

## Memorandum 75-61

Subject: Study 72 - Liquidated Damages

In January 1975, the Commission approved a Recommendation Relating to Liquidated Damages for printing and submission to the Legislature. However, neither Senator Stevens nor Assemblyman McAlister were willing to introduce the recommended legislation. I discussed the recommended legislation with another member of the Assembly Judiciary Committee. Not only was he unwilling to introduce the recommended legislation, but he stated that he doubted that there would be a single vote on the committee for the recommended legislation. While there was no objection to applying the more liberal rules for liquidated damages to a case where the parties were informed and experienced or were represented by counsel, there was a general reaction that it would be undesirable to liberalize the liquidated damages rules in consumer cases and cases where the parties are not in a substantially equal bargaining position. The mere shifting of the burden of proof to the party invoking the liquidated damages provision in consumer cases and the unequal bargaining position cases was not considered a satisfactory solution for those cases. Accordingly, the staff dropped its efforts to find an author for the recommended legislation and concluded that the matter needed further study by the Commission.

The Northern Section of the State Bar Committee on the Administration of Justice approved the Commission's recommendation in principle but felt that the Commercial Code should be amended to conform to the new standard recommended by the Commission. Also, the Northern Section believes that it would not be desirable to make the technical amendments that were recommended to make clear that the new standard would not apply to public construction contracts (set out as last two sections of staff draft). See Exhibit I attached.

The Board of Governors of the State Bar disapproved the Commission's recommendation because it would change existing law in cases where the parties are in unequal bargaining position. The restrictions on liquidated damages in

real property transactions, however, were considered to be improvements in existing law.

A copy of the approved recommendation is attached (it is the one dated January 1975). Also attached is a staff draft of a proposed recommendation (dated November 1975) that is designed to meet the objections to the approved recommendation. Also attached is a copy of the prior printed recommendation which contains the background study.

Before discussing the staff draft, it will be useful to outline other alternatives:

(1) The Commission could conclude that no recommendation should be submitted to the Legislature. The staff rejected this alternative for several reasons. We believe that there is a need to liberalize the law to permit use of reasonable liquidated damages provisions in contracts involving substantial sums between informed and experienced parties represented by counsel. We believe that it is this type of case that the Commission had in mind when it worked on the provision to adopt the "reasonableness" standard for liquidated damages. In addition, we believe that it is desirable to validate and provide standards for liquidated damages provisions in contracts for the sale of real property.

(2) The Commission could recommend a provision comparable to the Commercial Code provision (text of provision set out in footnote 5 of the Staff Draft) to apply to contracts not covered by that code. This alternative has some appeal, but the Commercial Code provision (allowing consideration of actual damages) would not be as liberal as the proposed provision would be in large transactions between parties represented by counsel. Moreover, despite the fact that the Commercial Code provision applies to sales of goods to retail consumers, the persons I discussed the recommendation with did not believe that the Commercial Code standard should be applied to the sale of services to consumers. There was a general feeling that, in a default judgment case, the seller should have to prove up his damages to the satisfaction of the judge. Accordingly, the staff does not recommend this alternative.

The Staff Draft

The staff draft revises the approved recommendation so that existing Sections 1670 and 1671 (rather than the new standard) will continue to apply to consumer cases and cases where the parties are in substantially unequal bargaining positions. We have revised the entire recommendation accordingly. If the Commission decides that it prefers this alternative to the two previously mentioned, we suggest that we go through the staff draft (section by section) at the meeting.

We do not believe that the Commercial Code provision should be revised in any way. Whatever merit there may have been to this suggestion of the State Bar as applied to the approved recommendation, the staff draft adopts dual standards that would make conforming revisions of the Commercial Code highly undesirable.

We believe that it is desirable to retain the proposed amendments to the Government Code provisions relating to public construction contracts. These amendments (set out as the last two sections of the staff draft) are necessary to eliminate objections to the proposal. Moreover, the proposed liquidated damages standards would apply unless another statute provides standards to govern a particular type of contract. The Government Code provisions do not contain any standards.

The staff is hopeful that the staff draft can be approved for printing at the October meeting. Accordingly, please mark your editorial revisions on your copy so you can turn it in to the staff at the meeting if the staff draft is approved by the Commission for printing.

Respectfully submitted,

John H. DeMouilly  
Executive Secretary

AGENDA 29.6 - LIQUIDATED DAMAGES (4/24/75)

ACTION TAKEN: Approve LRC proposal in principle and advise the commission that the committee feels that the Commercial Code provisions should be amended to conform and is concerned that proposed provisions amending the Government Code may cast doubt on the effect of the proposal on other sections not specified. (No dissent)

DISCUSSION: Mr. Wulff reported orally and reviewed the LRC proposal and Mr. Rove's letter of April 8, 1975. It was first noted that the LRC proposal does not amend provisions of the Commercial Code which treat liquidated damages differently than the proposed CC3319. It was generally agreed there is no valid reason for any distinction and that the difference in treatment should be brought to the attention of the commission. There was general agreement with provisions for liquidated damages set out in proposed CC1670, 1671, 1951.5 and 3319, but concern was expressed that the general provisions of CC 3358 "except as otherwise provided" might be rendered ineffective by the specific provisions added to Govt. C. 14376 and 53069.85 and that Section 3319 does not apply to these sections. There are other sections to which 3319 should not apply and by not also amending those sections, there may be doubt as to the applicability of 3319; it was concluded that the general provision was sufficient and that the specific references in the Government Code should not be added. There was considerable discussion of proposed CC 3320 and 3321, but despite some thought that there is no reason to treat contracts for the sale of real property differently than other contracts, and that in all cases the amount of damages should be limited to the deposit, the new sections were approved without dissent. Thereafter, a motion was adopted to approve the LRC proposal in principle but bring to the commission's attention the section's concern over the failure to amend the Commercial Code provisions and the proposed amendments to the Government Code.

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TITLE INSURANCE  
AND TRUST

April 8, 1975

Oliver F. Green, Jr., Esq.  
555 South Flower Street  
22nd Floor  
Los Angeles, California 90071

Re: CAJ Agenda Item 29.6A - Liquidated Damages

Dear Oliver:

After I sent my letter to you of April 7, I realized that I had forgotten to make any recommendations concerning this. I feel that the doctrine of liquidated damages as proposed by the Law Revision Committee to repeal Sections 1670 and 1671 of the Civil Code, amending Section 1951.5 and add Section 3319 should be approved for the reasons stated in the Commission's recommendation.

