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Attorneys for South Dakota Board of Regents dba South Dakota International Business Institute COUNTY OF LOS ANGELES SUPERIOR COURT FOR THE STATE OF CALIFORNIA CHARLE, CLERK COUNTY OF LOS ANGELES SUPERIOR COURT FOR THE STATE OF CALIFORNIA CHARLE, CLERK COUNTY OF LOS ANGELES COUNTY OF LOS ANGELES	1 2 3 4	James R. Lynch (SBN 144694) GCR, LLP 520 S. Grand Ave., Ste. 695 Los Angeles, California 90071 Tel: (213) 347-0210 Fax: (213) 347-0216	
SUPERIOR COURT FOR THE STATE OF CALIFORNIA ALLAHRE, GLERK COUNTY OF LOS ANGELES CASE NO.: BS121441 SOUTH DAKOTA BOARD OF REGENTS' MEMORANDUM OF POINTS AND AUTHORITIES IN OPPOSITION TO PETITION FOR ORDER COMPELLING ARBITRATION; DECLARATIONS; EXHIBITS; APPENDIX OF NON-CALIFORNIA AUTHORITY Filed concurrently with Respondent's Objections to Evidence Date: May 21, 2010 Time: 9:30 a.m. Dept.: 38 Judge: Hon. Maureen Duffy-Lewis DECLARATIONS DECLARATI		Attorneys for South Dakota Board of Reger dba South Dakota International Business In	stitute HIII III
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INTRODUCTION

Petitioner Darley International, Inc.'s ("Darley") petition to compel arbitration against the South Dakota International Business Institute ("SDIBI") and, by extension, the South Dakota Board of Regents ("Board of Regents"), is premised on three fictions: 1) that the SDIBI may sue and be sued in its own name; 2) that SDIBI Director Joop Bollen or Hanul Professional Law Corporation ("Hanul") had the authority to act as an agent of the SDIBI or the Board of Regents; 3) that Darley could acquire rights against the Board of Regents based upon an alleged violation of exclusive representation rights arising from a contract that specifically states, "the State of South Dakota is prohibited from granting exclusive rights to private entities in regards to SDIBI EB-5 Projects" (Petition (Exhibit 1 thereto, pg. 1 of 15, § I(A)); and 4) that the Board of Regents, although not a signatory to a contractual arbitration agreement, may nevertheless be compelled to arbitrate Darley's claims against the Board of Regents, even though the Board of Regents has never sought to enforce any third party rights it may have under the contract.

As a matter of law, this Court cannot compel the Board of Regents to participate in the arbitration that Darley demands.

STATEMENT OF FACTS

Darley's pleadings are inadmissible hearsay because they are only verified on information and belief, *Star Motor Imports, Inc. v. Superior Court (Shake)* (1979) 88 Cal. App. 3d 201, 204. Thus, Darley relies solely upon the Declaration of Robert D. Stratmore for the facts that it believes support its petition.¹

Suffice to say that Darley believes this Court may compel arbitration because Mr. Bollen was involved in the discussions leading to the Darley/Hanul contract and Darley "believed" that Hanul and Mr. Bollen had the authority to bind the SDIBI and the Board of Regents.

The Board of Regents manages and controls the State university system for the State of South Dakota. S.D. Const., Art. XIV, § 3; Warner Dec., pg. 1, ¶ 3. The Board of Regents, while a State agency, also exists as a corporation, with the delegated power to sue and be sued and to hold, lease, and manage its properties. SDCL § 13-49-11.

¹ Mr. Stratmore, Darley's President, has been a California attorney since 1972. Ex. 7.

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Northern State University ("NSU") is one of the public institutions of higher education under the Board of Regents' jurisdiction. *SDCL § 13-59-1*. The Board of Regents operates and determines the mission of NSU. Warner Dec., pp. 1-2, ¶¶ 3, 5; Ex. 2.

The SDIBI was created by official act of the Board of Regents in 1994, to replace the existing International Business Center at NSU. Warner Dec., pg. 1, ¶ 4; Ex. 1. The SDIBI is funded by the Board of Regents and the South Dakota Governor's Office of Economic Development, another State agency. Warner Dec., pp. 2-3, lines 25-10, ¶ 9; Bollen Dec., pg. 1, ¶ 2. Any money judgment or arbitration award against the SDIBI, for this or any other matter, would be paid out of the funds of the State of South Dakota. Warner Dec., pg. 3, ¶ 10. Conversely, at the time this dispute arose any funds earned by the SDIBI were placed in an account controlled by NSU. Warner Dec., pg 3, lines 10-12, ¶ 9. Employees of both the SDIBI and NSU have received their paychecks on the account of the State of South Dakota. Meyer Dec., pg. 2, ¶ 7; Bollen Dec., pg. 3, ¶ 10.

The SDIBI's Director at all times relevant to this action was Mr. Bollen. Mr. Bollen, who is not an attorney, was then an employee of NSU and listed in the staff directory for NSU.

Meyer Dec., pg. 1, ¶ 3; Ex. 5; Bollen Dec., pg. 1, ¶¶ 2-3. The SDIBI is a constituent part of NSU and the Board of Regents and has no independent legal capacity to sue or be sued, or to enter into contracts without an express grant of authority from the Board or other official authorized to grant such authority. SDCL § 13-49-11. Warner Dec., pg. 2, ¶ 6; Jackley Dec., pg. 1, ¶ 4;

Shekleton Dec., pg. 1, ¶ 4. Mr. Bollen did not have authority to retain attorneys to perform legal services for the SDIBI, nor did he seek such authority. Jackley Dec., pp. 1-2, ¶¶ 4-6; Warner Dec., pg. 2, ¶ 7; Shekleton Dec., pg. 1, ¶ 5.

The State of South Dakota prohibits the performance of legal services for the State except where performed by assistant or deputy attorneys general employed by the State, via contract with a State agency filed with the South Dakota Attorney General, or by special written appointment from the Attorney General. SDCL §§ 1-11-4, 1-11-5, 1-11-15. Jackley Dec., pg. 1, ¶ 4.

Su Ki Austin Kim, an attorney with Hanul, briefly appeared as an attorney for the SDIBI at the hearing on Darley's petition in federal court to compel arbitration, after first requesting

permission to substitute in on September 30, 2008. Ex. 8, pp. 086-089. However, neither Mr. Kim nor any attorney working for Hanul had authorization or appointment from the Board of Regents or the South Dakota State Attorney General's office to represent SDIBI or the Board of Regents, in litigation or in any other capacity. Mr. Bollen did not have such authorization or appointment, either. There is no contract authorizing Mr. Kim to represent the State of South Dakota or any of its agencies. <u>Jackley Dec.</u>, pg. 2, ¶ 6; <u>Warner Dec.</u>, pg. 2, ¶ 8.

James Lynch, who represents the Board of Regents and its constituent part, the SDIBI, has a legal services contract with the Board of Regents and a special appointment from the State Attorney General's office for this purpose. <u>Jackley Dec.</u>, pg. 2, ¶ 7; <u>Ex. 3</u>.

In August 2008, Hanul, which was not then a counsel of record, filed a "pro per" opposition to the Petition by the SDIBI bearing Mr. Bollen's signature. In September 2008, Mr. Kim filed a request to substitute into the action as the SDIBI's attorney, which the federal court approved. Mr. Kim subsequently "represented" the SDIBI before the federal court at the hearing on Darley's Petition on October 6, 2008.

On October 7, 2008, the federal court ordered the SDIBI to participate in the arbitration between Darley and Hanul, thereby exposing the SDIBI and, unbeknownst to that court, the Board of Regents to liability under Hanul's contract with Darley. The SDIBI, again "represented" by Mr. Kim, subsequently participated in an unsuccessful mediation in December 2008. Petition (Exhibit 2 thereto); Bollen Dec., pg. 2, ¶ 7; Ex. 4.

Throughout the foregoing events, Mr. Bollen purposefully avoided informing attorneys for NSU, the Board of Regents, or the State of South Dakota of his dealings with Darley or Hanul, or that these litigation events were taking place, and he continued to withhold this information from them until January 23, 2009, when he realized that he could not make the matter go away with just the assistance of Hanul. On that date, he contacted John Meyer, the University attorney for NSU, about the problem and forwarded some documents relating to the arbitration, but did not mention a lawsuit. On January 27, 2009, Mr. Meyer, having reviewed the documents and become suspicious that a lawsuit might be involved, instructed Mr. Bollen to bring him more documents related to the dispute, which revealed to Mr. Meyer the instant action

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but not the federal court order. Meyer Dec., pp. 1-2, ¶¶ 4-5; Bollen Dec., pp. 1-3, ¶¶ 4-9.

Neither the South Dakota Attorney General's office nor the Board of Regents had any knowledge of the existence of the federal action until January 27, 2009, and then only after Mr. Bollen spoke to Mr. Meyer. Having spoken to Mr. Bollen and seen some of the court documents, Mr. Meyer immediately notified James Shekleton, the General Counsel for the Board of Regents, of what Mr. Bollen had told him. Bollen Dec., pp. 2-3, ¶ 8-9; Shekleton Dec., pp. 1-2, ¶ 6; Meyer Dec., pg. 2, ¶ 6; Warner Dec., pg. 2, ¶ 6-8. The federal court order was discovered shortly thereafter. Meyer Dec., pg. 2, lines 4-7, ¶ 5. Mr. Shekleton thereafter retained California counsel to have the federal court vacate its arbitration order. Shekleton Dec., pg. 2, lines 1-5, ¶ 5.

The Board moved to vacate the order and the federal court tentatively ruled that the SDIBI was an arm of the State of South Dakota, shared the State's Eleventh Amendment immunity, and was not a "citizen" for the purposes of diversity jurisdiction; the federal court also permitted Darley 60 days to conduct discovery on the SDIBI's status, however. Darley asked the federal court to postpone finalizing its ruling because Darley was considering withdrawing its petition altogether. The federal court agreed. Darley thereafter filed a request for permission to withdraw its petition, which was granted on June 15, 2009. Lynch Dec., pp. 1-2, ¶ 5; Ex. 8, pp. 090-091. The withdrawal effectively nullified the federal court's October 2008 order. Darley filed and served the Petition in the instant case on July 2 and 14, 2009, respectively.

ARGUMENT

I.

STANDARD OF REVIEW

A. This Court Is Empowered To Decide The Issue Of Arbitrability.

The Board of Regents agrees that this Court, not an arbitrator, has the power to decide the arbitrability of the dispute between Darley and the Board of Regents.

B. The Federal Arbitration Act Does Not Preempt California Arbitration Statutes
And Rules, And So California Law Governs.

Darley seemingly argues that California law, which only authorizes compelling parties to a written arbitration agreement to arbitrate, gives way to a more lenient 'apropriateness'

standard under the Federal Arbitration Act (9 U.S.C. § 1 et seq.) ("FAA"), on the purported basis that the FAA preempts California law. Darley is incorrect.

The U.S. Supreme Court has ruled that when a contract with an arbitration agreement has a "choice of law" clause, the chosen forum's law governs the arbitration process and rules to be applied in compelling a party to arbitrate, even if it results in no arbitration taking place where the FAA would have compelled arbitration. *Volt Info. Sciences v. Leland Stanford Jr. Univ.* (1989) 489 U.S. 468, 477-479. *Volt* involved the application of *section 1281.2 of the California Code of Civil Procedure*, the same statute invoked in the instant action.

The Court of Appeal for the Second Appellate District followed *Volt*, ruling that the FAA's limited preemptive powers did not preempt applying California law to a contract with a "California law" clause. *Efund Capital Partners v. Pless* (2007) 150 Cal. App. 4th 1311, 1319.

The contract pleaded by Darley states that the contract is governed by and will be enforced under California law. (<u>Petition</u> (Exhibit. 1 thereto, Section 13(B)). Consequently, the provisions of California law governing the compulsion of arbitration apply to the Darley/Hanul contract and the FAA has no bearing on the outcome of this action.

II.

THE SDIBI CANNOT BE SUED IN ITS OWN NAME, AS IT HAS NO LEGAL CAPACITY INDEPENDENT OF THE BOARD OF REGENTS.

The Board of Regents is an arm and alter ego of the State of South Dakota. South Dakota Board of Regents v. Hoops (D.S.D. 1986) 624 F. Supp. 1179, 1184. S.D. Const. Art. XIV, § 3; SDCL § 13-49-1; Warner Dec., pg. 1, ¶ 3. Under South Dakota law, the SDIBI is a part of NSU, which in turn is part of the state university system over which the Board of Regents presides. Having not been granted authority by the South Dakota Legislature to sue or be sued (as opposed to the Board of Regents, which has), neither the SDIBI nor NSU has the legal capacity to sue or be sued. See, SDCL § 13-49-11; Warner Dec., pg. 1, ¶ 6. Cf. Lazarescu v. Arizona State University (D.Ariz. 2005) 230 F.R.D. 596, 601 (Arizona State University cannot be subject to suit because the Arizona Legislature has not so provided.)

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A THIRD PARTY CANNOT BE COMPELLED TO ARBITRATE A CONTRACT
DISPUTE WHEN IT HAS NOT AGREED IN WRITING TO ARBITRATE THE
DISPUTE OR TRIED TO ENFORCE ITS RIGHTS UNDER THE CONTRACT.

A. The Constitutional Right To Jury Trial Must Be Preserved Whenever There Is

Doubt As To The Existence Of An Agreement To Arbitrate.

Although California law favors the resolution of contractual disputes by arbitration, courts are nevertheless required to zealously guard the rights of a party to trial by jury, which is basic and fundamental. *Titan Group, Inc. v. Sonoma Valley County Sanitation Dist.* (1985) 164 Cal. App. 3d 1122, 1127-1128; *Cal. Const., Art. I, § 16.* Thus, absent a clear and unmistakable waiver of the right to jury trial, a court must deny a petition to compel arbitration. *Id*, at 1129.

"Even the strong public policy in favor of arbitration does not extend to those who are not parties to an arbitration agreement or who have not authorized anyone to act for them in executing such an agreement." *County of Contra Costa v. Kaiser Foundation Health Plan, Inc.* (1996) 47 Cal.App.4th 237, 245.

B. Section 1281.2 Of The Code Of Civil Procedure Authorizes The Courts To Compel
 A "Party To An Arbitration Agreement" To Arbitrate.

Sections 1281 and 1281.2 of the Code of Civil Procedure authorize courts to compel parties to arbitrate but, by their own terms, limit that authority to parties to the arbitration agreement. Code Civ. Proc. §§ 1281, 1281.2. Section 1280(e) limits "party to the arbitration" to a party to the arbitration agreement. Code Civ. Proc. § 1280(e).

Moreover, these statutes extend only to <u>written</u> agreements to arbitrate and oral agreements to extend or renew a written agreement. *Code Civ. Proc. § 1281. Magness Petroleum Co. v. Warren Resources of Cal., Inc.* (2002) 103 Cal. App. 4th 901, 907-909.

C. As A Matter of Law, Darley Cannot Prove The Purported Agency Of Hanul Or Mr. Bollen, Nor May The Board Of Regents Be Estopped From Denying Agency.

Darley argues that the Board of Regents and the SDIBI may be compelled to arbitrate

² The Board of Regents recognizes that there are judicially-created exceptions, which it will discuss further below.

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under judicially-recognized exceptions to the "party" rule. The two exceptions upon which it relies are 1) that agency and estoppel theories compel requiring them to arbitrate; and 2) non-signatories may always be compelled to arbitrate if the contract with the arbitration clause is for their benefit.

1. Darley Has Not Pleaded Or Proved That Hanul Had Authority To Act As An Agent Of The Board of Regents.

Darley argues that Hanul was a duly-appointed agent of the SDIBI (and, by extension, the Board of Regents). Indeed, Darley needs for Hanul to be an agency, as Hanul, not someone in South Dakota, signed the Darley/Hanul contract. However, Hanul had no authority to act as an agent, as a matter of law.

The existence of an agency relationship is not presumed but must be proven by the plaintiff by preponderance of the evidence. *Inglewood Teachers Assn. v. Public Employment Relations Board* (1991) 227 Cal. App. 3d 767, 779-780. Agency authority cannot be created by the purported agent. It created by express authority granted by the principal or the ostensible/apparent authority based on the acts and knowledge of the principal. *Yanchor v. Kagan* (1971) 22 Cal. App. 3d 544,549. *Inglewood Teachers Assn., supra*, 227 Cal. App. 3d at 781. Darley offers no evidence of express authority granted to Mr. Bollen to take the actions he did, nor does it offer evidence of knowledge by the Board of those actions. Thus, Darley offers no evidence that Hanul was the Board of Regents' agent when Hanul entered into the Darley/Hanul contract. Indeed, the only evidence is that Mr. Bollen and Hanul knowingly and deliberately avoided informing the Board of Regents what they were doing.

Not being the Attorney General for South Dakota, Mr. Bollen had no authority to contract with Hanul or retain Hanul as an agent of the SDIBI or the Board. Darley has presented no evidence that Hanul was lawfully retained to perform legal services or otherwise act on behalf of the Board, or that Hanul had a contract of any nature with the Board or even with the SDIBI.

³ Under South Dakota law, ostensible agency must be traceable to the principal and is not established solely by the acts, declarations, or conduct of an agent; if the principal has had no dealings with a claimant, the claimant has no recourse against the principal. *Kasselder v. Kapperman* (S.D. 1982) 316 N.W. 2d 628, 630. Darley had no dealings with the principal, which is the Board of Regents.

2. Darley Cannot Argue That Hanul Had Apparent Or Ostensible Authority, Such That The Board Of Regents Is Estopped From Denying Hanul's "Agency."

Darley's arguments rely in part on asserting that Hanul had ostensible or apparent authority, and therefore the Board of Regents is estopped from denying Hanul's agency. However, Darley cannot establish the elements of estoppel, as a matter of law. In California, two of the four elements of equitable estoppel are that 1) the party asserting it was ignorant of the true state of facts, and 2) that party relied upon the conduct of the party to be estopped, to its detriment. El Camino Community College District v. Superior Court (Information Associates) (1985) 173 Cal. App. 3d 606, 613. Darley cannot establish either of these two elements.

Darley cannot claim ignorance of the true state of facts and its consequent detrimental reliance. Even Darley knew that the SDIBI was not a private entity. The laws and rules governing the authority of an employee of a <u>public</u> entity are matters of statute and a plaintiff is held to constructive, if not actual, notice of any restrictions thereon. *Id*, at 613-614. *Seymour v*. *State of California* (1984) 156 Cal. App. 3d 200, 205 fn. 3. Coincidentally, the issue in *El Camino* was the enforceability of contractual arbitration clauses that had been signed by two vice presidents for a community college district—but not approved by the district's board, which by statute had sole authority to bind the district. *El Camino, supra*, 173 Cal. App. 3d at 612-613.

Based on the foregoing, as a matter of law Darley is charged with knowledge of Hanul's, and even Mr. Bollen's lack of authority to contract with Darley and to offer Darley the vague "unofficial exclusive rights" set forth in the Darley/Hanul contract.

El Camino further stands for the proposition that a public employee who has not been granted official authority to act has no power to bind the employing public entity by virtue of his ultra vires actions.

Perhaps more importantly, Darley knew that, with phrases such as "unofficial exclusive rights," Mr. Bollen and Hanul were making highly questionable assertions of their own authority

⁴ South Dakota also requires these two elements, *Dakota Truck Underwriters v. South Dakota Subsequent Injury Fund* (S.D. 2004) 689 N.W. 2d 196, 204, and only applies estoppel against public entities in exceptional circumstances to prevent manifest injustice. *City of Brookings v. Ramsay* (S.D. 2007) 743 N.W. 2d 433, 674.
⁵ In South Dakota, persons are presumed to know the law and the public entity status of public entities. *Hanson v. Brookings Hospital* (S.D. 1991) 469 N.W. 2d 826, 828.

to act, and was required to further investigate, as a matter of law. Civil Code § 19 states:

"Every person who has actual notice of circumstances sufficient to put a prudent man upon inquiry as to a particular fact, has constructive notice of the fact itself in all cases in which, by prosecuting such inquiry, he might have learned such fact." Civ. Code § 19.6

On October 4, 2007, before the Darley/Hanul contract was signed, Mr. Park responded to several questions Mr. Stratmore had raised about some contract provisions. The correspondence restates Mr. Stratmore's questions and provides Mr. Park's response to each question. Park Dec., pp. 1-2, ¶ 5; Ex. 6. In particular, Mr. Stratmore questioned the "unofficial exclusive rights" claimed by Hanul. In response, Mr. Park stated:

"This is a big point. As I mentioned in my email, Hanul does not have an exclusive agreement signed between Hanul and SDIBI. This is because SDIBI (South Dakota) SDIBI and Hanul felt that substance over form was important. WE wanted to start the work and secure our place by our performance. Furthermore, State government granting any sort of exclusivity is a major endeavor as you may know. Rather than to spend time on formalizing everything, we've decided to use the time on creating results. That strategy worked well as we have 'implied' exclusivity from SDIBI and South Dakota.

"I understand that this alone can derail our agreement effort since we do not have expressed right to base our agreement on. If Darley is willing to trust Hanul's relationship with SDIBI, our agreement will have the intended meaning. However, if not, there might not be anything that Hanul can offer Darley to Darley's legal satisfaction.

"Hanul is confident that the working relationship between Hanul and SDIBI is sufficient for Darley to take on the marketing efforts that it intends to. Therefore, our agreement will be one of practicality rather than absolute legal right. That is the best that we can offer at this time. We have had no reason to seek cumbersome, and may be impossible, expressed exclusivity from SD attorneys. I hope you can reason our rationale in this regard." Ex. 6, pp. 037-038.

Mr. Park was candid and blunt: Hanul had no agreement with the SDIBI, the SDIBI was a South Dakota functionary, and they were knowingly avoiding required governmental approval.

Mr. Park's October 4, 2007, correspondence to Mr. Stratmore triggered Mr. Stratmore's duty to inquire about Hanul's purported "agency" relationship with South Dakota and, indeed, the supposed authority of Mr. Bollen. Additionally, the very first page of the agreement should have roused the suspicions of Mr. Stratmore, the attorney. Section 1(A) of the agreement states:

⁶ South Dakota also requires diligent inquiry. A plaintiff "must show not only damages resulting from his reliance on the appearance of authority, but also reasonable diligence and prudence in ascertaining the fact of the agency and the nature and extent of the agent's authority." Dahl v. Sittner (S.D. 1988) 429 N.W.2d 458, 462.

"Because State of South Dakota is prohibited from granting exclusive rights to private entities in regards to SDIBI EB-5 Projects, Hanul's right to grant exclusive marketing rights specified herein is based on the unofficial rights' to exclusively market SDIBI EB-5 Projects promised by SDIBI to Hanul and therefore shall be valid only while Hanul's rights are honored by SDIBI and all rights, powers and authorities granted to DARLEY herein shall terminate when Hanul's rights are rescinded by SDIBI."

Petition (Exhibit 1 thereto, Section 1(A), page 1 of 15).

Translated into plain English, and in light of the October 4 correspondence just two weeks earlier, Mr. Stratmore knew that this clause meant 'The State of South Dakota is really in charge and will never grant exclusive rights of this nature, so the SDIBI is unofficially (i.e., without authority) giving us "exclusive" (wink, wink) rights that we hereby pass on to you for as long as we are all able to maintain this artifice by keeping the State out of the loop.'

This is the agreement that Darley urges this Court to impose upon the Board of Regents. Any prudent person in Mr. Stratmore's position, let alone a prudent attorney, would have questioned whether Mr. Bollen or Hanul had authority to do any of the things that had taken place during negotiations. Indeed, a reasonable person should have wondered if Mr. Bollen and Hanul were actually breaking South Dakota law. If Mr. Park's October 4 letter did not already inform Mr. Stratmore, the attorney, that government approval was needed for what they were doing, a reasonable inquiry would have quickly revealed that Hanul had no authority to represent the SDIBI and Mr. Bollen had no authority to negotiate or approve the Darley/Hanul contract.

The concepts of apparent authority or ostensible authority are the same as an estoppel argument, in which the defendant is purportedly barred from denying the authority of its agent because of the plaintiff's blameless ignorance and detrimental reliance on the agent's representations. See, *Armato v. Baden* (1999) 71 Cal. App. 4th 885, 897 fn. 4 (*citing Baptist Memorial Hosp. System v. Sampson* (Tex. 1998) 969 S.W.2d 945, 948, fn. 2). South Dakota law similarly views these theories as interchangeable. *Federal Land Bank of Omaha v. Sullivan* (S.D. 1988) 430 N.W. 2d 700, 701 (*citing Chleboun v. Varilek* (S.D. 1965) 136 N.W. 2d 348).

Lastly, the Petition's description of a private corporation, SDRC, Inc., as an extension of the SDIBI is not only inadmissible speculation but actually false. The SDRC was never

⁷ Amazingly, Darley pleads the "unofficial" rights in paragraph 8 of its Petition as though this establishes Hanul's authority rather than calling it into question.

approved or authorized by, or affiliated with, the Board of Regents or the SDIBI. Warner Dec., pp. 3-4, ¶¶ 13-14; Ex. 9.

3. The U.S. District Court's Now-Defunct Order Is Irrelevant.

Curiously, Darley acts as though Hanul's lack of agency authority does not matter, as though Mr. Bollen's "authority" will suffice. This is the point at which Darley undoubtedly will try to fall back on the defunct order of the U.S. District Court and the FAA, attempting to argue that Mr. Bollen's authority has already been adjudicated. The Board of Regents has already shown why the FAA is inapplicable to this case. The District Court's order is also inapplicable.

First, Darley dismissed the federal action in the face of the Court's stated intention to dismiss it once it learned that the SDIBI was a public entity; the order thus is not a final adjudication, as the matter was dismissed. More importantly, a federal court order issued in excess of its jurisdiction is void. *Watts v. Pinckney* (9th Cir. 1985) 752 F. 2d 406, 409. Thus, the federal court's order, made in violation of the *Eleventh Amendment* and *section 1332 of title 28 of the U.S. Code* (because a state is not a "citizen" for diversity jurisdiction purposes), was void—which is why the federal court was going to dismiss the action before Darley acted preemptively. It is not authority for any purpose.

Second, the Board of Regents was not represented in the federal action until long after the order was issued. Indeed, there was no legal representation at all, at the time that Mr. Bollen, a non-attorney, filed opposition to the federal petition.

Lastly, the federal court's order was issued under the authority and standards of the FAA⁸, not under the *Code of Civil Procedure*, which governs here and contains more specific requirements that Darley does not meet. Thus, the federal court's ruling is simply inapplicable to the instant case.

⁸ Moreover, the Federal Arbitration Act does not apply to a claim that the federal court would have jurisdiction over absent the arbitration agreement (9 U.S.C. § 4), because, as the Board of Regents demonstrated in federal court, the Board of Regents and the SDIBI had Eleventh Amendment immunity and were not "citizens" for purposes of diversity jurisdiction.

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4. Even If Mr. Bollen Were Presumed To Be An Agent, He Did Not Sign An Arbitration Agreement.

Aside from the absence of evidence of Mr. Bollen's purported authority to bind the Board of Regents or to support its claim that the SDIBI has the capacity to sue or be sued, one simple fact still works against Darley: Mr. Bollen did not sign the arbitration agreement.

The "subsequent ratification" of the Darley/Hanul agreement by the SDIBI is nowhere to be found in the evidence and ignores the lack of authority of Mr. Bollen or the SDIBI to ratify anything. Moreover, Darley offers no evidence that such "ratification" was made in a writing that agreed to arbitrate disputes. There still is no written agreement by Mr. Bollen to arbitrate.

This Court only has authority to compel arbitration pursuant to a <u>written</u> arbitration agreement. *Magness, supra*, 103 Cal. App. 4th at 907-909. If Hanul was not lawfully acting on the Board of Regents' behalf and did not bind the Board of Regents, there is no written arbitration agreement to which the Board of Regents (or the SDIBI) can be said to have subscribed; hence, there is no written arbitration agreement to enforce. This Court is without authority to order the Board of Regents or the SDIBI to arbitration, as a matter of law.

D. The Non-Signatory Arbitration Cases Cited By Darley Do Not Apply To The Instant Case.

Darley cites several cases for the proposition that a non-signatory third party beneficiary of a contract with an arbitration clause may be compelled to arbitrate. However, Darley fails to provide any context that makes these cases applicable to the facts in the instant case.

Matthau v. Superior Court (William Morris Agency, LLC) (2007) 151 Cal. App. 4th 593, involved the son of actor Walter Matthau and a "loan-out" company, each of whom were successors in interest to Matthau's rights (royalties, etc.) following Matthau's death. The William Morris Agency had received a commission from such benefits, as Matthau's agent. The successors refused to pay commissions to the agent. The agent demanded arbitration pursuant to the Screen Actors Guild contract arbitration clause, on the theory that the son and

⁹ The lone exception, an oral agreement to extend or renew an expired written agreement, is not applicable here. Code Civ. Proc. § 1280(f); Magness, supra.

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the loan-out company were third party beneficiaries to Matthau's contract and thereby bound to his obligations. The court found that they were not third party beneficiaries and refused to compel arbitration. *Id*, at 602. Thus, the *Matthau* court's comment on third party beneficiaries being bound to arbitrate was not only dicta but inapplicable to the facts of the instant case.

In *Contra Costa*, involving medical malpractice claims, the court, like the *Matthau* court, commented generally on the third party beneficiary rule without elaborating on it – or applying it. The Contra Costa court refused to compel arbitration because the signatory to the arbitration agreement did not have authority to do so for the non-signatory against whom the order to compel was sought. *Id*, at 245-246.

In Crowley Maritime Corp. v. Boston Old Colony Ins. Co. (2008) 158 Cal. App. 4th 1061, the court of appeal, as in Matthau and Contra Costa, cited the rule without applying it. The court found that the party against whom arbitration was sought was not a third party beneficiary. Id, at 1069-1070. However, the Crowley court did point out that third party beneficiaries historically have been compelled to arbitrate when they sought to enforce rights arising from the contract. Id, at 1070-1073. 10

Thomson-CSF, S.A. v. American Arbitration Assn. (2nd Cir. 1995) 64 F. 3d 773, is yet another case in which the appellate court ruled against compelling arbitration. Thomson-CSF did not involve any third party beneficiaries but instead addressed agency, parent-subsidiary relationships, and veil-piercing issues. Additionally, the court found that estoppel would not lie to permit a signatory to an arbitration agreement to compel a non-signatory to arbitrate a dispute arising under the contract to which the arbitration agreement related. *Id*, at 779.

The last case cited by Darley, *Fisser v. International Bank* (2nd Cir. 1960) 282 F. 2d 231, also ended with a court's refusal to compel arbitration by the non-signatory. In that case, the court found that a non-signatory parent was not bound by an agreement signed by its

¹⁰ This concept is acknowledged, to a point, by Darley in its equitable estoppel argument. However, Darley's argument omits the element of a third party beneficiary trying to enforce its rights under the agreement, substituting the word "embracing" so as to suggest that not rejecting the agreement is the equivalent of trying to enforce it against a party to the agreement. They are not the same; the premise of equitable estoppel is that a third party ought not to be permitted to accept the benefits of the contract but bring suit in a court to evade the arbitration clause. Neither the SDIBI nor the Board of Regents has ever sought to enforce the Darley/Hanul agreement, however.

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subsidiary because it had not acted as the "puppetmaster" so as to control the actions of the subsidiary; the court rejected the idea that merely being the parent rendered the parent subject to the arbitration agreement. *Id*, at 237-241.

Lest this Court believe that *Fisser* provides authority for compelling the SDIBI to arbitrate independently of the Board of Regents, please note that, in *Fisser*, the legal capacity of the subsidiary to sue and be sued was not in question, so the court did not address what occurs when the subsidiary is without legal authority to act. Similarly, the case did not involve public agencies for which agency and contract authority is prescribed and limited by statute or rule.

In summary, to support its burden of proving that a non-signatory may be bound by an arbitration agreement, Darley not only fails to cite a case in which the non-signatory was actually required to arbitrate (in the absence of proven agency), but fails to cite any case remotely describing facts similar to those of the instant case. Darley has failed to carry its burden of proof.

Additionally, Darley has not offered evidence that the SDIBI or the Board of Regents actually received or derived any benefit from the Darley/Hanul contract. Rather, Darley's allegations are premised on an assertion that Hanul and the SDIBI scuttled the agreement within mere weeks, before any benefit could be generated.

Section 1559 of the Civil Code confers upon third party beneficiaries the right to enforce the contract benefiting them. There is no parallel statute permitting a signatory to the contract to use the contract to sue the non-signatory third party beneficiary for breach, which Darley is in effect attempting to do through the arbitration clause. The Board of Regents is unaware of any authority holding that a signatory may sue a third party beneficiary non-signatory for the third party's alleged breach of the contract; rather, the cases involving third parties (not involving an agency issue) have compelled arbitration when the third party pursued its rights in court. However, the Board of Regents has never sought to enforce the Darley/Hanul contract.

Darley's argument for arbitration, based just on the Board of Regents' third party status, makes little sense. Effectively, Darley asserts that two parties may enter into an agreement to benefit a third person, include an arbitration agreement therein, and then either may deprive the

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third person of its constitutional jury trial rights by forcing it to arbitrate a breach of contract claim against it, even though it never signed the contract, never agreed to perform anything under the contract, and was never a party to the contract.

IV.

DARLEY'S PETITION IS BARRED BY THE DOCTRINE OF UNCLEAN HANDS.

A proceeding to compel arbitration is in essence a suit in equity for specific performance of a contract. Freeman v. State Farm Mut. Auto. Ins. Co. (1975) 14 Cal. 3d 473, 479. One who comes into equity must come with clean hands, or he/she is not entitled to equitable relief.

Bakersfield Elementary Teachers Assn. v. Bakersfield City School District (2006) 145 Cal. App. 4th 1260, 1275; Halls v. White (S.D. 2006) 715 N.W. 2d 577, 585 (quoting Action Mechanical, Inc. v. Deadwood Historic Pres. Comm'n (S.D. 2002) 652 N.W. 2d 742).

Darley knowingly participated in a scheme designed to skirt the authority of the appropriate South Dakota state agency, the Board, with persons of highly questionable purported agency, because Darley placed its desires first and incredulity last. This leave Darley with unclean hands. Darley cannot cry "agency!" when it knowingly conspired to evade the authority of the Board and the State of South Dakota. Darley is not entitled to the equitable relief of compelling the Board of Regents to arbitrate under its fraudulent contract.

V.

JURISDICTION

A substantial portion of Darley's points and authorities is devoted to the issue of the Court's personal jurisdiction over the Board of Regents and the SDIBI. These issues have already been addressed at length in the Board of Regents' motion to quash, which has been argued as far as it can be argued at the present time and will be revisited on appeal, if and when necessary, to the U.S. Supreme Court.

Dated: April 23, 2010

GCR, LLP

James R. Lynch

Attorneys for South Dakota Board of Regents, dba South Dakota International Business Institute

DECLARATION OF JACK R. WARNER

I, JACK R. WARNER, declare:

- 1. I have personal knowledge of the facts stated herein and would competently testify thereto under oath if called as a witness.
- 2. Since July 8, 2009, I have been employed by the South Dakota Board of Regents on a regular basis, full-time, as its Executive Director. I succeeded Dr. Robert T. Perry, who retired after 15 years of service as the Executive Director.
- 3. My official responsibilities include various aspects of supervision of the six state universities governed by the South Dakota Board of Regents pursuant to the provisions of article XIV, § 3, of the South Dakota Constitution and section 13-49-1 of the South Dakota Codified Laws. Northern State University (NSU) numbers among these institutions. SDCL § 13-59-1 and § 2, of chapter 114 of the 1901 Session Laws.
- 4. I also serve as custodian of all the official minutes of the South Dakota Board of Regents. The minutes are made and maintained by employees of the Board of Regents acting in the course and scope of their duties. The Board's secretary prepares the minutes of each meeting at and/or near the time of the meeting, from notes made during the course of the meeting. The draft minutes are then submitted to the Board of Regents for approval. Following approval, which may or may not include revisions to the draft minutes, the then-official minutes are maintained by employees of the Board of Regents. Among the matters set forth in the Board minutes is an official action taken by the Board of Regents at its May 4-5, 1994 meeting, to establish the Northern State University International Business Institute, also known as the South Dakota International Business Institute (SDIBI). Attached hereto as Exhibit 1 is a true and correct copy of an excerpt from the Minutes of the South Dakota Board of Regents, May 4-5, 1994, pp. 558, 999 through 1004.
- 5. Attached hereto as Exhibit 2 is a true and correct copy of the Board minutes reflecting an official action taken by the Board of Regents at its December 9-10, 2003 meeting (pp. 3002, 3632, 3649-3650), to amend its official mission statements to remove references to all centers and institutes at all universities under its control from such official mission statements.

This action did not repeal the 1994 authorization to operate the SDIBI as an administrative unit within NSU. It merely eliminated from Board policy statements enumerations of academic centers and public service programs that, in the case of some institutions, had grown to inordinate length. The revisions to Board Policy No. 1:10:6 (D) shown on page 3650 of the Minutes of the South Dakota Board of Regents, December 9-10, 2003 meeting, document the revision and confirm that the institute approved in 1994 had come to be known as the South Dakota International Business Institute.

- 6. The SDIBI does not have any capacity to sue or be sued that is independent of the Board of Regents. No university, institution, department, of the Board, or employee thereof, has the authority to conduct business or enter into contracts on behalf of the Board absent an express grant of authority by the Board or delegation by an official with such express grant of authority. There is no record of the Board of Regents ever authorizing Joop Bollen or the SDIBI to enter into or negotiate contracts generally, or with Darley International, LLC, or Hanul Professional Law Corporation specifically; there is no record of a delegation of authority to this effect, either. Indeed, there is no record of Mr. Bollen having ever requested that the Board of Regents approve agreements with Darley or Hanul.
- 7. Mr. Bollen has never served as an attorney for the Board of Regents, NSU, or the SDIBI; to my knowledge, Mr. Bollen is not licensed to practice law. The Board of Regents has never authorized Mr. Bollen to defend or appear in litigation on behalf of the Board of Regents, NSU, or the SDIBI, or to represent the Board of Regents, NSU, or the SDIBI in any legal disputes with Darley International, LLC.
- 8. There is no record that the Board of Regents has never authorized the Hanul Professional Law Corporation ("Hanul"), or any of its attorneys, to represent the Board of Regents, NSU, or the SDIBI, in any action or in any capacity.
- 9. The Governor's Office of Economic Development is a state agency operating within the South Dakota Department of Tourism and State development and is charged with promotion of "private-public partnership among state government, local communities, higher education, and the private sector to create jobs that create goods and services for use within the

state and for export outside the state, which results in the creation of new wealth." SDCL § 1-52-3.2. The Governor's Office of Economic Development operates with the South Dakota Department of Tourism and State development and is charged with promotion of "private-public partnership among state government, local communities, higher education, and the private sector to create jobs that create goods and services for use within the state and for export outside the state, which results in the creation of new wealth." SDCL § 1-52-3.2. Pursuant to that charge, the Governor's Office of Economic Development entered into a Letter of Agreement with NSU to provide funding to support the SDIBI. The SDIBI receives primary support from state funds paid to it through NSU's contract with GOED or from some \$100,000 allocated to it annually by NSU. Incidental income from seminars is deposited into accounts held by Northern Plains International Inc., a nonprofit corporation controlled by NSU, and such funds are disbursed to cover expenses that may not be compensable from state fund sources. In addition to its educational activities within the state, the SDIBI promotes export activities through providing trade leads, consulting and maintaining a directory of South Dakota exporters. The SDIBI also pursues foreign direct investment activities in South Dakota.

- 10. Were a court to permit a suit against the SDIBI in its own name and a money judgment were to be entered against the SDIBI, such judgment would be paid out of funds of the State of South Dakota.
- 11. Subsequent to the initiation of these proceedings, Mr. Bollen resigned his position with Northern State University. His resignation became effective on December 21, 2009, and he ceased to be on the payroll on December 31, 2009.
- 12. SDIBI continues to exist as a constituent unit of NSU, and the clerical staff member formerly assigned to the SDIBI has been reassigned to other duties, but will occasionally update a website for GOED. GOED has agreed to reimburse NSU for these incidental expenses, but the contractual services agreement between NSU and GOED relating to the SDIBI will expire on June 30, 2010, and NSU does not presently intend to renew the agreement.

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	13.	Based upon information and belief, Mr. Bollen presently works with SDRC, Inc.
SDRC	, Inc., is	s a for-profit corporation. According to records held by the South Dakota Secretar
of Stat	e, Mr. I	Bollen first filed articles of incorporation for SDRC, Inc., on January 10, 2008. Mi
Bollen	filed a	mended articles on June 1, 2009. True and correct copies of these documents are
attache	ed heret	o as Exhibit 9. The addresses that Mr. Bollen listed for SDRC, Inc., were not
associ	ated wit	th NSU or the SDIBI.

14. SDRC, Inc., has never been a constituent element in NSU or the Board of Regents; the Board of Regents has no contractual relationship with SDRC, Inc., and has never approved any contract between SDRC, Inc., and NSU or the SDIBI.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct. Executed this 23rd day of April, 2010, at Pierre, South Dakota.

Jack R. Warner

DECLARATION OF MARTY J. JACKLEY

I, MARTY J. JACKLEY, declare:

- 1. I have personal knowledge of the facts stated herein and would competently testify thereto under oath if called as a witness.
- 2. I am the Attorney General for the State of South Dakota. I took office on September 4, 2009, succeeding Lawrence E. Long, who had served in the position since 2002 and resigned to accept an appointment to the state circuit court.
- 3. The Attorney General's Office has received information that South Dakota International Business Institute, located at Northern State University in Aberdeen, South Dakota, was established by the South Dakota Board of Regents and, under South Dakota law, the Institute has no independent legal capacity to sue or be sued.
- 4. The attorney general has the duty under SDCL 1-11-1(1) to represent the state in legal proceedings. As such, in order for a person to represent the State of South Dakota in litigation generally requires a legal services contract with the State under SDCL 1-11-15 and an appointment from the attorney general under SDCL 1-11-4 and SDCL 1-11-5. This would apply to representation of the Board of Regents of South Dakota, as well, because the Board is a State agency. The Attorney General's Office maintains records of legal services contracts the State enters into with privately retained counsel as provided by SDCL 1-11-15. I am the custodian of these records. The Attorney General's Office also maintains records of assistant attorney general and special assistant attorney general appointments made during my and former Attorney General Long's tenure as attorney general. An appointment can last no longer than the term of the attorney general. I am the custodian of these records.
- 5. Based upon a review of the records on file with the Attorney General's Office, and conversations with staff who were involved with appointments and legal services contracts under former Attorney General Long, Joop Bollen has never served as a deputy or assistant attorney general for the State of South Dakota. No legal services contract for Joop Bollen to represent the State of South Dakota in a litigation matter has been filed with my office. Mr. Bollen has never been appointed as a special assistant attorney general for the State of South

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Dakota during my or former Attorney General Long's term as attorney general. Mr. Bollen has never been authorized by me, former Attorney General Long, or an authorized representative of either office to accept service of process, defend, or to appear in litigation for, the State of South Dakota.

- 6. Based upon a review of the records on file with the Attorney General's Office, and conversations with staff who were involved with appointments and legal services contracts under former Attorney General Long, no attorney for the Hanul Professional Law Corporation, nor Hanul itself, has ever served as a deputy or assistant attorney general for the State of South Dakota. No legal services contract for Hanul or its attorneys to represent the State of South Dakota in a litigation matter has been filed with my or former Attorney General Long's office. Neither Hanul nor any attorney working for Hanul has ever been appointed as a special assistant attorney general for the State of South Dakota during my term as attorney general. Neither Hanul nor any attorney working for Hanul has ever been authorized by me, former Attorney General Long, or an authorized representative of either office to accept service of process, defend, appear in litigation for, or otherwise represent the State of South Dakota.
- 7. Attached hereto as Exhibit 3 are true and correct copies of contracts between James R. Lynch and the South Dakota Board of Regents to perform legal services in litigation and/or arbitration against Darley International, LLC, and the appointment of Mr. Lynch as a special assistant attorney general to that end.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct. Executed this 22nd day of April, 2010, at Pierre, South Dakota.

Marty J. Jacktey

DECLARATION OF JAMES F. SHEKLETON

I, JAMES F. SHEKLETON, declare:

- 1. I have personal knowledge of the facts stated herein and would competently testify thereto under oath if called as a witness.
- 2. At all times referred to herein, I have been the General Counsel for the South Dakota Board of Regents. I have served in this capacity for nineteen years.
- 3. As the General Counsel, I am advised of and become involved in the handling of all litigation and legal disputes that involve the Board of Regents, the State universities of South Dakota, and their constituent colleges, schools, departments, institutes, and other bodies. I am also intimately familiar with the laws of South Dakota concerning the capacity of the Board of Regents and other State agencies to sue or be sued. I am also familiar with who is authorized to accept service of legal process on behalf of the Board of Regents.
- 4. The South Dakota International Business Institute (SDIBI) is a component of Northern State University (NSU), one of the universities over which the Board of Regents presides. The SDIBI was created by the Board of Regents in 1994. Although the Board of Regents has the legal capacity to sue and be sued, by virtue of section 13-49-11 of the South Dakota Codified Laws, neither NSU nor the SDIBI have been granted such authority by the State of South Dakota or by the Board of Regents.
- 5. At no point did NSU approach me to request that the Board of Regents authorize it to retain Hanul Professional Law Corporation to perform legal services on behalf of it or the SDIBI. Nor was I ever approached by NSU, the SDIBI, or Mr. Bollen with a request to review contracts of any sort related to South Dakota's EB-5 Immigrant Investor Program or to any other SDIBI initiative. Prior to January 27, 2009, I had never heard of Darley International, LLC, or Robert D. Stratmore, much less of any purported involvement by them in activities undertaken under the authority of the Board.
- 6. I first learned that the SDIBI had become involved in litigation and an arbitration with Darley International, LLC, on January 27, 2009, when John Meyer, the campus-based attorney at NSU, contacted me to inform me that he had just learned of this from Joop Bollen,

the SDIBI's Director. The first time that I saw any document in connection with the above-captioned matter was on January 27, 2009, when I first saw a California federal court's order compelling the SDIBI to participate in an arbitration with Darley. I immediately began to find California counsel and first spoke to James Lynch, a former attorney for the California State University system, on January 29, 2009.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct. Executed this 23rd day of April. 2016, at Pierre, South Dakota.

James F. Shekleton

I. JOHN MEYER, declare:

1. I have personal knowledge of the facts stated herein and would competently testify thereto under oath if called as a witness.

DECLARATION OF JOHN MEYER

- 2. At all times referred to herein, I have served as a Professor of Business Law at Northern State University (NSU) in Aberdeen, South Dakota. During the same time, I have also served part-time as a campus-based attorney for NSU. In my role as an NSU attorney, I normally would be aware of, and expect to promptly be notified of, any impending arbitrations or ongoing lawsuits naming NSU or SDIBI as a party.
- 3. The South Dakota International Business Institute (SDIBI) is physically housed at NSU. It and its former Director, Joop Bollen, at all times relevant herein were listed in the NSU directory. True and correct copies of portions of the NSU web site directory listing Mr. Bollen and the SDIBI are attached hereto as Exhibit 5. Mr. Bollen resigned as Director of the SDIBI effective December 21, 2009.
- 4. On January 22 or 23, 2009, Mr. Bollen called me on the telephone and asked me questions about whether someone who was not party to a contract could nevertheless be compelled to arbitrate the contract. On January 23, 2009, he sent me some documents by e-mail that I understood to relate to an arbitration between Hanul Professional Law Corporation and Darley International, LLC, which now also included the SDIBI. He had not previously advised me of any dispute involving these businesses and the SDIBI, or of any arbitration or litigation involving these parties.
- 5. By January 27, 2009, I had reviewed the documents that Mr. Bollen sent to me on the 23rd. I became concerned that this likely had involved litigation and instructed Mr. Bollen to provide me with additional documents. He suggested that I contact Hanul directly, but I insisted that he provide me with whatever he had. Later that day, he brought to me voluminous papers and documents relating to the impending arbitration. Mr. Bollen told me that he had deliberately not brought this dispute to my attention because he had been led to believe by attorneys from Hanul that this was a minor dispute that would be quickly resolved as to the SDIBI's

participation. Upon examining these papers and documents, I immediately discovered that SDIBI had been sued in the U.S. District Court for the Central District of California, having observed a captioned document with a "Filed" stamp on it. It was also apparent that the SDIBI had made an attempt to deny jurisdiction in the matter via a letter sent to Maxwell M. Blecher from Mr. Bollen dated May 7, 2008. An October 7, 2008, order from the federal court was not among the documents that Mr. Bollen provided to me. I did not see that document until several days later, after attorneys for the Board of Regents obtained a fuller set of documents relating to federal case.

- 6. On January 27, 2009, I informed James Shekleton, the Board of Regents' General Counsel, of what Mr. Bollen told me that day and of the apparent fact that the SDIBI had been involved in a lawsuit. Up until that time, I had never heard of Hanul or Darley, or the matters that were part of the federal suit.
- 7. Although I work for NSU, my paychecks are issued on the account of the State of South Dakota.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct. Executed this 23rd day of April, 2010, at Aberdeen, South Dakota.

John Meyer

Post-It* Fax Note 7671	Date 4/23/10 pages > /
To Varies R. Lynch	From John H. Meyer
(388) 144694) BCR	CO. NSU
Phone (2/3) 347-0210	Phone 1 605-626-2521
FAX # (2/3) 347-02/6	Fox # 605-626-3970

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DECLARATION OF JAMES R. LYNCH

I, JAMES R. LYNCH, declare:

- 1. I have personal knowledge of the facts stated herein and would competently testify thereto under oath if called as a witness.
- 2. I am a partner with the firm of Garcia Calderon Ruiz, LLP. Our firm represents the South Dakota Board of Regents. Our firm, and I personally, first became aware of a dispute between Darley International, LLC ("Darley") and the South Dakota International Business Institute (the "SDIBI," a functionary of the Board of Regents) in late January 2008, when James Shekleton, the Board's General Counsel, contacted me. The Board of Regents thereafter retained my firm and the South Dakota Attorney General appointed me as a special assistant attorney general. My appointment and our firm's contracts for legal services (collectively covering the period from January 2009 through June 2010) are attached hereto as Exhibit 3.
- 3. Attached hereto as Exhibit 7 is a true and correct copy of the data I retrieved from the web site of the State Bar of California for Robert D. Stratmore, State Bar No. 52930. The document link is http://members.calbar.ca.gov/search/member_detail.aspx?x=52930. I retrieved this from the web site on August 11, 2009.
- 4. Attached hereto as Exhibit 8 are true and correct copies of the August 22, 2008, Opposition to Darley's petition in federal court to compel arbitration, Hanul Professional Law Corporation's September 30, 2008, request to substitute in as counsel in that action (with what appears to be Joop Bollen's signature as the original "attorney" authorizing the substitution), the minutes of the October 6, 2008, hearing on the petition, and the federal court's dismissal of the petition on June 15, 2009, each of which is part of the case record on file with the U.S. District Court for the Central District of California in Case No. CV08-05034 DDP. The headers at the tops of these documents indicate that each was received as an electronic filing with that court.
- 5. Prior to the federal court's dismissal of the petition in June 2009, the Board of Regents moved that court to vacate its October 2008 order on the grounds that Mr. Bollen and Hanul lacked authority to represent the Board in federal court and that the SDIBI was an arm

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and alter ego of the Board and, by extension, the State of South Dakota. I represented the Board on the motion to vacate and appeared before the Honorable Dean Pregerson at the hearing on the motion on June 8, 2009. The federal court's tentative ruling was in favor of the Board, both in terms of Eleventh Amendment immunity from federal court jurisdiction and the Board's lack of status as a "citizen" within the meaning of diversity of citizenship jurisdiction. However, Darley's Petition in the instant case (at paragraph 33) correctly notes that the federal court was also going to give Darley 60 days to conduct jurisdictional discovery, in case it could establish that the SDIBI was not an arm or alter ego of South Dakota. The federal court never finalized its order, as Darley's counsel asked the federal court to postpone making a final ruling while Darley considered withdrawing the petition. Darley requested dismissal of its federal court petition shortly thereafter.

I declare under penalty of perjury that the foregoing is true and correct. Executed this 23rd day of April, 2010, at Los Angeles, California.

James R. Lynch

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DECLARATION OF JAMES J. PARK

I, JAMES J. PARK, declare:

- 1. I have personal knowledge of the facts stated herein and would competently testify thereto if called as a witness.
- 2. I am a partner with the Hanul Professional Law Corporation ("Hanul"), and served in that capacity at all times referred to herein. My firm is located in Los Angeles,

California. I am licensed to practice law in the State of California.

- 3. In or about July 2007, I began discussing a possible contract between Hanul and Darley International, LLC ("Darley"), for Darley's recruitment of investors in China and other countries for the benefit of the South Dakota International Business Institute ("SDIBI"). Specifically, I spoke with Robert Stratmore, Darley's President. I understand that Mr. Stratmore is also licensed to practice law in the State of California.
- 4. The agreement between Darley and Hanul was executed in October 2007. Si Il Jang, a partner for Hanul, executed the agreement on behalf of Hanul. However, I was the person who negotiated the terms of the agreement with Mr. Stratmore. I forwarded the executed agreement to Mr. Stratmore on October 18, 2007.
- 5. Although the agreement confers certain "exclusive" rights upon Darley, throughout my negotiations I advised Mr. Stratmore that Hanul did not have a written agreement with the SDIBI and therefore actually characterized the "exclusive" rights we were discussing as "unofficial." I also let Mr. Stratmore know that the SDIBI was a functionary of the State of South Dakota and that we were avoiding normal State procedures to obtain "official" exclusivity rights. By correspondence on October 4, 2007, to Mr. Stratmore, I also specifically addressed these issues in writing, in response to questions he had posed to me on or about October 1, 2007,

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via e-mail.	Attached hereto as Exhibit 6 is a true and correct copy of the October 4, 20	07,
correspond	lence that I sent to Mr. Stratmore via e-mail.	

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct. Executed this 11th day of August, 2009, at Los Angeles, California.

James J. Park

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DECLARATION OF JOOP BOLLEN

I, JOOP BOLLEN, declare:

- 1. I have personal knowledge of the facts stated herein and would competently testify thereto under oath if called as a witness.
- At all times referred to herein, I have served in the capacity of Director of the 2. South Dakota International Business Institute (SDIBI). The SDIBI is part of Northern State University (NSU) and the South Dakota Board of Regents system and has no independent status of its own. SDIBI's purpose is to promote international exports, trade, and investments on behalf of the State of South Dakota. SDIBI's funding comes entirely from the State, primarily from NSU and contracts from the Governor's Office of Economic Development and the South Dakota Department of Tourism and Development.
- 3. I am not and never have been an attorney. I am not admitted to practice law in any state in the United States, nor have I ever been a member of the bar of any court.
- 4. The SDIBI has no offices or employees in the State of California, nor does it maintain bank accounts, own or possess real or personal property, or carry on any operation in the State of California. In July 2007 through January 2008, I was involved in some written and telephone communications with James Park of Hanul Professional Law Corporation (Hanul) and Robert Stratmore of Darley International, LLC (Darley) relating to an agreement between Hanul and Darley to conduct investor recruitment activities in China for the benefit of the SDIBI's EB-5 Program, more particularly a Tilapia Fish Farm project. At the times of my communications with Mr. Park, he was in Hanul's Seoul, South Korea office.
- 5. In late 2007, with Mr. Park's and Mr. Stratmore's consent, I cancelled the Tilapia project. In the early part of 2008, Darley made an arbitration demand upon the SDIBI on the basis of an arbitration clause in the agreement between Darley and Hanul. Mr. Stratmore was claiming a breach of the agreement owing to not receiving proper documents related to the Tilapia project. I ignored the demand as the SDIBI was not a party to the contract between Hanul and Darley and that the demand was simply an effort by Darley to involve the SDIBI in the dispute between Darley and Hanul. Since the SDIBI was not a party to that contract, and

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based upon my general familiarity with international business practices, I could see no basis for believing that Darley had any ability to bring the SDIBI into this dispute. I thought that Darley was trying to get the SDIBI to become voluntarily involved in an arbitration dispute that did not concern it, and I sought to avoid that gambit by refusing to cooperate.

- 6. I recall that in August 2008, the dispute escalated to the point that Darley initiated a federal court proceeding in California. Mr. Park and/or Peter Lee of Hanul assured me that Hanul would take care of the matter and expressed the opinion that it would be easily resolved. I confess to not paying close attention to the details and timing with respect to this matter; I generally forwarded e-mails on this matter to my assistant, Cherri Brick, without reading them or their attachments. I relied exclusively upon attorneys from Hanul to deal with this. I do not recall experiencing any change in my thinking about this matter even after a federal court issued an Order in October 2008 because I assumed that Hanul would dispose of the matter insofar as the SDIBI's involvement was concerned.
- 7. On December 1, 2008, Mr. Lee sent me an e-mail informing me that a mediation matter was scheduled with "JAMS" on December 12, 2008, to which he attached a copy of a letter from JAMS relating to the same. A true and correct copy of the JAMS letter is attached hereto as Exhibit 4. I did not attend the mediation, as I continued to believe that Hanul would resolve this matter short of any real participation by the SDIBI.
- 8. Throughout 2008 and until January 23, 2009, I did not inform John Meyer, the NSU attorney, of the agreement between Hanul and Darley or of the subsequent dispute over the agreement. I believed and was reassured that no liability beyond participating as a witness would exist for the SDIBI in the worst case scenario. I thought that I could resolve this matter through Hanul, without having to bring Mr. Meyer or other South Dakota attorneys into it. For the same reasons, I did not inform anyone else in authority at NSU or at the Board of Regent's offices about the situation. Around January 22 or 23, 2009, Mr. Kim, upon questioning by myself, stated that a financial liability for the SDIBI could exist, after which I immediately contacted Mr. Meyer.

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- 9. On January 22 or 23, 2009, I spoke to Mr. Meyer by telephone and on January 23 sent some documents to him by e-mail, inquiring about whether someone who was not party to a contract could be compelled to participate in arbitration under that contract. I told him of the situation in which the SDIBI had been brought into the arbitration between Darley and Hanul. However, I did not inform him at that time there had been a lawsuit, as I was unaware there was one, nor did I send him any captioned documents from the Darley federal notification. On January 27, 2009, in response to a request from Mr. Meyers for additional documents relating to the arbitration, I suggested that he contact Hanul directly, but he instructed me to send him any documents that I had. I subsequently provided Mr. Meyer with all documents related to the Darley-Hanul dispute that I had printed out from e-mails from Hanul and met with him in person on January 27, 2009. These documents did not include the federal court's October 7, 2008, order.
- Although I work for the SDIBI, my paychecks are issued on the account of the
 State of South Dakota.
- 11. The SDIBI does not have any offices in California, nor does it have any employees who work in California. The SDIBI does not maintain bank accounts in California, does not pay income taxes in California, and does not own any personal or real property in California.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct. Executed this 11th day of August, 2009, at Aberdeen, South Dakota.

Joop Bollon

Management Information Systems on Inactive Status. He said the four actively enrolled students in the program are expected to graduate by August 1994, and no new students would be admitted to the program while it is on inactive status. Dr. Hillman said that USD plans to review the program in September of 1994 to determine if it should be reactivated.

IT WAS MOVED by Regent Wegner, seconded by Regent Lebrun to approve the USD request to place the Master of Science in Management Information Systems on inactive status effective March 5, 1994. All members voting AYE. The MOTION CARRIED. A copy of the request can be found on pages 225 to 228 of the official minutes.

NSU SOUTH DAKOTA INTERNATIONAL BUSINESS INSTITUTE

Dr. Hillman said that Northern State University has submitted a proposal for the South Dakota International Business Institute which replaces the existing International Business Center. He said that the Academic Affairs Council has discussed the proposal, and noted that they feel there is a need to develop more subjective criteria for the designation of "Institute" or "Center". Dr. Hillman stated that funding for the Institute is derived from some GOED sponsorship funds, and some student tuition.

Dr. Hutchinson stated that several years ago the campuses received a sum of money for the program through a grant from the Governor's Office of Economic Development. He added that it has been operating from those moneys, and they also receive some funds from offering workshops, seminars and conferences.

IF WAS MOVED by Regent Olsen, seconded by Regent Ritter to approve the NSU International Business Institute, which is also reflected in BOR Policy 1:10:6. All members voting AYE. The MOTION CARRIED. A copy of the proposal can be found on pages 999 to 1004 of the sofficial minutes.

CHANGES OR MODIFICATIONS IN PROGRAMS

Pit Hillman said the Academic Affairs Council and the Council of Presidents and Superintendents have reviewed and support the recommended changes or modifications to existing programs which includes the deletion of 20 majors, minors or options.

WAS MOVED by Regent Gienapp, seconded by Regent Olsen to approve the changes or productions in programs as submitted by BHSU, DSU, NSU, SDSU, and USD. All members of the MOTION CARRIED. A copy of background information can be found on PRS 1005 to 1057 of the official minutes.

VIEWASTER'S PROGRAM

Providinan stated that the Board approved the curriculum and degree requirements of the Populative MSEd in Vocational Technical Education requested by SDSU and DSU in October,

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SOUTH DAKOTA BOARD OF REGENTS

Full Board

AGENDA ITEM: R - 3

DATE: May 5-6, 1994

SUBJECT: NSU South Dakota International Business Institute

Attached is a proposed charter for the South Dakota International Business Institute that has been submitted by Northern State University. This is a revision of the existing international Business Center. The Academic Affairs Council and the Council of Presidents and Superintendents have reviewed this request and support it.

Also attached is a copy of BOR Policy 1:10:6, Northern State University Mission patement, which reflects this change.

RECOMMENDED ACTION OF THE EXECUTIVE DIRECTOR

Prove the NSU International Business Institute.

Northern State University Proposal for Authorization of the South Dakota International Business Institute

Introduction:

Northern State University has a long-standing relationship with the Governor's Office of Economic Development (GOED), the South Dakota Department of Agriculture, and other state and federal agencies that further economic development and promote international business for South Dakota. Though these associations have existed informally, a need exists to more clearly define these relationships in order to better serve the meeds of South Dakota.

the global society becomes more of a reality in the business of the institutions of South Dakota must evolve to meet the ampetition of tomorrow without exceeding the budgets of today. Economically, the South Dakota International Business Institute to formalize these relationships and to embody the service esistance needed.

Mission:

Je South Dakota International Business Institute will support to agencies and other organizations in their efforts to work the economic climate in South Dakota by increasing Walketional business activity leading ultimately to specify for our warens.

PACLIVES:

Confectives of the South Dakota International Business Lute include the following:

Provide continuing education opportunities in international business through workshops, seminars, and conferences.

Provide confidential consultation to South Dakota D

- o Provide consultation and support to GOED in creating international trade zone in South Dakota.
- o Provide South Dakota businesses with indepth knowledge of the international business climate and procedures
- o Provide a 24 hour per day state-wide bulletin board service via modem, and potentially internet to disseminate information at no cost to businesses throughout South Dakota.
- o Provide South Dakota businesses with alternatives and recommendations regarding specific international projects.
- o Provide students with practical experience by giving them an opportunity to solve, in team format, real international business problems.
- o Provide students with the opportunity to serve internships in organizations that are involved in international business, such as GOED, regional businesses, etc.
- o Provide faculty with the opportunity to work close with South Dakota businesses interested in international trade and to provide educational supprequired by these businesses.
- o Provide the faculty an opportunity to work with international business students and to conduct tead related research.
- o Provide a means to improve and expand international business programs at all South Dakota educational institutes including K 12, vocational, private regental institutions.
- o Provide for the development of international busing relationship among all regental institutions and foreign educational institutions.

Operations:

The Director of International Business operates the Institute under the guidance of the Dean of the School of Business director has a responsibility to achieve the objectives of Institute and fulfill its mission. To assist the director secretary provides administrative support 20 hours per week.

racilities:
The International Business Institute occupies offices in Lincoln Hall on the Northern State University campus with access to the facilities and personnel of the university.

Cost Estimates:

\$38,000 2,500 6,000 7,500 \$54,000 Salary Travel Student Labor OSM Total

It is expected that international business workshops, seminars, and conferences will be revenue generating activities.

SOUTH DAKOTA BOARD OF REGENTS

Policy Manual

SUBJECT: Northern State University Mission Statement

NUMBER: 1:10:6

The role of Northern State University is that of a liberal arts university providing programs in the arts and sciences, education, business, and the fine arts with special emphasis on the preparation of students for careers in business and education. Complementing these programs are pre-professional, one and two-year terminal, and junior college programs in fulfillment of its responsibility for college transfer programs in northeastern South Dakota. Degrees are authorized at the associate, baccalaureate, and masters level.

The following curriculum is approved for the University:

- A. Baccalaureate programs in the arts and sciences, fine arts, business, technology and education; associate degree programs in business, commercial art, orimin justice studies, general studies, industrial technology, office administration associal services and pre-professional programs (one- and two-year) in the architecture, pre-chiropractic, pre-engineering, pre-journalism, and pre-mortals.
- B. Masters programs in education.
- C. Research, creative activity, and scholarship, as activities incumbent to university community, are an integral part of the task of the faculty. Slices role of the university is primarily teaching, the central focus of research support of teaching, including primary research in areas related to profession preparation, and the fulfillment of the institution's service function.
- D. With other campuses in the Regental System, Northern State University will responsibility for continuing education and public service consistent will programmatic authorizations in A and B above by acting as a resolute region.

Northern State University Mission Statement Page 1 of 2 Services through the following approved centers and organizational units:

International Business Center
Small Business Institute
Environmental Education Center
Reading Center
Writing Center
Wathematics Center
Elementary and Secondary Science Teaching Center
South Center International Pusiness Institute

WRCE: BOR, March 21-22, 1991

University Mission Statement

1:10:6

1004

CONSENT CALENDAR

IT WAS MOVED by Regent Morris, seconded by Regent Nef to adopt the items on the consent calendar with the exception of item #X-7 Higher Education Facilities Fund. All members voting AYE. The MOTION CARRIED.

The following items were adopted:

The University Mission Statement Policy Revisions

A copy of the Mission Statements can be found on pages 3632 to 3650 of the official minutes.

BOR Policy 2:4 Registration

A copy of the Registration policy can be found on pages 3651 to 3652 of the official minutes.

BOR Policy 2:5 Transfer of Credit

The Transfer of Credit policy can be found on pages 3653 to 3664 of the official minutes.

BOR Policy 2:6 Academic Calendar

The Academic Calendar policy can be found on pages 3665 to 3669 of the official minutes.

BOR Policy 2:10 Grades and Use of Grade Point Averages

A copy of Policy 2:10 can be found on pages 3670 to 3676 of the official minutes.

BOR Policy 2:23 Certificate Programs and Certificates of Recognition

A copy of Policy 2:23 can be found on pages 3677 to 3678 of the official minutes.

BOR Policy 6:3 Higher Education Facilities Fund

Regent Jewett said that in the past years, the Board has tried to maintain an unobligated cash balance in the HEFF account of at least \$1.0M In discussions about the next ten-year capital plan and in looking at the HEFF cash flows, the question arose about a reserve requirement. Several Regents have indicated an interest in raising the cash balance to \$2.0M

IT WAS MOVED by Regent Nef, seconded by Regent Venhuizen to approve the policy as written, leaving the unobligated cash balance at \$1.0M.

Mr. Kramer indicated that the Board has the prerogative if there were to be a cash drop or if we were to lose a building, to take money out of the M&R allocation. The statute only states

3002



SOUTH DAKOTA BOARD OF REGENTS

Full Board

AGENDA ITEM

DATE: December 9:16

SUBJECT: University Mission Statement Policy Revisions

In May 2002, the Board approved a revised mission statement format that following mission and removed the listing of programs, centers, and public services. As part revision, an institutional profile statement is to be developed that includes a more explanation of university purpose as well as sections on scholarship, public service, con education, and off-campus delivery. The institutional profile statement is to be posted university web site by the end of May 2004.

The revised mission statements for each University are included in the attached files

- Attachment I BOR Policy 1:10:1 University of South Dakota
- Attachment II BOR Policy 1:10:2 South Dakota State University
- Attachment III BOR Policy 1:10:3 South Dakota School of Mines and Technol.
- Attachment IV BOR Policy 1:10:4 Black Hills State University
- Attachment V BOR Policy 1:10:5 Dakota State University
- Attachment VI BOR Policy 1:10:6 Northern State University

RECOMMENDED ACTION OF THE EXECUTIVE DIRECTOR

Approve the revisions to BOR policies, 1:10:1 USD Mission Statement, 1:10:3 South Dakota School of Mines and Technology Mission 1:10:4 Black Hills State University Mission Statement, 1:10:5 Dakota State University Statement, and 1:10:6 Northern State University Mission Statement.

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SOUTH DAKOTA BOARD OF REGENTS

Policy Manual

SUBJECT: Northern State University Mission Statement

NUMBER: 1:10:6

The legislature established Northern State University to meet the needs of the State, the region, and patient by providing undergraduate and graduate programs, in, education and other courses or programs as the Board of Regents may determine (SDCL, 13-59-1)

The Board implemented SDCL_13-59-1 by authorizing graduate and undergraduate programs in cluention to promote excellence in teaching and learning to support research, scholarly and freative activities, and to provide service to the State of South Dakota, the region, and the outlon, The Board approved a special emphasis on E-learning in the university carriculum and service.

