No. S183523

First District Court of Appeal
Division Two

Case No. A125567

IN THE SUPREME COURT OF THE STATE OF CALIFORNIA

STEVE ROSSA and CONNIE ROSSA,
Plaintiffs and Respondents,

vs.

D.L. FALK CONSTRUCTION, INC.,
Defendant and Appellant.

OPENING BRIEF ON THE MERITS

On Appeal from the Superior Court of San Mateo County
Superior Court Case No. CIV442294
Honorable Marie Weiner

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INTRODUCTION

Rule 8.278, subdivision (d)(1)(F) of the California Rules of Court enables appellants who obtain reversals of money judgments to recover as costs on appeal the "*reasonable . . . cost to procure a surety bond, including the premium and the cost to obtain a letter of credit as collateral*" for such a bond.[1] This case will enable the Court to decide whether an appellant who must borrow funds to secure letter-of-credit collateral for an appeal bond can be awarded the interest costs it reasonably and necessarily expended.

The Court of Appeal here refused to allow appellant to recover the interest it had to pay to secure an appeal bond. Its decision thus denied the victim of a flawed money judgment any reimbursement for the reasonable out-of-pocket expenses it was forced to incur to protect its assets pending appeal. As appellant will demonstrate, the Court of Appeal's rejection of an interest award disregarded the plain meaning, history, and purpose of the appellate costs rule. This Court can and should rectify its error.

ISSUES PRESENTED

1. A party falls victim to a legally-flawed money judgment. To protect its assets pending appeal, it must post an appeal bond. The surety posting the bond requires a bank's letter of credit as collateral for the

[1] All emphasis is added unless otherwise stated.

bond obligation. The bank, in turn, requires the party to obtain a loan in the amount of the letter of credit.

After obtaining reversal of the judgment, can such a party recover the interest expenses it paid for the letter of credit as "reasonable . . . cost to procure a surety bond, including the premium and the cost to obtain a letter of credit as collateral" under rule 8.278, subdivision (d)(1)F) of the California Rules of Court?

Short Answer: Yes. The plain language of the rule and its manifest purpose provides for awards to prevailing appellants for the actual and reasonable costs of posting and collateralizing appeal bonds with letters of credit. Parties faced with erroneous money judgments may lack the assets to collateralize bonds by posting 150% of the amount of the judgment – in this case nearly a million dollars. Instead they must borrow money, pay interest, and satisfy bank-mandated conditions to purchase letter-of-credit collateral. If they cannot recover the cost of those letters of credit, they have been forced to pay what may be large expenses for the sole benefit of a judgment creditor who was not entitled to a judgment.

2. **Does an interpretation of rule 8.278, subdivision (d)(1)(F) that does not allow recovery of interest payments and bank fees made for a surety bond, but nonetheless does allow recovery of interest**

for a cash deposit made in lieu of a surety bond, violate the equal protection clauses of the state and federal constitutions?

Short Answer: Yes. No rational basis supports discrimination against parties who must borrow money to purchase letters of credit to collateralize appeal bonds in favor of parties who must borrow money to make cash deposits in lieu of bond.

STATEMENT OF FACTS

1. The Underlying Litigation

In 2001, Steve and Connie Rossa ("the Rossas") entered into a contract with D.L. Falk Construction, Inc. ("Falk" or "Falk Construction") under which Falk agreed to build a home for the Rossas in Hillsborough for $1.7 million. (2 AA 458, 461.) Because the contract expressly excluded surveying from the scope of Falk's contractual obligations, the Rossas contracted with R&R Surveying ("R&R") to survey the property. (2 AA 459.) R&R improperly surveyed the property; as a result, a portion of the Rossas' home encroached upon a side set back. (2 AA 459.) When the City of Hillsborough discovered the set-back encroachment, it ordered the construction stopped. (2 AA 459.) After a delay of five months, and a $150,000 payment made to charity to compensate the encroached-upon neighbor, construction resumed. (2 AA 459.)

Ultimately, unresolved disputes between Falk and the Rossas prompted Falk to stop work on the project in October of 2002. (2 AA 459.)

In October of 2004, the Rossas sued both Falk and R&R, alleging breach of contract and negligence causes of action against Falk and R&R, and further alleging breach of express and implied warranty causes of action against Falk. (2 AA 459.) The crux of the Rossas' claim against R&R (the "encroachment claim") was that the missurvey of their property resulted in the set-back encroachment, causing significant delay and considerable expense. (2 AA 460.) This encroachment claim was settled with R&R on the eve of trial for $185,000. (2 AA 461.)

In January of 2006, trial proceeded against Falk. The Rossas sought roughly $360,000 in breach of contract and negligence damages. (2 AA 461.) The breach of contract claim pursued against Falk at trial (described by the Rossas' trial counsel as the "money case") alleged that Falk failed to build the Rossas' home for the agreed-upon sum of $1.7 million, and sought two categories of damages in connection with the alleged breach: (1) a "material overcharge" of $54,854; and (2) "unearned conditions" of $50,200. (2 AA 461.)

In addition to the breach of contract claim, the Rossas pursued two negligence claims against Falk at trial. The first of these negligence claims (described by counsel as the "defects case") alleged a number of construction defects, and sought $133,388 for these alleged breaches of the "standard of care." (2 AA 462.) The second negligence claim (described by counsel as the "delay case") alleged that Falk's negligence caused months

of delay, and sought $66,000 in damages allegedly attributable to Falk's negligence. (2 AA 462.)

The jury returned the following verdict: "On [the Rossas'] cause of action for breach of contract against Falk, the jury finds for [the Rossas] against defendant Falk. The jury finds damages caused by the breach of contract in the amount of $100,000. [¶] On [the Rossas'] cause of action for negligence against Falk, the jury finds against [the Rossas] and for defendant Falk." (2 AA 462.)

Following the jury's verdict, the trial court entered a Judgment on the Verdict, and subsequently a Nunc Pro Tunc Judgment on the Verdict, adjudging that: "(1) the Rossas recover $100,000 plus post-judgment interest against Falk on their breach of contract cause of action; (2) the Rossas take nothing on their negligence cause of action; (3) the Rossas were the prevailing parties with respect to their breach of contract cause of action; and (4) the Rossas shall recover their costs against Falk in the amount of $45,344, exclusive of attorney's fees and expert witness fees." (2 AA 463.) The trial court reserved the right to award attorney's fees and expert witness fees following a motion to be filed by the Rossas. (2 AA 463.)

2. The Attorneys' Fee Award

Based on their $100,000 victory on the breach of contract claim, the Rossas moved to recover over $500,000 in attorney's fees from Falk. (2 AA 463.) The motion was supported by the declarations of the Rossas' chief trial counsel Daniel McLennon, and California attorney's fee expert Richard Pearl. (2 AA 463.) McLennon's declaration divided the attorney's fees into four time periods: prior to the first mediation, $41,109.50 was billed for 215.8 hours of time; between the first and second mediations, $44,225 was billed for 225.9 hours of time; between the second mediation and the start of trial, $180,991.50 was billed for 826.05 hours of time; and during trial, $195,098 was billed for 894.23 hours of time. (2 AA 464.) McLennon did not provide any information as to the nature of the work done during these time periods. (1 AA 154.) Pearl's declaration provided an analysis of attorney's fees charged by various law firms, and concluded that – based on what he had been told in a 2.5 hour meeting with the Rossas' attorneys – the hourly rates were not unreasonable. (2 AA 465.)

Falk opposed the motion, arguing, among other things, that the Rossas failed to meet the burden of proof necessary to support an award of attorney's fees, and that the amount sought must be reduced because of the Rossas' limited success in their litigation against Falk, i.e., the abject failure of the encroachment claim, negligence claims, and breach of warranty claims. (2 AA 465.) Falk's opposition was supported by the

declarations of Falk's trial counsel Jeffrey Leon and Robert Keenan. (2 AA 466.) Keenan's declaration attached complete copies of numerous pretrial depositions taken by the Rossas' attorneys, and pointed out that a substantial number of these depositions pertained in whole or in part to the unsuccessful negligence and encroachment claims. (2 AA 466.) Keenan also pointed out that a substantial number of the pleadings prepared by the Rossas' attorneys pertained in whole or in part to these unsuccessful claims. (2 AA 466.)

The Rossas' memorandum in reply asserted, largely without analysis or support, that they had met their burden of proof and that the award should not be reduced. (2 AA 466.) The Rossas did not object to Keenan's declaration or attempt to take issue with his analysis of the pre-trial depositions and pleadings. (2 AA 466.) In a supplemental reply declaration, McLennon attached the attorneys' bills submitted to the Rossas, but redacted any description of the services provided in connection with the hours billed, prompting the trial court to observe at the hearing on the motion, "Mr. McLennon, that is a fairly interesting point. . . . [T]here are, well over several hundred pages here. [¶] . . . [¶] But it's nothing, but inked out things," and "Mr. Leon's point is why [did] you submit all these redacted. This is simply – well, it's almost mind boggling. All you had to do was[,] if you are going to do this[,] is say I spent X number of [hours] and X number of dollars per hour." (2 AA 467-468.)

