at the state-mandated minimum price. For example, in the month of September 2007, Cacique purchased over 20 million gallons of milk from CDI. Under the MPA, that milk should have been purchased from DFA. However, DFA did not seek damages on the full 20 million gallons; instead, it sought damages only for the 9 million gallons of milk that it was forced to sell in September at distressed prices (which, under the MPA, would have otherwise been sold to Cacique at the state-mandated minimum price.) Thus, for the portion of milk that DFA sought damages, there were no market participants willing to purchase at the state-mandated minimum price.

The trial court recognized this problem and, in effect, determined that there were two distinct markets: one market for milk intended for use as "Grade A" milk in California, which was required to be purchased at the state-mandate mandatory-minimum, and a second market for "distressed-milk" sold to vendors who were not required pay the state-mandated price for "Grade A" milk, either because of their location or their intended use for the milk (which includes milk dumped at a total loss). DFA only sought damages on milk falling into the latter market.

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[8] For example, a DFA witness testified that, in September 2007, its Western Division sold approximately 575 million gallons of milk at the state-mandatory minimum price to 23 different customers. In comparison, the company sold less than 10 million gallons at distressed prices during that same month. Given the large volume of milk sold at the state-mandated minimum, and the comparatively small amount sold at distressed prices, it is apparent that the "average" sales price of all milk would fall very close to the state-mandated minimum.

The California Supreme Court endorsed a similar approach in *Oosten v. Hay Haulers Dairy Emp. & Helpers Union* (1955) 45 Cal.2d 784 (*Oosten*). Plaintiff, a dairy farmer, sued a creamery for breaching a milk purchase agreement that required it to pay plaintiff the state-mandated rate for "Class I Milk." After confirming that the plaintiff was entitled to damages "suffered by reason of defendant's refusal to buy the milk," the Court considered whether the trial court had used the "proper measure of damages." (*Id.* at p. 791.)

The Court explained that damages were governed by former Civil Code section 1784, a predecessor to section 1708, which stated: "Where there is an available market for the goods in question, the measure of damages is . . . the difference between the contract price and the market or current price at the time or times when the goods ought to have been accepted." (*Oosten, supra,* 45 Cal.2d at p. 791.) At the time *Oosten* was decided, California applied different mandated-minimum prices to different classes of milk. The defendant, like Cacique, argued that "that the contract price and current market price [for Class I milk] were the same . . . hence plaintiff was entitled to no more than nominal damages." (*Ibid*.)

The trial court, however, concluded that "'the only creamery company within practicable delivery distance of plaintiff's dairy, which would accept plaintiff's milk during the [damages] period was the Excelsior Creamery Company.'" (*Oosten, supra,* 45 Cal.2d at p. 791.) Excelsior was only willing to accept the milk as "'Class II or as manufacturing milk,'" the regulated price of which was "'considerably less . . . than that paid for Class I milk.'" (*Ibid*.) The trial court therefore awarded plaintiff the difference between the price it received from Excelsior and the price it would have received from defendant under the parties' contract.

The Supreme Court affirmed this method, explaining

> The evidence shows plaintiff sold his milk to the Excelsior Creamery . . . but Excelsior had no market for Class I milk and paid plaintiff at the rate for a lower class of milk. Plaintiff testified that he tried to sell it elsewhere but could not. . . .

(*Oosten, supra,* 45 Cal.2d at p. 793.) Because the evidence showed that "that the only market available was Excelsior, the company to which plaintiff sold the milk," the trial court was "justified" in concluding that "the difference between the price they paid and that specified in the contract was a proper measure of damages." (*Ibid*.)