Northern State University is a multi-purpose, regional institution of higher education, authorized for the people of South Dakota by the South Dakota Legislature. Founded as a normal and industrial ideactive serve the northern part of the state, The University has diversified its offerings to address the energing needs of the statents, community, and region. Teacher preparation remains an important feature of the institutional mission, as do programs in the arts and sciences, business, and me arts. Through undergraduate and graduate programs, the university provides quality teaching and featuring. Distance delivery technology is a core mission in all degree programs, especially all coils of teacher preparation. Offering students a breadth and depth in the liberal arts and in notessional studies, the university develops effective and productive professionals and citizens traffic, the university creates and mutures a community of students, faculty, and staff, supporting purpose the university creates and mutures a community of students, faculty, and staff, supporting purpose the university research, and professional growth. Northern State University and accommunity if the programs to meet academic, social, cultural, and economic needs of the community of aca, providing lifelong learning opportunities, a center for the arts and recreation, and support

Discipllowing curriculum is approved for Northern State University:

harrey are authorized at the associate, baccalaureate, and masters levels.

It following curriculum is approved for the university

Undergraduate Programs

Tre-professional one- and two-year terminal and junior college degree-programs in the arts and sciences, fine arts, business-rechnology, and education:

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Associate degree programs in arts and sciences, business, education and fine arts

Baccalaureate degree programs in arts and sciences, business, education, technology a fine arts. Northern State University enjoys unique authorization to offer a bachelor's degree in international business.

B. Graduate Programs

Masters degrees in education and E-learning.

- Master of Science in Education degrees in E-learning Design and Instruction, Guidan Counseling, Leadership and Administration, and Teaching and Learning:
- Master of Science degree in E-learning Technology and Administration.

C. Scholarship

Scholarly and creative activities are conducted in all authorized disciplines consistent the academic purposes of the institution.

D. Public Service

Services are offered through the following approved centers and organizational units

Dakota International Business Center; Small Business Institute; Professional Beyold
School; Environmental Education Center; Reading, Writing, and Mathematics of
Elementary and Secondary Science Teaching Center; University Speech and Meaning
Northern State University Press; University Art Galleries, Center for Statewide Brown

E. Continuing Education

Continuing education opportunities, outreach, and public service to the state, regretand internationally in concert with the approved programmatic authorization listers.

F. Off-Campus Delivery

Off-campus delivery is provided throughout the state in designated particularly through the Capital University Center in Pierre. An emphasis computer delivery has enhanced the sites and numbers of students servicements delivery.

SOURCE: BOR, March 1991; BOR, May 1994; Access to Quality, May 1996; BOR, 2001; BOR, December 2003.

Northern State University Mission Statement

Office of Attorney General State of South Dakota

I, Larry Long, Attorney General of the State of South Dakota, do hereby appoint JAMES R. LYNCH of Los Angeles, California, to represent the

Board of Regents in legal matters involving the South Dakota International	ıl
Business Institute, Northern State University and the South Dakot	
Department of Tourism and State Development concerning Darle	У
International, LLC; to serve at the will of the Attorney General.	
Dated this day of February, 2009.	
mund h	
Larry/Long ()	
Attorney General	
State of California)	
; SS	
County of Los Angeles)	
I, James R. Lynch, having been appointed as a Special Assistant Attorne	
General for the State of South Dakota, do solemnly swear that I will support	
the Constitution of the United States and the Constitution of the State of	
South Dakota, and that I will faithfully and impartially discharge the duties of	
such office, and render a true account of all money, accounts, credits an	d
property of any kind that shall come into my hands as such office and pay over	3T
and deliver the same according to law.	
James R. Lynch	
Subscribed and sworn to before me, a notary public, this 6 day of	
February, 2009.	
Carolin Don	
Notary public/California	
Wy commission expires:	
CAROLYN DOMINGUEZ	

Comm. Expires Oct. 22, 2011

AGREEMENT FOR LEGAL SERVICES BETWEEN THE SOUTH DAKOTA BOARD OF REGENTS STATE OF SOUTH DAKOTA, AND

James R. Lynch of Garcia Calderon Ruiz, LLP

The South Dakota Board of Regents, hereinafter BOARD OF REGENTS and James R. Lynch of Garcia Calderon Ruiz, LLP, hereinafter James R. Lynch, hereby agree that BOARD OF REGENTS will receive legal advice and representation as provided in this Agreement.

Section I. Scope of Work:

James R. Lynch agrees to provide legal services and represent BOARD OF REGENTS to defend the South Dakota International Business Institute, Northern State University and the South Dakota Department of Tourism and State Development in court or arbitration proceedings brought by Darley International, LLC, against the South Dakota International Business Institute and the Hanul Professional Law Corporation.

Section II. Payment Provisions:

It is hereby agreed that, in consideration of fulfillment of the terms of this Agreement, BOARD OF REGENTS shall pay James R. Lynch, within thirty (30) days of receipt of acceptable invoices, subject to ordinary State of South Dakota voucher clearance requirements, an amount equal to the number of hours billed times an hourly rate not to exceed three hundred dollars \$300.00. The total amount expended under this contract shall not exceed \$30,000.00.

Expenses for travel, meals and lodging incurred by James R. Lynch on behalf of BOARD OF REGENTS shall be reimbursed, upon submission of a complete listing of all expenses actually incurred in the performance of this Agreement.

Section III. Independent Contractor:

While performing the services hereunder, James R. Lynch is acting as an independent contractor and not as an officer, agent or employee of BOARD OF REGENTS or of the State of South Dakota.

Section IV. Hold Harmless and Indomnification:

James R. Lynch agrees to indemnify and hold the State of South Dakota, its officers, agents and employees, harmless from and against any and all actions, suits, damages, liability or other proceedings which may arise as the result of performing services hereunder. This section does not require James R. Lynch to be responsible for or defend against claims or damages arising from the errors or omissions of the State, its officers, agents or employees or from the errors or omissions of third parties that are not officers, employees or agents of the James R. Lynch, unless such errors or omissions resulted from the acts or omissions of James R. Lynch. Nothing in this agreement is intended to impair the insurance coverage of James R. Lynch or any subrogation rights of James R. Lynch insurers.

Section V. Insurance:

James R. Lynch hereby agrees to maintain during the term of this Agreement appropriate and adequate insurance coverage including general liability, automobile liability and professional liability insurance and shall provide BOARD OF REGENTS with evidence thereof upon request.

Section VI. Limitations Upon Legal Representation:

It is agreed and acknowledged by James R. Lynch that in order for James R. Lynch to represent the State of South Dakota or the interests of BOARD OF REGENTS in any court of law, he or any substitute counsel must receive an appointment as an Assistant Attorney General from the Attorney General of the State.

Section VII. Term of the Agreement:

The term of this Agreement shall commence on July 1, 2009 and shall remain in effect through June 30, 2010.

Section VIII. Termination:

This Agreement may be terminated by either party hereto upon thirty (30) days written notice.

Section IX. Default Provision:

This Agreement depends upon the continued availability of appropriated funds and expenditure authority from the Legislature for this purpose. This Agreement will be terminated by the State if the Legislature fails to appropriate funds or grant expenditure authority. Termination for this reason is not a default by the State nor does it give rise to a claim against the State.

Section X. Amendment:

The provisions in this Agreement may only be altered, modified or changed by written amendment hereto subject to the same approval requirements as in this Agreement.

Section XI. Agreement Not Assignable:

This Agreement is not assignable by James R. Lynch either in whole or in part, without the written consent of BOARD OF REGENTS.

Section XII Payments Include All Taxes:

Payments made to James R. Lynch as specified herein shall be deemed to include all taxes of any description, federal, state or municipal assessed against James R. Lynch by reason of this Agreement.

Section XIII South Dakota Law Controlling:

It is expressly understood and agreed by the parties hereto that this Agreement shall be governed by the laws of the State of South Dakota both as to interpretation and performance.

Section XIV Conflict of Interest:

James R. Lynch agrees not to participate as Counsel, in person or his law firm, in opposition to the interests of the State of South Dakota or any of its departments, bureaus, boards or commissions consistent with the policy attached hereto and labeled Exhibit A.

FOR S	SOUT	H DA	KOTA
BOAF	RD OF	REG	ENTS:

JAMES R. LYNCH OF GARCIA CALDERON RUIZ, LLP

(Jack Warner, Executive Director and CEO) (James R. Lynch)

Dated: 8/3/69

Dated: 7/28/09

FOR NORTHERN STATE UNIVERSITY:

SOUTH DAKOTA OFFICE OF THE ATTORNEY GENERAL:

Dated: 8/11/09

The foregoing Agreement is hereby approved as to form.

Approved as to Form Larry Long

LOOPK AAC

Larry Long

Attorney General

Dated: 8/11/09

AGREEMENT FOR LEGAL SERVICES

BETWEEN THE SOUTH DAKOTA BOARD OF REGENTS

STATE OF SOUTH DAKOTA, AND

James R. Lynch of Garcia Calderon Ruiz, LLP

AMENDMENT 1 TO CONTRACT

This Amendment 1 is made and entered into between the parties this 3 day of 2009 and amends a February 4, 2009 State of South Dakota Legal Services Contract ("Agreement") by and between The South Dakota Board of Regents, hereinafter BOARD OF REGENTS and James R. Lynch of Garcia Calderon Ruiz, LLP, hereinafter (Consultant).

The parties hereby agree that the Agreement shall be amended as follows:

1. That Section II. be amended as follows to increase the total contract amount by \$30,000:

Section II. Payment Provisions:

It is hereby agreed that, in consideration of fulfillment of the terms of this Agreement, BOARD OF REGENTS shall pay James R. Lynch, within thirty (30) days of receipt of acceptable invoices, subject to ordinary State of South Dakota voucher clearance requirements, an amount equal to the number of hours billed times an hourly rate not to exceed three hundred dollars (\$300.00). The total amount expended under this contract shall not exceed (\$50,000.00).

Expenses for travel, meals and lodging incurred by James R. Lynch on behalf of BOARD OF REGENTS shall be reimbursed, upon submission of a complete listing of all expenses actually incurred.

- 2. The amendments set forth above are effective (upon execution or as of 1/2009).
- 3. All other terms and conditions of the Agreement and all addendums thereto shall remain as originally written.
- 4. Upon execution this Amendment will be attached to the Agreement and made part therein

In Witness Whereof, the parties signify their agreement by the signatures affixed below.

BOARD OF REGENTS:

GARCIA CALDERON RUIZ, LLP

Lames R. Lynch

Dated: 7/28/19

FOR NORTHERN STATE UNIVERSITY:

John Meyer

Dated: 8/0/09

SOUTH DAKOTA OFFICE OF

THE ATTORNEY GENERAL:

Approved as to Form
Larry Long

Larry Long

Approved as to Form
Larry Long

Approved as to Form
Larry Long

The ATTORNEY GENERAL:

JAMES R. LYNCH OF

FOR SOUTH DAKOTA

Jeffrey P. Hallem

8/10/09

POLICY CONCERNING CONFLICTS OF INTEREST

This policy is adopted to address the issue of potential conflicts of interest with regard to the State of South Dakota and attorneys contracting with the State of South Dakota ("State") to perform legal services. This policy will be attached as an addendum to any contract for legal services entered into between the State and any attorney contracting to perform those legal services and shall become a part of that contract.

Α. Except as provided in paragraph B of this policy, if an attorney contracting to perform legal services with the State has a pending claim against the State or its employees on behalf of a client; or in the event an attorney with an existing contract for legal services with the State is approached by a client seeking to file a lawsuit against the State or its employees, the contracting attorney shall notify the Attorney General and the manager of the state PEPL Fund in writing of that conflict of interest prior to the time a contract is signed or prior to undertaking representation of the adverse client. The Attorney General shall personally decide within ten working days whether or not the State will waive any conflict of interest created by that claim. The Attorney General will consider the magnitude of the claim against the State, the appearance of impropriety which could adversely affect the interests of the State, the degree, if any, to which the contracting attorney has or will gain access to information which would give him an undue advantage in representing a client whose interests are adverse to the State, whether the department or agency against which the claim is made is also a department or agency that will be represented by the contracting attorney, and any other factor which the Attorney General may deem pertinent in his discretion.

Notification of the Attorney General under this paragraph, prior to the commencement of an action is not required if the contracting attorney is approached by a client to commence an action against the State and the contracting attorney has a good faith belief that absent immediately filing, the action would be barred by a statute of limitations or comparable provision. Under

these circumstances, the contracting attorney shall, as soon as practical, contact the Attorney General regarding the conflict and agrees that if the conflict of interest is not waived, to withdraw from representing the client in the pending action.

- B. Any conflict of interest which may be created by the following situations will automatically be deemed to be waived by the Attorney General and will not be subject to the notification requirements of this policy statement:
 - 1. Any action where the contracting attorney represents a codefendant with the State in a claim or lawsuit, regardless of any cross-claim or third-party claim which the State and the attorney's non-State client may have against each other; unless the cross-claim or third-party claim was readily apparent at the time of contracting with the non-State client and seeks significant monetary consequences; the cross-claim is against a state agency which the contracting attorney represents; or by virtue of representation of the State under contract the attorney had access to information which would give the non-State client an unfair advantage.
 - 2. Any condemnation action in which the contracting attorney represents a condemnee.
 - 3. Any administrative licensing proceeding in which the contracting attorney appears representing a client, regardless of the fact that the client may make a claim which would be adverse to a position taken by a department or agency of state government; <u>unless</u> the claims, if successful, will have significant monetary consequences to the State; or by virtue of representation of the State under contract the contracting attorney had access to information which would give the non-State client an unfair advantage.
 - 4. Any administrative proceeding before the Department of Revenue in which the contracting attorney's client may have a claim which would create a potential liability for the State of South Dakota; <u>unless</u> the claim, if successful, will have significant monetary consequences to the State; or by virtue of representation of the State under contract the contracting attorney had access to information which would give the non-State client an unfair advantage.
 - 5. Any bankruptcy proceeding in which the contracting attorney represents a client other than the State of South Dakota and in which the State of South Dakota has a secured or unsecured claim.

- 6. Any activity relating to the negotiation of a contract with the State of South Dakota and another client represented by the contracting attorney; unless the contracting attorney is actively representing the department or agency of state government with which the contract is being negotiated; or by virtue of representation of the State under contract the contracting attorney had access to information which would give the non-State client an unfair advantage.
- 7. The defense of any criminal action; <u>unless</u> the attorney has an existing contract as a special prosecutor in criminal actions for the State of South Dakota; or if, in representation of the State under contract, the contracting attorney had access to information which would give the non-State client an unfair advantage in the criminal action.
- 8. Any small claims action in which the contracting attorney represents any plaintiff or defendant with interests adverse to those of the State.
- 9. Any action brought through representation under a long-term contract or appointment of any other governmental entity, whether or not governmental entity has interests that are adverse to those of the State; unless the claim, if successful, will have significant monetary consequences against the State of South Dakota.
- 10. Any action in which the State is a named party but has only a nominal interest, as in mortgage foreclosures and quiet title actions.
- 11. Any lobbying activity by the contracting attorney
- 12. Any worker's compensation case in which the contracting attorney represents a claimant; <u>unless</u> the contracting attorney represents the South Dakota Department of Labor in matters relating to worker's compensation claims or benefits.
- C. The Attorney General reserves the right to raise a conflict of interest, notwithstanding the automatic waiver provisions of paragraph B of this policy, where a conflict of interest covered by the South Dakota Rules of Professional Conduct exists and in the discretion of the Attorney General, is it determined to be in the State's best interest to raise the conflict. The Attorney General shall notify the contracting attorney of the existence of the conflict and the delineation of

waiver within seven days of the Attorney General's actual notice of the contracting attorney's action against the State.

- D. For purposes of this policy: 1) the term "c ontracting attorney" means the attorney actually signing the agreement and his entire law firm; 2) the term "State" means the State of South Dakota and any branch, constitutional office, department, agency, institution, board, commission, authority, or other entity by state government; and 3) the term "significant monetary consequences" means that the suit, claim, action or other proceeding against the State, if successful, could reasonably result in the State making payments to the contracting attorney, the client or the class the client represents in excess of \$50,000 or in the case of the proceeding against the Department of Revenue, or other state taxing entity payments or lost revenue in excess of \$50,000.
- E. This guideline shall not be construed as altering or reducing an attorney's obligations to his client under the South Dakota Rules of Professional Conduct specifically stated herein.

AGREEMENT FOR LEGAL SERVICES BETWEEN THE SOUTH DAKOTA BOARD OF REGENTS STATE OF SOUTH DAKOTA, AND James R. Lynch of Garcia Calderon Ruiz, LLP

The South Dakota Board of Regents, hereinafter BOARD OF REGENTS and James R. Lynch of Garcia Calderon Ruiz, LLP, hereinafter James R. Lynch, hereby agree that BOARD OF REGENTS will receive legal advice and representation as provided in this Agreement.

Section I. Scope of Work:

James R. Lynch agrees to provide legal services and represent BOARD OF REGENTS to defend the South Dakota International Business Institute, Northern State University and the South Dakota Department of Tourism and State Development in court or arbitration proceedings brought by Darley International, LLC, against the South Dakota International Business Institute and the Hanul Professional Law Corporation.

Section II. Payment Provisions:

It is hereby agreed that, in consideration of fulfillment of the terms of this Agreement, BOARD OF REGENTS shall pay James R. Lynch, within thirty (30) days of receipt of acceptable invoices, subject to ordinary State of South Dakota voucher clearance requirements, an amount equal to the number of hours billed times an hourly rate not to exceed three hundred dollars (\$300.00). The total amount expended under this contract shall not exceed (\$20,000.00).

Expenses for travel, meals and lodging incurred by James R. Lynch on behalf of BOARD OF REGENTS shall be reimbursed, upon submission of a complete listing of all expenses actually incurred in the performance of this Agreement.

Section III. Independent Contractor:

While performing the services hereunder, James R. Lynch is acting as an independent contractor and not as an officer, agent or employee of BOARD OF REGENTS or of the State of South Dakota.

Section IV. Hold Harmless and Indemnification:

James R. Lynch agrees to indemnify and hold the State of South Dakota, its officers, agents and employees, harmless from and against any and all actions, suits, damages, liability or other proceedings which may arise as the result of performing services hereunder. This section does not require James R. Lynch to be responsible for or defend against claims or damages arising from the errors or omissions of the State, its officers, agents or employees or from the errors or omissions of third parties that are not officers, employees or agents of the James R. Lynch, unless such errors or omissions resulted from the acts or omissions of James R. Lynch. Nothing in this agreement is intended to impair the insurance coverage of James R. Lynch or any subrogation rights of James R. Lynch insurers.

Section V. Insurance:

James R. Lynch hereby agrees to maintain during the term of this Agreement appropriate and adequate insurance coverage including general liability, automobile liability and professional liability insurance and shall provide BOARD OF REGENTS with evidence thereof upon request.

Section VI. Limitations Upon Legal Representation:

It is agreed and acknowledged by James R. Lynch that in order for James R. Lynch to represent the State of South Dakota or the interests of BOARD OF REGENTS in any court of law, he or any substitute counsel must receive an appointment as an Assistant Attorney General from the Attorney General of the State.

Section VII. Term of the Agreement:

The term of this Agreement shall commence on January 30, 2009 and shall remain in effect through June 30, 2009.

Section VIII. Termination:

This Agreement may be terminated by either party hereto upon thirty (30) days written notice.

Section IX. Default Provision:

This Agreement depends upon the continued availability of appropriated funds and expenditure authority from the Legislature for this purpose. This Agreement will be terminated by the State if the Legislature fails to appropriate funds or grant expenditure authority. Termination for this reason is not a default by the State nor does it give rise to a claim against the State.

Section X. Amendment:

The provisions in this Agreement may only be altered, modified or changed by written amendment hereto subject to the same approval requirements as in this Agreement.

Section XI. Agreement Not Assignable:

This Agreement is not assignable by James R. Lynch either in whole or in part, without the written consent of BOARD OF REGENTS.

Section XII Payments Include All Taxes:

Payments made to James R. Lynch as specified herein shall be deemed to include all taxes of any description, federal, state or municipal assessed against James R. Lynch by reason of this Agreement.

Section XIII South Dakota Law Controlling:

It is expressly understood and agreed by the parties hereto that this Agreement shall be governed by the laws of the State of South Dakota both as to interpretation and performance.

Fax:

Feb 4 2009 10:30am P002/002

Section XIV Confilet of Interest:

James R. Lynch agrees not to participate as Counsel, in person or his law firm, in opposition to the interests of the State of South Dekota or any of its departments, bureaus, boards or commissions consistent with the policy attached hereto and lebeled Exhibit A.

FOR SOUTH DAKOTA BOARD OF REGENTS:	JAMES R. LYNCH OF GARCIA CALDERON RUIZ, LLP
1	//h
Robert T. Perry	James Rollynch
Daled: 2/4/09	Dated: 2/3/09
FOR NORTHERN STATE UNIVERSITY:	
John Meyer	
John Meyer /	
Dated: 0/4/04	•
BOUTH DAKOTA OFFICE OF THE ATTORNEY GENERAL:	
Dalla PK200.	,

The foregoing Agreement is hereby approved as to form.

}			<u>.</u>
Post-In Fax Note	7871	Dato	(badea 4 c) →
" Jim Sherk	ton	From Je	ha Meyer
CO/Dept. BOR		Co.	
Pisone #		Phono # Co	26:2521
Fax# 773-24-	22	For#	

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ID: SO BOPPO OF REGENTS

PAGE:002 R

Approved as to Form
Larry Long

Larry Long Attorney General

Dated: 2/5/09

000028

POLICY CONCERNING CONFLICTS OF INTEREST

This policy is adopted to address the issue of potential conflicts of interest with regard to the State of South Dakota and attorneys contracting with the State of South Dakota ("State") to perform legal services. This policy will be attached as an addendum to any contract for legal services entered into between the State and any attorney contracting to perform those legal services and shall become a part of that contract.

Except as provided in paragraph B of this policy, if an attorney contracting to perform legal services with the State has a pending claim against the State or its employees on behalf of a client; or in the event an attorney with an existing contract for legal services with the State is approached by a client seeking to file a lawsuit against the State or its employees, the contracting attorney shall notify the Attorney General and the manager of the state PEPL Fund in writing of that conflict of interest prior to the time a contract is signed or prior to undertaking representation of the adverse client. The Attorney General shall personally decide within ten working days whether or not the State will waive any conflict of interest created by that claim. The Attorney General will consider the magnitude of the claim against the State, the appearance of impropriety which could adversely affect the interests of the State, the degree, if any, to which the contracting attorney has or will gain access to information which would give him an undue advantage in representing a client whose interests are adverse to the State, whether the department or agency against which the claim is made is also a department or agency that will be represented by the contracting attorney, and any other factor which the Attorney General may deem pertinent in his discretion.

Notification of the Attorney General under this paragraph, prior to the commencement of an action is not required if the contracting attorney is approached by a client to commence an action against the State and the contracting attorney has a good faith belief that absent immediately filling, the action would be barred by a statute of limitations or comparable provision. Under these circumstances, the contracting attorney shall, as soon as practical, contact the Attorney General regarding the conflict and agrees that if the conflict of interest is not waived, to withdraw from representing the client in the pending action.

- B. Any conflict of interest which may be created by the following situations will automatically be deemed to be waived by the Attorney General and will not be subject to the notification requirements of this policy statement:
 - 1. Any action where the contracting attorney represents a codefendant with the State in a claim or lawsuit, regardless of any cross-claim or third-party claim which the State and the attorney's non-State client may have against each other; unless the cross-claim or third-party claim was readily apparent at the time of contracting with the non-State client and seeks significant monetary consequences; the cross-claim is against a state agency which the contracting attorney represents; or by virtue of representation of the State under contract the attorney had access to information which would give the non-State client an unfair advantage.
 - 2. Any condemnation action in which the contracting attorney represents a condemnee.
 - 3. Any administrative licensing proceeding in which the contracting attorney appears representing a client, regardless of the fact that the client may make a claim which would be adverse to a position taken by a department or agency of state government; <u>unless</u> the claims, if successful, will have significant monetary consequences to the State; or by virtue of representation of the State under contract the contracting attorney had access to information which would give the non-State client an unfair advantage.
 - 4. Any administrative proceeding before the Department of Revenue in which the contracting attorney's client may have a claim which would create a potential liability for the State of South Dakota; <u>unless</u> the claim, if successful, will have significant monetary consequences to the State; or by virtue of representation of the State under contract the contracting attorney had access to information which would give the non-State client an unfair advantage.
 - 5. Any bankruptcy proceeding in which the contracting attorney represents a client other than the State of South Dakota and in which the State of South Dakota has a secured or unsecured claim.
 - 6. Any activity relating to the negotiation of a contract with the State of South Dakota and another client represented by the contracting attorney; unless the contracting attorney is actively representing the department or agency of state government with which the contract is being negotiated; or by virtue of representation of the State under contract the contracting attorney had access to information which would give the non-State client an unfair advantage.
 - 7. The defense of any criminal action; <u>unless</u> the attorney has an existing contract as a special prosecutor in criminal actions for the State of South Dakota; or if, in representation of the State under contract, the contracting attorney had access to

information which would give the non-State client an unfair advantage in the criminal action.

- 8. Any small claims action in which the contracting attorney represents any plaintiff or defendant with interests adverse to those of the State.
- 9. Any action brought through representation under a long-term contract or appointment of any other governmental entity, whether or not that governmental entity has interests that are adverse to those of the State; unless the claim, if successful, will have significant monetary consequences against the State of South Dakota.
- 10. Any action in which the State is a named party but has only a nominal interest, as in mortgage foreclosures and quiet title actions.
- 11. Any lobbying activity by the contracting attorney
- 12. Any worker's compensation case in which the contracting attorney represents a claimant; unless the contracting attorney represents the South Dakota Department of Labor in matters relating to worker's compensation claims or benefits.
- C. The Attorney General reserves the right to raise a conflict of interest, notwithstanding the automatic waiver provisions of paragraph B of this policy, where a conflict of interest covered by the South Dakota Rules of Professional Conduct exists and in the discretion of the Attorney General, is it determined to be in the State's best interest to raise the conflict. The Attorney General shall notify the contracting attorney of the existence of the conflict and the delineation of waiver within seven days of the Attorney General's actual notice of the contracting attorney's action against the State.
- D. For purposes of this policy: 1) the term "contracting attorney" means the attorney actually signing the agreement and his entire law firm; 2) the term "State" means the State of South Dakota and any branch, constitutional office, department, agency, institution, board, commission, authority, or other entity by state government; and 3) the term "significant monetary consequences" means that the suit, claim, action or other proceeding against the State, if successful, could reasonably result in the State making payments to the contracting attorney, the client or the class the client represents in excess of \$50,000 or in the case of the proceeding against the Department of Revenue, or other state taxing entity payments or lost revenue in excess of \$50,000.

E. This guideline shall not be construed as altering or reducing an attorney's obligations to his client under the South Dakota Rules of Professional Conduct specifically stated herein.

Office of Attorney General State of South Dakota

I, Marty J. Jackley, Attorney General of the State of South Dakota, do hereby appoint JAMES R. LYNCH of Los Angeles, California, as a Special Assistant Attorney General for the State of South Dakota, to represent the Board of Regents in legal matters involving the South Dakota International Business Institute, Northern State University and the South Dakota Department of Tourism and State Development concerning Darley

	erve at the will of the Attorney General. ay of September, 2009.
	Marty J. Jackley Attorney General
State of California)
County of Los Angeles	: ss)
General for the State of the Constitution of the South Dakota, and that such office, and render	aving been appointed as a Special Assistant Attorney. South Dakota, do solemnly swear that I will support United States and the Constitution of the State of I will faithfully and impartially discharge the duties of a true account of all money, accounts, credits and at shall come into my hands as such office and pay overcording to law. James R. Lynch

Notary Public/South Dakota

Subscribed and sworn to before me, a notary public, this ______ day of September, 2009.

My commission expires:

CAROLYN DOMINGUE COMM. # 1775068

OTARY PUBLIC - CALIFORNIA LOS ANGELES COUNTY My Comm. Expires Oct. 22.

000032A



NOTICE TO ALL COUNSEL (Please see Service List)

THE RESOLUTION EXPERTS!

November 25, 2008

RE:

Darley International, LLC vs. Hanul Professional Law Corporation

Reference #: 1100054680

Dear Counsel:

Thank you for choosing JAMS as your dispute resolution provider. This letter will confirm that your mediation has been scheduled as follows;

DATE:

December 12, 2008 at 9:30 AM for 4 hours

PLACE:

JAMS

160 West Santa Clara Street

Suite 1150

San Jose, CA 95113

NEUTRAL:

Hon. Robert A. Baines (Ret.)

in preparation for your mediation it is recommended that you submit memoranda, briefs or other documents to the neutral at 160 W. Santa Clara St., San Jose, CA 95113 by December 5, 2008. It is also essential to have in attendance the appropriate representatives who have complete settlement authority;

For your reference, attached please find an invoice for your share of the fees. To reserve your mediation please mail your payment to JAMS at the PO Box number located on the bottom of the invoice. If additional research or future session time is requested for the matter, another invoice will be sent to you at the conclusion of the session.

Please note that JAMS reserves the right to cancel your mediation if fees are not paid by November 28, 2008. However, cancellation will occur only following written notice from IAMS.

If time is reserved but goes unused or is canceled by one of the parties within 14 days of the scheduled date, JAMS will make every attempt to reschedule the neutral's time with another matter. However, if JAMS cannot reschedule and the time then goes unused, the party canceling the mediation is responsible for all fees associated with the reserved time.

As The Resolution Experts we take pride in helping you to resolve your dispute. If you have any questions about our procedures or the settlement process, please feel free to contact me directly at 408-346-0734.

Sincerely,

iii -EM Elizabeth S Medina

Case Manager

emedina@jamsadr.com

Fax# 408-295-5267

IZI NORTHERN state university

НОМЕ	ABOUT	ACADEMICS	ATHLETICS	ADMISSIONS	STUDENT LIFE	contactus
SEARCH		DIRECTO	RY -		HIJKLMNOPQ	RSTUVW
Search Opti	<u>ions</u>	OFFICES	that of the transport to the transport t		XYZ	·
Site Index		Office (Web site	link) 🖾 Email	Location	Location	
Site Map		Academic Advise	ement	Dacotah Hall,	Room 202	2633
SILD HADE		Academic Affairs	3	Spafford Hall,	Room 203	7786
DIRECT	ORY	Admissions 🖾		Dacotah Hall,	Room 101	2544
Offices		Alumni Services		Beckman Building, 620 15th Ave SE		2550
OTHIOGS		Aramark		Graham Hall,	Room 2/2A	2928
People		Art Department 🖾		Spafford Hall,	Room 206	2514
Fax Number	erc	Athletics/HPE		Barnett Cente	r, Room 42	2488
I ax Ivamos	<u>C13</u>	Athletic Develop	ment	Beckman Buil	ding, Room 3	7744
		Band Room		Johnson Fine	Arts Center, Room 115	2501
		Barnett Center I	nformation			7734
		Biology Prep Ro	om	MeWaldt-Jens	sen, Room 202	2478
		Biology Prep Ro	om	MeWaldt-Jens	sen, Room 207	2380
		Bookstore 🖾		Student Cente	er, Room 108	2655
		Briscoe Hall - H Briscoe Hall - D				2677 2680
		Campus Activitie	es Board	Student Cente	er, Room 202	7806
		Campus Police/	Security		ursday 6pm-2am) Machine - Student	Cell; 380-8925 626-2474
		Career Develop	ment and Placement	Student Cente	er, Room 217	2371
		Center for Exce Business ⊠	llence in International	Lincoln Hall, F	Room 123A	7721
		Center for State	wide E-learning	MeWaldt-Jen	sen, Room 122	3382
		Chemistry Lab		MeWaldt-Jen	sen, Room 302	2598
		Chemistry Lab		MeWaldt-Jen	sen, Room 309	2472
		Children's Cent	er 🖾	Lindberg Hall		2221
		CICS/Lutheran	Campus Ministries ⊠	Student Cent	er, Room 235	(605) 216- 3925
		College of Arts	and Sciences 🖾	Technology 0	Center, Room 358	2601
		Computer Cent	er	Technology (Senter, Lower Level	2283
		Correspondenc	e Studies	Spafford Hall	, Room 10 ő	2568
		Counselor Educ	cation	H.P. Gerber,	Room 115	2417
		Counseling Cer	nter	Student Cent	er, Room 217	2371
Party and the second of the se		Custodial Servi	ces	Facilities Mar	nagement, Physical Plant	2560
!		Den		Student Cent	er, Lower Level	2650
		Development	•	Beckman Bu	ilding, 620 15th Ave SE	2550
		Dining Hall - St	udent Center			2928

	Reading Clinic Office ⊠	H.P. Gerber, Room 145	2614
	Records	Dacotah Hall, Room 103	2012
	Regional Aging Council of Northeast SD	Technology Center, Room 353	3402
	Registrar ⊠	Dacotah Hall, Room 103	2012
	Research	MeWaldt-Jensen, Room 224	2456
	Residence Life Director ⊠	Student Center, Room 201	2531
	Resident Artist	Lincoln Hall Basement	3240
	Room Reservations		!
	Barnett Center		7738
	Johnson Fine Arts Center		2497
	Student Center		3007
	School of Business ⊠	Lincoln Hall, Room 101	2400
	School of Education	H.P. Gerber, Room 112	2415
	School of Fine Arts	Spafford Hall, Room 315	2497
	South Dakota Department of Agriculture	Physical Plant, Room 215	3335
*	South Dakota International Business Institute ☑	Graham Hall, Room 110	3149
	South Dakota School for the Deaf (SDSD) Outreach Consultant	Graham Hall, Room 114	3166
	Social Science	Technology Center, Room 358	2601
	Special Education	H.P. Gerber, Room 115	2417
	Speech Communications	Technology Center, Room 261	2404
	Sports Information	Barnett Center, Room 47A	7748
	Steele Hall - Hall Director		3047
	Steele Hall - Lobby Phone		3020
	Student Activities	Student Center, Room 203	3007
	Student Affairs ⊠	Student Center, Room 201	2530
	Student Association	Student Center, Room 204	2528
	Student Center Information Desk	Student Center, Lower Level	2651
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REPLY POINTS TO HANUL'S 2nd DRAFT OF OVERSEAS RECRUITMENT AND SERVICE AGREEMENT

September 30, 2007

Dear James,

The following are my comments in respect to the second draft of your counterproposal I received over this past weekend.

1. I believe there should be separate agreements between a) Darley & Hanul & b) Robert D. Stratmore, Esq. & Hanul. Different clauses, terms and conditions apply and are better determined under separate agreements.

The reason I think we should stick to agreement between Hanul & Darley is to make sure that you are part of the Chinese entity, to be in charge and in control of the situation. Furthermore, my partners have reluctance in sharing legal duty between Hanul and Stratmore firm when the legal duty is that of immigration which Hanul will handle in all respects..

2. Under Definition of Terms Used Herein and Appointment: What specifically are the "Unofficial Exclusive Rights" that Hanul holds to promote and process from SDIBI? Please provide me with a copy of your Agreement with SDIBI, since our rights derive directly therefrom. Your mandate from SDIBI is important for us to be knowledgeable and informed about. These include "Hanul's unofficial rights to exclusively market SDIBI EB-5 Projects promised by SDIBI."

This is a big point. As I mentioned in my email, Hanul does not have an exclusive agreement signed between Hanul and SDIBI. This is because SDIBI (South Dakota) SDIBI and Hanul felt that substance over form was important. WE wanted to start the work and secure our place by our performance. Furthermore, State government granting any sort of exclusivity is a major endeavor as you may know. Rather than to spend time on formalizing everything, we've decided to use the time on creating results. That strategy worked well as we have 'implied' exclusivity from SDIBI and South Dakota.

I understand that this alone can derail our agreement effort since we do not have expressed right to base our agreement on. If Darley is willing to trust Hanul's relationship with SDIBI, our agreement will have the intended meaning. However, if not, there might not be anything that Hanul can offer Darley to Darley's legal satisfaction.

Hanul is confident that the working relationship between Hanul and SDIBI is sufficient for Darley to take on the marketing efforts that it intends to. Therefore, our agreement will be one of practicality rather than absolute legal right. That is the best that we can offer at this time. We have had no reason to seek cumbersome, and may be impossible, expressed exclusivity from SD attorneys. I hope you can reason our rationale in this regard.

3. 1 B. Appointment—Contractor for other Territories Specified in Appendix B. We Cannot accept a mandate that "Hanul provides its policies which Recruiter must follow..." Who is Recruiter—it is not defined. Do you mean Darley or its subagents? What are Hanul's policies you are referring to?

Typo here, Recruiter is Darley and I have no problem taking that language out. It was there to actually make sure that over-zealous marketers promising the 'world' to investors.

4. 1C. You give us 6 months to produce a minimum of 50 investors. That is okay if Gave us ALL OF CHINA (but not Marketing for Guangdong Province) as we Discussed and agreed to, I thought, in our Berkeley meeting. You are changing Rules, so to speak. You are granting us essentially only Shanghai & the immediate

Environs exclusively & the rest of the country (apart from Guangdong) on a non-Exclusive basis. (By the way, you had previously stated that we could sign up Clients from Guangdong but we were not to ADVERTISE THERE—please Include this in any revisions).

That is right that we are granting exclusivity to Shanghai and the Provinces nearby. However, this is a very formidable region in that it is the economic center of modern China. I do not agree that we are changing the rule from Berkeley in that I have always maintained two things: (1) that we would want a Chinese entity to be our partner in China; and, (2) the Chinese partner must prove itself in terms of performance for us to give over the entire territory that Hanul see as our 'bread and butter' market.

One thing that I hope you can understand is that if our Chinese partner proves itself on performance, Hanul gladly will give up fee cuts to accommodate volume and to be free of hassle and care for China. However, that naturally entails time and performance to build up trust between us.

Furthermore, I can not over emphasize that performance and trust will build itself up as "Hanul was able to do so with SDIBI even without an exclusive agreement. I hope you fand your Chinese partner can see this and show strong proof that puts Hanul at ease and force Hanul to seek your hand. Believe me, we would love to be in that situation. In that sense, all these exclusivity talk may not even be necessary.

Our research of Chinese market shows that there are only few powerful companies who can handle US EB-5 marketing. We hope that you are the power that can move these companies in China. That is what you have expressed to us in our conversations and as such, if we can be certain of this fact, we would simply be ecstatic in our good fortune!!! And, if you do have such relationship with these Chinese companies, you will have no problem in taking all of China from us as your exclusive territory.

Therefore, we can commit to 50 investors from

Shanghai & the neighboring provinces within ONE YEAR. We are confident We will surpass this, and if we have exclusive for all China (except Guangdong), 50 applicants within 6 months is acceptable. (I thought in our last conversation by Phone that we were now getting exclusive for all of China, less Guangdong (where we could sign applicants but not advertise).

There might be some misunderstanding here. 50 cases from China in 6 months is not only from Shanghai and vicinity. Exclusivity and non-exclusivity really does not matter since we do not plan on granting exclusivity for entire China at all. You are the only entity that we have entertained and have expressed promise to grant all of China based on performance. If your team demonstrates strong 'presence of EB-5 in China' we will have no reason t to further develop Chinese market. But, until then, we will have to continue to seek ways to develop China. PLEASE NOTE that you will have full freedom to market in non-exclusive China territories and the 50 cases from entire China in 6 months will more than adequately prove to us of your marketing power. At such result, we will be happy to let your team take on the entire China. You can certainly sign up cases from Guangdong province as I said in Berkeley. But, please do it in discreet way as not to excite our partner in Guangzou.

In respect to Former Soviet Union ("FSU") Republics taken as a whole, I can Accept a number of 20 within 12 months. In addition, in the last line of 1C, it Needs to be changed so that a lack of performance in one region does not Constitute a "Material Breach of this Agreement" resulting in termination. It would mean exclusivity for that one defined geographic area would be Removed from its exclusive status, but it would not result in a material Breach and termination of the Entire Agreement.

Much of the rationale in China applies to former soviet block countries. Regardless of the number, your team will not have any problem marketing in that territory. If we get a strong lead for that region, I will discuss it with you beforehand. Let's not decide on a number for this region but have it open to all. As I have said before, you have an upper hand over any of our previous contacts in this region as well. We have no plans to factively pursue this region any time soon.

4. 1E. Why don't we just say that all other territories of the world are fine To bring in visa applicants, except for Guangdong Province there should be no

Advertising (but visa applicants are fine) & exclude also Korea. I thing This is a more clear formulation (albeit I originally suggested A & B). Otherwise, if Hanul can amend Appendix B by its own sole discretion, that We have nothing we can rely upon anyway.

Much of the rational above applies here as well. However, I want to make it clear that Hanul does not wish to give away our territories unless we have a strong partner who can handle that particular region. As such, we will leave these territories open for now until a strong partner emerges over a region. That is why we are maintaining the right to amend Appendix B. If Darley can show a strong potential over a region, we will have no problem adding that territory over to Appendix A. Otherwise, we will keep it under our full and sole control.

5. 1G. Amend so that Appendix B is removed. Add that Hanul shall agree not To compete with Darley or contact or do business with any of the individuals or companies that comprise Darley's sub-agents for 2 years from the date of any termination, for any reason of this Agreement.

This is difficult to do because of the fact that there are only few companies in China who can handle US EB-5. I don't' foresee a situation for such termination for Darley. Any how, once Darley and Hanul folds relationship, I don't understand why working with the subagents for SD EB-5 should be a problem for Darley. This is only a problem if HANUUL unrightfully terminates Darley's rights. If so, I am sure you have wealth of knowledge that I can not even fathom to 'sock it' to Hanul. Besides, I do not see why Hanul would do such a thing anyway.

6. 2A. "For Investors, implement the SDIBI EB-5 Project for Investors' Individual investments as chosen by each Investor." (Hanul shall not Have the right to select which Project each Investor invests in; they will Select their own project from the selection offered--#12, 13, etc). The Last line should state: "...place Darley's Investors without delay in Such projects."

This sounds fair. It is matter of practicality since we might only have one project at a time. But, if we have more than one project at a time, then, this certainly can be revised as such.

7. 2D. 3rd line. Should read"...inform Darley of any problems encountered."

Agreed

8. You go from 2 D to 2 F. Where is 2E? In current 2F, define "Amicable" Return of Investor's funds please. Last line:"...regulations of the United States."

Amicable-agree to define it. Any suggestions? Last line, agreed

9. 2G. I think you mean "preceding," not proceeding.

Agreed

10. 2H. "Hanul shall provide Chinese speaking employee based in China to be the liaison between Darley's Chinese recruiters, Investors and Hanul."

That employee, Joe Kim, will be working out of our office at Seoul. He will frequently travel to China as necessary (we figure about half of the time). We do not see a need to have a China office and as such, he will maintain a post in Korea.

11. 3A. "Establish or use an existing office with designated person(s) to be the contact and liaison with Hanul."

Agreed – I did not try to force a full time employee on your part.

12. 3 C (6). "Any known conditions or situations which otherwise may pose difficulties for US EB-5 visa issuance."

Agreed

13. 3G. "Assist Investors to complete Application for Visa and coordinate with Hanul's in-China employee (acting as a liaison) for preparation for interview with Overseas US Consular Officers."

Same as your point 10 above. Joe will be in Korea but will frequently travel to China as necessary.

14. 4. I believe we should agree to use an Escrow for the \$500,000 which will be held for a couple of years. Perhaps, HSBC Bank or Bank of America, with offices in Hong Kong, Shanghai & Beijing, for instance, would be suitable. I still believe the Attorney-Client's Trust Account can be used for the Legal Services, Service Fees and out-of-pocket expenses.

\$500,000 would only be held for about three month in average. Let's keep options for both escrow account and trust account as stated.

15. 5A. & 5B. At the end of each 5A & 5B, add: "The above-noted services are the responsibility of Hanul to fulfill."

Agreed – except that we would from time to time ask Darley (your Chinese team) to assist Hanul in communicating with your Chinese clients. Your Chinese clients would feel better with such involvement from your team.

16. 5C. DELETE. Darley will NOT indemnify Hanul. Do your other sub-agents actually do this? Absolutely NOT.

The indemnification is for any fees that agents may have taken from clients over and beyond what we have charged them (i.e. \$50,000). It is a common practice that agents charge extra fees besides from the \$50,000 fee. Perhaps we can better word it but the fact is that Hanul will not pay back fees over and beyond the refund provisions of Section 7.

17. 5D. This is very vague and ambiguous. What fees or charges do you mean in specific? So sweeping I have no idea what it is to cover.

It happens often that agents come up with fee items that are not legitimate. This clause is there to curtail any liability from it. In expression, it can only be ambiguous since we can not ascertain all the ways of agents creativity in coming up with additional fee items.

18. 5E. On LEGAL FEES that should be covered in the separately drafted Legal Fees Agreement between Robert D. Stratmore, Esq. ("RDS") & Hanul. This should be a very simple agreement in connection with the splitting of Legal Fees. Stage 1 should ALWAYS BE a 50%-50% split (When the \$20,000 Legal Fees come in, they should be divided immediately. With respect to the Service Fees (\$30,000), that should be covered in the main Agreement between Darley & Hanul. The split & distributions are further covered in what should be changed in Par. 6. In addition, legal fees shall be split 50%-RDS-50% Hanul for other Visa and legal matters referred to Hanul by RDS.

Please see my comments on 1 above.

19. 5F. The Success Fee split needs to be 50%-50%. That is only fair.

Not so, since the success fee comes from Hanul's continued monitoring and work for the duration. Darley's official responsibility ends with marketing. 50-50 may be plausible if Darley continues with Hanul in communicating and taking care of clients as specified in my comments on 15 above.

20. 6A (2). Project 12 (NBP). Legal fees of \$20,000 split in new RDS-Hanul Agreement (\$10,000 RDS & \$10,000 Hanul). Balance of fees split as \$5,000 to Hanul for Service Fees and \$25,000 to Darley.

Same as comments from above.

21. 6A (3), \$10,000 Legal Fees to Hanul & \$10,000 to RDS. \$20,000 to Darley in Stage 2 for Service Fees. \$10,000 to Hanul for Service Fees. In this manner, under the Legal Fees Agreement, the distribution of \$10,000 each to RDS and Hanul should be distributed upon receipt, as we previously agreed in Berkeley & other conversations. It seems that this new draft has pushed t so that the first \$20,000 of

the Legal Fees (distributed at the first stage) in the post-Project 12 matters goes all to Hanul and Darley & RDS wait until Stage 2. Unacceptable & unfair.

Not so! The 6A(2) specifies that DARLEY will receive \$10,000 from Sate 1 Service Fee. The Stage 1 in 5E states that first \$20,000 is \$10,000 for Legal fee and Service Fee each.

22. 7 A (1). 3rd line: "...Partnership within two (2) months from the date of denial of such approval;" To have Visa Applicants wait for 6 months is unfair and uncompetitive.

Agreed, we can shorten this time frame. But, I think if there is any denial, such denial is not a final denial but cause for some further action. I think the 6 months will be used up in trying to remedy the situation rather than just a drop. However, I do agree that for cases with no 'future' we can shorten the period.

23. 7A(2). No refund of Legal Fees or Service Fees.

I think we should return the un-realized fees (i.e. if client drops case in the Stage 1, then we should return Stage 2 fees back to client, and so on..) Wouldn't you think this more fair to client?

24. 7A (3). Define or expand upon "Fault." (Line 2). Spell it out more, please.

Any thing that may cause Investor to not receive I-526 such as veracity of investor's documents, etc.

25. 8A. Last line (3rd): "...HANUL in writing."

In discussing, as partners in marketing, we will be expressing points on projects that may be not written down. Not a big issue, we can make the change but I want to address that caution is warranted since marketers are far more 'reckless' than us attorneys.

26. 8D. 3rd line. "...Department of State and all other...."

Agreed

27. ADD 8E. "HANUL covenants and warrants that it has the legal written authority to represent SDIBI and to contract with Darley.

See my initial comments in 2 above.

28. ADD 8F. HANUL covenants and warrants that it will comply with all California State Bar Rules in respect to its laws, rules and regulations governing segregation of funds for clients and the proper maintenance of records and balances in Attorney-Client Trust Fund matters.

Agreed. Not a problem and if we are going to use trust account, we should be accountable.

29. 9A. This is way to broad & vague. "Contemplated purposes" is not defined. Darley and RDS would have to agree in writing in advance as to what ma is agreeable to cover.

I am not too keen about confidentiality provisions for this agreement. We can change as necessary.

30. 9B. Not clear what is meant in the last line as "Project Participants." Hanul should covenant and agree to a 2 year period wherein once the Agreement terminates, neither Hanul nor any of its employees shall contact or do business with subagents of Darley or any Visa Applicant clients.

See comment 5 above.

31. ADD 9C. "Hanul agrees to keep all information from Darley, its sub-agents, Visa Applicant clients or RDS confidential and to be treated as Proprietary Information

I can agree to client information as being confidential. I can drop confidentiality fro all other including anything from Hanul. What needs to be confidential, we can do it by expressed writing.

32. 10B. Agreement to be in effect for Three (3) Years (a compromise between 5 & 2). 2nd line: "...Agreement will automatically be renewed for additional terms of twelve (12) months each year unless terminated by sixty (60) days written notice prior to the expiring renewal period by either party.

I think we should start with two and move on to more lengthy duration as our relationship develops and trust is built.

33. 11B. This disclaimer in part makes little sense for us or our clients. You cannot guarantee the policies or procedures of the SDIBI EB-5 participating general partners or partnerships YET YOU WAN DARLEY OR RDS TO INDEMNIFY HANUL---Not going to happen. Totally unfair & unreasonable. Delete 11B.

I don't understand? The indemnification by Darley (4C) was only for the fees that we have received. It has nothing to do with the performance of the investment project. Am I missing something? Besides, how can we guarantee the performance of the business project operated by General Partner?

34. 12. Add: "All fees owed to RDS and/or Darley shall be paid in the normal payment schedule, notwithstanding any alleged breach or termination event which may be alleged or attempted to be implemented."

Agreed to do so if we can come up with a language that simply states that anything legitimately owed is payable...

35. 13B. Add in last line: "... California will have exclusive authority, exclusive jurisdiction, exclusive venue and be binding upon the parties." We should also agree to using JAMS for compulsory Mediation followed by Arbitration in the event of any dispute. (I am forwarding to you as a separate attachment language from JAMS (see their pages 3 & 4 from the attachment) as to the Clauses to be inserted in both the RDS/Hanul & Darley/Hanul Agreements). It should state as an introduction at the end of 13B:

"Any dispute arising out of this Agreement shall be compulsory mediated

"Any dispute arising out of this Agreement shall be compulsory mediated followed, if necessary, by Arbitration under the auspices of JAMS ADR (Arbitration and Dispute Resolution) in San Francisco, CA. Each party shall bear its own JAMS fees, legal fees, costs and expenses."

I will take a look at the JAMS language. Arbitration is good in general for us.

36. ADD 13D. COUNTERPARTS. This Agreement and any Addendums may be Executed in counterpart and transmitted via facsimile as if originally-executed documents.

Agreed

Please try to revisit the Addendum A description to cover all of China as an exclusive (apart from advertising in Guangdong Province). We would like the balance of China. If you must carve out only Beijing, although we do not like it, we may live with it. Otherwise, what you have given us in the revised Addendum A is not very positive for us.

Please let me know if am wasting the time of my colleague and the people we have set to go. I thought we had a detailed agreement & understanding from our three hour meeting in Berkeley & numerous calls. Many other projects would like our help & agreement to work with them. I have held off, wanting to do one extensive deal and relationship with you & your firm. Certainly if I came to any other Center, including your deal in South Dakota or others dealing with them, the onerous conditions (non-compete, indemnity, etc) would not be part of any deal. We can produce but we must be treated equitably and fairly.

I would also appreciate see your agreement with SDIBI at once, as we are basically subject to the terms and conditions under which you operate with them. We cannot be subject to those terms and conditions & be blind as to what is in the agreement.

I look forward to hearing from you ASAP. Perhaps a phone call to me at (925) 258-0600 with a 'heads up' and a discussion will be helpful.

Sincerely, ROBERT

Robert, please understand that relationships are built over a time ESPECIALLY on situation where you are simply asking us to turn over virtually the entire world over for five years. I have stated over and over that you can basically market EB-5 in all of China and in other nations (i.e. former Soviet bloc countries) unhindered to come up with the numbers that we spoke about. This still stands!

In all honesty, we do not have any information about your Chinese entities or other marketing entities in different countries. I think we are giving a lot of trust to you given the lack of information that we have on your partners, plans or potentials.

Even now, it is our sincere wish that we have a strong partner who can take care of our marketing duties in different part of world. HOWEVER, such delegation CAN ONLY be given after demonstration of ability to succeed in such market. Isn't it only fair for us to seek certain proof of things before fully committing to it? Wouldn't you ask for the same or even more?

I sense some frustration in your draft comments, but please do understand that my purpose in drafting the agreement was not to derail any of our talks or efforts. We are still hoping your team to be what you purported to be, a very powerful marketing machine that will dominate a region. If so, you are free to do so. As I have said numerous times before, you have an upper hand over anyone in these territories. It remains for you to show us your 'power' in an open field, with or without any agreement.

After all these writing, you might still want an expressed agreement between SDIBI and Hanul that we DO NTO HAVE. Perhaps, this alone can kill our deal... I hope it doesn't.

Please take a look at my comments and give it some careful thoughts as trust over time is what we need the most at this stage for obvious reasons.

I do really thank you for your patience, time and efforts thus far.

Sincerely,

James



The State Bar of California

Tuesday, August 11, 2009

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ATTORNEY SEARCH

Robert David Stratmore - #52930

Current Status: Active

This member is active and may practice law in California.

See below for more details,

Profile Information

Bar Number

52930

Address

Law Ofc Robert D Stratmore

PO Box 1838

Orinda, CA 94563

Phone Number

Fax Number

e-mail

(925) 258-0600

(925) 253-0999

Not Available

District

District 3

Undergraduate School

Univ of California Berkeley;

Berkeley CA

County

Contra Costa

Law School

UC Berkeley SOL Boalt Hall;

Berkeley CA

Sections

None

Status History

Effective Date

Status Change

Present

Active

6/9/1972

Admitted to The State Bar of California

Explanation of member status

Actions Affecting Eligibility to Practice Law

Effective Date

Description

Case Number

Resulting Status

Disciplinary and Related Actions

Discipline w/actual suspension

Administrative Actions

This member has no public record of administrative actions.

Copies of official attorney discipline records are available upon request.

Explanation of common actions

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8/11/2009

Filed 08/222008 Case 2:08-cv-05034-P-PLA Document 8 Joop Bollen, Director 1 SOUTH DAKOTA INTERNATIONAL BUSINESS INSTITUTE. 2 1200 South Jay Street Aberdeen, South Dakota 57401-7198 3 Telephone (605) 626-3149 4 Facsimile (605) 626-3004 5 SOUTH DAKOTA INTERNATIONAL **BUSINESS INSTITUTE** 6 In Pro Per 7 8 UNITED STATES DISTRICT COURT 9 CENTRAL DISTRICT OF CALIFORNIA, WESTERN DIVISION 10 11 Darley International, LLC, a Delaware CASE NO.: CV08-05034 DDP PLAX 12 corporation, RESPONDENT'S OPPOSITION TO NOTICE 13 OF HEARING RE DARLEY Petitioner, INTERNATIONAL, LLC'S PETITION FOR 14 ORDER COMPELLING ARBITRATION vș. PURSUANT TO WRITTEN AGREEMENT; 15 DECLARATION OF JOOP BOLLEN IN South Dakota International Business Institute, a 16 SUPPORT; [PROPOSED] ORDER non-profit organization; **DENYING PETITION** 17 Respondent. Hearing Date: September 8, 2008 18 10:00 a.m. Time: 19 Court Room: 20 21 22 23 24 25 26

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I. INTRODUCTION

The Petitioner in the present case seeks to compel Respondent to submit to an arbitration clause contained in an "Overseas Recruitment and Service Agreement for US EB-5 Permanent Residency Visa" (hereinafter "Agreement"). The Agreement is a contract between Petitioner and Hanul Professional Law Corporation (hereinafter "Hanul"), whereby the Petitioner agreed to recruit investors for Hanul. The Petitioner is forcing this court to decide whether the Respondent must join in the arbitration despite the fact that Respondent is not a signatory or beneficiary of said Agreement. As the evidence and case law will demonstrate, the Respondent is not bound by the Agreement or its arbitration clause.

Petitioner's presentation falls woefully short of demonstrating that a non-signatory to a contract must adhere to an arbitration clause of said contract when a dispute between the signatories arises. Courts generally recognize that arbitration eliminates unnecessary burden and lightens the caseloads of the Court system. However, courts have consistently held that arbitration is governed by general principles of contract law, and thus any party who did not contract to a clause should not be bound by the process. The courts recognize only three situations in which non-signatories will be held by the terms of a contract. For the reasons explained below, none of these situations exist here.

First, the Petitioner argues that Respondent received a direct benefit from the Agreement, and should thus be bound by its terms. However, the Petitioner utterly fails to show the benefit conferred on Respondent. In certain cases a non-signatory may be bound by a contract if he received a benefit flowing directly from the contract, or where the parties who formulated the contract intended a direct benefit to be conferred on the non-signatory. An indirect benefit, one not flowing directly from the terms of the contract, will not be sufficient to bind a non-signatory to the terms of the contract. In the present case the evidence will show that the Respondent was not a direct beneficiary of any benefit

and thus Respondent is not bound by the Agreement.

conferred by the Agreement, nor was the Agreement formulated to directly benefit the Respondent.

Second, the Petitioner requests that the Respondent be joined in the arbitration by the doctrine of Equitable Estoppel. It is true that courts have recognized that a party who knowing seeks and enjoys the benefits of an agreement cannot turn its back on a portion of the agreement when a dispute arises. However, the facts in the present case do not conform to this ideal. The Respondent did not intend to gain a benefit from the subject agreement as claimed by the Petitioner. In fact, the contract formation was for the benefit of the two signatories as well as the economy of South Dakota, not the Respondent.

Third, courts have reasoned in previous holdings that an intimate relationship, such as an agency relationship, between a signatory and non-signatory third party can bind that third party to the terms of the agreement. A party who "stands in the shoes" of another must be enjoined as the acts of one party are the same as the acts of the other. The court will see evidence that this relationship does not exist between the Respondent and any of the signatories to the subject agreement. In fact, each party acts in its own interest and not for the benefit of any other party.

Lastly, the court lacks personal jurisdiction on this matter over Respondent as shown below. A court is required to have subject matter jurisdiction as well as personal jurisdiction over the responding party in order to hear a case. Arbitration disputes are governed by the Federal Arbitration Act, and thus the subject matter jurisdiction is satisfied in this court. However, the court must also have personal jurisdiction over all parties. This court does not have personal jurisdiction over the Respondent, as SDIBI was not "present" in the state of California, is not domiciled here, did not aconsent to this action, and does not have "minimum contacts" sufficient to satisfy the personal

jurisdiction requirement. As a result, the Petition should be denied as this court does not have personal jurisdiction over the Respondent.

For the reasons outlined above, the court must reject the Petitioner's request.

II. STATEMENT OF FACTS

SDIBI, on an annual renewable cost recovery contract with the South Dakota Governor's Office of Economic Development (GOED), has been conducting export promotion and foreign direct investment activities for GOED since 1995. SDIBI is part of the School of Business at the Northern State University, a public state university, located in Aberdeen, South Dakota. In 2001, SDIBI initiated recruitment of European dairy farmers to South Dakota to construct and manage large state-of-the-art dairy farms in eastern portion of the state. SDIBI was successful in recruiting 15 such projects whose owners all legally entered the United States of America to settle in South Dakota on E-2 non-immigrant visas.

The Regional Center Program is an investment visa program designated as EB-5 which grants legal permanent residency to foreign nationals who create 10 direct or indirect full-time jobs by investing at least \$500,000.00 in an area with a low population or a high unemployment rate. Such areas are designated as "regional centers". SDIBI applied for regional center status in 2003, and was granted regional center status by United States Citizens and Immigration Services (USCIS) in April of 2004. SDIBI obtained regional center status to provide more security to the European investors that had settled in South Dakota and to provide South Dakota with a competitive advantage over other states which were also recruiting European dairy investors but were not able to offer permanent residency as they did not have regional center status.

Regional Center status resulted in many inquiries from Asian countries, including South Korea,

where interested parties wanted to invest in dairy projects in order to obtain permanent residency. This meant that additional Asian capital could now become available to South Dakota dairy farmers wishing to construct larger dairy farms, and thus benefit the economy of South Dakota. SDIBI went on a reconnaissance trip to South Korea where a working relationship was established with Hanul Professional Law Corporation (hereinafter "Hanul") to recruit investors which would be coupled with South Dakota dairy farmers. SDIBI's role was to locate and forward prospective projects to Hanul, and Hanul would locate South Korean and Asian investors and complete all paperwork related to the recruitment and green card petitions. SDIBI worked with various attorneys who pursued European markets for investors. The relationship with Hanul was not an exclusive one as SDIBI benefits from having as many recruiters of investors as possible. In fact, many of SDIBI's Regional Center cases were filed by European dairy-farmer-investors whom SDIBI recruited through various channels even when Hanul actively pursued the South Korean market. Because of trust gained by Hanul with their successful recruiting efforts, all inquiries SDIBI received related to recruiting South Korean and Asian investors subsequently were forwarded to Hanul including the one from Robert Stratmore, President of Darley International LLC (hereinafter "Darley").

SDIBI does not charge nor receive any financial rewards for the utilization of the Regional Center nor does it claim that the projects offered are economically sustainable. In fact, each investor of the Regional Center is required to sign a Memorandum of Understanding that holds SDIBI and the State of South Dakota free of liability. The due diligence associated with the projects is the responsibility of the investors with the help of their service providers. SDIBI merely provides access to the Regional Center in order to benefit South Dakota's economy. Despite not assuming any legal responsibility for the viability of the business, SDIBI does have an interest in protecting the integrity of the Regional Center to guarantee the longevity of the state's economic benefit.

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27 28 with pooled South Dakota/South Korean investors. All these equity projects required substantial bank financing which provided SDIBI with the confidence that the projects were economically feasible as the banks analyzed their viability before committing their funds. In 2007, it became clear that the increasingly competitive EB-5 market required SDIBI to

Recruitment by SDIBI's Regional Center and Hanul resulted in 12 successful dairy projects

source larger projects with a loan structure as opposed to the equity structure. A USCIS approved amendment allowed SDIBI to expand to include meat packing and processing projects with a loan structure. The Tilapia project, a meat processing center, was selected as a first project to test the market with this new loan structure. Because the number of jobs created in a meat packing and processing project is much larger than a dairy project, bank financing was no longer required as EB-5 funds, even at the required 10 jobs per EB-5 investor, were sufficient to finance the entire project. However, the absence of bank financing, as was later learned, created a problem where the prospects were not and could not be properly screened.

In or around the middle of 2007, Robert Stratmore, President of Darley, contacted SDIBI and inquired about recruiting Chinese investors for the regional center. SDIBI, just as with any other such inquiry, explained the working relationship Hanul had with Asian Countries and referred Mr. Stratmore accordingly. On or around October 18, 2007, Hanul and Darley agreed upon a recruitment contract between the two parties and the said fact was made available to SDIBI. SDIBI answered questions related to the Tilapia project and questions associated with the Regional Center when asked by either of the parties to the contract. However, SDIBI never actively participated in the negotiation of the Agreement. SDIBI, with both Hanul and Darley clearly understanding that no formal written agreement was in place with either party, and that SDIBI was not in a position to formulate nor advise as to the working contents of the contract between Hanul and Darley, answered questions with the hope that they would quickly start recruiting investors for South Dakota's benefit.

 SDIBI, Hanul and Darley participated in 2 seminars in China in or around December of 2007 to promote the Tilapia project to potential investors. However, during the seminar it became very clear that the Tilapia project was very risky based on new information revealed by the representative of the Tilapia project. Due to Tilapia's weak management and lack of equity, SDIBI was forced to pull the project in order to protect the foreign investors and the integrity of the Regional Center. Explanations for SDIBI's decision were e-mailed to Darley on December 27, 2007.

Shortly after the China seminars and the decision to pull the Tilapia project, Darley initiated false accusations as well as unfounded blame towards SDIBI and Hanul claiming that SDIBI had knowingly and willfully interfered with the recruitment process of Darley in PRC. Hanul and Darley had been advised previously that their unproductive quarrels related to disputes arising out of their failed contract were holding the State of South Dakota hostage with respect to Chinese investors while other regional centers were taking full advantage of the EB-5 opportunities. The recruiting impasse in China coupled with the needs to screen, qualify, and select all future projects in order to protect the integrity of the regional center led SDIBI to establish SDRC, INC. This entity performs the required screening process to select projects and enters into agreements with overseas recruiters to ensure robust recruiting efforts of the EB-5 projects. As of this date SDRC, INC. has only entered into agreements with overseas agencies but is not active from a financial perspective as no fees are charged.

On or about March 17, 2008, Darley demanded arbitration against Hanul on the basis of Breach of Contract for purported non-compliance with the Agreement. The Agreement contains an arbitration clause which states in part that any disputes between the parties shall be resolved through arbitration under the auspices of JAMS Alternate Dispute Resolution in San Francisco, California. An apparent dispute over the workings of the contract between the parties had occurred and the Petitioner

Case 2:08-cv-05034-DD-PLA Document 8 Filed 08/22) Page 10 of 36 initiated the Arbitration process via a Demand for Arbitration on or about March 17, 2008 through its Attorney of Record, Maxwell M. Blecher, Esq. Thereafter, Mr. Blecher sent correspondences to the Respondent stating that the Respondent must be included in the subject arbitration by reasons that the Respondent benefited from the Agreement signed between the Petitioner and Hanul.

The Respondent has strongly denied the contentions of the Petitioner that the Respondent had a part in the drafting of the Contract signed by the Petitioner and Hanul. Respondent has, on numerous occasions, strongly advised the Petitioner that the Respondent does not and cannot participate in the drafting of the Agreement on behalf of Hanul nor can it ratify a final version of the Agreement once it became available. The Respondent has, on numerous occasions, advised the Petitioner to stop trying to coax the Respondent into the Contract formulation between the Petitioner and Hanul. The Petitioner, through false accusations as well as misleading emails, has time and time again insinuated that the Respondent is wholly integrated with Hanul and that the Respondent had the right of final say in the Agreement formulation.

Thereafter, the Respondent was served with a copy of the Petitioner's Motion on August 5, 2008, requesting this Court to determine whether the Respondent must be joined in the arbitration proceedings.

III. ARGUMENTS

1. This court does not have personal jurisdiction over the Respondent

In order to hear a controversy a court must have jurisdiction over the subject matter as well as personal jurisdiction over all parties. In the present case, this court does not have personal jurisdiction over the Respondent. Personal jurisdiction is satisfied when a defendant is (1) present in the forum state; (2) domiciled in the forum state; (3) consents to personal jurisdiction; or (4) has minimum

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Case 2:08-cv-05034-D-PLA Document 8 Filed 08/22-308 Page 11 of 36 contacts with the forum state. SDIBI is a South Dakota based nonprofit organization, and is not present or domiciled in any California district. Furthermore, SDIBI does not consent to personal jurisdiction of the California courts. Lastly, SDIBI does not have minimum contacts with the state of California sufficient to satisfy personal jurisdiction.

Minimum contacts are established where a party has sufficient dealings or affiliations with the forum jurisdiction which makes it reasonable to require the party to defend a lawsuit brought in the forum state. (International Shoe Co. v. Washington, 326 U.S. 310, 66 S.Ct. 154, 90 L.Ed. 95.)

The threshold test for personal jurisdiction is that a defendant's activity in the forum state must be continuous and systematic, and the cause of action is related to that activity. Id. In the present case, Respondent conducts all of its activities exclusively in the state of South Dakota, and has no continuous or systematic contacts with the state of California. Respondent did not take part in any negotiations of the Agreement, never traveled to California, and does not conduct business in this state. Based on the foregoing, the forum state does not have personal jurisdiction over Respondent, and consequently the Petition should be denied.

1. The US District Court Central Division of California is not the proper venue for the present action

The proper venue of a civil action is governed by the Federal Rules of Civil Procedure and 28 U.S.C. § 1391. The Code states, in relevant part: A civil action wherein jurisdiction is not founded solely on diversity of citizenship may, except as otherwise provided by law, be brought only in (1) a judicial district where any defendant resides, if all defendants reside in the same State, (2) a judicial district in which a substantial part of the events or omissions giving rise to the claim occurred, or a substantial part of property that is the subject of the action is situated, or (3) a judicial district in which any defendant may be found, if there is no district in which the action may otherwise be brought. 28

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U.S.C. § 1391(b). For the reasons outlined below, the U.S. District Court of the Central District of California, Western Division is not the proper venue for the present action.