On September 11, 2006, the trial court awarded the Rossas the entire amount requested in their fee motion: $681,390.15. (1 AA 39-41, 468-469.) The court refused to apportion fees between successful and losing claims as requested by Falk. (*Id.*)

3. The Appeals and Appeal Bonds

On June 30, 2006, Falk appealed from the Nunc Pro Tunc Judgment on the Verdict, designated A114677 (the "initial appeal"). (1 AA 23-24, 226, 2 AA 469.) The same day, Falk filed an appeal bond in the amount of $225,000 to stay enforcement of the $100,000 judgment pending against Falk (the "initial appeal bond"). (1 AA 227, 2 AA 429-434.)

On September 26, 2006, the trial court entered a Nunc Pro Tunc Judgment on the Verdict in the total amount of $781,390.15, incorporating the September 11, 2006 Order awarding attorney's fees and costs. (2 AA 420-422.) On November 9, 2006, Falk appealed from both the September 26, 2006 Nunc Pro Tunc Judgment on the Verdict awarding attorney's fees and costs and the September 11, 2006 Order awarding attorney's fees and costs, designated A116151 (the "attorney fee appeal"). (2 AA 425-426, 469.) On November 17, 2006, Falk filed an additional appeal bond in the amount of $955,000 (the "second appeal bond"), increasing the total bonded amount to cover the full amount of the judgment, including attorney's fees and costs. (1 AA 227, 2 AA 443-446.) The annual

premium on the second appeal bond was $9,550. (2 AA 239 [Sutton Decl., ¶ 4]; 2 AA 446.)

In order to obtain issuance of the second appeal bond, the surety required Falk to procure a Standby Letter of Credit from a bank in the amount of $954,070. (2 AA 239 [Sutton Decl., ¶ 5].) Janice Sutton, Falk's Vice President, inquired of Wells Fargo Bank as to its requirements for issuance of the necessary Standby Letter of Credit, and was informed that Falk would be required to open a deposit account with Wells Fargo and deposit funds totaling $954,070 as security. (2 AA 239 [Sutton Decl., ¶ 5].)

In order to obtain the funds necessary to set up the deposit account, Falk Construction drew down $483,070 on its commercial line of credit with Wells Fargo. Falk's principal, David Falk, borrowed an additional $471,000. This loan was funded by a draw down on Mr. Falk's personal line of credit with Wells Fargo. (2 AA 239 [Sutton Decl., ¶ 6].) The terms of the loan from David Falk required Falk Construction to reimburse him for the actual interest paid and expenses incurred to borrow the funds from his personal line of credit. (2 AA 239 [Sutton Decl., ¶ 6].)

4. Settlement and the Judgment Appeal

On September 5, 2007, Falk and the Rossas settled Falk's initial appeal from the underlying judgment of $100,000. (2 AA 487:10-15 [Tanke Decl., ¶ 6].) In connection with the settlement, Falk satisfied the

judgment, dismissed the initial appeal, and withdrew the $225,000 bond posted to stay enforcement of the underlying verdict. (*Id.*)

5. Reversal of the Fee Award

Falk's attorney's fee award appeal continued after settlement of the judgment appeal. On September 9, 2008, the Court of Appeal issued an unpublished opinion reversing the award of attorney's fees and expert witness fees, holding that the trial court abused its discretion in four respects. (2 AA 457-483; 2008 WL 4147560.) As the appellate court observed:

First, the trial court abused its discretion by concluding that "the lodestar 'doctrine should not be utilized where the action deals only with a pecuniary claim, and not a matter dealing with the public interest.'" (2 AA 472.) Accordingly, awarding the full amount of fees requested by the Rossas, without analyzing "whether any of the work for which the Rossas sought payment was duplicative, or wasteful, or for some other reason should not have been compensated," constituted an abuse of discretion. (2 AA 474.)

Second, the trial court abused its discretion by failing to apportion the Rossas' attorney's fees between the successful and unsuccessful causes of action. (2 AA 474-480.) As the Court of Appeal succinctly explained: "[T]he Rossas' complaint alleged five causes of action: one for breach of contract, one for negligence, and three for breaches of warranty. The

Rossas dismissed three of the claims, went to the jury on two claims, and succeeded on one, the contract claim. They lost on the negligence claim. The trial court nevertheless gave them all the fees requested, with no analysis. This was error." (2 AA 475.) Contrary to the trial court's conclusion that "'it would be inappropriate to penalize [the Rossas] because their attorney utilized multiple theories,'" the Court of Appeal held that the Rossas did not utilize multiple theories, but rather brought "multiple claims, four out of five of which were unsuccessful." (2 AA 477.) Consequently, apportionment between the successful and unsuccessful claims was mandatory, and failure to do so constituted an abuse of discretion. (*Id.*)

Third, the trial court abused its discretion by awarding, "[w]ithout analysis or discussion – indeed, without mention," all requested expert witness fees despite the fact that such fees were not pleaded and proved as damages at trial. (2 AA 480-482.)

Finally, the trial court abused its discretion by awarding as costs "copying charges, federal express charges, facsimile charges, expenses for summarizing depositions, expenses for an investigator, travel expenses not related to depositions, and miscellaneous other expenses," many of which were unrecoverable as costs, and all of which were neither pleaded nor proved as damages at trial. (2 AA 482.)

The Court of Appeal remanded the matter for further proceedings consistent with its Opinion. Falk was awarded costs on appeal. (2 AA 483.)

6. The Trial Court's Order Striking Falk's Interest Costs

When the Court of Appeal's Opinion reversing the fee award was filed, Falk had been advised by its appeal bond surety that, unless Falk obtained an order exonerating the second appeal bond before the renewal date of November 16, 2008, Falk would be required to pay an additional annual bond premium of $9,550, and to replace or extend the line of credit obtained to secure the bond. (2 AA 241 [Sutton Decl., ¶ 12].) The following day, September 10, 2008, Falk's counsel contacted the Rossas' counsel, advised him of the appellate decision, explained the costs of renewing the bond, and asked that the Rossas stipulate to an order exonerating the bond. (2 AA 241:15-21 [Sutton Decl., ¶ 13; 2 AA 397:9-14 [Gutierrez Decl., ¶ 12].) The Rossas refused. (2 AA 397:15-19 [Gutierrez Decl., ¶ 13]; 2 AA 448:15-18 [Sherman Decl., ¶ 5].)

On October 30, 2008, Falk's appellate counsel sent an email to the Rossas' counsel renewing the request to release the bond and transmitting a proposed stipulation for the Rossas to sign providing for the issuance of an order releasing the bond. The Rossas' counsel did not respond. (2 AA 487:16-24 [Tanke Decl., ¶ 7].) Another email was sent on November 12, 2008, advising the Rossas' counsel that failure to respond and execute the

order would result in Falk seeking the recovery of the additional expenses for renewing the bond. The Rossas' counsel responded by questioning Falk's right to recover such expenses. (2 AA 487:25-488:2 [Tanke Decl., ¶ 8].)

Falk filed a timely Memorandum of Costs on Appeal seeking $146,030.11. (1 AA 3.) It was also required to pay the renewal premium of $9,550, as well as a fee of $1,784 to extend the line of credit by one month. (2 AA 241:15-21; 242:1-9 [Sutton Decl., ¶¶ 13, 15].) It then filed an Amended Memorandum of Costs on Appeal (Falk's "cost memorandum") seeking $147,814.11, including the $1,784 fee to extend the line of credit under the heading "[o]ther expenses reasonably necessary to secure surety bond." (1 AA 207.)

Without a stipulation from the Rossas, Falk was required to file a motion to exonerate the appeal bond surety. The Rossas did not oppose Falk's motion. The surety was exonerated and the bond discharged. (1 AA 213-216.)

Falk's cost memorandum consisted of four items, which were incurred by Falk in order to procure the letter of credit to obtain its surety bond:

Premium costs for the appeal bond. Falk incurred $28,650 for premium costs for the appeal bond. (1 AA 207; 2 AA 239:4-11.)

Bank credit extension fees. Falk incurred $1,784 from an additional "non-refundable commitment loan fee" to extend Falk's commercial line of

credit by an additional month. This additional fee was a bank charge to extend Falk Construction's commercial line of credit by an additional month because the funds collateralizing the Letter of Credit had been drawn down by the Bank, pending an order discharging the surety bond. The withdrawal of funds had been triggered by Wells Fargo's decision not to renew the Letter of Credit. (2 AA 242:1-9 [Sutton Decl., ¶ 15].)