I see no reason to treat contracts for the sale of real property differently than that of other contracts, and therefore would eliminate from their recommendations proposed Civil Code Sections 3320 and 3321.

The Commission proposes to amend Civil Code Section 3358 so that it now commences "Except as otherwise provided by statute,". Notwithstanding this preface Government Code Sections 14376 and 53069.85 have each been amended to add the following sentence: "Section 3319 of the Civil Code does not apply to contract provisions under this section." I do not feel that this is necessary and may cast doubts on other provisions which have not been amended. I would therefor not amend these sections.

This brings me to my final recommendation. Section 2718 of the Uniform Commercial Code treats liquidated damages differently than the proposed Section 3319 of the Civil Code. The Uniform Commercial Code uses hindsight to determine whether the amount of liquidated damages was reasonable. I would recommend that Section 2718 of

Oliver F. Green, Jr., Esq.

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April 8, 1975

the Uniform Commercial Code be amended to conform to the principles set forth in the proposed Section 3319. I have not had time to review other codes which may provide for liquidated damages. I do feel that these should be reviewed to ascertain if there should be other changes recommended.

Sincerely,



Robert G. Rove  
Vice President and  
Associate General Counsel

RGR:co

cc: ✓ William Eades, Esq.

SUPERSEDED  
BY STAFF  
DRAFT DATED  
NOVEMBER  
1975

STATE OF CALIFORNIA

CALIFORNIA LAW  
REVISION COMMISSION

**SUPERSEDED**  
RECOMMENDATION

relating to

Liquidated Damages

January 1975

CALIFORNIA LAW REVISION COMMISSION  
School of Law  
Stanford University  
Stanford, California 94305

FOR  
INFORMATION  
ONLY

STATE OF CALIFORNIA

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To: THE HONORABLE EDMUND G. BROWN, JR.  
*Governor of California* and  
THE LEGISLATURE OF CALIFORNIA

The California Law Revision Commission was authorized by Resolution Chapter 224 of the Statutes of 1969 to study whether the law relating to liquidated damages should be revised.

The Commission submitted a recommendation on this subject to the 1974 legislative session. Recommendation and Study Relating to Liquidated Damages, 11 Cal. L. Revision Comm'n Reports 1201 (1973). That recommendation was withdrawn for further study by the Commission. In preparing this new recommendation, the Commission has considered the objections made to its earlier recommendation.

Respectfully submitted,  
MARC SANDSTROM  
*Chairman*



## INTRODUCTION

Existing California law permits the parties to a contract, in some circumstances, to agree on the amount or the manner of computation of damages recoverable for breach.<sup>1</sup> Two requirements must be satisfied. Sections 1670 and 1671 of the Civil Code<sup>2</sup> permit the enforcement of a liquidated damages provision only where the actual damages "would be impracticable or extremely difficult to fix." In addition, the courts have developed a second requirement that the provision must reflect a "reasonable endeavor" to estimate actual damages.<sup>3</sup> The judicial decisions interpreting and applying these requirements, however, provide inadequate guidance to contracting parties and severely limit the use of liquidated damages provisions.<sup>4</sup> Unlike the Civil Code sections which

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1. For a discussion of the varying forms a liquidated damages clause may take, see background study, Sweet, Liquidated Damages in California, 60 Cal. L. Rev. 84 (1972), reprinted in 11 Cal. L. Revision Comm'n Reports at 1229 (1973) (hereinafter referred to as "background study").
  2. Sections 1670 and 1671, which were enacted in 1872 and have not since been amended, read:

1670. Every contract by which the amount of damage to be paid, or other compensation to be made, for a breach of an obligation, is determined in anticipation thereof, is to that extent void, except as expressly provided in the next section.

1671. The parties to a contract may agree therein upon an amount which shall be presumed to be the amount of damage sustained by a breach thereof, when, from the nature of the case, it would be impracticable or extremely difficult to fix the actual damage.
  3. 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). See also Garrett v. Coast & S. Fed. Sav. & Loan Ass'n, 9 Cal.3d 731, 511 P.2d 1197, 108 Cal. Rptr. 845 (1973); Clermont v. Secured Investment Corp., 25 Cal. App.3d 766, 102 Cal. Rptr. 340 (1972).
  4. See background study.

reflect a traditional hostility to liquidated damages provisions, recently enacted statutes such as Section 2718 of the Commercial Code<sup>5</sup> encourage the use of such provisions.<sup>6</sup>

A liquidated damages provision may serve useful and legitimate functions.<sup>7</sup> The parties to a contract may include a liquidated damages provision in order to avoid the cost, difficulty, and delay of proving damages in court. When the provision is phrased in such a way as to indicate that the breaching party will pay a specified amount if a particular breach occurs, troublesome problems involved in proving causation and foreseeability may be avoided. Also, through a liquidated damages provision, the parties may seek by contract to settle the amount of damages involved and thus improve the normal rules of damages. Finally, the parties may feel that, if they truly agree on damages in advance, it is unlikely that either will later dispute the amount of damages recoverable as a result of breach.

A nonbreaching party may use a liquidated damages provision because on occasion a breach will cause damage, but the amount of the damage cannot be proved under damage rules normally used in a judicial proceeding. He may fear that, without an enforceable provision liquidating the damages, the other party will lack incentive to perform since any damages

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5. The pertinent portion of Section 2718 provides:

2718. (1) Damages for breach by either party may be liquidated in the agreement but only at an amount which is reasonable in the light of the anticipated or actual harm caused by the breach, the difficulties of proof of loss, and the inconvenience or nonfeasibility of otherwise obtaining an adequate remedy. A term fixing unreasonably large liquidated damages is void as a penalty.

6. For provisions authorizing liquidated damages in marketing contracts, see Corp. Code § 13353; Food & Agri. Code § 54264. For provisions authorizing late payment charges, see Bus. & Prof. Code § 10242.5 (certain real estate loans); Civil Code §§ 1803.6 (retail installment sales), 2982 (automobile sales finance act); Fin. Code §§ 14852 (credit unions), 18667(a)(5) and 18934 (industrial loan companies), 22480 (personal property brokers). See also Govt. Code § 54348 (services of local agency enterprise); Pub. Res. Code § 6224 (failure to pay State Lands Commission); Sts. & Hwys. Code § 6442 (Improvement Act of 1911). For provisions authorizing liquidated damages in certain public construction contracts, see Govt. Code §§ 14376, 53069.85; Sts. & Hwys. Code §§ 5254.5, 10503.1.
7. The following discussion draws heavily upon the background study.

he causes will not be sufficiently provable to be collected. There is also a danger that, without a liquidated damages provision, the breaching party may recover the full contract price because the losses are not provable.

