MT. AIR ENTERS., LLC v. SUNDOWNER TOWERS, LLC

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Supreme Court of California

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MOUNTAIN AIR ENTERPRISES, LLC, Plaintiff and Respondent, v. SUNDOWNER TOWERS, LLC et al., Defendants and Appellants.

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Title

PETITION FOR REVIEW

Text

ISSUE FOR REVIEW

Can a party's assertion of an affirmative-defense trigger a clause that awards attorney's fees to the party who prevails in an ″action″ or ″proceeding″ to enforce the contract?

INTRODUCTION

The Court of Appeal's published 2-1 decision in this case is the latest entry in an intractable conflict among California courts about whether attorney fees are available when a contract is enforced via an affirmative defense. This dispute has now spawned five published decisions - which are split 3-to-2 - along with three dissents in those cases.

The fundamental question is whether an affirmative defense qualifies as an ″action or proceeding.″ If so, the standard language of most attorney fee provisions will apply in favor of a defendant who invokes the contract to defeat a claim. If not, the same provisions will only produce attorney fee awards when a party sues on the contract.

It sounds like a simple issue. But a clear answer [*2] has eluded the Court of Appeal. Both sides of the debate have constructed elaborate linguistic arguments based on dictionary definitions, the Code of Civil Procedure, and past appellate precedents. And each asserts that the other's interpretation would have unacceptable consequences.

Advocates of interpreting ″action or proceeding″ broadly argue that it would elevate form over substance if affirmative defenses were treated differently than complaints. Those who favor a narrow construction contend that litigants should not face the risk of an attorney fee award each time they so much as mention a contract in the course of a lawsuit.

The present case is an ideal opportunity for this Court to resolve the issue. The plaintiff sued to enforce one contract, and the defendants defeated that claim by invoking a second contract to prove a novation defense. Does that mean the defendants prevailed in an ″action″ or ″proceeding″ to enforce the second contract - and are therefore entitled to an award of attorney fees under that contract?

STATEMENT OF THE CASE

A. Factual Summary

1. The purchase and repurchase agreements are executed

The underlying dispute in this case [*3] concerned a piece of commercial real estate in Reno, Nevada. (Typed Majority Opinion (″Maj Opn.″) at 2.) The property includes multiple buildings, which were originally designated a single parcel located 450 Arlington Avenue. (*Id.)* On February 17, 2006 the property was subdivided into three separate legal parcels: the north tower, the south tower, and the casino building. (*Id.)*

Before the property was subdivided, it became the subject of a transaction between Steven Scarpa and a Nevada limited liability company named Sundowner Towers. (*Id.* at 2.) On December 12, 2005 Scarpa and Sundowner entered two separate written contracts. (*Id.)* In the first contract, Sundowner agreed to sell the south tower to Scarpa for $ 7 million. (*Id.*) In the second contract, Sundowner promised that it would later repurchase the south tower for the same price, plus a 12% inflation factor. (*Id.*)

Sundowner's members, Bijan Madjlessi and Glenn Larsen, personally guaranteed its obligations under the repurchase agreement. (*Id.)* And Scarpa's rights under both agreements were later assigned to Mountain Air Enterprises, a California limited liability company in which he is the sole member. [*4] (*Id.* at 2.)

2. The option agreement is executed

On April 25, 2006 Mountain Air entered an option agreement with Larsen and Madjlessi, giving them the exclusive right to purchase the south tower during a specified window of time. (*Id.* at 2.) Sundowner was not a party to the contract. (*Id.)*

The option agreement contained the following attorney fees clause:

> If any legal action or any other proceeding, including arbitration or an action for declaratory relief; is brought for the enforcement of this Agreement or because of an alleged dispute, breach, default, or misrepresentation in connection with any provision of this Agreement, the prevailing party shall be entitled to recover reasonable attorney fees, expert fees and other costs incurred in that action or proceeding, in addition to any other relief to which the prevailing party may be entitled. (*Id.* at 11-12.)

3. Sundowner fails to honor the repurchase agreement, so Mountain Air sues it and its members

On April 27, 2006 Sundowner complied with the purchase agreement by acquiring the south tower from a third party and transferring it to Mountain Air. (*Id.)* But Sundowner never repurchased [*5] the south tower, as it had promised to do in the repurchase agreement. (*Id.* at 3.) Mountain Air attempted to enforce the repurchase agreement by filing this lawsuit against Sundowner, Larsen, and Madjlessi. (*Id.* at 3.)

