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1 SUPERIOR COURT OF CALIFORNIA

2 COUNTY OF ALAMEDA

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4 RAMZY AYYAD, et al.,) Case No. RG03-121510

5) STATEMENT OF DECISION [C.C.P § 632, CRC § 232]

6 Plaintiffs,)

7 v.)

8 SPRINT SPECTRUM, L.P.,)

9 Defendant.)

10)

ENDORSED
FILED
ALAMEDA COUNTY
DEC - 4 2008
CLERK OF THE SUPERIOR COURT
By E. Opelski-Erickson, Deputy

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12 SUMMARY.

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14 Sprint has not met its burden of demonstrating that the Early Termination Fee

15 ("ETF") in its consumer contracts is a lawful liquidated damages provision under Civil

16 Code § 1671(d). On the class's claims, the Court finds that Sprint charged the class

17 $299,473,408 in ETFs and that the class paid $73,775,975 to Sprint. The class is entitled

18 to recover the $73,775,975 in ETFs its members paid to Sprint but has no right to recover

19 the amounts that were charged but not paid. Because the liquidated damage provision is

20 invalid, the Court enjoins Sprint from attempting to collect the unpaid flat ETFs and

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22 requires Sprint to provide this decision to third parties owners of Sprint's accounts

23 receivable that might include ETFs.

24 Sprint prevailed on its cross-claim against the class for breach of contract and the

25 jury found that Sprint's actual damages caused by the termination of the class members'

26 contracts was $225,697,433. The Court sets off the class's monetary recovery of

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$73,775,975 against Sprint's actual damages of $225,697,433 and Sprint's resulting net recovery of $151,921,458 is reduced to zero based on Sprint's prior statement that it will not seek an affirmative recovery from the class. The setoff does not affect the injunctive relief.

PROCEDURAL BACKGROUND

This case was tried to the Court and a jury. The Court set out the respective responsibilities of the Court and the jury in the Orders of March 17, 2008, April 17, 2008, and May 30, 2008. The Court decides (1) whether federal law preempts the claims; (2) whether the ETFs are an alternative means of performance; (3) whether the ETFs are a lawful liquidated damages provision under Civil Code § 1671(d), and (4) the monetary relief, if any, under the UCL and the claim for unjust enrichment. The jury determined (1) the amount of early termination fees paid by all class members; (2) whether the members of the class breached their contracts with Sprint; and (3) the amount of Sprint's actual damages (lost contract revenue less avoidable costs) caused by class members' contract breaches. The Court then calculates the amount of setoff, if any, based on the amount awarded to the class and the amount of actual damages awarded to Sprint.

FINDINGS OF FACT.

Sprint's business before 2000. In the late 1990s, most of Sprint's contracts with its customers were month-to-month contracts. Pryor Depo. at 8. In 1999, Sprint began to study the concept of term contracts and ETFs. Sprint tested term contracts with ETFs

in selected local markets. Pryor Depo. at 28-30; *see also* Exhibit 909A1 (Dippon database showing $2100 in ETFs charged in 1999).

In 2000 Sprint decided to offer term contracts with a $150 ETF. Sprint's goal in offering term contracts with ETFs was to decrease the number of customers who leave (churn), Pryor Depo. at 29. Sprint considered three factors when setting the amount of the ETF: what its competitors were doing; how term contracts with ETFs would financially impact Sprint; and customer inputs, including customer acceptance. Pryor Depo. at 28; 32-33.

The amount that Sprint would charge as an ETF was set from a competitive standpoint—between $150 and $200. Pryor Depo. at 30:23 to 31:11; 32:7-10. Sprint explored consumer reaction through market testing to determine whether its customers would enter into term contracts with ETFs if they received offsetting benefits such as handset subsidies and lower monthly rates. Exhibits 606-608, 617, 621 at SPR-W 000041643, 626, 629. Sprint analyzed different pricing scenarios in the $150 and $200 range through a Customer Lifecycle Value model ("CLV") that evaluated the impact of various pricing decisions given different assumptions and inputs, including average costs, revenues and customer tenure. Pryor Depo. at 43:1-7; 44:2-13; 46:9 to 47:2; 63:19 to 65:2; TR at 1115:13-1116:14 (Souder); Trial Exhibit 600 (CLV spreadsheet).

Sprint did no analysis that considered the lost revenue from contracts, the avoidable costs, and Sprint's expected lost profits from contract terminations. Sprint's early evaluations of the ETF assumed that Sprint would not collect any money from the ETFs. Exhibit 866. Sprint's later evaluations of the ETF assumed that Sprint would collect 50% of the ETFs charged. Exhibit 306.

In 2006 Sprint merged with Nextel and increased its ETF to $200. On August 12, 2005, Sprint merged with Nextel to form Sprint/Nextel. Sprint thereafter increased the amount of the early termination fee to $200.

Sprint's $200 post-merger ETF was based on Nextel's pre-merger ETF. Mr. Wiener, Nextel's Vice President of Strategic Pricing, testified that in 2000 Nextel adopted term contracts with ETFs after considering the competition, its customers, and the costs to the company. Weiner Depo. at 36:3 to 39:16; 40:25 to 43:10; 47:11 to 49:4; 80:12 to 81:3. Nextel's ETF was also implemented primarily as a means to discourage customers from leaving. There was no evidence at trial that Nextel did any analysis that considered the lost revenue from contracts, the avoidable costs, or Nextel's expected lost profits from contract terminations. Mr. Wiener's trial testimony, presented only by way of deposition, was in some respects narrower than his summary judgment declaration testimony. The Court relies only on the trial record.

