

Memorandum 74-26

Subject: Study 72 - Liquidated Damages

Senate Bill 1532 is the bill introduced to effectuate the Commission's recommendation concerning liquidated damages. This bill is set for hearing by the Senate Judiciary Committee on May 14. I delayed the hearing on the bill because I believe that the Commission needs to give the bill further consideration before the bill is heard.

We are in a difficult practical position with respect to the bill because it has twice been set and the hearings have been cancelled at the request of Senator Stevens. In neither case was I consulted before the hearing was cancelled, and in both cases the hearing was cancelled because someone had a concern about the bill based on a lack of understanding of what the bill did. In both cases, the bill had no effect on the situation that concerned the person who contacted the office of Senator Stevens. Ordinarily, this type of situation is dealt with by the person contacting me so that I can discuss his problem and work it out if a problem actually exists, but this practice was not followed in the case of Senate Bill 1532.

A further complication is that I was advised today that Senator Stevens is going to make an author's amendment to the bill to further strengthen the position of the California Real Estate Association with respect to earnest money deposits. The amendment would revise the definition of "deposit" in Section 3320 (earnest money deposits) to read:

For the purposes of this section, "deposit" includes but is not limited to a check (including a postdated check), note, ~~or~~ other evidence of indebtedness , or any amount clearly indicated to become part of the deposit and to be paid at a later date .

I told the representative of Senator Stevens that I had previously told the representative of the California Real Estate Association that I would not agree to such an amendment because I felt it was contrary to what the Commission would be willing to recommend. I suggested that he present the amendment for consideration by the Senate Judiciary Committee at the hearing after I had explained the reason for the section. I was

confident that the Senate Judiciary Committee would not accept the amendment if they understood the section. Nevertheless, Senator Stevens plans to make the amendment as an author's amendment. This greatly concerns me because the bill, even prior to this California Real Estate Association amendment, has caused various groups great concern. In my opinion, the amendment goes exactly contrary to the type of amendments that will be needed if the bill is to have any chance for enactment. I believe that the bill needs to be amended in various ways so that it operates less harshly against consumers.

The Committee on the Administration of Justice has recommended that the State Bar support the bill but indicated its view that an amendment should be made to protect tenants in residential leases. (This is the amendment previously considered by the Commission and rejected because it made no sense when it was carefully analyzed.) Assuming that the State Bar will support the bill, I still believe that the Commission should consider the following amendments to the bill. I believe that, with these amendments, the bill would have a chance for enactment:

(1) For the present section on late payment charges, I suggest that we keep the definition of a late payment charge and provide in substance:

A provision in the loan contract imposing a late payment charge is valid if it satisfies the requirements of Section 2954.5 and reflects a reasonable endeavor to estimate the probable damages. This section is not applicable in any case where the validity of a late payment charge is otherwise determined by statute.

The effect of this proposal is that we would do nothing with respect to late payment charges in our statute except to retain existing law. Our revised general provision on liquidated damages would not be applicable. With respect to late payment charges, see Exhibit I attached.

(2) With respect to the "earnest money deposit" section, I suggest that we delete entirely subdivisions (b) and (c) of Section 3320 which provide that an earnest money deposit "shall be deemed to be reasonable and valid . . . if it does not exceed five percent of the total purchase price in the contract." This will remove opposition based on the view that a five-percent deposit should not "be deemed to be reasonable" when, in fact, it is not.

(3) Consideration should be given to reversing the burden of proof on the reasonableness of the liquidated damages provision under the general rule to place the burden on the person seeking to enforce the provision. This would, of course, be a radical departure from the view previously taken by the Commission, but it is a change that would substantially improve the chances for enactment of the bill and still would result in a better body of law than the existing law.

As you would expect, Senate Bill 1532 is supported by the banks, savings and loan associations, and California Real Estate Association. Opposition ranges from individual lawyers to representatives of various poverty groups. Various persons with whom I have discussed the bill have the feeling that it is an anti-consumer bill. I advised the representative of Senator Stevens who called me that it was a serious mistake to accept the amendment of the California Real Estate Association, that I believed that the bill needed to be amended to provide consumers with substantially more protection if it is to have any chance for enactment, and that the Commission would be considering this matter at its May 3-4 meeting. Moreover, having lost two chances to determine the reaction of the committee when the two previous hearings were cancelled, it is my general feeling that the Commission will probably have to give this subject further study before a bill that will have any reasonable chance for enactment can be prepared. The three amendments suggested heretofore would perhaps be sufficient to give the bill a good chance for enactment, but the Commission may feel that the proposed changes are so drastic that the recommendation should be withdrawn and further study given to this topic with a view to perhaps submitting a new recommendation to some future session.