B. Procedural History

1. The trial court finds that the repurchase agreement cannot be enforced - but denies attorney fees

The defendants prevailed in a 13-day bench trial. (*Id.* at 3.) The trial court ruled in their favor on two affirmative defenses: (1) that the repurchase agreement was illegal and void under the subdivision-map laws of both California and Nevada, and

(2) that the option agreement was a novation that extinguished the repurchase agreement. (*Id.* at 3-4.) The trial court's final statement of decision was filed on October 10, 2012 and judgment was entered the same day. (*Id.*)

On December 7, 2012 the defendants moved for an award of attorney fees based on the relevant provisions of the repurchase and option agreements. (*Id.* at 4.) The trial court denied the defendants' motion on March 20, 2013. (Dissent at 5.)

The court determined that fees could not be awarded under the repurchase agreement because that contract [*6] was void for illegality. (*Id.* at 5-6.) It ruled that the option agreement's attorney fee provision did not apply because the present action was not brought to enforce that agreement or because of a dispute in connection with that agreement. (*Id.* at 6.) In the court's view, the relevance of the option agreement to the novation defense was not enough to warrant a fee award. (*Id.*)

On March 29, 2013 the defendants filed a timely notice of appeal from the trial court's order denying attorney fees. (Maj. Opn. at 4.)

2. The Court of Appeal holds that the novation defense warrants attorney fees

In a published 2-1 decision authored by Justice Stewart and joined by Presiding Justice Kline, the Court of Appeal reversed the order denying attorney fees. (Maj. Opn. at 21.) Justice Richman dissented. (Dissenting opn. of Richman, J. at 1-13.)

a. The majority opinion

The majority opinion approved of the trial court's refusal to award attorney fees pursuant to the void repurchase agreement. (Maj. Opn. at 11.) But it held that the defendants were entitled to an award of attorney fees based on the option contract. (*Id.* at 21.)

Applying a de novo standard of review, the [*7] majority determined that the novation defense constituted a ″legal action″ or ″proceeding″ for purposes of the attorney fee clause. (*Id.* at 13-14.) The majority acknowledged that a split of authority existed on this point; it endorsed a broad construction and rejected the appellate decisions to the contrary. (*Id.* at 15-18.) In the majority's view, it would be ″absurd″ for an attorney-fees provision to treat affirmative defenses differently than complaints. (*Id.* at 18.)

The majority held that the novation defense sought to enforce the option contract because it was based on the integration clause in that document. (*Id.* at 19.) Alternatively, the majority believed that the defense had been asserted because of a dispute ″in connection with″ the option agreement. (*Id.* at 20.) Because the subject matter of the novation defense fell within the scope of the attorney fee clause in the option contract, the majority concluded that the defendants were entitled to an award of attorney fees. (*Id.* at 21.)

b. Justice Richman's dissent

In his dissenting opinion, Justice Richman disputed whether the novation defense fell within the scope of the attorney-fee clause in [*8] the option contract. (Dissenting opn. of Richman, J. at 1.) In his view, the novation defense was not an attempt to enforce the option agreement, nor did it arise from a dispute in connection with that contract. (*Id.* at 10-11.)

Justice Richman also believed that the majority erred in applying a de novo standard of review. (*Id.* at 11.) He argued that, just as trial courts have wide discretion to determine who the prevailing party was, they should also have discretion to decide what was ″in dispute″ before them. (*Id.* at 11.)

WHY REVIEW IS WARRANTED

A. A split in authority exists about whether a party can recover attorney fees under a contract that has been raised defensively

The unresolved debate over a defendant's right to contractual attorney fees has produced a series of conflicting published opinions.

The first entry in the debate was *Stockton Theatres v. Palermo (1954) 124 Cal.App.2d 353,* which involved a lease provision awarding attorney fees to a party that had to ″*commence any legal proceedings* against the other″ because of a default in the lease. (*Id. at pp. 354-355,* emphasis added.) The Third District held [*9] that this language ″may give the right to recover attorney's fees not only to successful plaintiffs but also to successful defendants″ - because it believed that a defense was a ″proceeding″ that could be ″commenced.″ (*Id. at p. 362.)* It intentionally adopted a broad reading of those terms:

> The word 'commence' as used in this clause can just as well mean 'commence a successful defense.' It would be a narrow interpretation to declare that the word 'commence' must be given the restricted construction of 'file a complaint as plaintiff.' … (*Id. at p. 362.)*

