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CERTIFIED FOR PARTIAL PUBLICATION[*]

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

SECOND APPELLATE DISTRICT

DIVISION SEVEN

PBA, LLC, et al., Plaintiffs, Cross-Defendants, and Appellants, v. KPOD, LTD. et al., Defendants, Cross-Complainants, and Appellants.	B137295 (Los Angeles County Super. Ct. No. TC010027)

APPEAL from judgments and orders of the Superior Court of Los Angeles County. Michael B. Rutberg, John Leahy, Jack W. Morgan, Kenneth W. Gale, Judges. Affirmed in part and reversed in part with directions.

Law Offices of M. Reed Hunter, M. Reed Hunter; Jeffer, Mangels, Butler & Marmaro, Paul Hamilton and Neil C. Erickson for Plaintiffs, Cross-Defendants Appellants PBA, LLC, Bharat Patel, Ashik Patel and Purushottam Patel.

Law Offices of Frederico C. Sayre, Frederico C. Sayre, Roy L. Comer, Kent M. Henderson and Daniel Cargnelutti for Defendant, Cross-Complainant and Appellant Timothy P'Brien.

[*] Pursuant to California Rules of Court, rules 976(b) and 976.1, this opinion is certified for publication with the exception of Facts and Proceedings Below and parts II through VIII.

Sailor J. Kennedy, Defendant, Cross-Complainant, and Appellant in propria persona.

This appeal is the latest episode in a long story of litigation commencing in 1997. At different stages it was heard by five judicial officers, culminating in a record of nearly 20,000 pages. The action involves the purchase, operation and eventual sale of a hotel, the Carson Hilton, by three joint venturers, PBA, LLC (hereafter PBA), KRAD Associates, LLC, (hereafter KRAD), and KPOD Ltd. (hereafter KPOD).

After a brief relationship between the companies and their principals characterized primarily by disputes over management, allegations of mismanagement, and general discord, the hotel was partitioned by sale, its liabilities paid, and the remaining proceeds apportioned. Various cross-complaints between the companies and their principals were disposed of by dismissal or trial.

PBA's appeal focuses primarily on rulings made by Judge Gale, contending he "acted as a *de facto* court of appeal, overturning sound and well-grounded decisions. . . made by prior judges and, sometimes by courts of appeal. . . ." PBA argues Judge Gale abused his discretion and exceeded his jurisdiction by making rulings contrary to his predecessors, principally Judge Morgan, in violation of Code of Civil Procedure section 1008. Among other things, PBA challenges Judge Gale's order vacating an order by Judge Morgan declaring defendant and cross-complainant Sailor Kennedy a vexatious litigant and requiring Kennedy to obtain court permission before filing any new litigation in this state.

KPOD, which agrees for the most part with Judge Gale's rulings, primarily appeals from Judge Morgan's grant of summary judgment to PBA on the complaint for partition of the property and certain findings by the referee on the accompanying accounting. KPOD joins Sailor Kennedy in contending Kennedy successfully moved to disqualify Judge Morgan at an early point during the litigation, thereby voiding some of the principal rulings in this case.

Sailor Kennedy, a principal in KPOD, appeals the trial court's decision striking the first 12 causes of action of his cross-complaint against PBA and others and the court's ruling denying his motion to strike the orders of Judge Morgan on the ground Morgan had been disqualified.

Timothy O'Brien, a real estate agent, appeals from the trial court's decision striking the first eight causes of actions in his cross-complaint against the Patels, principals in PBA.

In the published portions of this opinion we hold: (1) Judge Morgan had jurisdiction to strike Kennedy's declaration of prejudice notwithstanding the fact the judge had previously filed a response to the declaration and (2) Judge Gale erred in vacating Judge Morgan's vexatious litigant and pre-filing orders because Kennedy failed to show a change in facts establishing the orders were no longer justified. The facts relevant to these subjects are discussed in our resolution of the issues below.

FACTS AND PROCEEDINGS BELOW

A. The Relevant Agreements.

1. The Tenant in Common Agreement.

PBA, KPOD and KRAD entered into a Tenant in Common agreement (the TIC agreement) for the purchase and operation of the Carson Hilton Hotel. (In the trial court proceedings and the appellate briefs the three companies are often referred to as the tenants-in-common or "the TIC." We will use that designation here where appropriate.)

Under the TIC agreement each of the companies owned an undivided one-third interest in the hotel.

The agreement stated "any decisions regarding the ownership, operation or disposition of the hotel shall be made by a majority vote of the parties." Additionally, it provided "the parties shall each cooperate with one another and shall, at all times, accede to the wishes of the majority of the parties."

With respect to sale of the hotel, the TIC agreement provided in relevant part no party could sell or transfer its interest in the property without "complying strictly" with certain provisions. Specifically, the agreement provided a party desiring to sell its interest in the property must advise the other parties in writing. Subsequent to this notification, the party wanting to sell must negotiate with the other parties in good faith regarding the terms of sale of either the entire property or the selling party's interest in the property if any of the other parties chose to purchase it. If the parties did not come to an agreement on the purchase and sale of the property the contract provided two ways in which an individual party's interest could be sold. A party could sell its interest to a third party if it offered the other parties a right of first refusal. Alternatively, the contract provided for a "put option" allowing any party at any time to deliver written notice to the others that it proposed to acquire the interest of another party. If one party took such action the agreement required the party receiving the notice to either sell its interest to the offeror or proceed in good faith to purchase the offeror's interest.

Any party could terminate the agreement on 90 days notice to the other parties.

Finally, the agreement contained a standard merger clause and a provision for amendment stating it could not be modified "in any manner, except by an instrument in writing stating that it is a supplement, modification or amendment" of the TIC.

2. The Hotel Purchase Agreement.

The TIC signed a contract with M&B Partners, a company controlled by Sailor Kennedy, to purchase the hotel for $5.5 million. The contract called for the TIC to make an earnest money deposit of $100,000 concurrently with the execution of the contract and to pay an additional $900,000 to M&B "outside of escrow" at closing.

The purchase was accomplished by a "double flip" in which M&B Partners purchased the hotel from its current owner for $4.2 million and simultaneously sold it to the TIC, purportedly for $5.5 million. The trial court, however, found the actual purchase price agreed to by M&B and the TIC was not $5.5 million but $4.2 million.

3. The Loan Agreement

To finance the hotel purchase the TIC borrowed $5.3 million from Allied Capital Commercial Corporation (hereafter "Allied"). Through a commitment letter and loan agreement the TIC and Allied agreed to the following terms and conditions.

In order to acquire the loan from Allied the TIC agreed to pay a $450,000 loan commitment fee and to provide Allied, on the closing date of escrow, "evidence that borrower is purchasing the property for $5.5 million and that the borrower is providing at least $1 million at the closing date in cash capital contributions to be used as payment to the sellers of the property and for other closing expenses." The loan agreement further provided: "In the event that the property is acquired by borrower for cash consideration of less than [$5.5 million] then it is understood and agreed that the amount of the loan shall be decreased dollar-for-dollar to reflect such reduced purchase price."

The loan was personally guaranteed by Bharat Patel, Purushottam Patel, Ashik Patel, principals in PBA, and Sailor Kennedy, a principal in KPOD.

The loan commitment letter stated that unless Allied provided written consent the TIC could not: (a) change the ownership interests of the partners, (b) "sell, assign, or transfer any additional interests" in the respective companies, (c) change the management or control of the parties' partnership or the hotel, (d) alter the current business entity, or (e) sell the assets necessary to run the business of the hotel.

Under the loan commitment letter, the current hotel management company, Seaspan, Inc., was approved by Allied and could not be replaced except with Allied's written consent.

Allied also required the parties to provide it with an agreement governing their relationship with respect to the hotel. Further, the loan agreement stated "The Borrower will . . . continue to conduct its business in the manner currently conducted . . ."

Under the loan agreement the appointment of a receiver for the hotel property would constitute a default on the loan.

B. Acrimony Between the Companies and Their Principals.

Not long after the parties purchased the hotel disputes broke out between the principals of PBA, the Patels, and the principals of KPOD, the Kennedys, over the hotel's management.

One dispute occurred between Bharat Patel and Sailor Kennedy over the general manager of the hotel, Steven Algood. Patel, who sought to appoint his father general manager, sprearheaded an investigation into allegations of sexual harassment against Algood which resulted in his eventual discharge, and the appointment of Darian, a friend of Patel's, as Assistant General Manager. Darian was subsequently fired by Sailor Kennedy's daughter, Irene.

In December of 1996 Bharat and Ashik Patel considered selling the hotel. They employed the law firm Corbett and Steelman to facilitate this maneuver. Accordingly, Corbett & Steelman began preparing a lawsuit for the partition and sale of the hotel.

In the midst of PBA's preparation for a partition sale of the hotel, and the discord among the parties with respect to the hotel's management, KRAD considered removing Seaspan. Given the difficulties amongst the parties, KRAD thought it best to seek outside management "for the purpose of harmony."

However, once it discovered appointing an outside management company could be construed as a violation of the Allied loan agreement, KRAD withdrew its support for new management and the parties eventually extended Seaspan's management agreement for another six months.

Other disputes arose over the management, or alleged mismanagement, of the hotel. PBA accused Kennedy of failing to pay property taxes to Los Angeles County, transient occupancy taxes to the city of Carson, payroll taxes to the federal government, writing several bad checks, and failing to pay Hilton Hotels for the use of its name and reservation service. O'Brien claimed he had not been paid by PBA for services he had rendered for the hotel along with services he provided specifically to PBA.

At one point, KPOD offered to purchase PBA's one-third interest in the hotel for $500,000. PBA countered with an offer to purchase KPOD's one-third interest for $200,000. Neither company accepted the other's offer.

Finally, PBA notified KPOD and KRAD it was exercising its rights to terminate the TIC agreement effective March 14, 1997.

C. Litigation Between the Companies, Their Principals and the Lender.

While the TIC agreement was still in effect, PBA filed an action against KPOD, KRAD, and Allied for partition of real property, appointment of a receiver and injunctive relief.

In support of PBA's application for a receiver and injunctive relief Bharat Patel filed a declaration primarily focusing on Kennedy's mismanagement of the hotel. Patel claimed, among other things, Kennedy had written several bad checks on behalf of the parties on an Ohio bank account resulting in a telephone call from a security fraud officer at the bank. Patel asserted the problem was not resolved until he advanced $60,000 to Seaspan for payment of the checks. He further alleged the Kennedys were "contributing nothing of value to the hotel" despite excluding the Patels from its control. Patel also alleged the hotel, under Kennedy's control, had failed to pay sales taxes to the State Board of Equalization, failed to pay over $125,000 in payroll taxes, and failed to pay franchise and reservation fees to Hilton Hotel Inc.

The trial court granted PBA's request for appointment of a receiver and appointed H. Joel Biggs to that position.[1] Biggs' appointment was made without Allied's approval. Biggs removed Seaspan as manager of the hotel and installed his own company, Hotel Management Group, in its place, again without approval from Allied.

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[1] We affirmed the trial court's order appointing a receiver. (*PBA, LLC v. KPOD, LTD., LLC* (July 6, 1998, B112274) [nonpub. opn.].)

KPOD filed a cross-complaint against PBA and the Patels for breach of contract, breach of fiduciary duty and various business torts. The gist of the cross-complaint was that PBA and the Patels had breached specific provisions of the TIC agreement as well as the implied covenant of good faith and fair dealing by: seeking the appointment of a receiver to manage the hotel; failing to "cooperate with the wishes of the majority parties;" providing financial information to third parties without authority; and by attempting to partition and sell the property without complying with the provisions of the TIC agreement regarding such sale. KPOD alleged several other causes of action including fraud, conspiracy to defraud, and intentional interference with prospective business advantage to name a few.

Allied also filed a cross-complaint against PBA as well as KPOD, KRAD and their principals for judicial foreclosure of the deed of trust securing the hotel loan and for a judgment against the Patels and Sailor Kennedy on their personal guaranties of the loan repayment. Allied alleged the companies and their principals were in default under the terms of their promissory note because they had failed to make the loan payments, failed to pay taxes due to the City of Carson and because a receiver had been appointed for the hotel.

PBA and the Patels filed a cross-complaint against KPOD, KRAD and the Kennedys for breach of contract, breach of fiduciary duty, various business torts, defamation and declaratory and injunctive relief. The cross-complaint also named O'Brien as a cross-defendant.

