

#72

3/21/74

Memorandum 74-15

Subject: Study 72 - Liquidated Damages (Senate Bill 1532)

Attached is a letter from the Chairman of the California Trial Lawyers Association Law Revision Committee commenting on the Commission's liquidated damages recommendation.

Also attached are the recommendations of the State Bar Committee on Administration of Justice. With one exception, the substance of these recommendations is incorporated into the revised copy of Senate Bill 1532 which is attached. The State Bar Committee is favorable to the recommendation; the Northern Section supports the bill even if the suggested revisions are not made.

The only State Bar Committee recommendation we have not incorporated into the draft of the bill is the one proposed for Civil Code Section 3319 (page 5 of Exhibit II--yellow). The additional sentence the Southern Section proposes to add to subdivision (a) of Section 3319 is unnecessary in view of the "except as otherwise provided" clause that introduces subdivision (a).

We plan to go through the revised draft of Senate Bill 1532 at the meeting so that the amendments approved by the Commission can be made early next week.

Respectfully submitted,

John H. DeMouly
Executive Secretary

Memorandum 74-15

EXHIBIT I

Law Office of

BRUCE I. CORNBLUM

COMMUNITY CENTER
111 WEST ST. JOHN, SUITE 310
SAN JOSE, CALIFORNIA 95113
(408) 998-4290

February 28, 1974

California Law Revision Commission
School of Law
Stanford, California 94305

Attention: John H. DeMouilly, Executive Secretary

Re: Study Pertaining to Liquidated Damages
(December 1973)

Dear Mr. DeMouilly:

I agree absolutely in concept with the policy considerations of the study and the recommendation. It is not the purpose of this letter to discuss the law per se. I will only, therefore, make brief comment which may be helpful to the Commission.

Relating to proposed Civil Code §2954.6 my first suggestion would be as follows: In the consumer market relating to the purchase of homes, it is the vogue of the day for workers and professional people to take a vacation lasting two weeks to a month. Many times the consumer will make the monthly payment, go on vacation and not return until they are technically in default on their next payment, to wit, ten to fifteen days. Obviously, the consumer does not want to prepay their next month's rent. I had a situation where I then returned from vacation and received a penalty charge.

It would seem to me equitable that a borrower should be allowed "one late payment per year without having incurred a penalty charge." This would not be prejudicial to the lender because if the person is one who intends, for whatever reason, to continue default, this would be picked up on the second time around.

Secondly, I was wondering if under Civil Code §2954.6[d] the lender does not add the late payment to the principal and thereafter not be able to treat the failure to pay as a "default", whether if the lender does not use this procedure it can then cause a foreclosure for the "penalty amount" where otherwise the borrower has paid all of the principal, interest and impound charges for that month? You could thus have

Law Office of

BRUCE I. CORNBLUM

COMMUNITY CENTER
111 WEST ST. JOHN, SUITE 310
SAN JOSE, CALIFORNIA 95113
(408) 998-4280

California Law Revision Commission

-2-

February 28, 1974

a default causing the borrower to incur reinstatement charges where the underlying debt is as little as \$10.00 to \$50.00. The borrower would not know, or may want to contest the charge as unreasonable. It would seem to me that a fair procedure would be for the lender to notify the borrower "if it is electing not to add said amount to principal" and will thereby cause a default for the minimal amount. This, of course, is assuming that one can have a default for an amount equal only to the unpaid late payment. I believe it should be spelled out either in the statute or in the comment as to the status of an unpaid default amount, whether that would be a debt giving rise to foreclosure and, if so, an obligation on the lender to notify the borrower that it will not act in accordance with §2954.6[d] to add to principal and interest.

Referring to Civil Code §3319 [Proposed] the statute starts:

"Except as otherwise provided by statute . . ."

It would appear that this statute does not in any way impair the public policy contained in Civil Code §3275 as discussed in Professor Sweet's study, pp.95-100. So that there is no confusion on this point, I believe the comment should make reference to Freedman, Caplan and related cases.

