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A Timely Award? Court Of Appeal Rules That Attorneys' Fees
May Be Awarded In Breach Of Contract Action To A "Prevailing Party"
Which Has Prevailed On An Alter Ego Claim Even Though An Adjudication
Of The Underlying Breach Of Contract Had Not Yet Occurred

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In a decision which provides a nuance to existing case law, the California Court of Appeal, Second Appellate District, ruled in the matter Pueblo Radiology Medical Group, Inc. v. J. Dalton Gerlach DJDAR 8190 ("Pueblo case") that individual defendants in a breach of contract case against a corporate entity which successfully prevailed on an alter ego claim in a bifurcated matter could recover attorneys' fees even though no determination had ever been made in regard to any breach of contract in the first instance.

In the Pueblo case, Pueblo Radiology Medical Group, Inc. ("Pueblo") had entered into a contract with Vitascan, Inc. ("Vitascan") to provide interpretation services of imaging scans from a Vitascan mobile imatron electron beam tomography scanner. The contract contained an attorney's fee clause. J. Dalton Gerlach ("Gerlach") signed the contract on behalf of Vitascan. Gerlach was Vitascan's President. Daniel Parker ("Parker") was Vitascan's secretary. Gerlach and Parker were the sole shareholders of Vitascan. Neither appeared to have executed a guarantee.

The subject contract was entered into for the time period covering June 1, 2001 to December 30, 2003. During the contractual time period, Vitascan advised Pueblo that its services were no longer needed. In June 2002, Pueblo filed a complaint for damages for breach of contract, common counts and an accounting naming Vitascan, Gerlach and Parker as defendants. The complaint alleged that Gerlach and Parker were alter egos of Vitascan.

Vitascan ceased operations in September 2003 and filed for bankruptcy in March 2004. In July 2004, Gerlach and Parker filed a motion to bifurcate the breach of contract claim from the alter ego claim. The trial court granted the motion and tried the alter ego issue first. In March 2006, following a 15-day bench trial, the court issued a statement of decision finding in favor of Gerlach and Parker on the alter ego issue, only, and later awarded \$250,000 in attorneys' fees to Gerlach and Parker under Civil Code section 1717.

On appeal, Pueblo did not challenge the trial court's finding on the alter ego issue, but argued that the trial court's award of attorneys' fees was premature because the breach

of contract claim had not yet been decided. In their briefing, both sides relied upon the seminal decision in Reynolds Metals Co. v. Alperson (1979) 25 Cal.3d 124 ("Reynolds Metals case"). In the Reynolds Metals case, a plaintiff had brought suit against two shareholders and directors of two bankrupt corporations seeking to hold them personally liable on an alter ego theory for debts the corporation owed. One of the promissory notes contained an attorney fee provision. The individual defendants had not signed the promissory notes. After the individual defendants prevailed on the alter ego claim and breach of contract claim, they sought attorneys' fees. The California Supreme Court held that the defendants were entitled to fees under the reciprocity provision of Civil Code section 1717, even though they were not signatories to the promissory note containing the attorney fee clause.

In the Pueblo case, Pueblo contended that the Reynolds Metals case was distinguishable because the alter ego defendants in that matter had only sought attorneys' fees after they had prevailed on both the alter ego claim and the breach of contract claim. The Court of Appeal disagreed, ruling that, since the only theory of liability against Gerlach and Parker related to the alter ego claim, no adjudication as to the underlying breach of contract claim was necessitated, at least as against them.

The Pueblo case provides an important nuance to breach of contract cases involving attorney fee clauses. If a shareholder or officer of a corporate entity is sued on an alter ego theory, and is not a guarantor of the corporate obligation, the Pueblo case stands for the proposition that, should the alter ego theory be bifurcated, the alter ego defendants can prevail and recover attorney's fees based on the entity's contract, even though no adjudication with respect to the breach of contract claim has yet occurred.

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