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NOT TO BE PUBLISHED IN THE OFFICIAL REPORTS

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

SECOND APPELLATE DISTRICT

DIVISION SEVEN

UNZIPPED APPAREL, LLC et al., Plaintiffs, Cross-defendants and Appellants, v. SWEET SPORTSWEAR, LLC et al., Defendants, Cross-complainants and Appellants.	B203995 (Los Angeles County Super. Ct. No. BC319612)

APPEALS from a judgment and orders of the Superior Court of Los Angeles County, James R. Dunn, Judge. Affirmed in part, reversed in part, vacated in part, and remanded.

Latham & Watkins, Kristine L. Wilkes and G. Andrew Lundberg; Blank Rome, James T. Smith, Brian S. Paszamant and Judd A. Serotta; Greenberg Traurig, George M. Belfield and Jordan D. Grotzinger for Unzipped Apparel, LLC, Iconix Brand Group, Inc., Michael Caruso & Co., Inc. and IP Holdings, LLC.

Law Offices of Gary Freedman and Gary A. Freedman; Browne Woods George, Edward A. Woods, Peter W. Ross, Michael A. Bowse and Marta B. Almli for Apparel Distribution Services, LLC, Sweet Sportswear, LLC, Azteca Production International, Inc. and Hubert Guez.

After an 11-week jury trial on numerous claims and cross-claims between the parties, the jury returned verdicts in favor of plaintiffs and appellants on all of their claims, and against defendants and appellants on all of their claims. The parties filed numerous posttrial motions. The trial court granted some of the posttrial motions and denied others. The trial court had also dismissed some of the parties' claims before trial. Both sides appeal. We affirm in part and reverse in part.

FACTUAL AND PROCEDURAL BACKGROUND

A. The Parties and their Contracts

Hubert Guez, in his words, is "a specialist of jeans, making jeans for everybody" and "for the whole world." Through his various companies, Guez manufactures and distributes designer jeans for brands such as Calvin Klein, Tommy Hilfiger, American Eagle, and Levi's. One of his companies is Azteca Production International, Inc. (Azteca), which Guez owns with his brother. Azteca through a Mexican subsidiary has a one million square foot facility in Mexico dedicated to manufacturing jeans. Azteca manufactures 100,000 pairs of jeans a day and 25 million pairs of girls junior jeans annually, and generates annual gross income of $250 to $350 million. Another one of Guez's companies is Apparel Distribution Services, LLC (ADS), which, as its name implies, provides warehousing, shipping, inventory, and distribution services for the jeans manufactured by Azteca. Sweet Sportswear, LLC (Sweet), another entity owned by Guez and his brother, provides management services for Guez-affiliated companies.

Iconix Brand Group, Inc., a publicly traded company formerly known as Candie's, Inc. (Candie's), is in the business of managing brands and licensing trademarks, including the Bongo and Candie's trademarks. Candie's has a wholly owned subsidiary, Michael Caruso & Co., Inc. (MC), which licenses these trademarks in exchange for royalty payments. Another wholly owned subsidiary of Candie's, IP Holdings, LLC (IPH), does what its name suggests: It is a holding company for intellectual property rights, and owns the Bongo trademark. Neil Cole is chairman of the board and chief executive officer of Candie's.

The parties' business relationship began in 1998 when they formed Unzipped Apparel, LLC (Unzipped), a joint venture among Candie's, MC, and Sweet, with MC and Sweet each owning 50 percent of the joint venture.[1] The 1998 joint venture agreement provided that MC would contribute to Unzipped $500,000 and royalty-free licenses for the Bongo and Candie's trademarks, and Sweet would contribute to Unzipped $500,000 and management services to supervise and operate Unzipped's business and affairs. The 1998 joint venture agreement also provided that Unzipped would be governed by a management committee, that Sweet would be the manager of Unzipped, and that Sweet would be responsible for maintaining and managing the "financial recordkeeping and accounting affairs" of the joint venture. The joint venture agreement was accompanied by two additional contracts: The 1998 Supply Agreement, pursuant to which Azteca agreed to manufacture and supply Bongo jeans for Unzipped at cost plus 7 percent, and the 1998 Distribution Agreement, pursuant to which ADS agreed to warehouse and distribute the jeans for Unzipped for $.50 per pair of jeans ($.35 for warehouse storage, shipping, tracking, labor and management services, and "maintenance of perpetual inventory," and $.15 for order entry, billing, "MIS" (presumably management information services), and office supplies).

One of the terms of the 1998 Unzipped joint venture agreement was that Candie's would purchase Sweet's 50 percent interest in Unzipped on January 31, 2003. This term was intended to provide a mechanism for ending the joint venture and separating the parties. The agreement established a formula for calculating the sale price: 50 percent of 7.5 times EBITDA (earnings before interest, taxes, depreciation, and amortization) for fiscal year 2003 (February 1, 2002 to January 31, 2003). The parties, however, did not wait until January 31, 2003 to consummate the buyout by Candie's of Sweet's 50 percent

[1] The parties generally refer to Candie's, Unzipped, MC, and IPH as "plaintiffs," and refer to Guez, Sweet, Azteca, and ADS as "defendants" or "the Guez parties." These general denominations, which we use in this opinion, are subject to the qualifications that the two groups of parties have a cross-complaint between them, and that not each plaintiff and not each defendant is a party to each cause of action.

interest in Unzipped. Instead, during April through October 2002 the parties negotiated an early buyout, documented by, among other agreements, a binding April 23, 2002 Term Sheet, and a more formal October 18, 2002 Equity Acquisition Agreement. Both aspects of this transaction, the formula for calculating the purchase price and the early purchase by Candie's of Sweet's 50 percent interest in Unzipped, created much of the dispute that eventually led to this litigation.

And here's why: The economic fundamentals of the transaction created uncertainties and incentives for each side to take advantage of the other side. For example, the purchase price was dependent on the financial performance of Unzipped for fiscal year 2003. Sweet had the incentive to report Unzipped's financial condition and performance as healthy and robust as possible; Candie's had the incentive to question and understate Unzipped's financial condition. Valuation issues, such as the subjective or discretionary component in determining the value of Unzipped's inventory at any point in time, contributed to the difficulty of valuing Unzipped's overall financial condition. The timing of the purchase also affected the parties' incentives, with each side gambling that the early purchase price in 2002 would be lower (Candie's) or higher (Sweet) than it would be in January 2003. The two sides' different levels of access to Unzipped's financial information created another significant potential for dispute. Candie's claimed that Sweet inflated Unzipped's financial figures so that Candie's paid more than it should have for Sweet's half of the joint venture and that Guez concealed financial information that would have affected the purchase price. Guez and Sweet claimed that Candie's "finagled" Unzipped's financial figures when it suited Candie's' purposes.

As part of the April 23, 2002 Term Sheet, Guez became a member of the board of directors of Candie's. As part of the October 18, 2002 Equity Acquisition Agreement, the parties entered into a new contract for the provision by Sweet of management services for Unzipped, the Management Services Agreement (MSA). Pursuant to this agreement, Sweet, although no longer a 50 percent owner of Unzipped, agreed to continue to serve as the manager of the Unzipped. Sweet also agreed to provide management services to Unzipped, including maintenance of Unzipped's financial records and preparation of its annual financial reports. The parties also entered into a new supply contract with Azteca, the Amended and Restated Supply Agreement (ARSA), which required Unzipped to pay Azteca cost plus 6 percent, and a new distribution agreement with ADS, the Amended and Restated Distribution Agreement (ARDA), which required Unzipped to pay ADS $.50 per pair of jeans.

The October 2002 agreements contained several terms that became important to the parties' subsequent dispute. Pursuant to the Equity Acquisition Agreement, Candie's paid for Sweet's 50 percent interest in Unzipped with stock (which Guez subsequently sold for $18 million) and an $11 million note at 8 percent interest, which required Candie's to make quarterly interest payments of $220,000 until April 23, 2012, the maturity date of the note. In the Equity Acquisition Agreement, Sweet warranted that Unzipped's financial statements were true, correct, and accurate and that Sweet had prepared them in accordance with generally accepted accounting principles (GAAP). Sweet also warranted that there were no undisclosed adverse material circumstances, liabilities, changes, or losses. The MSA provided that Sweet would manage Unzipped "in a faithful manner and in the best interest of" Unzipped and that Sweet would continue to maintain Unzipped's books and records. Significantly, Sweet guaranteed in Paragraph 2.7 of the MSA that Unzipped would make an annual profit of at least $1.7 million, and agreed that if Sweet failed to realize this profit, as determined by Unzipped's accountants "at the time of the issuance of the audited results," then Sweet would not earn a management fee for that year. Sweet also agreed that if Unzipped's annual net income was less than the $1.7 million guarantee, Sweet would pay Unzipped the difference. Candie's could receive the "shortfall" (i.e., the amount less than $1.7 million in net income) in cash, or Candie's could offset the shortfall amount against interest and principal due under the $11 million note.

The parties' relationship, which was never smooth, deteriorated in early 2004. Candie's owed quarterly interest payments on the $11 million note; Sweet would owe a shortfall payment if Unzipped's net income failed to reach $1.7 million; and neither side trusted the other side or its accountants and auditors. The issue of inventory reserves, which had a direct impact on Unzipped's profitability and therefore on whether Sweet would meet the $1.7 million guarantee and whether Candie's would have to make interest payments under the $11 million note, was one of the greatest points of controversy.[2] Plaintiffs claimed that defendants were artificially inflating Unzipped's financial performance by valuing the inventory reserve too low, and defendants claimed that plaintiffs were artificially depressing Unzipped's performance by valuing the inventory reserve too high.[3] Candie's also claimed that it could never get accurate financial information from Sweet or Guez, and Sweet claimed that Candie's was using accounting chicanery to conjure up excuses not to make interest payments on the $11 million note.

In addition to the fact that the personal relationship between the principal individuals, Cole and Guez, had deteriorated to the point that they were not on speaking terms, tension between the two sides increased as they began to look toward the future. The MSA expired on January 31, 2005. In February 2004 plaintiffs began exploring new license agreements with potential new licensees, even though the sublicense agreement between MC and Unzipped, according to defendants, prohibited plaintiffs from doing so until August 1, 2004.[4] Defendants claimed that the premature license negotiations by

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[2] Guez had his controller run internal pro forma analyses on the effect that different inventory reserve values would have on the $1.7 million guarantee. Candie's performed similar analyses of the relationship between the inventory reserve and the guarantee.

[3] The inventory reserve is the difference between the cost of a pair of jeans and the current estimated value. A low inventory reserve means that the jeans in the inventory are still near their original value, whereas a high inventory reserve means that the jeans in the inventory have declined in value. Essentially, Sweet and Guez believed that the jeans in the inventory could be sold for more than Candie's did. Each side consulted Unzipped employees and auditors in support of their different inventory reserve values. Sweet and Guez initially set the inventory reserve at $1,854,000; Candie's set the inventory reserve at $4.1 million. As Guez testified: "There is no right and wrong in inventory reserve. It's a carrying value. It's a management estimate." The auditors ultimately sided with Candie's on this issue.

[4] Paragraph 20 of the sublicense agreement between MC as licensor and Unzipped as licensee provides: "During the last six (6) months of the final Contract Year, Licensor shall have the right to design and manufacture merchandise of the types covered by this Agreement and to negotiate agreements which grant a license to a party of any of the

Candie's were not only a breach of contract, but also damaged Unzipped's operations and impeded Sweet's ability to maximize Unzipped's performance and meet the $1.7 million guarantee.

Meanwhile, Guez had approached Candie's with a proposal to sell several other brands of jeans, including brands called Hippie (the predecessor to True Religion), Hint, and Private Label. Guez was unable to interest Candie's in these new ventures, primarily because Candie's wanted to concentrate on selling Bongo jeans rather than starting "new business ventures with Mr. Guez." So Guez did the next best thing: He started a new business (actually, he reactivated a dormant company owned by him and members of his family called Commerce Clothing) to sell Hippie jeans using Unzipped resources, such as current and former Unzipped employees, business contacts, and showroom space. Guez, while he was still on the board of directors of Candie's and while Sweet was still the manager of Unzipped, hired Unzipped employees to arrange for the leasing of office and showroom space for the Hippie project in the same building that had the Bongo showroom, and for access by the new venture's computers to Unzipped's computers. One of these individuals, Gary Bader, whom the parties refer to as the "president" of Bongo jeans, conducted Hippie business for Guez on Unzipped time, using Unzipped email addresses, and working in Unzipped offices and showrooms. Guez testified that he did not feel that he had to disclose his new jeans businesses to Candie's because he believed that Hippie jeans, which would be priced higher, would not compete with Bongo jeans, and in fact would help and support the Bongo line of jeans. Plaintiffs presented evidence that Hippie and Bongo jeans were competitive.

On August 5, 2004 Candie's terminated the MSA, the ARSA, and the ARDA, and filed this action. In an anticipatory action to mitigate their claimed damages and to collect some of the money that defendants believed plaintiffs owed them, defendants sold

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rights herein mentioned." The purpose of this provision was disputed and unclear. Because the sublicense agreement between MC and Unzipped was a non-exclusive license, there should have been no reason for the parties to agree that MC could start looking for new licensees during the last six months of the term of the sublicense.

the remaining Bongo-trademarked jeans in their possession, despite plaintiffs' demand for the return of all of the Bongo jeans.

B. The Claims

Plaintiffs' 72-page (excluding hundreds of pages of exhibits), 293-paragraph, first amended complaint asserted 19 causes of action in four general categories: (1) fraud claims primarily against Guez and Sweet in connection with the April 23, 2002 Term Sheet and the October 18, 2002 Equity Acquisition Agreement (the first, second, third, fourth, fifth, sixth, and seventh causes of action); (2) breach of contract claims against Sweet and Azteca (the eighth (for breach of the MSA) and tenth (for breach of the Supply Agreement) causes of action); (3) breach of fiduciary duty claims against Sweet and Guez (the ninth and twelfth causes of action); and (4) trademark, conversion, and unfair competition claims against all four defendants (the eleventh, thirteenth, fourteenth, fifteenth, sixteenth, seventeenth, eighteenth, and nineteenth causes of action). Defendants' more modest 28-page, 135-paragraph, first amended cross-complaint asserted 11 causes of action also in four general categories: (1) breach of contract claims against Unzipped in connection with the MSA, the ARSA, and the ARDA (the first, second, and third causes of action); (2) interference claims against Cole (the fourth, fifth, and sixth causes of action); (3) breach of contract and fraud claims against Candie's in connection with the $11 million note (the seventh, eighth, ninth, and tenth causes of action); and (4) an indemnification claim by Guez against Candie's for failure to indemnify and defend Guez, as a board member of Candie's, for this action (the eleventh cause of action).

C. The Trial Court's Pretrial Rulings

Prior to trial, the trial court granted defendants' motion for summary adjudication on plaintiffs' original fraud claims in the first amended complaint. Plaintiffs subsequently filed a motion for leave to amend in order to allege five new (or at least new versions of their) fraud causes of action based on four new allegations of fraud. The trial court denied leave to amend as to three of plaintiffs' new fraud allegations and allowed plaintiffs to file a second amended complaint containing the five new causes of action based on the remaining new fraud allegation. The trial court, however, ultimately granted defendants' motion for summary adjudication on these five fraud causes of action as well. The trial court also sustained Cole's demurrer to the interference claims in defendants' first amended cross-complaint without leave to amend.

D. The Trial

The parties tried the remaining claims to the jury, over approximately two and a half months from January to April 2007. To keep track of the various claims arising out of the various contracts, duties, and relationships, the parties gave names to the claims, such as "Sylvain," "Belts and Sarongs," and "Perpetual Inventory." The trial court adopted these names, and the April 9, 2007 jury verdicts consist of findings on those claims.

Plaintiffs prevailed on all of their claims, including their punitive damages claim against Guez. Defendants prevailed on none of their claims. The jury awarded plaintiffs more than $50 million, although some of this amount required adjustment for duplicative awards on the trademark and conversion claims.

On June 4, 2007 defendants filed motions for judgment notwithstanding the verdict (JNOV) and a motion for a new trial. On November 16, 2007 the trial court issued its final order ruling on defendants' motions for JNOV and for a new trial. Also on November 16, 2007 the trial court entered judgment on the complaint as to defendants Guez and ADS only, and on the cross-complaint as to all parties. Both sides appeal.

JURISDICTION

Because the existence of an appealable judgment or order is a jurisdictional prerequisite for an appeal, "whenever a doubt exists as to whether the trial court has entered a final judgment or other order or judgment made appealable by Code of Civil Procedure section 904.1,[5] a reviewing court must raise the issue on its own initiative." (*First Security Bank of Cal., N.A. v. Paquet* (2002) 98 Cal.App.4th 468, 472; see *Harrington-Wisely v. State of California* (2007) 156 Cal.App.4th 1488, 1494; *Jennings v.*

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[5] Statutory references are to the Code of Civil Procedure unless otherwise indicated.

Marralle (1994) 8 Cal.4th 121, 126.) Even where none of the parties raises "the threshold issue of whether the judgment is appealable," this court is "dutybound" to consider it because the question of appealability goes to jurisdiction. (*Nguyen v. Calhoun* (2003) 105 Cal.App.4th 428, 436.)

A. The November 16, 2007 Judgment

On November 16, 2007 the trial court entered judgment on the complaint in favor of plaintiffs and against defendants Guez and ADS. The trial court refused (over plaintiffs' objections) to enter judgment in favor of plaintiffs and against Sweet and Azteca, because it had ordered a new trial on certain issues as to Sweet and Azteca. The court on November 16, 2007 also entered judgment in favor of plaintiffs and against defendants on all causes of action in the first amended cross-complaint. The trial court's decision to enter judgment on the complaint against only two of the four defendants raises issues under the one judgment rule of whether and how much of the judgment is appealable, and as to which parties, even though the judgment resolves all claims and issues in the cross-complaint.

The one judgment rule, effectively codified in section 904.1, subdivision (a), provides that only final judgments are appealable. (*Otay River Constructors v. San Diego Expressway* (2008) 158 Cal.App.4th 796, 803.) It is this finality that makes a judgment appealable. (*Sullivan v. Delta Air Lines, Inc.* (1997) 15 Cal.4th 288, 304; see *Walton v. Mueller* (2009) 180 Cal.App.4th 161, 172, fn. 9 ["Under this rule, an appeal lies only from a final judgment that terminates the trial court proceedings by completely disposing of the matter in controversy"].)

In multi-party, multi-claim actions, a "judgment is not final and not appealable when it decides the issues in a cross-complaint but not the issues in a complaint, unless the cross-complaint sought separate and independent relief by or against different parties, or the judgment or order on the cross-complaint leaves no issues to be determined as to one party." (*Westamerica Bank v. MBG Industries, Inc.* (2007) 158 Cal.App.4th 109, 132; see *ECC Construction, Inc. v. Oak Park Calabasas Homeowners Assn.* (2004) 122 Cal.App.4th 994, 1002; *American Alternative Energy Partners II v. Windridge, Inc.*

(1996) 42 Cal.App.4th 551, 557.) The rule requiring dismissal of an appeal "does not apply when the case involves multiple parties and a judgment is entered which leaves no issue to be determined as to one party." (*Nguyen v. Calhoun, supra,* 105 Cal.App.4th at p. 437.) Thus, a judgment that decides the issues in a cross-complaint but not the issues in the complaint may still be final and appealable if it decides all of the issues as to some of the parties. (*First Security Bank of Cal. v. Paquet*, *supra*, 98 Cal.App.4th at p. 473; see *Morehart v. County of Santa Barbara* (1994) 7 Cal.4th 724, 741 (*Morehart*) ["Judgments that leave nothing to be decided between one or more parties and their adversaries . . . have the finality required by section 904.1, subdivision (a)"].) The reason for this exception to the one judgment rule is "that it better serves the interests of justice to afford prompt appellate review to a party whose rights or liabilities have been definitively adjudicated than to require him to await the final outcome of trial proceedings which are of no further concern to him." (*Justus v. Atchison* (1977) 19 Cal.3d 564, 568, disapproved on another point in *Ochoa v. Superior Court* (1985) 39 Cal.3d 159, 171.)

1. Sweet and Azteca

The November 16, 2007 judgment does not resolve all of the claims and issues as to Unzipped, Candie's, MC, and IPH, on the one hand, and Sweet and Azteca, on the other hand. True, the judgment on the cross-complaint resolves all claims and issues in the cross-complaint against Sweet, Azteca, ADS, and Guez, and in favor of Unzipped, Cole, Candie's, MC, and IPH. But there is no judgment on the complaint in favor of or against Sweet and Azteca, and therefore there are still unresolved claims and issues against Sweet and Azteca in the complaint. In fact, not only are there unresolved claims against Sweet in the complaint, but the judgment against Sweet on the cross-complaint does not fully resolve Sweet's cross-claims. Although the judgment provides that Sweet "shall recover nothing on its cross-claims against any and all cross-defendants," it also provides that "[t]his judgment does not affect any amounts due on the 8 percent Senior Subordinated Note" between Sweet and Candie's.

Therefore, the exception to the one judgment rule for fully resolved claims and issues does not apply, and this court does not have jurisdiction to hear appeals from the November 16, 2007 judgment as to Sweet and Azteca. As to Guez and ADS, the issue is whether this court has jurisdiction to consider the appeal from the November 16, 2007 judgment in the absence of a judgment on plaintiffs' claims against Sweet and Azteca on the complaint.

2. Guez

In the second amended complaint, Guez is named as a defendant in 13 causes of action, including claims for fraud, breach of fiduciary duty, trademark infringement, conversion, and unfair competition. The trial court granted Guez's motions for summary adjudication on the fraud claims, and the jury found against Guez on the breach of fiduciary duty, trademark infringement, conversion, and unfair competition claims. The jury also found by clear and convincing evidence that Guez's infringement was intentional, and that he had acted with malice, fraud, or oppression. The trial court on November 16, 2007 entered judgment against Guez in the amount of $6,441,000 in compensatory damages, $4 million in punitive damages, and $523,730 in prejudgment interest. The trial court also entered judgment in favor of Guez on all of the fraud causes of action dismissed prior to trial, and entered judgment against Guez on the cross-complaint.[6]

The parties tried four breach of fiduciary duty claims asserted by Candie's against Guez to the jury. These claims were that (1) Guez failed to make certain disclosures to the board of directors of Candie's prior to the board's decision to invest $4.4 million in

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[6] The first amended cross-complaint includes a cause of action by Guez against Candie's, the eleventh, for breach of the indemnification agreement. In this cause of action Guez alleged that he had an indemnification agreement with Candie's that required Candie's to indemnify and defend him for the claims asserted in this action by Candie's, Unzipped, MC, and IPH. Plaintiffs filed a motion for nonsuit on this cause of action, but the record does not indicate the trial court's ruling on the motion. The November 16, 2007 judgment does not mention this claim, and the parties represent that Guez withdrew it.

Unzipped, for which the jury awarded Candie's $6,441,000; (2) Guez diverted Unzipped's resources to set up the Hippie, Hint, and Private Label businesses, for which the jury awarded Candie's $8.1 million; (3) Guez allowed Azteca to overcharge Unzipped, for which the jury awarded Candie's $11,238,000; and (4) Guez allowed ADS to overcharge Unzipped, for which the jury awarded $4,256,000.

This court has jurisdiction to hear Guez's appeal from the judgment on claims (1) and (2) because the judgment resolves those claims as to Guez. The judgment also resolves claim (4) as to Guez, because Guez's liability for "allowing" ADS to overcharge Unzipped depends on whether and how much ADS overcharged Unzipped, and, as explained below, this court has jurisdiction to hear the appeal from the judgment as to ADS. It is possible that Azteca's exposure for overcharging Unzipped may change after a new trial, and, as explained below, this court does not have jurisdiction to hear the appeal from the judgment as to Azteca. The November 16, 2007 judgment against Guez, however, forecloses the possibility that Guez would face additional exposure on claim (3), even if Azteca's liability for overcharging Unzipped changes. Therefore, the judgment resolves claim (3) as to Guez.

Therefore, this court has jurisdiction to hear the appeals from the November 16, 2007 judgment by Guez, on the one hand, and Candie's, MC, IPH, and Unzipped, on the other hand. (See *Morehart, supra*, 7 Cal.4th at p. 740 ["[j]udgment in a multiparty case determining all issues as to one or more parties may be treated as final even though issues remain to be resolved between other parties"]; *Tinsley v. Palo Alto Unified School Dist.* (1979) 91 Cal.App.3d 871, 880 ["when there is a several judgment resolving all issues between a plaintiff and one defendant, either party may appeal from an adverse judgment, although the action remains pending between the plaintiff and other defendants"].) This is true even though some of the legal issues with respect to these parties are the same as the legal issues that remain in the action among the other parties. (*Tinsley*, at pp. 880-881 [rejecting the contention that the exception to the one judgment rule does not apply because the legal issues raised and relief sought by the remaining parties were identical to those raised and sought by the appealing parties]; see *Oakland Raiders v. National*

Football League (2001) 93 Cal.App.4th 572, 578 [following *Tinsley* and rejecting the contention that "entry of judgment in favor of defendants was improper because they are indispensable parties whose interests are identical to those of the remaining defendants"].)

3. ADS

The November 16, 2007 judgment does resolve all claims and issues between ADS, on the one hand, and Candie's, MC, IPH, and Unzipped, on the other hand. In the second amended complaint, ADS is named as a defendant in eight causes of action, including a conversion claim and trademark/unfair competition claims. The jury found against ADS on all of these claims. The trial court entered judgment on the complaint against ADS in the amount of $1,210,000.

In the first amended cross-complaint, ADS asserted causes of action against Unzipped for breach of the ARDA, and against Cole, MC, and Candie's for inducing Unzipped to breach its contract with ADS. The trial court dismissed ADS's claims against Cole on demurrer, and the jury found against ADS on its remaining claims in the first amended cross-complaint. The court on November 16, 2007 entered judgment in favor of "any and all cross-defendants" and against ADS. Thus, the judgment decides all of the claims and issues between plaintiffs and ADS.[7] Therefore, this court has jurisdiction to hear the appeals from the November 16, 2007 judgment by ADS, on the one hand, and Candie's, MC, IPH, and Unzipped, on the other hand.

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[7] The judgment against ADS also provides: "This judgment is joint and several with any liability by Azteca Production International, Inc. and Sweet Sportswear, LLC in connection with IP Holdings, LLC, Michael Caruso & Co. and Unzipped Apparel, LLC's claims for conversion and trademark infringement." There is no judgment yet on plaintiffs' claims against Sweet and Azteca for conversion and trademark infringement, although presumably it will be for $1,210,000. The trial court denied defendants' motion for JNOV on this claim, and presumably any future entry of judgment on plaintiffs' trademark infringement and conversion claims will be for the same amount, exclusive of prejudgment interest.

4. Cole

The November 16, 2007 judgment also resolves all claims between Sweet, Azteca, and ADS, on the one hand, and Cole, on the other hand. In the first amended cross-complaint, Sweet asserted a cause of action against Cole for interference with the MSA between Sweet and Unzipped, and Azteca and ADS asserted causes of action against Cole for inducing breach of the ARSA and the ARDA between Azteca and ADS, respectively, and Unzipped. On October 25, 2005 the trial court sustained Cole's demurrer to these claims without leave to amend. The court entered judgment on November 16, 2007 against Sweet, Azteca, and ADS and in favor of "any and all cross-defendants," which includes Cole. The trial court's ruling is reviewed through the November 16, 2007 judgment. (*I.J. Weinrot & Son v. Jackson* (1985) 40 Cal.3d 327, 331; *Selleck v. Globe International, Inc.* (1985) 166 Cal.App.3d 1123, 1127, fn. 1.)

B. The November 16, 2007 Orders Granting a New Trial

The November 16, 2007 orders grant motions by Sweet, Azteca, and Guez for a new trial on seven claims. The notices of appeal filed by Unzipped, Candie's, MC, and IPH on November 26, 2007 include an appeal from these orders. The joint notice of appeal expressly states that these plaintiffs are appealing from the September 27, 2007 and November 16, 2007 rulings and corresponding orders.[8] We have jurisdiction to review these orders granting the motions for a new trial pursuant to section 904.1, subdivision (a)(4). The November 16, 2007 orders denying the motions for a new trial are not appealable. (See *Walker v. Los Angeles County Metropolitan Transp. Authority* (2005) 35 Cal.4th 15, 18; *Sole Energy Co. v. Petrominerals Corp.* (2005) 128 Cal.App.4th 212, 240.)

Sections 629 and 660 provide for a 60-day limit on the trial court's jurisdiction to grant a motion for a new trial and an accompanying motion for JNOV. (See *Fischer v.*

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[8] The September 27, 2007 order was a "ruling" that allowed the parties to file suggestions or proposed modifications. In other words, it was a tentative ruling that the parties treat as a precursor to the November 16, 2007 final ruling on the parties' posttrial motions.

First Internat. Bank (2003) 109 Cal.App.4th 1433, 1451; *Pratt v. Vencor, Inc.* (2003) 105 Cal.App.4th 905, 907; *Catania v. Halcyon Steamship Co.* (1975) 44 Cal.App.3d 348, 351-352.) The 60-day period starts to run at the earliest of the following three occurrences: (1) when the court clerk mails a notice of entry of judgment pursuant to section 664.5, (2) when any party serves written notice of the entry of judgment on the moving party, or (3) when the moving party files the first notice of intention to move for a new trial. (See § 660.) The 60-day time limit is mandatory and jurisdictional. (*Dodge v. Superior Court* (2000) 77 Cal.App.4th 513, 517-518.)

The 60-day period starts to run at the filing of the notice of intent to move or a new trial, regardless of when the judgment is entered, or when notice of entry of judgment is mailed or served, if ever. (See *Fischer v. First Internat. Bank*, *supra*, 109 Cal.App.4th at p. 1451 ["where there has been no notice of entry of judgment, 'section 660 unambiguously provides that the filing of the first notice of intention to move for a new trial is the operative event for determining the 60-day period'"]; *In re Marriage of Liu* (1987) 197 Cal.App.3d 143, 151 [same]; *Bunton v. Arizona Pacific Tanklines* (1983) 141 Cal.App.3d 210, 214-215 [if the notice of intent to move for a new trial is filed before notice of entry of judgment is served, the 60-day period runs from the earlier date that notice of intent was filed]; accord, *Worth v. Asiatic Transpacific, Inc.* (1979) 93 Cal.App.3d 849, 854; see also *Catania v. Halcyon Steamship Co.*, *supra*, 44 Cal.App.3d at p. 352 ["[t]he fact that a formal judgment comporting with the court's decision to grant a motion for judgment notwithstanding the verdict is not signed or filed until after the expiration of the 60-day period does not alter the situation"].)[9]

In this case, the first of these occurrences was (3), when defendants filed a pleading entitled "Defendants' and Cross-Complainants' Joint Notice of Motion and Motion for Intent to Move for New Trial," on Monday, June 4, 2007. The sixtieth day thereafter was Friday, August 3, 2007, after which the trial court lost jurisdiction. The

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[9] Where, unlike here, a motion for JNOV is unaccompanied by a notice of intention to move for a new trial, the time deadline is different, because event (3) does not occur. (See *Pratt v. Vencor, Inc.*, *supra*, 105 Cal.App.4th at p. 910.)

trial court did not issue its tentative rulings on the motions for JNOV and a new trial until September 27, 2007, and did not issue its final rulings until November 16, 2007, both of which were long after the August 3, 2007 jurisdictional deadline. Therefore, both orders are void. (See *Siegal v. Superior Court* (1968) 68 Cal.2d 97, 101; *Davcon, Inc. v. Roberts & Morgan* (2003) 110 Cal.App.4th 1355, 1362 (*Davcon*); *Westrec Marina Management, Inc. v. Jardine Ins. Brokers Orange County, Inc.* (2000) 85 Cal.App.4th 1042, 1048.) Defendants do not contend otherwise, but argue that their arguments on appeal are nevertheless "at issue" and reviewable by this court.

The November 16, 2007 orders granting the motions by Sweet, Azteca, and Guez for a new trial are void and therefore vacated.

C. The November 16, 2007 Orders Denying JNOV

The November 16, 2007 orders deny motions by Sweet, Azteca, and Guez for JNOV on some of the claims against them. The notices of appeal filed by Sweet, Azteca, and Guez include an appeal from these orders. We have jurisdiction to review these orders denying the motions for JNOV pursuant to section 904.1, subdivision (a)(4). The orders granting the motions for JNOV are not appealable. (*Cobb v. University of So. California* (1995) 32 Cal.App.4th 798, 803-804; *Walton v. Magno* (1994) 25 Cal.App.4th 1237, 1240.) As explained above, the November 16, 2007 orders denying the motions by Sweet, Azteca, and Guez for JNOV are void and therefore vacated.

D. The November 16, 2007 Order Denying Plaintiffs' Motion To Treble Damages on Their Trademark Claims

On November 16, 2007 the trial court denied plaintiffs' motion to treble damages on their trademark claims pursuant to title 15 United States Code section 1117(b). This order is not separately appealable. (Cf. *Smith v. TCI Communications, Inc.* (Colo.App. 1999) 981 P.2d 690, 695 [order denying request for treble damages under Colorado Antitrust Act is not appealable].) This order is reviewable as to ADS and Guez, however, through the November 16, 2007 judgment against ADS and Guez.

E. The August 3, 2007 "Orders" Denying JNOV by Operation of Law

The motions by Sweet, Azteca, ADS, and Guez for JNOV were all denied by operation of law on August 3, 2007. We have jurisdiction to review those denials pursuant to section 904.1, subdivision (a)(4). The August 3, 2007 "orders" denying defendants' motions for a new trial by operation of law are not appealable. (See *Walker v. Los Angeles County Metropolitan Transportation Authority, supra*, 35 Cal.4th at p. 18; *Sole Energy Co. v. Petrominerals Corp., supra*, 128 Cal.App.4th at p. 240.)[10]

None of the November 21, 2007 notices of appeal filed by the parties specifically mentions an appeal from the August 3, 2007 denial by operation of law of defendants' motions for JNOV. Nevertheless, the notices of appeal filed by Sweet, Azteca, ADS, and Guez must be liberally construed. (See *Walker v. Los Angeles County Metropolitan Transportation Authority, supra,* 35 Cal.4th at pp. 20-21; *Beltram v. Appellate Department* (1977) 66 Cal.App.3d 711, 714; Cal. Rules of Court, rule 8.100(a)(2).) So construed, they include an appeal from the denial by operation of law of defendants' motions for JNOV. The notices of appeal make two references to orders denying motions for JNOV. Although the dates are incorrect (i.e., September 27, 2007 and November 16, 2007, rather than August 3, 2007), the notices refer to the correct motions. And, because the parties have thoroughly and exhaustively briefed all of the issues raised by the motions for JNOV, there is no surprise or prejudice to any of the parties.