Mr. Souder, Sprint's Vice-President of Pricing, testified that following the merger Sprint decided to use a single ETF amount because it simplified the business. Sprint's rationale for setting the ETF at $200 was that Nextel's handsets were more expensive than Sprint's handsets and that a higher ETF would offset Nextel's higher handset subsidies. TR at 1084:3-14.

The relevant contract terms. The specific language of Sprint's Terms and Conditions changed throughout the class period. At all times, however, the relevant language was contained under the heading "Termination – Term Contracts" and in a single paragraph. Exhs. 279-292; 630. Although the ETF condition is stated in somewhat different language in the contract variations over the years, all the ETF

provisions state that the subscriber is required to pay an ETF if the subscriber terminates a term service plan before the end of the term or if Sprint terminates services for cause before the end of the term. Some contracts refer to the ETF as a "liquidated damage and not a penalty" (Exhs. 279 – 285), while others make no reference to "liquidated damages" (Exh. 286 – 292).

Sprint's business during the class period. The evidence established that Sprint charged ETFs each time a subscriber terminated a contract before the completion of a term contract. Sprint did not, however, charge a single ETF each time a subscriber terminated a single contract. Sprint charged a separate ETF for each phone line that was terminated early, irrespective of whether or not the customer received a Sprint phone at the time of contracting. A subscriber with a contract for a $100/month low monthly minute family plan with four phones would be subject to $700 in ETFs for terminating the contract early, whereas another subscriber with a contract for a high monthly minute $100 a month plan with one phone would be subject to a $175 ETF for terminating the contract early. Despite the fact that ETFs were linked to phone lines and not to subscribers or to accounts, almost all the evidence was presented in the context of the number of subscribers, the revenue per subscriber, and cost per subscriber.

Sprint's business changed during the class period. The evolution of Sprint's calling plans affects the relevance of Sprint's nationwide network. At the start of the class period most calling plans were regional in nature with extra fees imposed for calls outside the regional calling area, whereas at the conclusion of the class period most of Sprint's plans were national in nature without extra charges for long distance calls. Exhs 739, 816, 844-45, 847, 853, 923. This suggests that early in the class period the Court

should analyze class member expectation and Sprint's costs on a regional basis whereas later in the class period the Court should analyze class member expectation and Sprint's costs on a nationwide basis. The evolution of technology also presumably decreased Sprint's cost to provide each minute of service as the class period progressed. Dr. Selwyn testified that data on the cost per minute for use of a wireless network varied from $0.004/minute to $0.05/minute. TR at 447-448.

Effect of the ETF - basic facts. The evidence established these undisputed basic facts:

The class included 1,986,537 persons.

Sprint charged $299,473,408 in ETFs to the entire class.

Sprint collected $73,775,974 in ETFs from class members.

Sprint billed, but did not collect, $225,697,433 in ETFs from class members.

Sprint's lost revenue. The evidence established two ways to calculate Sprint's lost revenue as a result of early terminations – Monthly Recurring Charge ("MRC") and Average Revenue Per Unit ("ARPU"). MRC revenue does not include any optional charges for features such as text messaging, ring tones, and e-mail access. Sprint's average California lost MRC revenue per customer per month was $49.16. TR at 1389:21 to 1391:14 (Dippon). ARPU revenue is the MRC revenue plus charges for optional features. Sprint's average national lost ARPU revenue per customer per month was approximately $64.74. TR at 513 (Selwyn). The average customer terminated with 13.25 months remaining on the contract.

Cost Avoidance – Plaintiffs' evidence. Plaintiffs presented Dr. Lee L. Selwyn as their expert witness on economic issues. Dr. Selwyn examined financial data from

Sprint's 10-Ks and 10-Qs from 1999 to 2006 and derived information that permitted him to opine on the costs that Sprint avoided when a class member terminated early. Using a regression analysis, Dr. Selwyn identified a correlation between both Sprint's operating expenses ("opex") and its expenses for plant, property and equipment ("PPE") and its number of customers. TR at 429. Dr. Selwyn also observed that the class members represented a significant percentage of Sprint's California subscriber base. TR at 435 and 1372. From this information, Dr. Selwyn concluded that beyond a fixed cost base number of $7-8 billion per year, opex and PPE were each avoidable costs. TR at 432-437; 504-05. Dr. Selwyn concluded that for each customer-month of MRC revenue ($49.16) Sprint had a net loss of $0.70. TR at 512-13 and 1020. Stated otherwise, Dr. Selwyn concluded that when a customer terminated early, Sprint could avoid costs representing 98.6% of the lost MRC revenues.

An integral part of Dr. Selwyn's analysis was his observation that roughly 30% of Sprint's income was from optional services and his conclusion that Sprint's profit margin on optional services was 90%. Dr. Selwyn concluded that Sprint's profit margin on optional services was 90% by estimating that Sprint's cost per minute of voice service throughout the class period was $0.04 and that Sprint's charge per minute for optional voice service throughout the class period was $0.40. Dr. Selwyn concluded that Sprint made little to no profit (1.4% on the dollar) on MRC for providing basic services and made most of its profit (90% on the dollar) from charges for optional services.