A party to a contract may seek to control his risk exposure for his own breach by use of a liquidated damages provision. Such control is especially important if he is engaged in a high risk enterprise.<sup>8</sup>

Use of liquidated damages provisions in appropriate cases also may improve judicial administration. Enforcement of liquidated damages provisions will encourage greater use of such provisions, will result in fewer breaches, fewer law suits, and fewer or easier trials.

While liquidated damages provisions may serve these and other useful and legitimate functions, there are dangers inherent in their use. There is the risk that a liquidated damages provision will be used oppressively by a party able to dictate the terms of an agreement. And there is the risk that such a provision may be used unfairly against a party who does not fully appreciate the effect of the provision. This is frequently the case where consumers are involved.

The Commission believes that the use of liquidated damages provisions is beneficial and should be encouraged. However, limitations are needed to protect against the oppressive use of such provisions where the parties have substantially unequal bargaining power or where the contract is for the sale of retail goods or services or residential housing.

#### RECOMMENDATIONS

Having concluded that the existing law does not permit the use of a liquidated damages provision in many cases where it would serve a useful and legitimate function, the Commission makes the following recommendations.

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8. See, e.g., *Better Foods Mkts., Inc. v. American Dist. Tel. Co.*, 40 Cal.2d 179, 253 P.2d 10 (1953) (contract for burglar alarm system with a \$50 liquidation of damages clause).

### General Principles Governing Liquidated Damages

Sections 1670 and 1671 of the Civil Code should be replaced by a statute that applies to liquidated damages provisions in contracts generally (absent a specific statute that applies to the particular type of contract) and that implements the following basic principles:

(1) A contractual stipulation of damages that is reasonable should be valid. This rule would reverse the basic disapproval of such provisions expressed in Sections 1670 and 1671 and in the judicial decisions but would still enable courts to invalidate such provisions in situations where they are oppressive.

(2) Reasonableness should be judged in light of the circumstances confronting the parties at the time of the making of the contract and not by the judgment of hindsight. To permit consideration of the damages actually suffered would defeat one of the purposes of liquidated damages which is to avoid litigation of the amount of actual damages.

(3) In cases where the party seeking to invalidate the liquidated damages provision shows that the contract is a consumer contract (one for the retail purchase by the party of consumer goods or consumer services primarily for his personal, family, or household purposes) or that the contract was made when he was in a substantially inferior bargaining position, the party seeking to enforce the provision should bear the burden of proving reasonableness. This would protect significantly weaker and less experienced parties.

In other cases, the party seeking to invalidate a liquidated damages provision should have the burden of proving that it is unreasonable.

### Real Property Leases

The concurrent resolution directing the Law Revision Commission to study liquidated damages referred specifically to the use of liquidated damages provisions in real property leases.<sup>9</sup> The Commission has concluded that no special rules applicable to real property leases are necessary; the general rules recommended above will deal adequately with any liquidated damages problems in connection with such leases.

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9. See Cal. Stats. 1972, Res. Ch. 22 at 3223 (directing the Commission to study whether "the law relating to liquidated damages in contracts and, particularly, in leases, should be revised").

### Land Purchase Contracts

The parties to a contract for the sale of real property may desire to include in the contract a provision liquidating the damages if the purchaser fails to complete the purchase. In some cases, the parties may agree that an "earnest money" deposit constitutes liquidated damages if the purchaser fails to complete the sale. The validity of such provisions under existing law is uncertain.<sup>10</sup>

The Commission recommends enactment of a section providing that a liquidated damages clause in a contract for the sale of real property is valid only if the provision satisfies the general requirements for validity of a liquidated damages provision outlined above and is separately signed or initialed by each party to the contract. This requirement will alert the parties to the fact that the liquidated damages clause is included in the contract.<sup>11</sup>

An exception to this general rule is needed to protect the defaulting buyer of residential housing. A provision liquidating damages for the buyer's default in a contract for the sale of a single-family residential unit would be valid only if it designates all or part of the "earnest money" as liquidated damages and is separately signed or initialed. In such contracts, only the amount actually deposited in the

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10. See background study, 11 Cal. L. Revision Comm'n Reports 1229, 1242-1247 (1973).

11. The Commission's recommendation in large part would conform to existing practice. The Standard Real Estate Purchase Contract and Receipt for Deposit, approved in form only for use in "simple transactions" by the California Real Estate Association and the State Bar of California, contains the following provision:

7. If Buyer fails to complete said purchase as herein provided by reason of any default of Buyer, Seller shall be released from his obligation to sell the property to Buyer and may proceed against Buyer upon any claim or remedy which he may have in law or equity; provided, however, that by placing their initials here (Buyer) (Seller), Buyer and Seller agree that it would be impractical or extremely difficult to fix actual damages in case of Buyer's default, that the amount of the deposit is a reasonable estimate of the damages, and that Seller retain the deposit as his sole right to damages.

form of cash or check (including a postdated check) could be considered valid liquidated damages even where the liquidated damages clause designates a larger amount. This provision recognizes that in most cases even the unsophisticated buyer of residential housing expects that he will lose the deposit actually made if he does not go through with the deal. However, to protect the intended buyer of residential housing from forfeiting an unreasonably large deposit as liquidated damages, he should be allowed to show that a liquidated damages provision otherwise satisfying the applicable rules is invalid on the grounds that it was unreasonable under the circumstances existing at the time the contract was made.

#### PROPOSED LEGISLATION

The Commission's recommendation would be effectuated by enactment of the following measure:

An act to amend Sections 1951.5 and 3358 of, to add Sections 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 liquidated damages.

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

#### Civil Code § 1670 (repealed)

SECTION 1. Section 1670 of the Civil Code is repealed.

~~1670. Every contract by which the amount of damage to be paid, or other compensation to be made, for a breach of an obligation, is determined in anticipation thereof, is to that extent void, except as expressly provided in the next section.~~

Comment. Sections 1670 and 1671 are superseded by Section 3319.

Civil Code § 1671 (repealed)

SEC. 2. Section 1671 of the Civil Code is repealed.