§3319 does not make any attempt to define "liquidated damages." Conceptually, a liquidated damage clause falls between the forfeiture cases construing C.C. §3275 (See study pp.95-100) and the other extreme where damages are not in any way impracticable or extremely difficult to fix. As stated in Professor Sweet's study, pp.133-134:

"Taken together, these emphasize that liquidation will not be permitted when the actual damages or the anticipated damages can be computed by application of a well-established damage measure that can furnish a solution without great difficulty."

Thus, by definition these cases would not involve the parties, or give rise to a situation where the parties have a bona fide reason to

Law Office of

BRUCE I. CORNBUM

COMMUNITY CENTER
111 WEST ST. JOHN, SUITE 310
SAN JOSE, CALIFORNIA 95113
(408) 998-4280

California Law Revision Commission

-3-

February 28, 1974

"liquidate damages" as discussed in the recommendation pp.1208-1209.

It therefore appears to me that Commercial Code Section referred to in your recommendation, page 1207, is completely relevant and, further, "in the body of the statute" renders a relevant criterion. It seems that your proposed §3319 can only have meaning to a drafter after he has "analyzed" the comment and the prior existing law. In fact, Commercial Code §2718 as set forth in Professor Sweet's article, page 109, seems to say everything the Commission is saying in the comment to your proposed §3319.

I believe that Civil Code §3358 (Proposed) should have specific reference to Civil Code §3275 per my discussion above.

Very truly yours,



BRUCE I. CORNBUM, Chairman
California Trial Lawyers
Law Revision Commission

BIC/so

1 Agenda 29.6 - Liquidated Damages

2 South Approved Amendments to LRC Proposal

3 NOTE: LRC proposed language single underlining.
4 CAJ Southern Section proposed language
5 double underlining.

6 Civil Code 1951.5 (Amended)

7 SEC. 4. Section 1951.5 of the Civil Code is amended to read:

8 1951.5. ~~Sections-1670-and-1671~~ Section 3319, relating to
9 liquidated damages, apply applies to a all leases of real
10 property, subject to the following:

11 (a) In a lease for residential purposes the amount specified
12 by the parties as liquidated damages shall be deemed reason-
13 able and shall meet the requirements of Section 3319, if the
14 amount does not exceed the lesser of one-twelfth of the total
15 rental provided in the lease, or twice the monthly rental
16 rate as of the date of the breach.

17 (b) If the amount specified by the parties as liquidated
18 damages in a lease for residential purposes is greater than
19 as provided in Subsection (a), the party seeking to enforce
20 the liquidated damages provision must establish that the
21 amount was reasonable under the circumstances existing at the
22 time of the making of the lease.

23 (c) As used in Subsections (a) and (b), a lease for residen-
24 tial purposes is defined as a lease of a dwelling for not

1 more than four families occupied entirely or in part by the
2 lessee.

3
4 Civil Code 2954.6 (New)

5 SEC. 5. Section 2954.6 is added to the Civil Code, to read:

6 2954.6. (a) As used in this section:

7 (1) "Late payment charge" means a charge, whether or not
8 characterized in the loan contract as interest, that is im-
9 posed for late payment of an installment payment due on a
10 loan secured by a mortgage or deed of trust on real property.

11 (2) "Installment payment" means that portion of a periodic
12 payment that comprises any one or more of the following:
13 principal, interest, and funds to be allocated to impound
14 accounts for property taxes, special assessments, and insur-
15 ance.

16 (b) Except as provided in subdivision (c), a provision in
17 the loan contract imposing a late payment charge is valid if
18 it satisfies the requirements of Sections 2954.5 and 3319
19 and-all-other-applicable-provisions-of-law.