A split in authority emerged when the opposite rule was adopted by the Second District, Division One, in *Exxess Electronixx v. Heger Realty Corp. (1998) 64 Cal.App.4th 698.* The lease in that case authorized attorney's fees if a party ″*brings an action or proceeding* to enforce the terms hereof or declare rights hereunder.″ (*Id. at p. 712,* original italics.) The court held that this language did not permit a fee award based on an affirmative defense:

> Under any reasonable interpretation of the attorneys' fee provision, we cannot equate raising [*10] a ″defense″ with bringing an ″action″ or ″proceeding.″ By asserting a defense to the cross-complaint, Heger Realty did not bring an action or proceeding to enforce the lease or to declare rights under it. (*Id.*)

The issue arose again in *Gil v. Mansano (2004) 121 Cal.App.4th 739,* when the Second District, Division Five, addressed a similar attorney-fee clause: ″In the event *action is brought* to enforce the terms of this Release, the prevailing party shall be paid his reasonable attorney fees and costs incurred therein.″ (*Id. at p. 742,* italics added, original brackets omitted.) Following the *Exxess* precedent, the majority of the court held that ″the assertion of a contractual defense to a tort action is not an 'action brought to enforce the contract' and, therefore, the prevailing party is not entitled to an attorney fee award.″ (*Id. at p. 741.)*

In a dissenting opinion, Justice Armstrong faulted the majority for adopting a hyper-technical interpretation of the word ″action.″ (*Id. at p. 746.* (dis. opn. of Armstrong, J.).) He argued that the term should be read broadly to include defenses:

> In an [*11] everyday sense, *'action' includes both an answer and an affirmative defense,* for the simple reason that the two are in many ways alike. The defendant has the burden of proof on the affirmative defense just as the plaintiff does on a complaint … If the defendant prevails on the release defense, it will only be because the court has 'enforced' the release… *Raising a release as an affirmative defense is legally the same as bringing an 'action' to enforce it.* The defendant becomes an actor. (*Id. at p. 747,* italics added.)

The panel from *Gil* also addressed the same issue in the context of statutory attorney fees with its 2-1 decision in *Salawy v. Ocean Towers Housing Corp. (2004) 121 Cal.App.4th 664.* The statute in that case provided for an award of attorney fees to the prevailing party in an ″action … to enforce the governing documents ″of a common-interest development. (*Id. at p. 670,* quoting *Civ. Code § 1354*, subd. (f).) The majority followed *Exxess* and held that an affirmative defense based on the governing documents was not an ″action to enforce″ and therefore could not warrant attorney fees. (*Id. at pp. 672-674.)* [*12] Once again, Justice Armstrong dissented on the ground that the majority's interpretation was overly narrow. (*Id. at p. 677* (dis. opn. of Armstrong, J.).)

The broader interpretation finally prevailed the next time that the Second District confronted the issue in *Windsor Pacific LLC v. Samwood Co., Inc. (2013) 213 Cal.App.4th 263.* In a unanimous opinion, Division Three held that an affirmative defense was an ″action or proceeding″ that entitled the defendant to recover attorney fees. (*Id. at pp. 268, 276.)* The court rejected the holdings in *Exxess* and *Gil* because it ″believe[d] that the analysis inJustice Armstrong's dissent in *Gilis* correct.″ (*Id.* at p. 726.)

The present case is the culmination of this series of conflicting appellate opinions. The majority opinion followed *Windsor Pacific* by ″reject[ing] the interpretation … adopted by the courts in *Exxess* and *Gil*″ and endorsing the dissenting opinion from the latter case. (Maj. Opn. at 18.) The court ″agree[d] with Justice Armstrong″ that a defendant who raises an

affirmative defense has the same right to attorney fees as a plaintiff who brings [*13] an action. (*Id.*)

This ongoing rift within the Court of Appeal is a prototypical example of an issue that warrants this Court's attention. (See Cal. Rules of Court, rule 29 [review will be ordered ″where it appears necessary to secure uniformity of decision or the settlement of important questions of law″].) There is open disagreement both within and among different appellate panels. And the same issue will recur every time a defendant prevails by invoking a contract that contains an attorney-fee clause.

B. This Court can resolve the controversy by answering three discrete questions

In a given case, the availability of contractual attorney fees is a matter of contract interpretation that depends on the terms the parties chose. But there are three recurring questions that have given rise to the current split in authority. By answering them, this Court can restore predictability to this area of the law.

