

First Supplement to Memorandum 74-63

Subject: Study 72 - Liquidated Damages

This supplementary memorandum briefly discusses changes in the liquidated damages recommendation proposed by Mr. Ronald Denitz of Tishman Realty. A copy of Mr. Denitz's suggestions is attached (Exhibit I).

Mr. Denitz does not propose to change Section 3319, the general liquidated damages provision.

Mr. Denitz proposes several significant changes in Section 2954.6 concerning late payments. First, he proposes that the section be made applicable to late payment charges under a lease of real property.

Second, Mr. Denitz proposes to replace the 10-percent charge of subdivision (c)(2) with a provision that the late payment charge shall be "reasonably related to the probable bookkeeping and other non-litigation collection expenses of the creditor (except repossession costs) at the time of default." In theory this test is better than the automatically valid charge of up to 10 percent since probable bookkeeping and other non-litigation collection expenses (depending on what they are) should be less than 10 percent. However, this change would defeat the purpose of the Commission's recommended provision which is to avoid litigation by making charges of a certain amount automatically valid.

Labeling it "cumbersome," Mr. Denitz suggests deleting the procedure in Section 2954.6(d) for giving the borrower notice that the lender will not add the charge to principal--a condition precedent to treating the failure to pay the charge as a default. Mr. Denitz would leave the alternative of adding the charge to principal to contract provisions. The staff does not see his objection to the recommended provision nor do we believe the proposed change adequately deals with the question of what the lender can do if the borrower fails to pay the

late payment charge, particularly where the contract makes no provision concerning the matter.

Finally, Mr. Denitz suggests that liquidated damages in sales of real property provided by Section 3320 be automatically valid up to 10 percent whether the default is by the buyer or the seller. The staff thinks doubling the present five-percent figure is a move in the wrong direction; many feel that the five-percent figure is too high. The granting of an identical remedy to the buyer is not particularly useful, since the buyer is usually interested in specific performance, not damages. Mr. Denitz would also eliminate any requirement that the deposit be actually made. These suggested changes would do nothing to satisfy the objections of groups who opposed the bill.

Respectfully submitted,

Stan G. Ulrich
Legal Counsel



EXHIBIT I

(213) 477-1919

Tishman Realty & Construction Co., Inc.

WEST COAST HEADQUARTERS
10960 WILSHIRE BOULEVARD, LOS ANGELES, CALIFORNIA 90024

B-1 CONTRACTOR'S LICENSE NO. 170730

October 25, 1974

John H. DeMouilly, Esq.
Executive Secretary
California Law Revision Commission
School of Law
Stanford, California 94305

Re: Liquidated Damages

Dear John:

Today I received the Tentative Agenda for the November 14, 1974 Commission meeting, showing the captioned matter is to be considered at that time.

Preparatory to that consideration, enclosed is a copy of the ill-fated SB 1532, which I have marked up in order to hopefully make it more palatable to all concerned. You will note that my proposal would:

- (a) include rent in leases as "installment payments";
- (b) make the test of validity of liquidated damages re installment payments "reasonable relation at time of default" (rather than the earlier disputed dollar-certain formula);
- (c) remove a cumbersome portion of lines 1-11 on page 4, and
- (d) expand liquidated damages re real property sales to be validated up to 10% whether the default is by the Seller or Purchaser (rather than just the Purchaser).

Tishman Realty & Construction Co., Inc.

-2-

John H. DeMouilly, Esq.

October 25, 1974

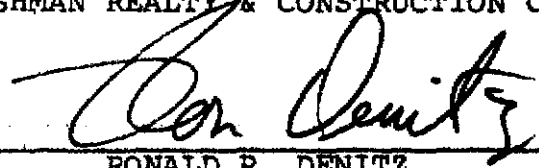
Although all of the above suggestions are of importance to us, my Firm feels that items (a) and (d) are the most essential.

With best personal regards, I am

Cordially,

TISHMAN REALTY & CONSTRUCTION CO., INC.

By



RONALD P. DENITZ

Assistant General Counsel

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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

1 due on a loan secured by a mortgage or deed of trust on
2 real property ~~OR~~ ^{OR A LEASE OF REAL PROPERTY.}

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

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

12 (c) Where each of a majority of the installment
13 payments is less than five hundred dollars (\$500), a
14 provision in the ~~loan~~ contract imposing a late payment
15 charge is valid if it satisfies the requirements of Section
16 2954.5 and both of the following conditions:

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

29 (2) The amount of the late payment charge shall ~~not~~ ^{BE}
30 exceed 10 percent of the amount of principal and interest ^{REASONABLY}
31 included in the installment payment except that, where ^{RELATED TO}
32 the amount of principal and interest included in the ^{THE PROBLE}
33 installment payment is less than fifty dollars (\$50), a ^{BOOKKEEPING}
34 charge not to exceed five dollars (\$5) or 20 percent of the ^{+ OTHER}
35 amount of principal and interest included in the ^{NON-LITIGATION}
36 installment payment, whichever is the lesser amount, ^{COLLECTION}
37 may be made. ^{EXPENSES OF}
^{THE CREDITOR}

