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IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

SIXTH APPELLATE DISTRICT

MISSION LINEN SUPPLY,
Plaintiff and Appellant,

v.

CARMEL COUNTRY INN, LLC,
Defendant and Respondent.

H039644
(Monterey County
Super. Ct. No. M115321)

Appellant Mission Linen Supply (Mission) appeals from a judgment awarding it \$6,000 in damages for breach of contract in its action against respondent Carmel Country Inn, LLC (Inn). Mission contends that the trial court abused its discretion in permitting Inn to rely on unpleaded unconscionability and unreasonableness defenses to the damages provisions of the contract. Mission asserts that it was prejudiced by its lack of notice of these defenses. We agree and reverse the judgment.

I. Background

Mission had been the linen rental service provider for Inn since at least 2000. Mission delivered bed and bath linens to Inn and picked up used bed and bath linens several times a week. Inn paid Mission about \$1,000 per week for linen service. The 2002 contract between Mission and Inn had a five-year term and provided for automatic

renewals unless there was timely notice to the contrary. All of the 2002 contract's terms appeared on a single one-sided page. The 2002 contract provided only two possible ways for Inn to cease utilizing Mission's services prior to the expiration of the contract. If Inn notified Mission by certified mail of a "valid" service problem and Mission failed to remedy the problem within 30 days, Inn could terminate the contract after providing Mission with 60 days of notice. Otherwise, Inn's "cancellation" of the contract prior to its expiration would obligate Inn to "purchase the entire inventory of regular items in service" and "pay, as liquidated damages and not as a penalty, 50% of the average weekly amounts invoiced during the month preceding the breach, multiplied by the number of weeks remaining in the term of this agreement, beginning with the date of the breach."

In May 2009, Inn and Mission entered into a new five-year contract. The 2009 contract contained essentially the same terms as the 2002 contract, but this time the terms were on the back of the one-page contract. The 2009 contract, like the 2002 contract, was for a five-year term with automatic renewals, and it contained very similar termination and cancellation provisions.¹

The driver who serviced Inn's account for Mission was "always short on product" and unable to provide what Inn needed. When the driver informed Mission's inventory

¹ The 2009 contract used slightly different language in the liquidated damages provision. It provided that Inn would be required to "pay, as liquidated damages and not as a penalty, 50% of the average weekly amount invoiced during the month preceding the breach, *or, if not available, the weekly minimum*, multiplied by the number of weeks remaining in the term of this agreement, beginning with the date of the breach." (Italics added.) It also used slightly different language in the service complaint provision. Instead of providing that Inn could terminate the contract if Mission failed to remedy a "valid" service complaint, it provided that Inn could terminate the contract only "Should MISSION in its discretion find such complaint to be valid" These differences are not material to our analysis.

control manager of this problem, the inventory control manager would shrug or “sometimes they would tell me that they just didn’t have it.” Not only were there shortages, but “there was a lot of product that was either stained or torn.”² Inn’s innkeeper repeatedly complained orally to Mission’s driver and its inventory control manager about problems with both shortages and defective linens. She never received a meaningful response. She also repeatedly complained about billing errors throughout 2011, but the same billing errors continued to be made. Mission eventually corrected most, but not all, of the billing errors.

In October 2011, Inn notified Mission by e-mail and fax that Inn was terminating Mission’s services due to the billing and service problems. At that time, 132 weeks remained before the 2009 contract’s expiration. Mission immediately responded with a written demand for \$76,217.01 under the 2009 contract’s “cancellation” provisions. In November 2011, Inn’s attorney responded with a letter in which he claimed that “those terms are void as a matter of law” and also “run afoul of California Civil Code §1670.5.”³

In December 2011, Mission filed a breach of contract action against Inn. Mission’s complaint sought \$8,788.10 “for failure to purchase inventory” and \$63,575.82 “for failure to pay liquidated damages.” In January 2012, Inn filed an answer that included a general denial and seven affirmative defenses. Inn’s answer did not mention unconscionability or allege that the liquidated damages provision was unreasonable.⁴

² Mission’s average “reject rate” for defective product was 3 percent.

³ Civil Code section 1670.5 concerns unconscionability.