Dr. Selwyn then calculated Sprint's avoidable costs. Dr. Selwyn multiplied the weighted average monthly lost profit per subscriber for MRC services ($0.70) by the average number of months remaining on the contract term (13.25 months), calculating

that Sprint's lost profits averaged $9.24 per class member. TR at 451-52. Dr. Selwyn determined that Sprint charged the class $299,470,408 in ETFs even though Sprint's actual lost profit was $18,425,130. TR at 1468-70.

Cost Avoidance – Sprint's evidence. Sprint expert Mr. Baliban examined Sprint's costs on a category-by-category basis to determine the costs that Sprint avoids when a class member terminates early. TR at 1291:25-1292:12; 1297:21-1299:7. In determining whether a cost was avoidable, Mr. Baliban considered the early termination of the class (California only) in relation to Sprint's national subscriber base. TR at 1298. Then, using financial data from Sprint for the third quarter of 2006, Baliban classified each category of expenses as either "avoidable" or "not avoidable" based on his judgment as to whether Sprint would avoid the costs nationwide if it were to lose California subscribers equal to 5% of its nationwide subscribers. TR at 1325. Baliban determined that when a customer terminated early that Sprint can avoid costs representing 18.13% of MRC revenues. *Id.* at 1279.

Sprint expert Dr. Taylor then calculated Sprint's avoidable costs. Dr. Taylor started with the average MRC ($48.75) (fn1), subtracted what Baliban determined to be avoidable costs ($8.84 or 18.13%) and concluded that lost MRC profits averaged $39.31 per month per class member. Multiplying that by the number of months remaining on the contract term (13.25 months), Dr. Taylor found that the lost MRC profits per customer averaged approximately $525.00 per class member. TR at 1429. Using MRC figures,

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1 The parties initially used Sprint only data without post-merger Nextel data, then later in the trial used Sprint data combined with post-merger Nextel data. As a result, the numbers used vary depending on when in the trial an expert was testifying. The distinctions are ultimately not material.

Dr. Taylor determined that Sprint charged the class $299,470,408 in ETFs even though Sprint's actual lost profit was approximately $987 million. TR. at 1432:25-28.

Sprint's actual damages. The jury found Sprint's actual damages to be $225,697,433. This amount is significantly higher than the $18,425,130 asserted by the class and significantly lower than the approximately $987,000,000 asserted by Sprint. The jury is not required to explain how it arrived at the amount of damages. After the close of evidence and argument, *Hoopes v. Dolan* (November 12, 2008) 2008 WL 4868623, held that where the Court and the jury consider the same evidence that the findings of the first fact finder bind the second fact finder. The Court is bound by the jury's factual findings because the jury issued its verdict before the Court issued its statement of decision. As a result, the Court finds that Sprint's actual damages were $225,697,433.

CATEGORIZING THE ETF.

Sprint argues that the ETF was designed to be part of its rate structure, was treated by Sprint and its customers as an alternative means of performance if a customer chose to terminate early, and was treated as a liquidated damage provision if a customer failed to pay his or her bills.

The Court categorizes and analyzes the ETF by looking at its true nature, which the Court discerns by looking at its objective effect on commerce generally and its effect on the majority of Sprint's customers specifically. *Ghirardo v. Antonioli* (1994) 8 Cal.4th 791, 802 (addressing difficulty of categorizing settlement note as a loan or as a modification of a credit sale); *In re Marriage of Frahm* (1996) 45 Cal.App.4th 536, 543

(addressing difficulty of categorizing severance payment as individual or community property).

The Court finds that Sprint's ETF operated primarily as a liquidated damages clause. For those customers who were never charged an ETF, the ETF was a dormant contract provision. Of those customers who were charged an ETF, 80% were terminated by Sprint and experienced the ETF as the imposition of liquidated damages, whereas only 20% paid the ETF voluntarily. When imposed on customers, the ETF limited Sprint's damages to the agreed amount and relieved Sprint of the need to calculate and pursue its actual damages.

PREEMPTION.

The factual nature of the ETF determines the legal standard to be applied in the preemption analysis. If the ETF concerns a matter that the states have traditionally occupied and regulated, then there is a presumption against federal preemption. *Smith v. Wells Fargo Bank, N.A.* (2005) 135 Cal.App.4th 1463, 1475-1476. If, on the other hand, the ETF concerns a matter where there is a history of significant federal regulation, then there is no presumption in favor of or against preemption. *In re Wholesale Electricity Anti-Trust Cases I & II* (2007) 147 Cal.App.4th 1293, 1304-1305. The Court has found that Sprint's ETF operated primarily as a liquidated damage clause. Civil Code § 1671(d) is a consumer protection statute of general application and regulates liquidated damages in consumer contracts. Consumer protection is a traditional state function. *Smith, supra,* 135 Cal.App.4th at 1475 ("The states' historic police powers include the regulation of consumer protection in general"). Therefore, in determining whether

federal law preempts Civil Code § 1671(d) as applied to Sprint's ETF, the Court applies the presumption against preemption.

The Federal Communications Act (FCA), 47 U.S.C. § 332(c)(3)(A), states, "No state ... shall have any authority to regulate ... the rates charged by any commercial mobile service ..., except that this paragraph shall not prohibit a state from regulating the other terms and conditions of commercial mobile services." The FCA does not have the unique preemptive force of statutes such as the LMRA and ERISA. 47 U.S.C. § 414; *Smith v. GTE Corp.* (11th Cir. 2001) 236 F.3d 1292, 1313. The FCA's legislative history suggests that Congress intended to remove state regulations about the setting of rates but intended that state law would apply to the interpretation and enforcement of consumer contracts and continue its traditional role in consumer protection matters. H.R. Rep. No. 103-111, 1993 U.S.C.C.A.N. 378, 588.