SDIBI is a South Dakota nonprofit public organization which is deemed to "reside" in the State of South Dakota for venue purposes. ("For purposes of venue under this chapter, a defendant that is a corporation shall be deemed to reside in any judicial district in which it is subject to personal jurisdiction at the time the action is commenced." 28 U.S.C. § 1391(c)). Therefore, this court is not the proper venue as this Respondent is not a resident of California. Additionally, as the present dispute stems from an Agreement which was drafted and negotiated in California, and the Respondent is not a signatory to the Agreement and did not participate in its drafting, the fact that the events giving rise to the claim occurred in California does not have any bearing on the Respondent. Finally, as SDIBI is not located in California, it is not subject to the jurisdiction of its courts under 28 U.S.C. § 1391 (b)(3), as it cannot be "found" in any district in California. It is evident from the foregoing that the present venue is improper as it relates to the Respondent, and therefore the Petition should be dismissed by this court on venue grounds.

The Standard for Compelling a Third Party Non-Signatory to be Bound by an **Arbitration Agreement**

Arbitration is a matter of contract, therefore "a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit." United Steelworkers of Am. v. Warrior & Gulf Navigation Co., 363 U.S. 574, 582, (1960). The public policy in favor of arbitration has one crucial caveat: "[A]rbitration assumes that the parties have elected to use it as an alternative to the judicial process. Arbitration is consensual in nature." County of Contra Costa v. Kaiser, 47 Cal. App. 4th 237. Thus, while there is a strong and "liberal federal policy favoring arbitration agreements," Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 625, 105 S.Ct. 3346, 3353, 87 L.Ed.2d

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444 (1985), such agreements must not be so broadly construed as to encompass claims and parties that were not intended by the original contract, Thomson-CSF, S.A. v. American Arbitration Ass'n, 64 F.3d 773.

Under federal and California law, a nonsignatory may be compelled to arbitrate under three sets of circumstances: (1) where the nonsignatory is a third party beneficiary of the contract containing the arbitration agreement; (2) under the principle of equitable estoppel; and (3) where "a preexisting relationship existed between the nonsignatory and on the parties to the arbitration agreement, making it equitable to compel the nonsignatory to also be bound to arbitrate his or her claims." (Contra Costa, supra, 47 Cal. App. 4th at p. 242) Crowley Maritime Corp. v. Boston Old Colony Insurance, 158 Cal.App.4th 1061

1. The Respondent is not a Third Party Beneficiary to the Agreement signed between the Petitioner and Hanul.

As the purpose of the contract in dispute clearly states, SDIBI is not a Third Party Beneficiary. In order to be deemed a Third Party Beneficiary, the express terms of the agreement must manifest intent by the signatories to benefit the third party, Restatement Second of Contracts, §302(1)(b)(1932), While the contract discusses the marketing of SDIBI EB5-Projects, any direct benefit conferred is clearly assigned to Hanul according to its terms. All the fees, including service fees and Darley Agent Fees, specified in the Agreement are for the benefit of Hanul and Darley. In fact, the Agreement does not mention a single benefit flowing to SDIBI.

(a) Incidental benefits cannot bind a non-signatory to an Arbitration Agreement. In order to be bound to a contract as a third-party beneficiary, the terms of the contract must clearly express intent to benefit that party or an identifiable class of which the party is a member. In cases where the contract lacks an express declaration of intent to benefit a third party, there is a strong

 presumption that the third party is not a beneficiary and that the parties contracted to benefit only themselves. A mere incidental benefit to the third party is insufficient to bind that party to the contract, 4 Am. Jur. 2d Alternative Dispute Resolution § 60.

Further, the benefit conferred to compel third party beneficiaries to arbitration must be direct or material to the underlying contract. Guardian Constr. Co. v. Tetra Tech Richardson, Inc., 583 A.2d 1378, 1386 (1990). ("In order for third-party beneficiary rights to be created, not only is it necessary that performance of the contract confer a benefit upon a third person that was intended, but the conferring of the beneficial effect on such third-party, whether it be creditor or donee, should be a material part of the contract's purpose.") Id. Thus, if it was not the promisee's intention to confer direct benefits upon a third party, but rather such third party happens to benefit from the performance of the promise either coincidentally or indirectly, then the third party will have no enforceable rights under the contract, and cannot be bound by its terms. E.I Dupont De Nemours and Company v. Rhone Poulenc Fiber and Resin Intermediaries 269 F.3d 187.

Petitioner's argument that the language of the Agreement "evinces the requisite intent to make SDIBI a third-party beneficiary" is misguided. The Agreement notes that the role of SDIBI is solely to review and approve candidates for US EB-5. The Agreement states in Clause 1. A: "Hanul's right to grant exclusive marketing rights is based on the unofficial rights to exclusively market SDIBI EB-5 Projects..." Hence, there is no official or contractual relationship between Hanul and SDIBI, and thus SDIBI cannot be considered an intended third party beneficiary.

At no time did SDIBI manifest an intention to be bound by the Agreement. In fact, SDIBI explicitly disavowed any obligations arising out of the Agreement in numerous email responses to Petitioner's questions. (See Exhibit "1" of Declaration of Joop Bollen). Accordingly, it cannot be said

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that SDIBI assumed the obligation to arbitrate. Thomson-CSF, S.A. v. American Arbitration Ass'n 64 F.3d 773.

Petitioner's Memorandum of Points and Authorities cites Medical Staff of Doctors Med. Center in Modesto v. Kamil, 132 Cal. App. 4th 679, 685-86. SDIBI agrees with the ruling of this case and believes that the case so cited by the Petitioner actually helps to clearly show why SDIBI should not be a party to the arbitration. The court concluded: "a third party beneficiary contract must either satisfy an obligation of the promisee to pay money to the beneficiary, or the circumstances indicate the promisee intends to give the beneficiary the benefit of the promised performance." Id. Just like the petitioner in that case. Darley fails to show that either of those circumstances apply here. The beneficiaries of the Agreement are Hanul and Darley who receive fees from new investors and the private businesses in the state of South Dakota that receive investment funds from new investors. There is no showing that SDIBI ever received or was intended to receive those or any other payments.

To the extent SDIBI may benefit from Darley contract, the benefit, if any, is purely incidental, Petitioner's argument that a direct benefit has been received by SDIBI does not hold weight as the benefit has always been for the Governor's Office of Economic Development and the economy of the state of South Dakota. SDIBI does not receive any financial reward from the contract between the signatories. SDIBI did not accept the benefits of the Agreement since the benefit contained in the Agreement was for Hanul, Darley, the EB-5 project participating business in South Dakota and the economy of South Dakota. SDIBI's incidental benefit is for the continued integrity of the Regional Center once the direct benefit is received by the economy and as a result, the economy improves. As such, SDIBI should not be bound to the arbitration clause of the Agreement signed between Petitioner and Hanul.

2. Respondent is not required to arbitrate under principles of equitable estoppel

Petitioner also makes an argument for enforcing arbitration on equitable estoppel grounds.

Under the estoppel theory, a company knowingly exploiting an agreement with an arbitration clause can be estopped from avoiding arbitration despite having never signed the agreement. Guided by "[o]rdinary principles of contract and agency," courts have concluded that where a company "knowingly accepted the benefits" of an agreement with an arbitration clause, even without signing the agreement, that company may be bound by the arbitration clause. Deloitte Noraudit A/S v. Deloitte Haskins & Sells, U.S., 9 F.3d 1060, 1064 (2d Cir.1993). The benefits must be direct, which is to say, flowing directly from the agreement. Thomson-CSF, 64 F.3d at 779. The benefit derived from an agreement is indirect where the nonsignatory exploits the contractual relation of parties to an agreement, but does not exploit (and thereby assume) the agreement itself. Thomson-CSF, 64 F.3d at 778-79. MAG Portfolio Consultant, GMBH v. Merlin Biomed Group LLC, 268 F.3d 58, C.A.2 (N.Y.), 2001.

Any benefit that may have been conferred on SDIBI was not direct in nature. SDIBI did not exploit, (and thereby assume), any part of the Agreement. In fact, SDIBI reiterated time and time again that it was not a signatory to the Agreement, and did not even read the Agreement until issues between Hanul and Darley arose.

SDIBI was not a willing participant in the subject Agreement between the signatories and as such had no bearing on the proceeding or execution of the Agreement. SDIBI's intent to remain a non-party to the contract and its negotiations was relayed to the Petitioner on numerous occasions via email and correspondence. As the Court in <u>E.I. Dupont v. Rhone</u> observed, "under the equitable estoppel theory, a court looks to the parties' conduct after the contract was executed. Thus, the snapshot this Court examines under equitable estoppel is much later in time than the snapshot for third

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27 28 party beneficiary analysis." E.I. Dupont De NeMours and Company v. Rhone Poulenc Fiber and Resin Intermediates, 269 F. 3d 187. Since the evidence shows that SDIBI has always held and will continue to hold the position that it was never an active participant who benefited from the Agreement, the Respondent should not be required to take part in the arbitration.

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3. An agency relationship does not exist between Hanul and SDIBI, and SDIBI is not bound by the arbitration clause of the Agreement under an agency theory.

The additional test under which SDIBI may be obligated to be bound by the subject Contract is under an Agency theory. "Traditional principles of agency law may bind a nonsignatory to an arbitration agreement." Thomson-CSF, S.A. v. American Arbitration Ass'n 64 F.3d 773. "Agency is the fiduciary relation which results from the manifestation of consent by one person to another that the other shall act on his behalf and subject to his control, and consent by the other so to act." Restatement (Second) of Agency § 1 (1958).

Given the above, Hanul is not an agent of SDIBI. There has never been any manifestation of consent between SDIBI and Hanul where SDIBI permitted Hanul to act on its behalf. In fact, the relationship between SDIBI and Hanul rests on the fact that SDIBI reviews and approves any investors Hanul may present. Hanul does not have the right to act on behalf of SDIBI, and is therefore not an agent for SDIBI. Furthermore, there is no contract anywhere between Hanul and SDIBI wherein both parties agrees to work within the scope of each other's business practices. Hanul is acting for its own gains and interests, while SDIBI is acting for the gains and interests of the economy of South Dakota. Therefore, Hanul was not acting as an agent of SDIBI when signing the subject Contract, and SDIBI remains unbound by it.

The Agreement between Hanul and Darley explicitly states: "Hanul's right to grant exclusive marketing rights is based on the unofficial right to exclusive markets promised by SDIBI." Hanul

RESPONDENT'S OPPOSITION TO NOTICE OF HEARING

,	Case 2:08-cv-05034-DP-PLA Documen	t 8 Filed 08/22 008 Page 19 of 36 -				
1 2 3 4	Joop Bollen, Director SOUTH DAKOTA INTERNATIONAL BUSINESS INSTITUTE. 1200 South Jay Street Aberdeen, South Dakota 57401-7198 Telephone (605) 626-3149 Facsimile (605) 626-3004					
5 6 7	SOUTH DAKOTA INTERNATIONAL BUSINESS INSTITUTE In Pro Per					
8	UNITED STATES DISTRICT COURT					
9	CENTRAL DISTRICT OF CALIFORNIA, WESTERN DIVISION					
10	Darley International, LLC, a Delaware					
11	corporation,	CASE NO.; CV08-05034 DDP PLAX				
12	Petitioner,	[PROPOSED] ORDER DENYING THE				
14	vs.	PETITION FOR ORDER COMPELLING ARBITRATION PURSUANT TO WRITTEN				
15	South Dakota International Business Institute, a	AGREEMENT				
16	non-profit organization;	Hearing Date: September 8, 2008 Time: 10:00 a.m.				
17	Respondent.	Court Room:				
18	The second secon)				
19	WHEREUPON considering the OPPOSITION TO NOTICE OF HEARING RE DARLEY					
20	INTERNATIONAL, LLC'S PETITION FOR ORDER COMPELLING ARBITRATION PURSUANT					
21	TO WRITTEN AGREEMENT of Respondent, South Dakota International Business Institute, and for					
22	Good Cause Appearing therefore,					
23	IT IS HEREBY ORDERED that the Respondent, South Dakota International Business					
24	Institute shall be barred from participating in the arbitration proceeding between Petitioner and Hanul					
25	Professional Law Corporation.					
26		:				
27	DATED:	HONORABLE DEAN D. PREGERSON				
28	HUNUKABLE DEAN D. FREGERSON					
:	19					
	RESPONDENT'S OPPOSITION TO NOTICE OF HEARING					

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DECLARATION OF JOOP BOLLEN

I, JOOP BOLLEN, hereby declare and state as follows:

- I am the Director of the South Dakota International Business Institute (hereinafter 1. "SDIBI"). I have personal knowledge of each of the facts stated herein and can testify competently thereto, except as to matters stated under information and belief, and to such matters as I believe them to be true.
- 2. SDIBI, on an annual renewable cost recovery contract with the South Dakota Governor's Office of Economic Development (GOED), has conducted export promotion and foreign direct investment activities for GOED since 1995.
- 3. SDIBI is part of the School of Business at the Northern State University, a public state university, located in Aberdeen, South Dakota.
- 4. In 2001, SDIBI initiated recruitment of European dairy farmers to South Dakota to construct and manage large state-of-the-art dairy farms in the eastern portion of the state. SDIBI was successful in recruiting 15 such projects whose owners all legally entered the United States of America to settle in South Dakota on E-2 non-immigrant visas.
- 5. The Regional Center Program is an investment visa program designated as EB-5 which grants legal permanent residency to foreign nationals who create 10 direct or indirect full-time jobs by investing at least \$500,000.00 in an area with a low population or a high unemployment rate. Such areas are designated as "regional centers."
- 6. In 2003 SDIBI applied for regional center status, which was approved by United States Citizens and Immigration Services (USCIS) in April of 2004.
- SDIBI obtained regional center status in order to provide more security to the European 7. ipprestors that had settled in South Dakota and to provide South Dakota with a competitive advantage

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over other states which were also recruiting European dairy investors, but were not able to offer permanent residency as they did not have regional center status.

- 8. Regional center status resulted in many inquiries from Asian countries, including South Korea. Interested parties wanted to invest in dairy projects in order to obtain permanent residency. This interest meant that additional Asian capital could now be available to South Dakota dairy farmers wishing to construct larger diary farms and thus benefit the economy of South Dakota.
- 9. SDIBI does not charge nor receive any financial rewards for utilization of the regional center nor does it claim that the projects offered are economically sustainable.
- 10. The due diligence associated with the projects is the responsibility of the investors with the help of their service providers. SDIBI merely provides access to a regional center for the benefit of South Dakota's economy.
- 11. At this time, Hanul Professional Law Corporation (hereinafter "Hanul") contacted SDIBI with Korean investors willing to invest in the State of South Dakota's dairy farms under the EB-5 investor visa program to receive permanent residency.
- 12. SDIBI's Regional Center with Hanul recruiting resulted in 12 successful dairy projects with pooled South Dakota/South Korean investors.
- 13. SDIBI's role was to locate and forward prospective projects to Hanul and Hanul would locate South Korean and Asian investors and complete all paper work related to recruitment and green card petitions.
- 14. Because of trust gained by Hanul with their successful recruiting efforts of the South Korean investors, all inquiries SDIBI received related to recruiting South Korean and Asian investors subsequently were forwarded to Hanul including the one from Robert Stratmore, President of Darley International LLC (hereinafter "Darley").

- 15. In 2007, it became clear that the increasingly competitive EB-5 market required SDIBI to source larger projects with a loan structure as opposed to the equity structure. An USCIS approved amendment allowed SDIBI to expand to include loan structure based meat packing & processing projects.
- 16. One meat processing center, Filapia, was selected as a first project to test the market with this new loan structure.
- 17. In or about the middle of 2007, Robert Stratmore contacted SDIBI requesting a relationship to recruit Chinese investors and was referred to Hanul. (See Declaration of Robert D. Stratmore, ¶ 3, filed by the Petitioner)
- 18. On or about October 18, 2007, Hanul and Darley agreed upon a recruitment contract between the two parties and the said fact was made available to SDIBI.
- 19. SDIBI did answer questions related to the Tilapia project and any questions associated with the regional center when asked by either of the parties to the contract. However, both parties were made aware that SDIBI would not be in a position to formulate nor advise as to the contents of the contract between Hanul and Darley. (Exhibit "1", ¶ 2)
- 20. SDIBI, with both Hanul and Darley clearly understanding that no formal agreement was in place with SDIBI, merely was providing information to the two parties with the hope that they would quickly start recruiting investors for South Dakota's benefit. (Exhibit "1", ¶ 1)
- 21. In or about December of 2007, two seminars were held in the People's Republic of China (PRC) to promote the Tilapia project to potential investors. However, during the seminar, it became very clear that the Tilapia project was very risky based on new information revealed by the representative of the Tilapia project. Due to Tilapia's weak management and lack of equity, SDIBI was forced to pull the project in order to protect the foreign investors and the integrity of the regional

center. (Exhibit "1", ¶ 6)

as no fees are charged.

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22. Given the failure of the Tilapia project, it became increasingly clear that Hanul, Darley, or any other service providers were not able to perform the due diligence needed to protect the investors. A separate entity was needed to screen, qualify, and select all future projects in order to protect the integrity of the regional center. SDRC was created to meet these roles, SDRC, Inc. was established to select projects and enter into agreements with overseas recruiters. To date, SDRC, INC. has only entered into agreements with overseas agencies but is not active from a financial perspective

- 23. At or about this time, Darley initiated false accusations as well as unfounded blame towards SDIBI and Hanul stating that SDIBI had knowingly and willfully interfered with the recruitment process of Darley in PRC.
- 24. Hanul and Darley had been advised previously that their unproductive quarrels in regards to disputes arising out of their failed contract is holding the State of South Dakota hostage with respect to China's investors while other regional centers were taking full advantage of the EB-5 opportunities.
- 25. Darley's claim that the China seminars resulted in 30 interested parties and that SDIBI/Hanul's failure to cooperate properly resulted in loss of Darley's credibility with its Chinese sub-agents, interfere with its business relationship, and drastically affect its ability to recruit investors for SDIBI's Tilapia project is unfounded as shown by the Declaration signed by Frank Lin, whom Robert Startmore described as colleague, not sub-agent, and who claims to be solely responsible for Darley's activities in China. (Exhibit "2")
- 26. As is shown by Mr. Lin's Declaration, Darley did not have "definite and concrete" interest from 30 investors to invest in the Tilapia project nor did it have "sub-agents" in China to

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Joop Bollen

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EXHIBIT 66199

arren Original Message ----From: Bollen, Joop

To: Sovtrade@pacbell.net Ce: James Park ; Richard, Benda@state.sd.us Sent: Tuesday, January 08, 2008 8:50 AM Subject: RE: SD-HANUL Ltr Jan 7, 2007

Mr. Robert Stratmore:

After reading your e-mail I felt compelled to set the record straight which I will do as follows:

- 1) SDIBI has no written agreement with Hanul which has been reiterated and explained to you time and time again. Upon your suggestion in the PRC, you e-mailed me a copy of the Hanul/Darley agreement (I told you I never reviewed your agreement the first time you e-mailed it to me as I had little time to review it and it was really not that important as SDIBI was not a party to the agreement) in order for me to mediate your differences with James Park so that we all could move forward in a constructive fashion. Now after reading section 1A of that agreement I must emphasize that even your own document clearly states that no formal written agreement between SDIBI and Hanul exists.
- 2) Your suggestion that SDIBI negotiated an agreement is false!! Since SDIBI was not part of the Darley-Hanul agreement and since all parties clearly understood that there was no SDIBI-Hanul agreement, I was willing to assist in forming an working agreement between Hanul and Darley, nothing more. You now stating that SDIBI negotiated and ratified the Hanul-Darley contract is completely manipulative!! Again, refer to your own agreement which clearly outlines the facts.
- 3) I want to make it very clear that SDIBI never approached your "sub-agents" and attempted to undermine your relationship with them. Your sub-agents initiated conversations and I merely was forced to listen as I did not want to be rude. Based on their initiated communications it became clear that a problem with respect to financial rewards existed that would make our projects uncompetitive. It also became evident that your partners felt they had an unfair deal with you and that was all.
- 4) You well know that Hanul prepares documents and SDIBI does not get involved with the preparation of legal documents. Upon your request I asked James to get the documents to you ASAP which he promised to do.
- 5) I never promised to work directly with Darley but merely expressed my interest in mediating your differences with Hanul as the current impasse is not constructive for anyone. To state that SDIBI would be working directly with Darley is again manipulative and incorrect.
- 6) SDIBI, because it does not have the resources to do so and because it can not assume legal responsibility, never makes or made any claims to the financial viability of any project and leaves it up to the investors to do their own due diligence with the assistance of their service providers!! With past equity participation projects commercial banks were willing to provide money to the projects and SDIBI reasoned that if commercial banks were willing to lend their own money than the project probably was financially sound. The Tilapia project is the first project without participation of a commercial bank and that created a problem that SDIBI was unaware of until Gary's presentation in the PRC. I will quote what I stated in the e-mail to you dated December 31; "SDIBI is freezing the Tilapia project until the owners increase their equity contribution and improve their management plan. This snafu is the result of the recent switching from an equity scenario with conventional financing to a loan scheme without the participation of a commercial institution. SDIBI is now working with a separate legal entity that would review the proposed projects from now on and which would contract with a local financial institution to monitor the loan. As you know SDIBI does not, and never did, get involved in deciding on the financial soundness of the projects and hoped that the

marketers, banks, lawyers and investors would do so. It is now apparent that a separate legal entity is needed to fulfill this function!!"

SDIBI felt compelled to freeze the Tilapia project as it became apparent that your and Hanul's due diligence was not sufficient and therefore would endanger future EB-5 projects. SDIBI never had to make such a difficult decision before but it became apparent that the lack of involvement of a commercial bank endangered the future of our regional center!! I object that SDIBI failed to do its due diligence as that is your and your investor's function. SDIBI's interest is merely to protect the longevity of our regional center and that is what we are attempting to do!!

Robert, based on your e-mail I must state that I am very leery to communicate with you as all communications, even in a relaxed setting, are loaded with legal hooks!! I am perplexed at the manipulations, twisting and accusations. SDIBI, based on unrequested but volunteered information by your sub-agents, is very concerned that your financial take will make SDIBI's projects uncompetitive in the PRC. I was also very surprised to find out that you did not have a working structure with employees in place in China, as was presented to me, but that you are attempting to obtain certain rights from James based solely on Linda's performance, not yours. I also would have thought that you would be glad that I pulled on the alarm with respect of the Tilapia project as it for the protection of your own investors!! Finally, I again emphasize that I assisted with the communications between Hanul and Darley as it was clear to all that no written agreement existed between Hanul and SDIBI.

Despite your unfair accusations, SDIBI hopes that Hanul and Darley can work together and that South Dakota will not suffer as a result of your current impasse. The Tilapia debacle has not just negatively affected Darley but Hanul and SDIBI as well! Hanul also encountered damages but are not blaming SDIBI as they realize that SDIBI had no choice. If it becomes evident that Hanul and Darley can not constructively work together then SDIBI will be forced to develop the PRC opportunities in a way that best serves the State of South Dakota without the marketing involvement of either party. I sincerely hope that this move will not be necessary.

Greetings, Joop

PS I apologize to Richard for being drawn into this mess.

From: Sovtrade@pacbell.net [mailto:sovtrade@pacbell.net]

Sent: Monday, January 07, 2008 2:21 PM

To: Bollen, Joop; james@hanullaw.com; Richard.benda@state.sd.us

Cc: alydar88@pacbell.net

Subject: SD-HANUL Ltr Jan 7, 2007

Gentlemen,

Please see the attached.

Robert D. Stratmore

EXHIBIT 66299

Statements of Frank Lin

June 1, 2008

I, Frank Lin of California, certify that the following is the true resollection of facts that I have personal knowledge on the affairs of Darley International and its efforts to secure China marketing rights of South Dakota Regional Center EB-5 Programs:

- 1. That I have been an acquaintance of Robert Stratmore, principal of Darley International, for many years and have been associating with him in the initial stages of Darley International's efforts to secure marketing rights to China from Hanul Professional Law Corporation ("Hanul");
- 2. That Robert Stratmore and Darley International, at the time of entering in to agreement with Hanul or anytime thereafter, had no Chinese marketing force, mechanism or agents in place to handle SDIBI Regional Center EB-5 projects in China:
- That I have been the one person with all contacts and means to promoting and marketing SDIBI EB-5 projects in China that Darley International have been representing and promoting to the third parties;
- 4. That I am not an employee of Darley International, and I have never entered in to any agreement or contract with Robert Stratmore or Darley International in this regard, and I am completely independent of Darley International and Robert Stratmore;
- 5. That Joe Zhou, a purported employee of Darley International as represented to others by Robert Stratmore, is not, and never have been, an employee of Darley International; and he had never been paid, remunerated or compensated by Darley International in regards to marketing and promotion of SDIBI EB-5;
- That I, in my personal capacity, am the one with contacts to Jinghong, Dragon
 Horse and other agents in China that Darley International has represented to third
 parties as Darley International's own agents in China;
- 7. That Robert Stratmore and Darley International always depended on me for any communication to China in this regard, and that I have never purported to be working for Darley International;
- 8. That Darley International did not have 20 Chinese clients to fill SDIBI EB-5 beef

XIANGFENG LI
COMM. #1582059 m
Notary Public Gallfornia
ALAMEDA COUNTY
My Comm. Exp. May 26, 2009

plant project in September-October of 2007, when Darley International entered in to agreement with Hanul based on the claim that it had 20 eases ready for processing;

- That Jinghong and Dragon Horse, purported subagents of Darley, never worked with Darley or had direct dealing with Darley in regards to SDIBI EB-5 marketing;
- 10. That Jinghong and other Chinese agents whom I introduced to Darley have conducted seminar with Hanul and SDIBI on the Tilapia project back in December 2007 but that particular project was cancelled by SDIBI due to project being unfit for EB-5 marketing;
- 11. That Jinghong and other agents have then made their own connections with SDIBI and some are now working directly with SDIBI on the new EB-5 project;
- 12. That Jinghong or any of the other agents working directly with SDIBI have yet to produce a single case for SDIBI as of this statement date;
- 13. That Darley International is not engaged in immigration marketing business in China back in September-October of 2007, and still is not engaged in the immigration business in China;
- 14. That Darley International has no employees, agents or other entities in China working on its behalf, or will work on its behalf for promoting and marketing SDIBI EB-5 projects in China;
- 15. That Darley international did not spend any money in arranging or conducting SDIBI EB-5 project promotions in China; and.
- 16. That I believe Robert Stratmore and Darley International have been bargaining for rights to market SDIBI EB-5 projects in China based on powers or ability that neither Robert Stratmore nor Darley International possessed both then and now.

The foregoing is the truth as I personally have knowledge of based on my recollection of events then occurred. Please do not hesitate to contact me for any further clarification of the matter at hand.

Sincerely yours,

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Frank Lin

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ALAMEDA COUNTY
My Comm, Exp. May 25, 2009 F

CALIFORNIA ALL-PURPOSE ACKI	
State of Cartfornia	
county of Alameda	
on June 2nd, 2m & before me,	Krangfeng Li
personally appeared Frank	Name and Title of Officer (e.g., "Jang Doe, Notary Public")
XIANGFENG LI COMM, #1582059 m Notary Public California G	Name(s) of Signer(s) ne on the basis of satisfactory evidence to be the person(s) whose name(s) (6) are subscribed to the within instrument and acknowledged to me that (he)/she/they executed the same in his/her/their authorized capacity(jes), and that by (his/her/their signature(s) on the instrument the person(s), or the entity upon behalf of which the person(s) acted, executed the instrument. WITNESS my hand and official seal.
	Signature of Malant Rubba
	Signature of Notary Public
Though the information below is not required by law, it may be	prove valuable to persons relying on the document and could provent fraudulent removal imment of this form to another document.
Description of Attached Document	
Title or Type of Document:	
Document Date;	Number of Pages:
Signer(s) Other Than Named Above:	
Capacity(ies) Claimed by Signer(s)	
Signer's Name:	Signer's Name:
	Individual Corporate Officer Title(s): Partner - Limited General Attorney-in-Fact Trustee Guardian or Conservator Of Signer Of Thomb here Other:
Signer is Representing:	Signer is Representing:

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PROOF OF SERVICE BY MAIL (C.C.P. Section 1013)

STATE OF SOUTH DAKOTA, COUNTY OF BROWN

I, Cherry Brick, am employed in the County of Brown, State of South Dakota. I am over the age of 18 and not a party to the within action. My business address is 1200 South Jay Street, Aberdeen, South Dakota 57401.

On 8/22/202. I served the following documents:

RESPONDENT'S OPPOSITION TO NOTICE OF HEARING RE DARLEY INTERNATIONAL, LLC'S PETITION FOR ORDER COMPELLING ARBITRATION PURSUANT TO WRITTEN AGREEMENT; DECLARATION OF JOOP BOLLEN IN SUPPORT; [PROPOSED] ORDER DENYING PETITION

on all interested parties in this action by placing the original thereof enclosed in a sealed envelope addressed as follows:

SEE ATTACHED MAILING LIST

I am readily familiar with the practice of this office of collection and processing of correspondence for mailing. Under that practice, mail would be deposited with the United States Postal Service on the same day which is stated in the proof of service, with postage fully prepaid, at Aberdeen, South Dakota in the ordinary course of business. I am aware that on motion of the party served, service is presumed invalid if the postal cancellation date or postage meter date is more than one day after the date of deposit for mailing on this proof of service.

I declare under the penalty of perjury under the laws of the United States of America that the above is true and correct.

Executed on $\frac{8/22/2006}{}$, at Aberdeen, South Dakota.

			Chin	Sa	t sed t	Ł)		
 	 		Cherry Brick				 PERSONAL PRO	A CONTRACTOR OF THE PARTY OF TH	3 4 00

Page 1

PROOF OF SERVICE

MAILING LIST

Jennifer S. Elkayam, Esq.
Maxwell M. Blecher, Esq.
Blecher & Collins, P.C.
515 South Figueroa Street, 17th Floor
Los Angeles, California 90071
Attorney for Petitioner

Name and CRSes2:08-cv-05034-P-PLA Document 13 Filed 0 Joop Bollen, Director SOUTH DAKOTA INTERNATIONAL BUSINESS INSTITUTE 1200 South Jay Street Aberdeen, South Dakota 57401-7198 (605) 626-3149 (605) 626-3004 UNITED STATES DISTRICT COURT CENTRAL DISTRICT OF CALIFORNIA Darley International, LLC., a CASE NUMBER Delaware corporation, CV08-05034 DDP PLAX Plaintiff(s) South Dakota International Business Institute, a non-profit organization REQUEST FOR APPROVAL OF SUBSTITUTION OF ATTORNEY Defendant(s). South Dakota International Name of Party hereby request the Court approve the substitution of Suki Kim, Esq. as attorney of record in place and stead of South Dakota International Business Institute Present Attorner Signature of Party/Authorized Representative of Party I have given proper notice pursuant to Local Rule 83-2.9 and further consent to the above substitution. Dated _ 9/30/08 Signature of Fresent Ayorney I am duly admitted to practice in this District pursuant to Local Rule 83-2. Dated 9/30/0A Signature of New Attorney CAB 242173 State Bar Number If party requesting to appear Pro Se: Dated Signoture of Requesting Parts NOTE: COUNSEL AND PARTIES ARE REMINDED TO SUBMIT A COMPLETED ORDER ON REQUEST FOR APPROVAL OF SUBSTITUTION OF ATTORNEY (G-01 ORDER) ALONG WITH THIS REQUEST: G2. 1 (03-06) REQUEST FOR APPROVAL OF SUBSTITUTION OF ATTORNEY

PROOF OF SERVICE BY MAIL (C.C.P. Section 1013)

STATE OF SOUTH DAKOTA, COUNTY OF BROWN

I, Cherry Brick, am employed in the County of Brown, State of South Dakota. I am over the age of 18 and not a party to the within action. My business address is 1200 South Jay Street, Aberdeen, South Dakota 57401.

On 9/30/08, I served the following documents:

REQUEST FOR APPROVAL OF SUBSTITUTION OF ATTORNEY; ORDER ON REQUEST FOR APPROVAL OF SUBSTITUTION OF ATTORNEY

on all interested parties in this action by placing the original thereof enclosed in a sealed envelope addressed as follows:

SEE ATTACHED MAILING LIST

I am readily familiar with the practice of this office of collection and processing of correspondence for mailing. Under that practice, mail would be deposited with the United States Postal Service on the same day which is stated in the proof of service, with postage fully prepaid, at Aberdeen, South Dakota in the ordinary course of business. I am aware that on motion of the party served, service is presumed invalid if the postal cancellation date or postage meter date is more than one day after the date of deposit for mailing on this proof of service.

I declare under the penalty of perjury under the laws of the United States of America that the above is true and correct.

Executed on 9/30/08 at Aberdeen, South Dakota.

Cherry Brick

Page 1

PROOF OF SERVICE

MAILING LIST

Jennifer S. Elkayam, Esq.
Maxwell M. Blecher, Esq.
Blecher & Collins, P.C.
515 South Figueroa Street, 17th Floor
Los Angeles, California 90071
Attorney for Petitioner

UNITED STATES DISTRICT COURT CENTRAL DISTRICT OF CALIFORNIA

CIVIL MINUTES - GENERAL

Case No.	CV 08-05034 DDP (PLAx)		Date	October 6,	2008
Title	DARLEY INTERNATIONAL, LUINTERNATIONAL BUSINESS				KOTA
Prese Honor		EGERSON, U.S. DIS	STRICT	JUDGE	
	John A. Chambers	Margaret Babyl	cin		N/A
THE POST OF THE PROPERTY OF THE PROPERTY OF	Deputy Clerk	Court Reporter / Re	corder	Annual programme of the control of t	Tape No.
	Attorneys Present for Plaintiffs	: Attorn	eys Pres	sent for Defe	endants:
	Maxwell M. Blecher Jennifer S. Elkayam		S	uki Kim	:
Proce	eedings:				
	PETITION [MOTON] FOR ORD (FILED ON 07-31-08)	ER COMPELLING AR	BITRAT	ION	
	Court hears oral argument	and takes the matte	er unde	r submiss	on.

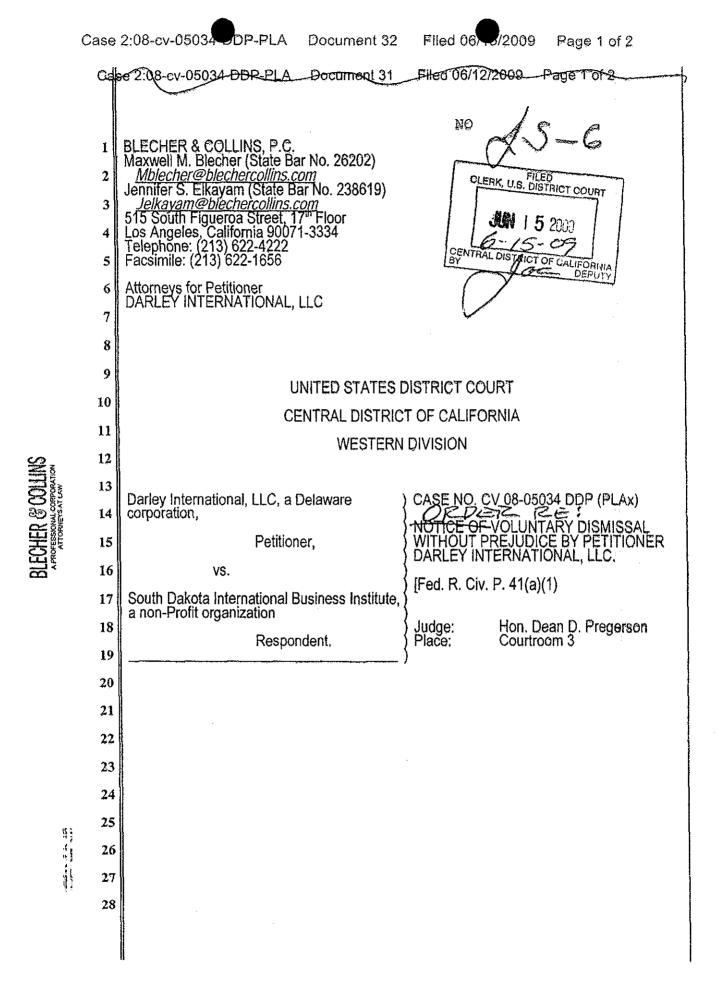
00; 05

Initials of Preparer JAC

CV-90 (12/02)

CIVIL MINUTES - GENERAL

Page 1 of 1



Case 2:08-cv-05034-DDP-PLA

Dated: June 12, 2009

Document 31

NOTICE IS HEREBY GIVEN that pursuant to Federal Rule of Civil Procedure

41(a)(1), Petitioner Darley International, LLC voluntarily dismisses its Petition to Compel

Arbitration as to Respondent South Dakota International Business Institute without

Filed 06/12/2009

Page 2 of 2

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prejudice.

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BLECHER & COLLINS, P.C MAXWELL M. BLECHER JENNIFER S. ELKAYAM

Maxwell M. Blecher
Attorneys for Petitioner
DARLEY INTERNATIONAL, LLC

IT IS SO ORDERED

JUDGE DEAN'D, PREGERSON UNITED STATES DISTRICT JUDGE

1

Receipt Number: 1915274

File Number

DB053166



* ARTICLES OF AMENDMENT *

ARTICLES_OF_AMENDMENT

For

SDRC, INC.

Filed at the request of:

JEFFREY T SVEEN SIEGEL BARNETT & SCHUTZ LLP 415 S MAIN ST 400 CAPITOL BUILDING PO BOX 490 ABERDEEN SD 57402

State of South Dakota Office of the Secretary of State

Filed in the office of the Secretary of State on: Monday, June 01, 2009

Secretary of State

Fee Received: \$50.00

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State of South Bakota



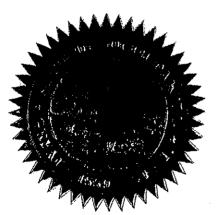
OFFICE OF THE SECRETARY OF STATE

Certificate of Amendment

ORGANIZATIONAL ID #: DB053166

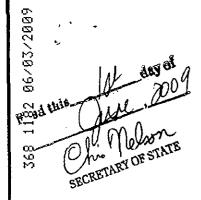
I, Chris Nelson, Secretary of State of the State of South Dakota, hereby certify that duplicate of the Articles of Amendment to the Articles of Incorporation of SDRC, INC. duly signed and verified pursuant to the provisions of the South Dakota Corporation Acts, have been received in this office and are found to conform to law.

ACCORDINGLY and by virtue of the authority vested in me by law, I hereby issue this Certificate of Amendment to the Articles of Incorporation and attach hereto a duplicate of the Articles of Amendment.



IN TESTIMONY WHEREOF, I have hereunto set my hand and affixed the Great Seal of the State of South Dakota, at Pierre, the Capital, this June 1, 2009.

Chris Nelson Secretary of State



AMENDED ARTICLES OF INCORPORATION

OF

SDRC, INC.

RECEIVED

JUN 0 1 2009 S.D. SEC. OF STATE

KNOWN ALL MEN BY THESE PRESENTS that I the undersigned, Joop Bollen, for myself and my successor, for the purpose of forming a corporation under and by virtue of the laws of the State of South Dakota, do hereby adopt the following Amended Articles of Incorporation.

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The name of the corporation shall be SDRC, Inc.

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The purpose for which this organization is to primarily engage in assisting foreign investment in South Dakota and any other purpose not prohibited by State law.

III.

The principal place of business of this Corporation shall be 1201 North Main Street, Aberdeen, South Dakota 57401.

IV.

The Corporation shall commence on the day that the Certificate of Incorporation is granted by the Secretary of State of the State of South Dakota, and shall continue thereafter perpetually or until such time as it shall be dissolved, as provided by the Bylaws of the Corporation or the laws of the State of South Dakota. The Corporation will not commence business until consideration of the value of at least \$1,000 has been received for the issuance of shares of stock in such Corporation.

٧.

The address of the registered office of the Corporation shall be 1201 North Main Street, Aberdeen, South Dakota 57401, and the name of its registered agent at such address shall be Joop Bollen. The street address is 1201 North Main Street, Aberdeen, South Dakota 57401.

VI.

The number of directors of this Corporation shall be not less than one (1) nor more than five (5), as shall be determined from time to time by the Bylaws of the Corporation, and the names and residences of the incorporator is listed below, which incorporator or incorporators shall serve as the initial director or directors of the Corporation until the election of his successor:

06053166

Joop Bollen

1201 North Main Street Aberdeen, South Dakota 57401

VII.

The amount of capital stock of this Corporation shall be 1,000,000 shares of common stock, with a par value of \$1.00 per share, fully paid and nonassessable. No stockholder shall be liable for the debts of the Corporation for any amount greater than his unpaid subscription.

VIII.

That none of the authorized common stock of the Corporation has been issued and it is the intent of the Board of Directors and incorporators that only stock that can qualify under the United States Internal Revenue Code, as Section 1244 stock, may be issued during the applicable period; and the Board of Directors shall have limited authority to issue, prior to one year after the date of these Articles of Incorporation, the maximum common stock of the Corporation for the maximum amount of 1,000,000 shares of \$1.00 par value per share. During such period, the common stock of the Corporation must only be issued in return for money or other property transferred to the Corporation by the purchaser. During the period of one year from and after the date of these Articles of Incorporation, the Board of Directors shall not have the authority to issue any type of stock which would not qualify under §1244 of the Internal Revenue Code and acts amendatory thereto, or which in any way would jeopardize the Section 1244 status of the common stock previously issued pursuant thereto.

Dated this 28th day of May, 2009.

Joop Bollen

STATE OF SOUTH DAKOTA

COUNTY OF BROWN

On this, the 28th day of May, 2009, before me, the undersigned officer, personally appeared Joop Bollen, known to me to be the person whose name is subscribed to the within instrument, and acknowledged that he executed the same for the purposes therein contained.

IN WITNESS WHEREOF, I hereunto set my hand and official seal.

My Commission Expires: _ 09.09-2011

File Number

DB053166





ARTICLES_OF_INCORPORATION

For

SDRC INC.

Filed at the request of:

ATTORNEYS CORPORATION SERVICE 3021 WEST MAGNOLIA BLVD BURBANK CA 91505

State of South Dakota Office of the Secretary of State

Filed in the office of the Secretary of State on: Thursday, January 10, 2008

Chi Nelson

Secretary of State

Fee Received: \$125

State of South Bakota

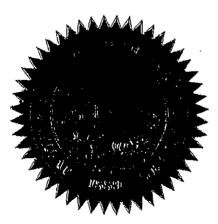


OFFICE OF THE SECRETARY OF STATE Certificate of Incorporation Business Corporation

ORGANIZATIONAL ID #: DB053166

I, Chris Nelson, Secretary of State of the State of South Dakota, hereby certify that the Articles of Incorporation of SDRC INC. duly signed and verified, pursuant to the provisions of the South Dakota Business Corporation Act, have been received in this office and are found to conform to law.

ACCORDINGLY, and by virtue of the authority vested in me by law, I hereby issue this Certificate of Incorporation and attach hereto a duplicate of the Articles of Incorporation.



IN TESTIMONY WHEREOF, I have hereunto set my hand and affixed the Great Seal of the State of South Dakota, at Pierre, the Capital, this January 10, 2008.

Chris Nelson Secretary of State

10.00

IncorpCertBusiness Merge.doc

RECEIVED

Articles of Incorporation

JAN 10 2003

S.D. SEC. OF STATE

Phone 605-773-4845 Fax 605-773-4550

Secretary of State State Capitol 500 E. Capitol Ave.

Pierre SD 57501

FILING FEE: \$125

Required Articles:

The name of the corporation is SDRC INC

Article II

Article I

The number of shares the corporation is authorized to issue 1,000,000

Article III

The complete address, or a statement that there is no street address, of its principal office_ 405 8th Ave. NW, Suite 330, Aberdeen, SD 57401

Article IV

The complete address, or a statement that there is no street address, of the corporation's initial registered office, and the name of its initial registered agent at that office Joop Bollen, 405 8th Ave. NW, Suite 330, Aberdeen, SD 57401

Article V

The name and address of each incorporator (one or more persons - persons includes an individual and an entity) NAME

Joop Boilen,

405 8th Ave. NW, Suite 330, Aberdeen, SD 57401

Optional Articles: (These may be attached followed by the final page with the signature and agent authorization.)

- (1) The names and addresses of the individuals who are to serve as the initial directors;
- (2) Provisions not inconsistent with law regarding:
 - (a) The purpose or purposes for which the corporation is organized;
 - (b) Managing the business and regulating the affairs of the corporation;
 - (c) Defining, limiting, and regulating the powers of the corporation, its board of directors, and shareholders;
 - (d) A par value for authorized shares or classes of shares; and
 - (e) The imposition of personal liability on shareholders for the debts of the corporation to a specified extent and upon specified conditions:

(3) Any provision that under this Act is required or permitted to be set forth in the bylaws;

- (4) A provision eliminating or limiting the liability of a director to the corporation or its shareholders for money damages for any action taken, or any failure to take any action, as a director, except liability for the amount of a financial benefit received by a director to which the director is not entitled; an intentional infliction of harm on the corporation or the shareholders; a violation of section 162 of this Act; or an intentional violation of criminal law;
- (5) A provision permitting or making obligatory indemnification of a director for liability, as defined in subdivision
- (5) of section 171 of this Act, to any person for any action taken, or any failure to take any action, as a director, except liability for receipt of a financial benefit to which the director is not entitled; an intentional infliction of harm on the corporation or its shareholders; a violation of section 163 of this Act; or an intentional violation of criminal
- (6) Any provision limiting or denying preemptive rights to acquire additional or treasury shares of the corporation.

This document must be executed by the chair of the board of directors, by its president, or by another of its officers. If directors have not been selected or the corporation has not been formed, an incorporator may execute this document. If the corporation is in the hands of a receiver, trustee, or other court-appointed fiduciary, that receiver, trustee, or court-appointed fiduciary may execute this document.

Date Signature

President
Title /Official Capacity

Filing Instructions:

Filling Fee: \$125

The proper filing fee must accompany the application. Make checks payable to the Secretary of State,

One originally signed and one photocopy of the articles of incorporation must be submitted.

The Consent of Appointment below must be signed by the registered agent.

Consent of Appointment h	y the Registered Agent
I, Joop Bollen, Name of Registered Agent	, hereby give my consent to serve as the
registered agent for SDRC INC Corporate Name Dated 1/3/08	Signature of Registered Agent

South Dakota Codified Laws

Sections

1-11-1

1-11-4

1-11-5

1-11-15

1-52-3.2

13-49-1

13-49-11

13-59-1

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approbin

- 1-11-1. General duties of attorney general. The duties of the attorney general shall be:
- (1) To appear for the state and prosecute and defend all actions and proceedings, civil or criminal, in the Supreme Court, in which the state shall be interested as a party;
- (2) When requested by the Governor or either branch of the Legislature, or whenever in his judgment the welfare of the state demands, to appear for the state and prosecute or defend, in any court or before any officer, any cause or matter, civil or criminal, in which the state may be a party or interested;
- (3) To attend to all civil cases remanded by the Supreme Court to the circuit court, in which the state shall be a party or interested;
- (4) To prosecute, at the request of the Governor, state auditor, or state treasurer, any official bond or contract in which the state is interested, upon a breach thereof, and to prosecute or defend for the state all actions, civil or criminal, relating to any matter connected with either of their departments;
- (5) To consult with, advise, and exercise supervision over the several state's attorneys of the state in matters pertaining to the duties of their office, and he shall be authorized and it is made his duty, whenever in his judgment any opinion written by him will be of general interest and value, to mail either written or printed copies of such opinion to the auditor-general and to every state's attorney and county auditor in the state;
- (6) When requested, to give his opinion in writing, without fee, upon all questions of law submitted to him by the Legislature or either branch thereof, or by the Governor, auditor, or treasurer;
- (7) When requested by the state auditor, treasurer, or commissioner of school and public lands, to prepare proper drafts for contracts, forms, and other writings, which may be wanted for use of the state;
- (8) To report to the Legislature, or either branch thereof, whenever requested, upon any business relating to the duties of his office;
- (9) To prosecute state officers who neglect or refuse to comply with the provisions of statutes of this state prohibiting officers of the state from accepting any money, fee, or perquisite other than salary for performance of duties connected with his office or paid because of holding such office and the statute requiring issue and delivery and filing of prenumbered duplicate receipts and accounting for money received for the state;
- (10) To pay into the state treasury all moneys received by him, belonging to the state, immediately upon the receipt thereof;
- (11) To attend to and perform any other duties which may from time to time be required by law.

Source: SDC 1939, § 55.1501.

1-11-4. Assistant attorneys general--Appointment and compensation--Powers--Oath. The attorney general may appoint such assistant attorneys general as may be necessary for efficient performance of his duties and may fix their compensation but no expenditure for any such purposes in excess of the amounts appropriated by the Legislature is authorized. The appointments of such assistants shall be in writing and filed in the Office of the Secretary of State.

Such assistant attorney general shall have the same power and authority as the attorney general, and he shall, before entering upon the duties of his office, take and subscribe the official oath prescribed by the Constitution.

Source: SDC 1939, § 55.1502; SL 1963, ch 305.

1-11-5. Special assistants--Appointment and powers. The attorney general is also authorized to appoint assistant attorneys general as he may deem necessary on a part-time basis for special assignments. The attorney general shall fix their compensation and the expenditures for such appointments may be made from whatever appropriation or source that may be made available to the attorney general. The appointment of such assistants shall be in writing and filed in the Office of the Secretary of State. Such assistant attorneys general shall have the power and authority specifically delegated to them by the attorney general in writing. Such assistant attorney general shall, before entering upon the duties of his office, take and subscribe the official oath prescribed by the Constitution.

Source: SDC 1939, § 55.1502 as added by SL 1963, ch 305.

1-11-15. Consolidation of legal services in state government. Except for legal services performed by a deputy or assistant attorney general employed by the state, any legal services performed for the state or any branch, department, agency, institution, board, commission, or other entity of state government shall be performed pursuant to a written contract. All contracts for legal services shall be filed with the attorney general. The provisions of this section do not apply to any attorney employed by the Unified Judicial System, the Legislative Research Council, or the judicial or legislative branches of the state.

Source: SL 1994, ch 6.

1-52-3.2. Purpose of Governor's Office of Economic Development. The Governor's Office of Economic Development shall forge a private-public partnership among state government, local communities, higher education, and the private sector to create jobs that create goods and services for use within the state and for export outside the state, which results in the creation of new wealth.

Source: SL 1987, ch 390 (Ex. Ord. 87-1), § 32; SDCL, § 1-33-18; SL 2005, ch 10, § 14.

13-49-1. Control of educational institutions vested in board--Appointment of members. The control of the public postsecondary educational institutions of the state offering college credit which are sustained wholly or in part by the state is vested in a board of nine members, designated as the Board of Regents. The Governor shall appoint the members with the consent of the Senate.

Source: SDC 1939, § 15.0701; SL 1955, ch 38, § 1; SL 1971, ch 129; SL 1976, ch 126, § 1; SL 1979, ch 125, § 1; SL 2007, ch 109, § 1.

13-49-11. Corporate powers of board--Management of property. The Board of Regents is, and it and its successors in office shall continue to be, a corporation, or body corporate, with power to sue and be sued, to hold, lease, and manage, for the purposes for which they were established, any property belonging to the educational institutions under its control, collectively or severally, of which it shall in any manner become possessed.

Source: SDC 1939, § 15.0706; SL 1989, ch 155.

13-59-1. Names, locations, and purposes of schools--Degrees authorized by Board of Regents. The primary purpose of Northern State University, at Aberdeen in Brown County, and Black Hills State University, at Spearfish in Lawrence County, is the preparation of elementary and secondary teachers, and a secondary purpose is to offer preprofessional, one-year and two-year terminal and junior college programs. Four-year degrees other than in education and graduate work may be authorized by the Board of Regents.

Source: SDC 1939, §§ 15.1301 to 15.1303; SL 1939, ch 39, § 1; SL 1941, ch 59; SL 1947, ch 58; SL 1947, ch 59; SL 1964, ch 36, §§ 1, 2; SDCL, §§ 13-59-2, 13-59-3; SL 1969, ch 41; SL 1975, ch 128, § 359; SL 1984, ch 142, § 1; SL 1989, ch 170, § 1.

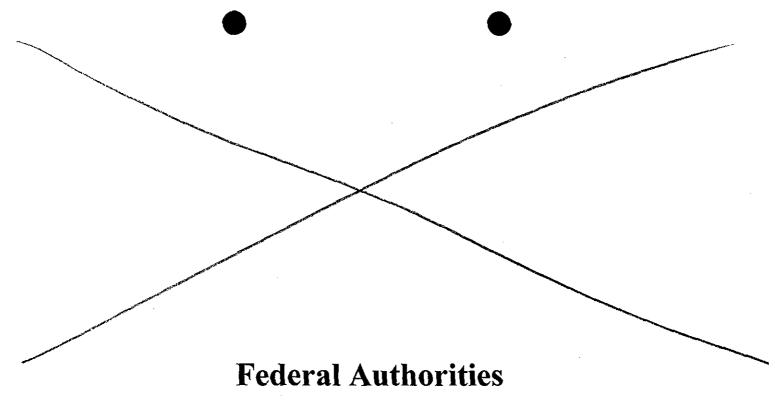
South Dakota Constitution

Article XIV, Section 3

§ 3. Board to govern state educational institutions. The state university, the agriculture college, the school of mines and technology, the normal schools, a school for the deaf, a school for the blind, and all other educational institutions that may be sustained either wholly or in part by the state shall be under the control of a board of five members appointed by the Governor and confirmed by the senate under such rules and restrictions as the Legislature shall provide. The Legislature may increase the number of members to nine.

History: Amendment proposed by SL 1895, ch 36, approved Nov., 1896; amendment proposed by SL 1913, ch 133, rejected Nov., 1914; amendment proposed by SL 1943, ch 264, approved Nov., 1944.

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Fisser v. International Bank (2nd Cir. 1960) 282 F. 2d 231

Lazarescu v. Arizona State University (D.Ariz. 2005) 230 F.R.D. 596

South Dakota Board of Regents v. Hoops (D.S.D. 1986) 624 F. Supp. 1179

Thomson-CSF, S.A. v. American Arbitration Assn. (2nd Cir. 1995) 64 F. 3d 773

Volt Info. Sciences v. Leland Stanford Jr. Univ. (1989) 489 U.S. 468

> Watts v. Pinckney (9th Cir. 1985) 752 F. 2d 406



LEXSEE 282 F.2D 231

Carl FISSER and Martha Fisser, co-partners doing business under the firm name and style of Fisser & v. Doornum, Libelants-Appellants, v. INTERNATIONAL BANK, Respondent-Appellee

No. 274, Docket 25914

UNITED STATES COURT OF APPEALS SECOND CIRCUIT

282 F.2d 231; 1960 U.S. App. LEXIS 3916

April 5, 1960, Argued August 1, 1960, Decided

COUNSEL: [**1] George L. Varian, of Crowell, Rouse & Varian, New York, City, for libelants-appellants.

Emanuel Becker, of Becker & Martin, New York City, for respondent-appellee.

JUDGES: Before LUMBARD, Chief Judge, and HINCKS and FRIENDLY, Circuit Judges.

OPINION BY: HINCKS

OPINION

The immediate issue for decision is whether the respondent-appellee, International Bank, may be directed to submit to arbitration the determination and [*233] measure of any liability it may owe to libelants-appellants, 1 German coal importers, 2 by reason of the conceded breach of a written contract of affreightment signed solely by the libelants and Allied Transportation Corporation, a Liberian corporation which libelants charge was the alter ego of the respondent. The court below answered this question in the negative. It reasoned that whatever liability might ultimately attach to the respondent growing out of the contract default of Allied, its alleged instrumentality or adjunct, the respondent could not be compelled to arbitrate the issue of its liability or the measure thereof because it had not signed the formal charter-party and hence as to it there was no'written provision' for arbitration [**2] within the meaning of the Federal Arbitration Act of 1952, 9 U.S.C. §§ 1-14. Accordingly, the court dismissed the libel with its accompanying petition for the enforcement of arbitration.

It is true that under the Act, a 'written provision in any maritime transaction * * * to settle by arbitration a controversy thereafter arising out of such * * * transaction' is the sine qua non of an enforceable arbitration agreement. 9 U.S.C. §§ 2, 4. It does not follow, however, that under the Act an obligation to arbitrate attaches only to one who has personally signed the written arbitration provision. 3 For the Act contains no built-in Statute of Frauds provision 4 but merely requires that the arbitration provision itself be in writing. Ordinary contract principles determine who is bound by such written provisions 5 and of course parties can become contractually bound absent their signatures. It is not surprising then to find a long series of decisions which recognize that the variety of ways in which a party may become bound by a written arbitration provision is limited only by generally operative principles of contract law.6

[*234] [**3] The charter-party here under consideration clearly contains a written provision in which it is agreed that a controversy such as that now presented shall be submitted to arbitration, ⁷ and the sole issue for determination is whether the respondent, as well as the formal signatories to the charter-party, is bound by the arbitration provision. Libelants argue that if in fact Allied was the respondent's mere alter ego, making this a proper case to pierce the corporate veil of Allied and to hold those controlling it as one with it, then consistency and the alter ego doctrine itself require that the respondent be obligated not only to respond in damages for Allied's breach of contract but to specifically perform

Allied's other contractual obligations, including that of arbitration.

We agree. While we discover no authority on this precise point, it is clear that the consequence of applying the alter ego doctrine is that the corporation and those who have controlled it without regard to its separate entity are treated as but one entity, and at least in the area of contracts, the acts of one are the acts of all. Weisser v. Mursam Shoe Corporation, supra; Shamrock Oil and Gas Co. v. Ethridge, D.C.Colo., 159 F.Supp. 693; [**4] Chilean Nitrate Sales Corp. v. The Nortuna, supra; Powell, Parent and Subsidiary Corporations, Chpt. I. There is no reasonable basis for distinguishing between the parent's obligation to respond in damages for its instrumentality's breach of contract and its obligation to arbitrate the measure of those damages. In neither instance does the parent consent to a contractual obligation; to the contrary it carefully avoids any such agreement, express or implied in fact. Farm Security Administration, Department of Agriculture v. Herren, 8 Cir., 165 F.2d 554.

We have heretofore held that the obligation to respond in damages arises from a contract to which the alter ego theory binds that parent which as 'puppeteer' has 'directed his marionnette' to sign. Weisser v. Mursam Shoe Corporation, supra. We hold now that if the parent is bound to the contract [*235] then like its marionette it is bound to submit to arbitration. 8 It follows that the judge erred in ruling that the respondent was not bound by the arbitration clause merely because it had not signed the charter. The respondent's amenability to arbitration could be solved only by determining whether [**5] Allied in entering into the charter did so as the respondent's alter ego. 9 The judge below thought it unnecessary to deal with that issue and so did not attempt to make comprehensive findings of the facts upon which it depends. We must, therefore, turn to the evidence and make our own findings.

We find the facts to have been as follows. On October 24, 1955 Mr. Lawn, who stated he represented a financial group, requested Phs. van Ommeren Shipping (U.S.A.), Inc., a firm of maritime brokers, to negotiate for ship charters and maritime contracts of affreightment. On that occasion and at later meetings on October 27 and 31 Lawn received general information about the incidents of such business from Mr. Solleveld and Mr. Vincent, the president and vice-president, respectively, of van Ommeren. At the latter meeting van Ommeren's representatives insisted that they could proceed no further with such business until authorized by a principal with a satisfactory credit rating. Lawn disclosed the respondent as principal, stating that it would operate through a Liberian company. On November 3 Lawn presented as evidence of his authority a letter dated November 2 from the respondent signed [**6] by Vreeland, its president. The letter stated, in part:

'We have in principle accepted a proposal to finance and conduct a shipping business which includes time chartering two Liberty dry cargo type ships to carry cargo generally between Mexico, the United States and certain foreign countries.

'The business would be operated through a corporation to be formed by us and to which we would supply the financial resources.

'We advise you of the foregoing so that the initiation of contracts may be expedited pending prompt formalization of the necessary corporate and financial arrangements. * * *'

The letter also referred van Ommeren to respondent's correspondent banks and listed respondent's officers and directors and their business connections. Prior thereto the respondent had been engaged in the business of financing ventures but never in operating ventures.

Thereafter, van Ommeren canvassed the market to discover available ships and cargoes. It secured an offer on two ships and so advised respondent by letter dated November 9 in which it requested authorization to negotiate and finalize the charters. No response was forthcoming until November 16 when Vreeland accompanied by Lawn [**7] and a Mr. Simonson discussed the project thoroughly with the van Ommeren representatives who told him that \$ 100,000 to \$ 150,000 would be necessary to start the venture. Vreeland gave van Ommeren authority to bid for charters on the two vessels and to continue negotiations on an available coal contract which van Ommeren had discovered. Also, Vreeland concededly told van Ommeren that the respondent would neither appear on nor guarantee the coal contract; that the contract would be performed by a Liberian corporation to be created for that purpose.

At this point, a conflict of testimony developed. Solleveld and Vincent testified [*236] that Vreeland's explanation to them for operating through a foreign subsidiary was to avoid the payment of United States income taxes; this explanation they accepted since such was common procedure for shipping ventures. These van Ommeren officers also testified that Vreeland assured them the respondent would furnish Allied with all necessary financial resources and that as responsible principal it would stand behind the performance of the operating company which it had nominated. There was, however, no evidence that these representations to van [**8] Ommeren were passed along to the libelants. And that such representations had been made was denied in Vreeland's testimony. He testified that the respondent's sole interest in the maritime venture, either expressed or otherwise, was the making of a secured loan to Allied. In his testimony he characterized as 'unfortunate' his language in the November 2 letter stating that respondent was 'prepared to conduct a shipping business.'

Whatever representations were in fact made to van Ommeren that firm successfully negotiated by November 28 a three-year coal contract with the libelants which was to commence April 1, 1957. In the course of these negotiations van Ommeren informed libelants that it was acting on behalf of Allied, a company 'nominated and controlled by International Bank who will not appear in Charter Party'; that the respondent had numerous companies available for a variety of purposes. The libelants informed van Ommeren that they had been unable to obtain a financial report on Allied and therefore requested a more detailed report on the respondent. In response van Ommeren forwarded a list of the respondent's officers and directors and their business connections. Neither [**9] van Ommeren nor the respondent ever made additional representations to the libelants relative to the relationship between Allied and the respondent.

At a conference on November 28, in response to Vincent's request for formal authorization to confirm the coal contract, Vreeland orally replied: 'I give you that authority.' (Now on appeal it is sharply disputed whether he gave this authority on behalf of respondent, as its president, or on behalf of Allied, as its president.) On that same day van Ommeren confirmed the contract with the libelants and simultaneously sent a letter to the respondent, attention Vreeland, in part as follows:

'We have pleasure in confirming herewith the fixture, made with your authority on behalf of Allied * * * which Corporation is understood to be controlled by you, as Owners and/or Charter Owners and/or Disponent Owners, with * * *.'

Vreeland acknowledged this letter in a letter of his own which was both written on respondent's letterhead and signed by Vreeland, as its president. He therein informed van Ommeren that a Mr. Becker had been retained by Allied to supervise its shipping activities. The letter stated, in part:

'From time to time Mr. Becker [**10] will be in touch with you regarding the operations of Allied Transportation Corporation which will be under your management and we want you to know that he is authorized to discuss with you all and any matters pertaining to these operations. We also authorize you to turn over to Mr. Becker, upon his request, any reports, contracts or other documents which concern such operations.'

On December 21, the contract was formally approved by Allied's directors and on December 28,

Vreeland signed the formal contract in the name of Allied after it had been carefully scrutinized by the respondent's attorneys. It was subsequently signed by the libelants. Allied completely breached the contract: it took no steps by way of performance. Indeed, it was wholly without financial ability to perform, never having had capital in excess of the \$ 500 paid by Simonson for one half of the capital stock, as will presently appear.

[*237] The relationship between the respondent, Allied, Simonson and Lawn was in fact as follows. The latter two men first became associated with the respondent in connection with the shipping venture. It was agreed that they were to act as Allied's managers in developing [**11] cargo contracts. Vreeland testified that the respondent agreed only to finance Allied through a secured loan but Lawn testified that at some time prior to November 16 it was agreed that respondent would own 50% Of Allied's stock and that the remaining 50% Would belong to Simonson but would be held by respondent as collateral until the operation resulted in a profit sufficient to repay \$ 100,000 of the \$ 150,000 loan which respondent agreed to advance Allied.

Meanwhile, Allied had been organized by one of respondent's subsidiaries on November 18. At that time the organization dummies executed proxies, two of which ran to Vreeland and one to Simonson who was not connected with the respondent. The subscriptions of the three dummies to one share each were assigned to respondent but no certificates of stock were then or thereafter ever issued. At the first stockholders' meeting on December 21, Vreeland, Simonson and Meyer, who was respondent's treasurer, were elected directors together with a lawyer, Wasson, who had previously represented certain of respondent's subsidiaries. These four men were also elected president, vice-president, treasurer and secretary, respectively. At the [**12] first directors' meeting it was voted that checks signed by the president or treasurer (who held corresponding offices in the respondent) must also be signed by Simonson, vice-president, or Lawn, agent (neither of who was an officer or employee of the respondent). At the trial, none of these mem could say who had paid Allied's organization fees and the cost of such items as its minute book and stock ledgers.

On December 28, Allied, Simonson and respondent of entered into a written agreement defining their relations. Under this agreement, Simonson agreed to purchase the 500 authorized shares of Allied's common stock at \$1 per share. These shares were to be issued to respondent, however, and it was to have full voting power until such time as Allied repaid respondent's \$100,000 loan. Allied agreed to repay the loan not later than February 1, 1957 and respondent on its part agreed to purchase or secure a purchaser for \$50,000 of converti-

ble preferred stock and to vote to retain Simonson as a member of the board and as vice-president as long as it remained holder of record of Simonson's shares.

Thereafter, Vreeland made contact with Gevers, an officer of the Bankers Trust Company, [**13] and inquired into the possibility of discounting Allied's \$ 100,000 note if it were endorsed by respondent. Gevers testified that Vreeland stated that respondent planned to enter the shipping field for which purpose it had created Allied. Vreeland in his testimony categorically denied making such a statement. It is agreed, however, that Bankers Trust Company consented to the proposed loan. Shortly thereafter the loan request was withdrawn and Allied never received any funds. For unexplained reasons respondent never purchased Allied's convertible preferred stock and Meyer never deposited Simonson's \$ 500 check in payment for the common stock. Nor did respondent ever loan Allied any money. Vreeland testified that it was the respondent's intention to make the loan only if Allied could carry out the business it had undertaken and this became impossible because Allied could not procure ships.

The foregoing facts, we hold, do not justify disregard of Allied's separate existence. An examination of all the cases which the parties cite and of many others dealing with this problem [*238] has left us with the conviction that nowhere is there a better statement of the generally [**14] applicable principles than that found in Lowendahl v. Baltimore & Ohio R.R. Co., 247 App.Div. 144, 287 N.Y.S. 62, affirmed 272 N.Y. 360, 6 N.E.2d 56. There, borrowing heavily from a leading text on this subject, 11 the court said:

'Restating the instrumentality rule, we may say that in any case, except express agency, estoppel, or direct tort, three elements must be proved:

- '(1) Control, not mere majority or complete stock control, but complete domination, not only of finances, but of policy and business practice in respect to the transaction attacked so that the corporate entity as to this transaction had at the time no separate mind, will or existence of its own; and
- '(2) Such control must have been used by the defendant to commit fraud or worse, to perpetrate the violation of a statutory or other positive legal duty, or a dishonest and unjust act in contravention of plaintiff's legal rights; and!
- proximately cause the injury or unjust loss complained of.' (247 App. Div. 144, 287 N.Y.S. 76.)

We incline to think that the libelants have failed to prove such control over Allied by the respondent [**15] as to bring its case within the first requirement of the rule

as above-stated. For aught that appears, Vreeland in authorizing van Ommeren to confirm the contract may have been acting as Allied's president — not as an executive of the respondent. Likewise, as to the arrangements for the loan from the Bankers Trust Company, and the subsequent withdrawal of the request therefor; also the arrangements whereby Becker was employed to supervise Allied's activity.

The proofs do not show that in doing these things, or others transpiring subsequent to Allied's organization, executives of the respondent were directly meddling with the management of Allied's affairs: it is equally plausible to ascribe the acts to the same individuals as Allied's executives participating in a manner normal and usual for stockholders and directors of an independent corporation. ¹² It would, of course, be a complete disregard of the basic structure of corporation law to hold that Allied, merely because it elected the respondent's officers to be its officers, forfeited its entity and deprived its parent-stockholder of immunity from liability for its contracts. ¹³

Moreover, there were outsiders on Allied's [**16] Board of Directors whose signature was required on checks signed by Vreeland and Meyer (officers of both Allied and the respondent) and who had demonstrated their independence by obtaining an arms-length contract with the respondent for Allied's financial requirements. These same outsiders were to be active in the management of Allied and it might well be said that they were the real entrepreneurs in the entire venture. Lowendahl v. Baltimore [*239] & Ohio R.R. Co., supra. 4 The proofs as to control on which the libelants rely, including the testimony of van Ommeren's officers as to statements made to them by Vreeland, 15 are fairly ascribable to the ordinary and temporary control over an incipient corporation by its incorporators. Such proofs, in our opinion, are not enough to demonstrate that Allied, subsequent to its organization, lacked an independent entity.

