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CERTIFIED FOR PUBLICATION

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

SECOND APPELLATE DISTRICT

DIVISION TWO

CITY OF HOPE NATIONAL MEDICAL CENTER, Plaintiff and Respondent, v. GENENTECH, INC., Defendant and Appellant.	B161549 (Los Angeles County Super. Ct. No. BC215152)

APPEAL from a judgment and order of the Superior Court of Los Angeles County. Edward Y. Kakita, Judge. (Retired judge of the L.A. Sup. Ct. assigned by the Chief Justice pursuant to art. VI, § 6 of the Cal. Const.) Affirmed.

Howard, Rice, Nemerovski, Canady, Falk & Rabkin, Jerome B. Falk, Jr., Steven L. Mayer, Amy L. Bomse; Keker & Van Nest, Robert A. Van Nest, Susan J. Harriman, Kara M. Andersen, and Steven A. Hirsch for Defendant and Appellant.

Fred Main for Chamber of Commerce of the United States, California Chamber of Commerce; Jim Hawley for TechNet; D. Bruce Sewell, Janet Craycroft for Intel Corporation; Robin S. Conrad for National Chamber Litigation Center, Inc. and Thomas R. Lavelle for Xilinx, Inc. as Amici Curiae on behalf Defendant and Appellant.

Horvitz & Levy, Ellis J. Horvitz, Jon B. Eisenberg, William N. Hancock; Irell & Manella, Morgan Chu, Gregory R. Smith, David I. Gindler, Joseph M. Lipner; Reed, Smith, Crosby, Heafey, Peter W. Davis, and James C. Martin for Plaintiff and Respondent.

This case arises out of a 1976 patent agreement (the agreement) that governs the right of respondent City of Hope National Medical Center (City of Hope) to receive royalties from appellant Genentech, Inc. (Genentech) with respect to patents[1] worth billions of dollars. The agreement contains ambiguous provisions regarding the royalty base that applies to product sales by Genentech's licensees and proceeds from patent infringement actions. According to City of Hope, Genentech breached the agreement and the fiduciary duty it owed under *Stevens v. Marco* (1956) 147 Cal.App.2d 357 (*Stevens*) by concealing and failing to pay royalties that were due. The jury agreed and awarded City of Hope $300,164,030 in compensatory damages and $200 million in punitive damages. Genentech appeals on multiple theories, primarily contending that the jury misinterpreted the agreement and *Stevens* does not apply. Absent an outright reversal, Genentech asks us to reduce the contract damages by $94 million and $181,817 which, respectively, represent two percent of sales by licensees who obtained licenses through settlement agreements and two percent of settlement proceeds. Also, Genentech asks us to reverse the punitive damages award on the grounds that (1) there was no evidence of fraud or malice because it withheld royalties pursuant to a legally tenable contract interpretation, and (2) the award was excessive.[2] At a minimum, Genentech asks us to remand the entire matter for a new trial.

We affirm in all respects.

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1 We sometimes refer to these patents as the Riggs-Itakura patents. These patents were invented by Dr. Arthur Riggs (Riggs) and Dr. Keiichi Itakura (Itakura) while they were working for City of Hope.

2 The notice of appeal refers to the judgment and the order denying Genentech's motion for judgment notwithstanding the verdict (JNOV). In its briefs, Genentech does not distinguish between the two. Insofar as we uphold the judgment, we also uphold the order denying the JNOV.

The lynchpin for the bulk of this case is the following question: Did the agreement require Genentech to pay royalties on the product sales of licensees of the Riggs-Itakura patents even if those licensees did not practice[3] the patents when manufacturing their products? The jury said yes. The next question is: Which product sales by licensees are part of the royalty base upon which royalties are calculated? Impliedly, the jury agreed with City of Hope that royalties are due on the sale of products listed in a license of a Riggs-Itakura patent. Genentech concedes that the agreement is susceptible to City of Hope's interpretation. The major battleground issues are whether it was error for the trial court to submit interpretation of the agreement to the jury, and whether the jury's interpretation was reasonable. After review, we conclude that both issues must be resolved in favor of City of Hope.

As for *Stevens*, we conclude that it applies. In the circumstances of this case -- where an inventor transfers its invention to a third party who exercises an option to patent, develop and commercially exploit the invention in exchange for royalties -- a confidential relationship is established.

Finally, there is no basis for reducing the contract damages, there was substantial evidence of fraud and malice, the punitive damages award was not excessive, and there are no grounds for a new trial.

FACTUAL AND PROCEDURAL HISTORY

Background

Initial contact between the parties

While they were working for City of Hope in the mid-1970's, Riggs and Itakura achieved a breakthrough in biotechnology by inventing a way to genetically engineer human proteins.[4] At about the same time, Dr. Herbert Boyer (Boyer) and a businessman

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[3] For purposes of this opinion, to practice or use a patent means to follow the manufacturing process contained in a patent.

[4] The agreement pertains to polypeptides, which include human proteins and animal proteins.

named Robert Swanson (Swanson) joined forces to form a venture to exploit biotechnology. Boyer, who had worked with Riggs and Itakura in the past, called Riggs and proposed that they collaborate together on a project to make bacteria produce human insulin. Riggs was amenable. In fact, when he received the call, Riggs was in the process of writing a grant application for the same sort of project.

Genentech came into being on April 7, 1976, when Boyer and Swanson incorporated their venture.

The parties negotiate a contract

On May 18, 1976, Swanson sent City of Hope a letter proposing that Genentech provide City of Hope with approximately $300,000 over a two-year period to "complete the synthesis of genes coding for somatostatin and insulin." The letter went on to aver: "Upon completion of each product development, Genentech will pay for securing the patent protection necessary for commercialization. Genentech will hold the patents, and pay City of Hope a royalty of one and one-half percent of sales for their part in the joint venture." Additionally, the letter stated that if Genentech failed to take "the necessary steps to commercialize the results of the joint development effort within a five year period from the date of agreement, all patent rights will become the property of City of Hope."

Thereafter, Genentech provided City of Hope with a copy of the University of California's schedule of support and patent privileges. According to Swanson's accompanying letter, the schedule "details the rights and obligations of industry funded research, and provided a guideline for Genentech's proposal to the City of Hope." Specifically, the schedule established that if the grantor paid all direct and indirect costs of research, then the grantor would receive "[a]n exclusive license for the life of the patent with the right to sublicense and the obligation to pay royalties on the license and sublicenses."

John J. Hall (Hall), City of Hope's patent attorney, began negotiating a patent agreement with Swanson and Genentech's patent attorney, Thomas Kiley (Kiley). Early on, Hall prepared a summary of points for agreement. That summary, in relevant part, proposed: "On all sales of products resulting from the research conducted by City of Hope under this agreement, Genentech shall pay City of Hope an annual royalty of 3% on the first [$]2,000,000 of gross sales, 2% on the next [$]2,000,000 of gross sales, and 1 1/2% on the gross sales over $4,000,000 per year. The royalties shall include gross sales of Genentech itself and of any and all Genentech subsidiaries and licensees or joint venturers."

On June 30, 1976, Hall met with Kiley and Swanson in order to discuss various aspects of the agreement.

The agreement goes through three revisions

Kiley eventually prepared and sent Hall a first draft of the parties' agreement. The cover letter explained that the royalty rate in Article 6.01 of the agreement[5] had been left blank. Kiley indicated that "[Swanson] has taken your proposal of [a] 2% flat rate under advisement" and that "[t]he agreement is in accordance with various points raised in [Swanson's] presentation to City of Hope and in discussions with you, save for the business of the royalty rate."

Kiley's cover letter for the second draft informed Hall, inter alia, "In Article 6.01 I have provided for sales by Genentech affiliates. That term is defined in new Article 6.10.[6] Articles 6.06 and 6.07 have been revised accordingly, with the result that the City of Hope royalty base in the case of a particular transaction will be the greater of Genentech's net sales or its affiliate's net sales." Also, Kiley wrote: "Both [Swanson] and I have indicated that the 2% flat royalty rate you proposed would likely prove acceptable assuming that no substantive deviations from the original draft were demanded by the City of Hope. Because we do not view the amendments incorporated in the new draft at your request as substantially diminishing Genentech's rights, I have inserted the 2% royalty in Article 6.01."

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5 Future references to Articles are to the Articles in the agreement.

6 Article 6.10 became Article 6.09 in the final version of the agreement.

Finally, after a third revision, the parties signed the agreement.

The agreement stated that Genentech proposed to "engage in the manufacture and sale of certain polypeptides" and "requires synthetic DNA[7] which codes for the production of a particular polypeptide when incorporated in a bacterial or other plasmid." Corollary to that, it stated: "For its part, CITY OF HOPE wishes to conduct DNA synthesis and related work with GENENTECH funding, to publish the results of such work, and to earn royalty income from GENENTECH sales of polypeptides in whose manufacture synthetic DNA is employed." Genentech was to "solely and exclusively own such patent or other proprietary property as emerges from the work performed by CITY OF HOPE under this agreement."

Article 5.03 provided that Genentech could, "at its sole option, elect to make application for United States and/or foreign letters patent on" on the technology generated by Riggs and Itakura.

City of Hope's right to payment of royalties was set forth in Article 6 and Article 7.

Pursuant to the terms of Article 6.01, City of Hope was entitled to receive "a royalty of two percent (2%) of the net sales of all polypeptides sold by [Genentech] or its affiliates, provided only that manufacture of the polypeptide employs DNA synthesized by CITY OF HOPE under this agreement and provided to GENENTECH by CITY OF HOPE."[8]

Next, Article 6.02 established that for the first five years of the agreement "GENENTECH will pay to CITY OF HOPE the royalty provided for in Article 6.01 hereof regardless of whether GENENTECH has secured one or more patents on Developments. Thereafter, GENENTECH's royalty obligations under Article 6.01 shall

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7 DNA stands for deoxyribonucleic acid. (Merriam-Webster's Collegiate Dict. (10th ed. 1999) pp. 310, 340.)

8 The dependent modifying clause that ends the quoted language from Article 6.01 shall be referred to as the DNA use requirement.

be limited to the payment of royalty only in respect to such manufacture, use or sale which would infringe the claims of an issued GENENTECH patent . . . but for GENENTECH's ownership of the patent."[9]

Article 6.05 defined "net sales" as "the monies actually received by GENENTECH or its affiliates . . . as a result of the sale of polypeptides, less any transportation charges, customary and reasonable discounts and commissions, returns, sales or excise taxes and duties imposed on and paid by the seller."

Under Article 6.08: "Should GENENTECH license any third party under any patent acquired by it hereunder, then GENENTECH shall secure from that party and pay to CITY OF HOPE the same royalty CITY OF HOPE would have received had GENENTECH itself carried out the licensed activity."

Article 7.02 added that "[s]hould GENENTECH recover from any infringer, whether by way of settlement or judgment, damages or profits for infringement of any patent secured by it under this Agreement, then after deduction from such recovery of GENENTECH's reasonable expenses in effecting the same, the balance shall be treated as net sales of GENENTECH for royalty purposes."

Genentech interprets the agreement to mean that royalties are not due on any sales by licensees unless both the DNA use requirement and patent infringement requirement are satisfied

On August 28, 1980, Swanson sent a letter to City of Hope's executive director that stated: "Our agreement of August 1976 currently calls for Genentech to pay City of Hope a two percent royalty on net sales by it *or its licensees* on polypeptide products: [¶] 1. The manufacture of which employs DNA synthesized by City of Hope under the Agreement or replications of that DNA; and [¶] 2. Which following five years from signing of the Agreement are covered by one or more patents accruing from Genentech's funding of research at City of Hope." Swanson proposed that Genentech pay City of

[9] The dependent modifying clause that ends the quoted language from Article 6.02 shall be referred to as the patent infringement requirement.

Hope $400,000 in exchange for reducing the royalty obligation to one percent and delaying it to 1985.

City of Hope rejected Swanson's offer.

In a prospectus for its initial public offering, Genentech wrote, inter alia: "Genentech has agreed to pay [City of Hope] royalties on sales of human insulin, human growth hormone and somatostatin, when made by it or its licensees. After August 1981, [Genentech's] royalty obligation to the City of Hope is contingent upon the existence of one or more patents arising from the funded research which would, but for Genentech's ownership of the patent(s), be infringed by the activities underlying the royalty payment."

On June 7, 1982, Genentech wrote City of Hope regarding DNA fragments created by Itakura. According to the letter, Genentech's scientists "decided some time ago not to use any of the fragments prepared by [Itakura] to assemble a gene coding for any polypeptide. Rather, our scientists determined to independently synthesize such fragments at Genentech. Because any organism we might develop to express IGF[10] will not employ DNA made by [Itakura], no payments will be due from Genentech to the City of Hope from any sales of IGF."

This interpretation went unchallenged by City of Hope until the mid-1990's.[11]

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10 Insulin growth factor.

11 City of Hope's position, both at trial and on appeal, is that it was unaware of Genentech's interpretation until a dispute arose with respect to a settlement between Genentech and Eli Lilly and Company (Eli Lilly) in the 1990's. Regarding the August 28, 1980 letter, which was purportedly drafted by Kiley but signed by Swanson, counsel for City of Hope told the jury: "Genentech's lawyer argued to you . . . [that Kiley] wrote words that were taken directly from Article 6.01 and placed in a letter for everybody to see. [¶] Let's take a look at what [Kiley] did there. He wrote, 'Net sales by it or its licensees.' He switched the word 'affiliates' that actually does appear in Article 6.01, took that out, slipped in 'licensees.' [¶] Maybe by 1980 that is the deal he wished he had written."