O'Brien filed a cross-complaint against PBA and the Patels for unpaid fees due for services rendered.

Kennedy too filed a cross-complaint against PBA and the Patels.

During the affray Kennedy filed five motions to disqualify Judge Morgan, all of which were stricken or denied, and Judge Morgan entered an order declaring Kennedy a vexatious litigant which was later vacated by Judge Gale.

D. Partition and Sale of the Hotel Property and Accounting.

The trial court granted PBA's motion for summary judgment on its complaint for partition and entered an interlocutory order of partition directing the sale of the property and appointing a referee to conduct an accounting. A year later the hotel was sold to Sunstone Hotel Investors, L.P. for approximately $12 million.[2]

Following the sale the court-appointed referee conducted an accounting of the sales proceeds to establish the parties' respective interests. The referee found the purchase of the hotel by the TIC was structured as described above at a price of $4.2 million. This was done, he found, so the parties would not have to invest any cash of their own into the hotel purchase. Moreover, upon evidence of the sham check transactions described above, the referee found M&B Partners through KPOD was not entitled to a $900,000 contribution reimbursement toward the purchase price of the hotel. The referee additionally determined Sailor Kennedy, Kennecorp, M&B Partners, KPOD and others were part of a single enterprise controlled by Sailor Kennedy throughout the operation and sale of the hotel.

In sum, the referee found the amount to be paid to each of the parties from the sale proceeds would be determined by first deducting the total outstanding indebtedness of the parties from the operation of the hotel. Next, the total amount contributed by each of the parties would be deducted from the net proceeds of the sale and repaid to each respective party. The remaining amount would be paid in equal amounts to the parties. Finally, the referee determined his fees to be $35,000, due in equal shares from PBA, KPOD, and KRAD. The trial court ordered the accounting report approved and adopted.

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[2] KPOD appealed from the interlocutory order granting partition. (Code Civ. Proc., § 904.1, subd. (a)(9).) However, once the hotel was sold we ordered the appeal dismissed as moot since it was no longer possible to grant appellant any effectual relief. (*PBA, LLC v. KPOD, Ltd.* (B118954), Order dismissing appeal, March 1, 1999.) This order is law of the case and precludes KPOD from attempting to challenge the judgment of partition in the present appeal. The question whether PBA breached the TIC agreement in seeking

E. Trial on the Cross-complaints Between PBA, KPOD and Their Principals.

The cross-complaints between PBA, KPOD and their principals were tried before Judge Gale. The court confirmed the partition and sale of the hotel to Sunstone.[3]

The court found against PBA and the Patels on their cross-complaint against KPOD and the Kennedys and found in favor of KPOD on its cross-complaint against PBA and the Patels. The court awarded KPOD damages from PBA in the amount of $107,666.66 representing KPOD's share of the costs and fees it incurred as a result of PBA's seeking the appointment of a receiver for the hotel in violation of the TIC agreement. PBA was awarded $12,143.91 as its costs in the partition action.

DISCUSSION

I. KENNEDY'S MOTION TO SET ASIDE ALL ORDERS ENTERED BY JUDGE MORGAN WAS PROPERLY DENIED BECAUSE (A) REVIEW OF A DISQUALIFICATION MOTION IS LIMITED TO A PETITION FOR A WRIT OF MANDATE AND (B) ALL OF THE DECLARATIONS OF BIAS AND PREJUDICE WERE EITHER PROPERLY ORDERED STRICKEN OR FOUND MERITLESS.

Pursuant to Code of Civil Procedure section 170.3,[4] Kennedy and O'Brien filed a declaration alleging bias and prejudice against Judge Morgan on January 8, 1998. On the same day, Judge Morgan filed and served a verified answer to the allegations. Still later

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partition is discussed in Part V, *post*, in connection with PBA's entitlement to attorney fees on the partition action.

[3] Prior to commencement of trial Kennedy and O'Brien each filed voluntary dismissals of the first 12 and 8 causes of action in their respective cross-complaints. Despite their doing so, the trial court struck O'Brien's cross-complaint in its entirety and struck the previously dismissed causes of action in Kennedy's cross-complaint. See discussion in Part VIII, *post*.

[4] All future statutory references are to the Code of Civil Procedure unless otherwise specified.

on the same day, Judge Morgan determined the declaration was untimely and failed to meet the requirements of the statute. Therefore, under the authority of section 170.4 subdivision (b), Judge Morgan ordered the declaration stricken from the record.

Four days later, Kennedy filed another declaration of bias and prejudice, which Judge Morgan immediately ordered stricken.

Kennedy and O'Brien filed two additional declarations of bias against Judge Morgan on May 17, 1999 and June 8, 1999. These declarations were denied by Judges Fujisaki and Gale respectively. Undeterred, on June 21, 1999 Kennedy filed his fifth declaration of bias and prejudice against Judge Morgan.

Judge Morgan recused himself on June 21, 1999 pursuant to section 170.1 subdivision (a)(6), "in furtherance of the interests of justice." Soon after, the case was transferred to Judge Gale. Kennedy then brought a motion to set aside all orders made by Judge Morgan from the time he was assigned to the case contending Judge Morgan had been effectively disqualified as of January 8, 1998. Judge Gale denied the motion.

A. Section 170.3 subdivision (d) Limits Review of a Judge's Disqualification to a Writ of Mandate Sought Within 10 Days of Notice of the Determination.

Section 170.3 subdivision (d) specifies "the determination of the question of disqualification of a judge is not an appealable order and may be reviewed only by a writ of mandate . . . sought within 10 days of notice to the parties of the decision . . ." As this court has held, all litigants "who seek to challenge denial of a statutory judicial disqualification motion are relegated to writ review as described in section 170.3(d)"[5] Likewise, section 170.3 subdivision (d) "forecloses appeal of a claim that a *statutory* motion for disqualification authorized by section 170.1 was erroneously denied, and this preclusion applies even when the statutory basis . . . appears to codify due process

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[5] *Roth v. Parker* (1997) 57 Cal.App.4th 542, 548.

grounds for challenging the impartiality of a judge."[6] Thus, as our Supreme Court has affirmed, "the exclusive means for review" of a determination on the disqualification of a judge is by a petition for writ of mandate in accordance with section 170.3 subdivision (d).[7]

"The purpose of this rule is twofold. It seeks to eliminate the waste of time and money which would flow from continuing the proceeding subject to its being voided by an appellate ruling that the disqualification decision was erroneous. It also promotes fundamental fairness by denying the party seeking disqualification a second 'bite at the apple' if he loses on the merits but succeeds on appeal from the disqualification order."[8]

Kennedy and O'Brien did not seek a writ of mandate after the striking or denial of any of the statements of bias and prejudice they brought against Judge Morgan. The proceedings then stretched out for over a year and a half, adding more volumes to an already voluminous record. Thus, given the unfairness of reconsidering the disqualification issue at this stage, the failure of Kennedy and O'Brien to seek writ review as provided by section 170.3 constituted a waiver of their statutory claims based on section 170.1.

We conclude, therefore, Kennedy and O'Brien are precluded from seeking review of their declarations of bias and prejudice (whether stricken or determined meritless), by a motion in the trial court or by appeal following the final judgment.

Furthermore, even assuming the issue is properly before us we find, for the reasons explained below, Judge Morgan was not disqualified prior to recusing himself in June, 1999 and therefore the trial court properly denied the motion to set aside his orders.

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[6] *Roth v. Parker*, *supra*, 57 Cal.App.4th at page 548. (Emphasis in original.)

[7] *Curle v. Superior Court* (2001) 24 Cal.4th 1057, 1059.

[8] *Gai v. City of Selma* (1998) 68 Cal.App.4th 213, 230.

B. Judge Morgan's Filing an Answer Pursuant to Section 170.3 Did Not Preclude Him From Striking the Statement of Bias and Prejudice Under Section 170.4.

Once a statement of disqualification has been filed by a party, the judge has four options. The judge may: (1) request any other judge agreed upon by the parties to sit and act; (2) within 10 days, "file a consent to disqualification;" (3) within 10 days file "a written verified answer admitting or denying any or all of the allegations . . . ;" or (4) strike the declaration.[9] Failure to respond within the time allowed is deemed a consent to disqualification.[10]

Kennedy contends Judge Morgan's filing an answer to the January 8 declaration pursuant to section 170.3 subdivision (c)(3) precluded him from thereafter striking the declaration of bias pursuant to section 170.4, subdivision (b). Thus, he argues the various procedural options of section 170.3 and 170.4 are mutually exclusive. We disagree.

Notwithstanding the options specified in section 170.3 listed above, if the statement is untimely filed or facially discloses no legal grounds for disqualification, the judge against whom it is filed may strike it.[11] This authority to strike the statement of disqualification derives from section 170.4, subdivisions (d) and (b). Section 170.4, subdivision (d) provides a judge against whom such a statement has been filed, has no power to act "*except as provided in this section*." (Italics added.) Section 170.4, subdivision (b) states "notwithstanding paragraph (5) of subdivision (c) of section 170.3, if a statement of disqualification is untimely filed or if on its face it discloses no legal grounds for disqualification, the trial judge against who it was filed may order it stricken." Thus, the authority to strike a declaration exists "notwithstanding" section

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[9] Sections 170.3, subdivision (c), 170.4 (b); *Urias v. Harris Farms* (1991) 234 Cal.App.3d 415, 420.

[10] Section 170.3 subdivisions (c)(2)-(4); *Urias v. Harris Farms*, *supra*, 234 Cal.App.3d at page 420.

[11] Section 170.4, subdivision (b); *Urias v. Harris Farms*, *supra*, 234 Cal.App.3d at page 420.

170.3 subdivision (c)(5) which precludes judges from ruling on their own disqualifications.

We recently held a challenged judge has the power to order a statement of disqualification stricken as legally insufficient as long as such discretion is exercised within the 10 day time limit imposed by section 170.3, subdivision (c).[12] This time limit is the *only* restraint on the power retained by a judge to strike a statement of disqualification pursuant to the guidelines of section 170.4, subdivision (b).

KPOD, Kennedy, and O'Brien cite *Hollingsworth v. Superior Court*[13] for the proposition the judge's options to consent to disqualification, answer, or strike the declaration, are mutually exclusive. They argue once a trial judge files an answer to the declaration, the judge loses power to take any further action. *Hollingsworth*, however, simply determined a judge cannot consent or answer *after* striking the statement of disqualification.[14] Therefore, in such circumstances a party need not wait 10 days before seeking relief via writ of mandate.[15] This makes sense because upon striking the declaration, it no longer exists to be consented to or answered. However, nothing prevents the challenged judge from striking the declaration after first answering it. We find no authority or logical reason to prevent a judge from striking such a statement subsequent to filing an answer so long as it is done within the ten days prescribed by the statute.

Thus, we conclude Judge Morgan's filing of an answer pursuant to section 170.3 subdivision (c)(3) did not preclude him from striking the statement of bias and prejudice within 10 days of its filing. Because Kennedy and O'Brien's January 8, statement of bias was properly stricken according to the statutory procedure, Judge Morgan's subsequent orders were valid.

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[12] *Lewis v. Superior Court* (1998) 198 Cal.App.3d 1101, 1104.

[13] *Hollingsworth v. Superior Court* (1987) 191 Cal.App.3d 22, 26.

[14] *Hollingsworth v. Superior Court*, *supra*, 191 Cal.App.3d at page 26.

[15] *Hollingsworth v. Superior Court* , *supra*, 191 Cal.App.3d at page 26.

C. Kennedy's January 12 Statement of Bias and Prejudice Was Ordered Stricken from the Record by Judge Morgan on the Day It Was Filed.

KPOD and Kennedy further claim Judge Morgan did not respond at all to the January 12 declaration of bias and prejudice filed by Kennedy. Therefore, they argue, by not responding within 10 days of the filing of this declaration, Judge Morgan effectively consented to his disqualification.

If Judge Morgan had not responded, according to section 170.3 subdivision (c)(4), he would have been deemed to have consented to disqualification. This section of the code is not relevant to the circumstances at hand, however, because the contention Judge Morgan did not respond is factually incorrect. He read, considered and ordered Kennedy's January 12 declaration of bias stricken from the record on the same day it was filed. This determination is clearly set forth in a minute order dated January 12, 1998. As discussed above, under section 170.4, within 10 days after the declaration is filed, the trial court retains the power to strike it as being untimely or for facially failing to meet the statutory requirements. Therefore, because Judge Morgan *did* respond to Kennedy's January 12 challenge for cause under section 170.1 by striking his declaration, the judge did not consent to disqualification and thus retained jurisdiction to enter subsequent orders.