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[10] Plaintiffs' motion for a new trial was also denied by operation of law, and any issue involving plaintiffs and ADS would be reviewable through the November 16, 2007 judgment as to ADS. (See *Greer v. Buzgheia* (2006) 141 Cal.App.4th 1150, 1152, fn. 1; *Dominguez v. Pantalone* (1989) 212 Cal.App.3d 201, 215.) Plaintiffs' motion for new trial, however, sought a new trial on the fraud causes of action on which the trial court had granted summary adjudication and denied leave to amend before trial. ADS is not a named defendant in those causes of action. Plaintiffs' appeal from the denial by operation of law of plaintiffs' motion for a new trial as to Guez raises the same issues as plaintiffs' appeal from the November 16, 2007 judgment regarding the trial court's pretrial rulings on plaintiffs' fraud claims, and is reviewable as to Guez through the judgment.

Although there is no actual order denying the motions by Sweet, Azteca, ADS, and Guez for JNOV, a denial of a motion for JNOV by operation of law is treated as an actual order denying the motion for purposes of section 904.1, subdivision (a)(4). (See *Nishihama v. City and County of San Francisco* (2001) 93 Cal.App.4th 298, 301; *Speece v. Browne* (1964) 229 Cal.App.2d 487, 489, fn. 1; *Estate of Shepard* (1963) 221 Cal.App.2d 70, 75.)

Plaintiffs argue that this court does not have jurisdiction to consider the merits of the motions for JNOV that were denied by operation of law, and that this court has no choice but to direct entry of judgment on the verdicts. All but one of the cases cited by plaintiffs, however, involve appeals from denials by operation of law of motions for a new trial, not denials by operation of law of motions for JNOV. (See *Siegal v. Superior Court, supra,* 68 Cal.2d 97; *Clemens v. Regents of the University of California* (1970) 8 Cal.App.3d 1; *Bunton v. Arizona Pacific Tanklines, supra,* 141 Cal.App.3d 210; *Worth v. Asiatic Transpacific, Inc., supra,* 93 Cal.App.3d 849.) Another case cited by plaintiffs, *Mercer v. Perez* (1968) 68 Cal.2d 104, involved both an order denying a motion for JNOV and an order granting a motion for a new trial, but the issue in the Supreme Court was whether the order granting the motion for a new trial was reversible because the trial court had failed to state its reasons, as required. The *Mercer* court made reference in its opinion to the 60-day limit to decide a motion for a new trial as a "persuasive analogy." (*Id.* at p. 123.) The court did not hold, however, that the merits of a motion for JNOV denied by operation of law are not reviewable.

The only case cited by plaintiffs involving a motion for JNOV is *Davcon, supra,* 110 Cal.App.4th 1355. In an earlier appeal, the Court of Appeal had reversed on procedural grounds the trial court's order granting the defendants' motion for JNOV. On remand, the defendants filed new motions for JNOV and for a new trial, and the plaintiffs filed a peremptory challenge pursuant to section 170.6. (*Davcon*, at p. 1357.) The primary issue in the second appeal was whether the filing of a peremptory challenge tolled the 60-day period under section 660 after reversal on appeal, a question the Court of Appeal answered in the negative. (*Davcon*, at pp. 1358-1366.) In a section entitled

"The Proper Remedy," the court also held that the reversal of the JNOV on procedural grounds did not allow a party, on remand, to file a new motion for JNOV to raise the same issues. (*Id.* at pp. 1366-1367.) The court then ordered the trial court to enter judgment on the jury's verdict. (*Id.* at pp. 1367-1368.) Putting aside the considerable procedural differences between *Davcon* and this case, *Davcon* was an appeal from an order granting a JNOV, and this is an appeal from an order denying (by operation of law) a JNOV.

We conclude that this court has jurisdiction over defendants' appeals from the trial court's August 3, 2007 denials by operation of law of defendants' motions for JNOV.

Azteca and ADS included in their motions for JNOV a request for offsets in the amounts of the balances that they claimed Unzipped owed them. Although included in the motions for JNOV, these motions were in effect motions for a new trial on the amount of damages. (See § 657, subd. (5).) The trial court's denials by operation of law of the motions for a new trial are not appealable. The trial court's denials by operation of law of the motions by Guez and ADS for a new trial, however, are reviewable through the November 16, 2007 judgment.

Finally, although this court can review the November 16, 2007 denial of Guez's motion for JNOV on liability for punitive damages claim, this court cannot review the trial court's August 3, 2007 denial by operation of law of Guez's motion for a new trial on the amount of punitive damages ($5 million). This court can review, however, the denial by operation of law of Guez's motion for a new trial on punitive damages through the November 16, 2007 judgment, because the judgment as to Guez is final.

F. The August 3, 2007 "Orders" Denying a New Trial by Operation of Law

The motion by Sweet, Azteca, ADS, and Guez for a new trial was denied by operation of law on August 3, 2007. As noted above, this "order" is not appealable. The denial by operation of law of the motion for a new trial by Guez and ADS, however, are reviewable through the November 16, 2007 judgment.

The jury returned verdicts against ADS on the trademark infringement/unfair competition and conversion causes of action. ADS did not move for a new trial on these causes of action. Therefore, ADS's appeal from the August 3, 2007 denial by operation of law of its motion for new trial (through the November 16, 2007 judgment) does not raise any additional claims or issues other than those raised by its appeal from the August 3, 2007 denial by operation of law of its motion for JNOV.

The jury returned verdicts against Guez for breach of fiduciary duty by allowing Azteca and ADS to overcharge Unzipped. Guez moved for JNOV and a new trial on these claims. As noted below, however, Guez does not make any argument on these claims other than those raised by Sweet and Azteca. Guez does argue that the $3,252,000 awarded by the jury on plaintiffs' perpetual inventory overcharge claim is excessive. His motion for a new trial on this ground was denied by operation of law. The jury also returned a verdict against Guez for breach of fiduciary duty by inducing the $4.4 million investment. Guez moved for JNOV on this claim, but not for a new trial. Finally, the jury returned a verdict against Guez for breach of fiduciary duty by setting up the Hippie, Hint, and Private Label businesses using Unzipped's resources. Guez moved for JNOV and for a new trial on this claim. Guez also moved for a new trial on the amount of punitive damages. Therefore, the only issues or claims raised by the denial by operation of law of Guez's motion for new trial (reviewed through the November 16, 2007 judgment) other than those raised by Guez's appeal from the August 3, 2007 denial by operation of law of his motion for JNOV are plaintiffs' claim for diversion of Unzipped's resources to the Hippie, Hint, and private label businesses, plaintiffs' claim for failure to maintain a perpetual inventory, and the award of punitive damages against Guez.

G. The Fraud Orders

On June 9, 2006 the trial court granted summary adjudication on all of the fraud causes of action in the first amended complaint asserted by Candie's and MC against Sweet and Guez. On June 23, 2006 plaintiffs filed a motion for leave to file a second amended complaint. Plaintiffs sought leave to add five fraud causes of action grounded on four new fraud allegations based on newly discovery evidence, claiming that the proposed new fraud allegations were "dissimilar to the now-dismissed fraud claims because they concern entirely different misrepresentations." On July 19, 2006 the trial court granted leave to amend as to one of the four proposed fraud allegations (which supported all five causes of action), and denied leave to amend as to the other three proposed fraud allegations. These orders are not appealable because they did not eliminate all of the issues between the parties or leave nothing left to be tried or determined. (See *Haro v. City of Rosemead* (2009) 174 Cal.App.4th 1067, 1078; *Figueroa v. Northridge Hospital Medical Center* (2005) 134 Cal.App.4th 10, 12.) Instead, these orders are reviewable from the final judgment. (*Freeman v. City of Beverly Hills* (1994) 27 Cal.App.4th 892, 896.) Therefore, these orders are reviewable as to Guez, but not as to Sweet.

On November 3, 2006 defendants moved for summary adjudication on the five fraud causes of action in the second amended complaint (based on the one remaining fraud allegation). On December 14, 2006 the trial court granted summary adjudication on the remaining fraud causes of action in the second amended complaint. This order is not appealable. (See *Fisherman's Wharf Bay Cruise Corp. v. Superior Court* (2003) 114 Cal.App.4th 309, 319.) Instead, it is reviewable from the final judgment. (See *Garcia v. Hejmadi* (1997) 58 Cal.App.4th 674, 680; *Anmaco v. Bohlken* (1993) 13 Cal.App.4th 891, 897.) Here, there is no final judgment as to Candie's, MC, and Sweet. Therefore, this order is reviewable in this appeal only as to Guez.

H. Summary of Appealable Judgment and Orders

CLAIM	VERDICT	APPEALING PARTY
Sylvain Inventory Overcharge	$834,000	Sweet, Azteca, Guez
Belts & Sarongs Overcharge	$1,027,000	Sweet, Azteca, Guez
Azteca Overcharge	$942,000	Sweet, Azteca, Guez
Agent Fees Overcharge	$568,000	Sweet, Azteca, Guez
Candie's Brand Overcharge	$6,485,000	Sweet, Azteca, Guez
Improper Interest Charges on $5 Million Note	$1,463,000	Sweet, Azteca, Guez
Failure to Give Credits for Discounts	$540,000	Sweet, Azteca
Excess Interest Charges from Third Party Lenders	$2,273,000	Sweet

Failure by ADS to Maintain a Perpetual Inventory	$3,252,000	Sweet, Guez
Distribution Charges by ADS for Sylvain Sold to Third Parties	$764,000	Sweet
Failure by ADS to Reimburse for Inventory Shortages	$240,000	Sweet, Guez
Diversion of Unzipped's Resources for Hippie/Hint/Private Label	$8,100,000	Sweet, Guez
Failure to Meet Payroll Budget FY 2004	$1,105,000	Sweet
Failure to Reduce Expenditures by $50,000	$1,194,000	Sweet
Failure to Meet $1.7 Million Guarantee for FY 2004	$1,888,000	Sweet
Failure to Meet $1.7 Million Guarantee for FY 2005	$4,900,000	Sweet
Breach of Fiduciary Duty by Inducing Candie's to Invest $4.4 Million in Unzipped	$6,441,000	Guez
Trademark Infringement	$1,210,000	Sweet, Azteca, Guez, ADS
Conversion	$1,210,000 (duplicative)	Sweet, Azteca, Guez, ADS
Punitive damages (liability and amount)	$5,000,000	Guez
Breach by Candie's of $11 Million Note	No liability	Sweet
Offset for Unzipped's Breach of the ARDA	No Liability	ADS
Interference Claims Against Cole	Demurrer	Sweet
Fraud Claims Against Guez	Demurrer; Summary Adjudication	Candie's, MC

DISCUSSION

A. The August 3, 2007 Denial by Operation of Law of Defendants' Motions for JNOV

1. Standard of review

"On appeal from the denial of a motion for judgment notwithstanding the verdict, we determine whether there is any substantial evidence, contradicted or uncontradicted, supporting the jury's verdict. [Citations.] If there is, we must affirm the denial of the motion. [Citations.] If the appeal challenging the denial of the motion for judgment notwithstanding the verdict raises purely legal questions, however, our review is de novo." (*Wolf v. Walt Disney Pictures & Television* (2008) 162 Cal.App.4th 1107, 1138.) The "'"appellate court must read the record in the light most advantageous to the plaintiff, resolve all conflicts in his favor, and give him the benefit of all reasonable inferences in support of the original verdict."'" (*Carter v. CB Richard Ellis, Inc.* (2004) 122 Cal.App.4th 1313, 1320.)

"When findings of fact are challenged in a civil appeal, we are bound by the familiar principle 'that the power of the appellate court begins and ends with a determination as to whether there is any substantial evidence, contradicted or uncontradicted,' to support the findings below. [Citation.] We view the evidence most favorably to the prevailing party, giving it the benefit of every reasonable inference and resolving all conflicts in its favor. [Citation.] Substantial evidence is evidence of ponderable legal significance, reasonable, credible and of solid value. [Citation.] However, '[s]ubstantial evidence . . . is not synonymous with "any" evidence.' [Citation.] Instead, the evidence must be '"substantial"' proof of the essentials which the law requires.' [Citation.] [¶] The focus is on the quality, rather than the quantity, of the evidence. 'Very little solid evidence may be "substantial," while a lot of extremely weak evidence might be "insubstantial."' [Citation.] Inferences may constitute substantial evidence as long as they are the product of logic and reason rather than speculation or conjecture. [Citation.] The testimony of a single witness can provide substantial evidence." (*Oregel v. American Isuzu Motors, Inc.* (2001) 90 Cal.App.4th 1094, 1100-1101; see *DiMartino v. City of Orinda* (2000) 80 Cal.App.4th 329, 336.)

2. Substantial evidence supports the jury's verdict on plaintiffs' Sylvain inventory overcharge claim

Plaintiffs claim that defendants charged Unzipped $538,000 for approximately 60,000 pairs of worthless irregular jeans that defendants had no right to sell Unzipped under the parties' contracts. The parties refer to these jeans as the "Sylvain inventory."[11] The jury awarded plaintiffs $538,000 against Sweet, Azteca, and Guez, which with prejudgment interest amounted to $834,000. The motions by Sweet, Azteca, and Guez for JNOV were denied by operation of law.[12]

There is no dispute about the $538,000 amount. This number arises out of an unusual accounting practice that defendants employed in connection with the Sylvain inventory. According to Edwin McKee, plaintiffs' forensic accounting expert who reviewed and analyzed the computerized accounting records of Unzipped and Azteca, on

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[11] The term "Sylvain" comes from the name of the person who managed the irregular inventory.

[12] For a group of claims that plaintiffs refer to as their "overcharge claims," plaintiffs note that the trial court's November 16, 2007 (void) order granted Guez's motion for JNOV "based on his supposed lack of personal responsibility, not the absence of the overcharges." The trial court concluded that Guez was not personally liable on the overcharge claims because he was only an officer and manager of Sweet, plaintiffs did not plead that Guez was an alter ego of Sweet, and Guez (as opposed to Sweet) did not owe fiduciary duties to Unzipped. Plaintiffs state that they "do not appeal that determination (other than as to the trial court's lack of jurisdiction to enter any posttrial orders)," and therefore do not discuss the merits of Guez's personal responsibility for the overcharges. Because the November 16, 2007 orders are void, and Guez's motion for JNOV was denied by operation of law, Guez had the burden to appeal the denial of his motion for JNOV on the ground that he had no personal liability for the overcharges. Guez does not make this argument on appeal. Instead, defendants incorrectly state in their reply brief that plaintiffs "concede that all of the 'overcharge' claims against Hubert Guez fail as a matter of law." As plaintiffs correctly point out in their reply brief, they made no such concession, but rather "merely appealed" the trial court's November 16, 2007 as void and argued that Guez's motion for JNOV was denied by operation of law, and that defendants "have identified no basis to overturn the denials [by operation of law] of Guez's JNOV and new trial motions."

the last day of each month between April 2002 and October 2004, defendants made a nonstandard topside journal entry in Unzipped's general ledger indicating a sale of Sylvain jeans by Azteca to Unzipped. Then, on the first day of the next month, defendants would reverse the transaction and make another entry taking the Sylvain inventory off Unzipped's books and reducing the amount due to Azteca. In April 2004, Sweet and Azteca charged Unzipped this $538,000, but for some reason Sweet and Azteca never reversed this charge, nor did Azteca ever give Unzipped any credits for the irregular jeans, as required by, and pursuant to a formula contained in, Paragraph 6 of the ARSA. Defendants do not challenge the existence of this $538,000 accounting error, but argue only that plaintiffs did not prove that the Sylvain jeans that defendants eventually delivered to Unzipped (pursuant to court order at beginning of the litigation in August 2004) were actually worthless.

There is substantial evidence that the Sylvain jeans were so defective that they were worthless. Cole, who actually saw the Sylvain jeans in the fall of 2004 and looked at representative samples in the warehouse, testified that they "were what you would call 'thirds' . . . jeans with broken zippers and holes and fit problems and unwearable problems." Contrary to defendants' contention, Cole's testimony regarding his personal observations of this inventory was not hearsay, and the trial court properly denied defendants' motion to strike a portion of Cole's testimony as hearsay.[13] Richard Danderline, who served as the executive vice president of operations and chief financial officer of Candie's from June 2000 to December 2004, testified on cross-examination without objection that "the Sylvain inventory from day one was always old unsalable garbage basically." Danderline also testified that he had never seen and could not think of any accounting reason for putting the Sylvain inventory on Unzipped's books for the

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[13] The only out-of-court statement Cole repeated was a statement by a warehouse worker identifying the jeans as the "Sylvan inventory." Cole, who was involved in the review of the damaged inventory and the attempts to mitigate Unzipped's damages caused by defendants' delivery of it, could have given the same testimony without using the name "Sylvain." The trial court did not abuse its discretion in allowing Cole to testify about his inspection of the Sylvain jeans.

last day of each month and then taking it off the next day. Nor could other board members. Guez, on the other hand, testified that the Sylvain inventory consisted of "merchandisable irregular" jeans, and was generally "of acceptable quality" and "salable." According to Guez, it was only when plaintiffs terminated the agreements and "came to take everything that had the Bongo label on [it] that belonged to Unzipped," that defendants gave plaintiffs "those units that were not salable, broken zipper, no buttons, no rivets, a hole . . . ." Guez testified that Azteca never charged Unzipped for this last batch of Sylvain inventory. The jury, however, believed Cole and Danderline and not Guez, and resolved this issue in favor of plaintiffs.

Citing California Uniform Commercial Code section 2601, defendants argue that upon delivery by Azteca of the non-conforming irregular jeans, Unzipped had three choices: (1) reject all of them, (2) accept all of them, or (3) accept some of them and return the rest. (See Cal. U. Com. Code, § 2601.) Defendants argue that because Unzipped accepted the Sylvain irregulars, and even sold them, Unzipped must pay for them. But that is not the issue. Unzipped paid for the Sylvain jeans when Sweet and Azteca charged Unzipped for them and failed to reverse the charge. Moreover, California Uniform Commercial Code section 2601 specifies courses of conduct, it "does not define the buyer's remedies." (Cal. Code com., 2d par., 23A pt. 1West's Ann. Cal. U. Com. Code (2002 ed.) foll. § 2601, p. 519; see com. to U. Com. Code (UCC), § 2-601 ["[a] buyer accepting a non-conforming tender is not penalized by the loss of any remedy otherwise open to him"]; 4 Lawrence's Anderson on the Commercial Code (3d ed. 2006) § 2-601:16, at p. 86 [under UCC § 2-601, "the buyer may accept the goods, despite the nonconformity, and recover damages for the nonconformity, including breach of warranty, plus incidental and consequential damages"].) Putting aside the difficulties of returning Bongo-trademarked goods to Azteca, the fact that Unzipped accepted the goods does not mean that the court should have granted defendants' motion for JNOV.

Defendants did not sue Unzipped for the sales price of the accepted Sylvain inventory.[14] Unzipped sued defendants for damages it incurred for delivery of nonconforming goods; i.e., the difference between the value of the goods promised and paid for ($538,000) and the value of the goods received ($0).[15]

It is undisputed, as defendants argue, that Unzipped sold some of the defective jeans and apparently obtained some amount of money in mitigation. Defendants, however, did not introduce evidence of the amount of this mitigation.[16] (See *Jackson v. Yarbray* (2009) 179 Cal.App.4th 75, 97 [burden of proving facts in mitigation of damages is on the breaching party or tortfeasor]; *Green Wood Industrial Co. v. Forceman Internat. Development Group, Inc.* (2007) 156 Cal.App.4th 766, 774 [burden of proving mitigation of consequential damages under Cal. U. Com. Code, § 2715, subd. (2)(a), rests on the breaching party]; accord, *Carnation Co. v. Olivet Egg Ranch* (1986) 189 Cal.App.3d 809, 818; see also *Summit Petroleum Corp. of Indiana v. Ingersoll-Rand Financial Corp.* (6th Cir. 1990) 909 F.2d 862, 868 [UCC generally places burden on the defendant to show mitigation].) To the contrary, Cole, who was personally involved in trying to sell the

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14 Azteca had already charged Unzipped the $538,000, and did not sue to recover that amount again. Azteca and ADS sued Unzipped for breach of the supply and distribution agreements, respectively, but present no argument or evidence that these alleged breaches included a failure to pay for the Sylvain inventory, or how much such claims would be.

15 The case relied on by defendants, *China National Metal Products Import/Export Co. v. Apex Digital, Inc.* (C.D. Cal. 2001) 141 F.Supp.2d 1013, 1024-1025, held that "a buyer's actions in continuing to order and sell known defective goods constitutes an acceptance of those goods." Unzipped, unlike the defendant buyer in *China National Metal*, did not continue to order and use the Sylvain jeans. In any event, the magistrate judge's opinion in *China National Metal* cited by defendants was set aside on appeal by the district court in *China National Metal Products Import/Export Co. v. Apex Digital, Inc.* (C.D. Cal. 2001) 155 F.Supp.2d 1174.

16 At one point on cross-examination, McKee testified that his "understanding was [that] they sold it for somewhere between twenty-five and thirty cents, a unit." McKee, however, did not have personal knowledge about this issue, as defendants argued in the trial court and argue on appeal, and relied on information that Cole had provided him. Cole testified that the Sylvain inventory was unsalable and worthless.

Sylvain inventory, indicated that he knew how much Unzipped had recovered from selling what it could of the Sylvain inventory. Defendants, however, successfully objected to this testimony on hearsay and foundation grounds and would not allow Cole to give this figure to the jury.[17]

Substantial evidence supports the jury's verdict in favor of plaintiffs on their claim for damages caused by defendants' delivery of the inventory of Sylvain jeans. The denial by operation of law of defendants' motion for JNOV is affirmed.

3. Substantial evidence supports the jury's verdict on plaintiffs' belts and sarongs overcharge claim

Plaintiffs claim that defendants charged Unzipped $663,000 for stand-alone belts and sarongs that defendants had no right to sell Unzipped under the parties' contracts, and which were worthless. Plaintiffs claim that although the contracts allowed defendants to sell Unzipped belts and sarongs that bore the Bongo mark and were affixed to jeans, these belts and sarongs did not and were not. Plaintiffs claim that these belts and sarongs were "worthless, unusable and a complete loss." The jury awarded plaintiffs $663,000 against Sweet, Azteca, and Guez, which with prejudgment interest amounted to $1,027,000.[18] The motions by Sweet, Azteca, and Guez for JNOV were denied by operation of law.

Defendants assert on appeal that they are entitled to JNOV, but argue only that plaintiffs failed to prove the amount of their damages for this claim. To the extent that

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[17] Actually, the trial judge never ruled on the objection, stating that he would "give it some thought," and asked counsel for plaintiffs to "move on to something else." Counsel for defendants never asked Cole to give the answer they had objected to Cole giving about how much Unzipped had received from the sale of the Sylvain jeans.

[18] Defendants engaged in the same unorthodox accounting practice with the belts and sarongs that they did with the Sylvain jeans. On the last day of each month, defendants would make a nonstandard topside journal entry indicating a sale of belts and sarongs by Azteca to Unzipped, and then the next day (the first day of the next month) defendants would reverse the "sale." The $663,000 (actually $662,969) amount comes from the failure of defendants to reverse the May 2004 phantom monthly charge for belts and sarongs.

defendants are claiming that the $663,000 damage award was excessive, the issue is not before us as to Sweet and Azteca. The trial court can only address the issue of excessive damages on a motion for a new trial. (See *Teitel v. First Los Angeles Bank* (1991) 231 Cal.App.3d 1593; Wegner et al., Cal. Practice Guide: Civil Trials and Evidence (The Rutter Group 2009) ¶ 18.16, at p. 18-4 (rev. #1 2008) ["[a] partial JNOV may not be used to reduce a damages verdict"].) Sweet, Azteca, and Guez moved for a new trial on this ground. As noted previously, the trial court's denial by operation of a law of this motion is not appealable and is not reviewable through the final judgment as to Sweet and Azteca (because there is no final judgment as to Sweet and Azteca).

To the extent the issue is before us on defendants' appeal from the denial by operation of law of their motion for JNOV and Guez's appeal from the denial by operation of law of his motion for a new trial, there is substantial evidence in the record to support the jury's award. Cole testified that the belt and sarong material was "trim that goes on the jean, that we would sell as part of the jean," and that are "accompaniments" to the jeans; they are not independent, stand-alone items. Michael Caruso, who founded the Bongo brand and served as a member of the Candie's board of directors and on the audit committee, explained that the belts and sarongs were part of a "belted pant product, such as pant products showing a silver concho belt, a beaded belt, or a ribbon belt that come into fashion from time to time in the junior market, usually in response to a look a celebrity has on television, in a movie, or in a magazine."

Cole, who personally reviewed several boxes of representative samples of the belts and sarongs in his office, testified that in the fall of 2004, after plaintiffs had terminated all of the contracts with defendants, Unzipped found in the warehouse "close to a million belts and sarongs." Cole testified that Unzipped tried to sell these belts and sarongs, but was unable to sell them, and "ended up giving most of them away." Caruso confirmed that the sarongs were worthless (although not because they were stand-alone items but because they went out of fashion with Britney Spears's decline in popularity), and that the belts had "a very low value." Guez testified that the belts were not worthless but were "perfectly fine." The jury resolved this issue in favor of plaintiffs.

On the issue of damages, McKee testified regarding the calculation of the belts and sarongs "overcharge." The calculation was straightforward: Defendants charged Unzipped $663,000 for the belts and sarongs; the value of the belts and sarongs as stand-alone items was $0; and therefore plaintiffs' damages were $663,000.

Defendants argue that plaintiffs did not prove their damages for this claim because some of the belts and sarongs could have been added to jeans, leaving only some of the belts and sarongs unattached and allegedly unusable, and that plaintiffs presented no evidence of this difference. Defendants rely on this excerpt of McKee's testimony on cross-examination: "Mr. Guez charged $663,000. That was the residual balance on the belts and sarongs. And it should've—some of those belts and sarongs should have been added to the jeanswear product. I think other people have testified about the value of those belts and sarongs. Yes, the difference was an overcharge." The problem with defendants' argument is that "other people" did testify about the value of those belts and sarongs, and they testified that their value was $0. McKee identified the charge ($663,000); Cole provided the value ($0); and then McKee did the math ($663,000 - $0 = $663,000). Defendants did not introduce any evidence of the value of the belts and sarongs to contradict plaintiffs' value of $0, other than Guez's statement that they were "perfectly fine." As McKee further testified on cross-examination:

> "Q. Well, it's just another false impression . . . you created with this jury, that you had the expertise to tell them these were overcharges; isn't that right?
>
> A. I'm sorry, sir, I disagree with your analysis that that was a false impression. If it had no value and you were charged six hundred and sixty-three thousand dollars, and charged to transport 'em to the impact warehouse, it's an overcharge.[19]
>
> Q. Well, maybe if you knew the value, you'd be able to tell us that.
>
> A. Other people—

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[19] Plaintiffs claimed that the belts and sarongs were actually "worth less than worthless" because ADS charged Unzipped ten cents per unit to transport the worthless belts and sarongs.

Q. Do you agree?

A. —have testified about that or, at least, that's my understanding."

The jury believed Cole, Caruso, and McKee, and not Guez. Substantial evidence supports the jury's verdict in favor of plaintiffs on their claim for damages caused by defendants' sale and delivery to Unzipped of the belts and sarongs. The denial of defendants' motion for JNOV by operation of law is affirmed.

4. Substantial evidence supports the jury's verdict on plaintiffs' Azteca overcharge claim

Plaintiffs claim that after the commencement of litigation, when they finally obtained full access to the books and records of Unzipped and Azteca, including the general ledgers, McKee determined that there was an unexplained $606,000 difference between the total amount that Unzipped had paid to Azteca and the total amount of jeans product that Unzipped had actually received. Plaintiffs claim that this unexplained $606,000 amount is an overcharge. Defendants presented evidence that they claimed explained some or all of this discrepancy. The jury believed plaintiffs' evidence, and awarded plaintiffs $606,000 against Sweet, Azteca, and Guez, which with prejudgment interest amounted to $942,000. The motions by Sweet, Azteca, and Guez for JNOV were denied by operation of law.

There is substantial evidence in the record to support the jury's verdict that this $606,000 was an overcharge. McKee and his staff spent thousands of hours analyzing the computerized books, records, general ledgers, and subledgers of Unzipped and of Azteca. McKee and his staff used accounting software called "Great Plains Dynamics" to analyze Unzipped's accounting data, and accounting software referred to as the "Vincent Reports" or "Vincent Database" to analyze Azteca's accounting data.[20] McKee described in his testimony how and for what kinds of inquiries he and his staff searched,

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[20] Great Plains is a Microsoft product. Vincent was developed internally at Azteca or ADS by an individual named Vincent Wei, which defendants presumably provided to plaintiffs in discovery. McKee's accounting firm actually worked on read-only copies of the two databases, and assigned a different staff member to work on each one.

tested, and analyzed a voluminous amount of data for the millions of dollars of transactions between Unzipped, on the one hand, and Azteca and ADS, on the other hand, over the six-year business relationship between the parties. McKee calculated that the difference between Unzipped's purchases from Azteca, as shown in Unzipped's general ledger, and Azteca's sales to Unzipped, as shown in the Vincent database, was $2,274,786.77. Taking into account the $538,000 Slyvain overcharge, the $663,000 belts and sarongs overcharge, and another $467,000 charge for trim, McKee calculated that Unzipped had paid Azteca $606,000 more than it had received from Azteca. Stated another way in the language of this litigation, Guez's company Sweet managed the affairs of Unzipped so that another one of Guez's companies, Azteca, received $606,000 more than it was entitled to receive. The jury believed McKee's testimony, despite aggressive cross-examination by counsel for defendants.[21] McKee's testimony constitutes substantial evidence.

But there was other substantial evidence to support this claim in addition to the forensic accounting and mathematics of McKee's calculations, which the jury determined was more credible than defendants' explanations. McKee also testified extensively and exhaustively on the inadequacies and deficiencies of defendants' accounting methodology, and the way defendants kept track of the financial transactions among Unzipped, Azteca, and ADS. McKee testified that there were numerous irregularities in Azteca's accounting practices. For example, McKee's analysis showed not only that Sweet caused Unzipped to pay Azteca's invoices earlier than Unzipped was contractually obligated to pay them (15 days after the invoice under the 1998 Supply Agreement and then 30 days after the invoice under the 2002 ARSA), but also that Sweet often caused

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[21] Counsel for defendants asked McKee: "Yesterday, we were talking about how an unscrupulous accountant could create a false impression that a company was prepaying its bills, by simply omitting the invoices from year one. Do you recall those questions?" Also: "Again, you're just telling the jury things you know nothing about; right?" And "you would agree, wouldn't you, that the impression you created with your chart is totally misleading?" And "as you told me, in deposition, when Jim Smith [counsel for plaintiffs] tells you to do something, you do it, right?"

Unzipped to pay Azteca *before* Azteca even issued the invoice. McKee testified that "because the managers are the same, the people are the same, money was taken out of Unzipped to pay Azteca, not with respect to any particular invoice, but just money was taken out of Unzipped and paid to Azteca and then sometime later, the funds were applied to particular invoices in the accounts payable subledger," and that "often times, quite often, they [the invoices] were inflated." Essentially, Sweet was causing Unzipped to prepay and overpay Azteca.

Azteca also issued credit memoranda, sometimes for millions of dollars, on the last day of the fiscal year in an effort to compensate for prior overcharges and discrepancies. As McKee explained: "In other words, inflated invoices were being issued throughout the year," and defendants would "wait 'till the last day of the year and issue twenty-six million dollars of credit memoranda." Sweet also charged Unzipped millions of dollars of debit memoranda for "miscellaneous," with no specific breakdowns. Sweet and Azteca also made numerous, non-standard entries of large amounts of money in Unzipped's general ledger without making any corresponding entries in Azteca's accounts receivable subledger, and then later issued credit memoranda to the general ledger. McKee explained that this practice resulted in defendants "bypassing the controls that most businesses put in place which is, have all your invoices recorded in the subledger, have all your payments recorded in the subledger. [You] look at the subledger any point in time, know exactly what is paid, what is unpaid and how old the bills are. You can't do that if you're originating payments to pay bills off the subledger, and then coming back months later and getting a credit memorandum for them." Benjamin Vargas, one of the controllers for Guez's companies, conceded that the subledgers were supposed to be in harmony with the general ledger, that the balances recorded in the Unzipped subledgers were "dramatically different than the balances that were recorded in the general ledger" and were "wrong," and that there was not supposed to be what McKee had determined was a $26 million difference between the amounts recorded in the subledger and the amounts recorded in the general ledger.

McKee also testified that Sweet and Azteca used another accounting method referred to as "actualization." McKee described this procedure as one in which Azteca would submit inflated invoices to Unzipped, periodically reconcile the invoices, and then post an "actualization entry to make it real to eliminate the overcharging or at least, most of the overcharges." Sometimes Azteca engaged in the opposite procedure. Vargas admitted that it was impossible to "point to any invoice by number and say these actualizations were related to these invoices."[22]

These details of defendants' accounting irregularities were additional substantial evidence in support of the jury's finding that the unexplained $606,000 was not, as defendants contended, an innocent and explainable figure, but an amount that Sweet caused Unzipped to pay Azteca for which Unzipped did not receive anything. Such an inference is logical and reasonable, if not irresistible. (See *Oregel v. American Isuzu Motors, Inc.*, *supra*, 90 Cal.App.4th at p. 1101.) Defendants' unusual accounting practices more than justify the jury's skepticism of defendants' attempts to explain away this overcharge.

Finally, Sweet contends that even if Azteca is liable for this $606,000 overcharge, Sweet is entitled to JNOV on this claim because Sweet was only the manager of Unzipped. Sweet argues that as Unzipped's manager, it can only be responsible for Azteca's overcharging if the cause of the overcharging was Sweet's self-interest or negligence. Sweet argues that it (as opposed to Guez) was not self-interested, and the case was not tried as a negligence case.

