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## Focus

# Courts Need to Constrain Fiduciary Duty to Narrow Class of Relationships

By Marty Katz and Lisa Stutz

For 40 years, the entertainment industry was plagued by dicta — from cases that determined that no breach of fiduciary duty occurred — suggesting that a "duty to account" gave rise to a fiduciary duty. See, e.g., *Waverly Productions Inc. v. RKO Gen. Inc.*, 217 Cal.App.2d 721 (1963), in which the court wrote: "We think it is clear that RKO was not a fiduciary with respect to the performance of the terms of this contract (except as to accounting for rentals received) and that arguments predicated on the assumption that it was are directed to a false issue."

The parenthetical from *Waverly* — "except as to accounting for [movie] rentals received" — was more forcefully, and inaccurately, overstated in *Recorded Picture Co. (Productions) Ltd. v. Nelson Entertainment*, 53 Cal.App.4th 350 (1997), when the court described the parenthetical exception to the holding in *Waverly* as an affirmative statement of duty:

"The *Waverly* court did state that the distributor owed a fiduciary duty to the producer to provide an accounting of proceeds received from subdistributors." However, in neither *Waverly* nor *Recorded Picture* was the "duty to account" the basis for the claims for breach of fiduciary duty. And, as in *Waverly*, the court in *Recorded Picture* held that neither a distributor nor a subdistributor owed a fiduciary duty to the producer with respect to the manner in which it distributes its motion picture.

Fortunately, the misguided dicta was disapproved in *Wolf v. Superior Court*, 107 Cal.App.4th (2003), when the Court of Appeal addressed the issue head on:

"*Wolf* misapprehends the import of the *Waverly* court's recognition of the producer's right to an accounting of proceeds received from subdistributors. Either a relationship is fiduciary in character or it is not. Whether the parties are fiduciaries is governed by the nature of the relationship, not by the remedy sought. *Waverly* recognized simply that [the distributor] RKO had a duty to account, not that RKO was a fiduciary with respect to its accounting obligation."

As the court in *Wolf* confirmed, under California law, "the contractual right to contingent compensation in the control of another has never, by itself, been sufficient to create a fiduciary relationship where one would not otherwise exist."

The Court of Appeal's decision in *Wolf* fully comports with other decisions in California, which uniformly conclude that the contractual right to receive contingent compensation — whether based upon a percentage of revenues or profits — does not create a fiduciary duty. See, e.g., *New v. New*, 148 Cal.App.2d 372 (1957) (ex-husband's contractual obligation to pay former wife a percentage of stock earnings created a debt obligation, not a fiduciary duty); *Wiltsee v. California Employment Commission*, 69 Cal.App.2d 120 (1945) (employment contract entitling employee to 25 percent of future profits did not give rise to a fiduciary relationship).

More recently, in *Oakland Raiders v. National Football League*, 131 Cal.App.4th 621 (2005), the court held that the relationship between the NFL and its member clubs does not constitute a joint venture (and thereby does not result in the imposition of fiduciary duties) because, among other reasons, "[t]hough the NFL teams share revenues, they do not share profits or losses." Thus, the contractual obligation of one party to pay contingent compensation to another, without more, creates nothing more than a creditor-debtor relationship.

While the *Wolf* court properly focused upon the "nature of the relationship," at one point of the opinion, the court noted that "there are no allegations in the instant complaint of the formation of a joint venture or a relationship '*akin*' to a joint venture." The unfortunate reference to a relationship "*akin*" to a joint venture followed the court's citation to a similar undisciplined reference in *Stevens v. Marco* that "the parties were allied in an enterprise similar to that of joint venturers for mutual gain." *Wolf*, quoting *Stevens*, 147 Cal.App.2d 374 (emphasis on akin added by the *Wolf* court).

At least one plaintiff in a contingent compensation case has seized upon the "akin" to a joint venture language in *Wolf* as the basis for asserting a claim for breach of fiduciary duty. See *Celador International Ltd. v. Walt Disney Co.*, 347 F.Supp.2d 846 (2004). While the court in that case permitted *Celador* to proceed beyond the pleading stage, it nevertheless confirmed that "in keeping with *Wolf*, the court concludes that a relationship short of a joint venture is not sufficient to sustain [the p]laintiffs' claim for breach of fiduciary duty."

While *Wolf* seemingly resolved the issue of whether a duty to account or pay contingent compensation to another gives rise to a fiduciary relationship, the door may remain slightly ajar because of *City of Hope National Medical Center v. Genentech Inc.*, which is pending before the California Supreme Court. In that case, the parties entered into a written agreement, whereby City of Hope agreed to provide certain independent contractor research services, and Genentech agreed to supply funding for research, aimed at synthesizing DNA. City of Hope agreed that Genentech would acquire the rights to all DNA that City of Hope personnel synthesized and such other proprietary property that resulted from the work City of Hope performed under the agreement.