In sum, because Kennedy and O'Brien's declarations pursuant to section 170.1 were stricken and not challenged via writ of mandate, the validity of Judge Morgan's orders could not be challenged on the ground the judge had been disqualified. Accordingly, Judge Gale properly denied the motion brought by Kennedy and O'Brien to set aside all orders entered by Judge Morgan.

II. PBA DID NOT BREACH ITS CONTRACT WITH KPOD WHEN IT OBTAINED A RECEIVER FOR THE HOTEL.

KPOD cross-complained against PBA claiming PBA breached the TIC agreement in bringing the partition action and seeking appointment of a receiver. The complaint

alleged two theories: breach of the implied covenant of good faith and fair dealing and breach of paragraph 4 of the TIC agreement requiring a majority vote on any actions affecting the "operation" of the hotel. (We will refer to paragraph 4 of the TIC agreement as the "operations clause.")

It is undisputed the parties' loan agreement with Allied specifically provided the appointment of a receiver for the hotel would constitute a default on the loan and PBA knew of this provision when it sought a receiver. It is further agreed that following the appointment of the receiver Allied filed a cross-complaint for judicial foreclosure against PBA, KPOD and KRAD alleging the cross-defendants were in default on the loan because, among other reasons, a receiver had been appointed for the hotel. Given these facts, KPOD contended PBA breached the implied covenant of good faith and fair dealing in the TIC agreement by taking an action it knew would result in a default under the Allied loan agreement and cause the parties to incur substantial costs in having to pay Allied's foreclosure costs and attorney fees.

KPOD further maintained PBA acted in bad faith by seeking the appointment of a receiver not to protect the assets of the parties but as a means of gaining control over the hotel after its efforts to remove Seaspan failed. KPOD also argued that by unilaterally seeking the appointment of a receiver for the hotel PBA breached the "operations clause" of the TIC agreement which required a majority vote on any "decisions regarding the . . . operation . . . of the hotel[.]"

The trial court (Judge Gale) ruled in favor of KPOD on both theories finding PBA breached the TIC agreement by: (1) causing a default on the Allied loan by obtaining a receiver for the hotel; (2) breaching the Allied loan agreement by causing the receiver to remove Seaspan as manager of the hotel; and (3) acting in bad faith in obtaining the receiver.[16] The court awarded damages to KPOD in the amount of $107,666.66

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[16] Judge Gale also found PBA breached the TIC agreement by not negotiating in good faith with KPOD and KRAD regarding the sale of the hotel but awarded no damages for this breach. We discuss the issue of the hotel's sale in Part V, *post*, in

representing its one-third share of Allied's foreclosure costs and attorney fees and its one-third share of the receiver's costs and fees. In addition, the court awarded KPOD attorney fees and costs on its breach of contract action. We reverse.

The TIC agreement does not specifically address the subject of what kinds of judicial relief one of the parties may seek against another in the case of a dispute; nor would we expect it to. Such details are not normally spelled out in a commercial contract. KPOD nevertheless contends a waiver of the right to seek the appointment of a receiver can be inferred from specific provisions of the Allied loan commitment letter, the TIC agreement and the Allied loan agreement as well as from the TIC agreement's implied covenant of good faith and fair dealing.

In a case such as this, where there is no conflict in the extrinsic evidence, we independently determine the meaning of the contract.[17] Based on our independent analysis of the TIC agreement in light of the extrinsic evidence of the Allied agreements which preceded and followed it we conclude PBA did not breach the TIC agreement in obtaining a receiver for the hotel.

A. PBA Did Not Breach the Covenant of Good Faith and Fair Dealing.

In every contract there exists an implied covenant a party will not do anything which would deprive the other parties of the benefits of the contract.[18] This covenant of "good faith and fair dealing" has both a subjective and objective component—subjective good faith and objective fair dealing.[19] "A party violates the covenant if it subjectively

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connection with KPOD's appeal of the attorney fee award to PBA on the partition cause of action.

17 *Parsons v. Bristol Development Co.* (1965) 62 Cal.2d 861, 866.

18 *April Enterprises, Inc. v. KTTV* (1983) 147 Cal.App.3d 805, 816.

19 *Carma Developers (Cal.), Inc. v. Marathon Development California, Inc.* (1992) 2 Cal.4th 342, 372. (Hereafter *Carma Developers*.)

lacks belief in the validity of its act or if its conduct is objectively unreasonable."[20] The nature and extent of a party's duty under this implied-in-law covenant depend on the contractual context.[21]

1. <u>KPOD was barred from relitigating PBA's good faith in seeking a receiver for the hotel.</u>

KPOD contended, and Judge Gale found, PBA's conduct in "seeking to appoint a receiver was done in bad faith as a means of and with the intent and purpose of circumventing [its] obligations" under the TIC agreement and the Allied loan agreement. The court made specific findings "the financial problem of the hotel was not a reason for PBA seeking a receiver;" "there was no evidence of a financial benefit by the appointment of the receiver to the tenants in common as such;" and "the only apparent benefit from the appointment of the receiver was to PBA [because] the appointment effectively gave PBA management of the hotel through the receiver."

Judge Gale, however, had no authority to make these findings of bad faith on the part of PBA with respect to appointment of the receiver. In its order appointing a receiver the trial court (Judge Rutberg) reviewed the declarations supporting and opposing the receivership and concluded there was "good cause" for the appointment of a receiver and found "the appointment of a receiver in the within action is appropriate." Upon motion for reconsideration the court (Judge Leahy) stated: "It is apparent that a substantial disagreement exists among the partners. The fact that the hotel's debts were not being paid, and that tax monies collected in trust for the City of Carson, and probably for the IRS, were delinquent, coupled with the uncertainty about [the] direction that should be taken to rectify the situation because of the partnership dispute, justifies the appointment of a receiver."

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[20] *Carma Developers*, *supra*, 2 Cal.4th at page 372.

[21] *Foley v. Interactive Data Corp.* (1988) 47 Cal.3d 654, 684; Prince, Contract Interpretation in California, (1998) 31 Loy. L.A. L.Rev. 557, 574-575 (hereafter Prince).

KPOD appealed the order appointing a receiver and we affirmed in an unpublished opinion.[22] In our opinion we noted that in granting the request for a receiver the trial court had found "the management of this hotel is in a mess."[23] Having previously litigated the issue of the need for a receiver in the trial court and on appeal and having lost in both forums KPOD could not litigate the issue a third time under the guise of a claim for breach of contract.[24]

The trial court erred, therefore, in finding a breach of contract based on bad faith by PBA in seeking a receiver for the hotel.

2. PBA's decision to seek a receiver for the hotel was commercially reasonable.

The test for objective fair dealing in this case is whether PBA's seeking a receiver for the hotel was commercially reasonable.[25]

As previously noted, KPOD maintains PBA acted unreasonably in obtaining a receiver for the property because it knew doing so would breach the parties' contract with Allied thus, at the very least, triggering a default on the Allied loan which in turn would lead to foreclosure proceedings resulting in significant costs to KPOD and KRAD in terms of Allied's foreclosure costs and attorney fees in addition to their own costs and attorney fees. Although a foreclosure sale of the hotel was ultimately avoided, KPOD was forced to pay $58,287, one-third of Allied's foreclosure costs and attorney fees.

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[22] See footnote 1, *ante*.

[23] *PBA, LLC v. KPOD, LTD. LCC*, *supra*, slip opinion at page 9.

[24] See *Allen v. Cal. Mutual B. & L. Assn.* (1943) 22 Cal.2d 474, 481. KPOD's real intent appears to be to try to litigate a claim of malicious prosecution, which would otherwise be barred because KPOD failed to obtain a favorable decision on the receivership, or to circumvent section 1008 which limits reconsideration of an order to a showing of new or different facts or circumstances or a change in the law. [See discussion *post* at page 53.]

[25] Compare *Foothill Properties v. Lyon/Copley Corona Associates* (1996) 46 Cal.App.4th 1542, 1552.

Courts and commentators, however, have long recognized there may be situations in which it is commercially reasonable to breach a contract.[26]

Under the doctrine of "efficient breach" it is difficult to argue a ship's captain has acted unreasonably if he throws his cargo overboard to save his sinking ship even if in doing so he breaches a contract to deliver the cargo to port and exposes himself and his partners to liability for damages to the cargo's owner. Assuming the ship is worth more to the captain and his partners than the cargo is worth to its owner, it would be commercially unreasonable to insist the captain perform under his contract with the cargo owner in the face of a substantial, albeit uncertain, risk of losing his ship when the cargo owner can be compensated in damages for the loss of his property. Thus, if after paying their share of damages to the cargo owner the partners sue the captain for violating the covenant of fair dealing in their partnership contract (because he knew throwing the cargo overboard would breach the contract with the cargo owner) it would seem the captain would have a good defense on the ground his conduct was commercially reasonable as to the partnership.

In the present case, the trial court hearing the application for a receiver found the hotel was "in a mess"—in effect, a sinking ship. This finding was supported by Bharat Patel's declaration in support of the receivership. Patel stated, in part, that under the management of Seaspan, effectively controlled by Kennedy, the hotel was currently in default on payments owed to the franchisor, Hilton Hotels, transient taxes owed to the city of Carson, sales taxes owed to the state government, and payroll taxes owed to the federal government. In addition, Kennedy had allowed the hotel to become up to three months delinquent in its mortgage payments to Allied. Five checks for the mortgage payments bounced in the past six months.

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[26] See *Harris v. Atlantic Richfield Co.* (1993) 14 Cal.App.4th 70, 77; Posner, Economic Analysis of Law (4th ed. 1992) 118-119.

The parties' duty under the Allied loan agreement to "protect the collateral" further supports our conclusion PBA acted in a commercially reasonable manner in obtaining the appointment of a receiver for the hotel. In section 5.22 of the agreement the parties promised "to conduct [their] business in a prudent manner, and to take all necessary steps to administer, supervise, preserve and protect the collateral" and "at all times in good faith . . . take all such action as may be necessary or appropriate to protect the rights of the lender." Appointment of a receiver for the hotel protected the loan collateral, the hotel, and the rights of the lender, Allied, by placing an officer of the court in charge of the hotel management with the direction and authority to collect all revenue derived from hotel operations and pay the costs and obligations of the hotel's operation including the mortgage payments, taxes and assessments both current and past-due.

Given the circumstances described above and exercising our independent judgment in interpreting the TIC agreement, we conclude PBA did not breach the implied covenant of good faith and fair dealing in its contract with KPOD.

B. PBA Did Not Breach the Operations Clause.

The "operations clause" of the TIC agreement states in relevant part: "Any decisions regarding the . . . operation . . . of the hotel shall be made by a majority vote of the parties. . . . The parties acknowledge that each intends to participate actively in the ownership and operation of the hotel; provided, however, that the parties shall each cooperate with one another and shall, at all times, accede to the wishes of the majority of the parties."

In the trial court, KPOD argued PBA's decision to seek a receiver for the hotel was a "decision regarding the operation of the hotel" which PBA could not make on its own but which required the consent of either KPOD or KRAD. A receiver has been defined as "an officer or representative of the court, appointed to the charge and

management of property which is the subject of litigation before it . . . ."[27] It is undisputed that once Biggs was appointed receiver he and his management company operated the hotel.

The question remains, however, whether, as KPOD contends, a decision to seek a receiver for the hotel was the kind of "decision regarding the operation of the hotel" the parties intended be put to a majority vote or whether, as contended by PBA, the parties' intent was simply to require agreement on so much as the normal operation of the hotel would require. Because both interpretations of the contract are reasonable, we first examine the extrinsic evidence in an effort to determine the intent of the parties.[28]

KPOD argues the parties' intent to require a majority agreement on seeking a receiver can be inferred from two extrinsic sources. In the Allied loan commitment letter, the parties agreed they would not "change the management or control of the borrowers or the property . . . without the lender's prior written approval." Furthermore, as discussed above, the Allied loan agreement specifically provides the appointment of a receiver constitutes a default on the loan. The majority vote provision in the operations clause was intended to prevent exactly what happened in this case: one party to the agreement taking action which could result in detriment to the other parties.