California case law does not provide substantial guidance on whether early termination fees are "rates" under the FCA. *Ball v. GTE Mobilnet* (2000) 81 Cal.App.4th 529, reads the FCA literally and suggests that "rate" is defined as a cost per unit of service. 86 Cal.App.4th at 538. In contrast, *Spielholz v. Superior Court* (2001) 86 Cal. App. 4th 1366, suggests that the word "rates" in section 332 refers to any direct price controls and is the mirror image of the word "charges" in section 205(a). 86 Cal.App.4th at 1373-1374. Neither *Ball* nor *Spielholz* concern early termination fees. *Pacific Bell Wireless, LLC v. Public Utilities Com.* (2006) 140 Cal. App. 4th 718, concerns a PUC decision that itself concerned the lack of a cancellation grace period and the adequacy of disclosures, and the PUC decision did not concern whether early termination fees were rates.

Sprint has not met its burden of demonstrating that the FCA preempts Civil Code § 1671(d) as applied to Sprint's ETF. The Court concludes that "rates charged" is best defined as what a cellular carrier charges its customers for the services it provides. This definition of "rates charged" is consistent with the plain language of the statute, the legislative history, *Ball v. GTE Mobilnet* (2000) 81 Cal.App.4th 529, 538, and *In re Southwestern Bell*, 14 FCCR 19898, para 19. The legislative history states clearly that state law would apply to the enforcement of consumer contracts and consumer protection matters. Civil Code § 1671(d) regulates the amount of damages that Sprint can recover for breach of contract. This regulation of damages is a traditional state function. In addition, in the absence of an ETF, if a consumer terminated a contract and Sprint brought an action for breach of contract then the amount of Sprint's actual damages would be decided under California contract law. Civil Code §§ 3300 and 3358. A contractual agreement to replace a calculation of actual damages with liquidated damages does not transmute the calculation of contract damages (a traditional state function) into a wireless carrier's "rate" (a federal concern).

ALTERNATIVE MEANS OF PERFORMANCE.

In determining whether Sprint's ETF is a liquidated damages clause or an alternative means of performance, the Court must "look to substance rather than form in determining the 'true function and character'" of the parties' arrangement. *Ridgley v. Topa Thrift & Loan Ass'n* (1998) 17 Cal.4th 970, 979. The Court has found that the ETF operated primarily as a liquidated damages clause. Sprint has not met its burden of establishing that the predominant effect of the ETF provisions was to provide consumers

with an alternative means of performing their contracts. Therefore, the following discussion of whether a consumer at the inception of a term contract might have considered the ETF to be an alternative means of performance is in the nature of dicta.

In determining whether the payment of a fee is an alternative means of performance, the Court considers whether at its inception the contract offered the terminating party "a 'realistic and rational choice in the future' between two alternative performances." *Blank v. Borden* (1974) 11 Cal.3d 963, 971. See also *Morris v. Redwood Empire Bancorp* (2005) 128 Cal. App. 4th 1305, 1314. 971.

Under each ETF provision in Sprint's various contracts, the ETF could be triggered by one of two events - either (1) a customer could terminate early by notifying Sprint that he or she wanted to terminate the contract or (2) Sprint could terminate a contract early for cause based on the customer's breach, and then impose an ETF. If this case concerned a Sprint clause that stated customers could terminate term contracts early by paying a fee, then that fee might well be an alternative means of performance. The contract clauses at issue, however, also permitted Sprint to terminate contracts early and then charge the ETF. In that circumstance, the ETF did not give customers a rational choice of paying the ETF or completing the contract - Sprint declared contracts breached, terminated service, and imposed ETFs as liquidated damages resulting from the asserted breaches. The existence of a contract breach precludes a finding that the ETF was an alternative means of performance. Compare *Blank,* 11 Cal.3d at 970 (alternative means of performance where "terms in no sense contemplate a "default" or "breach" of an obligation by the owner upon whose occurrence payment is to be made"); *Morris,* 128

Cal. App. 4th at 1314 ("to constitute a liquidated damage clause the conduct triggering the payment must in some manner breach the contract").

Sprint argues that the Court should treat the jury's verdict as an advisory verdict on whether Sprint's contracts provide for an alternative means of performance. The Court will not do so. The Court is responsible for deciding this issue. Order of 4/17/08 at 2:8-16; Statement of the case filed 5/9/08 at 2:14-25. The Court did not instruct the jury on the law related to alternative means of performance and the parties made no arguments to the jury on that issue. Order of 5/1/08 (Non-expert MIL # 7); Order of 5/6/08 (Non-expert MIL #2). The jury did not provide the Court with an advisory verdict on a matter not addressed to it.

LIQUIDATED DAMAGES UNDER CIVIL CODE § 1671(d) – LEGAL TESTS

There is a statutory test and a judicial test for determining whether a liquidated damages provision in a consumer contract is valid. The statutory test is based on the text of Civil Code § 1671 and the judicial test has developed in case law. Sprint must meet both tests. *Hitz v. First Interstate Bank* (1995) 38 Cal. App. 4th 274, 292, fn 13.

