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IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

FIRST APPELLATE DISTRICT

DIVISION FIVE

JACK HARTE et al.,
Plaintiffs and Respondents,
v.
GARY BRIDGEWATER,
Defendant and Appellant.

A133168
(Sonoma County
Super. Ct. No. SCV-243407)

In a series of transactions which the trial court aptly characterized as “very convoluted” and “confusing,” appellant Gary Bridgewater and respondent Jack Harte sought to acquire equity interests in a firearms business owned by Tyler Jones, a licensed firearms dealer. In April 2008, all three parties signed a written agreement purporting to allocate interests in the business, with Harte receiving cash from Bridgewater and a promissory note from Bridgewater and Jones. Neither Harte nor Bridgewater held a firearms license. Jones ultimately sold the store’s inventory without notice to Harte or Bridgewater, closed the business and absconded. Harte then sued Bridgewater and Jones seeking to recover on the promissory note, and Bridgewater cross-complained for rescission and restitution of the cash paid to Harte. Following a bench trial, the trial court granted judgment to Harte on the promissory note, and denied recovery to Bridgewater.

We conclude that the parties’ agreement was an illegal contract that recognized ownership in and transferred ownership to persons who were not licensed to own or

operate a firearms dealership. Therefore, the contract is unenforceable and neither Harte nor Bridgewater is entitled to relief.¹

I. BACKGROUND²

Jones owned and operated gun stores from 1986 to 2008. From 2000 to 2008, he operated a gun store in Penryn, California as a sole proprietor under the name Sportsman's Access. Sportsman's Access sold guns both at its retail location in Penryn and at gun shows around the country. Jones completed multiple state and federal licensing requirements to operate Sportsman's Access and held a federal firearms license throughout his operation of the Penryn store.³

Jones met Harte at a gun show in 1996. They became good friends and engaged in a number of business ventures together, including gun sales and investments in boats and real estate. Harte regularly sold guns on consignment through Jones, with Jones receiving a share of the profits. Between 2006 and 2010, selling guns was Harte's sole occupation, and Harte often attended gun shows with Jones. Harte did not have a federal firearms license.

Jones's Debt to Harte

In 2007, Jones began to have financial difficulties and started manipulating his accounts to cover his bills. Harte eventually demanded an accounting for several guns he had consigned. In an emailed letter to Harte on March 11, 2008, Jones admitted that he had been using proceeds from sales of Harte's guns to pay unrelated bills rather than to pay Harte his share of the proceeds and that all of the guns had been sold or traded. Jones

¹ Jones is not a party to this appeal.

² The evidence is taken from the record of the bench trial. Harte died in January 2010 before trial in this matter and thus the court did not have the benefit of his testimony. Harte's wife, Rebecca, was granted leave to continue the action on Harte's behalf as his successor.

³ In 2006, Jones opened a second gun store in Petaluma as a joint venture with Robert Johnson, under the name Sportsman's Access Too. Before Jones agreed to go into business with Johnson, he insisted that Johnson also obtain a certificate of eligibility, a firearms licensing requirement.

testified that he owed Harte about \$147,000 just for the capital costs of the guns; Rebecca Harte testified that the couple's financial records showed a debt of about \$344,000. Jones apparently also owed Harte money from their other business ventures. In his March 11, 2008 email, Jones told Harte he had a tentative deal with Bridgewater, who was aware of Jones's debt, to buy a one-half interest in Jones's business, which would give him money to pay his debt to Harte.

Jones and Bridgewater Negotiations

Jones and Bridgewater had met socially around 2005. Bridgewater attended a gun show with Jones in about October 2007, and became interested in going into the gun business. Jones and Bridgewater initially discussed a joint venture that would run Sportsman's Access and Sportsman's Access Too as a new legal entity and obtain a \$500,000 bank loan. Jones drafted a proposal (one of several he prepared) for the sale to Bridgewater of one-half interests in both the Penryn and Petaluma stores, creation of a new legal entity, and a guaranteed salary for Bridgewater's work managing the stores in addition to his share of the profits. Jones then cooled on the idea and pursued possible deals with other buyers. When those efforts were unsuccessful, however, he renewed discussions with Bridgewater in about January 2008. After Jones and Bridgewater met with a banker in February 2008, Jones concluded they would not be able to meet the bank's requirements for a \$500,000 loan.

By March 2008, Jones was pressing Bridgewater to consummate a deal. He told Bridgewater that he needed to make the sale so he could pay off a debt to Harte. In a March 14 email, Jones told Harte he had informed Bridgewater that his purchase payment needed to go directly to Harte and Bridgewater had agreed. As of March 16, Bridgewater understood that Jones owed Harte about \$100,000. Jones told Harte on March 20 that he "didn't want to alert [Bridgewater] to the sever[ity] of the situation, as I feared it might destroy the deal[.]" As demonstrated by these emails, Jones negotiated with Bridgewater without Harte's direct participation, but kept Harte apprised of the negotiations.

Assignment of Sportsman's Access to Harte

While negotiating with Bridgewater, Jones, on March 12, 2008, executed the following assignment and delivered it to Harte: “The undersigned here by assigns all of his right title and interest to his retail gun store known as, Sportsmans Access, located [in] . . . Penryn . . . [i]ncluding, but not limited to the lease for the building the inventory as of 3/12/2008 and all fixtures.”⁴ Bridgewater did not learn of this assignment until March 31.