20 (c) Where each of a majority of the installment payments is
21 less than five hundred dollars (\$500), a provision in the
22 loan contract imposing a late payment charge is valid if it
23 satisfies the requirements of Section 2954.5 and both of the
24 following conditions:

1 (1) No late payment charge may be collected on an install-
2 ment payment which is tendered or paid in full within 10
3 days after its scheduled due date even though an earlier
4 maturing installment payment, or a late payment charge on
5 an earlier installment payment, may not have been paid in
6 full. For the purposes of this subdivision, an installment
7 payment shall be considered paid as of the date it is re-
8 ceived by the lender and, unless the borrower otherwise di-
9 rects at the time the installment is paid, payments shall be
10 applied first to current installment payments and then to
11 delinquent installment payments.

12 (2) The amount of the late payment charge shall not exceed
13 10 percent of the amount of principal and interest included
14 in the installment payment except that, where the amount of
15 principal and interest included in the installment payment
16 is less than fifty dollars (\$50), a charge not to exceed five
17 dollars (\$5) or 20 percent of the amount of principal and in-
18 terest included in the installment payment, whichever is the
19 lesser amount, may be made.

20 (d) If the late payment charge referred to in subdivision
21 (c) is not paid within 40 days from the scheduled due date
22 of the delinquent installment payment for which the charge
23 was imposed, the lender may, at his option, add the late pay-
24 ment charge to the principal and thereafter charge interest

1 on it at the contract rate. If the lender elects to add the
2 late payment charge to principal, he cannot thereafter treat
3 the failure to pay the late payment charge as a default.

4 The lender, if he exercises said option, shall give written
5 notice thereof to the borrower within 10 days of exercise of
6 the option.

7 (e) This section limits only the obligation of a borrower to
8 pay a late payment charge. Nothing in this section excuses
9 or defers the borrower's performance of any other obligation
10 incurred in the loan transaction, nor does this section im-
11 pair or defer the right of the lender to enforce any other
12 obligation including but not limited to the right to recover
13 costs and expenses incurred in any enforcement proceeding
14 authorized by law. The lender must accept any installment
15 payments made by the borrower and apply such payments as pro-
16 vided herein, but this shall not prevent the lender from ex-
17 ercising his rights to enforce or continue to enforce his
18 rights against the borrower or the security.

19 (f) This section does not apply to loans made by a credit
20 union subject to the provisions of Division 5 (commencing
21 with Section 14000) of the Financial Code, by an industrial
22 loan company subject to the provisions of Division 7 (com-
23 mencing with Section 18000) of the Financial Code, or by a
24 personal property broker subject to the provisions of Division

1 9 (commencing with Section 22000) of the Financial Code.

2
3 Civil Code 3319 (New)

4 SEC. 6. Section 3319 is added to the Civil Code, to read:

5 3319. (a) Except as otherwise provided by statute, a provi-
6 sion in a contract liquidating the damages for breach of a
7 contractual obligation is valid unless the party seeking to
8 invalidate the provision establishes that it was unreasonable
9 under the circumstances existing at the time of the making of
10 the contract. This section shall not apply to the sale of
11 consumer goods bought for use primarily for personal, family,
12 or household purposes.

13 (b) Subdivision (a) does not apply to provisions included in
14 public contracts pursuant to Section 14376 or 53069.85 of the
15 Government Code.

16
17 Civil Code 3320 (New)

18 SEC. 7. Section 3320 is added to the Civil Code, to read:

19 3320. (a) Subject to subdivision (b), a provision in a con-
20 tract for the sale of real property liquidating the damages
21 to the vendor if the purchaser fails to satisfy his obliga-
22 tion to purchase the property is valid only if such provision
23 is separately signed or initialed by each party and is valid
24 under Section 3319.

1 (b) If the parties to a contract for the sale of real prop-
2 erty provide by a provision separately signed or initialed
3 by each party that all or any part of a deposit that actually
4 is made by the purchaser shall constitute liquidated damages
5 to the vendor if the purchaser fails to satisfy his obliga-
6 tion to purchase the property, the amount so specified by
7 the parties as liquidated damages shall be deemed to be rea-
8 sonable and valid under Section 3319 if it does not exceed
9 five percent of the total purchase price in the contract.

