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**UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF CALIFORNIA**

THOMAS HUBBARD,

vs.

PHIL'S BBQ OF POINT LOMA, INC., a
California corporation; PHILLIP C. PACE
and JEFFREY A. LOYA,

Plaintiff,

Defendants.

CASE NO. 09CV0735-LAB (CAB)

**ORDER DENYING MOTION FOR
CERTIFICATION OF
INTERLOCUTORY APPEAL AND
FOR STAY OF PROCEEDINGS
OR, IN THE ALTERNATIVE, FOR
RECONSIDERATION**

The Defendant corporation, Phil's BBQ of Point Loma, Inc. ("New Phil's") is the subject of proceedings under California Corporations Code § 2000. Two of its owners, Defendants Pace and Loya, are also the sole owners and officers of Phil's BBQ, Inc. ("Old Phil's"), which operated a different barbeque restaurant until December 2006.

In preparation for an evidentiary valuation hearing currently on calendar for Thursday, September 16, the Court made certain rulings concerning the valuation of New Phil's. The order directed the appraisers to assume New Phil's would be permitted, going forward, to use certain intellectual and tangible property on the same terms as it was currently using them, so as to permit the corporation to be sold as a going concern rather than piecemeal. The order also found as a matter of law Plaintiff owned a 10% interest in New Phil's.

1 Defendants, dissatisfied with this order, have moved for an order certifying three
2 issues for interlocutory appeal and seeking a stay. In the alternative, they have filed an *ex*
3 *parte* motion for leave to seek reconsideration of virtually all the Court's rulings. The Court
4 finds it appropriate to deny these requests summarily without requiring an opposition.

5 **I. Interlocutory Appeal**

6 Defendants ask the Court to certify three issues for appeal pursuant to 28 U.S.C.
7 § 1292:

8 1. Whether the fact that New Phil's does not own or have a written license to use the
9 intellectual property would prevent it from being sold as a going concern;

10 2. Whether appraisers in a § 2000 valuation proceeding "are entitled to make
11 assumptions about what reasonable shareholders would do to maximize the liquidation value
12 for the defendant corporation while acting in their capacity as officers/directors/fiduciaries
13 of "Old Phil's"; and

14 3. Whether California law permits the appraisers to make any assumption about how
15 shareholders would behave, considering Pace's and Loya's fiduciary duties to Old Phil's.

16 Certification of issues for appeal under § 1292(b) is granted only sparingly. *Ass'n of*
17 *Irrigated Residents v. Fred Schakel Dairy*, 634 F. Supp. 2d 1081, 1087 (E.D.Cal., 2008).
18 There is no reason to do so here. First, the issues are poorly framed. The first issue does
19 not present a meaningful question because it is undisputed New Phil's had a valid unwritten
20 license to use the intellectual property at issue. The second issue does not adequately
21 reflect the questions presented here; even if the Ninth Circuit were to address it, the answers
22 would have no direct bearing on this Court's ruling. The third issue is subsumed within the
23 second.

24 Furthermore, an interlocutory appeal would be of little assistance. The issues
25 presented here are questions of California state law, and the parties agree only five
26 published decisions have addressed the application of California Corporations Code § 2000
27 in a similar context. The California Supreme Court has not ruled on the precise issues

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1 concerning valuation presented here. The Ninth Circuit would have no more or better
2 information than this Court does. Finally, the interlocutory appeal would occasion needless
3 delay and would result in piecemeal litigation of the issues.

4 **II. Reconsideration**

5 While the Court recognizes its own authority to reconsider its rulings at any time
6 before a final judgment has been entered, *United States v. Martin*, 226 F.3d 1042, 1049 (9th
7 Cir. 2000), motions for reconsideration are disfavored and appropriate only if the Court is
8 presented with newly discovered evidence or a change in controlling law, or has committed
9 clear error. *Nunes v. Ashcroft*, 375 F.3d 805, 808 (9th Cir. 2004). Defendants argue that
10 virtually the entire order was clearly erroneous, and ask that errors be corrected

11 The Court considered all the pleadings in Plaintiff's motion for partial summary
12 judgment, as well as the applicable authority, and finds no reason for a wholesale re-
13 examination of its decision. Nevertheless, because it is clear Defendants substantially
14 misunderstand the order, the Court finds it appropriate to clarify several points Defendants
15 have raised.