March 16 Sales Agreement and Addendum between Jones and Bridgewater

On March 16, 2008, Jones and Bridgewater entered into a conditional sales agreement and addendum (the March 16 Sales Agreement) committing Jones to sell a one-half interest in the Penryn store to Bridgewater for \$375,000 subject to several conditions. Those conditions included (1) that the business be appraised at no less than \$750,000 (or there would be an adjustment to Bridgewater's ownership interest or transfer of an interest in the wholly owned inventory of the store); (2) that the business be operated by a new legal entity with Jones and Bridgewater as the “sole owners” with “a new bank account, modified accounting practices, and specific performance agreements” to be mutually determined by Jones and Bridgewater; (3) that Jones indemnify

⁴ Harte incorrectly states in his respondent's brief that the assignment “was explicitly related to a proposed sale to a third party to pay down Jones' debt to Harte.” Harte cites to Jones's assignment of his interest in the *Petaluma* store, which included language to that effect. Although this assignment apparently was not introduced in evidence at trial, Johnson testified at trial that Harte showed him an assignment that seemed to transfer an ownership interest in the *Petaluma* store, and a copy of two assignments were attached to Harte's unverified second amended complaint. The first assignment, dated March 12, 2008, is entitled “Str[a]ight Assignment” and states: “The undersigned [Jones] here by assigns all of his right title and interest to his retail gun store known as, Sportsmans Access Too, located [in] . . . Petaluma” The second, dated March 15 and signed by Jones, Harte and Harte's wife, states that Jones “hereby assign[s] all rights title and interest to” the Hartes and states, “Said assignment is made pursuant to a proposed sale to a third party, said sale to provide assignee with specific moneys and securities to be acceptable to assignee to partially offset previously incurred debt by assignor due assignee.” At this time, Jones apparently expected to sell part of his interests in both the Penryn and *Petaluma* stores to Bridgewater.

Bridgewater for past or future liabilities incurred by Jones or the business and for liabilities over \$2,500 incurred without Bridgewater's approval after the new entity was created. Bridgewater would pay Jones (in a combination of cash and vehicles) after these three conditions were met. Both parties agreed to expedite satisfaction of the conditions and Jones agreed that "[d]uring this 'interim period,' and throughout the association of Bridgewater and Jones," Jones would "retain all current licensure so the store may operate" and not take any actions to impair store operations.

An addendum to the March 16 Sales Agreement states that Jones's purpose in selling the one-half interest in the business was to generate cash to pay off short term debt, "thus leaving the store debt free," and to engage Bridgewater's assistance in operating and expanding the business. Bridgewater's stated purpose was to realize a profit. "HOWSOEVER, said appraisal is not complete, there has been no entity created, and the short term debt . . . has become critical to the operation of the business. In order to expedite the immediate distribution of cash and trucks from [Bridgewater] to [Jones]," Jones assigned "all of the business, business assets, and inventory for collateral purposes until Bridgewater and Jones receive the appraisal, make the appropriate adjustments, create the entity and complete the original agreement." At that time, Bridgewater "will re-assign what is NOT to be part of the sale, specifically the inventory, and 1/2 of the interest in the business back to" Jones. "In the interim, [the store] will operate as normal, but as of this date, profit accounting will begin, and Bridgewater will be entitled to 1/2 the net profit from operations."

None of the conditions in the March 16 Agreement were ever satisfied. Jones provided Bridgewater some of the financial information he had requested, but it was never reviewed by Bridgewater's accountant. Bridgewater did not have a lawyer review the agreement. No new ownership entity was created, no fictitious business name statement filed to show Bridgewater as a part owner of the store, and Bridgewater's name was never added to the lease or the business checking account. Jones testified that he continued to operate the business as a sole proprietorship and never formally transferred any part of the business to Bridgewater.

April 8 Agreement Among Jones, Harte and Bridgewater

On March 27, 2008, Harte set a March 28 deadline for Jones to make at least partial payment on the outstanding debt. On March 31, Bridgewater, Jones and Harte met at Harte's residence. Bridgewater learned for the first time that Harte claimed Jones owed him about \$600,000. Harte promised Bridgewater an accounting of what portion of this debt Jones owed specifically for Harte's guns. Bridgewater also learned for the first time about Jones's March 12 assignment of the Penryn store to Harte. Bridgewater described the assignment as "indicating that the Hartes . . . were the owners of . . . the Penryn gun store, and [Jones] had signed over all his rights to them."

Harte and Bridgewater then directly discussed Bridgewater's acquisition of an interest in the Penryn store—an arrangement later incorporated in a written agreement signed by the parties on April 8, 2008, which is the focus of this litigation. Bridgewater testified that he and Harte discussed how the firearms business was going to be run and Bridgewater gave Harte a \$5,000 check and the titles to three trucks as a "non refundable deposit" during the meeting. Bridgewater emailed Jones the next day: "I believe [Harte] will allow me to run the business . . . as we agreed. He will be apprised on a monthly basis of sales and return on investment."

On April 8, 2008, Jones, Harte and Bridgewater met again and executed a written agreement (the April 8 Agreement).⁵ The agreement recited that Harte had been assigned "all rights, title and interest in [Sportsman's Access] and is hereinafter called lien holder

⁵ On April 5, 2008, Jones and Bridgewater signed off on the basic terms of the April 8 Agreement that affected Bridgewater. On April 6 and 7, Jones sent Bridgewater several emails about his efforts to work out the remaining terms of the agreement and sent Bridgewater a draft agreement on April 7.