There is no dispute that Sweet owed Unzipped fiduciary duties, both as a matter of law and a matter of contract, to act always in Unzipped's best interests, and to refrain from dealing with Unzipped in the conduct of its business as an adverse party, or on

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[22] Used correctly, actualization, or realization, allows an accountant to record corrected sums (in this instance, costs of production) that can only be estimated at first, such as the allocated cost of the electricity used in the manufacture of the jeans. These estimated or "standard" costs are usually quite modest. Sweet was using "actualized" entries to account for millions of dollars of lump sums for "everything that was shipped to [*sic*] Azteca that was not otherwise recorded on Unzipped's books."

behalf of an adverse party. This is true under California law, which Sweet cites, and Delaware law, which plaintiffs cite (because Unzipped was a Delaware LLC and the MSA contained a Delaware choice of law provision), and it is true for Sweet as a member of the original joint venture and as a manager of the subsequent LLC. (See Corp. Code, § 17153 ["[t]he fiduciary duties a manager owes to the limited liability company and to its members are those of a partner to a partnership and to the partners of a partnership"]; Corp. Code, § 16404, subd. (b)(2);[23] *Bardis v. Oates* (2004) 119 Cal.App.4th 1, 13 ["managing partner [is] prohibited from engaging in self-dealing in any way, shape or form"]; *BT-I v. Equitable Life Assurance Society* (1999) 75 Cal.App.4th 1406, 1410-1411 ["'"'[p]artners are trustees for each other, and in all proceedings connected with the conduct of the partnership every partner is bound to act in the highest good faith to his copartner and may not obtain any advantage over him in the partnership affairs by the slightest misrepresentation, concealment, threat or adverse pressure of any kind'"'"]; 6 Del. Code. § 15-404, subd. (b)(2) [partner owes partnership and other partners duty to "refrain from dealing with the partnership in the conduct or winding up of the partnership business or affairs as or on behalf of a party having an interest adverse to the partnership"]; *Universal Studios, Inc. v. Viacom, Inc.* (Del. Ch. 1997) 705 A.2d 579, 593 ["co-venturers and partners owe fiduciary duties to each other"]; *In re Arthur Treacher's Fish & Chips of Fort Lauderdale, Inc.* (Del. Ch. 1978) 386 A.2d 1162, 1166 [joint venturers owe each other "a duty of utmost good faith, fairness and honesty with respect to their relationship to each other and the enterprise"]. This is also what the MSA says: "The Manager [Sweet] hereby accepts such engagement and agrees to perform the duties

[23] The list of duties included in the duty of loyalty under section 16404 is not exclusive. (*Enea v. Superior Court* (2005) 132 Cal.App.4th 1559, 1565.) Both section 16404 of the California Corporations Code and section 15-404 of the Delaware Code are derived from section 404 of the Uniform Partnership Act of 1997. The scope of the duty of loyalty in California's statute, however, is broader than the scope of the duty of loyalty in Delaware's statute and the uniform statute because California's statute uses the term "includes" rather than "is limited to" before listing the duties of loyalty. (*Enea*, at p. 1565.)

incident thereto in a faithful manner and in the best interest of the Company [Unzipped].” (Cf. *Bay Center Apartments Owner, LLC v. Emery Bay PKI, LLC* (Del. Ch. Apr. 20, 2009, No. 3658-VCS) 2009 WL 1124451, at *8 [“in the absence of a contrary provision in the LLC agreement, the manager of an LLC owes the traditional fiduciary duties of loyalty and care to the members of the LLC”].)

There was substantial evidence of failures by Sweet to act in Unzipped’s best interests, and to refrain from dealing with Unzipped on behalf of the adverse interests of Guez. By managing Unzipped so that it overpaid Azteca (a company that like Sweet was also owned by Guez and his brother) by $606,000, Sweet did not act in a good faith effort to advance the interests of Unzipped. Sweet had the authority to deal with Azteca and ADS in connection with the manufacture and distributions of jeans under the supply and distribution agreements, but not in a way that was unfair to and at the expense of Unzipped. More important, Sweet was interested in the transactions between its sister company Azteca and Unzipped. It is true, as defendants argue, that plaintiffs did not plead or prove that Sweet and Azteca were alter egos of Guez. But that does not mean that Sweet, Azteca, and Guez had no interest in the financial transactions between Unzipped and Azteca. Sweet, Azteca and Guez had a direct interest in when and how much Unzipped paid Azteca. (See Corp. Code, § 16404, subd. (b) [“partner’s duty of loyalty to the partnership and the other partners includes” the duty to “refrain from dealing with the partnership in the conduct . . . of the partnership business as *or on behalf of a party* having an interest adverse to the partnership,” italics added]; *Rhodes v. Silkroad Equity, LLC* (Del. Ch. Apr. 15, 2009, No. 2133-VCN) 2009 WL 1124476 [defendants can breach fiduciary duties by engaging in self-dealing transactions involving companies under the defendants’ control, if the transactions are unfair]; see also Corp. Code, § 310 [interested transaction includes a transaction “between a corporation and any corporation, firm or association in which one or more of its directors has a material financial interest”]; *In re ALH Holdings, LLC* (D. Del. 2009) 675 F.Supp.2d 462, 482 [“Aside from interested transactions which confer a direct or indirect financial benefit to the director, the duty of loyalty also arises in the corporate setting where a relationship with an interested party may affect the judgment of the director"].)

Guez testified that he was the "captain of the ship" for Unzipped, Sweet, Azteca, and ADS. His ships, however, had adverse interests, and there was substantial evidence that Sweet breached its fiduciary duty to Unzipped by managing Unzipped to the benefit of Azteca, ADS, and Guez, and at the expense of Unzipped. The denial of defendants' motion for JNOV by operation of law is affirmed.

5. Azteca's charge for plaintiffs' agent fees was not an overcharge under the ARSA

Plaintiffs claim that the 6 percent fee Azteca charged Unzipped for the manufacture of jeans included a mark up for the provision of sourcing services, and that by charging Unzipped fees that Azteca incurred in hiring third party sourcing agents, Azteca and Sweet forced Unzipped to pay twice for the same service. The jury awarded plaintiffs $568,000 against Sweet, Azteca, and Guez. The motions by Sweet, Azteca, and Guez for JNOV were denied by operation of law.

Paragraph 5(b) of the ARSA provides: "As consideration for the manufacture of the Products, Unzipped shall pay Azteca its cost plus six percent (6%) (the '*Percentage Add-on*') . . . . Manufacturing shall include (i) pre-production; (ii) sourcing; (iii) production planning and control; (iv) production; and (v) quality control." Although not specifically defined in the contract, the term "sourcing" refers to the process of securing sources from which Azteca supplied goods to Unzipped, and then verifying the quality of the goods. (See *Mid-America Tablewares, Inc. v. Mogi Trading Co., Ltd.* (7th Cir. 1996) 100 F.3d 1353, 1357 ["sourcing" is "arranging for the manufacture of"].)

Paragraph 10 of the ARSA provides: "Azteca may not transfer, delegate, sell or otherwise grant to any third party, by operation of law or otherwise, except to any entity owned by Azteca or which is under common control with Azteca, any of its obligations hereunder unless it shall have obtained the prior written approval, authorization and direction of Unzipped, which approval, authorization and direction shall not be unreasonably withheld. Notwithstanding the foregoing, Azteca may enter into agreements with other supply contractors (either directly or through agents representing such supply contractors) to manufacture for Unzipped, on behalf of Azteca, Products to be manufactured by Azteca hereunder, provided that Azteca (a) retains all responsibilities and obligations hereunder relating to such Products . . . ." An "agency fee" or "charge" is a fee charged by an agent who procures someone else to supply the goods.

There are ambiguities in these paragraphs. Paragraph 5(b) required Unzipped to pay Azteca cost plus 6 percent for the manufacture of the jeans, and manufacturing included sourcing. Paragraph 10 made Azteca's obligations non-delegable, but allowed Azteca to obtain jeans from other sources, and to use agents to find and negotiate with these other sources, as long as Azteca did not delegate its obligations under the ARSA. And one of Azteca's obligations under the ARSA was to pay other suppliers and manufacturers of jean product, if Azteca used another supplier or manufacturer.

It is undisputed that Azteca entered into agreements with other supply contractors, primarily in Turkey and Southeast Asia, to manufacture jeans for Unzipped. Azteca paid $568,000 in fees to agents of these foreign suppliers, and charged those agent fees (in addition to the cost of manufacturing the jeans) to Unzipped. Plaintiffs claim that this was an overcharge because Azteca was not allowed under the ARSA to charge Unzipped both a fee for sourcing as part of the 6 percent mark up, and a fee for sourcing paid to the agents of the other supply contractors. Plaintiffs contend that the fees paid to the agents for the foreign suppliers were not part of the "cost" that Unzipped was required to pay under the ARSA, but are part of Azteca's non-delegable obligations under the ARSA. Why, ask plaintiffs, should Unzipped have had to pay for the cost of third party sourcing, when Unzipped was already paying Azteca for sourcing? The reason, defendants answer, is that the ARSA specifically contemplated Azteca using and incurring costs of agents to contract with other supply contractors, with Azteca still retaining the control over the production and quality of the final product. Thus, defendants claim that Paragraphs 5(b) and 10 allowed Azteca to include this expense as part of the "cost" for which Unzipped was responsible.

The trial court admitted extrinsic evidence regarding these ambiguities. (See *City of Manhattan Beach v. Superior Court* (1996) 13 Cal.4th 232, 238.) But there wasn't much extrinsic evidence on this issue, nor was it particularly in conflict. Cole testified only that Unzipped never agreed to pay fees for sourcing or agency beyond those set forth in the contract, which is either a truism or circular. Cole did not testify on the issue of whether Azteca could charge Unzipped for the agent fees. His testimony was not particularly helpful in interpreting Paragraphs 5(b) and 10. Guez testified that he specifically negotiated for the right in Paragraph 10 to use other supply contractors and agents, because in certain countries "you need somebody there" as an agent, but he did not testify about any negotiations over who would pay for the costs of using agents for other supply contractors. Guez testified only that there was no discussion about whether Azteca could pass on the agent fees as part of the cost of acquiring the goods.[24] Guez also testified on cross-examination that one of the obligations that Azteca retained was the obligation to pay for products manufactured by other suppliers, but he did not testify that Azteca could not charge Unzipped for such payment and for the associated agent fees.

The "jury may interpret an agreement when construction turns on the credibility of extrinsic evidence." (*City of Hope National Medical Center v. Genentech, Inc.* (2008) 43 Cal.4th 375, 395.) Where there is no conflict in the evidence, however, the interpretation of an agreement is a judicial function, and the court must make an independent determination of the meaning of the contract. (*California Assn. of Professional Scientists v. Schwarzenegger* (2006) 137 Cal.App.4th 371, 382; *City of El Cajon v. El Cajon Police Officers' Assn.* (1996) 49 Cal.App.4th 64, 70-71; see *City of Hope*, at p. 394 [interpretation of an instrument is a judicial function "when it is based on the words of the instrument alone, when there is no conflict in the extrinsic evidence, or a determination was made based on incompetent evidence"].) Because there was no

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[24] Plaintiffs objected to this testimony, but they did not state a ground for the objection, and the trial court never ruled on the objection.

conflict in what little extrinsic evidence there was on this issue, we independently interpret Paragraphs 5(b) and 10.

We think defendants' interpretation is more reasonable. Azteca had the obligation to manufacture jeans for Unzipped. Azteca could satisfy this obligation in any number of ways: Azteca could manufacture the jeans in its facilities, Azteca could purchase jeans manufactured by other suppliers, or some combination of the two (such as assembling jeans from parts or fabric manufactured by other suppliers). Paragraph 10 specifically authorized Azteca to obtain jeans from "other supply contractors" and to pay the contractors directly or indirectly through agents. By using other supply contractors, Azteca could incur a variety of costs that Azteca could properly charge to Unzipped, such as shipping and handling the product, and negotiating and communicating with the foreign suppliers. The cost of an intermediary or agent is no different. Azteca retained the (non-delegable) duty to provide the final product to Unzipped in the proper design, quality, and quantity. Paying agent fees does not mean that Azteca was giving up or, as plaintiffs argue, "impermissibly abdicating" its responsibilities and obligations. Nor does the fact that these agents were performing "sourcing" services in foreign countries mean that Azteca was not also performing "sourcing" services.

We conclude that the costs Azteca paid to agents for the foreign supply contractors Azteca used to manufacture jeans for Unzipped were properly chargeable to Unzipped under Paragraphs 5(b) and 10 of the ARSA. The denial of defendants' motion for JNOV by operation of law is reversed.

6. Substantial evidence supports the jury's verdict on plaintiffs' "Candie's brand" overcharge claim

Plaintiffs claim that Sweet caused Unzipped to pay more than $4 million for Candie's brand jeans, but that Unzipped never received any proceeds, benefits, or credits for this $4 million expense. Plaintiffs rely on McKee's extensive review of the electronic accounting records of Unzipped and Azteca, which show the $4 million charge from Unzipped to Azteca, but do not show that Unzipped received anything in return. Defendants claim that there was a functioning Candie's brand jeans program, that

Unzipped's accounting records reflect sales of Candie's brand jeans, and that Unzipped must have received the proceeds or credits from the sale of the jeans. The jury awarded plaintiffs $6,485,000 against Sweet, Azteca, and Guez. The motions by Sweet, Azteca, and Guez for JNOV were denied by operation of law.

There is no dispute that in 2000 Azteca manufactured jeans with the Candie's brand label, which Unzipped sold in addition to jeans with the Bongo brand label until May 2000, when Candie's and Unzipped terminated the former label. Sweet accounted for the purchases (from Azteca) and sales by Unzipped of these Candie's brand jeans differently than how Sweet accounted for the purchases and sales of the Bongo brand jeans. Specifically, Sweet recorded the transactions by way of topside journal entries, again bypassing the accounts payable and accounts receivable subledgers, which McKee calculated increased the recorded amount that Unzipped owed to Azteca by a total of $4,022,235. McKee testified, however, that he could not find any support for this $4 million charge in any of Unzipped's or Azteca's ledgers, subledgers, or other records that he reviewed. McKee acknowledged that "obviously, there was a business being conducted where Unzipped was purchasing and selling jeanswear bearing the Candie's trademark," but testified that he could not determine where the $4 million charge came from and whether it was a "real number that's owed."

After McKee completed his forensic analysis, he concluded that "it's not intuitively obvious or even deductible why there would be a four [million] dollar amount owed to Azteca" by Unzipped for the Candie's brand jeans. When McKee went to the Vincent database to analyze Azteca's records, he found that there was no information at all in the Vincent database regarding Candie's brand jeans, and in fact, according to Vincent himself, the folder that had contained the information regarding Candie's brand jeans had been deleted. Azteca had deleted from its electronic accounting records all information about Candie's brand jeans, including any information about Unzipped's acquisition of Candie's brand jeans, returns by Unzipped to Azteca, sales by Unzipped to third parties, and returns applied to third parties. All of this information was gone. Nor could McKee find any information in Unzipped's subledgers about Candie's brand jeans.

There was only the $4 million charge, with no backup or other records. As McKee explained: "There's no information that would justify a four million dollar charge to Unzipped, recorded in Great Plains or recorded in the Vincent database. The information is nonexistent to support that money."

Defendants did not call a witness, expert or percipient, to rebut McKee's testimony by explaining when and what Unzipped received for this $4 million expenditure. Instead, defendants relied on two kinds of circumstantial evidence. First, defendants called Tricia Landry, who described herself as Guez's "right-hand woman," and who was involved in the production of documents by defendants during discovery in this litigation. Landry identified several boxes in the courtroom that contained documents relating to Candie's brand jeans that defendants produced in discovery, and that the parties stipulated could be received into evidence.[25] Neither Landry nor anyone else, however, identified the documents in the boxes that supported or explained the $4 million charge, nor did she or anyone else provide any testimony about how the documents supported or explained the charge. To the extent defendants were expecting the jurors to review the boxes of documents during their deliberations,[26] or to credit Landry's testimony and infer that the documents supported or explained the charge, the jury chose to believe plaintiffs' evidence over defendants' evidence. (See *Casella v. SouthWest Dealer Services, Inc.* (2007) 157 Cal.App.4th 1127, 1144 [on appeal from denial of a motion for JNOV, the reviewing court "indulge[s] all legitimate and reasonable inferences to uphold the verdict"].)

The trial court also gave proper jury instructions on the kinds of reasonable inferences that the jury could make from Sweet's deletion of the Candie's brand jeans

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[25] McKee admittedly did not review these documents, and instead analyzed the computerized accounting records of Unzipped and Azteca. McKee testified that he used the computerized databases over the hard copies of the documents because he believed that the latter were unreliable.

[26] Counsel for plaintiffs in closing argument actually urged the jurors to review the boxes of documents: "Take 'em back there and look through them because it will leave you with no explanation for where that [$4 million] went."

computerized accounting records, and defendants' failure to explain the $4 million charge. For example, the trial court properly instructed the jury that it could "consider the ability of each party to provide evidence," and that if a "party provided weaker evidence when it could have provided stronger evidence," the jury could "distrust the weaker evidence." The court also properly instructed the jury that it could consider "whether a party failed to explain or deny some unfavorable evidence," and that a party's "failure to explain or to deny unfavorable evidence may suggest that the evidence is true." The inferences that defendants' evidence was weaker and less trustworthy, and that defendants' failure to explain the $4 million overcharge suggested that the overcharge was true, were reasonable and logical inferences from the evidence. (See *Kuhn v. Department of General Services* (1994) 22 Cal.App.4th 1627, 1633 ["While substantial evidence may consist of inferences, such inferences must be 'a product of logic and reason' and 'must rest on evidence' [citation]; inferences that are the result of mere speculation or conjecture cannot support a finding"].)

Second, defendants presented evidence that Unzipped's outside auditors, Ernst & Young, had reviewed, confirmed, and approved Azteca's charges to Unzipped for the Candie's brand jeans. McKee testified, however, that Ernst & Young completed its audit that year in April 2000, and at the time the Candie's brand jeans account showed a zero balance. On June 15, 2000, after Unzipped had terminated the Candie's brand label, someone posted an account payable (i.e., from Unzipped to Azteca) in the amount of $3,473,453.34 to the previously-terminated Candie's brand jeans program account, retroactive and backdated to January 30, 2000. In other words, the audit concluded before defendants posted some or all of the Candie's brand charge. Thus, there was evidence in the record, which we view in the light most advantageous to plaintiffs, that, at a minimum, the Ernst & Young auditors did not know about, and therefore did confirm and approve, the charges for Candie's brand jeans.

McKee's unrebutted testimony is substantial evidence of the $4 million overcharge. (See *Casella v. SouthWest Dealer Services*, *supra*, 157 Cal.App.4th at p. 1144 ["Even the uncorroborated testimony of a single witness may constitute substantial evidence"].) McKee's testimony was significant, reasonable, solid, and based on an extensive and thorough analysis of defendants' accounting records. His opinions about the $4 million charge and absence of any explanation for it were the "product of logic and reason" and based on the electronic documentary evidence in the case and Vincent's testimony about the deleted accounting records. Substantial evidence supports the jury's verdict in favor of plaintiffs on their claim for $4,022,235 for Candie's brand jeans. The denial of defendants' motion for JNOV by operation of law is affirmed.

7. Substantial evidence and the terms of the contracts support the jury's verdict on plaintiffs' claim for improper interest on the $5 million note

Plaintiffs' claim that defendants overcharged interest on a $5 million note from Unzipped to Azteca is a puzzle. The parties have diametrically opposed views about what the issue even is, let alone whether the jury properly awarded $1,463,000 for the claimed overcharge. Here are the pieces of the puzzle:

The first piece is the subordination agreement. Unzipped's lender in 2001 and 2002 was Congress Financial. As additional collateral for the increase in the amount of credit Congress Financial was extending to Unzipped, Congress Financial required Azteca, also a creditor of Unzipped, to subordinate initially $3.5 million and subsequently by amendment $5 million in account payables (from Unzipped to Azteca) to Congress Financial. The subordination agreement was in lieu of a capital contribution by the principals of Unzipped (which defendants claim plaintiffs did not have the financial capacity to make at the time), in order to satisfy the lender and make Congress Financial more comfortable with its risk.

On June 1, 2000 Azteca and Congress Financial entered into a written subordination agreement, which provided: "Creditor [Azteca] subordinates payment by the Borrower [Unzipped] of any and all indebtedness, liabilities, guarantees and other obligations of the Borrower to Creditor, now existing or hereafter arising, evidenced by or in respect of that certain promissory note, dated as of May 31, 2000, made by Borrower to the order of Creditor in the original principal amount of $3,500,000 . . . (collectively, the 'Subordinated Debt'), to the payment to Congress, in full in cash, of all indebtedness, liabilities, guarantees and other obligations of the Borrower or any other obligor in respect thereof to Congress, now existing or hereafter arising (the 'Congress Debt')." Azteca agreed "not to ask for, demand, notify account debtors, sue for, take or receive all or any part of the Subordinated Debt, nor any security therefor, and not to exercise any rights or remedies with respect to, the Subordinated Debt . . . or attempt to do any of the foregoing, unless and until all of the Congress Debt has been paid and performed in full, in cash and all loan and other agreements between Congress and Borrower have been terminated."

The second piece is the $5 million note. Despite plaintiffs' description of the $3.5 million and $5 million notes as "bogus," they actually exist, are dated May 31, 2000 and March 15, 2002, and are signed by Guez on behalf of Unzipped. There is also a loan agreement between Unzipped and Azteca stating that Azteca will extend credit to Unzipped "up to the aggregate principal sum of $3,500,000" and later $5,000,000, and requiring Unzipped to pay interest each month on the unpaid balance of the loan. Because Azteca was agreeing in the subordination agreement not to collect on $3.5 million and then $5 million in liabilities and obligations owed by Unzipped, "now existing or hereafter arising," until Congress Financial had been paid in full, Azteca was charging Unzipped interest on this amount. It is undisputed that Azteca did not actually lend Unzipped $5 million; hence plaintiffs' rhetorical description of the loan as "bogus." Unzipped already owed Azteca trade payables for jeans Azteca had manufactured for Unzipped. Azteca, however, agreed that it would not receive this $5 million until Unzipped's debt to Congress Financial had been "paid and performed in full."

The third piece comes from the payment terms of the 1998 Supply Agreement and the 2002 ARSA. The Supply Agreement gave Unzipped 15 days from the date of the invoice from Azteca to pay the invoice: "Unzipped shall pay such invoice by electronic transfer of funds, which electronic transfer of funds shall be made within fifteen (15) days after the date such Products are shipped as reflected on the invoice relating to such Products." The ARSA increased the payment date to 30 days, and added a new sentence: "Unzipped shall pay such invoice by electronic transfer of funds, which electronic transfer of funds shall be made within thirty (30) days after the date such Products are shipped as reflected on the invoice relating to such Products. *In the event, however, that sufficient funds are available to Unzipped, Unzipped may, in its discretion, make such payments prior to the end of such period.*" (Italics added.) The parties dispute whether this new language, which gave Unzipped some discretion to pay Azteca's invoices in less than 30 days if "sufficient funds are available," meant that Unzipped could pay Azteca in less than 30 days if the funds required to do so were available in cash on hand, or that Unzipped could pay Azteca in less than 30 days if Unzipped had the capability of borrowing the funds.

Plaintiffs' claim for improper interest charges on the $5 million note arises out of the interplay of these three documents. The jury awarded plaintiffs $964,530 against Sweet, Azteca, and Guez, which with prejudgment interest amounted to $1,463,000. Defendants' motion for JNOV was denied by operation of law.

Defendants' position is straightforward: Azteca was not receiving payment from Unzipped on $5 million worth of invoices, Unzipped had the use of this money, and Azteca would not receive this $5 million until Unzipped paid Congress Financial in full. The $5 million note represented this indebtedness, and authorized Azteca to charge Unzipped interest at prime plus 4 percent for the use of this money.

Plaintiffs' position, based primarily on McKee's testimony, is a little more complicated. McKee analyzed Unzipped's accounts payable subledger and general ledger, and determined that from October 1998 to September 2004, Unzipped routinely paid Azteca sooner than 15 or 30 days after the invoice, and often months prior to the date of the invoice, from Azteca. Sweet essentially paid Azteca in advance, and later matched up the advances with subsequently issued invoices. One consequence of this procedure was that at any given month during the parties' business relationship, Unzipped's accounts payable subledger would show a credit balance owed by Azteca to Unzipped. When McKee combined Unzipped's $5 million subordinated debt to Azteca reflected in Unzipped's records with the various monthly credits from Azteca to Unzipped, most of the months had less than $5 million owed by Unzipped to Azteca. For example, in March 2002, the month the parties signed the first amendment to the subordination agreement which increased the subordinated debt from $3.5 million to $5 million, Azteca owed Unzipped $2,534,406, Unzipped owed Azteca $5,000,000 (the subordinated debt), which meant that the net amount Unzipped owed Azteca (and on which Azteca could charge Unzipped interest under the note) was $2,465,594, not $5 million.[27] In some months, McKee calculated that Unzipped did not owe Azteca any interest. For example, in October 2002, Azteca owed Unzipped $5,110,136, Unzipped owed Azteca $5 million, which meant that the net amount Unzipped owed Azteca (and on which Azteca could charge Unzipped interest under the note) was negative $110,136; i.e., Azteca owed Unzipped money, and should not have charged Unzipped any interest. McKee testified that because Azteca was charging Unzipped interest on the $5 million subordinated amount "from day one through day thirty or thirty-one," the excess interest charged by Azteca was $964,530.

McKee's analysis depended on three premises: (1) The contracts contain 15- and 30-day payment terms; (2) the principal amount due under the notes is limited to amounts due over 15 and 30 days; and (3) the monthly amount of invoices from Azteca to Unzipped, and the monthly amount of payments from Unzipped to Azteca, should be used in the calculation of how much interest should be charged for that month. Defendants state premise (3) as the assumption that monthly payments by Unzipped should be applied first to the $5 million subordinated amount and then to current trade payables. Defendants attack all three premises.

Premise (1) is an issue of contract interpretation. The 1998 Supply Agreement is unambiguous: Unzipped had 15 days to pay Azteca's invoices. Unzipped did not always get these payment terms. The ARSA provides that Unzipped has 30 days to pay Azteca's

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[27] As McKee explained, this is another way of saying that Sweet and Unzipped were not honoring the subordination agreement with Congress Financial, because the effect of Sweet paying Azteca early was to leave Azteca with less than $5 million in subordinated receivables from Unzipped. McKee testified that there never was a period of time when there was $5 million worth of Azteca invoices actually subordinated, which the overcharges by defendants helped conceal.

invoices, unless "sufficient funds are available to Unzipped," in which case Unzipped in its discretion may pay the invoices earlier. Defendants claim that "available" means available to be borrowed, not necessarily available as cash. The trial court admitted extrinsic evidence on this ambiguity. Guez testified that in the jeans manufacturing business, availability means the amount that can be borrowed, and that is what he negotiated for the ARSA. Cole testified the 15-day time limit of the Supply Agreement was simply extended to 30 days, to allow the company to have more capital in order to grow, and that borrowing to pay Azteca early would not give Unzipped any additional capital or help Unzipped grow. Danderline testified that Sweet could only exercise the discretion to have Unzipped pay Azteca early if Unzipped were getting a discount, "especially if you were going to borrow funds [and incur] interest expense in order to make that."[28] The jury believed Cole and Danderline, and not Guez.

We agree with Danderline's opinion, essentially a legal one that he gave without objection, that Sweet's discretion to pay Azteca's invoices in less than 30 days under the ARSA was limited by its fiduciary duty to Unzipped. (Sweet's discretion to pay Azteca's invoices in less than 15 days under the Supply Agreement was non-existent.) Defendants' proposed interpretation would allow Sweet to deprive Unzipped of needed capital even if Unzipped did not have funds available without incurring the interest and other expenses of a loan, and would give Azteca a benefit (early payment) at the considerable expense of Unzipped. Defendants' proposed interpretation of "available" would allow Sweet to use up any available credit Unzipped could obtain, simply to pay Azteca early. Plaintiffs' interpretation of "available" as available on hand without

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[28] Danderline did testify on cross-examination that "for the most part" availability in the apparel industry generally meant borrowing. Danderline also testified on cross-examination, however, that defendants' reading of this provision was incorrect. Counsel for defendants specifically asked Danderline whether the agreement as he understood it "meant that [if] there was borrowing or credit availability from the factor, that Unzipped was entitled, in its own discretion, to pay Azteca any time prior to thirty days, isn't that what the agreement says on its face?" Danderline answered: "No, I don't think that's what it says."

resorting to borrowing from one creditor to pay another is more reasonable in light of the parties' relationship and the jury's findings. (See *Bay Center Apartments Owner, LLC v. Emery Bay PKI, LLC*, *supra*, WL 1124451 at *9 ["the drafters of chartering documents must make their intent to eliminate fiduciary duties plain and unambiguous"]; *Miller v. American Real Estate Partners, L.P.* (Del. Ch. Sept. 6, 2001, No. 16788) 2001 WL 1045643 at *8 ["default principles of fiduciary duty will apply unless a partnership agreement plainly provides otherwise"]; *Sonet v. Timber Company, L.P.* (Del. Ch. 1998) 722 A.2d 319, 322 ["principles of contract preempt fiduciary principles" only where the parties "have made their intentions to do so plain" and "explicit"].)

Premise (2), that the principal amount due under the note is limited to amounts due over 15 and 30 days, is also an issue of contract interpretation. Defendants argue: "Nowhere in any of the loan documents between Unzipped and Azteca is there any provision that Azteca would charge interest only on amounts due from Unzipped for more than 30 days." The two commercial loan notes state only that Unzipped promises to pay Azteca $3.5 million on September 30, 2001, and then $5 million on September 30, 2002. The loan agreements between Unzipped and Azteca, however, provide that Azteca "will extend credit to [Unzipped] up to the aggregate principal sum of $3,500,000," which was increased to $5 million, to be used "to provide for working capital requirements of" Unzipped. Because Unzipped's payment was not due until 15 or 30 days after the date of Azteca's invoices, there was no extension of credit to Unzipped by Azteca during those time periods. Therefore, because the principal amount due under the notes was limited to the amount of credit extended by Azteca, the principal amount due was limited to amounts due over 15 days under the Supply Agreement, and 30 days under the ARSA.

Finally, defendants argue that premise (3) is unsupportable because none of the agreements between the parties requires Sweet to apply payments by Unzipped first to principal sums due under the $5 million note, and then to current trade payables. Defendants argue that under Section 1479 of the Civil Code, because the agreements are silent on the application of payments by Unzipped, Azteca was free to apply the payments from Unzipped first to current trade payables and then to the $5 million in subordinated payables.[29] Civil Code Section 1479 applies where "a debtor, under several obligations to another, does an act, by way of performance, in whole or in part, which is equally applicable to two or more of such obligations." In such a situation, the creditor, in the absence of any manifestation of the debtor's intent, can apply the payment "toward the extinction of any obligation." Azteca argues that it followed Civil Code Section 1479, and exercised its "unfettered right" to apply Unzipped's payments first to trade payables.

The problem with defendants' argument is that the relationship between Unzipped and Azteca was not a standard debtor-creditor relationship. At the time Sweet made the payments from Unzipped to Azteca, Sweet had the ability under section 1479 to manifest Unzipped's intention that its performance "be applied to the extinction of any particular obligation," and if Sweet had done so, Azteca would have had to apply Unzipped's intention. (See Civ. Code, § 1479, 2d par.) By allowing Azteca to apply Unzipped's payments to current payables, Sweet benefitted the interests of its affiliated company Azteca at the expense of Unzipped, to which it owed fiduciary duties. Sweet's interest in how Azteca applied Unzipped's payments precludes the application of Civil Code section 1479. (See *Copesky v. Superior Court* (1991) 229 Cal.App.3d 678 [debtor-creditor relationship is not a fiduciary relationship].)[30]

We conclude that the premises on which McKee's testimony is based regarding excess interest charged on the $5 million are sound. McKee's testimony constitutes

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29 By taking into account the current purchases and payments each month, defendants claim that McKee essentially applied Unzipped's payments first to the $5 million subordinated amount, and then to current payables. The subordination agreement acknowledges that the actual invoices subject to the $5 million subordinated amount may change, by applying the subordination to "existing or hereafter arising" indebtedness, liabilities, and obligations.

30 For these reasons, we reject defendants' alternative argument that Sweet cannot be liable for this overcharge by Azteca. In some respects, Sweet is more culpable and responsible for this overcharge than Azteca.

substantial evidence of the improper interest overcharge. The denial of defendants' motion for JNOV by operation of law is affirmed.

8. Substantial evidence supports the jury's verdict on plaintiffs'claim for failure to give credits for discounts

Plaintiffs claim that two manufacturers Azteca used as subcontractors to manufacture Bongo jeans, Suntex and Excel Kind, gave Azteca a combined discount of $427,746, but that Azteca did not pass on these discounts to Unzipped. The discounts arise out of the resolution of disputes Azteca had with these two suppliers. Plaintiffs claim that because the ARSA provides that Azteca can charge Unzipped its cost plus 6 percent , and because these discounts reduced Azteca's cost, Azteca's failure to credit Unzipped this $427,746 was an overcharge. The jury awarded plaintiffs $540,000 against Sweet and Azteca, including pre-judgment interest. The motions for JNOV by Sweet and Azteca were denied by operation of law.

There is no dispute that Suntex and Excel Kind supplied jeans for Azteca. There is also no dispute that Azteca manufactured jeans for many customers, and that Unzipped was only one of Azteca's customers. There is also no dispute about the amounts of the discounts (in fact, the parties stipulated to the amounts): $383,521.15 from Suntex and $44,225.07 from Excel Kind. Defendants argue that they are entitled to JNOV on this claim because there was no evidence that these particular discounts that Azteca received from Suntex and Excel Kind were for Bongo jeans, as opposed to another brand of jeans manufactured by Azteca.

The jury heard evidence that Suntex and Excel Kind manufactured Bongo jeans for Unzipped. McKee testified that he came across Suntex and Excel Kind in his review of and investigation into Unzipped's books and records, and that the records showed that Azteca in effect was "placing orders to these two folk—these two companies, to generate product jeans that will go to Unzipped." Danderline testified that Excel Kind manufactured Bongo jeans in Asia. Gloria Ng, who worked in the operations departments of Azteca and ADS and reported to Guez, testified through deposition testimony read at trial that Excel Kind supplied Bongo jeans. Guez testified that Excel

Kind manufactured Bongo jeans, and that after 2002 Azteca transferred the "source of supply of the Unzipped Bongo jeans" to Asia. Several exhibits at trial made reference to Excel Kind and other suppliers of Bongo jeans, including an April 13, 2004 memorandum from John Chan at Excel Kind to Unzipped discussing "Bongo products," and an April 21, 2004 letter from Guez to Candie's regarding Azteca's receipt of "discounted payment terms" from its suppliers. Defendants introduced evidence that Azteca made jeans for companies other than Unzipped, such as Calvin Klein and American Eagle, but not that Suntex or Excel Kind did.