10 If the amount is greater than five percent of the total pur-
11 chase price in the contract, then the party seeking to en-
12 force the liquidated damages provision must show that it is
13 reasonable. For the purposes of this section, "deposit"
14 includes but is not limited to a check (including a post-
15 dated check), note, or other evidence of indebtedness.

16 (c) The validity of the provision for liquidated damages is
17 determined under subdivision (a) rather than under subdivi-
18 sion (b), and nothing in subdivision (b) affects the validity
19 of the liquidated damages provision, in each of the following
20 cases:

21 (1) Where the amount specified as liquidated damages exceeds
22 five percent of the total purchase price in the contract.

23 (2) Where no deposit is made by the purchaser.

24 (3) Where the deposit actually made by the purchaser is less

1 than the amount specified as liquidated damages in the con-
2 tract.

3 (d) Nothing in this section affects the validity of any pro-
4 vision in a contract for the sale of real property other than
5 a provision liquidating the damages to the vendor if the pur-
6 chaser fails to satisfy his obligation to purchase the prop-
7 erty.

8 (e) This section does not apply to real property sales con-
9 tracts as defined in Section 2985.

10

11

12

13

14

15

16

17

18

19

20

21

22

23

24

AMENDED IN SENATE MARCH 12, 1974

SENATE BILL

No. 1532

Introduced by Senator Stevens

January 10, 1974

An act to repeal Section 10242.5 of the Business and Professions Code, and to amend Sections 1951.5 and 3358 of, to add Sections 2954.6, 3319, and 3320 to, and to repeal Sections 1670 and 1671 of, the Civil Code, AND TO AMEND SECTIONS 14376 AND 53069.85 OF THE GOVERNMENT CODE, relating to liquidation of damages.

1957.6,

LEGISLATIVE COUNSEL'S DIGEST

SB 1532, as amended, Stevens. Liquidated damages.

Repeals existing provisions relative to the enforcement of liquidated damages provisions in contracts generally and provisions regulating late payment charges imposed by real estate loan brokers for installments due on loans secured by a mortgage or deed of trust on real property.

Provides that, with noted exceptions, a contractual liquidated damage provision is valid unless party seeking to invalidate such provision establishes it was unreasonable under circumstances existing at the time of the making of the contract.

Provides for the regulation of both the imposition and the amount of a late payment charge that may be imposed for late payments of installments on loans secured by mortgage or deed of trust on real property. Defines "late payment charge" and "installment payment" for the purpose of such regulation and provides that loans made by specified lenders are not subject to such regulation. Provides that such regulation does not excuse or defer the borrower's performance of any other obligation under the loan transaction, nor impair or defer lender's right to enforce any other obligation under such loan.

Provides that, subject to specified circumstances, provisions

in contracts for the sale of real property liquidating the damages to the vendor if the purchaser fails to satisfy his obligation to purchase the real property are valid if such provisions are separately signed or initialed by each party and are reasonable under the circumstances existing at the time of the making of the contract. Provides that, under specified circumstances, if a purchaser's deposit is designated as constituting liquidated damages to the vendor in a provision of the contract separately signed or initialed by each party, it shall be deemed reasonable and valid if it does not exceed a specified percentage of the total purchase price in the contract.

Makes certain other conforming changes.

Vote: majority. Appropriation: no. Fiscal committee: no. State-mandated local program: no.

The people of the State of California do enact as follows:

- 1 SECTION 1. Section 10242.5 of the Business and
- 2 Professions Code is repealed.
- 3 SEC. 2. Section 1670 of the Civil Code is repealed.
- 4 SEC. 3. Section 1671 of the Civil Code is repealed.
- 5 SEC. 4. Section 1951.5 of the Civil Code is amended to
- 6 read:
- 7 1951.5. A Section 3319, relating to liquidated damages,
- 8 applies to ~~a lease~~ of real property.

Subject to
Section
1951.6,

all
leases

Sec. 4.5. Section 1951.6 is added to the Civil Code, to read:

1951.6. (a) As used in this section, "a lease for residential purposes" means a lease of a dwelling for not more than four families occupied entirely or in part by the lessee.