Bank letter of credit fees. Falk incurred $950.00 in bank letter of credit fees, including two annual charges of $450 each and two $25 charges for courier services. (2 AA 241:22-28 [Sutton Decl. ¶ 14].)

Interest. The total interest expense incurred by Falk to obtain the Letter of Credit was $99,289.81. (2 AA 239:12-20 [Sutton Decl., ¶ 5].) Calculation of the interest expense is explained in the Declaration of Janice Sutton as follows:

> "In calculating the interest expense for purposes of the Memorandum of Costs, I determined the total amounts paid on Falk Construction's line of credit and David Falk's line of credit as reflected on the monthly statements from the financial institutions that extended the credit lines.
>
> On the Falk Construction line of credit, there were additional sums drawn down on the line. To determine the amount of interest expense allocable to the deposit funds, I multiplied the monthly interest expense by a fraction the numerator of

which was the total borrowed and deposited in the Wells Fargo deposit account to secure the Letter of Credit ($483,070) and the denominator of which was the total borrowed on the line of credit. This totaled $77,033.81. I added to this the total interest paid to David Falk to reimburse him for the interest expense on his personal line of credit ($471,000), which totaled $77,949.67. I then subtracted from this total the interest payments received on the deposited funds totaling $55,693.57. [¶] [Accounting for updated information and additional interest paid,] the total interest paid on Falk Construction's line of credit was $80,658.05; the total interest paid to David Falk to reimburse him expenses on his line of credit were $83,195.84; and, the total interest earned on the funds deposited in the deposit account were $55,588.27. The total cost to Falk Construction to secure the Letter of Credit required to collateralize the surety bond was therefore $108,262.62." (2 AA 239:27-240:22 [Sutton Decl., ¶¶ 7-8].)

On December 3, 2008, the Rossas filed a Motion to Strike Defendant's Costs in Cost Bill After Appeal (the Rossas' "motion to strike costs"), challenging a number of items, including the $99,289.81 in interest

payments made on the letter of credit required to secure the bond and the $1,784 credit extension fee. (1 AA 7-16.)

In their memorandum in support of the motion to strike costs, the Rossas argued that rule 8.278, subdivision (d)(1)(F), "does not provide for interest." (1 AA 15:10-11.) This was so, according to the Rossas, because two appellate decisions, *Geldermann, Inc. v. Bruner* (1992) 10 Cal.App.4th 640, and *Golf West of Kentucky, Inc. v. Life Investors, Inc.* (1986) 178 Cal.App.3d 313, "held that the rule did not allow the recovery of costs for the obtaining of a surety bond." (1 AA 15:14-15.)

However, as the Rossas conceded immediately following their citations to this authority, "[t]his changed, of course, when the rule was amended to so specifically provide [for] costs to procure surety bonds." (1 AA 15:15-16.) The Rossas then cited two additional pre-amendment decisions, *Crag Lumber Co., Inc. v. Crofoot* (1958) 156 Cal.App.2d 568 [holding that the bond premium was not recoverable under the then-existing rule], and *Sequoia Vacuum Systems v. Stransky* (1964) 229 Cal.App.2d 281 [holding that interest paid on funds borrowed to make a deposit in lieu of a bond was not recoverable under the then-existing rule]. Without any analysis of the amendment to the rule, which added "the cost to obtain a letter of credit as collateral" to the items of cost recoverable under the rule (Rule 8.278, subd. (d)(1)(F)), the Rossas nonetheless reasoned that interest "is therefore not a permitted cost to be awarded." (1 AA 15:22-23.)

On January 16, 2009, Falk filed an opposition to the Rossas' motion to strike costs, explaining that *Sequoia Vacuum* and *Geldermann* had been superseded by the amendment to the rule, as explained in *Cooper v. Westbrook Torrey Hills* (2000) 81 Cal.App.4th 1294, 1300. As the opposition stated:

> "The Judicial Counsel responded directly to the *Geldermann* court's concern [that commercial realities may require an expenditure for a letter of credit to secure an appeal bond] by adding, as of January 1, 1994, subparagraph (6) to rule 26(c) [now rule 8.278, subdivision (d)(1)(F)] and expressly permitting recovery of any 'other expense' needed to obtain a bond, including the cost of obtaining a letter of credit." (1 AA 232:15-17.)

As Falk further explained in its opposition, *Cooper* involved a cash deposit in lieu of an appeal bond. The *Cooper* court reasoned that, because interest payments are required costs of obtaining a letter of credit to secure an appeal bond and a deposit in lieu of an appeal bond must be treated the same as an appeal bond under section 995.730 of the Code of Civil Procedure, interest incurred in making a cash deposit in lieu of a bond must logically be treated as a recoverable item of cost. (1 AA 232.) Accordingly, argued Falk, its reasonable interest expenses of $99,289.81 should be awarded.

On January 23, 2009, the Rossas filed a reply memorandum effectively conceding that interest payments "actually incurred" by Falk are recoverable under rule 8.278, subdivision (d)(1)(F), but argued that "evidence is lacking that what Falk now contends is over $100,000 i[n] interest was actually incurred as interest for the letters of credit obtained to secure its surety bond." (2 AA 505:23-26.) According to the Rossas: "$21,340.24 is the most that should be paid for interest to Falk for the Standby Letter of Credit." (2 AA 507:3-4.)

On April 24, 2009, the Honorable Marie Weiner of the San Mateo County Superior Court issued a Corrected Order on Motion to Tax Costs which, among other things, granted the Rossas' motion to strike Falk's interest payments and extension of credit fee from the cost bill. (2 AA 522.) Disregarding the Rossas' concession that reasonable interest payments that are actually incurred are recoverable under rule 8.278, subdivision (d)(1)(F), Judge Weiner expressed her understanding of the rule as follows:

> "A prevailing appellant may recover 'the cost to procure a surety bond, including the premium and the cost to obtain a letter of credit as collateral, unless the trial court determines the bond was unnecessary[.]" . . . [Falk] is being awarded the costs of the bond as well as the charges for the letter of credit as the collateral for the bond. [Falk] seeks to rely upon case

law pertaining to the situation where an appellant posts *cash* instead of a bond. That is not the situation here. If [Falk] had actually posted, as the appeal security, the fund of *cash*, [Falk] may well have been entitled to the interest paid to obtain that cash. [Citing *Cooper*, *supra*, 81 Cal.App.4th 1294.] Instead, [Falk] posted a bond, and [Falk] cannot [seek] recovery [of] both the expense of posting a bond as well as seek the expenses for if he had posted the cash – [Falk] doesn't get both. Although the bank required that [Falk] become a customer with certain cash funds on deposit, the *cost* to obtain the letter of credit was $950.00." (2 AA 522-523.)

7. Falk's Appeal, the Appellate Decision, and this Court's Review

The First District Court of Appeal affirmed the trial court's order in full in a published opinion on May 6, 2010, for reasons that will be discussed below. On June 14, 2010, Falk petitioned for review. This Court granted Falk's petition on August 11, 2010.

DISCUSSION

California law does not provide for a stay in the enforcement of money judgments pending appeal unless the appellant gives a bond to secure payment of the judgment amount, postjudgment interest, and costs in the event the judgment is affirmed or the appeal is abandoned or dismissed. A bond posted by an admitted surety insurer must be for one-and-one-half (1 1/2) times the amount of the judgment. (Code Civ. Proc., § 917.1, subd. (b).)

Without such a bond, appellant's assets are vulnerable to immediate execution, sale, and the full range of judgment enforcement remedies notwithstanding pendency of the appeal. (Code Civ. Proc., § 917.1(a); see also § 683.010 [". . . [A] judgment is enforceable . . . upon entry."]; § 695.010 ["Except as otherwise provided by law, all property of the judgment debtor is subject to enforcement of a money judgment."].)

The bond-premium and letter-of-credit costs incurred by Falk to secure and maintain an appeal bond are typical of those required of other appellants. The surety, International Fidelity Insurance Company, provided a bond in the amount of $955,000, which was one-and-one-half (1 1/2) times the amount of the attorneys' fee award against Falk. (2 AA 244, Code Civ. Proc., § 917.1.) For providing the bond, the surety charged an annual bond premium of $9,550 or 10% of the bond amount. The bond was

twice renewed during the appeal after its insurance, resulting in a premium charge of $28,650. (2 AA 239:1-11.)

As the Court of Appeal observed, in order to process the appeal bond, Falk had to obtain a letter of credit. (Opn. 2.)[2] Before issuing the bond, the surety required Falk Construction to procure a standby letter of credit by which a financial institution would guarantee payment of the bond amount in the event a claim were made against the bond following appeal. (2 AA 239:12-20.)