But even if on the issue of control the preponderance of the evidence favored the libelants, it is altogether plain that the second stated element of the rule has not been proved. There is no evidence that all the statements allegedly made by Vreeland to van Ommeren's officers had been passed along [**17] to libelants: they had been told only that the negotiations were 'on behalf of Allied, a company nominated and controlled by International Bank who will not appear in the charter party.' Surely there was no fraud in this representation, nor did it indicate an identity between respondent and Allied which now justifies a piercing of Allied's corporate veil. ¹⁶ It was foursquare with the truth: it misled the libelants not a whit. The caution that the respondent 'will not appear' apparently led them to make inquires as to Allied's financial standing. However, when their inquiries

turned up no information as to Allied -- a fact which of itself might have been expected to put them on their guard -- they made no demand on the respondent for a guarantee or other assurance. Nor did they inquire whether Allied even had the necessary ship-charters for performance. These omissions are perhaps of more significance in view of the earlier efforts in behalf of Allied or the respondent to obtain a guarantee from the libelants. The contract reserved to the libelants a right to cancel if at any time the German government prohibited the importation of American coal. It is plausible to ascribe [**18] to this provision, or perhaps to the favora-

ble freight rate, the libelants' readiness to deal with the subsidiary: they may well have felt that a thoroughly responsible principal such as the respondent could not be found which would accept such unfavorable terms. Even if the libelants on the strength of the representation believed that the respondent, because it 'nominated and controlled,' would be liable, its belief was not the product of the respondent's wrongdoing. We may not strip Allied of its separate entity merely because of the libelants' naivete nor because it is now dissatisfied with the bargain it made. New York Trust Co. v. Carpenter, 6 Cir., 250 F. 668; Texas Co. of Mexico S.A. v. Roos, 5 Cir., 43

F.2d 1; North v. Higbee Co., 131 Ohio St. 507, 3 N.E.2d 391; Hanson v. Bradley, 298 Mass. 371, 10 N.E.2d 259; Hooper-Mankin Co. v. Matthew Addy Co., 6 Cir., 4 F.2d 187. Certainly the respondent did not use its control over Allied to perpetrate the violation of any duty, statutory or otherwise, or any act, unjust or otherwise, in contravention of the libelants' legal rights. 17

[*240] The libelants [**19] make much of the fact that to carry out the contract Allied was greenly up.

fact that to carry out the contract Allied was grossly undercapitalized and claims this fact as a sufficient reason to pierce its corporate veil. There may be situations in which the launching of a subsidiary corporation upon the stream of commerce with capital grossly inadequate for its expected activities will be indicative of lack of an independent entity. However that may be, we are pointed to no authorities which justify a disregard of a corporation's separate existence merely because of its undercapitalization when its controlling stockholder has at least regarded the formalities of such existence. In Stark Electric R. Co. v. McGinty Contracting Co., supra, undercapitalization was not the only pertinent factor; the subsidiary was also represented as being one with the parent. And in Luckenbach S.S. Co. v. W. R. Grace & Cos. 4 Cir., 267 F. 676, while the subsidiary's disproportionate lack of capital was noted, there was also present the additional element of unconscionably holding the subsidiary out as the apparent owner of valuable assets. 18

In any event, this record affords no factual basis for such a claim. For aught that appears, [**20] the respondent and its associates, who were concededly unfamiliar with shipping ventures, were not unreasonable in their reliance on the predictions of experts that Allied would need no more than \$ 150,000 to successfully handle those operating expenses which would be incurred during the several months before monies would come due on the coal contract. While it is true that the respondent agreed to furnish \$ 100,000 of this sum through a loan rather than as a capital contribution, it also agreed to furnish an additional \$ 50,000 through the purchase of preferred stock. We cannot say that with these funds Allied would have been undercapitalized -- still less that its undercapitalization would have been so gross as to be a badge of fraud or wrong. At most, this was a case of inadequate capitalization, the risk of which under the normal rule the corporate creditors must bear.

Finally, even if we were to assume, as libelants would have us do, that respondent by failing to furnish Allied with the promised capital and loans thereby breached some duty owed to libelants, it is not proved that the libelants' loss was proximately caused thereby. Thus the third element of the above-stated [**21] rule is absent. 19 In fact, the sole explanation for Allied's failure to carry out the coal contract was its inability to charter vessels. And there is nothing to show that this inability was due to a failure of respondent's loan and capital commitments. Such evidence as there is flows in the opposite direction: it suggests that the respondent did not go through with the proposed loan to Allied because even with the loan ship charters could not be obtained. For owners having ships for hire demanded bankable charters which in turn depended upon the guaranty of a responsible United States corporation. This was an obvious risk inherent in dealing with a foreign subsidiary of a United States corporation and one which libelants cannot now claim was in any way caused by the wrongful control of an undercapitalized foreign subsidiary. The language of Judge Learned Hand is here appropriate. 'The libelant has been disappointed, not in failing to get the promise which it supposed, but in its performance, a risk [*241] inherent in any contract.' Kingston Dry Dock Co. v. Lake Champlain Transportation Co., 2 Cir., 31 F.2d 265, at p. 267.

And so, not because the contract [**22] had not been signed by the respondent but because the libelants failed to prove that Allied was the respondent's alter ego,

The judgment below is affirmed.

- 1. Throughout this opinion we will refer to the parties by their relation to the controversy below.
- 2. The libel was filed by Fisser & v. Doornum, a German partnership engaged in the import and wholesale coal business and as shipowners and brokers, on its own behalf as the chartering broker and on behalf of certain named German

entities. Judge Palmieri in an earlier opinion ruled that the libel was properly brought by the libelants on their behalf and for the benefit of their named principals. 164 F.Supp. 826.

3. Even assuming, arguendo, that a party can bind himself to a 'written provision' for arbitration only by signing such a provision, still, based upon ample authority in related fields, this would be no obstacle to imputing to a controlling parent its instrumentality's contractual obligation to arbitrate. Thus we noted in Weisser v. Mursam Shoe Corporation, 2 Cir., 127 F.2d 344, 145 A.L.R. 467, that the better reasoned authorities do not allow a defendant to abuse the privilege of stockholder-immunity by invoking the Statute of Frauds or the sealed instrument rule where its instrumentality, at least, has signed the necessary instrument. See Powell, Parent and Subsidiary Corporations, Chpt. V. and VIII.

[**23]

- Compare § 1449 of the New York Civil Practice Act which states that 'every submission to arbitrate an existing controversy is void, unless it or some note or memorandum thereof be in writing and subscribed by the party to be charged therewith or by his lawful agent.' (Emphasis added.) This provision obviously conditions the enforceability of a submission to arbitrate an existing controversy upon the signature of the party to be charged. Bellmore Dress Co. v. Tanbro Fabrics Corp., Sup., 115 N.Y.S.2d 11; In re Exeter Mfg. Co., 254 App.Div. 496, 5 N.Y.S.2d 438. These same authorities hold, however, that under another portion of § 1449, which like the Federal Arbitration Act provides that '(a) contract to arbitrate a controversy thereafter arising between the parties must be in writing, the liability of a party is determined by the ordinary principles of the law of contracts.
- 5. American Airlines, Inc. v. Louisville & Jefferson C.A.B., 6 Cir., 269 F.2d 811; Kulukundis Shipping Co. v. Amtorg Trading Corp., 2 Cir., 126 F.2d 978; Goldhill Trading & Ship. Co., etc. v. Caribbean Ship. Co., D.C.S.D.N.Y., 56 F.Supp. 31; cf. Corbin on Contracts, Vol. 6, § 1444A.

[**24]

6. Thus assignees of contracts containing arbitration provisions may become parties to such provisions, Application of Reconstruction Finance Corp., D.C.S.D.N.Y., 106 F.Supp. 358 (and cases cited therein); Instituto Cubano v. The M. V. Driller, D.C.S.D.N.Y., 148 F.Supp. 739; Corbin on contracts, Vol. 4, 892. The same result is reached under the New York Act, Matter of Lippman v. Haeuser Shell Co., 289 N.Y. 76, 43

N.E.2d 817, 142 A.L.R. 1088. Similarly, an optionee by exercising an option may create a mutually binding contract to arbitrate, Calvine Mills, Inc. v. L. A. Slesinger Inc., 2 Cir., 258 F.2d 288. When a party is added to a contract by novation he can enforce an arbitration provision therein even though he is not a signatory to the contract. And enforcement can be had against another nonsignatory who it merely the instrumentality of a party bound by the arbitration clause. Chilean Nitrate Sales Corp. v. The nortuna, D.C.S.D.N.Y., 128 F.Supp. 938. Also, a corporate beneficiary may enforce an arbitration provision which was executed when it was still inchoate. Application of Jacoby, Sup.Ct.N.Y.Co., N.Y.Co., 33 N.Y.S.2d 621. See also Parry v. Bache, 5 Cir., 125 F.2d 493; In re Exeter Mfg. Co., supra; and Bellemore Dress Co. v. Tanbro Fabrics Corp., supra, for other illustrations of parties being contractually bound to written arbitration provisions absent their signatories to such agreements.

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7. Section 3 of the charter-party provided: '* *
* If any dispute or difference should arise under this Charter, same to be referred to three parties in the City of New York, one to be appointed by each of the parties hereto, the third by the two so chosen, and their decision, or that of any two of them, shall be final and binding, and this agreement may, for enforcing the same, be made a rule of Court. Said three parties to be commercial men.'

It is no longer open to serious question that, even if damages are the sole issue for arbitration, that issue is within a clause of general arbitration and under the Federal Arbitration Act the clause will be specifically enforced against all those bound by it. Shanferoke Coal & Supply Corp. v. Westchester Service Corp., 2 Cir., 70 F.2d 297, affirmed 293 U.S. 449, 55 S.Ct. 313, 79 L.Ed. 583; Kulukundis Shipping Co. v. Amtorg Trading Corp., supra.

8. The libelants relied below upon Lehman v. Ostrovsky, 264 N.Y. 130, 190 N.E. 208; In re Bond and Mortgage Guarantee Co., 288 N.Y. 270, 42 N.E.2d 38; and General Commodities Corp. v. Hyman-Michaels Co., 9 Cir., 224 F.2d 952. But these cases are plainly distinguishable from that now before us. More directly in point and in accord with our conclusion is Judge Dawson's opinion in Chilean Nitrate Sales Corp. v. The Nortuna, supra.

[**26]

- 9. The libelants do not claim that Allied in signing the charter was the respondent's authorized agent.
- 10. In this, the respondent acted through the International Bank of Washington, a New York corporation wholly owned by it, to which it had transferred the operation of its foreign department.
- 11. Powell, Parent and Subsidiary Corporations (1931), pp. 4-6.
- 12. See Consolidated Rock Products Co. v. Du Bois, 312 U.S. 510, 523-524, 61 S.Ct. 675, 85 L.Ed. 982; United States v. Reading Co., 253 U.S. 26, 62, 40 S.Ct. 425, 64 L.Ed. 760; Kingston Dry Dock Co. v. Lake Champlain Transp. Co., 2 Cir., 31 F.2d 265 (and cases cited therein); Hollander v. Henry, 2 Cir., 186 F.2d 582; Costan v. Manila Electric Co., 2 Cir., 24 F.2d 383; Centmont Corporation v. Marsch, 1 Cir., 68 F.2d 460; Hooper-Mankin Co. v. Matthew Addy Co., 6 Cir., 4 F.2d 187; Fish v. East, 10 Cir., 114 F.2d 177.
- 13. See Taylor v. Standard Gas & Electric Co., 10 Cir., 96 F.2d 693, and the many cases cited therein, reversed on other grounds, 306 U.S. 307; Hooper-Mankin Co. v. Matthew Addy Co., supra; Garden City Co. v. Burden, 10 Cir., 186 F.2d 651; Powell, fn. 11, supra, at p. 10; Fletcher, Cyclopedea of Private Corporations, 43 at pp. 158-159.

[**27]

14. We note also the probability that respondent, as contrasted with Allied, had no power to carry on a shipping venture, i.e., that the held corporation had power to engage in activities without the scope of those authorized for the parent. This is a factor of considerable weight

- against a piercing of Allied's corporate veil. Fletcher, fn. 13, supra, at 43, fn. 76.
- 15. Although these statements were denied by Vreeland, for purposes of this opinion we take them as true.
- 16. This representation differed vitally from those in such cases as Weisser v. Mursam Shoe Corporation, supra; Hollander v. Henry, supra; Stark Electric R. Co. v. McGinty Contracting Co., 6 Cir., 238 F. 657.
- 17. See, e.g., Anderson v. Abbott, 321 U.S. 349, 64 S.Ct. 531, 88 L.Ed. 793; Weisser v. Mursam Shoe Corporation, supra; United States v. Morris & Essex R. Co., 2 Cir., 135 F.2d 711; Majestic Co. v. Orpheum Circuit, 8 Cir., 21 F.2d 720 (and many cases cited therein); Texas Co. of Mexico S.A. v. Roos, supra; New York Trust Co. v. Carpenter, supra; Bartle v. Home Owners Cooperative, 309 N.Y. 103, 127 N.E.2d 832; North v. Higbee Co., supra; United States v. Islip Machine Works, Inc., D.C.E.D.N.Y., 179 F.Supp. 585, Powell, fn. 11, supra, Chpt. III.

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- 18. This fact has led one commentator to classify this case as one growing out of estoppel, and it is of some interest that this same commentator makes no separate classification of mere undercapitalization as an actionable wrong, although he does list it as one persuasive, though not controlling, circumstance indicating improper control over a mere instumentality. Powell, fn. 11, supra, at pp. 14 and 66. Compare Note, 71 Harv.L.Rev. 1122, 1132-1133.
- 19. See Majestic Co. v. Orpheum Circuit, fn. 17, supra; North v. Higbee Co., supra; Hanson v. Bradley, supra; cf. Powell, fn. 11, supra, Chpt. IV.

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230 F.R.D. 596, 202 Ed. Law Rep. 675 (Cite as: 230 F.R.D. 596)

C

United States District Court, D. Arizona. Traian LAZARESCU, Plaintiff,

ARIZONA STATE UNIVERSITY, Office for Civil Rights of the U.S. Department of Education, Defendants.

No. CV 2004-1826 PHX ROS.

July 5, 2005.

Background: State university applicant who was denied admission brought pro se action against state university, alleging violations of federal and state law. University moved to dismiss and to strike, and applicant moved for leave to amend.

Holdings: The District Court, Silver, J., held that:

- (1) university's Eleventh Amendment immunity was not abrogated with respect to applicant's claim that he was discriminated against by the university by virtue of his status as a transfer student;
- (2) university's requirement that its transfer students complete a certain amount of hours at the institution before they would be allowed to enroll in additional classes above the standard number allowed per semester was rationally related to state's legitimate interest in education:
- (3) univ ersity's motion to strike applicant's second response to motion to dismiss would be granted; and (4) state university could not be subject to suit.

Motions granted in part, and denied in part.

West Headnotes

[1] Federal Civil Procedure 170A 657.5(1)

170A Federal Civil Procedure

§: 170AVII Pleadings and Motions .

170AVII(A) Pleadings in General

170Ak654 Construction

170Ak657.5 Pro Se or Lay Pleadings 170Ak657.5(1) k. In General, Most

Cited Cases

Pro se litigants are not held to the same standards in

drafting pleadings as are attorneys.

[2] Constitutional Law 92 4863

92 Constitutional Law

92XXVIII Enforcement of Fourteenth Amendment

92XXVIII(B) Particular Issues and Applications

92k4861 Governmental Immunity in Gen-

eral

92k4863 k. Abrogation of Immunity.

Most Cited Cases

(Formerly 92k82(6.1))

Federal Courts 170B 265

170B Federal Courts

170BIV Citizenship, Residence or Character of Parties, Jurisdiction Dependent on

170BIV(A) In General

170Bk264 Suits Against States

170Bk265 k. Eleventh Amendment in

General; Immunity. Most Cited Cases

Abrogation of a state's Eleventh Amendment immunity is limited to valid exercises of Congress' power under the Fourteenth Amendment, U.S.C.A. Const. Amends. 11, 14.

[3] Constitutional Law 92 5 3626(1)

92 Constitutional Law

92XXVI Equal Protection

92XXVI(E) Particular Issues and Applications

92XXVI(E)8 Education

92k3621 Post-Secondary Institutions 92k3626 Students

92k3626(1) k. In General. Most

Cited Cases

(Formerly 92k242.2(5.1))

Constitutional Law 92 4873

92 Constitutional Law

92XXVIII Enforcement of Fourteenth Amendment

92XXVIII(B) Particular Issues and Applica-

tions

92k4873 k. Education. Most Cited Cases (Formerly 92k243.2, 92k242.2(5.1))

Federal Courts 170B 269

170B Federal Courts

<u>170BIV</u> Citizenship, Residence or Character of Parties, Jurisdiction Dependent on

170BIV(A) In General

170Bk268 What Are Suits Against States 170Bk269 k. State Officers or Agencies,

Actions Against. Most Cited Cases

State university's Eleventh Amendment immunity was not abrogated with respect to state university applicant's pro se claim that he was discriminated against by the university by virtue of his status as a transfer student, under federal statute prohibiting denial of educational opportunity based on race, color, sex, or national origin; neither statute nor the Fourteenth Amendment protected academic status or origin. U.S.C.A. Const.Amends. 11, 14; Educational Amendments of 1974, § 204, 20 U.S.C.A. § 1703.

[4] Constitutional Law 92 533

92 Constitutional Law

92XXVI Equal Protection

92XXVI(A) In General

92XXVI(A)6 Levels of Scrutiny

92k3052 Rational Basis Standard;

Reasonableness

92k3053 k. In General. Most Cited

Cases

(Formerly 92k213.1(2))

When states create classifications that are not based on race, gender, or religion, the classification can survive an equal protection claim if it is rationally related to a state interest. <u>U.S.C.A. Const.Amend. 14</u>.

[5] Colleges and Universities 81 9.35(1)

81 Colleges and Universities

81k9 Students

81k9.35 Curriculum, Degrees, Grades, and Gredits

81k9.35(1) k. In General. Most Cited Cases

Constitutional Law 92 3626(1)

92 Constitutional Law

92XXVI Equal Protection

92XXVI(E) Particular Issues and Applications

92XXVI(E)8 Education

92k3621 Post-Secondary Institutions

92k3626 Students

92k3626(1) k. In General. Most

Cited Cases

(Formerly 92k242.2(5.1))

State university's requirement that its transfer students complete a certain amount of hours at the institution before they are allowed to enroll in additional classes above the standard number allowed per semester was rationally related to state's legitimate interest in making sure that students obtain the highest benefit from limited educational resources, and thus, requirement did not violate the Equal Protection Clause. <u>U.S.C.A.</u> Const.Amend. 14.

[6] Federal Civil Procedure 170A 1832

170A Federal Civil Procedure

170AXI Dismissal

170AXI(B) Involuntary Dismissal

170AXI(B)5 Proceedings

170Ak1827 Determination

170Ak1832 k. Matters Considered in

General. Most Cited Cases

Matters outside the pleadings are typically considered to be evidentiary on motion to dismiss.

[7] Federal Civil Procedure 170A \$\infty\$ 1825

170A Federal Civil Procedure

170AXI Dismissal

170AXI(B) Involuntary Dismissal

170AXI(B)5 Proceedings

170Ak1825 k. Motion and Proceedings

Thereon. Most Cited Cases

Defendant's motion to strike plaintiff's second response to defendant's motion to dismiss would be granted, where local court rules limited plaintiff to one responsive filing or reply for each motion, and plaintiff did not request leave to file an additional response and no such leave was granted by the court. Fed.Rules Civ.Proc.Rule 12(b), 28 U.S.C.A.

[8] Federal Civil Procedure 170A 1772

170A Federal Civil Procedure

170AXI Dismissal

170AXI(B) Involuntary Dismissal 170AXI(B)3 Pleading, Defects In, in Gen-

eral

170Ak1772 k. Insufficiency in General.

Most Cited Cases

Although it may appear on the face of the pleadings that a recovery is very remote and unlikely, that is not the test in a motion to dismiss for failure to state a claim. Fed.Rules Civ.Proc.Rule 12(b)(6), 28 U.S.C.A.

[9] Federal Civil Procedure 170A 657.5(2)

170A Federal Civil Procedure

170AVII Pleadings and Motions

170AVII(A) Pleadings in General

170Ak654 Construction

170Ak657.5 Pro Se or Lay Pleadings 170Ak657.5(2) k. Civil Rights Pro-

ceedings in General. Most Cited Cases

In civil rights cases where the plaintiff appears pro se, the court must construe the pleading liberally and must afford plaintiff the benefit of any doubt.

[10] Federal Civil Procedure 170A 235

170A Federal Civil Procedure

170AXI Dismissal

170AXI(B) Involuntary Dismissal

170AXI(B)5 Proceedings

170Ak1827 Determination

170Ak1835 k. Matters Deemed Ad-

mitted; Acceptance as True of Allegations in Complaint. Most Cited Cases

For purpose of a motion to dismiss for failure to state a claim, the district court need not assume that the plaintiff can prove facts different from those alleged in the complaint. Fed.Rules Civ.Proc.Rule 12(b)(6), 28 U.S.C.A.

[11] Federal Civil Procedure 170A 1772

170A Federal Civil Procedure

170AXI Dismissal

170AXI(B) Involuntary Dismissal

170AXI(B)3 Pleading, Defects In, in Gen-

eral

170Ak1772 k. Insufficiency in General.

Most Cited Cases

Federal Civil Procedure 170A 1835

170A Federal Civil Procedure

170AXI Dismissal

170AXI(B) Involuntary Dismissal

170AXI(B)5 Proceedings

170Ak1827 Determination

170Ak1835 k. Matters Deemed Ad-

mitted; Acceptance as True of Allegations in Com-

plaint. Most Cited Cases

Legal conclusions couched as factual allegations are not given a presumption of truthfulness, and conclusory allegations of law and unwarranted inferences are not sufficient to defeat a motion to dismiss. Fed.Rules Civ.Proc.Rule 12(b)(6), 28 U.S.C.A.

[12] Administrative Law and Procedure 15A €---305

15A Administrative Law and Procedure

15AIV Powers and Proceedings of Administrative Agencies, Officers and Agents

15AIV(A) In General

15Ak303 Powers in General

15Ak305 k. Statutory Basis and Limita-

tion. Most Cited Cases

In Arizona, the powers of any state agency are defined by the statutes creating it.

[13] States 360 \$\infty\$ 190

360 States

360VI Actions

360k190 k. Capacity of State to Sue in General. Most Cited Cases

States 360 5 191.9(1)

360 States

360VI Actions

360k191 Liability and Consent of State to Be Sued in General

360k191.9 Particular Actions

360k191.9(1) k. In General. Most Cited

Under Arizona law, the statutes creating a particular state entity must provide the agency with the power to sue and be sued.

[14] Colleges and Universities 81 210

81 Colleges and Universities

81k10 k. Actions. Most Cited Cases

Under Arizona law, state university could not be subject to suit, where state statute creating the university did not provide it with power to sue or be sued. A.R.S. § 15-1601.

*598 Traian Lazarescu, Scottsdale, AZ, pro se.

<u>Richard Albrecht</u>, Esq., Office of the Attorney General, Phoenix, AZ, for Defendants.

ORDER

SILVER, District Judge.

Pending before the Court are Defendant Arizona State University's ("ASU") Motion to Dismiss (Doc. # 4) and Motion to Strike (Doc. # 9). Also pending are Plaintiff's motion requesting the Court's leave to amend the Complaint to add the Arizona Board of Regents ("AZBR") as a defendant (included within his Response to Defendant Arizona State University['s] Motion to Dismiss (Doc. # 6)), and Plaintiff's Motion to Strike (Doc. # 10). For the reasons set forth below, both motions by ASU will be granted and Plaintiff's motions will be denied.

BACKGROUND

On August 31, 2004, Plaintiff filed a complaint in this Court alleging violations of Ariz.Rev.Stat. § 15-14-4, 50 App. U.S.C. § 451 et seq., and Title 34 of the Code of Federal Regulations. [Doc. # 1 (Compl.) ¶ 8.] All alleged violations stem from the ASU Financial Aid Office's request for proof of Plaintiff's Selective Service registration. [Id.] Plaintiff named as defendants both ASU and the Office for Civil Rights of the United States Department of Education ("DoE"). FN1 [Doc. # 1.] Plaintiff complained that the request for proof of registration is a pretext for ASU's denying him admission to the university due to complaints he had lodged regarding ASU's refusal to allow him to register for additional credit hours. [Id. at ¶ 7.] The essence of Plaintiff's complaint is that ASU discriminated against transfer students by not allowing them to take additional credit hours without first demonstrating their ability. [Id. at \P 7, 11.]

FN1. There is no evidence that the DoE was

ever served in this matter. While there is a Waiver of Service of Summons on file for ASU, nothing similar has been filed regarding the DoE.

Defendant ASU moved to dismiss the action on September 22, 2004 for failure to state a claim upon which relief can be granted, asserting that ASU is not an entity subject to suit and that the Eleventh Amendment prohibits a suit against a state entity. [Doc. # 4 (Mot.Dismiss) at 1.] On October 4, 2004, Plaintiff responded to the Motion to Dismiss claiming that it should be denied because any immunity enjoyed by Defendant ASU has been abrogated by Congress through the Fourteenth Amendment when it enacted legislation prohibiting discrimination in public education. [Doc. # 6 (Pl.'s Resp) at 2-3.] Additionally, in the October 4, 2004 filing, Plaintiff requested that the AZBR be named a defendant. [Id. at 5.] ASU replied on October 7, 2004 and reiterated that no immunity has been abrogated because the Fourteenth Amendment was not designed to protect against discrimination based on academic origin. [Doc. # 7 (Def.'s Reply) at 1-2.] Plaintiff filed a "Reply" to Defendant ASU's Reply on October 26, 2004. [Doc. # 8.]

On November 2, 2004, ASU moved to strike Plaintiff's Reply, noting that the filing was not authorized in the Federal Rules of Civil Procedure. [Doc. # 9 (Def.'s Mot. Strike) at 1.] On November 19, 2004, Plaintiff filed a Motion to Strike ASU's Motion to Strike, in turn alleging that ASU discussed matters outside the pleadings in the preceding motion, and thus Federal Rule of Civil Procedure 12(b) allowed "reasonable opportunity to present all material made pertinent to such a motion." [Doc. # 10 (Pl.'s Mot. Strike) at 2.] On November 30, 2004, ASU responded to Plaintiff's Motion to Strike, again citing that Federal Rule of Civil Procedure 7 was the basis of its original Motion to Dismiss. [Doc. # 11 (Def.'s Resp) at 1.] Plaintiff responded on December 22, 2004. [Doc. # 12.]

DISCUSSION

I. Plaintiff's Motion to Amend Complaint to include the Arizona Board of Regents as a Defendant (included in Doc. #6)

[1]Federal Rule of Civil Procedure 15(a) allows a party to amend a pleading "as a *599 matter of course at any time before a responsive pleading is served."

Additionally, pro se litigants such as Plaintiff are not held to the same standards in drafting pleadings as are attorneys. <u>Haines v. Kerner</u>, 404 U.S. 519, 520, 92 S.Ct. 594, 30 L.Ed.2d 652 (1972) (holding that pro se pleadings are held to "less stringent standards than [those] drafted by lawyers."); <u>Balistreri v. Pacifica Police Dep't</u>, 901 F.2d 696, 699 (9th Cir.1990) (holding that especially in civil rights claims, a court "has a duty to ensure that pro se litigants do not lose their right to a hearing on the merits ... due to ignorance of technical procedural requirements.").

[2] Even allowing Plaintiff the latitude due pro se litigants, his request to amend must be denied as futile. The Eleventh Amendment to the United States Constitution provides that: "The Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the Unites States by Citizens of another State, or by Citizens or Subjects of any Foreign State." In Fitzpatrick v. Bitzer, 427 U.S. 445, 96 S.Ct. 2666, 49 L.Ed.2d 614 (1976), the Court allowed Congress to abrogate state immunity, and thus subject states to retrospective damage suits, when Congress acts within its Fourteenth Amendment power. "We think that Congress may, in determining what is 'appropriate legislation' for the purpose of enforcing the provisions of the Fourteenth Amendment, provide for private suits against States or State officials" Id. at 456, 96 S.Ct. 2666. However, this abrogation of immunity is limited to valid exercises of Congress' Section 5 power of the Fourteenth Amendment. Seminole Tribe of Florida v. Florida, 517 U.S. 44, 72, 116 S.Ct. 1114, 134 L.Ed.2d 252 (1996) ("Article I cannot be used to circumvent the constitutional limitations placed upon federal jurisdiction."). See also Board of Trs. of the Univ. of Alabama v. Garrett, 531 U.S. 356, 374, 121 S.Ct. 955, 148 L.Ed.2d 866 (2001) (holding that Congress did not abrogate Eleventh Amendment immunity by enacting Title I of the Americans with Disabilities Act because the act did not fall within Fourteenth Amendment protections).

[3] Here, Plaintiff alleges that the Fourteenth Amendment provides for the abrogation of immunity when read in conjunction with 42 U.S.C. § 2000d-7, which allows for lawsuits against states for violations of specific pieces of legislation and other anticular conjunction statutes when the state accepts federal funding. Plaintiff suggests that 20 U.S.C. § 1703 is an anti-discrimination statute pursuant to which he

could bring his claim. FN2 These arguments are unpersuasive because the discrimination Plaintiff alleges is based on his academic origin (i.e., because he is a transfer student). Academic origin is not protected by the Fourteenth Amendment or by 20 U.S.C. § 1703. As a result, the AZBR's Eleventh Amendment immunity has not been rescinded by Congress. Further, the AZBR has not waived its immunity per Arizona Revised Statute § 15-1625. Harris v. Arizona Bd. of Regents, 528 F.Supp. 987, 994-95 (D.Ariz.1981) (holding that the provision in Arizona Revised Statutes § 15-1625 providing the AZBR the power to sue and be sued did not waive immunity, especially in federal court).

FN2.20 U.S.C. § 1703 provides: "No State shall deny equal educational opportunity to an individual on account of his or her race, color, sex, or national origin"

[4][5] Further, a general Fourteenth Amendment claim alleging denial of equal protection by AZBR is futile as the transfer student restriction satisfies the rational basis test. When states create classifications that are not based on race, gender, or religion, the classification can survive an equal protection claim if it is rationally related to a state interest. City of New Orleans v. Dukes, 427 U.S. 297, 303, 96 S.Ct. 2513, 49 L.Ed.2d 511 (1976). Here, the state interest is education. To ensure that students can obtain the highest benefit from limited educational resources, ASU requires that students have a minimum amount of completed credit hours at the university in order to take additional credit hours. This is to ensure that the student can handle the additional classes. As academic standards vary throughout the United States, the only way ASU can judge a student's ability is through their hours at ASU. Therefore, no equal protection violation is present when a university requires transfer students to complete a certain amount of *600 hours at the institution before they are allowed to enroll in additional classes above the standard number allowed per semester.

Consequently, amending the Complaint to add the AZBR as a defendant would be futile. Accordingly, Plaintiff's Motion to Amend Complaint will be denied.

II. Defendant's Motion to Strike Plaintiff's Reply to Defendant Arizona State University's Reply (Doc. #9)

In its Motion to Strike, ASU argues that Plaintiff's "Reply" to ASU's Reply to Plaintiff's Response to Defendant's Motion to Dismiss is not a valid filing. Local Rule 7.2 is on point. Local Rule 7.2(c) states that there should be one "responsive memorandum" by the opposing party after a motion is filed. Further, the filing party is entitled to a memorandum in reply according to Local Rule 7.2(d). "Unless otherwise ordered by the Court," no additional filings are authorized. LRCiv 7.2(c),(d).

An examination of the docket shows that ASU filed a motion to dismiss pursuant to Federal Rule of Civil Procedure 12(b) on September 22, 2004. The Plaintiff responded on October 4, 2004. On October 7, 2004, ASU replied. The docket further shows that Plaintiff did not request leave to file an additional response, and no such leave was granted by the Court.

[6][7] Plaintif f's reliance on Federal Rule of Civil Procedure 12(b) and "matters outside the pleading" to authorize an additional response is unfounded. Matters outside the pleadings are typically considered to be evidentiary. The jurisdictional issues ASU raises (sovereign immunity) are not evidentiary. See also National Agric. Chem. Ass'n v. Rominger, 500 F.Supp. 465, 472 (E.D.Cal.1980) (explaining that matters outside the pleadings are evidentiary and that a court has discretion whether to consider them). Any jurisdictional issues are certainly within the pleadings.

Consequently, Plaintiff's "Reply" to Defendant ASU's Reply in Support of its Motion to Dismiss (Doc. # 8) will be stricken.

III. Arizona State University's Motion to Dismiss pursuant to <u>Federal Rule of Civil Procedure 12(b)</u> because ASU is not an entity subject to suit (Doc. # 4)

A. Legal Standard

[8] A court may not dismiss a complaint for failure to state a claim "unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claims which would entitle him to relief." <u>Barnett v. Centoni</u>, 31 F.3d 813, 813 (9th Cir.1994) (citing <u>Buckey v. Los Angeles</u>, 957 F.2d 652, 654 (9th Cir.1992)). "The federal rules require only a 'short and

plain statement of the claim showing that the pleader is entitled to relief.' "Gilligan v. Jamco Dev. Corp., 108 F.3d 246, 248 (9th Cir.1997) (quoting Fed.R.Civ.P. 8(a)). Indeed, though "'it may appear on the face of the pleadings that a recovery is very remote and unlikely [,] ... that is not the test.' "Gilligan, 108 F.3d at 249 (quoting Scheuer v. Rhodes, 416 U.S. 232, 236, 94 S.Ct. 1683, 40 L.Ed.2d 90 (1974)). "'The issue is not whether the plaintiff will ultimately prevail but whether the claimant is entitled to offer evidence to support the claims.' "Id.

[9] It is well established that pro se complaints, "however inartfully pleaded[,] are held to less stringent standards than formal pleadings drafted by lawyers[.]" Hughes v. Rowe, 449 U.S. 5, 9, 101 S.Ct. 173, 66 L.Ed.2d 163 (1980) (quotation marks omitted); see Ortez v. Wash. County, 88 F.3d 804, 807 (9th Cir. 1996) ("Because Ortez is a pro se litigant, we must construe liberally his inartful pleading[.]") (citation omitted). "In civil rights cases where the plaintiff appears pro se, the court must construe the pleading liberally and must afford plaintiff the benefit of any doubt." Karim-Panahi v. L.A. Police Dep't, 839 F.2d 621, 623 (9th Cir.1988); Haines v. Kerner, 404 U.S. 519, 520, 92 S.Ct. 594, 30 L.Ed.2d 652 (1972); Frost v. Symington, 197 F.3d 348, 352 (9th Cir.1999) (citing Karim-Panahi, 839 F.2d at 623).

[10][11] When analyzing a complaint for failure to state a claim, "[a]ll allegations of material fact are taken as true and construed in the light most favorable to the non-moving *601 party." Smith v. Jackson, 84 F.3d 1213, 1217 (9th Cir.1996); see Miree v. DeKalb County, 433 U.S. 25, 27 n. 2, 97 S.Ct. 2490, 53 L.Ed.2d 557 (1977). In addition, the district court must assume that all general allegations "embrace whatever specific facts might be necessary to support them." Peloza v. Capistrano Unified Sch. Dist., 37 F.3d 517, 521 (9th Cir.1994), cert. denied, 515 U.S. 1173, 115 S.Ct. 2640, 132 L.Ed.2d 878 (1995) (citations omitted). The district court need not assume, however, that the plaintiff can prove facts different from those alleged in the complaint. See Associated Gen. Contractors of Cal. v. Cal. State Council of Carpenters, 459 U.S. 519, 526, 103 S.Ct. 897, 74 L.Ed.2d 723 (1983). Similarly, legal conclusions couched as factual allegations are not given a presumption of truthfulness and "conclusory allegations of law and unwarranted inferences are not sufficient to. defeat a motion to dismiss." Pareto v. F.D.I.C., 139

F.3d 696, 699 (9th Cir.1998).

B. Analysis

[12][13] ASU contends that it is not an entity subject to suit. In Arizona, the powers of any agency are defined by the statutes creating it. Ayala v. Hill, 136 Ariz. 88, 90, 664 P.2d 238, 240 (Ct.App.1983); Cox v. Pima County Law Enforcement Merit Sys. Council, 27 Ariz.App. 494, 495, 556 P.2d 342, 343 (Ct.App.1976). As this general rule relates to an agency being sued, the statutes creating the entity must provide the agency with the power to sue and be sued. Kimball v. Shofstall, 17 Ariz.App. 11, 13, 494 P.2d 1357, 1359 (Ct.App.1972) (holding that the State Board of Education could not sue or be sued because the statutes creating it did not provide it with such powers). Arizona Revised Statute § 15-1601 authorized the establishment of Arizona State University, but it did not grant the university the power to sue or be sued. Instead, pursuant to A.R.S. § 15-1625, that authority is vested with the AZBR, which oversees ASU.

[14] The effect of Arizona Revised Statutes §§ 15-1601 and 15-1625 is clear. Arizona State University cannot be subject to suit because the Arizona Legislature has not so provided. However, AZBR is an entity subject to suit pursuant to § 15-1625. Therefore, the complaint against ASU will be dismissed.

Accordingly,

IT IS ORDERED that Defendant Arizona State University's Motion to Strike (Doc. # 9) is GRANTED. Plaintiff's Reply to Defendant Arizona State University's Reply in Support of Motion to Dismiss (Doc. # 8) is STRICKEN.

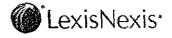
IT IS FURTHER ORDERED that Defendant Arizona State University's Motion to Dismiss (Doc. # 4) is GRANTED because ASU is not an entity subject to suit.

IT IS FURTHER ORDERED that Plaintiff's Motion to include Arizona Board of Regents Among the Defendants (included in Doc. # 6) is **DENIED** on grounds of futility.

IT IS FURTHER ORDERED that Plaintiff's Motion to Strike (Doc. # 10) is DENIED.

D.Ariz.,2005. Lazarescu v. Arizona State University 230 F.R.D. 596, 202 Ed. Law Rep. 675

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LEXSEE 624 F.SUPP 1179

SOUTH DAKOTA BOARD OF REGENTS, Plaintiff v. H. RAY HOOPS, Defendant

Civil No. 85-3042

UNITED STATES DISTRICT COURT FOR THE DISTRICT OF SOUTH DA-KOTA, CENTRAL DIVISION

624 F. Supp. 1179; 1986 U.S. Dist. LEXIS 30498

January 14, 1986

COUNSEL: [**1] Ronald W. Banks, Banks & Johnson, Rapid City, South Dakota, for Plaintiff.

Michael J. Hickey, Rapid City, South Dakota, for Defendant.

JUDGES: Porter

OPINION BY: PORTER

OPINION

[*1180] MEMORANDUM OPINION

Plaintiff, South Dakota Board of Regents, commenced a declaratory judgment action in state court seeking resolution of a controversy over an employment contract with defendant, H. Ray Hoops, former President of South Dakota State University. Pursuant to 28 U.S.C. §§ 1332 and 1441, defendant removed this action to the Central Division of the District of South Dakota. He has counterclaimed for loss of earnings, damage to reputation and emotional anxiety resulting from plaintiff's alleged violations of his property and contract rights under the United States Constitution and civil rights under 42 U.S.C. § 1983. Plaintiff has moved for remand of this action back to state court based on lack of diversity jurisdiction and claims immunity under the eleventh amendment.

A district court is required to examine petitions for removal and to remand to state court any case removed improvidently and without jurisdiction. 28 U.S.C. § 1447(c). In evaluating removal jurisdiction, a federal court [**2] must have original [*1181] jurisdiction in

the first instance. Sarnelli v. Tickle, 556 F. Supp. 557, 559 (E.D.N.Y. 1983). It is a well settled rule that in the absence of a specific statutory exception, a federal court may only exercise removal jurisdiction over a case if it would have had jurisdiction over the case as originally filed by the plaintiff. Betar v. DeHavilland Aircraft of Canada, Ltd., 603 F.2d 30, 36 (7th Cir. 1979), cert. denied, 444 U.S. 1098, 100 S. Ct. 1064, 62 L. Ed. 2d 785 (1980). Thus, any counterclaims raised by defendant will not be considered in examining whether removal was proper.

In its complaint, the South Dakota Board of Regents seeks a declaration of rights under a memorandum agreement made with defendant. No federal question appears on the face of the complaint. Removal will not be granted on the probability that a federal question will arise in subsequent proceedings. See Northwest Central Pipeline Corp. v. Mesa Petroleum Co., 576 F. Supp. 1495, 1498-99 (D.Del. 1983). Therefore, this court may retain jurisdiction only if there is diversity of citizenship between the parties.

Defendant alleges that he is a "citizen" of North Dakota [**3] and plaintiff is a "citizen" of South Dakota. Since the South Dakota Board of Regents is a state agency, it becomes important to determine whether the State or the Board is the real party in interest. A state is not considered a "citizen" for purposes of diversity jurisdiction under 28 U.S.C. § 1332. Moor v. County of Alameda, 411 U.S. 693, 717, 93 S. Ct. 1785, 36 L. Ed. 2d 596 (1973); State Highway Comm'n. v. Kansas City Bridge Co., 81 F.2d 689, 691 (8th Cir.), cert. denied, 298 U.S. 661, 56 S. Ct. 682, 80 L. Ed. 1386 (1936). If an agency performing a government function is independent from the state, separate and distinct, a district court has jurisdiction to proceed on the merits.

In determining whether a state agency is an "alter ego" of the state, the entity and its characteristics must be examined to determine whether the state is the real party in interest. In *Tradigrain, Inc. v. Mississippi State Port Authority, 701 F.2d 1131, 1132 (5th Cir. 1983)*, the Fifth Circuit has suggested the following factors be considered in evaluating the independence of an agency:

- 1) The right of the agency to hold and use property;
- 2) The authority to sue and be sued [**4] in its corporate name;
- 3) The extent of independent management authority;
- 4) The treatment of the agency by the state's courts;
- 5) Whether the state is responsible for the agency's debt;
- 6) The agency's concern with statewide, as opposed to local problems; and
- 7) The degree of financial autonomy of the agency.

In the present case, the Board is a corporate body appointed by the Governor and confirmed by the Senate, and responsible for the control of state supported educational institutions. S.D. Const. art. XIV, § 3. It is authorized to employ and dismiss officers and employees of such institutions, and is given the power to sue and be sued and to hold and manage any property belonging to educational institutions under its control. SDCL §§ 13-49-14, 13-49-11 (1982). The Board is authorized to bring suit in "any proper court in its own name to enforce any contract made by it" and "any money collected on any judgment . . . shall be paid into the treasury for the benefit of the educational institutions. . . . "SDCL § 13-49-18 (1982).

* See Appendix for listing of South Dakota statutes cited in this opinion.

[1] [**5] The defendant contends the Board is not an after ego of the state since it is a corporate body with the power to sue and be sued, to contract, and to hold, use and control the property which has been entrusted to it by statute. While the Board is clearly granted several powers of an independent agency, there are other factors which balance against reaching the conclusion that the Board is a citizen for purposes [*1182] of diversity ju-

risdiction. First, since members of the Board of Regents are appointed by the Governor and confirmed by the Senate, the State retains a significant measure of control. The Board "is not a fourth branch of government independent of legislative policies." South Dakota Bd. of Regents v. Meierhenry, 351 N.W.2d 450, 451 (S.D.1984). See South Dakota Board of Regents v. Meister, 309 N.W.2d 121, 123 (S.D. 1981) (authority of Board stems from the executive branch of government). Secondly, the Board is charged with the control of all state-supported educational institutions, and is thus absorbed in traditional state public welfare concerns and not acting in a private or proprietary capacity. See Morrison-Knudsen Co. v. Massachusetts Bay Transp. Authority [**6], 573 F. Supp. 698, 703-04 (D.Idaho 1983). Although the Board is granted power to supervise and manage state institutional property, it is unclear whether the state has transferred ownership rights to the Board. Lastly, there is nothing to suggest any financial autonomy on the part of the Board of Regents. "[A] crucial question in determining whether the suit should be regarded as one against the state is whether the named defendant has such independent status that a judgment against the defendant would not impact the state treasury." Ronwin v. Shapiro. 657 F.2d 1071, 1073 (9th Cir. 1981). In the present case, any declaration of rights under the employment agreement between plaintiff and defendant might impact the state treasury by requiring the payment of funds. SDCL & 21-32-16 (1985 Supp.) 2 provides for the waiver of immunity to the extent of insurance coverage. Even assuming, however, a policy was obtained and the proceeds were available to cover liabilities of this sort, there is no indication that the insurance would fully cover such liabilities and secure financial independence of the Board from the State. While SDCL § 13-49-18 (1982) suggests that any judgments [**7] obtained shall be paid to the treasury, no special funds appear to be reserved for the payment of liabilities resulting from such suits. The South Dakota Supreme Court has held that the Board of Regents' control "does not include the power of the purse." Kanaly v. State, 368 N.W.2d 819, 825 (S.D. 1985). The Board's lack of financial autonomy is demonstrated by the requirement that all moneys arising from any educational institution under its control be received by the state treasurer. SDCL § 13-53-15 (1985 Supp.). Further, the Board's authorization to make expenditures for building and maintaining educational institutions from the Educational Facilities Fund in the state treasury 3 also serves to suggest its lack of self-support.

1 SDCL § 13-49-11 (1982) confers upon the Board the power to "hold and manage" property belonging to educational institutions. SDCL § 13-49-15 (1982) grants the Board the power to purchase and contract for institutions. SDCL § 13-

51A-2 (1982) provides in part that the Board of Regents "shall have the power for each institution to: (1) Acquire any project or projects, or any combination thereof, and to own, operate and maintain the same." This statute falls within Chapter 13-51A, entitled "Board of Regents Revenue Bonds". In this context it is unclear whether the legislature intended to vest title to educational property in the Board or merely to grant bonding authority. Prior to adoption of the statute, the South Dakota Supreme Court held that "title to state-owned educational property in this state is in the state, and not in the board of regents." Mullen v. Dwight, 42 S.D. 171, 173 N.W. 645, 646 (1919).

[**8]

2 21-32-16. Waiver of immunity to extent of insurance coverage -- Consent to suit. To the extent such liability insurance is purchased pursuant to § 21-32-15 and to the extent coverage is afforded thereunder, the state shall be deemed to have waived the common law doctrine of sovereign immunity and consented to suit in the same manner that any other party may be sued.

3 SDCL § 13-51-2 (1985 Supp.).

In Laje v. R. E. Thomason General Hospital, 665 F.2d 724, 727 (5th Cir. 1982), the Fifth Circuit found "most telling" in determining whether a hospital district would be considered independent of the state a Texas Constitution provision stating that a hospital district "shall never become a charge against the State of Texas." In the present case, however, there is [*1183] no comparable disclaimer of liability by the state. The South Dakota Board of Regents is given the authority to issue bonds for the purpose of developing facilities at state institutions, SDCL § 13-51A-4 (1982). The statutes provide that the bonds are prohibited from becoming an obligation of the state of South [**9] Dakota, SDCL § 13-51A-23 and § 13-51A-24 (1982). Although this disclaimer serves to shield the state from liability on bonds issued by the Board, there is no indication it was intended to secure the state's financial independence from the Board's general debts and obligations.

II.

Is Independent of a finding of lack of diversity jurisdiction, this court would find preclusion of the present action in the federal court by the eleventh amendment. Under the eleventh amendment, " an unconsenting State is immune from suits brought in federal courts by her own citizens as well as by citizens of another State." Edelman v. Jordan, 415 U. S. 651, 662-63, 94 S. Ct. 1347, 39 L. Ed. 2d 662 (1974); Employees v. Missouri

Dept. of Public Health and Welfare, 411 U.S. 279, 280, 93 S. Ct. 1614, 36 L. Ed. 2d 251 (1973). 5

4 "Eleventh amendment immunity is a question of subject-matter jurisdiction." Walker v. Transport of New Jersey, 534 F. Supp. 719, 721 (E.D.Pa. 1982). The eleventh amendment provides: "The Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State, or by Citizens or Subjects of any Foreign State."

[**10]

5 Defendant erroneously suggests that eleventh amendment immunity is not a bar to suits such as the present action which seeks prospective and declaratory relief. However, when a suit is truly against the state as the real party in interest, the eleventh amendment bar "applies regardless of the nature of the relief sought." Pennhurst State Hospital v. Halderman, 465 U.S. 89, 100, 104 S. Ct. 900, 79 L. Ed. 2d 67 (1984); Barger v. State of Kansas, 620 F. Supp. 1432, 1434 (D.Kan. 1985). Prospective injunctive awards are proper under the eleventh amendment in redressing constitutional deprivations by State officials acting outside the scope of their official authority. Id. 465 U.S. at 102, 104-05. See Quern v. Jordan, 440 U.S. 332, 337, 99 S. Ct. 1139, 59 L. Ed. 2d *358 (1979*).

As in analysis of diversity jurisdiction, the central inquiry under the eleventh amendment is whether the state agency is an alter ego of the state or is functionally independent of the state. Tradigrain, Inc. v. Mississippi State Port Authority, 701 F.2d at 1132; Ronwin v. Shapiro, 657 F.2d at 1073. [**11] The Board's responsibility over the essential non-private realm of public education as well as the Board's lack of financial and structural independence from the state dictates a finding that the state is the substantial party in interest. There is no indication that a damage award could be paid through the Board's revenue bonds which are earmarked for the improvement of state institutions. See United Carolina Bank v. Board of Regents, 665 F.2d 553, 559-60 (5th Cir. 1982).

Defendant would argue, nevertheless, that even if the Board of Regents is part of the state, South Dakota has waived its *eleventh amendment* immunity by virtue of SDCL § 13-49-11 (1982). That statute confers upon the Board of Regents the "power to sue and be sued." The Supreme Court has indicated, however, that language conferring upon a public instrumentality the power to "sue and be sued" does not ordinarily operate to waive the defense of the *eleventh amendment* as such a waiver



"in the particular setting may be restricted to suits or proceedings of a special character in the state, not the federal, courts." Petty v. Tennessee-Missouri Bridge Comm'n., 359 U.S. 275, 276-77, 79 S. Ct. 785, 3 L. Ed. 2d 804 [**12] (1959). "A State's constitutional interest in immunity encompasses not merely whether it may be sued, but where it may be sued." Pennhurst State School & Hospital v. Halderman, 465 U.S. 89, 99, 104 S. Ct. 900, 906, 79 L. Ed. 2d 67 (1984) (emphasis in original). Accordingly, the Court indicated it will find an eleventh amendment waiver "only where stated by the most express language or by such overwhelming implications [*1184] from the text as [will] leave no room for any other reasonable construction. " Edelman v. Jordan, 415 U.S. at 673 (citing Murray v. Wilson Distilling Co., 213 U.S. 151, 171, 29 S. Ct. 458, 53 L. Ed. 742 (1909)).

An examination of state decisional law fails to suggest any intent of the state to confer consent to suit in federal court. On the contrary, the South Dakota Supreme Court has indicated that the doctrine of sovereign immunity provides for the state's immunity from suit in state court "unless the legislature has consented to the particular suit alleged." Kruger v. Wilson, 325 N.W.2d 851, 852 (S.D. 1982). In construing the significance of SDCL § 13-49-11, which grants the Board the power to "sue and be sued", the South [**13] Dakota Supreme Court declared that this clause "does not, in the absence of statutory authority expressly waiving sovereign immunity create a cause of action in tort against the Board." Kringen v. Shea, 333 N.W.2d 445, 446 (S.D. 1983), Although SDCL § 21-32-16 (1985 Supp.) confers a waiver of "the common law doctrine of sovereign immunity" to the extent of insurance coverage, this court declines to infer such a waiver in federal court since the concepts of sovereign immunity and the eleventh amendment are not synonymous. "[A] State's waiver of sovereign immunity in its own courts is not a waiver of Eleventh Amendment immunity in the federal courts." Pennhurst, 465 U.S. at 99 n. 9. Since there is no clear expression of consent as required to support a finding of waiver of eleventh amendment immunity, no such waiver will be implied. 6

6 In American Re-Insurance Co. v. Janklow, 676 F.2d 1177, 1183 n.15 (8th Cir. 1982), the Eighth Circuit determined that SDCL 21-32-15 and § 21-32-16 did not constitute "express language" of waiver of eleventh amendment immunity sufficient to infer South Dakota's consent to suit in federal court.

The defendant contends, nevertheless, that the Board has waived any eleventh amendment immunity it might otherwise enjoy by instituting the present declaratory judgment action in state court against a nonresident defendant. Because FRCP 13(a) and SDCL § 15-6-13(a) (1984) necessitate the raising of any claims arising out of the same transaction or occurrence as the claim of the opposing party, defendant alleges the Board has consented to all counterclaims. Even if this Court would otherwise have jurisdiction over defendant's federal claims, 7 the authorizing statute of the Federal Rules of Civil Procedure specifies the rules "shall not abridge, enlarge or modify any substantive right." 28 U.S.C. § 2072 (1982). This Court declines to find that a rule promulgated pursuant to this statute was intended to abridge the Board's constitutional right to immunity. See Chemehuevi Indian Tribe v. California State Bd. of Equalization, 757 F.2d 1047, 1051 (9th Cir. 1985).

> 7 The Eighth Circuit has held that the Board of Regents may not be sued under 42 U.S.C. § 1983 because it is not a "person" within the meaning of the statute. Prostrollo v. University of South Dakota, 507 F.2d 775, 777 n.1 (8th Cir. 1974), cert. denied, 421 U.S. 952, 95 S. Ct. 1687, 44 L. Ed. 2d 106 (1975). This finding is consistent with Monell v. New York City Dept. of Social Services. 436 U.S. 658, 98 S. Ct. 2018, 56 L. Ed. 2d 611 (1978), in which the Supreme Court held that municipal bodies and other governmental units are not entitled to absolute immunity from suit under § 1983. The Court limited its holding to "local government units which are not considered part of the State for Eleventh Amendment purposes." Monell, 436 U.S. at 690 n. 54.

[**15] Accordingly, this court finds that the South Dakota Board of Regents is a dependent arm of the state and is therefore immune to suit under the *eleventh amendment* and not a "citizen" for purposes of establishing diversity jurisdiction. Both a lack of jurisdiction as well as a lack of federal concerns on the face of the complaint indicate that this action was improvidently removed from the South Dakota courts. Any federal rights raised by defendant by way of counterclaim may be vindicated in the state courts which have been recognized as co-equal guardians of [*1185] constitutional rights. Plaintiff's motion to remand is therefore granted and this case is dismissed for lack of subject matter jurisdiction.

APPENDIX OF SOUTH DAKOTA STATUTES

[**14] III.

STATUTE		SLIP PAGE
SDCL § 13-49-11	(1982) (Corporate Powers of Board)	4,
		5n.1,9,10
		1183, 1184
SDCL § 13-49-14	(1982) (Employment at	
	Institutions)	4
SDCL § 13-49-15	(1982) (Purchasing and	
	Contracting Powers)	5n.1,7
SDCL § 13-49-18	(1982) (Prosecution of Actions)	4,6
SDCL § 13-51-2	(1985 Supp.) (Educational	
	Facilities Fund)	7
SDCL § 13-51A-2	(1982) (Power to Acquire	
	Property)	5n.1
SDCL § 13-51A-4	(1932) (Borrowing Power)	7
SDCL § 13-51A-23	(1982) (Prohibiting Obligation of	
	State)	7
SDCL § 13-51A-24	(1982) (Limited Obligation of	
	Bonds)	7
SDCL § 13-53-15	(1985 Supp.) (Receipt by State	
	Treasurer of Institutional Moneys)	
SDCL § 15-6-13(a)	(1984) (Compulsory Counterclaims)	11
SDCL § 21-32-15	(1985 Supp.) (Liability	
	Insurance)	10n.6
SDCL § 21-32-16	(1985 Supp.) (Waiver of Sovereign	
	In::aunity)	6, 10,
	· · · · · · · · · · · · · · · · · · ·	10n.6

[**16]



LEXSEE 64 F.3D 773

THOMSON-CSF, S.A., Plaintiff-Appellant, v. AMERICAN ARBITRATION AS-SOCIATION, Defendant, EVANS & SUTHERLAND COMPUTER CORPORA-TION, Defendant-Appellee.

Docket No. 94-9118

UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

64 F.3d 773; 1995 U.S. App. LEXIS 24146

April 18, 1995, Argued August 24, 1995, Decided

PRIOR HISTORY: [**1] Appeal from a judgment entered in the United States District Court for the Southern District of New York (Keenan, J.), denying plaintiff-appellant Thomson-CSF, S.A.'s request for declaratory and injunctive relief and granting defendant-appellee Evans & Sutherland Computer Corporation's cross-motion to compel arbitration.

DISPOSITION: Reversed and remanded.

COUNSEL: FREDRICK E. SHERMAN, Jones, Day, Reavis & Pogue, New York, New York (Steven C. Bennett, Jones, Day, Reavis & Pogue, New York, New York, David J. Hensler, A. Lee Bentley, Hogan & Hartson, Washington, D.C., on the brief), for plaintiff-appellant.

DANA H. FREYER, Skadden, Arps, Slate, Meagher & Flom, New York, New York (Daniel J. Fish, Skadden, Arps, Slate, Meagher & Flom, New York, New York, on the brief), for defendant-appellee.

JUDGES: BEFORE: MESKILL, ALTIMARI, and CALABRESI, Circuit Judges.

OPINION BY: ALTIMARI

ORINION

[*775] ALTIMARI, Circuit Judge:

Plaintiff-appellant Thomson-CSF, S.A. ("Thomson") appeals from a judgment entered in the United States District Court for the Southern District of New York (Keenan, J.), denying its request for declaratory and in-

junctive relief and granting defendant-appellee Evans & Sutherland Computer [**2] Corporation's ("E & S") cross-motion to compel arbitration. Thomson asserts that the district court improvidently compelled it to arbitrate against E & S based upon an arbitration agreement between E & S and Thomson's subsidiary, to which Thomson was not a signatory. Because, under ordinary principles of contract and agency law, Thomson cannot be said to have voluntarily submitted to arbitrate its disputes with E & S, we reverse the judgment of the district court and remand for proceedings consistent with this opinion.

BACKGROUND

Rediffusion Simulation Limited ("Rediffusion") was a British company engaged in the business of building flight simulators for the training of pilots. In 1986, Rediffusion entered into a "Working Agreement" with E & S, located in Salt Lake City, Utah. Under the Working Agreement, Rediffusion agreed to purchase computer-generated image equipment (the computer "brain" of the flight simulator) exclusively from E & S and to use its best efforts to market those systems containing E & S equipment; in return, E & S agreed to supply its imaging equipment only to Rediffusion.

Subsequent to entering into the Working Agreement, Rediffusion was sold to Hughes [**3] Aircraft Company. Hughes amended and extended the Working Agreement between Rediffusion and E & S. On December 31, 1993, Hughes sold Rediffusion to Thomson, which renamed it Thomson Training and Simulation Limited. Prior to purchasing Rediffusion, Thompson maintained a division engaged in the business of building flight simulation equipment (the Training and Simulation

Systems Division) into which it began integrating Rediffusion.

At the time Thomson began publicly contemplating the acquisition of Rediffusion, E & S informed Thomson that, if it purchased Rediffusion, E & S intended to bind Thomson and its flight simulation division to the Working Agreement. Specifically, E & S told Thomson that upon purchasing Rediffusion both Rediffusion and Thomson's Training and Simulation Systems Division would be required to purchase all needed computer-generated image equipment from E & S. In response, Thomson wrote to E & S seeking to have it waive those provisions of the Working Agreement that E & S believed to be binding upon Thomson. Thomson did not, however, concede that it would be bound by Rediffusion's Working Agreement. In fact, when it became clear that Thomson and E & S could reach [**4] no agreement prior to Thomson's acquisition of Rediffusion, Thomson explicitly informed E & S that it was not adopting the Working Agreement and did not consider itself bound by Rediffusion's Agreement which it had neither negotiated nor signed.

The Working Agreement

Section 6.1 of the Working Agreement provides for the arbitration of all disputes between the "parties" to the Agreement. While the Agreement provides no explicit definition of "parties," it does define "E & S" and "Rediffusion":

1.14 the term "E & S," wherever used in this Working Agreement, shall include the affiliates of E & S.

The term "Rediffusion" wherever used in this Working Agreement, shall . . . mean Rediffusion and each of its affiliates.

1.6 An "affiliate" of a party hereto shall mean any person, firm or corporation that, directly or indirectly, through one or more intermediaries, controls, or is controlled by, or is under common control with, such party.

Despite the lack of definition for "parties" in the Working Agreement, the district court [*776] found that the term "parties" was intended to mean "E & S and Rediffusion" and, therefore, was also intended to [**5] in-

clude the affiliates of the parties. Accordingly, the arbitration clause in the Working Agreement purported to bind not only Rediffusion, but also its affiliates--namely, Thomson (given that Thomson indisputably controlled Rediffusion).

Injunctive Relief

While under Thomson's ownership, Rediffusion's share of the flight simulator market drastically decreased. On August 8, 1994, E & S filed a demand for arbitration under the Working Agreement against both Rediffusion and its parent-company Thomson, asserting a breach of their obligations arising out of the Working Agreement. Despite Thomson's insistence that it was not bound by the Working Agreement (and the arbitration clause contained therein), E & S filed a demand for arbitration against both Rediffusion and Thomson on August 8, 1994. While Rediffusion did not contest the applicability of the arbitration clause to it, Thomson refused to answer E & S's demand for arbitration. On August 29, 1994, Thomson commenced this action in the Southern District of New York, seeking 1) a declaration that it was not bound by the arbitration clause of the Working Agreement and 2) an injunction prohibiting further proceedings against [**6] it under the Working Agreement. E & S cross-moved to compel Thomson to arbitrate.

The district court granted E & S's cross-motion to compel arbitration. In doing so, the district court stated that while E & S's claims did not fall under any of the traditional categories for binding a nonsignatory to an arbitration clause, Thomson was bound nonetheless. Adopting a hybrid approach to binding a nonsignatory to an arbitration agreement, the district court accepted E & S's assertion that "the Court may bind Thomson based on its conduct in voluntarily becoming . . . an affiliate, on the degree of control Thomson exercises over [Rediffusion], and on the interrelatedness of the issues." (internal citations and quotations omitted).

Thomson now appeals the judgment of the district court.

DISCUSSION

Arbitration is contractual by nature--"a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit." United Steelworkers of America v. Warrior & Gulf Navigation Co., 363 U.S. 574, 582, 4 L. Ed. 2d 1409, 80 S. Ct. 1347 (1960). Thus, while there is a strong and "liberal federal policy favoring arbitration agreements," Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., [**7] 473 U.S. 614, 625, 87 L. Ed. 2d 444, 105 S. Ct. 3346 (1985) (quotations omitted), such agreements must not be so broadly construed as to encompass claims and parties that were not intended by the original contract. "It does not follow,

however, that under the [Federal Arbitration] Act an obligation to arbitrate attaches only to one who has personally signed the written arbitration provision." Fisser v. International Bank, 282 F.2d 231, 233 (2d Cir. 1960); see also Deloitte Noraudit A/S v. Deloitte Haskins & Sells, U.S., 9 F.3d 1060, 1064 (2d Cir. 1993). This Court has made clear that a nonsignatory party may be bound to an arbitration agreement if so dictated by the "ordinary principles of contract and agency." McAllister Bros., Inc. v. A & S Transp. Co., 621 F.2d 519, 524 (2d Cir. 1980); see also A/S Custodia v. Lessin Int'l, Inc., 503 F.2d 318, 320 (2d Cir. 1974).

I. Traditional Bases For Binding Nonsignatories

This Court has recognized a number of theories under which nonsignatories may be bound to the arbitration agreements of others. Those theories arise out of common law principles of contract and agency law. Accordingly, we have recognized five theories for binding nonsignatories [**8] to arbitration agreements: 1) incorporation by reference; 2) assumption; 3) agency; 4) veil-piercing/alter ego; and 5) estoppel. The district court properly rejected each of these traditional theories as sufficient justification for binding Thomson to the arbitration agreement of its subsidiary.

[*777] A. Incorporation by Reference

A nonsignatory may compel arbitration against a party to an arbitration agreement when that party has entered into a separate contractual relationship with the nonsignatory which incorporates the existing arbitration clause. See Import Export Steel Corp. v. Mississippi Valley Barge Line Co., 351 F.2d 503, 505-506 (2d Cir. 1965) (separate agreement with nonsignatory expressly "assuming all the obligations and privileges of [signatory party] under the . . . subcharter" constitutes grounds for enforcement of arbitration clause by nonsignatory); Matter of Arbitration Between Keystone Shipping Co. and Texport Oil Co., 782 F. Supp. 28, 31 (S.D.N.Y. 1992); Continental U.K. Ltd. v. Anagel Confidence Compania Naviera, S.A., 658 F. Supp. 809, 813 (S.D.N.Y. 1987) (if a "party's arbitration clause is expressly incorporated into a bill of lading, nonsignatories [**9] ... who are linked to that bill through general principles of contract law or agency law may be bound"). As the district court noted, E & S has not attempted to show that the Working Agreement was incorporated into any document which Thomson adopted. Thus, Thomson cannot be bound under an incorporation theory.

B. Assumption

In the absence of a signature, a party may be bound by an arbitration clause if its subsequent conduct indicates that it is assuming the obligation to arbitrate. See Gvozdenovic v. United Air Lines, Inc., 933 F.2d 1100, 1105 (2d Cir.) (flight attendants manifested a clear intention to arbitrate by sending a representative to act on their behalf in arbitration process), cert. denied, 502 U.S. 910, 116 L. Ed. 2d 248, 112 S. Ct. 305 (1991); Keystone Shipping, 782 F. Supp. at 31; In re Transrol Navegacao S.A., 782 F. Supp. 848, 851 (S.D.N.Y. 1991). While Thomson was aware that the Working Agreement purported to bind it as an "affiliate" of Rediffusion, at no time did Thomson manifest an intention to be bound by that Agreement. In fact, Thomson explicitly disavowed any obligations arising out of the Working Agreement and filed this action seeking a declaration of non-liability [**10] under the Agreement. Accordingly, it cannot be said that Thomson assumed the obligation to arbitrate.

C. Agency

Traditional principles of agency law may bind a nonsignatory to an arbitration agreement. See *Interbras Cayman Co. v. Orient Victory Shipping Co., S.A., 663 F.2d 4, 6-7 (2d Cir. 1981); A/S Custodia, 503 F.2d at 320; Fisser, 282 F.2d at 233-38; Keystone Shipping, 782 F. Supp. at 31-32.* Because the Working Agreement was entered into well before Thomson purchased Rediffusion, Thomson could not possibly be bound under an agency theory.

D. Veil Piercing/Alter Ego

In some instances, the corporate relationship between a parent and its subsidiary are sufficiently close as to justify piercing the corporate veil and holding one corporation legally accountable for the actions of the other. As a general matter, however, a corporate relationship alone is not sufficient to bind a nonsignatory to an arbitration agreement. See Keystone Shipping, 782 F. Supp. at 30-31. Nonetheless, the courts will pierce the corporate veil "in two broad situations: to prevent fraud or other wrong, or where a parent dominates and controls a subsidiary." Carte Blanche (Singapore) [**11] Pte., Ltd. v. Diners Club Int'l, Inc., 2 F.3d 24, 26 (2d Cir. 1993); see also Wm. Passalacqua Builders, Inc. v. Resnick Developers S., Inc., 933 F.2d 131, 138-39 (2d Cir. 1991) ("Liability . . . may be predicated either upon a showing of fraud or upon complete control by the dominating corporation that leads to a wrong against third parties."). While the district court below noted that, "counsel for E & S also denied at oral-argument that its claim was properly articulated as veil-piercing," E & S now asserts that an alter ego relationship between Thomson and Rediffusion may exist. While E & S concedes that it can make no showing of fraud, it argues that Thomson sufficiently dominated Rediffusion as to justify veil piercing.

Veil piercing determinations are fact specific and "differ[] with the circumstances of each case." American Protein Corp. v. [*778] AB Volvo, 844 F.2d 56, 60 (2d Cir.), cert. denied, 488 U.S. 852, 102 L. Ed. 2d 109, 109 S. Ct. 136 (1988). This Court has determined that a parent corporation and its subsidiary lose their distinct corporate identities when their conduct demonstrates a virtual abandonment of separateness. See Carte Blanche, 2 F.3d at 29 ("No bank accounts, offices, stationery, [**12] transactions, or any other activities were maintained or carried on in the name of [the subsidiary]."); Wm. Passalacqua, 933 F.2d at 139 (corporate veil is pierced where, among other things, parent and subsidiary 1) share common office and staff; 2) are run by common officers; 3) intermingle funds; 4) do not deal at arms length with each other; and 5) are not treated as separate profit centers); see also Walter E. Heller & Co. v. Video Innovations, Inc., 730 F.2d 50, 53 (2d Cir. 1984) (absence of corporate formalities relevant factor in piercing corporate veil). "The factors that determine the question of control and domination are less subjective than 'good faith'; they relate to how the corporation was actually operated." Carte Blanche, 2 F.3d at 28-29.