~~1671. The parties to a contract may agree therein upon an amount which shall be presumed to be the amount of damage sustained by a breach thereof, when, from the nature of the case, it would be impracticable or extremely difficult to fix the actual damage.~~

Comment. Sections 1670 and 1671 are superseded by Section 3319.

Civil Code § 1951.5 (amended)

SEC. 3. Section 1951.5 of the Civil Code is amended to read:

1951.5. ~~Sections 1670 and 1671~~ Section 3319, relating to liquidated damages, ~~apply~~ applies to a lease of real property.

Comment. Sections 1670 and 1671 are superseded by Section 3319.

Civil Code § 3319 (added)

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

3319. (a) Except as otherwise provided by statute, a provision in a contract liquidating the damages for breach of the contract is valid unless the party seeking to invalidate the provision establishes that it was unreasonable under the circumstances existing at the time the contract was made.

(b) Notwithstanding subdivision (a), where the party seeking to invalidate the provision establishes that he was in a substantially inferior bargaining position at the time the contract was made or that the contract is for the retail purchase by him of consumer goods or consumer

services primarily for his personal, family, or household purposes, the provision is invalid unless the party seeking to enforce the provision establishes that it was reasonable under the circumstances existing at the time the contract was made.

Comment. Section 3319 provides that a liquidated damages provision in a contract is valid if it is reasonable and allocates the burden of proof on the issue whether the provision is reasonable. It thus reflects a policy that favors the use of liquidated damages provisions, reversing the restrictive policy of former Sections 1670 and 1671. In consumer cases and in cases where the parties are in unequal bargaining positions, Section 3319 places the burden of proof on the issue of reasonableness on the party seeking to enforce the liquidated damages provision. In other cases, the burden of proof on this issue is on the party seeking to invalidate the provision.

Section 3319 limits the circumstances that may be taken into account in the determination of reasonableness to those in existence "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.

Former 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 former 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 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. Other 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, and whether the liquidated damages provision is included in a form 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 I B. Witkin, Summary of California Law, Contracts § 13 at 35-36 (8th ed. 1973).

Subdivision (a) implements the policy favoring liquidated damages provisions by placing on the party seeking to avoid the provision the burden of proving that the provision was unreasonable when the contract was made. However, where the party seeking to avoid the provision makes an initial showing that he was in a substantially inferior bargaining position or that the contract is "for the retail purchase by him of consumer goods or consumer services primarily for his personal, family, or household purposes," subdivision (b) places the burden of proof to establish that the liquidated damages provision was reasonable on the party seeking to enforce the provision. The consumer purpose standard is based on the Unruh Act which governs retail installment sales. See Civil Code § 1802.1. It should be noted that, where the party seeking to avoid the provision is the nonconsumer party to a consumer contract or is the superior party in the case of substantially disparate bargaining positions, he may not take advantage of subdivision (b).

The introductory clause of subdivision (a) makes clear that the section does not affect the statutes that govern liquidation of damages for breach of certain types of contracts. E.g., Civil Code § 3321 (sale of single-family residential unit); Com. Code § 2718. For late payment charge provisions, see, e.g., Bus. & Prof. Code § 10242.5 (certain real estate loans), Civil Code §§ 1803.6 (retail installment sales), 2982 (automobile sales finance); Fin. Code §§ 14852 (credit unions), 13667(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). 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 in a contract a charge for late completion) remain unaffected by Section 3319. Note that Section 3320, providing a rule governing liquidated damages for the buyer's default on a contract for the sale of nonresidential real property, incorporates Section 3319.

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., Sections 3320 and 3321 ("earnest money" deposits). 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).

Civil Code § 3320 (added)

SEC. 5. Section 3320 is added to the Civil Code, to read:

3320. Except as provided by Section 3321, a provision in a contract for the sale of real property liquidating the damages to the seller if the buyer fails to purchase the property is invalid unless it is separately signed or initialed by each party and satisfies Section 3319.

Comment. Section 3320 provides for the validity of a liquidated damages provision for the buyer's default in a contract for the sale of real property other than a single-family residential unit. See Section 3321 (validity of liquidated damages provision in contract for the sale of single-family residential unit). Under Section 3320, 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 the contract was made." See Section 3319(a). However, where the defaulting buyer of nonresidential real property shows that he was in a substantially inferior bargaining position when the contract was made, "the provision is invalid unless the party seeking to enforce the provision establishes that it was reasonable under the circumstances existing at the time the contract was made." See Section 3319(b). The validity of a provision giving the buyer a right to recover liquidated damages is determined under Section 3319; the requirement of a separate signing or initialing provided by this section does not apply to contract provisions concerning anything other than liquidated damages for the buyer's failure to purchase the property. Where a liquidated damages provision satisfies the requirements of this section, the limitations of Section 3306 and 3307 do not apply.

Civil Code § 3321 (added)

SEC. 6. Section 3321 is added to the Civil Code, to read:

3321. (a) A provision in a contract for the sale of a single-family residential unit liquidating the damages to the seller if the

buyer fails to purchase the property is invalid unless it is separately signed or initialed by each party and satisfies the requirements of subdivision (b). For the purposes of this section, "single-family residential unit" means a dwelling which, at the time the contract for sale was made, the buyer intends to occupy.

(b) Where the parties to a contract for the sale of a single-family residential unit provide that all or any part of a deposit made by the buyer shall constitute liquidated damages to the seller if the buyer fails to purchase the property, such amount is valid as liquidated damages to the extent that it is actually deposited in the form of cash or check (including a postdated check) unless the buyer establishes that the provision was unreasonable under the circumstances existing at the time the contract was made.

(c) This section does not apply to real property sales contracts as defined in Section 2985.

Comment. Section 3321 governs the validity of a provision liquidating the damages for the buyer's default in a contract for the sale of a single-family residential unit. This section is an exception to the provisions of Sections 3319 and 3320. A provision in a contract for the sale of a single-family residential unit liquidating the seller's damages if the buyer fails to satisfy his obligation to purchase the property is valid only if it is separately signed or initialed by the parties as required by subdivision (a) and satisfies subdivision (b).