When Falk Construction sought to obtain the letter of credit from Wells Fargo Bank, the bank insisted that the company open a deposit account and deposit funds as collateral security in the sum of $954,070. To obtain the funds needed to make the deposit, Falk had to draw down the remainder of its corporate line of credit with the bank in the amount of $483,070. Lacking additional credit, it borrowed the $471,000 balance of the required deposit from the personal credit line of its principal and president, David Falk, and agreed to reimburse him for the actual interest and expenses of his use of his credit line. (2 AA 239:21-26.)

The trial court awarded Falk most of the premium costs of the appeal bond plus the bank's fees for issuing the letter of credit and certain courier charges. (Opn. 2; 2 AA 521-523.) But it denied $1,784 in charges from an

[2] The Court of Appeal's Opinion in Case No. A125567 will be referred to as "Opn.," followed by the page number.

additional "non-refundable commitment loan fee" to extend the Falk Construction business line of credit. (Opn. 2-3 & fn. 3; 2 AA 242:1-9; 386; 522.) And it also refused $99,289.81 in interest: (1) paid by Falk Construction on its business credit line; and (2) reimbursed to its principal David Falk on his personal line of credit which were used to make the bank deposit to collateralize the appeal bond. (Opn. 3; 2 AA 522-523.) The Court of Appeal affirmed the trial court's decision.

The Court of Appeal's construction of rule 8.278(d)(1)(F) disregards the rule's plain meaning, rulemaking history, and manifest purpose to introduce commercial reality and fairness into awards of appellate costs. To honor the Judicial Council's intentions in enacting the rule and to preserve the rule's constitutionality, the Court of Appeal's decision must be reversed.

I. THE APPEAL BOND COST RULE SHOULD BE INTERPRETED TO INCLUDE THE COST OF INTEREST NEEDED TO OBTAIN LETTER-OF-CREDIT COLLATERAL FOR AN APPEAL BOND.

A. The Plain Meaning Of the Rule Supports the Award of Interest.

Section 1034, subdivision (b) of the Code of Civil Procedure, enacted in 1986, expressly empowers the Judicial Council to determine the allowable costs on appeal as part of the California Rules of Court. The

statute provides: "The Judicial Council shall establish by rule allowable costs on appeal and the procedure for claiming those costs." (*Id.*) In rule 8.278, which establishes appellate costs, the Council authorizes recovery of the "*reasonable . . . cost to procure a surety bond, including the premium and the cost to obtain a letter of credit as collateral*, unless the trial court determines the bond was unnecessary." (Cal. Rules of Court 8.278(d)(1)(F).)

Falk's interest and extension-of-credit expenses to secure the letter of credit were unquestionably part of "the cost to obtain a letter of credit as collateral." The Court of Appeal contravened the plain meaning of the rule by denying those amounts to Falk as costs on appeal. (Opn. 11.)

"The rules applicable to interpretation of the rules of court are similar to those governing statutory construction. Under those rules of construction, [the Court's] primary objective is to determine the drafters' intent." (*Silverbrand v. County of Los Angeles* (2009) 46 Cal.4th 106, 125, citations omitted; see also *Branner v. Regents of University of California* (2009) 175 Cal.App.4th 1043, 1047; Cal. Const., art. VI, § 6; see also Gov. Code, § 68070, subd. (b); Cal. Rules of Ct., rule 10.1.) As this Court has observed: "Our objective is to determine the drafter's intent. If the rule's language is clear and unambiguous, it governs." (*Alan v. American Honda Motor Co., Inc.* (2007) 40 Cal.4th 894, 902.) "'In determining [drafters'] intent, a court must look first to the words of the [rule] themselves, giving

to the language its usual, ordinary import and according significance, if possible, to every word, phrase and sentence in pursuance of the [drafters'] purpose.' [Citation.]" (*State Farm Mutual Automobile Ins. Co. v. Garamendi* (2004) 32 Cal.4th 1029, 1043; *San Leandro Teachers Assn. v. Governing Bd. of San Leandro Unified School Dist.* (2009) 46 Cal.4th 822, 831.)

The plain meaning of the "cost to obtain a letter of credit as collateral" includes any expenses incurred to that end. *Cost* means the "amount paid or charged for something; price or expenditure." (Black's Law Dict. 8th ed. 2004.) *Expenditure* is a "sum paid out." (*Id.*)

In order to obtain the letter of credit, Falk was required to incur an obligation to pay interest as one component of the "price" of the letter of credit. Put another way, interest was part of the "amount paid or charged" – a "sum paid out" – for the letter of credit. Falk *could not* have obtained the letter of credit without paying the interest incurred on the money borrowed to acquire it. That interest is, by definition, a "cost" of obtaining the letter of credit.

The Court of Appeal sarcastically disregarded the plain meaning of the rule as reflected in definitions of its terms. (Opn. 7, fn. 5.) Indeed, it refused to analyze the ordinary meaning of the words used by the Judicial Council. This was an oversight. This Court's decisions repeatedly hold that dictionary definitions play an integral part in ascertaining the meaning

of statutory language. (*Goodman v. Lozano* (2010) 47 Cal.4th 1327, 1333-1334, citing *Wasatch Property Management v. Degrate* (2005) 35 Cal.4th 1111, 1121-1122 ["When attempting to ascertain the ordinary, usual meaning of a word, courts appropriately refer to the dictionary definition of that word."].)

The interpretation of words in context is vital to statutory construction. "Because the language of a statute is generally the most reliable indicator of . . . intent, we look first to the words of the statute, giving them their ordinary meaning and construing them in context. If the language is unambiguous, we presume the Legislature meant what it said, and the plain meaning of the statute controls." (*People v. Hudson* (2006) 38 Cal.4th 1002, 1009 [citations omitted].) The Court of Appeal did not examine the words used by the Judicial Council.

Nor did it find the phrase "cost to obtain a letter of credit as collateral" to be ambiguous. It was, therefore, required by rules of construction in this Court's decisions to apply the plain meaning of the court rule which allows recovery of the costs sought by Falk.

Instead of following the directions in this Court's decisions, the Court of Appeal held that appellate caselaw requiring "strict construction" of cost statutes trumped the plain-meaning reading of the court rule. But even a rule of strict construction "does not require that the narrowest possible meaning be given to words . . . [A] strict construction must still be

a reasonable one." (*Cedars of Lebanon v. Los Angeles County* (1950) 35 Cal.2d 729, 735; see also *In re Adoption of M.S.* (2010) 181 Cal.App.4th 50, 58 [rule of liberal construction not a license to enlarge or restrict evident meaning of statute or rule of court]; *Scripps Clinic & Research Foundation v. County of San Diego* (1997) 53 Cal.App.4th 402, 410 [strict construction must be reasonable in light of language used]; *Lammers v. Superior Court* (2000) 83 Cal.App.4th 1309, 1321 ["commonsense interpretation" required regardless of construction rules].)

When costs statutes are at issue, no rule of "strict construction" can justify disallowing a cost expressly authorized by statuary language. Rather, such a rule merely inquires "whether the statute expressly allows the particular item and whether it appears proper on its face." (*Gorman v. Tassajara Development Corp.* (2009) 178 Cal.App.4th 44, 71; see also *Benson v. Kwikset Corp.* (2007) 152 Cal.App.4th 1254, 1279 ["Under the plain language doctrine, a court's first step in determining legislative intent when construing a statute is to review the words used in the statute, giving the terms their plain and ordinary meaning."].)

Falk's cost claim satisfies "strict construction" because the court rule's broad language expressly allows Falk to recover the full "cost to obtain a letter of credit as collateral" which encompasses interest and credit-related costs as well as other necessarily incurred expenses of that collateral. A construction rule does not authorize a court to eliminate what

is written or to "*restrict*[]" the evident meaning of a statute. (*In re Adoption of M.S., supra,* 181 Cal.App.4th 50, 58.)

In sum, the Court of Appeal's refusal to ascertain and apply the plain meaning of the appeal bond cost rule was error. As Falk will further explain below, this threshold error was compounded by others that totally undermined the court's interpretation of the rule.

B. The Rulemaking History Reveals the Judicial Council's Intention to Permit the Award of All Reasonable and Necessary Costs of Obtaining an Appeal Bond – Including Interest to Fund Letters of Credit as Collateral.

When, as here, the plain meaning of a statute or court rule is clear, there is no need to resort to its history. (*Hughes v. Pair* (2009) 46 Cal.4th 1035, 1046; *Trans-Action Commercial Investors, Ltd. v. Jelinek* (1997) 60 Cal.App.4th 352, 363.) But even if the appellate cost rule here were deemed ambiguous and in need of construction, its rulemaking history unmistakably reveals the Judicial Council's objective – to provide compensation to appellants who are forced to incur surety bond and letter-of-credit collateral expenses to protect their assets from legally flawed money judgments.