City of Hope unsuccessfully attempts to obtain information about all of the licenses granted by Genentech, not just those that would meet the DNA use requirement and the patent infringement requirement

On October 24, 1986, Dr. Eric R. Jurrus (Jurrus) of City of Hope wrote to Kiley and requested, among other information, "a list of companies Genentech has third party licenses with which relate to methods of genetic engineering or DNA provided to Genentech by the City of Hope."

Instead of providing a list of Genentech's licenses, Kiley arranged a meeting and spoke to Jurrus and Ed Irons (Irons), an attorney representing City of Hope's interests, on November 19, 1986.[12]

Following their meeting, Irons wrote three times requesting unspecified documentation Kiley promised to produce. In two of those letters, Irons also asked for information about the application for Riggs and Itakura United States Patent No. 4,704,362 (patent 362). Kiley supplied nothing. Eventually Irons made a trip to Genentech in South San Francisco to review Genentech's files. Kiley asked Walter Buting (Buting), a patent attorney employed by Genentech, to show Irons files from the patent application he was interested in, and any documents that might be relevant to the agreement, but not unrelated third party licenses.

In November 1988, Jurrus wrote to David Kiszkiss of Genentech and inquired about patent 362. Jurrus wanted to know what licensing efforts had been made as to patent 362 by Genentech. Buting responded and explained that Genentech had decided to freely grant licenses for patent 362 at a nominal rate. Still, Buting did not specify whether any licenses had in fact been granted.

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12 In his deposition, Kiley testified that no substantive discussions took place during this meeting, instead saying that he and Jurrus and Irons were "just killing time." Kiley took a different position at trial. He testified that he relayed Genentech's interpretation of the agreement to Irons.

Genentech pays royalties on some sales but not others

Genentech obtained 11 United States patents and over a 100 foreign patents with Riggs and Itakura named as the inventors.

By practicing the Riggs-Itakura patents, Genentech was able to manufacture human growth hormone and generate $2.9 billion in sales. Also, Genentech received millions of dollars from licensing the Riggs-Itakura patents to third parties, including but not limited to: Eli Lilly, KabiGen, Hoffman-La Roche, Monsanto, Boehringer-Ingelheim, Mitsubishi Chemical Industries (Mitsubishi), SmithKline Beechum (SmithKline), Cambridge Biotech, Chiron, Delca Biotechnology, E. Merck, Life Technologies, Repligen, Research and Diagnostic Systems, Sandoz, Seragen, Shionogi, Sunnery, Takeda Chemical Industries (Takeda), and Wyeth-Ayerst.

City of Hope received $72 million under Article 6.02 from Genentech's sales of human growth hormone. Also, pursuant to Article 6.08, City of Hope received $133 million from Eli Lilly's licensed sales and $97 million from KabiGen's licensed sales. However, City of Hope never received royalties with respect to any of the other licenses.

Genentech settles a dispute with Schering Corporation

Schering Corporation (Schering) sued Genentech to void patent 362, one of Genentech's most valuable patents. The parties settled in 1993. Schering agreed to refrain from trying to invalidate patent 362 and to pay Genentech $19 million over four years. In exchange, Genentech agreed to grant Schering a license to certain Riggs-Itakura patents.

The parties' competing interpretations of the agreement come to a head

Genentech, with assistance from City of Hope, sued Eli Lilly for patent infringement with respect to unlicensed sales of human growth hormone. Eli Lilly tried to defend itself by challenging the validity of the Riggs-Itakura patents. In late 1994, in the midst of trial, Genentech and Eli Lilly settled their differences. Eli Lilly agreed to pay approximately $145 million. Also, in exchange for a license from Genentech, Eli Lilly agreed to pay a royalty on its sales of human growth hormone.

City of Hope requested a share of the $145 million settlement pursuant to Article 7.02. Beyond that, it requested a royalty from Eli Lilly's future sales under Article 6.08. Genentech offered to pay City of Hope a lump sum of $2 million and a royalty of one and one-half percent with respect to future sales. Then, during a video conference between the parties, Genentech changed its position. It stated that it had been informed that Eli Lilly was not using City of Hope DNA in the manufacture of human growth hormone and that, as a result, City of Hope was not entitled to share in any part of the settlement. In response, City of Hope took the position that the DNA use requirement did not apply.

Subsequently, in June 1995, the parties settled; Genentech agreed to pay City of Hope $3 million and a royalty of one and three-fourths percent on Eli Lilly's future sales (the 1995 settlement agreement).

The Novo Nordisk litigation

Genentech sued Novo Nordisk[13] for infringing the Riggs-Itakura patents. In 1998, the parties entered into a settlement which required Novo Nordisk to pay $20 million. Further, the parties agreed to grant each other cross-licenses to sell human growth hormone. After deducting expenses, City of Hope's two percent share would have been $181,817. Despite a demand by City of Hope under Article 7.02, Genentech refused to share any part of the settlement.

City of Hope threatened to sue. So that they could engage in discussions over their dispute, the parties entered into an agreement to toll the statute of limitations on any claims City of Hope might have under the agreement. Despite their discussions, the parties were unable to reach a settlement.

This lawsuit

The pleadings

Believing it had been wrongfully deprived of royalties from various licenses and the Novo Nordisk settlement, City of Hope sued Genentech for declaratory relief, breach

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[13] Collectively, Novo Nordisk refers to Novo Nordisk A/S, Novo Nordisk of North America, Inc., Novo Nordisk Pharmaceuticals, Inc. and Zymogenetics, Inc.

of contract, breach of the implied covenant of good faith and breach of fiduciary duty. City of Hope sought compensatory and punitive damages. In an affirmative defense, Genentech alleged that City of Hope's claims were time-barred by the "applicable" statutes of limitation.

The trial

The first trial ended when the jury deadlocked seven-to-five. The matter was reset and tried again. Regarding breach of contract, Genentech tried to demonstrate that it did not owe City of Hope any royalties. To do so, Genentech elicited testimony and offered evidence showing that the DNA use requirement and patent infringement requirement are part of the royalty base for the entire agreement, including Article 6.08 and Article 7.02, and that the licensee sales and patent infringement settlements at issue in the lawsuit did not meet those requirements. In contrast, City of Hope endeavored to show that the DNA use requirement and patent infringement requirement did not apply to Article 6.08 and Article 7.02.

City of Hope's expert, Brian Brunsvold (Brunsvold), explained the basics for understanding royalty payments for patents. A royalty payment, he stated, is calculated by multiplying the royalty rate by the royalty base. The royalty rate is frequently expressed as a percentage and the royalty base refers to the products or activity that qualify for earning a royalty payment. Parties to a license agreement typically negotiate over both the royalty rate and the royalty base. According to Brunsvold: "[I]t is frequently the case that the parties will negotiate and determine that the issues of infringement are so complex and difficult that the licensee will pay basically on all its sales and usually they then -- the licensee then negotiates a lower rate."

Closing argument

In closing argument, City of Hope advanced its interpretation of the agreement thusly: There are three ways Genentech can use a Riggs-Itakura patent under the agreement: (1) by using a Riggs-Itakura patent to make its own products, which is governed by Article 6.01 and Article 6.02; (2) by licensing a Riggs-Itakura patent to a third party, which is governed by Article 6.08; and (3) by filing a lawsuit under a Riggs-

Itakura patent and then recovering money by judgment or settlement, which is governed by Article 7.02. The DNA use requirement and patent infringement requirement in Article 6.01 and Article 6.02 do not apply to the royalty provisions in Article 6.08 and Article 7.02. The term "same royalty" in Article 6.08 refers to the royalty rate. Kiley used that term in the first draft of the agreement to refer back to the royalty rate that had been temporarily left blank in Article 6.01. He carried that term over to the final agreement.

When Genentech closed, it took its turn interpreting the agreement. Genentech told the jury: The agreement requires DNA use and patent use before royalties are due. All the same rules apply to sales by licensees. Article 6.08 does not establish the parameters of its royalty obligation. Therefore, the only way to understand the royalty obligation is to look to see what royalty would have accrued if Genentech itself had been the one to sell the products.

In rebuttal, City of Hope averred: The royalty obligation under Article 6.08 is clear. "Hoffman La Roche is licensed to sell interferon, so it is [two] percent royalty on their interferon. [¶] Schering is licensed to sell interferon. [Two] percent royalty on their interferon. [¶] Monsanto is licensed to sell bovine growth hormone. [Two] percent royalty on bovine growth hormone." Even if same royalty means royalty rate times royalty base, Article 6.08 still would not incorporate all the terms and conditions of Article 6.01 and Article 6.02. Instead, it would simply be two percent of the net sales of Genentech's licensees.

The verdict, the judgment and this appeal

The jury was instructed to interpret the contract. Also, it was told: "A fiduciary relationship arises when a person entrusts a secret idea or device to another under an arrangement whereby the other party agrees to develop, patent and commercially exploit the idea in return for royalties."[14] By way of a general verdict, the jury found that Genentech breached the agreement and its fiduciary duty. The jury awarded

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14 This instruction comes out of *Stevens*.

$300,164,030 in compensatory damages and found that Genentech had acted with fraud or malice. In the punitive damages phase of trial, the jury awarded $200 million.

Judgment was entered.

Among other posttrial relief, Genentech sought a new trial on the following grounds: (1) the postverdict interviews with the jury revealed that (a) the verdict was the result of a compromise, and (b) the jurors improperly relied on news articles that were not admitted into evidence; (2) the punitive damages award was excessive; (3) there was insufficient evidence of fraud or malice; (4) there was insufficient evidence to justify the compensatory damages award because the jury's interpretation of the agreement was unreasonable and it awarded a two percent royalty based on (a) sales of third party products on which Genentech only received a half percent royalty, and (b) sales of third party products[15] for which Genentech never received a penny; and (5) it was prejudicial error for the trial court to decline to instruct the jury (a) on the meaning of the agreement, and (b) that it could not award punitive damages if Genentech's contract interpretation was reasonable and held in good faith. The trial court denied Genentech's motion.

This appeal followed.

Upon application, we allowed the Chamber of Commerce of the United States, the California Chamber of Commerce, TechNet, Intel Corporation, National Chamber Litigation Center, Inc. and Xilinx, Inc. (the amicus parties) to appear as amici curiae to argue in favor of Genentech regarding fiduciary duty.

DISCUSSION

I.

Breach of Contract

This case calls upon us to decide whether to uphold the jury's implied adoption of City of Hope's interpretation of the agreement. After setting forth the rules of interpretation and the standard of review, we will explain why the agreement is

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15 Specifically, Genentech referred to sales covered by licenses granted to Novo Nordisk, Schering, SmithKline, and Monsanto.

susceptible to City of Hope's interpretation, why the trial court properly submitted interpretation to the jury as to the majority of issues, and why City of Hope's interpretation is reasonable. On the one item related to Article 7.02 that was a pure legal issue, we explain that the jury's interpretation was nonetheless correct and must be affirmed.

A. The rules of interpretation.

When reviewing a contract, a trial court must consider all relevant evidence offered to prove the parties' intent. (*Pacific Gas & E. Co. v. G.W. Thomas Drayage Etc. Co.* (1968) 69 Cal.2d 33, 39-40.) "Such evidence includes testimony as to the 'circumstances surrounding the making of the agreement . . . including the object, nature and subject matter of the writing . . . ' so that the court can 'place itself in the same situation in which the parties found themselves at the time of contracting.' [Citations.]" (*Id*. at p. 40.) It devolves upon the trial court to determine whether "the language of a contract, in the light of all the circumstances, 'is fairly susceptible of either one of the two interpretations contended for . . . ' [Citations.]" (*Ibid*.) "The test of admissibility of extrinsic evidence to explain the meaning of a written instrument is not whether it appears to the court to be plain and unambiguous on its face, but whether the offered evidence is relevant to prove a meaning to which the language of the instrument is reasonably susceptible. [Citations.]" (*Id*. at p. 37.) If the language is in fact fairly susceptible to two interpretations, then the evidence must be admitted for purposes of interpreting the contract. (*Id.* at p. 40.) When litigants present conflicting extrinsic evidence regarding an ambiguous term, the trial court is presented with a fork in the road. The trial court can "require the jury to make special findings on the disputed issues and then base . . . interpretation of the contract on those findings" (*Medical Operations Management, Inc. v. National Health Laboratories, Inc.* (1986) 176 Cal.App.3d 886, 892, fn. 4 (*Medical Operations*)), or it can submit interpretation of the ambiguous term to the jury. (*Horsemen's Benevolent & Protective Assn. v. Valley Racing Assn.* (1992) 4 Cal.App.4th 1538, 1562 [the trial court did not err in submitting interpretation of an ambiguous term to the jury].)