We decline to adopt KPOD's interpretation of the operations clause for the reasons explained below.

We begin our analysis by noting the appointment of a receiver is an ancillary statutory remedy in an action which seeks some other relief by final judgment, in this case partition.[29] In essence KPOD is arguing that by agreeing to the operations clause PBA waived its statutory right to seek a receiver for the hotel should conditions warrant. As we have previously explained, the burden is on the party claiming a waiver of a right

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[27] *Kreling v. Kreling* (1897) 118 Cal. 421, 422.

[28] *Pacific Gas & Elec. Co. v. G.W. Thomas Drayage Etc. Co.* (1968) 69 Cal.2d 33, 37, 39.

[29] Section 564, subdivisions (a), (b)(9); *Blodgett v. Haddock* (1949) 95 Cal.App.2d 17, 18.

to prove it by clear and convincing evidence which does not leave the matter to speculation; doubtful cases will be decided against a waiver.[30] "The pivotal issue in a claim of waiver is the intention of the party who allegedly relinquished the known right."[31]

The Allied loan commitment letter and loan agreement do not provide the "clear and convincing" evidence necessary to support an interpretation of the operations clause as a waiver of the right to seek a receiver.

We do not believe a contract drafted by *Allied* and presumably reflecting *Allied's* intent with respect to the loan for the purchase of the hotel is a reliable indicator of the *borrowers'* intent with respect to the operation of the hotel under a separate contract to which Allied is not a party and which does not even reference the Allied loan.

Furthermore, KPOD's interpretation of the operations clause would mean each party knowingly and voluntarily put itself at the mercy of the other two should problems develop in the operation or maintenance of the hotel. It is clear from the evidence in this case, however, the parties are experienced, sophisticated and shrewd businesspersons and were counseled by their attorneys in negotiating the TIC agreement. We find it unlikely any of these parties would knowingly and voluntarily relinquish the right to protect its investment through appointment of a receiver by putting the question to a majority vote. One of the purposes of a receivership, after all, is to protect the minority owners from the majority's mismanagement of the business or its assets.[32]

Finally, even granting the operations clause is subject to the construction urged by KPOD, such construction must be rejected under the long-standing rule courts seek to interpret a contract in a manner which leads to "a fair and just result."[33] A search for a fair and just result takes into account such factors as whether a particular interpretation

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[30] *DRG/Beverly Hills, Ltd. v. Chopstix Dim Sum Café & Takeout III, Ltd.* (1994) 30 Cal.App.4th 54, 60.

[31] *DRG/Beverly Hills, Ltd. v. Chopstix Dim Sum Café & Takeout III, Ltd.*, *supra*, 30 Cal.App.4th at page 60.

[32] *Misita v. Distillers Corp., Ltd.* (1942) 54 Cal.App.2d 244, 250-251.

would result in an out-of-pocket loss to one party or a windfall gain to another and whether either party has engaged in culpable or meritorious behavior.[34]

In the present case, adopting KPOD's interpretation of the operations clause would allow KPOD to benefit from the receivership while evading its fair share of the costs. As discussed above, the trial court (Judge Rutberg) found a receiver was "appropriate" because the loan payments and taxes were not being paid and "the management of this hotel is in a mess." In approving the receiver's final report and accounting the trial court (Judge Morgan) found "the receiver's fees and costs were appropriate." In addition, it was Kennedy, and Seaspan which Kennedy controlled, whose mismanagement of the hotel and its finances brought on the need for a receiver to straighten things out. KPOD, which Kennedy also controls, should bear its fair share of the costs of this culpable behavior.

For the reasons stated above, we reverse the judgment in favor of KPOD on its cross-complaint against PBA.[35]

III. PBA HAS NOT DEMONSTRATED GROUNDS FOR REVERSING THE NONSUIT IN FAVOR OF THE CROSS-DEFENDANTS ON ITS CROSS-COMPLAINT.

On the trial of PBA's cross-complaint alleging various contract and tort causes of action, the trial court granted motions for "nonsuit"[36] in favor of cross-defendants O'Brien, John Kennedy, SPM, Inc., Irenemarie Kennedy, M&B Partners, KAC, Inc., Kennecorp and Patrick Millican, leaving Sailor Kennedy and KPOD as the only cross-defendants. As to them, the court found after a full trial "there was no substantial evidence to support any of the . . . causes of action asserted by PBA."

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33 *Ersa Grae Corp. v. Fluor Corp.* (1991) 1 Cal.App.4th 613, 623.

34 Prince, *supra*, 31 Loy. L.A. L.Rev. at pages 562-563.

35 In light of our disposition, KPOD's cross-appeal from this judgment is moot.

36 Technically a "motion for judgment" under section 631.8.

A. The Trial Court Did Not Commit Prejudicial Errors in Awarding Judgment to Sailor Kennedy and KPOD On PBA's Cross-Complaint.

PBA contends there would have been sufficient evidence to support its cross-complaint against Kennedy and KPOD if the trial court had not erred in excluding relevant evidence and had not been biased against the Patels because of their ethnicity. Neither of these contentions has merit.

1. The court did not exclude relevant evidence.

PBA argues the trial court erred in excluding evidence of Bharat Patel's state of mind relative to legal disputes between Kennedy and Far East Bank and the Woodglen Company in which judgments apparently were rendered against Kennedy.

The court ruled Patel's state of mind with respect to Kennedy's dealings with Far East Bank was irrelevant but agreed to hear counsel's offer of proof on the matter. On appeal PBA does not disclose whether such an offer of proof was ever made nor whether the trial court was ever informed of the purpose for introducing evidence of Patel's state of mind or how his state of mind was relevant to any issue at trial. Therefore, PBA has not shown the trial court's evidentiary ruling to be reversible error.[37]

The court also sustained an objection to a question asking Patel whether he had learned any information concerning Far East or Woodglen which involved an attorney named Vollmer. The court ruled Vollmer's involvement was irrelevant since he was not a party defendant. Again, PBA failed to explain the purpose of this evidence or its relevance.

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[37] Under Evidence Code section 354 reversal on the ground of erroneous exclusion of evidence requires not only a showing the error "resulted in a miscarriage of justice" but that "[t]he substance, purpose, and relevance of the excluded evidence was made known to the court by the questions asked, an offer of proof, or by any other means . . . ."

PBA next complains it was not allowed to question Patel about statements made to him by an IRS agent regarding the hotel employees' tax withholdings which should have been sent to the IRS but were not. The trial court excluded this evidence on the grounds of relevancy and hearsay but agreed to allow PBA to bring the agent herself into court for questioning. PBA does not contend it ever did so. Absent any argument by PBA to the contrary, we conclude the court's hearsay ruling was correct.

PBA argues the trial court erred by excluding evidence of Kennedy's 1984 conviction for bank fraud. This evidence, PBA asserts, "was extremely relevant." PBA gives no reasons, however, why this is so.[38] A witness's prior felony conviction is, of course, relevant to the witness's credibility but PBA cites no testimony by Kennedy which the trial court could have found not credible and which finding could have affected the outcome of the trial on the cross-complaint.

2. The trial court did not exhibit bias toward the Patels.

PBA contends Judge Gale demonstrated bias toward the Patels by asking whether one of their witnesses was Egyptian and sustaining an objection based on relevancy when Kennedy was asked if he ever called Bharat Patel a "nigger."

PBA provides no cites to the reporter's transcript to support its claims. Therefore it is impossible to know the context in which the question regarding the witness's national origin was asked, if it ever was. Furthermore, PBA has not explained how the fact Kennedy called Patel a "nigger," if he did, was in any way relevant to proving PBA's cross-complaint.[39]

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[38] We are cited to certain pages of the clerk's transcript but these pages only relate to the conviction itself, not its relevancy.

[39] See Evidence Code section 354, discussed in footnote 37, *ante*.

From the scanty information PBA does provide we find the charge of ethnic bias against Judge Gale to be completely unfounded and its inclusion in an appellate brief extremely inappropriate.

B. The Trial Court Did Not Commit Prejudicial Error in Granting The Motions For Judgment As to the Remaining Cross-Defendants.

PBA contends the court erred in granting judgment to the remaining cross-defendants because the accounting referee had previously found these individuals and organizations formed a "single enterprise" controlled by Sailor Kennedy and the court (Judge Morgan) adopted this finding. If sufficient evidence existed to proceed against Sailor Kennedy and KPOD, PBA reasons, sufficient evidence existed to proceed against the members of the Kennedy "enterprise."

There are two flaws in PBA's reasoning.

First, PBA ignores the fact it consented to a nonsuit in favor of O'Brien, SPM, Inc. and John Kennedy.

Second, PBA ignores the fact the trial court granted judgment in favor of Sailor Kennedy and KPOD on PBA's cross-complaint. We upheld this judgment in Subpart A, above. Therefore, even if the trial court erred in granting a motion for judgment in favor of Irenemarie Kennedy, M&B Partners, KAC, Inc., Kennecorp and Patrick Millican, the error was harmless because under the "single enterprise" theory their only possible liability was contingent on that of KPOD and Sailor Kennedy.

IV. KPOD IS NOT ENTITLED TO A CONTRIBUTION FROM PBA TOWARD THE PURCHASE PRICE OF THE HOTEL FROM M&B PARTNERS.

A. Factual Background.

The trial court appointed a referee to render an accounting of the parties' contributions and expenses and allocate the net profit from the sale of the hotel. The parties stipulated to the issues to be determined in the accounting, a hearing was held in which the parties submitted evidence and argument, and the referee made a report containing findings of fact and conclusions of law which the trial court approved and adopted.

One of the principal issues in the accounting was whether KPOD, on behalf of M&B Partners, the seller of the hotel, was entitled to a pro rata contribution from PBA and KRAD to satisfy an alleged $900,000 deficit between the purchase price of the hotel and the Allied loan.[40]

The TIC's purchase of the hotel, it will be recalled, resulted from a "double flip" in which M&B Partners purchased the hotel from its current owner for $4.2 million and simultaneously sold it to the TIC, purportedly for $5.5 million. We say "purportedly" because the question of how much the TIC actually paid for the hotel goes to the heart of KPOD's claim for contribution.

KPOD asserted that at the time the hotel was sold through partition the TIC still owed M&B Partners $900,000 under their purchase agreement.

In support of its claim KPOD introduced the contract between M&B and the TIC showing the TIC agreed to purchase the hotel from M&B for $5.5 million and M&B agreed to pay a portion of the loan commitment fee and certain other fees and costs on

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[40] There is no evidence in the record funds were actually transferred from KPOD to M&B in satisfaction of this alleged debt of the TIC. The parties stipulated, however, all claims by the "Kennedy entities" including M&B Partners would be considered KPOD's claims for purposes of the accounting.

behalf of the TIC. KPOD also introduced the loan agreement under which Allied agreed to loan the TIC $5.2 million toward the purchase price of $5.5 million. Additional evidence showed, and the referee found, $4.2 million from the Allied loan went to pay what M&B owed the former owner of the hotel. According to KPOD this left an amount owed to M&B of $1.3 million. After crediting the TIC with the payments M&B agreed to make on its behalf toward the loan commitment fee and other costs the TIC owed M&B approximately $900,000 under the purchase agreement.

The referee found this $900,000 debt to be "illusory" for the reasons discussed below and denied KPOD's request for contribution.

Before turning to the referee's reasoning and the evidence supporting it, we reiterate three important points about this complex transaction. (1) As consideration for a purchase money loan to the parties of $5.3 million, Allied required a minimum $1 million capital contribution from the parties in addition to a $450,000 loan commitment fee and the payment of various other fees and costs. (2) The loan agreement specified that if the parties purchased the hotel for less than $5.5 million the amount of the loan would be reduced "dollar-for-dollar." For example, if the parties actually purchased the hotel for $5.3 million instead of $5.5 million Allied would reduce the loan amount by $200 thousand, from $5.3 million to $5.1 million. (3) The sale of the hotel was structured in a manner whereby M&B purchased the property for $4.2 million and simultaneously sold it to the TIC, at least on paper, for $5.5 million.