Jones testified that Harte "dictated" the terms of the agreement and Jones agreed to the terms—"I just signed everything he put in front of me"—because Jones was afraid of Harte. He testified that Harte told him over the phone that he could kill Jones for what Jones had done. He was also told by others in early March 2008, that Harte had said he might kill Jones if Jones's debt was not paid off. Johnson testified that Harte threatened Jones's life in three separate comments to Johnson on and before April 8 and he told Jones about the threats before the April 8 meeting.

but is to have all the rights of an owner.”⁶ It stated that Harte “will assign” a 33 percent interest in the business to Bridgewater for \$305,000 “under the following conditions”: (1) “Bridgewater to tender” \$200,000 to Harte on or before April 8, and (2) a promissory note for \$105,000 at 8.5 percent interest, payable monthly and signed by Bridgewater and Jones, would be given to Harte and “when note is paid in full, Harte will deliver” another 17 percent interest in the store, for a total interest of 50 percent. Harte would “retain the remaining 1/2 of [Sportsman’s Access],” but agreed to sell that interest to Jones under the following conditions. First, Jones would give Harte ownership of \$350,000 in guns; Jones would sell those guns and give Harte the first \$200,000 in proceeds; and Jones would give Harte 75 percent of proceeds from all additional sales with a monthly minimum payment. Second, Jones would give Harte clean title to a boat and would repair and ultimately sell it on Harte’s behalf for a credit of \$55,000 toward “the master note.” Third, Jones would assign his rights in the Petaluma store to Harte and pay Harte \$60,000 for a \$60,000 credit toward the master note.

On April 8, 2008, Bridgewater gave Harte and Jones a certified check for \$195,000, which combined with the \$5,000 he paid on March 31 satisfied his \$200,000 cash obligation. He and Jones both also signed a \$105,000 promissory note. Jones further signed a promissory note (in his personal capacity and on behalf of Sportsmans Access) promising to pay Harte \$606,927 by April 1, 2009 with 8.5 percent interest.

Events After April 8, 2008

Bridgewater did not spend much time in the store in the weeks after he signed the April 8 Agreement (at most once a week) because the store was being audited by the Bureau of Alcohol, Tobacco and Firearms (ATF) and there was not much room for him there.⁷ Also, he had never run a business before and was not yet knowledgeable enough

⁶ In an April 5, 2008 email, Jones told Harte that as a result of the agreement, he and Bridgewater would “own the store 50/50.”

⁷ Jones and Harte knew about the audit (or impending audit) by March 13, 2008. Bridgewater, however, testified that he did not know about the audit until after he signed the April 8 Agreement and would not have signed if he had known.

to run the store independently. However, Bridgewater went to gun shows with Jones. By October, Bridgewater had little involvement in the store.

Bridgewater knew at the time of the April 8 Agreement that a gun store business could only be operated by a licensed gun dealer. Bridgewater also knew that Harte did not have a license. Bridgewater testified he was under the impression that Harte was going to get a license as owner of the store, although Harte never told him so.

Bridgewater did not have a license and he cites no trial evidence that he took steps to get one.

Conflicts among the parties soon arose.⁸ Jones testified that Harte made several attempts to change the agreement, called the store daily, harassed the employees, and made demands on Bridgewater. Ultimately, Bridgewater made only three payments on the \$105,000 note.⁹ Jones never paid Harte \$200,000 from sales of guns per the April 8 Agreement. He also never gave Harte monthly reports of sales or returns on investment. However, Jones gave Harte several blank signed checks on the store's account, which Harte used to withdraw money from the store.

⁸ As early as April 23, 2008, Jones emailed Bridgewater about a possible way to invalidate the deal. Jones testified, “[W]e were already looking for a way to either unravel it or make [Harte] become more realistic and to quit making demands, quit harassing us at the store.” On August 21, Harte sued Jones and Bridgewater on the \$105,000 note because they had missed their August 1 payment. By the late summer 2008, Jones, Bridgewater and Harte had each retained counsel and were discussing possible resolutions of their disputes. On September 12, Harte and his wife filed a first amended complaint that added claims for conversion, possession of Harte's personal property, breach of fiduciary duty, civil conspiracy, elder abuse, and declaratory relief.

⁹ At some point, Jones agreed to pay the \$105,000 note and relieve Bridgewater of his obligation under the note, but Jones was unable to make the payments because the store had no surplus funds. Therefore, Bridgewater made the first three payments. Bridgewater testified that he stopped paying in part because Harte “never performed on his part of the agreement to give me one-third of the store. [¶] . . . [¶] . . . I had asked him. He never answered me.”

Not long after April 8, 2008, Harte demanded delivery of all of his guns in the Penryn store that were in Jones's name.¹⁰ In June 2008, Jones picked up Harte's driver's license to perform the computerized background checks required by state law to transfer the guns and asked Harte to come to the store to sign the forms. Harte asked Jones to sign his name for him; Jones refused and retained Harte's license. On July 18, Harte sent Bridgewater and Jones a written demand for the transfer of all of his firearms to a specified federal firearms license holder. At some point, Jones told Harte to stay away from the store.

Jones ultimately lost his firearms license, apparently as a result of the ATF audit.¹¹ On October 25, 2008, he consigned his remaining inventory to another business without telling Harte or Bridgewater. Jones then closed the Penryn store and "just left the area and hid." He used the proceeds (received over the following six to seven months) to pay store debts and consignors, but did not give any of the money to Harte or Bridgewater.

Litigation

The operative second amended complaint filed by Harte and his wife against Jones and Bridgewater asserts causes of action for breach of contract, conversion, possession of Harte's personal property, breach of fiduciary duty, civil conspiracy, elder financial abuse, and declaratory relief. The breach of contract claim sought enforcement of the

¹⁰ Johnson testified that, sometime in May 2008, Harte told him about Jones's assignment of his interest in the Petaluma store to Harte. Harte demanded an audit of the store and payment of his share of the profits. When Johnson refused, Harte threatened Johnson (according to Jones and Johnson). Johnson filed an application for a restraining order against Harte, which he later withdrew after Jones called and told him Harte had threatened the lives of Johnson and his family if the restraining order were issued, as it would prevent Harte from possessing firearms. However, Johnson removed all guns and equipment from the Petaluma store and reported these actions to the ATF. Although Harte reported these actions to the police, upon investigation the police determined it was a civil matter and took no action.

¹¹ Jones testified that he had lost his firearms license due to missing firearms, "[p]artially because some were hidden by people, which I can only speculate, and a large portion of it was errors by my employees in the record keeping." He also testified, "When I complied with Mr. Harte's demand to deliver his guns illegally and delivered them, it caused a real problem. Lost my license."

