The Art of Drafting Settlement Agreements

The Inland Empire Bankruptcy Forum

with the support of Central California Bankruptcy Association,

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Orange County Bankruptcy Forum, and Los Angeles Bankruptcy Forum

Presents a Zoom Webinar

Panelists:
James C. Bastian, Jr. – Shulman Bastian Friedman & Bui
Christopher D. Beatty – Miller | Barondess
Sharon Z. Weiss – Bryan Cave Leighton Paisner

Moderator:
Richard A. Marshack – Marshack Hays

Date/Time:
Tuesday, Sept. 21, 2021 at 6:00pm

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SPEAKER BIOGRAPHIES:

James C. Bastian, Jr. – Shulman Bastian Friedman & Bui LLP

James C. Bastian, Jr., is a partner resident in the Irvine and Riverside offices. Mr. Bastian heads the firm's Bankruptcy and Reorganization Practice Areas and serves as the firm's Director of Marketing. Mr. Bastian joined the firm in 1995 after serving as a judicial law clerk for one year to the Honorable Kathleen Thompson, U.S. Bankruptcy Court judge for the Central District of California. Mr. Bastian received a Bachelor of Arts in political science from UCLA in 1991 and his Juris Doctor from Southwestern University School of Law in 1994.

Mr. Bastian has represented nearly every type of party in a Chapter 7 or Chapter 11 bankruptcy proceeding, including bankruptcy trustees, debtors-in-possession, creditors' committees, purchasers of assets, individual creditors, secured creditors, plaintiffs and defendants in avoidance actions, plaintiffs and defendants in discharge actions, directors and officers and interest holders. As lead counsel, Mr. Bastian has successfully confirmed over 25 plans of reorganization on behalf of Chapter 11 debtors. While based primarily in Southern California, Mr. Bastian has represented parties in interest in every district in the State of California and has been specially admitted to represent parties in over 10 additional jurisdictions nationwide.

Mr. Bastian also has extensive experience representing trustees, estate representatives and defendants in avoidance actions which arise in bankruptcy proceedings. Mr. Bastian has represented parties in hundreds of these matters, the overwhelming number of which settled before trial. Mr. Bastian also devotes a large part of his practice to out of court workouts and restructurings, helping dozens of companies and individuals avoid bankruptcy. Mr. Bastian has developed a niche practice of representing construction companies and their principals who are involved in public construction projects and are in financial distress.

Mr. Bastian also has utilized alternative dispute resolution and mediation to resolve these and other contested matters in bankruptcy proceedings and has mediated dozens of contested matters and adversary proceedings throughout his career, including serving as mediator to successfully resolve several matters. Mr. Bastian also serves on the panel of arbitrators with U.S. Arbitration and Mediation Midwest, Inc. Mr. Bastian has built a reputation as a consensus builder and analytical mediator who can break down each party's position on a given issue and provide an honest assessment of each party's strengths and weaknesses to drive them to a successful resolution and avoid costly litigation.

Over the years, Mr. Bastian has served as a panelist or moderator in over 30 Continuing Legal Education seminars. From 1997-2003, Mr. Bastian served on the board of directors for the Orange County Bankruptcy Forum, including serving as its youngest-ever president in 2002. Mr. Bastian also served on the board of directors of the California Bankruptcy Forum from 2000-2003. Mr. Bastian is a member of the American Bankruptcy Institute and the Orange County Bar Association Commercial Law and Bankruptcy Section.

Mr. Bastian has long been committed to community service dating back to when he received the Chancellor's Service Award while an undergraduate at UCLA. Currently, he is the Golf Committee chair and a member of the board of directors of the Mission Hospital Foundation, chairman of the board of directors of Lion's Heart, a national youth volunteer organization, a member of his local Rotary Club where he served as president in 2007-2008, is past president of the Bell Tower Foundation, and has served as a youth sports coach for over 25 years. Mr. Bastian is also active in helping to raise money for numerous charitable organizations, including the American Heart Association, Education for the Children, Pediatric Cancer Research Foundation, The Public Law Center and other organizations.

Christopher D. Beatty – Miller | Barondess LLP

Christopher Beatty has substantial trial and appellate litigation experience in both state and federal courts. He was recently recognized as one of the "Top 40 Lawyers Under 40" in California by the Daily Journal. He has extensive experience in litigation involving finance, startups, "business divorces," entertainment matters, real estate, insurance issues, bankruptcy, trusts and estates, family disputes, employment, intellectual property, and other complex business matters.

Prior to joining Miller Barondess, Chris was a litigation associate at Irell & Manella LLP and served as a law clerk to the Honorable Richard F. Suhrheinrich of the United States Court of Appeals for the Sixth Circuit.

Chris received his Juris Doctorate cum laude from the University of Michigan in 2009, where he was a Contributing Editor of the Michigan Law Review and President of the J. Reuben Clark Law Society. During law school, Chris worked as a law clerk at Federal Signal Corporation, the University of Michigan Office of the Vice President and General Counsel, and Irell & Manella. Chris received his B.A. in History from Brigham Young University in 2005.

Chris has an active pro bono practice, volunteers in his community, and serves as the Chair of the Los Angeles Chapter of the J. Reuben Clark Law Society. He lives in Santa Monica, California, with his wife and three children.

Sharon Z. Weiss – Bryan Cave Leighton Paisner LLP

Sharon Weiss brings an exceptional breadth of local, state, and national level bankruptcy community ties to her insolvency practice. Through these substantive relationships, including those with co-counsel, adversaries, and clients, Ms. Weiss has attained a base of experience from which she serves as a true client advocate. She offers her clients the personal attention and warmth of her small firm background combined with the added benefits of the firm's wide array of department resources.

Ms. Weiss has extensive experience in a wide area of insolvency matters from various perspectives, including representation of creditors, individual and corporate debtors, trustees, franchisors, and creditors' committees. She has served as lead trial counsel in bankruptcy and commercial litigation, including alternative dispute resolution, and has considerable experience in

handling fraud and Ponzi scheme litigation and bankruptcy appeals, which have resulted in published Ninth Circuit opinions. Her clients include parties engaged in banking, real estate, consumer electronics, healthcare, restaurant, garment, entertainment, and retail sales industries. Ms. Weiss has served as lead counsel in out-of-court workouts and in the bankruptcy courts in cases involving such varied issues as disputed asset sales, financing, secured creditor rights, the avoiding powers, executory contracts, pension plans, claims priority, plan confirmation, surcharges, and the court's inherent powers

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Ms. Weiss was recognized as one of the "Top Women Lawyers" in California by the Daily Journal in 2013 and as a notable practitioner in Chambers USA since 2012 in the California bankruptcy and restructuring practice area. She frequently speaks on panels regarding insolvency-related topics. Ms. Weiss has organized dozens of programs and panels and delivered presentations to industry groups such as the California Society of CPAs and The Alternative Board. She is also invited annually to speak to the Women in the Law Seminar Class at Southwestern University School of Law in Los Angeles, California.

Richard A. Marshack – Marshack Hays LLP

Richard A. Marshack is a founding member of the firm of Marshack Hays LLP and has been a bankruptcy attorney since 1982 (36 years). He is a frequent lecturer and presenter of seminars (over 50) on Bankruptcy and Commercial Law issues. Additionally, he has authored more than 20 articles and materials relating to the practice of law. Richard has two practices: serving as an attorney and as a professional fiduciary.

As an attorney, his focus is commercial matters arising in bankruptcy proceedings, such as representing debtor/businesses and creditors/creditor committees in reorganization proceedings and representing Bankruptcy Trustees.

As a professional fiduciary, he serves as a Chapter 7 and 11 Trustee. He has served as a Trustee since 1985 and has served as a Receiver, Examiner, Special Trustee for Probate Court, Chief Responsible Officer, Disbursing Agent and Provisional Director.

Richard is a graduate of the University of California, Irvine (1979) and California School of Law, Magna Cum Laude (1982). Thereafter, he served as Law Clerk to the Honorable Folger Johnson, Chief Judge of the United States Bankruptcy Court, District of Oregon, 1982- 1984. Richard has three adult sons. He enjoys cycling, hiking, exercise and traveling.

SCENARIO 1

Exec accused of negligent management of company
Company sues to oust exec and for $200K damages arising from alleged negligence
Exec to pay $150K within 3 months and company agrees not to disparage
If a default on payment terms, company entitled to a stipulated judgment for $300K entered by court
Exec agrees in settlement agreement his debt is nondischargeable in bankruptcy under Section 523(a)(4) of the Bankruptcy Code

SCENARIO 2

Retirees sue investment broker for fraud and contract breach
Broker demurs on fraud and settles contract breach claim
As part of a late-night mediation term sheet signed by all the parties, Broker agrees that he is liable to Retirees for $300K and agrees that he knowingly made a false statement regarding his investment activities on Retirees' behalf, that the Retirees reasonably relied on that statement, and that they suffered $300K damages as a result
If Broker pays settlement within 3 months, he only has to pay $100K. If not paid in full within 3 months, the amount owed is $300K.
Broker's counsel thought he had an agreement with Retirees' counsel that that the late-night term sheet was not complete.

SCENARIO 3

Developer and secured lender agree on a final extension of time and a date certain by which to find replacement financing or an adequate buyer or else the lender will foreclose.
As conditions for the extension, the secured lender demands and developer agrees to the following:
(A) All disputes regarding amounts owed, the nature and extent of any default, damages, and a right, if any, to cure defaults can only be resolved in arbitration
(B) If a bankruptcy is filed before the foreclosure is complete, Developer waives all defenses to a motion under 11 U.S.C. § 362

1. Liquidated Damages vs. Forbearance
    a. Liquidated Damages
        i. are compensation to be paid (1) in the event of a breach of contract, (2) the sum of which is fixed and certain by agreement, and (3) which may not ordinarily be modified or altered when damages actually result from nonperformance of the contract. Courts look beyond the language of the contract to determine the actual circumstances of a liquidated damages clause to determine its validity under Cal. Civ. Code § 1671(b).
        ii. must represent "the result of a reasonable endeavor by the parties to estimate a fair average compensation for any loss that may be sustained. Absent a relationship between the liquidated damages and the damages the parties anticipated would result from a breach, a liquidated damages clause will be construed as an unenforceable penalty." *Purcell v. Schweitzer*, 224 Cal. App. 4th 969, 974 (2014).
        iii. *See also Ridgley v. Topa Thrift & Loan Assn.*, 17 Cal. 4th 970, 977 (1998) ("The characteristic feature of a penalty is its lack of proportional relation to the damages which may actually flow from failure to perform under a contract.")
        iv. Recent case: *Graylee v. Castro*, 52 Cal. App. 5th 1107 (2020) (stipulated judgment for fixed amount as a result of debtors' late delivery of premises not in broom swept condition was an unenforceable penalty because there was no reasonable relationship in the agreement between the breach and the damages imposed as a result).
    b. Forbearance
        i. A forbearance agreement can be properly structured so as not to come under the unenforceable penalty liquidated damages analysis.
        ii. Example case: *Jade Fashion & Co., Inc. v. Harkham Industries, Inc.*, 229 Cal. App. 4th 635, 650 (2014) (Although a creditor cannot circumvent unenforceable penalty analysis simply by labeling a penalty as a discount, an agreement to forbear on collection of an indisputable debt due and owing provided that debtor makes timely payments is not a penalty.)
        iii. *Compare with Vitatech Internat., Inc. v. Sporn*, 16 Cal. App. 5th 796 (2017) (Forbearance was ruled an unenforceable penalty because a stipulated judgment for $303,000 was not to be entered unless debtors failed to pay the discounted amount of $75,000. Because the $303,000 had no reasonable relationship to the failure to timely pay the $75,000, it was an unenforceable penalty.)

California Court of Appeal in *Graylee v. Castro*, 52 Cal. App. 5th 1107 (2020) Distinguishes Between Liquidated Damages Provisions and True Forbearance Agreements:

Acknowledged Liability?	Discount?	Enforceable? (C.C.C. § 1671(b))
Yes	Yes	**Yes.** *Jade Fashion & Co., Inc. v. Harkham Industries, Inc.*, 229 Cal. App. 4th 635, 650 (2014) (true forbearance agreement)
No	Yes	**No.** *Vitatech Internat., Inc. v. Sporn*, 16 Cal. App. 5th 796 (2017) (penalty labeled as a forbearance agreement)
No	No	**No,** when the parties do not attempt to anticipate the damages that flow from breach of stipulation. *Greentree Financial Group, Inc. v. Execute Sports, Inc.*, 163 Cal. App. 4th 495 (2008) (penalty that rewards creditor upon default).

2. Collateral Estoppel Effect of Stipulated Judgment in Bankruptcy
    a. Can You Settle Around Litigating Nondischargeability? (11 U.S.C. § 523(a)(2)(A))
        i. YES – If the stipulated judgment contains the appropriate admissions. *Yang v. Fund Management International, LLC (In re Yang)*, 847 F. App'x 419 (9th Cir. Feb. 26, 2021)
            1. In a state court action for breach of contract and fraud, debtor stipulated to the facts alleged in a complaint against him, including fraud, and admitted liability for the facts and claims under Section 523 of the Bankruptcy Code.
            2. Bankruptcy court was upheld on its determination that the stipulated judgment had issue preclusive effect in the bankruptcy when:
                a. the court properly determined that the parties to the stipulation had, in fact, intended to binding in other proceedings. *See California State Auto. Assn. Inter-Ins. Bureau v. Superior Court*, 50 Cal. 3d 658, 664 (1990) (stipulated judgment may have issue preclusive effect when the parties manifest an intent to be collaterally bound by its terms); *see also Landeros v. Pankey*, 39 Cal. App. 4th 1167, 1174 (1995) (in determining intent, reviewing court should look for "language of comprehensive settlement," "releases of all claims," and "waivers under Civil Code section 1542 typically found in settlement documents.");

b. the stipulated judgment is an exception to the general rule against prepetition waivers of discharge because the underlying facts giving rise to liability under 523(a)(2)(A) were stipulated to, not just the judgment. *See In re Cole*, 226 B.R. 647, 651 (B.A.P. 9th Cir. 1998) ("[A] debtor may not contract away the right to a discharge in bankruptcy. However, a debtor may stipulate to the underlying facts that the bankruptcy court must examine to determine whether a debt is dischargeable."); and
c. the issue of fraud was actually and necessarily decided in the prior action.

ii. NO – If the stipulated judgment only summarily deals with nondischargeability or if the underlying action does not give rise to nondischargeability claims.

1. *See Bank of China v. Huang (In re Huang)*, 275 F.3d 1173, 1178 (9th Cir. 2002) (pre-petition settlement agreement including stipulated judgment and waiver of bankruptcy protection not given issue preclusive effect because settlement resolved non-fraud claims, no facts of fraud mentioned in agreement or judgment, defendant/debtor made no fraud admission).

3. Can You Effectively Enjoin a Future Bankruptcy Filing in a Settlement Agreement?
   a. NO, generally speaking. *Bank of China v. Huang (In re Huang)*, 275 F.3d 1173, 1177 (9th Cir. 2002) ("It is against public policy for a debtor to waive the prepetition protection of the Bankruptcy Code.").
   b. POSSIBLY, in a federal receivership context. *See United States v. Vulpis*, 961 F.2d 368, 371 (2d. Cir. 1992) ("[A] debtor who, in connection with his debt, has agreed to the appointment of a federal receiver may be enjoined from pursuing a bankruptcy proceeding.").
4. Can You Substitute Arbitration for Bankruptcy Jurisdiction?
   a. YES, in non-core proceedings. *Continental Ins. Co. v. Thorpe Insulation Co. (In re Thorpe Insulation Co.)*, 671 F.3d 1011, 1021 (9th Cir. 2012).
   b. MAYBE, in core proceedings, subject to the bankruptcy court's discretion when the arbitration provision conflicts with the underlying purposes of the Bankruptcy Code. *Id.*
5. Can You Settle Out the Imposition of an Automatic Stay?
   a. GENERALLY, NO - "The automatic stay provision is designed to protect both creditors and debtors, *see Dean v. Trans World Airlines*, 72 F.3d 754, 755-56 (9th Cir. 1995), and [Debtor] cannot waive the stay. *See* 11 U.S.C. § 362(a), (c)." *Guthrie v. Pacific Sec. Cos. (In re Guthrie)*, 1996 U.S. App. LEXIS 14657, *3-4 (9th Cir. May 29, 1996).
6. Can You Settle Out "Cause" for Relief from the Automatic Stay (11 U.S.C. § 362(d)(1))?
   a. YES, if approved in by a prior bankruptcy court – *See In re BGM Pasadena, LLC*, 2016 U.S. Dist. LEXIS 72825, *10-11 (C.D. Cal. June 2, 2016) (distinguishing between pre-bankruptcy and bankruptcy waivers of the automatic stay), but may still be subject to a 10-factor balancing on whether a pre-petition stay waiver should be applied, citing *In re Frye*, 320 B.R. 786, 790-791 (Bankr. D. Vt. 2005):

(1) the sophistication of the party making the waiver;
(2) the consideration for the waiver, including the creditor's risk and the length of time the waiver covers;
(3) whether other parties are affected including unsecured creditors and junior lienholders;
(4) the feasibility of the debtor's plan;
(5) whether there is evidence that the waiver was obtained by coercion, fraud or mutual mistake of material facts;
(6) whether enforcing the agreement will further the legitimate public policy of encouraging out of court restructurings and settlements;
(7) whether there appears to be a likelihood of reorganization;
(8) the extent to which the creditor would be otherwise prejudiced if the waiver is not enforced;
(9) the proximity in time between the date of the waiver and the date of the bankruptcy filing and whether there was a compelling change in circumstances during that time;
(10) whether the debtor has equity in the property and the creditor is otherwise entitled to relief from stay under § 362(d).

7. Can You Settle Around Claim Subordination?
    a. NO, in a shareholder context if attempting to re-characterize damages in connection with equity position as general unsecured debt. See 11 U.S.C. § 510(b). Even fraud claims in connection with the purchase or sale of securities in the debtor are subject to mandatory subordination. *Liquidating Trust Comm. of the Del Biaggio Liquidating Trust v. Freeman (In re Del Biaggio)*, 834 F.3d 1003, 1010-12 (9th Cir. 2016).
8. Can You Settle Around a DIP's Preference Powers?
    a. POSSIBLY, if waiver of claims is not effective until 91 days after payment. Can introduce a provision that if there is an intervening bankruptcy during the 90 day period between payment and waiver, that the waiver is not effective.
9. Can a Pre-Petition Mediation Term Sheet Be Enforced?
    a. YES, as a matter of applicable nonbankruptcy law. *See Facebook, Inc. v. Pac. Northwest Software, Inc.*, 640 F.3d 1034, 1037-38 (9th Cir. 2011) (enforcing partial term sheet even though settlement efforts eventually broke down over remaining terms) (internal citations omitted):
        i. [A] term may be "material" in one of two ways: It may be a necessary term, without which there can be no contract; or, it may be an important term that affects the value of the bargain. Obviously, omission of the former would render the contract a nullity. But a contract that omits terms of the latter type is enforceable under California law, so long as the terms it does include are sufficiently definite for a court to determine whether a breach has occurred, order specific performance or award damages. This is not a very demanding test . . . .
    b. YES and can be assumed under Section 365 of the Bankruptcy Code, if executory. *See In re Kennedy*, 2020 Bankr. LEXIS 3573, *10-11 (Bankr. C.D. Cal. Sept. 29, 2020).
    c. *But see*:

i. *City of L.A. v. Superior Court of L.A. Cnty.*, 51 Cal. 2d 423, 433 (1959) (no enforceable contract when the "essential element" of the promise is reserved for future agreement of both parties); and
ii. *See In re Safakish*, 2018 Bankr. LEXIS 3320, *5-6 (Bankr. N.D. Cal. Oct. 23, 2018) (debtor in a Chapter 13 case prevented from rejecting mediation term sheet because he had already repudiated it prepetition in an anticipatory breach).

10. California Civil Code Section 664.6
    a. Statute:

(a) If parties to pending litigation stipulate, in a writing signed by the parties outside of the presence of the court or orally before the court, for settlement of the case, **or part thereof**, the court, upon motion, may enter judgment pursuant to the terms of the settlement. If requested by the parties, the court may retain jurisdiction over the parties to enforce the settlement until performance in full of the terms of the settlement.

(b) For purposes of this section, a writing is signed by a party if it is signed by any of the following:

(1) The party.

(2) An attorney who represents the party.

(3) If the party is an insurer, an agent who is authorized in writing by the insurer to sign on the insurer's behalf.

(c) Paragraphs (2) and (3) of subdivision (b) do not apply in a civil harassment action, an action brought pursuant to the Family Code, an action brought pursuant to the Probate Code, or a matter that is being adjudicated in a juvenile court or a dependency court.

(d) In addition to any available civil remedies, an attorney who signs a writing on behalf of a party pursuant to subdivision (b) without the party's express authorization shall, absent good cause, be subject to professional discipline.

    b. Cases of Note:
        i. *Osumi v. Sutton*, 151 Cal. App. 4th 1355, 1360 (2007) (internal citations omitted) ("Section 664.6 permits the trial court judge to enter judgment on a settlement agreement without the need for a new lawsuit. It is for the trial court to determine in the first instance whether the parties have entered into an enforceable settlement.")
        ii. *Hines v. Lukes*, 167 Cal. App. 4th 1174, 1185 (2008) ("[A] party moving for the entry of judgment pursuant to a settlement under Code of Civil Procedure section 664.6 need not establish a breach of contract to support relief under the statute.")
        iii. *Sully-Miller Contracting Co. v. Gledson/Cashman Construction, Inc.*, 103 Cal. App. 4th 30, 37 (2002) ("Because of its summary nature, strict compliance with the requirements of section 664.6 is prerequisite to invoking the power of the court to impose a settlement agreement. The ad hoc addition of a party's signature that was neither contemplated in the

original document nor bargained for is simply insufficient to render the document enforceable under section 664.6.")

11. California Civil Code Section 998

(a) The costs allowed under Sections 1031 and 1032 shall be withheld or augmented as provided in this section.

(b) Not less than 10 days prior to commencement of trial or arbitration (as provided in Section 1281 or 1295) of a dispute to be resolved by arbitration, any party may serve an offer in writing upon any other party to the action to allow judgment to be taken or an award to be entered in accordance with the terms and conditions stated at that time. The written offer shall include a statement of the offer, containing the terms and conditions of the judgment or award, and a provision that allows the accepting party to indicate acceptance of the offer by signing a statement that the offer is accepted. Any acceptance of the offer, whether made on the document containing the offer or on a separate document of acceptance, shall be in writing and shall be signed by counsel for the accepting party or, if not represented by counsel, by the accepting party.

(1) If the offer is accepted, the offer with proof of acceptance shall be filed and the clerk or the judge shall enter judgment accordingly. In the case of an arbitration, the offer with proof of acceptance shall be filed with the arbitrator or arbitrators who shall promptly render an award accordingly.

(2) If the offer is not accepted prior to trial or arbitration or within 30 days after it is made, whichever occurs first, it shall be deemed withdrawn, and cannot be given in evidence upon the trial or arbitration.

(3) For purposes of this subdivision, a trial or arbitration shall be deemed to be actually commenced at the beginning of the opening statement of the plaintiff or counsel, or, if there is no opening statement, at the time of the administering of the oath or affirmation to the first witness, or the introduction of any evidence.

(c)

(1) If an offer made by a defendant is not accepted and the plaintiff fails to obtain a more favorable judgment or award, the plaintiff shall not recover his or her postoffer costs and shall pay the defendant's costs from the time of the offer. In addition, in any action or proceeding other than an eminent domain action, the court or arbitrator, in its discretion, may require the plaintiff to pay a reasonable sum to cover postoffer costs of the services of expert witnesses, who are not regular employees of any party, actually incurred and reasonably necessary in either, or both, preparation for trial or arbitration, or during trial or arbitration, of the case by the defendant.

(2)

(A) In determining whether the plaintiff obtains a more favorable judgment, the court or arbitrator shall exclude the postoffer costs.

(B) It is the intent of the Legislature in enacting subparagraph (A) to supersede the holding in Encinitas Plaza Real v. Knight, 209 Cal.App.3d 996, that attorney's fees awarded to the prevailing party were not costs for purposes of this section but were part of the judgment.

(d) If an offer made by a plaintiff is not accepted and the defendant fails to obtain a more favorable judgment or award in any action or proceeding other than an eminent domain action, the court or arbitrator, in its discretion, may require the defendant to pay a

reasonable sum to cover postoffer costs of the services of expert witnesses, who are not regular employees of any party, actually incurred and reasonably necessary in either, or both, preparation for trial or arbitration, or during trial or arbitration, of the case by the plaintiff, in addition to plaintiff's costs.

(e) If an offer made by a defendant is not accepted and the plaintiff fails to obtain a more favorable judgment or award, the costs under this section, from the time of the offer, shall be deducted from any damages awarded in favor of the plaintiff. If the costs awarded under this section exceed the amount of the damages awarded to the plaintiff the net amount shall be awarded to the defendant and judgment or award shall be entered accordingly.

(f) Police officers shall be deemed to be expert witnesses for the purposes of this section. For purposes of this section, "plaintiff" includes a cross-complainant and "defendant" includes a cross-defendant. Any judgment or award entered pursuant to this section shall be deemed to be a compromise settlement.

(g) This chapter does not apply to either of the following:

(1) An offer that is made by a plaintiff in an eminent domain action.

(2) Any enforcement action brought in the name of the people of the State of California by the Attorney General, a district attorney, or a city attorney, acting as a public prosecutor.

(h) The costs for services of expert witnesses for trial under subdivisions (c) and (d) shall not exceed those specified in Section 68092.5 of the Government Code.

(i) This section shall not apply to labor arbitrations filed pursuant to memoranda of understanding under the Ralph C. Dills Act (Chapter 10.3 (commencing with Section 3512) of Division 4 of Title 1 of the Government Code).

12. Enforceability of a Section 998 Offer
    a. Section 998 offers must provide some kind of instruction or indication as to how they can be accepted, utilizing a written acceptance that includes a signature of the offeree's counsel or the unrepresented offeree or they will not be enforceable. *Finlan v. Chase*, 2021 Cal. App. LEXIS 759, *2 (2021).

Tips for drafting / reviewing settlement agreements:

1) Make a term sheet first. Consider:
    a. Who is being released?
    b. What is being released?
    c. Are unknown claims released?
    d. Is it a mutual release?
    e. How will payments be made?
    f. Conditional or Unconditional?
    g. How will disputes be resolved?
    h. Attorney fees in the event of enforcement?
    i. Potential tax consequences?
    j. Interest on late payments?
    k. Injunctive relief in the event of a breach?
    l. Confidentiality

2) Read the settlement carefully and confirm against your term sheet that all terms are included (it is easy to think that a material term is in the document, and then it is not there).

3) Review scope of release.
    a. Release should not be effective for at least 91 days after payment of settlement funds.
    b. Preserve right to assert a claim in the event that one of the parties files bankruptcy if settlement is avoided.
    c. If risk of preference exposure, consider making settlement secured against collateral or payment from a third party.

4) Retain jurisdiction (with the bankruptcy court and/or mediator).

5) If settlement is subject to bankruptcy court approval, and you represent the other party, confirm effectiveness of settlement for both parties is subject to bankruptcy court approval, and not just the fiduciary.

6) Make sure you have the proper parties (instead of an affiliated company).

7) Start drafting the settlement agreement during the mediation. Do not start when you too tired.

8) If you cannot do a thorough and competent job do not try to document a settlement late at night. It can lead to malpractice.

9) Think through your releases. For example, if you represent a trustee you really want to give a limited release. Trustees operate on very limited information unlike a party who has had years of understanding the transaction. Make the release limited to the claim being litigated.

10) Always draft the settlement agreement. That way you can make sure all of your terms get included and when they make changes you will see what is important to them.

11) Come to mediation with a settlement agreement draft in hand, have a laptop available, if necessary, and be able to draft a settlement agreement at the mediation.

12) Don't tip your hand too early in mediation about having a draft settlement agreement in mind.

Caution
As of: September 21, 2021 5:32 PM Z

Purcell v. Schweitzer

Court of Appeal of California, Fourth Appellate District, Division One

February 24, 2014, Opinion Filed

D063435

Reporter
224 Cal. App. 4th 969 *; 169 Cal. Rptr. 3d 90 **; 2014 Cal. App. LEXIS 242 ***; 2014 WL 1004430

LENNOX A. PURCELL, Plaintiff and Appellant, v. MICHAEL SCHWEITZER, Defendant and Respondent.

Subsequent History: [*1]** The Publication Status of this Document has been Changed by the Court from Unpublished to Published March 17, 2014.

Prior History: APPEAL from a judgment of the Superior Court of San Diego County, No. 37-2009-00059423-CU-BC-NC, Earl H. Maas III, Judge.

Purcell v. Schweitzer, 2014 Cal. App. Unpub. LEXIS 1242 (Cal. App. 4th Dist., Feb. 24, 2014)

Disposition: Affirmed.