It is undisputed the contract between M&B and the TIC states the purchase price of the hotel is $5.5 million. Based principally on the testimony of Bharat Patel, however, the referee found that notwithstanding the purchase price stated in the contract it was orally agreed between M&B and the TIC the TIC would purchase the hotel from M&B for $4.2 million, not $5.5 million. The purpose of this agreement, the referee found, was to permit the TIC to receive virtually 100 percent financing of the purchase price, loan fees and other costs out of the Allied loan while making it appear to Allied the sale price remained at $5.5 million. The ultimate effect of the parties' oral agreement as to the

actual sale price of the hotel was to allow the parties to purchase the hotel without any investment of cash, except for $50,000 deposited by KRAD.

The referee further found that in order to deceive Allied into believing the parties had contributed their required $1 million further sham transactions were instituted. Specifically, to create the appearance of a $900,000 capital investment "outside of escrow" checks of equal amounts were exchanged between M&B and Seaspan even though neither had sufficient funds to back them.[41] According to the referee, this is how it was done.

"In the second escrow for the sale from M&B to the TIC, $900,000.00 cash was supposed to be contributed by the TIC to cover loan fees to Allied Capital of $450,000.00; rehabilitation and renovation reserve of $350,000.00; and insurance reserved of $43,374.00. The M&B escrow closing statement shows M&B received $900,000.00 as 'funds paid outside of escrow.' The evidence showed the $900,000.00 never really existed. The TIC had to show Allied Capital evidence that $900,000.00 was paid to M&B outside escrow. To accomplish this, the TIC through Sailor Kennedy, with the assistance of Far East National Bank, caused checks to be written between M&B and Seaspan creating the impression $900,000.00 had been paid outside of escrow when in fact it had not.[42] . . .

"The evidence showed that when the simultaneous exchange of checks occurred between Seaspan and M&B, neither entity had amounts on deposit to honor the checks without the other's check. . . . In fact neither Seaspan's nor M&B's accounts had sufficient funds to cover the checks which were exchanged." Instead, "with the assistance of Far East National Bank, the Seaspan and M&B checks were simultaneously marked 'paid.' When [the bank] marked the offsetting checks 'paid,' it gave the appearance there were sufficient funds in each account to honor the checks."

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[41] The remaining $100,000 was deposited into escrow out of the $350,000 advanced by KRAD.

In summary, the referee found that through a series of transactions designed to defraud their lender the parties managed to purchase a hotel worth at least $5.5 million for an actual cash investment of only $50,000.

On appeal, KPOD contends the referee erred in finding PBA did not have an obligation to pay its share of the alleged $900,000 deficit between the purchase price of the hotel and the Allied loan.

KPOD does not contend the evidence is insufficient to support the referee's finding the alleged $900,000 debt to M&B was "illusory" or, as the trial court found "a sham and a fraud." Rather it contends the evidence which supports this finding was inadmissible under the parol evidence rule and the principal of equitable estoppel.

B. Evidence M&B and the TIC Collaterally Agreed to a Purchase Price of $4.2 Million In Order to Defraud the Lender Is Not Barred By the Parol Evidence Rule.

The parol evidence rule excludes evidence of a prior or contemporaneous agreement which contradicts a term in a writing the parties intended to be the final expression of their agreement.[43] In other words, as Justice Holmes explained, evidence is not admissible "to show that when [the parties] said five hundred feet they agreed it should mean one hundred inches, or that Bunker Hill Monument should signify the Old South Church."[44]

KPOD's argument is a simple one. Parol evidence is not admissible to show that when the parties said "$5.5 million" they really meant $4.2 million.

We agree with KPOD's argument as far as it goes. While parol evidence is admissible to explain the meaning of a term which appears to the court to be plain and

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[42] KPOD submitted evidence showing Ashik Patel was a part of this check kiting scheme and signed the checks on behalf of Seaspan. Assuming this is so, it does not effect the referee's finding this scheme was a fraud on the lender.

[43] Section 1856, subdivision (a).

[44] *Goode v. Riley* (Mass. 1891) 28 N.E. 228, 228.

unambiguous on its face, the offered evidence must still be relevant to prove a meaning to which the term “is reasonably susceptible.”[45] Admittedly “$5.5 million” is not reasonably susceptible of meaning $4.2 million.

The parol evidence rule notwithstanding, evidence is admissible to show a contract has as its object an illegal purpose and is therefore unenforceable.

Assume, for example, the ship captain in our previous hypothetical had agreed to carry a load of dynamite to the next port. Because the ship was neither licensed nor equipped to carry explosives the dynamite was listed on the cargo manifest as “lemondrops.” When the captain jettisons the cargo in a storm and the shipper sues for loss of its “lemondrops” the parol evidence rule would not bar the owners of the ship from producing evidence that when the parties said “lemondrops” they meant dynamite. The reason why the owners can introduce this evidence is not because “lemondrops” is reasonably susceptible of meaning dynamite but because “[t]he parol evidence rule does not exclude evidence showing that a contact lawful on its face is in fact part of an illegal transaction.”[46]

The *Lewis & Queen* case presented a factual situation analogous to the one in the present case in which the parties construct a series of agreements in a manner intended to circumvent a contract with a third party.

In *Lewis & Queen*, the state awarded the defendant, N.M. Ball Sons, two contracts for road construction. The contracts permitted Ball to subcontract some of the work but required Ball to personally perform work of a value not less than fifty percent of the value of all the work embraced in the contracts. Ball entered into a subcontract with Lewis & Queen to perform specified work on the roads. After entering into the agreement Ball discovered that by subcontracting all of this work to Lewis & Queen it violated the fifty percent provisions of its contracts with the state. The trial court found

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[45] *Pacific Gas & Elec. Co. v. G. W. Thomas Drayage Etc. Co., supra*, 69 Cal.2d at page 37.

[46] *Lewis & Queen v. N. M. Ball Sons* (1957) 48 Cal.2d 141, 148. (Hereafter *Lewis & Queen*.)

that after Ball realized its contract with Lewis & Queen violated its contracts with the state "[t]he parties agreed . . . with the intention of circumventing the provisions of the state contracts, to divide the five items of work under each state contract between two writings, a subcontract and an equipment rental agreement. Notwithstanding the form of these writings, it remained the agreement of the parties that plaintiff would perform all five items of work as an integrated subcontract operation."[47] When Lewis & Queen sued Ball for breach of the purported equipment rental agreements the trial court awarded judgment to Ball on alternative grounds one of which was "the equipment rental agreements were unenforceable because they violated the provisions in the state contracts against subcontracting more than a certain amount of the total work."[48]

On appeal Lewis & Queen contended that because the rental agreements stated they contained all the provisions agreed to by the parties, "the parol evidence rule precluded the admission of other evidence showing the true nature of the agreement between the parties . . . ."[49] The Supreme Court found this contention "without merit," explaining: "[T]he policy of the parol evidence rule favoring the conclusiveness of integrated written agreements [gives way] before the importance of discouraging illegal conduct. To this end, the trial court must be free to search out illegality lying behind the forms in which the parties have cast the transaction to conceal such illegality."[50]

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[47] *Lewis & Queen*, *supra*, 48 Cal.2d at page 145.
[48] *Lewis & Queen*, *supra*, 48 Cal.2d at page 146.
[49] *Lewis & Queen*, *supra*, 48 Cal.2d at page 148.
[50] *Lewis & Queen*, *supra*, 48 Cal.2d at page 148.

C. The Evidence Submitted at the Hearing on the Accounting Established the TIC Made Material Misrepresentations to Induce Allied to Furnish the Loan for the Hotel.

The referee's final accounting is supported by evidence establishing the TIC intend to make material misrepresentations to Allied in seeking a $5.3 million loan for the hotel.

In its commitment letter and loan agreement, Allied conditioned the $5.3 million loan to the TIC on the TIC purchasing the hotel for $5.5 million and contributing $1 million of its own funds towards the financing of the hotel. The findings in the referee's accounting clearly establish the TIC never met either of these requirements. Rather, the referee found the TIC constructed a number of straw transactions between M&B, Seaspan and the TIC to give the appearance the TIC had met Allied's loan requirements. Specifically, the referee found: "The evidence showed the Hotel was in fact purchased by the TIC using Allied Capital's loan and $50,000.00 of [KRAD's] money. The TIC plan to purchase the Hotel without any tenant in common investing any cash was completed as planned, except for KRAD's $50,000.00. . . ." The evidence at the accounting hearing corroborates these findings.

Thus, it is clear from the referee's findings and the evidence at the hearing the TIC constructed a number of transactions between M&B, Seaspan and the TIC for the purpose of making it appear the TIC had purchased the hotel for $5.5 million and contributed at least $1 million toward the venture. These representations were false. Furthermore, the stipulations in the loan agreement and commitment letter clearly establish these requirements were material. Accordingly, the evidence and findings before us establish the TIC intended to mislead Allied by making it appear it had met its requirements for the loan, although it had not. Further, the TIC utilized the purchase agreement in connection with these transactions for this fraudulent purpose. Consequently we find the purchase agreement was illegal and unenforceable to the extent the parties intended to use it as a vehicle to defraud Allied of its loan money.

D. PBA Was Not Equitably Estopped From Claiming the $4.2 Million Sales Price Because KPOD Had Knowledge of the True State of the Facts.

KPOD contends PBA is equitably estopped from claiming the purchase price of the hotel was $4.2 million because PBA represented to Allied, the city of Carson, KPOD, and M&B the purchase price was $5.5 million. This argument fails.

Embodied in Evidence Code section 623, the doctrine of equitable estoppel states: "Whenever a party by his own statement or conduct, intentionally and deliberately led another to believe a particular thing true and to act upon such belief, he is not, in any litigation arising out of such statement or conduct, permitted to contradict it."

"The doctrine of equitable estoppel has for elements: (1) The party to be estopped must be apprised of the facts; (2) he must intend that his conduct shall be acted upon, or must so act that the party asserting the estoppel had a right to believe it was so intended; (3) the other party must be ignorant of the true state of facts; and (4) he must rely upon the conduct to his injury."[51] If any of the elements is missing, equitable estoppel fails.[52] Specifically, California courts have not applied equitable estoppel where the party seeking to invoke it knows the true facts.[53]

KPOD claims it and M&B entered into the purchase agreement believing M&B would receive $5.5 million for the hotel: In its brief on appeal KPOD stated: "PBA executed a written contract to purchase the hotel from M&B for $5.5 million. By doing so, it induced M&B to transfer ownership of the property of the TIC." KPOD does not point to any evidence in the record, however, suggesting it or M&B were misled by this transaction or that they were ignorant of the true facts (i.e., the sales price was actually

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[51] *Skulnick v. Roberts Exp., Inc.* (1992) 2 Cal.App.4th, 884, 890.

[52] *Hair v. California* (1991) 2 Cal.App.4th 321, 328.

[53] *Friedman v. Friedman* (1993) 20 Cal.App.4th 876, 885 (where plaintiff and defendant claimed they were married in order to mislead federal government, appellate court refused to apply equitable estoppel because plaintiff knew she and defendant were not married.)

$4.2 million). Rather, the referee's findings clearly establish Kennedy, a principal in both M&B and KPOD, knowingly constructed the scheme involving the dual purchase prices. The referee found Kennedy had actively participated in the deception against Allied and thus was fully aware the TIC was purchasing the hotel from M&B for only $4,200,000.

Kennedy's intricate involvement in the construction of this fraud on Allied and his membership in both M&B and KPOD preclude him (and therefore either of those entities) from claiming a lack of knowledge of the true facts. Consequently, neither KPOD or M&B can assert equitable estoppel against PBA.

Alternatively, KPOD asserts if this court ignores the written purchase contract, we would be enforcing the terms of an alleged fraudulent agreement. To further bolster its contention, KPOD cites to Civil Code, section 3517 which reads "No one can take advantage of his own wrong." Because the referee's findings, adopted by the trial court, clearly show the purchase contract was part of a set of illegal transactions intended to defraud Allied, we refuse to enforce either contract.

V. NEITHER PARTY HAS SHOWN GROUNDS FOR REVERSING THE ATTORNEY FEES AWARDS ON THE ACTION FOR PARTITION.

Acting under section 874.010, subdivision (a), the trial court granted motions by PBA, KPOD and KRAD for attorney fees incurred in the partition action.[54] The court awarded $125, 021 to PBA, $28,696 to KRAD and $92,597 to KPOD. The court further ordered "each [party] shall bear one-third of the total of said amount." PBA and KPOD appeal this award of attorney fees. PBA claims it did not get enough; KPOD claims PBA should not have gotten anything. We affirm PBA's award as determined by the trial court.