\$105,000 note. Bridgewater filed a cross-complaint that, as amended, asserted claims against Harte for money had and received, breach of contract, and fraud. Bridgewater's breach of contract claim (apparently brought against both Harte and Jones) was based on allegations of "[c]hanging the terms and conditions of the [April 8 Agreement] without consideration and to [Bridgewater's] detriment; failing and refusing to transfer 1/2 interest, or any interest at all in [Sportsman's Access] to [Bridgewater]; depleting [*sic*] the assets of the business without consideration; failing to pay rent, and other business expenses." The fraud claim alleged, "The agreement with [Jones] by which [Harte] acquired [his] alleged ownership interest [in the Penryn store] had never been consummated [*sic*] and [he] had no right to transfer or sell a 1/2 interest or any interest in said business." Several other claims and cross-claims were brought that are not relevant to this appeal.

A court trial was conducted in April 2011. As relevant here, the court entered judgment for Harte and against Jones and Bridgewater on the breach of contract claim for payment of the \$105,000 with joint and several liability, and for Harte and against Bridgewater on Bridgewater's cross-claims.

At Bridgewater's request, the trial court issued the following statement of decision:

" 'First of all, the transactions between the parties are very convoluted, confusing. The documents are not always prepared by attorneys. The entities involved are unclear. The relationships tend to be unclear. And what the court is left with is looking at what the parties agreed to and holding them to their agreements. [¶] . . . [¶]

" 'I think it's clear that Mr. Bridgewater paid to Mr. Harte \$200,000 and signed a note jointly with Mr. Jones for \$105,000 to convey any right which Mr. Harte had in the business. Mr. Harte had obtained a right in the business by assignment from Mr. Jones. [¶] Now, why he wanted the assignment rather than ownership is beyond me, but that's the transaction and I'm going to hold the parties to it. [¶] I'm going to find that Mr. Bridgewater is liable jointly and severally with Mr. Jones on the \$105,000 note to

[Harte] . . . [¶] . . . [¶] Interest will be awarded at 8-1/2 percent on the \$105,000 note from August 4, 2008.

“ ‘And the one other thing I wanted to cover is that whether Mr. Harte received the note and the \$200,000 from Mr. Bridgewater as the assignor of his interest or whether he was simply a third-party beneficiary on the contract between Jones and Bridgewater I don’t think matters. I think it’s clear that Harte had received the assignment from Jones; that Jones was attempting to convey his half interest to Bridgewater and did it through this method of the payments to Harte to absolve Jones of a portion of the debt.’ ”

In response to Bridgewater’s requests for specific factual findings, the court found that Jones assigned an ownership interest in the Penryn store to Harte, which gave Harte legal standing to assign an interest in the store to Bridgewater; that Harte and Bridgewater were in privity of contract under the April 8 Agreement as evidenced in part by the \$105,000 note; that Harte assigned an interest in the store to Bridgewater by executing the April 8 Agreement—the court commented, “[Harte] took no steps contrary to [that] assignment after the agreement was fully executed and after [he] received partial payment from [Bridgewater]”; that Jones and Bridgewater were in a contractual relationship under the March 16 Agreement; that Harte was a third party beneficiary of the March 16 Agreement and an intended creditor beneficiary of the April 8 Agreement; and that Jones and Harte did not conspire to defraud Bridgewater—the court commented, “At the time [Bridgewater] paid \$200,000 to [Harte] for the purchase of [Harte’s] rights in the Sportsman’s Access gun store, [Bridgewater] was fully . . . advised of the agreements between [Harte and Jones], [Jones’s] obligation to [Harte], and the nature of the assignment of the business to [Harte].”

Motion for New Trial or to Vacate the Judgment

Bridgewater filed a motion for a new trial or to vacate the judgment and enter a different judgment. As relevant here, he first argued that Harte’s breach of contract claims were necessarily defeated because Harte did not own the gun store business, but merely held a security interest in the store. Because Harte did not own and thus could not convey an ownership interest to Bridgewater, the April 8 Agreement was void for lack of

consideration and mutual mistake of fact. Second, he argued the April 8 Agreement was void for illegality because the central object of the contract was to convey ownership from Harte to Bridgewater, neither of whom was licensed to hold ownership of the store. In opposition, Harte argued that the release of his lien interest in Sportsman's Access was sufficient consideration for Bridgewater's \$200,000 payment and \$105,000 note. On the illegal contract issue, he argued "the obligation to notify the [ATF] of any change in ownership falls upon the licensee and the new owner. Not on a creditor. . . . [¶] [After April 8, 2008, Harte] had done all he could legally do under the law to cooperate with and participate in the sales transaction. The onus at the time was on [Jones] as the licensee of the former sole proprietor of the establishment and [Bridgewater] as the new owner of a one-half interest in the store to notify the [ATF] of the change in structure"

The trial court denied the motions on both procedural and substantive grounds. On the merits of the first argument, the court ruled, "Whether [Harte] received assignment of an ownership interest, or as argued by [Bridgewater], an interest as a lien holder, [Harte's] relinquishment of that interest provided consideration for [Bridgewater's] promise to pay." On the merits of the illegal contract argument, the court wrote, "[Bridgewater] argues that any transfer of an interest by [Jones] to [Bridgewater] was illegal under federal regulations applicable to gun dealers. Any failures in this regard by [Jones] and [Bridgewater] may not be attributed to [Harte], and do not nullify [Bridgewater's] promise to pay in exchange for [Harte's] relinquishing any interest [he] had in the business."

