S 275843

IN THE SUPREME COURT
OF THE
STATE OF CALIFORNIA

JJD-ELK GROVE, LLC

Plaintiff and Appellant,

v.

JO-ANN STORES, LLC

Defendant and Respondent.

On Review From The Court Of Appeal
For the Third Appellate District,
Division One, 3rd Civil No. C094190

After An Appeal From the Superior Court
For The State of California, County of Sacramento,
Case Number 34-201900248163,
Hon. Shama H. Mesiwala

PLAINTIFF-APPELLANT JJD-HOV ELK GROVE, LLC'S REPLY BRIEF ON THE MERITS

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INTRODUCTION

This Court granted review to determine an important question of California commercial lease law: May courts refuse to enforce contractual penalties and forfeitures that come cloaked as co-tenancy provisions? Relying on 150 years of California codal law and this Court's teachings, the Fifth District Court of Appeal said yes. (*Grand Prospect Partners, L.P. v. Ross Dress for Less, Inc.* (2015) 232 Cal.App.4th 1332.) Relying on laissez-faire economics with a healthy dose of not-our-business, the Third District Court of Appeal said in the opinion now on review, in essence, no. (*JJD-HOV Elk Grove, LLC, v. Jo-Ann Stores, LLC* (2022) 80 Cal.App.5th 409.) This is the choice—at the highest level of generality, do California courts have a role to play in commercial leases?—that this Court confronts, as explained by disinterested California legal commentators such as Miller and Starr at the petition stage. (JJD-HOV's Reply in Support of Petition for Review at *6-*8, 2022 WL 4244661.)

The new arguments in Jo-Ann's Answering Brief (full compensation? estoppel? *judicial* estoppel?) are not responsive to this question. And all but one of the old arguments in the Answering Brief merely re-hash the petition stage question by pretending *Grand Prospect* and the opinion below are reconcilable on their facts. The single, solitary defense of the analytic framework in the opinion below, and since we are before a court of last resort that must concern itself primarily with governing standards, JJD assumes we should be discussing frameworks first, is this: "According to the Court of Appeal, the *Grand Prospect* court erred in finding that a condition precedent could operate as an unenforceable penalty." (Answering Brief at 36.) If this valorization of form over substance is to become the law, then JJD likely loses—as would the California Civil Code, the courts, and the entire edifice of California's regulated marketplace for business. JJD submits, however, that it should not become the law. Co-tenancy provisions that impose wildly

disproportionate punishments on (often, as here) local landlords to the benefit of national chain stores should be subject to penalty and forfeiture review the same as any other contractual term, no matter how cleverly the lawyering at the drafting stage framed them.

JJD believes that this result—keeping co-tenancy clauses within the judiciary's ambit, as has been the undisputed law since at least *Grand Prospect* — best comports with the tenor and tendency of this Court's teachings. It respects the California legislature's obvious acquiescence in *Grand Prospect*'s interpretation of its longstanding enactment. But if JJD is wrong and arms' length commercial transactions are *ipso facto* enforceable, very well. As superintendent of California law, the Court should say just that. There is no need to accept Jo-Ann's invitation to sophistic distinctions between conditions precedent versus penalties. Neither is there the need to accept Jo-Ann's earlier effort, now largely abandoned except for rote recitation, to pretend that JJD somehow freely elected an alternative performance involving the bankruptcy of an anchor tenant, loss of that anchor tenant's rent, *and* the gift of a windfall of riches to Jo-Ann despite zero harm. "Alternative performance" necessarily requires the existence of actual alternatives, and if Jo-Ann knows of a way JJD could have kept Toys-R-Us out of bankruptcy or otherwise kept the co-tenancy provision satisfied of JJD's own accord, JJD is all ears. But most landlords, JJD included, are not in the habit of letting leasable space sit unused.