There was substantial evidence that Suntex and Excel Kind manufactured Bongo jeans for Unzipped, and substantial evidence from which the jury could make a reasonable inference that the discounts Azteca received from Suntex and Excel Kind were for Bongo jeans. The denial by operation of law of the motion for JNOV by Sweet and Azteca is affirmed.

9. Substantial evidence supports the jury's verdict on plaintiffs' claim for excess interest charged by third party lenders

Plaintiffs claim that Sweet's practice of paying Azteca's invoices to Unzipped early (i.e., less than 15 or 30 days from the invoice, and sometimes even prior to the date of the invoice) caused Unzipped to borrow more money from third party lenders than it should have had to borrow, in order to pay Azteca early. McKee explained that "anytime that Unzipped is now paying invoices in advance, it's using borrowed money to pay those invoices in advance where there will be an interest charge on that borrowed money." Because Unzipped was essentially borrowing from lenders other than Azteca to pay Azteca early, plaintiffs sought to recover from Sweet the additional interest expenses these third party lenders had charged Unzipped for the amounts required to pay Azteca early. The jury awarded $1,644,875, which with prejudgment amounted to $2,273,000, against Sweet. Sweet's motion for JNOV was denied by operation of law.

McKee testified that he researched Unzipped's accounting records for five fiscal years of the parties' business relationship, from 2001 to 2005 (which ended early, in August 2004), and analyzed the average prepayments by Unzipped to Azteca, using the "monthly overcharges or prepayments to Azteca" to calculate an annual average. McKee also calculated the average debt owed to lenders other than Azteca, divided this figure into the average overpayments or prepayments to Azteca, and obtained a percentage. For example, McKee calculated that the overcharge percentage for fiscal year 2001 was 25.6 percent. By applying the overcharge percentage to the amount of interest that lenders other than Azteca had charged Unzipped, McKee determined, for each year, "the amount of interest Unzipped had to pay, to its lenders, in order to borrow the money necessary . . . in order to fund the other payments or prepayments to Azteca." McKee calculated that the total amount of this excess interest paid to third party lenders was $1,644,875.

Defendants do not contend that McKee's testimony is not substantial evidence on this claim. Instead, defendants contend that the trial court excluded this testimony, and that without this testimony there is no substantial evidence in support of this claim. But that is not what occurred at the trial. McKee testified about his calculation of $1,644,875 in excess interest charges by third party lenders using a multi-page chart referred to by the parties as McKee Chart 5. The trial court sustained defendants' objection to the admission of this chart into evidence, on the ground that the chart might have contained opinions not disclosed at McKee's deposition.[31] The trial court, however, allowed McKee to testify extensively about his third party interest charge calculations, and

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[31] The trial court asked counsel to provide the relevant portions of McKee's deposition so that the court could determine whether McKee had given an opinion at his deposition on third party interest charges. Although it is unclear whether counsel ever responded fully to the trial court's request, counsel for plaintiffs did refer the court to "McKee Opinion 24" from McKee's deposition. McKee Opinion 24, which counsel for plaintiffs read to the trial court at side bar from McKee's deposition transcript, was that "because Unzipped had to borrow from its primary secured lenders to fund prepayments or overpayments to Azteca and ADS, Sweet caused Unzipped to incur interest, excess interest charges on its credit facilities with its secured lenders, which is in an amount that is not less than three hundred dollars [probably $300,000]." Thus, counsel for defendants' objection of surprise at trial appears to have been not that McKee had an opinion about third party excess interest charges, but how "not less than" $300,000 became $1.6 million.

allowed plaintiffs to show McKee Chart No. 5 to the jury. The trial court admitted McKee's testimony on this issue "subject to a motion to strike." Although the trial court never received McKee Chart No. 5 into evidence, defendants never moved to strike McKee's testimony regarding the third party interest charge claim, even though the trial court stated to counsel for defendants at the time that "it will be up to you to raise that issue." (See *Ault v. International Harvester Co.* (1974) 13 Cal.3d 113, 123 ["When evidence is adduced upon the theory that it will be properly connected, subject to a motion to strike, and that motion is not subsequently urged, a party is deemed to have waived the objection thereto"].)

Defendants argue that the trial court "effectively determined" that their objection to McKee's testimony should have been sustained when the trial court stated in its November 16, 2007 rulings on defendants' posttrial motions: "At the sidebar conference the court did not permit the introduction of a chart [McKee Chart 5] seeking to show over two million in damages rather than the approximately $300,000 that Mr. McKee testified about at his deposition." Assuming without deciding that the trial court intended and had the power post-verdict to grant a motion to strike that defendants did not make,[32] the trial court's November 16, 2007 rulings are void. The trial court could not have "effectively" granted defendants' implied or de facto motion to strike in its void November 16, 2007 orders.

Defendants do not dispute that McKee's testimony on the excess interest charges by third party lenders, if it can be considered, constitutes substantial evidence. The trial court did not exclude McKee's testimony, and defendants did not move to strike it. (See *People ex rel. Department of Public Works v. Alexander* (1963) 212 Cal.App.2d 84, 98

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[32] "The motion to strike must be made when there is still time to cure any deficiency in the evidence. The objecting party cannot sit silent until after the other party rests and then belatedly move for mistrial or directed verdict. One purpose of the motion is to remind the proponent of the evidence of the need to supply the missing foundation." (Wegner et al., Cal. Practice Guide: Civil Trials and Evidence (The Rutter Group 2009) ¶ 8:3348, at p. 8G-13 (rev. #1, 2003) citing *Ault v. International Harvester Co.*, *supra*, 13 Cal.3d at p. 123.)

[even “evidence which is technically incompetent and immaterial under the exclusionary rules, if offered and received without proper objection or motion to strike, may be considered in support of a judgment”].) McKee’s testimony is in the evidence of the case, and supports plaintiffs’ claim for excess interest charges from third party lenders. The denial by operation of law of Sweet’s motion for JNOV is affirmed.

10. Substantial evidence supports the jury’s verdict on plaintiffs’ claim that ADS failed to maintain a perpetual inventory

Plaintiffs claim that ADS failed to provide the perpetual inventory that defendants promised ADS would provide. The jury agreed, and awarded $2,365,955 against Sweet and Guez, which with prejudgment interest amounted to $3,252,000. Sweet and Guez moved for JNOV on the grounds that the evidence showed that ADS did maintain a perpetual inventory, and that neither Sweet nor Guez could be liable for ADS’s failure to maintain one. The motion was denied by operation of law. Sweet does not argue on appeal that it is not responsible for any failure by ADS to provide or maintain a perpetual inventory.

McKee, who as a forensic accountant had a lot of experience working with perpetual inventory systems because “there are numerous companies that keep their books under perpetual inventory,” testified that a perpetual inventory is a “simple concept, but hard to do.” McKee explained that a perpetual inventory interacts with the computerized accounting records, and is capable of showing, by style or category of goods, exactly what goods are in the inventory at any particular time, and can generate a report that shows “product-by-product, when those products came into inventory; if there were sales of those products; who they were sold to and how many of the products are left; [and] how old those products are.” McKee stated that a perpetual inventory helps a company manage its business by showing what products have been selling and what products have not been selling, and by identifying problems with the inventory. Cole testified that a perpetual inventory is “critical to running a business,” because it can tell the business the precise status of its inventory without performing an audit, and can help the business understand the aging of its product. Danderline testified that a perpetual inventory's ability to provide instantaneous aging information was important to plaintiffs and crucial in the girls junior jeans industry, where fashions change virtually from day to day and "yesterday's hot item[] is today's close out."

McKee testified emphatically that "at no time did ADS actually maintain the perpetual inventory system or provide the management information services that were necessary to maintain the perpetual inventory system for Unzipped," and that the Vincent accounting system, as defendants operated it, could not have produced an inventory aging report. Testimony from other witnesses confirmed McKee's conclusion. Cole testified that defendants did not maintain a perpetual inventory. Danderline testified that it was difficult to get information about Unzipped's inventory and to determine the age of Unzipped's products in its inventory.

Defendants' witnesses did not always contradict the testimony of plaintiffs' witnesses that ADS did not provide a perpetual inventory. Vargas testified on direct examination that the Vincent database was a perpetual inventory system, but admitted on cross-examination that he was not certain what a perpetual inventory system was or how it differed from a periodic or other inventory systems. Vargas also stated that he had never really thought about a perpetual inventory system before coming to court to testify.

Guez testified that a perpetual inventory is nothing "other than that . . . it's in your inventory at any point in time," and that ADS had a perpetual inventory system. Defendants also had a document that Vincent Wei generated and distributed called a daily "flash report," which Guez stated "represents the fact that the system has the feature to give the inventory at any moment, not every day only, anytime." Danderline, however, explained why this "flash report" was not a perpetual inventory. Peter Siris, who served on the board of directors of Candie's from March 2000 to February 2003, testified that the "flash reports" were confusing and "of no use." When asked if the "flash report" represented Guez's understanding of a perpetual inventory report, Guez answered: "This is the summary of the inventory. This is the—the perpetual inventory is the function. There is no perpetual inventory. There is not an inventory that you call perpetual. It doesn't exist. It's a concept—perpetual inventory is the ability to have your inventory every day. There is no report that's called perpetual inventory, so it's hard for me to answer your question."

The evidence was substantial if not overwhelming that ADS did not provide a perpetual inventory, and that defendants' accounting system, the Vincent database, was not capable of doing so. Defendants presented some evidence that the Vincent database had some of the capabilities that a perpetual inventory system would have had, but there is substantial evidence to support the jury's verdict, and we do not reweigh the evidence on appeal. The denial by operation of law of the motion by Sweet and Guez for JNOV is affirmed.

11. Substantial evidence supports the jury's verdict on plaintiffs' claim for distribution charges by ADS for Sylvain jeans sold to third parties

Plaintiffs' claim relating to the Sylvain jean inventory distribution charges is different from their $538,000 claim for the unreversed April 2004 charge for the worthless batch of Sylvain jeans. This claim involves how ADS charged Unzipped for warehousing and distribution services in connection with the Sylvain jeans throughout the parties' relationship. Plaintiffs claim that Unzipped's accounting records show that the Sylvain jeans were part of Azteca's inventory, not Unzipped's inventory, and that the sales of Sylvain jeans were Azteca's sales, not Unzipped's sales. Therefore, plaintiffs claim that ADS should not have charged Unzipped any warehousing and distribution fees for the Sylvain jeans. Defendants contend that this claim is "pure, unadulterated nonsense," because Azteca in fact manufactured Sylvain jeans for Unzipped, ADS in fact warehoused and distributed Sylvain jeans for Unzipped, and Unzipped in fact sold Sylvain jeans to customers. The jury awarded plaintiffs $652,000, which with prejudgment interest amounted to $764,000, against Sweet for allowing Unzipped to pay these charges. Sweet's motion for JNOV was denied by operation of law.

Certain facts are undisputed. The ARSA authorized Azteca to manufacture and sell to Unzipped jeans, some of which could be irregulars. The percentage of jeans that were irregular affected the price that Unzipped paid for the jeans each month, so that the greater the percentage of irregular jeans that Azteca produced, the greater the credit

Azteca had to give Unzipped.[33] The ARDA authorized ADS to charge Unzipped $.50 "per apparel unit," which consisted of $.35 for distribution services and $.15 for operations services. For the Sylvain jeans, the sales price equaled the cost, so that Unzipped never made a profit.

Defendants contend that the ARDA allowed ADS to charge this fee even if Unzipped did not make a profit on the irregular jeans. Plaintiffs contend that that ARDA did not allow ADS to charge distribution fees if Sweet sold the irregular jeans in such a way that Unzipped did not make a profit. On this issue, we agree with defendants. The ARDA provides that ADS's warehouse and distribution fee is based on the apparel unit, not the apparel profit. Defendants' interpretation of the ARDA is more reasonable on this point.

The issue, however, is whether the irregular jeans that were sold were Azteca's jeans or Unzipped's jeans. The resolution of this dispute depends on whether it was permissible for the jury to view the sales of the Sylvain jeans from the perspective of the accounting level (plaintiffs) or the sales and delivery level (defendants). On the accounting level, there is substantial evidence that the Sylvain jeans, regardless of where they were physically at any given time, were on Azteca's books, and part of Azteca's inventory, for all but one day of the month. As noted above, McKee testified that the accounting journal entries showed that Azteca owned the Sylvain jeans for "every day except for the last day of the month," Unzipped owned the Sylvain jeans on the last day of the month, and then the first day of the next month Azteca owned the Sylvain jeans again. McKee testified that "during the month," Azteca sold the Sylvain inventory, and recorded "the cost to Unzipped exactly equal to the sales price that [was] going to be received for that inventory, not with respect to Azteca's cost." These "sales of the jeanswear product that were in the Sylvain inventory, to third parties," occurred during the 29- or 30-day period (or presumably the 27-day period for February) that the Sylvain

[33] Unzipped received no discount if fewer than 5 percent of the jeans were irregular, a 10 percent discount if 5 percent to 8 percent of the jeans were irregular, and a 15 percent discount if more than 8 percent were irregular.

jeans were on Azteca's books and that defendants' accounting showed were in Azteca's inventory.

At the sales and delivery level, there were "actual sales" of Sylvain jeans with the Bongo label to third party buyers. Azteca sold the jeans, ADS warehoused the jeans, and Unzipped paid Azteca and ADS. Guez testified that the Sylvain jeans were in ADS's warehouse, and were "Candie's merchandise" and "Candie's assets and Candie's liabilities to me." Defendants argue that, like everything else in ADS's warehouse with a Bongo label, regular or irregular, the Sylvain jeans were Unzipped's jeans.

The jury resolved this factual conflict in favor of plaintiffs, and essentially held defendants to their accounting. There is substantial evidence to support this finding. First, for whatever reason, defendants treated the Sylvain jeans as Azteca's jeans 29/30 or 30/31 of the time. Defendants recorded the Sylvain jeans as Unzipped's jeans only one day a month, and McKee's analysis showed that the sale of the Sylvain jeans generally occurred on the other 29 or 30 days of the month. Second, defendants did not treat the sale of the Sylvain jeans as a sale to Unzipped under the ARSA. The ARSA specifies that Azteca was entitled to charge Unzipped cost plus 6 percent, with an adjustment or discount for irregulars of 10 percent or 15 percent, depending on the number of irregulars. Azteca did not bill Unzipped for the Sylvain jeans in this way. Instead, Azteca billed Unzipped the sales price that Azteca received for the inventory, not the cost of the inventory plus 6 percent.

Thus, there is substantial evidence from which the jury could conclude that the sales of the Sylvain jeans were sales by Azteca and not Unzipped. Defendants did not treat the sales of the Sylvain jeans as sales by Azteca to Unzipped, either in the way defendants accounted for the jeans or the way they caused Unzipped to pay for the jeans. Paragraph 3 of the ARDA states that ADS agreed to "provide services . . . to Unzipped with respect to Unzipped's apparel products." The jury was entitled to conclude that, for the Sylvain jeans, ADS provided its services to Azteca, not to Unzipped. Therefore, ADS was not entitled under Paragraphs 3 and 4 of the ARDA to charge Unzipped $.50 for the warehousing and distribution of the Sylvain jeans. The denial by operation of law of Sweet's motion for JNOV is affirmed.

12. Substantial evidence supports the jury's verdict on plaintiffs' claim that ADS failed to reimburse Unzipped for inventory shortages

Paragraph 5 of the ARDA provided: "Unzipped shall, at the end of the second and fourth quarters, take an accounting of the inventory held by ADS on behalf of Unzipped. Overages and shortages will be balanced to a net result at the end of each fiscal year of Unzipped during the Term. [¶] If there is a net shortage of units after the overages and shortages have been balanced to a net result, then ADS shall pay to Unzipped an amount equal to the invoiced manufacturing costs incurred by Unzipped in connection with the units included in such net shortage (the 'Shortage Payment')."

It is undisputed that ADS owed but did not make the required shortage payments under Paragraph 5 of the ARDA. McKee calculated that the shortage payment amount owed was $186,764. The jury awarded this amount, plus prejudgment interest, for a total award of $240,000. Sweet's motion for JNOV was denied by operation of law.

Sweet does not contest McKee's calculation of how much ADS owed Unzipped as a result of ADS's failure to make the shortage payments. Sweet argues only that it, as opposed to ADS, should not be liable for this amount. We have already rejected this argument. As noted above, there was substantial evidence of failures by Sweet to act in a good faith effort to advance Unzipped's interests, and to refrain from dealing with Unzipped on behalf the adverse interests of ADS. By managing Unzipped so that it failed to collect money that ADS undeniably owed to Unzipped, Sweet did not act in a good faith effort to advance the interests of Unzipped. And, also as noted above, Sweet was interested in the transactions between its sister company ADS and Unzipped. The denial of Sweet's motion for JNOV by operation of law is affirmed.

13. Substantial evidence and Delaware law support the jury's verdict on plaintiffs' claim against Guez for diversion of Unzipped's resources for Hippie, Hint, and Private Label Jeans

Plaintiffs claim that in 2003 and 2004 while Guez was still a director of Candie's and Sweet was still the manager of Unzipped, Guez used Unzipped resources, employees, and assets to set up new brands of jeans that competed with Unzipped's Bongo brand jeans. The parties refer to these labels as Hippie, Hint, and Private Label jeans. The jury awarded plaintiffs $8.1 million, including prejudgment interest, against Guez and Sweet for breach of their fiduciary duties. The motions by Guez and Sweet for JNOV were denied by operation of law.

Guez and Sweet do not argue that there is no substantial evidence in the record to support the jury's verdict that they breached their fiduciary duties by diverting Unzipped's resources to set up the new labels. And with good reason: the evidence of liability is overwhelming. Guez's conduct was a classic law school casebook fact pattern of a breach of fiduciary duty claim.

In February 2004, while Guez was still a director of and owed fiduciary duties to Candie's, and while Sweet was still manager of Unzipped and owed fiduciary duties to Unzipped, Guez took affirmative steps to set up competing businesses, "resurrecting" a dormant company called Commerce Clothing that Guez controlled and that he and his children's trusts owned. Guez secretly hired Unzipped employees, including Gary Bader, the president of Bongo jeans,[34] to assist in setting up Guez's new business. Guez assembled a cadre of Unzipped personnel, directed Bader and others to find showroom space for the new labels in the same building in which Unzipped's showroom was located, had them divert potential Bongo business to the competing showroom, and

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[34] The parties dispute whether Bader was an employee of Unzipped or an independent contractor serving as the president and director of sales. Either way, Bader was the lead salesperson for Bongo jeans, and Unzipped was paying him to sell Bongo jeans to Unzipped's customers. Caruso testified that Bader was the "master salesman" for Bongo jeans, "the individual that the retail community [felt] most comfortable talking to" about the product. When asked if he denied that Bader was the president of Bongo, Guez stated: "I don't deny it or agree. I don't agree with the concept of it."

encouraged them to sell the new brands of jeans rather than Bongo brand jeans to Unzipped's customers. Unzipped employees, including Bader, kept Guez informed of their activities, using Bongo email accounts to conduct non-Bongo business for Guez, until Guez set up clandestine Commerce Clothing email accounts on which they could continue to update Guez on their progress.[35] As of February 2004, while Guez was still a director of Candie's, Guez had set up the showroom for the Hippie brand, opened an office for Bader to work on Commerce Clothing business, installed telephone lines, and set up an expense account for Bader, still without telling the Candie's board of directors what he was doing. And although the usual breach of fiduciary duty or trade secret case involves theft of computer or hard copy files with confidential information for use in setting up a competitive business, Guez went one step further. Guez had Bader hack in and set up a direct line into Unzipped's computers, so that Guez and his assistants could get information they needed about Unzipped's business and customers whenever they wanted it.

Guez even signed a secret employment contract and "binding commitment" with Bader in August 2003 (to commence in February 2005), which he concealed from Candie's until the board found out about it in February 2004. In this agreement, Guez agreed to pay Bader $300,000 annually to be Guez's "personal" exclusive employee, either working at Unzipped and selling "the Bongo brand and any other brand that Mr. Guez owns or controls," or, if Unzipped did not continue as a division of Candie's, working at "any apparel company or brand that Mr. Guez owns or controls that is categorically similar to the lines of apparel Mr. Bader currently sells, or any other non-similar line of apparel that is mutually agreed upon."

The conflict of interest in which Guez had placed Bader became increasingly uncomfortable and unworkable for Bader. For example, during an event in March 2004 called "market week," where customers come to the New York showrooms to look at the

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[35] When asked if he knew that his employees were using Bongo email accounts to conduct non-Bongo business, Guez stated: "I never asked myself that question."

product, Guez had Bader make appointments for Unzipped customers to visit the Hippie showroom Bader had set up, to sell Hippie jeans rather than Bongo jeans. At one point, Bader's conflict between simultaneously trying to sell Bongo jeans for Unzipped and Hippie jeans for Guez and Commerce Clothing to the same customers became almost comical, as Bader explained to Guez that he would have to present shows for both jeans at the same place at the same time, complained that he could not be in two places at once, and stated that it was "getting too hot in the kitchen." Caruso, with his decades of experience in the apparel industry, described Bader's conduct as "extraordinary," and said that it "may not have occurred at any time in the history of the apparel business prior or since."

Guez admitted that he never told the Candie's board of directors that he was setting up these new labels, because he believed that they did not compete with the Bongo label. Plaintiffs, however, presented substantial evidence that the brands did compete, including the testimony of Cynthia Roe, plaintiffs' apparel industry expert with more than 17 years in the business. Roe testified that the Hippie, Hint, and Private Label jeans competed with Bongo because they targeted the same customers, were sold to the same retailers, and were sold to different retailers in the same malls or other retail spaces. Ann Iverson, a member of the Candie's board of directors from March 2001 to July 2004 who had experience in running retail and wholesale companies and in selling junior denim, testified that Hippie competed with Bongo because it was junior denim and Guez was "overseeing it." Plaintiffs also presented evidence that Guez and Bader intended to price Hippie jeans as low as $34.99, which was only five dollars more than the price of Bongo jeans.

When Candie's finally learned what Guez and Bader where doing, the board passed a resolution directing Guez to stop working with Bader on the Hippie and other brands. Cole told Guez that hiring Bader away from Bongo "would greatly damage the Bongo brand," and that Guez had "totally undermined the company, by pulling the rug out, by hiring the president when he was working for us." Guez ignored the board's resolution and continued to work with Bader to set up the Hippie and Private Label businesses. Guez and Bader went on to set up the Hint label business in September 2004.

Guez and Sweet make four arguments on appeal. First, they argue that Candie's, not Unzipped, brought the claim for breach of fiduciary duty, and that Candie's, as the sole shareholder of Unzipped, may not maintain a direct (as opposed to a derivative) breach of fiduciary claim on behalf of Unzipped. This is a legal issue, to which the parties agree Delaware law applies.

Under Delaware law, a parent corporation generally may not bring a direct action for breach of fiduciary duty for injury done to a subsidiary corporation, because the subsidiary, not the parent, owns the claim. (*Kramer v. Western Pacific Industries, Inc.* (Del. 1988) 546 A.2d 348, 351.) This is true even where the parent owns all or practically all of the shares of the subsidiary. (*Case Financial, Inc. v. Alden* (Del. Ch Aug. 21, 2009, No. 1184-VCP) 2009 WL 2581873, at *6 & fn. 37). There are, however, exceptions. One exception is where the defendant is a director who sits on the board of directors for both the parent and the subsidiary corporations, because such a director owes fiduciary duties to both corporations. (*Grace Brothers, Ltd. v. Uniholding Corp.* (Del. Ch. July 12, 2000, No. 17612) 2000 WL 982401, at *12.) Another exception is where the defendant is a director of the parent corporation only, but has knowledge of injury to the subsidiary that will also harm the parent. Thus, "[t]o the extent that members of the parent board are on the subsidiary board *or have knowledge of proposed action at the subsidiary level that is detrimental to the parent*, they have a fiduciary duty, as part of their management responsibilities, to act in the best interests of the parent and its stockholders." (*Ibid.*, italics added.) After all, a "wholly-owned subsidiary functions to benefit its parent." (*Ibid.*)

Guez was a member of the Candie's board of directors. He had knowledge of action "at the subsidiary level" of Unzipped that a new company was using Unzipped's resources, personnel, and business contacts to establish competing brands of jeans. Guez's knowledge of this activity was based on the fact that he was orchestrating it. By engaging in this activity and not disclosing it to Candie's, on whose board he sat, Guez breached fiduciary duties that he owed directly to Candie's, the parent corporation. "There is no safe harbor in our corporate law for fiduciaries who purposely permit a wholly-owned subsidiary to effect a transaction that is unfair to the parent company on whose board they serve." (*Grace Brothers, Ltd. v. Uniholding Corp.*, *supra*, 2000 WL 982401, at *12; see *Hoover Industries, Inc. v. Chase* (Del. Ch. July 13, 1988, No. 9276) 1988 WL 73758, at *2 ["A director does breach his duty of loyalty if he knows that the company has been defrauded and does not report what he knows to the board, or to appropriate committee of the board, at the very least when he is involved in the fraud and keeps silent in order to escape detection"].)

Delaware courts have imposed liability on directors like Guez who harm subsidiaries of companies on whose board they serve. In *Case Financial, Inc. v. Alden, supra,* 2009 WL 2581873, the parent company (Case Financial) sued its former director and CEO (Alden) for fraud and breach of fiduciary duty arising out of loans made exclusively by the subsidiary (Case Capital). Rejecting Alden's argument that the claims were derivative and could not be brought by the parent, the court allowed the parent to sue Alden for breach of the fiduciary duties Alden owed directly to the parent. (*Id*. at *7.) The court held: "Ultimately, Alden, as a director of Case Financial, had a duty not to intentionally or knowingly participate in conduct that would injure Case Financial. Because Alden owed this duty to Case Financial directly, Case Financial's ability to pursue a suit against Alden directly would not depend, in this sense, on whether the entirety of the damage was sustained directly by Case Financial or derivatively through Case Capital. To the contrary, if Alden was substantially certain his conduct would injure Case Financial unjustifiably, regardless of how far down the causal chain the injury would occur, Alden should have refrained from the conduct, especially where he stood to benefit at Case Financial's expense, and, at a minimum, should have disclosed those activities to Case Financial." (*Ibid.*)

We conclude that Candie's had standing to bring its breach of fiduciary duty claim directly against Guez. There is substantial evidence that Guez breached his fiduciary duties to Candie's by using the resources of Unzipped, a wholly-owned subsidiary of

Candie's, to start his new jeans labels, and keeping his activities secret from the board of directors of Candie's on which he served.[36]

Second, Guez argues that he cannot be liable for diversion of Unzipped's resources to start his new businesses because he did not owe any fiduciary duties to Unzipped; only Sweet did. As noted above, however, Guez's liability on this claim is based on Guez's breach of fiduciary duties he owed to Candie's, not to Unzipped. Sweet's liability on this claim is based on Sweet's breach of its fiduciary duties to Unzipped, which fiduciary duties Sweet concedes.

Third, Guez and Sweet argue that plaintiffs failed to prove any damages to Unzipped. They argue that the trial court instructed the jury that if the jury found liability, then the jury should award plaintiffs damages for the harm caused by defendants' conduct. Guez and Sweet argue that plaintiffs did not introduce evidence of their damages, but only introduced evidence of the benefit that plaintiffs claim defendants obtained as a result of the diversion of Unzipped resources.

The trial court instructed the jury, over plaintiffs' objection: "If you find that a plaintiff is entitled to prevail on its cause of action for breach of fiduciary duty, then you must award that plaintiff an amount which will compensate that plaintiff for all the harm caused by the conduct on which you base your finding of liability, whether that harm could have been anticipated or not, including the value of the resources diverted if any." The trial court rejected plaintiffs' proposed instruction: "If you find by a preponderance of the evidence that Hubert Guez breached any of these fiduciary duties, you should award damages sufficient to: 1) restore Candie's to where it would have been absent the breach by Mr. Guez; and 2) ensure that Mr. Guez and/or his companies do not profit as a

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[36] Guez argues that some of his efforts to establish the Hippie, Hint, and Private labels occurred after he resigned from the board of directors on March 10, 2004. There was substantial and considerable evidence, however, that much of Guez's efforts occurred in February and early March 2004, before he resigned from the board. And Guez entered into his exclusive employment contract with Bader in August 2003.

result of Mr. Guez's breach." Plaintiffs argued for this instruction, citing Delaware case law that authorizes disgorgement as a remedy for breach of fiduciary duty.

The trial court's instruction was erroneous. Plaintiffs were entitled to an instruction on their claim for disgorgement of the unjust enrichment and ill-gotten gains that defendants obtained as a result of Guez's and Sweet's wrongful conduct in using Unzipped's resources to help start a competing business. Disgorgement of the defendant's unjust enrichment or wrongful gain is a proper remedy for breach of fiduciary duty under Delaware law and California law. (See *Thorpe by Castleman v. CERBCO, Inc.* (Del. 1999) 676 A.2d 436, 445, 463; *Oberly v. Kirby* (Del. 1991) 592 A.2d 445, 463; *Triton Construction Co., Inc. v. Eastern Shore Electrical Services, Inc.* (Del. Ch. May 18, 2009, No. 3290-VCP) 2009 WL 1387115, at *28; *Julian v. Eastern States Construction Service, Inc.* (Del. Ch. July 8, 2008, No. 1892-VCP) 2008 WL 2673300, at *19; *County of San Bernardino v. Walsh* (2007) 158 Cal.App.4th 533, 542.) Thus, plaintiffs' recovery for breach of fiduciary duty was not limited to their damages, either in the form of sales diverted from Unzipped to Commerce Clothing, or salaries paid by Unzipped to employees who were actually working for Guez and Commerce Clothing. These are damages that plaintiffs suffered, and plaintiffs introduced some evidence of these damages. Plaintiffs also sought to recover, however, the benefit that defendants obtained as a result of their wrongful conduct. (See *McPadden v. Sidhu* (Del. 2008) 964 A.2d 1262, 1276-1277 [breach of fiduciary duty plaintiff may have to elect whether to seek damages or disgorgement, but is entitled to pursue either theory].) The trial court should have given the jury instruction requested by plaintiffs that would have told the jurors that they could award plaintiffs the value of this benefit.

The instructional error on plaintiffs' breach of fiduciary duty claim for unjust enrichment, however, was cured by the verdict. (See *O'Neill v. Thomas Day Co.* (1907) 152 Cal. 357, 361 ["if it appears to the appellate tribunal that an instruction was erroneous, it will not disregard a verdict contrary to such erroneous instruction"]; *Rystrom v. Sutter Butte Canal Co.* (1925) 72 Cal.App. 518, 524.) "If the verdict is in accord with the evidence and the law, it is not subject to attack on the ground that it is contrary to an erroneous instruction. Disregard of the erroneous instruction is not prejudicial, and the error in the instruction is cured by the verdict." (7 Witkin, Cal. Procedure (5th ed. 2008) Trial, § 357, p. 416.) Even though the jury instruction did not advise the jurors that they could award disgorgement of defendants' unjust enrichment, the jurors made such an award anyway. Therefore, we review the record to determine whether plaintiffs presented substantial evidence of defendants' unjust enrichment as a result of their wrongful conduct.

Plaintiffs' evidence of the amount of unjust enrichment was primarily the testimony of Roe and Steven Kalos, an economic expert. Roe, who had extensive experience in the clothing industry in general and in the jeans and junior jeans industry specifically, testified that "defendants were able to have a one-year jump start for Hippie and Private Label and a six-month jump start" for Hint, based on their use of Unzipped's resources.

Roe had the qualifications, experience, and basis for giving this opinion, which constitutes substantial evidence of this one-year/six-month "jump start" benefit that the jury found defendants received. From 1997 to 2002 Roe was the Chief Operating Officer and Executive Vice President of Sun Apparel, a company that "focused on jeans and denim-based sportswear" and was "in the business of designing, marketing, merchandising, manufacturing and distributing denim jeans," including junior jeans for customers age 15 to 28. Roe had experience in and responsibility for all aspects of the business, including production scheduling and control, procurement and management of raw materials, purchase of trims and belts, design of a data base system to monitor production scheduling and purchasing, automation of the cutting room and laundries, development of product, and supervision of inventory control. At Sun Apparel Roe was "responsible for everything from making the first sample to the specifications that Private Label retail required through to actually shipping finished goods." When Sun Apparel promoted her to Executive Vice President and Chief Operating Officer in 1997, Roe's increased responsibilities included retail planning and sourcing, including sourcing in Asia and the western hemisphere. Roe was also involved in getting a new brand of jeans “up and running,” so she was qualified to testify about the process of starting up a new brand.

This experience was more than enough foundation for an opinion about how much time and expense defendants saved by starting the Hippie, Hint, and Private Label brands using Unzipped’s resources, rather than having to use their own resources. Roe explained that her opinion was based on the facts that the critical factor in building a new or unknown brand in the jeans business was the relationship between the manufacturer and the potential buyer, and that Bader had those relationships from his work at Unzipped. Roe testified that Bader had “a great reputation in the market for a really, really long time,” and that he “lent immediate credibility to these new products.” Roe also testified that Bader “really allowed the defendant[s] to have a jump start because they were able to set up this business” without having to incur “a major outlay of expense before they had any shipments,” because the new brands did not generate any revenue until June 2004.