1. Is it absurd for an attorney fee provision to differentiate claims from defenses?

The most basic question is whether or not it is absurd for an attorney-fee clause to treat plaintiffs and defendants differently. If that result would be absurd, then courts [*14] may legitimately avoid it by declining to enforce the literal meaning of the terms at issue. (*Civ. Code § 1638* [″The language of a contract is to govern its interpretation, if the language … does not involve an absurdity.″].)

That has been a repeated tactic of the opinions that endorse a broad reading of the attorney-fee clauses. For example, the majority opinion in this case argues that the *Exxess* and *Gil* courts' strict interpretation ″would lead to absurd results″ based on a ″form-over-function approach″ to attorney fees. (Maj. Opn. at 18.) Justice Armstrong went even further in *Gil,* stating ″that it is not within the imagination of mortal lawyers to draft an attorney fee clause which provides for fees if the winner filed, but not if the winner defended...″ (*Gil, 121 Cal.App.4th at p. 747* (dis. opn. of Armstrong, J.).) And the same concern animated his dissent in *Salary:*

> I simply cannot imagine that a lawyer or legislator ever reached the considered opinion that it was right and just that in some circumstances the party who files, but not the party who defends, may recover fees. What kind of sense would that make, if the context is not [*15] a laboratory analysis of language, but the ordinary lives of people, organizations, and their lawyers? None. (*Id., 121 Cal.App.4th at p. 677* (dis. opn. of Armstrong, J.).)

The majority in *Salawy* countered that there could, in fact, be legitimate reasons for a drafter to restrict the availability of attorney fees to plaintiffs. (*Id. at pp. 673-674.)* For example, allowing successful defenses to trigger attorney fees would expose defendants to liability for attorney fees if a contract-based affirmative defense was defeated. (*Id.*) After all, the plaintiff would be the prevailing party in that ″action.″

One's perspective on the initial plausibility of differentiating between plaintiffs and defendants will also dictate the meaning ascribed to ambiguous language. Justice Armstrong believed that ″if lawyers ever managed to agree on such an unusual arrangement, they would document that agreement with elaborate care.″ (*Gil, 121 Cal.App.4th at p. 747* (dis. opn. of Armstrong, J.).) In contrast, the majority believed that if the attorney-fee provision in the contract had been intended to apply to defensive use of the agreement, then [*16] the drafters would have inserted specific language to that effect. (*Gil, 121 Cal.App.4th at p. 745.)* The conflict between these divergent perspectives can only be resolved by this Court.

2. Should ″action″ and ″proceeding″ be interpreted broadly or narrowly?

The second question that the Court should address is the meaning of the words ″action″ and ″proceeding″ in the context of contractual attorney fees.

Clarifying the scope of these terms is critical because they are the core of the standard language employed in most attorney-fee provisions. (See, e.g., Knight, et al., *Cal. Practice Guide: Alternative Dispute Resolution* (The Rutter Group 2014) Form 126: ADR Clause [″In the event it becomes necessary to file a legal action or proceeding to enforce this agreement, the prevailing party in such action or proceeding shall be entitled to recover … reasonable attorney fees and

court costs.″]; Greenwald & Bank, *Cal. Practice Guide: Real Property Transactions* (The Rutter Group 2014) Form 4:H, Purchase and Sale Agreement and Joint Escrow Instructions [″If either party named herein brings an action or proceeding to enforce the terms hereof… the prevailing [*17] party in any such action (or proceeding) … shall be entitled to its reasonable attorneys' fees″].)

The majority opinion in this case embraced the broad construction of ″action or proceeding″ advanced by Justice Armstrong and the *Windsor Pacific* court. (Maj. Opn. at 13-17.) Based on dictionary definitions, it argued that each individual procedural step in a legal action constitutes a ″proceeding″ - including the assertion of an affirmative defense. (*Id.* at 14, fn. 9, citing Black's Law Dict. (10th ed. 2014) p. 1398, col. 1.) [″An act or step that is part of a larger action″].) The majority also demonstrated that the Court of Appeal had already employed this broad definition in other contexts. (*Id.* at 14, citing *Zellerino v. Brown (1991) 235 Cal.App.3d 1097, 1105* [″The term 'proceeding' is generally applicable to any step taken by a party in the progress of a civil action.″].)

