SUPERIOR COURT OF CALIFORNIA, COUNTY OF SOLANO

DEPARTMENT NINE

MERITAGE RESOURCES, LLC, a California limited liability company, DON MCCOY, an individual, PEGGY MCCOY, an individual, BRUCE MCPHERSON, an individual, TERESA MCPHERSON, an individual,

Plaintiffs,

v.

LADY OF AMERICA FRANCHISE CORPORATION, a Florida corporation and WATT/FAIRFIELD LIMITED PARTNERSHIP, a California limited partnership, and DOES 1-10, inclusive,

Defendants.

WATT/FAIRFIELD ASSOCIATES LIMITED PARTNERSHIP,

Cross-Complainants,

v.

MERITAGE RESOURCES, LLC, a California limited liability company, DON MCCOY, an individual, PEGGY MCCOY, an individual, BRUCE MCPHERSON, an individual, TERESA MCPHERSON, an individual,

Cross-Defendants.

Case No. FCS032217

STATEMENT OF DECISION

[Tentative Decision]

Judge: Ramona J. Garrett

I. INTRODUCTION

California Civil Code section 51, known as the Unruh Civil Rights Act, provides, in part, as follows:

> (b) All persons within the jurisdiction of this state are free and equal, and no matter what their sex, race, color, religion, ancestry, national origin, disability, medical condition, marital status, or sexual orientation are entitled to the full and equal accommodations, advantages, facilities, privileges, or services in all business establishments of every kind whatsoever.

California Civil Code section 52 sets forth a comprehensive recitation of potential penalties for violations of the Unruh Civil Rights Act, commencing with section 52, subdivision (a), which states:

> (a) Whoever denies, aids or incites a denial, or makes any discrimination or distinction contrary to Section 51, 51.5, or 51.6, is liable for each and every offense for the actual damages, and any amount that may be determined by a jury, or a court sitting without a jury, up to a maximum of three times the amount of actual damage but in no case less than four thousand dollars ($4,000), and any attorney's fees that may be determined by the court in addition thereto, suffered by any person denied the rights provided in Section 51, 51.5, or 51.6.

II. FACTUAL FINDINGS

In this case, the Plaintiffs, two married couples, with and through their limited liability company, decided to go into business operating a women's fitness center, under the franchise of Lady of America Franchise Corporation. The fitness center would be exclusively for women. They had no prior experience operating a fitness center.

The franchisor's Director of Real Estate assisted Plaintiffs in locating a site in a shopping center to be used for the business and negotiated the lease on behalf of Plaintiffs. The lessor was Defendant Watt/Fairfield Limited Partnership. Its broker during the lease negotiation was Terrance Tallen. The commercial lease was executed by Plaintiffs on November 8, 2002, for a

term of ten years. Plaintiffs also executed a ten-year franchise agreement with their franchisor four days later.

Both parties intended, at the time of contract, that Plaintiffs would operate a Lady of America Fitness Center, which for over 20 years has been a particular brand of single-sex fitness club franchise for women only.

All parties involved in the transaction understood that the business model for Plaintiffs' business was a women's-only fitness center. Defendant Watt/Fairfield had a women's-only center already in place in the shopping center, known as "Curves for Women."

At the time of contract, single-sex health clubs were illegal in California because such clubs denied and otherwise discriminated against men in violation of the Unruh Civil Rights Act. Therefore, Plaintiffs' business model, which excluded men, was illegal and subject to penalties.

At the time the parties entered into the lease agreement for the women's-only fitness center, none of the participants in the transaction in California were aware of this illegality. The parties believed that the transaction and ensuing operation of the fitness center, under the auspices of the lease, were legal.

At the time of contract, neither party would have entered into the lease if they had known that single-sex clubs, such as Lady of America Fitness Centers, were illegal in California and violated the non-discrimination clause contained in the CC&Rs and Article 37 of the lease.

Once Plaintiffs took possession of the property, they began operating their Lady of America Fitness Center for women. The fitness center had one women's locker room, one shower, and one dressing room. They paid their financial obligations to Defendant consistently.