Statutory Test - Impracticability. It must be impracticable or extremely difficult to fix the amount of actual damages. Civil Code § 1671(d). The inquiry is focused at the inception of the contract. *United Sav. & Loan Assn. v. Reeder Dev. Corp.* (1972) 57 Cal. App. 3d 282, 299. In the impracticability analysis, "the "proper focus is on actual damage" caused by a breach, "not average damage." *Hitz*, 38 Cal.App.4th at 292, fn. 13.

Judicial Test – Reasonable Endeavor. Recent and controlling case law holds that under Civil Code § 1671(d) Sprint must prove that it made a genuine and non-pretextual

effort to estimate a fair average compensation for the losses anticipated to be sustained. *Hitz,* 38 Cal.App.4th at 291, citing *Garrett v. Coast Southern Fed. Sav. & Loan Assn.*, (1973) 9 Cal. 3d 731, 739. The reasonable endeavor analysis considers the motivation and purpose at the inception of the contract in imposing the charges. *Hitz*, 38 Cal.App.4th at 289. *In re Cellphone Termination Fee Cases*, Case No. A11547 (June 9, 2008 Cal. Ct. App. 1st Dist.) ("*In re Cellphone*"), states, "[T]he focus is not ... on whether liquidated damages are disproportionate to the loss from breach, but on whether they were *intended* to exceed loss substantially – a result of which is to generate a profit." Following *Hitz*, *Garrett* and *In re Cellphone*, the Court focuses on Sprint's motivation and purpose; i.e., its reasonable endeavor at the inception of the contract. (fn2)

LIQUIDATED DAMAGES UNDER CIVIL CODE § 1671(d) - EVIDENCE

Impracticability of fixing the amount of actual damages. Sprint's actual damage resulting from each class member's early termination is the amount of its lost revenue less the amount of its avoidable costs.

Sprint's lost revenue could be based on the Monthly Recurring Charge ("MRC") or the Average Revenue Per Unit ("ARPU"). MRC is the appropriate measure of Sprints' lost revenue because that is the measure of revenue that the Court would use in determining Sprint's actual damages. First, the use of MRC is suggested by Sprint's

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2 Because Civil Code § 1671(d) focuses on a defendant's motivation and purpose at the inception of the contract, a liquidated damages clause could potentially be void under Civil Code § 1671(d) even though the resulting cross-claim for actual damages resulted in a net monetary judgment in favor of the defendant. *In re Cellphone* at 8 ("If a liquidated damages provision is declared void under section 1671(d), the consumer is still liable for the actual damages caused by his or her breach of the contract."). Compare *Trujillo v. First American Registry, Inc.* (2007) 157 Cal.App.4th 628, 637-638 (no liability under statute unless there is an aggrieved party with an actual injury).

terms and conditions, which states "If Services are terminated before the end of your current billing cycle, (1) the MRC is not prorated to the date of termination...." and limits Sprint's liability to consumers with reference to the MRC. Exh 630 at 000093 and 97. Second, Sprint could calculate lost revenue on ARPU only if Sprint demonstrated that its customers should have reasonably contemplated or foreseen paying for optional services at the time of contracting. *Archdale v. American Intern. Specialty Lines Ins. Co.* (2007) 154 Cal.App.4th 449, 469 (citing Civil Code § 3300 and *Hadley v. Baxendale*.). Sprint demonstrated that it expected that consumers would incur optional charges, but there was no evidence that Sprint's customers signed up for plans expecting to incur overage and other optional charges. It is not relevant for the impracticability test that Sprint has many different term plans over the class period – for any given customer with any given plan it would be simple to calculate the customer's MRC due for the remaining months in the contract.

For the individual customer, Sprint's avoidable costs are the costs it can avoid when that individual consumer terminates after the initiation of a contract. Sprint can and does plan for the average termination rate of its subscribers, but it cannot predict and plan for the early termination of any single customer. *Hitz*, 38 Cal.App.4th at 292, fn. 13 ("the "proper focus is on actual damage" caused by a breach, "not average damage.""). As the expert evidence in this case demonstrates, the avoidable cost analysis is complicated and expensive.

At the initiation of any given consumer contract with an ETF, it would have been practicable for Sprint and the customer to determine a means to calculate Sprint's lost MRC revenue in the event of a breach, but impracticable for Sprint and the consumer to

determine Sprint's avoidable costs. Because revenue and avoidable costs are both part of the damage analysis, Sprint has demonstrated that it was impracticable for it to fix the amount of actual damages at the inception of the contracts.

Reasonable endeavor (motivation and purpose). There are three relevant decision points in this case - Sprint's adoption of the $150 ETF in May 2000; Nextel's adoption of the $200 ETF in approximately 2000; and Sprint/Nextel's post merger decision to implement the $200 ETF companywide.

Sprint did not prove that its motivation and purpose in adopting an ETF in 2000 was to determine what losses it would sustain from breach by the early termination of its contracts, nor did Sprint prove it made any effort to estimate a fair average compensation for such losses. Rather, the evidence established that Sprint's motivation and purpose in imposing the ETF was an attempt to have a negative effect on the practice of its customers taking their cell service to Sprint's competitors, and thus preventing a substantial loss in revenue to Sprint. Sprint did not consider in its analysis what losses it would sustain from breach, or whether or not the amount of the ETF was proportionate or disproportionate to contract damages resulting from contract termination. Instead, as noted above, Sprint considered whether the competition had similar contracts and ETFs, whether customers would sign up with contracts with ETFs, and how different amounts of ETFs would impact Sprint financially. Regarding the financial impact on Sprint, Sprint analyzed different scenarios and considered Sprint's profitability resulting from the proposed pricing change.