B. The standard of review.

The following parameters apply on appeal: An appellate court is required to analyze a contract "de novo where '(a) the trial court's contractual interpretation is based solely upon the terms of the written instrument without the aid of extrinsic evidence; (b) there is no conflict in the properly admitted extrinsic evidence; or (c) the trial court's determination was made on the basis of improperly admitted incompetent evidence. [Citation.]' [Citations.]" (*Warburton/Buttner v. Superior Court* (2002) 103 Cal.App.4th 1170, 1180.) However, if the interpretation of an ambiguous provision turns upon the credibility of conflicting extrinsic evidence, an appellate court must determine whether the interpretation is supported by substantial evidence and then uphold that interpretation if it is reasonable. (*Ibid.*) Significantly, there is no conflict in extrinsic evidence when the facts are undisputed but merely give rise to conflicting inferences. (See *Medical Operations*, *supra*, 176 Cal.App.3d at p. 891, citing *Parsons v. Bristol Development Co.* (1965) 62 Cal.2d 861, 866, fn. 2 (*Parsons*) ["it is only when conflicting inferences arise from conflicting evidence, not from uncontroverted evidence, that the trial court's resolution is binding"].)

C. The jury's interpretation of Article 6.08 was supported by substantial evidence and was reasonable.

Genentech contends that (1) interpretation of the agreement is a question of law that should never have been submitted to the jury; (2) the interpretation must be reviewed de novo on appeal because there were no conflicts in the material extrinsic evidence; (3) when the agreement is interpreted as a question of law, it is clear that Genentech is required to pay royalties only on those licensee products that met the patent infringement requirement and DNA use requirement;[16] and (4) even if there were material conflicts in

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16 In its reply brief, Genentech contends that we can decide this appeal in its favor by limiting our analysis to the patent infringement requirement. But because we conclude that the patent infringement requirement does not apply to Article 6.08, we also analyze the DNA use requirement.

the extrinsic evidence, no reasonable person could conclude that City of Hope's interpretation was correct.

These contentions lack merit.

One preliminary point.

In its closing argument, City of Hope told the jury that "same royalty" refers to the two percent royalty rate that applies throughout the agreement. Alternatively, City of Hope told the jury that it could interpret "same royalty" to mean the royalty rate of two percent multiplied by the royalty base of "net sales," by which it meant net sales of a licensed product. Because the jury rendered a general verdict, whether it accepted either of these interpretations or developed one of its own is unknowable. All we can surmise with any degree of certainty is that the jury rejected Genentech's interpretation and found that the DNA use requirement and patent infringement requirement do not apply to Article 6.08.

It is axiomatic that a general verdict "imports findings in favor of the prevailing party on all material issues [citations]," and "if the evidence supports implied findings on any set of issues which will sustain the verdict," then it must "be assumed that the jury so found [citation]." (*Thomson v. Casaudoumecq* (1962) 205 Cal.App.2d 549, 555.) As a result, "the court on appeal does not have to speculate on what particular ground the jury may have found in favor of the prevailing party [citation]." (*Ibid*; see also *Codekas v. Dyna-Lift Co.* (1975) 48 Cal.App.3d 20, 24 ["A general verdict implies a finding in favor of the prevailing party of every fact essential to the support of his action; all inferences and intendments favor such a verdict"].)

These considerations delineate our path. We must query whether the evidence supports the position City of Hope has chosen to defend. If it does, we will adopt it as the jury's implied finding.

1. *Even in the absence of extrinsic evidence, Article 6.08 is ambiguous as to the applicable royalty base.*

Trying to understand the agreement's imprecise royalty provisions is like trying to walk across shifting sands. Each step is unsteady.

Article 6.01 establishes the royalty rate and royalty base applicable to the sales of Genentech and its affiliates in an independent clause, which is: "GENENTECH shall pay to CITY OF HOPE a royalty of two percent (2 %) of the net sales of all polypeptides sold by it or its affiliates." The DNA use requirement follows in a modifying dependent clause which states: "provided only that manufacture of the polypeptide employs DNA synthesized by CITY OF HOPE." The phrase "provided only" works to add a condition to the payment obligation.

Article 6.02 establishes that for five years "GENENTECH will pay to CITY OF HOPE the royalty provided for in Article 6.01." In this context, "royalty" encompasses the royalty base as modified by the DNA use requirement. Next, Article 6.02 states that thereafter, "GENENTECH's royalty obligations under Article 6.01 shall be limited to the payment of royalty only in respect to such manufacture, use or sale which would infringe the claims of an issued GENENTECH patent . . . , but for GENENTECH's ownership of the patent." This language is confusing. The word "limited" is a modifier. When Article 6.02 provides that the royalty obligation "shall be limited to the payment of royalty only in respect to," the word "only" suggests that there can only be one modifying dependent clause. In other words, it suggests that the modifying dependent clause in Article 6.01 is being replaced by a new modifying dependent clause. If both the DNA use requirement modifying clause and the patent infringement requirement modifying clause applied, then the royalty base would be modified by two clauses that say "only," but that would render those words meaningless because the word "only" would be false.

Article 6.05 adds to the confusion. It defines "net sales" as amounts from sales received by Genentech and its affiliates, but it does not include the DNA use requirement or the patent infringement requirement.

In our view, the interplay of Article 6.01, Article 6.02 and Article 6.05 suggests three ways to interpret the royalty base after five years. It could mean: (1) net sales of polypeptides that meet the DNA use requirement and the patent infringement requirement; (2) net sales of polypeptides that meet the patent infringement requirement;

or (3) net sales of polypeptides, with the proviso that this royalty base is subject to modifiers in different provisions.

Into the mix come Article 6.08 and Article 7.02.

Article 7.02 provides that proceeds from a patent infringement action "shall be treated as net sales of GENENTECH for royalty purposes." Article 7.02 does not reference Article 6.01 or Article 6.02 and the definition of net sales does not include the DNA use requirement nor the patent infringement requirement. This suggests that the royalty base is net sales of polypeptides. Then Article 6.08 refers to "the same royalty CITY OF HOPE would have received had GENENTECH itself carried out the licensed activity." But given the ambiguity with respect to the royalty base throughout the agreement, the meaning of Article 6.08 is murky. The phrase "the same royalty" could refer to a royalty payment subject to the DNA use requirement and patent infringement requirement, but that ignores the problem of the word "only" occurring twice if the two modifying dependent clauses are incorporated. It also ignores that the DNA use requirement and patent infringement requirement were not expressly referenced in Article 6.08. Finally, as a practical matter, there was no reason for the parties to create Article 6.08 unless it had different modifiers than Article 6.01 and Article 6.02. Otherwise, they could have been made expressly applicable to licensee sales.

2. *Article 6.08 is reasonably susceptible to the parties' competing interpretations*.

City of Hope argued below that the royalty base for Article 6.08 was the net sales of the products listed in licenses of the Riggs-Itakura patents. Genentech, for its part, attacked that theory as illogical. It claimed that Article 6.08 plainly means that no royalties are due on any sales unless and until the DNA use requirement and patent infringement requirement are met. Both sides offered extrinsic evidence in support of their respective positions. In its role as the gate keeper, the trial court was required to admit the parties' extrinsic evidence unless the agreement was "so clear that reasonable minds [could not] differ as to its interpretation, and that it mean[t] only one thing." (*Denver D. Darling, Inc. v. Controlled Environments Construction, Inc.* (2001) 89 Cal.App.4th 1221, 1235.)

Here, the extrinsic evidence heightened the ambiguities that exist in the text of Article 6.08. Also, the extrinsic evidence introduced the possibility that "same royalty" refers to the royalty rate instead of the royalty payment, which would be the sum of the royalty rate multiplied by the royalty base. As we shall demonstrate, reasonable minds could differ as to its interpretation.

We note that Genentech concedes that the admission of extrinsic evidence was proper. In its opening appellate brief, Genentech stated: "For purposes of this appeal, we assume that the trial court properly allowed the parties to present extrinsic evidence bearing on the [agreement's] meaning." Then, in a footnote in its reply brief, Genentech averred: "Genentech hasn't challenged the admission of extrinsic evidence. Indeed, both sides presented such evidence, and both sides quite properly cite it in their briefs. [¶] Nor does this portion of Genentech's appeal contend that 'no ambiguity exists' . . . in Article 6.08. In other words, we assume *arguendo* that Article 6.08 is capable of being read as [City of Hope] advocates."

Despite Genentech's concession, this issue is part and parcel of our analysis and we explain in detail why the agreement is susceptible to competing interpretations.

a. <u>Evidence suggesting "the same royalty" refers to the royalty rate</u>.

City of Hope contends that when Kiley wrote "the same royalty," he was using shorthand to incorporate the yet to be determined royalty rate into Article 6.08. In line with the strictures of Code of Civil Procedure section 1861, it was permissible for City of Hope to build a case establishing that "the same royalty" had a "peculiar signification" and was used and understood in that manner.[17] To support its case, City of Hope drew inferences from Brunsvold's testimony, Kiley's cover letter to the second draft of the agreement, and Hall's testimony.

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17 Code of Civil Procedure section 1861 provides: "The terms of a writing are presumed to have been used in their primary and general acceptation, but evidence is nevertheless admissible that they have a local, technical, or otherwise peculiar signification, and were so used and understood in the particular instance, in which case the agreement must be construed accordingly."

By way of Brunsvold, City of Hope showed that "royalty" can have more than one meaning. Brunsvold testified that the "meaning depends on the context in which the term 'royalty' is used."

Next, City of Hope adverted to the agreement's drafting history. Kiley left the royalty rate blank in Article 6.01 in his first draft of the agreement. Nowhere else did the first draft refer to a royalty rate for Genentech's sales, and nowhere else did it provide a blank for the royalty rate. Subsequently, in his second draft of the agreement, Kiley inserted a royalty rate of two percent into Article 6.01. His accompanying cover letter stated that the "2% flat royalty rate" would likely be acceptable, so he "inserted the 2% royalty in Article 6.01."

That Kiley referred to the royalty rate as a "royalty rate" and a "royalty" in the same paragraph demonstrated that he used the terms interchangeably. When, in the agreement, he referred to "the same royalty," it is conceivable that Kiley was referring to the yet to be determined royalty rate. If, as shown by City of Hope's extrinsic evidence, which we discuss in part I.C.2.b., *post*, the parties did not intend the DNA use requirement and patent infringement requirement to apply to Article 6.08, then a reasonable person could conclude that Kiley meant royalty rate when he wrote "the same royalty." This conclusion can be reached in the following manner: If "the same royalty" means the royalty payment City of Hope would have received had Genentech sold polypeptides, and if the royalty payment was modified by both the patent infringement requirement and also the DNA use requirement, then the DNA use requirement and patent infringement requirement would be incorporated into Article 6.08 in contradiction to the parties' intent. The only way to avoid this dilemma is to recognize that "the same royalty" means royalty rate.

When viewed in a cursory manner, this interpretation leaves Article 6.08 without a royalty base. But that is not so. Even though Article 6.08 does not specifically apply "the same royalty" to the sales of products listed in a license of a Riggs-Itakura patent, that fact can be garnered from reading the agreement as a whole. Article 1.03 ("GENENTECH proposes to engage in the manufacture and sale of certain polypeptides”), Article 1.04 (“CITY OF HOPE . . . wishes . . . to earn royalty income from GENENTECH sales of polypeptides”), Article 6.01 (“GENENTECH shall pay to CITY OF HOPE a royalty of two percent (2%) of the net sales”), Article 6.05 (defining net sales), Article 6.06 (referring to “polypeptides sold”), Article 6.07 (referring to “sale of any quantity of polypeptide”), and Article 7.02 (litigation proceeds to be treated as “net sales of GENENTECH for royalty purposes”) each amply demonstrate that all of City of Hope’s royalties are founded on net sales of polypeptides. Article 6.08 refers to “licensed activity,” which is a reference to the manufacture and sale of the specific polypeptides listed. When these two concepts are coupled, it is permissible to construe the royalty base in Article 6.08 as the net sale of polypeptides identified in a license.

b. Evidence suggesting that the parties *did not* intend to incorporate the DNA use requirement nor the patent infringement requirement into the royalty base applicable to Article 6.08.

Though Article 6.08 is the antithesis of clarity, City of Hope took the stance below that the jury would find the provision logical and simple once it heard City of Hope’s version of the negotiations. To prove the meaning of a contract, “evidence of the negotiations of the parties . . . [is] admissible.” (See *Mayers v. Loew’s, Inc.* (1950) 35 Cal.2d 822, 829.) In harmony with this rule, City of Hope put on evidence of the correspondence between the parties and the negotiations that Hall had with both Swanson and Kiley. Also, City of Hope offered the testimony of Brunsvold regarding the impracticality of Genentech’s interpretation.

We begin with the evidence suggesting that Article 6.01, and hence the DNA use requirement, pertained to a temporally limited extra royalty obligation.

Hall’s summary of points for agreement provided for royalties on all sales by Genentech, its affiliates and its licensees of products resulting from the research conducted by City of Hope. Products resulting from City of Hope’s research is a much broader category of products than only those which employ City of Hope’s DNA. It can be inferred that Hall, Kiley and Swanson had this broad royalty base in mind when the parties met on June 30, 1976.

Regarding the parties' meeting, Hall averred: He informed Kiley and Swanson that City of Hope should get paid during the time before Genentech secured patents. To that end, Hall proposed that Genentech pay an additional royalty. What the royalty base would be for the additional royalty was left open. Genentech, for its part, wanted to cut off this additional royalty obligation after a certain period of time if it did not obtain any patents.

At trial, Hall was aware that according to Kiley, the parties discussed basing royalties on DNA synthesized by City of Hope. Hall unequivocally testified that no such discussion took place.

On a more general note, Hall testified he had negotiated dozens of patent agreements by 1976 and that it was common practice to base royalties on patents. He had never encountered "such a restriction on a patent royalty as a DNA-use requirement."