Respectfully submitted,

John H. DeMouilly
Executive Secretary

Mem 74-26

EXHIBIT I
WESTERN CENTER ON LAW AND POVERTY
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BRIAN PADDOCK
Suing Attorney

4 April 1974

ANDREA GEISLER THRONE
Staff Associate

Assemblyman Wadie Deddeh
Room 4112
State Capitol
Sacramento, California 95814

RE: AB 105 (Deddeh) Late charges on loans secured by
single-family residences

Dear Assemblyman Deddeh:

I am writing you in your capacity as a member of the conference committee on AB 105. I thought you would be interested in the text of Section 6 of New York's Senate Bill 7268 (Print A31001) which is awaiting the Governor's signature after passage by the New York legislature. Note that it regulates late charges on loans secured by real property for residences of one to six families and prohibits the pyramidding of late charges. The maximum amount permitted is 2% of the delayed payment after a fifteen-day grace period.

All of these provisions in terms of coverage, grace period, and limitation on charges are more favorable than those found in the version of AB 105 now before your committee. I urge you to amend AB 105 to conform to the New York legislation or to hold it in committee. If the state of New York, the banking capital of the United States, can enact such legislation to benefit home purchasers, California should be able to do as well.

Sincerely,

BRIAN PADDOCK
Attorney at Law

BP/pm
Enclosure

Copies to: Assemblymen Moretti and Hayden
Senators Carpenter, Kennick, and Nejedly

bcc: David Jackson
Senator Nicholas Petris
John DeMouilly
Bill Kirschner

*Note: I AM ADVISED THAT THE
GOVERNOR HAS SIGNED THIS
BILL DAD*

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22 § 6. Such law is hereby amended by inserting therein a new sec-
23 tion, to be section two hundred fifty-four-b, to read as follows:

24 § 254-b. *Limitation on late charges.* 1. If a bond or note, or the
25 mortgage on real property, heretofore or hereafter made, improved
26 by a one to six family residence occupied by the owner, securing
27 the payment of same, or a note representing a loan for the purpose
1 of financing the purchase of an ownership interest in, and proprie-
2 tary lease from, a corporation or partnership formed for the pur-
3 pose of the cooperative ownership of residential real estate, contains
4 a provision whereby the mortgagee or lender retains the right to
5 collect a late charge on any instalment which has become due and
6 remains unpaid, such charge on any such delinquent instalment,
7 regardless of the period it remains in default, shall not exceed and
8 shall only be enforced to the extent of two percent of such delin-
9 quent instalment; provided, however, that no charge shall be
10 imposed on any instalment paid within fifteen days after the due
11 date. No such late charge shall be deducted from any regular instal-
12 ment payment by the mortgagor or borrower, but shall be sepa-
13 rately charged and collected by the mortgagee or lender. In the
14 absence of a specific provision in a bond, note or mortgage no late
15 charge on any delinquent instalment shall be assessed or collected.
16 The term "instalment" shall include amounts representing interest,
17 amortization of principal and payments in respect of insurance
18 premiums, taxes and utility charges if the bond, note or mortgage
19 provides for collection thereof by the mortgagee.

20 2. The provisions in this section shall not apply to any loan or
21 forbearance insured by the federal housing commissioner or for
22 which a commitment to insure has been made by the federal housing
23 commissioner or to any loan or forbearance insured or guaranteed
24 pursuant to the provisions of an act of congress entitled "Service-
25 men's Readjustment Act of 1944", or to the extent the provisions
26 of this section are inconsistent with any other federal law or regu-
27 lation.

AMENDED IN SENATE MARCH 26, 1974

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, 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.

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 *and for the treatment of such charges as a part of the principal at lender's election*. 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 if provisions re liquidating damages in such contracts exceed specified percentage of total purchase price, party seeking to enforce the provisions has burden of establishing reasonableness of the amount of such liquidated damages.* 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. Section 3319, relating to liquidated damages,
- 8 applies to a lease of real property.
- 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

1 real property.

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

7 (b) Except as provided in subdivision (c), a provision
8 in the loan contract imposing a late payment charge is
9 valid if it satisfies the requirements of ~~Sections 2954.5 and~~
10 *Section 2954.5 and is valid under Section 3319.*

11 (c) Where each of a majority of the installment
12 payments is less than five hundred dollars (\$500), a
13 provision in the loan contract imposing a late payment
14 charge is valid if it satisfies the requirements of Section
15 2954.5 and both of the following conditions:

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

28 (2) The amount of the late payment charge shall not
29 exceed 10 percent of the amount of principal and interest
30 included in the installment payment except that, where
31 the amount of principal and interest included in the
32 installment payment is less than fifty dollars (\$50), a
33 charge not to exceed five dollars (\$5) or 20 percent of the
34 amount of principal and interest included in the
35 installment payment, whichever is the lesser amount,
36 may be made.