⁴ The seven affirmative defenses were: (1) the complaint does not state a cause of action; (2) the complaint is “barred” because it seeks “recovery for injuries [Mission] has not suffered and . . . money damages to which [Mission] is not legally entitled”; (3) bad faith; (4) unlawful conspiracy in violation of Business and Professions Code section 17200; (5) recovery should be limited due to (a) failure to mitigate damages, (b) Mission’s wrongful acts, (c) wrongful conduct by third parties, and (d) comparative

(Continued)

The trial was scheduled for December 10, 2012. In Inn's December 6 trial brief, Inn argued that the contract's requirement that it purchase inventory and pay liquidated damages "is simply unenforceable" because it "is unconscionable as a matter of law since it penalizes one side (but not the other) whether or not the customer (as in our case) has reasonable cause for an early termination." "Furthermore, the assessment of what purports to be 'liquidated damages' . . . is clearly an invalid penalty under California law." Inn's trial brief proceeded to argue that the contract's liquidated damages provision was invalid because it was not "a 'reasonable attempt' to anticipate damages from default." Inn argued that the liquidated damages provision lacked a "rational nexus" to actual losses.

Mission's trial brief asserted that it "cannot even begin to guess what undisclosed contentions defendant may attempt to raise at trial."⁵ Mission asked the court to exclude any evidence on unpleaded affirmative defenses that had not been specified in Inn's responses to two form interrogatories. The first of these interrogatories asked: "'Was there a breach of any agreement alleged in the pleadings?'" and sought specification of each breach. The second interrogatory asked: "'Is any agreement alleged in the pleadings unenforceable? If so, identify each unenforceable agreement and state why it is unenforceable.'" Inn responded: "'Yes. The entire [2009] Agreement was rendered unenforceable by reason of Plaintiff's material breaches of contract'" Inn did not identify the inventory buy-out provision or the liquidated damages clause as

negligence; (6) laches, unclean hands, waiver, and estoppel; and (7) Mission "failed to state facts sufficient to justify [its] claim for any of the alleged relief, damages and/or costs, including attorneys fees, claimed by it in this action."

⁵ Mission's trial brief was signed by its attorney on December 6, 2012 and filed the next day, so it could not have been a response to Inn's trial brief, which was filed on December 6 and served on Mission's attorney by e-mail on December 7.

unenforceable nor did it claim that unconscionability or unreasonableness was a reason for the unenforceability of these provisions.

At the commencement of the one-day December 10, 2012 trial, Mission's attorney told the court: "There are some issues in the trial briefs about additional defenses. But we realize this is a bench trial so we are not going to make a big deal about objections." The court replied: "I was going to take up the issues raised in the trial brief as the trial proceeded." Mission's attorney responded: "Right."

Mission's general manager testified at trial that Mission's policy was that some of the provisions in its form contract were negotiable, including the length of the agreement, the liquidated damages clause, and the inventory buy-out provision. He testified that Inn had never provided Mission with written notice of a valid service problem as required under the contract. Had Inn done so, Mission would have been afforded a total of 13 weeks' notice, which he equated to a loss of \$6,000 under the liquidated damages provision. He explained that the liquidated damages amount was calculated as 50 percent of total charges because Mission had "fixed costs in place." He also testified that Mission purchased new inventory to service each new customer. Mission's inventory control manager testified that being unable to provide the amount of linens needed by a customer would be a "serious problem."

After the close of evidence, at the end of his opening argument to the court, Mission's attorney said: "We are not going to deal with the issues in the trial brief that was -- that was prepared by the other side until the court tells us that -- that we have to. The liquidated damage, that kind of thing."

During Inn's attorney's closing argument, Inn's attorney stated: "And I agree with [Mission's attorney], there is no point getting into matters that I've raised in my trial brief. But, you know, how come, how come Mission Linen can bill the Carmel Country Inn for supplies that are all returned to them? Why would they be billed for \$10,000 for those supplies? I mean, doesn't make sense." He also argued: "And for [Mission] to

claim in a contract that was good for about \$1,000 a week that they want -- that they want \$80,000 in liquidated damages is absolutely bizarre. . . . Yet the law requires, the law requires for a valid liquidated damages purpose there be some reasonable effort to estimate what the loss is going to be. . . . [T]he fact is that the language that's been relied on by Mission Linen here is not enforceable. . . . [I]t's so one sided and unconscionable as to be absurd."