Under *Oosten,* it is apparent that where there are no market participants willing to pay a state-mandated price for a certain item intended for a certain use, the state-mandated price cannot be treated as the appropriate "market price." Rather, under such circumstances, the market price must be determined by the distressed price that market participants who are not bound by the mandated-minimum are willing to pay for such goods. Indeed, several cases have ruled that the actual price at which a repudiated item is resold at "open market" is evidence of its proper market price. (See *Phillips v. Stark* (1921) 186 Cal. 369, 375 [where "measure of damages is the difference between the contract price and the market value of the property . . . [] the amount for which [the property] sold on the resale . . . was evidence of market value"]; *Hamberger-Polhemus Co. v. Lewin* (1929) 101 Cal.App. 704, 708; *Meyer v. McAllister* (1914) 24 Cal.App. 16, 17-18 [where plaintiff was entitled to difference between contract price and market value of goods, the price at which goods were resold constitutes evidence of its market value].)

Here, as in *Oosten*, the only market for the portion of milk on which DFA sought to collect damages consisted of parties who were unwilling to pay the state-mandated minimum price. Under such circumstances, it would be improper to treat the state mandated-minimum price as the "market price" because there were no buyers willing to actually pay that price.

Cacique attempts to distinguish *Oosten*, arguing that, in this case, the evidence shows that "at least part of the milk that would have gone to Cacique was sold at or above the state mandated minimum price." In contrast, all of the milk that should have been purchased by the defendant in *Oosten* was sold at a distressed price to a single buyer. According to Cacique, because some of the milk it had contracted to purchase was resold by DFA at the state-mandated minimum price, the price of that milk should have been included determining market price. Again, however, this argument would be more

compelling if DFA was seeking damages for the portion of Cacique milk that it re-sold at or above the state-mandated price. But DFA only sought damages for the portion of milk that it was forced to resell at distressed prices as the result of Cacique's breach. We therefore see no meaningful difference between the method of calculation in *Oosten* and the method used here.

The trial court's decision to treat the average price of distressed milk as the proper "market price" also finds support in section 1305, subdivision (a), which instructs that the Commercial Code's remedy provisions "shall be liberally administered to the end that the aggrieved party may be put in as good a position as if the other party had fully performed." The comment to the statute explains that "Subsection (a) is intended to . . . negate the possibility of unduly narrow or technical interpretation of remedial provisions by providing that the remedies in the California Uniform Commercial Code are to be liberally administered to the end stated in this section." If we were to accept Cacique's interpretation of the term "market price" under the circumstance of this case, DFA would not receive what it would have otherwise received under the MPA because there were no buyers willing to pay the state-mandated minimum price for the portion of milk on which DFA sought damages.[9]

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[9] Cacique also argues that, when calculating the volume of DFA's distressed milk sales that should be attributed to Cacique's breach, the court should have looked at daily transactional sales rather than monthly sales. Because milk is perishable, DFA sold, and Cacique purchased, milk every day. Cacique argues that monthly sales figures do not accurately reflect the distressed sales attributable to its breach because, on any given day, the milk Cacique should have purchased from DFA might have been resold by DFA to third-parties at or above the state minimum. The proper manner of calculating the volume of distressed milk for which DFA is entitled to damages is a question of fact that we review under the substantial evidence standard. (See *Franke, supra,* 172 Cal.App.4th at pp. 232-233.) DFA's witnesses, including its expert, testified at trial that the volume of distressed milk attributable to Cacique should be measured on daily versus monthly sales. Although Cacique's expert disagreed, the trial court was entitled to choose which theory to accept. Moreover, the parties agreed that there was insufficient data that would allow a daily computation for the entire damages period. Under such circumstances, the court acted within its discretion in choosing a method that best approximated damages. (See generally *GHK Associates v. Mayer Group, Inc*. (1990) 224 Cal.App.3d 856, 873-

DISPOSITION

The judgment is affirmed. Respondent is to recover its costs on appeal.

ZELON, J.

We concur:

PERLUSS, P. J.

JACKSON, J.

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874 ["Where the fact of damages is certain, the amount of damages need not be calculated with absolute certainty. [Citations.] The law requires only that some reasonable basis of computation of damages be used, and the damages may be computed even if the result reached is an approximation'].)