A. PBA Was Entitled to an Award of Costs Including Attorney Fees Incurred In the Partition Action.

KPOD contends the trial court erred in awarding any attorney fees to PBA in the partition action because PBA had no right to partition having waived such right in the TIC agreement and the loan agreement with Allied.[55] Furthermore, it argues, in seeking a partition PBA breached the provisions of the TIC agreement regarding sale of the property.

1. Procedural Background.

The trial court granted summary judgment to PBA on its cause of action for partition and entered an interlocutory judgment of partition. In doing so, the court rejected KPOD's waiver and breach of contract arguments.

KPOD appealed the interlocutory judgment as permitted under section 904.1, subdivision (a)(9). While the appeal was pending the hotel was sold. We thereafter dismissed the appeal as moot because we could no longer give any effective relief from the judgment of partition.[56] KPOD objected to dismissal on the ground an appellate ruling in its favor on the merits of PBA's partition action would be controlling should PBA subsequently seek costs and attorney fees under section 874.010. We overruled KPOD's objection because PBA had not yet moved for attorney fees and because an appellate court will not retain a moot appeal solely to decide liability for costs.[57]

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[54] Section 874.010, subdivision (a) states the costs in an action for partition include "[r]easonable attorney's fees incurred or paid by a party for the common benefit."

[55] Section 872.710 states in subdivision (a) "[a]t trial, the court shall determine whether the plaintiff has the right to partition." Subdivision (b) of the statute provides "partition . . . shall be as of right unless barred by a valid waiver."

[56] *PBA, LLC v. KPOD, et al., supra* (B118954) Order dated February 25, 1999.

[57] *Paul v. Milk Depots, Inc.* (1964) 62 Cal.2d 129, 134.

As KPOD anticipated, the trial court (Judge Gale) did subsequently award attorney fees to PBA on the partition action specifically finding the fees were incurred for the "common benefit." KPOD challenges the award in the present appeal renewing its arguments of waiver and breach of contract.

Although the judgment of partition is now final and cannot be reversed in the present appeal this does not prevent us from reviewing the question of PBA's entitlement to attorney fees incurred in bringing the partition action. The question before us is not whether the court properly ordered a partition sale of the property but whether the fees PBA incurred in the partition action were for "the common benefit" of the TIC.[58]

2. Substantial Evidence Supports the Trial Court's Finding PBA Incurred Attorney Fees For the Common Benefit of the TIC.

The purpose of awarding attorney fees in a partition action "is to divide the cost of the legal services among the parties benefited by the result of the proceeding."[59] The party bringing a successful partition action is not entitled to attorney fees as a matter of right but only insofar as the fees incurred were for the "common benefit" of all the property owners.[60] The mere fact the partition action was opposed by the other owners, however, does not preclude the allowance of attorney fees to the plaintiff if the court determines the partition resulted in a common benefit to all the owners.[61] Whether the attorney fees were incurred for the common benefit "must be decided upon the facts and circumstances in each particular case."[62]

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[58] Section 874.010, subdivision (a); *Forrest v. Elam* (1979) 88 Cal.App.3d 164, 173 [judgment of partition affirmed; plaintiff's attorney fees found not to have been incurred for the common benefit of the parties].

[59] *Stewart v. Abernathy* (1944) 62 Cal.App.2d 429, 433.

[60] Section 874.010, subdivision (a); *Forrest v. Elam*, *supra*, 88 Cal.App.3d at page 173.

[61] *Randell v. Randell* (1935) 4 Cal.2d 575, 582.

[62] *Stewart v. Abernathy*, *supra*, 62 Cal.App.2d at page 433.

Here the evidence showed the parties purchased the hotel in February 1995 for $4.2 million and sold it in a partition sale three years later for $12.2 million, earning a gross profit of $8 million. Although we have found nothing in the record showing the parties' net profit from this venture we believe a fair estimate would be in the range of $2 to $2.5 million each—not a bad "benefit" for a three year investment especially when one considers the parties put up virtually no money of their own for the purchase.[63]

The evidence also showed the parties were unable to manage the hotel in a businesslike way and unless the hotel was sold the venture was in danger of "going down the tubes." The hotel was in arrears in its mortgage payments and had failed to pay property taxes, occupancy taxes, payroll taxes and franchise fees. Either the hotel was not generating enough income to pay its bills or it was being grossly mismanaged. In either case, if PBA had not forced the TIC to sell the hotel through a partition action there was a substantial risk it would have been sold by someone else in a foreclosure or lien sale depriving the parties of any benefit from their joint venture.

KPOD maintains even if the acrimony between the parties and the hotel's mounting debts necessitated a sale of the hotel the TIC agreement provided for such a contingency. Hence, there was no need for a partition sale and PBA's partition action constituted a breach of the sale provisions in the agreement. KPOD cites as support for its position Judge Gale's statement of decision following trial on the KPOD and PBA cross-complaints. In this decision, issued nearly two years after Judge Morgan awarded the interlocutory judgment of partition, Judge Gale found PBA's partition action was a "willful, deliberate and bad faith" breach of the TIC agreement. Judge Gale, it will be recalled, had also ruled a few months earlier PBA was entitled to attorney fees on the partition action finding the fees had been incurred for the parties' common benefit.

We find no conflict between Judge Gale's conclusion PBA breached the TIC agreement in bringing an action for partition and his earlier ruling the attorney fees in the partition action were incurred for the common benefit of the parties.

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[63] See discussion in Part IV, *ante*.

Under the TIC agreement the entire property could only be sold upon the agreement of all three parties. One party could sell its individual interest in the property to another party or to an outsider after following certain procedures set out in the agreement.[64] Because KPOD and KRAD did not agree to the sale of the hotel PBA's only choices under the contract were to sell its one-third interest to KPOD or KRAD or to a third party. Neither KPOD or KRAD produced any evidence it had the financial wherewithal to purchase PBA's interest. A sale of PBA's interest in the hotel to a stranger might have benefited PBA but it would have left KPOD and KRAD with an unwanted and potentially even more uncooperative partner and would not have straightened out the hotel's financial "mess."

The evidence thus shows that even though they objected to it, PBA's partition action resulted in a greater benefit to KPOD and KRAD than PBA's sale of its one-third interest to a stranger would have. This explains why Judge Gale awarded no damages to KPOD after finding PBA breached the sale provisions of the TIC agreement and, instead, reconfirmed the previous awards of attorney fees on the partition action after finding the fees were incurred for the parties' common benefit.

B. PBA Has Presented No Factual Or Legal Basis For Challenging the Adequacy of the Fees Awarded To It.

The trial court awarded PBA $125,000 in attorney fees for the partition action instead of the nearly $600,000 it claimed. PBA maintains this award was inadequate. After offsetting the attorney fee awards to KPOD and KRAD, PBA complains it "received the paltry net sum of $3,750." PBA does not, however, provide a satisfactory explanation why the trial court's award was factually or legally erroneous.

PBA argues the attorney fee award failed to take into consideration the efforts it expended in the receivership and accounting aspects of the case. But the attorney fee

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[64] These procedures are detailed in the statement of facts at pages 4-5, *ante*.

award at issue is solely for the fees incurred in the partition action. It would have been error for the court to compensate PBA for attorney fees incurred in the receivership and accounting aspects of the case.[65]

Alternatively, PBA suggests Judge Gale was retaliating against PBA for bringing what he found to be a "bad faith" receivership action.[66] We find this claim, like the claim Judge Gale was ethnically biased, to be utterly lacking in merit. In making the attorney fees awards to PBA, KPOD and KRAD Judge Gale had before him the court file as well as the documentary evidence submitted by the parties and was aware of the nature and extent of the efforts of each attorney. Such being the case, absent evidence to the contrary, a finding of abuse of discretion is not justified.[67]

VI. <u>THE TRIAL COURT DID NOT ERR IN ORDERING THE RECEIVERSHIP ESTATE TO PAY THE RECEIVER'S ATTORNEY FEES IN DEFENDING AN ACTION BY SEASPAN.</u>

The order appointing Biggs as receiver for the hotel authorized him to operate the hotel or to "employ any person or firm to . . . manage . . . and operate [it]" and specifically authorized Biggs to hire Hotel Managers Group to conduct the day-to-day management of the hotel. Biggs was also authorized "to hire, employ and retain attorneys . . . which [he] deems necessary to assist him in the discharge of his duties. . . ."

Acting under authority of this order Biggs hired Hotel Managers Group to manage the hotel, replacing Seaspan. This led to a lawsuit against Biggs by Seaspan which Biggs defended incurring attorney fees in the sum of $14,504. In approving Bigg's final accounting the trial court found "the attorneys fees and costs incurred by the receiver were reasonable and necessary, including those fees expended in defense of the receiver

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[65] *Scott v. Staggs* (1954) 129 Cal.App.2d 54, 57; compare section 874.020 allowing attorney fees in a quiet title action brought in connection with a partition.

[66] See discussion at page 22, *ante*.

and Hotel Managers Group, LLC against the complaint filed by Seaspan, Inc. the former management company for the Carson Hilton Inn . . . ." Over the objection of KPOD, the court ordered these fees to be paid to the receiver's attorney out of funds set aside from the sale of the hotel.

KPOD appeals from this order contending the attorney fees incurred by the receiver in defending the Seaspan action were not in defense of the hotel or the TIC and therefore it was improper to charge the receivership estate with those fees.

Other than KPOD's skimpy description of the Seaspan suit in its appellate brief we have little to go on in analyzing KPOD's claim. KPOD does not provide a record cite to Seaspan's complaint nor any documents explaining its resolution nor has it supplied any legal authority to support its argument. It appears from the trial court's receivership order, however, Biggs had authority to replace Seaspan with a management company of his own choosing to operate the hotel and to retain counsel to assist him in the discharge of his duties. Therefore we conclude the trial court was correct in ruling Bigg's defense of the Seaspan action was in defense of the receivership estate.

The court in such circumstances has the power to charge the attorney fees against the property in receivership.[68]

VII. THE TRIAL COURT PROPERLY FOUND PBA WAS NOT LIABLE FOR A PRO RATA SHARE OF THE FEES SOUGHT BY THE ACCOUNTING FIRM OF WHITE NELSON & COMPANY.

A. Factual Background.

Soon after Biggs was appointed receiver for the hotel he moved to have an outside accounting firm hired claiming the current accountant, Gary Belz, and his firm, White

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[67] See *Forrest v. Elam*, *supra*, 88 Cal.App.3d at page 174 [upholding attorney fees award in partition action in amount less than claimed by plaintiff].

[68] *Murphy v. Cosentino* (1962) 204 Cal.App.2d 614, 615.

Nelson & Company (White), were not independent of Kennedy who had hired them. The trial court denied the motion finding there was insufficient evidence to support it "at the present time."

The hotel was subsequently sold for $12 million and the proceeds placed in escrow, pending the outcome of the trial on the parties' cross-complaints and the reconciliation of the TIC's past debts and liabilities. Among the alleged debts was a claim by White for accounting services to the TIC.

PBA maintained it was not liable for any part of White's fees because White's services were performed exclusively for KPOD and KRAD and not for the benefit of the TIC. Therefore, PBA moved to have released to it from escrow the sum of $14,396.36 which would have been its pro rata share of White's fees. The trial court granted the motion and KPOD appeals. We affirm the trial court's ruling.

In denying Biggs' previous motion to replace White the trial court stated: "Authorization for hiring [the] accounting firm of Pennell Kerr Forster is denied. No sufficient showing *at present time* that [the] firm reviewing books and records for income tax return purposes either is not independent or cannot adequately carry out the assignment for any other reasons." (Italics added.)

In its subsequent motion for release of the escrow funds, PBA alleged Kennedy initially engaged Belz to perform services for KPOD. PBA also claimed KPOD had retained Belz as an expert witness and consultant, using the TIC's financial information to prepare for trial against PBA. Therefore, PBA contended, it was not liable for its share of Belz's fees because Belz was not independent of Kennedy and had not performed any services on PBA's behalf.

KPOD conceded Belz performed some services exclusively for KPOD and KRAD and admitted the two companies had retained Belz as an expert witness. It argued, however, Belz also performed services for the common benefit of the TIC and $14,000 fairly represented PBA's share of these services. KPOD also contended that although Belz used some of the information he discovered while performing services for the

alleged benefit of the TIC to aid KPOD in its claims against PBA, KPOD paid Belz separately for those services.