In his closing argument, Mission's attorney objected to consideration of the defenses of unconscionability and unreasonableness of the liquidated damages provision: "And in spite of my fears, [Inn's attorney] has entered into a discussion about liquidated damages and about unconscionability which were not raised as defenses. Had they been raised as defenses, we would have had additional discovery. And we do have points and authorities that deal with those kind of things, which I can present to the court. We -- on the issue of the reasonableness, there is -- of the liquidated damages, there is no requirement that there be any effort. It's an objective test that the actual formula bear some reasonable relationship to the actual damages suffered. And we have a case that shows and that's why we asked [the general manager] which costs were saved when you didn't have this customer. . . . There is no requirement of mitigation, nothing like that. . . . Our loss is high because the revenue is high." The matter was submitted at the conclusion of Mission's closing argument.

After the case was submitted, the court asked Mission's attorney if it was his position that Inn "can't raise" the reasonableness of the liquidated damages provision "now" because it was not pleaded as an affirmative defense in Inn's answer. Mission's attorney pointed out that Inn not only had not raised the defense in its answer but had also failed to disclose it in discovery. "But as I said before, I have a points and authorities dealing with the liquidated damage provision, and we do think it's reasonable. We are willing to not waive the objection but we're not going to yell and scream about it."

The court never expressly ruled on Mission's objection to consideration of these two defenses, but it proceeded to base its decision on these two defenses. The court found that Inn had breached the 2009 contract, but it concluded that the inventory buy-out and liquidated damages provisions were unenforceable on unreasonableness and unconscionability grounds.

The court found that the inventory buy-out provision was unenforceable because Mission had failed to show that "an actual inventory to meet [Inn's] needs at their peak season was ever purchased for them per se" "I find it difficult to see the reasonableness of the provision that requires them in a termination situation to pay for the entire inventory, for example. There's where I think there is a lack of evidence on the Plaintiff's part." "And here I think the defense makes a point, especially given shortages, chronic shortages"

The court also found that the liquidated damages provision was unenforceable because it was "unreasonable as a matter of law." "I don't think the evidence shows that the liquidated damage provision was reasonable." "I think the idea of there being some connection to actual costs and/or an inability to assess those or all the other provisions and all the things that generally the court has to consider legally, is it a form contract, is it contained within somebody that has all the bargaining power, take it or leave it and I think that's all here. [¶] I don't think [the general manager] was the best witness to give us the best explanation to tell us how do you come up with this. And the 50 percent of being a reasonable evaluation of what their damages would be. Plus the idea that a five-year term is necessary to -- what's the reasonableness of that term being But I think tying in the liquidated damages to the full five-year term, I don't see evidence of the reasonableness of that under all the circumstances and the law that applies to the liquidated damage provision. . . . I think the cancellation provision that's included in these terms is reasonable and within what might be expected with a service provision such as this [requiring a written complaint and essentially 90 days of notice]. There is

nothing to suggest that that wouldn't have been a reasonable way for [Inn] to proceed in canceling this agreement." "And that the cancellation provisions should have been followed. And they should have been given an opportunity to be aware that these problems were such that you wanted to terminate the agreement and been given an opportunity to correct that. However, I find that the liquidated damage provision for assessing damages is unreasonable as a matter of law, and there is no evidence to support that it is reasonable."

After the court made these findings, it asked Mission's attorney: "Now any issues you wish to raise procedurally with the court's ruling as to the liquidated damage provision?" Noting that the court had stated that the general manager was "not the best person on that issue," Mission's attorney argued that this statement demonstrated that "we have been kind of prejudiced." "[I]f that defense had been out there, perhaps we would have had the opportunity to have a better person, perhaps from corporate." He also argued that "they had the burden of proof on the liquidated damages, they have to prove it is unreasonable. We don't have to prove it is reasonable." The court responded: "That's true. I did take them as having the burden of proof. But you take all the evidence presented, not just what they presented, and under all the evidence presented I think the burden of proof has been satisfied that it's unreasonable."

The court subsequently provided further explanation of its findings. It "didn't find the entire contract to be an adhesive contract," but it "did find the liquidated damages provision to be adhesive and unenforceable and not in compliance with general principals [sic] of law as to liquidated damages. And I feel as though almost there was a presumption on the defense in that regard due to it being a form contract in that regard prepared by the plaintiff, presented without letting them know it could be negotiated and without drawing attention on each renewal to the -- and that they needed to initial acknowledge acceptance of the terms and the terms on their face, applied under any circumstances of termination whether it happened in the first month or the last month of

the 60-[month] period, and the evidence was lacking to show all the connections to the law that the liquidated damage provision should have to be an enforceable one.” “[T]he ongoing shortage, which occurred chronically throughout the term of the contract and the billing errors, did not rise to a substantial breach of the contract to justify immediate termination, and . . . [Inn] was required to follow the procedures of the contract to try to work that out and give them written notice of the problems and an opportunity to correct, and then a termination period would be appropriate.”