38 (d) If the late payment charge referred to in ^{(EXCEPT}
39 subdivision (c) is not paid within 40 days from the ^{REPOSSESSION}
40 scheduled due date of the delinquent installment ^{COSTS)}
^{AT THE TIME OF}
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1 payment for which the charge was imposed, the lender
2 shall add the late payment charge to the principal and
3 thereafter charge interest on it at the contract rate, unless
4 the lender gives written notice to the borrower prior to
5 the expiration of such 40-day period of his election not to
6 add the amount of such late payment charge to the
7 principal. Unless the lender gives written notice to the
8 borrower within such 40-day period of his election not to
9 add the late payment charge to principal, he cannot
10 thereafter treat the failure to pay the late payment
11 charge as a default.

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

25 (f) This section does not apply to loans made by a
26 credit union subject to the provisions of Division 5
27 (commencing with Section 14000) of the Financial Code,
28 by an industrial loan company subject to the provisions of
29 Division 7 (commencing with Section 18000) of the
30 Financial Code, or by a personal property broker subject
31 to the provisions of Division 9 (commencing with Section
32 22000) of the Financial Code.

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

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

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

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

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

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

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

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

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

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(c) Nothing in this section affects the validity of any provision in a contract for the sale of real property other than a provision liquidating the damages to the vendor if the purchaser fails to satisfy his obligation to purchase the property.

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

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

3358. Nothing in this chapter authorizes a person to 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, 3320, 3339, and 3340.

SEC. 9. 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.

SEC. 10. 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

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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.

Tishman Realty & Construction Co., Inc.

WEST COAST HEADQUARTERS

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B-1 CONTRACTOR'S LICENSE NO. 170730

November 8, 1974

John H. DeMouilly, Esq.
Executive Secretary
California Law Revision Commission
School of Law
Stanford, California 94305

Re: Liquidated Damages

Dear John:

With all due respect to the opinions expressed in Memorandum 74-63 and its First Supplement, our firm urges that the following proposals of policy be circulated to the Commission prior to its November 14, 1974 meeting; the same are listed herein in the order of their importance.

1. The current law of liquidated damages (Civil Code Sections 1670, 1671 and case law thereunder) is manifestly inadequate, especially in the fields of real property sales and construction contracts. Therefore we urge that the Commission not "permanently drop" the topic of liquidated damages.

2. The Commission's Recommendation of December, 1973 (pp. 1225-1226) and Sec. 3320 of S.B. 1532 did not provide for liquidated damages to the purchaser of real property if the vendor fails to satisfy his obligation to sell. We believe such a "two-way street" is both commercially desirable and would also make the liquidated damages proposal more palatable to consumer-oriented groups.

3. We respectfully oppose the suggestion of Mr. Ulrich (Memo 74-63, pp. 1-2) that the burden of proof be placed upon the one seeking to enforce a liquidated damages provision. We believe that opposition in the Legislature can be overcome without requiring that the one asserting the liquidated damages provision, in effect, try to prove his actual losses in order to get the bargained-for liquidated sum. We believe the test of "reasonableness" in the Commission's general liquidated

Fishman Realty & Construction Co., Inc.

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-2-

November 8, 1974

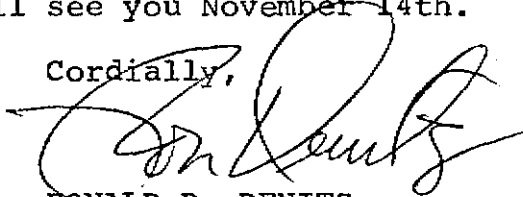
damages proposal (Sec. 3319) is a sufficient check on over-reaching, particularly in the field of real property sales, real property loans, and real property construction contracts.

4. The problem of opposition to S.B. 1532 seemed to center on the consumer credit area and appeared to result in various back-and-forth attempts to change the Commission's Section 2954.6 "late payment" proposals. Bearing in mind the virtual impotence of present Civil Code Sections 1670-71, we would rather see the Commission drop late payment charges altogether rather than see compromises made on crucial items such as the burden of proof. Such a revised Commission recommendation would consist of only a general section (much like Section 3319) and a section relating to real property sales.

5. Despite any opposition to automatic validation of 5% liquidated damages in real property sales, we believe that such a proposal is both commercially honest (in terms of real damages) and is actually practiced in today's market place. Perhaps practical considerations will ultimately dictate a compromise limiting the measure to 5% of deposits "actually made" (rather than also "clearly indicated"), but we urge that much unnecessary litigation over "reasonableness" can be avoided by retaining some kind of automatic validation provision.

As in the past, I appreciate your invitation to appear at the Commission's hearings and will see you November 14th.

Cordially,



RONALD P. DENITZ
Assistant General Counsel

RPD/svh