(b) In a lease for residential purposes, the amount specified by the parties as liquidated damages shall be deemed reasonable and shall meet the requirements of Section 3319 if the amount does not exceed the lesser of the following amounts:

(1) One-twelfth of the total rental provided in the lease.

(2) Twice the monthly rental at the rate in effect as of the date of the breach.

(c) If the amount specified by the parties as liquidated damages in a lease for residential purposes is ^e greater than the amount specified in subdivision (b), the party seeking to enforce the liquidated damages provision must establish that

the amount was reasonable under the circumstances existing at the time of the making of the lease.

9 SEC. 5. Section 2954.6 is added to the Civil Code, to
10 read:

11 2954.6. (a) As used in this section:

12 (1) "Late payment charge" means a charge, whether
13 or not characterized in the loan contract as interest, that
14 is imposed for late payment of an installment payment
15 due on a loan secured by a mortgage or deed of trust on
16 real property.

17 (2) "Installment payment" means that portion of a
18 periodic payment that comprises any one or more of the
19 following: principal, interest, and funds to be allocated to
20 impound accounts for property taxes, special assessments,
21 and insurance.

22 (b) Except as provided in subdivision (c), a provision
— 3 — SB 1532

1 in the loan contract imposing a late payment charge is
2 valid if it satisfies the requirements of Section 2954.5 and
3 3319.

4 (c) Where each of a majority of the installment
5 payments is less than five hundred dollars (\$500), a
6 provision in the loan contract imposing a late payment
7 charge is valid if it satisfies the requirements of Section
8 2954.5 and both of the following conditions:

9 (1) No late payment charge may be collected on an
10 installment payment which is tendered or paid in full
11 within 10 days after its scheduled due date even though
12 an earlier maturing installment payment, or a late
13 payment charge on an earlier installment payment, may
14 not have been paid in full. For the purposes of this
15 subdivision, an installment payment shall be considered
16 paid as of the date it is received by the lender and, unless
17 the borrower otherwise directs at the time the
18 installment is paid, payments shall be applied first to
19 current installment payments and then to delinquent
20 installment payments.

21 (2) The amount of the late payment charge shall not
22 exceed 10 percent of the amount of principal and interest
23 included in the installment payment except that, where
24 the amount of principal and interest included in the
25 installment payment is less than fifty dollars (\$50), a
26 charge not to exceed five dollars (\$5) or 20 percent of the
27 amount of principal and interest included in the
28 installment payment, whichever is the lesser amount,
29 may be made.

30 (d) If the late payment charge referred to in
31 subdivision (c) is not paid within 40 days from the
32 scheduled due date of the delinquent installment
33 payment for which the charge was imposed, the lender
34 may, at his option, add the late payment charge to the
35 principal and thereafter charge interest on it at the
36 contract rate. If the lender elects to add the late payment

is valid under
Section

charge to principal, he shall give written notice of such fact to the borrower within 10 days of the exercise of such election. If the lender elects to add the late payment

37 charge to principal, he cannot thereafter treat the failure
38 to pay the late payment charge as a default.

39 (e) This section limits only the obligation of a
40 borrower to pay a late payment charge. Nothing in this

SB 1532

-- 4 --

1 section excuses or defers the borrower's performance of
2 any other obligation incurred in the loan transaction, nor
3 does this section impair or defer the right of the lender
4 to enforce any other obligation, including, but not
5 limited to, the right to recover costs and expenses
6 incurred in any enforcement proceeding authorized by
7 law.

The lender must accept any installment payments made by the borrower and

apply such payments as provided in this section, but this requirement

does not prevent the lender from exercising his rights to enforce or continue to enforce his rights

against the borrower or the security.

8 (f) This section does not apply to loans made by a
9 credit union subject to the provisions of Division 5
10 (commencing with Section 14000) of the Financial Code,
11 by an industrial loan company subject to the provisions of
12 Division 7 (commencing with Section 18000) of the
13 Financial Code, or by a personal property broker subject
14 to the provisions of Division 9 (commencing with Section
15 22000) of the Financial Code.