Hall's testimony suggests that Article 6.01 was Kiley's response to the request for a pre-patent royalty obligation in order to protect City of Hope during the initial years of the agreement. This is further supported by the fact that the parties never discussed a DNA use requirement for patent royalties -- not in Swanson's letters, not in Kiley's letters, not in Hall's summary of points for agreement, not at the June 30, 1997 meeting, and not in later discussions. Also, it is inferable that the parties followed the common practice of basing royalties on patents.

This brings us to the evidence which supports the argument that the patent infringement requirement is limited to Article 6.02.

The initial negotiations set the stage for everything that was to follow. According to Hall, he spoke to Swanson about requiring Genentech to pay a royalty for use of the patents. The use that Hall referred to "was the use by Genentech in making its own products under the patents, and also licensing the patents to third parties." In a later letter, Swanson wrote Hall and explained that the University of California's schedule of support and patent privileges was the guideline for Genentech's proposal. Under that schedule, the holder of a license is obligated to pay royalties on its license as well as any sublicenses it may grant. From the preceding it can be gleaned that the parties had in mind different royalty bases for sales by Genentech and its affiliates on one hand, and by licensees on the other. For a royalty obligation to flow from Genentech and its affiliates, they actually had to practice a patent, i.e., engage in conduct that would infringe upon the patent if it was not owned by Genentech. In contrast, because the act of licensing was a use regardless of whether a patent was practiced, the parties intended for all licensed sales to generate royalties.

As Hall testified, nothing about the parties' positions changed at the June 30, 1976 meeting. There was no discussion of a patent infringement requirement shrinking City of Hope's royalties after five years. He was adamant that the negotiators did not discuss applying the same rules to Genentech and licensees. Specifically, there was no mention of licensees standing in Genentech's shoes for royalty purposes. Rather, Hall said that he, Kiley and Swanson talked about basing royalties on patents. This simply preserved the different royalty bases flowing from different uses.

The parties' subsequent negotiations were along the same lines. Hall explained that even after he reviewed Kiley's drafts of the agreement, the two of them continued to discuss basing royalties on patents. In his July 28, 1976 letter to Hall, Kiley wrote that Article 6.01 had been revised to include Genentech's affiliates, "with the result that the City of Hope royalty base in the case of a particular transaction will be the greater of Genentech's net sales or its affiliate's net sales." He could have also included licensees in Article 6.01, but he did not.

Brunsvold suggested why it would be impractical for the patent infringement requirement to apply to Article 6.08. He testified that it is difficult and time consuming to prove patent infringement. In particular, it is very difficult to prove infringement of a patented process. While a party can obtain a product and examine it to determine whether it has infringed on a product patent, it is not possible to get inside a manufacturing plant to examine whether a company is infringing on a manufacturing process. Importantly, the Riggs-Itakura patents cover manufacturing processes.

Hall's testimony that licensing was considered a use, and Brunsvold's testimony regarding proof of patent infringement, suggest that the parties did not intend for the patent infringement requirement to apply to Article 6.08. The granting of a license -- regardless of whether a Riggs-Itakura patent is ever practiced -- is a grant of a legal right. It is inferable from Hall's testimony that City of Hope wanted to be remunerated for that grant. Moreover, in the absence of any discussions to the contrary, it can be surmised that the parties did not want to afflict City of Hope with potentially costly disputes over the patent infringement requirement.

c. <u>Evidence suggesting that the parties *did* intend to incorporate the DNA use requirement and patent infringement requirement into the royalty base applicable to Article 6.08</u>.

Below, Genentech was bent on proving that royalties on licensee sales were subject to the DNA use requirement and patent infringement requirement. To do so, like its adversary, Genentech offered documents and testimony regarding the negotiating and drafting history of the agreement.

One of Genentech's themes at trial was that the same rules apply whether a sale is by it or one of its licensees. For example, Hall's summary of points made no distinction between royalties based on Genentech sales and licensee sales. Additionally, Kiley testified: Hall and he never discussed a business reason to treat licensees differently than Genentech. At the June 30, 1976 meeting, the parties said that licensees would stand in Genentech's shoes for royalty purposes and pay the "[s]ame 2 percent of synthetic DNA." In fact, according to Kiley, it was Hall's proposition that "the same royalty would apply, the same rules would apply, no matter whether it was Genentech or someone to whom Genentech had licensed making the sales." It was left to Kiley to "write it up." If the same rules applied, this suggests that the DNA use requirement and the patent infringement requirement apply to licensee sales.

From Kiley's vantage, Genentech hired City of Hope to synthesize DNA and that explains the structure of the deal. He testified that it was at the June 30, 1976, meeting that the negotiations took a turn. Two items in particular were in dispute: the royalty rate and the royalty base. Hall never proposed basing royalties on patents. Instead, through his points for agreement, Hall proposed using products arising from the research as the royalty base. Kiley thought this was impractical. He proposed that Genentech pay when it used DNA synthesized by City of Hope. "Since that is what we were contracting [City of Hope] to do," Kiley testified, "it seemed [to be an] appropriate basis on which to pay them."

Kiley's testimony suggests that the patent infringement requirement came about as a cumulative requirement. He averred that he proposed a "patent requirement" at the meeting. He went on to explain that either at the meeting or soon afterward, Hall and he discussed that royalties "would be paid for five years whether patents had been gotten or not. [¶] And after five years there would be an additional requirement that royalties would be paid on two conditions. [¶] First, we were making a product using DNA that was synthesized and, secondly, it was protected by a patent." He claimed he never told Hall that the "patent requirement" would replace the DNA use requirement. The "patent use requirement" was always discussed as a cumulative requirement, "[o]ne that would limit or shrink the royalty obligations, to just those situations where the products made with their DNA were protected by the patent. Or the method[s] that made those products were protected by patents."

Furthermore, Genentech relied on testimony by Brunsvold to demonstrate that if Article 6.08 had a broader royalty base than Article 6.01 and Article 6.02, then the parties would have negotiated a lower royalty rate for licensee sales. To recapitulate, Brunsvold testified that when the issues of infringement are complex, parties often agree that the licensee will pay on all of its sales, which is a total sales royalty base. However, in that instance, the licensee usually negotiates a lower rate.

Based on the foregoing evidence, it is possible the parties intended to create a deal whereby Genentech paid for the use of DNA synthesized by City of Hope because this was considered a workable royalty base. Article 6.02 is explained by the fact that Genentech did not want to keep paying for City of Hope DNA unless patents had been issued and were being used. Finally, because the parties did not negotiate a lower royalty rate for licensees sales as would be customary if there was a total sales royalty base, it can be inferred that Article 6.08 incorporates the DNA use and patent infringement requirements for sales by licensees.

The only glitch in Genentech's interpretation is the discord with the royalty base set forth in Article 7.02. However, that discord can be resolved by the language in Article 7.02 stating that litigation proceeds shall be "treated as net sales of Genentech for royalty purposes." In other words, it is not the same royalty base -- because it is illogical to presume that infringers would have DNA synthesized by City of Hope -- but it can be inferred that the parties agreed to engage in a fiction about those proceeds in order to trigger a royalty obligation.

3. *Interpretation of Article 6.08 was a question of fact because of the material conflicts in the extrinsic evidence. As a result, the trial court did not err in submitting the issue to the jury.*

Genentech's first offensive on the judgment is its claim that contract interpretation should not have been submitted to the jury because there were no outcome determinative conflicts in the extrinsic evidence. In response, City of Hope contends that the conflicts were material and profound. This issue is pivotal. If we agree with Genentech, then we must interpret the agreement de novo. If we agree with City of Hope, we must employ the substantial evidence test. The methodology of the parties is at odds, which precipitates this debate. While Genentech focuses on what was not discussed, or what went undisputed, City of Hope focuses on the disparity between Hall's view and Kiley's view of their negotiations. After turning a keen eye to this issue, we have but one choice, which is to avow the trial court.

a. <u>Genentech's position fails at its inception</u>.

In its reply brief, Genentech tells us we can decide this appeal based solely on the patent infringement requirement. While Genentech concedes that there are material conflicts regarding Article 6.01 and the purpose of the DNA use requirement, Genentech posits that those conflicts are irrelevant. Not so. Whether Article 6.01 was an additional royalty provision designed to ensure that City of Hope got paid during the pre-patent period as Hall testified, or whether it represented what City of Hope was hired to do and therefore represented the foundation for royalties on product sales as Kiley testified, impinges upon how the patent infringement requirement is interpreted. If Article 6.01 is an additional pre-patent royalty, then that means the modifying dependent clause containing the DNA use requirement is not carried over to Article 6.02, Article 6.08 or Article 7.02. If that is true, then the royalty base of net sales of polypeptides is the only constant in the royalty provisions. This makes it more plausible that the modifying dependent clause containing the patent infringement requirement is not part of the royalty base and that it only applies to Article 6.02. Logically, it becomes assumable that the structure of Article 6.01 mirrors the structure of Article 6.02 and therefore justifies the jury's interpretation.

b. <u>The conflicts in the evidence regarding the patent infringement requirement are outcome determinative</u>.

Even if we focused only on the evidence that relates to the patent infringement requirement, we would still find a material conflict that justified submission of Article 6.08 for the jury to interpret.

The stories told by Hall and Kiley were mutually exclusive regarding their negotiations. Hall testified that: (1) they never discussed applying the same rules to Genentech and licensees; (2) they never discussed a patent infringement requirement shrinking City of Hope's royalty after five years; and (3) what they did discuss was basing royalties on patents. In direct contrast, Kiley testified: (a) they discussed applying the same rules to Genentech and licensees; (b) they discussed a patent infringement requirement that would shrink City of Hope's royalties after five years; and (c) Hall never mentioned basing royalties on patents. After Hall reviewed Kiley's testimony, Hall was asked if he had changed his recollection of the events. He steadfastly stood by his own version of what transpired.

The materiality of these conflicts is manifest. Hall testified that, prior to June 30, 1976, the parties' understanding was that royalties would be based on patents and that Genentech could exploit the patents either by practicing them or licensing them. If that was true, the parties had to know that different rules would apply for determining the royalty base because the two uses were different in kind. For this reason, whether the parties subsequently discussed applying the same rules to Genentech and its licensees was significant. If they did not, we are left with the implication that the parties never changed their original understanding. Next, if the jury believed Kiley instead of Hall regarding whether there was a discussion about the same rules applying, and also about the patent infringement requirement, it could reasonably have accepted Genentech's view of the royalty base in Article 6.08. Lastly, whether Hall suggested basing royalties on patents is integral to understanding the direction of the June 30, 1976 meeting and whether Hall or Kiley was being truthful.

4. *The evidence submitted by City of Hope was substantial enough to support the jury's interpretation of Article 6.08*.

The jury, by implication from its verdict, found that the DNA use requirement and patent infringement requirement do not apply to Article 6.08. We are obligated to resolve all conflicts in the evidence in favor of the prevailing party and draw all reasonable inferences in a manner that upholds the verdict. (*Kuhn v. Department of General Services* (1994) 22 Cal.App.4th 1627, 1632-1633.) Evidence qualifies as substantial if it is "evidence of ponderable legal significance, evidence that is reasonable, credible and of solid value." (*Roddenberry v. Roddenberry* (1996) 44 Cal.App.4th 634, 651.) In passing, we note that the testimony of Hall and Brunsvold, as well as Kiley's cover letter for the second draft of the agreement, combined to create a legally sufficient bulwark for the jury's resolution of the ambiguity in Article 6.08.

5. *Genentech incorrectly contends that the jury's interpretation of Article 6.08 is unreasonable.*

"Where a contract is susceptible of two interpretations, one of which is reasonable and fair, and the other is unreasonable and unfair, the latter interpretation must be rejected and the first accepted. [Citations.]" (*Div. of Labor L. Enforce. v. Safeway Stores* (1950) 96 Cal.App.2d 481, 490.) However, if both interpretations are reasonable, then we must accept the one adopted by the jury. (See *Warburton/Buttner v. Superior Court*, *supra*, 103 Cal.App.4th at p. 1180.)

Genentech attacks City of Hope's interpretation of Article 6.08 and the phrase "the same royalty" (which, sub silentio, Genentech presumes the jury adopted) on the following theories: the interpretation (a) conflicts with California law with respect to the meaning of the word "royalty," (b) leaves the agreement without a defined royalty base for licensee sales, (c) causes "the same royalty" to conflict with the way "royalty" is used 22 other times in the agreement, and (d) produces a commercially unusual and unreasonable royalty structure.

We reject these contentions seriatim.

a. <u>There is no conflict with California law regarding the word "royalty</u>."

Relying on *Eastman Oil Etc. Corp. v. Lane-Wells Co.* (1943) 21 Cal.2d 872 (*Eastman*), Genentech contends that City of Hope's interpretation violates the presumption that, absent clear language to the contrary, it is presumed that patent licensing agreements do not provide for "total sales" royalties. Genentech's reliance on *Eastman* is flawed for several reasons.