PBA, on the other hand, presented evidence KPOD had retained Belz as an expert witness in October of 1997 but he did not begin performing his purported services for the TIC until December of 1997.

B. The Trial Court Properly Found PBA Was Not Required to Contribute to White's Accounting Fees.

In granting PBA's motion to release the $14,396.36 from escrow the trial court found KPOD and KRAD used the White firm and Belz to further their own interests against those of PBA. The court stated: "The order releasing escrow funds is granted in its entirety based upon the fact that I find there was an independent engagement [by KPOD], and it was essentially for the purposes of furthering the interest of KPOD . . . against the [other] litigants. And it would be unfair to have [PBA] pay for that."

KPOD contends the trial court erred in granting PBA's motion to release the escrow funds. It argues the trial court previously found the accounting firm was independent, barring the trial court from later finding otherwise. We disagree. The trial court, in its order denying the request by the receiver to hire the Pennell firm, stated there was no evidence "at [the] present time" to show White or Belz was not independent or could not adequately carry out their task. The trial court's order implies a denial of the motion for lack of sufficient evidence *without prejudice* to reconsideration if PBA or Biggs could present sufficient evidence to support it. Therefore, PBA and Biggs were not precluded by section 1008 from renewing the motion based on new evidence.[69]

KPOD does not challenge the sufficiency of the evidence to support the trial court's finding Belz was not independent from KPOD and was performing services exclusively for its benefit. In any event, the court's decision is supported by substantial

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[69] See discussion of section 1008 at pages 50-57, *post*.

evidence. Accordingly, we affirm the trial court's decision releasing the $14,396.36 from escrow.

VIII. THE TRIAL COURT LACKED JURISDICTION TO SUSTAIN DEMURRERS OR STRIKE THE CROSS-COMPLAINTS OF KENNEDY AND O'BRIEN AFTER THEY VOLUNTARILY DISMISSED THEIR CROSS-COMPLAINTS WITHOUT PREJUDICE.

A. Procedural Background.

Kennedy filed a cross-complaint against numerous cross-defendants including PBA, the Patels, the law firm of Corbett & Steelman, Ken Steelman, Joel Biggs (the Receiver) and the Hotel Managers Group, alleging thirteen causes of action.

In response, the PBA cross-defendants (which included the Patels) demurred and moved to strike all thirteen causes of action in Kennedy's cross-complaint. Corbett & Steelman and Ken Steelman moved to strike Kennedy's cross-complaint. Biggs and Hotel Mangers Group also demurred to the causes of action in which they were named as defendants.

Timothy O'Brien cross-complained against the Patels alleging nine causes of action. In response to O'Brien's cross-complaint, the Patels filed a demurrer and moved to strike all its causes of action.

Prior to the hearing on the demurrers and motions to strike, Kennedy voluntarily dismissed without prejudice the first twelve causes of action in his cross-complaint and O'Brien voluntarily dismissed without prejudice the first eight causes of action in his cross-complaint. The court clerk entered the dismissals as requested. This left as undismissed Kennedy's thirteenth cause of action against the PBA cross-defendants, Biggs and Hotel Managers Group and O'Brien's ninth cause of action against the Patels.

After the dismissals had been entered, the trial court heard argument on the demurrers and motions to strike the Kennedy and O'Brien cross-complaints. The court ruled as follows:

As to the demurrers and motions to strike by PBA, Corbett & Steelman and Ken Steelman directed to the Kennedy cross-complaint, the trial court took the demurrers off calendar as to the first through twelfth causes of action and struck the thirteenth cause of action with leave to amend.

As to the demurrer and motion to strike by Biggs and Hotel Management Group directed to the Kennedy cross-complaint, the trial court sustained the demurrer as to all causes of action without leave to amend.

As to the demurrer and motion to strike by the Patels directed to the O'Brien cross-complaint, the trial court sustained the demurrer without leave to amend.

Later, on motion of the PBA cross-defendants, the trial court entered an order dismissing the causes of action in Kennedy's and O'Brien's cross-complaints which Kennedy and O'Brien had previously voluntarily dismissed.

Kennedy and O'Brien appeal from the trial court's rulings contending the court lacked jurisdiction to sustain demurrers or motions to strike or dismiss with respect to the causes of action which they had previously voluntarily dismissed. The standard of review is de novo.[70]

For the reasons stated below, we conclude that because Kennedy and O'Brien's voluntary dismissals without prejudice were entered prior to the trial court's rulings, the court lacked jurisdiction to sustain demurrers to or strike or dismiss the already-dismissed causes of action.

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[70] *Groth Bros. Oldsmobile, Inc. v. Gallagher* (2002) 97 Cal.App.4th 60, 65 (asserting when a trial court engages in analysis and interpretation of a statute and its application to undisputed facts, the standard of review is *de novo*).

B. Section 581 Gives the Plaintiff the Right to Dismiss the Complaint With or Without Prejudice Subject to Limitations Not Applicable Here.

Section 581, subdivision (b) states: "An action may be dismissed in any of the following instances: (1) With or without prejudice, upon written request of the plaintiff to the clerk, filed with papers in the case, or by oral or written request to the court at any time before the actual commencement of trial, upon payment of the costs, if any." Additionally, subsection (c) states, "A plaintiff may dismiss his or her complaint, or any cause of action asserted in it, in its entirety, or as to any defendant or defendants, with or without prejudice prior to the actual commencement of trial." The plaintiff's right to voluntarily dismiss the complaint, however, is not absolute. For example, a plaintiff cannot dismiss the complaint once a defendant has sought affirmative relief in the form of a cross-complaint.[71] Additionally, a plaintiff cannot voluntarily dismiss a complaint after the commencement of trial.[72] None of these exceptions apply in the present case.

C. The Trial Court Had No Jurisdiction to Rule on The Causes of Action Previously Dismissed by Kennedy and O'Brien.

Where a plaintiff has properly obtained a voluntary dismissal of a complaint or cause of action prior to the commencement of trial or determinative adjudication, appellate courts have held trial courts lack jurisdiction to rule on the complaint.

For example, in *Datner v. Mann Theaters Corp.*, the Court of Appeal reversed a trial court's judgment of dismissal after sustaining a demurrer without leave to amend.[73] The defendant in *Datner* filed a demurrer and motion to strike the complaint. The plaintiff then filed a voluntary dismissal as to all defendants without prejudice and the dismissal was entered on the same day. Learning the hearing on the demurrer and motion

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71 Section 581, subdivision (i).

72 Section 581, subdivision (b), paragraph (1); subdivisions (c), (e).

73 *Datner v. Mann Theaters Corp.* (1983) 145 Cal.App.3d 768, 771.

to strike had been taken off calendar, the defendant convinced the court clerk this was a mistake and had the hearing placed back on calendar. The trial judge vacated and set aside the plaintiff's dismissal and sustained the demurrer.[74] The Court of Appeal held the trial court lacked jurisdiction to enter a judgment for the defendant because the plaintiff had voluntarily dismissed his claim prior to the order sustaining the demurrer.[75]

Similarly, in *Zapanta v. Universal Care, Inc.*, the appellate court reversed a trial court's judgment granting summary judgment and striking the plaintiffs' request for dismissal without prejudice.[76] There the defendants filed a motion for summary judgment. The day before their opposition to the motion was due the plaintiffs filed a voluntary dismissal which was entered by the clerk. The motion for summary judgment was taken off calendar but at the defendants' request the court clerk placed it back on calendar. The defendants subsequently filed a motion to strike the voluntary dismissal and grant the summary judgment. At the hearing, the trial court granted the summary judgment.[77] In reversing the trial court, the Court of Appeal held that because the plaintiffs filed their voluntary dismissal prior to the hearing on the motion for summary judgment the trial court lost its jurisdiction and thus could no longer grant the defendants' motion.[78]

Datner and *Zapanta* stand for the proposition once a plaintiff files a valid voluntary dismissal of the complaint or a cause of action and the dismissal is entered, the trial court exceeds its jurisdiction in granting the defendant's demurrer or motion to strike or dismiss the already-dismissed complaint or cause of action. Therefore, once Kennedy and O'Brien filed for dismissal of certain causes of action in their cross-complaints and

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[74] *Datner v. Mann Theaters Corp. supra,* 145 Cal.App.3d at pages 769-770.

[75] *Datner v. Mann Theaters Corp., supra,* 145 Cal.App.3d at pages 770-771.

[76] *Zapanta v. Universal Care, Inc.* (2003) 107 Cal.App.4th 1167, 1176.

[77] *Zapanta v. Universal Care, Inc., supra,* 107 Cal.App.4th at pages 1170-1171.

[78] *Zapanta v. Universal Care, Inc., supra,* 107 Cal.App.4th at pages 1173-1174.

the clerk entered the dismissals, the trial court lacked the jurisdiction to sustain demurrers or strike or dismiss those causes of action and its rulings must be reversed.[79]

Accordingly, we will reverse the trial court's order dismissing the first through twelfth causes of action in Kennedy's cross-complaint against the PBA cross-defendants. The thirteenth cause of action was not dismissed by Kennedy and thus it was properly subject to a motion to strike. Kennedy's appeal does not challenge the trial court's ruling striking the thirteenth cause of action with leave to amend and therefore that ruling will be affirmed.

The court's error also affected Kennedy's cross-complaint against Biggs and Hotel Management Group because the court sustained their demurrer as to the previously dismissed first through twelfth causes of action. Such ruling was made without jurisdiction and must be reversed. Again, Kennedy's appeal does not challenge the trial court's ruling sustaining the demurrer to the thirteenth cause of action and therefore that ruling will be affirmed.

The trial court erroneously sustained the Patels' demurrer to O'Brien's first through eighth causes of action because those causes of action had previously been voluntarily dismissed. That ruling must be reversed. O'Brien's appeal does not challenge the trial court's ruling sustaining the demurrer to the undismissed ninth cause of action and therefore that ruling will be affirmed.

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[79] *Zapanta v. Universal Care, Inc.*, *supra*, 107 Cal.App.4th at pages 1174, 1176; *Datner v. Mann Theatres Corp.*, *supra*, 145 Cal.App.3d at page 771.

IX. JUDGE GALE ABUSED HIS DISCRETION IN VACATING JUDGE MORGAN'S VEXATIOUS LITIGANT AND PREFILING ORDERS BECAUSE KENNEDY FAILED TO SHOW A CHANGE IN MATERIAL FACTS TO ESTABLISH THE ORIGINAL DETERMINATION WAS NO LONGER JUSTIFIED.

The vexatious litigant statutes were designed to curb misuse of the court system by those acting in propria persona who repeatedly relitigate the same issues, especially those "'persistent and obsessive' litigants [who] often file groundless actions against judges and other court officers who made adverse decisions against them."[80]

Soon after Kennedy's first two attempts to disqualify Judge Morgan with a declaration of bias and prejudice PBA filed a motion for an order declaring Kennedy a vexatious litigant pursuant to section 391. Section 391, subdivision (b)(3), defines a "vexatious litigant" as a person who "in any litigation while acting in propria persona, repeatedly files unmeritorious motions, pleadings, or other papers, conducts unnecessary discovery, or engages in other tactics that are frivolous or solely intended to cause delay." PBA additionally sought a prefiling order against Kennedy pursuant to section 391.7. A prefiling order under section 391.7 prohibits a vexatious litigant from "filing any new litigation in the courts of this state in propria persona without first obtaining leave of the presiding judge of the court."

In support of its motion, PBA alleged Kennedy had (a) accused no less than eight judges or retired judges of being biased, bigoted, or incompetent; (b) sued no less than two judges in groundless proceedings; (c) referred or threatened to refer virtually every judge who had ruled against him to the jurisdictional body overseeing the judge's performance and (d) accused no less than 15 attorneys of unethical conduct, perjury, altering documents, and incompetence. PBA also documented a pattern of Kennedy's lack of respect for judicial officers. Kennedy failed to challenge or rebut any of these allegations.

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[80] *Bravo v. Ismaj* (2002) 99 Cal. App. 4th 211, 220-221.

Based on PBA's motion, supporting documents, and his own observations of Kennedy's "substantial" misconduct Judge Morgan declared Kennedy a vexatious litigant pursuant to section 391.3 and entered a prefiling order pursuant to section 391.7. The prefiling order prevented Kennedy from "filing any new litigation, including any complaints or cross-complaints . . . in propria persona, in the courts of this state without first obtaining leave of the presiding judge of the court where the litigation is pending or proposed to be filed."