After Roe provided her opinion about the value of the benefit in terms of time (one-year/six-months), Kalos did the math and calculated the value of the benefit in terms of dollars. Kalos began his analysis by valuing Commerce Clothing in July 2005 at $69.3 million, approximately a year and a half after Guez (using Unzipped’s resources) re-activated the company to begin the Hippie, Hint, and Private Label lines. Kalos did not need an appraisal to determine this value, because Guez had actually sold Commerce Clothing in July 2005 to a company called Cygne Design, Inc. for approximately $69.3 million. Kalos did not assign all of this value to the diversion of Unzipped’s resources that Guez had only recently used to initiate the Commerce Clothing brands. Instead, he “place[d] a value on [the] head start” using the 10.15 percent expected rate of return for the apparel industry (actually the “Apparel and Other Finished Products Made from Fabrics” industry), which he took from a publicly available source called the “Cost of Capital Yearbook.” 10.15 percent was the published rate of return that defendants would have earned on the $69.3 million had they invested it in this industry. Using a trial exhibit that has not been included in the joint appendix, Kalos valued the one-year/six-month head start at between $3,436,000 and $7,042,000 million.[37]

In sum, plaintiffs submitted substantial evidence to support the remedy that they obtained for breach of fiduciary duty in connection with the diversion of Unzipped's resources-defendants' unjust enrichment. The testimony of Roe and Kalos was admissible and sufficient. Defendants did not present any evidence of a different value of this benefit.[38]

Finally, defendants argue that even if plaintiffs were entitled to seek recovery of the unjust enrichment defendants received as a result of the breaches of fiduciary duty, neither Guez nor Sweet received any benefit as a result of the wrongful conduct by Guez and Sweet. The recipient of the benefit was Commerce Clothing, a third party plaintiffs did not sue. Understandably, breach of fiduciary duty claims for unjust enrichment are not defeated by the fact that the defalcating fiduciary pocketed his or her ill-gotten gains in a related or affiliated entity. (See *Singh v. Batta Environmental Associates, Inc.* (Del. Ch. May 21, 2003, No. 19627) 2003 WL 21309115, at *11 [awarding "monetary damages" for usurpation of opportunities that the defendant diverted to a company he formed to perform the same kind of environmental consulting services that the plaintiff company performed]; *In re Summit Metals, Inc.* (D. Del. Aug. 6, 2004, No. 00-387 (KAJ) 2004 WL 1812700 [misappropriation of corporate opportunity case applying Delaware law and imposing a constructive trust on stock held by the defendant Gray "and the Gray Entities"].) Moreover, although plaintiffs did not plead or prove that Commerce Clothing was an alter ego of Guez (in fact, plaintiffs did not even name Commerce Clothing as a defendant), Guez testified that he controls Commerce Clothing, and that he and his

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[37] With Kalos's calculation of prejudgment interest, these figures became $3,952,649 and $8,100,048. The jury awarded the latter amount.

[38] Roe also testified that Unzipped suffered damages in the form of decreased revenue as a result of the diversion of resources and sales to Guez's new competing labels. Kalos quantified this decrease in gross sales at $8.3 million, and lost profits at $2.4 million. The jury did not award this amount.

children (through trusts) own Commerce Clothing. Thus, although Guez and his children may not be responsible as alter egos for Commerce Clothing's liabilities, they did receive the benefit of Commerce Clothing's success after Guez used Unzipped to get Commerce Clothing started.

Sweet argues that even if it is liable for breach of fiduciary duty, and even if disgorgement is an appropriate remedy, Sweet cannot be liable for disgorgement because it did not receive any benefit; only Guez and his other company Commerce Clothing did. We agree with Sweet. By allowing Guez to use Unzipped's resources to "jump start" the Hippie, Hint, and Private Label jeans for Commerce Clothing, Sweet caused damage to Unzipped (e.g., diverted sales, salaries and other payments for employees and expenses that did not benefit Unzipped), but the jury did not award those damages. The jury awarded plaintiffs the benefit that defendants received as a result of the breaches of fiduciary duty by Guez and Sweet. Guez received a benefit; Sweet did not.

The denial by operation of law of Guez's motion for JNOV is affirmed. The denial by operation of law of Sweet's motion for JNOV is reversed.

14. *Sweet did not breach the MSA by failing to meet payroll budget for fiscal year 2004*

This claim concerns several provisions of the MSA governing the annual budget for Unzipped. Paragraph 3 of the MSA provided that Sweet "shall at all times conduct the Business [of Unzipped] in accordance with and as permitted by the Approved Budget . . . then in effect." Paragraph 5 of the MSA provides for a detailed budget procedure, pursuant to which Sweet would submit a proposed budget to the board of Candie's, and Candie's would approve or revise the proposed budget. Once the budget was "approved," Paragraph 5.2 provided that Sweet "shall for the balance of that Year adhere to the guidelines set forth in that Approved Budget until another Approved Budget has superseded it or unless otherwise permitted by written action of the Board." Paragraph 5.4 provided that in the event that Unzipped "fails to meet its projections or is unable to adhere to the Approved Budget then in effect, the Manager [Sweet], if and when directed by the board, shall take remedial measures, including but not limited to making price and/or margin changes, payroll reductions and other cost-saving measures, as directed by the Board."

It is undisputed that Sweet did not adhere to the amount budgeted in fiscal year 2004 (February 1, 2003 to January 31, 2004) for payroll. In fact, Sweet caused Unzipped to exceed the payroll budget by $907,000. Plaintiffs sought to recover from Sweet the amount of this unauthorized payroll expense. The jury awarded plaintiffs $907,000 against Sweet, which with prejudgment interest amounted to $1,105,000. Sweet's motion for JNOV was denied by operation of law.

Sweet does not dispute that it went over the approved payroll budget by $907,000 in fiscal year 2004. Instead, Sweet argues that plaintiffs' initial remedy under Paragraph 5.4 is a directive from the board of directors of Candie's to take "remedial measures," such as reducing payroll, changing prices or margins, or taking "other cost-saving measures," not an immediate cause of action for breach of contract. We agree. The MSA sets forth the consequence for Sweet of failing to adhere to the approved budget by, for example, exceeding a budget item by $907,000: The MSA authorizes the board of Candie's to issue directions to Sweet, which Sweet must follow "if and when" the board issues those directions. Thus, at least in the first instance, Sweet's failure to comply with Paragraph 5.2 gives Candie's the contractual right to issue directives to Sweet pursuant to Paragraph 5.4. There is no evidence that Candie's issued a directive pursuant to Paragraph 5.4 because of Sweet's failure to adhere to the approved budget by overspending $907,000 on payroll, and plaintiffs do not claim that Sweet breached Paragraph 5.4 by failing to follow a directive issued by the board of directors of Candie's to take remedial measures. Therefore, Sweet did not breach the MSA by exceeding the fiscal year 2004 budget by overspending $907,000 on payroll.

The denial by operation of law of Sweet's motion for JNOV on this claim is reversed.

15. Sweet did not breach the MSA by failing to reduce expenditures by $50,000 per month

By April 2004, Candie's had decided that when the MSA expired in January 2005, Candie's was going to get out of the jeans manufacturing business and into a business model based on licensing the Bongo label to other jeans manufacturers. On April 15, 2004 the board of directors of Candie's sent a memorandum to Guez and Sweet explaining that it was now the goal of Candie's "to effect a smooth transition of the BONGO jeans business to a licensee with the least possible disruption to or loss of market share . . . ." The Candie's board stated that it wanted "to implement a transition plan and budget that contemplates a planned wind down of the business through the remainder of the fiscal year, with corresponding reductions in both the production of goods and the expenses associated therewith." The April 15, 2004 memorandum directed Guez and Sweet to take several actions, including a monthly reduction of payroll: "Beginning in May 2004, reduce overhead by at least $50,000 per month for the next nine months for a total reduction of $450,000." The directive also instructed defendants to stop shipping new orders after October 2004, to obtain at least 20-day terms for goods, and to return "$3-4 million in cash to Candie's by no later than June 30, 2005." The decision by Candie's to transition to a licensing business model in general and this directive in particular created additional conflict between the two sides, because defendants' compliance with the board's strategic plan would negatively affect Sweet's ability to meet the $1.7 million guarantee.

It is undisputed that Guez and Sweet did not reduce payroll and overhead by $50,000 per month for May, June, and July 2004 (Candie's terminated the MSA in August 2004). To the contrary, one of plaintiffs' forensic accounting and corporate investigation experts testified that Guez and Sweet instead increased overhead and payroll by more than $850,000. Plaintiffs sought to recover the three-month amount of $150,000, and the $850,000 overhead increase. The jury awarded plaintiffs $1,194,000 against Sweet, including prejudgment interest. Sweet's motion for JNOV was denied by operation of law.

Sweet argues that it did not have to comply with the board's April 15, 2004 directive to reduce payroll and overhead by $50,000 per month because the directive was invalid. We agree. The April 15, 2004 memorandum stated that the Candie's board was directing Sweet and Guez to reduce Unzipped's monthly expenses "pursuant to Section 5.4 of the Management Agreement." Section 5.4 authorized the board to direct Sweet to "take remedial measures" such as payroll reduction "in the event" that Sweet "fails to meet its projection or is unable to adhere to the Approved Budget then in effect." Not only was there no evidence of any such failure or inability on the part of Sweet, the board admittedly issued the directive to Sweet and Guez for a different reason: as part of the board's plan to wind down Unzipped and transition Bongo jeans to a licensing business model. The MSA did not give the board of Candie's the right to issue directives to Sweet for such reasons. Had Candie's wanted such a contractual right, it could have bargained for it in the MSA, but Candie's did not.

It is true, as plaintiffs argue, that Paragraph 3 as a general matter made Sweet "answerable" to the Candie's board. The April 15, 2004 directive, however, invoked Paragraph 5.4, not Paragraph 3, and Paragraph 5.4 did not authorize Candie's to direct Sweet to take the kinds of remedial measures listed in the April 15, 2004 memorandum. And it may be true, as plaintiffs also argue, that Paragraph 5.4 is "a nonexclusive example of when the Board can direct Sweet's spending. But the board issued its directive pursuant to Paragraph 5.4, and Paragraph 5.4 does not authorize such a directive.

Because the April 15, 2004 directive was invalid, Sweet did not breach the MSA by failing to comply. The denial by operation of law of Sweet's motion for JNOV is reversed.

16. Substantial evidence supports the jury's verdict on plaintiffs' claim that Sweet failed to meet the $1.7 million guarantee for fiscal year January 2004, but Candie's is not entitled to a double recovery

Paragraph 2.7 of the MSA provides: "The Manager [Sweet] guarantees that the Net Income of the Company [Unzipped] shall be no less than $1,700,000 for each Year during the Term (the '*Guarantee*'). Anything contained in this Agreement to the contrary notwithstanding, in the event that the Company fails to achieve the Net Income necessary to meet the Guarantee (the difference between the actual Net Income and the Guarantee shall hereinafter be referred to as the *'Shortfall'*) as determined, at the time of the issuance of the audited results of the Company for such Year, by the accounting firm then serving, pursuant to Section 6.2 below, as the Company's accountants, there shall be no Management Fee owed or due with respect to such Year . . . . Further, the Manager shall pay to the Company an amount equal to the Shortfall . . . (the *'Shortfall Payment'*), within thirty (30) days following the issuance of the Company's audited results for such Year (which payment shall be in cash unless either Candie's or the Manager elects, prior to the end of such 30-day period, to offset the amount of such Shortfall Payment against amounts then owed by Candie's to the Manager as set forth in Section 2.8 below." Thus, under Paragraph 2.7, if Sweet did not manage Unzipped well enough to earn net income of $1.7 million each fiscal year, then Sweet had to pay Candie's the difference. This "shortfall payment" could be in the form of cash, or an offset against the $11 million note executed by Candie's in favor of Sweet.

Whether Unzipped under Sweet's management earned $1.7 million in net income for fiscal year 2004 (February 1, 2003 to January 31, 2004) was a highly contested factual issue at trial. Defendants claimed that Sweet met its guarantee, but relied on an inventory reserve figure of $1.8 million to do so. Plaintiffs claimed that Sweet did not meet its guarantee, and fell short by $1,626,000, but relied on an inventory reserve figure of $4.1 million. Both sides accused the other side of cheating. The jury resolved this factual dispute in favor of plaintiffs, and awarded plaintiffs $1,626,000 against Sweet, which with prejudgment interest amounted to $1,888,000.

Plaintiffs' version is that the decision by Candie's to set the inventory reserve at $4.1 million had nothing to do with the $1.7 million guarantee. Cole testified that after Guez had set the inventory reserve at $1.8 million, Cole was having a meeting with the Bongo sales representatives (including Gary Bader, Larry Alimento, and Stacy Acuri) that actually had nothing to do with the inventory, but had to do with convincing them to stay with the company. Cole testified that in the course of this meeting, Alimento just happened to mention that he had come "to believe that there were substantial issues regarding the price [at] which Unzipped's inventory could be sold," and that the prices Guez had used to value the inventory "were too high." Cole then personally went with Alimento, Danderline, and the sales staff to inspect the inventory "garment by garment," in order to make sure that the inventory value on the financial statements was accurate. According to Cole, he, Danderline, Alimento, and the other sales representatives "looked at each garment, talked about how many units we owned, how long we've owned it and what were the . . . latest offers that Mr. Alimento had on the jeans." Danderline confirmed Cole's version of the events, and recalled looking with Alimento and Bader at "several of the items in question . . . which they felt were particularly out of style and difficult to sell."

Cole brought the issue to the Candie's board of directors, because any potential problem with the inventory valuation was "a serious issue" for the corporation's financial statements. Candie's became concerned that Guez's inventory value was too high (in other words, the inventory reserve was too low), and that Guez had represented that the jeans were "worth a lot more than [Unzipped could] actually sell them for." Cole testified that the board's investigation into this issue was "thorough," consumed "many hours of time," was conducted "very carefully, very scientifically and very studious[ly]," and lasted between ten days and two weeks. Candie's "looked at every aspect of inventory," "brought in experts [on its] board of directors," and performed a further audit. The investigation found "that the proper value of the inventory was different than what Mr. Guez represented," and that "the reserve was not adequate." At the conclusion of its investigation, and after consulting with the auditors, Candie's concluded that the proper inventory reserve was $4.1 million, not $1.8 million. The auditors agreed.

Defendants' version is that Sweet's decision to set the inventory reserve at $1.8 million also had nothing to do with the $1.7 million guarantee. Guez testified that he too consulted with Alimento (although Alimento denied that Guez had consulted with him) and "the salesmen who were actually out in the field selling the product," used information from the sales representatives "to draw an average of the carrying value of the goods based on the categories," performed his analysis, and set the inventory reserve at $1,854,000 (although he later advised the auditors that an inventory reserve of $2.775 million was acceptable).[39] Guez testified that Unzipped's auditors had reviewed and approved his financial statements for Unzipped and the inventory reserve amount.[40]

As far as Guez was concerned, that was the end of it; the inventory reserve was $1.8 million and Sweet had met its $1.7 million net income guarantee for fiscal year 2004. The next thing Guez knew, Candie's, without informing Guez what it was doing, had completed its investigation of the inventory, and had convinced the auditors to increase the inventory reserve from $1.8 million to $4.1 million. When Guez called one of the auditors, Larry Shapiro, to find out what was going on, Shapiro told Guez that he had been instructed not to speak with Guez. Guez testified that Shapiro was a liar, and that the investigation and revision of the inventory reserve from $1.8 million to $4.1 million was "all a setup" and "a CYA thing." Guez testified that, unlike the auditors, he had no motive to understate the inventory reserve, stating: "I have no motive—I'm an honest man. I have no motive to do anything."

The jury believed Cole, Danderline, and Shapiro, and not Guez. The accounting testimony at the trial was extensive, detailed, and contested. There is no reason for this court to second-guess the jury's resolution of this issue. There is substantial evidence that the revised inventory reserve figure of $4.1 million was proper, and that therefore Sweet had failed to meet its $1.7 million guarantee for fiscal year 2004.

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[39] With Guez's revised inventory reserve figure of $2.775 million, Unzipped's net income for fiscal year 2004 would have been $1.7 million, which would have meant that there would have been no shortfall under Paragraph 2.7. Guez testified that "it makes no difference" whether the right inventory reserve was $1,854,000 or $2,775,000. When asked to concede that his first inventory reserve figure of $1.8 million was incorrect, Guez answered: "There's only one problem with what you're saying. I was the manager of Unzipped. It was my evaluation of the inventory."

[40] One of the auditors initially told Guez that his inventory reserve might actually have been too high.

Defendants argue that Paragraph 2.7 of the MSA requires that the calculation of the "shortfall payment" occur within 30 days "following the issuance of the Company's audited results," and Unzipped never issued audited results for fiscal year 2004. Defendants contend that "whether the $1.7 Million Guarantee was satisfied must be measured against Unzipped's audited financial statements," and "the absence of any such audited financial statements from the record forecloses any determination that the guarantee was not met." This argument ignores the facts that the reason Unzipped did not issue audited results in the spring of 2004 for fiscal year 2004 was that the parties were engaged in the dispute over the inventory reserve and its affect on the $1.7 million guarantee, and that the manager of Unzipped disputed the auditors' decision to side with Candie's and approve the $4.1 million inventory reserve amount. Danderline testified that because Guez did not agree with the revised inventory reserve amount, Guez refused to sign a "management rep" letter for the auditors, which the auditors required before they could issue final audited financial statements for Unzipped. Cole testified that Guez was using his refusal to allow Unzipped to issue final audited financial statements as leverage to get Unzipped to pay him the $5 million he believed Unzipped owed him because of the Congress Financial subordinated debt.

Defendants' theory would permit Sweet to avoid making a shortfall payment, even if Sweet undeniably owed Unzipped a shortfall payment, simply by refusing to issue audited financial statements. That is not the law. (See *Mobile Communications Corp. of America v. MCI Communications Corp.* (Del. Ch. Aug. 27, 1985, No. 8108) 1985 WL 11574, at *4 ["The 'prevention doctrine' provides that a party may not escape contractual liability by reliance upon the failure of a condition precedent where the party wrongfully prevented performance of that condition precedent"]; *Jacobs v. Freeman* (1980) 104 Cal.App.3d 177, 190 ["the condition of board approval does not give [the] corporation the absolute right to escape its obligations under the agreement" by not submitting the matter to the board for approval, because "there is an implied obligation . . . to carry out the objectives of the contract in good faith by submitting the proposal to the board"]. In any event, Unzipped's fiscal year 2004 final financial statements, audited by Unzipped's auditors pursuant to Paragraph 6.2 of the MSA, were ultimately issued as part of the consolidated statements of Candie's, Unzipped's parent corporation.

There is one more issue, discussed by the parties in connection with Sweet's cross-claim, which is related to the $11 million note. After the auditors had established that the shortfall for fiscal year 2004 was $1,626,000, Danderline wrote Guez and gave Sweet the option of making a shortfall payment of $1,626,000, and stated that otherwise Candie's would offset the shortfall amount against interest and principal due Sweet under the $11 million note. Sweet did not make the payment, and Candie's applied the $1,626,000 to the note, first to interest and then to the principal, "leaving a balance of $9,371,000. One of plaintiffs' forensic accounting experts, Harvey Kelly, testified that Candie's used the shortfall payment both to excuse quarterly interest payments under the $11 million note as they came due, and to reduce the principal of the note at the end of each year (and that doing so was proper under generally accepted accounting principles).[41] Candie's relied on its usage of the shortfall to offset quarterly interest payments to avoid defaulting on the $11 million note, which is interest only until April 2012.

And that is the problem with this claim. We agree with plaintiffs that Sweet failed to meet the $1.7 million guarantee by $1,626,000, and that therefore Candie's was entitled either (1) to a payment of $1,626,000 "in cash" pursuant to Paragraph 2.7, or (2) an offset of $1,626,000 against "any amounts due by Candie's" to Sweet under the $11 million note pursuant to Paragraph 2.8. Plaintiffs, however, are not entitled to both (1) and (2). Plaintiffs used the $1,626,000 against quarterly interest payments as they became due (and, because the note does not mature until April 2012, as they become due)

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[41] The accounting details of how Candie's used the $1,626,000 shortfall are actually a little more complicated. As each $220,000 quarterly interest payment became due, Candie's would use $220,000 of the unused shortfall to excuse the interest payment, then apply the rest of the shortfall to reduce the principal. When the next $220,000 quarterly interest payment became due, Candie's would take another $220,000 from the remaining shortfall that Candie's had previously applied against the principal, which effectively "increased" by $220,000 the principal balance due on the note from the previously reduced principal amount.

and against the remaining principal due on the note. Plaintiffs are not entitled to an additional money judgment for $1,626,000 for Sweet's failure to make the shortfall payment for fiscal year 2004. To give Candie's a $1,626,000 offset against the interest and principal due on the note, and a damage award for $1,626,000, would be a double recovery for the same breach of contract.

When the liability of Candie's on the $11 million note is ultimately determined, either in this case or in future litigation, the amount that Candie's owes Sweet should take into account the amount of the offset payments Candie's properly applied to the interest and principal due under the note. In the meantime, Candie's is entitled to a declaration, consistent with the jury's findings, that Candie's properly has and may continue to offset the fiscal year shortfall amount (exclusive of prejudgment interest because Candie's used the offset immediately and the note does not provide for interest on any unused shortfall amounts) against interest and principal due under the $11 million note. Therefore, the denial by operation of law of Sweet's motion for JNOV on this claim is reversed in part and modified in part, so that Candie's may have a declaratory judgment that it properly has and may continue to offset the fiscal year 2004 shortfall amount against interest and principal due under the $11 million note, pursuant to Paragraph 2.8 of the note.

17. Sweet breached the MSA by failing to meet the $1.7 million guarantee for fiscal year January 2005, but Candie's is not entitled to a double recovery

Plaintiffs claim that Sweet breached Paragraph 2.7 of the MSA by not making the shortfall payment for fiscal year 2005. As with the shortfall for fiscal year 2004, the issue is whether Candie's properly applied the fiscal year 2005 shortfall to interest and principal due under the $11 million note. If plaintiffs are correct that Sweet breached the MSA by failing to make a shortfall payment for fiscal year 2005, then Candie's properly offset the shortfall first to quarterly $220,000 interest payments, and then to the principal of the note.

The jury awarded $4.9 million against Sweet on this claim. Sweet's motion for JNOV was denied by operation of law.

The merits of whether Sweet owed a shortfall payment for fiscal year 2005 involve entirely different legal and factual issues than the merits of whether Sweet owed a shortfall payment for fiscal year 2004. Fiscal year 2005 would have been from February 1, 2004 to January 31, 2005, but plaintiffs terminated the MSA in August 2004. The parties do not dispute that in such a situation, the guarantee is prorated. Paragraph 2.5 provides that in the event the MSA "is terminated or expires prior to the last day of a" fiscal year, then the $1.7 million guarantee of Paragraph 2.7 "shall be prorated based on the number of days" from February 1 to the termination date "as compared to 365." Danderline referred to this number as the "prorated guarantee." Danderline testified that from February 1, 2004 to January 31, 2005, Unzipped had an adjusted loss of $6,303,000. Using the prorated guarantee for the truncated fiscal year of February 1, 2005 to August 4, 2005 of $873,000, Danderline calculated that the prorated shortfall for fiscal year 2005 was $7,176,000. Sweet did not make this payment, and Candie's applied this amount to the $11 million note, pursuant to Paragraph 2.8.

Sweet does not dispute the amount of the prorated guarantee or the amount of the shortfall payment. Nor does Sweet argue that a guarantee of $1.7 million in "net income" does not authorize a payment of greater than $1.7 million, i.e., negative net income. Instead, Sweet argues that Candie's cannot recover for breach of Paragraph 2.7 for fiscal year 2005 because Candie's breached Paragraph 20 of the sublicense agreement which, although it is between MC and Unzipped, is incorporated into the MSA between Candie's and Sweet. Sweet contends that the conduct of Candie's in engaging in negotiations for a new licensee prior to the last six months of fiscal year 2005 (i.e., August 1, 2004) constituted a material breach of the MSA, and excused Sweet's obligation to pay Unzipped any shortfall payment under Paragraph 2.7. Sweet's position requires that the sublicense agreement between MC and Unzipped, which is *attached* to the MSA, also be *incorporated* into the MSA, because Candie's and Sweet are not parties to the sublicense agreement. The issue is one of contract interpretation under Delaware law, which applies to the MSA. There was no extrinsic evidence of discussions about the contractual provisions at issue.[42]

"Other writings, or matters contained therein, which are referred to in a written contract may be regarded as incorporated by the reference as a part of the contract and therefore, may properly be considered in the construction of the contract. Where a written contract refers to another instrument and makes the terms and conditions of such other instrument a part of it, the two will be construed together as the agreement of the parties." (*I.U. North America, Inc. v. A.I.U. Ins. Co.* (Del. 2006) 896 A.2d 880, 886.) "A mere reference in one agreement to another agreement, without more, does not incorporate the latter agreement into the former by reference. To incorporate one document into another, an explicit manifestation of intent is required." (*Wolfson v. Supermarkets General Holdings Corp.* (Del. Ch. Jan. 23, 2001, No. 17047) 2001 WL 85679, at *5; see *Star States Development Co. v. CLK, Inc.* (Del. Super. May 10, 1994, No. 93L-08-048) 1994 WL 233954, at *4 ["an agreement will not be deemed to incorporate matter in some other instrument or writing except to the extent that the same is specifically set forth or identified by reference"].)

Whether the MSA incorporates the attached sublicense agreement is a close question. Paragraph 14.4 of the MSA states that Exhibit A, the sublicense agreement, and Exhibit B, the Approved Budget for fiscal year 2003, are part of the agreement and understanding of the parties to the MSA; namely, Candie's, MC, Unzipped, and Sweet. But it falls short of incorporating into the MSA all of the terms, conditions, and other provisions of the sublicense agreement (and the fiscal year 2003 Approved Budget, for

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[42] This issue forced the parties to flip positions on the issue of related entity liability. Plaintiffs, who argue elsewhere that Guez, Sweet, and Azteca should be responsible for each other's liabilities even though plaintiffs did not plead or prove alter ego liability, now argue that defendants' position on this claim "defies rules of corporate separateness." Defendants, who elsewhere argue Guez, Sweet, Azteca, and ADS should not be liable for each other's liabilities, now argue that "Sweet's obligations were due to" all of the plaintiffs, "and thus all three must accept the consequences of the breach of the Management Agreement."

that matter). Paragraph 14.1 does not, as did the contract in *I.U. North America*, state that "all terms and conditions" of the sublicense agreement "are incorporated herein by reference . . . ." (*I.U. North America, Inc. v. A.I.U. Ins. Co., supra*, 896 A.2d at p. 886.) Paragraph 14.1 of the MSA does not, as did Section 9.21 of the concurrently executed October 2002 Equity Acquisition Agreement, state that the "exhibits, annexes and schedules identified in this Agreement are incorporated herein by reference and made a part hereof." The parties knew how to incorporate exhibits into contracts when then intended to do so, and they did so in the Equity Acquisition Agreement but they did not do so in the MSA. (See *Leung v. Schuler* (Del. Ch. Sept. 29, 2000, No. 17089) 2000 WL 264328, at *5 [under California law "if the parties intended to incorporate the entire Reorganization Agreement into the Note Exchange Agreement, they could have explicitly so provided"]; *Amtower v. Photon Dynamics, Inc.* (2008) 158 Cal.App.4th 1582, 1608 ["To impliedly incorporate an external document by reference, the subject document must contain some clear and unequivocal reference to the fact that the terms of the external document are incorporated"].) Moreover, although it is true that the MSA's integration clause (Paragraph 14.4) references the "annexes and exhibits" to the MSA as part of the parties' "entire agreement and understanding . . . in respect to its subject matters," it is also true that the sublicense agreement's integration clause (Paragraph 27) states that the sublicense agreement (and not the MSA) "constitutes the entire agreement between the parties as to the Licensed Items."

Because we conclude that the MSA does not incorporate the terms and conditions of the sublicense agreement, Candie's conduct in negotiating with potential new licensees prior to August 1, 2004 was not a breach by Candie's of the MSA. Nor can Sweet, which was not a party to the sublicense agreement, claim that Candie's breached the sublicense agreement. Therefore, Sweet's argument that the breach by Candie's excused Sweet from its obligation under the MSA to make the fiscal year 2005 shortfall payment fails. The result is a bit harsh on Sweet: MC could have breached the sublicense agreement by taking action that adversely affected the trademark rights it had contributed to Unzipped. But Sweet and Guez did not negotiate for a right to prevent or object to such conduct, such as insisting on becoming a party to the sublicense agreement, or including in the MSA a remedy for such conduct.

Therefore, Candie's properly offset the fiscal year 2005 shortfall against the interest and principal due under the $11 million note. As noted above, however, Candie's is not entitled to a money judgment for the fiscal year 2005 shortfall. As Kalos acknowledged, "if at the end of the day the jury were to find for the plaintiffs and find that the note write-down[s] were . . . appropriate then, in effect, plaintiffs already collected 8.8 million dollars in the damages" for failure to meet the guarantees for fiscal years 2004 and 2005. The denial by operation of law of Sweet's motion for JNOV on this claim is reversed in part and modified in part. As noted above, Candie's is entitled to a declaration, consistent with the jury's findings, that Candie's properly has and may continue to offset the fiscal year 2005 shortfall amount (exclusive of prejudgment interest) against interest and principal due under the $11 million note.[43]

18. Substantial evidence supports the jury's verdict on plaintiffs' claim that Guez breached his fiduciary duties by inducing Candie's to invest $4.4 million in Unzipped

At the August 14, 2002 Candie's board meeting, the "only item on the agenda was to review the request by Mr. Guez concerning the investment of $5 million by Candie's, Inc., in the Unzipped business." Candie's ultimately invested $4.4 million in Unzipped at this time.[44] Candie's claims that when Guez requested that Candie's invest this sum in Unzipped, he concealed from the board of directors two material facts: (1) Unzipped's auditors were going to tag Unzipped with a "going concern" label, which is a sign that

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[43] The exhibits showing how Kalos calculated prejudgment interest on the fiscal year 2005 shortfall have not been included in the record. The jury's award of $4,900,000 includes prejudgment interest. Kalos appears to have testified that prejudgment interest on this claim was $1,675,000. The jury, however, did not award Candie's the entire claimed shortfall amount.

[44] Kalos calculated the precise amount as $4,433,481.

the company might not be able to continue as an operating business,[45] and (2) Unzipped's lender Congress Financial had advised Guez that it intended to end its lending relationship with Unzipped. Guez conceded that the board of directors of Candie's approved the $4.4 million cash infusion without knowing about either of these two issues. The jury awarded $4.4 million against Guez, which with prejudgment interest amounted to $6,441,000. Guez's motion for JNOV was denied by operation of law.

Guez does not argue that there is no substantial evidence in the record to support the jury's verdict that he breached his fiduciary duties to Candie's by urging Candie's to make the $4.4 million cash "infusion" into Unzipped, without disclosing these two material pieces of financial bad news. And with good reason: the evidence of liability is overwhelming. Although defendants attempted to create a factual dispute at trial, there was substantial evidence that Guez knew about the "going concern" issue raised by Unzipped's auditors and about Congress Financial's decision to terminate its lending relationship with Unzipped (not the other way around, as Guez testified), and that Guez did not disclose either fact to Candie's before the board voted to invest the $4.4 million.

Instead, Guez focuses on the elements of causation and damages. Guez argues that plaintiffs did not prove a causal link between Guez's fraudulent concealment and the board's decision in August 2002 to invest the $4.4 million in Unzipped, because only one of the five directors testified that he or she would not have voted for the infusion if he or she had known the true facts about Unzipped's financial condition. Guez is legally and factually incorrect. There is no requirement that a plaintiff produce a majority of directors, with each one testifying how he or she would have voted had the defendant been truthful, in order to show that a defendant fraudulently induced a board of directors to take an action. Guez provides no authority for such a proposition. The testimony of one director, if believed, is sufficient to prove causation. Cole testified that the facts that

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[45] Cole testified that a "going concern opinion" is "when an accounting firm issues an opinion that the business—they don't believe the business can make it." Siris testified that a "going concern" means that the auditor "thinks that there is a risk that the company might not be able to continue in business, for the entire next fiscal year."

Unzipped's auditors had a "going concern" issue, and that Unzipped's bank was "withdrawing" and leaving Unzipped without credit, were vitally important "to the business," that the members of the board of directors did not know and never discussed these facts, and that he would not have voted to make the $4.4 million cash investment into the operations of Unzipped had the board known this information at the time.

Moreover, two other directors did testify at trial, which brought the total number of testifying directors to a majority of three out of five. Siris testified that Guez never advised him that Congress Financial had decided to terminate its lending relationship with Unzipped, nor that Unzipped's auditors had raised the "going concern" issue. Siris stated that he "absolutely" would have expected Guez to tell him these kinds of things, and he was "very surprised that we weren't provided with this information." Siris stated that as a member of the board of directors, he would not have voted to approve the $4.4 million cash infusion had he known about these matters, and that this information "would have raised a red flag for me that . . . would have forced me to drill deeper into the numbers before I agreed to put up any money." Siris testified: "I would have sent auditors out . . . there the next morning. I would've gone out myself. And would've asked . . . them to look at every single item on the books, because . . . this information was significantly different from what I had been led to expect." Siris stated that "knowing that the people who were making millions of dollars lending millions of dollars to Unzipped, didn't want to keep making millions of dollars lending millions of dollars to Unzipped" was "a material fact that I didn't know that I would have liked to know before I invested money."

Iverson testified that she also did not know about the Congress Financial and "going concern" problems, and that had she known about them she would have essentially stopped everything and initiated an investigation. Iverson testified that these issues were "really troubling" and "important signals and red flags" requiring "all hands on deck," and that these kinds of problems cause directors to "immediately drill down, start an investigation, sometimes use outside support, but yet get right to the bottom of it." She testified she would not have had any further discussions about making the

$4.4 cash infusion until the completion of such a thorough investigation, and that she would not have voted for the cash infusion until she knew more.

The testimony of Cole, Siris, and Iverson was substantial evidence that a majority of the members of the board of directors would not have voted to invest $4.4 million in Unzipped had the directors known about the Congress Financial and going concern issues, even assuming that the law required plaintiffs to call three out of the five directors to the witness stand. Given the seriousness of the issues, Cole's testimony was enough. The jury reasonably could have inferred causation by the materiality of the information Guez concealed, even if Siris and Iverson had not testified that they would not have voted for the $4.4 million cash infusion had they known the true facts.

Guez also argues that plaintiffs did not introduce evidence that the damages caused by Guez's wrongful concealment were $4.4 million. Guez argues that Candie's did not lose the $4.4 million; the money was invested in Unzipped and helped Unzipped make money.

Substantial evidence supports the jury's finding that Candie's lost the $4.4 million it invested in Unzipped in ignorance of the material financial facts that Guez kept from the board. McKee testified that in the summer of 2002, before Candie's invested the $4.4 million in Unzipped, Unzipped "was a bankrupt worthless company that would've collapsed, financially, without that cash infusion and probably collapse within thirty or ninety days." At the time, "Unzipped was maxxed out on its borrowings with Congress Financial" and "was in default, under the net worth provisions of its credit facility with Congress Financial." Unzipped faced the possibility of failing to remain "economically viable" more than a "full business cycle," and "unless it could continue to borrow money from Congress Financial to finance its working capital requirements it would be outa [*sic*] business." Azteca was in a similar situation with Congress Financial. McKee testified that for its $4.4 million investment into the (undisclosed) financial mess that was Unzipped, "Candie's got a zero return."