E & S has not demonstrated that Thomson exerted the degree of control over Rediffusion necessary to justify piercing the corporate veil. While the district court found that "Thomson has common ownership with [Rediffusion]; that Thomson actually controls [Rediffusion]; . . . [and] that Thomson incorporated [Rediffusion] into its own organizational and decision-making structure," the district court did not find [**13] an abandonment of the corporate structure. E & S has not shown an absence of corporate formalities, nor has it shown an intermingling of corporate finances and directorship. Rather, as the district court found, Rediffusion continued to function as a distinct entity closely incorporated into the existing corporate structure of its parent company, Thomson. Accordingly, in light of the totality of the circumstances, Thomson cannot be bound by Rediffusion's arbitration agreement under a veil piercing/alter ego theory.

E. Estoppel

This Court has also bound nonsignatories to arbitration agreements under an estoppel theory. In *Deloitte Noraudit A/S v. Deloitte Haskins & Sells, U.S., 9 F.3d 1060, 1064 (2d Cir. 1993)*, a foreign accounting firm received a settlement agreement concerning the use of the trade name "Deloitte" in association with accounting practices. Under the agreement--containing an arbitration clause--local affiliates of the international accounting association Deloitte Haskins & Sells International were entitled to use the trade name "Deloitte" in exchange for compliance with the dictates of the agreement. A Norwegian accounting firm received the agreement, made no

[**14] ob jection to the terms of the agreement, and proceeded to utilize the trade name. This Court held that by knowingly exploiting the agreement, the accounting firm was estopped from avoiding arbitration despite having never signed the agreement. See 9 F.3d at 1064 ("Noraudit failed to object to the Agreement when it received it . . . In addition, Noraudit knowingly accepted the benefits of the Agreement Thus, Noraudit is estopped from denying its obligation to arbitrate under the 1990 Agreement.").

Although the district court did not analyze the case at hand under an estoppel theory, the court specifically found that:

Thomson had notice of the Working Agreement prior to . . . completing the purchase of Rediffusion, that E & S expressed the intention to bind Thomson to the Agreement prior to the completion of the purchase of Rediffusion, that Thomson incorporated [Rediffusion] into its own organizational and decision-making structure, and that Thomson benefitted from that incorporation.

(citations omitted). On their face, these factual findings appear sufficient to bind Thomson to the arbitration clause of its subsidiary under Deloitte. Upon closer [**15] inspection, however, the district court's determination that Thomson derived direct benefit from the Working Agreement is erroneous.

As Thomson points out, the Working Agreement provided that Rediffusion would purchase computer-generated image equipment exclusively from E & S and, in return, E & S would supply its imaging equipment only to Rediffusion. E & S concedes that [*779] Thomson has never acquired, nor sought to acquire, imaging equipment from E & S. Rather, E & S asserts a theory of benefit under the Working Agreement which in essence amounts to an anti-trust violation--according to E & S, Thomson purchased Rediffusion (its only serious competitor in the flight simulation industry) so that it could keep Rediffusion from competing; by incorporating Rediffusion into its own structure, Thomson was able to eliminate all simulators utilizing E & S imaging equipment from the market; because E & S was contractually bound to supply only Rediffusion with imaging equipment, it was effectively shut out of the market; thus, E & S contends that Thomson benefitted from the Working Agreement by eliminating E & S as a competi-

This indirect benefit which E & S asserts--and the district court [**16] implicitly adopts--is not the sort of

benefit which this Court envisioned as the basis for estopping a nonsignatory from avoiding arbitration. Had Thomson directly benefitted from the Working Agreement by seeking to purchase equipment from E & S or enforcing the exclusivity provisions of the Agreement, it would be estopped from avoiding arbitration. The benefit which E & S asserts, however, derives directly from Thomson's purchase of Rediffusion, and not from the Working Agreement itself; Thomson received no benefit at all from the Working Agreement (as opposed to the acquisition). Thus, Thomson is not bound by its subsidiary's arbitration agreement under Deloitte.

Several courts of appeal have recognized an alternative estoppel theory requiring arbitration between a signatory and nonsignatory. See Sunkist Soft Drinks, Inc. v. Sunkist Growers, Inc., 10 F.3d 753, 757-58 (11th Cir. 1993), cert. denied, 115 S. Ct. 190 (1994); J.J. Ryan & Sons, Inc. v. Rhone Poulenc Textile, S.A., 863 F.2d 315, 320-21 (4th Cir. 1988); McBro Planning & Dev. Co. v. Triangle Elec. Constr. Co., 741 F.2d 342, 344 (7th Cir. 1984). In these cases, a signatory was bound to arbitrate with [**17] a nonsignatory at the nonsignatory's insistence because of "the close relationship between the entities involved, as well as the relationship of the alleged wrongs to the nonsignatory's obligations and duties in the contract . . . and [the fact that] the claims were 'intimately founded in and intertwined with the underlying contract obligations." Sunkist, 10 F.3d at 757 (quoting McBro Planning, 741 F.2d at 344). It is clear that an arbitration clause bound Thomson's subsidiary, Rediffusion. The district court also found that the management of Rediffusion and Thomson were closely related. Moreover, E & S argues that the claims against Thomson are "intimately founded in and intertwined with" the Working Agreement. Nonetheless, Thomson can not be bound to arbitrate under this line of cases.

As these cases indicate, the circuits have been willing to estop a signatory from avoiding arbitration with a nonsignatory when the issues the nonsignatory is seeking to resolve in arbitration are intertwined with the agreement that the estopped party has signed. As the district court pointed out, however, "the situation here is inverse: E & S, as signatory, seeks to compel Thomson, [**18] a non-signatory." While E & S suggests that this is a non-distinction, the nature of arbitration makes it important. Arbitration is strictly a matter of contract; if the parties have not agreed to arbitrate, the courts have no authority to mandate that they do so. See United Steelworkers, 363 U.S. at 582. In the line of cases discussed above, the courts held that the parties were estopped from avoiding arbitration because they had entered into written arbitration agreements, albeit with the affiliates of those parties asserting the arbitration and not the parties themselves. Thomson, however, cannot be estopped from denying the existence of an arbitration clause to which it is a signatory because no such clause exists. At no point did Thomson indicate a willingness to arbitrate with E & S. Therefore, the district court properly determined these estoppel cases to be inapposite and insufficient justification for binding Thomson to an agreement that it never signed.

Moreover, these estoppel cases all involve claims which are integrally related to the contract containing the arbitration clause. The same cannot be said of the case at hand. As discussed above, E & S's claims against [**19] [*780] Thomson amount to the assertion that Thomson purchased Rediffusion in order to eliminate it as a competitor. While a cause of action may lie against Thomson for such alleged predatory business practices, the violation can hardly be characterized as arising out of or being integrally related to the Working Agreement between E & S and Rediffusion. Thus, the analogy to this line of estoppel cases again must fail.

II. The District Court's Hybrid Approach

Despite properly determining that E & S's claims did not fall within any of the traditional theories for binding a nonsignatory, the district court stated, "nevertheless, E & S asserts that the Court may bind Thomson based on its conduct in 'voluntarily becoming . . . an affiliate,' on the degree of control Thomson exercises over [Rediffusion], and on the interrelatedness of the issues. This Court agrees." (citations omitted). In so doing, the district court improperly extended the law of this Circuit and diluted the protections afforded nonsignatories by the "ordinary principles of contract and agency." McAllister, 621 F.2d at 524. A nonsignatory may not be bound to arbitrate except as dictated by some accepted theory [**20] under agency or contract law.

The district court's opinion relies principally upon two decisions of this Court, McAllister and Deloitte. According to the district court, these cases in combination provide sufficient support to bind Thomson to the arbitration clause despite Thomson having never signed the Agreement. The district court found that many of the elements present in McAllister and Deloitte were also present in the case at hand: 1) Thomson's common ownership of Rediffusion; 2) Thomson's actual control of Rediffusion; 3) Thomson's notice of the Working Agreement prior to purchasing Rediffusion; 4) E & S's express intention to bind Thomson to the Working Agreement; 5) Thomson's incorporation of Rediffusion into its own organizational and decision-making structure; and 6) Thomson's benefit from that incorporation. Based upon the totality of these factors, the district court held that McAllister and Deloitte bound Thomson to Rediffusion's arbitration clause.

(A F 2 1 772 * 1005 11 0 A . . 1 F 110 0 114 (**

The district court's reliance upon McAllister and Deloitte is misplaced. Both McAllister and Deloitte fall squarely within traditional theories for binding nonsignatories to an arbitration [**21] agreement. In McAllister, this Court remanded the case to the district court for an evidentiary hearing in light of indications (on a "scant record") of a close affiliation between the signatory and nonsignatory. This Court, however, specifically instructed the district court to apply "ordinary principles of contract and agency," and clearly pointed to the traditional theories of agency and piercing the corporate veil when directing the district court to reconsider its determination. 621 F.2d at 524. The district court's reliance on Deloitte is equally misplaced. As in McAllister, this Court in Deloitte stated that the district court should apply "ordinary principles of contract and agency." 9 F.3d at 1064. This Court again pointed to traditional theories for binding nonsignatories, specifically estoppel and agency. Id. ("We believe that appellants have . . . strong[] arguments, particularly those based upon estoppel."). Neither McAllister or Deloitte indicate that a nonsignatory can be bound to an arbitration agreement with a less

than full showing of some articulable theory under contract or agency law.

The district court below improperly extended [**22] the limited theories upon which this Court is willing to enforce an arbitration agreement against a nonsignatory. The district court's hybrid approach dilutes the safeguards afforded to a nonsignatory by the "ordinary principles of contract and agency" and fails to adequately protect parent companies, the subsidiaries of which have entered into arbitration agreements. Anything short of requiring a full showing of some accepted theory under agency or contract law imperils a vast number of parent corporations. This Court did not intend such an outcome in Deloitte or McAllister and does not adopt such an approach here.

CONCLUSION

Accordingly, the judgment of the district court is reversed and remanded for proceedings consistent with the foregoing.



LEXSEE 489 U.S. 468

VOLT INFORMATION SCIENCES, INC. v. BOARD OF TRUSTEES OF LEL-AND STANFORD JUNIOR UNIVERSITY

No. 87-1318

SUPREME COURT OF THE UNITED STATES

489 U.S. 468; 109 S. Ct. 1248; 103 L. Ed. 2d 488; 1989 U.S. LEXIS 1273; 57 U.S.L.W. 4295

November 30, 1988, Argued March 6, 1989, Decided

PRIOR HISTORY: APPEAL FROM THE COURT OF APPEAL OF CALIFORNIA, SIXTH APPELLATE DISTRICT.

DISPOSITION: Affirmed.

DECISION:

California statute allowing stay of arbitration held not pre-empted by Federal Arbitration Act (9 USCS 1 et seq.) where parties contracted that arbitration agreement would be governed by California law.

SUMMARY:

Under the terms of a construction contract between a private California university and a construction firm for installation work on the university's campus, the parties agreed that (1) all disputes between them arising out of or relating to the contract or the breach thereof would be decided by arbitration, and (2) the contract would be governed "by the law of the place where the Project is located." When a dispute developed during construction regarding compensation for extra work, the firm made a formal demand for arbitration of its claim. The university responded by filing an action in California Superior Court, alleging fraud and breach of contract against the firm, and additionally seeking indemnity from two other companies involved in the construction project with whom the university did not have arbitration agreements. The firm moved to compel arbitration of the dispute pursuant to the contract. In turn, the university moved to stay arbitration, pursuant to a California procedural statute which allowed a court to stay arbitration, pending resolution of related litigation between a party to an arbitration agreement and third parties not bound by such agreement, where there was a possibility of conflicting rulings on a common issue of law or fact. The Superior Court denied the firm's motion to compel arbitration and granted the university's stay motion. On appeal, the California Court of Appeal, Sixth District, affirmed (195 Cal App 3d 349, 240 Cal Rptr 558), holding that (1) under the contract's choice-of-law provision, the parties had chosen to be governed by California law, and (2) application of the California procedural statute invoked by the university in its motion to stay arbitration was not pre-empted by the Federal Arbitration Act (9 USCS 1 et seq.), although the parties' contract involved interstate commerce, and although the Act governed contracts in interstate commerce. The Supreme Court of California denied review.

On appeal, the United States Supreme Court affirmed. In an opinion by Rehnquist, Ch. J., joined by White, Blackmun, Stevens, Scalia, and Kennedy, JJ., it was held that (1) the California Court of Appeal's holding that the parties intended the choice-of-law clause to incorporate the California rules of arbitration into their arbitration involved a question of state law and would not be set aside by the Supreme Court, and (2) application of the California procedural statute was not pre-empted by the Federal Arbitration Act, because (a) the Act contained no provision authorizing a stay of arbitration in such a situation; (b) even if 3 and 4 of the Act (9 USCS 3 and 4) were fully applicable in state court proceedings, they did not prevent application of the California statute to stay arbitration where the parties to the contract had agreed to arbitrate in accordance with California law; (c) the Act contained no express pre-emptive

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provision and did not reflect a congressional intent to occupy the entire field of arbitration; (d) application of the California statute to stay arbitration, in accordance with the parties' arbitration agreement, would not undermine the goals and policies of the Act; and (e) enforcement of California rules of arbitration according to the terms of the parties' agreement to abide by such rules was fully consistent with the goals of the Act, even if the result was that arbitration was stayed where the Act would otherwise permit it to go forward.

Brennan, J., joined by Marshall, J., dissented, expressing the view (1) that the California Court of Appeal's construction of the choice-of-law clause was reviewable by the Supreme Court and was incorrect, and (2) that the question of pre-emption should not have been reached.

O'Connor, J., did not participate.

LAWYERS' EDITION HEADNOTES:

[***LEdHN1]

ARBITRATION §2

STATES, TERRITORIES, AND POSSESSIONS §46

Federal Arbitration Act -- pre-emption of state law -- Headnote:[1A][1B][1C][1D]

The application of a state procedural statute providing that a state court may stay arbitration, pending resolution of related litigation between one party to an arbitration agreement and third parties not bound by such agreement where there is a possibility of conflicting rulings on a common issue of law or fact, is not pre-empted by the Federal Arbitration Act (9 USCS 1 et seq.), because (1) the Act contains no provision authorizing a stay of arbitration in such a situation; (2) even if 3 and 4 of the Act (9 USCS 3 and 4) are fully applicable in state court proceedings, they do not prevent application of the state statute to stay arbitration where the parties to the contract have agreed to arbitrate in accordance with that state's law; (3) the Act contains no express pre-emptive provision and does not reflect a congressional intent to occupy the entire field of arbitration; (4) application of the state statute to stay arbitration, in accordance with the parties' arbitration agreement, would not undermine the goals and policies of the Act; and (5) enforcement of state rules of arbitration according to the terms of the parties' agreement to abide by such rules is fully consistent with the goals of the Act, even if the result is that arbitration is stayed where the Act would otherwise permit it to go forward.

[***LEdHN2]

APPEAL §475

Supreme Court review -- state court decision upholding validity of state statute --

Headnote:[2A][2B]

A state statute is sustained, for purposes of the United States Supreme Court's appellate jurisdiction under 28 USCS 1257(2), when a state court holds such statute applicable to a particular set of facts as against the contention that such application is invalid on federal grounds, regardless of the particular grounds or reasons on which the state court's decision is put; thus, a state intermediate appellate court's upholding of the application of a state procedural statute against the challenge that such statute, as applied to stay arbitration under a contract in interstate commerce, so conflicted with the Federal Arbitration Act (9 USCS 1 et seq.) that it was invalid under the Federal Constitution's supremacy clause (Art VI, cl 2), may be appealed to the United States Supreme Court under 28 USCS 1257(2) where the state's highest court has denied discretionary review, even though the intermediate appellate court's decision may have been premised on its interpretation of the contract.

[***LEdHN3]

APPEAL §779

Supreme Court -- review of state court's construction of contract --

Headnote:[3]

A state court's interpretation of private contracts is ordinarily a question of state law, which the United States Supreme Court does not sit to review.

[***LEdHN4]

ARBITRATION §6

construction of agreement --

Headnote:[4A][4B][4C]

The United States Supreme Court will not set aside a finding by a state court that a construction contract's choice-of-law clause, to the effect that "the contract shall be governed by the law of the place where the Project is located", incorporated into the contract the rules of arbitration of the state in which the project was located, and thus that the parties to the contract had agreed that arbitration would not proceed in situations which fell within the scope of a state procedural statute, notwithstanding their contractual agreement to arbitrate all disputes arising under the contract, because such interpretation (1) was not in effect a finding that a party had waived its

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federally guaranteed right to compel arbitration under the Federal Arbitration Act (9 USCS 1 et seq.), but rather was a finding that the party had no such right in the first place, and (2) did not violate the federal rule that questions of arbitrability in contracts subject to the Act must be resolved with a healthy regard for the federal policy favoring arbitration, in that the applicability of state rules governing arbitration does not offend such federal rule or any other policy embodied in the Act. (Brennan and Marshall, JJ., dissented from this holding.)

[***LEdHN5]

ARBITRATION §2

Federal Arbitration Act -- purpose --

Headnote:[5A][5B]

The Federal Arbitration Act (9 USCS 1 et seq.), whose passage was motivated first and foremost by a congressional desire to enforce agreements into which parties had entered, is designed (1) to overrule the judiciary's longstanding refusal to enforce agreements to arbitrate, and (2) to place such agreements upon the same footing as other contracts.

[***LEdHN6]

ARBITRATION §6

construction of agreement --

Headnote:[6]

In applying general state law principles of contract interpretation to the interpretation of an arbitration agreement within the scope of the Federal Arbitration Act (9 USCS 1 et seq.), due regard must be given to the federal policy favoring arbitration, and ambiguities as to the scope of the agreement's arbitration clause must be resolved in favor of arbitration.

[***LEdHN7]

ARBITRATION §1

federal policy --

Headnote:[7]

There is no federal policy favoring arbitration under a certain set of procedural rules; the federal policy is simply to insure the enforceability, according to their terms, of private agreements to arbitrate.

[***LEdHN8]

STATES, TERRITORIES, AND POSSESSIONS §18

pre-emption of state law --

Headnote:[8]

Even when Congress has not completely displaced state regulation in an area, state law may nonetheless be pre-empted to the extent that it stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.

[***LEdHN9]

ARBITRATION §2

Federal Arbitration Act -- scope --

Headnote:[9]

The Federal Arbitration Act (9 USCS 1 et seq.) does not require parties to arbitrate where they have not agreed to do so, nor does it prevent parties who do agree to arbitrate from excluding certain claims from the scope of their arbitration agreement; it simply requires courts to enforce privately negotiated agreements to arbitrate, like other contracts, in accordance with their terms.

[***LEdHN10]

ARBITRATION §2

STATES, TERRITORIES, AND POSSESSIONS §46

Federal Arbitration Act -- pre-emption of state law -- effect of agreement --

Headnote:[10]

The Federal Arbitration Act (9 USCS 1 et seq.) pre-empts state laws which require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration, but the Act does not prevent the enforcement of agreements to arbitrate under different rules than those set forth in the Act itself; arbitration under the Act is a matter of consent, not coercion, and parties are generally free to structure their arbitration agreements as they see fit, being just as free to specify by contract the rules under which arbitration will be conducted as they are to limit by contract the issues which they will arbitrate.

SYLLABUS

A construction contract between appellant and appellee contained an agreement to arbitrate all disputes arising out of the contract and a choice-of-law clause providing that the contract would be governed by the law of "the place where the Project is located." When a dispute arose under the contract, appellant made a formal demand for arbitration. In response, appellee filed an action against appellant in the California Superior Court alleging fraud and breach of contract; in the same action,

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appellee sought indemnity from two other parties involved in the construction project, with whom it did not have arbitration agreements. The trial court denied appellant's motion to compel arbitration and granted appellee's motion to stay arbitration under Cal. Civ. Proc. Code Ann. § 1281.2(c), which allows such a stay pending resolution of related litigation between a party to the arbitration agreement and third parties not bound by it. The State Court of Appeal affirmed, holding that (1) by specifying that the contract would be governed by "the law of the place where the Project is located," the choice-of-law clause incorporated the California rules of arbitration, including § 1281.2(c), into the parties' arbitration agreement, and (2) application of § 1281.2(c) was not preempted by the Federal Arbitration Act (FAA or Act), even though the contract involved interstate commerce.

Held:

- 1. The Court of Appeal's conclusion that the parties intended the choice-of-law clause to incorporate the California arbitration rules into their arbitration agreement is a question of state law, which this Court will not set aside. Pp. 474-476.
- (a) Appellant's contention that the state court's construction of the choice-of-law clause was in effect a finding that appellant had "waived" its federally guaranteed right to compel arbitration, a waiver whose validity must be judged by reference to federal rather than state law, fundamentally misconceives the nature of the rights created by the FAA. Section 4 of that Act does not confer an absolute right to compel arbitration, but only a right to obtain an order directing that "arbitration proceed in the manner provided for in [the parties'] agreement." (Emphasis added.) Here, the state court found that, by incorporating California arbitration rules into their agreement, the parties had agreed that arbitration would not proceed in situations within the scope of § 1281.2(c). This was not a finding that appellant had "waived" an FAA-guaranteed right to compel arbitration, but a finding that it had no such right in the first place, because the parties' agreement did not require arbitration to proceed in this situation. Pp. 474-475.
- (b) Also without merit is appellant's argument that the state court's construction of the choice-of-law clause must be set aside because it violates the settled federal rulethat questions of arbitrability in contracts subject to the FAA must be resolved with a healthy regard for the federal policy favoring arbitration. See Moses H. Cone Memorial Hospital v. Mercury Construction Corp., 460 U.S. 1, 24-25. There is no federal policy favoring arbitration under a certain set of procedural rules; the federal policy is simply to ensure the enforceability, according to their terms, of private agreements to arbitrate. Interpret-

ing a choice-of-law clause to make applicable the California arbitration rules -- which are manifestly designed to encourage resort to the arbitral process -- does not offend *Moses H. Cone*'s rule of liberal construction. Pp. 475-476.

2. Application of § 1281.2(c) to stay arbitration under the parties' contract is not pre-empted by the FAA. The FAA contains no express pre-emptive provision, nor does it reflect a congressional intent to occupy the entire field of arbitration. Moreover, since the FAA's principal purpose is to ensure that private arbitration agreements are enforced according to their terms, it cannot be said that application of $\S 1281.2(c)$ here would undermine the Act's goals and policies. Arbitration under the Act in a matter of consent, not coercion, and the parties are generally free to structure their arbitration agreements as they see fit. Just as they may limit by contract the issues which they will arbitrate, Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 628, so too may they specify by contract the rules under which the arbitration will be conducted. Where, as here, the parties have agreed to abide by state arbitration rules, enforcing those rules according to the terms of the agreement is fully consistent with the FAA's goals, even if the result is that arbitration is stayed when the Act would otherwise permit it to go forward. Pp. 476-479.

COUNSEL: James E. Harrington argued the cause for appellant. With him on the briefs were Robert B. Thum and Deanne M. Tully.

David M. Heilbron argued the cause for appellee. With him on the brief was Leslie G. Landau.

JUDGES: Rehnquist, C. J., delivered the opinion of the Court, in which White, Blackmun, Stevens, Scalia, and Kennedy, JJ., joined. Brennan, J., filed a dissenting opinion, in which Marshall, J., joined, post, p. 479. O'-Connor, J., took no part in the consideration or decision of the case.

OPINION BY: REHNQUIST

OPINION

[*470] [***494] [**1251] CHIEF JUSTICE REHNQUIST delivered the opinion of the Court.

[***LEdHR1A] [1A] Unlike its federal counterpart, the California Arbitration Act, Cal. Civ. Proc. Code Ann. § 1280 et seq. (West 1982), contains a provision allowing a court to stay arbitration pending resolution of related litigation. We hold that application of the California statute is not pre-empted by the Federal Arbitration Act (FAA or Act), 9 U. S. C. § 1 et seq., in a case

where the parties have agreed that their arbitration agreement will be governed by the law of California.

Appellant Volt Information Sciences, Inc. (Volt), and appellee Board of Trustees of Leland Stanford Junior University (Stanford) entered into a construction contract under which Volt was to install a system of electrical conduits on the Stanford campus. The contract contained an agreement to arbitrate all disputes between the parties "arising out of or relating to this contract or the breach thereof." 1 The contract also contained a choice-of-law clause providing that "[t]he Contract shall be governed by the law of the place where the Project is located." App. 37. During the course of the project, [***495] a dispute developed regarding compensation for extra work, and Volt made a formal demand for arbitration. Stanford responded by filing an action against Volt [*471] in California Superior Court, alleging fraud and breach of contract; in the same action, Stanford also sought indemnity from two other companies involved in the construction project, with whom it did not have arbitration agreements. Volt petitioned the Superior Court to compel arbitration of the dispute. ² Stanford in turn moved to stay arbitration pursuant to Cal. Civ. Proc. Code Ann. § 1281.2(c) (West 1982), which permits a court to stay arbitration pending resolution of related litigation between a party to the arbitration agreement and third parties not bound by it, where "there is a possibility of conflicting rulings on a common issue of law or fact." ³ The Superior Court denied [**1252] Volt's motion to compel arbitration and stayed the arbitration proceedings pending the outcome of the litigation on the authority of § 1281.2(c). App. 59-60.

1 The arbitration clause read in full as follows:

"All claims, disputes and other matters in question between the parties to this contract, arising out of or relating to this contract or the breach thereof, shall be decided by arbitration in accordance with the Construction Industry Arbitration Rules of the American Arbitration Association then prevailing unless the parties mutually agreed [sic] otherwise. . . This agreement to arbitrate . . . shall be specifically enforceable under the prevailing arbitration law." App. 40.

2 Volt's motion to compel was apparently brought pursuant to § 4 of the FAA, 9 U. S. C. § 4, and the parallel provision of the California Arbitration Act, Cal. Civ. Proc. Code Ann. § 1281.2 (West 1982); the motion cited both Acts as authority, but did not specify the particular sections upon which reliance was placed. App. 45-46. Volt also asked the court to stay the Superior Court litigation until the arbitration was completed, presumably pursuant to § 3 of the FAA, 9

U. S. C. § 3, and the parallel provision of the California Arbitration Act, Cal. Civ. Proc. Code Ann. § 1281.2(c)(3) (West 1982). App. 45-46.

Section 1281.2(c) provides, in pertinent part, that when a court determines that "[a] party to the arbitration agreement is also a party to a pending court action or special proceeding with a third party, arising out of the same transaction or series of related transactions and there is a possibility of conflicting rulings on a common issue of law or fact[,]... the court (1) may refuse to enforce the arbitration agreement and may order intervention or joinder of all parties in a single action or special proceeding; (2) may order intervention or joinder as to all or only certain issues; (3) may order arbitration among the parties who have agreed to arbitration and stay the pending court action or special proceeding pending the outcome of the arbitration proceeding; or (4) may stay arbitration pending the outcome of the court action or special proceeding."

The California Court of Appeal affirmed. court acknowledged that the parties' contract involved interstate [*472] commerce, that the FAA governs contracts in interstate commerce, and that the FAA contains no provision permitting a court to stay arbitration pending resolution of related litigation involving third parties not bound by the arbitration agreement. App. 64-65. However, the court held that by specifying that their contract would be governed by "the law of the place where the project is located," the parties had incorporated the California rules of arbitration, including § 1281.2(c), into their arbitration agreement. Id., at 65. Finally, the court rejected Volt's contention that, even if the parties had agreed to arbitrate under the California rules, application of § 1281.2(c) here was nonetheless pre-empted by the FAA because the contract involved interstate commerce. Id., at 68-80.

[***LEdHR2A] [2A]The court reasoned that the purpose of the FAA was "not [to] mandate the arbitration of all claims, but merely the enforcement [***496] ... of privately negotiated arbitration agreements." Id., at 70 (quoting Dean Witter Reynolds Inc. v. Byrd, 470 U.S. 213, 219 (1985)). While the FAA therefore pre-empts application of state laws which render arbitration agreements unenforceable, "[i]t does not follow, however, that the federal law has preclusive effect in a case where the parties have chosen in their [arbitration] agreement to abide by state rules." App. 71. To the contrary, because "[t]he thrust of the federal law is that arbitration is strictly a matter of contract," ibid., the parties to an arbitration agreement should be "at liberty to choose the terms under which they will arbitrate." Id., at 72. Where, as here, the parties have chosen in their agreement to abide

by the state rules of arbitration, application of the FAA to prevent enforcement of those rules would actually be "inimical to the policies underlying state and federal arbitration law," id., at 73, because it would "force the parties to arbitrate in a manner contrary to their agreement." Id., at 65. The California Supreme [*473] Court denied Volt's petition for discretionary review. Id., at 87. We postponed consideration of our jurisdiction to the hearing on the merits. 485 U.S. 976 (1988). We now hold that we have appellate jurisdiction 4 and affirm.

Under 28 U. S. C. § 1257(2), this Court has appellate jurisdiction to review a final judgment rendered by the highest court of a State in which a decision could be had "where is drawn in question the validity of a statute of any state on the ground of its being repugnant to the Constitution, treaties or laws of the United States, and the decision is in favor of its validity." Here appellant explicitly drew in question the validity of Cal. Civ. Proc. Code Ann. § 1281.2(c) (West 1982) on federal grounds, contending that the statute, as applied to stay arbitration of this dispute, was pre-empted by the FAA and thus invalid under the Supremacy Clause. Because the California Court of Appeal upheld application of the statute against this challenge, our appellate jurisdiction would seem to be assured. See Longshoremen v. Davis, 476 U.S. 380, 387, n. 8 (1986) (§ 1257(2) jurisdiction exists when a state statute is upheld against a claim that its application to a particular set of facts is pre-empted by federal law); McCarty v. McCarty, 453 U.S. 210, 219-220, n. 12 (1981) (same). Appellee contends, however, that $\S 1257(2)$ jurisdiction does not exist because the Court of Appeal's decision did not directly address the validity of the statute itself, but "simply uph[eld] the validity of the parties' agreement," which in turn required application of the statute. Brief for Appellee 4. Because an agreement is not a "statute," appellee argues, the Court of Appeal's decision is not one from which an appeal under § 1257(2) will lie. Id., at 4-5.

[***LEdHR2B] [2B]We disagree. Our decisions establish that "a state statute is sustained within the meaning of § 1257(2) when a state court holds it applicable to a particular set of facts as against the contention that such application is invalid on federal grounds." Japan Line, Ltd. v. County of Los Angeles, 441 U.S. 434, 441 (1979) (citing Cohen v. California, 403 U.S. 15, 17-18 (1971); Warren Trading Post Co. v. Arizona Tax Comm'n, 380 U.S. 685, 686, and n. 1 (1965); Bantam Books, Inc. v. Sullivan, 372 U.S. 58, 61, n. 3 (1963); Dahnke-Walker Milling Co.

v. Bondurant, 257 U.S. 282, 288-290 (1921)), regardless of "the particular grounds or reasons on which the [state court's] decision is put." Id., at 289. In this case, appellant contended before the Court of Appeal that even if the contract required application of Cal. Civ. Proc. Code Ann. § 1281.2(c) (West 1982), the California statute, as applied to stay arbitration under this contract in interstate commerce, so conflicted with the FAA that it was invalid under the Supremacy Clause. The Court of Appeal upheld application of the statute against this challenge, and under Dahnke-Walker and its progeny, that was sufficient to bring the case within the terms of δ 1257(2), even though the court's decision may have been premised on its interpretation of the contract.

[*474] [***497] [**1253] [***LEdHR3] [3] Appellant devotes the bulk of its argument to convincing us that the Court of Appeal erred in interpreting the choice-of-law clause to mean that the parties had incorporated the California rules of arbitration into their arbitration agreement. See Brief for Appellant 66-96. Appellant acknowledges, as it must, that the interpretation of private contracts is ordinarily a question of state law, which this Court does not sit to review. See id., at 26, 29. But appellant nonetheless maintains that we should set aside the Court of Appeal's interpretation of this particular contractual provision for two principal reasons.

[***LEdHR4A] [4A] [***LEdHR5A] [5A]Appellant first suggests that the Court of Appeal's construction of the choice-of-law clause was in effect a finding that appellant had "waived" its "federally guaranteed right to compel arbitration of the parties' dispute," a waiver whose validity must be judged by reference to federal rather than state law. Id., at 17, 30-36. This argument fundamentally misconceives the nature of the rights created by the FAA. The Act was designed "to overrule the judiciary's longstanding refusal to enforce agreements to arbitrate," Byrd, supra, at 219-220, and place such agreements "upon the same footing as other contracts," Scherk v. Alberto-Culver Co., 417 U.S. 506, 511 (1974) (quoting H. R. Rep. No. 96, 68th Cong., 1st Sess., 1, 2 (1924)). Section 2 of the Act therefore declares that a written agreement to arbitrate in any contract involving interstate commerce or a maritime transaction "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract," 9 U. S. C. δ 2, and δ 4 allows a party to such an arbitration agreement to "petition any United States district court . . . for an order directing that such

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arbitration proceed in the manner provided for in such agreement."

[***LEdHR4B] [4B]But § 4 of the FAA does not confer a right to compel arbitration of any dispute at any time; it confers only the [*475] right to obtain an order directing that "arbitration proceed in the manner provided for in [the parties'] agreement." 9 U. S. C. § 4 (emphasis added). Here the Court of Appeal found that, by incorporating the California rules of arbitration into their agreement, the parties had agreed that arbitration would not proceed in situations which fell within the scope of Calif. Code Civ. Proc. Ann. § 1281.2(c) (West This was not a finding that appellant had "waived" an FAA-guaranteed right to compel arbitration of this dispute, but a finding that it had no such right in the first place, because the parties' agreement did not require arbitration to proceed in this situation. Accordingly, appellant's contention that the contract interpretation issue presented here involves the "waiver" of a federal right is without merit.

[***LEdHR6] [6]Second, appellant argues that we should set aside the Court of Appeal's construction of the choice-of-law clause because it violates the settled federal rule that questions of arbitrability in contracts subject to the FAA must be resolved with a [**1254] healthy regard for the federal policy [***498] favoring arbitration. Brief for Appellant 49-52; id., at 92-96, citing Moses H. Cone Memorial Hospital v. Mercury Construction Corp., 460 U.S. 1, 24-25 (1983) (§ 2 of the FAA "create[s] a body of federal substantive law of arbitrability, applicable to any arbitration agreement within the coverage of the Act," which requires that "questions of arbitrability . . . be addressed with a healthy regard for the federal policy favoring arbitration," and that "any doubts concerning the scope of arbitrable issues . . . be resolved in favor of arbitration"); Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 626 (1985) (in construing an arbitration agreement within the coverage of the FAA, "as with any other contract, the parties' intentions control, but those intentions are generously construed as to issues of arbitrability"). These cases of course establish that, in applying general state-law principles of contract interpretation to the interpretation of an arbitration agreement within the scope of the Act, see Perry v. Thomas, 482 U.S. 483, 493, n. 9 (1987), [*476] due regard must be given to the federal policy favoring arbitration, and ambiguities as to the scope of the arbitration clause itself resolved in favor of arbitration.

[***LEdHR4C] [4C] [***LEdHR7] [7]But we do not think the Court of Appeal offended the *Moses H. Cone* principle by interpreting the choice-of-law provision to mean that the parties intended the California rules of

arbitration, including the § 1281.2(c) stay provision, to apply to their arbitration agreement. There is no federal policy favoring arbitration under a certain set of procedural rules; the federal policy is simply to ensure the enforceability, according to their terms, of private agreements to arbitrate. Interpreting a choice-of-law clause to make applicable state rules governing the conduct of arbitration -- rules which are manifestly designed to encourage resort to the arbitral process -- simply does not offend the rule of liberal construction set forth in Moses H. Cone, nor does it offend any other policy embodied in the FAA. ⁵

5 Unlike the dissent, see post at 486-487, we think the California arbitration rules which the parties have incorporated into their contract generally foster the federal policy favoring arbitration. As indicated, the FAA itself contains no provision designed to deal with the special practical problems that arise in multiparty contractual disputes when some or all of the contracts at issue include agreements to arbitrate. California has taken the lead in fashioning a legislative response to this problem, by giving courts authority to consolidate or stay arbitration proceedings in these situations in order to minimize the potential for contradictory judgments. See Calif. Civ. Proc. Code Ann. § 1281.2(c).

[1B]The question remains [***LEdHR1B] whether, assuming the choice-of-law clause meant what the Court of Appeal found it to mean, application of Cal. Civ. Proc. Code Ann. § 1281.2(c) is nonetheless pre-empted by the FAA to the extent it is used to stay arbitration under this contract involving interstate commerce. It is undisputed that this contract falls within the coverage of the FAA, since it involves interstate commerce, and that the FAA contains no provision authorizing a stay of arbitration in this situation. Appellee contends, however, that §§ 3 and 4 of the FAA, which are the specific sections [*477] claimed to conflict with the California statute at issue [***499] here, are not applicable in this state-court proceeding and thus cannot pre-empt application of the California statute. See Brief for Appellee 43-50. While the argument is not without some merit, 6 we need not resolve it to decide [**1255] this case, for we conclude that even if $\S \S 3$ and 4 of the FAA are fully applicable in state-court proceedings, they do not prevent application of Cal. Civ. Proc. Code Ann. § 1281.2(c) to stay arbitration where, as here, the parties have agreed to arbitrate in accordance with California law.

6 While we have held that the FAA's "substantive" provisions -- $\S\S$ 1 and 2 -- are applicable in state as well as federal court, see *Southland Corp*.

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v. Keating, 465 U.S. 1, 12 (1984), we have never held that §§ 3 and 4, which by their terms appear to apply only to proceedings in federal court, see 9 U. S. C. § 3 (referring to proceedings "brought in any of the courts of the United States"); § 4 (referring to "any United States district court"), are nonetheless applicable in state court. See Southland Corp v. Keating, supra, at 16, n. 10 (expressly reserving the question whether "§§ 3 and 4 of the Arbitration Act apply to proceedings in state courts"); see also id., at 29 (O'Connor, J., dissenting) (§§ 3 and 4 of the FAA apply only in federal court).

[***LEdHR1C] [1C] [***LEdHR8] [8]The FAA contains no express pre-emptive provision, nor does it reflect a congressional intent to occupy the entire field of arbitration. See Bernhardt v. Polygraphic Co., 350 U.S. 198 (1956) (upholding application of state arbitration law to arbitration provision in contract not covered by the FAA). But even when Congress has not completely displaced state regulation in an area, state law may nonetheless be pre-empted to the extent that it actually conflicts with federal law -- t hat is, to the extent that it "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." Hines v. Davidowitz, 312 U.S. 52, 67 (1941). The question before us, therefore, is whether application of Cal. Civ. Proc. Code Ann. § 1281.2(c) to stay arbitration under this contract in interstate commerce, in accordance with the terms of the arbitration agreement itself, [*478] would undermine the goals and policies of the FAA. We conclude that it would not.

[***LEdHR5B] [5B] [***LEdHR9] [9]The FAA was designed "to overrule the judiciary's longstanding refusal to enforce agreements to arbitrate," Dean Witter Reynolds Inc. v. Byrd, 470 U.S., at 219-220, and to place such agreements "upon the same footing as other contracts," Scherk v. Alberto-Culver Co., 417 U.S., at 511 (quoting H. R. Rep. No. 96, 68th Cong., 1st Sess., 1, 2 (1924)). While Congress was no doubt aware that the Act would encourage the expeditious resolution of disputes, its passage "was motivated, first and foremost, by a congressional desire to enforce agreements into which parties had entered." Byrd, 470 U.S., at 220. Accordingly, we have recognized that the FAA does not require parties to arbitrate when they have not agreed to do so, see" id., at 219 (the Act "does not mandate the arbitration of all claims"), nor does it prevent parties who do agree to arbitrate from excluding certain claims from the scope of their arbitration agreement, see Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S., at 628 (citing Prima Paint Corp. v. Flood & [***500] Conklin Mfg. Co., 388 U.S. 395, 406 (1967)). It simply requires courts to enforce privately negotiated agreements to arbitrate, like other contracts, in accordance with their terms. See *Prima Paint, supra, at 404, n. 12* (the Act was designed "to make arbitration agreements as enforceable as other contracts, but not more so").

[***LEdHR1D] [1D] [***LEdHR10] [10]In recognition of Congress' principal purpose of ensuring that private arbitration agreements are enforced according to their terms, we have held that the FAA pre-empts state laws which "require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration." Southland Corp. v. Keating, 465 U.S. 1, 10 (1984). See, e. g., id., at 10-16 (finding pre-empted a state statute which rendered agreements to arbitrate certain franchise claims unenforceable); Perry v. Thomas, 482 U.S., at 490 (finding pre-empted a state statute which rendered unenforceable [*479] private agreements to arbitrate certain wage collection claims). But it does not follow that the FAA prevents the enforcement of agreements to arbitrate under different rules than those set forth in the Act itself. Indeed, such a result would be quite inimical to the FAA's primary purpose of ensuring that private agreements [**1256] to arbitrate are enforced according to their terms. Arbitration under the Act is a matter of consent, not coercion, and parties are generally free to structure their arbitration agreements as they see fit. Just as they may limit by contract the issues which they will arbitrate, see Mitsubishi, supra, at 628, so too may they specify by contract the rules under which that arbitration will be conducted. Where, as here, the parties have agreed to abide by state rules of arbitration, enforcing those rules according to the terms of the agreement is fully consistent with the goals of the FAA, even if the result is that arbitration is stayed where the Act would otherwise permit it to go forward. By permitting the courts to "rigorously enforce" such agreements according to their terms, see Byrd, supra, at 221, we give effect to the contractual rights and expectations of the parties, without doing violence to the policies behind by the FAA.

The judgment of the Court of Appeals is

Affirmed.

JUSTICE O'CONNOR took no part in the consideration or decision of this case.

DISSENT BY: BRENNAN

DISSENT

JUSTICE BRENNAN, with whom JUSTICE MARSHALL joins, dissenting.

The litigants in this case were parties to a construction contract which contained a clause obligating them to arbitrate disputes and making that obligation specifically enforceable. The contract also incorporated provisions of a standard form contract prepared by the American Institute of Architects and endorsed by the Associated General Contractors of America; among these general provisions was § 7.1.1: "The [*480] Contract shall be governed by the [***501] law of the place where the Project is located." When a dispute arose between the parties, Volt invoked the arbitration clause, while Stanford attempted to avoid it (apparently because the dispute also involved two other contractors with whom Stanford had no arbitration agreements).

1 American Institute of Architects Document A201, General Conditions of the Contract for Construction § 7.1.1 (1976). See App. 40.

The Federal Arbitration Act (FAA), 9 U. S. C. § 1 et seq., requires courts to enforce arbitration agreements in contracts involving interstate commerce. See ante, at 474. The California courts nonetheless rejected Volt's petition to compel arbitration in reliance on a provision of state law that, in the circumstances presented, permitted a court to stay arbitration pending the conclusion of related litigation. Volt, not surprisingly, suggested that the Supremacy Clause compelled a different result. The California Court of Appeal found, however, that the parties had agreed that their contract would be governed solely by the law of the State of California, to the exclusion of federal law. 2 [**1257] In reaching this [*481] conclusion the court relied on no extrinsic evidence of the parties' intent, but solely on the language of the form contract that the "law of the place where the project is located" would govern. App. 66-67.3

2 The California Court of Appeal correctly assumed that the FAA, were it applicable, would pre-empt the provisions of Cal. Civ. Proc. Code Ann. § 1281.2(c) (West 1982): "[I]t is apparent that were the federal rules to apply, Volt's petition to compel arbitration would have to be granted." App. 65.

Stanford nonetheless attempts to cast doubt on this conclusion by arguing that $\S\S$ 3 and 4 of the FAA, which provide for court orders to stay litigation and to compel arbitration, are not applicable in state court. Brief for Appellee 43-50. While we have stated that "state courts, as much as federal courts, are obliged to grant stays of litigation under \S 3 of the Arbitration Act," Moses H. Cone Memorial Hospital v. Mercury Construction Corp., 460 U.S. 1, 26 (1983); see also id., at 26, nn. 34-35, it is immaterial to the resolution of this case whether $\S\S$ 3 and 4 actually "apply." The parties here not only agreed to arbi-

trate, but they also agreed that that agreement would be specifically enforceable. See ante, at 470, n. 1. FAA § 2 -- which indisputably does apply in state court, Southland Corp. v. Keating. 465 U.S. 1 (1984) -- requires the court to enforce the parties' agreement. (Indeed, Southland Corp. can be read to stand for the proposition that δ 2 makes all arbitration agreements specifically enforceable. See id., at 31, and n. 20 (O'Connor, J., dissenting).) To stay the arbitration proceedings pending litigation of the same issues, as § 1281.2(c) provides, is not compatible with specific enforcement of the agreement to arbitrate -which is what the FAA requires here. Section 1281.2(c) therefore cannot be given effect unless -- as the California Court of Appeal held -- the parties somehow agreed that federal law was to play no role in governing their contract.

3 The court held that "the word 'place' was intended to mean the forum state." App. 66. It added: "We do not find reasonable Volt's interpretation that the 'place' where the project is located be construed to mean not only the state of California but also the nation of the United States of America." *Id.*, at 67.

This Court now declines to review that holding, which denies effect to an important federal statute, apparently because it finds no question of federal law involved. I can accept neither the state court's unusual interpretation of the parties' contract, nor this Court's unwillingness to review [***502] it. I would reverse the judgment of the California Court of Appeal. 4

4 I do not disagree with the Court's holding, ante, at 477-479, that the FAA does not pre-empt state arbitration rules, even as applied to contracts involving interstate commerce, when the parties have agreed to arbitrate by those rules to the exclusion of federal arbitration law. I would not reach that question, however, because I conclude that the parties have made no such agreement.

I

Contrary to the Court's view, the state court's construction of the choice-of-law clause is reviewable for two independent reasons.

A

The Court's decision not to review the state court's interpretation of the choice-of-law clause appears to be based on the principle that "the interpretation of private contracts is ordinarily a question of state law, which this Court does [*482] not sit to review." *Ante*, at 474. I have no quarrel with the general proposition that the interpretation of contracts is a matter of state law. By end-

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ing its analysis at that level of generality, however, the Court overlooks well-established precedent to the effect that, in order to guard against arbitrary denials of federal claims, a state court's construction of a contract in such a way as to preclude enforcement of a federal right is not immune from review in this Court as to its "adequacy."

Many of our cases that so hold involve, understandably enough, claims under the Contract Clause. In Appleby v. City of New York, 271 U.S. 364 (1926), for example, petitioners alleged that the city had unconstitutionally impaired their rights contained in a contract deeding them certain submerged lands in the city harbor. Chief Justice Taft stated the issue for the Court as follows:

"The questions we have here to determine are, first, was there a contract, second, what was its proper construction and effect, and, third, was its obligation impaired by subsequent legislation as enforced by the state court? These questions we must answer independently of the conclusion of [the state] court. Of course we should give all proper weight to its judgment, but we can not perform our duty to enforce the guaranty of the Federal Constitution as to the inviolability of contracts by state legislative action unless we give the questions independent consideration." *Id.*, at 379-380.

Similarly, in Indiana ex rel. Anderson v. Brand, 303 U.S. 95 (1938), the question was whether the State's repeal of a teacher tenure law had impaired petitioner's contract of employment. We reversed the judgment of the State Supreme Court, notwithstanding that it rested on the state ground that petitioner had had no contractual right to continued employment: "On such a question, one primarily of state law, we accord respectful consideration and great weight to the views [**1258] of the State's highest court but, in order that the constitutional [*483] mandate may not become a dead letter, we are bound to decide for ourselves whether a contract was made, what [***503] are its terms and conditions, and whether the State has, by later legislation, impaired its obligation." Id. at 100. See also Phelps v. Board of Education of West New York, 300 U.S. 319, 322-323 (1937); Irving Trust Co. v. Day, 314 U.S. 556, 561 (1942).

The issue has not arisen solely in cases brought under the Contract Clause. Memphis Gas Co. v. Beeler, 315 U.S. 649 (1942), was a Commerce Clause case where appellant's constitutional challenge to a state tax was dependent on a particular interpretation of a contract

under which appellant operated. While we sustained the Tennessee court's construction of that contract (and thus did not reach the federal issue), we emphasized that the "meaning and effect of the contract" were "local questions conclusively settled by the decision of the state court save only as this Court, in the performance of its duty to safeguard an asserted constitutional right, may inquire whether the decision of the state question rests upon a fair or substantial basis." *Id.*, at 654.

Indeed, our ability to review state-law decisions in such circumstances is not limited to the interpretation of contracts. In *Rogers v. Alabama*, 192 U.S. 226 (1904), we noted the

"necessary and well settled rule that the exercise of jurisdiction by this court to protect constitutional rights cannot be declined when it is plain that the fair result of a decision is to deny the rights. It is well known that this court will decide for itself whether a contract was made as well as whether the obligation of the contract has been impaired. But that is merely an illustration of a more general rule." *Id.*, at 230 (citation omitted).

We accordingly reversed the state court's dismissal, on grounds of "prolixity," of petitioner's motion to quash an [*484] indictment returned against him by a grand jury from which all blacks had been excluded. 5

As in Rogers, we have frequently declined to be bound by state procedural rulings that would have prevented us from reaching the federal issue. See, e. g., Davis v. Wechsler, 263 U.S. 22, 24 (1923); Brown v. Western R. Co. of Ala., 338 U.S. 294, 295-297 (1949); NAACP v. Alabama ex rel. Patterson, 357 U.S. 449, 454-458 (1958); James v. Kentucky, 466 U.S. 341, 348-349 (1984). While in recent years we may have been more willing to examine state procedural rulings, see e. g., Henry v. Mississippi, 379 U.S. 443 (1965), one study of our cases has concluded that we have historically shown less deference to state substantive decisions on ancillary questions than to similar procedural decisions. Hill, The Inadequate State Ground, 65 Colum. L. Rev. 943, 991 (1965); cf. Davis, supra, at 25.

While in this case the federal right at issue is a statutory, not a constitutional, one, the principle under which we review the antecedent question of state law is the same. Where "the existence or the application of a federal right turns on a logically antecedent finding on a

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matter of state law, it is essential to the Court's performance of its function that it exercise an ancillary jurisdiction to consider the state question. Federal rights could otherwise be nullified by the manipulation of state law." Wechsler, The [***504] Appellate Jurisdiction of the Supreme Court: Reflections on the Law and the Logistics of Direct Review, 34 Wash. & Lee L. Rev. 1043, 1052 (1977). See also Hill, The Inadequate State Ground, 65 Colum. L. Rev. 943 (1965).

No less than in the cited cases, the right of the instant parties to have their arbitration agreement enforced pursuant to the FAA could readily be circumvented by a state-court construction of their contract as having intended to exclude the applicability of federal law. It is therefore essential that, while according due deference to the [**1259] decision of the state court, we independently determine whether we "clearly would have judged the issue differently if [we] were the state's highest court." Wechsler, *supra*, at 1052. ⁶

6 While the principle of independent review by this Court of the adequacy of the state court's ruling is clear, the proper standard for such review poses a more difficult question. Indeed, our cases have employed a wide range of standards, ranging from de novo review, e. g., Appleby v. City of New York, 271 U.S. 364, 380 (1926) ("[W]e must give our own judgment . . . and not accept the present conclusion of the state court without inquiry"), to inquiring whether the state judgment rested on a "fair or substantial basis," Memphis Gas Co. v. Beeler, 315 U.S. 649, 654 (1942); Demorest v. City Bank Co., 321 U.S. 36, 42 (1944), to determining whether the state court's decision was "palpably erroneous," Phelps v. Board of Education of West New York, 300 U.S. 319, 323 (1937). I have no doubt that the proper standard of review is a narrow one, but I see no need for purposes of the present case to settle on a precise formulation. As will appear below, the state court's construction of the choice-of-law clause cannot be sustained regardless of the standard employed.

[*485] B

Arbitration is, of course, "a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit." Steelworkers v. Warrior & Gulf Co., 363 U.S. 574, 582 (1900). I agree with the Court that "the FAA does not require parties to arbitrate when they have not agreed to do so." Ante, at 478. Since the FAA merely requires enforcement of what the parties have agreed to, moreover, they are free if they wish to write an agreement to arbitrate outside the coverage of the FAA. Such an

agreement would permit a state rule, otherwise pre-empted by the FAA, to govern their arbitration. The substantive question in this case is whether or not they have done so. And that question, we have made clear in the past, is a matter of federal law.

Not only does the FAA require the enforcement of arbitration agreements, but we have held that it also establishes substantive federal law that must be consulted in determining whether (or to what extent) a given contract provides for arbitration. We have stated this most clearly in Moses H. Cone Memorial Hospital v. Mercury Construction Corp., 460 U.S. 1, 24-25 (1983):

"Section 2 [of the FAA] is a congressional declaration of a liberal federal policy favoring arbitration agreements, [*486] notwithstanding any state substantive or procedural policies to the con-The effect of the section is to create a body of federal substantive law of arbitrability, applicable to any arbitration agreement within the coverage [***505] of the Act. ... [T]he Courts of Appeals have . . . consistently concluded that questions of arbitrability must be addressed with a healthy regard for the federal policy favoring arbitration. We agree. The Arbitration Act establishes that, as a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration, whether the problem at hand is the construction of the contract language itself or an allegation of waiver, delay, or a like defense to arbitrability."

More recently, in Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614 (1985), we stated that a court should determine whether the parties agreed to arbitrate a dispute "by applying the 'federal substantive law of arbitrability." Id., at 626, quoting Moses H. Cone, supra, at 24. See also Southland Corp. v. Keating, 465 U.S. 1 (1984).

The Court recognizes the relevance of the *Moses H. Cone* principle but finds it unoffended by the Court of Appeal's decision, which, the Court suggests, merely determines what set of procedural rules [**1260] will apply. *Ante*, at 476. ⁷ I agree fully with the Court that "the federal policy is simply to ensure the enforceability, according to their terms, of private agreements to arbitrate," *ibid.*, but I disagree emphatically [*487] with its conclusion that that policy is not frustrated here. Applying the California procedural rule, which stays

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arbitration while litigation of the same issue goes forward, means simply that the parties' dispute will be litigated rather than arbitrated. Thus, interpreting the parties' agreement to say that the California procedural rules apply rather than the FAA, where the parties arguably had no such intent, implicates the *Moses H. Cone* principle no less than would an interpretation of the parties' contract that erroneously denied the existence of an agreement to arbitrate. §

7 Some of the Court's language might be read to suggest that the *Moses H. Cone* principle applies only to construction of the arbitration clause itself. *Ante*, at 476 ("[A]mbiguities as to the scope of the arbitration clause itself [must be] resolved in favor of arbitration"). Such a reading is flatly contradicted by *Moses H. Cone*. In language the Court omits from its quotation, *ante*, at 475, we made clear that the liberal rule of construction in favor of arbitrability applies "whether the problem at hand is the construction of the contract language itself or an allegation of waiver, delay, or a like defense to arbitrability." *Moses H. Cone Memorial Hospital*, 460 U.S., at 25.

Whether or not "the California arbitration rules . . . generally foster the federal policy favoring arbitration," ante, at 476, n. 5, is not the relevant question. Section 2 of the FAA requires courts to enforce agreements to arbitrate, and in Moses H. Cone we held that doubts as to whether the parties had so agreed were to be resolved in favor of arbitration. Whether California's arbitration rules are more likely than federal law to foster arbitration, i. e., to induce parties to agree to arbitrate disputes, is another matter entirely. On that question it is up to Congress, not this Court, to "fashio[n] a legislative response," ante, at 476, n. 5, and in the meantime we are not free to substitute our notions of good policy for federal law as currently written.

While appearing to recognize that the state court's interpretation of the contract does raise a question of federal law, the Court nonetheless refuses to determine whether the state court misconstrued that agreement, [***506] There is no warrant for failing to do so. The FAA requires that a court determining a question of arbitrability not stop with the application of state-law rules for construing the parties' intentions, but that it also take account of the command of federal law that "those intentions [be] generously construed as to issues of arbitrability. Mitsubishi Motors, supra, at 626. Thus, the decision below is based on both state and federal law, which are thoroughly intertwined. In such circumstances the state-court judgment cannot be said to rest on an "adequate and independent state ground" so as to bar review by this Court. See Enterprise Irrigation Dist. v. Farmers Mutual Canal Co., 243 U.S. 157, 164 (1917) ("But where the non-federal [*488] ground is so interwoven with the other as not to be an independent matter . . . our jurisdiction is plain"). With a proper application of federal law in this case, the state court's judgment might have been different, and our review is therefore not barred. Cf. Ake v. Oklahoma, 470 U.S. 68, 74-75 (1985) ("[W]hen resolution of the state procedural law question depends on a federal constitutional ruling, the state-law prong of the court's holding is not independent of federal law, and our jurisdiction is not precluded").

II

Construed with deference to the opinion of the California Court of Appeal, yet "with a healthy regard for the federal policy favoring arbitration," *Moses H. Cone, 460 U.S., at 24*, it is clear that the choice-of-law clause cannot bear the interpretation the California court assigned to it.

Construction of a contractual provision is, of course, a matter of discerning the parties' intent. It is important to recall, in the first place, that in this case there is no extrinsic evidence of their intent. We must [**1261] therefore rely on the contract itself. But the provision of the contract at issue here was not one that these parties drafted themselves. Rather, they incorporated portions of a standard form contract commonly used in the construction industry. That makes it most unlikely that their intent was in any way at variance with the purposes for which choice-of-law clauses are commonly written and the manner in which they are generally interpreted.

It seems to me beyond dispute that the normal purpose of such choice-of-law clauses is to determine that the law of one State rather than that of another State will be applicable; they simply do not speak to any interaction between state and federal law. A cursory glance at standard conflicts texts confirms this observation: they contain no reference at all to the relation between federal and state law in their discussions of contractual choice-of-law clauses. See, e. g., [*489] R. Weintraub, Commentary on the Conflict of Laws § 7.3C (2d ed. 1980); E. Scoles & P. Hay, Conflict of Laws 632-652 (1982); R. Leflar, L. McDougal, & R. Felix, American Conflicts Law § 147 (4th ed. 1986). The same is true of standard codifications. See Uniform Commercial Code § 1-105(1) (1978); Restatement (Second) of Conflict of Laws § 187 (1971). Indeed the Restatement of Conflicts notes expressly that it does not deal with "the ever-present problem of determining [***507] the respective spheres of authority of the law and courts of the nation and of the member States." Id., δ 2, Comment c. Decisions of this Court fully bear out the impression that choice-of-law clauses do not speak to any state-federal issue. On at least two occasions we have been called upon to determine the applicability vel non of the FAA to contracts containing choice-of-law clauses similar to that at issue here. Despite adverting to the choice-of-law clauses in other contexts in our opinions, we ascribed no significance whatever to them in connection with the applicability of the FAA. Scherk v. Alberto-Culver Co., 417 U.S. 506 (1974); Bernhardt v. Polygraphic Co., 350 U.S. 198 (1956). The great weight of lower court authority similarly rejects the notion that a choice-of-law clause renders the FAA inapplicable. 10 Choice-of-law clauses simply [**1262] have never been used for the purpose of dealing with the relationship between state and federal law. There is no basis whatever for believing that the parties in this case intended their choice-of-law clause to do so.

9 In Scherk, the contract contained the following clause: "The laws of the State of Illinois, U. S. A. shall apply to and govern this agreement, its interpretation and performance." 417 U.S., at 509, n. 1. Despite discussing the effect of that clause in a different context, id., at 519, n. 13, we did not consider the possibility that the FAA might not apply because of the parties' choice of the law of Illinois. Similarly, in Bernhardt the contract provided for arbitration under New York law. While we recognized a choice-of-law problem as to whether New York or Vermont law was applicable, 350 U.S., at 205, we resolved the question of arbitrability under the FAA without any reference to the choice-of-law clause.

See, e. g., Huber, Hunt & Nichols, Inc. v. Architectural Stone Co., 625 F. 2d 22, 25-26, n. 8 (CA5 1980); Commonwealth Edison Co. v. Gulf Oil Corp., 541 F. 2d 1263, 1268-1271 (CA7 1976); Burke County Public Schools Board of Education v. The Shaver Partnership, 303 N. C. 408, 420-424, 279 S. E. 2d 816, 823-825 (1981); Episcopal Housing Corp. v. Federal Ins. Co., 269 S. C. 631, 637, n. 1, 239 S. E. 2d 647, 650, n. 1 (1977); Tennessee River Pulp & Paper Co. v. Eichleay Corp., 637 S. W. 2d 853, 857-858 (Tenn. 1982); Mamlin v. Susan Thomas, Inc., 490 S. W. 2d 634, 636-637 (Tex. Civ. App. 1973); see also Liddington v. The Energy Group, Inc., 192 Cal. App. 3d 1520, 238 Cal. Rptr. 202 (1987) (reversing trial court ruling that had applied δ 1281.2(c) rather than the FAA because choice-of-law clause specified contract would be construed under California law). But see Garden Grove Community Church v. Pittsburgh-Des Moines Steel Co., 140 Cal. App. 3d 251, 262, 191 Cal. Rptr. 15, 20 (1983); Standard Co. of New Orleans, Inc. v. Elliott Construction Co., 363 So. 2d 671, 677 (La. 1978).

Stanford contends that because the Garden Grove decision antedated the conclusion of the present contract, it must have informed the language the parties used. Brief for Appellee 31-32; Tr. of Oral Arg. 35. This argument might have greater force if the clause had been one the parties actually negotiated, rather than one they incorporated from an industrywide form contract. In any case it is impossible to believe that, had they actually intended that a result so foreign to the normal purpose of choice-of-law clauses flow from their agreement, they would have failed to say so explicitly.

Moreover, the literal language of the contract --"the law of the place" -- gives no indication of any intention to apply only state law and exclude other law that would normally be applicable to something taking place at that location. By settled principles of federal supremacy, the law of any place in the United States includes federal law. See Claflin v. Houseman, 93 U.S. 130, 136 (1876); Hauenstein v. Lynham, 100 U.S. 483, 490 (1880) ("[T]he Constitution, laws, and treaties of the United States are as much a part of the law of every [***508] State as its own local laws and Constitution"). As the dissenting judge below noted, "under California law, federal law governs matters cognizable in California courts upon which the United States has definitively spoken." App. 82 (opinion [*491] of Capaccioli, J.). Thus, "the mere choice of California law is not a selection of California law over federal law " Id., at 84. In the absence of any evidence to the contrary it must be assumed that this is what the parties meant by "the law of the place where the Project is located."

Indeed, this is precisely what we said when we once previously confronted virtually the same question. In Fidelity Federal Savings & Loan Assn. v. De la Cuesta, 458 U.S. 141 (1982), a contract provision stated: "This Deed of Trust shall be governed by the law of the jurisdiction in which the Property is located." Id., at 148, n. 5. Rejecting the contention that the parties thereby had agreed to be bound solely by local law, we held: "Paragraph 15 provides that the deed is to be governed by the 'law of the jurisdiction' in which the property is located; but the 'law of the jurisdiction' includes federal as well as state law." Id., at 157, n. 12. We should similarly conclude here that the choice-of-law clause was not intended to make federal law inapplicable to this contract.

Ш

Most commercial contracts written in this country contain choice-of-law clauses, similar to the one in the Stanford-Volt contract, specifying which State's law is to

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govern the interpretation of the contract. See Scoles & Hay, Conflict of Laws, at 632-633 ("Party autonomy means that the parties are free to select the law governing their contract, subject to certain limitations. They will usually do so by means of an express choice-of-law clause in their written contract"). Were every state court to construe such clauses as an expression of the parties' intent to exclude the application of federal law, as has the California Court of Appeal in this case, the result would be to render the Federal Arbitration Act a virtual nullity as to presently existing contracts. I cannot believe that the parties to contracts intend such consequences to flow from their insertion of a standard choice-of-law [*492] clause. Even less can I agree that we are powerless to review decisions of state courts that effectively nullify a vital piece of federal legislation. I respectfully dissent.

REFERENCES

5 Am Jur 2d, Arbitration and Award 6, 83

- 3 Federal Procedure, L Ed, Arbitration 4:8
- 3 Federal Procedural Forms, L Ed, Arbitration 4:3

USCS, Constitution, Art VI, cl 2; 9 USCS 1 et seq.

US L Ed Digest, Arbitration 2, 6; States, Territories, and Possessions 46

Index to Annotations, Arbitration and Award; Pre-emption

Annotation References:

Validity, under Federal Constitution, of arbitration statutes. 87 L Ed 2d 787.

Contract containing arbitration agreement as subject to the stay and enforcement provisions of the *United States Arbitration Act.* 100 L Ed 211, 18 L Ed 2d 1685.

Appealability of state court's order or decree compelling or refusing to compel arbitration. 6 ALR4th 652.



LEXSEE 752 F.2D 406

PAUL E. WATTS and LYNN WATTS, his wife, individually and as husband and wife, Plaintiffs-Appellants, v. LOREN G. PINCKNEY, dba PINCKNEY CONSTRUCTION COMPANY, Defendant-Third Party, Plaintiff/Appellee; PAUL E. WATTS and LYNN WATTS, his wife, individually and as husband and wife, Plaintiffs-Appellants, v. LOREN G. PINCKNEY, dba PINCKNEY CONSTRUCTION COMPANY, Defendant-Third Party, Plaintiff/Appellee, v. UNITED STATES OF AMERICA, Third-Party Defendant-Appellee

Nos. 83-2616, 83-2715

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

752 F.2d 406; 1985 U.S. App. LEXIS 28685; 40 Fed. R. Serv. 2d (Callaghan) 1415

October 2, 1984, Argued and Submitted January 22, 1985, Decided

PRIOR HISTORY: [**1] Appeal from the United States District Court for the District of Arizona at Phoenix, Valdemar A. Cordova, District Judge, Presiding.

DISPOSITION:

Affirmed

COUNSEL: For Appellant:

John B. Schuyler, Jr., Esq., John M. Favour, Esq., Favour, De Pasquale, Moore & Schuyler, P.A., Prescott, Arizona.

For Appellee:

Robert P. Simbro, Esq., Phoenix, Arizona, Paul Gary Sterling, San Francisco, California.

JUDGES: Farris, Alarcon, and Norris, Circuit Judges. Norris, J., concurring separately.

OPINION BY: ALARCON

OPINION

[*407] ALARCON, Circuit Judge:

These are consolidated appeals from two separate judgments entered against Paul E. Watts and Lynn Watts (hereinafter the Watts). We are asked to decide: (1) whether the district court lacked subject matter jurisdic-

tion in an action against the United States under the Suits in Admiralty Act 46 U.S.C. § 742 and (2) whether the court had the authority to vacate a void judgment and to order restitution pursuant to Fed. R. Civ. P. 60(b)(4). For the reasons set forth below, we affirm both judgments.

I PERTINENT FACTS

On September 12, 1975, the Watts' houseboat was severely damaged during a storm while moored at a marina operated under the authority [**2] of the National Park Service (hereinafter United States). When the damage occurred, Loren G. Pinckney, doing business as the Pinckney Construction Company (hereinafter Pinckney), was in the process of relocating a floating breakwater pursuant to a contract with the United States.

On November 30, 1976, the Watts filed a diversity action against Pinckney in which it was alleged that the vessel was destroyed as a direct result of Pinckney's negligence in moving the breakwater. On August 30, 1977, Pinckney filed a third-party complaint against the United States in which he sought indemnity for any damages that might be awarded to the Watts.

On June 30, 1978, -- thirty-three months after the cause of action arose -- the Watts filed an amended complaint which joined the United States as a defendant. The amended complaint alleged that "Pinckney was employed under the direct supervision and control of the United States." (CR 114(5)). Federal jurisdiction was invoked under the Federal Tort Claims Act (FTCA) 28

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U.S.C. § 1346(b), §§ 2671-2680 and the Suits in Admiralty Act (SSA) 46 U.S.C. §§ 741-752. The complaint was mailed to the United States Attorney and the United States Department [**3] of Justice.

On August 25, 1978, the United States answered. At the same time, it filed a cross-complaint against Pinckney claiming a right to indemnification.

On July 3, 1980, the district court entered judgment in favor of the Watts on their amended complaint against Pinckney and the United States. Judgment was entered in favor of Pinckney against the United States in the third-party complaint.

The United States appealed both judgments. Pinckney did not appeal the judgment against him. Instead, he paid the Watts the full amount awarded by the court.

In a memorandum disposition filed on November 24, 1982, we held that the Watts' claim was exclusively within admiralty jurisdiction and that the Watts' remedy was solely against the *United States*. [*408] 696 F.2d 1003, 696 F.2d 1005. We reversed and remanded to the district court with directions to determine: (1) whether the mailing of the amended complaint to the United States Attorney satisfied the "forthwith service" requirements of 46 U.S.C. § 742 and (2) whether the complaint could satisfy the two year statute of limitation period in 46 U.S.C. § 745 in light of the relation back doctrine set forth in Fed. R. Civ. P. [**4] 15(c).

The district court determined that it lacked subject matter jurisdiction because the Watts failed to comply with the "forthwith service" requirements of 46 U.S.C. § 742. The Watts' complaint against the United States was dismissed on November 22, 1983.

The Watts' appeal No. 83-2715 is from this judgment.

On June 24, 1983, Pinckney filed a motion pursuant to Fed. R. Civ. P. 60(b)(4) in which he requested that judgment against him be vacated as void. He also requested that the court order restitution of the funds paid in satisfaction of that judgment.

