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*Digest: City of Hope National Medical Center v. Genentech, Inc.*

*Mike M. Khalilpour*

Opinion by Kennard, J., expressing the unanimous view of the Court.

#### Issues

(1) Does a fiduciary relationship necessarily arise when a party, in return for royalties, entrusts a secret scientific discovery to another party to develop, patent, and to commercially exploit?

(2) Did the evidence that the plaintiff introduced at trial to prove that the defendant had breached a fiduciary duty so prejudice the jury as to require setting aside the jury's award of compensatory damages for breach of contract?

#### Facts

In the mid-1970's, two scientists employed by City of Hope developed a groundbreaking scientific process enabling production of medicines having great "therapeutic and commercial value."<sup>1</sup> The two scientists, along with a venture capitalist, applied for a confidential grant application relating to this discovery, and proceeded to incorporate the company, Genentech, Inc. (Genentech), to exploit this biotechnology.<sup>2</sup>

During this time, Genentech contacted City of Hope and started negotiations to enter into a contract.<sup>3</sup> The contract stated that Genentech would manufacture and sale the new discovery in laboratories provided by City of Hope, and Genentech would then secure patents that emerged from this work.<sup>4</sup> City of Hope would then publish the results of this work and earn royalty income, for a specified period of time, from the sales of the new scientific discovery, provided that the publication was done by City of Hope under this agreement.<sup>5</sup> The contract also provided that Genentech would exclusively own the patents and other "proprietary" property.<sup>6</sup> Royalties paid to City of Hope would also include income derived by Genentech via licensing agreements with third parties and lawsuit

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<sup>1</sup> City of Hope Nat'l Med. Ctr. v. Genentech, Inc., 181 P.3d 142, 146-47 (Cal. 2008).

<sup>2</sup> *Id.* at 147.

<sup>3</sup> *Id.*

<sup>4</sup> *Id.*

<sup>5</sup> *Id.*

<sup>6</sup> *Id.*

settlements and awards for potential infringers, should they arise.<sup>7</sup> The contract also expressly provided that the agreement did not create an agency or joint venture relationship and that City of Hope would act as an independent contractor.<sup>8</sup>

By the late 1980's and early 1990's, Genentech had secured many patents in which City of Hope's two scientists were listed as inventors and had granted numerous licenses for its patents with third parties.<sup>9</sup> Genentech divulged some of the companies it had granted licenses to, but not all, despite exchanges between the two parties whereby City of Hope requested documents pertaining to licenses granted and royalties reporting.<sup>10</sup>

During this time, City of Hope received over \$300 million in royalties from sales due to Genentech's licensing of certain products, but City of Hope had not received any royalties from certain other products.<sup>11</sup>

Also in the 1990's, Genentech sued a party alleging infringements of certain patents whereby the parties ended settling for \$145 million plus 6% royalties on future sales resulting from the infringements.<sup>12</sup> Initially, City of Hope did not receive any royalties from this settlement.<sup>13</sup> Eventually, Genentech agreed to pay City of Hope \$3 million and 1.75% of royalties (of the 6% per settlement).<sup>14</sup> In 1998, Genentech settled another infringement lawsuit for \$20 million, of which City of Hope did not receive any payment.<sup>15</sup>

City of Hope brought this instant action, alleging claims for breach of fiduciary duty, breach of contract, and breach of the implied covenant of good faith and fair dealing.<sup>16</sup>

## Analysis

### 1. Fiduciary Relationship

The Court first addressed the issue of whether the contract itself created a fiduciary relationship.<sup>17</sup> The Court began with the principle that a fiduciary relationship exists when a party "must either knowingly undertake to act on behalf and for the benefit of another, or must enter into a relationship which imposes that undertaking as a matter of law."<sup>18</sup> The

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<sup>7</sup> *Id.* at 148.

<sup>8</sup> *Id.*

<sup>9</sup> *Id.* at 148-49.

<sup>10</sup> *Id.*

<sup>11</sup> *Id.* at 149.

<sup>12</sup> *Id.*

<sup>13</sup> *Id.*

<sup>14</sup> *Id.*

<sup>15</sup> *Id.*

<sup>16</sup> *Id.*

<sup>17</sup> *Id.* at 150-54.

<sup>18</sup> *Id.* at 150 (internal quotations omitted).