In 2004, Plaintiffs received an initial notification from their franchisor that the legality of women's-only fitness clubs was being challenged in court. They were advised that only in the state of California would franchisees be required to admit males if a male insisted upon joining. All other states would continue to be women's-only. The franchisor advised franchisees to discourage men if they tried to join the club.

In 2005, Plaintiffs received notice that California legislation would be proposed to exempt women's-only fitness clubs from the Unruh Act.

In 2006, the legislation failed. In late 2006, Plaintiffs received official notice from their franchisor that California expressly prohibited single-gendered clubs.

During this time, Plaintiffs continued to fulfill their financial obligations to Defendant under the terms of the lease.

Men toured Plaintiffs' club on several occasions to inquire about joining, but were subtly discouraged from joining based upon previous suggestions given to the franchisees by the franchisor. No man actually attempted to join Plaintiffs' women's-only club.

The Lady of America Franchise Corporation had a number of franchises nationally and internationally. Under the franchise system, members of one fitness club received reciprocal membership privileges at all other franchise branches. If a man joined Plaintiffs' club, they would not have been able to provide him with the reciprocity benefit that women club members had, because men were excluded from all Lady of America fitness centers, except in California.

Plaintiffs also lacked the physical facilities in their center to accommodate men.

As time passed, Plaintiffs became increasingly concerned about the illegality cloud hovering over their business operations. They did not communicate any of these concerns to Defendant until 2008. In late 2007, Plaintiffs retained counsel to advise them regarding the issue of single-sex clubs. They had learned of a single-sex club in Santa Rosa which had shut down. Eventually, the decision was made to explore rescission.

Finally, on September 3, 2008, Plaintiff Don McCoy sent a letter to Richard Heller, Defendant's Vice President of Development, requesting to schedule a meeting with him to discuss the lease and the illegality of Plaintiffs' women-only facility, and advising that the Plaintiffs were considering rescission of the lease based on illegality. Plaintiffs did not pay the monthly rent due for September 2008.

Defendant responded to this letter with its letter dated September 18, 2008, through counsel, responding to Plaintiffs' assertions, and, in effect, denying that Defendant knew that the lease and franchise were for a women's-only facility. Included with this letter was a copy of a Three-Day Notice to Pay Rent or Quit, which had been sent out for service, which demanded

$15,408.06, which erroneously included $1,400.73 as late charges for June 2008. No meeting was ever scheduled.

Thereafter, Plaintiffs began the rescission process. Plaintiffs ultimately vacated the property on September 27, 2008. By the time Plaintiffs vacated, they had paid rent for approximately five years, in an amount which exceeded $600,000.

Plaintiffs filed suit in this matter on October 3, 2008, seeking declaratory relief against Defendants and against Lady of America Franchise Corporation. Plaintiffs also alleged a cause of action for unfair business practices against Lady of America.

Defendant Watt/Fairfield answered and filed a Cross-Complaint for rent due, past and future, estimated to exceed $700,000.

Plaintiffs/Cross-Defendants answered and asserted 25 affirmative defenses, including mistake of law (16th Affirmative Defense) and rescission (19th Affirmative Defense). Lady of America ultimately released Plaintiffs from the Franchise Agreement.

The court trial in this matter between Plaintiffs and Defendant Watt/Fairfield commenced on June 8, 2010, and concluded on August 23, 2010.

Defendant Watt/Fairfield failed to prove that it suffered "substantial prejudice" as a result of Plaintiffs' delay in seeking rescission of the lease contract and restoring possession of the leased property.

III. CONCLUSIONS OF LAW

1. Claim that Lease Is Void for Illegality

Plaintiffs claim that the lease is illegal, and therefore, it is void. Defendant Watt/Fairfield Associates, in turn, contends that the lease is legal and enforceable.

The determination of whether a contract is illegal presents a question of law to be resolved upon the circumstances of each case. (*Bovard v. American Horse Enterprises, Inc.* (1988) 201 Cal.App.3d 832). An independent lawful contract will not be denied enforcement simply because it is connected with or indirectly aiding in the accomplishment of an illegal purpose. (1 Witkin, *Summary of California Law* (10th ed.), Contracts, Section 423; *Keating v.*

Preston (1940) 42 Cal.App.2d 110; *Robertson v. Hyde* (1943) 58 Cal.App.2d 667). Where a transaction is fair and regular on its face, the burden of proving that the contract has an unlawful purpose falls on the party asserting the illegality. (*Hamilton v. Abadjian* (1947) 30 Cal.2d 49). In the present case, the lease is not illegal on its face. Therefore, the burden is on Plaintiffs to establish that the lease is illegal.