Subdivision (b) makes clear that a provision liquidating the damages if the buyer defaults is valid only to the extent that the buyer actually makes a deposit in the form of cash or a check (including a postdated check). Hence, if the liquidated damages provision specifies damages for the buyer's default in an amount greater than the amount of the deposit actually made, the provision may be valid only in the amount of

the deposit; the seller may not enforce the greater amount under Section 3319 or 3320. Where the deposit is greater than the amount specified as liquidated damages, only the amount so specified may be retained as liquidated damages for the buyer's default. Section 3321 recognizes that generally the buyer of residential housing, including the buyer who does not read the contract or does not understand it, expects that he will lose the deposit actually made if he does not go through with the deal. However, to protect the buyer of residential housing from forfeiting an unreasonably large deposit as liquidated damages, subdivision (b) provides that a liquidated damages provision satisfying the other requirements of this section is nevertheless invalid if the buyer establishes that it was unreasonable under the circumstances existing at the time the contract was made. Section 3321 does not apply to contract provisions concerning anything other than liquidated damages for the buyer's failure to purchase the property.

Where a liquidated damages provision satisfies the requirements of this section, the limitations of Sections 3306 and 3307 do not apply. Subdivision (c) makes clear that liquidated damages provisions in real property sales contracts as defined in Section 2985 (commonly called installment land contracts) are not governed by Section 3321.

Civil Code § 3358 (amended)

SEC. 7. Section 3358 of the Civil Code is amended to read:

3358. ~~Notwithstanding the provisions of this Chapter,~~ Except as otherwise provided by statute, no person can recover a greater amount in damages for the breach of an obligation than he could have gained by the full performance thereof on both sides ~~;~~ except in the cases specified in the Articles on Exemplary Damages and Penal Damages, and in Sections 3319, 3339, and 3340 .

Comment. Section 3358 is amended to replace the former listing of specific provisions with a general reference to statutes that constitute an exception to the rule stated. The former listing of specific provisions was incomplete.

Government Code § 14376 (amended)

SEC. 8. Section 14376 of the Government Code is amended to read:

14376. Every contract shall contain a provision in regard to the time when the whole or any specified portion of the work contemplated shall be completed, and shall provide that for each day completion is delayed beyond the specified time, the contractor shall forfeit and pay to the state a specified sum of money, to be deducted from any payments due or to become due to the contractor. A contract for a road project may also provide for the payment of extra compensation to the contractor, as a bonus for completion prior to the specified time, such provision, if used, to be included in the specifications and to clearly set forth the basis for such payment. Section 3319 of the Civil Code does not apply to contract provisions under this section.

Comment. The last sentence is added to Section 14376 to make clear that the enactment of Civil Code Section 3319 has no effect on contract provisions under Section 14376.

Government Code § 53069.85 (amended)

SEC. 9. Section 53069.85 of the Government Code is amended to read:

53069.85. The legislative body of a city, county or district may include or cause to be included in contracts for public projects a provision establishing the time within which the whole or any specified portion of the work contemplated shall be completed. The legislative body may provide that for each day completion is delayed beyond the specified time, the contractor shall forfeit and pay to such agency involved a specified sum of money, to be deducted from any payments due or to become due to the contractor. A contract for such a project may

also provide for the payment of extra compensation to the contractor, as a bonus for completion prior to the specified time. Such provisions, if used, shall be included in the specifications upon which bids are received, which specifications shall clearly set forth the provisions.

Section 3319 of the Civil Code does not apply to contract provisions under this section.

Comment. The last sentence is added to Section 53069.85 to make clear that the enactment of Civil Code Section 3319 has no effect on contract provisions under Section 53069.85.

STATE OF CALIFORNIA

# CALIFORNIA LAW REVISION COMMISSION

PROPOSED STAFF DRAFT

RECOMMENDATION

*relating to*

**Liquidated Damages**

November 1975

CALIFORNIA LAW REVISION COMMISSION  
Stanford Law School  
Stanford, California 94305



**CALIFORNIA LAW REVISION COMMISSION**

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To: THE HONORABLE EDMUND G. BROWN JR.  
*Governor of California* and  
THE LEGISLATURE OF CALIFORNIA

The California Law Revision Commission was authorized by Resolution Chapter 224 of the Statutes of 1969 to study whether the law relating to liquidated damages should be revised.

The Commission submitted a recommendation on this subject to the 1974 legislative session. Recommendation and Study Relating to Liquidated Damages, 11 Cal. L. Revision Comm'n Reports 1201 (1973). That recommendation was withdrawn for further study by the Commission. In preparing this new recommendation, the Commission has considered the objections made to its earlier recommendation.

Respectfully submitted,  
MARC SANDBLUM  
*Chairman*

## INTRODUCTION

Existing California law permits the parties to a contract, in some circumstances, to agree on the amount or the manner of computation of damages recoverable for breach.<sup>1</sup> Two requirements must be satisfied. Sections 1670 and 1671 of the Civil Code<sup>2</sup> permit the enforcement of a liquidated damages provision only where the actual damages "would be impracticable or extremely difficult to fix." In addition, the courts have developed a second requirement that the provision must reflect a "reasonable endeavor" to estimate actual damages.<sup>3</sup> The judicial decisions interpreting and applying these requirements, severely limit the use of liquidated damages provisions.<sup>4</sup> Unlike the Civil Code sections

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1. For a discussion of the varying forms a liquidated damages clause may take, see background study, Sweet, Liquidated Damages in California, 60 Cal. L. Rev. 84 (1972), reprinted in 11 Cal. L. Revision Comm'n Reports at 1229 (1973) (hereinafter referred to as "background study").
  2. Sections 1670 and 1671, which were enacted in 1872 and have not since been amended, read:

1670. Every contract by which the amount of damage to be paid, or other compensation to be made, for a breach of an obligation, is determined in anticipation thereof, is to that extent void, except as expressly provided in the next section.

1671. The parties to a contract may agree therein upon an amount which shall be presumed to be the amount of damage sustained by a breach thereof, when, from the nature of the case, it would be impracticable or extremely difficult to fix the actual damage.
  3. *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). See also *Garrett v. Coast & S. Fed. Sav. & Loan Ass'n*, 9 Cal.3d 731, 511 P.2d 1197, 108 Cal. Rptr. 845 (1973); *Clermont v. Secured Investment Corp.*, 25 Cal. App.3d 766, 102 Cal. Rptr. 340 (1972).
  4. See background study.

which reflect a traditional hostility to liquidated damages provisions, recently enacted statutes such as Section 2718 of the Commercial Code<sup>5</sup> encourage the use of such provisions.<sup>6</sup>

A liquidated damages provision may serve useful and legitimate functions.<sup>7</sup> The parties to a contract may include a liquidated damages provision in order to avoid the cost, difficulty, and delay of proving damages in court. When the provision is phrased in such a way as to indicate that the breaching party will pay a specified amount if a particular breach occurs, troublesome problems involved in proving causation and foreseeability may be avoided. Also, through a liquidated damages provision, the parties may seek by contract to settle the amount of damages involved and thus improve the normal rules of damages. Finally, the parties may feel that, if they truly agree on damages in advance, it is unlikely that either will later dispute the amount of damages recoverable as a result of breach.