On September 1, 1983, the district court granted this motion stating:

That by virtue of the law as set forth in the Memorandum Opinion of the 9th Circuit, Court of Appeals, [the Watts'] cause of action was exclusively against the United States of America; that the judgment against [Pinckney] is void; that pursuant to Rule 60(b)(4), Federal Rules of Civil Procedure, [Pinckney] is entitled to be relieved from the effect of a final

judgment which is void; that as the underlying judgment is void, the Court must grant appropriate *Rule* 60(b) relief.

The Watts attack this order in Appeal No. 83-2716.

[**5] II DISCUSSION

A. Effect of the Absence of Forthwith Service (Appeal No. 83-2715)

In our earlier decision, we held that the Watts' case arose solely within admiralty jurisdiction. In order to effect jurisdiction over the United States in an admiralty action:

The libelant shall forthwith serve a copy of his libel on the United States Attorney of such district and mail a copy thereof by registered mail to the Attorney General of the United States and shall file a sworn return of such service and mailing. Such service and mailing shall constitute valid service on the United States.

46 U.S.C. § 742.

The record satisfies us that the Watts failed to comply with the "forthwith service" requirement of \S 742. The record conclusively demonstrates that "forthwith service" was not effected. The amended complaint was filed thirty-three months after the cause of action arose. The United States Attorney and the Attorney General of the United States were not served as required by Congress.

We have consistently held that a "failure to comply with the forthwith service demand of § 742 is a jurisdictional defect which denied a court subject matter jurisdiction [**6] in the controversy." Amella v. United States, 732 F.2d 711, 713 (9th Cir. 1984), citing Kenyon v. United States, 676 F.2d 1229 (9th Cir. 1981) (per curiam).

The district court's dismissal of the Watts' claim against the United States for lack of subject matter jurisdiction was compelled by the law of this circuit. 1

- 1 We do not address the Watts' other arguments in Appeal No. 83-2715 because of our determination that the district court lacked subject matter jurisdiction.
- B. Dismissal of Void Judgment is a Direct Attack (Appeal No. 83-2716)

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The Watts' amended complaint alleged that Pinckney was acting as an agent of the United States. As noted above, we held in our memorandum disposition of the appeal filed by the United States that the Watts' exclusive remedy, under 46 U.S.C. § 745 ², was against the United States

2 Section 745 provides in relevant part:

Suits as authorized by this chapter may be brought only within two years after the cause of action arises: *Provided*, that where a remedy is provided by this chapter it shall hereafter be exclusive of any other action by reason of the same subject matter against the agent or employee of the United States or of any incorporated or unincorporated agency thereof whose act or omission gave rise to the claim . . .

[**7] Pinckney successfully persuaded the district court to vacate the judgment and to [*409] order restitution by invoking Fed. R. Civ. P. 60(b)(4) which provides:

On motion and upon such terms as are just, the court may relieve a party or his legal representative from a final judgment, order or proceeding for the following reasons: . . .

(4) the judgment is void.

The district court held that the original judgment against Pinckney was invalid for lack of jurisdiction.

The Watts contend that the court was without power to act under $Rule\ 60(b)(4)$ because the judgment against Pinckney was merely erroneous, not void.

Relying on Kansas City Southern Ry. Co. v. Great Lakes Carbon, 624 F.2d 822 (8th Cir.), cert. denied, 449 U.S. 955, 66 L. Ed. 2d 220, 101 S. Ct. 363 (1980), the Watts contend that the district court was without power to declare the judgment against Pinckney void under Rule 60(b)(4). This authority is neither dispositive nor apposite.

In Kansas City Southern Ry. Co., the Eighth Circuit was required to determine whether the failure of the district court to join an indispensable party pursuant to 28

U.S.C. § 2322 rendered a prior judgment [**8] void under Section 60(b)(4). The Eighth Circuit held that it did not. The court held that absence of subject matter jurisdiction will render a judgment void when there is a "total want of jurisdiction' as distinguished from an error in the exercise of jurisdiction." Id. at 825.

The Eighth Circuit noted that the district court had personal jurisdiction over the appellant Kansas City Southern Railway Company and "jurisdiction over the general subject matter and accordingly could decide whether the United States should be joined and whether its non joinder was a jurisdictional defect." *Id. at 826*.

Here, there was a total want of jurisdiction over the claim against Pinckney due to the strict requirements of δ 745. Williams v. United States, 711 F.2d 893, 897 (9th Cir. 1983). Section 745 mandates that an action in admiralty be brought solely against the United States. The remedy for an aggrieved party "is exclusive of any action against the agent or employee of the United States whose act or omission gave rise to the claims." Doyle v. Bethlehem Steel Corp., 504 F.2d 911, 912 (5th Cir. 1974); Smith v. United States, 346 F.2d 449 (4th Cir.), cert. denied, 382 [**9] U.S. 878, 15 L. Ed. 2d 119, 86 S. Ct. 163 (1965) (intent of Congress in promulgating proviso excluding agent from suitability was not to keep alive liability of private person, firm, or corporation). The district court correctly concluded that the original judgment against Pinckney was void and the proper subject of a 60(b)(4) motion to vacate.

It is well settled that a judgment is void "if the court that considered it lacked jurisdiction of the subject matter, or if the parties or if [the court] acted in a manner inconsistent with due process of law." Vol. 11, Wright and Miller, Federal Practice and Procedure at 198, 200 (emphasis added); Textile Banking Co., Inc. v. Rentschler, 657 F.2d 844, 850 (7th Cir. 1981) (judgment is void if the court lacked jurisdiction); Marshall v. Board of Ed. Bergenfield, N.J., 575 F.2d 417, 422 (3d Cir. 1978) (judgment may be void and therefore subject to relief under 60(b)(4) if rendering court lacked subject matter jurisdiction).

The Watts assert that Pinckney was not entitled to relief because Rule 60(b)(4) applies only to relief from judgments. We are told that "where the judgment previously entered by a court has been fully [**10] paid and satisfied, the judgment no longer exists, the duties and obligations imposed by the judgment are extinguished and there remains nothing from which the party seeking relief can be relieved." The Watts rely on Mitchell v. Lindly, 351 P.2d 1063, 1067 (Okla. 1960) in support of this argument. The Mitchell decision is inapplicable [*410] to a challenge of a void judgment. The Oklahoma court, after noting that the appellant did not

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contend that the judgment was void, held that "a correct judgment, although based on the wrong reasons, will not be set aside on appeal." Id. at 1066. Here, the judgment against Pinckney was void. Thus, Pinckney was entitled to restitution under Section 60(b)(4). See Jordon v. Gilligan, 500 F.2d 701, 704 (6th Cir. 1974), cert. denied, 421 U.S. 991, 44 L. Ed. 2d 481, 95 S. Ct. 1996 (1975) (a Rule 60(b) motion is proper where appellants failed to object to an award of attorney's fees and expenses until after the judgment is entered and execution proceedings were undertaken); See also Vander Zee v. Karabatsos, 683 F.2d 832 (4th Cir. 1982) (garnisher entitled to restitution of payment made on void judgment).

The Watts also argue [**11] that the doctrine of res judicata precludes a collateral attack upon a court's determination of its own jurisdiction. In support of this proposition, the Watts cite Chicot County Drainage District v. Baxter State Bank, 308 U.S. 371, 84 L. Ed. 329, 60 S. Ct. 317 (1940) and Lubben v. Selective Service System Local Board No. 27, 453 F.2d 645 (1st Cir. 1972). While it is true that these cases provide that res judicata bars a collateral attack on a final judgment, the Watts' reliance on these decisions is misplaced.

Pinckney's attack on the judgment was *direct*, not collateral. A direct attack is defined as follows:

A direct attack on a judicial proceeding is an attempt to correct it, or to void it, in some manner provided by law to accomplish that object. It is an attack . . . by appropriate proceedings between the parties to it seeking, for sufficient cause alleged, to have it annulled, reversed, vacated or declared void.

1B J. Moore, Moore's Federal Practice para. 0.407 at 282 n. 1, quoting Intermill v. Nash, 94 Utah 271, 75 P.2d 157.

The doctrine of res judicata does not apply to *direct* attacks on judgments. "Res judicata does not preclude [**12] a litigant from making a direct attack [under *Rule 60(b)*] upon the judgment before the court which rendered it." *Jordan v. Gilligan, 500 F.2d at 710, quoting* 1B J. Moore, *Moore's Federal Practice* para. 0.407 at 931 (2d ed. 1973).

The district court was compelled to exercise its authority under *Rule* 60(b)(4) to vacate the judgment against Pinckney. "A void judgment is a legal nullity and a court considering a motion to vacate has no discretion in determining whether it should be set aside." *Jordan at* 704, citing 7 J. Moore, *Moore's Federal Practice*, para. 60.25[2] at 301 (2d ed. 1973).

The judgment in each matter is AFFIRMED.

CONCUR BY: NORRIS

CONCUR

Norris, J., concurring separately.

I concur in Judge Alarcon's opinion except for Part IIB. I concur in Part IIB solely to the extent it rests on the ground that appellants' failure to comply with the forthwith requirements of 46 U.S.C. § 742 resulted in a total want of jurisdiction and, therefore, the district court's judgment was void and subject to attack pursuant to $Rule\ 60(b)(4)$. I think that Judge Alarcon's discussion of res judicata and direct versus collateral attack is unnecessary to the disposition [**13] of the case.

Other State Case Authority

Chleboun v. Varilek (S.D. 1965) 136 N.W. 2d 348

Kasselder v. Kapperman (S.D.1982) 316 N.W. 2d 628

Dahl v. Sittner (S.D. 1988) 429 N.W.2d 458

Federal Land Bank of Omaha v. Sullivan (S.D. 1988) 430 N.W. 2d 700

> Hanson v. Brookings Hospital (S.D. 1991) 469 N.W. 2d 826

Action Mechanical, Inc. v. Deadwood Historic Pres. Comm'n (S.D. 2002) 652 N.W. 2d 742

Dakota Truck Underwriters v. South Dakota Subsequent Injury Fund (S.D. 2004) 689 N.W. 2d 196

Halls v. White (S.D. 2006) 715 N.W. 2d 577

City of Brookings v. Ramsay (S.D. 2007) 743 N.W. 2d 433

Baptist Memorial Hosp. System v. Sampson (Tex. 1998) 969 S.W.2d 945

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136 N.W.2d 348 81 S.D. 421, 136 N.W.2d 348 (Cite as: 81 S.D. 421, 136 N.W.2d 348)

C

Supreme Court of South Dakota.

Bessie C. CHLEBOUN, Plaintiff and Appellant,

Robert E. VARILEK, Mildred Varilek and Ed Varilek, Defendants and Respondents.

No. 10188.

July 21, 1965.

Action to determine adverse claims to real estate. From a judgment of dismissal entered upon a jury verdict in the Circuit Court, Tripp County, Don G. Grieves, J., the plaintiff farm owner appealed. The Supreme Court, Rentto, J., held that where the farm owner's husband, with her full knowledge and consent, leased the property to defendants for a period of five years and defendants incurred financial obligations on the strength of such lease, the jury, in the absence of evidence of bad faith on the part of defendants, could find that the owner was estopped to deny the authority of her husband to enter into the lease.

Affirmed.

West Headnotes

[1] Appeal and Error 30 € 930(1)

30 Appeal and Error
30XVI Review
30XVI(G) Presumptions
30k930 Verdict

30k930(1) k. In General. Most Cited

<u>Cases</u>

In reviewing appellant's contention that evidence was insufficient to sustain verdict, Supreme Court was bound to accept evidence most favorable to verdict.

121 Principal and Agent 308 137(1)

308III Rights and Liabilities as to Third Persons
308III(A) Powers of Agent

308k137 Estoppel to Deny Authority 308k137(1) k, In General. Most Cited

Cases

Acts of an ostensible agent bind principal not because of agency, but because principal will not be permitted to deny ostensible agent's authority. SDC 3.0203.

[3] Frauds, Statute Of 185 2 144

185 Frauds, Statute Of
1851X Operation and Effect of Statute

185k144 k. Waiver of Bar of Statute; Estoppel. Most Cited Cases

(Formerly 185k119(1))

Statute requiring that when an estate in real property, other than estate at will or for term not exceeding one year, is transferred by agent his authority must be in writing did not prevent defendants from relying on estoppel to establish their defense of agency to enter into contract whereby premises were leased to defendants. SDC 3.0203, 51.1401.

[4] Husband and Wife 205 \$\infty\$ 25(5)

205 Husband and Wife

2051 Mutual Rights, Duties, and Liabilities
 205k25 Agency of Husband for Wife
 205k25(5) k. Ratification of Agency. Most

Cited Cases

Where farm owner's husband, with her full knowledge and consent, leased property to defendants for period of five years and defendants incurred financial obligations on strength of such lease, jury, in absence of evidence of bad faith on part of defendants, could find that owner was estopped to deny authority of her husband to enter into lease. SDC 3.0203, 3.0303, 51.1401.

**348 *422 G. F. Johnson, Gregory, Maule, Maule & Day, Winner, for plaintiff and appellant.

No appearance for defendants and respondents.

RENTTO, Judge.

This is an action to determine adverse claims to real

136 N.W.2d 348 81 S.D. 421, 136 N.W.2d 348 (Cite as: 81 S.D. 421, 136 N.W.2d 348)

estate.

Plaintiff alleges that she is the owner in fee simple and entitled to the immediate possession of a described farm in Tripp County, South Dakota. Defendants answer that the husband of the plaintiff, acting as her agent and with her full knowledge and consent leased the property to them for a period of five years. They further assert that because of her conduct she is estopped to deny the lease. The jury returned a verdict finding *423 in favor of the defendants and against the plaintiff on all of the issues. Plaintiff appeals from the judgment of dismissal entered on such verdict.

On June 9, 1962 the husband of the plaintiff and all of the defendants, they being a husband, his wife, and their eldest son, executed a written agreement. It designated plaintiff's husband as the landlord and the defendants as the operator. After stating that the landowner was the owner of the premises involved, including the buildings and improvements thereon, and certain described livestock and farm machinery the agreement goes on to state that the parties **349 are entering into a joint venture for the operation of the farm and ranch unit involved. It then provides in detail concerning their contributions to and receipts from the joint operation of the premises. The agreement is for the term of five years commencing March 1, 1962. The landlord reserved for the use of his family a dwelling house on the premises and the operator was given the use of the tenant house thereon for his living quarters.

[1] Plaintiff's principal complaint on this appeal is that the evidence is insufficient to sustain the verdict. In our review we must accept the evidence most favorable to the verdict.

When the agreement was entered into plaintiff was 82 years of age and her husband 83. Both were suffering the physical infirmities common to persons of their age group because of which they had been unable to operate the farm for some time without help. It had been their home and means of livelihood throughout their long married life during which both of them worked together in its operation. The year before the lease period in question, August Severin had assisted them in their farming and ranching ac-

tivities. The written agreement that he operated under was identical with the one given the defendants. It too was executed by plaintiff's husband and stated that he was the owner of the premises. However, its term was one year.

The Severin lease expired with no new agreement with him and apparently no arrangements made with anyone else to take over. In these circumstances the defendant, Ed Varilek, was directed to the Chleboun farm by the Employment Service at *424 Winner. Severin was still living in the tenant house, but did not work on the place. Varilek, with his son Robert and Chleboun, in the presence of the plaintiff, discussed the possibility of Varilek assisting them in the operation of the farm. The Varileks in the course of this discussion read over the Severin agreement, They observed that it was for a one-year term and inquired if the Chlebouns would consider making it for three or five years. To this Chleboun replied 'No. we make it for one year with the privilege of renewing every year.'

The next day the Varileks, including Mrs. Varilek, returned to the farm and further discussions were had concerning the agreement and especially about the Chlebouns assisting the Varileks financially to acquire some livestock to keep on the place while they operated it. Mrs. Varilek indicated her assent to moving to the farm, but nothing was said in these conversations, in the presence of the plaintiff, as to the duration of the contract. Two days later, about March 17, 1962, Varilek returned to the farm with his tractor and farmhand and began doing chores on the farm. He lived with the Chlebouns in the dwelling house reserved to the landlord until his family moved to the farm after school was out. The family consisted of Mr. and Mrs. Varilek and their eight children.

While living with the Chlebouns, Varilek had a conversation with Chleboun in the presence of the plaintiff concerning the contract, but 'there wasn't too much said as to the duration at that time.' A little later while having breakfast with the Chlebouns they discussed the matter of entering into a written contract. He was asked by Mr. Chleboun what the advantage would be in a three or five-year contract. To this he replied 'Well, if we had a contract for longer period of time the kids and the missus and I would run it like

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it was our own place and it would be beneficial for him and us both.'To this Chleboun replied 'they would talk it over.'

Plaintiff admitted that her husband pretty much ran their farming business. She indicated that they generally talked things over, but that he made the decisions and put on the land the people that he wanted on. This seems to have been their long *425 continued practice. She further admitted that in 1962 he talked it over with her about Mr. and Mrs. Ed Varilek.

**350 Concerning the lease in issue the record next shows that Chleboun took a copy of the Severin agreement to an insurance and real estate office in Winner and had the new lease typed by a stenographer there, with the principal change being to extend the term from one to five years. It was typed in accordance with instructions received from Mr. Chleboun. He admitted that it embodied the arrangements they had orally agreed on in their previous discussions and that he and his wife had discussed entering into this written agreement.

Varilek stated that on an occasion before the lease was signed Chleboun told him that plaintiff was the owner of the premises, but coupled it with the statement that 'he was the manager of the whole deal.'About three weeks after the agreement was signed Mrs. Varilek visited the plaintiff in the hospital in Winner where she was a patient. In the course of their conversations Mrs. Varilek told the plaintiff that the lease which they had signed was for five years. To this plaintiff said 'she was glad they had somebody on the place that liked the place. However, during the course of their operation of the premises differences arose between Chleboun and Varilek resulting in an action instituted by Chleboun early in 1963 for an accounting in their joint venture and its termination, which is pending and undetermined. The complaint in this action was filed November 16, 1963. The notice to quit, served on the defendants, is dated January 13, 1964 directing them to vacate the premises on March 1, 1964.

[2][3] The court submitted to the jury the defenses of agency and equitable estoppel. Defendants do not contend that Chleboun had written authority to lease the premises. The agency relied on by them is of the

ostensible type provided for in SDC 3,0203. That section states 'Ostensible authority is such as a principal intentionally, or by want of ordinary care, causes or allows a third person to believe the agent to possess."This type of agency is grounded on the elements of estoppel. *426 Hartford Accident & Indemnity Co. v. Bear Butte Valley Bank, 63 S.D. 262, 257 N.W. 642. See also Restatement of Law, Agency, 2d, § 8B.

As stated in that case 'ostensible agency is no agency at all; it is in reality based entirely upon an estoppel.'The acts of an ostensible agent bind the principal not because of an agency, but because the principal will not be permitted to deny his authority. In this connection plaintiff directs our attention to SDC 51.1401 which requires that when an estate in real property, other than an estate at will or for a term not exceeding one year, is transferred by an agent his authority must be in writing.

In the cited case the court was dealing with a negotiable instrument endorsed by an agent whose authority was not in writing. It was faced with a statute which provided that the signature of a party on such instrument may be made by an agent duly authorized in writing. The court there held that such requirement would not deprive an indorsee from setting up the defense of an estoppel. Accordingly, we feel compelled to hold that SDC 51.1401 does not prevent the defendants from relying on an estoppel to establish their defense of agency. 37 C.J.S. Frauds, Statute of § 216.

[4] In the early case of <u>Tolerton & Stetson v. Casperson, 7 S.D. 206, 63 N.W. 908</u>, this court quoting from the Supreme Court of the United States in <u>Dickerson v. Colgrove</u>, 100 U.S. 587, 25 L.Ed. 618, set out the principles of equitable estoppel as follows:

'The vital principle is that he who, by his language or conduct, leads another to do what he would not otherwise have done, shall not subject such person to loss or injury by disappointing the expectations upon which he acted. Such a change of position is strictly forbidden. It involves fraud and falsehood, and the law abhors both. This remedy is always so applied as to promote the ends of justice. It is available only for protection, and cannot be used **351 as a weapon of

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assault. It accomplishes that which ought to be done between man and man, and is not permitted to go beyond this limit.'

*427 This statement was more recently quoted with approval by us in Reichert v. Reichert, 77 S.D. 258, 90 N.W.2d 403. Viewing this record most favorably to the verdict, including the inferences to be drawn therefrom, we think the jury could properly find that plaintiff's conduct was such as to reasonably induce in Varilek the belief that her husband had authority to execute the lease in question.

Varilek admitted that he was in better financial position at the time of the trial, which began on February 10, 1964, than he was when he went onto the place. Plaintic seizes on this to urge that he had suffered no injury or loss by reason of the conduct of the plaintiff on which he predicates an estoppel. This we think misses the point, Plaintiff admitted that she authorized her husband to execute a lease for one year. Her conduct led Varilek to believe that he had authority to execute a lease for a five-year period. On the strength of this longer term lease he obtained credit and bought farm machinery. With a one-year lease Varilek would not have incurred these and other financial obligations which he assumed under the belief that his farming operations were stabilized for a five-year period.

SDC 3,0303 states: 'A principal is bound by acts of his agent under ostensible authority, to those persons only who have in good faith, and without negligence, incurred a liability or parted with value upon the faith thereof.'Plaintiff argues that Varilek did not deal with her agent in good faith. This is predicated on the fact that he was an elderly man and not in good health. There is nothing in the record to indicate that Varilek's conduct in entering into the transaction was anything other than prudent and proper. That Varilek thereafter in operating the farm might have violated the provisions of the agreement as claimed by the plaintiff would have no bearing on his good faith in entering into the agreement. Under this record we feel it was for the jury to decide whether plaintiff was estopped to deny the authority of her husband to enter into this lease.

*428 Plaintiff assigns other errors in the giving of

and refusal to give requested instructions. We find no error in these prejudicial to the plaintiff.

Affirmed.

All the Judges concur.

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(Cite as: 316 N.W.2d 628)

C
Supreme Court of South Dakota.
Alice and Gene KASSELDER, doing business as A
& G Diesel Truck Repair, Plaintiffs and Appellees,

Jerome KAPPERMAN, doing business as Kapperman Construction Company, Defendant, and
James Schladweiler, Defendant and Appellant.
No. 13455.

Submitted on Briefs Jan. 21, 1982. Decided March 3, 1982.

Prospective buyer of road grader appealed from a judgment of the Circuit Court, Davison County, George W. Wuest, J., in favor of truck repair business ordering prospective buyer to pay \$3,441.06 of \$6,441.06 repair bill on the grader. The Supreme Court, Dunn, J., held that: (1) owner of grader made no representations or actions to cause truck repair business to believe that prospective buyer was his agent, and in fact did not deal with the repair business until after he received the final bill from them, and therefore, because the only proof introduced at trial supporting an agency relationship in excess of the \$3,000 which owner specified to buyer he would pay in cost of repairing engine were the words and actions of buyer, evidence was insufficient to support finding of an ostensible agency between the two so as to render prospective buyer liable for \$3,441.06 of the \$6,441.06 actual cost of repairs, and (2) evidence supported finding that an actual agency relationship existed between owner and prospective buyer; however, because owner specified he would not pay more than \$3,000 for repair costs, prospective buyer exceeded scope of his agency authority when he authorized repairs exceeding \$3,000 and failed to consult with owner regarding increased expenditures, and uthus prospective buyer was liable for \$3,441.06 of the \$6,441.06 actual repair bill as that sum represented the portion of the bill resulting from prospective buyer's unauthorized acts as agent.

Affirmed.

West Headnotes

[1] Principal and Agent 308 2 19

308 Principal and Agent
308I The Relation
308I(A) Creation and Existence
308k18 Evidence of Agency
308k19 k. Presumptions and Burden of
Proof. Most Cited Cases

When the existence of an agency relationship is denied, the burden of proof is upon the party who affirms its existence.

[2] Principal and Agent 308 5-1

308 Principal and Agent
3081 The Relation
3081(A) Creation and Existence
308k1 k. Nature of the Relation in General.

Most Cited Cases
"Agency" is a legal concept which depends upon the

existence of required factual elements: the manifestation by the principal that the agent shall act for him, the agent's acceptance of the undertaking, and the understanding of the parties that the principal is to be in control of the undertaking.

[3] Principal and Agent 308 23(1)

308 Principal and Agent
308I The Relation
308I(A) Creation and Existence
308k18 Evidence of Agency
308k23 Weight and Sufficiency
308k23(1) k. In General. Most Cited

Cases

Owner of road grader made no representations or actions to cause truck repair business to believe that prospective buyer was his agent, and in fact did not deal with the repair business until after he received the final bill from them, and therefore, because the only proof introduced at trial supporting an agency relationship in excess of the \$3,000 which owner

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specified to buyer he would pay in cost of repairing engine of the road grader were the words and actions of buyer, evidence was insufficient to support finding of an "ostensible agency" between the two so as to render prospective buyer liable for \$3,441.06 of the \$6,441.06 actual cost of repairing the engine. <u>SDCL</u> 59-1-5.

[4] Principal and Agent 308 14(1)

308 Principal and Agent
308I The Relation
308I(A) Creation and Existence
308k14 Implied Agency
308k14(1) k. In General. Most Cited

Cases

Principal and Agent 308 23(1)

308 Principal and Agent
 308I The Relation
 308I(A) Creation and Existence
 308k18 Evidence of Agency
 308k23 Weight and Sufficiency
 308k23(1) k. In General. Most Cited

<u>Cases</u>

Ostensible agency for which a principal may be held liable must be traceable to the principal and cannot be established solely by the acts, declarations or conduct of an agent. <u>SDCL 59-1-5</u>.

[5] Principal and Agent 308 23(5)

308 Principal and Agent 308I The Relation

308I(A) Creation and Existence
308k18 Evidence of Agency
308k23 Weight and Sufficiency
308k23(5) k. Sufficiency to Support
Verdict or Finding as to Agency. Most Cited Cases
Evidence, including proof that owner of road grader
allowed prospective buyer to act for him regarding
repair of the grader, and that prospective buyer
agreed to represent owner in the transaction with
struck repair business, supported finding that an actual
agency relationship existed between owner and prospective buyer; however, because owner specified he
would not pay more than \$3,000 for repair costs, pro-

spective buyer exceeded scope of his agency authority when he authorized repairs exceeding \$3,000 and failed to consult with owner regarding increased expenditures, and thus prospective buyer was liable for \$3,441.06 of the \$6,441.06 actual repair bill, as that sum represented the portion of the bill resulting from prospective buyer's unauthorized acts as agent. <u>SDCL</u> 59-1-4, 59-6-2.

*629 Burleigh E. Boldt of Shandorf, Bleeker, Boldt & Koch, Mitchell, for plaintiffs and appellees.

James R. Davies, Alexandria, for defendant and appellant.

DUNN, Justice.

This is an appeal from an order and judgment entered in favor of appellees Alice and Gene Kasselder, doing business as A & G Diesel Truck Repair (Truck Repair), for repairs performed on a Galion road grader owned by appellee Jerome Kapperman (Kapperman), and from an order denying a new trial. We affirm the order and judgment.

Kapperman owns a Galion road grader which had a defective engine. Appellant James Schladweiler (Schladweiler) offered to purchase the grader for the sum of \$8,500.00, if the grader was in running condition. Kapperman said he would pay up to \$3,000.00 to have the engine repaired and Schladweiler said he could have it repaired for less than that sum at Truck Repair in Mitchell, South Dakota. Kapperman shipped the grader from Minnesota to Schladweiler's residence in Mitchell.

At the request of Schladweiler, Truck Repairs' mechanics took the engine apart and discovered that it was not repairable. They suggested to Schladweiler that a new engine be purchased for \$7,000.00. Schladweiler informed Kapperman of this information and Kapperman said he was not interested in spending that much money. Kapperman tried to locate a used engine that could be rebuilt, but was unsuccessful. The mechanics located a used engine in Omaha, Nebraska, and told Schladweiler the cost of repairs would be \$1,000.00 to purchase the engine, \$1,300.00 for labor, and the cost of oil and gaskets. Schladweiler informed Kapperman of this estimate and Kapperman approved the purchase of the engine

but specified that he would not pay more than \$3,000.00 in repair costs.

A short time later, the mechanics contacted their supplier in Sioux Falls, South Dakota and were informed that the supplier had repaired a similar engine for \$5,000.00, which did not include repairing the cylinder head. The Omaha engine had a cracked cylinder head. Truck Repair relayed this estimate to Schladweiler. Schladweiler authorized the repairs, but did not inform Kapperman of this increased bid. The repairs to the engine took several months and Schladweiler periodically followed the progress of the repairs. At no time did Truck Repair discuss the cost of repairs with Kapperman. When the repairs were finally completed, the total cost was \$6,441.06. Neither Kapperman nor Schladweiler would pay the bill.

The trial court found for Truck Repair and entered an order and judgment against Schladweiler in the amount of \$3,441.06 plus interest and against Kapperman in the amount of \$3,000.00 plus interest. Schladweiler moved for a new trial, alleging insufficiency of the evidence to support the judgment. FN* This motion was denied.

FN* Schladweiler did not propose findings of fact and conclusions of law to the trial court. However, under SDCL 15-26A-9, this court may review all matters properly and timely presented to the trial court by the application for new trial. Schladweiler's motion for new trial properly alleged insufficiency of the evidence, so that question is preserved for appeal.

*630 The order denying Schladweiler's motion for a new trial is not appealable, <u>SDCL 15-26A-3</u>, but the propriety of that order is reviewable in an appeal from the judgment. <u>SDCL 15-26A-7</u>. See <u>Fales v. Kaupp.</u> 83 S.D. 487, 161 N.W.2d 855 (1968). Thus, we need not address that portion of the notice which appurports to appeal from the denial of a new trial.

Schladweiler's only contention is that the evidence presented at trial was insufficient to support the trial court's finding that he was liable for \$3,441.06, plus interest, of the Truck Repair bill. He alleges that his agency relationship with Kapperman should have

precluded his liability. We disagree. In reviewing this matter, we must give due regard to the opportunity of the trial court to judge the credibility of the witnesses. We cannot set aside the trial court's findings unless they are clearly erroneous. SDCL 15-6-52(a); In re Estate of Hobelsberger, 85 S.D. 282, 181 N.W.2d 455 (1970).

[1] An agency relationship is defined by SDCL 59-1-1 as "the representation of one called the principal by another called the agent in dealing with third persons." An agency relationship is either actual or ostensible. It is actual when the principal appoints the agent. SDCL 59-1-4. It is ostensible when the principal by conduct or want of ordinary care causes a third person to believe another, who is not actually appointed, to be his agent. SDCL 59-1-5; Kirkus v. Bender. 34 S.D. 317, 148 N.W. 513 (1914). When the existence of an agency relationship is denied, the burden of proof is upon the party who affirms its existence. Farmers Union Oil Co. of Dickinson v. Wood, 301 N.W.2d 129 (N.D.1980); Joerger v. Schumacher, 203 N.W.2d 572 (Iowa 1973).

[2] To determine whether an agency relationship has in fact been created, we examine the relations of the parties as they exist under their agreement or acts. Agency "is a legal concept which depends upon the existence of required factual elements: The manifestation by the principal that the agent shall act for him, the agent's acceptance of the undertaking, and the understanding of the parties that the principal is to be in control of the undertaking." Watkins Company v. Dutt, 84 S.D. 453, 457, 173 N.W.2d 41, 43 (1969); Buck v. Nash-Finch Company, 78 S.D. 334, 102 N.W.2d 84 (1960).

[3][4] The evidence indicates that this was not an ostensible agency. Kapperman made no representations or actions to cause Truck Repair to believe that Schladweiler was his agent. In fact, Kapperman did not deal with Truck Repair until after he received the final bill from them. The only proof introduced at trial supporting an agency relationship in excess of \$3,000.00 was the words and actions of Schladweiler. Ostensible agency for which a principal may be held liable must be traceable to the principal and cannot be established solely by the acts, declarations or conduct of an agent. Berg v. Midwest Laundry Equipment

Corporation, 175 Neb. 423, 122 N.W.2d 250, opinion modified, rehearing denied 175 Neb. 874, 124 N.W.2d 699 (1963); Tostenson v. Ihland, 147 N.W.2d 104 (N.D.1966).

[5] The evidence indicates that an actual agency relationship did exist between Kapperman and Schladweiler but only to the extent of \$3,000.00. Kapperman allowed Schladweiler to act for him regarding repair of the grader but specified that he would not pay more than \$3,000.00 for repair costs. Schladweiler agreed to represent Kapperman in the transaction with Truck Repair. However, Schladweiler exceeded the scope of his agency authority when he authorized repairs exceeding \$3,000.00 and failed to consult with Kapperman regarding the increased expenditures. Under SDCL 59-6-2, "[w]hen an agent exceeds his authority, his principal is bound by his authorized acts so far only as they can be plainly separated from those which are unauthorized." We hold that the trial court was correct in its determination that Schladweiler was liable for \$3,441.06, plus interest, of the Truck Repair bill, because this sum represented the portion of the bill *631 resulting from his unauthorized acts as agent.

We affirm the judgment and order of the trial court.

All the Justices concur. S.D.,1982. Kasselder v. Kapperman 316 N.W.2d 628

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LEXSEE 429 N.W.2D 458

DEWEY DAHL and LAVONNE DAHL, Plaintiffs and Appellants, v. PETER SITTNER and SITTNER REAL ESTATE, INC., Defendants and Appellees

No. 16018

Supreme Court of South Dakota

429 N.W.2d 458; 1988 S.D. LEXIS 136

May 25, 1988, Argued September 14, 1988

PRIOR HISTORY: [**1] APPEAL FROM THE CIRCUIT COURT OF THE FIFTH JUDICIAL CIRCUIT, WALWORTH COUNTY, SOUTH DAKOTA, HONORABLE EUGENE DOBBERPUHL, Judge.

COUNSEL: Rodney C. Lefholz of Fousek, Lefholz & Mairose, Rapid City, South Dakota, Patrick M. Ginsbach of Farrell, Farrell & Ginsbach, Hot Springs, South Dakota, Attorneys for Plaintiffs and Appellants.

Dale L. Morman of Morman, Smit, Shepard & Hughes, Sturgis, South Dakota, Randolph J. Seiler of Seiler & Cain, Mobridge, South Dakota, Attorneys for Defendants and Appellees.

JUDGES: Wuest, Chief Justice. All the Justices concur.

OPINION BY: WUEST

OPINION

[*459] Dewey and LaVonne Dahl (Dahls) appeal an order granting summary judgment in favor of Peter Sittner (Sittner) in an action charging Sittner with fraud and misrepresentation and breach of fiduciary duty regarding the sale of the Dahls' ranch. We reverse and remand for further proceedings.

On July 25, 1979, the Dahls and Sittner signed a listing contract to sell the Dahls' 1400 acre ranch in Ziebach County, South Dakota. The Dahls had been contemplating selling their ranch because Dewey's back problems and pending back surgery placed serious doubt on his ability to continue ranching.

Under the terms of the listing agreement, [**2] Sittner, a realtor licensed in South Dakota and North

Dakota, 'agreed to use his best efforts to locate a buyer at the Dahls' asking price of \$ 265 per acre. ² The terms further provided that the purchase price was to be paid entirely in cash and that Sittner would receive a 5% commission in the event a suitable buyer was found. The duration of the listing agreement was one year.

- I Sittner conducted his real estate business as Sittner Real Estate, Inc. in Mobridge, South Dakota. In 1983, Sittner surrendered his South Dakota realtor's license.
- At that time, \$ 265 per acre was quite high for the area. The Dahls, however, insisted on a price that would not bring immediate interest because Dewey was not yet severely incapacitated and they were not entirely ready to sell their ranch. In addition, the Dahls hoped to realize sufficient proceeds from the sale of their ranch, livestock and equipment to satisfy a \$ 350,000 FmHA mortgage and still have money left over for their retirement.

On February 20, 1980, Sittner entered a contract with Donna Klock (Klock), 3 a real estate broker from Minnesota. This contract stated that Klock could solicit buyers for the Dahl property [**3] and present them to Sittner. If Sittner then completed a sale, Klock would receive 40% of Sittner's commission. Sittner cancelled this agreement in July, 1980, but the parties renewed it on December 4, 1980.

3 Klock is now deceased.

Klock first contacted the Dahls on January 28, 1981, when she brought them a handwritten listing agreement running from that date through March 13, 1981. This listing contract was written on one of Sittner's forms and appeared to bear Sittner's signature. Sittner, however,

claims that he was unaware of Klock's meeting with the Dahls and that the signature on this agreement was not his.

Klock again visited the Dahls at their ranch in the summer of 1981. This time she accompanied Sittner. Sittner formally introduced Klock to the Dahls and indicated that she would be assisting him in his efforts to sell the Dahls' ranch. Although it is not clear whether Sittner explained the extent of Klock's involvement, the Dahls contend that Sittner stated Klock would be "handling the sale of their ranch."

On October 27, 1981, Sittner brought the Dahls a third listing contract which was signed by both parties. This agreement listed the Dahls' ranch for sale at \$ 280 [**4] per acre. In all other aspects, the agreement was identical to the first listing contract.

[*460] Prior to this meeting with the Dahls, Sittner had little, if any, contact with them. Klock, on the other hand, visited the Dahls frequently. In addition to bringing potential buyers to the Dahl property and telephoning the Dahls regarding the sale of their ranch, Klock also stopped at the ranch for personal visits.

In February, 1982, Klock telephoned the Dahls and stated that she found a buyer for their ranch. Klock then drove to the ranch to discuss the sale of the Dahls' livestock and equipment, Klock informed the Dahls that she arranged for Duane Harter (Harter), an auctioneer from Minnesota, to sell their personal property at a public auction and that Harter would be contacting them. The Dahls subsequently received a telephone call from Harter and the two parties signed an auction contract on February 21, 1982. The agreement set the auction date for March 2, 1982, and provided that Harter was to conduct the sale of not only the Dahls' livestock and equipment but also the real estate. Although a buyer for the land supposedly had been found, Klock's and Harter's plan was to "exercise" the [**5] real estate at the auction to see if someone would bid higher than the price the secured buyer had agreed to pay. This auction was cancelled when Klock informed the Dahls that the buyer subsequently revoked his offer.

The Dahls entered another auction contract with Harter and Irvin Salzer (Salzer), an auctioneer from Timber Lake, South Dakota, after Klock apparently informed them that she had received another offer to purchase the ranch. This auction was set for March 15, 1982. Klock and Harter again wanted to "exercise" the real estate to see if the auction would produce a higher price. Because the Dahls were not confident that Harter should be trusted to handle the transaction alone, they instructed Salzer to direct the auction.

A few days before the auction, the Dahls telephoned Sittner and requested that Harter be given the abstracts of title to their ranch. Sittner had not communicated with the Dahls since the previous October and just recently had learned through a published sale bill that the real estate was being auctioned along with the livestock and equipment. He was aware of neither Harter's involvement nor the alleged buyer Klock had located. Although Sittner did not understand [**6] why the Dahls were auctioning their real property and apparently breaching the agreement giving him the exclusive right to sell, Sittner failed to ask the Dahls about the transpiration of these recent events. The Dahls similarly failed to inquire of Sittner whether he had authorized the auction sale, whether he would receive a commission if the land sold by auction, whether Klock was still "working for" him, or even whether he or Klock had received a firm offer to purchase the land. Nonetheless, Sittner delivered the abstracts of title to Harter on March 12, 1982. At that time, however, Sittner expressed to Harter his intention to get his commission on the sale of the land even though Harter and Salzer would receive a 10% commission if the real estate sold at the auction.

The auction was conducted on March 15, 1982. Several bids were received on the real estate, but none of them were accepted. Prior to the start of the auction, the Dahls asked Klock if she had a suitable buyer for their ranch. Klock assured them that an offer to purchase had been signed and that \$ 10,000 had been deposited in an escrow account in Mobridge, South Dakota. She further stated that another potential buyer [**7] was going to be present at the auction. Klock, however, did not show the Dahls the purchase offer until after the auction.

The Dahls found the terms of this offer to purchase unacceptable. Although the stated price was \$ 295 per acre, the purchase price was to be paid not in cash, but by assuming the existing FmHA mortgage. The difference between the purchase price and the mortgage was to be paid to the Dahls over a period of twenty-five years. Interest on the unpaid balance would accrue annually at a rate of 9%. If the purchase price was paid in full within eighteen months after the contract for deed was signed, the buyer was entitled to a 17.5% discount. Finally, the \$ 10,000 represented by Klock to be on deposit in an [*461] escrow account was instead stated as a promissory note.

The offer to purchase was signed on March 6, 1982, on behalf of Robert Briggs (Briggs), a real estate investor from Minnesota. It is not clear whether Klock, Harter or both participated in preparing the offer. The offer was written on one of Sittner's forms, but he denies having any knowledge about the offer, including the use of his form.

No sale of the Dahls' real estate occurred and the Dahls subsequently [**8] filed suit against Sittner alleging fraud on behalf of Sittner's agent, Klock. The Dahls claimed that Briggs' offer to purchase was a "sham" and that they sold their personal property after relying on Klock's representations that she had a buyer and a valid offer to purchase their ranch. The Dahls further contended that they were effectively displaced from their ranching business by the auction sale of their personal property as a result of their reliance on Klock and that they were damaged because their real property had not been sold.

Sittner asserted that he was completely unaware of Klock's activities and that Klock was acting on her own and outside the scope of their agreement. He further claimed that at no time did he make any representations to the Dahls that Klock was handling the sale of their ranch or that she had any authority from him whatsoever.

On August 28, 1987, Sittner brought a motion for summary judgment pursuant to SDCL 15-6-56(b), contending that the Dahls had demonstrated no genuine issue of material fact. The trial court granted Sittner's motion, essentially noting that (1) nothing in the record established a relationship among Klock, Harter and Sittner that [**9] would create a duty for Sittner toward the Dahls; (2) if the Dahl's land sold at auction, the auctioneers would receive a 10% commission and Sittner would receive nothing; (3) the Dahls were negligent in breaching their agreement with Sittner and, therefore, were precluded from seeking recovery from him on the theory of apparent authority; and (4) since Briggs' purchase offer was legitimate, no fraud was committed by Klock and the damages claimed by the Dahls, if any, resulted from their refusal to accept his offer.

The only question presented to us by this appeal is whether the trial court erred in granting summary judgment. We believe that it did. The aforementioned matters present genuine issues of material fact upon which reasonable minds could differ.

Summary judgment is properly awarded only when the moving party clearly shows that he is entitled to judgment as a matter of law because there is no genuine issue as to any material fact. SDCL 15-6-56(c); Groseth Intern., Inc. v. Tenneco, Inc., 410 N.W.2d 159, 164 (S.D. 1987); Bego v. Gordon, 407 N.W.2d 801, 803-04 (S.D. 1987); Hamaker v. Kenwel-Jackson Mach., Inc., 387 N.W.2d 515, 517 (S.D. 1986). "The evidence must be viewed most [**10] favorably to the nonmoving party and reasonable doubts should be resolved against the moving party." Groseth Intern., 410 N.W.2d at 164. See also Wilson v. Great Northern Ry. Co., 83 S.D. 207, 157 N.W.2d 19 (1968). Summary judgment is an extreme remedy and is not intended as a substitute for a trial.

Bego, 407 N.W.2d at 804; Wilson, 83 S.D. at 212, 157 N.W.2d at 21. A belief that the nonmoving party will not prevail at trial is an inappropriate basis for granting summary judgment on issues not shown to be sham, frivolous, or so unsubstantial as to obviate the futility of their litigation. Laber v. Koch, 383 N.W.2d 490, 492 (S.D. 1986); American Indian Agr. Credit v. Fort Pierre, 379 N.W.2d 318, 320 (S.D. 1985); Wilson, 83 S.D. at 212, 157 N.W.2d at 21. If reasonable persons, upon examining the evidence, might reach different conclusions, a motion for summary judgment should be denied and the case tried on the merits. See Laber, 383 N.W.2d at 493.

In support of our conclusion that the motion for summary judgment should have been denied, we examine the general rules of agency law. An agency relationship is defined as "the representation of one called the principal [**11] by another called the agent in dealing with third persons." [*462] SDCL 59-1-1. This relationship is either actual or ostensible. Actual agency exists if the relationship is expressly created by an agreement whereby the principal appoints his agent who agrees to serve in that capacity. SDCL 59-1-4. Ostensible agency exists where the law implies an agency relationship because the principal affirmatively, intentionally, or by lack of ordinary care causes a third party to believe another is serving as his agent. SDCL 59-1-5; Kasselder v. Kapperman, 316 N.W.2d 628, 630 (S.D. 1982); Kirkus v. Bender, 34 S.D. 317, 319, 148 N.W. 513 (1914). Whether an agency relationship has in fact been created depends upon the relations of the parties as they exist under their agreement or acts. Kasselder, 316 N.W.2d at 630.

An agent's authority, like the agency relationship itself, can be either actual or ostensible. "Actual authority is such as a principal intentionally confers upon the agent, or intentionally or by want of ordinary care, allows the agent to believe himself to possess." SDCL 59-3-2. Ostensible or apparent authority is "such as a principal intentionally, or by want of ordinary care, causes [**12] or allows a third person to believe the agent to possess." SDCL 59-3-3; Leafgreen v. American Family Mut. Ins. Co., 393 N.W.2d 275, 277 (S.D. 1986).

Generally, a principal may be held liable for the fraud and deceit of his agent acting within the scope of his actual or apparent authority, even though the principal was unaware of or received no benefit from the agent's conduct. SDCL 59-6-1; Myzel v. Fields, 386 F.2d 718, 738 (8th Cir. 1967); Leafgreen, 393 N.W.2d at 277. Whether or not an agent is acting within the scope of his apparent authority is to be determined as a question of fact from all the circumstances of the transaction and the nature of the principal's business. If the apparent authority can only be established through the acts, declarations and conduct of the agent and is not in some way trace-

able to the principal, no liability will be imposed on him. Draemel v. Rufenacht, Bromagen & Hertz, Inc., 223 Neb. 645, 651, 392 N.W.2d 759, 763 (1986); Kasselder, 316 N.W.2d at 630.

Once ostensible agency is determined, the principal is bound by the acts of his agent to only those persons who have "in good faith, and without negligence, incurred a liability or parted with [**13] value upon the faith thereof." SDCL 59-6-3. The third person dealing with the agent, therefore, must show not only damages resulting from his reliance on the appearance of authority, but also reasonable diligence and prudence in ascertaining the fact of the agency and the nature and extent of the agent's authority. 3 Am.Jur.2d Agency §\$ 80, 83 at 587, 592-93 (1986).

Applying the general rules of agency law to the facts before us, with a view of the propriety of summary judgment, we believe that a genuine issue of fact exists as to whether an agency relationship, either actual or ostensible, existed between Sittner and Klock. If Klock was in fact acting as Sittner's agent, there must likewise exist genuine issues as to whether and, if so, to what extent Sittner clothed her with the actual or apparent authority to deal with the Dahls. These material issues of fact are best determined by a jury after the presentation of evidence regarding (1) Sittner's representations to the Dahls when he introduced Klock to them, (2) his subsequent conduct, and (3) the reasonableness of the Dahls' belief that Klock was Sittner's agent and that she was authorized to conduct business with them.

If, [**14] in fact, the evidence should establish that Klock was not exceeding her authority as Sittner's agent in dealing with the Dahls and that the Dahls were prudent in ascertaining this fact, additional issues of material fact exist. Such factual questions include whether Klock's representations to the Dahls that she had located a suitable buyer prior to the auction sale were fraudulent and whether the Dahls in fact relied upon the claimed fraud to their detriment. These questions of fact should

also be resolved by the jury. See Laber, 383 N.W.2d at 492; Commercial Credit [*463] Equipment Corp. v. Johnson, 87 S.D. 411, 416, 209 N.W.2d 348, 551 (1973).

"To prove fraud there must be a misrepresentation: (1) known to be such (or recklessly conceived) by the party making it; (2) made for the purpose of inducing the other party to act; and (3) relied on to the detriment of the innocent party." Sperry Corp. v. Schaeffer, 394 N.W.2d 727, 730 (S.D. 1986), See also Northwest Realty Company v. Colling, 82 S.D. 421, 147 N.W.2d 675 (1967). The record shows that Klock informed the Dahls prior to the sale that a buyer had been located and that \$ 10,000 had been deposited in an escrow account. The record [**15] further shows that the \$ 10,000 earnest money was in the form of a promissory note instead of cash and that other terms in Briggs' offer to purchase also differed from those specified in the Dahls' listing contract. The Dahls were unaware of these facts at the time their livestock and equipment were sold. Because of the conflicting claims of the parties, we believe that reasonable minds could differ as to whether Briggs was a suitable buyer as Klock had represented. If an issue of fact exists as to whether Klock's representations were fraudulent, a genuine issue must also exist as to whether the Dahls relied upon that alleged fraud and were damaged as a result.

We are mindful of the fact that the evidence may ultimately be insufficient to establish liability on Sittner. That, however, is not the question to be addressed at this point. The question here is simply whether genuine issues of material facts exist as to these matters. We believe that such issues do exist and that the Dahls are entitled to have a jury determine the agency question and the other issues under the proper instructions.

Accordingly, we reverse and remand for further proceedings.

All the justices concur.

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430 N.W.2d 700 430 N.W.2d 700, 57 USLW 2331 (Cite as: 430 N.W.2d 700)

Supreme Court of South Dakota.
FEDERAL LAND BANK OF OMAHA, A Corporation Plaintiff and Appellee,

٧.

Tom V. SULLIVAN and Judith A. Sullivan, Defendants and Appellants,

United States of America, acting through the Farmers
Home Administration, Defendant.
No. 15890.

Considered on Briefs April 28, 1988. Decided Oct. 26, 1988.

Property owners appealed from judgment of foreclosure entered in favor of bank by the Circuit Court, First Judicial Circuit, Clay County, Riley W. Connelly, J., contending that bank was bound by settlement agreement entered into by its attorney. The Supreme Court, Sabers, J., held that bank's attorney had actual authority to settle case and bind client based upon client's acquiescence in attorney's actions.

Reversed.

Morgan and Henderson, JJ., filed dissenting opinions.

West Headnotes

[1] Principal and Agent 308 5 96

308 Principal and Agent
308III Rights and Liabilities as to Third Persons
308III(A) Powers of Agent
308k95 Express Authority
308k96 k. In General. Most Cited Cases

Actual authority to enter into agreement on behalf of principal is created by manifestations from principal io agent. <u>SDCL 59-3-2</u>.

Principal and Agent 308 99

308 Principal and Agent

308III Rights and Liabilities as to Third Persons
308III(A) Powers of Agent
308k98 Implied and Apparent Authority
308k99 k. In General, Most Cited Cases
Ostensible authority to enter into agreements on be-

half of principal is created when principal allows third person to believe agent has authority to act on principal's behalf, <u>SDCL 59-3-3</u>.

[3] Principal and Agent 308 2 137(1)

308 Principal and Agent
308III Rights and Liabilities as to Third Persons
308III(A) Powers of Agent
308k137 Estoppel to Deny Authority
308k137(1) k. In General, Most Cited

Cases

Strictly speaking, ostensible agency is no agency at all; it is in reality based entirely on estoppel.

[4] Attorney and Client 45 [101(1)

45 Attorney and Client 45 Retainer and Authority

45k101 Settlements, Compromises, and Releases

45k101(1) k. In General. Most Cited Cases Attorney had actual authority to bind client to settlement agreement based on client's acquiescence in attorney's actions, which allowed attorney to believe he possessed actual authority to settle case; client had received copy of letter by its attorney inviting settlement proposals and copy of subsequent letter by attorney making concrete offer of settlement, but failed to act to dissuade attorney from settling upon receipt of letters. SDCL 59-3-2.

*700 Steve M. Johnson of Brady, Reade & Johnson, Yankton, for plaintiff and appellee.

John F. Murphy, Elk Point, for defendants and appellants.

Wanda Howey-Fox, U.S. Atty., Sioux Falls, for defendant.

SABERS, Justice.

Sullivans appeal from a judgment of foreclosure entered in favor of the Federal Land Bank of Omaha (FLB). We reverse.

FACTS

FLB instituted this action to foreclose its mortgage against real estate owned by Sullivans. Prior to trial, Sullivans' attorney wrote a letter to FLB's attorney asking if there was a possibility that the case could be settled. On September 11, 1986, FLB's attorney replied with the following offer of settlement:

Thank you for your letter dated September 3rd, proposing a resolution of the above matter. After consideration by my client, we are willing to do the following:

We will accept a deed in lieu of proceeding with the foreclosure action upon the following conditions:

- 1. All 1985 real estate taxes must be paid;
- 2. The FmHA mortgage must be released;
- There can be no other liens of whatsoever nature or kind against said property at the time of conveyance; and
- *701 4. The parties will execute a mutual release.

My client has authorized me to extend this offer to you which must be accepted within ten (10) days. I would believe that if you contacted the FmHA they would realize there is no equity in the property and release their mortgage. (emphasis added)

A copy of this letter was sent to Wayne Williamson, who is the assistant vice president of special accounts at the FLB office in Yankton, South Dakota.

On September 19, 1986, Sullivans accepted FLB's offer to settle the case. However, three weeks later FLB's attorney wrote to Sullivans' attorney stating:

"Any compromises regarding Federal Land Bank loans must be cleared through Omaha. The proposed compromise was not approved and therefore we have been requested to proceed through the foreclosure process."

The case went to trial and FLB obtained a judgment of foreclosure. The trial court found that FLB was not bound by the offer made by its attorney and that FLB was not estopped to proceed despite the settlement agreement between the parties.

ISSUE

Did the parties enter into a binding settlement agreement precluding the trial court's judgment of foreclosure?

DECISION

Sullivans recognize the general rule that an attorney who is clothed with no authority other than that arising from his employment has no implied power by virtue of his general retainer to compromise and settle his client's claim or course of action. Northwest Realty Co. v. Perez, 80 S.D. 62, 119 N.W.2d 114 (1963). Nevertheless, Sullivans argue that an attorney who has or appears to have authority from his client can compromise and settle his client's claim. Sullivans contend that even if FLB's attorney had only ostensible authority to settle the case, FLB should be bound to the agreement since Sullivans acted in reliance upon the agreement.

[1][2][3] In the law of agency, a principal will be liable for contracts made in its behalf by an agent if the agent was authorized to enter into the agreements. Mueller v. Union Pacific, 220 Neb. 742, 371 N.W.2d 732 (1985); 3 C.J.S. Agency § 408. This authority may be actual or ostensible. Actual authority is created by manifestations from the principal to the agent, SDCL 59-3-2, while ostensible authority is created when the principal allows a third person to believe the agent has authority to act on the principal's behalf. SDCL 59-3-3. Strictly speaking, ostensible agency is no agency at all; it is in reality based entirely on an estoppel. Chleboun v. Varilek, 81 S.D. 421, 136 N.W.2d 348 (1965); Hartford Accident & I.

Co. v. Bear Butte Valley Bank. 63 S.D. 262, 257 N.W. 642 (1934). "[W]here it appears that the principal knew, or by a proper supervision of the affairs of the agency ought to have known, of the acts of the agent, or the general course and manner in which he was conducting the business of the agency, he is estopped as against innocent third persons from denying the power of the agent to act." Hartford Accident & I. Co., 63 S.D. at 267, 257 N.W. at 645. If the agent had ostensible authority, the principal is bound by the acts of his agent "to those persons only who have in good faith, and without negligence, incurred a liability or parted with value upon the faith thereof." SDCL 59-6-3.

[4] In this case, the trial court proceeded on the assumption that FLB's attorney had only ostensible authority to extend the offer of settlement. It found that FLB was not estopped by the settlement agreement since Sullivans did not incur a liability or part with any value in reliance on the agreement until after they received notice disclaiming the agreement. SeeSDCL 59-6-3. However, a careful review of the record indicates that FLB's attorney had actual authority to settle the case, thereby rendering the estoppel argument irrelevant.

It is well settled that actual authority can be created by the acquiescence of the *702 principal in the actions of the agent. Kansas Educational Ass'n v. McMahan, 76 F.2d 957 (10th Cir.1935); H. Reuschlein & W. Gregory, Agency and Partnership § 14 (1979). See also Restatement (Second) of Agency § 26 (1958), SDCL 59-3-2 states: "Actual authority is such as a principal intentionally confers upon the agent, or intentionally or by want of ordinary care. allows the agent to believe himself to possess." (emphasis added) Here, FLB acquiesced in its attorney's actions, allowing the attorney to believe he possessed actual authority to settle the case. First, in a letter to Sullivans' attorney dated August 26, 1986, FLB's attorney invited settlement proposals from the Sullivans. A copy of this letter was sent to FLB officer Wayne Williamson, but FLB made no attempt to stop the negotiations or inform its attorney of limitations to his authority. Then in the letter dated September ILI, 1986, set forth in the facts above, FLB's attorney made a concrete offer of settlement, indicating that his client was in complete agreement with the offer.

Again, a copy of the letter was sent to FLB officer Williamson, but FLB failed to disavow the offer. The letter containing the settlement offer clearly shows the attorney's belief that he possessed authority to settle the case, and FLB's failure to act upon receipt of the letter constitutes acquiescence in the offer. Therefore, FLB's attorney had actual authority, as defined by SDCL 59-3-2, to settle the case, and the agreement is binding on the parties.

This result is consistent with the rulings of other courts which have faced the same issue. Of particular importance is International Telemeter Corp. v. Teleprompter Corp., 592 F.2d 49 (2d Cir.1979), in which Teleprompter's attorney wrote a letter to opposing counsel stating: "Teleprompter now wishes to settle the litigation ... on the terms which have been agreed upon." A copy of the letter was sent to Teleprompter's general counsel, who took no immediate action to disavow the settlement agreement. Later, Teleprompter argued that its attorney had no authority to bind it to a settlement. The federal appeals court disagreed and upheld the agreement for the following reasons: 1) Teleprompter knew that the other party believed Teleprompter's attorney had authority to settle the matter and did nothing to correct the impression. 2) The attorney sent copies of all the correspondence to Teleprompter. 3) Teleprompter officials failed to disavow the attorney's actions even when the attorney sent copies of his letter announcing that a settlement had been reached. 592 F.2d at 55-56. We find the court's reasoning in Teleprompter to be persuasive and hereby adopt its rationale. See also Capital Dredge and Dock v. City of Detroit, 800 F.2d 525 (6th Cir.1986); Corbesco, Inc. v. Local No. 542, 620 F.Supp. 1239 (D.Delaware 1985); Brumbelow v. Northern Propane Gas Co., 169 Ga.App. 816, 315 S.E.2d 11 (1984). FLB acquiesced in the actions herein and must abide by the agreement negotiated by its attorney.

REVERSED.

WUEST, C.J., and MILLER, J., concur.
MORGAN and HENDERSON, JJ., dissent.
MORGAN, Justice (dissenting).
I respectfully dissent from the majority opinion. We have long had the *Northwest Realty* rule. "The rule is almost universal that an attorney who is clothed with

no other authority than that arising from his employment in that capacity has no implied power by virtue of his general retainer to compromise and settle his client's claim or cause of action." Northwest Realty Company v. Perez, 80 S.D. 62, 65, 119 N.W.2d 114, 115 (1963) (reaffirmed in Petersen v. Petersen, 90 S.D. 666, 673, 245 N.W.2d 285, 288 (1976)). I think that the majority opinion shreds that rule. In my opinion, the trial court was correct when it found that the defendants had not parted with any value or incurred any obligation in reliance on the alleged settlement offer. Based on the statutory provisions, SDCL 59-6-3, EN* the *703 trial court was correct in concluding that FLB was not equitably estopped from foreclosing.

FN* SDCL 59-6-3 provides: "A principal is bound by acts of his agent under ostensible authority, to those persons only who have in good faith, and without negligence, incurred a liability or parted with value upon the faith thereof."

The reliance on International Telemeter Corp. v. Teleprompter Corp., 592 F.2d 49 (2d Cir.1979), is particularly inappropriate. In that case, just as here, the defendant in a patent infringement suit had initiated settlement discussions. That is about the only similarity. In Teleprompter, negotiations were carried on for a period of nine months during which time drafts and redrafts of settlement agreements were exchanged. At the eleventh hour, a third party involved in the negotiations withdrew. In an attempt to save the settlement, counsel for the defendant attempted to redraft the agreement, omitting references to the third party. Then, as the opinion specifically notes, new management for defendant corporation refused to proceed. That scenario, upon which the majority would decide this case, is obviously as different from the facts in this case as night is from day.

The total period of correspondence in this case was approximately two months. Only one month elapsed between the offer and the withdrawal. No documents were prepared, let alone exchanged. Most importantly, the offer was withdrawn, not on a change of management but apparently for the reason that Sullivans had failed to fully disclose their assets on a financial statement they had furnished to FLB.

Finally, I would point out that the *Teleprompter* opinion is self-limiting in that it is specifically noted therein that New York law governs the enforceability of the settlement agreement which was negotiated, consummated, and to be performed in New York and which was explicitly made subject to New York law. I think that South Dakota law, embodied in the statute above cited, should govern here. I would affirm the trial court.

HENDERSON, Justice (dissenting).

A judgment of foreclosure entered below, based on fact and correct in law, should be sustained. Therefore, I respectfully dissent.

We see another erosion of the doctrine of stare decisis in the case before us. Northwest Realty has been the law of this state since 1963. There is no reason to depart from it. Basically, that rule is: An attorney may negotiate for and advise settlement of a controversy, but the decision is ultimately the client's. For recent cases, in accord with our precedent, see Dillon v. City of Davenport, 366 N.W.2d 918 (Iowa 1985); Aetna Life & Cas. v. Anderson, 310 N.W.2d 91 (Minn.1981); and Smith v. Ganz, 219 Neb. 432, 363 N.W.2d 526 (1985). The majority opinion obtains a result by not accepting the findings of fact and conclusions of law and by disregarding the testimony at trial.

In this case, the trial court entered a specific finding that Sullivans did not part with any value or incur any obligations in reliance upon the settlement offer. The trial court concluded that Sullivans did not meet the requirements of <u>SDCL 59-6-3</u>. Said statute provides: "A principal is bound by acts of his agent under ostensible authority, to those persons only who have in good faith, and without negligence, incurred a liability or parted with value upon the faith thereof."

This entire case may be said to rest upon the old *Hobelsberger* precedent. *In re Estate of Hobelsberger*, 85 S.D. 282, 181 N.W.2d 455 (1970). Were the findings of fact clearly erroneous? Do you see that in the majority opinion? No. Again, I express that the majority opinion obtained a result by passing over a basic rule of appellate review in this Court. Narrowing this analysis, I point out: Sullivans maintain that the trial court's finding is clearly erroneous because

they parted with consideration by incurring obligations in reliance upon the settlement offer. Sullivans claim these obligations were (1) payment of the 1985 real estate taxes, (2) time expended in obtaining a release of the FmHA mortgage, (3) removal of a grain bin from the *704 property, and (4) time expended to obtain a grain bin lien release from the Agricultural Soil Conservation Service.

Let us scope these, mentally, to see if what Sullivans say is true. One, Sullivans admitted at trial that they were ultimately liable to pay the 1985 real estate taxes. Two, Sullivans (by the record) did not obtain the release of the FmHA mortgage until about three months after FLB refused to honor the settlement negotiated by its attorney. Three, Sullivans failed to obtain any bin lien release until eighteen days after the FLB refused to honor the settlement agreement. Four, no evidence appears in the record to establish that the Sullivans ever removed the grain bin. The last argument is particularly hollow since the Sullivans had to remove the grain bin, in any event, because the FLB had no ownership interest in the bin.

Primary thrust of appellants' position is simply this: Appellee should be equitably estopped from being entitled to a judgment against the defendants, or from foreclosing its mortgages upon the mortgaged property, because of a settlement of the controversy. To prevail in their appeal, the Sullivans must establish equitable estoppel. This record does not establish equitable estoppel. Sullivans, as I have pointed out in the four matters above, failed to suffer prejudice or injury. I quote from <u>Cromwell v. Hosbrook</u>, 81 S.D. 324, 329, 134 N.W.2d 777, 780-81 (1965), wherein this Court, in a landmark case, expressed:

In order to constitute an equitable estoppel, or estoppel in pais, false representations or concealment of material facts must exist; the party to whom it was made must have been without knowledge of the real facts; that representations or concealment must have been made with the intention that it should be acted upon; and the party to whom it was made must have relied thereon to his prejudice or injury.

In addition, the *Cromwell* Court held: "There can be no estoppel if any of these essential elements are

lacking, or if any of them have not been proved by clear and convincing evidence." <u>Cromwell. 81 S.D. at 329, 134 N.W.2d at 781</u>. Note that the degree of proof is "clear and convincing evidence." The majority opinion skirts all precedent in this Court to achieve a result by disregarding the rule in <u>Hobels-berger</u>, <u>Cromwell</u>, and <u>Northwest Realty</u>. Therefore, I cannot join the majority opinion and I also express that my academic sentiments are with Justice Morgan, who has likewise dissented in this case.

S.D.,1988. Federal Land Bank of Omaha v. Sullivan 430 N.W.2d 700, 57 USLW 2331

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Hanson v. Brookings Hosp. S.D.,1991.

> Supreme Court of South Dakota. Sherrie HANSON, Plaintiff-Appellant,

BROOKINGS HOSPITAL, Defendant-Appellee. No. 17188.

> Considered on Briefs Feb. 15, 1991. May 8, 1991. Review Denied July 24, 1991.

Medical malpractice claim was brought against city hospital. City hospital moved to dismiss. The Circuit Court, Third Judicial Circuit, Brookings County, Rodney J. Steele, J., granted hospital's motion, and patient appealed. The Supreme Court, Miller, C.J., held that: (1) hospital was not estopped from raising notice requirement as defense, and (2) notice requirement was not final judgment, order, or proceeding within provision allowing court to grant relief for excusable neglect from final judgment, order, or proceeding.

Affirmed.

Wuest, J., concurred specially and filed statement.

Sabers, J., specially concurred and filed statement.

West Headnotes

[1] Municipal Corporations 268 741.25

268 Municipal Corporations

268XII Torts

268XII(A) Exercise of Governmental and Corporate Powers in General

268k741 Notice or Presentation of Claims for Injury

268k741.25 k. Applicability in Particular Cases. Most Cited Cases

(Formerly 268k741.1(4))

Hospital established by city was "public entity" under statute setting forth specific notice requirements that must be satisfied as prerequisite to maintenance of tort action against "public entity." SDCL 3-21-1(1),

3-21-2.

[2] Municipal Corporations 268 741.55

268 Municipal Corporations

268XII Torts

268XII(A) Exercise of Governmental and Corporate Powers in General

268k741 Notice or Presentation of Claims for Injury

268k741.55 k. Waiver. Most Cited

Cases

(Formerly 268k741.3)

City hospital was not estopped from raising notice requirements as basis for dismissing tort suit against it on ground that it did not hold itself out as public entity where it was created as public entity by enactment of ordinance.

[3] Evidence 157 @---65

157 Evidence

157II Presumptions

157k65 k. Knowledge of Law. Most Cited

Cases

Individuals are presumed to know the law and the law includes municipal ordinances.

[4] Estoppel 156 \$\infty\$ 95

156 Estoppel

156III Equitable Estoppel

156III(B) Grounds of Estoppel

156k95 k. Silence. Most Cited Cases

Mere innocent silence or inaction will not work estoppel unless one remains silent when he has duty to speak.

[5] Estoppel 156 53

156 Estoppel

156III Equitable Estoppel

156III(A) Nature and Essentials in General

156k53 k. Intent. Most Cited Cases

Generally, to work estoppel, there must be some intended deception in conduct or declaration of party to be estopped.

[6] Estoppel 156 56

156 Estoppel

156III Equitable Estoppel

156III(A) Nature and Essentials in General
156k56 k. Acts Done or Omitted, and Change of Position. Most Cited Cases

Estoppel 156 58

156 Estoppel

156III Equitable Estoppel

156III(A) Nature and Essentials in General
156k58 k. Prejudice to Person Setting Up

Estoppel. Most Cited Cases

To work estoppel, conduct must have induced other party to alter his position or do that which he would not otherwise have done to his prejudice.

[7] Municipal Corporations 268 741.40(1)

268 Municipal Corporations

268XII Torts

<u>268XII(A)</u> Exercise of Governmental and Corporate Powers in General

<u>268k741</u> Notice or Presentation of Claims for Injury

 $\underline{268k741.40} \quad \text{Excuses} \quad \text{for and Relief} \\ \text{from Delay or Failure}$

268k741.40(1) k. In General. Most

Cited Cases

(Formerly 268k741.1(7))

Notice requirement for bringing claim against public entity is not "final judgment, order, or proceeding" under provision allowing court to grant relief from "final judgment, order, or proceeding" for mistake, inadvertence, surprise, or excusable neglect. <u>SDCL</u> 15-6-60(b), (b)(1).

*827 Philip R. Parent of Lammers, Lammers, & Kleibacker, Madison, for plaintiff-appellant.

James L. Hoy of Hoy & Hoy, Sioux Falls, for defendant-appellee.

MILLER, Chief Justice.

Sherrie Hanson (Hanson) appeals the dismissal of her hegligence action against the Brookings Municipal Hospital (the hospital). We affirm.