The only point both interesting and serious in Jo-Ann's Answering Brief—that the terms of California Civil Code section 3275's relief from forfeiture require full compensation to a party harmed by a breach, default, lapse, failure of condition, or any other way of describing the non-performance of an obligation—is the very definition of a new argument on appeal. Not even a whiff appears in the reams of paper below. But because this Court's time is valuable and the California commercial real estate

community deserves clarity, it is worth addressing. If Jo-Ann had made a demand for full compensation or had ever once told JJD (or especially the courts below) what full compensation might look like for the short period the Toys-R-Us space was closed for business, JJD would happily compensate it. Yet after full discovery and the close of summary judgment briefing, Jo-Ann did not—in fact it made no effort to. It did not because it cannot, and it cannot because Jo-Ann has not suffered or ever even tried to provide evidence that it has suffered one iota of harm here, or at least an iota large enough to justify making a lease manager write a three-sentence letter.[1] Unless Jo-Ann would like to take the position that JJD is entitled to determine what "full compensation" means and therefore was required to make the first offer, and this would surely be a ridiculous position given that only Jo-Ann knows its own books, Jo-Ann's waived argument for compensation rings hollow.

Once the analytical framework is settled, the result should be clear. Jo-Ann's Answering Brief nowhere engages with the fact the parties' agreement uses "Substitute Rent" as a bludgeon with which to beat JJD into performance under outrageously differing circumstances that bear no relation to one another or the harm reasonably likely to flow from each. The temporary closure of the Toys-R-Us space for business is not the same as the opening of a tattoo parlor or a church or a nuclear waste depository. Yet all such events impose on JJD the same procrustean loss. That the amount of Substitute Rent is set across the life of the contract even as Fixed Minimum Rent rises each year (and so the possible loss to JJD increases each year) is further evidence that the co-tenancy clause made zero effort, and far less a reasonable one, to approximate harm from its breach, default, non-

1 By way of example, "The closure of Toys-R-Us means JJD is no longer performing its co-tenancy obligation. Jo-Ann is being harmed in the amount of x dollars. Full compensation of this loss is hereby demanded."

occurrence, or whatever other term Jo-Ann likes. And the percentage of JJD's loss compared to Jo-Ann's harm (or even potential for harm) falls well outside anything courts have found reasonable.

Whatever the Court decides in this case, commercial parties will keep litigating the enforceability of contractual terms in general and co-tenancy clauses in particular. They will make unconscionability arguments, as were made in *Grand Prospect* and took judicial resources to resolve. They will make Section 1671 arguments, which as the parties both agreed at oral argument before the Third District, does not apply in this case.[2] They will, even under the analytic framework advanced by Jo-Ann and adopted by the Third District, continue to make Section 3275 arguments about whether any given co-tenancy clause constitutes alternative performance or a prohibited penalty.

None of those approaches, each of which would persist even if Jo-Ann wins this case, would offer the coherence and simplicity of a wholistic assessment of the reasonableness and proportionality of the loss that a co-tenancy provision imposes. While it is true that each case will necessarily turn on its facts and that there are inevitably line drawing problems whenever reasonableness and proportionality are involved, those terms and that approach to adjudication are the lifeblood of the law. Any other approach may remove the courts from commercial leases in the end but would still leave the parties mired in litigation to get there—all the while inviting sophisticated national corporations to try to remove the courts from other areas of regulation of commercial leases. JJD respectfully submits that the judgement below should therefore be reversed and rendered in its

2 While JJD cannot speak to Jo-Ann's rationale for taking this position, JJD posits that there has been no "breach of the contract" within the meaning of California Civil Code section 1671; the parties have continued to function under the contract.

favor or that the matter should be remanded for such additional proceedings as this Court deems appropriate.

ARGUMENT

A. Jo-Ann's Repeated, and Repetitive, Assertions of Waiver Are Still Meritless

Amid the movie script closing argument accusations of bad faith, misrepresentation, and the like in the Answering Brief, there is one procedural argument that is potentially worth this Court's attention. Jo-Ann continues to insist that JJD's reliance on Section 3275 and even this Court's opinion in *Ridgley v. Topa Thrift & Loan Assn.* (1998) 17 Cal.4th 970, is somehow new or waived. The Court necessarily, if implicitly, rejected this argument, made by Jo-Ann at the petition stage in an effort to defeat review, as presumably the Court did not decide to ask which analytical framework governs co-tenancy clauses only to answer "never mind." Nevertheless, JJD responds.