In *Eastman*, the plaintiff entered into a license agreement to use a patented method for orienting oil wells in exchange for a percentage of the fee it charged its clients. Subsequently, the plaintiff developed its own method for oil well orientation. It sought a declaration that it need not pay a royalty when it used its own methods. (*Eastman*, *supra*, 21 Cal.2d at p. 873.) The royalty language, the appellate court admitted, "taken by itself, might be construed to require plaintiff to pay a royalty on any orienting service, whether or not the patented methods were used." (*Ibid.*) Nonetheless, the court read the language "in the light of the subject matter of the contract and the apparent intentions of the parties. [Citations.]" (*Ibid.*)

In affirming the trial court's ruling that the plaintiff did not have to pay royalties, the *Eastman* court engaged in contract interpretation. It explained that the "term royalty ordinarily envisages a duty to make and a corresponding right to receive payments proportionate to the use of patented methods or machines. [Citations.]" (*Eastman*, *supra*, 21 Cal.2d at p. 873.) Turning its attention to the license agreement, the court stated: "The contract gave plaintiff the right to use methods and devices covered by patents identified in the contract itself as 'the subject matter of this Agreement.' Presumably the schedule of payments is based on plaintiff's use of the patented methods. [Citations.] It would be an extraordinary schedule that would be based also on plaintiff's use of methods that were his own property, and the succeeding clause of the contract leads to the conclusion that no such departure from ordinary practice was intended: Licensee 'Agrees to keep a true and accurate set of books of account showing. . . . All transactions in connection with all services rendered under this license . . . And further agrees to render a true statement in writing to the licensor . . . setting forth a true statement of each service rendered hereunder. . . .' The phrases 'services rendered under this license,' and 'service rendered hereunder,' are not the equivalent of 'all orientation services;' they are limiting phrases that make it unnecessary to account for all services, and indicate that the royalty clause was not intended to apply to transactions in which plaintiff used its own methods." (*Id.* at pp. 873-874.)

In support of its position, the defendant relied "less on the language of the instrument than on the circumstances surrounding the execution of the contract." (*Eastman*, *supra*, 21 Cal.2d at p. 874.) According to the defendant, the trial court's finding that the license agreement was clear and unambiguous showed "that the evidence of the circumstances surrounding the contract was not even considered." (*Id*. at p. 875.) *Eastman* rejected this contention, noting that the extrinsic "evidence was admitted over objection, after counsel for plaintiff had argued that it should not be used in the interpretation of the contract. When counsel were about to argue its interpretation, the court emphasized its wish to have a full discussion of the negotiations preceding its execution. It is reasonable to conclude that this finding means that the court, having examined the contract in the light of all the evidence, was convinced that it was open to only one interpretation. Defendant, moreover, set forth the surrounding circumstances in detail in its first separate defense, and alleged as part of that defense that it was intended by the parties that plaintiff pay a royalty on all orientation services. The court found that the allegations of this defense, with minor exceptions, were untrue. This finding, clearly against defendant on the effect of the extrinsic evidence, is conclusive, since the evidence of surrounding circumstances was in conflict and could give rise to varying inferences. [Citations.] It is thus of no avail for defendant to assail the finding that the contract was clear and unambiguous." (*Ibid*.)

The first flaw in Genentech's position is that it misconstrues *Eastman*. Though *Eastman* did say that "[p]resumably the schedule of payments is based on plaintiff's use of the patented methods" (*Eastman*, *supra*, 21 Cal.2d at p. 874), it did not treat that presumption as a talisman which can beat back properly admissible parol evidence of a contrary meaning. Rather, the court engaged in contract interpretation. It even went to pains to explain why -- quite separate from the presumption to which Genentech points -- that the defendant's extrinsic evidence did not command a different result. The evident moral of *Eastman* is that whether a licensee must pay a royalty on its use of patented methods, or on its use of all methods it might otherwise employ, is subject to the general rules of contract interpretation.

The second and perhaps more damaging flaw in Genentech's position is that *Eastman* is distinguishable in a crucial aspect. While the license agreement in *Eastman* was between a patent owner and a licensee, the agreement between Genentech and City of Hope was not. It transferred ownership of inventions and gave the transferee the right to commercially exploit the inventions in exchange for royalties. Therefore, these two agreements are not amenable to scrutiny under the same lens. Even if *Eastman*, as Genentech suggests, had announced a talismanic presumption, it would not apply. The reason is forceful. *Eastman* stated a presumption because, unless the parties specifically agreed, it would be inequitable to require a licensee to pay for using its own property. But here, the iniquity to be countermanded is a different species. When Genentech enters into a license agreement, it can demand a total sales royalty or it can agree to base royalties on the licensee's use of a Riggs-Itakura patent. If the agreement did not recognize the possibility of a total sales royalty license, then Genentech could profit on such licenses even when City of Hope did not. There is nothing about such an arrangement that would be fair to City of Hope.

b. Article 6.08 has a sufficiently definite royalty base.

To undermine City of Hope's interpretation of Article 6.08, Genentech contends that even assuming the "licensed activity" refers to "sales," there is still no way to know whether the two percent royalty rate applies to all products sold by the licensee, only to products for which the licensee is authorized to use the Riggs-Itakura technology, or only to licensee products that actually use the Riggs-Itakura technology. Also, Genentech complains that there is no way to determine whether the two percent royalty rate applies to gross sales or "net sales."

We cannot concur.

City of Hope posits that the royalty base is a third party's net sales of products listed in a license of a Riggs-Itakura patent. This interpretation, as we have previously discussed, finds support in the appellate record. Though Article 6.08 does not expressly define the royalty base, we can look to the various clauses in the agreement to aid our understanding. (Civ. Code, § 1641.)[18] "Licensed activity" is a limiting phrase that implies that the royalty base is products for which the licensee is authorized to use a Riggs-Itakura patent. Article 6 and Article 7 amply demonstrate that the royalty rate is applied to net sales of polypeptides, as specifically modified by the different royalty provisions. Simply put, the royalty base applicable to Article 6.08 does not suffer from the infirmity that Genentech suggests.

c. The use of the word "royalty" in other parts of the agreement was not uniform and does not dictate a particular interpretation of the "the same royalty."

Continuing on in its endeavor to overturn the jury's verdict, Genentech suggests that we must interpret "royalty" to mean royalty payment because that is how it is used elsewhere in the agreement. Genentech relies on *Caminetti v. Pac. L. Ins. Co.* (1943) 22 Cal.2d 344, 358, which stated that "[w]ords used in a certain sense in one part of an

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18 Civil Code section 1641 provides: "The whole of a contract is to be taken together, so as to give effect to every part, if reasonably practicable, each clause helping to interpret the other."

instrument are deemed to have been used in the same sense in another. [Citation.]" But, akin to its argument regarding the presumption in *Eastman*, Genentech cited no law establishing that this statement in *Caminetti* trumps all the other rules of contract interpretation. Nonetheless, we examine whether City of Hope's interpretation brooks this contention.

To support its position, Genentech directs our attention to royalty references in Articles 5.11 ("non-royalty bearing"), 6.01 ("royalty of two percent (2%) of the net sales"), 6.02 ("the royalty provided for in Article 6.01"; "royalty obligations"; "payment of royalty"), 6.03 ("royalty payments"; "royalty paid"), 6.04 ("royalty at the rate of one percent (1%)"), 6.06 ("royalty payment"), 6.07 ("for which royalty is payable"; "required to pay royalties to others"; "upon which royalty to CITY OF HOPE is to be based"; "royalties to others"), 7.02 ("net sales of GENENTECH for royalty purposes"), 8.01 ("[f]or the purpose of computing the royalties to be paid to CITY OF HOPE hereunder"; "royalty payments"; "amount of royalties due"), 8.02 ("to permit the royalties payable hereunder to be determined"), 8.03 ("all information concerning royalty payments"), 10.03 ("obligation to pay royalties under this Agreement"), 13.02 ("royalty payments by GENENTECH") and 13.04 ("obligation to pay royalties").

Though the word royalty appears many times in the agreement, only once does the agreement refer to the "same royalty," which sets Article 6.08 apart. As a consequence, the use of that phrase in Article 6.08 cannot be compared to an identical use elsewhere. Also, there was specific evidence demonstrating that the parties may have intended "the same royalty" in Article 6.08 to mean royalty rate, not royalty payment. Nothing prohibited the jury from finding that the "same royalty" had a particular signification. This is bolstered by the varied manner in which the agreement utilizes the word royalty. Sometimes it refers to a royalty payment or an obligation to pay royalties. Other times it refers to royalties payable or just royalties. It was the jury's task to sort through the import of these different utilizations. The jury carried out that task in a reasonable manner given the extrinsic evidence.

d. The royalty structure is commercially sound.

Genentech paints City of Hope's interpretation of Article 6.08 as contrary to established custom. But Genentech takes untoward artistic license with this argument.

There is a presumption that parties contract pursuant to "fixed and established usage and custom of trade." (*Southern Pacific Transportation Co. v. Santa Fe Pacific Pipelines, Inc.* (1999) 74 Cal.App.4th 1232, 1241.) Latching onto this presumption, Genentech points out that, as testified by Brunsvold, a licensee will usually negotiate a lower rate for a total sales royalty. To Genentech, this is dispositive. It posits that if the agreement provides a two percent royalty on sales by Genentech that satisfy the patent infringement requirement and a two percent total sales royalty on a licensee's authorized sales, then the agreement is unreasonable because it violates the normative precepts outlined by Brunsvold.

Though Genentech skips over the consequences of its argument, we are duty bound to consider them.

To reiterate, the agreement was between an inventor and a patent holder, not between a patent holder and a patent licensee. This distinction, which is not addressed by Genentech, is not immaterial. If the patent infringement requirement applies to licensee sales, then Genentech could increase its profits and cut off City of Hope's royalty rights by granting licenses in exchange for total sales royalties. In that sense, Genentech's interpretation is unreasonable.

Moreover, we point out the following: If Genentech and a licensee both practiced a Riggs-Itakura patent, manufactured human growth hormone, and had $1 million in sales from their human growth hormone, the royalty owing to City of Hope would be $20,000 in either case. But if there was a lower royalty rate for the license, then City of Hope would receive less on the licensee's sales. The jury's interpretation is therefore reasonable because it ensures that City of Hope will receive at least the same royalty payment when a patent is practiced regardless of whether the sale was by Genentech or a licensee. Properly understood, the two percent royalty rate in Article 6.08 does double duty: it applies to licenses that impose royalties on patent use and those that impose royalties on total sales. The parties' experts shed no light on this particular wrinkle in the agreement.

Genentech complains that City of Hope was awarded royalties on licenses even though Genentech received no royalties of its own. This occurred, Genentech tells us, because those licenses only paid on patent use. On a superficial level, this seems unreasonable. But it is not. Article 6.08 obligated Genentech to secure a two percent royalty for City of Hope on the net sales of products listed in a license. Furthermore, Genentech was the master of its own destiny. It had the power to negotiate license agreements that protected City of Hope's rights. That Genentech failed to do so is no basis for calling foul. We understand that this could have hindered Genentech's ability to fashion license agreements. Licensees may have refused to accede to a two percent total sales royalty for City of Hope's benefit. Or, Genentech may have been prevented from licensing a Riggs-Itakura patent at a lower rate in order to establish its acceptance and protect it from attack.[19] However, nothing prohibited Genentech and City of Hope from agreeing, for their mutual benefit, to permit Genentech to grant a license with a lower royalty rate or a different royalty base.

D. There is no basis for reducing the compensatory damages award.

In the alternative, Genentech argues that we must reduce the judgment by $94 million attributable to two percent of licensed sales by Schering and Novo Nordisk, and by $181,817, which represents two percent of the proceeds from the Novo Nordisk settlement. Genentech reasons that: (1) the Schering and Novo Nordisk licenses do not create a royalty obligation under Article 6.08 because they were the result of a settlement; and (2) no royalty is due from the Novo Nordisk settlement funds because Novo Nordisk did not use DNA synthesized by City of Hope.

Genentech's first point is unavailing.

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[19] The parties inform us that Genentech widely licensed certain Riggs-Itakura patents at lower rates as a method of demonstrating market acceptance. This is a strategy designed to defeat patent challenges.

The parties have not adverted to any extrinsic evidence that illuminates whether Article 7.02 was intended to cover licenses granted in settlements. Therefore, we broach this issue independently.[20]

A court must give effect to the intention of the parties, so far as it is ascertainable. (Civ. Code, § 1636.) The language of the contract shall govern its interpretation if the language is clear and explicit. (Civ. Code, § 1638.) If a contract is reduced to writing, the intention of the parties is to be ascertained from the writing alone, subject to the statutory rules of construction. (Civ. Code, § 1639.) Words are to be understood in their ordinary and popular sense, unless the parties used them in a technical sense, or gave them a special meaning. (Civ. Code, § 1644.)

Article 6.08 requires Genentech to pay a royalty on the sales of third party licensees. There is no distinction between those who receive licenses in a commercial deal as opposed to in a settlement. Article 7.02 requires Genentech to treat damages or profits it receives from a patent infringement case as net sales for royalty purposes. It does not encompass licenses.

The plain meaning of these provisions establishes that the licensed sales by Schering and Novo Nordisk were covered by Article 6.08.

Genentech argues that Article 6.08 and Article 7.02 are in conflict and that therefore Article 7.02, by virtue of being the more specific provision, must control

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20 Genentech settled its patent infringement case against Eli Lilly for $145 million. When City of Hope demanded a two percent share, Genentech at first refused on the grounds that Eli Lilly was not using DNA synthesized by City of Hope. Eventually Genentech agreed to pay $3 million. According to City of Hope, this postcontract performance is relevant to prove the parties intent regarding Article 7.02. However, postcontract performance is relevant to interpretation only if it relates to actions occurring before a dispute has arisen. (*Heston v. Farmers Ins. Group* (1984) 160 Cal.App.3d 402, 413.) Moreover, even if the 1995 settlement agreement was competent extrinsic evidence, there is nothing to contradict it. Therefore, we would still interpret Article 7.02 independently.

pursuant to Code of Civil Procedure section 1859.[21] But we fail to see a conflict. Article 7.02, as we have explained, only deals with consideration Genentech receives in connection with a patent infringement action, not to licenses. In contrast, Article 6.08 is the only provision governing licenses granted by Genentech. According to Genentech, the parties could not have intended such a result. But absent extrinsic evidence demonstrating a contrary intent, we are left with plain language that only has one reasonable interpretation.