Before January 1, 1994, former rule 26 (the predecessor to rule 8.278) made recoverable as an appeal bond cost only "the premium on any surety bond procured by the party recovering costs." (Former rule 26,

subd. (c)(5), as amended Jan. 1, 1987.) No other bond-related costs were authorized in the rule. In *Geldermann, supra,* 10 Cal.App.4th 640, the prevailing appellant sought to recover the $26,340 premium for the appeal bond and an additional $28, 676 in unspecified bank charges for a letter of credit to collateralize the bond.[3]

In affirming the trial court's order striking the letter-of-credit charges, the *Geldermann* court quoted the language of rule 26(c), which then expressly provided that a prevailing appellant "may recover *only* the following, when actually incurred," and made no mention of letter-of-credit expenses. As the court observed: "[A]ppellate costs are not made recoverable by the mere fact they are reasonable; they are recoverable only as authorized by statute or rule of court." (*Id.* at 643.) Because, under the plain meaning of the rule, only the specifically-enumerated costs were recoverable, and because a "charge incurred for a letter of credit to secure an appeal bond [was] not a listed cost," that charge was therefore not recoverable. (*Id.* at 642-643.)

The *Geldermann* court agreed with the appellant that its holding did not comport either with manifest equity or sound practical economics. It recognized that denial of letter-of-credit costs ignored "commercial realities

[3] Although the court's opinion is not clear on the point, it is likely that bank charges of this size were made at least in part for an extension of credit to purchase the letter of credit and not merely as a letter-of-credit fee. By comparison, the fee for the letter of credit in this case was $950.

as to the true costs of obtaining appeal bond," but explained that is was not free to disregard the rule's plain meaning which made the specifically-listed costs exclusive. And it acknowledged that pragmatic considerations might prompt a change in the rule:

> "Commercial realities might convince the Judicial Council to amend rule 26(c) to permit recovery of charges for letters of credit, but that has not yet happened. Absent such authorization, we may not rely on practical considerations to permit recovery of a charge that is not among the 'only' costs recoverable under rule 26(c)." (*Id.* at 643-644.)

Although constrained to rule against appellant's cost claim by the limiting language of the rule, the *Geldermann* court urged the Judicial Council to undertake reform to permit recovery of letter-of-credit costs in the interests of fairness and commercial reality. As the court stated:

> "We agree with [appellant] . . . that rule 26(c) ignores the commercial realities of today which may require an expenditure for a letter of credit to use as security for the appeal bond. Fairness in this case would compel [respondent] to reimburse [appellant] for the cost of the letter of credit. Unfortunately, this is not a matter of equity, but a rule which we must construe strictly. Although it will not benefit [appellant] we suggest his argument must be addressed to the

Judicial Council. That body possesses the authority to adopt or amend California Rules of Court; we do not. Our authority is limited to applying them as written." (*Id.* at 644.)[4]

The *Geldermann* decision was written by former Justice Donald King of Division Five of the First Appellate District. True to what he wrote for the court in *Geldermann,* Justice King called the decision to the attention of the Judicial Council and recommended that rule 26 be amended to allow recovery of the expense of obtaining a letter of credit to serve as collateral for an appeal bond. A Judicial Council internal memorandum dated July 20, 1993 from the Council's Appellate Standing Advisory Committee, chaired by Justice Marvin Baxter, recounted the history of a proposed rule change designed to address *Geldermann:*

> "Rule 26 - Recoverable costs on appeal. Justice Donald King referred us to *Geldermann, Inc. v. Bruner* (1992) 10 Cal.App.4th 640, which denied recovery, as costs, of *the expense of a letter of credit required in order to obtain the appeal bond. He suggests amending rule 26 to allow recovery of such expense.*

[4] Thus, the court's "strict construction" of the rule merely reflected the plain and unambiguous meaning of its limiting language.

Comments. The Appellate Court Committees of the Los Angeles and San Diego County Bar Associations support the proposal. There was no opposition.

Recommendation. The Appellate Standing Advisory Committee recommends that the Judicial Council amend rule 26, effective January 1, 1994, to permit *the expense of a letter of credit needed to secure an appeal bond to be recovered as costs.*

The text of the proposed amendment is at pages 9-10."

(Appellant's Request for Judicial Notice (RJN), p. 4.)[5]

In direct response to the *Geldermann* court's concern that rule 26(c) ignored fairness and the commercial realities of letter-of-credit collateral financing, the Judicial Council added subparagraph (6) to subdivision (c), making recoverable any "other expense reasonably necessary to procure the surety bond, such as the expense of acquiring a letter of credit required as collateral for the bond." (Rule 26, subdivision (c)(6), as amended Jan. 1, 1994.

While the new rule could have addressed *Geldermann*'s holding narrowly by allowing, for example, only "bank fees charged to open a letter of credit," the Judicial Council chose to address the commercial constraints and equities referred to in *Geldermann* more broadly and realistically. The

[5] The RJN was filed in support of Appellant's Petition for Review.

language of the new rule thus goes beyond a single selected kind of expense to include *any* expense necessary to obtain the bond, giving as but one example the expense of acquiring a letter of credit to serve as collateral for the bond.

Between 1994 and the present, rule 26(c)(6) was modified as a part of wholesale changes in language and rule numbering made to streamline and simplify the operation of the rules on appeal. None of the changes altered the substance of the rule which expressly allows recovery of interest and all other reasonable letter-of-credit expenses incurred to collateralize an appeal bond. The particular change resulting in the current language of current rule 8.278, subdivisions (d)(1)(F) was made effective on January 1, 2003. That change revised former rule 26(c)(6) to substitute "cost" for "expense" language to provide that the "reasonable . . . cost to procure a surety bond, including the premium and the cost to obtain a letter of credit as collateral" are fully compensable to a prevailing appellant. (RJN, p. 92.)

The Judicial Council's intention to preserve to the present day the broad rule of bond and letter-of-credit cost recovery first enacted in 1994 is confirmed by the rulemaking history. The 2003 change that produced the language of current rule 8.278, subdivision (d)(1)(F) is discussed in a memorandum to the Judicial Council from the Appellate Advisory Committee, Justice Joyce L. Kennard, Chair, dated October 3, 2002. With *respect to rules revisions under consideration at that time,* including

changes resulting in rule 27, subdivision (c)(1)(F) [now rule 8.278, subdivision (d)(1)(E)], the committee explained that such revisions were purely stylistic unless otherwise explained in an Advisory Committee Comment:

> "Rationale for Recommendation to Adopt Revised Rules 19-29.9. Existing rules 19-29.9 suffer in varying degrees from the same deficiencies of language and structure as former rules 1-18 (revised in the first installment of this project), i.e., obscure and ambiguous wording, redundant and obsolete provisions, long and complex sentences and paragraphs, and inconsistencies of style and terminology. To cure these deficiencies, the revision simplifies the wording and clarifies the meaning of each provision; restructures individual rules into subdivisions to promote readability and understanding; and rearranges the order of subdivisions or the rules themselves when logic or clarity dictates. *The vast majority of the changes are stylistic only; but when necessary and appropriate, the revisions also make selected substantive changes for limited purposes, i.e., to resolve ambiguities; to fill unintended gaps in rule coverage; to conform older rules to current law, practice, and technology; and to otherwise improve the appellate process. Whenever the revision results*

in a substantive change, the Advisory Committee Comment to the rule identifies and explains the change." (RJN, pp. 79-80.)

No substantive change was identified in any Advisory Committee Comment. (See also RJN, p. 124.)

Thus, while subparagraph (6) of rule 26, subdivision (c) eventually migrated to rule 8.278, subdivision (d)(1)(F) and the text of the rule was changed in immaterial ways, the substance of the rule and its rationale remained unaltered. In light of commercial realities which often require expenditures to obtain a letter of credit as collateral to secure an appeal bond, the rule makes recoverable the full "cost to obtain a letter of credit as collateral" to secure an appeal bond. (Rule 8.278, subd. (d)(1)(F).)

Finally, the Judicial Council has reaffirmed in another way its manifest and continuing intention, as expressed in rule 8.278(1)(d)(F), to allow recovery of *all* expenses that are reasonable and necessary to obtain an appeal bond. The Council has express statutory authority to adopt mandatory forms for use in carrying out the provisions of the rules of court. (Gov. Code, § 68511; Cal. Rules of Court, rule 1.31.)

The Judicial Council adopted Judicial Council Form MC-013, Memorandum of Costs on Appeal, last revised on January 1, 2007, for mandatory use by prevailing appellants in claiming appellate costs. (Form MC-013; rule 8.228, subd. (c)(1); see *Eisenberg, et al., California Practice*

Guide – Civil Appeals and Writs (Rutter Group 2010), § 14:97.) Falk used the form to claim its costs on appeal on this case. (1 AA 207.)