Core Terms

damages, parties, default judgment, settlement agreement, unenforceable penalty, no reasonable relation, anticipated, lawsuit, liquidated damages, public policy, installments, defaulted, costs, bore

Case Summary

Procedural Posture
In an action arising out of a promissory note in the amount of $85,000, defendant debtor moved to set aside a default judgment entered against him. The San Diego County Superior Court, California, set aside the default judgment, finding that it constituted an unenforceable penalty. Plaintiff appealed.

Overview

The court concluded that the stipulation that allowed for entry of judgment in the amount of almost $60,000 was an unenforceable penalty under *Civ. Code, § 1671*, because the underlying settlement was for $38,000. The stipulation bore no reasonable relationship to the damages that it could be expected that plaintiff would suffer as a result of a breach by defendant. This was shown by the payment plan itself, which provided that defendant would make payments of $750 per month. Indeed, plaintiff suffered no damages at all because judgment was entered on October 17, 2011, after payment was accepted on October 11, 2011. Plaintiff's contention that the $85,000 amount reflected the economics associated with "proceeding further" with the lawsuit was unavailing. There was nothing in the record to support the fact that obtaining a judgment and instituting postjudgment procedures would cost $85,000. The language in the stipulation seeking to tie the $85,000 to the economics of proceeding further with the matter was an obvious attempt to circumvent the public policy expressed in *§ 1671*.

Outcome
The order setting aside the default judgment was affirmed.

LexisNexis® Headnotes

Civil Procedure > Appeals > Standards of Review > De Novo Review

Civil Procedure > Appeals > Standards of Review > Questions of Fact & Law

HN1[] **Standards of Review, De Novo Review**

Where the appellate court is presented with a question of law on undisputed facts, its review is de novo.

Contracts Law > Contract Conditions &

Provisions > General Overview

Contracts Law > ... > Damages > Types of Damages > Liquidated Damages

HN2 **Contracts Law, Contract Conditions & Provisions**

A provision in a contract liquidating the damages for the breach of the contract is valid unless the party seeking to invalidate the provision establishes that the provision was unreasonable under the circumstances existing at the time the contract was made. *Civ. Code, § 1671, subd. (b)*. However, a liquidated damages clause becomes an unenforceable penalty if it bears no reasonable relationship to the range of actual damages that the parties could have anticipated would flow from a breach. The amount set as liquidated damages must represent the result of a reasonable endeavor by the parties to estimate a fair average compensation for any loss that may be sustained. Absent a relationship between the liquidated damages and the damages the parties anticipated would result from a breach, a liquidated damages clause will be construed as an unenforceable penalty.

Contracts Law > Contract Conditions & Provisions > General Overview

Contracts Law > ... > Damages > Types of Damages > Liquidated Damages

HN3 **Contracts Law, Contract Conditions & Provisions**

The public policy expressed in *Civ. Code, §§ 1670* & *1671*, may not be circumvented by words used in a contract; that whether or not a particular clause is a penalty or forfeiture or a bona fide provision for liquidated damages depends upon the actual facts existing at the time the contract is executed and whether or not, in fact, it was then impracticable or extremely difficult to fix actual damages and that the parties did in fact then make a good faith and reasonable effort to do so; that a litigant seeking the benefits of a clause purporting to fix liquidated damages must plead and prove that the clause is valid under the facts which then existed. The applicability of *§ 1671* depends upon the actual facts not the words which may have been used in the contract.

Civil Procedure > Remedies > Damages > Punitive Damages

Contracts Law > ... > Damages > Types of Damages > Punitive Damages

HN4 **Damages, Punitive Damages**

Punitive damages are not recoverable in breach of contract actions.

Headnotes/Summary

Summary

CALIFORNIA OFFICIAL REPORTS SUMMARY

In an action arising out of a promissory note in the amount of $85,000, defendant moved to set aside a default judgment entered against him. The trial court set aside the default judgment, finding that it constituted an unenforceable penalty. (Superior Court of San Diego County, No. 37-2009-00059423-CU-BC-NC, Earl H. Maas III, Judge.)

The Court of Appeal affirmed the order setting aside the default judgment. The court concluded that the stipulation that allowed for entry of judgment in the amount of almost $60,000 was an unenforceable penalty under *Civ. Code, § 1671*, because the underlying settlement was for $38,000. The stipulation bore no reasonable relationship to the damages that it could be expected that plaintiff would suffer as a result of a breach by defendant. This was shown by the payment plan itself, which provided that defendant would make payments of $750 per month. Indeed, plaintiff suffered no damages at all because judgment was entered on October 17, 2011, after payment was accepted on October 11, 2011. Plaintiff's contention that the $85,000 amount reflected the economics associated with “proceeding further” with the lawsuit was unavailing. There was nothing in the record to support the fact that obtaining a judgment and instituting postjudgment procedures would cost $85,000. The language in the stipulation seeking to tie the $85,000 to the economics of proceeding further with the matter was an obvious attempt to circumvent the public policy expressed in *§ 1671*. (Opinion by Nares, Acting P. J., with Haller and McDonald, JJ., concurring.)

Headnotes

CALIFORNIA OFFICIAL REPORTS HEADNOTES

CA(1)[] (1)

Contracts § 45—Actions—Liquidated Damages—Unenforceable Penalty—Reasonable Relationship.

A provision in a contract liquidating the damages for the breach of the contract is valid unless the party seeking to invalidate the provision establishes that the provision was unreasonable under the circumstances existing at the time the contract was made (*Civ. Code, § 1671, subd. (b)*). However, a liquidated damages clause becomes an unenforceable penalty if it bears no reasonable relationship to the range of actual damages that the parties could have anticipated would flow from a breach. The amount set as liquidated damages must represent the result of a reasonable endeavor by the parties to estimate a fair average compensation for any loss that may be sustained. Absent a relationship between the liquidated damages and the damages the parties anticipated would result from a breach, a liquidated damages clause will be construed as an unenforceable penalty.

CA(2)[] (2)

Contracts § 45—Actions—Liquidated Damages—Public Policy.

The public policy expressed in *Civ. Code, §§ 1670* & *1671*, may not be circumvented by words used in a contract; that whether or not a particular clause is a penalty or forfeiture or a bona fide provision for liquidated damages depends upon the actual facts existing at the time the contract is executed and whether or not, in fact, it was then impracticable or extremely difficult to fix actual damages and that the parties did in fact then make a good faith and reasonable effort to do so; that a litigant seeking the benefits of a clause purporting to fix liquidated damages must plead and prove that the clause is valid under the facts which then existed. The applicability of *§ 1671* depends upon the actual facts, not the words which may have been used in the contract.

CA(3)[] (3)

Contracts § 45—Actions—Liquidated Damages—Unenforceable Penalty—Reasonable Relationship.

In an action arising out of a promissory note, a stipulation that allowed for entry of judgment in the amount of almost $60,000 was an unenforceable penalty under *Civ. Code, § 1671*, because the underlying settlement was for $38,000. The stipulation bore no reasonable relationship to the damages that it could be expected that plaintiff would suffer as a result of a breach by defendant.

[*Cal. Forms of Pleading and Practice (2013) ch. 177, Damages, § 177.78*; 1 Witkin, Summary of Cal. Law (10th ed. 2005) Contracts, § 505.]

CA(4)[] (4)

Contracts § 45—Actions—Punitive Damages.

Punitive damages are not recoverable in breach of contract actions.

Counsel: **[*971]** Soden & Steinberger, Robert J. Steinberger, Jason W. Cobberly; Boudreau Williams and Jon R. Williams for Plaintiff and Appellant.

The Perry Law Firm, Michael R. Perry, Larry M. Roberts and Michelle A. Hoskinson for Defendant and Respondent.

Judges: Opinion by Nares, Acting P. J., with Haller and McDonald, JJ., concurring.

Opinion by: Nares, Acting P. J.

Opinion

[92]**

NARES, Acting P. J.—This action arises out of a promissory note in the amount of $85,000 given by defendant Michael Schweitzer to plaintiff Lennox A. Purcell. After Schweitzer defaulted on the promissory note, Purcell brought a lawsuit seeking to recover the monies he had loaned him. The parties settled the action, with Schweitzer agreeing to pay the sum of $38,000, along with interest at the rate of 8.5 percent, in installments over 24 months. The settlement agreement also provided that payments were due on the first day of each month. To be considered timely, payment had to be received no later than the fifth day **[***2]** of the month. Of relevance to this appeal, the agreement provided that if a payment was not made on time, it was considered a breach of the entire settlement agreement,

making the entire original liability of $85,000 due. The agreement also specified that that provision did not constitute an unlawful "penalty" or "forfeiture."

When Schweitzer was late on a payment, Purcell sought and was granted a default judgment in the amount of $58,829.35. Schweitzer thereafter brought a motion to set aside the default judgment, asserting the default judgment was the result of an unlawful penalty. The court set aside the default judgment, finding that it constituted an unenforceable penalty because the amount of the judgment bore no reasonable relationship to the amount of damages Purcell would actually suffer as a result of Schweitzer's breach.

Purcell appeals, asserting the court erred in setting aside the judgment because (1) Schweitzer waived his right to challenge the judgment on any grounds and (2) the judgment did not constitute an unenforceable penalty because it fairly represented the amount of his damages. We affirm.[1]

[*972]

FACTUAL AND PROCEDURAL BACKGROUND

A. *The Original Lawsuit and Settlement*

In September 2009 Purcell brought a lawsuit against Schweitzer and others to recover the money he loaned them. In March 2010 Schweitzer signed a settlement agreement with Purcell. Pursuant to that agreement, Schweitzer agreed to pay Purcell the sum of $38,000, along with interest on the unpaid principal at the rate of 8.5 percent in installments over 24 months. Monthly payments by Schweitzer then began on April 1, 2010, with a balloon payment of all remaining principal and accrued interest due on April 1, 2012. Schweitzer was to make an initial payment of $20,000, with monthly payments of $750 occurring thereafter. The payments Schweitzer made under the payment plan ranged from $750 to $1,332.58.

The settlement agreement also provided that all payments by Schweitzer were due on the first day of **[***4]** each month and considered **[**93]** late if not actually received by the fifth calendar day of the month. Moreover, the settlement agreement provided that in the event of such a breach, a judgment for the full amount of Schweitzer's original liability of $85,000 could be entered against him. The stipulation for entry of judgment attached to the settlement agreement further provided that the $85,000 "is an agreed upon amount of monies actually owed, jointly and severally, by the Defendant [(Schweitzer)] to the Plaintiff [(Purcell)] and *is neither a penalty nor is it a forfeiture*." (Italics added.) That section also provided that the $85,000 took into consideration "the economics associated with proceeding further with this matter, including but not limited to: [¶] (1) A fully performed settlement; [¶] (2) Limiting the continuing attorneys' fees and costs relating to litigation; [¶] (3) Limiting attorneys' fees and costs relating to post-judgment procedures, including without limitation debtor examinations, debtor and asset searches, levies, writs, assignments and sister-state judgments; [¶] (4) Elimination of uncertainties relating to collection of a Judgment in contrast to a full, voluntary payment **[***5]** and performance by Defendant; and [¶] (5) Support for the public policy of judicial economy."

Finally, the agreement provided that Schweitzer waived any right to an appeal and any right to contest or otherwise set aside the judgment whether pursuant to *Civil Code*[2] *section 3275* "or otherwise."

B. *The Second Default Judgment*

In October 2011 Schweitzer failed for the first time to make a monthly payment on time, paying it on October 11 instead of October 5. Purcell accepted that payment, even though it was late.

[*973]

Nevertheless, Purcell applied for entry of judgment, and judgment was thereafter entered on October 17, 2011, in the amount of $58,829.35, with $58,101.85 of that amount identified as consisting of "punitive damages."

Thereafter, Schweitzer continued to make payments pursuant to the stipulated payment plan, making monthly payments in November and December 2011. The December payment was the last payment due.

According to Schweitzer, he was informed by Purcell's attorney in August 2012 that there was a balance remaining on the payment plan of $67.42. Purcell denies that he or his attorney ever said the balance due was **[***6]** $67.42. Rather, Purcell states that the

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[1] Schweitzer asserts that the appeal should be dismissed because Purcell **[***3]** failed to comply with ***California Rules of Court, rule 8.204(a)(2)(B)*** by failing to explain why the appealed from order is appealable. However, Purcell has cured that defect in his reply brief explaining that an order setting aside a judgment is appealable under *Code of Civil Procedure section 904.1, subdivision (a)(2)*.

[2] All further undesignated statutory references are to the Civil Code.

balance was $1,776.58 and supports this contention by pointing out that Schweitzer paid that amount in August 2012. Payment of that balance was accepted by Purcell. Thus, as of August 2012, the settlement had been paid in full.

C. *Motion to Set Aside Default Judgment*

Schweitzer thereafter brought a motion to set aside the second default judgment. In that motion Schweitzer asserted that the stipulation and subsequently entered judgment represented an unlawful penalty for his breach of the settlement agreement.

Purcell opposed that motion, arguing the parties' agreement anticipated strict compliance by Schweitzer and materially differed from other installment agreements inasmuch as Schweitzer had expressly agreed that if he defaulted, the full amount would be due and was not a penalty or a forfeiture. Purcell further asserted that the parties also agreed that the full amount of the judgment was the actual **[**94]** amount of Purcell's damages, that Schweitzer expressly waived his right to challenge that amount by moving to set aside or appealing the judgment, and that such a waiver was fully enforceable and should be enforced by the court.

D. *Court's Order*

The **[***7]** court granted the motion to set aside the default judgment, finding the damages sought by Purcell bore no rational relationship to the damages Purcell would actually suffer as a result of Schweitzer's breach. The court further found Schweitzer's waiver was unenforceable as against public policy.
[*974]

DISCUSSION

I. *STANDARD OF REVIEW*

HN1[] Because we are presented with a question of law on undisputed facts, our review is de novo. (*Harbor Island Holdings v. Kim (2003) 107 Cal.App.4th 790, 794 [132 Cal. Rptr. 2d 406]*.)

II. *ANALYSIS*

HN2[] ***CA(1)***[] **(1)** "[A] provision in a contract liquidating the damages for the breach of the contract is valid *unless the party seeking to invalidate the provision establishes that the provision was unreasonable under the circumstances existing at the time the contract was made*." (*§ 1671, subd. (b)*, italics added.)

However, a liquidated damages clause becomes an unenforceable penalty "if it bears no reasonable relationship to the range of actual damages that the parties could have anticipated would flow from a breach." (*Ridgley v. Topa Thrift & Loan Assn. (1998) 17 Cal.4th 970, 977 [73 Cal. Rptr. 2d 378, 953 P.2d 484]*.) "The **[**95]** amount set as liquidated damages 'must represent the result of a reasonable endeavor by the parties to estimate a fair average compensation **[***8]** for any loss that may be sustained.'" (*Ibid*.) "Absent a relationship between the liquidated damages and the damages the parties anticipated would result from a breach, a liquidated damages clause will be construed as an unenforceable penalty." (*Morris v. Redwood Empire Bancorp (2005) 128 Cal.App.4th 1305, 1314 [27 Cal. Rptr. 3d 797]*.)

Greentree Financial Group. Inc. v. Execute Sports, Inc. (2008) 163 Cal.App.4th 495 [78 Cal. Rptr. 3d 24] (*Greentree*) is instructive. The plaintiff brought an action for breach of contract against the defendant, alleging the defendant failed to pay $45,000 due under the contract. The parties settled the action, which was memorialized in a stipulation for entry of judgment. The stipulation provided the defendant would pay a total of $20,000 in two installments, but if the defendant defaulted, the plaintiff was entitled to have judgment entered against the defendant for the full amount prayed for in the complaint. After the defendant defaulted on the first installment payment of $15,000, the plaintiff succeeded in having a judgment entered for $61,232, consisting of $45,000 in damages, $13,912 in prejudgment interest, $2,000 in attorney fees, and $320 in costs. (*Id. at p. 498*.)

In reversing and directing the trial court to **[***9]** reduce the judgment to $20,000, the Court of Appeal concluded the stipulated judgment amount constituted an unenforceable penalty under *section 1671*. (*Greentree, supra, 163 Cal.App.4th at pp. 500–501*.)

The *Greentree* court further explained that under *section 1671, subdivision (b)*, a liquidated damages clause constitutes an unenforceable penalty "'if it **[*975]** bears no reasonable relationship to the range of actual damages that the parties could have anticipated would flow from a breach. The amount set as liquidated damages "must represent the result of a reasonable endeavor by the parties to estimate a fair average compensation for any loss that may be sustained." [Citation.] In the absence of such relationship, a contractual clause purporting to predetermine damages "must be construed as a penalty."'" (*Greentree, supra, 163 Cal.App.4th at p. 499*.)

Further, the relevant breach to be analyzed "is the breach of the *stipulation*, not the breach of the *underlying contract*." (*Greentree, supra, 163 Cal.App.4th at p. 499*.) In *Greentree*, the stipulation provided for payment of $20,000. But rather than attempting to anticipate the possible damages resulting from breach of the *stipulation*, the parties **[***10]** had designated the full amount claimed as damages in the underlying lawsuit. The Court of Appeal concluded the $61,232 judgment bore "no reasonable relationship to the range of actual damages the parties could have anticipated from a breach of the stipulation to settle the dispute for $20,000. '[D]amages for the withholding of money are easily determinable—i.e., interest at prevailing rates … .' [Citation.] The amount of the judgment, however, was more than triple the amount for which the parties agreed to settle the case." (*Id. at p. 500*.)

Purcell attempts to distinguish the *Greentree* case on the basis that the Court of Appeal there was not confronted with a situation where the defendant provided an "express waiver" of any challenges to the stipulated judgment "on any basis." He also asserts that the parties agreed that the amount of the stipulated judgment reflected the economics of proceeding further with the matter.

CA(2)[↑] **(2)** However, ***HN3***[↑] "the public policy expressed in *Civil Code sections 1670* and *1671 may not be circumvented by words used in a contract*; that whether or not a particular clause is a penalty or forfeiture or a bona fide provision for liquidated damages depends upon the actual **[***11]** facts existing at the time the contract is executed and whether or not, in fact, it was then impracticable or extremely difficult to fix actual damages and that the parties did in fact then make a good faith and reasonable effort to do so; that a litigant seeking the benefits of a clause purporting to fix liquidated damages must plead and prove that the clause is valid under the facts which then existed. The applicability of *Civil Code section 1671* depends upon the actual facts *not the words which may have been used in the contract*." (*Cook v. King Manor and Convalescent Hospital (1974) 40 Cal.App.3d 782, 792 [115 Cal. Rptr. 471]*, italics added.)

CA(3)[↑] **(3)** Here, the stipulation that allowed for entry of judgment in the amount of almost $60,000 was likewise an unenforceable penalty because the underlying settlement was for $38,000. The stipulation bore no reasonable relationship to the damages that it could be expected that Purcell would suffer as a **[*976]** result of a breach by Schweitzer. This is shown by the payment plan itself, which provided that Schweitzer would make payments of $750 per month. Indeed, Purcell suffered no damages at all because judgment was entered on October 17, *after* payment was accepted on October **[***12]** 11.

Purcell's contention that the $85,000 amount reflected the economics associated with "proceeding further" with the lawsuit is also unavailing. That provision in the settlement agreement bore no reasonable relationship to damages he would be expected to actually suffer as a result of a breach, such as the late payment that occurred in this case. There is nothing in the record to support the fact that obtaining a judgment and instituting postjudgment **[**96]** procedures would cost $85,000. Moreover, Purcell entered a default judgment for alleged "punitive damages," not for costs associated with pursuing the lawsuit.

The language in the stipulation seeking to tie the $85,000 to the economics of proceeding further with the matter was an obvious attempt to circumvent the public policy expressed in *section 1761*. However, as discussed, *ante*, that public policy may not be circumvented by words used in a contract. (*Cook v. King Manor and Convalescent Hospital, supra, 40 Cal.App.3d at p. 792*.)

CA(4)[↑] **(4)** Finally, the judgment was improperly entered as "punitive damages." ***HN4***[↑] Punitive damages are not recoverable in breach of contract actions. (*Myers Building Industries, Ltd. v. Interface Technology, Inc. (1993) 13 Cal.App.4th 949, 960 [17 Cal. Rptr. 2d 242]*.)

DISPOSITION

The **[***13]** order setting aside the default judgment is affirmed. Respondent shall recover his costs on appeal.

Haller, J., and McDonald, J., concurred.

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As of: September 21, 2021 5:32 PM Z

Jade Fashion & Co., Inc. v. Harkham Industries, Inc.

Court of Appeal of California, Second Appellate District, Division Seven

August 18, 2014, Opinion Filed

B248432

Reporter
229 Cal. App. 4th 635 *; 177 Cal. Rptr. 3d 184 **; 2014 Cal. App. LEXIS 807 ***

JADE FASHION & CO., INC., Plaintiff and Respondent, v. HARKHAM INDUSTRIES, INC., et al., Defendants and Appellants.

Subsequent History: [*1]** The Publication Status of this Document has been Changed by the Court from Unpublished to Published September 8, 2014.

Prior History: APPEAL from a judgment of the Superior Court of Los Angeles County, No. BC479461, James R. Dunn, Judge.

Jade Fashion & Co. v. Harkham Indus., 2014 Cal. App. Unpub. LEXIS 5785 (Cal. App. 2d Dist., Aug. 18, 2014)

Disposition: Affirmed.

Core Terms

trial court, discount, installment payment, parties, damages, summary judgment motion, installments, weekly, summary judgment, declaration, forfeiture, triable, matter of law, undisputed, extrinsic evidence, continuance, default, actual damage, settlement, terms, unenforceable penalty, principal balance, attorney's fees, deposition, lender, breach of contract claim, entitled to judgment, weekly payments, unclean hands, common count

Case Summary

Overview
HOLDINGS: [1]-As a matter of law, a discount provision in an agreement between a buyer and a seller regarding the repayment of a debt was not an unenforceable penalty or forfeiture because the buyer remained liable to the seller for the full amount of its debt, given that it failed to fully perform under the agreement by paying five installments late; [2]-A provision in the agreement that "time was of the essence" with respect to each installment payment was unambiguous, as it clearly and explicitly stated that the buyer would not be entitled to the discount if it failed to fully and timely pay each installment when due; [3]-Because the seller's procurement and retention of a $30,000 overpayment did not result in any prejudice to the buyer, given that the seller agreed to credit the overpayment to the balance owed by the buyer under the agreement, the unclean hands defense did not apply.

Outcome
Judgment affirmed.

LexisNexis® Headnotes

Civil Procedure > ... > Summary Judgment > Entitlement as Matter of Law > General Overview

Civil Procedure > ... > Summary Judgment > Burdens of Proof > Movant Persuasion & Proof

Civil Procedure > ... > Summary Judgment > Burdens of Proof > Nonmovant Persuasion & Proof

HN1[] **Summary Judgment, Entitlement as Matter of Law**

The party moving for summary judgment bears the burden of persuasion that there is no triable issue of material fact and that he is entitled to judgment as a matter of law. Once the movant has met that burden, the burden shifts to the other party to show that a triable issue of one or more material facts exists as to that cause of action. *Code Civ. Proc., § 437c, subd. (p)(2)*.

The party opposing summary judgment may not rely upon the mere allegations or denials of its pleadings, but rather shall set forth the specific facts showing that a triable issue of material fact exists. *§ 437c, subd. (p)(2)*. A triable issue of material fact exists where the evidence would allow a reasonable trier of fact to find the underlying fact in favor of the party opposing the motion in accordance with the applicable standard of proof.

Civil Procedure > Judgments > Summary Judgment > Evidentiary Considerations

Civil Procedure > Appeals > Summary Judgment Review > Standards of Review

***HN2*[] Summary Judgment, Evidentiary Considerations**

Where summary judgment has been granted, an appellate court reviews the trial court's ruling de novo. The appellate court considers all the evidence presented by the parties in connection with the motion (except that which was properly excluded) and all the uncontradicted inferences that the evidence reasonably supports. The appellate court affirms summary judgment where it is shown that no triable issue of material fact exists and the moving party is entitled to judgment as a matter of law. *Code Civ. Proc., § 437c, subd. (c)*. The decision whether to grant a continuance under *§ 437c, subd. (h)*, is reviewed for an abuse of discretion.

Civil Procedure > Appeals > Record on Appeal

Evidence > Inferences & Presumptions > Presumptions > Particular Presumptions

***HN3*[] Appeals, Record on Appeal**

The California Rules of Court require an appellant who elects to proceed by appendix to include, among other things, any document filed in the trial court that is necessary for proper consideration of the issues, including any item that the appellant should reasonably assume the respondent will rely on. *Cal. Rules of Court, rule 8.124(b)(1)(B)*. An appealed judgment or order is presumed correct. All intendments and presumptions are indulged to support it on matters as to which the record is silent, and error must be affirmatively shown. To overcome this presumption, the appellant must provide an adequate appellate record demonstrating error. A necessary corollary to this rule is that a record is inadequate if the appellant predicates error only on the part of the record he or she provides the trial court, but ignores or does not present to the appellate court portions of the proceedings below that may provide grounds upon which the decision of the trial court could be affirmed. Where the appellant fails to provide an adequate record of the challenged proceedings, the appellate court must presume that the appealed judgment or order is correct, and on that basis, affirm.

Business & Corporate Compliance > ... > Breach > Breach of Contract Actions > Elements of Contract Claims

***HN4*[] Breach of Contract Actions, Elements of Contract Claims**

To establish a cause of action for breach of contract, the plaintiff must plead and prove (1) the existence of the contract, (2) the plaintiff's performance or excuse for nonperformance, (3) the defendant's breach, and (4) resulting damages to the plaintiff.

Contracts Law > Contract Conditions & Provisions > General Overview

Contracts Law > ... > Damages > Types of Damages > Liquidated Damages

Contracts Law > Contract Interpretation > General Overview

***HN5*[] Contracts Law, Contract Conditions & Provisions**

Under *Civ. Code, § 1671*, a provision in a contract liquidating the damages for the breach of the contract is valid unless the party seeking to invalidate the provision establishes that the provision was unreasonable under the circumstances existing at the time the contract was made. *Civ. Code, § 1671, subd. (b)*. A liquidated damages clause will generally be considered unreasonable, and hence unenforceable under *§ 1671 subd. (b)*, if it bears no reasonable relationship to the range of actual damages that the parties could have anticipated would flow from a breach. The amount set as liquidated damages must represent the result of a

reasonable endeavor by the parties to estimate a fair average compensation for any loss that may be sustained. In the absence of such relationship, a contractual clause purporting to predetermine damages must be construed as a penalty. Whether an amount to be paid upon breach is to be treated as liquidated damages or as an unenforceable penalty is a question of law.

Contracts Law > ... > Damages > Types of Damages > Liquidated Damages

Contracts Law > Defenses > Public Policy Violations

HN6[] Types of Damages, Liquidated Damages

Parties to a contract may not circumvent the public policies embodied in Civ. Code, § 1671, merely by labeling a penalty a discount.

Civil Procedure > Remedies > Forfeitures > General Overview

Contracts Law > Remedies > General Overview

HN7[] Remedies, Forfeitures

Civ. Code, § 3275, provides that whenever, by the terms of an obligation, a party thereto incurs a forfeiture, or a loss in the nature of a forfeiture, by reason of his or her failure to comply with its provisions, the party may be relieved therefrom, upon making full compensation to the other party, except in case of a grossly negligent, willful, or fraudulent breach of duty.

Contracts Law > Remedies > Damages > Types of Damages

HN8[] Damages, Types of Damages

The characteristic feature of a penalty is its lack of proportional relation to the damages that may actually flow from failure to perform under a contract.

Contracts Law > Contract Interpretation > Ambiguities & Contra Proferentem > General Overview

Governments > Courts > Authority to Adjudicate

Contracts Law > Contract Interpretation > Intent

Contracts Law > Contract Interpretation > Parol Evidence > General Overview

HN9[] Contract Interpretation, Ambiguities & Contra Proferentem

The interpretation of a contract is a judicial function. In engaging in this function, the trial court gives effect to the mutual intention of the parties as it existed at the time the contract was executed. Ordinarily, the objective intent of the contracting parties is a legal question determined solely by reference to the contract's terms. The court generally may not consider extrinsic evidence of any prior agreement or contemporaneous oral agreement to vary or contradict the clear and unambiguous terms of a written, integrated contract. Extrinsic evidence is admissible, however, to interpret an agreement when a material term is ambiguous.

Civil Procedure > Trials > Jury Trials > Province of Court & Jury

Contracts Law > Contract Interpretation > Ambiguities & Contra Proferentem > General Overview

Contracts Law > Contract Interpretation > Parol Evidence > General Overview

HN10[] Jury Trials, Province of Court & Jury

When the meaning of the words used in a contract is disputed, the trial court engages in a three-step process. First, it provisionally receives any proffered extrinsic evidence that is relevant to prove a meaning to which the language of the instrument is reasonably susceptible. If, in light of the extrinsic evidence, the language is reasonably susceptible to the interpretation urged, the extrinsic evidence is then admitted to aid the court in its role in interpreting the contract. When there is no material conflict in the extrinsic evidence, the trial court interprets the contract as a matter of law. This is true even when conflicting inferences may be drawn from the undisputed extrinsic evidence or that extrinsic evidence renders the contract terms susceptible to more than one reasonable interpretation. If, however, there is a conflict in the extrinsic evidence, the factual conflict is to be resolved by the jury.