Sprint did not prove that Nextel's motivation and purpose in 2000 was to estimate the losses that Nextel would suffer from an early termination. Nextel's analysis was

essentially the same as Sprint's, considering whether the competition had similar contracts and ETFs, whether customers would sign up with contracts with ETFs, and how different amounts of ETFs would financially impact Nextel's profits. As with Sprint, Nextel did not do any analysis of losses it would sustain from breach by the early termination of its contracts, nor did Sprint prove Nextel made any effort to estimate a fair average compensation for such losses. Weiner Depo at 65.

Sprint did not prove that its motivation and purpose in 2005 in increasing the ETF from $150 to $200 was to estimate the damage that Sprint would suffer from early terminations. The only evidence on this decision suggests that it was motivated by a desire to establish a uniform ETF, with no consideration given to whether the amount of the ETF was justified by the losses that Sprint would suffer from an early termination.

Sprint did not prove that it made a reasonable endeavor to have the ETF estimate its actual damages.

Sprint argues the Court should follow *Utility Consumers' Action Network, Inc. v. AT&T Broadband* (2006) 135 Cal. App. 4th 1023 ("*UCAN*") and thereby use a different legal standard that would lead to a different result. The Court will not do so. *UCAN* does not address directly the judicial test under Civil Code § 1671(d) and expressly avoided a direct conflict with *Hitz.* 135 Cal.App.4th at 1038 fn 9. *UCAN* concerned whether a provision in a consumer services contract was invalid simply because the corporate defendant did not negotiate the late fee amount individually with each customer. In *UCAN* the parties stipulated that the Defendant, AT&T Broadband, did an analysis to determine its actual damages, and Plaintiff UCAN conceded that the late fee charged was reasonable. 135 Cal.App.4th at 1026. Therefore, the legal argument now

advanced by Sprint was expressly not addressed by *UCAN* and the major factual issues in this case were not even disputed in *UCAN.*

The Court is not required to use Sprint's proposed *UCAN* analysis because the Court used that analysis in prior orders. Trial court orders do not establish law of the case. *People v. Sons* (2008) 164 Cal.App.4th 90, 100. In addition, "the doctrine of 'law of the case' does not apply where the controlling rules of law have been altered or clarified by a decision intervening between the first and second judicial determinations." *Provience v. Valley Clerks Trust Fund* (1984) 163 Cal.App.3d 249, 256. This Court will follow *In re Cellphone* rather than this Court's prior orders.

Sprint's analysis of *UCAN* is, however, worthy of discussion because *UCAN* thoroughly discusses the legislative history and case law and implicitly suggests a different approach to considering claims under Civil Code § 1671(d). *UCAN* considered the origin of the judicial "reasonable endeavor" requirement in *Rice v. Schmid* (1941) 18 Cal.2d 382, 385-386. After a review of three sources in *Rice*, *UCAN* states, "All three sources demonstrate that the focus had been more on the *amount* of liquidated damages, and not the process by which that amount was derived," and "we believe the reasonable endeavor test they prescribed had more to do with the result and effect of a liquidated damages provision and nothing to do with whether both parties to the contract negotiated the amount of liquidated damages." *UCAN,* 135 Cal. App. 4th at 1034 and 1035.

UCAN's suggestion that "amount" or "effect" is a proper factor to consider is supported by the purpose of Civil Code § 1671(d), which is "to prevent a liquidated damages provision from being used oppressively against a consumer with little or no bargaining power." *In re Cellphones*, Case No. A11547, at 8. This statement of purpose

suggests a focus on how a liquidated damage provision is "used." By making sure that liquidated damages reasonably approximate actual damages, the statute prevents coercion before the termination and punitive payments after the termination. The efforts or subjective intent of the parties at the time of contracting concerns whether the parties expected a liquidated damage clause to serve as a penalty, not whether it actually functioned as a penalty. *McCarthy v. Tally* (1956) 46 Cal.2d 577, 585 fn 4.

UCAN's suggestion that the judicial test consider factors other than the reasonable endeavor at the inception of the contract is supported by older case law. (fn3) In *Dyer Bros. Golden West Iron Works v. Central Iron Works* (1920) 182 Cal. 588, 593 the Court looked first to "the entire agreement," and then deduced whether there was an intent to estimate just compensation. In *Smith v. Royal Mfg. Co.* (1960) 185 Cal.App.2d 315, 324, a case with facts similar to those here, the Court considered the objective terms of the contract and held that because the contract imposed the same fixed sum as liquidated damages without regard to whether the termination was at the start or the end of a contract term, the Court could infer that a penalty was intended.(fn4) These cases support *UCAN's* suggestion that the focus of the judicial test is, or should be, on "reasonableness" rather than on "reasonable endeavor."

One explanation for *UCAN*'s different focus is that the claim arises in the context of a mass consumer contract. Where a negotiated or two-party contract is at issue, as in *Rice*, *McCarthy*, *Dyer Bros. Golden West Iron Works v. Central Iron Works* (1920) 182

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3 *UCAN,* 135 Cal. App. 4th at 1029 ("Because the current law governing liquidated damages in consumer contracts is a continuation of prior law on the subject, decisions interpreting former section 1671 apply with equal force.").

4 When considering reasonableness in the context of non-consumer contracts, "All the circumstances existing at the time of the making of the contract are considered." *Weber, Lipshie & Co. v. Christian* (1997) 52 Cal.App.4th 645, 654.