Defendants did not object to McKee's opinion that Candie's received nothing for its $4.4 million investment. Nevertheless, defendants argue that McKee's opinion "was unsupported by any facts in the record and thus could not constitute substantial evidence." As noted above, however, McKee conducted a thorough and exhaustive review and analysis of all aspects of Unzipped's business. McKee had sufficient facts to support his opinion.

More important, defendants precluded McKee from giving further facts in support of his opinion by objecting to part of McKee's explanation on the ground that it was precluded by the trial court's summary adjudication rulings on plaintiffs' fraud claims. The trial court erroneously sustained the objection, on the mistaken grounds that the "summary judgment basically took out of the case" the financial statements McKee had used in part to formulate his opinion, and that the limited issue was "whether or not the board members may have come to some similar conclusion regarding Congress" and the going concern issue. The summary adjudication rulings, however, dismissed plaintiffs' fraud claims based on statements made by Guez in April 2002 that induced Candie's to exercise the buyout of Sweet's 50 percent interest in Unzipped pursuant to the 1998 joint venture agreement before the agreed-upon contractual date, not plaintiffs' breach of fiduciary duty claim based on statements made by Guez in August 2002 that induced Candie's to invest $4.4 million in Unzipped. (And to the extent the summary judgment rulings dismissed plaintiffs' fraud claims regarding statements made by Guez in October 2002, we reverse those rulings below.) Thus, the trial court should have overruled defendants' objection to McKee's testimony about (some of) the reasons for his opinion that Candie's lost its entire $4.4 million investment. Defendants cannot complain that McKee's explanation was insufficient or unsupported, when their objection to McKee's further explanation and support caused the trial court to exclude that testimony. (See *Watenpaugh v. State Teachers' Retirement System* (1959) 51 Cal.2d 675, 680 ["Under the doctrine of invited error, a party may not object to the sufficiency of the evidence to support a finding against him when the lack is the result of improper exclusion of evidence at his own instance"]; *Horsemen's Benevolent & Protective Assn. v. Valley Racing Assn.* (1992) 4 Cal.App.4th 1538, 1555 ["Where a party by his conduct induces the commission of error, he is estopped from asserting it as a ground for reversal. This application of the estoppel principle is generally known as the doctrine of invited error."]; *Kessler v. Gray* (1978) 77 Cal.App.3d 284, 290.)

Moreover, the fact of the $4.4 million loss was supported by evidence other than the testimony of McKee. For example, Cole, Iverson, and Caruso all testified that in January 2004 and April 2004 Candie's asked Guez to have Unzipped return $2 million of the $4.4 million to Candie's, but Guez never arranged for Unzipped to return it. Guez's refusal to allow Unzipped to return any of the $4.4 million investment, despite repeated requests by Candie's, is substantial circumstantial evidence that it was lost.

Defendants argue that the $4.4 million investment by Candie's in August 2002 was not lost because Candie's received more than $7 million in actual and guaranteed net income in fiscal years 2003, 2004, and 2005. This argument is unpersuasive because it relies on the $1.7 million guarantee. There was evidence that in fiscal year 2003, which ended five months after Candie's made the $4.4 million investment in Unzipped, Unzipped earned over $2 million in net income. For fiscal year 2004, Unzipped essentially broke even at $74,000 in net income, and only earned net income of $1.7 million because of the guarantee. Candie's, however, would have received $1.7 million in fiscal year 2004 regardless of whether it made the $4.4 million cash infusion into Unzipped, because it was guaranteed. For prorated fiscal year 2005, Unzipped actually lost over $6 million. Candie's only made money because of the guarantee, and Sweet again would have had to pay that money (or accept an offset to the $11 million note) regardless of whether Candie's made the $4.4 million investment. The fact that Unzipped barely broke even in fiscal year 2004 and lost over $6 million in fiscal year 2005 is more evidence that Candie's $4.4 million investment was lost.[46]

The denial by operation of law of Guez's motion for JNOV on this claim is affirmed.

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[46] Guez does not argue on appeal that the $4.4 million award is excessive because it did not take into account that the cash infusion may have helped Unzipped survive and either earn income or generate shortfall payments.

19. Defendants are not liable for trademark infringement

After Candie's terminated the MSA, the ARSA, and the ARDA on August 5, 2004, Candie's began efforts to obtain from defendants all of the Bongo-trademarked property in defendants' possession, including jeans that were in the middle of the manufacturing and distribution process at the time of the termination. Danderline testified that at the time of the termination, there were Bongo jeans in the ADS warehouse, "in transit," "at the pier," "at the dock," and "all through the supply chain, at that point." Cole specifically advised Guez that defendants were not authorized to sell anything bearing the Bongo trademark to anyone other than Unzipped.

On September 9, 2004, after a month of unsuccessful efforts to acquire this Bongo merchandise, Cole wrote Guez to try to resolve the dispute and to get the Bongo jeans to Unzipped's customers, who were anxiously awaiting the jeans for their back-to-school customers. Cole also cancelled all orders to Azteca for Bongo jeans, and put defendants on notice that Candie's would consider any sale or use of products with the Bongo trademark as trademark infringement. Cole sent a follow-up letter on September 17, 2007. Guez responded the same day, stating that he had not responded to Cole's "self-serving" September 9, 2004 letter because the parties were already engaged in litigation. Guez stated: "I wish to let you know that I intend to sell all the goods made by Azteca to all accounts which purchased them, and to the extent that there are goods left over, due to cancellations or for other reasons, I intend to dispose of these goods as well." Cole wrote Guez again on October 18, 2004 to demand that defendants stop selling or shipping any jeans bearing the Bongo trademark. Candie's never approved of the shipment or sale of its trademark jeans in defendants' possession after the termination of the agreements.

Azteca sold the jeans anyway, kept the proceeds, and did not deduct the proceeds from the amounts Azteca claimed Unzipped owed Azteca. Guez testified that he ignored the instructions from Candie's not to sell the Bongo jeans, and decided to sell jeans in order to mitigate his claimed damages. Guez explained: "I had to mitigate my damages and collect the money I was owed." Guez stated that he sold the jeans despite the letters from Cole because Cole was "the same guy that owed me four million dollars."

McKee calculated that Azteca's profit from selling the post-termination Bongo jeans was $1,439,049.34 ($4,766,000 in sales less $3,326,755.86 in costs). Kalos calculated the profit as $1,037,632. The jury found against all four defendants, and made special findings that defendants were aware that the use of the Bongo trademark was not authorized, that Unzipped, MC, and IPH were harmed by defendants' use of the Bongo trademark, and that the infringement by all four defendants was intentional. The jury awarded Unzipped, MC, and IPH $1,037,632, which with prejudgment interest amounted to $1,210,000.

Defendants' appeal raises the trademark issues of "genuineness" and "first sale," doctrines and terminologies that have caused division among the courts and some confusion in the cases. Defendants argue that the Bongo jeans Azteca sold after August 5, 2004 were in fact "genuine" Bongo jeans, ordered by Unzipped and manufactured by Azteca, just like all the other millions of pairs of jeans previously ordered by Unzipped and manufactured by Azteca. Defendants rely on one of the two leading trademark infringement cases on genuineness, *Monte Carlo Shirt, Inc. v. Daewoo International* (*America*) *Corp.* (9th Cir. 1983) 707 F.2d 1054 (*Monte Carlo*), which held that the unauthorized sale of "genuine product," "planned and sponsored" by the trademark holder and manufactured by the defendant, was not infringement because there could be no customer confusion. (*Id.* at p. 1058.) Plaintiffs rely on the other leading trademark infringement case on genuineness, *El Greco Leather Products Co. v. Shoe World, Inc.* (2d Cir. 1986) 806 F.2d 392 (*El Greco*), which held that "[t]he mere act of ordering a product to be labeled with a trademark does not deprive its holder of the right to control the product and the trademark," and that products sold without the holder's authorization are not genuine. (*Id.* at pp. 395-396.)

Between the poles of *Monte Carlo* and *El Greco* lie cases reaching varying results and announcing and applying occasionally inconsistent rules. (See *John Paul Mitchell Systems v. Pete-N-Larry's Inc.* (W.D.N.Y. 1994) 862 F.Supp. 1020, 1025 [stating, after reviewing the case law, that it was "tempt[ing] . . . to declare the test of 'genuineness' to be either meaningless or unworkable and to abandon it entirely"].) As one treatise has recognized, "[t]here is a split of authority" over whether *Monte Carlo* or *El Greco* applies "when goods are left after when the trademark proprietor first authorizes a private-label manufacturer to affix the mark to the goods on behalf of the trademark proprietor, and later revokes that authorization." (4 Callmann, Unfair Competition, Trademarks and Monopolies (4th ed. 2004) Trade Identity Infringement, § 22:18, at p. 22-312 (rev. 8/2004) (Callmann).)

"If the trademark is readily removable without undue expense and without damage to the goods, then the manufacturer can mitigate damages or recoup his investment by removing the private label before selling the goods. But is the manufacturer justified in mitigating damages or recouping his losses by selling the goods *with* the trademark in place, particularly in those cases where removal of the mark is not feasible because it is too expensive or can not be accomplished without physical damage to the goods? Or should he look solely to the law of contract for his remedy? And what of the case where the manufacturer is the one who is in breach of the agreement (e.g., by virtue of late delivery) and therefore has no remedy in contract; may he reduce his losses by selling the rejected goods without first removing the trademark? If removal is not feasible in this fact situation, must he absorb the entire loss rather than trespass on another's trademark rights?" (Callmann, *supra*, § 22:18, at p. 22-313, italics in original.)

All good questions, and all raised by this case, because the Bongo mark apparently is not removable from the jeans. And questions with which both sides have had some prior experience.

In *Monte Carlo*, Monte Carlo contracted with Daewoo for the manufacture of 2,400 men's dress shirts with the Monte Carlo label. Monte Carlo rejected the shirts because Daewoo delivered them too late for Christmas sales. (*Monte Carlo, supra*, 707 F.2d at p. 1055.) Daewoo through a subsidiary sold the shirts to discount retailers, without Monte Carlo's permission. The court held that Daewoo's unauthorized sale was a not a trademark violation under California state trademark law, set forth in the Unfair Practices Act, Business and Professions Code section 17043. (*Monte Carlo*, at p. 1057.) The court stated that under state and federal trademark law, a "showing of buyer confusion as to the source, origin, or sponsorship of goods is part of a cause of action for infringement of a registered mark," and "no such confusion was possible in this case." (*Id.* at p. 1058.) "The goods sold by Daewoo were not imitations of Monte Carlo shirts; they were the genuine product, planned and sponsored by Monte Carlo and produced for it on contract for future sale. The shirts were not altered or changed from the date of their manufacture to the date of their sale. Their source was Monte Carlo; the absence of Monte Carlo's authorization of the discount retailers to sell does not alter this." (*Ibid.*)[47]

In *El Greco*, El Greco Leather Products contracted with Solemio, a Brazilian shoe factory, for the manufacture of 25,000 pairs of shoes with El Greco's trademark, "Candie's."[48] The contract required an inspection certificate issued by El Greco's agent in Brazil before Solemio could receive payment, in order to make sure that the shoes met El Greco's specifications and quality standards. (*El Greco, supra,* 806 F.2d at pp. 393, 395.) El Greco cancelled the last two lots of shoes because they were either defective or delivered late. (*Id*. at p. 394.) Solemio then sold the shoes to the defendant Shoe World. Reversing the district court's refusal to grant an injunction against Shoe World for trademark infringement under the Lanham Act, the *El Greco* court found that the shoes were not genuine. The court held: "One of the most valuable and important protections

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[47] Although *Monte Carlo* was decided under California law, federal courts have cited, relied on, and distinguished it in Lanham Act cases. (See, e.g., *Diebold, Inc. v. Positran Mfg., Inc.* (D. Del. Sept. 26, 2002, No. 02-374-GMS) 2002 WL 31129726, at *4, fn. 3 ["[a]lthough the court is mindful that *Monte Carlo* involved a California common law infringement action, at least one other court has also applied this holding in a federal trademark infringement action"]; *Ballet Makers, Inc. v. United States Shoe Corp.* (S.D.N.Y. 1986) 633 F.Supp. 1328, 1333 ["Although *Monte Carlo* involved (California) common law infringement, courts in [the Second] Circuit have relied on the Ninth Circuit analysis in federal trademark cases"].) Even *El Greco* cites and discusses *Monte Carlo*. (See *El Greco, supra,* 806 F.2d at p. 398.) Although the Ninth Circuit has pointed out that *Monte Carlo* applied California law and did not construe the Lanham Act (*Intel Corp. v. Terabyte Internat., Inc.* (9th Cir. 1993) 6 F.3d 614, 620), *Monte Carlo* has become part of the fabric of Lanham Act jurisprudence. (See Callmann, *supra*, § 22:18; 4 McCarthy on Trademarks and Unfair Competition, § 25:49.)

[48] Yes, the same Candie's. Cole testified that El Greco "was a company that imported and sold Candie's shoes." Cole worked for El Greco from 1983 to 1985.

afforded by the Lanham Act is the right to control the quality of the goods manufactured and sold under the holder's trademark. [Citations.] For this purpose the actual quality of the goods is irrelevant; it is the control of quality that a trademark holder is entitled to maintain." (*Id.* at p. 395.) Thus, "[o]nce it cancelled the order, El Greco was entitled to assume that Solemio would not dispose of the shoes without either removing the CANDIE'S trademark (as in the custom and practice in the industry), or affording El Greco an opportunity to inspect the goods and certify their quality prior to disposal, or, at the minimum, seeking instructions from El Greco on how to dispose of them." (*Id.* at p. 396.)

In *Sasson Jeans, Inc. v. Sasson Jeans, L.A., Inc.* (S.D.N.Y. 1986) 632 F.Supp. 1525 (*Sasson Jeans*), plaintiff Sasson Jeans and its president Paul Guez terminated a license agreement with defendants Sasson Jeans, L.A. and its officers Hubert Abraham Guez and Gerard Guez, and ordered the defendants "to cease all use of the Sasson trademarks" and to make no shipments of jeans without Paul Guez's approval.[49] (*Id.* at p. 1526.) Paul claimed that his brothers had made an "unauthorized sale of 'goods in process,'" and that Abraham (aka Hubert) and Gerard were "flooding the market with discount jeans without obtaining prior approval" from Paul. (*Id.* at pp. 1526-1527.) Citing *Monte Carlo* and the district court opinion in *El Greco* (before the Second Circuit reversed it), the *Sasson Jeans* court stated that "the unauthorized sale of authorized goods does not give rise to a claim for trademark infringement," and found that the jeans were "genuine" under the district court's opinion in *El Greco*. (*Sasson Jeans*, at p. 1528.) *Sasson Jeans*, however, is of questionable authority, because the *El Greco* district court decision it relied on is no longer good law.

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[49] Yes, the same Hubert Guez. The opinion refers to him by his middle name, Abraham. Guez's brothers started Sasson Jeans, and asked Guez to come work with them. Gary Bader was also involved in the *Sasson Jeans* case. As in this case, Bader sided with Hubert Guez against the company for which Bader had previously served as the president of sales, by submitting a declaration supporting Guez's position in the litigation. (*Sasson Jeans, supra,* 632 F.Supp. at p. 1526.)

Cases and commentators have discussed the *Monte Carlo* and *El Greco* lines of cases. (See, e.g., Callmann, *supra*, § 22:18, at p. 22-316 [“In direct contrast to the *Monte Carlo* and [other] cases is the more thoughtful opinion of the Second Circuit in the *El Greco* case, [fn. omitted] which held that only a trademark proprietor has the right to decide whether a product will bear his mark”]; 4 McCarthy on Trademarks and Unfair Competition (4th ed) § 25:49 (McCarthy) [describing the *Monte Carlo*/*El Greco* “conflict of authority”].) One of the main themes of the *El Greco* line of cases is that “a product is not truly ‘genuine’ unless it is manufactured and distributed under quality controls established by the trademark owner.” (McCarthy, *supra*, § 25:49.) Thus, “goods are not genuine if they do not conform to the trademark holder’s quality control standards, [citation] or if they differ materially from the product authorized by the trademark holder for sale.” (*Zino Davidoff, SA v. CVS Corp.* (2d Cir. 2009) 571 F.3d 238, 243; see *Iberia Foods Corp. v. Romeo* (3d Cir. 1998) 150 F.3d 298, 304 [“When a trademark owner arranges to have its mark placed on a product manufactured by another company, the owner’s rigorous quality control and inspection procedure on receipt from the manufacturer has often been recognized as the basis of a material difference between products sold by the trademark owner and those offered by another company without the trademark owner’s stamp of approval”]; *Enesco Corp. v. Price/Costco Inc.* (9th Cir. 1998) 146 F.3d 1083, 1087 [“Under the quality control theory, largely developed by the Second Circuit, ‘distribution of a product that does not meet the trademark holder’s quality control standards may result in the devaluation of the mark by tarnishing its image,’” quoting *Warner-Lambert Co. v. Northside Development Corp.* (2d Cir. 1996) 86 F.3d 3, 6].) Thus, where “the alleged infringer has interfered with the trademark holder’s ability to control quality, the trademark holder’s claim is not defeated because of failure to show that the goods sold were defective. This is because the interference with the trademark’s holder’s legitimate steps to control the quality unreasonably subjects the trademark holder to the risk of injury to the reputation of its mark.” (*Zino Davidoff*, at p. 243.) Indeed, the key fact in *El Greco* was Solemio’s failure to get an inspection certificate from El Greco. (*El Greco*, *supra*, 806 F.2d at p. 396.)

Here, plaintiffs do not argue or cite to evidence in the record that the jeans defendants sold after August 5, 2004 did not comply with Unzipped's quality control standards, that plaintiffs lost the opportunity or ability to control the quality of the jeans, or that there even were any applicable quality control standards. The ARSA provides that the "quality of the Products . . . shall meet the specifications and standards of both parties," not just Unzipped (the sublicense holder). Paragraph 6 provides: "No Products shall be shipped to Unzipped, nor shall Unzipped be invoiced for any Products, which, in either case, fail to meet both Unzipped's quality standards for Firsts and its quality standards for Irregulars." Plaintiffs present no evidence or argument, however, that Unzipped did not have the opportunity to exercise its quality control rights before Azteca sold the post-termination jeans, or even that quality control was an issue with these jeans. (See *Iberia Foods v. Romeo, supra,* 150 F.3d at pp. 304-305 ["'quality control' is not a talisman the mere utterance of which entitles the trademark owner to judgment," but instead "the test is whether the quality control procedures established by the trademark owner are likely to result in differences between the products such that consumer confusion regarding the sponsorship of the products could injure the trademark owner's goodwill"]; *Au-Tomotive Gold Inc. v. Volkswagen of America, Inc.* (2010) 603 F.3d 1133, 1139 ["likelihood of confusion, not quality control, is 'the "key-stone" of trademark law,'" quoting *Westinghouse Elec. Corp. v. General Circuit Breakers & Elec. Supply Inc.* (9th Cir. 1997) 106 F.3d 894, 900].). Thus, the *Monte Carlo* cases are more applicable to this case than the *El Greco* cases.

Plaintiffs argue that "the genuine goods defense is inapplicable where, as here, the trademarked product's initial sale was not authorized." Some cases say this. (See, e.g., *FURminator, Inc. v. Kirk Weaver Enterprises, Inc.* (N.D. Ohio 2008) 545 F.Supp.2d 685, 690 ["Goods are not genuine goods until their sale is authorized by the trademark owner"]; *Ryan v. Volpone Stamp Co., Inc.* (S.D.N.Y. 2000) 107 F.Supp.2d 369, 382 ["If the trademark owner did not approve the original sale, then goods cannot be considered genuine as a matter of law and infringement is established"]; *Liz Claiborne, Inc. v. Mademoiselle Knitwear, Inc.* (S.D.N.Y. 1997) 979 F.Supp. 224, 230 ["If the first sale by [the defendant manufacturer] was not authorized, then the garments cannot be genuine for infringement purposes"].) Other cases say the opposite. (See, e.g., *McCoy v. Mitsuboshi Cutlery, Inc.* (Fed. Cir. 1995) 67 F.3d 917, 924 [sale by manufacturer of genuine knives "did not cause customer confusion" and did not infringe on trademark, and the fact that the trademark holder "did not authorize resale is immaterial"]; *Matrix Essentials, Inc. v. Emporium Drug Mart, Inc.* (5th Cir. 1993) 988 F.2d 587, 590 ["the general rule is that 'trademark law does not apply to the sale of genuine goods bearing a true mark, even if the sale is without the mark owner's consent,'" quoting *Shell Oil Co. v. Commercial Petroleum, Inc.* (4th Cir. 1991) 928 F.2d 104, 107]; *Italverde Trading, Inc. v. Four Bills of Lading* (E.D.N.Y. 2007) 485 F.Supp.2d 187, 208 ["even where a defendant makes an unauthorized sale of a trademarked good, the plaintiff must still prove customer confusion"]; *Diebold, Inc. v. Positran Mfg., Inc*., *supra*, 2002 WL 31129726, at *4 ["sale, authorized or not, of the genuine article cannot lead to confusion"].) Consistent with the latter line of cases, defendants argue that a "party's sale of genuine goods, even if the sale is not approved of by the trademark owner, is non-infringing."

We think that defendants have the better of the argument, at least in the situation where, as here, the trademark holder or licensee (Unzipped) is suing a non-licensee manufacturer (Azteca) of goods for the trademark holder. When the trademark holder sues a non-licensee former manufacturer of goods bearing the mark, the first sale of the goods by the manufacturer is always unauthorized. Unlike the cases where a defendant retailer or reseller buys trademarked goods from an authorized purchaser of the trademark holder's goods (i.e., where the first sale is authorized), the defendant with whom the trademark holder contracts to manufacture the goods never has authorization to sell unwanted, rejected, or leftover goods to anyone other than the trademark holder or its designee. In other words, "if one views the manufacturer as being in the position of a purchaser of genuine goods who then resells them without change, then there is no infringement," and the fact "[t]hat the trademark owner does not 'authorize' the sale would be irrelevant, for no such approval is required if the goods are 'genuine.'"

(McCarthy, *supra*, § 25:49.) If the defendant manufacturer were required to prove authorization in order to invoke the genuine goods defense, then manufacturers could never resell rejected or leftover goods when the trademark holder terminates the contract, refuses to pay for the goods, or wrongfully claims that the goods are defective. If the manufacturer were required to prove authorization in cases brought by trademark holders, cases like *Monte Carlo* and *McCoy* would never find infringement.[50]

The denial by operation of law of defendants' motion for JNOV on plaintiffs' trademark claims is reversed. Defendants' sale of the Bongo jeans in their possession after the August 5, 2004 termination letter may have been a breach of contract, or it may have been a tort (see below). It may have been unprofessional and meanspirited. It was not, however, trademark infringement.

20. Defendants are liable for conversion

But it was conversion. The jury awarded the same amount, $1,037,632 plus prejudgment interest for a total of $1,210,000, against Guez, Azteca, Sweet, and ADS. Defendants' motion for JNOV was denied by operation of law.

The elements of a conversion cause of action are "the plaintiff's ownership or right to possession of the property at the time of the conversion; the defendant's conversion by a wrongful act or disposition of property rights; and damages." (*Haro v. Ibarra* (2009) 180 Cal.App.4th 823, 835; see *Hernandez v. Lopez* (2009) 180 Cal.App.4th 932, 939.) Defendants challenge the first element, arguing that plaintiffs did not have the right to ownership or possession of the post-termination jeans because Unzipped had cancelled the orders for those jeans. Defendants rely on a September 9, 2004 letter from

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[50] *Ryan v. Volpone Stamp Co.*, *supra*, 107 F. Supp.2d 369, one of the two primary cases on which plaintiffs rely, is distinguishable for other reasons. The baseballs and other items signed by baseball pitcher Nolan Ryan and marketed by the defendant licensee were not genuine because after Ryan had terminated the license, the defendant continued to market and sell the products as if they were still endorsed by Ryan, which they no longer were. (*Id.* at pp. 380-381.) In addition, the defendant in *Ryan,* unlike Azteca, was a holdover licensee, and claimed that it could sell products manufactured prior to the date of the termination of the license. (*Id.* at p. 381.) Azteca never was a licensee; it was the manufacturer. Unzipped was the (sub)licensee.

Cole to Guez, which states: "As you know, for almost a month Unzipped Apparel LLC ('Unzipped'), has been attempting to purchase from Azteca Production International, Inc. ('Azteca') certain goods and work in process that is [*sic*] being manufactured in Azteca's facilities exclusively for Unzipped. You have refused to sell us the goods. [¶] Accordingly, you are hereby advised that all orders to Azteca for BONGO® product are canceled. [¶] Any attempt by Azteca or any of its or your affiliates to sell BONGO® jeans wear . . . is unauthorized and will be deemed a deliberate and willful infringement of our trademarks." Cole testified that he wrote this letter because Unzipped's customers were demanding their fall shipments of jeans, Azteca was holding the jeans "hostage" in connection with this dispute, and Candie's was concerned that defendants would "be dumping the goods into distribution that would dramatically hurt the brand." (See *Sasson Jeans*, *supra*, 632 F.Supp. at p. 1527 [in which Guez's brother accused Guez of doing the same thing by "flooding the market with discount jeans"].)

What Cole did not know when he wrote this letter in September 2004 (and would not know until defendants produced their financial records in this litigation), however, was that Unzipped had already paid for the jeans. The jury heard the evidence of defendants' accounting and financial transactions, resolved this factual issue in favor of plaintiffs, and found that plaintiffs had paid for the post-termination jeans, owned them, and had the right to possess them. Cole testified that he believed at the time that Azteca and Guez's other entities owed Candie's "a lot of money" because of the unpaid shortfall payment, but he did not know and could not have known that defendants had overcharged Unzipped in general, and that defendants had often arranged for Unzipped to prepay Azteca or pay Azteca early. Nor could Cole have known that his statements that Unzipped had "been attempting to purchase" the post-termination jeans, and that Azteca had "refused to sell us the goods," were not correct. Unzipped in fact had already purchased the jeans, and Azteca in fact had already sold Unzipped the jeans; Azteca had simply refused to deliver them to Unzipped.[51]

Defendants also argue that Azteca and not Unzipped had the right to possess the post-termination jeans pursuant to California Uniform Commercial Code section 2702, subdivision (2), because Unzipped was insolvent. Section 2702, subdivision (2), provides in relevant part: "Where the seller discovers that the buyer has received goods on credit while insolvent he may reclaim the goods upon demand made within 10 days after the receipt . . . ." This section is inapplicable, however, regardless of whether or not Unzipped was insolvent (which, if it were, would have been Sweet's responsibility), because Unzipped never received the jeans Azteca sold to third parties, nor did Azteca make a demand to reclaim jeans it had delivered to Unzipped. Section 2-702(2) of the Uniform Commercial Code, on which Section 2702, subdivision (2), of the California Uniform Commercial Code is based, "is designed to allow the seller to recover goods *that have been delivered to the buyer* under circumstances that the Code regards as fraudulent." (2 W. Hawkland & L. Rusch, Uniform Commercial Code Series (2009) § 2-702:4, at p. 2-334, italics added.) It requires that the insolvent buyer have "possession of the goods at the time of the reclamation." (4A Lawrence's Anderson on the Commercial Code, *supra*, § 2-702:16, at pp. 12-13; see *In re Marin Motor Oil, Inc.* (3d Cir. 1984) 740 F.2d 220, 226 [seller's right to reclamation under UCC § 2-702(2) begins when seller's right to stop delivery terminates].) California Uniform Commercial Code section 2702, subdivision (2), was not, as defendants argue, a "complete defense" to plaintiffs' conversion claim. It was no defense at all.

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[51] Defendants argue that "the coherence of this argument is embarrassing" and "this claim is not even a close call" because defendants did not actually overcharge plaintiffs until the jury made that determination in the trial in this case, and "obtaining a judgment against a company does not mean that a judgment creditor *owns* the company's goods." This argument ignores the reality of how defendants maintained their books and records. Plaintiffs did not own and have a right to possess the post-termination jeans because they won at trial. Plaintiffs owned and had a right to possess the jeans because defendants' accounting records showed that they had paid for them. Defendants disputed this, and the jury agreed with plaintiffs.

The denial by operation of law of defendants' motion for JNOV on plaintiffs' conversion claim is affirmed.

21. The jury's finding of punitive damages against Guez stands

The jury found by clear and convincing evidence that Guez had acted with malice, fraud, or oppression in connection plaintiffs' claims for breach of fiduciary duty by fraudulently inducing Candie's to make the $4.4 million investment in Unzipped, by using Unzipped's resources to set up the Hippie, Hint, and Private Label businesses, and by allowing Azteca and ADS to overcharge Unzipped. After a relatively brief punitive damages phase of the trial in which Guez was the only witness, the jury awarded plaintiffs $5 million in punitive damages against Guez, and no punitive damages against any of the other defendants.

Guez moved for JNOV on the ground that because all of the compensatory damages awards were improper, "the punitive damages award should be reversed as well." Because we have not reversed all of the compensatory damages against Guez, this argument necessarily fails. Guez also argued in his motion for JNOV that there was no evidence of malice, fraud, or oppression. Guez has abandoned this argument on appeal.

The denial by operation of law of Guez's motion for JNOV on plaintiffs' claim for punitive damages is affirmed.

22. Substantial evidence supports the jury's verdict on Sweet's claim against Candie's for breach of the $11 million note

The jury found against defendants on all of their cross-claims, including Sweet's claim for breach of the $11 million note. The special verdict form for the "Guez party claims" asked the jury: "Is Sweet entitled to prevail on its claim against Candie's for breach of the $11 Million Note?" In response to the question, the jury answered: "No." Sweet's motion for JNOV was denied by operation of law.

As noted above, Candie's properly offset the fiscal year 2004 shortfall of $1,626,000 and the fiscal year 2005 prorated shortfall of $4.9 million first against the quarterly interest payments of $220,000 as they became due, and then against principal. Because the offsets were proper, Candie's did not breach the note by failing to make any of the interest payments. As of the January 2007 trial, Candie's had not made 13 interest payments of $220,000 (May 2004 to November 2006), for a total of $2,860,000. Therefore, Candie's has not used up the shortfall offsets on interest payments, and the principal is not due until April 2012. Substantial evidence supports the jury's special verdict that Candie's did not breach the $11 million note.

Of course, how much money Candie's will owe Sweet in April 2012, or earlier if the shortfall offsets are insufficient to cover all of the quarterly interest payments due and Candie's fails to make an interest payment, will be an interesting accounting issue.[52] These parties, however, have shown that they are capable of presenting complicated, disputed accounting issues to a trier of fact for resolution, if necessary. How much Candie's owes Sweet on the $11 million note is an issue for another day. In this case, the jury found that Candie's did not breach the note, and there is substantial evidence to support that finding. The denial by operation of law of Sweet's motion for JNOV is affirmed.

B. The August 3, 2007 Denial by Operation of Law of Defendants' Motions for a New Trial (*Reviewable as to Guez and ADS Through the November 16, 2007Judgment*)

1. Standard of review

"When the court has denied a motion for a new trial, [the reviewing court] must determine whether the court abused its discretion by examining the entire record and making an independent assessment of whether there were grounds for granting the motion." (*ABF Capital Corp. v. Berglass* (2005) 130 Cal.App.4th 825, 832; *Sherman v. Kinetic Concepts, Inc.* (1998) 67 Cal.App.4th 1152, 1160-1161.) The abuse of discretion standard of review "applies with equal force, when the motion for new trial is automatically denied under the provisions of section 660 for failure to affirmatively pass

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[52] It does not appear to our non-accountant eyes that Candie's will be able to avoid making all of the quarterly interest payments that become due under the note by using the fiscal years 2004 and 2005 shortfall offsets. Candie's stopped making the $220,000 quarterly interest payments in May 2004, and the last quarterly interest payment is due in February 2012. These 34 quarterly interest payments amount to $7,480,000.

upon the motion within 60 days after filing the notice of intention to move for a new trial." (*Shepard's Estate*, *supra*, 221 Cal.App.2d at p. 75, quoting *Strauch v. Bieloh* (1936) 16 Cal.App.2d 278, 281.)

2. The jury's award against Guez for diversion of Unzipped's resources for Hippie, Hint, and Private Labels was not excessive

As noted above, the jury awarded plaintiffs $8.1 million, including prejudgment interest, against Guez and Sweet for breach of their fiduciary duties by using Unzipped's resources, such as Gary Bader, to start new brands of competitive jeans. In addition to moving for JNOV on this claim, Guez moved for a new trial, arguing that the "$8.1 million awarded on this claim was plainly excessive" because the jury "instruction regarding the damages available for a claim for breach of fiduciary duty made clear that plaintiffs could only recover the 'value' of the Unzipped resources purported[ly] diverted by the defendants." Guez's motion for a new trial was denied by operation of law. (As explained above, we do not have jurisdiction to review the denial by operation of law of Sweet's motion for a new trial, because there is no judgment against Sweet.) Guez repeats his argument on appeal: "No one tried to figure out, based on what Unzipped was paying Gary Bader by the hour, how many hours of his time were 'diverted.'"

As explained above in connection with Guez's appeal from the denial by operation of law of his motion for JNOV on this claim, the jury did not award plaintiffs the value of resources diverted (i.e., plaintiffs' damages), but the value defendants received as a result of the resources diverted (i.e., defendants' unjust enrichment). The jury instruction limiting plaintiffs' recovery to their damages rather than defendants' enrichment was erroneous. Guez's argument falls with this instruction. There was substantial evidence of the amount of defendants' unjust enrichment, and there are no grounds for granting a new trial. The denial by operation of law of Guez's motion for a new trial on this claim is affirmed.

3. The jury's award against Guez for ADS's failure to maintain a perpetual inventory was speculative and must be reversed

As noted above, the jury awarded plaintiffs $3,252,000 for ADS's failure to maintain a perpetual inventory, as required by Paragraph 4(a) and Annex 1 of the ARDA.