Civil Procedure > ... > Equity > Maxims > Clean Hands Principle

HN11[] Maxims, Clean Hands Principle

The doctrine of unclean hands is a defense available in both legal and equitable actions. Whether the defense applies in particular circumstances depends on the analogous case law, the nature of the misconduct, and the relationship of the misconduct to the claimed injuries. The focus is the equities of the relationship between the parties, and specifically whether the unclean hands affected the transaction at issue. Not every wrongful act constitutes unclean hands. The misconduct that brings the unclean hands doctrine into play must relate directly to the cause at issue. Past improper conduct or prior misconduct that only indirectly affects the problem before the court does not suffice. The misconduct must prejudicially affect the rights of the person against whom the relief is sought so that it would be inequitable to grant such relief.

Civil Procedure > ... > Standards of Review > Harmless & Invited Errors > Harmless Error Rule

Evidence > Burdens of Proof > Allocation

Civil Procedure > Appeals > Standards of Review > Reversible Errors

HN12[] Harmless & Invited Errors, Harmless Error Rule

It is the appellant's burden to demonstrate the existence of prejudicial error. *Cal. Const., art. VI, § 13*, provides that no judgment shall be set aside for any error as to any matter of procedure, unless the court shall be of the opinion that the error complained of has resulted in a miscarriage of justice. A ruling that resulted in no discernible prejudice cannot be characterized as a miscarriage of justice.

Civil Procedure > ... > Summary Judgment > Opposing Materials > Motions for Additional Discovery

HN13[] Opposing Materials, Motions for Additional Discovery

Code Civ. Proc., § 437c, directs a trial court to deny a motion for summary judgment, or to continue the hearing, upon a good faith showing that an extension of time is needed to obtain facts essential to justify opposition to the motion. *Code Civ. Proc., § 437c, subd. (h)*. To demonstrate good faith, the party seeking a continuance must submit an affidavit or declaration showing that (1) the facts to be obtained are essential to opposing the motion; (2) there is reason to believe such facts may exist; and (3) the reasons why additional time is needed to obtain these facts. The purpose of the affidavit required by *§ 437c, subd. (h)*, is to inform the court of outstanding discovery that is necessary to resist the summary judgment motion. It is not sufficient under the statute merely to indicate further discovery or investigation is contemplated. The statute makes it a condition that the party moving for a continuance show facts essential to justify opposition may exist.

Headnotes/Summary

Summary

CALIFORNIA OFFICIAL REPORTS SUMMARY

The trial court granted summary judgment in favor of a seller on its breach of contract claims against a buyer. The parties had entered into a series of purchase order agreements under which the buyer purchased certain garments from the seller at specified quantities and prices. After the buyer fell behind on its payment obligations to the seller, the parties entered into a written agreement regarding the repayment of the debt. (Superior Court of Los Angeles County, No. BC479461, James R. Dunn, Judge.)

The Court of Appeal affirmed the judgment. The court held that the trial court properly granted summary judgment on the breach of contract claims. As a matter of law, a discount provision in the agreement at issue was not an unenforceable penalty or forfeiture because the agreement expressly obligated the buyer to pay off the entirety of the original debt in weekly installment payments and entitled it to a discount from its final payment only if each installment was timely paid. Because the buyer failed to fully perform under the agreement by paying five installments late, it remained liable to the seller for the full amount of its debt. A provision in the agreement that “time was of the essence” with respect to each installment payment was

unambiguous because it clearly and explicitly stated that the buyer would not be entitled to the discount if it failed to fully and timely pay each installment when due. Because the seller's procurement and retention of a $30,000 overpayment did not result in any prejudice to the buyer, given that the seller agreed to credit the overpayment to the balance owed by the buyer under the agreement, the unclean hands defense did not apply. The court concluded the trial court did not abuse its discretion in denying the buyer's request for a continuance because the buyer failed to demonstrate how a continuance to depose the seller's counsel could have led to the discovery of facts essential to its **[*636]** summary judgment opposition. (Opinion by Zelon, J., with Woods, Acting P. J., and Segal, J.,† concurring.)

Headnotes

CALIFORNIA OFFICIAL REPORTS HEADNOTES

CA(1)[] **(1)**

Appellate Review § 79—Record—Adequacy—Presumption of Correctness.

The California Rules of Court require an appellant who elects to proceed by appendix to include, among other things, any document filed in the trial court that is necessary for proper consideration of the issues, including any item that the appellant should reasonably assume the respondent will rely on (*Cal. Rules of Court, rule 8.124(b)(1)(B)*). An appealed judgment or order is presumed correct. All intendments and presumptions are indulged to support it on matters as to which the record is silent, and error must be affirmatively shown. To overcome this presumption, the appellant must provide an adequate appellate record demonstrating error. A necessary corollary to this rule is that a record is inadequate if the appellant predicates error only on the part of the record he or she provides the trial court, but ignores or does not present to the appellate court portions of the proceedings below that may provide grounds upon which the decision of the trial court could be affirmed. Where the appellant fails to provide an adequate record of the challenged proceedings, the appellate court must presume that the appealed judgment or order is correct, and on that basis, affirm.

CA(2)[] **(2)**

Contracts § 44—Performance—Breach—Elements.

To establish a cause of action for breach of contract, the plaintiff must plead and prove (1) the existence of the contract, (2) the plaintiff's performance or excuse for nonperformance, (3) the defendant's breach, and (4) resulting damages to the plaintiff.

CA(3)[] **(3)**

Contracts § 44—Performance—Breach—Summary Judgment—Shifting Burdens of Proof—Triable Issues.

Because a seller met its initial burden on summary judgment by demonstrating that it was entitled to judgment as a matter of law on its breach of contract claims, the burden shifted to the buyer to establish the existence of a triable issue. The buyer failed to show there were triable issues of material fact as to (1) whether the provision for a $17,500 discount contingent upon timely installment payments constituted an unenforceable penalty or forfeiture, (2) whether the provision that “time was of the essence” with respect to each installment payment was impermissibly ambiguous, or (3) whether the seller's procurement and retention of the additional $30,000 sum **[*637]** paid by the buyer supported an unclean hands affirmative defense. Accordingly, the trial court properly granted summary judgment on the breach of contract claims.

[*Cal. Forms of Pleading and Practice (2014) ch. 140, Contracts, § 140.83*; 1 Witkin, Summary of Cal. Law (10th ed. 2005) Contracts, § 505; 13 Witkin, Summary of Cal. Law (10th ed. 2005) Equity, § 13; 6 Witkin, Cal. Procedure (5th ed. 2008) Proceedings Without Trial, § 253.]

CA(4)[] **(4)**

Contracts § 35—Provisions—Liquidated Damages—Validity.

Under *Civ. Code, § 1671, subd. (b)*, a provision in a contract liquidating the damages for the breach of the contract is valid unless the party seeking to invalidate the provision establishes that the provision was unreasonable under the circumstances existing at the time the contract was made. A liquidated damages

† Judge of the Los Angeles Superior Court, assigned by the Chief Justice pursuant to *article VI, section 6 of the California Constitution*.

clause will generally be considered unreasonable, and hence unenforceable under § 1671, subd. (b), if it bears no reasonable relationship to the range of actual damages that the parties could have anticipated would flow from a breach. The amount set as liquidated damages must represent the result of a reasonable endeavor by the parties to estimate a fair average compensation for any loss that may be sustained. In the absence of such relationship, a contractual clause purporting to predetermine damages must be construed as a penalty. Whether an amount to be paid upon breach is to be treated as liquidated damages or as an unenforceable penalty is a question of law.

CA(5)[] **(5)**

Contracts § 8—Public Policy—Penalties.

Parties to a contract may not circumvent the public policies embodied in Civ. Code, § 1671, merely by labeling a penalty a discount.

CA(6)[] **(6)**

Contracts § 35—Conditions—Penalties.

The characteristic feature of a penalty is its lack of proportional relation to the damages that may actually flow from failure to perform under a contract.

CA(7)[] **(7)**

Contracts § 25—Interpretation—Function of Courts—Questions of Law—Intent of Parties—Ambiguity—Extrinsic Evidence—Factual Conflict.

The interpretation of a contract is a judicial function. In engaging in this function, the trial court gives effect to the mutual intention of the parties as it existed at the time the contract was executed. Ordinarily, the objective intent of the contracting parties is a legal question determined solely by reference to the contract's terms. The court generally may not consider extrinsic evidence of any prior agreement or contemporaneous oral agreement to vary or contradict the clear and unambiguous terms of a written, integrated contract. Extrinsic evidence is admissible, however, to interpret an agreement when a material term is ambiguous. When the meaning of the words used in a contract is disputed, the trial court engages in a three-step process. First, it provisionally receives any proffered extrinsic evidence that is relevant to prove a meaning to which the **[*638]** language of the instrument is reasonably susceptible. If, in light of the extrinsic evidence, the language is reasonably susceptible to the interpretation urged, the extrinsic evidence is then admitted to aid the court in its role in interpreting the contract. When there is no material conflict in the extrinsic evidence, the trial court interprets the contract as a matter of law. This is true even when conflicting inferences may be drawn from the undisputed extrinsic evidence or that extrinsic evidence renders the contract terms susceptible to more than one reasonable interpretation. If, however, there is a conflict in the extrinsic evidence, the factual conflict is to be resolved by the jury.

CA(8)[] **(8)**

Equity § 6.2—Maxims—Unclean Hands.

The doctrine of unclean hands is a defense available in both legal and equitable actions. Whether the defense applies in particular circumstances depends on the analogous case law, the nature of the misconduct, and the relationship of the misconduct to the claimed injuries. The focus is the equities of the relationship between the parties, and specifically whether the unclean hands affected the transaction at issue. Not every wrongful act constitutes unclean hands. The misconduct that brings the unclean hands doctrine into play must relate directly to the cause at issue. Past improper conduct or prior misconduct that only indirectly affects the problem before the court does not suffice. The misconduct must prejudicially affect the rights of the person against whom the relief is sought so that it would be inequitable to grant such relief.

Counsel: Sussman Shank, John A. Schwimmer, Clifford S. Davidson; Law Offices of Gary Freedman and Gary Freedman for Defendants and Appellants.

Resch Polster & Berger, Robert W. Barnes and Sandra Khalili for Plaintiff and Respondent.

Judges: Opinion by Zelon, J., with Woods, Acting P. J., and Segal, J.,* concurring.

Opinion by: Zelon, J.

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* Judge of the Los Angeles Superior Court, assigned by the Chief Justice pursuant to article VI, section 6 of the California Constitution.

Opinion

[187] ZELON, J.**—Appellants Harkham Industries, Inc., and Uri Harkham (collectively Harkham Industries) appeal from the trial court's grant of summary judgment in favor of respondent Jade Fashion & Co., Inc. We affirm.

[188] FACTUAL BACKGROUND AND PROCEDURAL HISTORY**

I. *The Parties' Agreement*

Jade Fashion is in the business of manufacturing and selling garments to other businesses. Starting in Spring 2010, Jade Fashion and Harkham Industries entered into a series of purchase order agreements under which Harkham **[*639]** Industries purchased certain garments **[***2]** from Jade Fashion at specified quantities and prices. In 2011, Harkham Industries had cashflow problems and fell behind on its payment obligations to Jade Fashion. As of November 28, 2011, Harkham Industries owed Jade Fashion the principal balance of $341,628.77 for the goods.

In November 2011, Sandra Khalili, counsel for Jade Fashion, and David Meniane, the chief financial officer at Harkham Industries, had several communications about the outstanding debt that Harkham Industries owed to Jade Fashion. According to Meniane, Khalili initially demanded that Harkham Industries pay off the entirety of the debt by the end of 2011. After further negotiations, Khalili and Meniane agreed that Harkham Industries would have until February 2012 to repay the debt and would make weekly payments toward the satisfaction of the debt until the balance due was paid. The amount of each weekly payment was determined by dividing the total debt by the number of weeks remaining before the February 2012 deadline for paying off the entirety of the debt. Khalili and Meniane further agreed that, if Harkham Industries made all payments timely, it could take a discount of $17,500 from the total amount that was **[***3]** owed. Following these communications, Jade Fashion and Harkham Industries entered into a written agreement on November 28, 2011, regarding the repayment of the debt (the Agreement).

As set forth in the Agreement, Harkham Industries acknowledged that it owed Jade Fashion a total of $341,628.77 for the purchased goods. Harkham Industries agreed to pay "the weekly sum of $25,000 to Jade [Fashion] by wire transfer commencing on Friday, December 2, 2011 and on each Friday thereafter for a total amount of $341,628.88[1] until the entire balance due is paid in full." Uri Harkham, the chief executive officer of Harkham Industries, agreed to execute a continuing guaranty for the repayment of the debt, including the principal balance, accrued interest, collection costs, and attorney fees. In exchange, Jade Fashion agreed to release the balance of the goods in Harkham Industries' then pending orders upon its receipt of the first two installment payments. Jade Fashion further agreed that if Harkham Industries "timely make[s] each installment payment when due, [it] may deduct $17,500 from the final installment due." The Agreement also included the following provision: "Time is of the essence with respect **[***4]** to each of the payments set forth herein and if [Harkham Industries] fails to make full and timely payment of any of the weekly payments, [Harkham Industries] will not **[*640]** be entitled to the discount of $17,500 and the remaining balance due by [Harkham Industries] shall be immediately due and payable."

The continuing guaranty that was concurrently signed by Uri Harkham similarly provided that Harkham Industries owed Jade Fashion the principal sum of $341,628.77, which was "currently due and **[**189]** payable." It further stated that Jade Fashion "agreed to forbear on the immediate collection of the Debt in full on the condition that [Harkham Industries] make installment payments of principal and interest pursuant to a schedule approved by [the parties] concurrently herewith," and that Jade Fashion was "willing to agree to accept repayment of the Debt in accordance **[***5]** with the Payment Plan provided that [Uri Harkham] personally guaranties [*sic*] the repayment of the Debt." The guaranty extended to "all principal, interest, late charges, fees, remedial advance reimbursements, future advances, costs of collection and attorneys' fees" related to the debt.

Under the Agreement, the weekly installment payments were due on December 2, 9, 16, 23, and 30, 2011, on January 6, 13, 20, and 27, 2012, and on February 3, 10, 17, and 24, 2012. Harkham Industries timely made its

[1] The Agreement incorrectly stated that the total amount of the outstanding debt was $341,628.88 rather than $341,628.77 (a difference of 11 cents). It is undisputed that the original principal balance owed by Harkham Industries to Jade Fashion was $341,628.77, which was the amount used to calculate the judgment entered by the trial court.

first two installment payments on December 2 and 9, 2011, respectively. Jade Fashion in turn released all of the remaining goods in Harkham Industries's purchase orders in accordance with the Agreement. Following its receipt of the goods, however, Harkham Industries ceased making all of the weekly installment payments when they were due. Of the 13 scheduled payments, Harkham Industries did not fully and timely pay the installments that were due on December 16 and 23, 2011, on January 20 and 27, 2012, and on February 3, 2012. Each of these five installments was paid in full, but from three to 12 days late.[2]

On February 10, 2012, two weeks before the final installment was due, Harkham Industries made three payments to Jade Fashion—a wire transfer of $25,000, a check for $30,000, and a check for $39,128.77. The wire transfer of $25,000 and the check for $30,000 reflected a part of the principal balance that was owed for the goods. The check for $39,128.77 reflected the remaining principal balance less the $17,500 discount, which Harkham Industries contended was the final payment due. Jade Fashion accepted the $25,000 wire transfer and the $30,000 check. It refused to cash the $39,128.77 check, asserting that Harkham Industries's failure to timely make **[*641]** all of the weekly installment payments precluded it from applying the $17,500 discount to its final payment. **[***7]**

On February 15, 2012, Khalili sent Harkham Industries a letter in which she demanded payment of the principal balance of $17,500, plus interest and attorney fees incurred in collection of the debt. She also indicated that the $39,128.77 check could be credited to Harkham Industries's account if the balance due was paid. Harkham Industries refused to make the requested payment.

II. *Jade Fashion's Lawsuit Against Harkham Industries*

On February 23, 2012, Jade Fashion filed a civil action against Harkham Industries asserting causes of action for breach of contract, goods sold and delivered, open book account, account stated, and breach of guaranty. The complaint alleged that Harkham Industries breached the parties' written agreement by failing to comply with the payment terms set forth in the **[**190]** agreement, including refusing to pay the remaining principal balance of $17,500 for the goods it had purchased from Jade Fashion. The complaint sought damages in the amount of $56,628.77 (the sum of the $17,500 discount and the $39,128.77 uncashed check), plus interest and attorney fees.

On March 2, 2012, based on erroneous information provided by Jade Fashion's bank, Khalili sent a letter to counsel **[***8]** for Harkham Industries in which she represented that the $30,000 check issued on February 10, 2012, had been returned due to unavailable funds, and demanded that the unpaid amount be wired to Jade Fashion by the following business day. After making that payment and then confirming that the original check had in fact been paid, Harkham Industries filed a cross-complaint against Jade Fashion and its counsel for fraud, conversion, and unjust enrichment. The trial court granted the special motion to strike brought by Jade Fashion and its counsel pursuant to *Code of Civil Procedure section 425.16* and dismissed each cause of action in the cross-complaint.[3]

III. *Jade Fashion's Motion for Summary Judgment*

On September 21, 2012, Jade Fashion filed a motion for summary judgment. Jade Fashion argued that it was entitled to judgment as a matter of law on each of its claims because the undisputed facts established that Harkham Industries breached the parties' written Agreement by failing to **[***9]** pay the principal balance owed for the goods that Jade Fashion sold and delivered to **[*642]** Harkham Industries. The motion was supported by various exhibits and declarations from Khalili and Ricky Lee, the Jade Fashion employee who was responsible for Harkham Industries's purchase orders.

On November 19, 2012, Harkham Industries filed a motion to compel the deposition of Khalili. Harkham Industries contended that Khalili was an agent of Jade Fashion and a percipient witness in the case because she was Jade Fashion's sole negotiator of the

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[2] The five late payments were made follows: (1) the installment due on December 16, 2011, was paid **[***6]** on December 19, 2011; (2) the installment due on December 23, 2011, was paid on December 29, 2011; (3) the installment due on January 20, 2012, was paid in part on that date and in full on January 24, 2012; (4) the installment due on January 27, 2012, was paid in part on February 1 and 3, 2012, and in full on February 8, 2012; and (5) the installment due on February 3, 2012, was paid in part on February 8, 2012, and in full on February 10, 2012.

[3] On August 26, 2013, in a nonpublished opinion, this court affirmed the trial court's order granting the special motion to strike the cross-complaint. (See *Harkham Industries, Inc. v. Jade Fashion & Co., Inc*. (Aug. 26, 2013, B242972) [nonpub. opn.].)

Agreement and had personal knowledge of Harkham Industries's payment history. Two days later, on November 21, 2012, Harkham Industries filed its opposition to the summary judgment motion. Harkham Industries argued that there were triable issues of material fact as to whether it substantially performed under the terms of the Agreement, whether the $17,500 discount provision was an unenforceable penalty or forfeiture, and whether Jade Fashion's wrongful procurement and retention of the additional $30,000 payment gave rise to an unclean hands affirmative defense. Harkham Industries also argued that the summary judgment motion should be denied or continued under **[***10]** Code of Civil Procedure section 437c, subdivision (h) based on Khalili's refusal to appear and produce documents at her noticed deposition.

The trial court continued the hearing on Jade Fashion's summary judgment motion to December 13, 2012, the date set for Harkham Industries's motion to compel. At that hearing, the trial court denied the motion to compel and granted the motion for summary judgment.[4] With respect to the motion to compel and related request **[**191]** for a continuance, the trial court found that Harkham Industries had not submitted a declaration showing good cause, and had not otherwise demonstrated how Khalili's deposition might lead to facts relevant to its opposition. With respect to the summary judgment motion, the trial court found that the parties' written Agreement unambiguously provided that Harkham Industries would receive a $17,500 discount only if it timely paid all of the weekly installments, and that Harkham Industries failed to comply with these material terms by making some of its payments late. The court also found that the $17,500 at issue was part of the original $341,628.77 debt that Harkham Industries owed to Jade Fashion, and as such, it was not an unlawful penalty or forfeiture.

On March 15, 2013, the trial court entered a judgment in favor of Jade Fashion and awarded Jade Fashion the principal sum of $26,628.77 and interest of $6,936.28. On April 30, 2013, Harkham Industries filed a notice of appeal. On June 27, 2013, in a postjudgment proceeding, the trial court awarded Jade Fashion $70,000 in attorney fees.
[*643]

[4] In granting summary judgment, **[***11]** the court also sustained 26 of Jade Fashion's 36 evidentiary objections.

DISCUSSION

I. *Standard of Review*

HN1[] "[T]he party moving for summary judgment bears the burden of persuasion that there is no triable issue of material fact and that he is entitled to judgment as a matter of law." (Aguilar v. Atlantic Richfield Co. (2001) 25 Cal.4th 826, 850 [107 Cal. Rptr. 2d 841, 24 P.3d 493], fn. omitted.) "Once the [movant] has met that burden, the burden shifts to the [other party] to show that a triable issue of one or more material facts exists as to that cause of action … ." (Code Civ. Proc., § 437c, subd. (p)(2); see Aguilar v. Atlantic Richfield Co., supra, at p. 850.) The party opposing summary judgment "may not rely upon the mere allegations or denials of its pleadings," but rather "shall set forth the specific facts showing that a triable issue of material fact exists … ." (Code Civ. Proc., § 437c, subd. (p)(2).) A triable issue of material fact exists where "the evidence would allow a reasonable trier of fact to find the underlying fact in favor of the party opposing the **[***12]** motion in accordance with the applicable standard of proof." (Aguilar v. Atlantic Richfield Co., supra, at p. 850.)

HN2[] Where summary judgment has been granted, we review the trial court's ruling de novo. (Aguilar v. Atlantic Richfield Co., supra, 25 Cal.4th at p. 860.) We consider all the evidence presented by the parties in connection with the motion (except that which was properly excluded) and all the uncontradicted inferences that the evidence reasonably supports. (Merrill v. Navegar, Inc. (2001) 26 Cal.4th 465, 476 [110 Cal. Rptr. 2d 370, 28 P.3d 116].) We affirm summary judgment where it is shown that no triable issue of material fact exists and the moving party is entitled to judgment as a matter of law. (Code Civ. Proc., § 437c, subd. (c).) The decision whether to grant a continuance under Code of Civil Procedure section 437c, subdivision (h), is reviewed for an abuse of discretion. (Knapp v. Doherty (2004) 123 Cal.App.4th 76, 100 [20 Cal. Rptr. 3d 1]; Frazee v. Seely (2002) 95 Cal.App.4th 627, 633 [115 Cal. Rptr. 2d 780].)

II. *Inadequate Appellate Record*

CA(1)[] **(1)** As a preliminary matter, we address Jade Fashion's argument that the trial court's judgment must be affirmed because Harkham Industries failed to present an adequate record on appeal. HN3[] **[**192]** The California Rules of Court require an appellant who elects to proceed by appendix to include, among other things, any document filed in the trial court which "is necessary for proper consideration of the

issues, including … any item that the appellant should reasonably assume the respondent will rely on." (*Cal. Rules of Court, rule 8.124(b)(1)(B)*.) It is also a fundamental rule of appellate review **[***13]** that an **[*644]** appealed judgment or order is presumed correct. (*Denham v. Superior Court (1970) 2 Cal.3d 557, 564 [86 Cal. Rptr. 65, 468 P.2d 193]*.) "'All intendments and presumptions are indulged to support it on matters as to which the record is silent, and error must be affirmatively shown. …' [Citations.]" (*Ibid*.) To overcome this presumption, the appellant must provide an adequate appellate record demonstrating error. (*Maria P. v. Riles (1987) 43 Cal.3d 1281, 1295 [240 Cal. Rptr. 872, 743 P.2d 932]*.) "'A necessary corollary to this rule [is] that a record is inadequate … if the appellant predicates error only on the part of the record he [or she] provides the trial court, but ignores or does not present to the appellate court portions of the proceedings below which may provide grounds upon which the decision of the trial court could be affirmed.' [Citation.]" (*Osgood v. Landon (2005) 127 Cal.App.4th 425, 435 [25 Cal. Rptr. 3d 379]*.) Where the appellant fails to provide an adequate record of the challenged proceedings, we must presume that the appealed judgment or order is correct, and on that basis, affirm. (*Maria P. v. Riles, supra, at pp. 1295–1296*; *Estrada v. Ramirez (1999) 71 Cal.App.4th 618, 620, fn. 1 [84 Cal. Rptr. 2d 73]*.)

In its appeal, Harkham Industries submitted an appendix which included all of the documents that it filed in support of its motion to compel the deposition of Khalili, and in opposition to Jade Fashion's motion for summary judgment. The appendix also included the complaint, Jade Fashion's opening **[***14]** and reply memoranda in support of its summary judgment motion, the trial court's order granting the summary judgment motion, and the judgment. On the other hand, the appendix omitted Jade Fashion's opposition to the motion to compel, all of its evidence in support of the summary judgment motion, its requests for judicial notice, its separate statement of undisputed material facts, its response to Harkham Industries's separate statement of opposing material facts, and its objections to Harkham Industries's opposing evidence. The appendix also omitted the trial court's rulings on Jade Fashion's evidentiary objections.

In its reply brief, Harkham Industries concedes that certain documents necessary for appellate review of the judgment were omitted from its appendix, but contends that such error was inadvertent. Given that Harkham Industries included all of the papers that it filed in opposition to the summary judgment motion, and excluded almost all of the papers filed by Jade Fashion, its claim of inadvertent error is suspect. However, because Jade Fashion filed a respondent's appendix that included all of the improperly omitted documents, we review the trial court's summary judgment ruling **[***15]** on the merits.
[*645]

III. *Breach of Contract Claims*

HN4[↑] ***CA(2)***[↑] **(2)** To establish a cause of action for breach of contract, the plaintiff must plead and prove (1) the existence of the contract, (2) the plaintiff's performance or excuse for nonperformance, (3) the defendant's breach, and (4) resulting damages to the plaintiff. (*Oasis West Realty, LLC v. Goldman (2011) 51 Cal.4th 811, 821 [124 Cal. Rptr. 3d 256, 250 P.3d 1115]*; *Thrifty Payless, Inc. v. The Americana at Brand, **[**193]** LLC (2013) 218 Cal.App.4th 1230, 1244 [160 Cal. Rptr. 3d 718]*.)

The undisputed evidence demonstrates that Jade Fashion and Harkham Industries entered into a written contract under which Harkham Industries agreed to pay Jade Fashion a weekly installment of $25,000 until the balance of $341,628.77 was paid in full, and in exchange, Jade Fashion agreed to deliver all of the remaining goods purchased by Harkham Industries. In addition, Jade Fashion agreed to discount the final payment by $17,500 if Harkham Industries fully and timely paid each weekly installment. It is also undisputed that Jade Fashion fully performed its obligations under the Agreement by delivering all of the purchased goods, and that Harkham Industries failed to make each weekly installment payment when due. The undisputed facts further show that, despite paying some of the weekly installments late, Harkham Industries deducted $17,500 from its final payment. As a result, Harkham **[***16]** Industries paid Jade Fashion a total of $324,128.77 for the delivered goods rather than the agreed balance of $341,628.77.

CA(3)[↑] **(3)** Given these undisputed facts, Jade Fashion met its initial burden on summary judgment by demonstrating that it was entitled to judgment as a matter of law on its breach of contract claims. The burden therefore shifted to Harkham Industries to establish the existence of a triable issue. On appeal, Harkham Industries argues that it satisfied its burden because there were triable issues of material fact as to (1) whether the provision for a $17,500 discount contingent upon timely installment payments constituted an unenforceable penalty or forfeiture, (2) whether the

provision that "[t]ime [was] of the essence" with respect to each installment payment was impermissibly ambiguous, and (3) whether Jade Fashion's procurement and retention of the additional $30,000 sum paid by Harkham Industries supported an unclean hands affirmative defense. We conclude that the trial court properly granted summary judgment on the breach of contract claims.

A. *Unenforceable Penalty or Forfeiture*

CA(4)[⬆] **(4)** Harkham Industries first contends that the trial court erred in failing to conclude that, as a matter **[***17]** of law, the provision in the Agreement **[*646]** concerning the $17,500 discount was an unenforceable penalty or forfeiture. ***HN5***[⬆] Under *Civil Code section 1671*, "a provision in a contract liquidating the damages for the breach of the contract is valid unless the party seeking to invalidate the provision establishes that the provision was unreasonable under the circumstances existing at the time the contract was made." (*Civ. Code, § 1671, subd. (b)*.) The California Supreme Court has held that a "liquidated damages clause will generally be considered unreasonable, and hence unenforceable under *[Civil Code] section 1671[, subdivision] (b)*, if it bears no reasonable relationship to the range of actual damages that the parties could have anticipated would flow from a breach." (*Ridgley v. Topa Thrift & Loan Assn. (1998) 17 Cal.4th 970, 977 [73 Cal. Rptr. 2d 378, 953 P.2d 484]* (*Ridgley*).) "The amount set as liquidated damages 'must represent the result of a reasonable endeavor by the parties to estimate a fair average compensation for any loss that may be sustained.' [Citation.] In the absence of such relationship, a contractual clause purporting to predetermine damages 'must be construed as a penalty.'" (*Ibid.*) "Whether an amount to be paid upon breach is to be treated as liquidated damages or as an unenforceable penalty is a question of law." (*Harbor Island Holdings v. Kim (2003) 107 Cal.App.4th 790, 794 [132 Cal. Rptr. 2d 406]* (*Harbor Island*).)