As a follow up, Genentech contends that awarding City of Hope damages based on the licensed sales of Schering and Novo Nordisk was commercially unreasonable because it punished Genentech for compromising a dispute. We are not persuaded. Genentech was punished for breaching the agreement, not for entering into settlements. To avoid being sued due to the Schering and Novo Nordisk settlements, Genentech could have asked City of Hope to waive its royalty rights. Or, Genentech could have negotiated for Schering and Novo Nordisk to pay a two percent royalty to City of Hope. As discussed before, Genentech had an array of options.

Genentech's second point also fails.

In part I.C.5., *ante*, we upheld the jury's implied finding that the DNA use requirement does not apply to Article 6.08. Impliedly, the jury reached the same conclusion as to Article 7.02. This interpretation is reasonable because Article 7.02 does not reference the DNA use requirement. Moreover, it would involve an absurdity to impose the DNA use requirement on Article 7.02. A patent infringer, by definition, is utilizing a patented idea without permission. We can scarcely imagine the instance in which an entity would obtain synthesized DNA from City of Hope but not a license from

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[21] Code of Civil Procedure section 1859 provides: "In the construction of a statute the intention of the Legislature, and in the construction of the instrument the intention of the parties, is to be pursued, if possible; and when a general and [a] particular provision are inconsistent, the latter is paramount to the former. So a particular intent will control a general one that is inconsistent with it."

Genentech. Under Genentech's interpretation, for all practical purposes, Article 7.02 would be rendered a nullity.

II

Breach of Fiduciary Duty

Genentech theorizes that: (1) *Stevens* is no longer good law; (2) under the facts of this case, it did not owe a fiduciary duty to City of Hope; (3) its conduct cannot be construed as breach of fiduciary duty because its interpretation of the agreement was legally tenable; and (4) even if there was a fiduciary duty and a corresponding breach, City of Hope did not prove any resulting damages. The amicus parties join in on the discussion regarding the existence of a fiduciary duty.

We turn to these issues.

A. ***Stevens*** is good law.

According to *Stevens*: "Where an inventor entrusts his secret idea or device to another under an arrangement whereby the other party agrees to develop, patent and commercially exploit the idea in return for royalties to be paid the inventor, there arises a confidential or fiduciary relationship between the parties. [Citations.]" (*Stevens*, *supra*, 147 Cal.App.2d at p. 373.) Genentech argues that this language is gratuitous dicta and should be rejected as such because it impermissibly permits the recovery of tort damages for a breach of contract. The amicus parties argue that the application of *Stevens* in a case such as this will have dire consequences in the intellectual property field and must be rejected on policy grounds. But, as we shall show, neither contention is true and *Stevens* serves the public interest.

1. *The holding in Stevens was not dicta*.

In *Stevens*, an inventor developed a device designed to test whether the bulb in an airplane indicator light was burnt out. He eventually entered into an agreement with Marco to develop the device, secure the necessary patents and then manufacture the device. (*Stevens*, *supra*, 147 Cal.App.2d at pp. 362-364.) After years of working together, Marco wrote the inventor and falsely claimed that the patents might be in conflict with a previously granted patent. (*Id.* at pp. 364-366.) After Marco paid the inventor his outstanding royalties and got him to sign both a release and an accord and satisfaction, the two parted ways. (*Id*. at pp. 366-367.)

Many years passed. When the inventor learned that Marco and his corporation were selling the device, the inventor sued. He subsequently went to trial on his claims for breach of contract, fraud and common counts. At the close of the inventor's case, Marco moved for a nonsuit based on insufficiency of the evidence, the statute of limitations, the inventor's knowledge of the facts allegedly constituting false representations, lack of a confidential relationship, the inventor's inexcusable failure to investigate the facts presented to him, and lack of evidence of concealed fraud or a fiduciary relationship. The trial court granted the motion and did not specify the grounds. (*Stevens*, *supra*, 147 Cal.App.2d at pp. 371-372.)

In reversing the trial court, *Stevens* stated, inter alia, that Marco owed the inventor a fiduciary duty because the inventor entrusted his device to Marco.[22] The *Stevens* court went on to say that the jury might also have found that the parties engaged in an

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22 In elaborating on its holding, the *Stevens* court added: "Indeed, it would be difficult to postulate a relationship more confidential than one in which a secret is imparted to a person professing to have the ability and facilities to develop, patent, and exploit it upon his promise to give the inventor a return in the form of royalties. In the instant case, the salutary character of such a rule is manifest. Plaintiff transferred to Marco a new and valuable idea and Marco assumed full responsibility for securing a patent. Since the processing of a patent application is secret, plaintiff could learn only what Marco cared to divulge about the progress of the Marco applications, as well as other applications on improvements, and he had of necessity, because of Marco's superior position in this respect, to repose a special confidence in Marco's integrity. In addition, since Marco was in charge of the marketing of the device, plaintiff had also to rely on his business judgment with respect to production, and on his fidelity with respect to keeping and furnishing honest accountings of sales. Here, too, Marco occupied a superior position. There was present, therefore, all the classic elements of a confidential relation, and Marco owed to plaintiff the fiduciary obligations of utmost good faith and fair dealing of one occupying a status akin to that of a trustee." (*Stevens*, *supra*, 147 Cal.App.2d at pp. 373-374.)

undertaking akin to a joint venture that imposed attendant fiduciary obligations. (*Stevens*, *supra*, 147 Cal.App.2d at pp. 372-376.)

The fiduciary duty ruling was pivotal. Due to the confidential nature of the parties' relationship, the inventor was justified in relying on Marco's misrepresentation even in the absence of an investigation. (*Stevens*, *supra*, 147 Cal.App.2d at p. 378.) Moreover, the delayed discovery rule was relaxed and the same degree of diligence was not required. Consistent with that rule, it was for the jury to determine whether the inventor's delay in suing Marco was reasonable. (*Id*. at p. 382.) Finally, the court went on to state: "In view of the confidential relationship, and the fact that Marco obtained an unconscionable advantage by [the] execution [of the accord and the release], a rebuttable presumption arises that they were obtained by fraud . . . and the burden was upon Marco" to overcome that presumption. (*Id*. at p. 383.) Relying on the special rules that append to confidential relationships, the *Stevens* court was able to find questions of fact as to Marco's varied arguments.

We find it indisputable that the language City of Hope relies upon in *Stevens* constitutes a holding. "It is an elementary concept that ratio decidendi is the principle or rule which constitutes the basis of the decision and creates binding precedent, while dictum is a general argument or observation unnecessary to the decision which has no force as precedent. [Citation.]" (*United Steel Workers of America v. Board of Education* (1984) 162 Cal.App.3d 823, 834.) In order to delineate between the two, the test "is to take account of facts treated by the [appellate court] as material and determine whether the contested opinion is based upon them." (*Ibid*.) The *Stevens* court treated the fiduciary duty issue as material. Beyond that, the opinion was based on fiduciary duty as it related to issues such as reasonable reliance and delayed accrual. That *Stevens* set forth alternative grounds for bringing in the special rules that apply to fiduciary relationships does not shake us from our conclusion. It is axiomatic that "[w]hen an appellate court bases its decision on alternative grounds, none is dictum." (*Greyhound Lines, Inc. v. County of Santa Clara* (1986) 187 Cal.App.3d 480, 485.)

2. *Stevens should be followed.*

On principles of stare decisis and public policy, we confirm the viability of the rule announced by our predecessors.

a. Stare decisis.

The policy of common law jurisdictions is for courts to follow precedent. This is based "on the assumption that certainty, predictability, and stability in the law are the major objectives of the legal system." (9 Witkin, Cal. Procedure (4th ed. 1997) Appeal, § 917, p. 954.) In general, appellate courts follow their own decisions, and also the decisions of other divisions or districts. (*Id*. at § 935, p. 973.) If a decision has been accepted by the courts, the legal profession and the general public, that "is a potent argument in favor of allowing it to stand." (*Id*. at § 951, p. 995.) On the other hand, "the desirability of retaining a long established rule and of maintaining consistency in decision must be weighed against the evil of perpetuating a bad principle of law." (*Id*. at § 957, p. 1002.) "[T]he doctrine of stare decisis faces its most serious test when a decision is challenged as contrary to modern social or economic policy, or productive of undesirable consequences in the administration of justice." (*Ibid*.) The cases "recognize the necessity, at times, of abandonment of rules that have only the virtue of age, and that are, in the light of present day beliefs and customs, unjust and unworthy of retention." (*Id*. at § 957, p. 1003.) Giving due consideration to these principles, we should adhere to *Stevens* unless it has become an anachronism that must be laid to rest in favor of a rule more appropriate for today's world.

b. There is no basis for reversing *Stevens*.

There is a history in this state and others of viewing the relationship between inventors and those they entrust their secrets to as confidential or fiduciary in nature. (See *Schaake v. Eagle etc. Can Co.* (1902) 135 Cal. 472, 485 [a fiduciary relationship resulted when an employee assigned his inventions to his employer in exchange for a percentage of the profits]; *Hollywood M.P. Equip. Co. v. Furer* (1940) 16 Cal.2d 184, 188-189 [stating that a person who gives up ownership of his invention does not yield the right to have his contracts "protected by the courts where a confidential relationship has been created on the basis of the inventor's secret"]; *Crutcher-Rolfs-Cummings, Inc. v. Ballard* (Tex.App. 1976) 540 S.W.2d 380, 387 [a confidential relationship was formed when an inventor entrusted his secret to a manufacturer]; *Ewen v. Gerofsky* (1976) 382 N.Y.S.2d 651, 652-654 [even in the absence of a joint venture, the parties formed a confidential relationship when the inventor disclosed his secrets to the defendant for mutual development].)

Genentech would have us believe that there has been a policy shift away from this earlier history. But that is not born out by the cases.

We are told that *Stevens* was expressly rejected by *Wolf v. Superior Court* (2003) 107 Cal.App.4th 25 (*Wolf*). But when *Wolf* is consulted, this contention is easily debunked. In *Wolf*, an author assigned the rights to his novel and its characters to Walt Disney Pictures and Television in exchange for fixed compensation upon execution of the agreement, a percentage of net profits from a motion picture based on the novel, and additional, contingent compensation. (*Id*. at pp. 27-28.) The court held that "a contingent entitlement to future compensation within the exclusive control of one party does not make that party a fiduciary in the absence of other indicia of a confidential relationship[.]" (*Id*. at p. 27.) The author cited *Stevens* for the proposition that profit sharing agreements are inherently fiduciary in nature. (*Id*. at p. 31.) The *Wolf* court distinguished *Stevens* on the grounds that the author had not alleged a relationship akin to a joint venture. (*Id*. at p. 32.) Although *Wolf* quoted the language upon which City of Hope relies, no commentary was provided. In other words, *Wolf* neither approved nor disapproved of *Stevens*.

Equally unavailing are Genentech's citations to cases that bar tort remedies for breach of contract and decline to impose fiduciary obligations on ordinary commercial relationships. (See *Sutherland v. Barclays American/Mortgage Corp.* (1997) 53 Cal.App.4th 299, 314 [as a general rule noninsurance breach of the implied covenant of good faith does not give rise to a tort remedy]; *New v. New* (1957) 148 Cal.App.2d 372, 382-383 [the implied covenant of good faith does not create a fiduciary duty]; *Kim v. Sumitomo Bank* (1993) 17 Cal.App.4th 974, 979 [a bank does not owe a fiduciary duty to its loan customers]; *Rickel v. Schwinn Bicycle Co.* (1983) 144 Cal.App.3d 648, 653 [no fiduciary duty between a manufacturer and an authorized dealer]; *Wolf*, *supra*, 107 Cal.App.4th at p. 29 [there must be something more than a mere obligation to pay a debt for a fiduciary duty to arise]; *Recorded Picture Company* [*Productions*] *LTD v. Nelson Entertainment,, Inc*. (1997) 53 Cal.App.4th 350, 370 ["the typical distribution contract, negotiated at arm's length, does not create a fiduciary relationship between the owner of a product and the distributor"]; *Downey v. Humphreys* (1951) 102 Cal.App.2d 323 [collecting premiums from policyholders did not make an insurance agent a fiduciary]; *Wiltsee v. California Emp. Com.* (1945) 69 Cal.App.2d 120, 124-125, 128 [employer's promise to pay employee 25 percent of profits did not create a fiduciary relationship]; *Freeman & Mills, Inc. v. Belcher Oil Co.* (1995) 11 Cal.4th 85, 88 (*Freeman*) [overruling *Seaman's Direct Buying Service, Inc. v. Standard Oil Co.* (1984) 36 Cal.3d 752 (*Seaman's*) and thereby eliminating the tort of bad faith denial of the existence of a contract].) These cases may arrest the expansion of contract remedies, but none of them purports to shrink previously existing tort remedies decided under cases pertaining to confidential relationships.