16 **A. Dealings Between Corporate Entities**

17 Defendants identify a large number of what they call "inconsistencies" in the Court's
18 order, but these appear to be misreadings of the Court's order, misunderstandings of the
19 law, or simple disagreements with the Court's rulings.

20 Defendants Pace and Loya together own Old Phil's. Together with Hubbard, they
21 also own New Phil's. Old Phil's has not operated a restaurant since December 2006, and
22 New Phil's is a successful restaurant currently in business. No evidence was presented to
23 show Old Phil's and New Phil's owed each other any duty, nor are they related, except by
24 partial overlap in ownership.

25 Until now, Old Phil's has allowed New Phil's to use its intellectual and tangible
26 property freely without requiring any payments even though, from the point of view of each
27 corporation, Old Phil's and New Phil's are competitors. One way to analyze this would be
28 to say that Pace and Loya are disregarding Old Phil's corporate existence by plundering its

1 assets, and using them as their own, to benefit themselves and not the corporation to which
2 they owe fiduciary duty. However, as the Court observed in its July 13 order, no party has
3 argued this; therefore, under the business judgment rule, the Court presumes Old Phil's has
4 legitimate reasons for lending out its equipment, vehicles, and other tangible property, and
5 for allowing New Phil's to use its trademarked names and have access to its secret recipes.

6 The parties agree New Phil's is not a thief or infringer, but has a license to use the
7 intellectual and tangible property. The question is, whether the appraisers in valuing New
8 Phil's should consider this license to be among New Phil's assets. If this license is included
9 in New Phil's assets, New Phil's could be valued as a going concern rather than valued as
10 if it were going to be sold piecemeal. New Phil's value would likely be higher if valued as a
11 going concern.

12 Two of the five cited California decisions, *Abrams v. Abrams-Rubaloff & Assocs.*, 114
13 Cal. App. 3d 240 (Cal. App. 2 Dist. 1980) and *Mart v. Severson*, 95 Cal. App. 4th 521 (Cal.
14 App. 1 Dist. 2002) apply § 2000 in a similar context. Those two decisions particularly note
15 that § 2000 requires appraisers to consider the possibility that a business might be able to
16 be sold as a going concern. This is part of the plain language of § 2000.

17 The hypothetical sale model is one method of calculating the fair value of a
18 corporation, *Mart* at 531–32, and the appraisers are permitted to use it. Both cases require
19 the appraisers “to consider the manner in which the parties to such a hypothetical sale are
20 most likely to maximize their return.” *Abrams* at 249, *Mart* at 532.

21 Both cases dealt with sales in which the value of the business would be enhanced if
22 the hypothetical sellers agreed to enter into covenants not to compete with it. Obviously, a
23 covenant not to compete costs the covenanter something, but the *Abrams* court held the
24 appraisers properly assumed a hypothetical seller would enter into such a covenant in order
25 to maximize the selling price. *Abrams* at 249. *Mart* similarly found the appraisers properly
26 assumed not only shareholders but also key employees would execute hypothetical
27 covenants to compete. *Mart* at 531. *Mart* noted that the appraisers properly did not consider
28 what the actual sellers would do. *Id.*

1 *Mart* also discussed *Brown v. Allied Corrugated Box. Co.* 91 Cal. App. 3d 477 (Cal.
2 App. 2 Dist. 1979), which dealt with a predecessor statute. *Mart* at 532. *Mart*'s construction
3 of *Brown* noted that discounting the value of the corporation because of the threat of
4 competition by a shareholder unfairly deprives a movant of the true value of his stock. *Mart*
5 at 532. The situation here is analogous. Pace and Loya own Old Phil's outright and in an
6 actual sale they could obviously drive down the price of New Phil's by canceling the license.
7 The question is not, however, what Pace and Loya would do, but what hypothetical willing
8 sellers would do in order to maximize the return. And, as *Mart* explains, appraisers'
9 assumptions should not be limited to covenants not to compete: appraisers should also
10 "assume that the parties to the hypothetical sale will negotiate the other requisite terms to
11 a sales agreement." *Id.* at 534.

12 Neither *Abrams* nor *Mart* asked what the covenant not to compete would cost the
13 sellers or other covenanting parties in the long term, or whether it would be in their overall
14 interest, nor did they consider such issues at all. Defendants would have the Court examine
15 the interests of the actual sellers, and adjust the return from the hypothetical sale to account
16 for the effect on their finances if New Phil's were owned by someone else. This is what both
17 *Abrams* and *Mart* said appraisers should not do when using the hypothetical sale method
18 of valuation.