16 SEC. 6. Section 3319 is added to the Civil Code, to
17 read:

18 3319. (a) Except as otherwise provided by statute, a
19 provision in a contract liquidating the damages for
20 breach of a contractual obligation is valid unless the party
21 seeking to invalidate the provision establishes that it was
22 unreasonable under the circumstances existing at the
23 time of the making of the contract.

24 (b) Subdivision (a) does not apply to provisions
25 included in public contracts pursuant to Section 14376 or
26 52060.85 of the Government Code.

27 SEC. 7. Section 3320 is added to the Civil Code, to
28 read:
29 3320. (a) Subject to subdivision (b), a provision in a
30 contract for the sale of real property liquidating the
31 damages to the vendor if the purchaser fails to satisfy his
32 obligation to purchase the property is valid only if such
33 provision is separately signed or initialed by each party
34 and is valid under Section 3319.

If the amount specified by the parties in the contract as liquidated damages is greater than five percent of the total purchase price in the contract, the party seeking to enforce the liquidated damages provision must establish that the amount was reasonable under the circumstances existing at the time of the making of the contract.

35 (b) If the parties to a contract for the sale of real
36 property provide by a provision separately signed or
37 initialed by each party that all or any part of a deposit that
38 actually is made by the purchaser shall constitute
39 liquidated damages to the vendor if the purchaser fails to
40 satisfy his obligation to purchase the property, the

— 5 —

SB 1532

1 amount so specified by the parties as liquidated damages
2 shall be deemed to be reasonable and valid under Section
3 3319 if it does not exceed five percent of the total
4 purchase price in the contract. For the purposes of this
5 section, "deposit" includes but is not limited to a check;
6 ~~including a postdated check (including a postdated~~
7 ~~check)~~, note, or other evidence of indebtedness.
8 (c) The validity of the provision for liquidated
9 damages is determined under subdivision (a) rather than
10 under subdivision (b), and nothing in subdivision (b)
11 affects the validity of the liquidated damages provision, in
12 each of the following cases:
13 (1) Where the amount specified as liquidated
14 damages exceeds five percent of the total purchase price
15 in the ~~contracts~~ contract.
16 (2) Where no deposit is made by the purchaser.
17 (3) Where the deposit actually made by the purchaser
18 is less than the amount specified as liquidated damages in
19 the contract.
20 (d) Nothing in this section affects the validity of any
21 provision in a contract for the sale of real property other
22 than a provision liquidating the damages to the vendor if
23 the purchaser fails to satisfy his obligation to purchase the
24 property.
25 (e) This section does not apply to real property sales
26 contracts as defined in Section 2985.

27 SEC. 8. Section 3358 of the Civil Code is amended to
28 read:

29 3358. Nothing in this chapter authorizes a person to
30 recover a greater amount in damages for the breach of an
31 obligation than he could have gained by the full
32 performance thereof on both sides, except in the cases
33 specified in the articles on exemplary damages and penal
34 damages, and in Sections 3319, 3320, 3339, and 3340.

35 SEC. 9. Section 14376 of the Government Code is
36 amended to read:

37 14376. Every contract shall contain a provision in
38 regard to the time when the whole or any specified
39 portion of the work contemplated shall be completed,
40 and shall provide that for each day completion is delayed

SB 1532

— 6 —

1 beyond the specified time, the contractor shall forfeit and
2 pay to the state a specified sum of money, to be deducted
3 from any payments due or to become due to the
4 contractor. A contract for a road project may also provide
5 for the payment of extra compensation to the contractor,
6 as a bonus for completion prior to the specified time, such
7 provision, if used, to be included in the specifications and
8 to clearly set forth the basis for such payment. *Section*
9 *3319 of the Civil Code does not apply to contract*
10 *provisions under this section.*