FACTS

During February and March 1988, Hanson underwent three separate operations for the removal of kidney stones. All three operations were performed at the hospital. The operations were unsuccessful and Hanson subsequently had the surgery performed at a different hospital.

On December 18, 1989, well over 180 days after the surgeries, Hanson served a summons and complaint on the hospital. The complaint alleged various acts of negligence in the course of her treatment and sought damages for Hanson's pain, mental anguish, separation from her family and lost income. The hospital served its answer on December 26, 1989. In its answer, the hospital moved to dismiss Hanson's complaint for failure to provide notice of her injury pursuant to <u>SDCL 3-21-2</u>:

No action for the recovery of damages for personal injury, property damage, error or omission or death caused by a public entity or its employees may be maintained against the public entity or its employees unless written notice of the time, place and cause of the injury is given to the public entity as provided by this chapter within one hundred eighty days after the injury. (emphasis added).

A hearing was held on the hospital's motion to dismiss on April 24, 1990. The *828 trial court subsequently entered its order and judgment dismissing Hanson's complaint for failure to comply with <u>SDCL 3-21-2</u>. Hanson appeals.

ISSUE ONE

WHETHER THE HOSPITAL SHOULD HAVE BEEN ESTOPPED FROM RAISING THE NOTICE REQUIREMENTS OF SDCL CH. 3-21 AS A DEFENSE?

[1] SDCL ch. 3-21 sets forth specific notice requirements that must be satisfied as a prerequisite to maintenance of a tort action against a "public entity." *Finck v. City of Tea*, 443 N.W.2d 632 (S.D.1989). SDCL 3-21-1(1) defines the term "public entity" to include, "all ... legal entities that public

entities are authorized by law to establish[.]" Municipalities are authorized to establish hospitals in SDCL 34-9-1: "every city shall have power ...[t]o establish, construct, purchase, and maintain hospitals and medical clinics and to regulate the same[.]" (emphasis added). The hospital was, in fact, established by the City of Brookings in 1964 by Chapter 18, Article I, § 18-1 of its ordinances: "The Brookings Municipal Hospital is hereby created and established in and for the city." (emphasis added). Based upon these provisions, it is clear that the hospital is a public entity as contemplated by SDCL ch. 3-21.

SDCL 3-21-2 requires a plaintiff in a tort action against a public entity to give written notice to the entity of the, "time, place and cause of the injury." The notice must be given to the attorney general and, in a case such as this, to the chief executive officer or secretary of the governing board of the public entity. SDCL 3-21-3(5). During the course of the hearing on this matter, Hanson conceded her failure to comply with the notice requirements of SDCL 3-21-2. Based upon this failure, the trial court dismissed Hanson's action.

[2] Hanson asserts that the hospital should have been estopped from raising the notice requirements of SDCL ch. 3-21 as a defense because the hospital has in no way held itself out as a public entity. She asserts that the only record evidence indicating that the hospital is a public entity is an affidavit of the hospital's counsel in the settled record and a city ordinance referring to the creation of a hospital board.

Hanson's arguments are partially resolved by the record. During the hearing on this matter, the trial court explicitly took judicial notice of Brookings, "ordinance number 18-1." As previously quoted in this decision, Ordinance No. 18-1 specifically states that it creates and establishes the Brookings Municipal Hospital. The only person during the thearing on this matter to refer to an ordinance merely threating a hospital board was Hanson's own counsel. However, that is a separate Ordinance No. 18-18 which was not judicially noticed by the trial court.

[3] Moreover, the enactment of the ordinance establishing the hospital forestalls any contention by Hanson that the hospital does not hold itself out as a public entity. Individuals are presumed to know the law. Hieb v. Opp. 458 N.W.2d 797 (S.D.1990); Johnson v. Graff. 68 S.D. 562, 5 N.W.2d 33 (1942). The law includes municipal ordinances. SDCL 1-1-22; SDCL 1-1-23(7). Thus, Hanson must be presumed to have had knowledge of the ordinance establishing the hospital and, therefore, the existence of the public entity status of the hospital.

[4][5][6] Furthermore, mere innocent silence or inaction will not work an estoppel unless one remains silent when he has a duty to speak. <u>Matter of Estate of Williams</u>, 348 N.W.2d 471 (S.D.1984); <u>Willadsen v. Crawford</u>, 75 S.D. 161, 60 N.W.2d 692 (1953). Generally, to work an estoppel, there must be some intended deception in the conduct or declaration of the party to be estopped. <u>In re Cancel. of Stabio Ditch Water Right</u>, 417 N.W.2d 391 (S.D.1987). The conduct must have induced the other party to alter his position or do that which he would not otherwise have done to his prejudice. Estate of Williams, supra.

*829 Here, Hanson has failed to point to any particular act or conduct on the part of the hospital that induced her to believe it was not a public entity. The argument she raises merely points to silence or inaction on the part of the hospital in failing to affirmatively notify her that it is a public entity. She asserts that nowhere in the hospital's letterhead, correspondence, billing statements or release forms did the hospital reference the city's ownership. Yet, she fails to provide any authority that the hospital is under a duty to advise patients of the city's ownership in any such manner. Moreover, she ignores that the name of the hospital itself implies municipal participation in its operation. Finally, she fails to cite any evidence that the failure of the hospital to note its municipal ownership in the forms and documents she received was an intended deception as opposed to a standard operating procedure. Based upon these considerations and the rule that estoppels against the public are little favored and should be used sparingly, Hanson's attempt to raise an estoppel against the hospital must be rejected. Sioux Valley Hosp. Ass'n v. Tripp County, 404 N.W.2d 519 (S.D.1987).

ISSUE TWO

WHETHER THE TRIAL COURT ABUSED ITS DISCRETION IN FAILING TO GRANT HANSON RELIEF FROM THE NOTICE REQUIREMENTS OF SDCL CH. 3-21 UNDER SDCL 15-6-60(B)(1)?

[7]SDCL 15-6-60(b)(1) provides in pertinent part:

On motion and upon such terms as are just, the court may relieve a party or his legal representative from a final judgment, order, or proceeding for the following reasons:

(1) Mistake, inadvertence, surprise, or excusable neglect[.]

During the hearing on this matter, Hanson argued before the trial court that because of the hospital's failure to represent itself as a public entity, her failure to comply with the notice requirements of SDCL ch. 3-21 should be deemed excusable neglect. Rejecting that argument, the trial court stated that it didn't see where it had any discretion to act in equity allowing for excusable neglect or anything else. On appeal, Hanson asserts that SDCL 15-6-60(b) provides grounds for relief from the notice requirements of SDCL ch. 3-21 on the grounds of excusable neglect, that her failure to discover that the hospital is a public entity subject to these notice requirements constitutes excusable neglect and, therefore, that it was within the jurisdiction of the trial court to relieve her of the notice requirements under SDCL 15-6-60(b).

Hanson's arguments simply ignore the plain language of <u>SDCL 15-6-60(b)</u>. It states only that a court may relieve a party, "from a final *judgment*, order, or proceeding [.]" Id.(emphasis added). We fail to perceive how the notice requirements of SDCL ch. 3-21 can be construed as a final judgment, order, or proceeding subject to this rule and Hanson cites no authority for such a proposition.

Further,

a party cannot have relief under Rule 60(b)(1) merely because he is unhappy with the judgment. Instead he must make some showing of why he

was justified in failing to avoid mistake or inadvertence. Gross carelessness is not enough. Ignorance of the rules is not enough, nor is ignorance of the law.

11 C. Wright & A. Miller, Federal Practice and Procedure § 2858 (1973) (emphasis added). See also, United States v. Thompson, 438 F.2d 254 (8th Cir.1971); Hoffman v. Celebrezze, 405 F.2d 833 (8th Cir.1969). Thus, Hanson's ignorance of the applicability of the notice requirements of SDCL ch. 3-21 to the hospital would not provide Rule 60(b) grounds for relieving her from the notice requirements even if they were subject to relief under Rule 60(b).

Affirmed.

HENDERSON, J., and HERTZ, Acting Justice, concur.

*830 WUEST and SABERS, JJ., concur specially. AMUNDSON, J., not having been a member of the Court at the time this action was submitted did not participate.WUEST, Justice (concurring specially). I concur in the majority opinion, and although it is not an issue in this case, I wish to point out that trial courts cannot take judicial notice of municipal ordinances. Nase v. Christensen, 409 N.W.2d 131 (S.D.1987); Anderson v. Adamson, 79 S.D. 429, 112 N.W.2d 612 (1962).

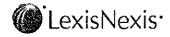
SABERS, Justice (specially concurring).

The pitfalls of this case SHOUT a message to ALL the people of this state:

"If you deal with a city or a 'public entity' EN* and suffer injury or damage-go immediately to a good attorney! Do not delay! Better yet, in cases like this, have the attorney come to the hospital-anything else may be too late!"

FN* The term may include a public entity of almost any kind in any capacity. SDCL 3-21-1(1) defines "public entity" to include "all other legal entities that public entities are authorized by law to establish[.]"

S.D.,1991. Hanson v. Brookings Hosp. 469 N.W.2d 826



LEXSEE 652 N.W.2D 742

ACTION MECHANICAL, INC., a South Dakota Corporation, Plaintiff and Appellee, v. THE DEADWOOD HISTORIC PRESERVATION COMMISSION; MITCH PECK, d/b/a TEMPERATURE CONTROL; RONALD DIGGES; DENNIS DIGGES; DONNA DIGGES, PEPSI COLA BOTTLING COMPANY; RC WESTERN MEATS; AND THE STATE OF SOUTH DAKOTA DEPARTMENT OF REVENUE, Defendants, and H & N ELECTRIC, Defendant and Appellee, and DAMON REEL, DONNA WYNIA, DWIGHT THOMAS, and RANDY BECKMAN, d/b/a FOUR SQUARE PARTNERSHIP, a South Dakota General Partnership, Defendants and Third Party Plaintiffs and Appellants, v. IRON HORSE INN, INC., Third Party Defendant.

22160

SUPREME COURT OF SOUTH DAKOTA

2002 SD 121; 652 N.W.2d 742; 2002 S.D. LEXIS 139

May 29, 2002, Argued October 2, 2002, Opinion Filed

PRIOR HISTORY: [***1] APPEAL FROM THE CIRCUIT COURT OF THE FOURTH JUDICIAL CIRCUIT. LAWRENCE COUNTY, SOUTH DAKOTA. HONORABLE WARREN G. JOHNSON, Judge.

DISPOSITION: Affirmed.

COUNSEL: BARTON R. BANKS of Banks, Johnson, Colbath Sumner & Kappelman, Rapid City, South Dakota, Attorneys for appellee Action Mechanical.

ROBERT A. MARTIN, Rapid City, South Dakota, Attorney for appellee H & N Electric.

BRAD P. GORDON and MICHELLE K. PERCY of Fuller, Tellinghuisen, Gordon and Percy, Lead, South Dakota, Attorneys for appellants.

JUDGES: GORS, Circuit Judge. GILBERTSON, Chief Justice, and SABERS and ZINTER, Justices, and WILBER, Circuit Judge, concur. GORS, Circuit Judge, for AMUNDSON, Justice, disqualified. WILBUR, Circuit Judge for KONENKAMP, Justice, disqualified.

OPINION BY: GORS

OPINION

[**746] GORS, Circuit Judge

[*P1] Four Square Partnership (Four Square) appeals the judgment of the trial court in favor of Action Mechanical, Inc. (Action Mechanical) and H & N Electric, Inc. (H & N). Four Square claims principles of equity preclude Action Mechanical and H & N from prevailing. We affirm.

FACTS

[*P2] Action Mechanical is a family owned corporation located in Rapid City, South Dakota. The president of Action Mechanical is Dale Sheesley. [***2] H & N, also located in Rapid City, is an electrical contracting corporation. The president of H & N is Harlan Nielsen. Four Square Partnership is a general partnership in Deadwood, South Dakota. The partners [**747] are Damon Reel, Donna Wynia, Dwight Thomas and Randy Beckman.

[*P3] In 1989 Four Square bought a building in Deadwood for \$ 75,000 for use as an auto parts store. The development of Deadwood gambling soon made the area too congested for a retail store. In August 1994, Four Square entered into a lease with Lana Coffman. There were discussions about starting a hotel and casino on Four Square's land. Later in April 1995, a corporation called Iron Horse Inn (Iron Horse) was formed with the intent to start a hotel and casino. Members of the new

corporation included Damon Reel (a partner in Four Square), Dale Sheesley (president of Action Mechanical), Harlan Nielsen (president of H & N), Larry Lamb, Lana Coffman and others. Four Square then novated its lease with Coffman and named Iron Horse the new lessee.

[*P4] The lease required Iron Horse to make not less than \$ 200,000 in improvements to the property. The lease also prohibited Iron Horse from allowing liens to attach [***3] to the property. Under the lease, Four Square retained the right to post notices of non-liability for labor and materials furnished and the right of approval on all construction plans. Four Square then appointed Iron Horse as its attorney in fact to acquire necessary zoning and building permits.

[*P5] At the first shareholder's meeting of the newly formed corporation, Iron Horse Inn, all shareholders were appointed as directors. Damon Reel was elected treasurer. Lana Coffman was elected president and Larry Lamb was named construction manager. The shareholders also signed the Smith Block Agreement allowing shareholders and investors to contribute cash or services in exchange for stock.

[*P6] After taking over the lease, Iron Horse solicited bids to begin construction on the hotel and casino. Action Mechanical was the low bidder on plumbing and other work in the amount of \$ 339,000. \text{'} Action Mechanical's president, Sheesley, agreed to a reduction of the bid by \$ 50,000 in exchange for 50,000 shares of stock. H & N agreed to provide electrical services. H & N's president, Nielsen, also agreed that payment for the first \$ 50,000 of electrical work would be in the form of [***4] 50,000 shares of stock.

1 Ultimately Action Mechanical's total bill was \$ 439,390.20.

[*P7] As work started on the hotel and casino, Action Mechanical made periodic requests for payment. Iron Horse obtained a low-interest loan through the Deadwood Historical Society in the amount of \$250,000. Out of that loan, Action Mechanical was paid \$213,800. Iron Horse eventually went into default on this loan and Four Square has since taken it over.

[* [*P8] Iron Horse was unable to attract more investors to obtain new capital. The corporation was unable to pay its monthly lease payments and, subsequently, Four Square started issuing default notices. However, each time a default notice was issued, Four Square would allow Iron Horse an extension on the project. On four separate occasions, Four Square accepted 15,000 shares of penalty stock in lieu of delinquent rent, which eventually totaled 60,000 shares. Four Square gave Iron Horse a total of nine extensions.

[*P9] By March 28, 1996, the hotel and casino [***5] project was 90 percent complete. Everyone involved from Four Square to Iron Horse to Action Mechanical and H & N knew the financial condition of the project was not good. Action Mechanical and H & N felt that if they did not complete their respective work the hotel and casino [**748] would not open and they would not get paid.

[*P10] By April 1996 the situation became worse. Four Square stopped granting extensions on the lease agreement. In November, Four Square retook possession of the completed hotel and casino. Ultimately, Action Mechanical and H & N concluded that compensation for their services would not be forthcoming and they both filed respective mechanic's liens which precipitated the current dispute.

[*P11] Action Mechanical sued to foreclose its mechanic's lien and for unjust enrichment. The suit named all parties who claimed an interest in the Iron Horse Inn property. H & N's mechanic's lien was dismissed because it was not filed within 120 days after the date of last service on the project. Following a court trial, Action Mechanical was awarded a judgment against Four Square foreclosing its mechanic's lien and for unjust enrichment in the amount of \$ 174,267.02. [***6] The trial court also awarded H & N a judgment against Four Square for unjust enrichment in the amount of \$ 109,259.60. Four Square appeals. We affirm.

ISSUES

Whether principles of equity preclude the award of judgments to Action Mechanical and H & N.

Whether an agency relationship existed between Four Square and Iron Horse Inn, Inc.

Whether Action Mechanical overstated amounts in the filing of its mechanic's lien.

Whether the trial court erred as a matter of law by awarding personal judgments against the individual partners of Four Square.

STANDARD OF REVIEW

[*P12] Findings of fact will not be set aside unless they are clearly erroneous. SDCL 15-6-52(a). A finding of fact is clearly erroneous if we are left with a definite and firm conviction that a mistake has been made. In re Dokken, 2000 SD 9, P10, 604 N.W.2d 487, 490-491. We review a trial court's conclusions of law de novo, giving no deference to the trial court's conclusions. Osloond v. Osloond, 2000 SD 46, P6, 609 N.W.2d 118, 121.

[*P13] Foreclosure of a mechanic's lien is an action in equity. Franksen v. Crossroads Joint Venture, 245 Neb.

863, 515 N.W.2d 794, 798 (Neb 1994); [***7] Schumacher Elec., Inc. v. DeBruyn, 604 N.W.2d 39, 41 (Iowa 1999); Dane Const. v. Royal's Wine & Deli, 480 N.W.2d 343, 345 (MichCt 1991). An action to recover for unjust enrichment is an action in equity. Himrich v. Carpenter, 1997 SD 116, P21, 569 N.W.2d 568, 573.

[*P14] This Court's standard of review for cases in equity is abuse of discretion. Mattson v. Rachetto, 1999 SD 51, P9, 591 N.W.2d 814, 817 (citations omitted). "'We determine that an abuse of discretion occurred only if no judicial mind, in view of the law and the circumstances of the particular case, could reasonably have reached such a conclusion." Id. (quoting Gilkyson v. Wheelchair Express, Inc., 1998 SD 45, P6, 579 N.W.2d 1, 3). Accord, Dacy v. Gors, 471 N.W.2d 576, 580 (SD 1991).

ANALYSIS

ISSUE ONE

[*P15] Whether principles of equity preclude the award of judgments to Action Mechanical and H & N

[*P16] Four Square appeals the trial court's award of damages to Action Mechanical [**749] and H & N. Four Square argues the judgments should be set aside under the equity doctrines of unclean hands and equitable [***8] estoppel. The trial court found that Action Mechanical was entitled to a judgment foreclosing its mechanic's lien and based on unjust enrichment. It also found that H & N had failed to perfect its lien, but Four Square would be unjustly enriched if it were allowed to retain the benefits conferred by H & N.

1. Mechanic's Lien

[*P17] South Dakota allows persons who provide labor and materials to file mechanic's liens to ensure that they get paid. See SDCL ch 44-9. "The purpose of mechanic's lien laws is to provide security or protection to persons who improve the property of others by furnishing materials and labor." Lytle v. Morgan, 270 N.W.2d 359, 361 (SD 1978) (citations omitted). In South Dakota, a mechanic's lien not only attaches to the actual structure, but to the land upon which the structure is located. Amert Canst. Co. v. Spielman, 331 N.W.2d 307, 311 (SD 1983) (citing Atlas Lumber Co. v. Semmler, 48 SD 541, 205 MW 376 (1925)). It also allows owners to protect themselves against the filing of mechanic's liens by posting notices of non-liability. ²

2 The following South Dakota statutes apply to mechanic's liens:

44-9-1. Whoever shall, at the request of the owner or the duly authorized agent or representative of the owner, or of any contractor or subcontractor, furnish skill, labor, services, including light, power, or water, equipment, or materials for the improvement, development, or operation of property as hereinafter specified, shall have a first lien thereon and the appurtenances thereto

44-9-2. When improvements are made by one person upon the land of another, all persons interested therein otherwise than as bona fide prior encumbrancers or lienors shall be deemed to have authorized such improvements, insofar as to subject their interests to the liens therefor; provided that as against a lessor no lien is given for repairs made by or at the instance of his lessee.

44-9-4. Any person who has not authorized the improvement may protect his interests from such liens by serving upon the persons doing the work or otherwise contributing to such improvement, within five days after knowledge thereof, written notice that the improvement is not being made at his instance, or by posting like notice, and keeping the same posted, in a conspicuous place on the premises.

[***9] 2. Waiver by the Lease

[*P18] The lease provided that the tenant, Iron Horse, would prevent the attachment of any mechanic's lien. However, parties to contracts can waive certain contractual provisions.

The doctrine of waiver is applicable where one in possession of any right, whether conferred by law or by contract, and with full knowledge of the material facts, does or forbears the doing of something inconsistent with the exercise of the right. To support the defense of waiver, there must be a showing of a clear, unequivocal and decisive act or acts showing an intention to relinquish the existing right.

Norwest Bank South Dakota v. Venners, 440 N.W.2d 774, 775 (SD 1989) (quoting Subsurfco, Inc. v. B-Y Water Dist., 337 N.W.2d 448, 456 (SD 1983)). In addition, a creditor is not bound by a contractual provision in an agreement to which the creditor is not a party. See Weaver v. Boortz, 301 N.W.2d 673 (SD 1981).

[*P19] Four Square remained the actual owner of the property while Iron Horse was merely a tenant. Four Square knew improvements were being made. Four Square knew that Iron Horse was in a precarious financial [***10] situation. After Iron Horse defaulted on the lease by failing to [**750] pay the rent for several months, Four Square granted a series of extensions to

Iron Horse. Four Square agreed to take \$ 60,000 worth of penalty stock in lieu of delinquent rent. Four Square permitted Iron Horse to continue to make improvements even after Iron Horse could not pay the rent.

[*P20] Four Square obviously knew Iron Horse could not pay for the improvements if Iron Horse could not even pay the rent. Damon Reel, one of the four general partners in Four Square, was treasurer of Iron Horse and knew its shaky financial condition. Four Square did not post any notice of non-liability as required by SDCL 44-9-4 and did not object to any improvement Iron Horse was making. Therefore, Four Square waived its right to protection under the lease provision preventing the attachment of mechanic's liens.

3. Unjust Enrichment

[*P21] "When a party confers a benefit upon another party who accepts [or] acquiesces in that benefit and it is inequitable to receive that benefit without paying therefore, a contract will be implied between the parties." Amert Const., 331 N.W.2d at 310. [***11] (citations omitted). For Action Mechanical and H &N to prevail on the claim of unjust enrichment they must show: (1) Four Square received a benefit; (2) Four Square was aware it was receiving a benefit; and, (3) Four Square retained that benefit without reimbursement. Juttelstad v. Juttelstad, 1998 SD 121, P19, 587 N.W.2d 447, 451.

[*P22] The Amert Const. case is very similar. In Amert, Guy Spielman contracted with Amert Construction to erect a large building to house trucks. Amert Const., 331 N.W.2d at 308. Guy was the son of Cliff and Evelyn Spielman. Id. The Spielmans owned the land upon which the building was to be constructed and lived directly across from the site. Id. at 308-309. This Court observed that the Spielmans were aware that their son was constructing a trucking business on their land. Id. at 310. Spielmans also encouraged the construction of the building by financing a "commitment fee." Id. At no time did the Spielmans ask their son or Amert Construction to cease operations. Id.

Interested persons are required to take action rather than remain silent when notified that unauthorized [***12] improvements are being made on their real estate or they will be equitably estopped from attacking a mechanic's lien which attaches thereto.

1d. (citing Thorson v. Maxwell Hardware Co., 82 SD 385, 146 N.W.2d 739 (1966)). This Court held that the Spielmans received a benefit from the improvements and it would be inequitable for them to retain the improvements without paying, An implied contract was formed.

[*P23] Four Square received the benefit of a new hotel and casino on its property. Four Square initially paid approximately \$ 75,000 for the property and took over the \$ 250,000 Iron Horse loan from the Deadwood Historical Society. By the time all the improvements were finished, more than \$ 1,000,000 in improvements had been made and the property was appraised in excess of \$ 800,000.

[*P24] Four Square was aware it was receiving a benefit. The lease required at least \$ 200,000 worth of improvements to be made to the property. Four Square had the right of approval on any improvements made. Four Square never objected to any of the plans or improvements made by Action Mechanical or H & N.

[*P25] Finally, Action Mechanical and H & N were not [***13] paid for the work they performed. Action Mechanical provided \$ 439,390.20 worth of services and materials [**751] but received only \$ 213,800 and \$ 50,000 worth of stock. H & N provided materials and services in the amount of \$ 159,259.60 and received no money and only \$ 50,000 in Iron Horse stock. It would be unjust for Four Square to receive an \$ 800,000 hotel and casino for \$ 325,000 while Action Mechanical is left with an unpaid bill of \$ 174,267.02 and H & N is left with an unpaid bill of \$ 109,259.60. The trial court did not abuse its discretion in awarding judgment to Action Mechanical and H & N under the theory of unjust enrichment.

4. Unclean Hands

[*P26] "He who comes into equity must come with clean hands." Miller v. County of Davison, 452 N.W.2d 119, 121 (SD 1990) (quoting Precision Instrument Mfg. Co. v. Automotive Maintenance Mach. Co., 324 U.S. 806, 65 S. Ct. 993, 89 L. Ed. 1381, 1945 Dec. Comm'r Pat. 582, (1945)). A party seeking equity must act fairly and in good faith. Id.

[*P27] There was no evidence that Action Mechanical or H & N acted in bad faith. Four Square argues that Action Mechanical and H & N knew that Iron Horse was in dire financial [***14] straits because Sheesley and Nielsen were investors and on the board. Four Square submits that since Action Mechanical and H & N knew of the financial problems, they should not have continued to work on credit. One of the general partners in Four Square, Damon Reel, was also on the board of Iron Horse. All parties knew the bad financial condition of Iron Horse. Both Action Mechanical and H & N knew that they would have to finish their respective jobs to enable the hotel and casino to open and start generating income before they would be paid. Four Square encouraged them to finish by taking penalty stock for delinquent rent instead of terminating the lease. Finishing the work was not bad faith on the part of either [**752] Action Mechanical or H & N. It was simply a reasonable business decision. Their hands were clean. Therefore, the doctrine of unclean hands does not preclude the judgments in favor of Action Mechanical and H & N.

[*P28] If anyone had unclean hands, it was Four Square which led all of the contractors on by waiving Iron Horse's defaults in rent and by allowing the project to be completed before terminating the lease. Four Square did not object or notify Action Mechanical [***15] or H & N. Instead, Four Square waited until the contractors were done with their work and asked to be paid. "Clean hands" is a two-way street.

5. Equitable Estoppel

[*P29] Estoppel occurs when one party persuades another party to do something they normally would not have done and they are prejudiced by those actions. Cooper v. James, 2001 SD 59, P16, 627 N.W.2d 784, 789 (citing L.R. Foy Const. Inc. v. SD State Cement Plant, 399 N.W.2d 340, 344 (SD 1987)). The elements of equitable estoppel are set forth in Taylor v. Tripp, 330 N.W.2d 542, 545 (SD 1983):

In order to constitute an equitable estoppel... false representations or concealment of material facts must exist; the party to whom it was made must have been without knowledge of the real facts; the representations or concealment must have been made with the intention that it should be acted upon; and the party to whom it was made must have relied thereon to his prejudice or injury. There can be no estoppel if any of these essential elements are lacking, or if any of them have not been proved by clear and convincing evidence. (quoting Cromwell v. Hosbrook, 81 SD 324, 134 N.W.2d 777, 780-81 (1965)). [***16]

The facts do not establish equitable estoppel. There was no false representation or concealment of any material facts by either Action Mechanical or H & N. Since the first element of equitable estoppel does not exist, there is no need to address the additional elements. Therefore, equitable estoppel does not preclude the judgments in favor of Action Mechanical and H & N.

[*P30] Citing Voorhees-Jontz Lumber Co. v. Bezek, 137 Ind. App. 382, 209 N.E.2d 380, 384 (IndApp 1965), Four Square argues that a lien claimant may be estopped by its conduct. According to Voorhees-Jontz, conduct may include positive acts, spoken words and silence when there is a duty to speak. Id. In Arr-Em Plastering Corp. v. 315 East 85th Street Corp., 21 A.D.2d 415, 250 N.Y.S.2d 995 (NYAD 1964), cited by Four Square, the court refused to foreclose a mechanic's lien on the basis

of equitable estoppel. The owner leased real estate to Brosen Associated, Inc. The lease required Brosen to construct an apartment building on the land. In the lease, Brosen agreed not to allow any mechanic's liens to attach to the property. Brosen hired Gilsen Construction Corporation to build the apartments. Brosen and Gilsen [***17] were family corporations owned by the Sens brothers and their father, who were the shareholders and directors of both corporations. Both corporations had the same office and attorney. When Brosen failed to get a loan and could not pay for work on the apartments, Gilsen filed a mechanic's lien. The court held Gilsen was estopped from foreclosing its lien because "a single mind and a single will" directed the activities of the separate legal entities. Id. at 997 (quoting Shelton Holding Corp. v. 150 E. 48th St. Corp., 264 NY 339, 344, 191 NE 8, 10). Gilsen was estopped because it was held to know about Brosen's agreement not to allow mechanic's liens to be filed.

[*P31] This case is distinguishable. A single mind and a single will did not direct Iron Horse, Action Mechanical and H & N. In addition, Four Square encouraged Action Mechanical and H & N to continue working by taking penalty stock in lieu of rent when Iron Horse defaulted on several occasions. By taking penalty stock, Four Square was not only accepting the risk of not collecting the rent but also was accepting the risk that Action Mechanical and H & N would not be paid and would file [***18] mechanic's liens. Four Square could have stopped the financial hemorrhaging when the rent was not paid. Instead, Four Square led the contractors on by waiving the defaults in return for stock. If anyone should be estopped by conduct. Four Square is the party that encouraged the contractors to continue to put labor and materials into the project by making it look like everyone was in the same boat together.

[*P32] Four Square's apparent sharing of the risk was actually an illusion because there was no risk to Four Square in either event. If Iron Horse was completed and successful, Four Square would have a prosperous tenant and an equity position in a profitable casino. If Iron Horse failed, Four Square could retake possession of the casino. Four Square would win either way. The only ones to lose would be the unpaid contractors. Although Action Mechanical and H & N were also investors, it would be inequitable to estop them from being paid for the labor and materials they supplied beyond their investment. Principles of equity preclude Four Square from receiving an \$800,000 casino for a \$325,000 investment while Action Mechanical and H & N are left with their unpaid bills.

ISSUE [***19] TWO

[*P33] Whether an agency relationship existed between Four Square and Iron Horse Inn, Inc.

[*P34] Four Square claims that no agency relationship existed between itself [**753] as landowner and Iron Horse as tenant. Such a relationship is a requirement for a mechanic's lien to attach when a tenant contracts for improvements to the land. See SDCL 44-9-2. Iron Horse counters that it was a tenant required to make improvements to the property and, therefore, it was an agent of Four Square for the purpose of making the required improvements.

[*P35] Existence of an agency relationship is a fact specific issue. For a mechanic's lien to attach to improvements on the property, an obligation must exist under either an express or implied contract. See SDCL 44-9-1. "The mere relationship of lessor and lessee of property neither makes the lessee an authorized agent of the owner nor does it create any privity of contract between the owner and a lien claimant who has contracted with the lessee." Thorson v. Maxwell Hardware Co., 82 SD 385, 388, 146 N.W.2d 739, 741 (1966) (citing Smith v. McCoy, 58 SD 256, 235 NW 661 (1931)). [***20] However, under certain circumstances a tenant may become an authorized agent of the landowner. Thorson, 82 SD at 388, 146 N.W.2d at 741.

Where a lease requires or obligates a lessee to make certain improvements the lessee is generally regarded as agent of the owner for that purpose. However, where the lease merely authorized the lessee to make alterations or improvements, the lessee is not ordinarily considered to be the agent of the owner.

Id. (citations omitted).

[*P36] The lease agreement provided that the tenant had the following duty to construct:

Article XV. Duty to Construct.

1. Tenant shall, at Tenant's sole cost and expense, remodel or construct or cause to be remodeled or constructed on said premises a motel and gambling casino, or so much thereof as can be constructed by the expenditure of not less than Two Hundred Thousand Dollars (\$200,000.00), herein called 'said building project'. In the manner and according to the terms and conditions specified herein.

Four Square required Iron Horse to make substantial improvements under the lease. Four Square appointed Iron Horse as its attorney in fact to obtain necessary building and zoning [***21] permits. Under the lease, Four Square also maintained the right to approve in writing all proposed improvements. Four Square never objected to any improvements that were made. Therefore, an agency relationship existed for the mechanic's lien to

attach. The trial court's judgment foreclosing the mechanic's lien is affirmed.

ISSUE THREE

[*P37] Whether Action Mechanical overstated amounts in the filing of its mechanic's lien.

[*P38] Four Square argues that Action Mechanical overstated the amount of its mechanic's lien and, because of this overstatement, the lien should be dismissed as a matter of law. Action Mechanical admits that it made some mistakes in calculating the amount of the mechanic's lien. However, the trial court heard testimony on this issue and believed Action Mechanical merely made a mistake and that the overstatement was not intentional.

3 Action Mechanical conceded that it failed to deduct \$50,000 in stock issuance as partial payment for work completed. Also, Action Mechanical admitted that it failed to subtract approximately \$400 of work done by a subcontractor on another project. The trial court hearing testimony on this issue believed the measures taken by Action Mechanical to be bona fide mistakes and adjusted their award accordingly,

[***22] [*P39] SDCL 44-9-6 provides:

[**754] If the contribution be made under a contract with the owner and for an agreed price, the lien as against him shall be for the sum so agreed upon together with the cost of any additional material or work agreed upon, otherwise, and in all cases as against others than the owner, it shall be for the reasonable value of the work done, and of the skill, material, and machinery furnished. (emphasis added).

Not only does the value of the work have to be reasonable, but the amount also has to be proved by the party asserting the lien. SDCL 44-9-40.

[*P40] A mechanic's lien will not be enforced when the lien intentionally and willfully exaggerates the claim. Ringgenberg v. Wilmsmeyer, 253 N.W.2d 197, 201 (SD 1977) (citing Bohn Mfg. Co. v. Keenan, 15 SD 377, 89 NW 1009 (1902)). "A claim is not intentionally or willfully false, however, if the mistakes were honestly made." Ringgenberg, 253 N.W.2d at 201 (citing Wittrock v. Hall, 51 SD 39, 211 NW 801 (1927)). If the lien grossly misrepresents the amount, the burden is on the person asserting [***23] the lien to prove the mistake was made in good faith. Ringgenberg, 253 N.W.2d at 201 (citing E.S. Gaynor Lumber Co. v. Morrison, 75 SD 132, 60 N.W.2d 83 (1953)).

1. Credit for Stock Issued

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[*P41] Four Square claimed Action Mechanical did not credit \$ 50,000 in stock against the mechanic's lien. Sheesley agreed and in his testimony stated that it was merely an oversight and an honest mistake. Accordingly, the trial court reduced the mechanic's lien by \$ 50,000.

2. Improper Items

[*P42] Four Square claimed that there were numerous items totaling \$ 22,671.23 that should not have been included in the lien. Four Square complained that some of the items were not used in the work at the casino; other items were tools not expended at the casino; some items were not itemized in sufficient detail; and additional items were provided after the last date of service listed in the lien. The trial court heard extensive testimony and reviewed numerous exhibits concerning these claimed overstatements. For example, Sheesley explained that small hand tools could be expended on the job by breaking them, losing them or wearing them out. The trial court [***24] was able to assess Sheesley's credibility and resolved the rest of the claimed overstatements against Four Square and in favor of Action Mechanical by deducting only \$ 1,323.18 of the contested \$ 22,671.23.

[*P43] Additionally, the trial court awarded Action Mechanical a judgment based not only on its mechanic's lien, but also on its unjust enrichment claim. Therefore, items that were not sufficiently itemized in the lien or that were provided after the last date of service stated in the lien were still properly included in the judgment based on unjust enrichment.

3. Lien Waivers

[*P44] A lien waiver waives only the portion of the claim which is paid. Lyons Federal Tr. & Sav. v. Moline Nat., 193 Ill. App. 3d 108, 549 N.E.2d 933, 936 (IllAppCt 1990); Portland Elec. & Plumbing Co. v. Simpson, 59 Or. App. 486, 651 P.2d 172, 174 (Or App 1982). See generally Metropolitan Federal Bank v. A.J. Allen, 477 N.W.2d 668 [**755] (Iowa 1991) (concerning interpretation of lien waivers). Specifically, all doubts about the lien waiver are to be resolved in favor of the lien. Id. at 673.

a. Action Mechanical

[*P45] A contractor may waive the right to file [***25] a mechanic's lien. Peterson Mechanical, Inc. v. Nereson, 446 N.W.2d 568, 571 (ND 1991). Lenders typically demand lien waivers before disbursing more proceeds on construction loans to avoid misapplication of funds by contractors who fail to pay suppliers. See Larson Concrete Co. v. Stroschein, 353 N.W.2d 354, 361 (SD 1984) (Fosheim, J., dissenting). Here, Action Mechanical

signed a lien waiver for 50,000 shares of stock valued at \$50,000. The lien waiver was dated December 29, 1995. At that time, Action Mechanical's unpaid bill was \$162,394. Four Square contends Action Mechanical waived the entire \$162,394 in exchange for the 50,000 shares of stock.

[*P46] Resorting to the language in the lien waiver shows that it was a partial waiver to the extent of the value of the shares received. The shares were valued at one dollar each making \$ 50,000 for 50,000 shares. The waiver specifically states "said stock being partial payment of all demands." Therefore, by its own terms, the waiver only satisfied \$ 50,000 of Action Mechanical's bill, not the entire \$ 162,394 owed at the time.

b. H & N Electric

[*P47] Four Square also claims a lien [***26] waiver signed by H & N on December 29, 1995, in return for \$ 50,000 worth of stock, waived the entire \$ 159,217.60 claim subsequently submitted by H & N. H & N filed its mechanic's lien too late and the court awarded a judgment to H & N based solely on unjust enrichment. The court deducted the \$ 50,000 worth of stock referred to in the lien waiver, leaving H & N with a net judgment of \$ 109,217.60. The lien waiver makes it clear that H & N's claim was only waived to the extent of \$ 50,000 "said stock being partial payment of all demands" represented by the stock. The trial court properly deducted only the partial payment.

ISSUE FOUR

[*P48] Whether the trial court erred as a matter of law by awarding personal judgments against the individual partners of Four Square.

[*P49] Four Square asserts that the trial court erred as a matter of law by entering the judgment personally against the partners of Four Square. Iron Horse argues that Four Square did not present this issue to the trial court; therefore, it is not properly before this Court for review. Iron Horse argues further that, even if this Court does review this issue, the partners of Four Square are [***27] jointly and severally liable for the obligations of the partnership.

[*P50] The trial court's memorandum decision and findings of fact and conclusions of law did not address this issue. This Court has said "to preserve issues for appellate review litigants must make known to trial courts the actions they seek to achieve or object to the actions of the court, giving their reasons." State v. Nelson, 1998 SD 124, P7, 587 N.W.2d 439, 443. An issue not raised at the trial court level cannot be raised for the first time on appeal. Id.

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[*P51] Although it is not necessary to address this issue, South Dakota Law provides that partners are jointly and severally liable for obligations of the partnership. SDCL 48-7A-306 provides:

- (a) Except as otherwise provided in subsections (b) and (c), all partners are [**756] liable jointly and severally for all obligations of the partnership unless otherwise agreed by the claimant or provided by law.
- (b) A person admitted as a partner into an existing partnership is not personally liable for any partnership obligation incurred before the person's admission as a partner.

An obligation of a partnership [***28] incurred while the partnership is a limited liability partnership, whether arising in contract, tort, or otherwise, is solely the obligation of the partnership. A partner is not personally liable, directly or indirectly, by way of contribution or otherwise, for such an obligation solely by reason of being or so acting as a partner. This subsection applies notwithstanding anything inconsistent in the partnership agreement that existed immediately before the vote required to become a limited liability partnership under § 48-7A-1001(b).

Four Square is a general partnership. The partners of Four Square are jointly and severally liable for the debts of the partnership. Therefore, the trial court has the authority to name the individual partners personally liable. See SDCL 48-7A-306. Accordingly, it was not error for the trial court to award personal judgments against the individual partners of Four Square on the unjust enrichment claims. The judgment foreclosing the mechanic's lien is a judgment against the property and is not a personal judgment against the individual partners of Four Square.

CONCLUSION

[*P52] [***29] The trial court is affirmed.

[*P53] GILBERTSON, Chief Justice, and SABERS and ZINTER, Justices, and WILBER, Circuit Judge, concur.

[*P54] GORS, Circuit Judge, for AMUNDSON, Justice, disqualified.

[*P55] WILBUR, Circuit Judge for KONENK-AMP, Justice, disqualified.



LEXSEE 689 N.W.2D 196

DAKOTA TRUCK UNDERWRITERS, Petitioners and Appellants, and TRAVEL-ERS INSURANCE COMPANY, Petitioners and Appellants, v. SOUTH DAKOTA SUBSEQUENT INJURY FUND, Respondent and Appellee.

22975

SUPREME COURT OF SOUTH DAKOTA

2004 SD 120; 689 N.W.2d 196; 2004 S.D. LEXIS 191

April 28, 2004, Argued October 27, 2004, Opinion Filed

PRIOR HISTORY: [***1] APPEAL FROM THE CIRCUIT COURT OF THE SIXTH JUDICIAL CIRCUIT HUGHES COUNTY, SOUTH DAKOTA. HONORABLE LORI S. WILBUR Judge.

DISPOSITION: Affirmed in part, reversed in part and remanded with instructions.

COUNSEL: MARK F. MARSHALL of Davenport, Evans, Hurwitz & Smith, Attorneys for petitioners and appellant. Sioux Falls, South Dakota.

SARA B. HARENS, Special Assistant Attorney General, S. D. Department of Revenue & Regulation Division of Insurance, Attorneys for respondent and appellee. Pierre, South Dakota and appellee.

JUDGES: ANDERSON, Lee D, Circuit Judge. GILBERTSON, Chief Justice (dissenting). ZELL, Circuit Judge, joins this dissent.

OPINION BY: [**198] ANDERSON

OPINION

ANDERSON, LEE D, Circuit Judge

[*P1] Dakota Truck Underwriters and Travelers Insufance Co. (Insurers) appeal from a circuit court order which dismissed Insurers' claims for reimbursement from the South Dakota Subsequent Injury Fund (SIF) because Insurers failed to file their claims within the applicable statute of limitations period. The court held that the doctrines of equitable estoppel and equitable tolling did not apply. Due to the unique history and circumstances of these subsequent injury claims, we hold that the doctrine

of equitable tolling applied [***2] to extend the claims filing period. Insurers' claims against SIF were timely filed. We affirm, in part, reverse, in part and remand for consideration of the merits of Insurers' claims.

BACKGROUND

[*P2] For many years prior to July 1, 1999, there was a South Dakota Subsequent Injury Fund. Employers/insurers that paid workers' compensation benefits to injured employees who had sustained prior injuries were entitled to file a claim for partial reimbursement against SIF. The fund was financed by employers paying an additional surcharge into the fund based upon their workers' compensation premiums. ¹

1 This Court reviewed the fund and its purpose in South Dakota SIF v. Homestake Mining, 1999 SD 159, 603 N.W.2d 527 and S.D. S.I.F. v. Heritage Mut. Ins. Co., 2002 SD 34, 641 N.W.2d 656.

[*P3] The statutes dealing with SIF and claims procedures were set forth in SDCL 62-4-34 et seq. The 1992 version of SDCL 62-4-34.1, which was in [***3] effect prior to July 1, 1999, provided in pertinent part:

Any claim against the subsequent injury fund shall be filed with the division of insurance within ninety days from the date of the final decision by the department [of Labor] that a compensable injury exists resulting in additional permanent partial or permanent total disability, or approval by the department of settlement between the parties. No claim may be filed prior to a decision or approval of settlement from the department.

method of reimbursement pursuant to § 62-4-34 in effect prior to July 1, 1999.

[*P4] The South Dakota Legislature repealed SDCL 62-4-34.1 in 1999. 1999 SD SessL ch 262 § 3. SDCL 62-4-34.7 was enacted to provide a process for resolving outstanding claims. 1999 SD SessL ch 262, § 1. It required such claims to be filed by June 30, 1999. SDCL 62-4-34.7 provided:

Administration of the subsequent injury fund by the Division of Insurance and reimbursement of complete and valid claims shall continue until approved, denied, or settled. Any claim for reimbursement from the subsequent injury fund shall be filed by June 30, 1999. Only those claims timely filed with the division [***4] by June 30, 1999, pursuant to the requirements of \S 62-4-34.1 in effect prior to July 1, 1999, and completed by October 1, 1999, pursuant to the requirements set forth in § 62-4-34.4 in effect prior to July 1, 1999, shall be eligible for reimbursement from the subsequent injury fund. Any claim timely filed by June 30, 1999, and completed by October 1, 1999, as set forth in this section, shall be approved or denied by the division pursuant to the requirements of §§ 62-4-34 to 62-4-36.3, inclusive, in effect prior to July 1, 1999. The [**199] division shall continue to make any necessary assessments pursuant to the requirements set forth in § 62-4-35 in effect prior to July 1, 1999, until all eligible claims completed as set forth in this section that are approved by the division or determined by the court to be eligible for reimbursement are paid, and until all matters in litigation concerning the subsequent injury fund are resolved. Any claim in matters being litigated concerning the subsequent injury fund is not eligible for interest or costs. Any remaining balance in the fund after [***5] all obligations of the fund have been satisfied shall be deposited in the general fund. Priority of payment shall be determined as of the date and time they are determined by the division to be complete and valid. No claim against the subsequent injury fund is vested until it is complete as set forth in this section. Any completed claim regardless of the date of injury or the date of notice of claim is subject to the two-thirds [*P5] Insurers in this case had eight potential claims arising out of injuries that had occurred prior to July 1, 1999. However, these claims were neither decided nor were their settlements approved by Department until between November 1, 1999 and December 22, 2000. During this time period, Insurers were aware of the June 30, 1999 deadline for filing claims under SDCL 62-4-34.7. Therefore, Insurers believed it to be a useless act to file claims with SIF after June 30, 1999.

[*P6] During 2000-2001 Homestake Mining v. Subsequent Injury Fund, 2002 SD 46, 644 N.W.2d 612 was making its way through the court system. [***6] The circuit court judge in that case ruled that the provisions of SDCL 62-4-34.7 and the former 62-4-34.1 worked to unconstitutionally deny Homestake of its right to receive a reimbursement from the fund. Id. 2002 SD 46 at P 6, 644 N.W.2d at 614. Nevertheless, the circuit court ruled the Homestake claims were untimely filed and granted summary judgment upholding the dismissal of the claims. The judgment was affirmed. Id., 2002 SD 46 at P 37, 644 N.W.2d at 622.

[*P7] During the 2001 legislative session, while the Homestake claims were being litigated in the circuit court, House Bill 1208 was passed extending the deadline for filing a timely claim with SIF. 2001 SD SessL ch 293 § 1. This legislation amended SDCL 62-4-34.7 and allowed claims to be filed for subsequent injuries that occurred before July 1, 2001. It removed the language from § 62-4-34.7 which allowed "only those claims timely filed with the division by June 30, 1999..." and stated in pertinent part:

Administration of the subsequent injury fund by the Division of Insurance and reimbursement [***7] of complete and valid claims shall continue until approved, denied, or settled. No claim for reimbursement from the subsequent injury fund may be filed based on a subsequent injury that occurs on or after July 1, 2001. Any claim for reimbursement filed as set forth in this section shall be approved or denied by the division pursuant to the requirements of \$\$ 62-4-34 to 62-4-36.3, inclusive, in effect prior to July 1, 1999.

[*P9] Insurers filed claims for reimbursement from SIF during September 2001, within ninety days of July 1, 2001.

[**200] FACTS AND PROCEDURE

[*P10] The facts and sequence of events concerning Insurers' claims are undisputed by either party. Insurers filed eight separate claims for reimbursement from SIF. ²

- 2 The eight individual claims are as follows:
 - 1. Dakota Truck Underwriters v. South Dakota Subsequent Injury Fund HF No. 110, 2001/2002 (Scott Harlan SIF 0798). The subsequent injury occurred on March 28, 1996 and Department approved settlement of appellant's claim on January 3, 2000. SIF received notice of the claim on September 6, 2001.
 - 2. Dakota Truck Underwriters v. South Dakota Subsequent Injury Fund HF No. 139, 2001/2002 (Langley Hughes SIF 0801). The injury occurred on March 27, 1998. Department approved settlement of appellant's claim on March 23, 2000. SIF received notice of the claim on September 6, 2001.
 - 3. Trail King West Plant v. South Dakota Subsequent Injury Fund HF No. 118 2001/2002 (Roxanne Fitzler SIF 0794). The injury occurred on January 15, 1998 and Department approved settlement of appellant's claim on January 26, 2000. SIF received notice of the claim on September 10, 2001.
 - 4. Trail King West Plant v. South Dakota Subsequent Injury Fund HF No. 165, 2001/2002 (Gilchrist SIF 0796). The injury occurred on September 1, 1994. The South Dakota Supreme Court determined a compensable injury

existed on May 24, 2000. SIF received notice of the claim on September 21, 2001.

- 5. Travelers Insurance Company v. South Dakota Subsequent Injury Fund HF No. 145, 2001/2002 (Gary Duschscherer SIF 0792). The injury occurred on August 10, 1998 and Department approved settlement of the appellant's claim on December 28, 2001.
- 6. Trail King West Plant v. South Dakota Subsequent Injury Fund HF No. 114, 2001/2002 (Buddy Pauley SIF 0817). The injury occurred on June 22, 1999 and Department approved settlement of the appellant's claim on February 10, 2000. SIF received notice of the claim on September 28, 2001.
- 7. Dakota Truck Underwriters v. South Dakota Subsequent Injury Fund HF No. 109 2001/2002 (Gregory Knapp SIF 0806). The injury occurred on September 19, 1996 and Department approved settlement of appellant's claim on February 7, 2000. SIF received notice of the claim on September 10, 2001.
- 8. Dakota Truck Underwriters v. South Dakota Subsequent Injury Fund HF No. 115 2001/2002 (Mary Jenkins SIF 0803). The injury occurred on April 26, 1999 and Department approved settlement of appellant's claim on November 1, 1999. SIF received notice of the claim on September 28, 2001.
- [***8] [*P11] This Court has consistently ruled that in workers' compensation cases the law in effect when the injury occurred governs the rights of the parties. S.D. S.I.F., 2002 SD 34, at P 3, 641 N.W.2d at 657. Accordingly, following the filing of the claims, Department ruled that the governing law in effect at the time of the subsequent injury controlled. Thus, Department ruled that Insurers were required to file their claims within ninety days of the approval of settlement or determina-

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tion of the employee's workers' compensation claims by Department. Department found that this did not occur and the claims were dismissed as being untimely.

[*P12] Insurers appealed Department's dismissal of the eight claims to circuit court. Insurers questioned whether Department correctly concluded that Insurers' claims for reimbursement against SIF were untimely filed. Insurers argued that equitable estoppel, equitable tolling, or both, should apply to relieve them of the effects of the law and allow the presentation of Insurers' claims.

[*P13] The circuit court held that the doctrine of equitable tolling did not apply to Insurers because the filing of their claims against SIF [***9] was not reasonable or in good faith. The court also held that the doctrine of equitable estoppel did not apply since there was neither false representation [**201] nor concealment of material facts. The circuit court held that Department properly dismissed Insurers' claims because they were untimely filed.

[*P14] The issue on appeal is whether the doctrines of equitable tolling or equitable estoppel applied to extend the period within which Insurers could file their claims with SIF.

STANDARD OF REVIEW

[*P15] This case turns on the application of the statute of limitations and interpretation of the effect of a statutory amendment, both questions of law. "Questions of law are reviewed de novo with no deference given to the conclusions of law of the circuit court." Homestake, 2002 SD 46 at P 12, 644 N.W.2d at 616. "Questions of law are subject to de novo review; no deference is given to an agency's conclusion of law." Enger v. FMC, 2000 SD 48, P7, 609 N.W.2d 132, 134. Further, this Court's review of the administrative agency's decision is unaided by any presumption that the circuit court's review of the agency's decision was correct. Interstate Tel. Co-op., Inc. v. PUC, 518 N.W.2d 749, 751 (SD 1994). [***10]

[*P16] This Court has not determined its standard of review for equitable tolling. We have, however, recognized that in reviewing the application of the doctrine of equitable estoppel, we are presented with a fully reviewable mixed question of law and fact. See Crouse v. Crouse, 1996 SD 95, P14, 552 N.W.2d 413, 417 (equitable estoppel is reviewed de novo). "Where relevant facts are undisputed and the district court denied equitable tolling as a matter of law, we review the district court's decision de novo." Rouse v. Lee, 339 F.3d 238, 247 (4th Cir 2003). We agree and hold that when the facts are undisputed, as they are here, we will apply a de novo standard of review to the applicability of equitable tolling.

ANALYSIS AND DECISION

1. Purpose of a Statute of Limitations

[*P17] SDCL 62-4-34.1 is a statute of limitations. S.D. S.I.F., 2002 SD 34 at P 3, 641 N.W.2d at 657. Traditionally, compliance with statutes of limitations is strictly required and doctrines of substantial compliance or equitable tolling are not invoked to alleviate a claimant from a loss of his right to proceed with a claim. See [***11] Peterson v. Hohm, 2000 SD 27, 607 N.W.2d 8. This principle finds justification in the rationale for creating statutes of limitations:

"the purpose of a statute of limitations is speedy and fair adjudication of the respective rights of the parties." State of Minn. v. Doese, 501 N.W.2d 366, 370 (SD 1993). See Jiricek v. Woonsocket Sch. Dist. #55-4, 489 N.W.2d 348, 350 (SD 1992); Merkwan v. Leckey, 376 N.W.2d 52, 53 (SD 1985); Burke v. Foss, 334 N.W.2d 861, 864 (SD 1983); Chipperfield v. Woessner, 84 SD 13, 14, 166 N.W.2d 727, 728 (1969). The trial court also noted that statutes of limitation have allowed people, through "legislative grace," to be "freed from the consequences of their actions after a statutory period of time resulting in peace of mind for the individual, less docket congestion, fewer administrative problems for the courts, and less work for law enforcement agencies. Stale claims are eliminated."

Peterson, 2000 SD 27, P 14, 607 N.W.2d 8 at 12.

[*P18] In most cases, this important principle underlining the statute of limitations is appropriately advanced [***12] by refusing to judicially modify the harsh effect imposed by a statute of limitations. Nevertheless, [**202] courts have recognized an exception in some instances under the doctrines of equitable tolling and equitable estoppel.

2. Equitable Tolling

[*P19] Equitable tolling is the doctrine under which a plaintiff may sue after the statutory time period has expired if he has been prevented from doing so due to inequitable circumstances. See Bailey v. Glover, 88 U.S. 342, 22 L. Ed. 636 (1874); Shempert v. Harwick Chemical Corp., 151 F.3d 793, 797 (8th Cir 1998).

[*P20] "As a general rule, equitable tolling is a remedy reserved for circumstances that are 'truly beyond the control of the plaintiff." Hill v. John Chezik Imports,

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869 F.2d 1122, 1124 (8th Cir 1989); see also Heideman v. PFL, Inc., 904 F.2d 1262, 1266 (8th Cir 1990); Lown v. Brimeyer, 956 F.2d 780, 782 (8th Cir 1992). The doctrine of equitable tolling should be applied where a party acts diligently, "only to find himself caught up in an arcane procedural snare." Warren v. Department of Army, 867 F.2d 1156, 1160 (8th Cir 1989).

[*P21] In the [***13] majority of reported decisions courts have been reluctant to apply equitable principles to relieve a party of the effect of the statute of limitations. In Klein v. Menke, 83 SD 511, 517, 162 N.W.2d 219, 222 (1968), a workers' compensation case, we noted that "we are aligned with those courts where 'the making or filing of a claim within the required time is jurisdictional . . . being an essential element of the right to compensation.' 100 CJS Workmen's Compensation § 468(2), pp 363, 364. Where the making or filing of a timely claim is jurisdictional it cannot be waived or avoided on equitable grounds such as by a waiver or an estoppel."

[*P22] In Klein, the claim was not filed until more than twenty two months after Klein had returned to his employment. The applicable statute required the claim to be filed within eighteen months. Klein argued that because he had been contacted by the insurer a number of times before the time for filing with the Industrial Commissioner had expired, the doctrine of equitable estoppel should apply. This Court disagreed, holding that the claimant had no justification for not making a timely claim; the facts did not support the finding [***14] of an estoppel.

[*P23] In Peterson, 2000 SD 27, 607 N.W.2d 8, we acknowledged the doctrine of equitable tolling, but held it did not apply under the facts of the case. In Peterson, we quoted with approval the North Dakota case Braaten v. Deere & Co., 1997 ND 202, 569 N.W.2d 563, 566 (ND 1997): "imprudent legal practice is not reasonable conduct and would not invoke equitable tolling." Both Peterson and Braatan involved similar facts where the plaintiffs sought to bring suits in federal courts only to have them dismissed because diversity jurisdiction was lacking. Even though plaintiffs' counsel were aware that the cases might be subject to dismissal by the federal courts, they let the statutes of limitation run in the respective state courts before attempting to file their claims in the state forums.

[*P24] For the doctrine of equitable tolling to apply, three things must be shown: "(a) a timely notice, (b) lack of prejudice to the defendant, and (c) reasonable and good-faith conduct on the part of the plaintiff." Peterson, 2000 SD 27 at P 16, 607 N.W.2d 8 at 13 (quoting Bragtan, 569 N.W.2d at 566).

[*P25] The [***15] circuit court below made no mention of the first two factors. It is not disputed, however, that Insurers timely filed their claims with SIF within ninety days of the legislature's curative legislation, which came into effect on July I, [**203] 2001. In addition, there is no basis to conclude that SIF would be prejudiced. Insurers' claims fall well within the scope of why SIF was initially created. SIF was created to "encourage employers to hire or retain disabled or handicapped workers." Sioux Falls Sch. Dist. v. South Dakota Subsequent Injury Fund, 504 N.W.2d 107 (SD 1993). Funding to cover the claims is readily available within SIF to pay the claims of Insurers and, if required, the legislature has provided for continuing assessments to cover such claims. SDCL 62-4-34.7.

[*P26] The circuit court's reasoning for not applying the doctrine of equitable tolling was that Insurers did not satisfy the third factor: reasonable and good faith conduct. The circuit court noted that Insurers had not filed the claims within ninety days of the determination or the approval of the settlements by Department. Instead, Insurers waited to file their claims with SIF [***16] within ninety days following the effective date of the 2001 legislation. The circuit court ruled that Insurers conduct in filing their claims against SIF was not reasonable and in good faith, and that therefore equitable tolling was not applicable.

[*P27] In considering whether Insurers acted reasonably and in good faith, Insurers were entitled to presume that the statute repealing the SIF in 1999 was constitutional and that the procedure barring vested but unripe claims was constitutional as well. See Hancock v. Juvenile Services Center, 2002 SD 69, P 11, 647 N.W.2d 722, 724. Insurers should not have had to file their claims just in case the legislature later would repeal a previous law eliminating their right to file claims. Lex non cogit ad inutilia: the law does not require a useless act. State ex rel. Strothers v. Murphy, 132 Ohio App. 3d 645, 725 N.E.2d 1185 (Ohio Ct. App. 1999).

[*P28] The conduct of Insurers in filing their claims is readily distinguishable from the conduct of the claimant/plaintiffs in *Klein, Peterson*, and *Braaten*. The circumstance which led to Insurers missing the filing deadline under the pre-1999 law was out of Insurers' hands. The [***17] July 1, 1999 cutoff for filing vested but unripe claims created a type of "arcane procedural snare" referred to in *Warren*, 867 F.2d at 1160.

[*P29] The circuit court erred in holding that Insurers' conduct was not reasonable and not in good faith. The purpose of SIF is to reimburse worthy claims of employers who had employed persons with prior injuries. As a result of the curative legislation of 2001 extending the claims period, the legislature intended to reimburse

vested claims. Any claims which would have been filed after the July 1, 1999 cutoff, and prior to July 1, 2001, would not have proceeded to payment prior to enactment of the 2001 amendment. Those claims would only be processed by SIF after July 1, 2001.

[*P30] Further observation of the theory behind statutes of limitations is set forth in *Burnett v. New York Central Railroad Co.*, 380 U.S. 424, 428, 85 S. Ct. 1050, 13 L. Ed. 2d 941 (1965):

Statutes of limitations are primarily designed to assure fairness to defendants. Such statutes "promote justice by preventing surprises through the revival of claims that have been allowed to slumber until evidence has been lost, memories have [***18] faded, and witnesses have disappeared. The theory is that even if one has a just claim it is unjust not to put the adversary on notice to defend within the period of limitation and that the right to be free of stale claims in time comes to prevail over the right to prosecute them." Order of Railroad Telegraphers v. Railway Express Agency, [**204] Inc., 321 U.S. 342, 348-349, 64 S. Ct. 582, 586, 88 L. Ed. 788. Moreover, the courts ought to be relieved of the burden of trying stale claims when a plaintiff has slept on his rights.

[*P31] In the case at bar, however, we are not dealing with plaintiffs who have slept on their rights or with burdening defendants with surprise or stale claims. *Id.* The unique circumstances which were presented to Insurers after July 1, 1999 together with the reinstatement of subsequent injury fund filings by the 2001 legislation, require the application of the doctrine of equitable tolling to extend the filing period for Insurers' claims for ninety days beyond July 1, 2001.

3 In Homestake, 2002 SD 46 at P12, 644 N.W.2d at 616, this Court ruled that the ninety day statute of limitations for filing claims against SIF, which existed under the pre-July 1, 1999 law, still applied once the new statute was found unconstitutional. This Court also ruled that after the limitations period had expired and Homestake had done nothing to preserve its claims during that time, the July 1, 2001 amendment would do nothing to revive the claim.

On appeal Homestake argued, among other points, that doctrines of equitable tolling and sub-

stantial compliance should apply to relieve them of the effects of the limitations period. This Court thereafter affirmed the circuit court, but declined to discuss or rule on the equitable tolling and substantial compliance issues because they were not properly presented to the circuit court.

Homestake is distinguishable. The equitable tolling doctrine was not preserved for consideration on appeal. In addition, Homestake's claims were never filed with SIF after the underlying employees' worker compensation claims had been settled or decided by Department.

[***19] 3. Equitable Estoppel

[*P32] The doctrine of equitable estoppel has four elements:

In order to constitute an equitable estoppel... representations or concealment of material facts must exist; the party to whom it was made must have been without knowledge of the real facts; the representations or concealment must have been made with the intention that it should be acted upon; and the party to whom it was made must have relied thereon to his prejudice or injury.

Cooper v. James, 2001 SD 59, P 16, 627 N.W.2d 784, 789. Estoppel cannot exist "if any of these essential elements are lacking, or if any of them have not been proved by clear and convincing evidence." Id. In application of this doctrine to public entities, equitable estoppel may only be used when an entity actively misled or deceived an individual with the intent to have the individual, or in this case, Insurers, alter their position to his detriment. Erickson v. County of Brookings, 1996 SD 1, P14-16, 541 N.W.2d 734, 737. There is no evidence of record to indicate any misconduct or misrepresentations by SIF. The circuit court did not err in ruling that equitable estoppel [***20] was not applicable.

CONCLUSION

[*P33] The doctrine of equitable tolling does apply to relieve Insurers of the effects of the statute of limitations under SDCL 62-4-34.1. Therefore Insurers' claims against SIF must be allowed to proceed as timely filed.

Application of the state of the

[*P34] The order is affirmed, in part, reversed, in part, and remanded for consideration of the merits of Insurers' claims.

[*P35] ANDERSON, Lee, Circuit Judge for SA-BERS, Justice, disqualified.

[*P36] ZELL, Circuit Judge for ZINTER, Justice, disqualified.

[*P37] KONENKAMP and MEIERHENRY, Justices, concur.

DISSENT BY: [*P38] GILBERTSON and ZELL

DISSENT

[**205] GILBERTSON, Chief Justice (dissenting).

[*P39] I respectfully dissent. I would affirm the Department of Labor decision, as I agree that neither equitable tolling nor equitable estoppel allow the resurrection of Insurer's claims.

[*P40] I agree with the Court that the issues in this case turn on the application of the statute of limitations and interpretation of the effect of a statutory amendment. Homestake Mining Co. v. South Dakota Subsequent Injury Fund, 2002 SD 46, P12, 644 N.W.2d 612, 616. As such, both applications are reviewed by this [***21] Court de novo giving no deference to the circuit court's conclusions of law, Id.

[*P41] As this Court has often stated, "the purpose of a statute of limitations is speedy and fair adjudication of the respective rights of the parties." Peterson v. Hohm, 2000 SD 27, P14, 607 N.W.2d 8, 12 (quoting Minn. v. Doese, 501 N.W.2d 366, 370 (SD 1993)) (citing Jiricek v. Woonsocket Sch. Dist. #55-4, 489 N.W.2d 348, 350 (SD 1992); Merkwan v. Leckey, 376 N.W.2d 52, 53 (SD 1985); Burke v. Foss, 334 N.W.2d 861, 864 (SD 1983); Chipperfield v. Woessner, 84 SD 13, 14, 166 N.W.2d 727, 728 (1969)). The statute of limitations in workers compensation cases is jurisdictional in nature, as making a timely claim is an essential element of the right to compensation. Klein v. Menke, 83 SD 511, 517, 162 N.W.2d 219, 222 (1968) (citation omitted).

[*P42] It is a "well established principle that statutes of limitation applicable to suits [or claims] against the government are conditions attached to the sovereign's consent to be sued and must be strictly construed." Kraiger v. United States, 539 F.2d 317, 320 (3rd Cir 1976) [***22] (citing Soriano v. United States, 352 U.S. 270, 276, 77 S. Ct. 269, 273, 1 L. Ed. 2d 306, 311 (1957) (holding statute of limitations should not be equitably tolled for taxpayer who filed a refund claim after the applicable statute of limitations). The United States Supreme Court has stated that the remedy of equitable

tolling should be applied "sparingly" when the government is the defendant and extends no further than its use for claims between private litigants. Irwin v. Dept. of Veterans Affairs, 498 U.S. 89, 96, 111 S. Ct. 453, 457, 112 L. Ed. 2d 435, 444 (1990). Equitable tolling has been upheld by that Court in just two instances: when a defendant has filed a defective pleading within the statutory period, or where the plaintiff was induced or tricked by the defendant's conduct into allowing the statute of limitations to expire. Irwin, 498 U.S. at 96, 111 S. Ct. at 457-58. The doctrine has never been applied to a "garden variety claim of excusable neglect." Id.

[*P43] Despite the favor with which statute of limitations defenses are met in the courts, an additional exception to their harsh outcome may be appropriate when a plaintiff [***23] acts "with 'utmost diligence,' only to find himself caught up in an arcane procedural snare." Warren v. Department of Army, 867 F.2d 1156, 1160 (8th Cir 1989). In Warren, the pro se plaintiff filed his complaint within the time requirements of the applicable statute of limitations, but due to confusing language in the procedures provided to the plaintiff by the government, the plaintiff did not name the correct government official as the defendant. Id. at 1157-38. The case was dismissed by the lower court, but reversed by the Eighth Circuit using the doctrine of equitable tolling. Id. at 1160-61. That court was careful to note that Warren was not a case of imprudent legal practice, but rather confusion on the part of a pro se plaintiff created by the government itself. Id.

[*P44] Imprudent legal practice is not reasonable conduct sufficient to invoke equitable [**206] tolling. Peterson, 2000 SD 27, P16, 607 N.W.2d at 13 (quoting Braaten v. Deere & Company, 1997 ND 202, 569 N.W.2d 563, 564 (ND 1997). When the doctrine has been applied in favor of the plaintiff in South Dakota, the plaintiff has been victimized by [***24] active, fraudulent conduct on the part of the defendant. See Smith v. Neville, 539 N.W.2d 679, 682 (SD 1995) (holding equitable tolling applied when state and state's insurance adjuster engaged in affirmative conduct that would have led a reasonable person to believe the state had received timely notice of the claim).

[*P45] I agree with the US Supreme Court that the doctrine should apply no further when the defendant is the government than when the defendant is a private litigant. Without active fraud or concealment on the part of the government, the doctrine of equitable tolling should not act to subvert the clear intent of the legislature when enacting a statute of limitations.

[*P46] Insurers in the present case fall outside the two situations in which the US Supreme Court has employed the doctrine of equitable tolling. Insurers did not

2004 SD 120, *; 689 N.W.2d 196, **; 2004 S.D. LEXIS 191, ***

timely file within the 90-day period as required by the pre-1999 version of SDCL 62-4-34.1. Nor did the government engage in any deceptive conduct to trick Insurers into missing the statute of limitations. Despite the absence of fraudulent or active conduct on the part of SIF, the Court focused on [***25] the diligence of the Insurers.

[*P47] I fail to see how Insurers acted with the "utmost diligence" in the present case. In their brief, Insurers make much of the background of the two claims examiners involved in the eight claims at issue, and their reliance on copies of the South Dakota code provided by their employer, Risk Administration Services. (Appellant Br. at 14). One clerk was a high school graduate, and the other had an associate degree. Id. Insurers would have this Court believe that "utmost diligence" for Risk Administration and Insurers amounted to two hardworking employees, without legal training, determining how to interpret revisions to SDCL 62-4-34.7. For the term "utmost diligence" to have any meaning in this context, Insurers must have at the very least had legal counsel attempt to discern the correct course of action with regard to the SIF claims. This, Insurers failed to do and now wish to assert that they acted with "utmost diligence" in attempting to process their SIF claims.