McKee's method of calculating the damages caused by ADS's failure to provide a perpetual inventory was simple. Because a perpetual inventory was one of the seven things ADS contracted to provide, McKee determined the total amount Unzipped paid ADS, $16,561,826, and divided that amount by 7, to get $2,365,975, which with prejudgment interest became $3,252,000. Guez's motion for a new trial on the ground that the damages were excessive and speculative was denied by operation of law.[53]

We agree with Guez that the jury's damages award for failure to maintain a perpetual inventory is entirely speculative and cannot stand. Plaintiffs were seeking to recover their "out-of-pocket" loss under Civil Code section 3343 of the money they spent for a perpetual inventory system they did not receive. "The out-of-pocket measure [of damages] restores a plaintiff to the financial position he enjoyed prior to the fraudulent transaction, awarding the difference in actual value between what the plaintiff gave and what he received." (*Fragale v. Faulkner* (2003) 110 Cal.App.4th 229, 236; *Salahutdin v. Valley of California, Inc.* (1994) 24 Cal.App.4th 555, 561-562.) McKee did not testify, however, as to the actual value of what plaintiffs gave for the perpetual inventory, nor the actual of what plaintiffs received. Plaintiffs presented no evidence of the value of the perpetual inventory in general or as compared to the other services ADS contracted to provide, the proper portion of payments to ADS that were attributable to the perpetual inventory service, what portion or percentage of the services provided by ADS were attributable to perpetual inventory maintenance, the value of what plaintiffs did receive from the non-perpetual inventory service that ADS provided, or the detriment proximately caused by the absence of a perpetual inventory. McKee just divided by seven. In fact, because the ARDA lists 13 services "to be provided by" ADS (seven

[53] In arguing for a new trial, defendants argued that even if "the Vincent Database did not qualify as a perpetual inventory system," it came pretty close, and "lacked only one of the five asserted components of a perpetual inventory system. Thus, if any award was warranted, it should have been limited, at most, to 1/35th of ADS' charges, not 1/7th." Sweet also moved for a new trial on this ground, but, as noted above, the denial of Sweet's motion for a new trial is not appealable, and is not reviewable through a judgment because there is no judgment against Sweet.

distribution and six operations), McKee did not even divide by the right arbitrary and inappropriate number.

Moreover, the damages for defendants' failure to provide a perpetual inventory, according to McKee, may already include some of the damages plaintiffs received on their other overcharge claims. McKee testified that a perpetual inventory system, if defendants had been able to maintain one, might have prevented some of the irregularities that plagued defendants' accounting, such as the early payment and prepayment by Unzipped of Azteca's invoices, the overcharges by Azteca, the use of actualizations to try to correct the books, the undocumented topside journal entries, the large credit memoranda to compensate for inaccurate charges by Azteca, the missing data for the Candie's brand jeans, and the posting of returns to the subledger months after the returns had occurred. McKee opined that "if the perpetual inventory system had been maintained, I do not believe that we would've been seeing all of the overcharges that we have been talking about from Azteca in this case, from 1998 through 2004." If McKee was correct, then plaintiffs' damages on their perpetual inventory claim may duplicate or at least overlap some of plaintiffs' damages on their other accounting claims.

The denial by operation of law of Guez's motion for a new trial on this claim is reversed and remanded for a new trial on the issue of damages.

4. The $5 million punitive damages award against Guez is not excessive

As noted above, the jury awarded plaintiffs $5 million in punitive damages against Guez. Guez moved for a new trial on punitive damages, arguing that "to the extent [his] JNOV motion is granted in whole or in part, thereby vacating some or all of the claims upon which the compensatory damages award against him was based, the punitive damages award as to those vacated claims would likewise have to be vacated." Guez's motion for a new trial was denied by operation of law.

The trial court's November 16, 2007 orders reduced the $5 million punitive damages award against Guez to $4 million. Guez argues on appeal that the "mere twenty percent reduction" (from $5 million to $4 million) was not enough, because as "a result of posttrial rulings . . . the jury verdicts on twelve of Plaintiffs' thirteen claims were vacated and $17.5 million, nearly 75 percent, was axed from the compensatory damage award." The November 16, 2007 orders, however, are void. In addition, we have reversed some of the denials by operation of law. Thus, Guez's mathematical argument is irrelevant.

To the extent Guez's argument can be construed as an argument that the punitive damages award against him is independently excessive under California law,[54] a punitive damages award may be reversed only if the entire record, viewed most favorably to the award, indicates that the award was the result of passion and prejudice. (*Stevens v. Owens-Corning Fiberglas Corp.* (1996) 49 Cal.App.4th 1645, 1658; see *Bardis v. Oates* (2004) 119 Cal.App.4th 1, 25.) "The California Supreme Court has established three criteria for making that determination: (1) the reprehensibility of the defendant's misdeeds; (2) the amount of compensatory damages, though there is no fixed ratio for determining whether punitive damages are reasonable in relation to actual damages; and (3) the defendant's financial condition." (*Stevens*, *supra*, at p. 1658; see *Baxter v. Peterson* (2007) 150 Cal.App.4th 673, 679.)

Criterion (3) is not an issue here. Guez does not argue that plaintiffs failed to introduce evidence of his financial condition, nor that $5 million is "disproportionate to [his] ability to pay." (*Adams v. Murakami* (1991) 54 Cal.3d 105, 112; *Zaxis Wireless Communications, Inc. v. Motor Sound* (2001) 89 Cal.App.4th 577, 582.)

As to criterion (2), the jury awarded plaintiffs over $30 million in compensatory damages against Guez. The ratio of the punitive damages award against Guez to compensatory damages award against Guez, roughly one to six, is relatively modest. Our reversal of the trial court's denial by operation of law of Guez's motion for JNOV on plaintiffs' agent fees overcharge reduces the compensatory damages against Guez by $568,000. Our reversal of the trial court's denial by operation of law of Guez's motion for a new trial on plaintiffs' perpetual inventory claim reduces, for the moment, the

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[54] Guez does not argue that the punitive damages award is unconstitutional under *State Farm Mutual Insurance v. Campbell* (2003) 538 U.S. 408 [123 S.Ct. 1513, 155 L.Ed.2d 585].

compensatory damages against Guez by $3,252,000. These reversals reduce the compensatory damages by a total $3,820,000, from approximately $30 million to $26 million. This change in compensatory damages does not, in our view, impact in any significant way the jury's assessment of the appropriate amount of punitive damages against Guez. The ratio of punitive damages to compensatory damages remains relatively modest, at slightly more than one to five.

With respect to criterion (1), there is substantial evidence of sufficiently reprehensible conduct on the part of Guez. This is particularly true for Guez's conduct in secretly establishing a new company to compete with a company on whose board he served as a director, and accomplishing it by using the resources of the victim company to which he owed fiduciary duties. Guez's conduct, although it caused economic rather than physical harm, was deceitful, was carefully planned and executed, and consisted of a series of actions rather than an isolated incident. After reviewing the entire record, we do not believe that the $5 million punitive damages award is excessive, considering the facts of Guez's conduct in this case.

The denial by operation of law of Guez' motion for a new trial on plaintiffs' claim for punitive damages is affirmed. The jury's award of $5 million in punitive damages against Guez is reinstated.

5. ADS is not entitled to an offset for its claim that Unzipped breached the ARDA

ADS claims that after the parties ended their business relationship, the accounting records show that Unzipped owed ADS over $2.2 million dollars, which with prejudgment interest amounted to over $2.6 million. ADS sued Unzipped for breach of the ARDA for failing to pay this amount. The jury found that Unzipped did not breach the ARDA, and awarded ADS nothing on this claim. ADS included in its motion for JNOV a motion for a new trial on the amount of damages, claiming that it was entitled to an offset. The trial court's denial by operation of law of ADS's motion for a new trial is reviewable through the November 16, 2007 judgment.

Vargas testified that he performed a calculation of the amount of money Unzipped owed to ADS at the end of the parties' relationship. Vargas calculated that the total amount that Unzipped owed ADS, including interest, was $2,717,063.17. Kalos, testifying about how he calculated the total amount of plaintiffs' damages, assumed a "possible offset" of approximately $2,261,000, from Unzipped's general ledger, which showed this amount due from Unzipped to ADS. Although Kalos characterized this figure as a "possible offset," he testified that in his damages analysis he assumed that "at the end of the day" Unzipped owed this amount to ADS, and he subtracted it from the total amount of damages claimed by plaintiffs.

ADS's recovery on its cross-claim for breach of the ARDA is barred by its breach of the ARDA. Under a breach of contract theory, the plaintiff must demonstrate its performance or an excuse for nonperformance. (*Amelco Electric v. City of Thousand Oaks* (2002) 27 Cal.4th 228, 243; *Wall Street Network, Ltd. v. New York Times Co.* (2008) 164 Cal.App.4th 1171, 1178, 1181.) "A party complaining of the breach of contract is not entitled to recover therefor unless he has fulfilled his obligations." (*Wiz Technology, Inc. v. Coopers & Lybrand LLP* (2003) 106 Cal.App.4th 1, 12.)

The trial court instructed the jury that to recover damages for breach of the ARDA, ADS had to prove that it "did all, or substantially all, of the significant things that the contract required it to do, or that [ADS] was excused from doing those things." The trial court also instructed the jury: "The parties each contend that the opposing parties did not perform all of the things that they were required to do under the respective contracts. If one party does not perform its significant obligations under a contract, the other party is relieved of its obligation to perform."[55] The jury found that ADS had failed to perform under the ARDA in several significant ways, including (1) failing to maintain

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[55] The trial court also instructed the jury: "To overcome this contention, a party must prove both the following: [¶] 1. That party made a good faith effort to comply with the agreement; and [¶] 2. The other party received essentially what the contracts called for because failures, if any, were so trivial or unimportant that they could have been easily fixed or paid for."

a perpetual inventory in violation of Paragraph 3 and Annex A of the ARDA, (2) overcharging Unzipped for distribution charges associated with the Sylvain inventory in violation of Paragraph 4 of the ARDA, and (3) failing to make inventory shortage payments in violation of Paragraph 5 of the ARDA.[56] Substantial evidence supports the jury's finding that ADS did not do all or substantially all of the significant things that the ARDA required it to do, that ADS did not perform its significant obligations under the ARDA, that Unzipped's obligation to pay ADS was excused, and that ADS's material breaches of the ARDA precluded ADS from recovering on its claim for breach of the ARDA.

ADS argues that the "'material prior breaches' by ADS are irrelevant" because "a prior, material breach would not excuse payment for subsequent product or services delivered." ADS relies exclusively on *Filet Menu, Inc. v. C.C.L. & G., Inc.* (2000) 79 Cal.App.4th 852 for this argument. The issue in *Filet Menu*, however, was whether the contract at issue in the case was divisible, so that the plaintiff's fraud in inducing the defendant to enter into the contract would void only part of the contract. (*Id.* at p. 859.) The court stated: "A 'divisible' contract is one 'under which the whole performance is divided into two sets of partial performances, each part of each set being the agreed exchange for a corresponding part of the set of performances to be rendered by the other promisor . . . .' It is one in which two or more separate partial performances on each side are agreed to be exchanged for partial performances on the other side. The failure to perform one part does not bar recovery for performance of another." (*Id.* at p. 860, quoting 6 Williston on Contracts (3d ed. 1962) § 860, p. 252.) Defendants have never contended, in the trial court or in this court, that the ARDA is a "divisible contract." Nor is there any evidence that the parties' performances are divided into two sets of partial performances. *Filet Menu* is inapplicable.

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[56] Indeed, ADS's failure to maintain a perpetual inventory may have been the most significant and material breach of all, because, according to McKee, it made many of the other breaches by ADS, Azteca, and Sweet more difficult for plaintiffs to discover.

The denial by operation of law of ADS's motion for a new trial included as part of its motion for JNOV is affirmed.

C. Plaintiffs Are Not Entitled to Treble Damages on Their Trademark Claims Against ADS and Guez

Because we have reversed the denial by operation of law of defendants' motion for JNOV on plaintiffs' trademark claims, plaintiffs are not entitled to treble damages on their trademark claims. The November 16, 2007 order denying plaintiffs' request to treble the trademark damages against ADS and Guez is affirmed.

D. The October 25, 2005 Order Properly Sustained Without Leave To Amend Cole's Demurrer to the Cross-claims by Sweet, Azteca, and ADS

In their first amended cross-complaint, defendants alleged that Cole interfered with various contracts and economic relationships among the parties. Sweet alleged in the fourth cause of action for interference with contract that Cole and IPH interfered with the MSA between Sweet, on the one hand, and Unzipped, Candie's, and MC, on the other hand, by interfering with all four parties' "duties and obligations under the" MSA. Sweet, Azteca, and ADS alleged in the fifth cause of action for interference with prospective economic advantage that Cole, MC, and Candie's interfered with the economic relationships that Sweet, Azteca, and ADS had with Unzipped. And Azteca and ADS alleged in the sixth cause of action for inducing breach of contract that Cole, MC, and Candie's induced Unzipped to breach the ARSA and the ARDA "by failing to pay amounts due to Azteca and ADS under those agreements," and by causing Unzipped to terminate the ARSA and the ARDA "without cause and before they were to expire."[57]

Specifically, defendants alleged that Cole was the President, CEO, and Chairman of the Board of Candie's, the CEO of MC, "and an agent of" IPH. Defendants alleged

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[57] Interference with contractual relations is a "slightly broader theory" than inducing breach of contract because the former "protects against intentional acts not necessarily resulting in a breach." (*Shamblin v. Berge* (1985) 166 Cal.App.3d 118, 122.) Interference with contractual relations "permits liability where the defendant does not literally induce a breach of contract, but makes plaintiff's performance of the contract more expensive or burdensome." (*Ramona Manor Convalescent Hosp. v. Care Enterprises* (1986) 177 Cal.App.3d 1120, 1131.)

that "Candie's, through its CEO, Neil Cole, and others, intentionally and aggressively interfered with the financing arrangement between GE Capital [one of Unzipped's lenders] and Unzipped." Defendants alleged that Candie's, "through its CEO, Neil Cole," failed to provide funding to Unzipped as promised, and "interfered with Sweet's efforts to secure funding independently, thereby depriving Unzipped of the funding needed to satisfy customer orders." Defendants also alleged that Candie's, "through its CEO, Neil Cole, and others" interfered with Unzipped's "financing arrangements" with lenders, by telling the lenders that Sweet would be terminated as Unzipped's manager, by preventing Unzipped from issuing final audited financial statements, and by "maintaining inappropriately high reserves." Defendants further alleged that "as a result of these and other interferences . . . Candie's and MC caused GE Capital to withdraw its financing for Unzipped." Defendants alleged that "Candie's, MC, and Neil Cole caused Unzipped to issue false financial statements" with "inflated reserve amounts" that interfered with Unzipped's ability to meet the $1.7 million guarantee and inflated Candie's earnings.

Cole filed a demurrer to the first amended cross-complaint and argued that he could not be liable on any of the interference claims because he was an agent for the contracting parties, and "an agent acting within the scope of his authority cannot tortiously interfere with a contract to which his principal is a party." The trial court, after overruling the demurrers by IPH to the fourth cause of action and by Candie's and MC to the fifth cause of action, sustained Cole's demurrer to all three causes of action without leave to amend. The trial court stated: "As to Cole, the allegation that some of the parties are acting as agent some of the time is insufficient to defeat the other allegations in the pleadings that show that Cole is acting on behalf of the entities. Also there are no allegations that would take him out of the role as agent for the contracting parties."

1. Standard of review

"On appeal from an order dismissing an action after the sustaining of a demurrer, we independently review the pleading to determine whether the facts alleged state a cause of action under any possible legal theory. [Citations.] We give the complaint a reasonable interpretation, 'treat[ing] the demurrer as admitting all material facts properly pleaded,' [citation] but do not 'assume the truth of contentions, deductions or conclusions of law.' We liberally construe the pleading with a view to substantial justice between the parties." (*Broberg v. The Guardian Life Ins. Co. of America* (2009) 171 Cal.App.4th 912, 919, quoting *Aubry v. Tri-City Hospital Dist.* (1992) 2 Cal.4th 962, 967.)

2. Fourth cause of action for interference with contract

"The elements which a plaintiff must plead to state the cause of action for intentional interference with contractual relations are (1) a valid contract between plaintiff and a third party; (2) defendant's knowledge of this contract; (3) defendant's intentional acts designed to induce a breach or disruption of the contractual relationship; (4) actual breach or disruption of the contractual relationship; and (5) resulting damage." (*Pacific Gas & Electric Co. v. Bear Stearns & Co.* (1990) 50 Cal.3d 1118, 1126; see *Nygard, Inc. v. Uusi-Kerttula* (2008) 159 Cal.App.4th 1027, 1047.) It is also "settled that 'corporate agents and employees acting for and on behalf of a corporation cannot be held liable for inducing a breach of the corporation's contract.'" (*Mintz v. Blue Cross of California* (2009) 172 Cal.App.4th 1594, 1604 (*Mintz*); see *Reynolds v. Bement* (2005) 36 Cal.4th 1075, 1087, quoting *Shoemaker v. Myers* (1990) 52 Cal.3d 1, 24-25 (*Shoemaker*), abrogated on another point by *Martinez v. Combs* (May 20, 2010, S121552) 49 Cal.4th 35, __; *Woods v. Fox Broadcasting Sub., Inc.* (2005) 129 Cal.App.4th 344, 352 (*Woods*) ["contracting party or its agent . . . could not be liable for interference" with contract]; *PM Group, Inc. v. Stewart* (2007) 154 Cal.App.4th 55, 65 (*PM Group*) [neither Rod "Stewart nor his agents can be liable for the tort of interfering with the subcontracts" for concert performances by Stewart]; *Jenkins v. Inglewood Unified School Dist*. (1995) 34 Cal.App.4th 1388, 1395 [demurrer to cause of action for interference with contract properly sustained without leave to amend where "the named defendants were agents or employees of the contracting party [and] cannot be liable for contract interference"].)

Sweet's fourth cause of action for interference with contract against Cole fails. Sweet alleged that Cole interfered with the MSA by causing Candie's (acting "through" Cole) to interfere with the MSA. Candie's, however, was a party to the MSA, and cannot be liable for interfering with the performance of another party to the MSA. (See *Applied*

Equipment Corp. v. Litton Saudi Arabia Ltd. (1994) 7 Cal.4th 503, 513-514 (*Applied Equipment*); *Kasparian v. County of Los Angeles* (1995) 38 Cal.App.4th 242, 262.) Nor can Candie's be liable for interfering with the performance of the other parties to the MSA, Unzipped and MC. (See *Wynn v. National Broadcasting Co., Inc.* (C.D. Cal. 2002) 234 F.Supp.2d 1067, 1123 [*Applied Equipment* applies to bar interference claims "where one party to the contract interferes with the performance of another party to the contract"].) Candie's can be liable for breach of the MSA, but not for interfering with the performance of other parties to the MSA. (See *Applied Equipment*, at p. 514 ["One contracting party owes no general tort duty to another not to interfere with performance of the contract; its duty is simply to perform the contract according to its terms."].) Because Candie's cannot interfere with any of the contractual relationships in the MSA, Candie's "through" Cole cannot interfere with any of the contractual relationships in the MSA, including Sweet's contractual relationship with Unzipped and MC.

The first amended cross-complaint contained numerous allegations that Cole was acting for and on behalf of Candie's and MC when he took the actions and engaged in the conduct alleged by defendants. Defendants did not allege that Cole did anything other than act as an agent of Candie's, MC, and IPH. Under *Shoemaker* and *Mintz*, Cole cannot be liable for interfering with contractual relationships between Candie's, MC, or IPH, on the one hand, and defendants, on the other hand, because Cole allegedly was acting as an agent of Candie's, MC, and IPH. Defendants concede as much by acknowledging on appeal that "the trial court was correct insofar as the [first amended cross-complaint] alleges that Cole was in a principal-agent relationship with at least some of the parties to the contract at issue here," and that "the fourth cause of action . . . alleges that Cole interfered with a contract to which two of his alleged principals were parties."

Defendants cite two cases for the proposition that officers and directors of a corporation can be sued for interference with a contract to which the corporation is a party: *Woods, supra*, 129 Cal.App.4th 344, and *Collins v. Vickter Manor, Inc.* (1957) 47 Cal.2d 875 (*Collins*). *Woods* did not involve an interference claim against an officer, director, or agent, but an interference claim against "a powerful shareholder [who] allegedly interfere[d] in a contract between the corporation whose shares it owns and some other person or entity." (*Woods*, at p. 353.) The *Woods* court concluded that the Supreme Court in *Applied Equipment* did not hold that "persons or entities with an ownership interest in a corporation are automatically immune from liability for interfering with their corporation's contractual obligations." (*Woods*, at p. 353.) As the *Mintz* court stated in distinguishing *Woods*: "In short, *Woods* merely concludes that a shareholder is not automatically immune from liability for interfering with the contractual obligations of the company in which it holds shares [citation]; *Woods* does not stand for the proposition that the agent of a contracting party may be liable for interference with its principal's contract." (*Mintz*, *supra*, 172 Cal.App.4th at p. 1603, fn. 3.) Indeed, *Woods* actually supports Cole and not defendants by recognizing that in all of the cases cited in the *Applied Equipment* opinion "it was clear that the defendant was either a contracting party or its agent who could not be liable for interference." (*Woods*, at p. 352.)

In *Collins*, *supra*, 47 Cal.2d 875, two real estate brokers who found a "ready, willing, and able" buyer for property owned by a corporation sued to recover a $3,000 commission that the corporation did not pay after the two individual defendants, officers and directors of the corporation, prevented the closing of escrow. (*Id*. at pp. 877-878, 880.) The Supreme Court held that the "right of the brokers to their commission is not, on the facts here alleged, defeated by the failure of the parties to consummate the transaction." (*Id.* at p. 880.) The court also held that the brokers stated causes of action for interference with contractual relations against the two individual defendants. (*Id.* at p. 883.) The court stated that whether or not the individual defendants "were privileged to cause the corporation to discontinue its relations with plaintiffs, in the belief that such a course of action was in the best interests of the corporation, is a matter of defense, to be decided by a resolution of the factual issues presumptively involved." (*Ibid.*)

Collins, however, did not directly discuss the issue raised, decided, and answered in the negative 33 years later in *Shoemaker* of "whether the representative of a contracting party may be held liable for the substantive tort of interfering with the contract." (*Mintz, supra*, 172 Cal.App.4th at p. 1606, citing *Shoemaker*, *supra*, 52 Cal.3d at pp. 24-25, and *PM Group*, *supra*, 154 Cal.App.4th at p. 65.) Although the court in *Collins* did mention the affirmative defense of privilege, Cole is not arguing that his alleged actions are privileged. He is arguing that as an officer and agent of Candie's, he cannot be liable for inducing Candie's to breach a contract under *Shoemaker* and *Woods*. *Shoemaker* did not involve an affirmative defense of privilege. *Shoemaker* held that the trial court properly sustained a demurrer without leave to amend to interference claims for failing to "set forth viable cause[s] of action." (52 Cal.3d at pp. 24-25.)

Defendants argue that they "clearly pleaded that Cole engaged in the tortious activity for *his own* interests, *not* 'on behalf of the entities.'" The first amended cross-complaint did allege, in a conclusory manner, that Cole's interference with the MSA was "for the purpose of benefitting [his] perceived interests."[58] There is, however, "no 'financial advantage' exception to the rule that a corporate agent cannot be liable for interfering with its principal's contract . . . ." (*Mintz*, *supra*, 172 Cal.App.4th at p. 1606.) As the *Mintz* court explained: "Every agent, in one way or another, acts for its own financial advantage when it acts for its principal, because the agent is compensated by its principal, and conduct in furtherance of the principal's interest will necessarily serve the agent's interests as well. A 'financial advantage' exception to the sound rule that the contracting party's agent, like the contracting party, cannot be liable for interference with the contract, would entirely swallow up the rule." (*Ibid.*)

Finally, defendants did not in their opposition to the demurrer request leave to amend to allege, if they could, that Cole was not "acting for and on behalf of" Candie's and MC, nor, given the allegations in the first amended cross-complaint, does it appear that they could have made such an allegation.[59] In their reply brief on appeal, defendants

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58 Defendants made this allegation in more detail in the first amended complaint in the accompanying appeal, *Sweet Sportswear, LLC v. Cole*, Case No. B197273.

59 At the October 25, 2005 hearing on the demurrer, counsel for defendants stated that "it's an open question as to whether [Cole] was acting in the interest of his principals. And I think we could amend to allege that he was not, if that were necessary." Counsel for defendants, however, did not state how defendants could amend to make those allegations, and instead argued that "as a matter of law" the "affirmative defense

state that “if necessary” they “could easily amend the cross-complaint to more expressly allege— to whatever extent this Court might deem necessary— that in interfering with the Management Agreement . . . Cole was not acting on behalf of any of the parties to the [MSA] but was acting outside the scope of his agency and authority . . . .” It is true that defendants can make a request for leave to amend their cross-complaint even for the first time on appeal. (See *Performance Plastering v. Richmond American Homes of California, Inc.* (2007) 153 Cal.App.4th 659, 669.) The request, however, must be accompanied by a showing in what manner defendants can amend the cross-complaint, and “how that amendment will change the legal effect” of the cross-complaint. (*Ibid.*) “While such a showing can be made for the first time to the reviewing court, it must be made.” (*Galbiso v. Orosi Public Utility Dist.* (2010) 182 Cal.App.4th 652, 674.) Defendants have not made any showing of how they would amend their cross-complaint to allege that Cole was not “acting for and on behalf of” Candie’s and MC, other than to assert that, “if necessary,” they could do so. Such a showing is particularly necessary here, where everything defendants alleged in their cross-complaints is that everything Cole did was for and on behalf of Candie’s and MC.

Thus, Cole cannot be liable for interfering with any of the contractual relationships in the MSA. The trial court’s order sustaining the demurrer to the fourth cause of action for interference with contract is affirmed.

3. Fifth cause of action for interference with prospective economic advantage

Defendants’ fifth cause of action for interference with prospective economic advantage alleged that Cole interfered with the economic relationships between Unzipped, on the one hand, and Sweet, Azteca, and ADS, on the other hand. As noted above, the trial court sustained Cole’s demurrer to this cause of action without leave to amend.

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had to be asserted by them in their answer, and there would have to be evidence taken by the court as to whether he was acting in the interest of his principal to establish that defense.”

The elements of a cause of action for intentional interference with prospective economic advantage are (1) an economic relationship between the plaintiff and some third party with the probability of future economic benefit to the plaintiff; (2) the defendant's knowledge of the relationship; (3) intentional acts on the part of the defendant designed to disrupt the relationship; (4) actual disruption of the relationship; and (5) economic harm to the plaintiff proximately caused by the acts of the defendant. (*LiMandri v. Judkins* (1997) 52 Cal.App.4th 326, 339.) The plaintiff must also prove that the defendant "not only knowingly interfered with the plaintiff's expectancy, but engaged in conduct that was wrongful by some legal measure other than the fact of interference itself." (*Della Penna v. Toyota Motor Sales, U.S.A., Inc.* (1995) 11 Cal.4th 376, 393.) Conduct is independently wrongful when it is "proscribed by some constitutional, statutory, regulatory, common law, or other determinable legal standard." (*Korea Supply Co. v. Lockheed Martin Corp.* (2003) 29 Cal.4th 1134, 1159.)

Whether under California law agents and employees acting for and on behalf of a corporation can be liable for interfering with the corporation's prospective economic advantage is not entirely settled. In *Kasparian v. County of Los Angeles*, *supra*, 38 Cal.App.4th at page 266, the court held that partners could not be liable for interfering with their partnership's prospective economic advantage. The *Woods* court declined to follow *Kasparian* on this point. (See *Woods, supra*, 129 Cal.App.4th at p. 354.) We do not have to reach this issue in this case because defendants cannot allege an independent wrongful act, as required for a cause of action for interference with prospective economic advantage under *Korea Supply* and *Della Penna*.

As noted above, to state a claim for interference with prospective economic advantage, defendants must allege facts that are independently wrongful because they are "proscribed by some constitutional, statutory, regulatory, common law, or other determinable legal standard." (*Edwards v. Arthur Andersen LLP* (2008) 44 Cal.4th 937, 944.) Defendants alleged that Cole wrongfully interfered with defendants' prospective economic advantage by issuing "false financial statements for the fiscal year ending January 31, 2004 that wrongfully inflated Unzipped's inventory reserves by more than

$1.8 million," and filing "false financial statements" with the SEC containing this allegedly inaccurate inventory reserve. Defendants alleged: "Candie's is presently bound by an administrative order of the Securities and Exchange Commission to refrain from violating the anti-fraud provisions of the Securities and Exchange Act of 1934 and the Securities Act of 1933. However, the purpose and effect of Candie's, Neil Cole's, and MC's conduct was to cause Candie's to overstate materially its earnings and understate its liabilities for Fiscal Year 2004, and during the first, second, and third quarters of Fiscal Year 2005. Those falsified financial reports have had the effect of improperly inflating the public trading price of Candie's common stock." Defendants argue on appeal that "causing Candie's to file a materially false and misleading annual report with the Securities and Exchange Commission" was independently wrongful.[60]

Filing false statements with governmental agencies like the SEC can constitute independent wrongful conduct. The jury found, however, that the inventory reserve figure reported by Candie's to the SEC, $4.1 million, was proper and was not false or inflated. The allegation that Candie's reported an inflated inventory reserve, and the resulting overstating of Candie's earnings, was defendants' only allegation of independently wrongful conduct. Without this allegation, defendants cannot state a cause of action for interference with prospective economic advantage. Defendants' fifth cause of action for prospective economic advantage is barred by the jury's findings that the inventory reserve figure reported by Candie's was not false and misleading. The trial court's order sustaining the demurrer to the fifth cause of action for interference with prospective economic advantage without leave to amend is affirmed.

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[60] Defendants also argue that "interfering with Sweet's contractual relations with Unzipped under the Management Agreement" and "interfering with Unzipped's contractual relations with GE Capital" were independently wrongful. These alleged acts of interference, however, are not independently wrongful within the meaning of *Korea Supply* and *Della Penna* because they are not proscribed by any determinable legal standard, other than the contracts with which defendants claim Candie's and Cole interfered.

4. Sixth cause of action for inducing breach of contract

Defendants' sixth cause of action against Cole is for inducing Unzipped to breach the ARSA and the ARDA. The elements of a cause of action for inducing breach of contract are (1) a valid contract between the plaintiff and a third party; (2) the defendant's knowledge of it; (3) the defendant's intentional acts designed to induce a breach of the contractual relationship; (4) consequent breach; and (5) resulting damage. (*Quelimane Co. v. Steward Title Guaranty Co.* (1998) 19 Cal.4th 26, 55; see *1-800 Contacts, Inc. v. Steinberg* (2003) 107 Cal.App.4th 568, 585.) Defendants' sixth cause of action for inducing breach of contract is barred by the jury's findings, which we affirm in this appeal, that Azteca and ADS breached the ARSA and ARDA, respectively, and Unzipped did not. Defendants concede that this cause of action stands or falls with defendants' claims against Unzipped for breach of the ARSA and the ARDA. It falls. The trial court's order sustaining the demurrer to the sixth cause of action for inducing breach of contract is affirmed.

E. The Fraud Orders

1. The June 29, 2006 order properly granted summary adjudication on the fraud causes of action in the first amended complaint

In their first amended complaint, plaintiffs asserted six fraud-based causes of action. All of these fraud claims were based on the allegation that in the spring of 2002, Guez misrepresented to Candie's that based on his "projections, Unzipped would generate up to $8 million in EBITDA profit for fiscal year 2003" (which ended January 31, 2003). An EBITDA of $8 million for fiscal year 2003 would have put the sales price of Sweet's 50 percent interest in Unzipped at approximately $30 million (50 percent of 7.5 x $8 million). Plaintiffs allege that the true facts, which Guez concealed, were that Guez "had knowingly overstated Unzipped's financial condition and projected EBITDA" by making wrongful "accounting adjustments" and using "unreasonable and unrealistic" sales and inventory figures. Based on these projections, Guez induced plaintiffs in April 2002 to negotiate a sales price of approximately $19.25 million. Had Guez used the correct sales and inventory figures in his projections, Unzipped's projected EBITDA for fiscal year 2003 would have been approximately $539,000, which would have put the sales price of Sweet's 50 percent interest in Unzipped at approximately $2 million. Plaintiffs alleged that Guez intentionally and negligently made these misrepresentations (first, second, and seventh causes of action), concealed the true facts behind the projections (third cause of action), breached his fiduciary duties by misleading plaintiffs (fourth cause of action), and conspired to commit this fraud (fifth cause of action).[61]

Guez moved for summary adjudication on all six fraud causes of action, arguing that the undisputed facts (primarily from deposition testimony of the officers and directors of Candie's) established that (1) Candie's did not rely on Guez's April 2002 projections; (2) Guez's projections were statements of opinion and not fact; (3) Guez's projections were not false or misleading; (4) Guez believed his projections were reasonable and true when gave them to Candie's; (5) any reliance by Candie's on Guez's projections was not reasonable; and (6) Candie's "waived" its fraud claims in connection with the April 2002 Term Sheet by executing the Equity Acquisition Agreement in October 2002. The trial court granted summary adjudication on all six causes of action on all six grounds. We conclude that summary adjudication was appropriate on ground (5). The undisputed evidence was that even if the directors of Candie's had actually relied on Guez's April 2002 projections (and there was considerable evidence that they did not), it was unreasonable as a matter of law for them to have done so.

A motion for summary judgment or summary adjudication is properly granted only when "all the papers submitted show that there is no triable issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." (Code Civ. Proc., § 437c, subd. (c).) We review a grant of summary adjudication de novo and decide independently whether the facts not subject to triable dispute warrant judgment for the

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[61] Plaintiffs make these same allegations against Sweet. As noted above, however, we do not have jurisdiction to review the trial court's pretrial rulings on Sweet's motions for summary adjudication on plaintiffs' fraud claims in the first amended complaint.

moving party as a matter of law. (*Intel Corp. v. Hamidi* (2003) 30 Cal.4th 1342, 1348; *Guz v. Bechtel National, Inc.* (2000) 24 Cal.4th 317, 334.)