“I found a breach and we have to calculate actual damages. This is not a liquidated damage.” “[W]hat are the actual damages to plaintiff for not having gotten that 90-day cancellation period turnaround, the inability to work the contract during that time.” The “90-day period in which Mission would have continued to provide services and receive the income . . . is perhaps the best measure of damages. I think that’s about 12 weeks”⁶ The court determined that “12 weeks at \$1,000 on average for rental” reduced by “50 percent of actual savings” to Mission from not servicing Inn produced a damage award of \$6,000. On March 4, 2013, the court entered judgment in favor of Mission for \$6,000 plus attorney’s fees and costs.

Mission moved for modification of the verdict or a new trial. It argued that “evidence and argument regarding unconscionability and the invalidity of the inventory buyout clause and liquidated damage clause should have been excluded because defendant failed to disclose those defenses in discovery.” Mission argued that it would have called additional witnesses at trial had it been aware in advance of trial that unconscionability and reasonableness were issues. Mission also asserted that the

⁶ The court originally calculated damages as \$12,000 (12 weeks times \$1000 per week), but it later decided that it should have reduced this by 50 percent to account for Mission’s costs and reduced the damages to \$6,000 (plus attorney’s fees and costs).

evidence did not support the court's finding that either of these clauses was unconscionable or unreasonable.

Inn's opposition noted that it had raised unconscionability in its November 2011 letter to Mission before Mission filed this action. Inn's opposition relied on and attached its July 2012 "Mediation Brief" in which it had explicitly contended that the liquidated damages clause was "unreasonable." In addition, Inn referred to, but did not attach, a November 2012 "settlement conference statement" in which it had apparently mentioned deposition testimony that the liquidated damages provision "did not reflect the 'true cost' to Plaintiff."

At the May 3, 2013 hearing on Mission's new trial motion, the court explicitly relied on the assertion in Inn's mediation brief of a reasonableness defense to the liquidated damages provision. The court denied the motion. Mission timely filed a notice of appeal from the court's March 4 judgment.

II. Discussion

Mission claims that the trial court abused its discretion in considering reasonableness and unconscionability challenges to the liquidated damages and inventory buy-out provisions because Inn had not pleaded these affirmative defenses in its answer.⁷

"The answer to a complaint shall contain: [¶] (1) The general or specific denial of the material allegations of the complaint controverted by the defendant. [¶] (2) A

⁷ Mission also argues that the evidence does not support the court's findings concerning these two defenses. Due to the fact that these defenses were never pleaded, the evidence at trial relevant to them was minimal. The trial court's findings are also ambiguous as to whether its conclusions were based on unreasonableness, unconscionability, or both. As a result, it is difficult to evaluate whether those findings are supported by the evidence. Because we remand this matter for a new trial, we need not attempt to do so.

statement of any new matter constituting a defense.” (Code Civ. Proc., § 431.30, subd. (b).) Unconscionability and the unreasonableness of a liquidated damages clause are both affirmative defenses, and Inn plainly did not allege either of them in its answer.⁸ Inn’s answer claimed only, without further explanation, that Mission sought “money damages to which it is not legally entitled.”

“No variance between the allegation in a pleading and the proof is to be deemed material, unless it has actually misled the adverse party to his prejudice in maintaining his action or defense upon the merits. Whenever it appears that a party has been so misled, the Court may order the pleading to be amended, upon such terms as may be just.” (Code Civ. Proc., § 469.)

Mission contends that it was “actually misled . . . to [its] prejudice” by Inn’s failure to allege these affirmative defenses because it was unable to conduct adequate discovery and present relevant testimony at trial on the issues pertinent to these defenses. It points out that the trial court found that Mission’s general manager was not “the best witness” on these issues. Inn contends that Mission was not prejudiced by Inn’s failure to allege these affirmative defenses in its answer because Inn had repeatedly told Mission

⁸ Until 1978, a liquidated damages provision was presumed void, and the party seeking to utilize a liquidated damages provision was required to both plead and prove the impracticability of establishing actual damages in order to validate a liquidated damages provision. (*Better Food Markets v. American Dist. Tel. Co.* (1953) 40 Cal.2d 179, 184-185.) In 1977, the Legislature amended Civil Code section 1671 to its present form, which provides that a liquidated damages provision “is valid unless the party seeking to invalidate the provision establishes that the provision was unreasonable” (Civ. Code, § 1671.) This amendment of Civil Code section 1671 explicitly shifted the burden of proof from the plaintiff to the defendant, which necessarily shifted the pleading obligation. Since the plaintiff has no obligation to prove that a liquidated damages provision is reasonable, the facts necessary to establish the unreasonableness of a liquidated damages provision will be “new matter” that the defense must allege in its answer in support of this affirmative defense.

well in advance of trial that Inn’s position was that these provisions were unenforceable due to their unreasonableness and unconscionability.