37 (d) If the late payment charge referred to in
38 subdivision (c) is not paid within 40 days from the
39 scheduled due date of the delinquent installment
40 payment for which the charge was imposed, the lender

1 ~~may, at his option,~~ *shall* add the late payment charge to
2 the principal and thereafter charge interest on it at the
3 contract rate : ~~If the lender elects~~ *unless the lender gives*
4 *written notice to the borrower prior to the expiration of*
5 *such 40-day period of his election not to add the amount*
6 *of such late payment charge to the principal. Unless the*
7 *lender gives written notice to the borrower within such*
8 *40-day period of his election not to add the late payment*
9 *charge to principal, he cannot thereafter treat the failure*
10 *to pay the late payment charge as a default.*

11 (e) This section limits only the obligation of a
12 borrower to pay a late payment charge. Nothing in this
13 section excuses or defers the borrower's performance of
14 any other obligation incurred in the loan transaction, nor
15 does this section impair or defer the right of the lender
16 to enforce any other obligation, including, but not limited
17 to, the right to recover costs and expenses incurred in any
18 enforcement proceeding authorized by law. *The lender*
19 *shall accept any installment payments made by the*
20 *borrower and apply such payments as provided in this*
21 *section, but this requirement does not prevent the lender*
22 *from enforcing or continuing to enforce his rights against*
23 *the borrower or the security.*

24 (f) This section does not apply to loans made by a
25 credit union subject to the provisions of Division 5
26 (commencing with Section 14000) of the Financial Code,
27 by an industrial loan company subject to the provisions of
28 Division 7 (commencing with Section 18000) of the
29 Financial Code, or by a personal property broker subject
30 to the provisions of Division 9 (commencing with Section
31 22000) of the Financial Code.

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

34 3319. Except as otherwise provided by statute, a
35 provision in a contract liquidating the damages for
36 breach of a contractual obligation is valid unless the party
37 seeking to invalidate the provision establishes that it was
38 unreasonable under the circumstances existing at the
39 time of the making of the contract.

40 SEC. 7. Section 3320 is added to the Civil Code, to

1 read:

2 3320. (a) Subject to subdivision (b), a provision in a
3 contract for the sale of real property liquidating the
4 damages to the vendor if the purchaser fails to satisfy his
5 obligation to purchase the property is valid only if such
6 provision is separately signed or initialed by each party
7 and is valid under Section 3319. *If the amount specified*
8 *by the parties in the contract as liquidated damages is*
9 *greater than 5 percent of the total purchase price in the*
10 *contract, the burden is on the party seeking to enforce*
11 *the liquidated damages provision to establish that the*
12 *amount was reasonable under the circumstances existing*
13 *at the time of the making of the contract.*

14 (b) If the parties to a contract for the sale of real
15 property provide by a provision separately signed or
16 initialed by each party that all or any part of a deposit that
17 actually is made by the purchaser shall constitute
18 liquidated damages to the vendor if the purchaser fails to
19 satisfy his obligation to purchase the property, the
20 amount so specified by the parties as liquidated damages
21 shall be deemed to be reasonable and valid under Section
22 3319 if it does not exceed five percent of the total
23 purchase price in the contract. For the purposes of this
24 section, "deposit" includes but is not limited to a check
25 (including a postdated check), note, or other evidence of
26 indebtedness.

27 (c) The validity of the provision for liquidated
28 damages is determined under subdivision (a) rather than
29 under subdivision (b), and nothing in subdivision (b)
30 affects the validity of the liquidated damages provision, in
31 each of the following cases:

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

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

36 (3) Where the deposit actually made by the purchaser
37 is less than the amount specified as liquidated damages in
38 the contract.

39 (d) Nothing in this section affects the validity of any
40 provision in a contract for the sale of real property other

1 than a provision liquidating the damages to the vendor if
2 the purchaser fails to satisfy his obligation to purchase the
3 property.

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

6 SEC. 8. Section 3358 of the Civil Code is amended to
7 read:

8 3358. Nothing in this chapter authorizes a person to
9 recover a greater amount in damages for the breach of an
10 obligation than he could have gained, by the full
11 performance thereof on both sides, except in the cases
12 specified in the articles on exemplary damages and penal
13 damages, and in Sections 3319, 3320, 3339, and 3340.

14 SEC. 9. Section 14376 of the Government Code is
15 amended to read:

16 14376. Every contract shall contain a provision in
17 regard to the time when the whole or any specified
18 portion of the work contemplated shall be completed,
19 and shall provide that for each day completion is delayed
20 beyond the specified time, the contractor shall forfeit and
21 pay to the state a specified sum of money, to be deducted
22 from any payments due or to become due to the
23 contractor. A contract for a road project may also provide
24 for the payment of extra compensation to the contractor,
25 as a bonus for completion prior to the specified time, such
26 provision, if used, to be included in the specifications and
27 to clearly set forth the basis for such payment. Section
28 3319 of the Civil Code does not apply to contract
29 provisions under this section.

30 SEC. 10. Section 53069.85 of the Government Code is
31 amended to read:

32 53069.85. The legislative body of a city, county or
33 district may include or cause to be included in contracts
34 for public projects a provision establishing the time
35 within which the whole or any specified portion of the
36 work contemplated shall be completed. The legislative
37 body may provide that for each day completion is
38 delayed beyond the specified time, the contractor shall
39 forfeit and pay to such agency involved a specified sum
40 of money, to be deducted from any payments due or to

1 become due to the contractor. A contract for such a
2 project may also provide for the payment of extra
3 compensation to the contractor, as a bonus for
4 completion prior to the specified time. Such provisions,
5 if used, shall be included in the specifications upon which
6 bids are received, which specifications shall clearly set
7 forth the provisions. Section 3319 of the Civil Code does
8 not apply to contract provisions under this section.

O