[194]** In support **[***18]** of its argument that the $17,500 discount provision was an unlawful penalty, Harkham Industries primarily relies on three Court of Appeal decisions—*Sybron Corp. v. Clark Hosp. Supply Corp. (1978) 76 Cal.App.3d 896 [143 Cal. Rptr. 306]* (*Sybron*), *Greentree Financial Group, Inc. v. Execute Sports, Inc. (2008) 163 Cal.App.4th 495 [78 Cal. Rptr. 3d 24]* (*Greentree*), and *Purcell v. Schweitzer (2014) 224 Cal.App.4th 969 [169 Cal. Rptr. 3d 90]* (*Purcell*).

In *Sybron*, a seller of goods sued the buyers for approximately $144,000 and the buyers cross-complained for approximately $160,000 on grounds of defective goods and rescission. The parties reached a settlement under which the buyers would pay the seller $72,000 plus interest in 12 monthly installments; if the buyers defaulted on any payment, a stipulated judgment for $100,000 could be entered in the seller's favor. After paying $42,000, the buyers became delinquent and the seller obtained a stipulated judgment of $100,000. (*Sybron, supra, 76 Cal.App.3d at pp. 898–899*.) The Court of Appeal held that the stipulated judgment was an unenforceable penalty and forfeiture because it bore "no reasonable relationship to actual damages suffered by [the seller] as the result of delay but to the contrary appears grossly disproportionate in amount." (*Id. at p. 903*.) As the court explained, a "creditor is entitled to bargain that if the installment debtor imposes upon the creditor by a continuing course of dilatory payment the creditor may accelerate and collect the entire obligation, plus a reasonable **[***19]** amount to compensate for delay. On the other hand, the equitable powers of the court exist to insure that the ultimate obligation imposed on the debtor is not unreasonable *in* ***[*647]*** *proportion* to the original obligation and the seriousness of the default." (*Ibid*.) The court reasoned that enforcement of the default provision "would result in a $28,000 penalty for delay in payment of $30,000, a penalty which bears no rational relationship to the amount of actual damages suffered." (*Ibid.*)

In *Greentree*, the plaintiff sued the defendant for failing to pay $45,000 due under a financial services contract. In its answer, the defendant asserted affirmative defenses for failure to mitigate and prior material breach by the plaintiff. The parties entered into a settlement agreement which provided the defendant would pay the plaintiff $20,000 in two installments; if the defendant defaulted on either payment, the plaintiff would be entitled to a judgment for the entire amount sought in its complaint. After the defendant defaulted on the first payment, the plaintiff obtained a judgment for $61,000, consisting of $45,000 in damages plus interest and attorney fees. (*Greentree, supra, 163 Cal.App.4th at p. 498*.) The Court of Appeal held that the **[***20]** judgment was an unlawful penalty because it bore "no reasonable relationship to the range of actual damages the parties could have anticipated would flow from a breach of their settlement agreement." (*Id. at p. 497*.) The court noted that the relevant breach to be analyzed "is the breach of the *stipulation*, not the breach of the *underlying contract*." (*Id. at p. 499*.) It then reasoned that the parties "did not attempt to anticipate the damages that might flow from a breach of the stipulation. Rather, they simply selected the amount [the

plaintiff] had claimed as damages in the underlying lawsuit, plus prejudgment interest, attorney fees, and costs. But the appellate record contains nothing showing [the plaintiff's] chances of complete success on the merits of its case—the record contains only the complaint, the answer, and the stipulation. In the stipulation, '[e]ach party **[**195]** disclaims any admission of wrongdoing, fault, liability, or violation of law.'" (*Id. at pp. 499–500*.) The court observed that "the judgment would have been enforceable if it had been designed to encourage [the defendant] to make its settlement payments on time, and to compensate [the plaintiff] for its loss of use of the money plus its reasonable costs in pursuing **[***21]** the payment." (*Id. at p. 500*.) However, "[t]he amount of the judgment, which awarded … approximately $40,000 more than the settlement amount, does not merely compensate [the plaintiff]—it rewards [the plaintiff] by penalizing [the defendant]." (*Ibid.*)

In *Purcell*, the defendant borrower defaulted on an $85,000 loan given by the plaintiff lender. After the lender sued to recover on the loan, the parties entered into a settlement under which the borrower would pay the lender $38,000 plus interest in monthly installments; if any payment was late, the entire original liability of $85,000 would be due. (*Purcell, supra, 224 Cal.App.4th at p. 971*.) The agreement further provided that the $85,000 was " 'an agreed upon amount of monies actually owed … by the [borrower] to the [lender] and is neither a penalty nor is it a forfeiture,' " and that it took **[*648]** into account " 'the economics associated with proceeding further with this matter,' " including attorney fees and costs of litigation. (*Id. at p. 972*, italics omitted.) When the borrower made one $750 payment six days late, the lender immediately sought and obtained a judgment for almost $60,000. (*Id. at p. 973*.) Relying on *Greentree*, the Court of Appeal held that the judgment was an unenforceable penalty because it "bore no reasonable relationship **[***22]** to the damages that it could be expected that [the lender] would suffer as a result of a breach by [the borrower]." (*Id. at pp. 975–976*.) In response to the lender's argument that the parties had agreed the $85,000 amount reflected the economics of proceeding with the lawsuit, the court stated: "That provision in the settlement agreement bore no reasonable relationship to damages [the lender] would be expected to actually suffer as a result of a breach, such as the late payment that occurred in this case. There is nothing in the record to support the fact that obtaining a judgment and instituting postjudgment procedures would cost $85,000. … [¶] The language in the stipulation seeking to tie the $85,000 to the economics of proceeding further with the matter was an obvious attempt to circumvent the public policy expressed in [*Civil Code section 1671*]. However, … that public policy may not be circumvented by words used in a contract." (*Id. at p. 976*.)

Harkham Industries argues that, like the default provisions in *Sybron*, *Greentree*, and *Purcell*, the $17,500 discount was an impermissible penalty because it bore no reasonable relationship to the damages that Jade Fashion actually suffered as a result of the late payments. Harkham Industries **[***23]** claims that the actual damages suffered consisted of the net interest on the late payments, which according to its calculation, was less than $27. However, in each of the above cited cases, the parties agreed to settle a pending lawsuit for a stipulated amount that was less than the damages alleged in the plaintiff's complaint; if the defendant breached the settlement agreement, it then would be required to pay a fixed amount of additional damages, which was disproportionately higher than the settlement amount. In contrast, the agreement between Jade Fashion and Harkham Industries was not an agreement to settle or compromise a disputed claim. Rather, it was an agreement to forbear on the collection of a debt **[**196]** that was admittedly owed for goods that had been delivered so long as timely installment payments were made.

The parties expressly agreed that Harkham Industries owed Jade Fashion the balance of $341,628.77 for the goods it had purchased, and that it would make weekly installment payments of $25,000 "for a total amount of $341.628.[77] until the entire balance due [was] paid in full." The Agreement also specified that, if Harkham Industries "timely make[s] each installment payment when **[***24]** due, [it] may deduct $17,500 from the final installment due"; however, if it "fails to make full and timely payment of any of the weekly payments, [it] will not be entitled to the discount." The continuing guaranty signed by Uri Harkham likewise provided that Harkham Industries owed Jade **[*649]** Fashion the sum of $341,628.77, which was "currently due and payable," and that Jade Fashion "agreed to forebear on the immediate collection of the Debt in full on the condition that [Harkham Industries] make installment payments of principal and interest" pursuant to the agreed upon schedule.

The express language of the Agreement accordingly establishes that the $17,500 discount was not liquidated damages for a breach of contract, nor was it an

additional payment over and above any debt that was owed. Instead, the $17,500 was part of the $341,628.77 debt which Harkham Industries specifically admitted it owed to Jade Fashion in both the Agreement and the continuing guaranty. Under these circumstances, Civil Code section 1671's restriction on liquidated damages clauses does not apply, and the enforceability of the $17,500 discount provision does not depend on whether it bore a reasonable relationship to the actual damages **[***25]** suffered from the late payments. Because Harkham Industries expressly agreed to pay the entire balance of $341,628.77 and to take the $17,500 discount only if it paid each weekly installment when due, Jade Fashion suffered actual damages of $17,500 when Harkham Industries failed to timely make its payments and then refused to pay the entirety of the debt owed.

Harkham Industries nevertheless asserts that, under *Greentree* and *Purcell*, "the original debt [it] allegedly owed is irrelevant to determining the damages that flow from breach of the Agreement." As support, Harkham Industries notes that both cases provide that the relevant breach to be analyzed for purposes of Civil Code section 1671 is "the breach of the *stipulation*, not the breach of the *underlying contract*." (Greentree, supra, 163 Cal.App.4th at p. 499; see Purcell, supra, 224 Cal.App.4th at p. 975.) However, unlike the stipulations at issue in *Greentree* and *Purcell*, the plain language of the Agreement and the continuing guaranty make clear that the parties did not enter into an agreement to compromise the original debt for a lesser amount subject to a penalty for late payment. Instead, the parties specifically agreed that Harkham Industries continued to owe Jade Fashion the original balance of $341,628.77 for the purchased goods, **[***26]** and that Harkham Industries would make weekly installment payments of $25,000 "for a total amount of $341,628.[77] until the entire balance due is paid in full." The $17,500 discount would not be available until the final installment payment, and would not apply unless all prior installment payments had been fully and timely made.

Harkham Industries argues that, while the $17,500 amount was framed as a discount, it was simply a penalty by another name. Citing *Harbor Island*, Harkham Industries reasons that a party may not avoid application of Civil Code section 1671 by recharacterizing a penalty as a bargained-for discount. **[**197]** In *Harbor Island*, a landlord and its tenants entered into a commercial lease **[*650]** extension under which the tenants agreed to pay an increased monthly rent of $96,365, which was more than triple the amount of the original rent. Under the extension, half of the new monthly rent would be conditionally deferred and ultimately forgiven if the tenants complied with all of their lease obligations. When the tenants breached the lease by failing to properly maintain the premises, the landlord sued to recover $14,000 in damages for that breach, plus $240,000 in deferred rent. (Harbor Island, supra, 107 Cal.App.4th at p. 793.) In holding that the **[***27]** deferred rent provision was an unlawful penalty, the Court of Appeal rejected the landlord's argument that its actual loss was the amount of rent that was conditionally deferred in anticipation of perfect performance. As the court explained: " 'A forfeiture or unreasonable penalty, imposed only upon the other party's default, is unenforceable even though the same money, property or other consideration might have validly been bargained for as a form of contractual performance. A contrary conclusion would allow unreasonable late charges and other penalties to escape legal scrutiny through simple rephrasing as a conditional waiver.' " (Id. at pp. 798–799, quoting Ridgley, supra, 17 Cal.4th at p. 982.)

CA(5)[↑] **(5)** Harkham Industries's reliance on Harbor Island is misplaced. By its terms, the Agreement did not purport to increase the amount of the original debt owed by Harkham Industries if any future payments were late. As discussed, the $17,500 amount was part of the existing $341,628.77 debt, which Harkham Industries admitted was due and owing, and which it agreed to repay in accordance with a specified payment schedule. While we agree that **HN6**[↑] parties to a contract may not circumvent the public policies embodied in Civil Code section 1671 merely by labeling a penalty a discount, **[***28]** the plain language of the Agreement does not support a finding that Jade Fashion intended to penalize Harkham Industries by agreeing to forbear on collection of a debt that was indisputably due and owing so long as timely payments on the original debt amount were made.

We also reject Harkham Industries's contention that the trial court erred in failing to consider whether it was entitled to relief because the $17,500 discount constituted an unlawful forfeiture. **HN7**[↑] Civil Code section 3275 provides that "[w]henever, by the terms of an obligation, a party thereto incurs a forfeiture, or a loss in the nature of a forfeiture, by reason of his failure to comply with its provisions, he may be relieved therefrom, upon making full compensation to the other party, except in case of a grossly negligent, willful, or fraudulent breach of duty." Harkham Industries's

forfeiture claim is similarly premised on the theory that the parties effectively settled their dispute for $324,128.77 when they entered into the Agreement and that Harkham Industries met its overall obligation by paying that sum two weeks early. This theory, however, is inconsistent with the express language of the Agreement: Harkham Industries specifically acknowledged **[***29]** that it owed Jade Fashion the balance of $341,628.77 for the purchased goods and agreed to **[*651]** pay the entire balance due in weekly installment payments. Therefore, contrary to Harkham Industries's claim, the actual damages suffered by Jade Fashion were not limited to interest on the late payments. The actual damages also included the $17,500 portion of the debt that Harkham Industries owed but refused to pay.

CA(6)[↑] **(6)** **[**198]** As the Supreme Court described in *Ridgley*, *HN8*[↑] " '[t]he characteristic feature of a penalty is its lack of proportional relation to the damages which may actually flow from failure to perform under a contract. [Citations.]' " (*Ridgley, supra, 17 Cal.4th at p. 977*.) The contract at issue here expressly obligated Harkham Industries to pay off the entirety of the original debt in weekly installments payments and entitled it to a discount from its final payment only if each installment was timely paid. Because Harkham Industries failed to fully perform under the Agreement by paying five installments late, it remained liable to Jade Fashion for the full amount of its $341,628.77 debt. As a matter of law, the $17,500 discount provision was not an unenforceable penalty or forfeiture.

B. *Alleged Ambiguity in the Agreement*

Harkham Industries **[***30]** also argues that the trial court should have denied summary judgment on the breach of contract claims because the provision in the Agreement that "[t]ime [w]as of the essence" with respect to each installment payment was impermissibly ambiguous. Harkham Industries specifically asserts that the trial court erred in failing to provisionally consider extrinsic evidence of the parties' oral communications, and if such evidence had been considered, the trial court would have found that the Agreement was ambiguous and that triable issues of fact existed as to its proper interpretation.

CA(7)[↑] **(7)** "The rules governing the role of the court in interpreting a written instrument are well established. *HN9*[↑] The interpretation of a contract is a judicial function. [Citation.] In engaging in this function, the trial court 'give[s] effect to the mutual intention of the parties as it existed' at the time the contract was executed. [Citation.] Ordinarily, the objective intent of the contracting parties is a legal question determined solely by reference to the contract's terms. [Citations]. [¶] The court generally may not consider extrinsic evidence of any prior agreement or contemporaneous oral agreement to vary or contradict **[***31]** the clear and unambiguous terms of a written, integrated contract. [Citations.] Extrinsic evidence is admissible, however, to interpret an agreement when a material term is ambiguous. [Citations.] [¶] *HN10*[↑] When the meaning of the words used in a contract is disputed, the trial court engages in a three-step process. First, it provisionally receives any proffered extrinsic evidence that is relevant to prove a meaning to which the language of the instrument is reasonably **[*652]** susceptible. [Citations.] If, in light of the extrinsic evidence, the language is reasonably susceptible to the interpretation urged, the extrinsic evidence is then admitted to aid the court in its role in interpreting the contract. [Citations.] When there is no material conflict in the extrinsic evidence, the trial court interprets the contract as a matter of law. [Citations.] This is true even when conflicting inferences may be drawn from the undisputed extrinsic evidence [citations] or that extrinsic evidence renders the contract terms susceptible to more than one reasonable interpretation. [Citations.] If, however, there is a conflict in the extrinsic evidence, the factual conflict is to be resolved by the jury. [Citations.]" **[***32]** (*Wolf v. Walt Disney Pictures & Television (2008) 162 Cal.App.4th 1107, 1125–1127 [76 Cal. Rptr. 3d 585]*, fn. omitted.)

Paragraph 5 of the Agreement provided as follows: "Time is of the essence with respect to each of the payments set forth herein and if [Harkham Industries] fails to make full and timely payment of any of the weekly payments, [Harkham Industries] **[**199]** will not be entitled to the discount of $17,500 and the remaining balance due by [Harkham Industries] shall be immediately due and payable. Jade [Fashion] shall be entitled to exercise all of its rights and remedies against [Harkham Industries] and Uri Harkham, as guarantor." On its face, this provision in the Agreement is unambiguous. It clearly and explicitly stated that Harkham Industries would not be entitled to the $17,500 discount if it failed to fully and timely pay each installment when due. Consistent with this provision, Paragraph 4 of the Agreement stated that if Harkham Industries and Uri Harkham "timely make *each installment payment when due*, they may deduct $17,500 from the final installment due." (Italics added.) There is nothing in the plain language of the Agreement

which would indicate that the parties intended for the discount to apply even if Harkham Industries failed to pay each weekly installment when due.

In support of **[***33]** its argument that the "[t]ime is of the essence" provision is susceptible to more than one interpretation, Harkham Industries relies on the statements in David Meniane's declaration regarding his oral communications with Khalili. According to Meniane, Khalili initially insisted that Harkham Industries pay off the entirety of the debt by the end of 2011, but eventually agreed that it could have until February 2012 to pay off the debt. Khalili and Meniane also agreed that Harkham Industries would make weekly payments toward satisfaction of the debt, and could take a discount of $17,500 if it timely paid off the debt. After setting the February 2012 deadline, Khalili and Meniane calculated the amount of each weekly payment by dividing the total debt to be paid by the number of weeks remaining before the deadline for paying off the debt.

These statements in Meniane's declaration about the parties' oral communications merely reflect that they agreed the debt would be repaid in weekly **[*653]** installments, and that if the debt was timely repaid, Harkham Industries would receive a $17,500 discount. However, nothing in the declaration indicates that Harkham Industries was not required to make its installment **[***34]** payments on time under the terms of the parties' Agreement. Moreover, contrary to Harkham Industries's characterization, the record reflects that the trial court did provisionally receive into evidence these portions of Meniane's declaration, and ultimately found that the "[t]ime is of the essence" provision was not ambiguous or susceptible to the interpretation urged by Harkham Industries. As the trial court correctly concluded, the language of the Agreement "is clear, and its plain terms control."

Harkham Industries also contends that the parties' course of performance shows that time was *not* of the essence with respect to each weekly installment payment because Jade Fashion never insisted on the accelerated amount despite the lateness of some payments. This claim is not supported by the record. In its summary judgment motion, Jade Fashion submitted multiple e-mails and letters from Khalili to Harkham Industries in which she explicitly stated that, because Harkham Industries had failed to timely make its installment payments, the entire balance of the debt was immediately due. In each correspondence, Khalili also expressly reserved all of Jade Fashion's rights and remedies under the Agreement. **[***35]** In opposing the summary judgment motion, Harkham Industries did not dispute that Jade Fashion sought to invoke the default provision in the Agreement when Harkham Industries became delinquent in its payments. To the contrary, Harkham Industries's submitted evidence included a December 16, 2011 e-mail **[**200]** from Khalili to Meniane in which she asserted that Harkham Industries had defaulted under the Agreement by failing to timely pay its third installment, and that as a result, the "entire unpaid balance of the debt owed … is immediately due and payable." Based on the undisputed evidence, Harkham Industries has failed to demonstrate the existence of a triable issue of material fact as to the proper interpretation of the Agreement.

C. *Unclean Hands Defense*

CA(8)[↑] **(8)** Harkham Industries further asserts that the trial court erred in failing to consider whether Jade Fashion's alleged fraudulent inducement of a $30,000 overpayment raised triable issues of fact as to the affirmative defense of unclean hands. ***HN11***[↑] The doctrine of unclean hands is a defense available in both legal and equitable actions. "'Whether the defense applies in particular circumstances depends on the analogous case law, the nature of the **[***36]** misconduct, and the relationship of the misconduct to the claimed injuries.' [Citation.]" (*Aguayo v. Amaro (2013) 213 Cal.App.4th 1102, 1110 [153 Cal. Rptr. 3d 52]*.) "The focus is the equities of the relationship between the parties, and specifically whether the unclean hands affected the transaction at issue. **[*654]** [Citations.]" (*Jaramillo v. County of Orange (2011) 200 Cal.App.4th 811, 820 [133 Cal. Rptr. 3d 751]*.) "Not every wrongful act constitutes unclean hands." (*Kendall-Jackson Winery, Ltd. v. Superior Court (1999) 76 Cal.App.4th 970, 979 [90 Cal. Rptr. 2d 743]*.) "The misconduct that brings the unclean hands doctrine into play must relate directly to the cause at issue. Past improper conduct or prior misconduct that only indirectly affects the problem before the court does not suffice. … The misconduct must ""'prejudicially affect … the rights of the person against whom the relief is sought so that it would be inequitable to grant such relief.'"" [Citation.]" (*Ibid.*; see *Brown v. Grimes (2011) 192 Cal.App.4th 265, 282 [120 Cal. Rptr. 3d 893]* ["the improper conduct must be 'in the particular transaction or connected with the subject matter of the litigation that is a defense'"].)

Harkham Industries's unclean hands defense is based on the alleged fraudulent statements made in the March 2, 2012 letter that Khalili sent to Harkham Industries's

attorney during the course of the litigation. In that letter, Khalili stated that, based on information provided by Jade Fashion's bank, the $30,000 check **[***37]** issued by Harkham Industries on February 10, 2012, had been returned unpaid due to unavailable funds. She also demanded payment of that amount by the following business day. When it was later confirmed by the parties that the check had in fact been paid, Jade Fashion refused to return the additional $30,000 payment that had been made by Harkham Industries.

In opposing summary judgment, Harkham Industries did not offer any evidence that either Jade Fashion or Khalili acted with an intent to defraud in connection with the letter. However, even if we assume that Khalili intentionally misrepresented the status of the $30,000 check in her letter, such conduct does not support an unclean hands defense as a matter of law. Harkham Industries cannot show how the alleged misconduct prejudicially affected its rights in the litigation because it is undisputed that Jade Fashion agreed to credit the $30,000 overpayment to the balance owed by Harkham Industries under the Agreement. Accordingly, while Jade Fashion initially sought to recover the principal balance of $56,628.77 (the sum of the $17,500 discount and the $39,128.77 uncashed check) in its complaint, it reduced the principal balance portion **[***38]** **[**201]** of the demand to $26,628.77 following Harkham Industries's payment of the additional $30,000 sum. The trial court properly applied this credit in entering judgment in Jade Fashion's favor, and thus, awarded Jade Fashion the principal amount of $26,628.77 as damages for Harkham Industries's breach. Because Jade Fashion's procurement and retention of the $30,000 overpayment did not result in any prejudice to Harkham Industries, the unclean hands defense did not apply. Jade Fashion was entitled to judgment as a matter of law on its breach of contract claims.
[*655]

IV. *Common Count Claims*

Harkham Industries also challenges the trial court's grant of summary judgment in favor of Jade Fashion on the common count claims for goods sold and delivered, open book account, and account stated. Harkham Industries contends that the common counts fail as a matter of law because the Agreement constituted a novation that extinguished the prior debt and expressly governed the transaction between the parties. At the summary judgment hearing, the trial court noted that it had "some problem … with the common counts," but stated that "[a]s a practical matter, it doesn't really matter if I grant summary adjudication **[***39]** on some and not others."

HN12[↑] It is the appellant's burden to demonstrate the existence of prejudicial error. (*County of Orange v. Smith (2005) 132 Cal.App.4th 1434, 1443 [34 Cal. Rptr. 3d 383]*.) As Jade Fashion correctly points out, its three common count claims were pled as alternatives to its breach of contract claims. For each cause of action alleged, Jade Fashion sought to recover, and the trial court ultimately awarded, the same damages—the unpaid principal due under the Agreement plus accrued interest. Therefore, even assuming the trial court erred in granting summary judgment on the common count claims, Harkham Industries cannot show prejudice because Jade Fashion was entitled to judgment as a matter of law on the breach of contract claims and no additional damages were awarded on the common count claims. On this record, Harkham Industries has failed to demonstrate any error requiring reversal. (*Cal. Const., art. VI, § 13* ["[n]o judgment shall be set aside … for any error as to any matter of procedure, unless … the court shall be of the opinion that the error complained of has resulted in a miscarriage of justice"]; *Cristler v. Express Messenger Systems, Inc. (2009) 171 Cal.App.4th 72, 81 [89 Cal. Rptr. 3d 34]* ["[a] ruling that resulted in no discernible prejudice cannot … be characterized as a miscarriage of justice"].)

V. *Denial of Request for a Continuance*

Harkham Industries **[***40]** further claims that the trial court erred in failing to continue or deny the summary judgment motion to permit it to depose Khalili in her capacity as an agent for Jade Fashion. We conclude that the trial court acted within its discretion in denying the request for a continuance because Harkham Industries failed to show how facts essential to its opposition could be obtained by deposing Jade Fashion's attorney.

HN13[↑] *Section 437c of the Code of Civil Procedure* directs a trial court to deny a motion for summary judgment, or to continue the hearing, upon a good faith showing that an extension of time is needed to obtain facts essential to justify opposition to the motion. (*Code Civ. Proc., § 437c, subd. (h)* ["[i]f it appears **[*656]** from the affidavits submitted in opposition to a motion for summary judgment … that facts **[**202]** essential to justify opposition may exist but cannot, for reasons stated, then be presented, the court shall deny the motion, or order a continuance to permit affidavits to be obtained or discovery to be had …"].) To demonstrate good faith, the party seeking a continuance must submit an affidavit or declaration showing that "'(1) the facts to

be obtained are essential to opposing the motion; (2) there is reason to believe such facts may exist; and (3) the reasons **[***41]** why additional time is needed to obtain these facts.'" (*Cooksey v. Alexakis (2004) 123 Cal.App.4th 246, 254 [19 Cal. Rptr. 3d 810]*.) "'The purpose of the affidavit required by *Code of Civil Procedure section 437c, subdivision (h)* is to inform the court of outstanding discovery which is necessary to resist the summary judgment motion. [Citations.]'" (*Bahl v. Bank of America (2001) 89 Cal.App.4th 389, 397 [107 Cal. Rptr. 2d 270]*.) "It is not sufficient under the statute merely to indicate further discovery or investigation is contemplated. The statute makes it a condition that the party moving for a continuance show 'facts essential to justify opposition may exist.'" (*Roth v. Rhodes (1994) 25 Cal.App.4th 530, 548 [30 Cal. Rptr. 2d 706]*.)

It is undisputed that Khalili refused to appear for deposition on the grounds of the attorney-client privilege. Harkham Industries asserts that Khalili's deposition was necessary because she was Jade Fashion's sole negotiator of the Agreement and one of two individuals who submitted a declaration in support of its summary judgment motion. This showing is not sufficient, however, to constitute good cause for a continuance. First, the mere fact that Khalili submitted a declaration for the summary judgment motion does not establish that she possessed facts essential to Harkham Industries's opposition. As the trial court observed, the majority of Khalili's supporting declaration merely authenticated the parties' written **[***42]** correspondence and discovery responses, none of which was disputed by Harkham Industries. Second, the declarations that Harkham Industries submitted with its opposition failed to show what specific facts it believed could be obtained by deposing Khalili. The declaration from Harkham Industries's attorney, John Schwimmer, primarily recounted his efforts to meet and confer with Khalili about her refusal to be deposed, but did not articulate why her deposition was essential to opposing summary judgment in the first place. The declaration from David Meniane, Harkham Industries's negotiator of the Agreement, described his oral communications with Khalili about how the debt would be repaid; however, as discussed, the trial court admitted this evidence in ruling on the summary judgment motion and correctly concluded that it failed to raise a triable issue as to the proper interpretation of the Agreement. Neither declaration explained what additional information could be obtained from Khalili about the terms of the Agreement or how that information was essential to justify Harkham Industries's opposition.
[*657]

Harkham Industries also argues that Khalili's deposition was necessary to support its unclean **[***43]** hands affirmative defense because, as the author of the March 2, 2012 letter, Khalili was a percipient witness to Jade Fashion's alleged fraudulent inducement of the additional $30,000 payment. This claim likewise fails. As previously discussed, Harkham Industries cannot establish the elements of the unclean hands defense because it cannot show how the alleged misconduct prejudicially affected its rights in the litigation. Even if we assume that Khalili acted with an improper motive in sending the letter, it is undisputed that Jade Fashion agreed to credit the $30,000 overpayment to the balance due under the Agreement, and that the **[**203]** trial court applied that credit in awarding damages to Jade Fashion for Harkham Industries's breach. Under these circumstances, Harkham Industries has failed to demonstrate how a continuance to depose Khalili could have led to the discovery of facts essential to its summary judgment opposition. The trial court accordingly did not abuse its discretion in denying the request for a continuance.

DISPOSITION

The judgment is affirmed. Jade Fashion shall recover its costs on appeal.

Woods, Acting P. J., and Segal, J.,* concurred.

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* Judge of the Los Angeles Superior Court, **[***44]** assigned by the Chief Justice pursuant to *article VI, section 6 of the California Constitution*.