Neither do cases cited by the amicus parties sound the death knell of *Stevens*. *Aas v. Superior Court* (2000) 24 Cal.4th 627, 643 (*Aas*), for example, stated that a "person may not ordinarily recover in tort for the breach of duties that merely restate contractual obligations." But the *Aas* court recognized that when the breach of contract also violates social policy, tort damages may be warranted. (*Ibid.*, citing *Erlich v. Menezes* (1999) 21 Cal.4th 543, 551 (*Erlich*).) As we shall discuss, this case implicates public policy concerns and falls within the exception.

Our Supreme Court, the amicus parties tell us, has rejected similar efforts to secure tort damages for breach of contract. But there is no California Supreme Court case on point. The amicus parties advert, inter alia, to *Cates Construction, Inc. v. Talbot Partners* (1999) 21 Cal.4th 28, 46. In that particular case, the court took special note that bad faith law in the insurance context is a major departure from traditional principles of contract law and that it has "cautioned courts to exercise great care in considering whether to extend '"the exceptional approach taken in those cases" to "another contract setting."' [Citation.]" Crucially, *Stevens* is not based on the implied covenant of good faith.

Even if we trace the reasoning of *Freeman* in deciding to overrule *Seaman*'*s*, we do not reach the result the amicus parties urge.

The *Freeman* court reviewed and borrowed policy considerations from *DuBarry Internat., Inc. v. Southwest Forest Industries, Inc.* (1991) 231 Cal.App.3d 552 (*DuBarry*) and *Harris v. Atlantic Richfield Co.* (1993) 14 Cal.App.4th 70 (*Harris*), two cases that circumscribed tort remedies for contract breaches. (*Freeman*, *supra*, 11 Cal.4th at p. 95.)

In *DuBarry*, the court refused to extend the *Seaman's* tort to bad faith defenses of contract claims because it would expand litigation into inquiries about the defendant's state of mind and motivation. (*DuBarry*, *supra*, 231 Cal.App.3d at p. 569.) Otherwise, opined the court, "[t]he distinction between tort and contract actions, and their purposefully different measures of damages, would be blurred if not erased. The insult to commercial predictability and certainty would only be exceeded by the increased burden on an already overworked judicial system." (*Ibid*.)

In *Harris*, which involved a claim by a franchisee against a franchisor, the court denied tort recovery for bad faith breach of contract in violation of public policy and held that *Tameny v. Atlantic Richfield Co.* (1980) 27 Cal.3d 167, 178 (holding that an employee could sue in tort after being wrongfully discharged for refusing to engage in unlawful conduct) does not apply outside the employment context. (*Harris*, *supra*, 14 Cal.App.4th at p. 72.) As summarized by *Freeman*, the policy reasons pinpointed by *Harris* for denying tort recovery for breach of contract were: "(1) the different objectives underlying the remedies for tort and contract breach, (2) the importance of predictability in assuring commercial stability in contractual dealings, (3) the potential for converting every contract breach into a tort, with accompanying punitive damage recovery, and (4) the preference for legislative action in affording appropriate remedies. [Citations.]" (*Freeman*, *supra*, 11 Cal.4th at p. 98.)

Though these policy considerations ended the *Seaman's* era (*Freeman*, *supra*, 11 Cal.4th at p. 98), they are not implicated here.

Because *Stevens* relies on traditional fiduciary tort principles, it does not blur the distinction between torts and contracts and does not work an insult to the commercial predictability and certainty of contracts. Also, whereas creating a tort under the scenarios presented in *Seaman's, supra,* 36 Cal.3d 752, *DuBarry*, *supra*, 231 Cal.App.3d 552 and *Harris, supra,* 14 Cal.App.4th 70, would implicate all commercial contracts, *Stevens* implicates only select commercial contracts that involve an inventor entrusting a secret to a third party.

Moreover, *Stevens* is neither contrary to modern social or economic policy, nor is it productive of undesirable consequences in the administration of justice. In a growing global economy, where a valuable patent can be licensed all over the world and be worth billions of dollars, there is every reason to afford the utmost protection to inventors who entrust their secrets to others for developing, patenting, manufacturing and licensing the secrets in exchange for royalties. Inventors cannot be expected to scour the world to determine whether they are being fleeced. Moreover, we note that the "fundamental policy behind the American patent system is to provide inventors with a limited monopoly in exchange for public disclosure. [Citation.]" (*Chamberlin v. Isen* (1985 9th Cir.) 779 F.2d 522, 525.) To encourage inventors to disclose their ideas to third parties who can bring the ideas to the market place, those third parties should be held to the standards of a fiduciary.

Freeman departed from stare decisis and overruled *Seaman's* because our Supreme Court was convinced that *Seaman's* was "incorrectly decided, that it has generated unnecessary confusion, costly litigation, and inequitable results." (*Freeman*, *supra*, 11 Cal.4th at p. 93.) *Stevens* does not fall into the same category. It is consistent with the principles of confidential relationship law. (See *Barbara A. v. John G.* (1983) 145 Cal.App.3d 369, 383 ["The essence of a fiduciary or confidential relationship is that the parties do not deal on equal terms, because the person in whom trust and confidence is reposed and who accepts that trust and confidence is in a superior position to exert unique influence over the dependent party"].) Further, there is no indication that *Stevens* has engendered any confusion, and we conclude that the results flowing from *Stevens*, due to the policies we enunciated, are in fact equitable. Contract law exists to enforce legally binding agreements between parties, and tort law is designed to vindicate social policy. (*Applied Equipment Corp. v. Litton Saudi Arabia Ltd.* (1994) 7 Cal.4th 503, 514.) Based on the foregoing, we conclude that reaffirming *Stevens* is necessary to vindicate public policy.

c. *Stevens* is not adverse to public policy.

The amicus parties advance a series of public policy arguments in favor of overruling *Stevens*. None of these arguments find purchase.

To begin, the amicus parties express fear that our reaffirmation of *Stevens* will inhibit commerce in intellectual property. In particular, the amicus parties believe that our holding will mean that "any [intellectual property] user that obtains rights to another's [intellectual property] before the [intellectual property] has been patented or otherwise made public -- if not, indeed, anyone who agrees to pay royalties for [intellectual property] rights -- becomes the [intellectual property] owner's fiduciary." However, this is a mischaracterization of the scope of *Stevens*. It only pertains to a secret idea entrusted to a third party who agrees to develop, patent and commercially exploit the idea in return for royalties.[23] Because *Stevens* is much narrower in scope than the amicus parties suggest, we do not share their fear that it will lead to loathsome economic consequences.

Next, the amicus parties extol the virtues of restricting tort damages in contract cases. They tell us it encourages contractual relations by enabling parties to estimate and allocate their risks, and it limits needless litigation. On the flip side of the coin, they claim that the spectre of tort and punitive damages will make commercial relations far

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[23] We express no opinion on what duties do or do not pertain under different facts involving intellectual property.

less predictable. For instance, that spectre might cause parties to pay questionable claims rather than risk the outcome of a tort action. But these generalized concerns do not outweigh the countervailing policies that will be served by the imposition of fiduciary obligations in this type of case.

B. Genentech owed City of Hope a fiduciary duty.

Even if *Stevens* is good law, Genentech tries to get out from underneath its yolk by claiming it does not apply.

According to Genentech, *Wolf* applies rather than *Stevens* because the facts of this case and *Wolf* are indistinguishable. This claim is tenuous and we dispense with it summarily. *Wolf* involved an assignment of literary rights, not the entrustment of a secret idea for patenting, manufacturing and exploiting. This distinction is dispositive. Genentech likens this case to *Wolf* on the premise that they are both devoid of a relationship that is akin to a joint venture.[24] But Genentech ignores that the entrustment of a secret device was a separate basis for the *Stevens* court to find a fiduciary duty. It is that holding in *Stevens* which governs.

Next, Genentech argues that the only fiduciary duty imposed by *Stevens* is the duty to protect the confidentiality of a secret idea. That duty, so claims Genentech, ends when a patent is issued and the secret idea is publicly disclosed. This ipse dixit argument lacks analytical force. Not only did *Stevens* state that the inventor had to rely on Marco to learn about the progress of the patent application, but it also stated: "In addition, since Marco was in charge of the marketing of the device, plaintiff had also to rely on his business judgment with respect to production, and on his fidelity with respect to keeping and furnishing honest accountings of sales. Here, too, Marco occupied a superior position." (*Stevens*, *supra*, 147 Cal.App.2d at p. 373.) Elsewhere in the opinion, the author of *Stevens* wrote that "Marco was at all times the custodian of plaintiff's secret invention; he continued to prosecute the patent applications; and at all times he continued

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[24] We neither agree nor disagree with this assertion. This is not an issue that we need to resolve.

to manufacture, sell and profit from the device plaintiff had conceived. It was his . . . duty, therefore, to act with the integrity and probity of a fiduciary during such time in relation to plaintiff." (*Id*. at p. 377.)

Finally, Genentech contends that *Stevens* does not apply because here, as was true in *Wolf*, *supra*, 107 Cal.App.4th 25, there was no obligation to exploit the intellectual property, there was no need to get permission to license it, and there was an opportunity for nonmutual profit. But again, *Wolf* did not involve an inventor who entrusted secrets to another, so it is not on point. Further, City of Hope's entrustment of the secret Riggs-Itakura process for developing, patenting and exploiting was the "other indicia" that created a fiduciary duty. While the entrusted party in *Stevens*, *supra*, 147 Cal.App.2d 357 was contractually obligated to attempt to bring the indicator light to market and Genentech had no similar obligation, this distinction is immaterial. For policy reasons, there should be no distinction between when a third party agrees to develop, patent and exploit an inventor's secret and when a third party is given that option and takes it. The inventor is still in the same position of trusting the third party regarding information and accountings. As well, the policy of encouraging public disclosure of inventions is better served by protecting both types of agreements. In reaching this conclusion, we remain mindful of City of Hope's trust, Genentech's superior position, and the importance of encouraging public disclosure of life saving inventions in today's world. Conversely, we decline to dissect the terms of the parties' agreement in search of ways to find superficial reasons to declare that a confidential relationship does not exist.

There is no need to belabor the point. Under the facts of this case, the parties had a confidential relationship and Genentech had a fiduciary obligation to treat City of Hope with the utmost good faith.

C. Genentech breached its fiduciary duty.

Genentech does not dispute that it failed to disclose various licenses and pay royalties on those licenses. Rather, it contends that it did not breach any fiduciary duty so long as it was adhering to an erroneous but legally tenable interpretation of the agreement. In essence, Genentech would have us hold that even if it followed an interpretation it knew was contrary to what the parties intended and agreed upon, it could not be held liable so long as that interpretation was objectively sustainable under the law. It cites *Careau & Co. v. Security Pacific Business Credit, Inc*. (1990) 222 Cal.App.3d 1371, 1402 (no bad faith denial of the existence of a contract in the absence of subjective bad faith and a position which, as an objective matter, is not legally tenable), *Opsal v. United Services Auto. Assn.* (1991) 2 Cal.App.4th 1197, 1205-1207 (an insurer's failure to pay benefits is not bad faith unless the refusal was unreasonable and without proper cause), and *Lee v. Crusader Ins. Co*. (1996) 49 Cal.App.4th 1750, 1760 (an insurance company need not independently investigate a claim for fire insurance pending an insured's arson prosecution even if the insurance company believes an acquittal is likely). These cases provide Genentech with no aid. None of them allows a party to profit from a legally tenable contract interpretation when the party knows that the agreement has a wholly different meaning. In any event, it would be antithetical to the very nature of the obligations imposed on fiduciaries for us to hold that a fiduciary could act in the manner suggested by Genentech.

To the extent Genentech contends that its interpretation of the agreement was held in good faith, that contention fails. The jury's finding of fraud or malice demonstrates that it believed that Genentech acted in bad faith. That finding, which is discussed in part III.B., *post*, is supported by substantial evidence and is sufficient for concluding that Genentech breached its fiduciary duty.

D. City of Hope proved damages.

Genentech contends that if there was a breach of fiduciary duty, it was the failure to report licenses and properly account for royalties. But any injury, Genentech posits, flowed strictly from the nonpayment of royalties, which only gave rise to contract damages. We disagree. Where, as here, the nonpayment violated "a duty independent of the contract arising from principles of tort law" (*Erlich, supra,* 21 Cal.4th at pp. 550-551), it gave rise to contract *and* tort liability.[25] Moreover, Genentech's failure to report the licenses and properly account for royalties prevented City of Hope from asserting its contractual right for an accounting and to receive payment. This additional breach

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[25] Genentech argues that City of Hope conceded that nonpayment of royalties was only a breach of contract and that we therefore must reverse the fiduciary duty and punitive damages judgment. Genentech refers to the following passage in City of Hope's appellate brief: "As a threshold matter, Genentech did not breach its fiduciary duty by 'non-payment of royalties.' That is how Genentech breached the *contract*. Instead, consistent with the instruction given the jury, Genentech's breach of its fiduciary duty was based on its failure to act towards City of Hope with the utmost good faith, including its failure to deal fairly with City of Hope, and its failure to make full and fair disclosure to City of Hope of facts materially affecting its rights under the contract. These are independent duties that arose because Genentech entered into a fiduciary relationship with City of Hope -- which Genentech breached by, among other acts, deceitfully concealing its license agreements and the royalties that should have been paid on them. [¶] City of Hope's contract and tort claims do share one common aspect. The measure of damages for both breaches is identical and is equal to the sum of unpaid royalties. But that equivalence does not change the fact, as found by the jury, that Genentech owed two duties to City of Hope (one contractual and the other fiduciary) and breached those duties in two separate ways (by failing to pay the royalty owed under the contract and by failing to live up to the standards of a fiduciary). California law affords relief on both theories, even though they involve identical damages." (Fns. omitted.)

