UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

CATAPHORA INC., Plaintiff(s), v. JERROLD SETH PARKER, et al., Defendant(s).	No. C09-5749 BZ **ORDER DENYING PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT**

Plaintiff has moved for summary judgment that each defendant is jointly and severely liable to plaintiff for payment of the $366,000.00 non-refundable fee due under the services contract which the parties executed.[1] Based on the record before me, I find that plaintiff is not entitled to the judgment it seeks because the non-refundable fee is an illegal penalty under governing California law. In reaching that decision I find that the following material facts are either

[1] All parties have consented to my jurisdiction for all proceedings including entry of final judgment, pursuant to 28 U.S.C. § 636(c).

undisputed or not genuinely in dispute.[2] See Rule 56(f)(3).

In late September or early October 2009, plaintiff and Jerrold Parker on behalf of defendants, entered into a written services contract. I find that Mr. Parker had actual and ostensible authority to enter into the agreement. The contract is integrated and the provisions relevant to this dispute are not ambiguous and can be interpreted without resorting to parol evidence. Essentially, the parties, after negotiations, agreed that defendants would retain Cataphora to work on the drywall litigation, that in recognition of the significance of the litigation, Cataphora agreed to reduce its usual fees by deferring a substantial portion in return for the defendants paying an initial $366,000.00 fee. Plaintiff and defendants agreed that either party could terminate the contract within 30 days, but once the contract was executed, the initial fee would be invoiced immediately, due within 30 days, and non-refundable. The initial fee was to cover certain specified services that were to be performed over a 24 month period of time, during which time other specified services would be billed at incremental amounts. Cataphora sent to defendants an invoice dated September 30, 2009 for $366,000.00. On October 6, 2009, defendants instructed Cataphora to stop work on the drywall litigation and shortly thereafter advised plaintiff that they would not pay the invoice. Defendants never provided any data from the drywall

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[2] The Court adopts the facts in the parties' joint statement of undisputed facts (Docket No. 40) except for paragraph six.

litigation for plaintiff to analyze. This suit ensued.

Defendants argue that no fee is due because they timely terminated the contract under paragraph 2.2. Based on this record, it is not clear when the defendants terminated the contract pursuant to paragraph 2.2 and 10.1 since neither party produced any writing which is a clear notice of termination. In any event, in paragraph 2.3(a) the contract provides that once proper notice of termination is given, the $366,000.00 fee becomes payable. So for purposes of this decision, I need not decide whether the contract was properly terminated.

I also find that the contract was not an illegal fee sharing agreement. I can find no provision that I would consider a success fee within the meaning of the cases cited by the defendants since any payment of the deferred fees appears to have rested entirely within defendants' discretion.[3] Because there is no improper success fee in the contract, the agreement is not the result of fraudulent inducement or unilateral mistake.

I do however find the $366,000.00 fee to be an illegal penalty under California law. As the California Supreme Court ruled in Freedman v. The Rector, 37 Cal.2d 16 (1951) "'any provision by which money or property would be forfeited without regard to the actual damage suffered would be an unenforceable penalty.'" Id. at 21-22, quoting Ebbert v.

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[3] Although the term "success fee calculation" is used once in the contract, it is not defined and later sections of the contract clarify that any deferred fees are discretionary and not related to the outcome of the case.

Mercantile Trust Co., 213 Cal. 496, 499 (1931). See also Kuish v. Smith, 181 Cal.App. 4th 1419, 1427 (2010); Cal. Civ. Code Section 3369 ("Neither specific nor preventive relief can be granted to enforce a penalty or forfeiture in any case, nor to enforce a penal law, except in a case of nuisance or as otherwise provided by law.") The $366,000.00 fee is an unenforceable penalty because it bears no relation to the work performed or to the damage the defendants may have caused. While plaintiff asserts that it sustained damage, such as the loss of other business, that damage will have to be proved at trial.