Caution
As of: September 21, 2021 5:33 PM Z

Vitatech Internat., Inc. v. Sporn

Court of Appeal of California, Fourth Appellate District, Division Three

September 29, 2017, Opinion Filed

G053477

Reporter
16 Cal. App. 5th 796 *; 224 Cal. Rptr. 3d 691 **; 2017 Cal. App. LEXIS 944 ***; 2017 WL 4876175

VITATECH INTERNATIONAL, INC., Plaintiff and Respondent, v. ALAN R. SPORN et al., Defendants and Appellants.

Prior History: [*1]** Appeal from an order of the Superior Court of Orange County, No. 30-2011-00459259, Sheila Fell, Judge.

Vitatech Int'l, Inc. v. Sporn, 2017 Cal. App. Unpub. LEXIS 6796 (Cal. App. 4th Dist., Sept. 29, 2017)

Disposition: Reversed and remanded. Motion for judicial notice. Granted.

Core Terms

damages, parties, entry of judgment, trial court, stipulated judgment, liquidated damages provision, anticipated, void, settlement amount, settlement, discount, enter a judgment, breached, unenforceable penalty, underlying contract, amount of damages, costs, lawsuit, vacate, financial services, liquidated damages, attorney's fees, fail to pay, unenforceable, aggrieved, products, settle, admission of liability, no reasonable relation, breach of contract

Case Summary

Overview

HOLDINGS: [1]-Although a corporation was not named in the complaint, it was an aggrieved party with standing to appeal under *Code Civ. Proc., § 902*, because the complaint alleged it was a continuation of a named defendant, it filed an answer and fully participated in the litigation without objection, it signed a stipulation for entry of judgment, information about it was sought in postjudgment collection efforts, and it filed a motion to vacate that was the subject of the appeal; [2]-The trial court had authority under *Code Civ. Proc., § 473, subd. (d)*, to vacate a stipulated judgment upon finding it void under *Civ. Code, §§ 1599*, *1671, subd. (b)*, as a penalty rather than liquidated damages; [3]-The stipulated judgment was void as a penalty because the amount bore no reasonable relationship to the damages that could have been anticipated from failure to timely pay the settlement amount.

Outcome

Reversed and remanded.

LexisNexis® Headnotes

Civil Procedure > Appeals > Reviewability of Lower Court Decisions > Adverse Determinations

***HN1*[]** **Reviewability of Lower Court Decisions, Adverse Determinations**

Any party aggrieved by an order or judgment has standing to appeal. *Code Civ. Proc., § 902*. The test for determining appellate standing is twofold. The party seeking to appeal must (1) be a party of record in the trial court, and (2) be aggrieved by the order or judgment from which the appeal is taken. A party is aggrieved for appellate standing purposes if the party's rights or interests are injuriously affected by the judgment or order. The appellant's interest must be immediate, pecuniary, and substantial and not nominal or a remote consequence of the judgment or order. Standing is a jurisdictional requirement, but courts must liberally construe standing and resolve all doubts about it in favor of the right to appeal.

Contracts Law > ... > Damages > Types of

Damages > Liquidated Damages

HN2[] Types of Damages, Liquidated Damages

A provision for liquidation of damages for contractual breach can under some circumstances be designed as, and operate as, a contractual forfeiture. To prevent such operation, California's laws place limits on liquidated damages clauses.

Contracts Law > ... > Damages > Types of Damages > Liquidated Damages

HN3[] Types of Damages, Liquidated Damages

A liquidated damages clause will generally be considered unreasonable, and hence unenforceable under Civ. Code, § 1671, subd. (b), if it bears no reasonable relationship to the range of actual damages that the parties could have anticipated would flow from a breach. The amount set as liquidated damages must represent the result of a reasonable endeavor by the parties to estimate a fair average compensation for any loss that may be sustained. In the absence of such relationship, a contractual clause purporting to predetermine damages must be construed as a penalty. The validity of the liquidated damages provision depends upon its reasonableness at the time the contract was made and not as it appears in retrospect. Accordingly, the amount of damages actually suffered has no bearing on the validity of the liquidated damages provision.

Contracts Law > ... > Damages > Types of Damages > Liquidated Damages

HN4[] Types of Damages, Liquidated Damages

A penalty provision operates to compel performance of an act and usually becomes effective only in the event of default, upon which a forfeiture is compelled without regard to the damages sustained by the party aggrieved by the breach. The characteristic feature of a penalty is its lack of proportional relation to the damages which may actually flow from failure to perform under a contract. In short, an amount disproportionate to the anticipated damages is termed a penalty. A contractual provision imposing a penalty is ineffective, and the wronged party can collect only the actual damages sustained. Absent a relationship between the liquidated damages and the damages the parties anticipated would result from a breach, a liquidated damages clause will be construed as an unenforceable penalty. A liquidated damages provision is not invalid merely because it is intended to encourage a party to perform, so long as it represents a reasonable attempt to anticipate the losses to be suffered. A court will interpret a liquidated damages clause according to its substance, and if it is otherwise valid, will uphold it even if the parties have referred to it as a penalty.

Contracts Law > ... > Damages > Types of Damages > Liquidated Damages

Evidence > Burdens of Proof > Allocation

HN5[] Types of Damages, Liquidated Damages

Based on the presumption in Civ. Code, § 1671, subd. (b), that liquidated damage provisions in nonconsumer contracts are valid, the party challenging the provision bears the burden to show the provision was unreasonable under the circumstances existing when the parties entered into the contract.

Civil Procedure > Judgments > Relief From Judgments > Void Judgments

HN6[] Relief From Judgments, Void Judgments

A court's statutory authority to vacate a judgment or order under Code Civ. Proc., § 473, subd. (d), is limited to void judgments and orders. Jurisdictional errors in rendering a judgment or order generally fall into two categories: A court can lack fundamental authority over the subject matter, question presented, or party, making its judgment void, or it can merely act in excess of its jurisdiction or defined power, rendering the judgment voidable.

Civil Procedure > Judgments > Relief From Judgments > Void Judgments

Contracts Law > ... > Damages > Types of Damages > Liquidated Damages

HN7[] Relief From Judgments, Void Judgments

A liquidated damages provision lacking a reasonable

relationship to the range of damages the parties reasonably could have anticipated is unenforceable and void as against public policy. *Civ. Code, § 1599*, provides that where a contract has several distinct objects, of which one at least is lawful, and one at least is unlawful, in whole or in part, the contract is void as to the latter and valid as to the rest. Liquidated damages not reasonably related to actual damages are unenforceable and void as penalties. A court cannot validly enter a judgment or order which is void even if the parties agree to it.

Civil Procedure > Settlements > Settlement Agreements > Validity of Agreements

Contracts Law > ... > Damages > Types of Damages > Liquidated Damages

Civil Procedure > Judgments > Relief From Judgments > Void Judgments

HN8[] **Settlement Agreements, Validity of Agreements**

A stipulated judgment that includes an unlawful liquidated damages provision is void and may be vacated under *Code Civ. Proc., § 473, subd. (d)*.

Civil Procedure > Appeals > Standards of Review > Questions of Fact & Law

Contracts Law > ... > Damages > Types of Damages > Liquidated Damages

Civil Procedure > Settlements > Settlement Agreements > Validity of Agreements

HN9[] **Standards of Review, Questions of Fact & Law**

Several cases have assumed that the validity of a stipulation for entry of judgment as a liquidated damages provision is a question of law subject to de novo review. One court has carefully examined the nature of this inquiry and concluded this issue may depend on factual determinations more appropriately reviewed under the substantial evidence standard, and it becomes a question of law only when undisputed facts support a single reasonable conclusion. It explained that in determining the reasonableness of a provision for liquidated damages, the court should place itself in the position of the parties at the time the contract was made and should consider the nature of the breaches that might occur and any consequences that were reasonably foreseeable. It is essentially a factual question whether the parties reasonably estimated foreseeable damages under the prevailing circumstances that becomes a question of law when the facts are undisputed and susceptible of only one reasonable interpretation.

Civil Procedure > Settlements > Settlement Agreements > Validity of Agreements

Contracts Law > ... > Damages > Types of Damages > Liquidated Damages

HN10[] **Settlement Agreements, Validity of Agreements**

Damages for the withholding of money are easily determinable—i.e., interest at prevailing rates. A stipulated judgment is enforceable if it is designed to encourage the defendant to make its settlement payments on time, and to compensate the plaintiff for its loss of use of the money plus its reasonable costs in pursuing the payment, but a judgment for the full amount claimed as damages goes well beyond compensating the plaintiff for the defendant failing to pay the lower settlement amount and instead impermissibly punishes the defendant for its failure to pay. The relevant breach is the breach of the settlement stipulation, not the breach of the underlying agreement. By entering into the settlement stipulation, the plaintiff substitutes the defendant's undisputed obligation to pay the lower settlement amount for the disputed claim based on the underlying agreement, the uncertainty of what, if anything, the trier of fact might award on that claim, and the outlay of time and money required to try the claim. Accordingly, any judgment based on the settlement stipulation has to be reasonably related to the anticipated damages caused by breach of the stipulation, not breach of the underlying agreement.

Civil Procedure > Settlements > Settlement Agreements > Validity of Agreements

Contracts Law > ... > Damages > Types of Damages > Liquidated Damages

HN11[] Settlement Agreements, Validity of Agreements

Where parties mutually agree upon the liability of one party and the resulting amount of damage caused by that party, a stipulated judgment in the amount of those damages is not unreasonable. The absence of a disclaimer of any admission of liability is not sufficient when there also is no express admission of liability.

Contracts Law > ... > Damages > Types of Damages > Liquidated Damages

HN12[] Types of Damages, Liquidated Damages

As amended, Civ. Code, § 1671, has made liquidated damages provisions presumptively valid in nonconsumer contracts and has shifted the burden to the party challenging a provision to show it was unreasonable. Nonetheless, the amendment of the statute does not save a judgment that imposes a penalty bearing no proportional relationship to the damages that might actually flow from a breach.

Headnotes/Summary

Summary

[*796] CALIFORNIA OFFICIAL REPORTS SUMMARY

The trial court entered judgment based on the parties' stipulation for entry of judgment and denied a motion to vacate the judgment as void (Code Civ. Proc., § 473, subd. (d)). (Superior Court of Orange County, No. 30-2011-00459259, Sheila Fell, Judge.)

The Court of Appeal reversed and remanded. The court determined that although a corporation was not named in the complaint, it was an aggrieved party with standing to appeal (Code Civ. Proc., § 902) because the complaint alleged it was a continuation of a named defendant, it filed an answer and fully participated in the litigation without objection, it signed the stipulation for entry of judgment, information about it was sought in postjudgment collection efforts, and it filed the motion to vacate that was the subject of the appeal. The trial court had authority to vacate the stipulated judgment if it found the judgment void as a penalty rather than liquidated damages (Civ. Code, §§ 1599, 1671, subd. (b)). The stipulated judgment was void as a penalty because the amount bore no reasonable relationship to the damages that could have been anticipated from failure to timely pay the settlement amount. (Opinion by Aronson, J., with Bedsworth, Acting P. J., and Ikola, J., concurring.)

Headnotes

CALIFORNIA OFFICIAL REPORTS HEADNOTES

CA(1)[] (1)

Appellate Review § 7—Parties—Standing To Appeal.

Any party aggrieved by an order or judgment has standing to appeal (Code Civ. Proc., § 902). The test for determining appellate standing is twofold. The party seeking to appeal must (1) be a party of record in the trial court, and (2) be aggrieved by the order or judgment from which the appeal is taken. A party is aggrieved for appellate standing purposes if the party's rights or interests are injuriously affected by the judgment or order. The appellant's interest must be immediate, pecuniary, and substantial and not nominal or a remote consequence of the judgment or order. Standing is a jurisdictional requirement, but courts must liberally construe standing and resolve all doubts about it in favor of the right to appeal.

CA(2)[] (2)

Damages § 20—Liquidated Damages and Penalties—Preventing Forfeiture.

A provision for liquidation of damages for contractual breach can under some circumstances be designed as, and operate as, a contractual forfeiture. To prevent such operation, California's laws place limits on liquidated damages clauses.

CA(3)[] (3)

Damages § 20—Liquidated Damages and Penalties—Reasonableness of Relationship to Damages Anticipated.

A liquidated damages clause will generally be considered unreasonable, and hence unenforceable under Civ. Code, § 1671, subd. (b), if it bears no reasonable relationship to the range of actual damages that the parties could have anticipated would flow from a breach. The amount set as liquidated damages must

represent the result of a reasonable endeavor by the parties to estimate a fair average compensation for any loss that may be sustained. In the absence of such relationship, a contractual clause purporting to predetermine damages must be construed as a penalty. The validity of the liquidated damages provision depends upon its reasonableness at the time the contract was made and not as it appears in retrospect. Accordingly, the amount of damages actually suffered has no bearing on the validity of the liquidated damages provision.

CA(4)[] (4)

Damages § 20—Liquidated Damages and Penalties—Reasonableness of Relationship to Damages Anticipated.

A penalty provision operates to compel performance of an act and usually becomes effective only in the event of default, upon which a forfeiture is compelled without regard to the damages sustained by the party aggrieved by the breach. The characteristic feature of a penalty is its lack of proportional relation to the damages which may actually flow from failure to perform under a contract. In short, an amount disproportionate to the anticipated damages is termed a penalty. A contractual provision imposing a penalty is ineffective, and the wronged party can collect only the actual damages **[*798]** sustained. Absent a relationship between the liquidated damages and the damages the parties anticipated would result from a breach, a liquidated damages clause will be construed as an unenforceable penalty. A liquidated damages provision is not invalid merely because it is intended to encourage a party to perform, so long as it represents a reasonable attempt to anticipate the losses to be suffered. A court will interpret a liquidated damages clause according to its substance, and if it is otherwise valid, will uphold it even if the parties have referred to it as a penalty.

CA(5)[] (5)

Damages § 20—Liquidated Damages and Penalties—Reasonableness of Relationship to Damages Anticipated—Burden of Proof.

Based on the presumption in Civ. Code, § 1671, subd. (b), that liquidated damage provisions in nonconsumer contracts are valid, the party challenging the provision bears the burden to show the provision was unreasonable under the circumstances existing when the parties entered into the contract.

CA(6)[] (6)

Judgments § 61—Void Judgments and Collateral Attack—Distinction Between Void and Voidable Judgments.

A court's statutory authority to vacate a judgment or order under Code Civ. Proc., § 473, subd. (d), is limited to void judgments and orders. Jurisdictional errors in rendering a judgment or order generally fall into two categories: A court can lack fundamental authority over the subject matter, question presented, or party, making its judgment void, or it can merely act in excess of its jurisdiction or defined power, rendering the judgment voidable.

CA(7)[] (7)

Damages § 20—Liquidated Damages and Penalties—Provision Lacking Reasonable Relationship to Damages Void.

A liquidated damages provision lacking a reasonable relationship to the range of damages the parties reasonably could have anticipated is unenforceable and void as against public policy. Civ. Code, § 1599, provides that where a contract has several distinct objects, of which one at least is lawful, and one at least is unlawful, in whole or in part, the contract is void as to the latter and valid as to the rest. Liquidated damages not reasonably related to actual damages are unenforceable and void as penalties. A court cannot validly enter a judgment or order which is void even if the parties agree to it.

CA(8)[] (8)

Damages § 21—Liquidated Damages and Penalties—Vacating Stipulated Judgment as Void.

A stipulated judgment that includes an unlawful liquidated damages provision is void and may be vacated under Code Civ. Proc., § 473, subd. (d).

[*799] CA(9)[] (9)

Damages § 21—Liquidated Damages and Penalties—

Stipulated Judgment—Reasonableness of Relationship to Damages Anticipated—Loss of Use of Money Plus Costs.

Damages for the withholding of money are easily determinable—i.e., interest at prevailing rates. A stipulated judgment is enforceable if it is designed to encourage the defendant to make its settlement payments on time, and to compensate the plaintiff for its loss of use of the money plus its reasonable costs in pursuing the payment, but a judgment for the full amount claimed as damages goes well beyond compensating the plaintiff for the defendant failing to pay the lower settlement amount and instead impermissibly punishes the defendant for its failure to pay. The relevant breach is the breach of the settlement stipulation, not the breach of the underlying agreement. By entering into the settlement stipulation, the plaintiff substitutes the defendant's undisputed obligation to pay the lower settlement amount for the disputed claim based on the underlying agreement, the uncertainty of what, if anything, the trier of fact might award on that claim, and the outlay of time and money required to try the claim. Accordingly, any judgment based on the settlement stipulation has to be reasonably related to the anticipated damages caused by breach of the stipulation, not breach of the underlying agreement.

CA(10)[] **(10)**

Damages § 21—Liquidated Damages and Penalties—Stipulated Judgment—Reasonableness of Relationship to Damages Anticipated—Evidence.

Nothing in a stipulation for entry of judgment or in the appellate record established a reasonable relationship between the judgment debtors' failure to pay the settlement amount and the much larger judgment. The parties made no effort to anticipate the damages that might flow from a failure to pay the settlement amount. Instead, the parties simply selected the amount the judgment creditor had sought as damages in the underlying lawsuit. The record, however, lacked any evidence suggesting the judgment creditor was likely to recover all of the damages it sought if it proceeded to trial. The stipulation for entry of judgment illegally penalized the judgment debtors for failing to pay the settlement amount, rather than compensating the judgment creditor for the reasonably anticipated damages caused by that failure.

[Cal. Forms of Pleading and Practice (2017) ch. 177, Damages, § 177.78; *1 Crompton et al., Matthew Bender Practice Guide: Cal. Contract Litigation (2017) § 7.05*; 1 Witkin, Summary of Cal. Law (11th ed. 2017) Contracts, §§ 507 et seq., 545 et seq.; 9 Witkin, Cal. Procedure (5th ed. 2008) Appeal, § 24; 8 Witkin, Cal. Procedure (5th ed. 2008) Attack on Judgment in Trial Court, § 207.]

CA(11)[] **(11)**

Damages § 21—Liquidated Damages and Penalties—Stipulated Judgment—Reasonableness of Relationship to Damages Anticipated—Admission of Liability.

Where parties mutually agree upon the liability **[*800]** of one party and the resulting amount of damage caused by that party, a stipulated judgment in the amount of those damages is not unreasonable. The absence of a disclaimer of any admission of liability is not sufficient when there also is no express admission of liability.

CA(12)[] **(12)**

Damages § 20—Liquidated Damages and Penalties—Reasonableness of Relationship to Damages Anticipated.

As amended, *Civ. Code, § 1671*, has made liquidated damages provisions presumptively valid in nonconsumer contracts and has shifted the burden to the party challenging a provision to show it was unreasonable. Nonetheless, the amendment of the statute does not save a judgment that imposes a penalty bearing no proportional relationship to the damages that might actually flow from a breach.

Counsel: Friedman Stroffe & Gerard, Andrew R. Nelson and Sasan K. Behnood for Defendants and Appellants.

Steponovich & Associates and Michael J. Steponovich, Jr., for Plaintiff and Respondent.

Judges: Opinion by Aronson, J., with Bedsworth, Acting P. J., and Ikola, J., concurring.

Opinion by: Aronson, J.

Opinion

[694]** ARONSON, J.**—Seeking more than $166,000 in damages, plaintiff Vitatech International, Inc. (Vitatech), filed this breach of contract lawsuit against

defendants National Marketing, Inc., CortiSlim International, formerly known as National Marketing, Inc., CortiSlim International, LLC, and Alan R. Sporn (collectively, Defendants). On the eve of trial, the parties settled for a one-time payment of $75,000. As part of the settlement, Defendants stipulated to entry of judgment against them "in the full prayer of the Complaint," but Vitatech agreed to "forbear" from filing the stipulation and to accept the $75,000 "as full Settlement of its claims against Defendants" if they paid by the designated date. When Defendants failed to pay, Vitatech filed the stipulation **[***2]** and the trial court entered judgment against Defendants for more than $300,000, which included compensatory damages, prejudgment interest, attorney fees, and costs.

Sporn and appellant CortiSlim International, Inc. (collectively, Appellants), moved to vacate the judgment, arguing it was an unenforceable penalty under *Civil Code section 1671, subdivision (b)* (*section 1671(b)*). The trial court denied the motion because it found the judgment's higher amount was not a penalty or liquidated damages provision subject to *section 1671(b)*. Rather, **[*801]** the court concluded the reduced amount Vitatech agreed to accept was merely a discount if Defendants paid their debt as agreed.

We reverse and remand for the trial court to grant the motion and enter a new judgment for the $75,000 settlement amount, plus trial court costs. Under well-established precedent, including this court's decision in *Greentree Financial Group, Inc. v. Execute Sports, Inc. (2008) 163 Cal.App.4th 495 [78 Cal. Rptr. 3d 24]* (*Greentree*), the stipulated judgment for more than four times the amount Vitatech agreed to accept as full settlement of its claims is an unenforceable penalty because it bears no reasonable relationship to the range of damages the parties could have anticipated would result from Defendants' failure timely to pay the settlement amount. Contrary to Vitatech's **[***3]** argument, **[**695]** the stipulation for entry of judgment is not merely a permissible discount provision because the stipulation compromises disputed claims and resolves pending litigation. Although Defendants stipulated to entry of judgment if they did not timely pay, they never admitted liability on the underlying claims or the amount of damages allegedly caused by the breach of the underlying contract.

We also reject Vitatech's contention CortiSlim International, Inc., lacks standing to appeal the trial court's order because Vitatech did not name it as a defendant and the judgment did not award any relief against it. Vitatech ignores that its complaint included allegations that CortiSlim International, Inc., was liable for Defendants' debts, CortiSlim International, Inc., answered the complaint and fully participated in the litigation without objection, and Vitatech focused its postjudgment collection efforts on CortiSlim International, Inc.'s potential liability for Defendants' debts.

I

Facts and Procedural History

Vitatech and National Marketing, Inc., entered into a contract for Vitatech to manufacture certain products for National Marketing, Inc. In March 2011, Vitatech filed this lawsuit against **[***4]** Defendants alleging National Marketing, Inc., failed to pay the invoices for the products it purchased. The operative first amended complaint did not name CortiSlim International, Inc., as a defendant, but it alleged CortiSlim International, Inc., and CortiSlim International, LLC, were continuations of National Marketing, Inc. Vitatech named Sporn as a defendant based on a personal guaranty he signed and also alleged Sporn is the alter ego of all entity defendants. The complaint sought $166,372.14 in compensatory damages, plus attorney fees and costs, based on claims for (1) breach of contract; (2) breach of oral contract; (3) breach of implied in fact contract; (4) open book account; (5) account stated; and (6) breach of guaranty.
[*802]

In August 2011, CortiSlim International, LLC, and CortiSlim International, Inc., filed an answer asserting numerous affirmative defenses, including that the underlying contract was unenforceable, Vitatech breached the underlying contract, and Vitatech improperly manufactured and labeled its products. In February 2012, Sporn and National Marketing, Inc., filed an answer alleging many of the same affirmative defenses.

In September 2014, the parties agreed to settle **[***5]** this lawsuit. According to Vitatech's president, Defendants agreed to pay Vitatech $75,000 on or before June 5, 2015, and the parties entered into a stipulation for entry of judgment that authorized Vitatech to have the court enter judgment against Defendants for the full amount alleged in the complaint if they failed to make the settlement payment. Upon timely receipt of the settlement payment, Vitatech agreed to dismiss its complaint with prejudice.

The only written agreement setting forth the terms of the parties' settlement was a stipulation that provided "judgment shall be entered against Defendants Alan R. Sporn, an individual; CortiSlim International formerly known as National Marketing, Inc.; National Marketing, Inc. and CortiSlim International, LLC, in favor of [Vitatech], in the full prayer of the Complaint on file herein; [¶] … [but Vitatech] will forbear from the filing hereof and will accept, as full settlement of its claims against Defendants Alan R. Sporn, an individual; CortiSlim International formerly known as National Marketing, Inc.; National Marketing, Inc. and CortiSlim International, LLC, **[**696]** the principal sum of Seventy-Five Thousand Dollars ($75,000.00), payable **[***6]** in one (1) payment on or before June 5, 2015." Although the stipulation did not provide for entry of judgment against CortiSlim International, Inc., that entity signed the stipulation along with Sporn, CortiSlim International, formerly known as National Marketing, Inc., and National Marketing, Inc. CortiSlim International, LLC, did not sign the stipulation.

Defendants failed to make the settlement payment and Vitatech asked the trial court to enter judgment based on the stipulation. Vitatech sought a judgment for $303,620.12, comprised of $166,372.14 in compensatory damages, $104,427.01 in prejudgment interest, $28,315 in attorney fees, and $4,505.97 in costs. In July 2015, the court entered judgment against Defendants in the amount requested. The judgment did not name CortiSlim International, Inc.

In November 2015, Appellants moved to vacate the judgment under *Code of Civil Procedure section 473, subdivision (d)* (*section 473(d)*). They argued the judgment was void because it constituted an unlawful penalty in violation of *section 1671(b)*'s prohibition against liquidated damages provisions that bear no reasonable relationship to the damages likely to be caused by the **[*803]** breach of contract. Vitatech opposed the motion, arguing the judgment is not a penalty or illegal **[***7]** liquidated damages provision because Defendants judicially admitted and stipulated to their liability in the full amount of the prayer for relief alleged in the complaint and the stipulated judgment merely enforces that acknowledgement. The $75,000 settlement amount, Vitatech contends, was merely a discount of the agreed-upon liability to encourage prompt and timely payment.

The trial court agreed with Vitatech and denied the motion, ruling that "Defendants were served with [Vitatech's] declarations re breach of the Stipulation and Request for Entry of Judgment prior to the Judgment being entered. The Stipulated Judgment was for the amount of the debt alleged in the Complaint. The reduced amount agreed by the parties represented a discount if the debt was paid as agreed. The amount of the judgment did not represent a penalty; the lower amount represented a discount to Defendants. [¶] Defendants have not shown extrinsic fraud or mistake. Nor have Defendants shown a meritorious defense, satisfactory excuse, or diligence. Defendants have not shown special circumstances to justify setting the Judgment aside. Further, the Judgment is not void or voidable." This appeal followed.

II

DISCUSSION **[***8]**

A. *CortiSlim International, Inc., Has Standing to Appeal*

Vitatech contends CortiSlim International, Inc., lacks standing to appeal because CortiSlim International, Inc., was not a party of record in the trial court, the stipulation for entry of judgment did not refer to it, and the court did not enter the judgment against it. We conclude CortiSlim International, Inc., has standing to appeal.[1]

HN1[↑] ***CA(1)***[↑] **(1)** **[**697]** "Any party aggrieved" by an order or judgment has standing to appeal. (*Code Civ. Proc., § 902*.) The test for determining appellate standing is twofold. The party seeking to appeal must (1) be a party of record in the trial court, and (2) be aggrieved by the order or judgment from which the **[*804]** appeal is taken. (*In re Marriage of Burwell (2013) 221 Cal.App.4th 1, 13 [164 Cal. Rptr. 3d 702]*.) A party is aggrieved for appellate standing purposes if the party's ""'rights or interests are injuriously affected by the judgment [or order].'"" (*People ex rel. Allstate Ins. Co. v. Dahan (2016) 3 Cal.App.5th 372, 376 [207 Cal. Rptr. 3d 569]*.) "The appellant's 'interest "'must be

[1] We also note Vitatech failed to properly challenge CortiSlim International, Inc.'s standing to appeal. A party seeking to dismiss an opponent's appeal based on a lack of appellate standing must file a separate motion to dismiss in the appellate court. (*Halliburton Energy Services, Inc. v. Department of Transportation (2013) 220 Cal.App.4th 87, 106 [162 Cal. Rptr. 3d 752]*; *Jocer Enterprises, Inc. v. Price (2010) 183 Cal.App.4th 559, 565 [107 Cal. Rptr. 3d 539]*; *American Alternative Energy Partners II v. Windridge, Inc. (1996) 42 Cal.App.4th 551, 557–558 [49 Cal. Rptr. 2d 686]*.) Vitatech improperly raised the issue in its brief rather than by a separate motion.

immediate, pecuniary, and substantial and not nominal or a remote consequence of the judgment [or order].'"'" (*Ibid.*) Standing is a jurisdictional requirement (*Sabi v. Sterling (2010) 183 Cal.App.4th 916, 947 [107 Cal. Rptr. 3d 805]*), but we must liberally construe standing and resolve all doubts about it in favor of the right to appeal (*Burwell, at p. 14*; *In re L. Y. L. (2002) 101 Cal.App.4th 942, 948 [124 Cal. Rptr. 2d 688]*).

Here, CortiSlim International, Inc., was a party of record in the trial court. Although the complaint did **[***9]** not name CortiSlim International, Inc., as a defendant, it included several allegations about the company. For example, the complaint alleged Sporn was the president of CortiSlim International, Inc., when he ordered and purchased the products on CortiSlim International, Inc.'s behalf. The complaint further alleged CortiSlim International, Inc., was "simply a continuation of National Marketing, Inc. and is a new name but with essentially the same stockholders and officers." CortiSlim International, Inc., responded to these allegations by filing an answer to the complaint and fully participating in the litigation without any objection by Vitatech. Indeed, CortiSlim International, Inc., was one of the parties who brought the motion to vacate, and Vitatech did not challenge CortiSlim International, Inc.'s standing to do so in the trial court.