Cal. 588, 593, or *Better Food Markets, Inc. v. American Dist. Tel. Co.* (1953) 40 Cal. 2d 179, the available evidence has included the motivation and purpose of the parties at the inception, the liquidated damages amount, and a calculation of the actual damages in that single situation.(fn5) With a two-party contract there is usually no evidence about what "average" actual damages might be, so these cases necessarily focus on the efforts of the parties at the inception of the contract to estimate actual damages. In contrast, where a mass consumer contract is at issue, as in *UCAN*, *Garrett*, or *Hitz*, the parties can, as here, collect and present information about the average timing and average damage associated with contract breaches. That information permits the Court to consider as a factor whether the contractual liquidated damages are significantly above the actual average damages and therefore an unlawful penalty.

The Court does not, however, find that Sprint's suggested *UCAN* analysis reflects the current state of the law. The current state of the law is that Civil Code § 1671 focuses on the intent of the parties at the inception of the contract. *Hitz, supra; Cellphone Termination Fees, supra.* If the Court were to interpret section 1671(d) and the case law to permit Sprint to use data compiled years after the ETF was implemented to establish that the amount of the ETF was reasonable, and the Court did not consider Sprint's intent, motivation, and purpose at the time of contracting, then Sprint might prevail. The law, however, requires the Court to focus on Sprint's endeavor at the initiation of the contract. The evidence establishes that when Sprint implemented the ETF in 2000 and increased it in 2005 it made no endeavor, reasonable or otherwise, to determine what losses it would sustain from breach or to estimate a fair average compensation for such losses.

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5 *Rice* and *Better Food* concerned standardized form contracts, but arose in the context of two party cases where there was apparently no evidence of how the contracts affected non-parties.

THE REMAINING CLAIMS.

The class prevails on its CLRA claim under Civil Code §§ 1770(a)(14) and (19) because Plaintiffs have demonstrated that the ETF is a violation of Civil Code § 1671(d).

The class prevails on its claim for a violation of the unlawful and unfair prongs of the UCL because Plaintiffs have demonstrated that the ETF is a violation of Civil Code § 1671(d).

The class prevails on its claim for unjust enrichment because Plaintiffs have demonstrated that the ETF is a violation of Civil Code § 1671(d), and, as a result, Sprint is not entitled to keep the ETFs it collected.

The class prevails on its claim for money had and received because Plaintiffs have demonstrated that the ETF is a violation of Civil Code § 1671(d) and any monies paid to Sprint for ETFs must be returned to Plaintiffs.

THE CLASS'S REMEDIES.

The Court must examine the status of the ETFs charged to determine the nature of the class's remedy. Sprint charged the class a total of $299,473,408 in ETFs. Of that amount, the class paid $73,775,975 to Sprint and the class has not paid the balance of $225,697,433. Of the unpaid amount, Sprint's ordinary course of business is to try to collect the money internally for 60 days and then to retain primary, secondary, and possibly tertiary collection agencies to pursue collections for 18 months. During this process Sprint still owns the debt but pays a commission on any amounts collected. Since 2004, Sprint has typically collected 20%-25% of the gross amount of ETFs billed.

Exh 866. After 18 months, Sprint typically sells any remaining uncollected debt to third parties for pennies on the dollar. Franklin testimony 6/2/08.

Sprint has collected $73,775,975 in ETFs. The class is entitled to recover as restitution and damages the $73,775,975 in ETFs the class paid to Sprint. This will provide full relief to the class regarding the amounts that the class actually paid to Sprint.

Sprint is still trying to collect some unknown amount of ETFs from the class. Given that Sprint typically pursues collection activities on an account for 18 months and that the class period expired on 3/18/07, Order of 5/9/08, Sprint is probably not still in possession of many class member accounts or trying to collect the ETFs in those accounts. For the accounts still in Sprint's possession, the Court orders that Sprint must reverse the charges to class members for any charged put unpaid flat ETFs and is enjoined from attempting to collect the unpaid flat ETFs from class members. This is full relief for the class regarding the ETFs that Sprint might still be attempting to collect.

Sprint has sold accounts receivable including an unknown amount of ETFs to third parties. For the class members accounts sold to third parties, the Court orders that Sprint must inform the third parties of this decision. Directing Sprint to provide notification to the third party assignees will provide substantial relief for the class. See Cal. Comm. Code § 9404 ("the rights of an assignee are subject to both of the following: … (1) All terms of the agreement between the account debtor and assignor and any defense … arising from the transaction that gave rise to the contract."). See also Restatement (Second) of Contracts § 336 (1981) ("By an assignment the assignee acquires a right against the obligor only to the extent that the obligor is under a duty to the assignor; and if the right of the assignor would be voidable by the obligor or

unenforceable against him if no assignment had been made, the right of the assignee is subject to the infirmity.").(fn6)

SPRINT'S CONTINGENT CROSS-CLAIM AGAINST THE CLASS.

"If a liquidated damages provision is declared void under section 1671(d), the consumer is still liable for the actual damages caused by his or her breach of the contract." *In re Cellphone* at 8. Sprint's cross-claim addressed whether the class breached their contracts with Sprint and, if so, the amount of Sprint's actual damages.

The jury in this case was asked to answer three questions:

(1) What was the amount of ETFs paid by the class? $73,775,975.

(2) Did the class breach their contracts? Yes

(3) What was the amount of Sprint's actual damages? $225,697,433.