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5. The pertinent portion of Section 2718 provides:

2713. (1) Damages for breach by either party may be liquidated in the agreement but only at an amount which is reasonable in the light of the anticipated or actual harm caused by the breach, the difficulties of proof of loss, and the inconvenience or nonfeasibility of otherwise obtaining an adequate remedy. A term fixing unreasonably large liquidated damages is void as a penalty.

6. For provisions authorizing liquidated damages in marketing contracts, see Corp. Code § 13353; Food & Agri. Code § 54264. For provisions authorizing late payment charges, see Bus. & Prof. Code § 10242.5 (certain real estate loans); Civil Code § 1803.6 (retail installment sales), 2982 (automobile sales finance act); Fin. Code §§ 14852 (credit unions), 18667(a)(5) and 18934 (industrial loan companies), 22480 (personal property brokers). See also Govt. Code § 54348 (services of local agency enterprise); Pub. Res. Code § 6224 (failure to pay State Lands Commission); Sts. & Hwys. Code § 6442 (Improvement Act of 1911). For provisions authorizing liquidated damages in certain public construction contracts, see Govt. Code §§ 14376, 53069.85; Sts. & Hwys. Code §§ 5254.5, 10503.1.
7. The following discussion draws heavily upon the background study.

A nonbreaching party may use a liquidated damages provision because on occasion a breach will cause damage, but the amount of the damage cannot be proved under damage rules normally used in a judicial proceeding. He may fear that, without an enforceable provision liquidating the damages, the other party will lack incentive to perform since any damages he causes will not be sufficiently provable to be collected. There is also a danger that, without a liquidated damages provision, the breaching party may recover the full contract price because the losses are not provable.

A party to a contract may seek to control his risk exposure for his own breach by use of a liquidated damages provision. Such control is especially important if he is engaged in a high risk enterprise.<sup>8</sup>

Use of liquidated damages provisions in appropriate cases also may improve judicial administration. Enforcement of liquidated damages provisions will encourage greater use of such provisions, will result in fewer breaches, fewer law suits, and fewer or easier trials.

While liquidated damages provisions may serve these and other useful and legitimate functions, there are dangers inherent in their use. There is the risk that a liquidated damages provision will be used oppressively by a party able to dictate the terms of an agreement. And there is the risk that such a provision may be used unfairly against a party who does not fully appreciate the effect of the provision. This is frequently the case where consumers are involved.

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8. See, e.g., *Better Foods Mkts., Inc. v. American Dist. Tel. Co.*, 40 Cal.2d 179, 253 P.2d 10 (1953)(contract for burglar alarm system with a \$50 liquidation of damages clause).

The Commission believes that the use of liquidated damages provisions is beneficial and should be encouraged. However, existing limitations should be retained and additional protection provided to protect against the oppressive use of such provisions where the parties have substantially unequal bargaining power or where the contract is for the retail sale of goods, property, or services or for the sale of residential housing.

#### RECOMMENDATIONS

Having concluded that the existing law does not permit the use of a liquidated damages provision in some cases where such a provision would serve a useful and legitimate function, the Commission makes the following recommendations.

##### General Principles Governing Liquidated Damages

Civil Code Sections 1670 and 1671 should continue to apply to cases where the party seeking to invalidate a liquidated damages provision shows either of the following:

(1) The contract is a consumer contract (one for the retail purchase by the party of consumer goods, property, or services primarily for his personal, family, or household purposes).

(2) The contract was made when he was in a substantially inferior bargaining position.

This would continue the protection now given to significantly weaker and less experienced parties.

The other specific statutes that now apply to particular types of contracts--such as Commercial Code Section 2718--should be retained without change.

A new statutory provision should be enacted to apply to contracts made by parties in relatively equal bargaining positions absent a specific statute that applies to the particular type of contract. In this situation, a contractual stipulation of damages that is reasonable should be valid. The party seeking to invalidate the provision should have the burden of proving that it is unreasonable. Reasonableness should be judged in light of the circumstances confronting the parties at the time of the making of the contract and not by the judgment of hindsight. To permit consideration of the damages suffered would defeat one of the purposes of liquidated damages which is to avoid litigation of the amount of actual damages. This new statutory provision would reverse the basic disapproval of liquidated damages provisions expressed in Sections 1670 and 1671 and in the judicial decisions. Under the new provision, informed parties or parties represented by counsel would be able to develop and agree to a reasonable liquidated damages provision with assurance that the provision will be held valid if it is contested in court.

### Real Property Leases

The concurrent resolution directing the Law Revision Commission to study liquidated damages referred specifically to the use of liquidated damages provisions in real property leases.<sup>9</sup> The Commission has concluded that no special rules applicable to real property leases are necessary; the general rules recommended above will deal adequately with any liquidated damages problems in connection with such leases.

### Land Purchase Contracts

The parties to a contract for the sale of real property may desire to include in the contract a provision liquidating the damages if the purchaser fails to complete the purchase. In some cases, the parties may agree that an "earnest money" deposit constitutes liquidated damages if the purchaser fails to complete the sale. The validity of such provisions under existing law is uncertain.<sup>10</sup>

The Commission recommends enactment of a section providing that a liquidated damages clause in a contract for the sale of real property is valid only if the provision satisfies the general requirements for

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9. See Cal. Stats. 1972, Res. Ch. 22 at 3223 (directing the Commission to study whether "the law relating to liquidated damages in contracts and, particularly, in leases, should be revised").