In its supplemental brief, plaintiff contends that the above cases only apply to actions where equitable relief is sought, which plaintiff argues is not the case here. Given the merger of law and equity courts, this seems to be a distinction without a difference in this case. Although Cataphora labels its action as one to recover a non-refundable fixed fee as damages for breach of contract, it could just as readily have sought specific performance of the promise requiring defendants to pay the non-refundable fixed fee as soon as it was invoiced. In any event, plaintiff's construction of Freedman is too narrow. The statutes, principles, and policy discussed in Freedman "enormously expand the situations and conditions where relief from forfeiture may be given" and apply to other kinds of contracts and scenarios besides vendor-purchaser forfeiture cases. 13 Witkin, Summary of Cal. Law (10th Ed. 2005) Equity, § 64 at 358-60. See e.g. Hill v. Hearron, 113 Cal.App.2d 763, 766-68

(1952) (applying Freedman to hold that a provision in a partnership agreement for forfeiture in event of breach constituted an unenforceable penalty); Bach v. Curry, 258 Cal.App.2d 676, 680-81 (1968) (in holding that a provision of an insurance agent's employment contract was not an unenforceable penalty, the Court assumed *arguendo* that the Freedman doctrine applied to such contracts).[4]

Plaintiff further argues that I should apply the rule from Parker v. Twentieth Century-Fox Film Corp., 3 Cal.3d 176 (1970), and Payne v. Pathe Studios, Inc., 6 Cal.App.2d 136 (1935), to this matter. This argument is also not persuasive. Both Parker and Payne interpreted contracts for employment where movie studios specifically agreed to pay actresses a guaranteed sum for the exclusive right to employ them in a film. Id. This type of "pay or play clause"[5] in an employment contract — where the employer guarantees payment in consideration for an employee agreeing to be available to work during a specific time period or perform in a certain

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[4] If I accept plaintiff's position that Freedman may only be used to grant equitable relief, then an absurd result follows. Defendants would be forced to pay plaintiff the initial fee. Then, defendants could file a lawsuit in attempt to recover their initial fee as a forfeiture under Freedman. With there no longer being a distinction between courts of equity and courts of law, I see no reason to require the parties to go through these extra steps. Accordingly, because plaintiff has not presented any persuasive authority of why Freedman should be limited to only equitable relief cases, I apply it here.

[5] See Directors Guild of America, Inc. v. Millennium Television Network, Inc., 2001 WL 1744609 at *4 (C.D. Cal. 2001) ("the 'pay or play' principle reflects a bilateral promise between the employee and the employer that is integral to the entertainment industry").

film — is not analogous to plaintiff's services agreement with defendants in this matter. Plaintiff did not contract with defendants to be an exclusive service provider that would get paid just to be available. Rather, plaintiff agreed to provide services in consideration for an initial fee. Before plaintiff could provide such services, defendants repudiated the contract. Defendants may be liable for the actual damages caused by this repudiation. Enforcing the payment of the initial fee, however, would result in an illegal penalty under Freedman.

Plaintiff's reliance on Parker and Payne is misplaced for other reasons as well. For one thing, the Parker Court did not address whether Parker's contract resulted in an unenforceable penalty. 3 Cal.3d at 180-81. Instead, the only issue in Parker was whether plaintiff's mitigation efforts were adequate. Id. at 182. The issue of mitigation has no relevance to this case. In Payne, the Court reached its decision that the minimum payment was not a penalty based on the holding in San Joaquin Light & Power Corp. v. Costaloupes, 96 Cal.App. 322, 329 (1929). Payne, 6 Cal.App.2d at 141. San Joaquin, however, relied on dicta from another case to reach its result. San Joaquin, 96 Cal.App. at 329 (citing A.B. Field & Co., Inc. v. Haven, 36 Cal.App. 669, 672 (1918)). Furthermore, the decision in San Joaquin has been criticized as "unsound and inconsistent with the modern rule." 1 Witkin, Summary of Cal. Law (10th Ed. 2005) Contracts, § 846 at 932-33. Notably, Payne was decided by the Court of Appeal sixteen years before the Supreme Court decided Freedman. Freedman is

therefore the law I apply to this case.

For the foregoing reasons, **IT IS ORDERED** that plaintiff's motion for summary judgment in the amount of $366,000.00 is **DENIED**.

Dated: November 17, 2010

Bernard Zimmerman
United States Magistrate Judge

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