But the arguments in favor of a narrower definition are at least as formidable. ″The word 'proceeding' may be used synonymously with 'action' or 'suit' to describe the entire course of an action at law or suit in equity from the filing of the complaint until the entry of final [*18] judgment.″ (*Exxess, 64 Cal.App.4th at p. 712, fn. 15,* internal brackets and ellipses omitted, quoting Black's Law Dict. (6th ed. 1990) p. 1204, col. 1.); accord *Nassif v. Municipal Court (1989) 214 Cal.App.3d 1294, 1298* [″An action is not limited to the complaint but refers to the entire judicial proceeding… and is generally considered synonymous with 'suit.'″].)

This narrow approach is consistent with how the terms are used in the Code of Civil Procedure, which says that ″[a]n action is an ordinary proceeding in a court of justice by which one party prosecutes another...″ (*Code Civ. Proc. § 22*.) A 'proceeding' is therefore logically distinct from a 'defense,' which refers to ″[t]hat which is offered and alleged by the party *proceeded against in an action or suit* as a reason in law or fact why the plaintiff should not recover or establish what he seeks.″ (*Exxess, 64 Cal.App.4th at p. 712, fn. 15,* quoting with italics, Black's Law Dict., *supra,* p. 419, col. 2.)

The choice between the broad and narrow senses of the words ″action″ and ″proceeding″ also raises important policy considerations. The majority in this case [*19] argued that a narrow definition might create incentives for defendants to file needless cross-complaints instead of restricting themselves to affirmative defenses. (Maj. Opn. at 18.)

Yet a broad definition risks creating a procedural minefield for defendants, who could be held liable for attorney fees any time they lost a motion that relied on a contract with an attorney-fee clause. (See *Salawy, 121 Cal.App.4th at pp. 673-674* [noting that a broad definition of ″action″ could result in defendants being held responsible for attorney fees simply for losing a demurrer].) Given the far reaching consequences of choosing either definition, it is imperative for this Court to provide an authoritative answer.

3. Is review de novo or deferential?

The third issue the Court should address is the appropriate standard of review.

The majority in this case held that the availability of attorney fees under the option agreement was a question of contract interpretation, which it reviewed de novo in the absence of any relevant extrinsic evidence. (Maj. Opn. at 12.) The majority expressly rejected the idea that it had any obligation to defer to the trial court's ruling. (Maj. [*20] Opn. at 20, fn. 12.)

In his dissenting opinion, Justice Richman argued that the majority should have deferred to the trial court's finding about the substance of the bench trial:

> We said in *Sears v. Baccaglio (1998) 60 Cal.App.4th 1136, 1158,* that the trial court is given wide discretion in determining whether a party has prevailed for purposes of awarding attorney fees. While Judge Chernus's determination did not determine who was the prevailing party, I see no reason why similarly wide discretion should not apply to a trial court's decision as to what was ″in dispute″ before him for 18 days. (Dissenting opn. of Richman, J. at 11.)

This is not a complex issue, but it is one for which there is currently no clear answer. Unless this Court clarifies the proper standard of review, appellate courts will risk making a foundational error every time they consider a trial judge's ruling on a motion for contractual attorney fees.

CONCLUSION

Attorney fees are a fundamental aspect of modern contract law, and it is has become commonplace for defendants to seek them. So it is troubling that no one knows how the standard clauses will be enforced in the world's [*21] eighth largest economy.

After five published opinions from the Court of Appeal, the state of the law is less certain than ever. This Court should grant review and resolve the controversy.

Dated: December 30, 2014.

Respectfully submitted,

LAW OFFICE OF ERIK A. HUMBER

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By /s/ [Signature]
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Certificate of Word Count

(*Cal. Rules of Court, Rule 8.504(d)(1)*)

The text of this petition consists of 3,799 words, according to the word count generated by the Microsoft Word word-processing program used to prepare the brief.

Dated: December 30, 2014.

/s/ [Signature]
Jeffrey I. Erlich

PROOF OF SERVICE

STATE OF CALIFORNIA, COUNTY OF LOS ANGELES I am employed in the County of Los Angeles, State of California. I am over the age of 18 and not a party to the within action; my business address is: 237 West Fourth Street, Second Floor, Claremont, California 91711.

On **December 30, 2014,** I served the foregoing documents described as **PETITION FOR REVIEW** on the interested parties in this action by placing a true [*22] copy thereof enclosed in sealed envelopes addressed as follows:

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Executed on **December 30, 2014,** at Claremont, California.

/s/ [Signature]
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