Citing *In re Joseph G. (2000) 83 Cal.App.4th 712, 714–716 [99 Cal. Rptr. 2d 915]*, Vitatech argues CortiSlim International, Inc., is not a party of record with standing to appeal simply because its name appears in some of the documents filed in the trial court. CortiSlim International, Inc.'s involvement in this lawsuit, however, goes well beyond that. As explained above, it filed an answer, participated in the litigation, and **[***10]** filed the motion to vacate that is the subject of this appeal. Vitatech fails to explain how CortiSlim International, Inc., is not a party of record when these facts are considered.

CortiSlim International, Inc., also is an aggrieved party because it was one of the parties that brought the motion to vacate, and therefore necessarily was aggrieved by the order denying it. Moreover, CortiSlim International, Inc., was aggrieved by the judgment the motion sought to set aside. Vitatech points out neither the stipulation for entry of judgment nor the judgment expressly granted any relief against CortiSlim International, Inc. But CortiSlim International, Inc., signed the stipulation, the complaint included the foregoing allegations regarding its potential liability, and Vitatech has continued to pursue CortiSlim International, Inc., in postjudgment collection proceedings. For example, in **[*805]** seeking an order to conduct Sporn's judgment debtor examination, Vitatech's counsel filed a declaration requesting information about CortiSlim International, Inc., because counsel suspected the judgment debtors transferred their **[**698]** assets to CortiSlim International, Inc., without adequate consideration.[2] These facts **[***11]** show that CortiSlim International, Inc., has a substantial pecuniary interest affected by the judgment.

Finally, on a practical level, we note that Vitatech's challenge to CortiSlim International, Inc.'s appellate standing would not end this appeal even if we agreed that corporation lacked standing. Sporn also is an appellant and Vitatech does not dispute his standing to appeal from the trial court's order denying the motion to vacate.[3]

B. *The Trial Court Erred in Denying the Motion To Vacate*

1. *Governing Legal Principles on Liquidated Damages Provisions*

CA(2)[↑] **(2)** "California law has … long recognized that ***HN2***[↑] a provision for liquidation of damages for contractual breach … can under some circumstances be designed as, and operate as, a contractual forfeiture. To prevent such operation, our laws place limits on liquidated damages clauses. Under the 1872 Civil Code, a provision by which damages for a breach of contract were determined in anticipation of breach was enforceable only if determining actual damages was impracticable or extremely difficult. (*1872 Civ. Code, §§ 1670*, *1671*.) As amended in 1977, the code continues to apply that strict standard to liquidated damages clauses in certain contracts (consumer goods **[***12]** and services, and leases of residential real property (*§ 1671, subds. (c)*, *(d)*), but somewhat liberalizes the rule as to other contracts: '[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 the provision was unreasonable under the circumstances existing at the time the contract was made.' (*§ 1671, subd. (b)* … .)" (*Ridgley v. Topa Thrift &*

[2] We grant Vitatech's motion to judicially notice this declaration and several governmental filings and listings relating to CortiSlim International, Inc., CortiSlim International, LLC, and National Marketing, Inc. Appellants did not oppose the motion.

[3] Vitatech also argues the judgment is not appealable because it is a stipulated judgment. But Appellants are appealing from the order denying the motion to vacate the judgment, and not from the entry of the stipulated judgment.

Loan Assn. (1998) 17 Cal.4th 970, 976–977 [73 Cal. Rptr. 2d 378, 953 P.2d 484] (*Ridgley*); see Krechuniak v. Noorzoy (2017) 11 Cal.App.5th 713, 720 [217 Cal. Rptr. 3d 740] (*Krechuniak*).)

HN3[↑] CA(3)[↑] **(3)** "A liquidated damages clause will generally be considered unreasonable, and hence unenforceable under section 1671(b), if it bears no reasonable **[*806]** relationship to the range of actual damages that the parties could have anticipated would flow from a breach. The amount set as liquidated damages 'must represent the result of a reasonable endeavor by the parties to estimate a fair average compensation for any loss that may be sustained.' [Citation.] In the absence of such relationship, a contractual clause purporting to predetermine damages 'must be construed as a penalty.'" (Ridgley, supra, 17 Cal.4th at p. 977.) "'The validity of the liquidated damages provision depends upon its reasonableness at the time the contract was made and not as it appears in retrospect. Accordingly, the amount of damages actually suffered has no bearing **[***13]** on the validity of the liquidated damages provision.'" (Krechuniak, supra, 11 Cal.App.5th at p. 721.)

HN4[↑] CA(4)[↑] **(4)** "'A penalty provision operates to compel performance of an act [citation] and usually becomes effective only in the **[**699]** event of default [citation] upon which a forfeiture is compelled without regard to the damages sustained by the party aggrieved by the breach [citation]. The characteristic feature of a penalty is its lack of proportional relation to the damages which may actually flow from failure to perform under a contract.'" (Ridgley, supra, 17 Cal.4th at p. 977.)

"In short, '[a]n amount disproportionate to the anticipated damages is termed a "penalty." A contractual provision imposing a "penalty" is ineffective, and the wronged party can collect only the actual damages sustained.'" (Ridgley, supra, 17 Cal.4th at p. 977; see Purcell v. Schweitzer (2014) 224 Cal.App.4th 969, 974 [169 Cal. Rptr. 3d 90] (*Purcell*) ["'Absent a relationship between the liquidated damages and the damages the parties anticipated would result from a breach, a liquidated damages clause will be construed as an unenforceable penalty'"].)

"A liquidated damages provision is not invalid merely because it is intended to encourage a party to perform, so long as it represents a reasonable attempt to anticipate the losses to be suffered. [Citation.] A court will interpret a liquidated damages clause according **[***14]** to its substance, and if it is otherwise valid, will uphold it even if the parties have referred to it as a penalty." (Weber, Lipshie & Co. v. Christian (1997) 52 Cal.App.4th 645, 656 [60 Cal. Rptr. 2d 677] (*Weber*); see Ridgley, supra, 17 Cal.4th at p. 979 ["'We have consistently ignored form and sought out the substance of arrangements which purport to legitimate penalties and forfeitures'"]; Greentree, supra, 163 Cal.App.4th at p. 499.)

HN5[↑] CA(5)[↑] **(5)** Based on section 1671(b)'s presumption that liquidated damage provisions in nonconsumer contracts are valid, the party challenging the provision bears the burden to show the provision was unreasonable under the circumstances existing when the parties entered into the contract. (Krechuniak, supra, 11 Cal.App.5th at p. 721; see Weber, supra, 52 Cal.App.4th at p. 654.)
[*807]

2. *Appellants Properly Sought To Vacate the Judgment Under* Section 473(d)

Vitatech contends the trial court lacked authority to grant Appellants' motion because they improperly brought it under section 473(d). According to Vitatech, the stipulated judgment's alleged violation of section 1671(b) at most rendered the judgment voidable, but section 473(d) only authorizes a court to vacate a void judgment. Vitatech misconstrues the legal impact of a contract provision violating section 1671(b)'s prohibition on unlawful penalties.

HN6[↑] CA(6)[↑] **(6)** A court's statutory authority to vacate a judgment or order under section 473(d) is limited to void judgments and orders. (Cruz v. Fagor America, Inc. (2007) 146 Cal.App.4th 488, 495–496 [52 Cal. Rptr. 3d 862].) And as Vitatech points out, our Supreme Court has repeatedly observed that jurisdictional **[***15]** errors in rendering a judgment or order generally fall into two categories: "A court can lack fundamental authority over the subject matter, question presented, or party, making its judgment void, or it can merely act in excess of its jurisdiction or defined power, rendering the judgment voidable." (In re Marriage of Goddard (2004) 33 Cal.4th 49, 56 [14 Cal. Rptr. 3d 50, 90 P.3d 1209].) Here, Vitatech contends the court's judgment in its favor is at most voidable because no **[**700]** one disputes the trial court had fundamental authority over the subject matter, the questions presented, and the parties.

CA(7)[↑] **(7)** Vitatech, however, fails to recognize that HN7[↑] a liquidated damages provision lacking a

reasonable relationship to the range of damages the parties reasonably could have anticipated is unenforceable and void as against public policy. (Civ. Code, § 1599 ["Where a contract has several distinct objects, of which one at least is lawful, and one at least is unlawful, in whole or in part, the contract is void as to the latter and valid as to the rest"]; Sybron Corp. v. Clark Hosp. Supply Corp. (1978) 76 Cal.App.3d 896, 900 [143 Cal. Rptr. 306] (*Sybron*) ["Under California law liquidated damages not reasonably related to actual damages are unenforceable and void as penalties"].) "[A] court cannot validly enter a judgment or order which is void even if the parties agree to it." (Plaza Hollister Ltd. Partnership v. County of San Benito (1999) 72 Cal.App.4th 1, 13 [84 Cal. Rptr. 2d 715].)

CA(8)[↑] **(8)** Accordingly, HN8[↑] a **[***16]** stipulated judgment that includes an unlawful liquidated damages provision is void and may be vacated under section 473(d). Any other rule effectively would insulate such provisions from challenge and render the prohibition against them meaningless.

3. *Standard of Review*

The central question presented is whether the stipulation for entry of judgment is a permissible liquidated damages provision or a void and **[*808]** unenforceable penalty under section 1671(b). HN9[↑] Several cases have assumed this is a question of law subject to de novo review. (Jade Fashion & Co., Inc. v. Harkham Industries, Inc. (2014) 229 Cal.App.4th 635, 646 [177 Cal. Rptr. 3d 184] (*Jade Fashion*); Purcell, supra, 224 Cal.App.4th at p. 974; McGuire v. More-Gas Investments, LLC (2013) 220 Cal.App.4th 512, 523 [163 Cal. Rptr. 3d 225]; Greentree, supra, 163 Cal.App.4th at p. 499; Harbor Island Holdings v. Kim (2003) 107 Cal.App.4th 790, 794 [132 Cal. Rptr. 2d 406].) Recently, however, one court carefully examined the nature of this inquiry and concluded this issue may depend on factual determinations more appropriately reviewed under the substantial evidence standard, and it becomes a question of law only when undisputed facts support a single reasonable conclusion. (Krechuniak, supra, 11 Cal.App.5th at pp. 722–725.)

The *Krechuniak* court explained: "In determining the reasonableness of a provision for liquidated damages, 'the court should place itself in the position of the parties at the time the contract was made and should consider the nature of the breaches that might occur and any consequences that were reasonably foreseeable.' [Citation.] The California Supreme Court **[***17]** has recognized that it is essentially a factual question whether the parties reasonably estimated foreseeable damages under the prevailing circumstances [citations] that becomes a question of law when the facts are undisputed and susceptible of only one reasonable interpretation." (Krechuniak, supra, 11 Cal.App.5th at pp. 722–723.)

Neither side identified any disputed facts relating to their stipulation for entry of judgment, and therefore we review de novo the question whether the stipulation is a void and unenforceable penalty or a permissible liquidated damages provision.

4. *The Stipulated Judgment Is an Unenforceable Penalty*

Appellants contend the trial court erred in denying their motion to vacate the stipulated judgment as void. According to Appellants, the stipulated judgment was **[**701]** void as a matter of law because no reasonable relationship exists between the damages that could have been anticipated based on their failure to pay the $75,000 settlement amount and the stipulated judgment for more than $300,000. We agree.

In *Greentree*, we applied the foregoing principles regarding liquidated damages to reverse a stipulated judgment on facts similar to this case. There, the plaintiff sued the defendant for breach of contract, alleging **[***18]** the defendant failed to pay the plaintiff $45,000 for financial services. The parties reached a settlement they memorialized in a stipulation for entry of judgment, which provided the defendant would pay the plaintiff $20,000 in two installments, **[*809]** and if the defendant failed to make either payment the plaintiff could enter judgment against the defendant for the full amount sought in the plaintiff's complaint, including interest and attorney fees. (Greentree, supra, 163 Cal.App.4th at p. 498.) The stipulation also stated that "'[e]ach party disclaims any admission of wrongdoing, fault, liability, or violation of law.'" (Id. at p. 500.) The defendant failed to make the initial payment and the plaintiff asked the trial court to enter judgment against the defendant for more than $61,000, consisting of $45,000 in damages for breach of the financial services contract, $14,000 in prejudgment interest, and $2,000 in attorney fees and costs. Over the defendant's objection the judgment was excessive, the trial court entered the requested judgment. (Id. at p. 498.)

CA(9)[↑] **(9)** We reversed because "[the parties] did not attempt to anticipate the damages that might flow from a breach of the stipulation. Rather, they simply selected

the amount [the plaintiff] had claimed as damages **[***19]** in the underlying lawsuit, plus prejudgment interest, attorney fees, and costs. But the appellate record contains nothing showing [the plaintiff's] chances of complete success on the merits of its case … . [¶] Also, the $61,232.50 amount in the judgment bears no reasonable relationship to the range of actual damages the parties could have anticipated from a breach of the stipulation to settle the dispute for $20,000. ***HN10***[] '[D]amages for the withholding of money are easily determinable—i.e., interest at prevailing rates … .' [Citation.] The amount of the judgment, however, was more than triple the amount for which the parties agreed to settle the case." (*Greentree, supra, 163 Cal.App.4th at pp. 499–500*.)

We further explained, "the judgment would have been enforceable if it had been designed to encourage [the defendant] to make its settlement payments on time, and to compensate [the plaintiff] for its loss of use of the money plus its reasonable costs in pursuing the payment," but the judgment for $61,000 went well beyond compensating the plaintiff for the defendant failing to pay the $20,000 settlement amount and instead impermissibly punished the defendant for its failure to pay. (*Greentree, supra, 163 Cal.App.4th at p. 500*; see *Purcell, supra, 224 Cal.App.4th at pp. 975–976* [stipulated judgment for nearly $60,000 constituted illegal **[***20]** penalty for breach of settlement agreement requiring payment of $38,000]; *Sybron, supra, 76 Cal.App.3d at pp. 899, 903* [stipulated judgment for $100,000 constituted illegal penalty for failure to make timely installment payment on $72,000 settlement].)

The *Greentree* plaintiff argued the amount specified in the judgment was reasonably related to the damages the plaintiff suffered based on the defendant's breach of the underlying financial services **[**702]** agreement. We rejected that argument because the relevant breach was the breach of the settlement stipulation, not the breach of the underlying financial services agreement. The **[*810]** trial court entered the judgment because the defendant breached the settlement stipulation, not because the defendant breached the underlying financial services agreement. By entering into the settlement stipulation, the plaintiff substituted the defendant's undisputed obligation to pay $20,000 for the disputed claim based on the financial services agreement, the uncertainty of what, if anything, the trier of fact might award on that claim, and the outlay of time and money required to try the claim. Accordingly, any judgment based on the settlement stipulation had to be reasonably related to the anticipated damages **[***21]** caused by breach of the stipulation, not breach of the underlying financial services agreement. (*Greentree, supra, 163 Cal.App.4th at pp. 499–500*.)

Here, Vitatech sued Appellants for breach of contract, alleging Appellants failed to pay $166,372.14 for various products Vitatech manufactured for them. Appellants answered the complaint, denied liability, and asserted a variety of affirmative defenses, including that the underlying contract was unenforceable, Vitatech breached the underlying contract, and Vitatech improperly manufactured and labeled its products. On the eve of trial, and after several trial continuances, the parties agreed to a settlement, with Appellants stipulating to entry of judgment "in the full prayer of the Complaint" and Vitatech agreeing to "forbear from the filing [of the stipulation for entry of judgment and to] accept, as full settlement of its claims … the principal sum of Seventy-Five Thousand Dollars ($75,000), payable in one (1) payment on or before June 5, 2015."

The parties' stipulation for entry of judgment does not use the phrase liquidated damages, but its legal effect is the same as a liquidated damages provision. (*Ridgley, supra, 17 Cal.4th at p. 979*; *Greentree, supra, 163 Cal.App.4th at p. 499*; *Weber, supra, 52 Cal.App.4th at p. 656*.) The stipulation predetermines the amount of damages Vitatech is entitled **[***22]** to receive if Appellants breached the stipulation by failing timely to pay the settlement amount. The provision establishing the amount of the stipulated judgment therefore is unenforceable unless that amount bears a reasonable relationship to the amount of damages the parties could have anticipated Vitatech would suffer if Appellants breached their obligation to pay the settlement amount. (*Ridgley, at p. 977*.) Indeed, the amount of the judgment must reasonably relate to the damages likely to arise from the breach of the stipulation, not the alleged breach of the underlying contract, because it is the breach of the stipulation that allows Vitatech to enter judgment against Appellants. (*Greentree, at pp. 499–500*.)

CA(10)[] **(10)** Nothing in the stipulation or appellate record establishes a reasonable relationship between Appellants' failure to pay the $75,000 settlement amount and the $303,000 judgment. As in *Greentree*, the parties made no **[*811]** effort to anticipate the damages that might flow from Appellants' failure to pay the settlement amount. Instead, the parties simply selected the amount Vitatech had sought as damages in the underlying lawsuit. The record, however, lacks any evidence

suggesting Vitatech was likely to recover all of the damages **[***23]** it sought if it proceeded to trial. Moreover, we cannot conceive of any meaningful relationship between Appellants' failure to pay the amount Vitatech agreed to accept in **[**703]** settlement of its disputed claims and a judgment that is more than four times that amount. *Greentree* and the other cases cited above therefore compel the conclusion the stipulation for entry of judgment illegally penalizes Appellants for failing to pay the settlement amount, rather than compensating Vitatech for the reasonably anticipated damages caused by that failure.[4] (*Greentree, supra, 163 Cal.App.4th at pp. 499–500*; see *Purcell, supra, 224 Cal.App.4th at pp. 975–976*; *Sybron, supra, 76 Cal.App.3d at pp. 899, 903*.)

Vitatech contends *Greentree* is distinguishable because the stipulation in *Greentree* included language "'disclaiming any admission of wrongdoing, fault, [or] liability,'" but here Appellants judicially admitted liability and stipulated to judgment in the full amount sought in the complaint. We disagree because Vitatech misconstrues the stipulation for entry of judgment.

Although the stipulation here does not include a disclaimer of any admission of liability like the stipulation in *Greentree*, it also does not include an admission of liability on the underlying claims. As explained above, Appellants stipulated to entry of judgment "in the **[***24]** full prayer of the Complaint" if they failed timely to pay the $75,000 Vitatech agreed to accept "as full settlement of its claims." This language does not constitute an admission of liability for breach of the underlying contract nor does it constitute an admission of the amount of damages that breach caused. Rather, this language is nothing more than an agreement to settle a disputed claim for less than the amount demanded and a penalty if Appellants fail timely to pay the settlement amount.

Vitatech's reliance on two United States District Court cases is misplaced. (*Seamen v. Valley Health Care Medical Group, Inc. (C.D.Cal., Dec. 16, 2015, No. SA CV 13-1709-DOC (RNBx)) 2015 U.S.Dist. Lexis 168407* (*Seamen*); *Rose v. Enriquez (C.D.Cal., Dec. 19, 2012, No. CV 11-07838 DDP (AJWx)) 2012 U.S.Dist. Lexis 179711* (*Rose*).) These cases support, rather than undermine, our conclusion that the language of the stipulation for entry of judgment is not an admission of liability sufficient to distinguish this case **[*812]** from *Greentree*. In *Rose*, the plaintiff sued the defendants for more than $3.6 million based on claims for extortion, fraud, racketeering, and counterfeiting. At a mediation, the parties agreed to settle the case for "significant[ly]" less than the plaintiff sought in the complaint, and the defendants stipulated to entry of a $3.5 million judgment if they failed to make the settlement payments. After the defendants missed several payments, the plaintiff asked the court to enter the stipulated judgment and **[***25]** the defendants objected that the judgment was an unenforceable penalty under *section 1671(b)* and *Greentree*. (*Rose, at pp. *3–*4*.)

CA(11)[↑] **(11)** The *Rose* court nonetheless entered the stipulated judgment, explaining, "Here, in contrast [to *Greentree*], the Agreement memorializes evidence presented to the Mediator by the Plaintiff as to the loss caused by Defendants' fraud, counterfeiting, and other wrongful acts, and also contains an express statement of Defendants' liability. [Citation.] This is in distinct contrast to *Greentree*, where no evidence was **[**704]** presented and the figure for the stipulated judgment was taken from the complaint with no inquiry or evidence and with no admission of liability. [¶] … ***HN11***[↑] Where, as here, parties mutually agree upon the liability of one party and the resulting amount of damage caused by that party, a stipulated judgment in the amount of those damages will not be unreasonable." (*Rose, supra, 2012 U.S.Dist. Lexis 179711 at pp. *5–*6*.) *Seamen* relied on *Rose* to reach a similar result. (*Seamen, supra, 2015 U.S.Dist. Lexis 168407 at pp. *7–*8*) [stipulated judgment in amount of prayer permissible when defendant failed to pay lesser settlement amount because defendant expressly admitted liability on underlying claims and amount of damages].)

Here, the stipulation for entry of judgment fails to describe any evidence presented to a neutral third party to show the damages Appellants **[***26]** allegedly caused by breaching the underlying contract. Similarly, Appellants did not expressly admit liability for breaching the underlying contract or the amount of damages any purported breach caused Vitatech. Instead, as in *Greentree*, the stipulation for entry of judgment merely used the amount of damages Vitatech alleged in the complaint with no inquiry or evidence to support it. Granted, the stipulation in *Greentree* included an express disclaimer of any admission of liability that is not present in this case, but the absence of that

[4] Although we apply the de novo standard in reviewing the trial court's order, we note that we would reach the same outcome under the substantial evidence standard because no substantial evidence supports the trial court's conclusion the settlement amount was a discount from an admitted liability rather than an unenforceable liquidated damages provision.

disclaimer is not sufficient to distinguish this case from *Greentree* when there also is no express admission of liability. (C.f. *Purcell, supra, 224 Cal.App.4th at pp. 971–973* [finding stipulated judgment in original amount of alleged liability was unenforceable penalty even though stipulation did not include disclaimer of any admission of liability].)

Citing *Jade Fashion*, Vitatech also contends none of the foregoing cases apply to the stipulation for entry of judgment because the stipulation does not **[*813]** include a liquidated damages provision. Rather, Vitatech argues the stipulation merely provides a discount on an admitted obligation based on Appellants' timely payment. This contention also fails because it again **[***27]** misconstrues the stipulation for entry of judgment.

In *Jade Fashion*, the plaintiff was a garment manufacturer that sold a large volume of its products to the defendant, but the defendant experienced significant cashflow problems and fell behind in its payment obligations. The defendant did not dispute that it owed $340,000 to the plaintiff, and worked out a payment plan to bring its account current and allow it to receive additional shipments from the plaintiff. The written agreement the parties signed acknowledged the precise amount of the defendant's debt, established a detailed payment schedule, and provided that the defendant could deduct $17,500 from the final payment if the defendant timely made all other payments. Under the agreement, the defendant was not entitled to the discount if even one payment was late. (*Jade Fashion, supra, 229 Cal.App.4th at pp. 638–639*.) The defendant was late in making several payments, but made its payments before the last one was due and deducted the $17,500 from its final payment. Concluding the defendant was not entitled to the discount because of the late payments, the plaintiff refused to accept the defendant's final payment unless the defendant also paid the $17,500. When the defendant refused, **[***28]** the plaintiff sued for breach of contract and obtained a summary judgment against the defendant. (*Id. at pp. 640–641*.)

On appeal, the defendant cited *Greentree*, *Purcell*, and *Sybron* and argued the $17,500 discount was an unenforceable **[**705]** penalty because that amount bore no relationship to the few dollars in damages the plaintiff suffered when some payments were a few days late. *Jade Fashion* rejected this argument, explaining the parties in *Greentree*, *Purcell*, and *Sybron* "agreed to settle a pending lawsuit for a stipulated amount that was less than the damages alleged in the plaintiff's complaint; if the defendant breached the settlement agreement, it then would be required to pay a fixed amount of additional damages, which was disproportionately higher than the settlement amount. In contrast, the agreement [in *Jade Fashion*] was not an agreement to settle or compromise a disputed claim. Rather, it was an agreement to forbear on the collection of a debt that was admittedly owed for goods that had been delivered so long as timely installment payments were made." (*Jade Fashion, supra, 229 Cal.App.4th at p. 648*.) The Court of Appeal emphasized the parties' agreement provided the $17,500 discount was part of the original $340,000 debt that the defendant expressly **[***29]** admitted it owed, and therefore *section 1671(b)* did not apply and the enforceability of the discount provision did not turn on its relationship to any anticipated damages. (*Jade Fashion, at p. 649*.) **[*814]**

Jade Fashion does not apply here because the stipulation for entry of judgment was an agreement to compromise a *disputed* claim for less than alleged in the complaint. Unlike in *Jade Fashion*, Vitatech and Appellants agreed to the stipulation for entry of judgment on the eve of trial to resolve a pending lawsuit. As explained above, Appellants never acknowledged their liability for the underlying claims or the damages Vitatech alleged in the complaint. Rather, they agreed to settle Vitatech's claims for a lesser amount and Appellants agreed to pay additional damages if they defaulted. This stipulation for entry of judgment therefore is governed by *Greentree*, not *Jade Fashion*.

Finally, Vitatech argues *Sybron* is no longer good law because it was decided under *section 1671*'s prior version, and *Greentree* and *Purcell* were wrongly decided because they applied *Ridgley* in a completely different factual context. Not so.

CA(12)[↑] **(12)** In *Greentree*, we considered the impact the 1977 amendments to *section 1671* had on *Sybron*, and published our decision to "reaffirm that the **[***30]** rule set forth in *Sybron* … continues to apply after the intervening amendment to … *section 1671*." (*Greentree, supra, 163 Cal.App.4th at pp. 497–498*.) We acknowledged ***HN12***[↑] the amendments to *section 1671* made liquidated damages provisions presumptively valid in nonconsumer contracts and shifted the burden to the party challenging a provision to show it was unreasonable. Nonetheless, we explained, "The amendment of the statute does not save a judgment that imposes a penalty bearing no proportional

relationship to the damages that might actually flow from a breach. (*Ridgley, supra, 17 Cal.4th at pp. 976–977*.) Indeed, the Supreme Court cited *Sybron* with approval in a case analyzing the postamendment version of *section 1671*. (*Ridgley, supra, 17 Cal.4th at p. 978*.)" (*Greentree, at p. 501, fn. 2*.)

Ridgley involved the validity of a loan provision that required the borrower to pay a prepayment fee equal to six months of interest if the borrower sought to prepay the loan after making late interest payments. (*Ridgley, supra, 17 Cal.4th at pp. 973–974*.) The Supreme Court applied the foregoing principles regarding liquidated damages provisions to conclude the prepayment fee was an unenforceable penalty for **[**706]** late payment of interest because the amount of the fee bore no reasonable relationship to the damages the parties anticipated the borrower's late interest payments would cause. (*Id. at pp. 976–979*.) Nothing in *Ridgley* limited the standards **[***31]** it established regarding liquidated damages provisions to the context of a loan, and *Greentree* and *Purcell* properly applied those standards to the stipulations for entry of judgment at issue in those cases. We see no basis for Vitatech's efforts to criticize *Greentree* and *Purcell.*
[*815]

III

DISPOSITION

The order denying Appellants' motion to vacate the stipulated judgment is reversed and we remand with directions for the trial court to grant the motion and enter a new judgment for $75,000 based on the parties' stipulation for entry of judgment. The stipulation includes no provision for attorney fees or prejudgment interest and Vitatech directs us to no authority authorizing it to recover either of those items. Vitatech may apply to recover its trial court costs because nothing in the stipulation for entry of judgment relinquishes that right when Appellants failed to timely pay. (*Greentree, supra, 163 Cal.App.4th at p. 502*; *Sybron, supra, 76 Cal.App.3d at pp. 903–904*.) Appellants shall recover their costs on appeal.

Bedsworth, Acting P. J., and Ikola, J., concurred.

On October 30, 2018, the opinion was modified to read as printed above.

Neutral
As of: August 9, 2021 9:04 PM Z

Graylee v. Castro

Court of Appeal of California, Fourth Appellate District, Division Three

July 13, 2020, Opinion Filed

G057901, G058409

Reporter
52 Cal. App. 5th 1107 *; 265 Cal. Rptr. 3d 885 **; 2020 Cal. App. LEXIS 725 ***

FRED GRAYLEE, Plaintiff and Respondent, v. JOHN CASTRO et al., Defendants and Appellants.

Subsequent History: [*1]** The Publication Status of this Document has been Changed by the Court from Unpublished to Published August 4, 2020.

Prior History: Appeals from judgments of the Superior Court of Orange County, No. 30-2018-01003115, Carmen Luege, Commissioner, and Sherri L. Honer, Judge.

Graylee v. Castro, 2020 Cal. App. Unpub. LEXIS 4384 (Cal. App. 4th Dist., July 13, 2020)

Disposition: Reversed and remanded with directions.