II. DISCUSSION

Bridgewater argues on two grounds that the trial court erred in finding the April 8 Agreement enforceable. First, he argues (albeit on somewhat different grounds than he argued in his new trial motion) that the court erred in finding Harte had fulfilled his obligation to assign Bridgewater a 33 percent interest in the business in exchange for the \$200,000 Bridgewater paid on April 8, 2008. Second, he argues the agreement was an

illegal contract to transfer a firearms dealership to unlicensed persons. We find the second point to be dispositive.

Bridgewater argues the April 8 Agreement is unenforceable as a contract to carry out an illegal transaction, specifically a recognition of Harte's ownership of and a transfer of ownership in a firearms dealership without compliance with licensing requirements. As a preliminary matter, we consider whether the trial court found, and whether the evidence supports a finding, that Harte held an ownership or a security interest in Sportsman's Access at the time the April 8 Agreement was signed. We next consider whether the April 8 Agreement contemplates an illegal transaction and, if so, whether the illegal nature of that transaction renders the contract unenforceable.

A. *Nature of Harte's Interest in Dealership*

The trial court observed generally, “ ‘[T]he transactions between the parties are very convoluted, confusing. The documents are not always prepared by attorneys. The entities involved are unclear. The relationships tend to be unclear. And *what the court is left with is looking at what the parties agreed to and holding [them] to their agreements.*’ ” (Italics added.) We construe this statement as a finding that the extrinsic evidence on the meaning of the parties' contracts was inconclusive and the contracts had to be construed based on the plain meaning of the contract language. A contract interpretation issue based on contractual language is subject to de novo review. (*Parsons v. Bristol Development Co.* (1965) 62 Cal.2d 861, 865–866.)

The court generally understood the parties' various transactions as a combination of (1) some type of assignment of Jones's interest in the Penryn store to Harte to guarantee Jones's payment of his debt to Harte; (2) the sale of a one-half interest in the Penryn store to Bridgewater from Jones through Harte (and release of Harte's claim in that half interest) with payment by Bridgewater directly to Harte as a partial satisfaction Jones's debt to Harte, and (3) the release of Harte's other half interest in the store to Jones upon Jones's payment to Harte of the remainder of his debt to Harte.

While this may be a fair characterization of the evidence, we do not agree with the trial court's suggestion that all of the contracts signed by the parties were reconcilable

and thus all remained operative. As noted, the court found the March 16 Sales Agreement and its addendum remained in effect even after execution of the April 8 Agreement. The March 16 Sales Agreement, however, conditioned the sale of the business (and Bridgewater's obligation to pay \$375,000 for the business) on completion of an appraisal, creation of a new legal entity to run the business, establishment of new accounting procedures, and execution of an indemnification agreement. The addendum purported to assign Jones's inventory and interest in the store to Bridgewater as collateral for his advance payment of cash and trucks to Jones (so Jones could pay off debt) and allows Bridgewater to share in the store's profits immediately. Several of these terms flatly contradicted the terms of the April 8 Agreement. Most obviously, the April 8 Agreement recited that it was Harte that held all rights in the store. Even if this plain language were properly construed to refer to a security interest only, Harte's holding of such an interest would contradict the terms and eliminate the consideration for the addendum to the March 16 Sales Agreement. The April 8 Agreement also requires Jones to assign ownership of part of his gun inventory to Harte and to remit proceeds from sales of these guns to Harte, which is in tension with (if not in contradiction to) Jones's assignment of his inventory to Bridgewater as collateral for the payments mentioned in the addendum. Finally, the unconditional requirement that Bridgewater pay \$200,000 and \$105,000 for the release of Harte's interest in the store is inconsistent with his rights under the March 16 Sales Agreement to demand an appraisal, creation of a new legal entity, establishment of new accounting procedures, and an indemnity agreement before any payments were due.

An irreconcilable tension also exists between the March 12, 2008 assignment of Jones's interest in the Penryn store to Harte and the March 16 Sales Agreement and addendum. If the March 12 assignment was an assignment of an ownership interest, Jones had no interest to sell at the time he signed the March 16 Sales Agreement and that contract must fail for lack of consideration. If the March 12 assignment was an assignment of a security interest, Jones was not free to commit the store as collateral to

obtain money from Bridgewater per the terms of the addendum and that agreement must fail for lack of consideration.

Relying on the plain language of the agreements (and thus applying de novo review), we conclude the most reasonable interpretation is that the April 8 Agreement (1) superseded the March 16 Sales Agreement and addendum and (2) confirmed the March 12 assignment as the transfer of an ownership interest in the store. First, the plain language of the March 12 assignment manifested a present and unconditional intent to transfer “all” rights in the property to Harte. All parties were aware of this assignment at the time they signed the April 8 Agreement (although Bridgewater was not aware of it when he signed the March 16 Sales Agreement and addendum). The language of the April 8 Agreement included some minor ambiguity regarding the nature of Harte’s interest in the store by stating that he would thereafter be “called lien holder” (although he was not thereafter called a lien holder in the agreement), but otherwise unambiguously stated that Harte held “all” rights and interests in the store and “is to have all the rights of an owner.” It states that when Bridgewater paid the additional \$105,000 in full, “Harte will deliver remaining percentage of *ownership*” to Bridgewater.” (Italics added.) The April 8 Agreement further provides that Harte will “*retain* the remaining 1/2 of [Sportsman’s Access], but will *sell* to Jones” (italics added) under specified conditions. The combination of this unambiguous language and the fact that several critical terms of the March 16 Sales Agreement and addendum were set aside in the April 8 Agreement support the conclusion that the April 8 Agreement *replaced* rather than modified the March 16 Sales Agreement and addendum.

Under the combined terms of the March 12, 2008 assignment and the April 8 Agreement, therefore, Harte was confirmed as holding an *ownership* interest, not a security interest in the Penryn store, which he agreed to relinquish under the terms of the April 8 Agreement.

B. *Illegality of the Transaction*

The April 8 Agreement contemplates an illegal transaction because it recognizes a current ownership interest in Harte and anticipates an immediate transfer of an interest to Bridgewater—both unlawful under federal firearms licensing law.