Plaintiffs contend that, in determining whether the lease is illegal, the court should construe the lease, the franchise agreement, and the use permit application as all part of the same transaction. However, the court finds that the parties to these documents are not all the same; that they were signed separately; and that none of the documents indicate that they are a part of the other documents and are to be construed as such. Therefore, the court does not construe the franchise agreement or the use permit application as part of the lease in determining whether the lease is illegal.

A valid contract must have both a lawful object and lawful consideration (Civil Code Sections 1550, 1667) The object of a contract and the consideration for a contract are unlawful if contrary to express law, the policy of an express law, or otherwise contrary to good morals. (Civil Code Section 1667). In the present case, the court finds that the objects of the lease were not illegal, and the consideration for the lease was also not illegal. Therefore, the lease is not void for illegality.

The "object of a contract" is what the party receiving the consideration has agreed to do or not to do. (Civil Code Section 1595). The object must be lawful when the contract is made. (Civil Code Section 1596). If a contract has one or more objects, any of the objects that are lawful remain valid, despite the illegality of another object. (Civil Code Section 1599). A contract that has a lawful object but is drafted by one party so as to result in an unlawful incidental benefit for that party may nevertheless be enforceable by the other party, as long as the other party was not *in pare dilecto* in the structuring of the transaction with that unlawful motive. (*Maudlin v. Pacific Decision Sciences Corp.* (2006) 137 Cal.App.4th 1001).

The court finds that the objects of the lease in the present case were: (1) for Plaintiffs to pay rent for the exclusive use and possession of the premises, and (2) for Defendant

Watt/Fairfield Associates to provide Plaintiffs with exclusive use and possession of the premises for the operation of a fitness facility. These objects of the lease were not contrary to any express law, contrary to any policy of express law, or otherwise contrary to good morals. Therefore, the court finds that the objects of the lease are not illegal, and the lease is not void for having an illegal object. Any illegal use of the premises by Plaintiffs (i.e., gender discrimination) was beyond the limited scope of the objects of the lease, and does not render the lease illegal.

Consideration for a contract is "any benefit conferred, or agreed to be conferred, upon the promisor, by any other person, to which the promisor is not lawfully entitled, or any prejudice suffered, or agreed to be suffered, by such person, other than such as he is at the time of consent lawfully bound to suffer, as an inducement to the promisor, is a good consideration for a promise." (Civil Code Section 1605). The consideration of a contract must be lawful within the meaning of Section 1667. (Civil Code Section 1607).

The court finds that the consideration for the lease in the present case was: (1) Plaintiffs' obligation to pay rent, and (2) Defendant Watt/Fairfield's obligation to grant Plaintiffs the right to exclusive use and possession of the premises and the right to quiet enjoyment of the premises. This consideration was not contrary to any express law, contrary to any policy of express law, or otherwise contrary to good morals. Therefore, the court finds that the consideration for the lease was not illegal, and the lease is not void for illegal consideration.

In view of the above, the court finds that the lease in the present case is not void for illegality.

2. <u>Claim for Rescission Based on Mutual Mistake of Law</u>

Plaintiffs seek to rescind the lease based on mutual mistake of law. Plaintiffs contend that there was a mutual mistake made by both parties when they entered into the lease in that they mistakenly understood that the operation of Plaintiffs' single-sex fitness facility on the leased premises was not illegal. Defendant contends that there was no mistake of law, and also contends that Plaintiffs' action for rescission is barred on several grounds.