Form MC-013 contains as Item No. 9 the "Premium on any surety bond on appeal." (1 AA 207.) *Then, as Item No. 10, the Cost Memorandum form broadly invites submission of all: "Other expenses reasonably necessary to secure surety bond." (Id.)* Among such other expenses are, of course, the interest on a loan required to purchase a letter of credit as collateral for the bond. By requiring the use of this form, the Judicial Council has further expressed its intention that any expense "reasonably necessary to secure" the appeal bond – including letter-of-credit collateral costs – be a recoverable cost on appeal.

In sum, the rulemaking history of rule 8.278 strongly reinforces the plain meaning of subdivision (d)(1)(F) which requires that prevailing appellants receive the full reasonable costs of letter-of-credit collateral purchased for appeal bonds.

C. Fairness to Prevailing Appellants and Economic Reality Favor the Award of Interest Expenses Incurred to Obtain Letter-Of-Credit Collateral.

As discussed in Section I(B) above, the Judicial Council enacted current rule 8.278(d)(1)(F) to address the commercial reality that financing costs of letter-of-credit collateral must borne by appellants and the unfairness of denying them reimbursement for those costs when they

prevail on appeal. The Court of Appeal's decision disregards both the realities and the manifest equities of bond costs on appeal.

Court rules, like statutes, are given a commonsense construction in accordance with their purpose and underlying policy. As the Court of Appeal has stated:

> "We interpret court rules in accordance with the cardinal rules of statutory construction, liberally construing them to facilitate the court's mandate to do justice between the parties. (16 Cal.Jur.3d (1983) Courts, §§ 154, 166, pp. 566, 584.) Rule 1.3 expressly provides the 'rules shall be construed to secure the efficient administration of the business of the court and to promote and facilitate the administration of justice by the court.' . . . We accord a challenged rule a reasonable and commonsense interpretation consistent with its apparent purpose, practical rather than technical in nature, which upon application will result in wise policy rather than mischief or absurdity." (*Lammers*, *supra*, 83 Cal.App.4th at 1321.)

The Court of Appeal's construction of the rule thwarts "the administration of justice by the court." It ignores commercial reality and unfairly forces appellants to subsidize appeal bonds for the sole benefit of respondents. Leaving prevailing appellants without *any* reimbursement for an actual, reasonable, and necessary expense of the appellate process laid

out only to secure respondent's interest in an invalid judgment does not comport with substantial justice.

Falk's legal odyssey here is a case on point. An appellant – especially one of limited means like Falk – who confronts a large but flawed money judgment faces a daunting set of hurdles. Falk lost a construction contract case and was subjected to a $100,000 judgment after defeating hundreds of thousands of dollars in additional claims made against it by respondent Rossas. Notwithstanding this modest result, the trial court made an attorneys' fee award against Falk for $630,000 that included no allocation for the numerous unsuccessful claims and disregarded established California law governing attorneys' fee awards. (1 AA 39-41.) Falk had to overcome the presumption of correctness in the trial court's fee order and meet the deferential abuse of discretion standard in order to obtain a reversal in full. (Opn. 1-2; see also 2 AA 470-481; *Rossa v. D.L. Falk Construction, Inc.,* No. A116151 (September 9, 2009).)

As the beneficiaries of an erroneous money judgment, the Rossas insisted on and received the protection of a surety bond of one-and-one-half (1 1/2) times the judgment amount that could insure immediate payment if the fee order were upheld on appeal. (§ 917.1, subd. (b); *Grant v. Superior Court* (1990) 225 Cal.App.3d 929, 934 [The bonding statute insures that "[a] successful litigant will have an assured source of funds to meet the amount of the money judgment, costs and postjudgment interest after

postponing enjoyment of a trial court victory."].) The appeal bond amount secures payment of the principal plus a generous above-market interest rate of 10% on the judgment amount. (§ 685.010.)

The principal goal of awarding costs on appeal is to compensate the prevailing party for its out-of-pocket expenses. "The purpose of [former] section 1034 [providing for costs to prevailing party] is not to pay a successful litigant for his own work, but to reimburse him for his actual out-of-pocket payment for the type of costs allowed. (*Muller v. Reagh* (1959) 170 Cal.App.2d 151, 154; see also *Falk v. Falk* (1941) 48 Cal.App.2d 780, 785-786 [former section 1034 entitled prevailing party to "costs actually incurred on appeal *for the purpose of reimbursement.*"].)

Here Falk was forced to pay nearly $100,000 in interest and bank fees in order to defend its assets against the Rossas' faulty judgment while Falk challenged it on appeal. The Rossas alone perversely benefited from that expenditure. In fairness, Falk is entitled to be reimbursed by the Rossas for the cost of that benefit – one that Falk should not have had to bear.

II. *COOPER* v. *WESTBROOK TORREY HILLS, LP* CORRECTLY INTERPRETED THE APPEAL BOND COST RULE.

Instead of focusing its analysis on the plain meaning, rulemaking history, and manifest purpose of the rule of court, the Court of Appeal mounted a large-scale attack on the Fourth District's decision in *Cooper,*

supra, 81 Cal.App.4th 1294. (Opn. 5-12.) The court's assault was misdirected in numerous ways; *Cooper* easily survives it.

Cooper correctly held that financing expenses laid out to procure a loan to fund a deposit in lieu of bond are recoverable costs on appeal in the same manner as similar expenses made to purchase a letter of credit. Moreover, the court's overarching premise that *Cooper* was somehow inconsistent with costs statutes and the Bond and Undertaking Law is fundamentally misguided because it disregards the governing statutory provision – Code of Civil Procedure section 1034(b) – that expressly empowers the Judicial Council to determine what costs are recoverable on appeal. Finally, the rule of court's insistence that all recoverable costs be reasonable and necessary outlays overcomes the Court of Appeal's speculation that Cooper's interpretation of the rule will encourage unsavory maneuvering and give rise to undesirable consequences.

A. *Cooper* Correctly Held That Interest Expenditures Are Recoverable Under the Predecessor Appeal Bond Cost Rule.

In *Cooper*, *supra*, 81 Cal.App.4th at 1300, the Court of Appeal held that reasonable and necessary *interest costs incurred in making a cash deposit in lieu of a surety bond* were recoverable costs on appeal. There, after losing at trial and in order to stay foreclosure proceedings initiated by Westbrook, Cooper "obtained a $3 million loan and deposited $2.5 million

of the loan proceeds with the clerk of the court" and "used the remaining loan proceeds to pay interest on the loan." (*Id.* at 1297.)

After obtaining a reversal of the trial court's judgment, Cooper filed a memorandum of costs in which he sought to recover over $200,000 in "interest costs he incurred in making the deposit." (*Id.* at 1297, 1300.) Denying Cooper's request for costs, the trial court ruled that former "rule 26(c) does not permit a party to recover the expenses associated with making a cash deposit in lieu of a surety bond." (*Id.* at 1298.)

Reversing the trial court's order denying interest costs, the Court of Appeal explained that "[a] deposit given instead of a bond has the same force and effect, is treated the same, and is subject to the same conditions, liability, and statutory provisions, including provisions for increase and decrease of amount, as the bond.'" (*Id.*, quoting Code Civ. Proc., § 995.730, emphasis omitted.) Therefore, as the court reasoned, because rule 26(c) makes recoverable the necessary and reasonable costs of procuring a surety bond, "[i]n order to read rule 26(c) consistent with section 995.730, the reasonable or necessary costs associated with procuring a deposit in lieu of a bond must be awarded to a prevailing party." (*Id.* at 1299.) Such costs include interest payments. (*Id.* at 1300.)

In reaching the conclusion that recoverable costs include interest payments, the court explained that three cases relied on by Westbrook – and also relied on by the Rossas in their opposition to Falk's cost

memorandum – had been superseded by an amendment to rule 26(c) "expressly permitting recovery of any 'other expense' needed to obtain a bond, including the cost of obtaining a letter of credit." (*Cooper*, *supra*, 81 Cal.App.4th at 1300 [distinguishing *Sequoia Vacuum*, *supra*, 229 Cal.App.2d at 289, *Golf West*, *supra*, 178 Cal.App.3d at 316-317, and *Geldermann*, *supra*, 10 Cal.App.4th at 644, as pre-rule-amendment cases].) Indeed, as *Cooper* explained, "the *Geldermann* court put the Legislature on notice that [then-existing] rule 26(c) 'ignores the commercial realities of today which may require an expenditure for a letter of credit to serve as security,' and further noted that '[f]airness in this case would compel [plaintiff] to reimburse [defendant] for the cost of the letter of credit.' [Citation.]" (*Id.*) The Judicial Council "responded directly to the *Geldermann* court's concern" by amending the rule to permit recovery for such expenditures. (*Id.*)

Accordingly, because reasonable and necessary interest expenditures would be recoverable as costs associated with obtaining a surety bond, and because a bond and a deposit in lieu of such a bond must be treated as equivalents by statutory command, the *Cooper* court justly and understandably held that appellant Cooper was entitled to his reasonable and necessary interest expenditures. (*Id.*) Its interpretation of the rule is the only one that furthers the rule's purpose and is fully consistent with its language and history. The Court of Appeal's criticism is unfounded.