19 Old Phil's actions in granting the license show two things are beyond dispute. First,
20 such a license is feasible. Old Phil's is not using the tangible property and no evidence
21 shows this is about to change. And Old Phil's has found ways to license its intellectual
22 property without fear of losing it. Second, Old Phil's is willing to license its property royalty-
23 free to a competitor.

24 Although the Court did not rely on this evidence, Defendants also filed declarations
25 stating that they are negotiating a new location for another Phil's BBQ restaurant, and Old
26 Phil's is willing to license its intellectual property royalty-free to that restaurant as well. (Pace
27 Decl. in Supp. of Opp'n to Mot. for Partial Summ. J. ("Pace Decl."), ¶ 46, Loya Decl. in Supp.
28 of Opp'n to Mot. for Partial Summ. J. ("Loya Decl."), ¶ 43.) Defendants agree the licenses

1 for both New Phil's and the contemplated new restaurant would be royalty-free for an
2 indefinite period, to be renegotiated later when each new restaurant was well-established.
3 The time for renegotiation was undetermined, and no renegotiation of New Phil's license was
4 expected soon. (Pace Decl., ¶ 43; Loya Decl., ¶ 40 (discussing compensation to Old Phil's
5 "at some point in the future").)

6 Defendants' motion relies on Pace's and Loya's alleged fiduciary duty not to allow Old
7 Phil's to grant royalty-free licenses of its property. Apparently they are arguing that allowing
8 a competing business to use Old Phil's property is a violation of their duties of loyalty and
9 care to Old Phil's. Defendants' motion argues this fiduciary duty would require hypothetical
10 sellers to cancel the license. This argument collapses under its own weight. If Pace and
11 Loya owe a fiduciary duty, it is to Old Phil's, not to themselves. In other words, they must
12 act to benefit Old Phil's, regardless of whether it helps or hurts them personally. And if the
13 royalty-free licensing of Old Phil's intellectual property is not in Old Phil's best interest (even
14 if it is in Pace's and Loya's), they have been violating their duty for several years and are
15 planning to continue violating it.

16 Defendants attempt to get around this problem by distinguishing between "related
17 party" transactions and arm's-length transactions (Am. Mot. at 22:5–9). But Old Phil's has
18 no particular interest in helping New Phil's. Its owners do, to be sure, but as a corporation
19 it does not. Treating the licensing agreement as a transaction between related parties for
20 purposes of this case would blur the distinctions between corporations and their owners.
21 Defendants depend heavily on these distinctions as a source of the fiduciary duties which,
22 they argue, stand in the way of the hypothetical sale. But Defendants cannot have it both
23 ways. Either the current licensing agreement benefits Old Phil's or it does not. If it does, it
24 would continue after a hypothetical sale. If it does not, Pace's and Loya's fiduciary duties
25 to Old Phil's would have required that it be canceled long before now. One way or another
26 their arguments must fail.

27 Defendants also rely heavily on affidavits by Pace and Loya declaring their intent to
28 cancel the license if New Phil's were ever sold or liquidated. (Pace Decl., ¶¶ 47, 48; Loya

1 Decl., ¶¶ 44, 45.) The Court cannot and does not rely on this evidence, however. “Only
2 admissible evidence may be considered in deciding a motion for summary judgment.” *Miller*
3 *v. Glenn Miller Prods., Inc.*, 454 F.3d 975, 988 (9th Cir. 2006). This evidence is
4 inadmissible, first, because it is irrelevant. The hypothetical sale method of valuation asks
5 what hypothetical willing sellers would do to maximize their return. *Mart* at 725. What Pace
6 and Loya say they would do is irrelevant. Second, Pace and Loya are lay witnesses offering
7 hypothetical testimony. Their testimony about what they would do in a range of imagined
8 situations is not based on their personal knowledge, and is therefore incompetent.

9 Finally, relying on declarations about the actual sellers’ intent would gut the holdings
10 of *Abrams* and *Mart*. Actual sellers could render a hypothetical sale impossible simply by
11 filing self-serving declarations stating what they would or would not do. *See Mart* at 534–35
12 (noting a purchaser could always prevent a corporation from being valued as a going
13 concern by refusing to agree to its terms).