This case has been litigated from the outset under *Grand Prospect*'s implementation of Section 3275, which appears as its own subheading and consumes multiple pages of analysis (232 Cal.App.4th at 1365-68), and *Ridgley*, which is the lead case *Grand Prospect* cites for the rule that "[u]nder California law, the characteristic feature of a penalty is the lack of a proportional relationship between the forfeiture compelled and the damages or harm that might actually flow from the failure to perform a covenant or satisfy a condition. (*Id.* at p. 1358.)

One need not take JJD's word for this. This, from Jo-Ann's Cross-Complaint for Declaratory Relief (AA406):

> 12. In letters dated September 18, 2018 and October 11, 2018, and for the first time during the term of the parties' Lease, landlord JJD advised tenant Jo-Ann that Section 15(a) of the Lease was not valid or enforceable between the parties. Specifically, counsel for landlord JJD's letter dated October 11, 2018 states that the entire Section 15(a) "cotenancy provision is an unenforceable penalty under the holding of *Grand Prospect Partners, L.P. v. Ross Dress for Less, Inc.* (2015) 232 Cal.App.4th 1332 . . ."

JJD will not tax the Court's patience with further recitation of the record when, by Jo-Ann's own admission at the outset of this case, this matter has always and entirely been about *Grand Prospect* and therefore necessarily also about the authorities on which *Grand Prospect* relied to reach its result. Of course JJD relies more extensively on authorities like Section 3275 and *Ridgley* during merits briefing in this Court, because unlike *Grand Prospect*, a District Court of Appeal opinion that is not binding on this Court, those are primary authorities this Court is bound to interpret and apply.

Jo-Ann is apparently under the impression that anything other than cut-and-paste argument, copied word for word from demand letter to demurrer to summary judgment to appeal to petition for review to the merits stage in this Court, results in waiver. Obviously that is not the case. Whereas in the trial court JJD could and did argue that *Grand Prospect* governs, in this Court JJD must defend *why* that analytic framework should govern. JJD's Opening Brief does so. All the facts and authorities relied on here were presented, and exhaustively litigated, below. There is no waiver here.

B. Jo-Ann's Two Entirely New Legal Theories, Raised for the First Time in Its Answering Brief, Are Waived—but Also Meritless.

Jo-Ann's ostentatiously wrong assertions of waiver by JJD bring to mind Shakespeare's observation that "suspicion always haunts the guilty mind," for there can be no doubt that Jo-Ann's assertions of estoppel and failure to receive full compensation are utterly new—or in Jo-Ann's brief's orthography, with its liberal use of quotation marks for emphasis, "new"—

arguments. (Henry VI, Part 3, Act 5, Scene 6.) These issues were not argued at summary judgment, they were not passed on during appeal, they were not raised during the petition stage, and the facts that would be necessary to support these arguments do not appear in the record. Even if these arguments were not waived for failing to have been raised before, however, the bare handful of words devoted to estoppel *simpliciter* would be insufficient to constitute proper briefing of the issue (as distinct from judicial estoppel and the full compensation argument, which are probably adequately, if barely, briefed).

In any event, the arguments would fail even if they were not waived. There is no California Evidence Code section 623 estoppel because JJD asserted its *Grand Prospect* claim against enforcement of the co-tenancy clause's penalty provision the very first time Jo-Ann imposed that penalty after *Grand Prospect*, which was the first appellate decision to make clear that Section 3275's general terms apply to co-tenancy agreements in particular.

Judicial estoppel requires a party to *succeed* on a legal theory before a tribunal that relies on that legal theory to reach its result and then to take a diametrically opposite position before another tribunal. (*Jackson v. County of Los Angeles* (1997) 60 Cal.App.4th 171, 183.) JJD has searched its archives but can find no instance of a judicial ruling against Jo-Ann and in favor of JJD that relied on the enforceability of the co-tenancy agreement. Estoppel, no matter the flavor, simply has no role to play in this proceeding.