B. *Cooper's* Holding that Appeal Bonds and Cash Deposits Are Equivalents Is Supported By Statutory Authority.

By statutory allowance given in the Bond and Undertaking Law, appellants seeking review of money judgments may choose to provide security by a surety bond (see § 917.1) or a deposit of cash or cash-equivalent instrument in lieu of a bond. Section 995.710, subdivision (a) provides:

> "Except as provided in subdivision (e) [governing deposits with the Secretary of State] or to the extent the statute providing for a bond precludes a deposit in lieu of bond or limits the form of deposit, the principal may instead of giving a bond, deposit with the official [i.e., the court with which the bond is filed under section 995.160] any of the following: [listing cash, bearer bonds, certification of deposit, savings and share accounts, or investment certificates in federally-insured amounts]."

As *Cooper* recognized, the consequences of making a deposit and posting a bond must be legally identical as declared by section 995.730 which provides that: "A deposit in lieu of a bond has the same force and effect, is treated the same, and is subject to the same conditions, liability, and statutory provisions, including provisions for increase or decrease of amount, as the bond." (*Cooper*, 81 Cal.App.4th at 1298-1300.)

The Court of Appeal calls *Cooper*'s recognition of the equivalence of bonds and cash deposits a "fault line" (Opn. 7), but nowhere explains why section 995.730 does not mean what is says or why the *Cooper* court's application of the statute to costs on appeal is in any way suspect. While the court points to other statutes in the Bonds and Undertaking Law, none of these enactments provides for or mandates different treatment of bonds and cash deposits with respect to appellate costs. (Opn. 7-9.)

Cooper's holding that bonds and deposits are to be treated the same for costs and other purposes is well recognized in California practice and flows from the plain statutory terms of section 995.730. (Eisenberg, et al., *California Practice Guide – Civil Appeals and Writs* (Rutter Group 2010), § 7.116-7.125.)

The Court of Appeal offers no reasonable basis for distinguishing bonds from cash deposits for cost purposes. A rule of court, like a statute, should be construed to avoid doubts as to its constitutionality. (*Timothy J. v. Superior Court* (2007) 150 Cal.App.4th 847, 858, citing in part *In re Howard N.* (2005) 35 Cal.4th 117, 134.) *Cooper's* construction avoids such doubts; the Court of Appeal's construction exacerbates them. (See Section III below.)

The central theme of the Court of Appeal's disagreement with *Cooper* lies in the assertion that *Cooper* is inconsistent with cost statutes and provisions of the Bond and Undertaking Law. (Opn. 7-10.) But that

premise is flawed at the outset because the Legislature has given plenary authority to the Judicial Council to specify recoverable costs on appeal, thereby rendering other statutory provisions, e.g., those governing trial court costs or other matters, inapposite. Section 1034(b) provides that: "The Judicial Council shall establish by rule allowable costs on appeal and the procedure for claiming those costs." (Stats. 1986, c. 377, § 15.)

The Council's plenary authority to establish allowable costs on appeal stands in contrast with its more limited authority regarding allowable trial court costs which are defined by statute: "Prejudgment costs allowable under this chapter [i.e., the statutes in Chapter 6 in Title 14 of the Code of Civil Procedure entitled "of costs"] shall be claimed and contested in accordance with rules adopted by the Judicial Council." (§ 1034(a).) Thus, when allowable costs on appeal are in issue, the central question is whether such costs are authorized by the plain meaning of court rules and not whether they are independently listed in other statutes.

The right to recover costs on appeal was originally governed by statute. (Opn. 4; *Lavine v. Jessup* (1959) 175 Cal.App.2d 136, 138.) In 1898, this Court held that: "The right to recover is purely statutory, and, in the absence of a statute, no costs could be recovered by either party." (*Fox v. Hale & Norcross Silver-Min. Co.* (1898) 122 Cal. 219, 223; cited in Opn. at 4.) In accordance with this principle, early caselaw adopted a rule of strict construction based on presumed legislative intent to restrict recovery

of costs to specific items expressly authorized by statute. (Opn. 4-5; *Moss v. Underwriters' Report, Inc.* (1938) 12 Cal.2d 266, 274-275 ["costs" strictly construed]; *Williams v. Atchison etc. Ry. Co.* (1909) 156 Cal. 140, 141 [costs disallowed "for lack of statutory authority"]; *Combs v. Haddock* (1962) 209 Cal.App.2d 627, 633-634 [same]; *Christenson v. Cudahy Packing Co.* (1927) 84 Cal.App. 237, 238-239 [same].)

Historically, where a distinction was made between costs on appeal and other costs, costs on appeal were governed by rule 26, originally drafted by Bernard Witkin in 1943. (Opn. 4.) In its original form, rule 26 made no mention of bond premiums or costs on appeal; however, it was amended in 1959 to allow recovery of "the premium on any surety bond procured by the party recovering costs." (*Id.*; *Combs, supra,* Cal.App.2d at 633.) Since that time, it has been generally held that costs on appeal are governed exclusively by rule. (*Lavine, supra,* 175 Cal.App.2d at 138 ["Costs on appeal from superior and municipal courts, formerly provided for by statute, are now entirely governed by rule."]; see also *Muller, supra,* 170 Cal.App.2d at 153.)

In 1986, the Legislature cemented the Judicial Council's autonomy with regard to appellate costs by adding sections 1033.5 and 1034 to the Code of Civil Procedure. In section 1033.5, (Stats.1986, c. 377, § 13), which is "trial court-oriented" and do not "govern costs on appeal," (*Alan S., Jr. v. Superior Court (*2009) 172 Cal.App.4th 238, 259-260), the

Legislature explicitly prescribed on the face of the statute those costs that are recoverable at trial. In contrast, in section 1034(b) governing costs on appeal, the Legislature did something decidedly different: It vested the power to define those costs squarely in the hands of the Judicial Council.

With one exception, all of the statutes referred to by the Court of Appeal as allegedly inconsistent with the award of interest as bond interest are inapposite because they disregard section 1034 subdivision (b)'s authorization to the Judicial Council to establish allowable costs on appeal.

For example, the Court of Appeal points to its own prior decision in *Sequoia Vacuum Systems, supra,* 229 Cal.App.2d 281, a case that antedates all of the rule changes and case authority at issue here, and observes that former section 1035, which allows only bond premiums to be recovered as costs, and 1054a, which permits cash in lieu of bonds, are substantially continued in the Bond and Undertaking Law. (Opn. 9-10.) But these statutory provisions no longer govern appellate costs in light of the Legislature's exclusive authorization in section 1034, subdivision (b) of the Judicial Council to define appellate costs. (Stats. 1986, c. 377, § 15.) The Court of Appeal has fallen into the trap of confusing trial costs – which are governed by statute – and appellate costs – which are governed by court rule under statutory command. (See *Alan S.,* 172 Cal.App.4th 238, 259-260 [reversing decision that confused trial cost statutes and appellate cost court rules].)

Similarly, the Court of Appeal cites section 995.740 for the proposition that interest on a deposit is "statutorily recoverable" only to the extent there are no proceedings pending to enforce the principal's liability. (Opn. 8.) But that statute has nothing to do with *recoverable appellate costs*. It requires only that cash depositors be paid interest on their deposits as long as no claim against the deposit has been made. It says nothing about what depositors may collect as costs from their opponents if they win an appeal. That is defined solely by rule 8.278(d) as authorized by section 1034, subdivision (b).

Moreover, the court further asserts that Cooper is "dubious" because it construed former rule 26(c) to allow recovery as a matter of law of loan interest paid to secure a cash deposit notwithstanding section 1033.5, subdivision (c)(4) which makes items not listed in that statute (e.g., bank fees or interest costs) allowable in the court's discretion. (Opn. 10-11.) This statute is likewise inapposite because it does not govern allowable costs on appeal. By statutory authority conferred in section 1034 subdivision (b), only the rules of court define such costs. (*Alan S., supra,* 172 Cal.App.4th at 259-260 [§ 1033.5 does not apply to costs on appeal].)

The only conceivably relevant statute the Court of Appeal cites is section 995.250, which the court calls "the most pertinent provision of the Bond and Undertaking Law." (Opn. 8.) Section 995.250 allows bond premiums paid "in an action or proceeding" which are paid "pursuant to a

statute that provides for the bond" or "in connection with the action or proceeding." (§ 995.250, subds. (a) and (b).) But that statute does not provide that these are the only allowable costs. It simply authorizes them. Nothing in the statute restricts cost recovery on appeal or undermines the Judicial Council's authority to define allowable costs on appeal as vested by section 1034, subdivision (b).