A party may rescind a contract if the consent of the party rescinding, or of any party jointly contracting with him, was given by mistake. (Civil Code Section 1689). A mistake may be either of fact or law. (Civil Code Section 1576). A mistake of fact is a mistake, not caused by the neglect of a legal duty on the party of the person making the mistake, consisting in: (1) an unconscious ignorance or forgetfulness of a fact past or present, material to the contract; or (2) belief in the present existence of a thing material to the contract, which does not exist, or in the past existence of such a thing, which has not existed. (Civil Code Section 1577). A mistake of law occurs in contracting when there is: (1) a misapprehension of the law by all parties, all supposing that they knew and understood it, and all making substantially the same mistake as to the law; or (2) a misapprehension of the law by one party, of which the others are aware at the time of contracting, but which they do not rectify. (Civil Code Section 1578).

In the present case, Plaintiffs and Defendant Watt/Fairfield Associates, through its agents, understood the fitness facility that Plaintiffs were going to operate under the lease was a single-sex fitness facility, and they mistakenly believed that the operation of such a facility was not in violation of the law in California. In fact, at the time the lease was entered into, the operation of a single-sex fitness facility was discriminatory, and therefore a violation of the Unruh Civil Rights Act. Moreover, it was and is legally impossible and impracticable for Plaintiffs' facility to comply with the Unruh Civil Rights Act and provide equal membership privileges, benefits, and accommodations to men.

The operation of Plaintiffs' business as a single-sex fitness facility was a material assumption upon which the parties based their decision to enter into the lease; it was not a collateral issue. Neither party would have signed the lease if they understood that the operation of the single-sex fitness facility was illegal in California. Therefore, the court finds that lease may be rescinded based on mutual mistake of law.

Defendant contends that Plaintiffs' claim for rescission is barred on several grounds: (1) Plaintiffs were in material default under the lease at the time they attempted to rescind it; (2) Rescission is barred under the equitable doctrines of laches and waiver because Plaintiffs delayed in giving notice of rescission, and continued to accept benefits under the lease after

learning of the grounds for rescission; and (3) Plaintiffs' claim for rescission is barred by the four-year statute of limitations of CCP Section 337. The court finds that none of these factors operates as a bar to Plaintiffs' claim for rescission based on mutual mistake of law.

Defendant contends that Plaintiffs are precluded from seeking rescission of the lease because they were in material default of the lease at the time they gave notice of rescission in September 2008, in that: (1) they failed to pay rent in September 2008; and (2) they were operating a business on the premises that was discriminatory and therefore in violation of the lease.

With regard to the failure to pay rent, the claim for rescission is based on an unrelated, independent ground of mutual mistake of law; the claim for rescission is not based on an alleged breach of a dependent, concurrent covenant on which the other party's performance depends. Moreover, Plaintiffs' notice of rescission was effectuated prior to the expiration of the Three-Day Notice to Pay Rent or Quit. In addition, up until September 2008, when they gave notice of rescission, Plaintiffs had consistently paid their rent, as required under the lease. Therefore, the court finds that Plaintiffs' failure to pay one month's rent in September 2008, does not bar their claim for rescission.

With regard to the operation of a business that was discriminatory in violation of the lease, Plaintiffs were never actually in default of these provisions in the lease because Defendant Watt/Fairfield never gave written notice and an opportunity to cure this alleged breach, as required for a default to arise under the lease. (Lease, Article 21A(ii)). Therefore, the court finds that there was no material default of the lease by Plaintiffs that would bar their claim for rescission.[1]

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[1] Lease Articles 7A and 36S, further, do not preclude Plaintiffs' claims for rescission. There is nothing in the language of Article 7A which places the risk of operating illegally upon the Plaintiffs.

Lease Article 36S imposes upon the Plaintiffs/tenants the duty and burden of confirming that the title and physical condition of the premises have been inspected and are accepted "as is."

Defendant contends that Plaintiffs waived their right to rescind the lease by their delay in giving notice of rescission and by their continued receipt of benefits under the lease with knowledge of the grounds for rescission.

In an action for rescission, relief shall not be denied on the ground of delay unless the court finds that the delay caused substantial prejudice to the other party. (Civil Code Section 1693). In the present case, Defendant did not establish that it suffered substantial prejudice as a result of Plaintiffs' delay in giving notice of rescission. Therefore, the court finds that Plaintiffs' action for rescission is not barred based on any delay in giving notice of rescission.