14 Defendants’ arguments appear to be motivated by a concern to protect the value of
15 their intangible property. Pace and Loya are concerned that their trade secrets would leak
16 out and their trademarked names be lost if they allowed other businesses to use them.
17 Certainly it is easier to maintain confidentiality when only one or two people know the secret.
18 But businesses license this type of property and protect trade secrets routinely by means of
19 licensing and confidentiality agreements. In fact, Old Phil’s has already done this, protecting
20 its barbeque sauce recipe by outsourcing its manufacture to Kraft and binding Kraft by a
21 confidentiality agreement. There is no reason to think this property could not continue to be
22 licensed if New Phil’s were ever sold. (See Am. Mot, 16:1–3 (“The use of confidentiality
23 agreements . . . is exactly the type of reasonable measure[] that will protect a trade secret
24 from loss or disclosure.”))

25 **B. Trade Secrets: Recipes**

26 The trade secrets at issue consist of secret recipes Pace developed. The undisputed
27 evidence showed that Pace and Loya used the recipes while working at New Phil’s, to make
28 food for New Phil’s to sell. In so doing they were acting for New Phil’s, with the consent of

1 Old Phil's. Old Phil's did not charge New Phil's for use of the recipes, and there was no
2 evidence New Phil's had agreed to stop using the recipes at any point. Defendants also
3 represented that various other employees of New Phil's had access to the recipes, and were
4 required not to disclose them to outsiders. The Court therefore found that Old Phil's had not
5 kept its recipes secret from New Phil's, and directed the appraisers to assume for purposes
6 of valuing New Phil's as a going concern that New Phil's had this information and would
7 continue to be able to use it. The Court accepted the parties' representations that the
8 recipes remained trade secrets.

9 Defendants still agree with these findings and agree that New Phil's had and used
10 the information. Yet, inexplicably, they fault the Court's finding, and argue that the recipes
11 were kept a secret from New Phil's:

12 In the Order, the Court indicates Old Phil's did not take steps to protect the
13 secrecy of its recipes from New Phil's. In making this statement, the Court
14 has either disregarded the declaration and report of defendants' expert
15 witness John L. Haller, or has simply failed to take it into account. In his
16 report, Mr. Haller describes the steps Old Phil's took to protect its trade
17 secret during its use at New Phil's and to ensure that individuals involved in
18 the production of Phil's BBQ branded items knew that the intellectual
19 property associated with those items was the property of Old Phil's. In
20 particular, Mr. Haller notes that the employees of New Phil's are each
21 presented with an employee handbook that specifically states that the
22 various items of intellectual property are owned by Old Phil's. The
23 handbooks and employee instructions themselves are the property of Old
24 Phil's. Contained within the handbook is a Confidentiality & Non-Disclosure
25 Agreement which states that the employees must keep information such as
26 secret recipes confidential for the benefit of Old Phil's.

20 (Am. Mot., 14:20–15:11; footnotes deleted, emphasis added.)¹

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26 ¹ The agreement and employee handbook the citation refers to were not submitted
27 as evidence; the only information about the contents of these comes from Defendants'
28 witnesses' summaries and characterizations of them. Witnesses' testimony about the
contents of writings are not generally admissible as evidence, Fed. R. Evid. 1002–4, but for
purpose of this argument the Court takes note of Defendants' representations in the
pleadings. No evidence suggests the agreements or employee handbook would require
New Phil's to stop using the recipes at some point.

1 Apparently Defendants are now arguing New Phil's never had, knew, or used the
2 recipes:

3 Although not expressly articulated, this conclusion [that New Phil's knows the
4 recipes] appears to be grounded on the assumption that since the owner's
5 agent [Pace] used trade secret information that was/is held exclusively in his
6 mind for the benefit of another user (either at sufferance or per agreement),
7 that trade secret is somehow imputed to the user [New Phil's] and thereby
8 destroys the confidentiality of the trade secret.

9 (*Ex Parte* App. for Reconsideration, 4:1–5 (second and third bracketed remarks in original).)

10 This argument fails, first, because the representations it contains contradict Defendants' own
11 newly-submitted evidence that various people had access to the trade secrets. And second,
12 when acting over a period of several years for the benefit of New Phil's, and as an owner
13 and officer of New Phil's, Pace was unquestionably New Phil's agent. To view him as an
14 agent of Old Phil's (the "owner's agent") and a stranger to New Phil's the entire time is
15 unreasonable. When Old Phil's allowed New Phil's agent to have and use the recipes, it
16 effectively gave New Phil's those recipes.