In summary, the Court of Appeal's statutory analysis – like its construction of the court rule at issue here – fails to attend to the plain meaning of governing statutory provisions. It cannot undermine the soundness of *Cooper*'s holding.

C. Under *Cooper*, Interest Awards Must Be Reasonable, Necessary, and Out-of-Pocket Outlays.

The Court of Appeal further contends that its rule of strict construction should operate to deny interest costs on appeal because there would otherwise be no way to avoid awarding credit card interest, employee time and labor, and other "difficult to calculate" expenses. (Opn. 11-12.) But the court takes no account of the express provision of rule 8.278(d)(1) that no costs on appeal – of any kind – are awardable unless "reasonable." Nor does the court acknowledge the established legal requirements that all costs be necessary and out-of-pocket. (*Wilson v. Board of Retirement of Los Angeles County Emp. Retirement Assn.* (1959) 176 Cal.App.2d 320, 323 [awarded costs must be based on a "valid

judgment," allowed by statute or rule, "actually incurred," and "reasonable"]; *Muller v. Reagh* (1959) 170 Cal.App.2d 151,154 [only out-of-pocket costs are recoverable].)

Cooper stresses the express reasonableness requirement inherent in former rule 26(c) – and now in current rule 8.278. It states: "Rule 26(c)(6) requires that *reasonable* expenses *necessary* to acquire a bond are to be awarded to the prevailing party." (81 Cal.App.4th at 1298.) And the Judicial Council has reiterated its commitment to the reasonableness of all appellate cost awards by including Item No. 10 on Judicial council Form MC-013, Memorandum of Costs on Appeal, which provides for: "Other expenses *reasonably necessary* to secure surety bond." (1 AA 207.) Based on the long history of rule 8.278, any suggestion that reasonableness will not continue to be required by the rule is unfounded.

Appellate costs must not only be reasonable – they must be out-of-pocket costs actually and necessarily incurred or paid by the appellant and not "overhead" or alleged internal expenses. "The Judicial Council has been directed to establish by rule allowable costs on appeal and the procedure for claiming those costs. The purpose of this statute is not to pay the successful litigant for his or her own work, but to reimburse him or her for actual out-of-pocket payment for the type of costs allowed by the rules." (5 Cal.Jur.3d., Appellate Review, § 708; *Muller*, *supra*, 170 Cal.App.2d at 154.)

Like all costs, appellate costs under rule 8.278 must be definite out-of-pocket sums. (*Wilson*, *supra*, 176 Cal.App.2d at 323 [construing former rule 26(c)].) Only out-of-pocket costs are recoverable. (*Muller*, *supra*, 170 Cal.App.2d at 154 ["A definite sum of money must be paid out."].) And they must be necessarily incurred. "A court has the obligation to ensure that only costs that are necessary and reasonable in amount are allowed to a prevailing party." (*Serrano v. Stefan Merli Plastering Co., Inc.* (2008) 162 Cal.App.4th 1014, 1039.)

Courts can withhold recovery of "costs . . . incurred solely for the incurring party's convenience (i.e., not 'necessary' to the appeal)." (Eisenberg, et al., *California Practice Guide – Civil Writs and Appeals* (Rutter Group 2009), § 14:93.) "Where an item of costs or disbursements is not necessarily incurred, it will not be allowed, and in the absence of a showing of its necessity it will be stricken." (16 Cal.Jur.3d, Costs, § 62.)

In conclusion, the Court of Appeal's dire predictions about skyrocketing cost awards disregard the court's power to disallow unreasonable, unnecessary, or unpaid/unincurred outlays. No such fear is warranted. And speculation of this kind affords no basis to eviscerate the plain language of the appellate costs rule.

III. THE COURT OF APPEAL'S INTERPRETATION OF THE APPEAL BOND COST RULE VIOLATES THE EQUAL PROTECTION CLAUSES OF THE STATE AND FEDERAL CONSTITUTIONS.

Whenever possible, statutes and rules of court are to be construed in a manner that preserves their constitutionality. (*Dyna-Med, Inc. v. Fair Employment & Housing Com.* (1987) 43 Cal.3d 1379, 1387; *Conservatorship of Cooper* (1993) 16 Cal.App.4th 414, 418.) The Court of Appeal's construction of the rule governing appeal bond costs violates the equal protection clauses of the state and federal constitutions. It unconstitutionally treats victorious appellants who post an appeal bond differently than similarly-situated appellants who instead make a cash deposit in lieu of such a bond.

Under the court's interpretation of the rule, victorious appellants who are required to pay interest to make a cash deposit in lieu of an appeal bond are entitled to recover such payments as a matter of right, while appellants who are required to make interest payments to secure an appeal bond are barred from recovering those payments as a matter of law. There is no rational basis for such a distinction. This Court should interpret the rule in a manner which avoids the potential constitutional invalidity.

"The Equal Protection Clause of the Fourteenth Amendment commands that no State shall 'deny to any person within its jurisdiction the

equal protection of the laws,' which is essentially a direction that all persons similarly situated should be treated alike. [Citation.]" (*Cleburne v. Cleburne Living Center, Inc.* (1985) 473 U.S. 432, 439.) "'The equal protection clause of the California Constitution similarly states that a person "may not be denied equal protection of laws" (Cal. Const., art. I, § 7), and statutory classifications challenged thereunder are analyzed by the same rules applicable to challenges to the Fourteenth Amendment. [Citations.]'" (*Bernardo v. Planned Parenthood Federation of America* (2004) 115 Cal.App.4th 322, 364-365.)

As this Court has explained: "In resolving equal protection issues, the United States Supreme Court has used three levels of analysis. Distinctions in statutes that involve suspect classifications or touch upon fundamental interests are subject to strict scrutiny, and can be sustained only if they are necessary to achieve a compelling state interest. Classifications based on gender are subject to an intermediate level of review. But most legislation is tested only to determine if the challenged classification bears a rational relationship to a legitimate state purpose. [Citations.]" (*People v. Hofsheier* (2006) 37 Cal.4th 1185, 1200 (*Hofsheier*); *Romer v. Evans* (1996) 517 U.S. 620, 635; *Kasler v. Lockyer* (2000) 23 Cal.4th 472, 481-482 (*Kasler*); *Warden v. State Bar* (1999) 21 Cal.4th 628, 641 (*Warden*).) The trial court's distinction between appeal

bonds and cash deposits in lieu of bonds does not survive even a minimal rational basis review.

"The first prerequisite to a meritorious claim under the equal protection clause is a showing that the state has adopted a classification that affects two or more *similarly situated* groups in an unequal manner." (*In re Eric J.* (1979) 25 Cal.3d 522, 530; *Cooley v. Superior Court* (2002) 29 Cal.4th 228, 253.) However, in making this determination, the court does not "inquire 'whether persons are similarly situated for all purposes, but "whether they are similarly situated for purposes of the law challenged."' [Citation.]" (*Hofsheier*, *supra*, 37 Cal.4th, 1199-1200.)

It cannot be seriously disputed that, for purposes of recovering costs on appeal, a victorious appellant who posts an appeal bond is situated similarly to a victorious appellant who deposits cash in lieu of an appeal bond. Indeed, the Legislature has mandated by statute that such appellants are not merely *similarly* situated, but must be treated *identically* for purposes of recovering costs on appeal. (Code Civ. Proc., § 995.730 ["*A deposit given instead of a bond has* the same force and effect, is treated the same, and is subject to the same conditions, liability, and statutory provisions . . ."].)

Accordingly, assuming the trial court's interpretation of rule 8.278, subdivision (d)(1)(F), is correct, i.e., that interest is recoverable with respect to a cash deposit, but not with respect to obtaining a letter of credit

to secure an appeal bond, there must be a rational basis for such a distinction or the rule would run afoul of the Equal Protection Clause. No such rational basis exists. In either event, the appellant is required to pay interest for respondent's benefit to secure payment of the judgment on appeal. No reason supports denial of that cost in one instance and awarding it in another.

CONCLUSION

The Court of Appeal's decision should be reversed with instructions to award Falk the interest and bank extension-of-credit fees it paid to obtain the letter of credit it was required to post as security for the appeal bond.

DATED: November 9, 2010

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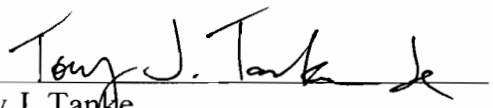
By: 
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CERTIFICATE OF WORD COUNT

(Cal. Rules of Court, rule 8.204(c)(1))

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DATED: November 9, 2010

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Executed on November 9, 2010 at Davis, California

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