Jo-Ann's new argument that JJD cannot rely on Section 3275 because it has not made "full compensation" to Jo-Ann for any harm deserves slightly more discussion. Of note, *Grand Prospect* did not address any such requirement, if a requirement it is, probably because the tenant in that case, like the tenant in this case, forgot to raise the issue. But Jo-Ann's point, at least in the abstract, does merit discussion. As JJD's Opening Brief makes

clear, it is not trying to skate out of all co-tenancy obligations. There are plenty of ways of constructing a co-tenancy clause that would be enforceable.[3] Likewise, if Jo-Ann had been harmed by JJD's temporary failure to satisfy this particular co-tenancy clause, or if Jo-Ann had bothered even to *assert* some amount of harm, JJD might well have agreed to partial rent abatement equal to that harm. But unlike proportionality review of the *enforceability* of a co-tenancy clause as written, which focuses on the reasonableness of the parties' efforts to approximate any loss at the time of contracting, Section 3275 clearly contemplates "full compensation" to mean *actual* harm *at the time of breach*. Otherwise, Section 3275 would not, as per it terms, permit a party who "incurs a forfeiture, or a loss in the nature of a forfeiture . . . [to] be relieved therefrom." (Civ. Code § 3275.)

That is to say, "full compensation" cannot mean "Substitute Rent" (a 72% rent reduction) unless Jo-Ann can show that it lost something like 72% of its business because of the temporary closure of the Toys-R-Us space. That interpretation of "full compensation," seemingly advanced in Jo-Ann's brief, equates "full compensation" with whatever the co-tenancy clause specifies as damages. This tautological and self-fulfilling argument fails to recognize that, if accepted, JJD would suffer exactly the penalty imposed by the co-tenancy clause. Surely the California Legislature did not intend such an obviously self-defeating result, in effect smuggling the terms of an unenforceable penalty into the definition of "full compensation."

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3 For example, by a reduction in rent in proportion to the change in foot traffic in the mall, a comparison of lost business, if any as between when the co-tenant was open and when closed, or in proportion to the expected change in overall business. Even a static reduction, so long as it could plausibly be said to have been an effort to approximate damage from closure of an anchor tenant might well be enforceable. Of course the fact that *this* contract's fixed reduction applies across wildly differing circumstances necessarily defeats any inference that Substitute Rent was intended to approximate the harm flowing from the violation of the co-tenancy provision.

Discovery in this case has long since ended, and the issues presented for disposition never included a claim that Jo-Ann suffered a single scintilla of loss. If, at some point in the future, circumstances again beyond JJD's control—for recall that Section 3275 does not apply when any default, breach, failure, or otherwise is "grossly negligent, willful, or fraudulent"[4]—conspire to prevent satisfaction of the co-tenancy clause, JJD invites Jo-Ann to request full compensation for any resulting harm. JJD will negotiate with Jo-Ann in good faith over this point, as it has on any number of other issues over the years. What JJD does not wish to abide is a NASDAQ-listed company attempting to pay rent with a song over something that publicly traded company has never even bothered to say caused a penny of harm this time around.

C. Jo-Ann's Isolated Efforts To Engage on the Merits Reveal the Extremity of Its Position.

This Court is a court of last resort, and if it decides that excepting co-tenancy agreements from the protections of Section 3275 is consistent with an otherwise-unknown legislative intent and prudent policy, it may do so. JJD then would lose. But JJD's Opening Brief sets out a number of reasons why this would usurp the role of the Legislature, be unfair and unworkable in theory and in practice, and would invite an all-out assault by powerful national corporations on California's balanced, regulated form of capitalism.

Jo-Ann engages with none of these arguments beyond calling them waived or simply asserting, without any effort at a defense from first principles or sound policy, that commercial agreements subject to negotiation must be enforced as written. (E.g., Answering Brief at 7 ["The

4 No party has contended (because there would be no basis to) that the forfeiture at issue is the result of JJD's grossly negligent, willful, or fraudulent conduct.

parties' contractual intent when reduced to writing should be controlling and enforced, particularly as applied to the commercial leasing market in arms-length negotiations and transactions."].) Curiously, for a party taking such a position, Jo-Ann nevertheless spends pages seeming to defend the result Grand Prospect reached on its facts (*id*. at 45-53), despite elsewhere acknowledging that the Third District in the opinion below repudiated Grand Prospect more or less entirely. (*Id.* at 36 ["According to the Court of Appeal, the Grand Prospect court erred in finding that a condition precedent could operate as an unenforceable penalty."].)