With regard to the receipt of benefits by Plaintiffs, there is a *presumption* of a waiver of the right to rescind by a party who, having full knowledge of the grounds for rescission, accepts and retains benefits under the contract. (*Neet v. Holmes* (1944) 25 Cal.2d 447). However, in the present case, this presumption was rebutted. The evidence indicates that Plaintiffs continued to pay rent out of concern for their obligations under the lease. As was stated previously, in late 2007, they retained counsel to advise them regarding the issue of single-sex clubs. They had learned of a single-sex club in Santa Rosa which had shut down. Eventually, at that point, the decision was made to explore rescission. Therefore, the court finds that Plaintiffs did not waive their right to rescind by continuing to rent the premises after they learned that single-sex facilities were illegal in California.

Defendant contends that the claim for rescission is barred by the four-year statute of limitations of CCP Section 337. A cause of action for rescission based on mistake accrues when the party seeking to rescind discovers the facts constituting the mistake. (CCP Section 337). In 2004, Plaintiffs were advised that lawsuits had been filed challenging the single sex status of facilities like theirs. However, it was not until 2006 that Plaintiffs discovered that such facilities were, in fact, in violation of the Unruh Civil Rights Act in California. Thus, the statute of limitations began to run at that time. This action, filed on October 8, 2008, was filed within the statutory period. Therefore, the court finds that Plaintiffs' claim for rescission is not barred by CCP Section 337.

In view of the above, the court grants Plaintiffs' claim for rescission of the lease based on mutual mistake of law. The lease is rescinded.

3. Restitution

Plaintiffs seek restitution, specifically, the rent money they paid under the lease up until September 2008. When a contract is rescinded, in whole or in part, a party may make a claim for relief, including restitution. However, the court is empowered to do equity, and may make any order that justice requires or "otherwise in its judgment adjust the equities between the parties." (Civil Code Section 1692). In the present case, Plaintiffs received the right to exclusive use and possession of the premises and the right to quiet enjoyment of the premises in consideration for their payment of rent. Therefore, the court finds that Plaintiffs are not entitled to restitution.

4. Cross-Complaint

Watt/Fairfield Associates Limited Partnership filed a cross-complaint against Plaintiffs in this action, seeking to recover rent due under the lease from September 2008, up until the date the lease expires, plus interest thereon. Based on the court's findings set forth above, the court denies such relief to Watt/Fairfield under the cross-complaint.

5. Prevailing Party

The court finds that there is no prevailing party in this action. Therefore, each party is to bear its own costs and attorney fees.

Dated: 3-18-11

RAYMONA J. GARRETT
Judge of the Superior Court

SUPERIOR COURT OF CALIFORNIA
COUNTY OF SOLANO
Case Number FCS032217
CERTIFICATE OF MAILING AND FACSIMILE

I, the undersigned, certify under penalty of perjury that I am a deputy clerk of the above-entitled Court and not a party to the within action; that I am familiar with the County of Solano's procedure for collection and processing of correspondence for mailing with the United States Postal Service. This document will be deposited with the United States Postal Service on the same day as the execution of this document in the ordinary course of business. This document was sealed and placed for collection and mailing on the same day as the execution of this document at the address given for deposit in the United States Postal Service and following ordinary business practices. Said envelope was addressed to the attorneys for the parties, or the parties, as shown below.

By facsimile. I also caused such document(s) to be transmitted by facsimile transmission by use of facsimile machine telephone number 707/648-8171, on the following interested parties by transmitting by facsimile machine as stated above. The facsimile machine I used complied with California Rules of Court, Rule 2.301, and no error was reported by the machine.

Document mailed: Statement of Decision [Tentative Decision]

Courtney M. Coates, Esq.
Law Offices of Courtney M. Coates
31938 U.S. Highway 79 South Ste A-334
Temecula CA 92592
Fax: 951.587.3991

David E. Frank, Esq.
Gregory W. Koonce, Esq.
Frank Law Group
1517 Lincoln Way
Auburn CA 95603
Fax: 530.887.8586

Dated: 3-18-11

CLERK OF THE SUPERIOR COURT

By _____
Karen Ogden, Deputy Clerk