[*P48] Insurers' conduct at best approaches the level of "garden variety excusable neglect" held insufficient to invoke equitable tolling in *Irwin* [***26], and at worst a complete failure to obtain legal advice on how to process SIF claims given the changes in the statutory scheme. More importantly, there was no active conduct

on the part of the government to induce Insurers into missing the 90-day filing deadline, an essential element necessary to invoke equitable tolling.

[*P49] I agree that there was no way for Insurers to know how our decision in Homestake Mining Co. v. South Dakota Second Injury Fund, 2002 SD 46, 644 N.W.2d 612, would re-open the door for SIF claims. But in Homestake, the plaintiffs were without remedy for failure to adhere to the statute of limitations contained in SDCL 62-4-34.1. We cannot now judicially legislate a remedy for Insurers given their failure to adequately investigate and comply with the same provisions in SDCL 62-4-34.1 that cost Homestake its opportunity to recover from the SIF.

4 In Homestake Mining Co. v. South Dakota Second Injury Fund, this Court held that statute of limitations for SIF claims in effect at the time of the injury, not at the time the claim arose, applied. 2002 SD 46, 644 N.W.2d 612.

[***27] [*P50] [**207] While the outcome may seem harsh to Dakota Truck Underwriters, the Department correctly applied the provisions of SDCL 62-4-34.1 to Insurers' claims. For the above reasons I would affirm the trial court's and therefore respectfully dissent.

5 I agree with the Court that the equitable estoppel issue is without merit.

[*P51] ZELL, Circuit Judge, joins this dissent.

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715 N.W.2d 577 715 N.W.2d 577, 2006 SD 47 (Cite as: 715 N.W.2d 577)

> Supreme Court of South Dakota. Marvin J. HALLS, Plaintiff and Appellant,

Jerry A. WHITE and Janet D. White, Defendants and Appellees. Nos. 23683, 23708.

> Argued on Feb. 14, 2006. Decided May 24, 2006. Rehearing Denied June 28, 2006.

Background: Resident of housing development sought a permanent injunction against neighbors, seeking to enforce a restrictive covenant against mobile homes. The Seventh Judicial Circuit Court, Fall River County, Janine M. Kern, J., denied resident's request for permanent injunction. Resident appealed.

Holdings: The Supreme Court, Meierhenry, J., held

(1) manufactured home fell within restrictive covenant's prohibition on using a mobile home as a residence, and thus resident was entitled to a permanent injunction, and

(2) resident purged himself of unclean hands and, thus, was not precluded from seeking injunctive re-

Affirmed in part, reversed in part and remanded.

West Headnotes

[1] Injunction 🖘 1 212k1 Most Cited Cases

Granting or denying an injunction rests in the sound discretion of the trial court.

[2] Appeal and Error 5 946 30k946 Most Cited Cases

[2] Appeal and Error \$\infty\$954(i) 30k954(1) Most Cited Cases

Appellate court will not disturb a ruling on injunctive

relief unless it finds an abuse of discretion; an "abuse of discretion" can simply be an error of law or it might denote a discretion exercised to an unjustified purpose, against reason and evidence.

[3] Appeal and Error \$\infty\$842(2) 30k842(2) Most Cited Cases

[3] Appeal and Error 1024.2

30k1024.2 Most Cited Cases

In reviewing trial court's decision regarding injunctive relief, appellate court reviews the trial court's findings of fact under a clearly erroneous standard, but gives no deference to the trial court's conclusions of law.

[4] Appeal and Error \$\operator\$893(1)

30k893(1) Most Cited Cases

Interpretation of a covenant is a legal question which appellate court reviews de novo.

[5] Appeal and Error \$\infty\$ 949

30k949 Most Cited Cases

Equitable determinations are reviewed only for abuse of discretion.

[6] Covenants \$\infty\$ 69(1) 108k69(1) Most Cited Cases

[6] Injunction \$\infty\$62(1)

212k62(1) Most Cited Cases

Manufactured home fell within restrictive covenant's prohibition on using a "mobile home" as a residence in housing development, and thus resident of housing development was entitled to a permanent injunction against neighbors who sought to move a mobile home onto their lot; term "manufactured home" replaced the term "mobile home" in modern parlance.

[7] Covenants \$\infty\$=49

108k49 Most Cited Cases

When interpreting the terms of a restrictive covenant, courts use the same rules of construction applicable to contract interpretation.

[8] Contracts \$\infty\$ 143(2) 95k143(2) Most Cited Cases

A contractual term is ambiguous if it is reasonably capable of being understood in more than one sense.

[9] Covenants 21

108k21 Most Cited Cases

A covenant is ambiguous if there is genuine uncertainty-as-to-which of two or more meanings is correct.

[10] Covenants 21

108k21 Most Cited Cases

A finding of ambiguity in a covenant requires more than the disagreement of two parties as to the meaning of a term.

[11] Covenants 21

108k21 Most Cited Cases

Failure to define a term in a covenant does not automatically create ambiguity.

[12] Covenants —49

108k49 Most Cited Cases

Guidance as to the plain and ordinary meaning of a term in a restrictive covenant may come from statutory definitions.

[13] Covenants 21

108k21 Most Cited Cases

Plain, ordinary meaning of a term in a covenant may be gleaned from statutory definitions.

[14] Equity \$\infty\$ 65(1)

150k65(1) Most Cited Cases

Resident of housing development who had temporarily placed a motor home on his lot, in violation of restrictive covenant, purged himself of unclean hands and, thus, was not precluded from seeking injunctive relief against neighbors who sought to move a mobile home onto their lot; resident's offensive act was committed and remedied long before issue in this case arose.

[15] Appeal and Error €---949

30k949 Most Cited Cases

Trial court's determination that litigant purged himself of unclean hands would be reviewed under an abuse of discretion standard.

[16] Equity € 65(1)

150k65(1) Most Cited Cases

"Doctrine of unclean hands" requires that a party seeking equity must act fairly and in good faith.

*578 Patrick M. Ginsbach, Heather M. Sudbeck of Farrell, Farrell and Ginsbach, Hot Springs, South Dakota, for plaintiff and appellant.

<u>Timothy L. Thomas</u> of Thomas, Nooney, Braun, Solay & Bernard, LLP, Rapid City, South Dakota, for defendants and appellees.

MEIERHENRY, Justice.

[¶ 1.] Marvin J. Halls (Halls) sought a permanent injunction against Jerry and Janet White (Whites) to enforce a restrictive covenant prohibiting the use of a mobile home as a temporary or permanent residence in a housing development. Whites claimed that the covenants do not prohibit moving a "manufactured home" onto their lot because the definition of "mobile home" is different from and does not include "manufactured home." Whites also claimed that Halls should be denied equitable relief because of unclean hands. Based on the evidence, the trial court found Halls could seek equitable relief; however, the court denied the relief. The court determined that the definition of "mobile home" as used in the restrictive covenant did not preclude Whites from placing their manufactured home on the lot. We affirm the trial court's determination that Halls could seek injunctive relief, but we reverse the denial of the permanent injunction.

FACTS

[¶ 2.] Gary and Meredith Shelstead established the Pine Haven development in 1974 along with Malon and Katherine Anderson. Pine Haven included twenty lots which were subject to certain covenants and restrictions running with the *579 land. [FN1] On November 29, 2004, Whites, as buyers, and Gary and Meredith Shelstead, as sellers, signed a purchase agreement for a Pine Haven lot. Whites' offer, however, was contingent on whether they would be allowed to place a manufactured home on the lot. Gary Shelstead (Shelstead) agreed to that contingency.

<u>FN1</u>. The covenants, which were recorded in 1976, included 17 numbered provisions preceded by a preamble. Whites' structure did

> not violate any of the other provisions. The preamble declares that the purpose of the covenants was for "enhancing and protecting the value, desirability, and attractiveness of the lands and every part thereof." Other restrictions limited certain lots to single family units not exceeding two stories, garages were limited to housing no more than three cars, either attached or separate. Storage and pet structures were allowed on the lots. Total structures were limited to four per lot, including the dwelling. A one-story dwelling had to measure at least 1300 square feet; a two story dwelling had to be at least 1500 square feet. Placement of the family dwelling had to be on concrete or cement block foundation and had to be a minimum 24 feet long. Horses, cows and sheep were allowed on each home site, "but no more than three animals [] allowed on any one lot," unless the animals were 4-H or FFA projects and cared for properly. Swine, unless kept as 4-H or FFA project, and poultry, kennels, billy goats or boarded horses were not allowed. All lots with large animals had to be fenced to comply with SDCL 43-23-4. Other provisions involved set backs, garbage disposal, sewage disposal and culverts. The provisions ran with the land and "were binding on all parties and all persons claiming under them for a period of thirty years from the date the[] covenants [were] recorded." After thirty years, covenants would be "automatically extended for successive periods of ten years unless an instrument signed by a majority of the then owners of the lots had[] been recorded, agreeing to change said covenants in whole or in part."

[¶ 3.] Whites closed on the property in early 2005. Shortly thereafter they began the process of moving the home onto the lot. This prompted Halls, a resident of Pine Haven, to seek injunctive relief against Whites. Halls sought to enforce the Pine Haven dovenants' restriction against mobile homes. Halls claimed that Whites' manufactured home fell within the "mobile home" restriction of the covenants. The trial court granted a temporary restraining order in Halls' favor. After a hearing, however, the trial court

dissolved the temporary restraining order and denied Halls' request for a permanent injunction. Halls appeals that determination and presents for review the following issue:

Whether the trial court erred in holding that the Pine Haven covenants allowed Whites to place a manufactured home on their lot.

STANDARD OF REVIEW

[1][2][3][4][5] [¶ 4.] Our review of a trial court's decision regarding injunctive relief is well established:

Granting or denying an injunction rests in the sound discretion of the trial court. We will not disturb a ruling on injunctive relief unless we find an abuse of discretion. An abuse of discretion can simply be an error of law or it might denote a discretion exercised to an unjustified purpose, against reason and evidence.

Hendrickson v. Wagners. Inc., 1999 SD 74, ¶ 14, 598 N.W.2d 507, 510-11 (quoting Knodel v. Kassel Twp., 1998 SD 73, ¶ 6, 581 N.W.2d 504, 506) (citations omitted). In doing so, we review the trial court's findings of fact under a clearly erroneous standard, but we give no deference to the trial court's conclusions of law. Id. ¶ 9, 598 N.W.2d at 509 (citations omitted). The interpretation of a covenant is a legal question which we review de novo. Harksen v. Peska, 1998 SD 70, ¶ 11, 581 N.W.2d 170, 173. Equitable determinations, however, *580 are reviewed only for abuse of discretion. Adrian v. McKinnie, 2002 SD 10, ¶ 9, 639 N.W.2d 529, 533.

DECISION

Applicability of Covenants to Whites' Manufactured Home

[6] [¶ 5.] The covenant provision at issue is entitled, "Mobile Homes, Trailers and Basement Houses Prohibited." It provides:

No mobile home or trailer or basement house shall be used as a residence at any time, either temporary or permanent, on any of the lots in the above described subdivision. No mobile homes, excepting utility or camping trailers, may be stored on any lot.

The trial court found ambiguity in the term "mobile home" because it was not defined elsewhere in the covenants. Consequently, the trial court looked be-

yond the document to the statutory definitions of "mobile home" and "manufactured home." In addition, the trial court considered Shelstead's intent when drafting the covenants as well as testimony from realtors and contractors. Shelstead testified that he used the term "mobile homes" to mean pull-behind campers and self-contained motor homes. Construing the restrictive covenant strictly in favor of free use of property, the trial court concluded that covenants did not apply to Whites' "manufactured home." [FN2]

FN2. Whites' home clearly falls within the definition of "manufactured statutory home." See infra ¶ 12. It consisted of two 14-feet-wide sections which were 72 feet long. Those sections were built on permanent chassis and they included plumbing, heating, air conditioning, and electrical systems. Once erected on Whites' Pine Haven lot, the home consisted of 1989 square feet. The mechanisms used to haul the home to Pine Haven, including the wheels and the axels, were not included in the purchase price and were removed once the home was placed on its foundation, which consisted of concrete block footings and concrete piers. All the documentation concerning Whites' home refers to it as a "manufactured home."

[¶ 6.] Halls claims that the trial court erred in finding ambiguity in the term "mobile home" and should have applied the ordinary meaning set out in the South Dakota statutes in effect at the time the covenants were written in 1976. Alternatively, Halls argues that if the term is found ambiguous, it should be construed against the preparer and in favor of the testimony of several witnesses who testified that the commonly accepted definition of "mobile home" was the 1976 statutory definition. Under either scenario, Halls maintains that Whites' manufactured home falls within the covenant's prohibition of using a "mobile home" as a residence and that our decisions in Farnam v. Evans, 306 N.W.2d 228 (S.D.1981), and Waughn v. Eggleston, 334 N.W.2d 870 (S.D.1983), control.

[7][8][9][10] [¶ 7.] When interpreting the terms of a restrictive covenant, we use the same rules of construction applicable to contract interpretation. See

Harksen, 1998 SD 70, ¶ 11-20, 581 N.W.2d at 173-74. A term is ambiguous if it is reasonably capable of being understood in more than one sense. Piechowski v. Case, 255 N.W.2d 72, 74 (S.D.1977). Thus, a covenant is ambiguous if we have "a genuine uncertainty as to which of two or more meanings is correct." Harksen, 1998 SD 70, ¶ 15, 581 N.W.2d at 173 (citation omitted). A finding of ambiguity, however, requires more than the disagreement of two parties as to the meaning of a term. Id. (citation omitted). We have said, "[u]nder the Plain Meaning Rule, if a term 'appears to be plain and unambiguous on its face, its meaning must be determined *581 from the four corners of the instrument without resort to extrinsic evidence of any nature.' " Id. (citation omitted).

[11][12][13] [¶ 8.] The provision in the covenant clearly prohibits using a mobile home as a residence. It specifies that "[n]o mobile home ... shall be used as a residence at any time, either temporary or permanent, on any of the lots in the above described subdivision." Because the term "mobile home" was not defined in the covenant, the trial court determined the term was ambiguous. Failure to define a term in a covenant, however, does not automatically create ambiguity. We have said that a term is not ambiguous if "the term ... has a plain and ordinary meaning and that meaning can be defined." Spring Brook Acres Water Users Ass'n, Inc. v. George, 505 N.W.2d 778, 780 (S.D.1993). Guidance as to the plain and ordinary meaning of a term in a restrictive covenant may come from statutory definitions. Cf. Divich v. Divich. 2002 SD 24, ¶¶ 12-13, 640 N.W.2d 758, 762 (relying on the statutory definition of "benefit" in determining that the term had a plain and ordinary meaning as used in a divorce stipulation). Other courts have relied upon statutory definitions to determine the plain and ordinary meaning of an undefined word in a restrictive covenant. See, e.g., Adult Group Props., Ltd. v. Imler, 505 N.E.2d 459, 465-66 (Ind.Ct.App.1987) (considering definitions from case law, statutes, and a legal dictionary when interpreting the term "family" in a restrictive covenant); Newman v. Wittmer, 277 Mont. 1, 8-9, 917 P.2d 926, 930-31 (1996) (determining that a sentence in a restrictive covenant which prohibited mobile homes to be used as a residence was not ambiguous); Hill v. Cmty. of Damien, 121 N.M. 353, 359-60, 911 P.2d 861, 867-68 (1996) (considering the definition of "family" in zoning or-

dinances when interpreting that undefined term in a restrictive covenant); <u>LuMac Dev. Corp. v. Buck Point Ltd. P'ship.</u> 61 Ohio App.3d 558, 573 N.E.2d 681. 685-86 (1988) (consulting the statutory definition of "house trailer" which existed when covenants were drafted in order to determine if a "manufactured home" constituted a "house trailer" under restrictive covenants). Thus, the plain, ordinary meaning of a term in a covenant may be gleaned from statutory definitions. Consequently, we turn our attention to the term, "mobile home," as established by South Dakota and federal law.

[¶ 9.] At the time the Pine Haven covenants were drafted, South Dakota law defined the term "mobile home." See Farnam, 306 N.W.2d at 229-30 (setting forth the statutory definition of "mobile home"). The term first appeared in South Dakota law in 1973. At that time, the statutory definition provided:

"Mobile home," a moveable or portable unit, designed and constructed to be towed on its own chassis (comprised of frame and wheels), and designed to be connected to utilities for year-round occupancy. The term shall include: (a) units containing parts that may be folded, collapsed or telescoped when being towed and that may be expanded to provide additional cubic capacity; and (b) units composed of two or more separately towable components designed to be joined into one integral unit capable of being separated again into the components for repeated towing. The term shall include units designed to be used for residential, commercial, educational or industrial purposes, excluding however, recreational vehicles as defined in this Act.

1973 SD Laws ch. 216, § 1. The "Act" referred to in the statute defining "mobile home" is the South Dakota Mobile Home Safety Act, 1973 SD Laws ch. 216. Along *582 with defining "mobile home," the South Dakota Mobile Home Safety Act established safety guidelines applicable to the sale or rental of mobile homes in South Dakota. See 1973 SD Laws ch. 216, §§ 2-16. The state agency then known as the Department of Commerce and Consumer Affairs was responsible for administering those guidelines. See id. The Mobile Home Safety Act was codified in Chapter 34-34A of the South Dakota Codified Laws.

[¶ 10.] One year after South Dakota adopted mobile

home safety standards, the federal government did the same. As a part of the Housing and Community Development Act of 1974, Congress enacted the National Mobile Home Construction and Safety Standards Act of 1974, which sought "to reduce the number of personal injuries and deaths and the amount of insurance costs and property damage resulting from mobile home accidents and to improve the quality and durability of mobile homes" by establishing "federal construction and safety standards for mobile homes" and authorizing "mobile home safety research and development." Housing & Community Development Act of 1974, Pub.L. No. 93-383, §§ 601-02, 88 Stat. 633 (1974) (codified at 42 USC 5401). Like the South Dakota enactment, the federal act provided a definition of mobile home:

"Mobile home" means a structure, transportable in one or more sections, which is eight body feet or more in width and is thirty-two body feet or more in length, and which is built on a permanent chassis and designed to be used as a dwelling with or without a permanent foundation when connected to the required utilities, and includes the plumbing, heating, air-conditioning, and electrical systems contained therein.

Id. § 603(6) (codified at 42 USC 5402). Neither the South Dakota Mobile Home Safety Act nor the National Mobile Home Construction and Safety Standards Act of 1974 contained a definition of the term "manufactured home."

[¶ 11.] In 1980, however, Congress amended the National Mobile Home Construction and Safety Standards Act of 1974 so as to change all uses of the term "mobile home" to "manufactured home." Housing and Community Development Act of 1980, Pub.L. No. 96-399, § 308(c)(4)-(5). Thus, the definition of "mobile home" established by Congress in 1974 became the definition of "manufactured home," and the federal standards ceased to refer to "mobile home." The Conference Report of the United States House of Representatives recognized the name change when it stated that "[i]t is expected that for a reasonably brief transition period the term 'mobile home' may have to be used interchangeably with the term 'manufactured home.' " HR Conf. Rep. No. 96-1420, at 129 (1980), reprinted in 1980 USCCAN 3617, 3674.

[¶ 12.] South Dakota followed suit in 1982. That year the Legislature deleted the definition of "mobile home" from SDCL 34-34A-1 and added a definition of "manufactured home." 1982 SD Laws ch. 361, § 1. The definition of "manufactured home" reflected the definition provided by federal law for the same term-that is, the federal definition which previously applied to "mobile home." See id. In relevant part, the 1982 enactment provided that as used in Chapter 34-34A, the terms "manufactured home" and "home" mean:

[A] structure, transportable in one or more sections, which is eight body feet or more in width or forty body feet or more in length in the traveling mode, or is three hundred twenty or more square feet when erected on a site; which is built on a permanent chassis and designed *583 to be used as a dwelling, with or without a permanent foundation, when connected to the required utilities; and which contains the plumbing, heating, air conditioning and electrical systems therein. The term includes any structure which meets all the requirements of this subdivision and any other structure which has been certified by the secretary of housing and urban development.

1982 SD Laws ch. 267, § 1. Significantly, the session law which amended SDCL 34-34A-1 was titled, "An act to revise mobile home safety requirements in accordance with the national manufactured housing construction and safety standards program." 1982 SD Laws ch. 267 (emphasis added): In 1990, the definition of "manufactured home" was moved to SDCL 34-34A-1.1. The changes made in 1990 are still in effect today, and the statute currently provides:

A manufactured home is a structure that meets the following requirements:

- (1) It is transportable in one or more sections:
- (2) Its body is eight or more feet wide or forty or more feet long in the traveling mode or it occupies three hundred twenty or more square feet when erected on a site;
- (3) It is built on a permanent chassis;
- (4) It is designed to be used as a dwelling with or without a permanent foundation when it is connected to the required utilities.

 The term includes the plumbing, heating, air condi-
- The term includes the plumbing, heating, air conditioning, and electrical systems contained in the 'structure. The term also includes any structure that meets all of the requirements of this section except the size requirements and for which the manufac-

turer voluntarily files a certification required by the secretary and complies with the standards established under [Chapter 34-34A].

SDCL 34-34A-1.1. [FN3] Thus, the structure formally referred to as a "mobile home," in effect, was renamed "manufactured home."

<u>FN3.</u> The same definition of "manufactured home" exists in the motor vehicle licensing statutes at <u>SDCL 32-3-1(6)</u>.

[¶ 13.] Several other courts have also noted the evolution of the terms "house trailer," "mobile home," and "manufactured home" when considering the meaning of those terms. See, e.g., White v. McGowen, 222 S.W.3d 187, ---, 2006 WL 62131 (Ark.2006); Wilmoth v. Wilcox, 734 S.W.2d 656, 658 (Tex.1987); Carr v. Michael Motors, Inc., 210 W.Va. 240, 246-47, 557 S.E.2d 294, 300-01 (2001). As one court stated,

[T]he term "house trailer" acquired an undesirable connotation resulting in a concerted effort by the industry to change its image. In the late 1960's the term "mobile home" began to replace the term "house trailer." In the late 1970's the industry applied the term "manufactured home" to the products, replacing the name "mobile home."

Wilmoth, 734 S.W.2d at 658. Another court stated,
"We use the term 'mobile home' interchangeably
with the term 'manufactured home,' while acknowledging that the construction of mobile homes
has improved greatly over the past thirty years.
However ... 'Even though mobile homes have a
more pejorative connotation than manufactured
housing, it is merely a rose by another name.'"

McCollum v. City of Berea, 53 S.W.3d 106, 107 n. 1 (Ky.Ct.App.2000).

[¶ 14.] The evolution of the term "mobile home" is instructive in this case. It *584 appears, as other courts have pointed out, that the term "manufactured home" has replaced the term "mobile home" in modern parlance. "Mobile home," as defined in South Dakota in 1976, included "a moveable or portable [residential] unit, designed and constructed to be towed on its own chassis (comprised of frame and wheels), and designed to be connected to utilities for year-round occupancy." See Farnam, 306 N.W.2d at 229-30. It included "units composed of two or more

separately towable components designed to be joined into one integral unit capable of being separated again into the components for repeated towing." See id. The definition of "manufactured home" in the current statute is very similar. See SDCL 34-34A-1.1. A "manufactured home" is a dwelling structure that "is transportable in one or more sections" "is built on a permanent chassis," contains "the plumbing, heating, air conditioning, and electrical systems," and is "designed to be used as a dwelling with or without a permanent foundation when it is connected to the required utilities." SDCL 34-34A-1.1. The Pine Haven covenants clearly sought to exclude "mobile homes." In light of the evolution of the term, we are convinced that the plain, ordinary meaning of "mobile home" as used in the restrictive covenant now includes "manufactured homes."

[¶ 15.] Whites argue, however, that their home is not a "mobile home" because that term maintains a meaning separate from "manufactured home" under South Dakota law. While Whites are correct that the term "mobile home" still appears in other sections of the South Dakota code, it no longer appears in the section of the law which sets forth the safety standards applicable to such homes, SDCL Chapter 34-34A, [FN4] In fact, for a period of time the term was completely removed from the statutes. In 1982, the term "mobile home" and its definition in Chapter 34-34A were replaced by the term "manufactured home" and its definition under federal law. In 1985, an act by the Legislature to correct minor errors and inconsistencies reinserted the definition of "mobile home" into SDCL 34-34A-1. 1985 SD Laws ch. 15, § 42. In 1990, however, that definition was again removed. 1990 SD Laws ch. 278 (entitled "An act to revise provisions relating to manufactured homes and to provide for the promulgation of certain rules"). Since 1990, the term "mobile home" has not appeared in Chapter 34-34A.

FN4. Currently, the definition of "mobile home" appears in two places in the code, both of which lie within the motor vehicle statutes, Title 32. See SDCL 32-3-1; SDCL 32-7A-1. It appears in SDCL 32-3-1(8) and provides the definition of "mobile home" for purposes of chapter 32-3 (Title Registration, Liens and Transfers), chapter 32-3A (Title,

Registration and Taxation of Boats), chapter 32-4 (Theft and Misappropriation of Vehicles), chapter 32-5 (Annual Registration and License Plates), chapter 32-5A (County Wheel Tax), and chapter 32-5B (Excise Tax on Motor Vehicles). Additionally, it appears in SDCL 32-7A-1(5) and provides the definition of "mobile home" for purposes of chapter 32-7A (Dealers and Manufacturers of Manufactured Homes and Mobile Homes).

[¶ 16.] Even if we were to look to the current statutory definition of "mobile home" in the motor vehicle statutes, we cannot say that Whites' manufactured home falls outside that definition. The characteristics of Whites' home are virtually indistinguishable from the home at issue in <u>Farnam</u>, which we found to fall within the original definition of "mobile home." See 306 N.W.2d at 229-30. It therefore follows that the covenants preclude the placement of Whites' manufactured home on the Pine Haven lot. The trial court's ruling to the contrary was in error.

Unclean Hands

[14][15] [¶ 17.] Whites argued to the trial court that Halls was not entitled to *585 injunctive relief because of the doctrine of unclean hands. They claimed that Halls breached the covenants when he placed a mobile home on his lot during construction of his current home. The trial court determined that Halls purged himself of unclean hands. We review the trial court's determination under an abuse of discretion standard. Adrian. 2002 SD 10. ¶ 9, 639 N.W.2d at 533. Under the facts of this case, we cannot say that the trial court abused its discretion.

[16] [¶ 18.] We have recognized the doctrine of unclean hands which requires that "[a] party seeking equity must act fairly and in good faith." Action Mech., Inc. v. Deadwood Historic Pres. Comm'n, 2002 SD 121, ¶ 26, 652 N.W.2d 742, 751. In the same vein, we have stated that "the right to enforce restrictive covenants may be lost." Vaughn, 334 N.W.2d at 873. None of our cases, however, consider whether unclean hands have been purged. Under that concept, "[i]f a person guilty of unconscionable or wrongful conduct purges himself or herself by ade-

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(Cite as: 715 N.W.2d 577)

quate and effective renunciation and repudiation, the right to relief will be restored." 27A Am. Jur. 2d Equity § 135; see also Beavers v. Walters, 537 N.W.2d 647, 651 (N.D.1995) (stating that "one who purges himself of his wrongdoing will have his right to relief restored" and finding that parties purged themselves of wrongdoing when they reached a settlement with another party).

[¶ 19.] The only discoverable case which applies this doctrine in the context of restrictive covenants is Stewart Jackson, 635 N.E.2d (Ind.Ct.App.1994). In that case, the plaintiffs sought to preclude their neighbors from operating a home day care by invoking covenants barring both nonresidential and commercial uses of property. Id. at 188. The plaintiffs had previously operated two businesses in their home, and they admitted doing so violated the covenants. Id. at 188-89. The court found, however, that the plaintiffs purged their wrongdoing by ceasing business operations in their home. Id. at 190.

[¶ 20.] In this case, Halls admitted that he placed a motor home on his Pine Haven lot on a temporary basis, and he testified that his adjoining landowners agreed to his action. Halls admitted, however, that he did not get Shelstead's approval, even though Shelstead owned most of the Pine Haven lots at that time. Halls never admitted his actions violated the covenants, but like the plaintiff in Stewart, he guit violating the restrictive covenants. Halls' offensive act was committed and remedied long before the issue in this case arose. Under the facts of this case, we cannot say that the trial court abused its discretion by not precluding Halls from seeking equitable relief.

[¶ 21.] Whites' other arguments challenging the validity and enforceability of the covenants are without merit. We reverse and remand for the trial court to enter a permanent injunction in conformity with this opinion.

[¶ 22.] GILBERTSON, Chief Justice, and SABERS and KONENKAMP, Justices, and WILBUR, Circuit Judge, concur.

#23.] WILBUR, Circuit Judge, sitting for ZINTER, Justice, disqualified.

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City of Brookings v. Ramsay S.D.,2007.

Supreme Court of South Dakota.
CITY OF BROOKINGS, South Dakota, Plaintiff and
Appellee,

Donna RAMSAY, dba DHR Design Services, Ltd.,
Defendant and Appellant.
No. 24497.

Considered on Briefs on Oct. 1, 2007. Decided Dec. 19, 2007.

Background: Defendant was convicted in the Third Judicial Circuit Court, Brookings County, <u>Jon R. Erickson</u>, J., of three municipal ordinance violations for unauthorized construction of a structure on a public sidewalk, failure to obtain a building permit, and violation of a stop work order. Defendant appealed.

Holdings: The Supreme Court, Meierhenry, J., held that:

(1) city was not **estopped** from denying that building permit issued for remodeling of historic building permitted the construction of an exterior deck, and (2) city was not required to exhaust administrative remedies before filing criminal complaints.

Affirmed.

West Headnotes

[1] Criminal Law 110 \$\infty\$ 1159.2(7)

110 Criminal Law
110XXIV Review
110XXIV(P) Verdicts

110k1159 Conclusiveness of Verdict 110k1159.2 Weight of Evidence in

General

110k1159.2(7) k. Reasonable Doubt.

Most Cited Cases

In reviewing the sufficiency of the evidence on appeal in a criminal case, the issue before Supreme Court is whether there is evidence in the record which, if believed by the trier of fact, is sufficient to

sustain a finding of guilt beyond a reasonable doubt.

[2] Zoning and Planning 414 762

414 Zoning and Planning

414XI Enforcement of Regulations

414XI(A) In General

414k762 k. Defenses to Enforcement. Most

Cited Cases

City, in prosecution for municipal ordinance violations, was not estopped from denying that building permit issued for remodeling of historic building permitted the construction of a deck on building's exterior, despite defendant's contention that employee of city zoning and building department consulted on the building project for four years without giving notice that the permit did not allow construction of a deck; defendant did not present city employee as a witness, defendant began construction on deck after city employee retired, defendant sought inspection from the city before she finished the deck. defendant continued to build deck after being informed that it would require an additional permit, and original permit indicated on its face that it was limited to interior remodeling.

[3] Estoppel 156 2116

156Estoppel

156III Equitable Estoppel 156III(F) Evidence

156k116 k. Presumptions and Burden of

Proof. Most Cited Cases

The burden of establishing that exceptional circumstances are present is on the party seeking to apply estoppel against public entities.

[4] Criminal Law 110 \$\infty\$ 1134(3)

110 Criminal Law

110XXIV Review

110XXIV(L) Scope of Review in General 110k1134 Scope and Extent in General 110k1134(3) k. Questions Considered

in General. Most Cited Cases

Scope of review as to whether an equitable estoppel exists is fully reviewable as a mixed question of law and fact.

[5] Criminal Law 110 € 1155

110 Criminal Law

110XXIV Review

110XXIV(N) Discretion of Lower Court
110k1155 k. Custody and Conduct of Jury.

Most Cited Cases

Supreme Court reviews denials of motions for a new trial under an abuse of discretion standard.

[6] Criminal Law 110 5 990.1

110 Criminal Law

110XXIII Judgment

<u>110k990</u> Requisites and Sufficiency of Judgment

110k990.1 k. In General. Most Cited Cases Without subject matter jurisdiction, any decision rendered by the court is void.

[7] Administrative Law and Procedure 15A

15A Administrative Law and Procedure

15AIII Judicial Remedies Prior to or Pending Administrative Proceedings

15Ak229 k. Exhaustion of Administrative Remedies. Most Cited Cases

Failure to exhaust administrative remedies where required is a jurisdictional defect.

[8] Zoning and Planning 414 5 801

414 Zoning and Planning

414XII Offenses and Penalties

414k801 k. In General. Most Cited Cases
Although city council had not made a final determination on defendant's petition for a variance, city was not required to exhaust administrative remedies before filing criminal complaints against defendant on municipal ordinance violations for unauthorized construction of a structure on a public sidewalk, failure to obtain a building permit, and violation of a stop work order. SDCL §§ 1-26-1(1), 11-26-30.

[9] Criminal Law 110 913(4)

110 Criminal Law

110XXI Motions for New Trial

110k913 Grounds for New Trial in General

110k913(4) k. Imposition of Improper

Sentence. Most Cited Cases

Trial-court's alleged error at sentencing in prosecution for municipal ordinance violations, in conditioning suspension of fines upon defendant's complying with certain ordinances that were not in effect at time defendant applied for the building permits at issue, was not grounds for grant of motion for new trial.

[10] Criminal Law 110 5 913(1)

110 Criminal Law

110XXI Motions for New Trial

110k913 Grounds for New Trial in General

110k913(1) k. In General. Most Cited

<u>Cases</u>

City's alleged bad faith in passing ordinances was not grounds for defendant's motion for new trial following convictions for municipal ordinance violations.

*435<u>Steven J. Britzman</u>, Brookings, South Dakota, Attorney for plaintiff and appellee.

Michael S. McKnight, Charles A. Larson of Boyce, Greenfield, Pashby & Welk, L.L.P., Sioux Falls, South Dakota, Attorneys for defendant and appellant. MEIERHENRY, Justice.

[¶1.] Donna Ramsay (Ramsay), d/b/a DHR Design Services, Ltd. was convicted of three municipal ordinance violations. She was convicted of unauthorized construction of a structure on a public sidewalk, failure to obtain a building permit and violation of a stop work order. Ramsay filed a motion for a new trial, which the circuit court denied. Ramsay appeals. We affirm.

FACTS

[¶ 2.] The charges against Ramsay stem from remodeling and renovations she was making to a historic building in downtown Brookings, SD. The building is referred to as the Old City Hall and Old Fire Hall. Ramsay began the interior remodeling in 2000. Later, as part of the construction, Ramsay built

a deck on one of the building's several entrances. The deck was elevated approximately forty inches above the public sidewalk and extended over the sidewalk 1.5 feet. All of the charges against Ramsay involve the non-compliance of the deck with the City building code and her failure to discontinue construction of the deck after the issuance of a stop work order.

[¶ 3.] In 2000, Ramsay obtained a building permit from the City of Brookings. The City claimed the 2000 permit was valid for interior remodeling only. Ramsay testified that she believed the permit also included plans for the outside deck. After working on the interior renovations to the building, Ramsay began construction of the deck in September, 2004. She contacted the City of Brookings Building Services Administrator, Gregory Miller, to inspect the deck structure prior to completion. Miller observed that the deck was protruding into the public sidewalk area. Protrusions into public right-of-ways are prohibited by the City code. Miller returned to his office and reviewed Ramsay's 2000 building permit. He concluded that the 2000 permit for interior remodeling did not cover the non-attached external deck. He advised Ramsay that she needed to apply for a separate building permit for the deck. Ramsay went to City Hall on September 15, 2004, to complete the paperwork. At that time, the City Engineer told Ramsay that a new permit would not be approved if her building plan showed that the deck would protrude onto the sidewalk. Ramsay's only recourse was to request a variance from the City Council.

[¶ 4.] Ramsay brought her petition for a variance before the Brookings City Council on October 12, 2004. She was instructed by the Council to return on October 26, 2004. The City Council neither granted nor denied Ramsay a variance. The City Council passed a motion "to instruct the city manager and staff to define approval criteria in regards to encroachments in the public right-of-way." The City approved Resolution No. 68-04 setting forth nine criteria for building in the public right-of-way on November 23, 2004.

*436 [¶ 5.] Ramsay was unable to meet the newly adopted criteria despite efforts to do so. Thus, she did

not obtain a permit or variance for the deck. Nevertheless, she continued to build the deck without a permit. The City Engineer sent several letters to Ramsay informing her of the necessity of obtaining a permit. Ramsay acknowledged that she received the letters but failed to respond to them. In June, 2005, the City issued a stop work order. Ramsay continued construction of the deck after the issuance of the stop work order. The City later filed charges against Ramsay alleging that she had violated City Ordinances by 1) unauthorized construction of a structure on a public sidewalk, 2) construction without a building permit, and 3) construction in violation of a stop work order. Ramsay argued that the City should be estopped from bringing charges against her. She claims that an employee from the City zoning and building department had worked with her in the earlier stages of the building project and that he had not told her of the necessity of getting a separate permit for the deck. The circuit court found Ramsay guilty of the charges. Ramsay appeals. She claims the circuit court erred on two grounds: (1) in convicting her when there was insufficient evidence to warrant the convictions, and (2) in denying her Motion for a New Trial.

Insufficiency of Evidence-Estoppel

[1] [¶ 6.] Ramsay argues the court erred in convicting her because there was insufficient evidence to warrant the convictions. In reviewing "the sufficiency of the evidence on appeal in a criminal case, the issue before this Court is whether there is evidence in the record which, if believed by the [trier of fact], is sufficient to sustain a finding of guilt beyond a reasonable doubt." <u>State v. Bordeaux</u>, 2006 SD 12, ¶ 6,710 N.W.2d 169, 172 (citation omitted).

[2] [¶ 7.] Ramsay's insufficiency of the evidence claim relies on her estopped defense. She claims that the City was estopped from denying that the 2000 building permit covered the construction of the deck; thus, the prosecution failed to meet the elements of the charges against her. Ramsay claims that the previous City Building Services Administrator, Ray Froelich, worked with her and advised her on the building renovations over the years and had not told her she needed a separate permit for the deck or that the deck did not comply with the building code.

Froelich was not called as a witness by either the City or Ramsay. Ramsay also claimed that the configuration and placement of the deck was necessary to meet requirements of the American Disabilities Act, Fire and Life Safety Codes and the South Dakota State Historical Preservation Office. Ramsay argues Froelich's actions induced her to alter her position and to proceed with the construction of the deck.

[¶ 8.] We have recognized the doctrine of equitable estoppel against municipalities in our prior cases. See Even v. City of Parker, 1999 SD 72, ¶ 9, 597 N.W.2d 670, 674; City of Rapid City v. Hoogterp, 85 S.D. 176, 179, 179 N.W.2d 15, 16 (1970); Tubbs v. Custer City, 52 S.D. 458, 218 N.W. 599, 601 (1928); City of Deadwood v. Hursh, 30 S.D. 450, 138 N.W. 1122, 1123 (1912); Missouri River Tel. Co. v. City of Mitchell, 22 S.D. 191, 116 N.W. 67, 68 (1908). We explained the estoppel doctrine as follows:

When considering the application of equitable estoppel, each case is dependent on application of the doctrine to the specific facts. When applying the doctrine to municipal corporations in matters pertaining to their governmental functions [t]he basis of its application ... is ... municipal officers ... taken affirmative have some action influencing*437 another which renders inequitable for the municipality to assert a different set of facts. More than municipal acquiescence ... should be required to give rise to an estoppel. The conduct must have induced the other party to alter his position or do that which he would not otherwise have done to his prejudice.

Even, 1999 SD 72, ¶ 12, 597 N.W.2d at 674 (internal citations omitted).

[3][4] [¶ 9.] We also said we only apply estoppel against public entities in "exceptional circumstances to 'prevent manifest injustice." Id. at ¶ 11 (citations emitted). "The burden of establishing that such exceptional circumstances are present is on the party seeking the protection of the doctrine." Hoogterp. 85 § 1D. at 180, 179 N.W.2d at 17. "[E]ach case is dependent on application of the doctrine to the specific facts." Even, 1999 SD 72, ¶ 12, 597 N.W.2d at 674. Our "scope of review as to whether an

equitable estoppel exists is fully reviewable as a mixed question of law and fact." *Id.* ¶ 9.

[¶ 10.] Ramsay argues that estoppel applies because her situation was similar to the facts in Even v. City of Parker. Id. ¶¶ 2-6. In Even, we held that the City of Parker-was-estopped from-denying-the-existence of a building permit for a pole-type garage granted to Mr. Even. In that case, Even applied for a building permit. He specified that he had purchased materials for a pole-type garage unit. The City granted the request. Four days later, the City discovered that it granted the permit in error because the pole-type garage units were not permitted by City ordinance. The City revoked Mr. Even's permit and denied his reapplication for a new permit. We affirmed the circuit court's finding that the City was estopped from denying Mr. Even's permit. We determined in Even that the City did not have a duty to tell Even that his structure would not comply with the zoning ordinance, but did have a duty not to create the impression of compliance and then withdraw approval after Even had started to build the facility. Id. ¶ 14. We said,

The City did not have a duty to call to Even's attention the fact he could not build a garage of pole type construction under the terms of the zoning ordinance. Nevertheless, the City may not, through its agents, affirmatively create an objectively reasonable impression in an applicant that he has fully complied with all zoning requirements and then proceed to withdraw permission after the applicant has taken steps towards construction which result in a substantial detriment to the applicant.

Id. ¶ 14 (citations omitted).

[¶ 11.] Ramsay argued that Froelich worked with her for four years without notifying her that the 2000 building permit did not allow construction of the deck. She further claimed that Froehlich was actively involved in the project and consulted with her regularly. She claimed Froelich required her to make costly changes and additions to the building in order to comply with ADA and Fire and Life Safety Codes. Froelich was not called to testify, allegedly because he had retired. The only evidence concerning whether

Froehlich gave Ramsay "an objectively reasonable impression" that she had "fully complied with all zoning requirements" came from Ramsay's own testimony. She admits, however, that the plans for the deck had changed from the original drawing submitted with the 2000 permit application. Her testimony concerning Froehlich's involvement centered more on his advice on how to comply with ADA and Fire and Life Safety Codes. In fact, her testimony seemed to indicate that the deck had not actually been approved by Froehlich*438 because she testified that she started construction on the deck sometime after Froehlich retired. Ramsav testified that she initiated inspection of the deck after she started building it in September of 2004. Miller, the employee who inspected the deck, informed Ramsay that she needed to get a permit because the 2000 permit did not include construction of the deck. At that time, she did not disagree that she needed a permit and proceeded to apply for one.

19 12.1 The trial judge ruled that the 2000 building permit only covered internal furnishing or remodeling. The court found that under the law, Ramsay was required to get a second permit for the deck. The court also denied the estoppel claim finding that because Ramsay's building permit did not cover the deck construction, the City had no duty and could not be equitably estopped from asserting the need for a second building permit. Although the court's comments on the record as to estoppel are brief, we cannot say his conclusion on the issue was in error. Ramsay bore the burden to bring forth facts necessary to establish that the City (through its agent Froehlich) had created "an objectively reasonable impression" that Ramsay's deck plans had fully complied with the building code. Her own testimony does not support such a finding. Although she may not have realized she needed a second permit for the deck, she sought inspection from the City before she finished the deck. At that point, Miller told her she needed a second permit because the deck was not attached to the building. It was when she attempted to acquire the second permit that her problems began. What happened after that is not in dispute. The City never granted her the permit for the deck. She admitted she continued to build the deck without the permit and in disregard of the stop work order.

[¶ 13.] Despite Ramsay's contention, the 2000 building permit on its face was limited to the interior remodeling of the building. Neither the building permit nor any other evidence indicates that the City induced Ramsay to begin construction on the exterior deck. Since the City's conduct did not induce Ramsay to alter her position before beginning and proceeding with construction of the deck, Ramsay's equitable estoppel defense fails. The circuit court did not err in concluding the City was not estopped from denying the existence of a valid building permit for exterior construction.

Motion for a New Trial

[5] [¶ 14.] Ramsay also claims that the circuit court erred by not granting her motion for a new trial. We review denials of motions for a new trial under an abuse of discretion standard. <u>State v. Gehm</u>, 1999 SD 82, ¶ 12, 600 N.W.2d 535, 539.

[¶ 15.] Ramsay moved for a new trial pursuant to <u>SDCL 15-6-59(a)(6)</u>. This statutory provision provides that a new trial may be granted if the evidence is insufficient to justify the verdict or if the verdict is against the law. Ramsay argues the circuit court abused its discretion because (1) the court lacked jurisdiction over the case because the City failed to exhaust the administrative remedies; and (2) the court impermissibly required Ramsay to comply with a retroactive City ordinance.

[6][7][8] [¶ 16.] Ramsay argues the circuit court lacked subject matter jurisdiction because the City failed to exhaust its administrative remedies prior to filing the criminal complaints. Without subject matter jurisdiction, any decision rendered by the court is void. See <u>Barnes v. Matzner</u>, 2003 SD 42, ¶ 10, n2, 661 N.W.2d 372, 375, n2. "Failure to exhaust administrative remedies where required is a jurisdictional *439 defect." <u>S.D. Bd. of Regents v. Heege</u>, 428 N.W.2d 535, 539 (S.D.1988).

[¶ 17.] Ramsay argues the City could not file criminal charges against her until the City Council made a final determination on her petition for a variance. Ramsay cites two cases in support of her argument from other jurisdictions that have held that the pending administrative proceedings are fatal to a

prosecution under these circumstances and deprive the circuit court of jurisdiction. She cites <u>City of Woburn v. McNutt Bros. Equipment Corp.</u>, 16 Mass.App.Ct. 236, 451 N.E.2d 437 (1983) and <u>State v. Anonymous</u>, 36 Conn.Supp. 103, 413 A.2d 134 (1980). Both cases are distinguishable. The holdings of the cases are based on state statutory provisions requiring the government to exhaust administrative remedies before bringing criminal sanctions because the illegality of the defendants' acts was contingent upon the outcome of the administrative proceedings. In both *Woburn* and *Anonymous*, Massachusetts and Connecticut state administrative procedure codes provided for exhaustion of remedies by city and local governments.

[¶ 18.] Unlike the law in Massachusetts and Connecticut, the South Dakota Administrative Procedures Act excludes cities. It applies to agencies but in the Act's definition of "agency", SDCL 1-26-1(1), "any unit of local government" is specifically excluded. SDCL 1-26-30. ENI Under South Dakota law, the City was not required to exhaust administrative remedies. Thus, the circuit court had subject matter jurisdiction over the criminal action.

FN1. Compare GL c 40A, § 7 ("No action, suit, or proceeding shall be maintained in any court ... except in accordance with the provisions of this section") where the Woburn court stated "GL c 40A, § 7 requires that local administrative remedies, if available be exhausted before judicial relief is sought; and Conn. Gen. Stat. s 47a-68 (establishing administrative remedies) where the court in Anonymous held [a] [prosecution based upon municipal code violations requires compliance with the procedural due process requirements of the code]" as applied to cities; with SDCL 1-2630 providing: "A person who has exhausted all administrative remedies available within any agency or a party who is aggrieved by a final decision in a contested case is entitled to judicial review under this chapter...."SeeSDCL 1-26-1(1) governments (excluding local definition of agency).

[9] [¶ 19.] Ramsay also claimed in her Motion for a New Trial that the circuit court lacked jurisdiction because the Amended Judgment of Conviction required Ramsay to comply with the City's subsequently adopted criteria for a variance (Resolution No. 68-04) in order for her fines to be suspended. Ramsay argues that she should only be required to comply with the laws in place at the time she applied for the permits.

FN2. Ramsay's basis for her motion for a new trial is lack of subject matter jurisdiction. However, if the court lacks jurisdiction to hear the matter, then a motion for a new trial would not be the appropriate remedy because the court would lack jurisdiction upon remand as well.

[¶ 20.] Ramsay claims that because Resolution 68-04 was not passed until October 26, 2004, the court erred in requiring compliance with the ordinance in order for her fines to be suspended. Ramsay, however, cites no authority to support her argument that an erroneous sentence provision entitled her to a new trial. Ramsay's argument is directed at a provision of the court's suspended sentence rather than any trial error. The City's subsequently adopted criteria in Resolution 68-04 were not the basis of her charges nor did they enter into the court's finding of guilt. The court merely gave Ramsay the option of complying with the ordinance in his sentencing order. If Ramsay could comply *440 with the criteria in Resolution 68-04, then the court would not impose her fines. Thus, we find no merit in her request for a new trial based on the sentencing provision.

[10] [¶ 21.] Ramsay also alleges that the City passed the ordinance in bad faith. She cites examples of other Brookings residents who were previously granted building permits allowing encroachments onto public rights-of-way. At the time of Ramsay's original application and the variances granted to other residents, the City had no established criteria for granting encroachments onto public rights-of-way. Again, Ramsay cites no applicable authority requiring a new trial under these circumstances, even presuming the bad faith allegations were true. FN3

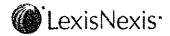
FN3. Ramsay cites one case in support of

her argument. Whitehead Oil Co. v. City of Lincoln, 245 Neb. 660, 515 N.W.2d 390, 397 (1994) (holding new ordinances enacted in bad faith cannot be retroactively applied). However, the facts of this case are distinguishable, and further, do not support granting a new trial when the retroactive ordinances were not a basis of guilt.

[¶ 22.] Therefore, the circuit court did not abuse its discretion in denying Ramsay's motion for a new trial. We affirm the circuit court on all issues.

[¶ 23.] <u>GILBERTSON</u>, Chief Justice, and <u>SABERS</u>, <u>KONENKAMP</u>, and <u>ZINTER</u>, Justices, concur. S.D.,2007. City of Brookings v. Ramsay

743 N.W.2d 433, 2007 SD 130



LEXSEE 969 S.W.2D 945

BAPTIST MEMORIAL HOSPITAL SYSTEM, PETITIONER V. RHEA SAMPSON, RESPONDENT

No. 97-0268

SUPREME COURT OF TEXAS

969 S.W.2d 945; 1998 Tex. LEXIS 83; 41 Tex. Sup. J. 833

December 2, 1997, Argued May 21, 1998, Delivered

PRIOR HISTORY: [**1] ON APPLICATION FOR WRIT OF ERROR TO THE COURT OF APPEALS FOR THE FOURTH DISTRICT OF TEXAS.

DISPOSITION: Judgment of court of appeals reversed and judgment rendered that Sampson take nothing.

JUDGES: CHIEF JUSTICE PHILLIPS delivered the opinion of the Court.

OPINION BY: THOMAS R, PHILLIPS

OPINION

[*946] In this case, we decide whether the plaintiff raised a genuine issue of material fact that defendant Hospital was vicariously liable under the theory of ostensible agency for an emergency room physician's negligence. We granted Baptist Memorial Hospital System's application for writ of error to resolve a conflict in the holdings of our courts of appeals regarding the elements required to establish liability against a hospital for the acts of an independent contractor emergency room physician. We hold that the plaintiff has not met her burden to raise a fact issue on each element of this theory. Accordingly, we reverse the judgment of the court of appeals, 940 S.W.2d 128, and render judgment that the plaintiff take nothing.

: I

On March 23, 1990, Rhea Sampson was bitten on the arm by an unidentified creature that was later identified as a brown recluse spider. By that evening, her arm was swollen and painful, [**2] and a friend took her to the Southeast Baptist Hospital emergency room. Dr.

Susan Howle, an emergency room physician, examined Sampson, diagnosed an allergic reaction, administered Benadryl and a shot of painkiller, prescribed medication for pain and swelling, and sent her home. Her condition grew worse, and she returned to the Hospital's emergency room by ambulance a little over a day later. This time Dr. Mark Zakula, another emergency room physician, treated her. He administered additional pain medication and released her with instructions to continue the treatment Dr. Howle prescribed. About fourteen hours later, with her condition rapidly deteriorating, Sampson went to another hospital and was admitted to the intensive care ward in septic shock. There, her bite was diagnosed as that of a brown recluse spider, and the proper treatment was administered to save her life. Sampson allegedly continues to have recurrent pain and sensitivity where she was [*947] bitten, respiratory difficulties, and extensive scarring.

Sampson sued Drs. Howle and Zakula for medical malpractice. She also sued Baptist Memorial Hospital System ("BMHS"), of which Southeast Baptist Hospital is a member, for negligence [**3] in failing to properly diagnose and treat her, failing to properly instruct medical personnel in the diagnosis and treatment of brown recluse spider bites, failing to maintain policies regarding review of diagnoses, and in credentialing Dr. Zakula. Sampson also alleged that the Hospital was vicariously liable for Dr. Zakula's alleged negligence under an ostensible agency theory. Sampson nonsuited Dr. Howle early in the discovery process. The trial court granted BMHS summary judgment on Sampson's claims of vicarious liability and negligent treatment. The trial court severed those claims from her negligent credentialing claim against BMHS and her malpractice claim against Dr. Zakula. 'Sampson appealed only on the vicarious liability theory.

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1 Sampson subsequently nonsuited her negligent credentialing claim against BMHS.

Both parties agree that BMHS established as a matter of law that Dr. Zakula was not its agent or employee. Thus the burden shifted to Sampson to raise a fact issue on each element of her ostensible [**4] agency theory, which Texas courts have held to be in the nature of an affirmative defense, See Brownlee v. Brownlee, 665 S.W.2d 111, 112 (Tex. 1984); Smith v. Baptist Mem'l Hosp. Sys., 720 S.W.2d 618, 622 (Tex. App.--San Antonio 1986, writ refd n.r.e.), disapproved on other grounds by St. Luke's Episcopal Hosp. v. Agbor, 952 S.W.2d 503, 509 n.1 (Tex. 1997). Sampson contended that she raised a material fact issue on whether Dr. Zakula was BMHS's ostensible agent. The court of appeals, with one justice dissenting, agreed and reversed the summary judgment. 940 S.W.2d 128. In our review, we must first determine the proper elements of ostensible agency, then decide whether Sampson raised a genuine issue of material fact on each of these elements.

П

Under the doctrine of respondeat superior, an employer is vicariously liable for the negligence of an agent or employee acting within the scope of his or her agency or employment, although the principal or employer has not personally committed a wrong. See DeWitt v. Harris County, 904 S.W.2d 650, 654 (Tex. 1995); RESTATE-MENT (SECOND) OF AGENCY § 219 (1958). The most frequently proffered justification for imposing such liability [**5] is that the principal or employer has the right to control the means and methods of the agent or employee's work. See Newspapers, Inc. v. Love, 380 S.W.2d 582, 585-86 (Tex. 1964); RESTATEMENT (SECOND) OF AGENCY § 220, cmt. d. Because an independent contractor has sole control over the means and methods of the work to be accomplished, however, the individual or entity that hires the independent contractor is generally not vicariously liable for the tort or negligence of that person. See Enserch Corp. v. Parker, 794 S.W.2d 2, 6 (Tex. 1990); Redinger v. Living, Inc., 689 S.W.2d 415, 418 (Tex. 1985). Nevertheless, an individual or entity may act in a manner that makes it liable for the conduct of one who is not its agent at all or who, although an agent, has acted outside the scope of his or her:authority. Liability may be imposed in this manner under the doctrine of ostensible agency in circumstances when the principal's conduct should equitably prevent it from denying the existence of an agency. 2 [*948] See, e.g., Marble Falls Hous. Auth. v. McKinley, 474 S.W.2d 292, 294 (Tex. Civ. App.--Austin 1971, writ refd n.r.e.). Ostensible agency in Texas is based on the notion of [**6] estoppel, that is, a representation by the principal causing justifiable reliance and resulting harm. See Ames

v. Great S. Bank, 672 S.W.2d 447, 450 (Tex. 1984); RE-STATEMENT (SECOND) OF AGENCY § 267; KEETON ET AL., PROSSER AND KEETON ON THE LAW OF TORTS § 105, at 733-34 (5th ed. 1984).

> 2 Many courts use the terms ostensible agency, apparent agency, apparent authority, and agency by estoppel interchangeably. As a practical matter, there is no distinction among them. See, e.g., Birmingham-Jefferson County Transit Auth. v. Arvan, 669 So. 2d 825, 830-31 (Ala. 1995), (Cook, J., dissenting from overruling of application for rehearing); State of Fla. Dep't of Transp. v. Heckman, 644 So. 2d 527, 529 (Fla. Dist. Ct. App. 1994); Kissun v. Humana, Inc., 267 Ga. 419, 479 S.E.2d 751, 752 (Ga. 1997); O'Banner v. McDonald's Corp., 173 Ill. 2d 208, 670 N.E.2d 632, 634, 218 Ill. Dec. 910 (Ill. 1996); Deal v. North Carolina State Univ., 114 N.C. App. 643, 442 S.E.2d 360, 362 (N.C. Ct. App. 1994); Hill v. St. Clare's Hosp., 67 N.Y.2d 72, 490 N.E.2d 823, 827, 499 N.Y.S.2d 904 (N.Y. 1986); Evans v. Ohio State Univ., 112 Ohio App. 3d 724, 680 N.E.2d 161, 174 (Ohio Ct. App. 1996); Luddington v. Bodenvest Ltd., 855 P.2d 204, 209 (Utah 1993); Hamilton v. Natrona County Educ. Ass'n, 901 P.2d 381, 386 (Wyo. 1995). But see Guillot v. Blue Cross of La., 690 So. 2d 91, 99 (La. Ct. App. 1997) (Saunders, J., concurring and dissenting) (stating apparent authority is based on contract law, whereas agency by estoppel is grounded in tort principles); Houghland v. Grant, 119 N.M. 422, 891 P.2d 563, 568 (N.M. Ct. App. 1995)(recognizing that although ostensible agency and agency by estoppel are based on slightly different rationales, the theories have been used interchangeably). See also McWilliams & Russell, Hospital Liability for Torts of Independent Contractor Physicians, 47 S.C. L. REV. 431, 445-452 (1996). Regardless of the term used, the purpose of the doctrine is to prevent injustice and protect those who have been misled. See Roberts v. Haltom City, \$43 S.W.2d 75, 80 (Tex. 1976).

[**7] Texas courts have applied these basic agency concepts to many kinds of principals, including hospitals. See Sparger v. Worley Hosp., Inc., 547 S.W.2d 582, 585 (Tex. 1977) (explaining that "hospitals are subject to the principles of agency law which apply to others"). A hospital is ordinarily not liable for the negligence of a physician who is an independent contractor. See, e.g., Berel v. HCA Health Servs., 881 S.W.2d 21, 23 (Tex. App.-Houston [1st Dist.] 1994, writ denied); Jeffcoat v. Phillips, 534 S.W.2d 168, 172 (Tex. Civ. App.--Houston [14th Dist.] 1976, writ refd n.r.e.). On the other hand, a

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hospital may be vicariously liable for the medical malpractice of independent contractor physicians when plaintiffs can establish the elements of ostensible agency. See, e.g., Lopez v. Central Plains Reg'l Hosp., 859 S.W.2d 600, 605 (Tex. App.--Amarillo 1993, no writ), disapproved on other grounds by Agbor, 952 S.W.2d at 509 n.1; Nicholson v. Mem'l Hosp. Sys., 722 S.W.2d 746, 750 (Tex. App.--Houston [14th Dist.] 1986, writ refd n.r.e.).

Ш

In this case, the court of appeals held that two distinct theories of vicarious liability with different elements [**8] are available in Texas to impose liability on a hospital for emergency room physician negligence: agency by estoppel (referred to in this opinion as ostensible agency), based on the Restatement (Second) of Agency section 267, and apparent agency, based on the Restatement (Second) of Torts section 429. See 940 S.W.2d at 131. Under section 267, the party asserting ostensible agency must demonstrate that (1) the principal, by its conduct, (2) caused him or her to reasonably believe that the putative agent was an employee or agent of the principal, and (3) that he or she justifiably relied on the appearance of agency. RESTATEMENT (SEC-OND) OF AGENCY § 267 (1958). Although neither party mentioned section 429 in the trial court or in their briefs to the court of appeals, the court of appeals then proceeded to adopt section 429 and hold that under that section, plaintiff had only to raise a fact issue on two elements: (1) the patient looked to the hospital, rather than the individual physician, for treatment; and (2) the hospital held out the physician as its employee. See 940 S.W.2d at 132. Holding that the plaintiff had established a genuine issue of material fact on each element [**9] of this latter affirmative defense, the court reversed and remanded to the trial court for trial on the merits. The court of appeals further suggested that a hospital could do nothing to avoid holding out a physician in its emergency room as its employee because notification to prospective patients in any form would be ineffectual:

We take an additional step in our analysis to consider whether notice provided in consent forms and posted in emergency rooms can ever be sufficient to negate a hospital's "holding out"....

Because we do not believe hospitals should be allowed to avoid such responsibility, we encourage the full leap--imposing a nondelegable duty on hospitals for the negligence of emergency room physicians.

940 S.W.2d at 135-136. Thus, the court of appeals would create a nondelegable duty on [*949] a hospital solely because it opens its doors for business.

We first reject the court of appeals' conclusion that there are two methods, one "more difficult to prove" than the other, to establish the liability of a hospital for the malpractice of an emergency room physician. 940 S.W.2d at 132. Our courts have uniformly required proof of all three elements [**10] of section 267 to invoke the fiction that one should be responsible for the acts of another who is not in fact an agent acting within his or her scope of authority. As we have explained:

Apparent authority in Texas is based on estoppel. It may arise either from a principal knowingly permitting an agent to hold herself out as having authority or by a principal's actions which lack such ordinary care as to clothe an agent with the indicia of authority, thus leading a reasonably prudent person to believe that the agent has the authority she purports to exercise

A prerequisite to a proper finding of apparent authority is evidence of conduct by the principal relied upon by the party asserting the estoppel defense which would lead a reasonably prudent person to believe an agent had authority to so act.

Ames v. Great S. Bank, 672 S.W.2d at 450; see also, e.g., Douglass v. Panama, Inc., 504 S.W.2d 776, 778-79 (Tex. 1974); Chastain v. Cooper & Reed, 152 Tex. 322, 257 S.W.2d 422, 427 (Tex. 1953). Thus, to establish a hospital's liability for an independent contractor's medical malpractice based on ostensible agency, a plaintiff must show that (1) he or she had a [**11] reasonable belief that the physician was the agent or employee of the hospital, (2) such belief was generated by the hospital affirmatively holding out the physician as its agent or employee or knowingly permitting the physician to hold herself out as the hospital's agent or employee, and (3) he or she justifiably relied on the representation of authority. See, e.g., Drennan v. Community Health Inv. Corp., 905 S.W.2d 811, 820 (Tex. App.--Amarillo 1995, writ denied); Lopez, 859 S.W.2d at 605; Nicholson, 722 S.W.2d at 750. While a few courts of appeals have referred to section 429, it has never before been adopted in this state by any appellate court. See Smith, 822 S.W.2d 67, 72-73 (mentioning Restatement (Second) of Torts section 429 as additional support, but recognizing that the applicable rule is provided by Restatement (Second) of Agency section 267); Byrd v. Skyline Equip. Co., 792 S.W.2d 195, 197 (Tex. App. -- Austin 1990), writ denied per curiam, 808 S.W.2d 463 (Tex. 1991) (citing section 429 as an additional reason summary judgment in the case was improper); Brownsville Med. Ctr. v. Gracia, 704 S.W.2d 68, 74 (Tex. App.--Corpus Christi 1985, writ [**12] ref'd n.r.e.) (after stating that section 267 provides the applicable rule, mentions section 429 as additional authority). To the extent that the Restatement

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(Second) of Torts section 429 proposes a conflicting standard for establishing liability, we expressly decline to adopt it in Texas.

Next, we reject the suggestion of the court of appeals quoted above that we disregard the traditional rules and take "the full leap" of imposing a nondelegable duty on Texas hospitals for the malpractice of emergency room physicians. 940 S.W.2d at 136. Imposing such a duty is not necessary to safeguard patients in hospital emergency rooms. A patient injured by a physician's malpractice is not without a remedy. The injured patient ordinarily has a cause of action against the negligent physician, and may retain a direct cause of action against the hospital if the hospital was negligent in the performance of a duty owed directly to the patient. See, e.g., Diaz v. Westphal, 941 S.W.2d 96, 98 (Tex. 1997); Medical & Surgical Mem'l Hosp. v. Cauthorn, 229 S.W.2d 932, 934 (Tex. Civ. App.--El Paso 1949, writ refd n.r.e.).

IV

We now examine the record below in light of the appropriate standard. [**13] The Hospital may be held liable for the negligence of Dr. Zakula if Sampson can demonstrate that (1) she held a reasonable belief that Dr. Zakula was an employee or agent of the Hospital, (2) her belief was generated by some conduct on the part of the Hospital, and (3) she justifiably relied on the appearance that Dr. Zakula was an agent or employee [*950] of the Hospital. See, e.g., Drennan, 905 S.W.2d at 820.

As summary judgment evidence, BMHS offered the affidavit of Dr. Potyka, an emergency room physician, which established that the emergency room doctors are not the actual agents, servants, or employees of the Hospital, and are not subject to the supervision, management, direction, or control of the Hospital when treating patients. Dr. Potyka further stated that when Dr. Zakula treated Sampson, signs were posted in the emergency room notifying patients that the emergency room physicians were independent contractors. Dr. Potyka's affidavit also established that the Hospital did not collect any fees for emergency room physician services and that the physicians billed the patients directly. BMHS presented copies of signed consent forms as additional summary judgment evidence. During [**14] both of Sampson's visits to the Hospital emergency room, before being examined or treated, Sampson signed a "Consent for Diagnosis, Treatment and Hospital Care" form explaining that alliphysicians at the Hospital are independent contractors who exercise their own professional judgment without control by the Hospital. The consent forms read in part:

I acknowledge and agree that . . ., Southeast Baptist Hospital, . . . and any Hospital operated as a part of Baptist Memorial Hospital System, is not responsible for the judgment or conduct of any physician who treats or provides a professional service to me, but rather each physician is an independent contractor who is self-employed and is not the agent, servant or employee of the hospital.

To establish her claim of ostensible agency. Sampson offered her own affidavits. In her original affidavit, she stated that although the Hospital directed her to sign several pieces of paper before she was examined. she did not read them and no one explained their contents to her. Her supplemental affidavit stated that she did not recall signing the documents and that she did not, at any time during her visit to the emergency room, see any signs stating [**15] that the doctors who work in the emergency room are not employees of the Hospital. Both affidavits state that she did not choose which doctor would treat her and that, at all times, she believed that a physician employed by the hospital was treating her. Based on this record we must determine if Sampson produced sufficient summary judgment evidence to raise a genuine issue of material fact on each element of ostensible agency, thereby defeating BMHS's summary judgment motion.

Even if Sampson's belief that Dr. Zakula was a hospital employee were reasonable, that belief, as we have seen, must be based on or generated by some conduct on the part of the Hospital. "No one should be denied the right to set up the truth unless it is in plain contradiction of his former allegations or acts." Gulbenkian v. Penn, 151 Tex. 412, 252 S.W.2d 929, 932 (Tex. 1952). The summary judgment proof establishes that the Hospital took no affirmative act to make actual or prospective patients think the emergency room physicians were its agents or employees, and did not fail to take reasonable efforts to disabuse them of such a notion. As a matter of law, on this record, no conduct by the Hospital would [**16] lead a reasonable patient to believe that the treating emergency room physicians were hospital employees.

Sampson has failed to raise a fact issue on at least one essential element of her claim. Accordingly, we reverse the judgment of the court of appeals and render judgment that Sampson take nothing.

Thomas R. Phillips

Chief Justice

Opinion delivered: May 21, 1998

PROOF OF SERVICE

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2 I declare that I am over the age of eighteen (18) and not a party to this action. My business address is 520 South Grand Avenue, Suite 695, Los Angeles, California 90071. 3 On April 23, 2010, I served the following documents: SOUTH DAKOTA BOARD OF 4 REGENTS' MEMORANDUM OF POINTS AND AUTHORITIES IN OPPOSITION TO PETITIONER'S MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT OF 5 PETITION FOR ORDER COMPELLING ARBITRATION; DECLARATIONS; **EXHIBITS**; APPENDIX OF NON-CALIFORNIA AUTHORITY on the interested parties in 6 this action by placing a true and correct copy of such document, enclosed in a sealed envelope, 7 addressed as follows: 8 Maxwell M. Blecher Jennifer S. Elkayam 9 515 South Figueroa Street, 17th Floor Los Angeles, CA 90071-3334 10 11 (\mathbf{X}) **BY MAIL:** I am readily familiar with the business' practice for collection and processing of correspondence for mailing with the United States Postal Service. 12 know that the correspondence was deposited with the United States Postal Service on the same day this declaration was executed in the ordinary course of business. 13 I know that the envelope was sealed and, with postage thereon fully prepaid, placed for collection and mailing on this date in the United States mail at Los 14 Angeles, California. 15 () BY OVERNIGHT COURIER: I caused the above-referenced document(s) to be deposited in a box or other facility regularly maintained by the overnight 16 courier, or I delivered the above-referenced document(s) to an overnight courier service, for delivery to the above addressee(s). 17 BY HAND-DELIVERY: I caused the above-referenced document(s) to be hand-() 18 delivered to the addressee(s) 19 (\mathbf{X}) (State) I declare under penalty of perjury under the laws of the State of California that the above is true and correct. 20 I declare that I am employed in the office of a member of the bar 21 ()(Federal) of this court at whose direction the service was made. 22 23 Executed April 23, 2010, Los Angeles, California. 25 Carolyn Dominguez 26 27