Core Terms

tenants, landlord, damages, parties, settlement, vacate, unpaid rent, liquidated damages, trial court, unenforceable penalty, liquidated damages clause, costs, attorney's fees, anticipated, amount of the judgment, stipulated judgment, entry of judgment, actual damage, discount, notice, no reasonable relation, settlement agreement, disputed claim, broom, swept, quit, rent

Case Summary

Overview

HOLDINGS: [1]-A stipulated judgment in an unlawful detainer action, which required the tenants to pay an amount based on the claimed unpaid rent as a consequence of failing to vacate by a specified deadline, was an unenforceable penalty because the amount did not reasonably relate under Civ. Code, § 1671, subd. (b), to the range of actual damages the parties could have anticipated would flow from a breach of the stipulation; [2]-A liquidated damages analysis was appropriate because Code Civ. Proc., § 664.6, did not authorize the inclusion of an unlawful liquidated damages provision in a stipulated judgment, and thus the exception in § 1671, subd. (a), for other statutory standards did not apply; [3]-Because the tenants never admitted owing the amount sought and nothing in the record showed the landlord's chances of recovering it, the stipulation was a compromise of disputed claims.

Outcome
Reversed and remanded.

LexisNexis® Headnotes

Civil Procedure > Appeals > Standards of Review > De Novo Review

Contracts Law > ... > Damages > Types of Damages > Liquidated Damages

HN1 **Standards of Review, De Novo Review**

In evaluating whether a liquidated damages clause is an unenforceable penalty, courts apply a de novo standard of review when there are no conflicting or disputed facts.

Civil Procedure > Settlements > Settlement Agreements > Incorporation in Judgment

Contracts Law > ... > Damages > Types of Damages > Liquidated Damages

Contracts Law > Defenses > Public Policy Violations

HN2[] Settlement Agreements, Incorporation in Judgment

Code Civ. Proc., § 664.6, allows courts to enter judgment under the terms of a settlement agreement, and, if requested, retain jurisdiction to enforce the settlement. But a court cannot enter a judgment that contains an unenforceable liquidated damages clause. Section 664.6 does not allow a court to endorse or enforce a provision in a settlement agreement or stipulation which is illegal, contrary to public policy, or unjust. A court cannot validly enter a judgment or order which is void even if the parties agree to it. Unenforceable liquidated damages provisions are void as against public policy. As such, a stipulated judgment that includes an unlawful liquidated damages provision is void and may be vacated.

Contracts Law > ... > Damages > Types of Damages > Liquidated Damages

HN3[] Types of Damages, Liquidated Damages

The term "liquidated damages" is used to indicate an amount of compensation to be paid in the event of a breach of contract, the sum of which is fixed and certain by agreement, and which may not ordinarily be modified or altered when damages actually result from nonperformance of the contract. Liquidated damages constitute a sum which a contracting party agrees to pay for breach of some contractual obligation. Courts look beyond the language of the contract to determine the actual circumstances of a liquidated damages clause.

Contracts Law > ... > Damages > Types of Damages > Liquidated Damages

HN4[] Types of Damages, Liquidated Damages

Civ. Code, § 1671, subd. (b), provides that a liquidated damages clause is valid unless the party seeking to invalidate the provision establishes that the provision was unreasonable under the circumstances existing at the time the contract was made. Under this subdivision, a liquidated damages clause becomes an unenforceable penalty if it bears no reasonable relationship to the range of actual damages that the parties could have anticipated would flow from a breach. The amount set as liquidated damages must represent the result of a reasonable endeavor by the parties to estimate a fair average compensation for any loss that may be sustained. Absent a relationship between the liquidated damages and the damages the parties anticipated would result from a breach, a liquidated damages clause will be construed as an unenforceable penalty.

Civil Procedure > Settlements > Settlement Agreements > Incorporation in Judgment

Contracts Law > ... > Damages > Types of Damages > Liquidated Damages

HN5[] Settlement Agreements, Incorporation in Judgment

In the context of a stipulated judgment, the amount of the judgment must reasonably relate, for purposes of Civ. Code, § 1671, subd. (b), to the damages likely to arise from the breach of the stipulation, not the alleged breach of the underlying contract, because it is the breach of the stipulation that allows the plaintiff to enter judgment against the defendant.

Civil Procedure > Settlements > Settlement Agreements > Incorporation in Judgment

Contracts Law > ... > Damages > Types of Damages > Liquidated Damages

HN6[] Settlement Agreements, Incorporation in Judgment

The crucial distinction between decisions that found a stipulated judgment to be an unenforceable penalty and another decision that did not apply liquidated damages analysis was whether the settlement was a compromise of a disputed claim. This was true in the decisions that found an unenforceable penalty. It was not in the other decision, where the defendant expressly admitted to owing the sum claimed by the plaintiff.

Civil Procedure > Appeals > Appellate Briefs

HN7[] Appeals, Appellate Briefs

Generally, a reviewing court is not required to make an independent, unassisted study of the record in search of error or grounds to support the judgment.

Headnotes/Summary

Summary

[*1107] CALIFORNIA OFFICIAL REPORTS SUMMARY

The trial court entered a stipulated judgment in an unlawful detainer action, which required the tenants to pay an amount based on the claimed unpaid rent after they failed to vacate by a specified deadline. (Superior Court of Orange County, No. 30-2018-01003115, Carmen Luege, Commissioner, and Sherri L. Honer, Judge.)

The Court of Appeal reversed and remanded, holding that the stipulated judgment was an unenforceable penalty because the amount did not reasonably relate (*Civ. Code, § 1671, subd. (b)*) to the range of actual damages the parties could have anticipated would flow from a breach of the stipulation. A liquidated damages analysis was appropriate because the inclusion of an unlawful liquidated damages provision in a stipulated judgment is not authorized by statute (*Code Civ. Proc., § 664.6*), and thus the exception for other statutory standards (*§ 1671, subd. (a)*) did not apply. Because the tenants never admitted owing the amount sought and nothing in the record showed the landlord's chances of recovering it, the stipulation was a compromise of disputed claims. (Opinion by Moore, Acting P. J., with Aronson and Goethals, JJ., concurring.)

Headnotes

CALIFORNIA OFFICIAL REPORTS HEADNOTES

CA(1) **(1)**

Compromise, Settlement, and Release § 8—Settlements—Validity—Stipulated Judgment—Unenforceable Liquidated Damages Clause.

Code Civ. Proc., § 664.6, allows courts to enter judgment under the terms of a settlement agreement, and, if requested, retain jurisdiction to enforce the settlement. But a court cannot enter a judgment that contains an unenforceable liquidated damages clause. *Section 664.6* does not allow a court to endorse or enforce a provision in a settlement agreement or stipulation which is illegal, contrary to public policy, or unjust. A court cannot validly enter a judgment or order which is void even if the parties agree to it. Unenforceable liquidated damages provisions are void as against public policy. As such, a stipulated judgment that includes an unlawful liquidated damages provision is void and may be vacated.

CA(2) **(2)**

Damages § 20—Liquidated Damages and Penalties—What Constitutes.

The term "liquidated damages" is used to indicate an amount of compensation to be paid in the event of a breach of contract, the sum of which is fixed and certain by agreement, and which may not ordinarily be modified or altered when damages actually result from nonperformance of the contract. Liquidated damages constitute a sum which a contracting party agrees to pay for breach of some contractual obligation. Courts look beyond the language of the contract to determine the actual circumstances of a liquidated damages clause.

CA(3) **(3)**

Damages § 20—Liquidated Damages and Penalties—Reasonableness of Relationship to Anticipated Damages.

Civ. Code, § 1671, subd. (b), provides that a liquidated damages clause is valid unless the party seeking to invalidate the provision establishes that the provision was unreasonable under the circumstances existing at the time the contract was made. Under this subdivision, a liquidated damages clause becomes an unenforceable penalty if it bears no reasonable relationship to the range of actual damages that the parties could have anticipated would flow from a breach. The amount set as liquidated damages must represent the result of a reasonable endeavor by the parties to estimate a fair average compensation for any loss that may be sustained. Absent a relationship between the liquidated damages and the damages the parties anticipated would result from a breach, a liquidated damages clause will be construed as an unenforceable penalty.

CA(4) **(4)**

Damages § 21—Liquidated Damages and Penalties—Stipulated Judgment—Reasonableness of Relationship to Anticipated Damages.

In the context of a stipulated judgment, the amount of the judgment must **[*1109]** reasonably relate (Civ. Code, § 1671, subd. (b)) to the damages likely to arise from the breach of the stipulation, not the alleged breach of the underlying contract, because it is the breach of the stipulation that allows the plaintiff to enter judgment against the defendant.

CA(5)[] **(5)**

Damages § 21—Liquidated Damages and Penalties—Stipulated Judgment—Reasonableness of Relationship to Anticipated Damages—Compromise of Disputed Claims.

The crucial distinction between decisions that found a stipulated judgment to be an unenforceable penalty and another decision that did not apply liquidated damages analysis was whether the settlement was a compromise of a disputed claim. This was true in the decisions that found an unenforceable penalty. It was not in the other decision, where the defendant expressly admitted to owing the sum claimed by the plaintiff.

CA(6)[] **(6)**

Damages § 21—Liquidated Damages and Penalties—Stipulated Judgment—Reasonableness of Relationship to Anticipated Damages—Compromise of Disputed Claims.

A stipulated judgment in a landlord-tenant dispute was a compromise of disputed claims. The tenants did not expressly concede the merits of the unlawful detainer claim. Nor did they admit to owing the claimed amount of unpaid rent in the stipulation. Rather, the tenants disputed the claims and intended to challenge them at trial. On the brink of trial, the parties compromised their dispute. They agreed that the landlord would be awarded possession of the property and waive the unpaid rent allegedly owed (i.e., settle for a lesser amount). In exchange, the tenants would move out by a specified deadline and release all their claims against the landlord. If the tenants failed to timely vacate, they would pay the landlord liquidated damages in the form of a judgment. The amount of the judgment did not withstand scrutiny. Nothing in the record showed the parties made any effort to reasonably anticipate the amount of damages that might flow from the tenants' breach of the stipulation. And there was no meaningful relationship between the judgment and the tenants' failure to move out by the deadline (or alleged failure to leave the property in broom swept condition). Instead, the amount of the judgment was calculated using the unpaid rent alleged in the complaint. But nothing in the record showed the landlord's chances to completely succeed at trial and recover all the unpaid rent allegedly owed. The judgment thus was an unenforceable penalty.

[Cal. Forms of Pleading and Practice (2020) ch. 177, Damages, § 177.78; 1 Crompton et al., Matthew Bender Practice Guide: Cal. Contract Litigation (2020) § 7.05.]

[*1110] CA(7)[] **(7)**

Appellate Review § 108—Briefs—Form and Requisites—Reference to Record—Reviewing Court Not Required to Search.

Generally, a reviewing court is not required to make an independent, unassisted study of the record in search of error or grounds to support the judgment.

Counsel: John Castro, in pro. per., for Defendants and Appellants.

Duringer Law Group, Stephen C. Duringer, Edward L. Laird II and Stephanie A. Pittaluga for Plaintiff and Respondent.

Judges: Opinion by **[**887]** Moore, Acting P. J., with Aronson and Goethals, JJ., concurring.

Opinion by: Moore, Acting P. J.

Opinion

MOORE, Acting P. J.—Defendants John and Rosa Castro (the tenants) leased a residential property from plaintiff Fred Graylee (the landlord).[1] The landlord brought an unlawful detainer action against the tenants,

[1] The lease agreement lists the tenants' landlord as "B&G Property Management." The parties do not explain Graylee's connection to this entity or how he has standing. Nor is this clear from the record. However, both sides agree that Graylee was the tenants' landlord. Thus, we will accept this fact as true for purposes of this consolidated appeal. As explained below, the tenants appealed two judgments: one signed by a commissioner in June 2019 (G057901) and one signed by a judge in September 2019 (G058409). The June 10, 2019 judgment has been vacated and thus the appeal of that judgment is moot.

alleging they owed him $27,100 in unpaid rent. The day of trial, the parties entered into a stipulated judgment in which the tenants agreed to vacate the property by a certain date and time. If they failed to do so, the landlord would be entitled to enter a $28,970 judgment against them. The tenants missed their move-out deadline by a few hours and the landlord filed a motion seeking entry of judgment. The trial court granted **[***2]** the motion and entered a $28,970 judgment against the tenants under the terms of the stipulation. The tenants appealed, arguing the judgment constitutes an unenforceable penalty because it bears no reasonable relationship to the range of actual damages the parties could have anticipated would flow from a breach of the stipulation. We agree. The judgment is reversed and the matter remanded for further proceedings as set forth within this opinion.

I

FACTS AND PROCEDURAL HISTORY

The tenants entered into a residential lease with the landlord in May 2015 for a property in Anaheim, agreeing to pay **[**888]** $3,195 in monthly rent. In June **[*1111]** 2018, the landlord served the tenants with a three-day notice to pay rent or quit (notice to quit) that alleged the tenants owed $27,170 in unpaid rent. The tenants neither paid the amount demanded nor vacated the property, so the landlord filed this unlawful detainer action on July 3, 2018. The landlord filed a second amended complaint in August 2018 (the complaint) seeking $27,170 in past-due rent, reasonable attorney fees, and forfeiture of the lease agreement, among other things. The tenants answered the complaint, denying most of the material allegations, including **[***3]** the landlord's claim that they owed $27,170 in unpaid rent. The answer also asserted two affirmative defenses. First, the landlord "waived, changed, or canceled the notice to quit." Second, the landlord had "accepted rent from [the tenants] to cover a period of time after the date the notice to quit expired." Trial was set for October 2, 2018.

On the day of trial, but prior to its commencement, the parties filed a handwritten stipulation for entry of judgment on a preprinted form (stipulation), which the trial court entered that day. Under the stipulation, the landlord was awarded possession of the property. A $28,970 judgment (consisting of unpaid rent and damages, attorney fees, and costs) would be granted in favor of the landlord "ONLY IF [the tenants] Fail[ed] to comply with [the] terms" of the stipulation.[2] The tenants agreed to return the keys and vacate the property by 3:00 p.m. **[**889]** on October 31, 2018, leaving it "in broom swept condition." Any personal property left behind would become property of the landlord and could be thrown away without notice. The tenants also waived all claims, known or unknown, against the landlord and his agents up through the date of the stipulation. **[***4]** The parties specified the stipulated judgment was contingent on the tenants vacating the property by 3:00 p.m. on October 31, 2018. If they did, the landlord would "waive[] all of the [$28,970] money Judgment … . If [they] fail[ed] to comply, the full Judgment Amount [would] be collectible and due from [the tenants] … ."

In January 2019, the landlord filed a motion for entry of the $28,970 judgment against the tenants, alleging they had failed to timely vacate the property and failed to leave it in broom swept condition.[3] The motion was supported by a declaration from the landlord's property manager stating that tenant John Castro returned the key to the property around 1:15 p.m. on October 31, 2018. Castro told the manager that the tenants would not be ready to vacate by 3:00 p.m. that day and asked for more time. The manager accepted the key but denied the extension request. The manager drove by the property later that day at 3:15 p.m. and saw the tenants carrying boxes out of **[*1112]** the house, furniture, and other personal belongings inside the garage. The tenants had vacated by the time she returned to the property around 10:30 a.m. the next day. Her declaration also stated that **[***5]** the property had not been left in broom swept condition but did not elaborate.

The tenants opposed the motion and filed declarations from John Castro and others asserting that the tenants had moved everything out of the house by 3:00 p.m. on October 31. After which, the tenants moved personal belongings from outside the house into a moving truck without reentering the house. John Castro's declaration also attached pictures to show the property had been

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[2] The stipulation states the judgment would be $27,970, but this appears to be a typo. The stipulation specifies the judgment consists of $27,170 in rent and damages, $1,200 in attorney fees, and $600 in costs. The sum of these components is $28,970, not $27,970.

[3] Initially, the landlord filed a declaration of noncompliance requesting that the trial court declare a default under the stipulation and declare the $28,970 judgment due and owing. The trial court denied this request, stating that the landlord must request a hearing.

left in broom swept condition.

Following briefing, the trial court set an evidentiary hearing. At the hearing's conclusion, the trial court found the tenants had failed to vacate the property by 3:00 p.m. on October 31, and granted the landlord's motion. The trial court also issued a minute order clarifying that its entry of the stipulation on October 2, 2018, was not a final judgment: "[A]lthough the pre-printed form indicates 'judgment is hereby ordered on all terms of the foregoing stipulation,' the stipulation clearly contemplated entry of judgment was conditional (i.e., it was not meant to serve as a final order) until after it was determined whether [the tenants] complied with vacating the premises by 3:00 p.m. on 10/31/18. [The **[***6]** landlord] filed his motion to enforce the stipulation, and after evidentiary hearing, the court found [the tenants] failed to vacate the property as agreed … . Accordingly, the court enters a money judgment for $28,970 in favor of [the landlord] and against [the tenants]." Judgment was entered on June 10, 2019 (June judgment), which the tenants appealed.

After filing their appeal, the tenants filed a motion to set aside the June judgment. They argued it had been erroneously signed by Commissioner Carmen Luege, who had previously been disqualified by peremptory challenge. The judgment should have been signed by Judge Sherri L. Honer, they asserted, since she had presided over the evidentiary hearing and had granted the landlord's motion for entry of judgment. On September 26, 2019, the trial court granted the tenants' motion, vacated the June judgment, and entered an amended judgment (signed by Judge Honer) against the tenants in the amount of $28,970. The tenants then appealed the amended judgment. This appeal was consolidated with the appeal of the June judgment by order of this court.
[*1113]

II

DISCUSSION

Because the trial court vacated the June judgment, we find the appeal of that judgment **[***7]** to be moot. All references to the judgment below refer to the amended judgment entered on September 26, 2019.

Among other things, the tenants contend the $28,970 judgment entered against them is an unenforceable penalty under *Civil Code section 1671, subdivision (b)*,[4] which governs liquidated damages clauses. The amount of the judgment, they argue, bears no reasonable relationship to the range of actual damages the parties could have anticipated would flow from a breach of the stipulation. We agree, as explained below.

HN1[↑] In evaluating whether a liquidated damages clause is an unenforceable penalty, courts apply a de novo standard of review when there are no conflicting or disputed facts. Neither side has identified any such facts as to this issue. Thus, the de novo standard applies. (*Vitatech Internat., Inc. v. Sporn (2017) 16 Cal.App.5th 796, 807–808 [224 Cal. Rptr. 3d 691]* (*Vitatech*).) We note that the landlord argues the proper standard is abuse of discretion under *Denham v. Superior Court (1970) 2 Cal.3d 557, 564 [86 Cal. Rptr. 65, 468 P.2d 193]*. *Denham* is inapposite. It involved a court's denial of a motion to dismiss for failure to diligently prosecute a case. (*Id. at pp. 563–564*.)
[890]**

A. *Applicability of Section 1671 to the Stipulation*

The landlord offers only one rebuttal to the tenants' unenforceable penalty argument. He maintains liquidated damages analysis under *section 1671* is irrelevant to the stipulation under *subdivision (a)* of **[***8]** that section, which provides: "This section does not apply in any case where another statute expressly applicable to the contract prescribes the rules or standard for determining the validity" of a liquidated damages provision. (*§ 1671, subd. (a)*.) Based on this subdivision, he contends *Code of Civil Procedure section 664.6* is expressly applicable and governs the stipulation at issue, rendering the remainder of *Civil Code section 1671* inapplicable.

CA(1)[↑] **(1)** We disagree. The exception in *section 1671, subdivision (a)*, does not apply here. ***HN2***[↑] *Code of Civil Procedure section 664.6* allows courts to enter judgment under the terms of a settlement agreement, and, if requested, retain jurisdiction to enforce the settlement. But a court cannot enter a judgment that contains an unenforceable liquidated damages clause. "*[S]ection 664.6* **[*1114]** does not allow a court to endorse or enforce a provision in a settlement agreement or stipulation which is illegal, contrary to public policy, or unjust." (*Timney v. Lin (2003) 106 Cal.App.4th 1121, 1127 [131 Cal. Rptr. 2d 387]*.) "'[A] court cannot validly enter a judgment or order which is void even if the parties agree to it.'"

[4] Subsequent statutory references are to the Civil Code unless otherwise indicated.

(*Vitatech, supra, 16 Cal.App.5th at p. 807*.) Unenforceable liquidated damages provisions are void as against public policy. (*Ibid.*) As such, "a stipulated judgment that includes an unlawful liquidated damages provision is void and may be vacated." (*Ibid.*)

B. *Liquidated Damages Clause*

CA(2)[↑] **(2)** Before performing **[***9]** any analysis under *section 1671, subdivision (b)*, we must first determine whether the stipulation contains a liquidated damages clause. ***HN3***[↑] "'The term "liquidated damages" is used to indicate an amount of compensation to be paid in the event of a breach of contract, the sum of which is fixed and certain by agreement, and which may not ordinarily be modified or altered when damages actually result from nonperformance of the contract.' [Citation.] 'Liquidated damages constitute a sum which a contracting party agrees to pay … for breach of some contractual obligation.'" (*McGuire v. More-Gas Investments, LLC (2013) 220 Cal.App.4th 512, 521 [163 Cal. Rptr. 3d 225]*.) "Courts look beyond the language of the contract to determine the actual circumstances of a liquidated damages clause." (*Del Monte Properties & Investments, Inc. v. Dolan (2018) 26 Cal.App.5th Supp. 20, 23 [236 Cal. Rptr. 3d 923]*.)

Here, the $28,970 judgment would only be entered if the tenants failed to comply with the stipulation. In other words, the stipulation predetermined the amount of damages the landlord would be entitled to receive if the tenants breached their settlement obligations. While the stipulation does not use the phrase "liquidated damages," its legal effect is the same as a liquidated damages provision. As such, liquidated damages analysis applies. (See, e.g., *Vitatech, supra, 16 Cal.App.5th at pp. 802, 810* [applying liquidated damages analysis where stipulation provided the **[***10]** plaintiff would "'forbear from the filing'" of a judgment for the full amount of the complaint if the defendants timely made a lower settlement payment].)

C. *Analysis of Relevant Case Law*

HN4[↑] ***CA(3)***[↑] **(3)** *Section 1671, subdivision (b)*, provides that a liquidated damages clause **[**891]** "is valid unless the party seeking to invalidate the provision establishes that the provision was unreasonable under the circumstances existing at **[*1115]** the time the contract was made."[5] Under this subdivision, "a liquidated damages clause becomes an unenforceable penalty 'if it bears no reasonable relationship to the range of actual damages that the parties could have anticipated would flow from a breach.' [Citation.] 'The amount set as liquidated damages "must represent the result of a reasonable endeavor by the parties to estimate a fair average compensation for any loss that may be sustained."' [Citation.] 'Absent a relationship between the liquidated damages and the damages the parties anticipated would result from a breach, a liquidated damages clause will be construed as an unenforceable penalty.'" (*Purcell v. Schweitzer (2014) 224 Cal.App.4th 969, 974 [169 Cal. Rptr. 3d 90]*.)

HN5[↑] ***CA(4)***[↑] **(4)** In the context of a stipulated judgment, "the amount of the judgment must reasonably relate to the damages likely to arise *from the breach of the stipulation* ***[***11]*** , not the alleged breach of the underlying contract, because it is the breach of the stipulation that allows [the plaintiff] to enter judgment against [the defendant]." (*Vitatech, supra, 16 Cal.App.5th at p. 810*, italics added.) Thus, we analyze the damages flowing from the breach of the stipulation itself, not any damages that may have arisen from the tenants' alleged breach of the underlying lease agreement.

This Division has applied liquidated damages analysis to settlement agreements in two recent cases: *Greentree Financial Group, Inc. v. Execute Sports, Inc. (2008) 163 Cal.App.4th 495 [78 Cal. Rptr. 3d 24]* (*Greentree*) and *Vitatech, supra, 16 Cal.App.5th 796*. These cases are discussed below, along with *Jade Fashion & Co., Inc. v. Harkham Industries, Inc. (2014) 229 Cal.App.4th 635 [177 Cal. Rptr. 3d 184]* (*Jade Fashion*), which involved the same issue and was decided between *Greentree* and *Vitatech*.

In *Greentree*, the plaintiff sued for breach of contract, alleging the defendant had failed to pay the plaintiff $45,000 for services rendered. The parties settled prior to trial. Under the settlement, the defendant agreed to pay the plaintiff $20,000 total in two installments. If the defendant missed either payment, the plaintiff would be entitled to a judgment against the defendant in the amount of $45,000 plus interest, attorney fees, and costs. The defendant missed the first payment and,

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[5] Under *section 1671, subdivision (c)*, a liquidated damages clause in a lease of real property used as a dwelling is evaluated under *subdivision (d)* of that section, rather than *subdivision (b)*. As explained below, the relevant document is the stipulation, not the underlying lease. Thus, *section 1671, subdivision (b)*, applies.

under the settlement, had a $61,232.50 judgment entered against it. (*Greentree, supra, 163 Cal.App.4th at p. 498*.)

We found the judgment **[***12]** to be an unenforceable penalty. The parties "did not attempt to anticipate the damages that might flow from a breach of the **[*1116]** stipulation. Rather, they simply selected the amount [the plaintiff] had claimed as damages in the underlying lawsuit, plus prejudgment interest, attorney fees, and costs. But the appellate record contain[ed] nothing showing [the plaintiff's] chances of complete success on the merits of its case … . [¶] Also, the $61,232.50 amount in the judgment [bore] no reasonable relationship to the range of actual damages the parties could have anticipated from a breach of the stipulation to settle the dispute for $20,000." (*Greentree, supra, 163 Cal.App.4th at pp. 499–500*.)

[892]** We further explained "the judgment would have been enforceable if it had been designed to encourage [the defendant] to make its settlement payments on time, and to compensate [the plaintiff] for its loss of use of the money plus its reasonable costs in pursuing the payment. The amount of the judgment, which awarded [the plaintiff] approximately $40,000 more than the settlement amount, [did] not merely compensate [the plaintiff]—it reward[ed the plaintiff] by penalizing [the defendant]." (*Greentree, supra, 163 Cal.App.4th at p. 500*.)

The Second District Court of Appeal issued the *Jade Fashion* ***[***13]*** decision a few years after *Greentree*. In *Jade Fashion*, the defendant purchased garments from the plaintiff and then fell behind on its payments. (*Jade Fashion, supra, 229 Cal.App.4th at pp. 638–639*.) Prior to litigation, the parties entered into a settlement in which the defendant expressly admitted to owing the plaintiff $341,628.77 in both the settlement agreement and a guaranty provided by the defendant's CEO. (*Id. at pp. 639–640*.) The defendant agreed to make weekly payments until that balance was completely paid. If all its payments were timely, the defendant would receive a $17,500 discount on the total amount owed. (*Ibid.*) The agreement specified that time was of the essence for each payment and that the defendant would not be entitled to the discount if any payment was untimely. (*Ibid.*) Though the defendant made all its payments, several were late. Despite this, the defendant deducted the discount from its final payment. (*Id. at p. 640*.) The plaintiff demanded the defendant pay the outstanding $17,500, but the defendant refused. (*Id. at pp. 640–641*.) The plaintiff sued for breach of contract and obtained summary judgment against the defendant. (*Id. at pp. 641–642*.)

On appeal, the defendant argued the $17,500 discount was an unenforceable penalty because it bore no reasonable relationship to **[***14]** the damages the plaintiff would suffer from the late payments. (*Jade Fashion, supra, 229 Cal.App.4th at pp. 645–646, 648*.) The appellate court disagreed, finding that liquidated damages analysis did not apply: "The express language of the [settlement] … establishe[d] that the $17,500 discount was not liquidated damages for a breach of contract, nor was it an additional payment over and above any debt that was owed. Instead, the $17,500 was part of the **[*1117]** $341,628.77 debt which [the defendant] specifically admitted it owed to [the plaintiff] in both the [settlement agreement] and the continuing guaranty." (*Id. at p. 649*.) In distinguishing *Greentree*, the *Jade Fashion* court found the parties' settlement "was not an agreement to settle or compromise a disputed claim. Rather, it was an agreement to forbear on the collection of a debt that was admittedly owed for goods that had been delivered so long as timely installment payments were made." (*Id. at p. 648*.)

After the decision in *Jade Fashion*, we revisited this issue in *Vitatech*. In *Vitatech*, the plaintiff filed a lawsuit alleging that the defendants failed to pay for certain goods and seeking $166,372.14 in damages plus attorney fees and costs. (*Vitatech, supra, 16 Cal.App.5th at p. 801*.) The parties agreed to a stipulated judgment prior to trial that provided, **[***15]** "'judgment shall be entered against [the defendants], in favor of [the plaintiff], in the full prayer of the Complaint … [but the plaintiff] will forbear from the filing hereof and will accept, as full settlement of its claims against [the defendants], the principal sum of'" $75,000, payable by June 5, 2015. (*Id. at p. 802*.) **[**893]** The defendants failed to make the required payment and had a $303,620.12 judgment (comprised of damages, interest, attorney fees, and costs) entered against them. The defendants sought to vacate the judgment on grounds it was an unlawful penalty. (*Id. at pp. 802–803*.) The trial court denied the request, finding "'[t]he amount of the judgment did not represent a penalty; the lower amount [in the settlement] represented a discount to Defendants.'" (*Id. at p. 803*.)