The rule which appends is the following: "'[While] briefs and argument are outside the record, they are reliable indications of a party's position on the facts as well as the law, and a reviewing court may make use of statements therein as admissions against the party.' [Citation.]" (*DeRose v. Carswell* (1987) 196 Cal.App.3d 1011, 1019, fn. 3.) We exercise our discretion and decline to treat the statements in City of Hope's appellate brief as an adverse admission. There are a variety of reasons. At oral argument counsel for City of Hope informed us that a concession was not intended. We note also that the quoted passage stated that the measure of damages for breach of contract and breach of fiduciary duty was the unpaid royalties. In our view, City of Hope's phrasing of the issue was semantics, not substance. Finally, City of Hope cited several cases that hold that conduct which constitutes a breach of contract can also constitute a tort if it violates an independent duty. It would be inconsistent for City of Hope to cite those cases if it was conceding that the failure of Genentech to pay royalties could not be a breach of fiduciary duty.

enabled Genentech to withhold royalties to which it had no rightful claim and helped precipitate the damages.

III

Punitive Damages

Genentech attacks the $200 million award of punitive damages on two grounds. First, it claims that there was insufficient evidence to support a finding of fraud or malice. Second, it claims that the award was excessive because it did not act in a reprehensible manner. Both claims fail.

A. Standard of review.

An appellate court will uphold a jury's finding of fraud or malice if it is supported by evidence that is not only substantial but that also satisfies the clear and convincing standard imposed by Civil Code section 3294, subdivision (a). (See *Shade Foods Inc. v. Innovative Products Sales & Marketing, Inc.* (2000) 78 Cal.App.4th 847, 891 (*Shade*).) "As in other cases involving the issue of substantial evidence, we are bound to 'consider the evidence in the light *most favorable to the prevailing party*, giving him the benefit of *every reasonable inference*, and *resolving conflicts* in support of the judgment.' [Citation.]" (*Ibid*.)

Our task in reviewing the punitive damages award is to ensure that it does not offend due process concerns. (*Diamond Woodworks, Inc. v. Argonaut Ins. Co.* (2003) 109 Cal.App.4th 1020, 1056.)

Appellate courts will reverse only those punitive damages "'judgments which the entire record, when viewed most favorably to the judgment, indicates were rendered as the result of passion and prejudice. . . .' [Citation]." (*Neal v. Farmers Ins. Exchange* (1978) 21 Cal.3d 910, 927 (*Neal*).) The courts examine three factors to determine whether an award is excessive. (1) The court looks at the particular nature of the defendant's acts in light of the whole record. "[D]ifferent acts may be of varying degrees of reprehensibility, and the more reprehensible the act, the greater the appropriate punishment, assuming all other factors are equal. [Citations.]" (*Id*. at p. 928.) (2) Next, the court must heed the amount of compensatory damages awarded. "[I]n general, even an act of considerable reprehensibility will not be seen to justify a proportionally high amount of punitive damages if the actual harm suffered thereby is small. [Citation.]" (*Ibid*.) (3) Finally, the court must take note of the defendant's wealth. "[T]he function of deterrence . . . will not be served if the wealth of the defendant allows him to absorb the award with little or no discomfort. [Citations.] By the same token, of course, the function of punitive damages is not served by an award which, in light of the defendant's wealth and the gravity of the particular act, exceeds the level necessary to properly punish and deter." (*Ibid.*)

B. Genentech's liability for punitive damages was supported by substantial evidence of fraud or malice.

1. *The prerequisites for punitive damages*.

Punitive damages may be awarded when there is clear and convincing evidence that a defendant is found guilty of fraud, oppression or malice. (Civ. Code, § 3294, subd. (a).) In this case, City of Hope sought to prove that Genentech's acted fraudulently and maliciously. Fraud "means an intentional misrepresentation, deceit, or concealment of a material fact known to the defendant with the intention on the part of the defendant of thereby depriving a person of property or legal rights or otherwise causing injury." (Civ. Code, § 3294, subd. (c)(3).) Malice is "conduct which is intended by the defendant to cause injury to the plaintiff or despicable conduct which is carried on by the defendant with a willful and conscious disregard of the rights or safety of others." (Civ. Code, § 3294, subd. (c)(1).) For conduct to be malicious, it must pass so far beyond the pale of the excepted norms of decency that it would be instantly condemned by any member of the citizenry as noxious to our sensibilities, our morals and our concept of right and wrong. (*Shade, supra,* 78 Cal.App.4th at p. 891 ["the requirement of 'despicable' conduct represents a 'substantive limitation on punitive damage awards. Used in its ordinary sense, the adjective "despicable" is a powerful term that refers to circumstances that are "base," "vile," or "contemptible." [Citation.]'"].)

2. *The jury's finding must be upheld*.

In its opening brief, Genentech states: "Acting in accordance with a legally tenable (though erroneous) contract interpretation cannot be deemed 'despicable,' 'reprehensible,' 'vile,' or 'contemptible.'" We disagree. Whether a fiduciary acts in accordance with a legally tenable contract interpretation does not end the inquiry. The dispositive question is whether the fiduciary was relying upon an interpretation it knew to be wrong in order to take advantage of the other party. Impliedly, the jury found that Genentech did exactly that. A review of the record reveals that this implied finding was supported by substantial evidence.

The evidence credited by the jury showed that the parties negotiated a deal whereby Genentech would pay when it used a Riggs-Itakura patent, and also when it licensed a Riggs-Itakura patent. The evidence also showed that the parties did not intend to incorporate the DNA use requirement or the patent infringement requirement into Article 6.08. Further, there was evidence that Genentech engaged in a campaign to defraud and stonewall City of Hope. For example: By 1980, Genentech projected that it would earn $100 million through its license with Eli Lilly and believed that interferon, a drug that could be made with a Riggs-Itakura patent that Genentech had licensed to Hoffman La-Roche, could cure cancer. Rather than inform City of Hope of these facts, Genentech tried to buy down its royalty obligation in a move that would have cost City of Hope millions of dollars. Then, when Jurrus and Irons attempted to determine who had received licenses of the Riggs-Itakura patents, they were thwarted by Kiley and Buting at every turn. Finally, even after City of Hope made its interpretation known in the mid-1990's, Genentech did not disclose its licenses to Hoffman-La Roche or any other third parties.

Based on the evidence, the jury could and did reasonably conclude that Genentech understood the nature of the deal yet withheld royalties and actively concealed licenses in order to enrich itself. Such conduct, under the circumstances, amounts to fraud or malice and qualifies as being despicable, base and vile.

C. The punitive damages award does not violate due process.

Genentech focuses solely on reprehensibility, the first element set forth in *Neal*, *supra*, 21 Cal.3d 910. By implication, it does not claim that the punitive damages award is disproportionate to the compensatory damages award. Nor does it claim that, in light of its net worth, the amount exceeds the level necessary to deter. It contends that a $200 million punitive damages award is excessive because its contract interpretation was legally tenable, it was not guilty of a widespread pattern or practice of wrongful conduct, and its conduct did not jeopardize anyone's life, safety, or health. Last, Genentech suggests that the economic nature of the harm, and also the sophistication of the two parties involved, calls upon us to reign in the award.

We assay these issues.

1. *The controlling law.*

The United States Supreme Court, in its recent decision in *State Farm Mut. Automobile Ins. Co. v. Campbell* (2003) 538 U.S. 408 (*Campbell*), instructed "courts to determine the reprehensibility of a defendant by considering whether: the harm caused was physical as opposed to economic; the tortious conduct evinced an indifference to or a reckless disregard of the health or safety of others; the target of the conduct had financial vulnerability; the conduct involved repeated actions or was an isolated incident; and the harm was the result of intentional malice, trickery, or deceit, or mere accident. [Citation.] The existence of any one of these factors weighing in favor of a plaintiff may not be sufficient to sustain a punitive damages award; and the absence of all of them renders any award suspect. It should be presumed a plaintiff has been made whole for his injuries by compensatory damages, so punitive damages should only be awarded if the defendant's culpability, after having paid compensatory damages, is so reprehensible as to warrant the imposition of further sanctions to achieve punishment or deterrence. [Citation.]" (*Id*. at p. 419.)

We are guided by *Campbell* as well as *Neal*.

2. *The* *Neal* *and* *Campbell* *factors are satisfied*.

The jury found Genentech's contract interpretation to be a sham, so whether it was legally tenable is irrelevant. The withholding, as the jury found, amounted to fraud or malice. Not only that, but Genentech's scheme of concealing licenses and withholding royalties spanned decades. The conduct may not have been widespread as to the number of victims, but it was pervasive and continuous as to City of Hope. While Genentech did not directly jeopardize anyone's life, safety, or health, it damaged an entity that is in the business of providing medical care to the poor, often at City of Hope's own expense. Additionally, at the time Genentech offered to buy down the royalty rate, it knew that City of Hope was in need of money. Last, Genentech essentially cheated City of Hope out of a staggering amount of money.

These facts demonstrate that Genentech acted in a reprehensible manner. Because Genentech does not argue proportionality or net worth, we presume those issues support the judgment. (See *Denham v. Superior Court* (1970) 2 Cal.3d 557, 564; *Brewer v. Simpson* (1960) 53 Cal.2d 567, 583.)

3. *The economic nature of the harm does not undermine the award*.

Genentech offers *Las Palmas Associates v. Las Palmas Center Associates* (1991) 235 Cal.App.3d 1220, 1259 as the standard for what is reasonable in a commercial dispute. In *Las Palmas*, the compensatory damages for fraud were $232,393, and the jury awarded $10 million in punitive damages. (*Id*. at p. 1228.) The *Las Palmas* court reduced the amount to $2 million "to keep it in line with the actual compensatory losses suffered by buyers." (*Id*. at p. 1259.) *Las Palmas* offers Genentech no assistance. Here, the award was not proportionally high. Rather, it was only two-thirds of the compensatory damages award.

In any event, we take our cue from the Supreme Court.

In *TXO Production Corp. v. Alliance Resources Corp.* (1993) 509 U.S. 443, the plaintiff suffered economic damages between $1 million and $4 million and was awarded $10 million in punitive damages. (*Id*. at pp. 446, 462.) The Supreme Court upheld the punitive damages award, noting that the defendant had embarked on illicit, bad faith scheme to cheat the plaintiff out of lucrative oil and gas royalties. (*Id*. at p. 462.) If the award and its proportion in TXO was constitutional, then the award against Genentech was constitutional as well.

IV

The Motion for New Trial

In Genentech's parting salvo, it tells us that the trial court committed two fundamental errors that mandate a new trial. First, the trial court instructed the jury pursuant to Civil Code section 1654.[26] Second, it admitted the 1995 settlement agreement into evidence.[27] These two grounds were not raised by Genentech in its motion for new trial and need not be considered on appeal. (*Doers v. Golden Gate*

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[26] Civil Code section 1654 provides: "In cases of uncertainty not removed by the preceding rules, the language of a contract should be interpreted most strongly against the party who caused the uncertainty to exist."

[27] Genentech seeks a new trial on two additional theories. It argues that if we reverse the fiduciary duty verdict, then we must remand the breach of contract claim for a new trial. Its theory is that the concealment evidence related to the fiduciary duty claim prevented the jury from objectively viewing the evidence pertaining to the contract claim. Because we affirm the fiduciary duty verdict, this issue is moot. Next, Genentech contends that we must order a new trial and instruct the trial court to interpret the agreement itself after a new jury resolves the factual disputes. However, as we explained in part I.C.3., *ante*, the trial court properly submitted the interpretation of royalty rate and royalty base to the jury. The only legal issues pertaining to contract interpretation involved whether application of Article 6.08 to the sales of Schering and Novo Nordisk based on licenses obtained in settlements. However, that issue was properly decided and Genentech was not prejudiced.

Bridge etc. Dist. (1979) 23 Cal.3d 180, 184-185, fn. 1.) If we were to consider these grounds, neither would mandate a new trial.

Though we are not told, we assume Genentech contends that it could have sought relief under Code of Civil Procedure section 657, subdivision (1). That statute provides that a party may move for a new trial based on any order of the court or abuse of discretion by which either party was prevented from having a fair trial. Our task, in analyzing such an issue, is to review the entire record and make an independent determination as to whether the alleged error caused a party any prejudice. (*Los Angeles v. Decker* (1977) 18 Cal.3d 860, 872.) Even if the trial court erred with respect to the Civil Code section 1654 instruction and the 1995 settlement agreement,[28] the error was harmless. The jury -- which is charged with deciding credibility issues -- believed Hall rather than Kiley. Therefore, the absence of the instruction and the 1995 settlement agreement would not have altered the verdict.

DISPOSITION

The judgment and order are affirmed.

City of Hope shall recover its costs on appeal.

CERTIFIED FOR PUBLICATION.

_______________________________, J.
ASHMANN-GERST

We concur:

________________________________, P. J.
BOREN

________________________________, J.
NOTT

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[28] We need not resolve this issue. Our statement should not be construed as a holding in any respect.