Reasonable or justifiable reliance is an element of all six of plaintiffs' fraud causes of action. (See *Manderville v. PCG&S Group, Inc.* (2007) 146 Cal.App.4th 1486, 1498-1499 [intentional misrepresentation]; *Buckland v. Threshold Enterprises, Ltd.* (2007) 155 Cal.App.4th 798, 806-807 [negligent misrepresentation]; *Engalla v. Permanente Medical Group, Inc.* (1997) 15 Cal.4th 951, 974 [concealment]; *Alliance Mortgage Co. v. Rothwell* (1995) 10 Cal.4th 1226, 1239, fn. 4 [constructive fraud]; *Grisham v. Philip Morris U.S.A., Inc.* (2007) 40 Cal.4th 623, 633 [conspiracy to commit fraud].)[62] Although the issue of whether the plaintiff's reliance was reasonable is usually a question of fact, "'whether a party's reliance was justified may be decided as a matter of law if reasonable minds can come to only one conclusion based on the facts.'" (*Alliance Mortgage*, at p. 1269, quoting *Guido v. Koopman* (1991) 1 Cal.App.4th 837, 843 (*Guido*); see *Manderville*, at p. 1499 [quoting *Alliance Mortgage* and *Guido*]; *Ostayan v. Serrano Reconveyance Co.* (2000) 77 Cal.App.4th 1411, 1419 [affirming summary judgment granted on claims for intentional misrepresentation, negligent misrepresentation, and concealment, for failure to meet burden on reasonable reliance]; *Hadland v. NN Investors Life Ins. Co.* (1994) 24 Cal.App.4th 1578, 1586 ["although the issue of justifiable reliance ordinarily presents a question of fact [citation], there are cases in which it may be decided as a matter of law"].) Moreover, in "determining whether one can reasonably or justifiably rely on an alleged misrepresentation, the knowledge, education and experience of the person claiming reliance must be considered." (*Guido*, at pp. 843-844; see *Wagner v. Benson* (1980) 101 Cal.App.3d 27, 36 [evidence of the

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[62] Plaintiffs' fifth claim for conspiracy to commit fraud did not state a cause of action. (See *Applied Equipment, supra*, 7 Cal.4th at pp. 510-511 ["Conspiracy is not a cause of action, but a legal doctrine that imposes liability on persons who, although not actually committing a tort themselves, share with the immediate tortfeasors a common plan or design in its perpetration"].)

plaintiffs' past investments was relevant to the issue of whether the plaintiffs' reliance was "unreasonable in light of plaintiffs' intelligence and experience"].)

Here, defendants presented evidence on summary adjudication that to the extent the board of directors relied on Guez's projections at all in deciding whether to purchase Sweet's 50 percent interest in Unzipped in April 2002, it was not reasonable for them to have done so. For example, Siris testified in deposition testimony submitted by defendants in support of their motion for summary adjudication that he, his fellow board members, and "everyone in the world" understood that financial projections like the ones Guez was making in April 2002 might turn out to be inaccurate, particularly in the fashion business. Siris testified that "the best you can do, whether it's Neil's projections or Hubert's projection, the best you can do is sit there and say, this is what I think we are going to do." Siris testified that in the fashion business, everyone understands that the numbers in financial projections are "absolutely" unpredictable. Siris stated: "Sometimes the numbers are right and sometimes they are wrong. It's not like you know ahead of time." And Siris stated that "in the apparel business, there is lots of room to play games with the numbers."

With respect to the role that Guez's fiscal year 2003 projections for Unzipped had in the decision by Candie's to purchase Sweet's 50 percent interest in April 2002, Siris said that he knew enough not to rely on Guez's projections. Siris testified that when Candie's made the decision to enter into the April 23, 2002 Term Sheet, he knew that Guez's projections were "highly incomplete," and were "stretch numbers" and "optimistic." Siris testified that his vote was not based on the numbers because he was uncomfortable with Guez's projections. Moreover, Siris stated that when Guez "came with projections by division," the board of directors, rather than taking Guez's word for it, "got the division people in" so that the board could "drill down to the division level" and check Guez's numbers. Candie's also prepared its own projections for Unzipped's fiscal year 2003 earnings.

Cole testified that prior to the spring of 2002 he had become "very leery of Mr. Guez and Mr. Guez's information," that he could not trust what Guez told him, and that he did not feel he could rely on the financial information Guez had been providing Candie's about Unzipped. Cole also knew in 2002 that despite Guez's annual assurances that Unzipped would make a profit, Unzipped had lost money in fiscal years 1999, 2000, and 2001. Similarly, Danderline testified that he did not "particularly" trust Guez, and that he did not "particularly" believe or rely on financial information from Guez about Unzipped.

These undisputed facts, which came exclusively from the testimony of the directors of Candie's who voted to purchase Sweet's 50 percent interest in Unzipped in April 2002 rather than January 31, 2003, preclude plaintiffs from showing that any reliance the directors placed on Guez's projections in April 2002 was reasonable. Plaintiffs did not present evidence sufficient to create a triable issue of fact on this element of their fraud causes of action. For example, plaintiffs presented deposition testimony from board member Barry Emanuel stating that he relied on representations and projections by Guez in deciding to enter into the Term Sheet. Plaintiffs did not present any testimony from Emanuel on the issue of whether such reliance was reasonable, such as whether his experience with Guez's financial projections for Unzipped or financial projections in the apparel business in general was different from the experiences and beliefs of Siris, Cole, and Danderline. Similarly, plaintiffs on appeal cite to deposition testimony of Danderline, Cole, Siris, and Emanuel and argue: "Not only did Guez's representations play a 'substantial part' in Plaintiffs' decision to purchase the Put, but multiple witnesses said that it was a **critical** factor." None of the cited testimony, however, says this. As the trial court noted, "there are instances where deposition testimony cited by plaintiffs does not accurately reflect the actual testimony in the record or raise a triable issue." This is such an instance.

Plaintiffs' primary argument on appeal is that Guez owed fiduciary duties to Candie's, and a party is entitled to rely on its fiduciary's representations. At the time Guez presented his projections for fiscal year 2003 to the Candie's board of directors and made the representations on which plaintiffs' fraud claims in the first amended complaint were based, Guez did not owe fiduciary duties to Candie's. He did not become a member of the board of directors of Candie's until after the execution of the Term Sheet. Nor was Guez at the time, as plaintiffs contend, a joint venturer of Candie's. Sweet "had a joint venture relationship" with Candie's, but Guez did not (and we do not have jurisdiction in this appeal to review the order granting summary adjudication in favor of Sweet). Guez was, as plaintiffs claim, an "officer of Unzipped," but Unzipped was not making the decision to purchase Sweet's 50 percent in Unzipped, Candie's was. Unzipped is not even a plaintiff in plaintiffs' six fraud causes of action.

Plaintiffs cite *Weatherly v. Universal Music Publishing Group* (2004) 125 Cal.App.4th 913, 919 (*Weatherly*), and *Linden Partners v. Wilshire Linden Associates*, (1998) 62 Cal.App.4th 508 (*Linden Partners*), and argue that even "without a fiduciary relationship, the recipient of explicit fraudulent representations is entitled to rely on them without investigation." *Weatherly* and *Linden Partners*, however, are distinguishable. *Weatherly* was a statute of limitations case, where the court held that "an unexercised contractual right to conduct an audit" did not automatically demonstrate "a lack of diligence for purposes of the delayed discovery doctrine." (*Weatherly*, at p. 914.) The court concluded that the plaintiff, whose contract gave him the right on 10 days notice to inspect the defendant's books and records, was not barred on summary judgment by the statute of limitations from suing the defendant for allegedly false royalty statements. (See *id.* at p. 920 ["the right to conduct an audit is not dispositive of diligence where there is evidence that the plaintiff was 'hindered' from discovering the breach by the defendant's misrepresentations"].) This case does not involve the statute of limitations or the discovery rule.

Linden Partners belongs to a line of cases involving real estate transactions where the seller defendant claims that the buyer plaintiff could have conducted an investigation to determine some fact about the real property that the buyer subsequently claims the seller concealed or misrepresented. In *Linden Partners* the allegedly misrepresented fact was the amount of rent a subtenant paid that was incorrectly calculated based on the terms of the sublease. Both sides "had performed the math and had come up with the same (wrong) answer." (*Linden Partners v. Wilshire Linden Associates, supra*, 62

Cal.App.4th at p. 527.) In concluding that the plaintiffs did not have a duty to undertake an independent investigation into how to compute the subtenant's rent, the court stated: "It has been repeatedly held by the courts of our state that one to whom a representation is made has no duty to employ means of knowledge which are open to that party and which could, if pursued, reveal the falsity of that representation." (*Id.* at p. 529.) The court emphasized, however, that this "principle, holding as it does the potential for harsh results, must be applied carefully to the facts of each case." (*Ibid.*) We conclude that this principle should not apply here. The issue is not whether Candie's should be excused from failing to investigate further into Guez's projections, or whether Candie's was negligent in failing to discover the falsity of Guez's projections. (See *Alliance Mortgage, supra*, 10 Cal.4th at p. 1239.) Putting aside the difference between a statement about the amount of rent in an existing lease and a projection about future income, Candie's admittedly had no need to investigate Guez's projections, because its directors did not put any faith in financial projections for the apparel industry generally and Guez's projections for Unzipped specifically. It is also undisputed that the board of directors of Candie's performed an investigation of Unzipped's finances by interviewing the "division people" and preparing its own projections. (See *Ostayan v. Serrano Reconveyance Co.*, *supra*, 77 Cal.App.4th at p. 1419 [no reasonable reliance where plaintiff did his own investigation and "drew the wrong conclusion"].)

In light of the undisputed facts presented on summary adjudication, we conclude that reasonable minds could only have come to only one conclusion: any reliance in April 2002 by the board of directors of Candie's on Guez's fiscal year 2003 financial projections for Unzipped was unreasonable. This is particularly true in light of the directors' extensive knowledge of, experience in, and intelligence about the apparel business. The trial court's order granting Guez's motion for summary adjudication on the fraud causes of action in the first amended complaint is affirmed.

2. *The July 19, 2006 order improperly denied in part plaintiff's motion for leave to file a second amended complaint*

Two weeks after the trial court granted defendants' motion for summary adjudication on plaintiffs' fraud claims in the first amended complaint, plaintiffs on June 23, 2006 filed a motion for leave to file a second amended complaint, seeking to add five new fraud causes of action. These fraud claims were based on the following four categories of allegations:

> (1) The representations by Sweet and Guez in Paragraph 3.06 of the Equity Acquisition Agreement and page two of the Term Sheet (Paragraph 3), that Unzipped's financial statements were accurate and prepared in accordance with GAAP, were false. Unzipped's January 2002 audited financial statements were not accurate and consistent with GAAP, and were materially false because they inflated the value of Unzipped's inventory. Because Sweet and Guez had concealed this fact from Unzipped's auditors, the January 2002 financial statements were false and inconsistent with GAAP even though they had been audited.
>
> (2) The representations by Sweet and Guez in Paragraph 3.06 of the Equity Acquisition agreement, that Unzipped's financial statements were accurate and prepared in accordance with GAAP, were materially false and not consistent with GAAP for another reason. Unzipped's July 2002 unaudited financial statements, prepared by Sweet and Guez, were materially false because they overstated Unzipped's income by $2,450,000.
>
> (3) The representation by Sweet and Guez in Paragraph 3.06(b)(i) of the Equity Acquisition Agreement, that there had not been any material adverse events, situations, or occurrences, was false. Sweet and Guez concealed the facts that Congress Financial had required Unzipped to increase its inventory reserve, and that Congress Financial had expressed its intention to terminate its lending relationship with Unzipped.

(4) The representations by Sweet and Guez in Paragraphs 3.06(b)(iii), 3.06(b)(iv), 3.06(b)(v), and 3.06(b)(vi) of the Equity Acquisition Agreement, that there had not been any out of the ordinary liabilities, material changes in the business, or losses, were false. Guez concealed the fact that Unzipped was purchasing "non-existent" Sylvain inventory.

Plaintiffs alleged in the proposed second amended complaint that Guez intentionally and negligently made these misrepresentations (first, second, and seventh causes of action), concealed the true facts (third cause of action), and breached his fiduciary duties by not disclosing the true facts (fourth cause of action). Plaintiffs abandoned their cause of action for conspiracy to commit fraud.

On July 19, 2006 the trial court granted the motion for leave to amend only as to the allegations in category (2), the allegation (part of all five fraud causes of action) that "defendants provided to plaintiffs financial statements for the period ending July 31, 2002 for Unzipped that fraudulently concealed $2,450,000 in losses by charging inventory and accounts receivable reserves to goodwill rather than profits." The trial court denied the motion as to all five of the proposed fraud causes of action for the allegations in categories (1), (3), and (4). The trial court found "that the claims set forth in Categories 1, 3 and 4 were untimely brought and therefore cannot be raised at this late date, in light of the imminence of the trial of this matter, which the Court is at present unwilling to continue." At the time, the trial date was October 30, 2006, although the trial court subsequently continued the trial to January 2007.

We review the denial of a motion for leave to amend a complaint for abuse of discretion. (*Branick v. Downey Savings & Loan Assn*. (2006) 39 Cal.4th 235, 242.) "It is well established that California courts have "a policy of great liberality in allowing amendments at any stage of the proceeding so as to dispose of cases upon their substantial merits where the authorization does not prejudice the substantial rights of others.' [Citation.] Indeed, "it is a rare case in which 'a court will be justified in refusing a party leave to amend his [or her] pleading so that he [or she] may properly present his [or her] case.'" [Citation.]' [Citation.] Thus, absent a showing of prejudice to the adverse party, the rule of great liberality in allowing amendment of pleadings will prevail." (*Board of Trustees v. Superior Court* (2007) 149 Cal.App.4th 1154, 1163 [2d & 3d brackets in original]; see *Lincoln Property Co., N.C., Inc. v. Travelers Indemnity Co.* (2006) 137 Cal.App.4th 905, 916 ["'This discretion should be exercised liberally in favor of amendments, for judicial policy favors resolution of all disputed matter in the same lawsuit.'"].) "'"When a request to amend has been denied, an appellate court is confronted by two conflicting policies. On the one hand, the trial court's discretion should not be disturbed unless it has been clearly abused; on the other, there is a strong policy in favor of liberal allowance of amendments. This conflict 'is often resolved in favor of the privilege of amending . . . .'"'" (*Berman v. Bromberg* (1997) 56 Cal.App.4th 936, 945.) It is "an abuse of discretion to deny leave to amend where the opposing party was not misled or prejudiced by the amendment." (*Atkinson v. Elk Corp.* (2003) 109 Cal.App.4th 739, 761.)

Most of the alleged misrepresentations on which the five fraud causes of action in the proposed second amended complaint were based were representations and warranties made by Sweet in the Term Sheet and the Equity Acquisition Agreement. For example, plaintiffs alleged in their proposed second amended complaint that they "agreed to enter into the Term Sheet in reliance upon, inter alia, Guez's material representations contained in the Term Sheet," that "in the binding Term Sheet Guez and Sweet represented that Unzipped's financial statements [were] true and accurate," that the "representations contained in the Term Sheet and the Acquisition [Agreement] were materially false," and that had Candie's "known that the Term Sheet and the Acquisition Agreement contained these material representations, Candie's would not have purchased Sweet's 50 percent interest in Unzipped, or would have only purchased that interest at a substantially reduced price." Guez, however, did not make any representations in the Term Sheet or the Equity Acquisition Agreement. In the Term Sheet, Sweet (but not Guez) represented "that the audited financial statements of UA [Unzipped Apparel] f/y/e [fiscal year ending] January 31, 2002 are true and accurate and that there are no undisclosed material liabilities or off balance sheet transaction, the disclosure of which would be required to present a true and accurate financial presentation of UA." In the Equity Acquisition Agreement, Sweet (but not Guez) represented and warranted that Unzipped's financial statements were prepared in accordance with GAAP, and that "to the best of Sweet's knowledge" were true and accurate in all material respects. Guez did not represent or warrant anything in either agreement, nor is either agreement conditioned on anything about his knowledge. Guez cannot be liable for any alleged misrepresentations contained in the two written contracts.

Plaintiffs' fraud claims in the proposed second amended complaint, however, were also based on the allegations that the January 31, 2002 and July 31, 2002 financial statements were inaccurate. Plaintiffs alleged that Guez as well as Sweet falsely represented that "the financial statements referenced within the Term Sheet and incorporated into the Acquisition Agreement accurately described the financial position of Unzipped." Plaintiffs alleged that Guez fraudulently prepared these financial statements, and used them to mislead Unzipped's auditors and Candie's. Plaintiffs alleged that Guez as well as Sweet provided the January 31, 2002 and July 31, 2002 financial statements "for the purpose of inducing Candie's to enter into the Acquisition Agreement, and Candie's in fact justifiably relied upon these representations to its detriment . . . ." By basing their proposed fraud claims on the financial statements as well as the representations contained in the written agreements, plaintiffs' proposed second amended complaint stated fraud claims against Guez as well as Sweet.[63]

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[63] In addition, the fourth cause of action of the proposed second amended complaint for constructive fraud alleged that "despite their fiduciary obligations to Candie's and MC, Sweet and Guez failed to account properly for a loss of at least $2.45 million consisting of overvalued inventory and uncollectible accounts receivable," and "failed to assure that its representations and warranties in Section 3.06(b) of the Acquisition Agreement were accurate." Although as noted above Guez did not owe Candie's or MC fiduciary duties prior to the execution of the April 23, 2002 Term Sheet, he did owe Candie's fiduciary duties as a director during the period between the April 2002 Term Sheet and the October 18, 2002 Equity Acquisition Agreement. Even though he was not making any representations and warranties in the Equity Acquisition Agreement, Guez

The remaining issue is whether the trial court abused its discretion by denying plaintiffs leave to amend as to the allegations in categories (1) (fraudulent January 2002 statements), (3) (Congress Financial fraud), and (4) (Sylvain fraud), by ruling that these claims were "untimely brought" and could not "be raised at this late date." We conclude the trial court did.

The facts of plaintiffs' discovery of the factual bases of the fraud claims contained in the proposed second amended complaint show that plaintiffs were diligent in filing their motion for leave on June 23, 2006**.** McKee stated in his supporting declaration that plaintiffs had only obtained Unzipped's electronic general ledger on April 7, 2006, despite having requested it at the outset of the litigation in September 2004, and only after filing discovery motions to compel its production. Plaintiffs explained that their accounting experts "worked diligently before they located the fraudulent entries in Unzipped's general ledger," and that it "would be unfair to prevent Plaintiffs from bringing these new fraud claims when virtually all the delay was caused not by Plaintiffs, but by Defendants, who refused to produce the general ledger for a year and a half after it was requested, and for a year after the Court first ordered its production." Defendants do not dispute this chronology.

McKee also explained in his declarations that although defendants had previously produced Unzipped's accounting records in hard copy, the production was so "unorganized" and "undifferentiated" that there was "virtually no realistic way that any accountant, no matter how diligent, could have discerned this fraud by reviewing" the documents in hard copy. McKee stated that plaintiffs could only have uncovered the facts underlying the fraud claims in their proposed second amended complaint with an extensive analysis of Unzipped's electronic accounting records. Defendants had made the task of plaintiffs' forensic accountants and auditors of unraveling defendants' accounting records and discovering the true financial facts of Unzipped even more

had a duty to disclose to the board on which he served that Sweet's representations and warranties in the agreement were allegedly not true.

difficult, because defendants had misled Unzipped's auditors by providing them with information that was, according to Vargas, "wrong," "erroneous," and "corrupt." Given the volume of transactions among the parties, the unusual method of defendants' bookkeeping, the quantity and quality of defendants' accounting irregularities, plaintiffs' limited access to Unzipped's books and records, and the persistent if not Herculean efforts plaintiffs had to undertake before and during litigation to obtain access to the information, the delay is understandable, and the motion for leave was timely. The complicated bases of some of plaintiffs' claims, fraud and otherwise, could only have been discovered and reconstructed with access to, and detailed analyses of, the computerized accounting records of Unzipped and Azteca. Plaintiffs filed their motion for leave to amend within two months of obtaining defendants' computerized accounting records, hardly a significant delay.

Moreover, at the time the trial court ruled on plaintiffs' motion for leave to amend in July 2006, there was still time for the parties to conduct discovery and prepare for trial on all of the proposed fraud claims. The parties had not completed significant non-expert discovery. Danderline, McKee, Iverson, Guez, Vargas, Shapiro, and Bruce Laughton were all deposed after the trial court ruled on plaintiffs' motion for leave to file the second amended complaint.[64] The parties had not even exchanged information regarding expert witnesses, on whose testimony plaintiffs' new fraud claims were primarily based, let alone conducted expert discovery. (See § 2034.230, subd. (b).) Indeed, the parties were able to take discovery and brief a motion for summary adjudication on the five new fraud causes of action based on the one fraud allegation (out of the four) that the trial court granted plaintiffs leave to pursue. There is no reason that the parties could not have done the same for the same five fraud causes of action based on the other three fraud allegations. And although the trial court stated that it was "unwilling at present" to continue the trial, the trial court ultimately did continue the trial from October 2006 to January 2007. The proposed amendments did not prejudice defendants. (See *Thompson*

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[64] Laughton was the Congress Financial executive on the Unzipped account.

Pacific Construction, Inc. v. City of Sunnyvale (2007) 155 Cal.App.4th 525, 544-545 [although "a court may deny a good amendment in proper form where there is unwarranted delay in presenting it," "where there is no prejudice to the adverse party, it may be an abuse of discretion to deny to amend"]; *Higgins v. Del Faro* (1981) 123 Cal.App.3d 558, 564-565 [even if there has been a delay in filing a motion for leave to amend, it is an abuse of discretion to deny leave if the other party has not been prejudice or misled].)

Finally, the jury heard virtually all of the evidence regarding plaintiffs' fraud claims in the proposed second amended complaint at the trial anyway, as part of plaintiffs' breach of fiduciary duty and breach of contract claims. The jury heard evidence and reached verdicts in plaintiffs' favor on plaintiffs' allegations regarding the parties' competing valuations of the inventory, the dispute over calculating the inventory reserve, defendants' concealment of adverse financial actions by and communications from Unzipped's lender Congress Financial, and defendants' Sylvain accounting irregularities. The only legal consequence of the trial court's ruling was that while plaintiffs were allowed to seek and recover fraud damages for the $4.4 million cash infusion and various categories of contract damages, plaintiffs were precluded from seeking and potentially recovering on their claim for approximately $20 million based on essentially the same evidence. Plaintiffs should have had the same opportunity with their fraud claims that they had with their breach of fiduciary duty claims. (See *Garcia v. Roberts* (2009) 173 Cal.App.4th 900, 910 ["'If the same set of facts supports merely a different theory . . . no prejudice can result'" from an amendment of the pleadings]; *Atkinson v. Elk Corp.*, *supra*, 109 Cal.App.4th at p. 761 ["'it is irrelevant that new legal theories are introduced as long as the proposed amendments "relate to the same general set of facts,"'" quoting *Kittredge Sports Co. v. Superior Court* (1989) 213 Cal.App.3d 1045, 1048].)

These parties have been litigating with each other for years. It is likely, given that for jurisdictional reasons this appeal can provide only partial closure, they will continue to do so. The trial court abused its discretion in denying three-fourths of plaintiffs' motion for leave to file their second amended complaint. The July 19, 2006 order denying plaintiffs' motion for leave to file a second amended complaint is reversed, and, because we reverse the trial court's December 14, 2006 order granting summary adjudication in the next section, plaintiffs may have leave to pursue their five proposed fraud causes of action based on all four categories of fraud allegations.

3. The December 14, 2006 order improperly granted summary adjudication on the fraud claims in the second amended complaint

On November 3, 2006 defendants moved for summary adjudication on the five fraud causes of action in the second amended complaint based on the fraud allegations in category (2), the only category the trial court gave plaintiffs leave to pursue. The trial court granted defendants' motion for summary adjudication on all five causes of action, primarily on the ground that the $2,450,000 figure in the second amended complaint's remaining fraud claim was the same as the $2,450,000 figure in the first amended complaint's fraud claims. The trial court stated that "there is no doubt in the court's mind that plaintiffs are talking about the very same adjustments to inventory and charge-back reserves which formed the basis of the extensive discussions throughout this case, and which were the center of the first fraud claims." The trial court stated: "In the first fraud claims Candies [*sic*] alleged essentially the same thing they are alleging here, e.g., that shortly after Candie's executed the Term Sheet 'Guez and [Sweet] provided Candie's representatives with previously undisclosed information that Unzipped's inventory and receivables were impaired and had to be written down.' Both the original and the second amended complaint alleged that Sweet's failure to record $2.45 million in inventory and accounts receivable reserves against Unzipped's earnings statement caused Unzipped's profits to be [over]stated." The trial court concluded that the "'new allegations' are barred by the June 9, 2009 adjudication."[65]

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[65] Defendants' argument on appeal mirrors the trial court's reasoning: "It is understandable if this Court experiences a bit of *déjà vu* in reading plaintiffs' SAC. Both the FAC and the SAC alleged Sweet failed to disclose $2.4 million in inventory and accounts-receivable reserves and thereby overstated Unzipped's net income. Both the FAC and the SAC also alleged the overstated net income induced Candie's to buy

The issue, however, was not whether the $2,450,000 figure alleged in the second amended complaint and its supporting calculations were the same as the figure alleged in the first amended complaint and its supporting calculations. The issue was whether the claims were the same. And they were not. The fraud claims in the first amended complaint were based on alleged misrepresentations and concealment of material facts in projections by Guez and Sweet for how Unzipped would perform financially in fiscal year 2003; i.e., the future. The fraud claims in the second amended complaint were based on alleged misrepresentations and concealment of material facts contained in written financial statements prepared by Guez and Sweet for how Unzipped had performed financially in fiscal year 2002; i.e., the past. The fraud claims in the first amended complaint were based on allegedly fraudulent projections by Guez and Sweet in the spring of 2002 about how much income Unzipped would "generate" during the then-incomplete time period of February 1, 2002 through January 31, 2003. The fraud claims in the second amended complaint were based on a series of allegedly fraudulent representations by Guez and Sweet at various times in 2002 about how much income Unzipped had actually generated during the completed time periods of February 1, 2001 through January 31, 2002 (as stated in the January 2002 audited financial statements) and February 1, 2002 to July 31, 2002 (as stated in the July 2002 unaudited financial statements). It was improper for the trial court to grant summary adjudication on the latter on the ground that the court had done so on the former.

The trial court also found that "under the evidence, plaintiffs were not misled as they knew by at least September 2002 that entries would be booked to goodwill." Defendants similarly argue that plaintiffs could not have been misled by the financial

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Sweet's interest in Unzipped at an inflated price. The only nominal difference between the FAC and the SAC is that the FAC asserts Guez and Sweet concealed the need for the reserves entirely, and fraudulently induced plaintiffs to enter into the *Term Sheet*, while the SAC asserts that Guez and Sweet concealed the fact that the reserves were recorded as an increase to goodwill, and thereby fraudulently induced plaintiffs to enter into the *Final Agreements*."

statements defendants provided because "they indisputably knew the $2.45 million in inventory and account-receivable reserves were post-dated against goodwill" before they signed the October 2002 agreements.

Given the state of the record in this appeal, we cannot affirm the trial court's order granting summary adjudication on the remaining fraud allegation (i.e., category (2)) in the five fraud causes of action in the second amended complaint on this ground. The evidence regarding plaintiffs' allegations that the financial statements inflated the value of the inventory (category (1)), concealed material facts regarding Congress Financial (category (3)), and concealed material facts about the Sylvain inventory (Category (4)), is so intertwined with the evidence regarding plaintiffs' allegations that the financial statements overstated Unzipped's income (category (2)), that as a practical matter the four categories of allegations that comprise the five fraud causes of action cannot be separately summarily adjudicated. Nor, for that matter, can they be summarily adjudicated as a procedural matter. (See § 437c, subd. (f)(1); *Hindin v. Rust* (2004) 118 Cal.App.4th 1247, 1256, 1259.) In any event, whether and when plaintiffs knew about the details of the representations of defendants' accounting, and how much plaintiffs knew, either directly or through the auditors who worked on the Unzipped financial statements (including whether the auditors were plaintiffs' agents), are factual issues that on this record cannot be decided on summary adjudication. Plaintiffs should have the opportunity to present their evidence, and defendants should have the opportunity to move for summary adjudication, on all four fraud allegations in all five causes of action.

Therefore, the trial court's December 14, 2006 order granting summary adjudication on the five fraud causes of action in the second amended complaint is reversed.

CONCLUSION

The appeals by Sweet and Azteca from the November 16, 2007 judgment, and the appeals by plaintiffs from the November 16, 2007 judgment as to Sweet and Azteca, are dismissed. The appeals by Sweet and Azteca from the November 16, 2007 orders granting motions for JNOV and denying motions for a new trial are dismissed. The

November 16, 2007 orders denying motions for JNOV and granting motions for a new trial are void and therefore vacated. The appeal from the November 16, 2007 order denying plaintiffs' motion to treble damages on their trademark claims is dismissed as to Sweet and Azteca.

The denial by operation of law of defendants' motions for JNOV on plaintiffs' Sylvain inventory overcharge claim is affirmed.

The denial by operation of law of defendants' motions for JNOV on plaintiffs' belts and sarongs overcharge claim is affirmed.

The denial by operation of law of defendants' motions for JNOV on plaintiffs' Azteca overcharge claim is affirmed.

The denial by operation of law of defendants' motions for JNOV on plaintiffs' agent fees overcharge claim is reversed.

The denial by operation of law of defendants' motions for JNOV on plaintiffs' Candie's brand overcharge claim is affirmed.

The denial by operation of law of defendants' motions for JNOV on plaintiffs' claim that Azteca charged improper interest on the $5 million note is affirmed.

The denial by operation of law of defendants' motions for JNOV on plaintiffs' claim that Sweet and Azteca failed to credit Unzipped for discounts is affirmed.

The denial by operation of law of defendants' motion for JNOV on plaintiffs' claim that Sweet caused Unzipped to incur excess interest from third party lenders is affirmed.

The denial by operation of law of defendants' motion for JNOV on plaintiffs' claim that ADS failed to maintain a perpetual inventory is affirmed. The denial by operation of law of Guez's motion for a new trial on plaintiffs' claim that Guez allowed ADS to fail to maintain a perpetual inventory is reversed and remanded for a new trial on damages.

The denial by operation of law of Sweet's motion for JNOV on plaintiffs' claim for distribution charges by ADS for Sylvain jeans sold to third parties is affirmed.

The denial by operation of law of defendants' motion for JNOV on plaintiffs' claim that ADS failed to reimburse Unzipped for inventory shortages is affirmed.

The denial by operation of law of Guez's motions for JNOV and a new trial on plaintiffs' claim for diversion of Unzipped's resources is affirmed. The denial by operation of law of Sweet's motion for JNOV on plaintiffs' claim for diversion of Unzipped's resources is reversed.

The denial by operation of law of defendants' motion for JNOV on plaintiffs' claim for failure to meet payroll budget for fiscal year 2004 is reversed.

The denial by operation of law of defendants' motion for JNOV on plaintiffs' claim that Sweet failed to reduce expenditures by $50,000 per month is reversed.

The denial by operation of law of defendants' motion for JNOV on plaintiffs' claim that Sweet failed to meet the $1.7 million guarantee for fiscal year 2004 is reversed in part and modified in part. Candie's is entitled to use the fiscal year 2004 shortfall of $1,626,000 as an offset against quarterly interest payments and principal due under the $11 million note, but are not also entitled to a money judgment of $1,626,000 ($1,888,000 with prejudgment interest). Candie's is entitled to a declaratory judgment against Sweet that Candie's properly has and may continue to offset the fiscal year 2004 shortfall amount against interest and principal due under the $11 million note.

The denial by operation of law of defendants' motion for JNOV on plaintiffs' claim that Sweet failed to meet the prorated $1.7 million guarantee for fiscal year 2005 is reversed in part and modified in part. Candie's is entitled to use the fiscal year 2005 shortfall as an offset against quarterly interest payments and principal due under the $11 million note, but are not also entitled to a money judgment of $4,900,000 (which includes prejudgment interest). Candie's is entitled to a declaratory judgment against Sweet that Candie's properly has and may continue to offset the fiscal year 2005 shortfall amount against interest and principal due under the $11 million note.

The denial by operation of law of Guez's motion for JNOV on plaintiffs' claim for breach of fiduciary duty by inducing Candie's $4.4 million investment in Unzipped is affirmed.

The denial by operation of law of defendants' motion for JNOV on plaintiffs' trademark infringement claims is reversed.

The denial by operation of law of defendants' motion for JNOV on plaintiffs' conversion claims is affirmed.

The denial by operation of law of Guez's motion for JNOV on plaintiffs' punitive damages claim is affirmed. The denial by operation of law of Guez's motion for a new trial on plaintiffs' punitive damages claim is affirmed.

The denial by operation of law of Sweet's motion for JNOV on Sweet's claim that Candie's breached the $11 million note is affirmed.

The denial by operation of law of ADS's motions for JNOV and a new trial on ADS's claim that Unzipped breached the ARDA is affirmed.

The trial court's October 25, 2005 order sustaining without leave to amend the cross-claims by Sweet, Azteca, and ADS against Cole is affirmed.

The trial court's June 29, 2006 order granting Guez's motion for summary adjudication on plaintiffs' fraud claims in the first amended complaint is affirmed. The trial court's July 19, 2006 order granting in part and denying in part plaintiffs' motion for leave to file a second amended complaint is reversed. Plaintiffs may have leave to file their proposed second amended complaint with all five causes of action based on all four fraud allegations. The trial court's December 14, 2006 order granting summary adjudication on the fraud claims in the second amended complaint is also reversed.

DISPOSITION

The November 16, 2007 orders on defendants' motions for JNOV and a new trial are vacated. The August 3, 2007 denials by operation of law of defendants' motions for JNOV are affirmed and reversed, as stated in this opinion.

The judgment against ADS and Guez is modified and affirmed. The trial court is to deduct $568,000 from the judgment against Guez for the reversal of the denial by operation of law of plaintiffs' agent fees overcharge claim, and to grant a new trial on damages on plaintiffs' claim that Guez allowed ADS to fail to maintain a perpetual inventory. The trial court is to enter judgment in favor of ADS and Guez on plaintiffs' trademark infringement claim, in favor of plaintiffs and against ADS and Guez on plaintiffs' conversion claim, and against ADS and in favor of Unzipped on ADS's cross-complaint. The October 25, 2005 order sustaining without leave to amend Cole's demurrer to first amended cross-complaint and the November 16, 2007 judgment in favor of Cole are affirmed.

The June 29, 2006 order granting Guez's motion for summary adjudication on plaintiffs' fraud claims in the first amended complaint is affirmed. The July 19, 2006 order granting in part and denying in part plaintiffs' motion for leave to file a second amended complaint is reversed. The December 14, 2006 order granting summary adjudication on the fraud claims in the second amended complaint is also reversed.

The case is remanded for further proceedings consistent with this opinion. The parties are to bear their own costs on appeal.

SEGAL, J.*

We concur:

PERLUSS, P. J.

JACKSON, J.

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