Genentech was also entitled, at its sole option, to patent such proprietary property, which Genentech would own exclusively. In exchange, Genentech agreed to pay royalties to City of Hope on net sales of certain products developed as a result of the research. In their agreement, the parties disclaimed the creation of a partnership, joint venture or agency relationship, using language similar to what is frequently contained in contracts entered into in the entertainment industry.

City of Hope claimed that Genentech failed to report royalties and sued, among other things, for breach of contract and breach of fiduciary duty. The trial court instructed the jury, over Genentech's objection, that a fiduciary relationship arises when a person entrusts a secret idea or device to another under an arrangement whereby the other party agrees to develop, patent and commercially exploit the idea in return for royalties. The sole support for this instruction was dicta in *Stevens v. Marco* — a case that did not even involve a cause of action for breach of fiduciary duty.

Based on that instruction, the jury found that Genentech breached its fiduciary duty by failing to pay royalties that were due and awarded City of Hope more than $300 million in compensatory damages and $200 million in punitive damages. However, the dicta from *Stevens v. Marco* cannot

support the imposition of a fiduciary duty whenever a contract calls for a party to develop and exploit a "secret" of some kind — whether it be a secret idea or device. In *Davies v. Krasna*, 14 Cal.3d 502 (1975), the California Supreme Court held that the mere transmission of a "secret" — in that case a "secret" story idea — does not create a confidential relationship that would result in the imposition of "fiduciary-like" duties.

That conclusion, which is undoubtedly correct, should not change merely because the transferred intellectual property is a "secret idea or device" that can be patented, rather than a secret story idea. Not surprisingly, more than 15 amicus briefs have been filed in *City of Hope v. Genentech*, including on behalf of Motion Picture Association of America Inc., Writers Guild of America Inc., Directors Guild of America Inc., Screen Actors Guild Inc. and numerous high-tech companies.

Traditionally, fiduciary relationships have been reserved for special, legally cognizable relationships, such as partnerships, joint ventures and agency relationships, or express undertakings on behalf of another, such as trust relationships. In the absence of such a relationship, the sharing of a "secret" — whether a secret idea or a device — may give rise to an express or implied contractual obligation to maintain a confidence, but most assuredly, it does not give rise to a fiduciary relationship.

Sophisticated, commercial parties should be permitted to define the nature of their legal relationship when entering into a contract, as the parties did in *Genentech* when they disavowed any notion that the agreement created a partnership, joint venture or agency relationship. In such a case, the parties have unambiguously expressed their intent (the focal point for contract interpretation) relative to the scope of their respective obligations to the other, and courts should not be at liberty to override such an explicit expression of intent.

In other contexts, courts routinely enforce contractual provisions limiting the rights and obligations of and remedies available to contracting parties. Contractual provisions that define the nature of the parties' legal relationship should be treated no differently. One appellate court, confronting a contractual provision in which the parties agreed that an independent contractor relationship was created, suggested that a joint venture may exist "despite an express declaration to the contrary." *April Enterprises Inc. v. KTTV*, 147 Cal.App.3d 805 (1983).

That, of course, could be true if, by conduct, the parties entered into an additional relationship not governed by — i.e., outside the parameters of — their contractual relationship. Insofar as their contractual relationship and the nature of the obligations created thereby are concerned, however, the parties' agreement should be controlling.

There is no public policy basis for enabling a party to assert a cause of action for breach of fiduciary duty. See *Nedlloyd Lines B.V. v. Superior Court*, 3 Cal.4th (1992) (public policy did not prohibit enforcement of choice-of-law clause that had the effect of eliminating plaintiff's breach of fiduciary duty claim). When issues of public policy are not implicated, no court has recognized a judicial prerogative to simply ignore the terms of an agreement reached between the parties, let alone an explicit statement of intention regarding the nature of their legal relationship.

A cause of action for breach of fiduciary duty ought not become a litigation device to alter the playing field in (or "tortify") disputes arising from arms-length commercial transactions by introducing the threat of punitive damages. Rather, courts should continue to maintain that, with the exception of express undertakings on behalf of another, such as trust agreements, fiduciary relationships are reserved for a narrow class of legally cognizable relationships, such as partnerships, joint ventures and agency relationships.

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Marty Katz, a partner and co-chairman of the entertainment, media and communications group at Sheppard Mullin Richter & Hampton, and Lisa Stutz an associate in the group, represented Disney in *Wolf v. Walt Disney Pictures and Television*. They also filed an amicus brief on behalf of Intel in *City of Hope National Medical Center v. Genentech Inc.*