11 SEC. 10. Section 53069.85 of the Government Code is
12 amended to read:

13 53069.85. The legislative body of a city, county or
14 district may include or cause to be included in contracts
15 for public projects a provision establishing the time
16 within which the whole or any specified portion of the
17 work contemplated shall be completed. The legislative
18 body may provide that for each day completion is
19 delayed beyond the specified time, the contractor shall
20 forfeit and pay to such agency involved a specified sum
21 of money, to be deducted from any payments due or to
22 become due to the contractor. A contract for such a
23 project may also provide for the payment of extra
24 compensation to the contractor, as a bonus for
25 completion prior to the specified time. Such provisions,
26 if used, shall be included in the specifications upon which
27 bids are received, which specifications shall clearly set
28 forth the provisions. *Section 3319 of the Civil Code does*
29 *not apply to contract provisions under this section.*

REPORT OF SENATE COMMITTEE ON JUDICIARY
ON SENATE BILL 1532

In order to indicate more fully its intent with respect to Senate Bill 1532, the Senate Committee on Judiciary makes the following report:

Except for the revised comments set out below, the comments contained under the various sections of Senate Bill 1532 as set out in Recommendation and Study of the California Law Revision Commission Relating to Liquidated Damages (December 1973), 11 Cal. L. Revision Comm'n Reports 1201 (1973), reflect the intent of the Senate Committee on Judiciary in approving the various provisions of Senate Bill 1532.

The following revised comments also reflect the intent of the Senate Committee on Judiciary in approving Senate Bill 1532.

Civil Code § 3319 (new)

Comment. Section 3319, providing that a liquidated damages provision is valid unless shown to be unreasonable, reflects a policy that favors the use of such provisions. See *Recommendation and Study Relating to Liquidated Damages*, 11 CAL. L. REVISION COMM'N REPORTS 1201 (1973).

Section 3319 limits the circumstances that may be taken into account in the determination of reasonableness to those existing "at the time of the making of the contract." Accordingly, the amount of damages actually suffered has no bearing on the validity of the liquidated damages provision. The validity of the provision depends upon its reasonableness at the time the contract was made. To permit consideration of the damages actually suffered would defeat one of the legitimate purposes of the clause, which is to avoid litigation on the damages issue. Contrast COM. CODE § 2718.

Relevant considerations in the determination whether the amount of liquidated damages is so high or so low as to be unreasonable include but are not limited to such matters as the relative equality of the bargaining power of the parties, the anticipation of the parties that proof of actual damages would be costly or inconvenient, the range of damages that reasonably could have been anticipated by the parties, and whether the liquidated damages provision is included in a form contract provided by one party. Thus, for example, there is little likelihood that a specially drafted liquidated damages provision in a contract executed by informed parties represented by attorneys after proper negotiation would be held invalid under Section 3319. On the other hand, where the liquidation of

damages provision is in a form contract, the court should carefully consider the circumstances existing at the time of the making of the contract to assure that the provision does not unreasonably benefit the party who prepared the contract. In this connection, it should be noted also that nothing in Section 3319 affects the power of a court to modify or nullify terms in a contract of adhesion. See discussion in 1 B. WITKIN, SUMMARY OF CALIFORNIA LAW *Contracts* § 13 at 35-36 (8th ed. 1973).

To further implement the policy favoring liquidated damages provisions, Section 3319 places on the party seeking to avoid the provision the burden of pleading and proving that the liquidated damages provision is invalid.

Section 3319 supersedes former Civil Code Sections 1670 and 1671. Section 1671 permitted liquidated damages only where the actual damages "would be impracticable or extremely difficult to fix." This ambiguous limitation failed to provide guidance to the contracting parties and unduly limited the use of liquidated damages provisions. In addition, the courts developed a second requirement under Sections 1670 and 1671—the provision must reflect a "reasonable endeavor" to estimate the probable damages. See *McCarthy v. Tally*, 46 Cal.2d 577, 584, 297 P.2d 981, 986 (1956); *Better Foods Mkts., Inc. v. American Dist. Tel. Co.*, 40 Cal.2d 179, 187, 253 P.2d 10, 15 (1953). Section 3319 does not limit the use of liquidated damages provisions to cases where damages would be difficult to fix or where the amount selected by the parties reflects a reasonable effort to estimate the probable amount of actual damages. Instead, the parties are given considerable leeway to determine damages for breach. *All* the circumstances existing at the time of the making of the contract are considered including but not limited to the relationship the damages provided bear to the range of harm that reasonably could be anticipated at the time of the making of the contract.