17 The Court found that Old Phil's had freely shared its trade secrets with New Phil's, not
18 with other businesses or the public generally. In some cases, Old Phil's shared its trade
19 secrets with a third party, Kraft Foods, entering into an agreement that Kraft would keep the
20 recipe or recipes confidential and sell the products only to authorized buyers. Old Phil's then
21 authorized Kraft to sell the products to New Phil's. But the Court accepts that the recipes
22 remain trade secrets and that Old Phil's has taken care to ensure that they remain so.
23 Bearing in mind the precautions taken to prevent disclosure outside New Phil's, there is no
24 reason to find the recipes lost their status as trade secrets as to entities altogether.

25 It may also be that Defendants believe "trade secret" status confers a protection like
26 that of a patent, so that even if a competitor has the secret information, the competitor may
27 not legally use it. California law does recognize a cause of action for misappropriation of
28 trade secrets. See 61 Cal. Jur. 3d, Unfair Competition, § 24. But misappropriation requires
that, at some point, the trade secret was improperly disclosed or acquired. Cal. Civ. Code

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1 § 3426.1(b). Here, it is undisputed that Pace developed the recipes, and that they were
2 freely disclosed to New Phil's with the consent of Old Phil's.

3 **C. Manufacture of "Gooba Dust"**

4 The Court's order noted that Old Phil's had authorized Kraft to manufacture both the
5 barbeque sauce and the rub (known as "Gooba Dust") using Pace's secret recipes.
6 Defendants make a point of objecting to this:

7 Although it is undisputed that Kraft was provided the recipe for the secret
8 Phil's BBQ sauce (under Protection of a written confidentiality agreement),
9 nothing in the record suggests or supports the finding that Kraft was provided
10 with any information concerning the Gooba Dust. Because these statements
11 are not based on the evidence before the Court, and are factually inaccurate,
12 the Order must be corrected.

13 (Am. Mot. at 23:5–10.) The Court's understanding of the facts, however, comes from
14 Defendants' own statements to the Court:

15 When the Point Loma business opened, Pace and Loya could no longer
16 make the Phil's BBQ Sauce and Gooba Dust themselves because of the
17 volume needed to run the business, so they entered into an agreement with
18 Kraft Foods whereby Kraft Foods would manufacture the items in bulk.

19 (Defs'. Opening Br. in Supp. of Valuation (Docket no. 61), 17:22–18:3.)

20 Apparently Defendants wish the record to be very clear on this point for some reason,
21 even though it makes no difference to the Court's ruling or the valuation. If, as Defendants
22 said earlier, Kraft is manufacturing Gooba Dust for New Phil's, hypothetical buyers of New
23 Phil's would continue to be permitted to buy it from Kraft. If, as Defendants now maintain,
24 New Phil's is making Gooba Dust for itself, it could continue to do so after the hypothetical
25 sale.

26 Defendants did not mention any evidence about Kraft in their opposition to the motion
27 for partial summary judgment, and the Court was not required to "comb the record" to look
28 for it. *Carmen v. S.F. Unified Sch. Dist.*, 237 F.3d 1026, 1029, 1031 (9th Cir. 2001). Had
the Court combed through the record, however, the only evidence on this point says that
Kraft was "hired to make one of the trade secret items." (Pace Decl. ¶ 26; Loya Decl. ¶ 23.)

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1 Neither declaration says which item Kraft was hired to make. In other words, there is no
2 evidence in the record to support Defendants' new representations.

3 If Kraft is not manufacturing the Gooba Dust and Defendants think the point is
4 important, they should correct their earlier misstatements and submit evidence. In the
5 absence of evidence and a showing of why the correction is necessary, the Court will not
6 amend its order.

7 **III. Conclusion and Order**

8 The motion to certify an interlocutory appeal, and for a stay, is **DENIED**. The *ex parte*
9 application for leave to seek reconsideration is **DENIED**. The parties are directed to prepare
10 diligently for the evidentiary hearing on September 16, 2010 at 10:00 a.m.

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13 **IT IS SO ORDERED.**

14 DATED: August 2, 2010

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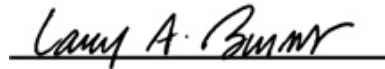
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HONORABLE LARRY ALAN BURNS
United States District Judge