Court found no express language of the contract to indicate that Genentech was acting primarily for the benefit of City of Hope.<sup>19</sup> The contract provisions, the Court found, indicated the parties had a common goal to achieve a “mutually beneficial arrangement,” the express terms of which did not expressly provide for Genentech to subordinate its interests to those of City of Hope.<sup>20</sup> Nor did the contract indicate that Genentech undertook obligations of a fiduciary.<sup>21</sup>

The Court next examined whether “an agreement to develop, patent, and commercially exploit a secret scientific discovery in exchange for payment of royalties” is a type of relationship that imposes fiduciary obligations.<sup>22</sup> Looking to the contract, the Court found that the express terms stated that the agreement did not create an agency, venture, or partnership relationship between the parties.<sup>23</sup>

The Court, relying on *Wolf v. Superior Court*<sup>24</sup>, concluded that a fiduciary duty does not arise simply from a party’s

contractual right to receive compensation contingent upon the receipt of future revenues . . . or from the profit-sharing provisions of an agreement, or from [the party’s] contractual right to an accounting, but that the profit-sharing provisions of the contract did shift burden of proof to defendant to prove compliance with contractual payment obligations.<sup>25</sup>

In accordance with *Wolf*, the court reasoned that fiduciary obligations are not created when one party entrusts valuable intellectual property to another for commercial development in exchange for the payment of compensation contingent on the venture’s commercial success.<sup>26</sup>

Genentech contended that, during closing arguments, City of Hope’s counsel made improper references to “concealment of evidence” and that such evidence was inadmissible to show Genentech breached the agreement.<sup>27</sup> The Court concluded that when a “party’s conduct occurring between execution of the contract and a dispute about the meaning of the contract’s terms may reveal what the parties understood and intended those terms to mean.”<sup>28</sup> Therefore, evidence of conduct, including concealment of certain information, which Genentech was charged with concerning certain third party licensing agreements and reporting royalties, was admissible to resolve ambiguities in the contract’s language.<sup>29</sup>

<sup>19</sup> *Id.*

<sup>20</sup> *Id.*

<sup>21</sup> *Id.*

<sup>22</sup> *Id.*

<sup>23</sup> *Id.*

<sup>24</sup> 130 Cal. Rptr. 2d 860 (App. Ct. 2003).

<sup>25</sup> *City of Hope*, 181 P.3d at 153.

<sup>26</sup> *Id.* at 154.

<sup>27</sup> *Id.* at 155.

<sup>28</sup> *Id.*

<sup>29</sup> *Id.*

## 2. Prejudice to Jury

Genentech contended that, during closing arguments, City of Hope's counsel improperly referenced the importance of determining witness credibility in deciding City of Hope's breach of contract claim.<sup>30</sup> The Court disposed of this contention by stating that credibility determinations were a role for the jury, which also had the task of interpreting the contract.<sup>31</sup>

Genentech further contended that a comment made to the jury to decide the breach of contract before resolving the breach of fiduciary duty was improper.<sup>32</sup> However, the Court found this to be appropriate since the verdict forms instructed the jury as such.<sup>33</sup>

Lastly, Genentech contended that a jury instruction stating that fiduciary duties include action in the "utmost good faith and making full and fair disclosure of facts which materially affect City of Hope's rights and interests under the 1976 agreement."<sup>34</sup> The jury was also instructed that it was to decide City of Hope's breach of contract claim separately from the breach of fiduciary duty.<sup>35</sup> These instructions, the Court reasoned, adequately distinguished the two claims and that it is presumed that the jury followed the instructions.<sup>36</sup>

The court also failed to see any impropriety on the part of City of Hope's counsel's "witness credibility" and "big picture" arguments in regards to determining the meaning of several contract provisions, stating that these were within the realm of the jury's functions.<sup>37</sup> The court also dismissed Genentech's challenge that City of Hope's counsel incorrectly informed the jury the order by which to decide key issues of the case.<sup>38</sup>

## Holding

The Court held that (1) no fiduciary relationship arose from the contract between Genentech and City of Hope;<sup>39</sup> and (2) the jury was not prejudiced in its decision regarding Genentech's breach of contract claim due to the concurrent admission of evidence relating to the City of Hope's breach of fiduciary duty claim.<sup>40</sup>

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<sup>30</sup> *Id.* at 155-56.

<sup>31</sup> *Id.* at 156.

<sup>32</sup> *Id.*

<sup>33</sup> *Id.*

<sup>34</sup> *Id.* (internal quotations omitted).

<sup>35</sup> *Id.*

<sup>36</sup> *Id.*

<sup>37</sup> *Id.* at 155-56.

<sup>38</sup> *Id.* at 156.

<sup>39</sup> *Id.* at 146, 158.

<sup>40</sup> *Id.*

Legal Significance

As a result of this decision, the court modified the definition of fiduciary obligations in that one is not formed when a scientific discovery is, in exchange for royalties, entrusted to be developed, marketed, and exploited. The court also refrained from stifling commercial arrangements such as this by refusing to place a fiduciary duty on City of Hope.