“ ‘No principle of law is better settled than that a party to an illegal contract cannot come into a court of law and ask to have his illegal objects carried out; nor can he set up a case in which he must necessarily disclose an illegal purpose as the groundwork of his claim.’ [Citation.]” (*Lee On v. Long* (1951) 37 Cal.2d 499, 502; see also *Wong v. Tenneco, Inc.* (1985) 39 Cal.3d 126, 134–135 [refusing to enforce contract related to farming operation conducted in violation of Mexican law].) “Whenever a court becomes aware that a contract is illegal, it has a duty to refrain from entertaining an action to enforce the contract. [Citations.]” (*Bovard v. American Horse Enterprises, Inc.* (1988) 201 Cal.App.3d 832, 838 (*Bovard*)). This rule applies even if the parties to the contract were unaware of its illegality. (*Stockton Morris etc. Co. v. Calif. Tractor etc. Corp.* (1952) 112 Cal.App.2d 684, 689.) The court must raise the issue sua sponte even if it is not raised by the parties. (*Wells v. Comstock* (1956) 46 Cal.2d 528, 532; *Yoo v. Jho* (2007) 147 Cal.App.4th 1249, 1256; *Homami v. Iranzadi* (1989) 211 Cal.App.3d 1104, 1109 (*Homami*); *Russell v. Soldinger* (1976) 59 Cal.App.3d 633, 642.)

Federal law declares it unlawful for any person except a licensed dealer to engage in the business of dealing in firearms. (*Bryan v. United States* (1998) 524 U.S. 184, 187; 18 U.S.C. §§ 922(a)(1)(A), 923(a).) Federal regulations specifically require that the license be obtained *before* the person engages in the business. (27 C.F.R. § 478.41 [“[e]ach person intending to engage in business as . . . a dealer in firearms shall, *before commencing such business*, obtain the license . . .” (italics added)].) Moreover, licenses are not transferable and “[i]n the event of the lease, sale, or other transfer of the operations authorized by [an existing] license, the successor must obtain the license required by this part *prior to commencing such operations*.” (27 C.F.R. § 478.51, italics added.) The only regulatory exception to this rule applies to persons inapplicable here (such as surviving relatives, estate administrators and bankruptcy trustees), and those

successors must nevertheless comply with certain administrative requirements within 30 days of assuming control of the business. (27 C.F.R. § 478.56.)

The statute that describes the requirements for obtaining a federal firearms license specifies that, “in the case of a corporation, partnership, or association,” certain requirements apply to “any individual possessing, directly or indirectly, the power to direct or cause the direction of the management and policies of the corporation, partnership, or association.” (18 U.S.C. § 923(d)(1)(B).) Consistent with this provision, the application for a federal firearms license requires a corporation, partnership or association applying for a license to identify each owner, partner or other “responsible person,” which is defined as “any individual possessing, directly or indirectly, the power to direct or cause the direction of the management, policies, and practices of the [applicant] insofar as they pertain to firearms.”¹²

As a result of Jones’s assignment of his interest in the store to Harte on March 12, 2008 and Harte’s assignment of a 33 percent interest in the store to Bridgewater on or

¹² Courts have held that this language may apply to persons who exert indirect control of a dealership by virtue of holding the company’s debt. In *Casanova Guns, Inc. v. Connally*, the Seventh Circuit held that an entity with a substantial security interest in a firearms dealership might qualify as “an individual possessing, directly or indirectly, the power to direct” management of a dealership. (*Casanova Guns, Inc. v. Connally* (1972) 454 F.2d 1320, 1322–1323.) In that case, the dealership’s “inventory was purchased on a \$424,000 unsecured note which is payable on demand. We believe that a debt of this nature and magnitude warrants an inference that [the entity] possessed a substantial degree of control over” the dealership. (*Ibid.* [party exercising the control had had license revoked]; see also *Virlow LLC v. Bureau of Alcohol, Tobacco, Firearms and Explosives* (W.D.Mich. Mar. 28, 2008, No. 1:06-CV-375) 2008 WL 835828 [license denied in part because of corporation’s financial dependence on entity that had lost its firearms license]; *National Lending Group, L.L.C. v. Mukasey* (D.Ariz. Dec. 19, 2008, No. CV 07–0024–PHX–PGR) 2008 WL 5329888 [license properly revoked in part because person who had lost his license held a \$1 million security note against the dealership’s assets and worked for the dealership as a consultant]; *XVP Sports, LLC v. Bangs* (E.D.Va. Mar. 21, 2012, No. 2:11 CV 379) 2012 WL 4329263 [license properly denied in part because of financial control by person who had lost license]; cf. (*United States v. 1,922 Assorted Firearms, etc.* (E.D.Mo. 1971) 330 F.Supp. 635, 638 [employee left in charge of store in absence of owner was not “responsible person”].)

after April 8, the firearms dealership was no longer owned by Jones’s sole proprietorship but was then owned by a partnership or association. There was a transfer of ownership before the new owner applied for and received a license naming the new owners and responsible persons. The assignment, sale and transfer, therefore, were illegal.¹³