Instead of promising to pay a fixed sum as liquidated damages in case of a breach, a party to a contract may provide a deposit as security for the performance of his contractual obligations, to be forfeited in case of a breach. If the parties intend that the deposit be liquidated damages for breach of a contractual obligation, the question whether the deposit may be retained in case of breach is determined just as if the amount deposited were promised instead of deposited, and the standard provided in Section 3319 controls this determination. *But see, e.g.*, Section 3320. On the other hand, the deposit may be nothing more than a fund to secure the payment of actual damages if any are recovered; and, in such case, the deposit is not considered as liquidated damages. See CIVIL CODE § 1950.5 (payment or deposit to secure performance of rental agreement). Compare CIVIL CODE § 1951.5 (liquidation of damages authorized in real property lease).

The introductory clause makes clear that Section 3319 does not affect the statutes that govern liquidation of damages for breach of certain types of contracts. *E.g.*, COM. CODE § 2718. For late payment charge provisions, see, *e.g.*, CIVIL CODE §§ 1803.6 (retail installment sales), 2954.6 (real estate loans), 2982 (automobile sales finance); FIN. CODE §§ 14852 (credit unions), 18667 (a) (5) and 18934 (industrial loan companies), 22480 (personal property brokers); GOVT. CODE § 54348 (services of local agency enterprise). These other statutes—not Section 3319—govern the situations to which they apply. Of course, where there are exceptions to the coverage of some provision governing liquidated damages in certain types of contracts, Section 3319 does apply. *E.g.*, FIN. CODE §§ 18649 and 18669.2 (exceptions to Section 18667), 22053 (exception to Section 22480). Compare Section 3320 (b), which establishes an amount of earnest money deposit that is deemed to satisfy Section 3319 but does not preclude the parties from providing for a different amount of deposit if such amount satisfies the requirements of Section 3319. Government Code Sections 14376 (requiring state public works contract to contain a charge for late completion) and 53069.85 (allowing cities, counties, and districts to include charge for late completion in contract) remain unaffected by Section 3319; this has been made clear by adding an express statement to that effect in Section 14376 or 53069.85.

Civil Code § 3320 (new)

Comment. Section 3320 makes clear that the parties to a contract to purchase real property may provide for liquidated damages for the buyer's failure to satisfy his obligation to purchase the property. Such a provision is valid if separately signed or initialed by the parties "unless the party seeking to invalidate the provision establishes that it was unreasonable under the circumstances existing at the time of the making of the contract" (Section 3319); but, where the amount specified as liquidated damages is greater than five percent of the total purchase price, the burden is on the party seeking to enforce the liquidated damages provision to establish the reasonableness of such amount.

Subdivision (b) is included to avoid dispute in a case where an "earnest money" deposit has been made and the amount specified as liquidated damages does not exceed the five-percent limitation.

Subdivision (c) makes clear that subdivision (b) does not preclude the parties from providing for liquidated damages under subdivision (a) where no "earnest money" deposit is made or where the deposit is less than the damages specified in the contract; nor does subdivision (b) preclude the parties from providing that an amount in excess of the five-percent

limitation shall constitute liquidated damages. In these cases, the validity of the provision for liquidated damages is determined under subdivision (a).

Subdivision (d) makes clear, for example, that Section 3320 does not deal with the validity of a provision giving the buyer a right to recover liquidated damages; the validity of such a provision or any other provision not covered by subdivision (a) or (b) of Section 3320 is determined under Section 3319.

Subdivision (e) makes clear that liquidated damages provisions in real property sales contracts (commonly called installment land contracts) as defined in Section 2985 are not governed by Section 3320.