Jo-Ann's vacillation reveals a lack of commitment to the analytic framework it advances—perhaps because the result in Grand Prospect seems so obviously correct. But if, as Jo-Ann at least suggests with its extended discussion, Grand Prospect is defensible on its facts, then the parties are actually in agreement on the first question this Court has asked: the analytical framework. Grand Prospect applies to co-tenancy provisions in commercial leases.

Once the framework is established, Jo-Ann's Answering Brief offers no real response on the merits, except to claim—in obvious, even flagrant contradiction to what it wrote above—that "This fact-specific analysis [under Grand Prospect] is exactly what the trial court and Court of Appeal in JJD-HOV conducted here, and in great detail." (*Id.* at 47.) JJD's only response to this argument is to ask when and where? The trial court did not conduct a proportionality analysis. The Court of Appeal did not either. Jo-Ann's Answering Brief doesn't actually cite to any of the lower courts' application of this analytical framework, and neither does Jo-Ann engage with JJD's observations about the irrationality of the Substitute Rent penalty (applicable across all time and all manner of breaches in like amount) if it was actually intended to function as an approximation of damages instead of a tool to coerce performance. Instead, Jo-Ann simply

repeats over and over again that the parties negotiated the co-tenancy clause and the numbers changed. But of course, that numbers can be negotiated and changed out of a desire to develop the right size bludgeon does not suggest they were negotiated and changed out of a desire to approximate likely harm. Jo-Ann never offers or explains an analytical framework a commercial tenant might use to approximate the harm flowing from the breach of a co-tenancy agreement. It does not do so because it knows such a term would look nothing like the Substitute Rent term used in this co-tenancy provision. And Jo-Ann certainly never engages with why it would be reasonable to give a party a 72% reduction in rent, more than $30,000 per month (and ballooning to over $40,000 per month by the end of the lease), for zero harm under all manner of difference scenarios (choir practice space, beer garden, missile manufacturing facility). Jo-Ann does not because it cannot.

CONCLUSION

The Court has before it a simple choice: confirm that Section 3275 means what it says, as the Fifth District Court of Appeal did in *Grand Prospect* and as has worked perfectly well in the intervening years; or craft a judicial exception to this important protection in the Civil Code. The record is sufficient, and indeed ample, to permit decision of the entire case. Substitute Rent is not an enforceable co-tenancy penalty any more than the loan penalty in the negotiated, arms-length, commercial agreement in *Ridgley* was enforceable. If, however, the Court is uncertain it can or desires to apply the standard it selects to this particular agreement, it may remand. Regardless, JJD respectfully suggests the judgment below should be reversed.

DATED: January 30, 2023

WHITNEY, THOMPSON & JEFFCOACH LLP

By: 

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CERTIFICATE OF COMPLIANCE PURSUANT TO CALIFORNIA RULES OF COURT RULE 8.504(d)(1)

Pursuant to California Rules of Court Rule 8.504(d)(1), I certify that according to Microsoft Word the attached brief is proportionally spaced, has a typeface of 13 points and contains 3,417 words.

DATED: January 30, 2023

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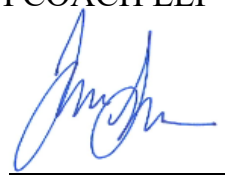
By: 

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PROOF OF SERVICE

JJD-HOV ELK GROVE v. JO-ANN STORES, LLC
Case No. 34-2019-00248163

STATE OF CALIFORNIA, COUNTY OF FRESNO

At the time of service, I was over 18 years of age and not a party to this action. I am employed in the County of Fresno, State of California. My business address is 970 W. Alluvial Ave., Fresno, CA 93711.

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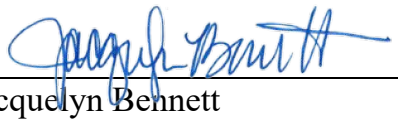

Jacquelyn Bennett

STATE OF CALIFORNIA
Supreme Court of California

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Supreme Court of California

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Lower Court Case Number: **C094190**

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