“ “[T]he allowance of amendments to conform to the proof rests largely in the discretion of the trial court and its determination will not be disturbed on appeal unless it clearly appears that such discretion has been abused Such amendments have been allowed with great liberality ‘and no abuse of discretion is shown unless by permitting the amendment *new and substantially different issues are introduced in the case or the rights of the adverse party prejudiced*’” Conversely, “ ‘amendments of pleadings to conform to the proofs should not be allowed when they *raise new issues not included in the original pleadings* and upon which the adverse party had *no opportunity to defend. . . .*’” [¶] “The cases on amending pleadings during trial suggest trial courts should be guided by two general principles: (1) whether facts or legal theories are being changed and (2) whether the opposing party will be prejudiced by the proposed amendment. Frequently, each principle represents a different side of the same coin: If new facts are being alleged, prejudice may easily result because of the inability of the other party to investigate the validity of the factual allegations while engaged in trial or to call rebuttal witnesses. If the same set of facts supports merely a different theory . . . no prejudice can result.” . . . “The basic rule applicable to amendments to conform to proof is that the amended pleading must be based upon the same general set of facts as those upon which the cause of action or defense as originally pleaded was grounded.” ” (Duchrow v. Forrest (2013) 215 Cal.App.4th 1359, 1378, original italics (Duchrow).)

The defenses that Inn pleaded in its answer and pursued at trial were directed at showing that Inn had no liability at all under the contract. Inn asserted that it had not agreed to the terms on the back of the 2009 contract and that Mission had breached the contract by providing poor service. The factual issues related to these defenses had nothing to do with the validity of the liquidated damages and inventory buy-out provisions. Thus, these unpleaded defenses were “ “ “new and substantially different

issues’””” from the ones pleaded in the answer. (*Duchrow, supra*, 215 Cal.App.4th at 1378, italic omitted.) This was not a situation where prejudice was absent because the ““same set of facts supports merely a different theory””” (*Ibid.*) The facts relevant to these unpleaded affirmative defenses were unrelated to those supporting Inn’s other defenses.

Nor did Mission have adequate notice of these defenses to enable it to prepare to combat them at trial. It is true that Inn told Mission before this action was filed that Inn considered these provisions to be “void as a matter of law” and to “run afoul of California Civil Code §1670.5 [unconscionability].” However, Inn’s mere mention of unconscionability in a pre-litigation letter did not place Mission on notice that Inn would be pursuing reasonableness and unconscionability defenses in this action where Inn not only did not plead either of these defenses in its answer but also did not identify them as defenses in response to Mission’s interrogatories. Indeed, in the course of this litigation, the only notice that Inn ever provided to Mission that it intended to pursue these unpleaded defenses at trial was in Inn’s trial brief, which Mission did not receive until the Friday before the Monday trial. Obviously, Inn’s trial brief did not afford Mission a reasonable opportunity to prepare to challenge these defenses.

Mission repeatedly objected to consideration of these unpleaded defenses and pointed out to the court that “[h]ad they been raised as defenses, we would have had additional discovery.” In fact, it was not clear that the court was going to permit consideration of these defenses until after the close of evidence and after the parties had argued and submitted the case. The trial court never expressly ruled on Mission’s repeated objections prior to the hearing on Mission’s new trial motion. And at that hearing the court based its rejection of Mission’s objections on Inn’s mediation brief, which, as Mission correctly points out, was privileged and could not properly be considered. (Evid. Code, § 1119.)

Accordingly, we conclude that the trial court abused its discretion in permitting consideration of these unpleaded defenses because Mission was prejudiced by the absence of adequate notice to permit it to prepare to challenge them. The appropriate remedy is a remand for a new trial after Mission has been given the opportunity that it was not afforded in these proceedings.

III. Disposition

The judgment is reversed. Mission shall recover its appellate costs.

Mihara, J.

WE CONCUR:

Bamattre-Manoukian, Acting P. J.

Grover, J.