10. See background study, 11 Cal. L. Revision Comm'n Reports 1229, 1242-1247 (1973).

validity of a liquidated damages provision outlined above and is separately signed or initialed by each party to the contract. This requirement will alert the parties to the fact that the liquidated damages clause is included in the contract.<sup>11</sup>

A further limitation is needed to protect the defaulting buyer of residential housing. A provision liquidating damages for the buyer's default in a contract for the sale of a single-family residential unit should be valid only if it designates all or part of the "earnest money" as liquidated damages and is separately signed or initialed. In such contracts, only the amount actually deposited in the form of cash or check (including a postdated check) would be considered valid liquidated damages even where the liquidated damages clause designates a larger amount. This provision recognizes that in most cases even the unsophisticated buyer of residential housing expects that he will lose the deposit actually made if he does not go through with the deal. However, to protect the intended buyer of residential housing from forfeiting an unreasonably large deposit as liquidated damages, he should be allowed to show that a liquidated damages provision otherwise satisfying the

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11. The Commission's recommendation in large part would conform to existing practice. The Standard Real Estate Purchase Contract and Receipt for Deposit, approved in form only for use in "simple transactions" by the California Real Estate Association and the State Bar of California, contains the following provision:

7. If Buyer fails to complete said purchase as herein provided by reason of any default of Buyer, Seller shall be released from his obligation to sell the property to Buyer and may proceed against Buyer upon any claim or remedy which he may have in law or equity; provided, however, that by placing their initials here (Buyer) (Seller), Buyer and Seller agree that it would be impractical or extremely difficult to fix actual damages in case of Buyer's default, that the amount of the deposit is a reasonable estimate of the damages, and that Seller retain the deposit as his sole right to damages.



applicable rules is invalid on the grounds that it was unreasonable under the circumstances existing at the time the contract was made.

#### PROPOSED LEGISLATION

The Commission's recommendation would be effectuated by enactment of the following measure:

An act to amend Sections 1670, 1951.5, and 3358 of, and to add Sections 1672, 1673, and 1674 to, the Civil Code, and to amend Sections 14376 and 53069.85 of the Government Code, relating to liquidated damages. The people of the State of California do enact as follows:

#### Civil Code § 1670 (technical amendment)

SECTION 1. Section 1670 of the Civil Code is amended to read:

1670. Every contract by which the amount of damage to be paid, or other compensation to be made, for a breach of an obligation, is determined in anticipation thereof, is to that extent void, except as expressly provided ~~in the next section~~ by statute .

Comment. The amendment to Section 1670 recognizes that there are numerous statutory exceptions to the rule stated in Section 1670. See e.g., Bus. & Prof. Code § 10242.5 (certain real estate loans); Civil Code §§ 1671 (liquidated damages generally), 1672 (contracts between parties in substantially equal bargaining position), 1673 and 1674 (contracts for sale of real property), 1803.6 (retail installment sales), 2982 (automobile sales finance act); Com. Code § 2718 (Commercial Code contracts); Corp. Code § 13353 (marketing contracts), Fin.

Code §§ 14852 (credit unions), 18667(a)(5) and 18934 (industrial loan companies), 22480 (personal property brokers); Food & Agri. Code § 54164 (marketing contracts); Govt. Code §§ 14376, 53069.85 (public construction contracts), 54348 (services of local agency enterprise); Pub. Res. Code § 6224 (failure to pay State Lands Commission); Sts. & Hwys. Code §§ 5254.5 (public construction contracts), 6442 (Improvement Act of 1911), 10503.1 (public construction contracts).

Civil Code § 1672 (added). Contract between parties in substantially equal bargaining positions

SEC. 2. Section 1672 is added to the Civil Code, to read:

1672. Notwithstanding Sections 1670 and 1671, except as otherwise expressly provided by statute, a provision in a contract liquidating the damages for breach of the contract is valid unless the party seeking to invalidate the provision establishes any of the following:

(a) The contract is for the retail purchase by him of consumer goods, property, or services and such goods, property, or services were purchased by him primarily for his personal, family, or household purposes.

(b) He was in a substantially inferior bargaining position at the time the contract was made.

(c) The provision was unreasonable under the circumstances existing at the time the contact was made.

Comment. Section 1672 provides that a reasonable damages provision in a contract is valid, but the section does not apply against the consumer in a consumer case or against the party in an inferior bargaining position in a case where the parties are in substantial unequal bargaining positions. In the cases where the section applies, the burden of proof on the issue of reasonableness is on the party seeking

to invalidate the provision. The section thus reflects a policy that favors the use of liquidated damages provisions, reversing the restrictive policy of Sections 1670 and 1671.

Section 1672 limits the circumstances that may be taken into account in the determination of reasonableness to those in existence "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.

Section 1671 permits liquidated damages only where the actual damages "would be impracticable or extremely difficult to fix." In addition, the courts have 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 1672, however, 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 the relationship the damages provided bear to the range of harm that reasonable could be anticipated at the time of the making of the contract. Other 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, and whether the liquidated damages provision is included in a form contract.

Section 1672 implements the policy favoring liquidated damages provisions by placing on the party seeking to avoid the provision the burden of proving that the provision was unreasonable when the contract was made. However, where the party seeking to avoid the provision makes an initial showing that he was in a substantially inferior bargaining position or that the contract is for the retail purchase by him of consumer goods, property, or services and such goods, property or services were purchased by him primarily for his personal, family, or household purposes, subdivisions (a) and (b) of Section 1672 provide that the section does not apply at all and the validity of the provision is determined under Section 1671. The consumer purpose standard is based on the Unruh Act which governs retail installment sales. See Civil Code § 1802.1. It should be noted that, where the party seeking to avoid the provision is the nonconsumer party to a consumer contract or is the superior party in the case of substantially disparate bargaining positions, Section 1672 is applicable.

The introductory clause of Section 1672 makes clear that the section does not affect the statutes that govern liquidation of damages for breach of certain types of contracts. E.g., Civil Code § 1674 (sale of single-family residential unit); Com. Code § 2718. For late payment charge provisions, see, e.g., Bus. & Prof. Code § 10242.5 (certain real estate loans), Civil Code §§ 1803.6 (retail installment sales), 2982 (automobile sales finance), Fin. Code §§ 14352 (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 1672--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 1671 or Section 1672 does apply. E.g., Fin. Code §§ 18649 and 18669.2 (exceptions to Section 18667), 22053 (exception to Section 22480). 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 in a contract a charge for late completion) remain unaffected by Sections 1670-1674. Note that Section 1673, providing a rule governing liquidated damages for the buyer's default on a contract for the sale of nonresidential real property, incorporates Section 1671 or Section 1672.

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 1671 or Section 1672 controls this determination. But see, e.g., Sections 1673 and 1674 ("earnest money" deposits). 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).