After the case was transferred to Judge Gale, Kennedy brought a motion to vacate the orders declaring him a vexatious litigant and imposing prefiling restrictions. Judge Gale granted Kennedy's motion and vacated the prefiling order and vexatious litigant finding. PBA appeals this reversal on the ground it was improper based on the record before Judge Gale.

Despite the apparent unfairness of *permanently* branding a person as a vexatious litigant, it is unclear how the vexatious litigant determination can be erased in appropriate cases. The statutory scheme of sections 391 through 391.7 does not itself provide a procedural mechanism for dissolving an order declaring a person a vexatious litigant. Indeed, in most cases, vacating the vexatious litigant determination appears to be precluded by section 1008 beyond 10 days of notice of entry of the finding.[81]

The court in *Wolfgram v. Wells Fargo Bank,* by analogizing to a licensing system, implied a prefiling order entered pursuant to section 391.7 may be a permanent form of relief.[82] The court reasoned "to the extent [section 391.7] keeps vexatious litigants from clogging courts, it is closer to 'licensing or permit systems which are administered pursuant to narrowly drawn, reasonable and definite standards' which represent 'government's only practical means of managing competing uses of public facilities[.]' [Citation omitted]. When a vexatious litigant knocks on the courthouse door with a

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[81] Section 1008 requires an application for reconsideration be made to the same judge who made the order within 10 days of notice of the order and only upon a change of facts, circumstances or law.

[82] *Wolfgram v. Wells Fargo Bank* (1997) 53 Cal.App.4th 43, 60.

colorable claim, he may enter."[83] While there is much to recommend this reasoning, the conclusion section 391.7 is to be a permanent, irrevocable restriction is troubling. Although section 391.7 does not *absolutely* exclude the "pro per" litigant from the courts, we believe fundamental fairness requires the "vexatious litigant" brand be erasable in appropriate circumstances.

In the present case, we need not reach the issue of whether or not the brand of "vexatious litigant" can be erased once applied. At a minimum, to cast off the vexatious litigant label the court would have to find a change in facts or circumstances relating to the original determination. Kennedy failed to establish such new facts. Thus, even if it is theoretically possible to remove the brand of vexatious litigant, Judge Gale abused his discretion in doing so here because Kennedy failed to show a change in facts indicating a mending of his ways or conduct to support a reversal of the original determination. Furthermore, although we believe a prefiling order entered pursuant to section 391.7 may be reversible under section 533 as a form of injunction, Kennedy did not make the showing necessary for such a reversal. Kennedy failed to establish under section 533 either (a) "the ends of justice would be served" by the dissolution of the pre-filing order or (b) there was a "material change in the facts" upon which the order was entered.

A. Judge Gale Abused His Discretion by Vacating Judge Morgan's Order Declaring Kennedy a Vexatious Litigant Because There Were No New Facts to Support a Reversal of The Original Determination.

Judge Morgan stated his order declaring Kennedy a vexatious litigant was based on "reasons stated at the hearing and in the pleadings and exhibits, and also . . . substantial [mis]conduct of Sailor Kennedy observed by the Court during the course of proceedings before the Court." Moreover, Judge Morgan declared Kennedy a vexatious litigant on what he found to be an ample, "overwhelming," "dismal record." Specifically, Judge Morgan told Kennedy: "I have observed your actions throughout. And I have seen

[83] *Wolfgram v. Wells Fargo Bank*, *supra*, 53 Cal.App.4th at page 60.

what I deem to be frivolous actions in many categories, many ways in arguing with the court, presenting documents to the court." He further considered Kennedy's tactics such as his last minute dismissal of his cross-complaint just days before the hearing on the demurrer and after Judge Morgan had already spent considerable time in preparing for the hearing.

Assuming Judge Gale had the power to reverse Judge Morgan's order declaring Kennedy to be a vexatious litigant, he would at least have had to find a change in facts or circumstances showing the finding was no longer appropriate.

Judge Gale's order was expressly based on several factors, none of which amounted to a change in facts or circumstances sufficient to reverse the vexatious litigant order. First, Judge Gale believed the "abrupt" proceedings under Judge Rutberg at the receivership proceedings on March 20, 1998 had sent Kennedy "off the deep end." Judge Gale emphasized he would "not even give a second thought" to vacating the vexatious litigant declaration and prefiling order if it were not for the events of March 20, which he felt triggered Kennedy's frustration and vexatious actions. However, even if the events of March 20 were a mitigating circumstance which should have been considered in making the initial vexatious litigant finding against Kennedy, they do not amount to a change in the facts upon which the original determination was based. The transcripts from the receivership proceedings on March 20 were available for Judge Morgan to consider when he declared Kennedy to be a vexatious litigant. Additionally, the significance of the March 20 hearing is questionable because Judge Morgan was not the first judge to have a declaration of bias and prejudice brought against him by Kennedy.[84]

Furthermore, in addition to his observations of Kennedy's conduct, Judge Morgan's order was based in part on the pleadings and exhibits which detailed a litany of vexatious or frivolous actions by Kennedy in previous proceedings. Therefore, Judge

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[84] Kennedy's lack of respect towards judicial officers who rule against him is displayed in a July 28, 1994 deposition in which he bragged: ". . . I don't let judges run over me anymore. Scumbucket attorneys – *they are just as low as scumbucket attorneys*."

Gale's belief there was an event which understandably (although unjustifiably) triggered Kennedy's actions was not a sufficient basis for vacating Judge Morgan's order. This order was based in part on a long pattern of conduct prior to the receivership proceedings. Therefore, rather than simply showing circumstances to warrant sympathy towards his position, Kennedy needed to show he had ceased the behavior which defined him as a vexatious litigant under section 391, subdivision (b)(3). We find Kennedy failed to demonstrate any facts which would suggest such a change in his behavior as a *propria persona* litigant.

Additionally, Judge Gale considered the merits of Kennedy's case and the credibility of Kennedy as a witness. Neither of these considerations are relevant to the determination of whether a person is a vexatious litigant within the meaning of section 391, subdivision (b)(3). Kennedy's credibility as a witness and the merits of part of his defense do not alter the court's findings based on his relevant actions before the court and as demonstrated in previous proceedings. As discussed above, section 391, subdivision (b)(3) defines a vexatious litigant as one who "while acting in propria persona, repeatedly files unmeritorious *motions*, pleadings or *other papers* . . . or engages in *other tactics* that are frivolous or solely intended to cause unnecessary delay." (Emphasis added). Therefore, with ample findings directly related to the definition provided by section 391, subdivision (b)(3), Kennedy's subsequent credibility as a witness and improvement in the merits of portions of his case were irrelevant.

Kennedy failed to establish he had mended his ways. On the contrary, rather than ceasing his frivolous and delaying tactics, after being declared a vexatious litigant Kennedy brought his third and fourth declarations of bias and prejudice against Judge Morgan.

In sum, Judge Gale abused his discretion by vacating Judge Morgan's vexatious litigant finding because Kennedy completely failed to establish this determination was either incorrect in the first instance or no longer required in light of new facts.

B. Judge Gale Abused His Discretion by Vacating and Dissolving Judge Morgan's Prefiling Order Against Kennedy Because There Was No Change in Material Facts Upon Which The Original Determination Was Based.

Upon declaring Kennedy to be a vexatious litigant pursuant to section 391, subdivision (b)(3), Judge Morgan entered a prefiling order pursuant to 391.7. Under that section, the presiding judge can permit the filing of a pro per's litigation only if it appears to have merit and is not filed for the purposes of harassment or delay.[85] Further, the presiding judge may condition the filing of the litigation upon the furnishing of security.[86] "The prefiling order component of the vexatious litigant statute is a necessary method of curbing those for whom litigation has become a game."[87] These prefiling restrictions are enforced through the requirement the court provide the Judicial Council with a copy of the order. The Judicial Council then annually disseminates a list of vexatious litigants to the clerks of courts of the state.[88]

Viewing the prefiling order as a form of injunction, it may have been reversible according to the guidelines of section 533. Under section 533, the prefiling order could be reversed if either (a) "the ends of justice would be served" by the dissolution of the order or (b) there has been a "material change in the facts" upon which the order was entered.

When Judge Gale reviewed the motion to vacate the prefiling order nothing on the record suggested the order would no longer be an appropriate safeguard against Kennedy's vexatious and frivolous actions. Furthermore, there were no new facts to indicate Kennedy had ceased the behaviors which formed the basis for Judge Morgan's vexatious litigant determination. By nature of the statutory scheme, Judge Morgan's

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[85] Section 391.7, subdivision (b)

[86] Section 391.7, subdivision (b)

[87] *Wolfgram v. Wells Fargo Bank*, *supra*, 53 Cal.App.4th at page 60.

[88] Section 391.7, subdivision (d).

vexatious litigant finding was the crux of his basis for entering the prefiling order.[89] Thus, because there were no new facts to support vacating the vexatious litigant determination, likewise, there was no material change in the facts upon which the prefiling order was based.

Kennedy contends a change in the merits of his defense was sufficient to support the reversal of the prefiling order. This apparent change in facts may be relevant under section 391 which requires the posting of security only upon showing the plaintiff is a vexatious litigant and "there is not a reasonable probability that he will prevail in the litigation against the moving defendant." However, the provisions of section 391.7 do not require an inquiry into the probability of the vexatious litigant's success in the particular case in order to enter a prefiling order. Thus, an improvement in the merits of Kennedy's defense was not relevant to Judge Morgan's vexatious litigant declaration under 391(3) or the prefiling order entered pursuant to 391.7.

Kennedy further argues it would serve the ends of justice to reverse the prefiling order in light of the change in the merits of his defense. However, Judge Morgan's order declaring Kennedy a vexatious litigant was not solely based on his filing frivolous lawsuits nor upon the merits of the present case. The declaration was based in large part on Kennedy's vexatious behavior before the court and in his past repeated, meritless attempts to disqualify judges. Therefore, in light of the statute's aim to prevent abuse of the court system by *propria persona* litigants, a change in the merits of Kennedy's defense does not alter Judge Morgan's determination based upon his own observations of substantial misconduct.

In conclusion, we find Judge Gale erred in reversing the order declaring Kennedy to be a vexatious litigant and imposing prefiling restrictions because there were no new material facts to support a reversal. Further, it did not serve the ends of justice to vacate the prefiling order. To the contrary there was ample evidence to indicate Judge Morgan's

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[89] See Sections 391-391.7.

order was justified and continued to be an appropriate preventive measure against future frivolous filings by Kennedy.

We will remand this matter to the trial court with directions to vacate Judge Gale's order reversing the previous orders declaring Kennedy to be a vexatious litigant and imposing prefiling restrictions against Kennedy. Should Kennedy choose to refile a complaint containing the causes of action he previously voluntarily dismissed, the vexatious litigant and prefiling orders will apply to that complaint.

DISPOSITION

The order denying the motion by Kennedy and O'Brien to set aside all orders by Judge Morgan is affirmed.

The judgment in favor of KPOD on its cross-complaint against PBA is reversed.

The judgment in favor of KPOD and the other cross-defendants on PBA's cross-complaint is affirmed.

The order approving and adopting the referee's final accounting is affirmed.

The order awarding attorney fees to PBA on the partition action is affirmed.

The order requiring the receivership estate to pay the receiver's attorney fees in defending the action brought by Seaspan, Inc. is affirmed.

The order releasing from escrow PBA's share of the accounting fees billed to the hotel by White Nelson & Company is affirmed.

The orders sustaining demurrers to and dismissing the first through twelfth causes of action in Sailor Kennedy's cross-complaint are reversed. The order striking the thirteenth cause of action with leave to amend is affirmed.

The orders sustaining demurrers to and dismissing the first through eighth causes of action in Timothy O'Brien's cross-complaint are reversed. The order sustaining the demurrer to the ninth cause of action is affirmed.

The trial court is directed to vacate Judge Gale's order reversing the previous orders declaring Sailor Kennedy a vexatious litigant and imposing prefiling restrictions.

Each party to bear its own costs on appeal.

CERTIFIED FOR PARTIAL PUBLICATION

JOHNSON, J.

We concur:

PERLUSS, P.J.

MUNOZ, J.*

* Judge of the Los Angeles Superior Court, assigned by the Chief Justice pursuant to article VI, section 6 of the California Constitution.