C. *Enforceability of the April 8 Agreement*

“A contract must have a lawful object. (Civ. Code, § 1550.) Any contract which has as its object the violation of an express provision of law is unlawful. (Civ. Code, § 1667, subd. 1.) The object of a contract is the thing which it is agreed, on the part of the party receiving the consideration, to do or not to do. (Civ. Code, § 1595.) The object must be lawful when the contract is made. (Civ. Code, § 1596.) And that part of the contract which is unlawful is void. (Civ. Code, § 1599.) [¶] . . . ‘ “The general principle is well established that a contract founded on an illegal consideration, or which is made for the purpose of furthering any matter or thing prohibited by statute, or to aid or assist any party therein, is void. This rule applies to every contract which is founded on a transaction *malum in se*, or which is prohibited by a statute on the ground of public policy.” ’ [Citation.]” (*Homami, supra*, 211 Cal.App.3d at p. 1109; see, e.g., *id.* at p. 1106 [no enforcement of promissory note falsely stating it was interest-free in order to evade taxes]; *Wong v. Tenneco, Inc.* (1985) 39 Cal.3d 126, 128, 133–134 [no enforcement of marketing agreement with Mexican farming business operated in violation of Mexican law]; *Yoo v. Jho, supra*, 147 Cal.App.4th at p. 1251 [no enforcement of contract for sale of a business dealing, in part, in counterfeit goods]; *Bovard, supra*, 201 Cal.App.3d at pp. 836–838, 841 [no enforcement of contract for the sale of a business making drug paraphernalia because the business, even though not expressly outlawed, was counter to public policy].)

¹³ We note that the trial court did not rule that the April 8 Agreement was *not* illegal; rather it ruled that any illegality “may not be attributed to [Harte]” and therefore did not relieve Bridgewater of his obligation to pay Harte per the terms of the contract. The issue of the relative culpability of the parties to the contract is a separate issue that we address *post*.

In a case more factually analogous to that before us, the court in *Kashani v. Tsann Kuen China Enterprise Co.* (2004) 118 Cal.App.4th 531, 536–537 (*Kashani*) refused to enforce a contract to build a plant to manufacture computer products in Iran because the parties to the contract did not have a federal license to do so. Federal executive orders and regulations had prohibited “any United States person from engaging in any transaction, directly or indirectly, relating to the . . . sale, or supply of goods, technology or services to Iran” without a license. (*Id.* at p. 539.) The court rejected the plaintiffs’ argument that the contract should be construed as legal if possible, taking account of the fact that the plaintiffs could have applied for and might have received the required license. (*Id.* at pp. 548–549.) The court noted that performance had begun without a license and concluded the circumstances did not warrant overlooking the illegality. (*Id.* at p. 550.) “The Orders and Regulations here are regulating [rather than revenue-generating] in nature and involve national security. [Citation.] No one could seriously contend that enforcement of the agreement in question is not outweighed by the public policy behind the government provisions. [Citation.]” (*Ibid.*; see also *Denning v. Taber* (1945) 70 Cal.App.2d 253, 257 [ruling “the illegal conducting of the saloon business without a proper license for each individual partner would ordinarily require the court to refuse upon the ground of public policy to determine issues between the partners regarding . . . the assets of the business,” but allowing action for accounting of partners’ agreement to equally divide assets after termination of partnership].)

Here, as in *Kashani, supra*, 118 Cal.App.4th 531, the licensing requirements violated by the parties to the April 8 Agreement are regulatory rather than revenue-generating in nature and they involve important public safety concerns. “The principal purpose of . . . federal gun control legislation . . . [is] to curb crime by keeping ‘firearms out of the hands of those not legally entitled to possess them because of age, criminal background, or incompetency.’ [Citation.] [¶] . . . The principal agent of federal enforcement is the dealer.” (*Huddleston v. United States* (1974) 415 U.S. 814, 824.) As in *Kashani*, however, the April 8 Agreement was not written to be contingent on compliance with federal licensing requirements and was in fact performed without

compliance with those requirements. Moreover, the object of the contract was the sale and transfer of a firearms dealership, the very transaction that rendered the contract illegal. (See *Homami, supra*, 211 Cal.App.3d at p. 1109; Civ. Code, § 1595 [“[t]he object of a contract is the thing which it is agreed, on the part of the party receiving the consideration, to do or not to do”].)

Under the aforementioned principles, we conclude that the April 8 Agreement was generally unenforceable as an illegal contract.

D. *Relative Culpability of the Parties*

Ordinarily, “when the illegality of [a] contract renders the bargain unenforceable, ‘[t]he court will leave [the parties] where they were when the action was begun’” [citations].” (*Kashani, supra*, 118 Cal.App.4th at p. 541.) “The reason for this . . . is not that the courts are unaware of possible injustice between the parties, and that the defendant may be left in possession of some benefit he should in good conscience turn over to the plaintiff, but that this consideration is outweighed by the importance of deterring illegal conduct. Knowing that they will receive no help from the courts and must trust completely to each other’s good faith, the parties are less likely to enter an illegal arrangement in the first place. [Citations.]” (*Lewis & Queen v. N. M. Ball Sons* (1957) 48 Cal.2d 141, 150–151.) However, “In some cases, . . . effective deterrence is best realized by enforcing the plaintiff’s claim rather than leaving the defendant in possession of the benefit; or the forfeiture resulting from unenforceability is disproportionately harsh considering the nature of the illegality. In each such case, how the aims of policy can best be achieved depends on the kind of illegality and the particular facts involved. [Citations.]” (*Id.* at p. 151.)

Thus, if the parties are not in *pari delicto*, an exception allowing enforcement of an illegal contract may apply “ ‘so long as the party seeking its enforcement is less morally blameworthy than the party against whom the contract is being asserted, and there is no overriding public interest to be served by voiding the agreement.’ [Citations.]” (*McIntosh v. Mills* (2004) 121 Cal.App.4th 333, 347.) For example, the Supreme Court has ruled that a plaintiff who was “not asking the court to carry out an illegal contract or

to enforce rights arising out of the illegal transaction, [citation], but [was] seeking relief from a contract which was illegally made” should have an opportunity to show he did not personally know about the illegal nature of the contract (involving a purchase of stock by a corporation from its capital assets rather than from its earned surplus) and seek relief under the in pari delicto exception. (*Tiedje v. Aluminum Taper Milling Co.*(1956) 46 Cal.2d 450, 454–455; see also *Tri-Q, Inc. v. Sta-Hi Corp.*(1965) 63 Cal.2d 199, 220–221 [in stock transaction, corporation was responsible for the illegality and other party was permitted to enforce his rights under the contract].)