Civil Code § 1673 (added). Contract for sale of real property

SEC. 3. Section 1673 is added to the Civil Code, to read:

1673. Except as provided by Section 1674, a provision in a contract for the sale of real property liquidating the damages to the

seller if the buyer fails to purchase the property is invalid unless it is separately signed or initialed by each party and satisfies the requirements of Section 1671 or, when the contract is one covered by Section 1672, the requirements of that section.

Comment. Section 1673 provides for the validity of a liquidated damages provision for the buyer's default in a contract for the sale of real property other than a single-family residential unit. See Section 1674 (validity of liquidated damages provision in contract for the sale of single-family residential unit). Under Section 1673, such a provision is valid if separately signed or initialed by the parties and the requirements of Section 1671 or, where applicable, Section 1672, are satisfied. The requirement of a separate signing or initialing provided by this section does not apply to contract provisions concerning anything other than liquidated damages for the buyer's failure to purchase the property. Where a liquidated damages provision satisfies the requirements of this section, the limitations of Sections 3306 and 3307 do not apply.

Civil Code § 1674 (added). Contract for sale of single family residential unit

SEC. 4. Section 1674 is added to the Civil Code, to read:

1674. (a) A provision in a contract for the sale of a single-family residential unit liquidating the damages to the seller if the buyer fails to purchase the property is invalid unless it is separately signed or initialed by each party and satisfies the requirements of subdivision (b). For the purposes of this section, "single-family residential unit" means a dwelling which, at the time the contract for sale was made, the buyer intends to occupy.

(b) Where the parties to a contract for the sale of a single-family residential unit provide that all or any part of a deposit made by the buyer shall constitute liquidated damages to the seller if the buyer fails to purchase the property, such amount is valid as liquidated damages to the extent that it is actually deposited in the form of cash or check (including a postdated check) unless the buyer establishes that the provision was unreasonable under the circumstances existing at the time the contract was made.

(c) This section does not apply to real property sales contracts as defined in Section 2985.

Comment. Section 1674 governs the validity of a provision liquidating the damages for the buyer's default in a contract for the sale of a single-family residential unit. This section is an exception to the provisions of Sections 1670-1673. A provision in a contract for the sale of a single-family residential unit liquidating the seller's damages if the buyer fails to satisfy his obligation to purchase the property is valid only if it is separately signed or initialed by the parties as required by subdivision (a) and satisfies subdivision (b).

Subdivision (b) makes clear that a provision liquidating the damages if the buyer defaults is valid only to the extent that the buyer actually makes a deposit in the form of cash or a check (including a postdated check). Hence, if the liquidated damages provision specifies damages for the buyer's default in an amount greater than the amount of the deposit actually made, the provision is valid only in the amount of the deposit; the seller may not enforce the greater amount under Sections 1670-1673. Where the deposit is greater than the amount specified as liquidated damages, only the amount so specified may be retained as liquidated damages for the buyer's default. Section 1674 recognizes that generally the buyer of residential housing, including the buyer who does not read the contract or does not understand it, expects that he will lose the deposit actually made if he does not go through with the

deal. However, to protect the buyer of residential housing from forfeiting an unreasonably large deposit as liquidated damages, subdivision (b) provides that a liquidated damages provision satisfying the other requirements of this section is nevertheless invalid if the buyer establishes that it was unreasonable under the circumstances existing at the time the contract was made. Section 1674 does not apply to contract provisions concerning anything other than liquidated damages for the buyer's failure to purchase the property.

Where a liquidated damages provision satisfies the requirements of this section, the limitations of Sections 3306 and 3307 do not apply. Subdivision (c) makes clear that liquidated damages provisions in real property sales contracts as defined in Section 2985 (commonly called installment land contracts) are not governed by Section 1674.

Civil Code § 1951.5 (technical amendment)

Sec. 5. Section 1951.5 of the Civil Code is amended to read:

1951.5. Sections 1670 and 1671, relating to liquidated damages, apply to a lease of real property except that Section 1672 applies where the lease is one covered by that section.

Comment. Section 151.5 is amended to reflect the addition of Civil Code Section 1672.

Civil Code § 3358 (technical amendment)

SEC. 6. Section 3358 of the Civil Code is amended to read:

3358. ~~Notwithstanding the provisions of this Chapter,~~ Except as otherwise provided by statute, no person can recover a greater amount in damages for the breach of an obligation than he could have gained by the full performance thereof on both sides ~~;~~ except in the cases specified in the Articles on Exemplary Damages and Penal Damages, and in Sections 3319, 3339, and 3340 .



Comment. Section 3358 is amended to replace the former listing of specific provisions with a general reference to statutes that constitute an exception to the rule stated. The former listing of specific provisions was incomplete. See the Comment to Section 1670.

Government Code § 14376 (technical amendment)

SEC. 7. Section 14376 of the Government Code is amended to read:

14376. Every contract shall contain a provision in regard to the time when the whole or any specified portion of the work contemplated shall be completed, and shall provide that for each day completion is delayed beyond the specified time, the contractor shall forfeit and pay to the state a specified sum of money, to be deducted from any payments due or to become due to the contractor. A contract for a road project may also provide for the payment of extra compensation to the contractor, as a bonus for completion prior to the specified time, such provision, if used, to be included in the specifications and to clearly set forth the basis for such payment. Section 1670 to 1672, inclusive, of the Civil Code do not apply to contract provisions under this section.

Comment. The last sentence is added to Section 14376 to make clear that Civil Code Sections 1670-1672 have no effect on contract provisions under Section 14376.

Government Code § 53069.85 (technical amendment)

SEC. 8. Section 53069.85 of the Government Code is amended to read:

53069.85. The legislative body of a city, county or district may include or cause to be included in contracts for public projects a provision establishing the time within which the whole or any specified portion of the work contemplated shall be completed. The legislative body may provide that for each day completion is delayed beyond the specified time, the contractor shall forfeit and pay to such agency involved a specified sum of money, to be deducted from any payments due or to become due to the contractor. A contract for such a project may also provide for the payment of extra compensation to the contractor, as a bonus for completion prior to the specified time. Such provisions, if used, shall be included in the specifications upon which bids are received, which specifications shall clearly set forth the provisions. Sections 1670 to 1672, inclusive, of the Civil Code do not apply to contract provisions under this section.

Comment. The last sentence is added to Section 53069.85 to make clear that Civil Code Sections 1670 to 1672 have no effect on contract provisions under Section 53069.85.