In summary, the jury found that the class members made ETF payments totaling $73,775,975, breached their contracts by terminating early, and that Sprint's actual damages as a result of that breach were $225,697,433.(fn7)

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6 The Court will not declare that the third parties cannot pursue collection of the assigned contracts, as that would directly affect the property rights of the third parties without providing them an opportunity to present evidence or argument.

7 The jury was instructed to calculate the actual damages by calculating the lost contract revenue and subtracting Sprint's avoidable costs from that amount. The amount of actual damages determined by the jury is an amount that appears, based on the evidence presented at trial, to suggest that the jury might have treated the ETFs as valid and found that Sprint's actual damages were the amount of ETFs owed but not collected. If that is the case, then validity of the verdict might be questionable. For purposes of this Statement of Decision, the Court presumes that the jury made its calculation of actual damages as they had been instructed.

THE SETOFF.

The goal of a setoff is to "eliminate a superfluous exchange of money between the parties." *250 L.L.C. v. Photopoint Corp.* (USA) (2005) 131 Cal.App.4th 703, 727-728. A setoff should not place a party in a better position than it would otherwise be in with cross-judgments. *Jess v. Herrmann* (1997) 26 Cal.3d 131, 142-143. Because this is a class action where different class members might be differently situated with regard to whether the ETF exceeded Sprint's actual damages, this Court's predecessor, Judge Ronald Sabraw addressed how the setoff would work in the class context. Judge Sabraw, considered several alternative approaches and described Approach No. 5 as follows:

> Plaintiffs would pursue their class action and Defendants could assert class cross-claims, but the affirmative recovery of the class as a whole would be set off against the actual damages the class as a whole owed to the Defendant and a Defendant could not obtain a net positive recovery against the class as a whole. As with approach #4 the cross claims would have the effect of cross-demands for payment under C.C.P. 431.70. This approach refocuses the intra-class conflict, but does not eliminate it. Instead of a conflict where some class members would recover money from Defendants and other class members might have to pay money to Defendants, the conflict would be that class members with net positive recoveries would subsidize the class members who owed money to Defendants. This approach would provide Defendants with greater due process than Approach #4 because they could assert claims for their total actual damages against the class up to the total amount that the class might recover against the Defendants. At the hearing on December 7, 2006, Verizon and Sprint/Nextel stated that if the Court adopted this approach those Defendants would waive their right to affirmative recovery against the members of the class and the class as a whole.

Order of 12/27/06 at 5:9-26. The Court then concluded:

> The Court will follow Approach #5. This approach permits Plaintiffs to use the class mechanism for their claims, permits Defendants [to] use the class mechanism for their cross claims, resolves all the claims in a single case, minimizes the potential harm to the absent class members by precluding Defendant from obtaining any affirmative recovery from any class member, permits the Defendants to offset their total actual damages against the total amount of any liability to the class on the ETF claims, and

> is procedurally faster and simpler than most of the alternatives. Approach #5 does not eliminate the intra class conflict, but minimizes it while still maintaining the class mechanism.

Order of 12/27/06 at 6:24-7:7.

This Court determines the setoff in keeping with the 12/27/08 Order. The Court found that the class prevailed on their claims and that Sprint must return the $73,775,974 to the class. The jury found that Sprint prevailed on its cross-claim for breach of contract and the class must pay Sprint's actual damages of $225,697,433. Calculating the setoff pursuant to the Order of 12/27/06, the Court sets off the class's monetary recovery of $73,775,975 against Sprint's actual damages of $225,697,433 and Sprint's resulting net recovery of $151,921,458 is reduced to zero. The setoff of monetary relief does not affect the injunctive relief.

CONCLUSION.

The Court will enter judgment in favor of Plaintiffs on their claims, and in favor of Sprint on its cross-claim. After the set off of the monetary relief neither the class nor Sprint is entitled to any monetary recovery. The Court orders that for those class member accounts still in the possession of Sprint that Sprint must reverse the charges for any charged put unpaid flat ETFs and is enjoined from attempting to collect the unpaid flat ETFs. The Court orders that for those class member accounts sold by Sprint to third parties Sprint must inform the third parties of this order.

1 The Court directs Plaintiffs to prepare and submit a judgment consistent with this

2 Statement of Decision.

3 DEC - 4 2008

4 Dated: ~~November __, 2008~~

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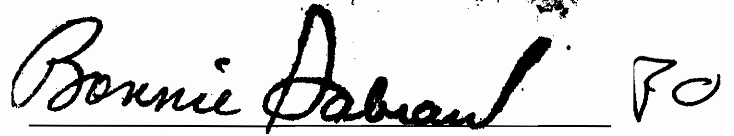

6 Judge Bonnie Sabraw (Ret.)

7 Sitting on Assignment by Appointment
Of the Chair of the Judicial Council

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Case Title/No.: **AYYAD VS. SPRINT RG03121510**

CLERK'S CERTIFICATE OF MAILING
(CCP §1013a)

I certify that the following is true and correct:

I am a Deputy Clerk employed by the Alameda County Superior Court. I am over the age of 18 years. My business address is 1221 Oak Street, Oakland, California. I served this STATEMENT OF DECISION [C.C.P. § 632, CRC § 232] by placing copies in envelopes addressed as shown below and then by sealing and placing them for collection, stamping or metering with prepaid postage, and mailing on the date stated below, in the United States mail at Oakland, California, following standard court practices.

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Dated: December 4, 2008

Executive Officer/Clerk of the Superior Court

By
Elizabeth Opelski-Erickson, Deputy Clerk