Here, the trial court ruled, “[Bridgewater] argues that any transfer by [Jones] to [Harte] was illegal under federal regulations applicable to gun dealers.^[14] Any failures in this regard by [Jones] and [Bridgewater] may not be attributed to [Harte], and do not nullify [Bridgewater’s] promise to pay in exchange for [Harte’s] relinquishing any interest [he] had in the business.”

The trial court’s statement that “[a]ny failures in this regard by [Jones] and [Bridgewater] may not be attributed to [Harte]” is not supported by substantial evidence. The statement suggests an arrangement whereby Jones sold his business to Bridgewater and Harte was nothing more than a secured creditor with an interest in the store’s assets to ensure Jones’s payment of his debt. Such a view, however, ignores the express terms of the parties’ contracts, and it ignores the behavior of the parties after April 8, 2008,

¹⁴ The ruling misrepresents Bridgewater’s argument in his motion for new trial. Bridgewater argued that the failure of *both Harte and Bridgewater* to hold or obtain a federal firearms license meant “the central object of the [April 8 Agreement], to convey ownership of [Sportsman’s Access] from Harte to Bridgewater, was unlawful, *rendering the [April 8 Agreement] void* for illegality” (Italics added.)

The trial court’s reference to a transfer by Jones to Harte apparently was referring to Jones’s assignment of the dealership to Harte on March 12, 2008. Although that assignment probably was illegal for the reasons stated *ante* with respect to the April 8 Agreement, our analysis does not turn on the illegality of the March 12 assignment. The April 8 Agreement itself is illegal on its face in light of the undisputed facts that neither Harte nor Bridgewater held a federal firearm license.

with Harte allegedly “harassing” store employees and directly drawing money from store accounts.

As explained *ante*, Harte directly participated in renegotiation and complete restructuring of Jones and Bridgewater’s initial sales agreement, asserting ownership of the firearms dealership in his discussions with Bridgewater, and demanding payments from Bridgewater directly to him. In contrast to the terms of Jones and Bridgewater’s original deal set forth in the March 16 Sales Agreement, the April 8 Agreement made no provision for creating a new legal entity or ensuring that Jones maintained his firearms license.¹⁵ Harte, who had been exclusively engaged in the business of selling firearms since 2006 and was presumably familiar with regulatory requirements for firearms sales, expressed little if any concern with the legalities of the transactions, and far more concern for collection of Jones’s debt. The evidence was that Harte was at a minimum an equal participant in crafting the terms of the April 8 Agreement, if not the driving force.

The evidence further demonstrates that Harte was far more experienced and sophisticated in the firearms business than was Bridgewater. Harte, but not Bridgewater, was aware of the ATF audit of the Penryn store at the time the April 8 Agreement was signed. At the time the April 8 Agreement was signed, Harte told Robert Johnson, Jones’s partner in the Petaluma store, that Bridgewater was a “fish” and “said that if

¹⁵ Although the March 16 Sales Agreement did not expressly require Bridgewater or the new entity to obtain a firearms license, it contemplated a delayed transfer of ownership after numerous contingencies were satisfied, including creation of a new legal entity, and thus provided an opportunity for receipt of a valid license before an actual change in ownership. The April 8 Agreement, in contrast, contemplated an immediate change of ownership to an unlicensed partnership or association (i.e., Harte and Bridgewater) and recognized the existing ownership of Harte, an unlicensed person.

It is true that an addendum to the March 16 Sales Agreement provided for an immediate assignment of Jones’s interest in the business to Bridgewater as “collateral” in exchange for “the immediate distribution of cash and trucks” from Bridgewater to Jones. However, it is clear from the whole record that this addendum was anticipatory to the April 8 Agreement and ultimately superseded by it. The cash and trucks mentioned in the addendum were ultimately delivered by Bridgewater directly to Harte, first as earnest money showing a firm intent to enter into a deal with Harte and then as consideration for the April 8 Agreement.

[Bridgewater's] dumb enough to give me \$200,000, I'm going to take it. He says, I don't care who gets screwed."

The court's finding that Harte was not in *pari delicto* with Bridgewater and Jones is not supported by substantial evidence.

E. *Bridgewater's Claim for Restitution*

Bridgewater argues he should be awarded restitution of the \$200,000 he paid to Harte under the April 8 Agreement because he was not in *pari delicto* with Jones and Harte.

We conclude that the trial court's finding that Bridgewater was at least as blameworthy as Harte is supported by substantial evidence. Bridgewater was fully informed of Jones's debt to Harte and Harte's ownership of all interests in the dealership before Bridgewater signed the April 8 Agreement. The terms of the March 16 Sales Agreement demonstrate that Bridgewater knew how to protect his interests if he chose to do so (by conditioning the sale on an appraisal and creation of a new legal entity, for example). He failed to include those conditions in the April 8 Agreement for reasons not readily apparent from the record. During his early negotiations with Jones to purchase an interest in the business, Bridgewater was advised to consult an attorney, but did not do so. In exchange for his investment he received what he bargained for—a one-third interest in the Penryn firearms dealership that became worthless, largely due to Jones's subsequent conduct.¹⁶ Bridgewater's claim for restitution from Harte, therefore, was properly denied.

¹⁶ The trial court also rejected Bridgewater's claim for rescission and restitution based on failure of consideration. Because we conclude that illegality of the contract precludes either party from recovery, we need not separately address that issue.

III. DISPOSITION

We reverse the trial court's judgment in favor of Harte and against Bridgewater, and affirm the trial court's denial of Bridgewater's cross-claim for restitution. Each side shall bear its own costs.

Bruiniers, J.

We concur:

Simons, Acting P. J.

Needham, J.