We reversed, finding the judgment was an unenforceable penalty. We distinguished *Jade Fashion*, explaining that unlike the settlement in that case the *Vitatech* stipulation "was an agreement to compromise a *disputed* claim for less than alleged in the complaint."

(*Vitatech, supra, 16 Cal.App.5th at p. 814*.) The parties "agreed to the stipulation for entry of judgment on the eve of trial to resolve a pending lawsuit… . [The defendants] never acknowledged their liability for the underlying **[***16]** claims or the damages … alleged in the complaint. Rather, they agreed to settle [the plaintiff's] claims for a lesser amount and [the defendants] agreed to pay additional damages if they defaulted." (*Ibid.*)

We also found "[n]othing in the stipulation or appellate record establishe[d] a reasonable relationship between [the defendants'] failure to pay the $75,000 settlement amount and the $303,000 judgment. … [T]he parties made no effort to anticipate the damages that might flow from [the defendants'] failure to pay the settlement amount. Instead, the parties simply selected the amount [the defendants] had sought as damages in the underlying lawsuit. … Moreover, we [could not] conceive of any meaningful relationship between [the defendants'] failure to pay the amount [the plaintiff] agreed to accept in **[*1118]** settlement of its disputed claims and a judgment that [was] more than four times that amount." (*Vitatech, supra, 16 Cal.App.5th at pp. 810–811*.)

HN6[] ***CA(5)***[] **(5)** The crucial distinction between the *Greentree* and *Vitatech* decisions and the *Jade Fashion* decision was whether the settlement was a compromise of a disputed claim. This was true in *Greentree* and *Vitatech*. (*Greentree, supra, 163 Cal.App.4th at pp. 499–500*; *Vitatech, supra, 16 Cal.App.5th at p. 814*.) It was not in *Jade Fashion*, where the defendant expressly admitted to owing the sum claimed by **[***17]** the plaintiff in two separate documents. (*Jade Fashion, supra, 229 Cal.App.4th at pp. 648–649*.)

CA(6)[] **(6)** Like *Greentree* and *Vitatech*, the stipulation at issue was a compromise of disputed claims. Here, the tenants did not expressly concede the merits of the unlawful detainer claim. Nor did they admit to owing $27,100 in unpaid rent in the stipulation or anywhere else in the record. Rather, the record shows the tenants disputed these claims and intended to challenge them at trial. For example, the answer denied the allegations in the complaint and asserted affirmative defenses, and the tenants also filed a motion in limine prior to trial to strike the notice to quit. On the brink of trial, the parties compromised their dispute. They agreed that the landlord would be awarded possession of the property and waive the unpaid rent allegedly owed (i.e., settle for a lesser amount). In exchange, the tenants would move out by 3:00 p.m. on October 31, 2018, and release all their claims against the landlord. If the tenants failed to timely vacate, they would pay the landlord liquidated damages in the form of a $28,970 judgment.

Further, the amount of the judgment does not withstand scrutiny. Nothing in **[**894]** the record shows the parties made any effort to reasonably **[***18]** anticipate the amount of damages that might flow from the tenants' breach of the stipulation. And we see no meaningful relationship between the $28,970 judgment and the tenants' failure to move out by 3:00 p.m. (or alleged failure to leave the property in broom swept condition). Instead, the amount of the judgment was calculated using the unpaid rent alleged in the complaint. But, like *Greentree* and *Vitatech*, nothing in the record shows the landlord's chances to completely succeed at trial and recover all the unpaid rent allegedly owed. Based on *Greentree* and *Vitatech*, we find the $28,970 judgment to be an unenforceable penalty.

CA(7)[] **(7)** Finally, we note the landlord argued in the trial court that the tenants had admitted to owing the entire sum of unpaid rent because the stipulated judgment specifically included $27,170 in unpaid rent, which matched the sum alleged in the complaint. Curiously, the landlord omitted this argument from his brief on appeal. ***HN7***[] Generally, "'[t]he reviewing court is not required to make an independent, unassisted study of the record in search of error or **[*1119]** grounds to support the judgment. …'" (*McComber v. Wells (1999) 72 Cal.App.4th 512, 522 [85 Cal. Rptr. 2d 376]*.) Nonetheless, we briefly address this contention and find it unpersuasive. **[***19]**

There was no express admission by the tenants in the stipulation that they owed any unpaid rent. Nor was the $27,170 in unpaid rent set forth in the stipulation a tacit admission by tenant that they owed this amount. Instead, it was provided to show how the $28,970 judgment was calculated. This is evident from the language of the stipulation, which states that the parties agreed "that a money judgment be granted in favor plaintiff(s) [*sic*] as follows: [¶] $27,170.00 Rent & Damages, $1,200 Attorney fees, $600.00 Costs, for a TOTAL SUM OF [$28,970]." That the amount of unpaid rent in the stipulation matches the amount alleged in the complaint is unconvincing by itself. In *Vitatech*, like here, the defendants "stipulated to entry of judgment 'in the full prayer of the Complaint' if they failed" to timely make their settlement payment to the plaintiff. (*Vitatech, supra, 16 Cal.App.5th at p. 811*.) We found "[t]his language [did] not constitute an admission of liability for

breach of the underlying contract nor [did] it constitute an admission of the amount of damages that breach caused." (*Ibid.*)

Because we determine the $28,970 judgment constitutes an unenforceable penalty, we do not address the tenants' arguments that the trial court abused **[***20]** its discretion by (a) failing to find the tenants' return of the key to the landlord at 1:15 p.m. constituted substantial compliance with the stipulation; and (b) failing to award only actual damages sustained by the landlord under *section 1492*.[6] We also provide no opinion as to whether either side is owed any attorney fees or trial court costs under the stipulation since neither side briefed these issues. We direct the trial court to consider these issues on remand and to also determine whether the landlord suffered any actual damages as a result of the tenants' breach of the stipulation.

III

DISPOSITION

The judgment entered on June 10, 2019, has been vacated, and the appeal of that **[**895]** judgment is moot. The amended judgment entered on September 26, **[*1120]** 2019, is reversed. The matter is remanded for further proceedings as directed within this opinion. The defendants are entitled to their costs in this appeal.

Aronson, J., and Goethals, J., concurred.

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[6] *Section 1492* states "[w]here delay in performance is capable of exact and entire compensation, and time has not been expressly declared to be of the essence of the obligation, an offer of performance, accompanied with an offer of such compensation, may be made at any time after it is due, but without prejudice to any rights acquired by the creditor, or by any other person, in the meantime."

Neutral
As of: September 21, 2021 5:37 PM Z

Jun Ho Yang v. Fund Mgmt. Int'l, LLC

United States Court of Appeals for the Ninth Circuit

February 2, 2021, Argued and Submitted, Pasadena, California; February 26, 2021, Filed

No. 20-55051

Reporter
847 Fed. Appx. 419 *; 2021 U.S. App. LEXIS 5755 **; 2021 WL 754571

JUN HO YANG; HO SOON HWANG YANG, Appellants, v. FUND MANAGEMENT INTERNATIONAL, LLC, Appellee.

Notice: PLEASE REFER TO *FEDERAL RULES OF APPELLATE PROCEDURE RULE 32.1* GOVERNING THE CITATION TO UNPUBLISHED OPINIONS.

Prior History: [1]** Appeal from the United States District Court for the Central District of California. D.C. No. 2:18-cv-10183-JAK. John A. Kronstadt, District Judge, Presiding.

Disposition: AFFIRMED.

Core Terms

bankruptcy court, state court, parties, collateral estoppel, non-dischargeability, de novo, collateral, preclusion, funds, stipulated judgment, factual findings, husband and wife, supporting facts, district court, clear error, fraudulently, prepetition, proceedings, manifest, privity, bind

Case Summary

Overview

HOLDINGS: [1]-The bankruptcy court did not err in interpreting the court's mandate because the court's prior decision required the bankruptcy court to determine whether the parties manifested an intent for a state court stipulation and judgment to bind them in subsequent proceedings. Because the bankruptcy court was free to decide other issues on remand, its decision to confine the evidentiary hearing to the issue of intent was consistent with the mandate; [2]-The bankruptcy court did not err in determining that the requirements of issue preclusion were met because the stipulated judgment could properly be given collateral estoppel effect; an appellant stipulated to the facts supporting a finding of fraud under California law, which contained the same elements as the fraud exception to discharge in *11 U.S.C.S. § 523(a)(2)*.

Outcome

Judgment affirmed.

LexisNexis® Headnotes

Bankruptcy Law > ... > Judicial Review > Standards of Review > Clear Error Review

Civil Procedure > ... > Preclusion of Judgments > Estoppel > Collateral Estoppel

Bankruptcy Law > ... > Judicial Review > Standards of Review > De Novo Standard of Review

HN1 **Standards of Review, Clear Error Review**

The United States Court of Appeals for the Ninth Circuit reviews a district court's decision on appeal from a bankruptcy court decision de novo. When reviewing a bankruptcy court order, the court reviews conclusions of law de novo and factual findings for clear error. The court reviews the application of collateral estoppel de novo.

Governments > Courts > Authority to Adjudicate

HN2 **Courts, Authority to Adjudicate**

A district court that has received the mandate of an appellate court cannot vary or examine that mandate for any purpose other than executing it. But the district

court may decide anything not foreclosed by the mandate.

Bankruptcy Law > Procedural Matters > Judicial Review

Civil Procedure > ... > Preclusion of Judgments > Estoppel > Collateral Estoppel

HN3 **Procedural Matters, Judicial Review**

The preclusive effect of a state court judgment in a subsequent bankruptcy proceeding is determined by the preclusion law of the state in which the judgment was issued. Under California law, a stipulated judgment may properly be given collateral estoppel effect, at least when the parties manifest an intent to be collaterally bound by its terms.

Bankruptcy Law > Procedural Matters > Judicial Review

Civil Procedure > ... > Preclusion of Judgments > Estoppel > Collateral Estoppel

HN4 **Procedural Matters, Judicial Review**

Generally, it is against public policy for a debtor to waive the prepetition protection of the Bankruptcy Code. Collateral estoppel is an exception to that rule. When the parties stipulate to the underlying facts that support a finding of nondischargeability, a stipulated judgment would then be entitled to collateral estoppel application.

Civil Procedure > ... > Preclusion of Judgments > Estoppel > Collateral Estoppel

Family Law > ... > Property Rights > Characterization > Community Property

Real Property Law > ... > Present Estates > Marital Estates > Community Property

Family Law > ... > Property Distribution > Characterization > Community Property

HN5 **Estoppel, Collateral Estoppel**

Under California law, collateral estoppel may be asserted against a party who was a party or in privity with a party at the prior proceeding. Spouses are in privity with each other where the cause of action in the prior litigation was community in nature and the proceeds of any judgment that might have been recovered would have belonged to both husband and wife, as community property.

Counsel: For JUN HO YANG, HO SOON HWANG YANG, Appellants: Christian T. Kim, Attorney, Dumas & Kim, APC, Los Angeles, CA.

For FUND MANAGEMENT INTERNATIONAL, LLC, Appellee: Steven R. Fox, Attorney, Steven R Fox, Encino, CA; Mark Edwards, Attorney, Heller & Edwards, Woodland Hills, CA.

Judges: Before: GOULD, LEE, and VANDYKE, Circuit Judges.

Opinion

[*420] MEMORANDUM*

Jun Ho Yang ("Jun Ho") and his wife, Ho Soon Hwang Yang ("Ho Soon") (collectively, the "Yangs"), appeal the district court's affirmance of the bankruptcy court's grant of judgment in favor of Fund Management International, LLC ("FMI") on its claim of non-dischargeability under 11 U.S.C. § 523(a)(2). Because the parties are familiar with the facts and procedural history of the case, we recite only those facts necessary to decide this appeal. We have jurisdiction under 28 U.S.C. § 1291, and we affirm.

HN1 We review a district court's decision on appeal from a bankruptcy court decision *de novo*. Preblich v. Battley, 181 F.3d 1048, 1051 (9th Cir. 1999). When reviewing a bankruptcy court order, we review conclusions of law *de novo* and factual findings for clear error. *Id.* We review the application **[**2]** of collateral estoppel *de novo*. *See* United States v. 22 Santa Barbara Drive, 264 F.3d 860, 868 (9th Cir. 2001).

The bankruptcy court did not err in interpreting our mandate in *Yang v. Fund Mgmt. Int'l, LLC (In re Jun Ho Yang), 698 F. App'x 374 (9th Cir. 2017)*. ***HN2*** The rule is settled that "[a] district court that has received the

* This disposition is not appropriate for publication and is not precedent except as provided by Ninth Circuit Rule 36-3.

mandate of an appellate court cannot vary or examine that mandate for any purpose other than executing it." *Hall v. City of Los Angeles, 697 F.3d 1059, 1067 (9th Cir. 2012)*. But the district court may "decide anything not foreclosed by the mandate." *Id.* Here, our prior decision required the bankruptcy court to determine whether the parties manifested an intent for the State Court Stipulation and Judgment to bind them in subsequent proceedings—including this one. *See In re Jun Ho Yang, 698 F. App'x at 374*. Because we left the bankruptcy court free to decide other issues on remand, its decision to confine the evidentiary hearing to the issue of intent was consistent with our mandate, and was not error.

Nor did the bankruptcy court err in determining that the requirements of issue preclusion were met. ***HN3***[↑] "[T]he preclusive effect of a state court judgment in a subsequent bankruptcy proceeding is determined by the preclusion law of the state in which the judgment was issued." *Harmon v. Kobrin (In re Harmon), 250 F.3d 1240, 1245 (9th Cir. 2001)* (citing *28 U.S.C. § 1738*). Under California law, "a stipulated **[*421]** judgment may properly be given collateral estoppel effect, at least when the parties manifest an intent **[**3]** to be collaterally bound by its terms." *Cal. State Auto. Ass'n Inter-Ins. Bureau v. Superior Court, 50 Cal. 3d 658, 664, 268 Cal. Rptr. 284, 788 P.2d 1156 (1990)*.[1]

Applying these principles, the bankruptcy court found that the parties intended for the state court judgment to bind them in subsequent proceedings. That factual finding withstands clear error review. Under the Settlement Agreement, Jun Ho stipulated to the "facts supporting the claims made against him"—including fraud—and admitted in Paragraph 12 that the facts and claims in the State Court Complaint "are within the meaning of *11 U.S.C.A. 523*," which is the same statute under which FMI brought its non-dischargeability claim in these proceedings.

Moreover, Paragraph 12 of the Settlement Agreement does not amount to a prepetition waiver. ***HN4***[↑] Generally, "[i]t is against public policy for a debtor to waive the prepetition protection of the Bankruptcy Code." *Bank of China v. Huang (In re Huang), 275 F.3d 1173, 1177 (9th Cir. 2002)*. Collateral estoppel is an exception to that rule. When "the parties stipulate[] to the underlying facts that support a finding of nondischargeability, [a] Stipulated Judgment would then be entitled to collateral estoppel application." *Hayhoe v. Cole (In re Cole), 226 B.R. 647, 655 (B.A.P. 9th Cir. 1998)*.

The factual admissions in the Settlement Agreement directly relate to the fraud alleged in FMI's complaint for non-dischargeability. As noted above, Jun Ho stipulated to the **[**4]** facts supporting a finding of fraud under California law, which contains the same elements as the fraud exception to discharge in *11 U.S.C. § 523(a)(2)*. *See Younie v. Gonya (In re Younie), 211 B.R. 367, 373-74 (B.A.P. 9th Cir. 1997)*, *aff'd*, *163 F.3d 609 (9th Cir. 1998)*.

Finally, the bankruptcy court did not err in entering judgment against Jun Ho's wife, Ho Soon. ***HN5***[↑] Under California law, collateral estoppel may be asserted against a party who "was a party or in privity with a party at the prior proceeding." *Mueller v. J. C. Penney Co., 173 Cal. App. 3d 713, 723, 219 Cal. Rptr. 272 (1985)*. "[S]pouses are in privity with each other where the cause of action in the prior litigation was 'community in nature' and the 'proceeds of any judgment that might have been recovered . . . would have belonged to both husband and wife, as community property.'" *Id.* (omission in original) (quoting *Zaragosa v. Craven, 33 Cal. 2d 315, 321, 202 P.2d 73 (1949)*).

Ho Soon was named in the State Court Complaint, which alleged that she "participated in the fraud by knowingly accepting the benefits of the FMI funds diverted by [Jun Ho] for their personal use as husband and wife," that she "was fully aware of the facts of the fraud at the time it was occurring," and that "the FMI funds fraudulently taken . . . by [Jun Ho] were funneled to family trusts in which [Ho Soon] is a beneficiary." Because the fraudulently obtained funds were deposited into accounts shared by the Yangs, **[**5]** the bankruptcy court properly gave collateral effect to the state court judgment against Ho Soon.

AFFIRMED.

[1] The California Supreme Court went on to observe: "It seems fair to say that by specifically stipulating to the issue of liability, the parties intended the ensuing judgment to collaterally estop further litigation on that issue." *Cal. State Auto., 50 Cal. 3d at 664 n.2*. "Were their intent otherwise, the parties easily could have expressly restricted the scope of the agreement." *Id.*

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Hayhoe v. Cole (in Re Cole)

United States Bankruptcy Appellate Panel for the Ninth Circuit

September 25, 1998, Argued and Submitted at San Francisco, California ; October 27, 1998, Filed

BAP No. NC-97-1857-RyJuR

Reporter
226 B.R. 647 *; 1998 Bankr. LEXIS 1397 **; 40 Collier Bankr. Cas. 2d (MB) 1482; 33 Bankr. Ct. Dec. 478; 98 Cal. Daily Op. Service 8322

In re RICHARD A. COLE, Debtor. JAMES S. HAYHOE, Appellant, v. RICHARD A. COLE, Appellee.

Prior History: [1]** Appeal from the United States Bankruptcy Court for the Northern District of California. Bk. No. 94-45829-TS, Adv. No. 94-4748-AT. Honorable Leslie Tchaikovsky, Bankruptcy Judge, Presiding.

Disposition: AFFIRMED.

Core Terms

stipulated judgment, bankruptcy court, nondischargeability, collateral estoppel, state court, counter motion, unenforceable, prepetition, waive, writ of attachment, deny a motion, waivers, stipulated facts, representations, bankruptcy discharge, cause of action, false pretenses, public policy, former proceeding, summary judgment, courts

Case Summary

Procedural Posture

Appellant creditor challenged the judgment of the United States Bankruptcy Court for the Northern District of California, which denied the creditor's motion for summary judgment, holding that a stipulated judgment from a state court could not be used to prove liability under *11 U.S.C.S. § 523(a)(2)(A)* because it was an impermissible attempt to waive the bankruptcy discharge.

Overview

In a business transaction, appellee debtor executed a promissory note. The creditor obtained an ex parte writ of attachment in state court following nonpayment of the note, but the debtor cross-complained breach of contract and fraud. In a stipulated judgment, the debtor agreed to pay the debt, and the creditor agreed not to list the debt in any bankruptcy petition. Thereafter, the debtor filed for bankruptcy, and the creditor filed the instant complaint to determine the dischargeability of the debt under *11 U.S.C.S. § 523(a)(2)(A)*. The court first held that the bankruptcy court did not err in concluding the debtor's pre-petition waiver of discharge was void as against public policy. The stipulated judgment was nothing but an attempt to waive the bankruptcy discharge prospectively and was therefore unenforceable. The bankruptcy court had exclusive jurisdiction to determine the dischargeability of a claim under *11 U.S.C.S. § 523(a)(2)*, pursuant to *11 U.S.C.S. § 523(c)*. The court also held that the bankruptcy court did not err in holding that collateral estoppel did not apply to the stipulated judgment. The stipulated facts were unrelated to the merits of the instant complaint.

Outcome

The court affirmed the bankruptcy court's decisions to deny the creditor's motion for summary judgment because a stipulated judgment from a state court could not be used to prove the debtor's liability. The court also affirmed that collateral estoppel did not apply because the creditor did not assert a sufficient basis to support its claim of nondischargeability of the debt.

LexisNexis® Headnotes

Bankruptcy Law > Case Administration > Commencement of Case > General Overview

HN1[] **Case Administration, Commencement of Case**

The Bankruptcy Code is set forth in *11 U.S.C.S. §§ 101-1330*.

Bankruptcy Law > Discharge & Dischargeability > Exceptions to Discharge > Embezzlement & False Representations

Bankruptcy Law > Discharge & Dischargeability > General Overview

Bankruptcy Law > Discharge & Dischargeability > Exceptions to Discharge > General Overview

HN2[] Exceptions to Discharge, Embezzlement & False Representations

See Bankruptcy Code *11 U.S.C.S. § 523(a)(2)(A)*.

Bankruptcy Law > ... > Judicial Review > Standards of Review > Clear Error Review

Civil Procedure > ... > Preclusion of Judgments > Estoppel > Collateral Estoppel

Bankruptcy Law > Procedural Matters > Judicial Review > General Overview

Bankruptcy Law > ... > Judicial Review > Standards of Review > De Novo Standard of Review

Civil Procedure > Judgments > Preclusion of Judgments > General Overview

Civil Procedure > ... > Preclusion of Judgments > Estoppel > General Overview

Civil Procedure > Appeals > Standards of Review > Clearly Erroneous Review

HN3[] Standards of Review, Clear Error Review

The court reviews the bankruptcy court's findings of fact for clear error and the court's conclusions of law de novo. The court reviews the bankruptcy court's application of collateral estoppel de novo.

Bankruptcy Law > ... > Judicial Review > Standards of Review > De Novo Standard of Review

Civil Procedure > Appeals > Standards of Review > De Novo Review

Bankruptcy Law > Procedural Matters > Judicial Review > General Overview

Civil Procedure > Appeals > Summary Judgment Review > General Overview

Civil Procedure > Appeals > Summary Judgment Review > Standards of Review

Civil Procedure > ... > Summary Judgment > Entitlement as Matter of Law > General Overview

Governments > Agriculture & Food > General Overview

HN4[] Standards of Review, De Novo Standard of Review

The court reviews rulings on summary judgment de novo.

Bankruptcy Law > Discharge & Dischargeability > Exceptions to Discharge > General Overview

Business & Corporate Compliance > ... > Contracts Law > Standards of Performance > Creditors & Debtors

Bankruptcy Law > Discharge & Dischargeability > General Overview

HN5[] Discharge & Dischargeability, Exceptions to Discharge

A debtor cannot contract away his right to a discharge.

Business & Corporate Compliance > ... > Contracts Law > Types of Contracts > Executory Contracts

Contracts Law > Contract Conditions & Provisions > General Overview

Bankruptcy Law > Administrative Powers > Executory Contracts & Unexpired

Leases > General Overview

Bankruptcy Law > Discharge & Dischargeability > Exceptions to Discharge > General Overview

Contracts Law > Types of Contracts > Lease Agreements > General Overview

HN6[] Types of Contracts, Executory Contracts

An ipso facto clause is a provision in an executory contract or unexpired lease that results in a breach solely due to the financial condition or the bankruptcy filing of a party. Such clauses are generally unenforceable in bankruptcy.

Bankruptcy Law > Discharge & Dischargeability > Exceptions to Discharge > Embezzlement & False Representations

Civil Procedure > ... > Subject Matter Jurisdiction > Jurisdiction Over Actions > Exclusive Jurisdiction

Bankruptcy Law > Discharge & Dischargeability > Exceptions to Discharge > General Overview

Civil Procedure > ... > Jurisdiction > Subject Matter Jurisdiction > General Overview

Civil Procedure > ... > Subject Matter Jurisdiction > Jurisdiction Over Actions > General Overview

Civil Procedure > Judgments > Preclusion of Judgments > General Overview

Civil Procedure > Judgments > Preclusion of Judgments > Res Judicata

HN7[] Exceptions to Discharge, Embezzlement & False Representations

Dischargeability is the central issue in bankruptcy dischargeability litigation, and bankruptcy courts have exclusive jurisdiction to determine the dischargeability of a claim under 11 U.S.C.S. § 523(a)(2). Consequently, a state court stipulated judgment where the debtor waives his right to discharge is unenforceable as against public policy. However, a stipulation in a related bankruptcy case that a debt is nondischargeable is enforceable and res judicata.

Bankruptcy Law > Discharge & Dischargeability > Exceptions to Discharge > Automatic Discharge & Determinations

Civil Procedure > ... > Subject Matter Jurisdiction > Jurisdiction Over Actions > Exclusive Jurisdiction

Bankruptcy Law > Discharge & Dischargeability > General Overview

Bankruptcy Law > Discharge & Dischargeability > Exceptions to Discharge > General Overview

Bankruptcy Law > Discharge & Dischargeability > Exceptions to Discharge > Embezzlement & False Representations

Civil Procedure > ... > Jurisdiction > Subject Matter Jurisdiction > General Overview

Civil Procedure > ... > Subject Matter Jurisdiction > Jurisdiction Over Actions > General Overview

HN8[] Exceptions to Discharge, Automatic Discharge & Determinations

Pursuant to 11 U.S.C.S. § 523(c), bankruptcy courts have exclusive jurisdiction to determine the dischargeability of claims arising under 11 U.S.C.S. § 523(a)(2). Thus, the bankruptcy court must make a determination regarding the dischargeability of a 11 U.S.C.S. § 523(a)(2) claim notwithstanding a state court stipulated judgment or pre-petition agreement that purports to determine the dischargeability of a debt.

Bankruptcy Law > Discharge & Dischargeability > Exceptions to Discharge > Automatic Discharge & Determinations

Bankruptcy Law > Discharge & Dischargeability > General Overview

HN9[] Exceptions to Discharge, Automatic Discharge & Determinations

See Bankruptcy Code, 11 U.S.C.S. § 523(c).

Bankruptcy Law > ... > Discharge & Dischargeability > Liquidations > Eligible Debts

Bankruptcy Law > Discharge & Dischargeability > General Overview

Bankruptcy Law > Discharge & Dischargeability > Liquidations > General Overview

Bankruptcy Law > ... > Discharge & Dischargeability > Liquidations > Waiver of Discharge

Bankruptcy Law > Discharge & Dischargeability > Exceptions to Discharge > General Overview

HN10[] Liquidations, Eligible Debts

There is no recognized exception to discharge for pre-petition waivers of discharge or dischargeability. 11 U.S.C.S. § 727(b) states that all debts are dischargeable in bankruptcy unless specifically excepted under 11 U.S.C.S. § 523. Exceptions to discharge are to be narrowly construed in favor of the debtor. 11 U.S.C.S. § 523(a) enumerates the exceptions to discharge, but does not except from discharge those debts that the debtor has agreed pre-petition not to be discharged in bankruptcy. If bankruptcy courts enforced pre-petition waivers of discharge, they would effectively be creating an exception to discharge that Congress had not enumerated.

Bankruptcy Law > ... > Discharge & Dischargeability > Effect of Discharge > Hearings & Reaffirmation

Business & Corporate Compliance > ... > Contracts Law > Standards of Performance > Creditors & Debtors

Bankruptcy Law > Discharge & Dischargeability > General Overview

Bankruptcy Law > Discharge & Dischargeability > Liquidations > General Overview

Bankruptcy Law > ... > Discharge & Dischargeability > Liquidations > Waiver of Discharge

Bankruptcy Law > Discharge & Dischargeability > Exceptions to Discharge > General Overview

Governments > Legislation > Interpretation

HN11[] Effect of Discharge, Hearings & Reaffirmation

There are two methods for a debtor to waive the discharge of all debts or the dischargeability of specific debts. 11 U.S.C.S. § 727(a)(10) permits a debtor to waive the discharge of all debts simply by executing a post-bankruptcy written agreement that is approved by the bankruptcy court. Similarly, a debtor may waive the dischargeability of a specific debt if the waiver satisfies the reaffirmation requirements of 11 U.S.C.S. § 524(c). Where Congress has failed to include language in statutes, it is presumed to be intentional when it has used such language elsewhere in the Code. 11 U.S.C.S. §§ 524(d), (c) have been applied strictly by the courts to carry out their remedial purposes and to ensure that they are not evaded by agreements which, though not labeled as reaffirmation, have the effect of waiving the protections of the discharge.

Bankruptcy Law > Discharge & Dischargeability > Exceptions to Discharge > Embezzlement & False Representations

Bankruptcy Law > Discharge & Dischargeability > General Overview

Bankruptcy Law > Discharge & Dischargeability > Exceptions to Discharge > General Overview

HN12[] Exceptions to Discharge, Embezzlement & False Representations

An exception to discharge impairs the debtor's fresh start and should not be read more broadly than necessary to effectuate policy, such as to prevent debtors from avoiding debts incurred by fraud or other

culpable conduct. One of the primary purposes of the bankruptcy act is to relieve the honest debtor from the weight of oppressive indebtedness and permit him to start afresh free from the obligations and responsibilities consequent upon business misfortunes. This purpose of the Bankruptcy Code, *11 U.S.C.S. §§ 101-1330*, has been again and again emphasized by the courts as being of public as well as private interest, in that it gives to the honest but unfortunate debtor who surrenders for distribution the property which he owns at the time of bankruptcy, a new opportunity in life and a clear field for future effort.

Bankruptcy Law > Discharge & Dischargeability > Exceptions to Discharge > Embezzlement & False Representations

Bankruptcy Law > Discharge & Dischargeability > Exceptions to Discharge > General Overview

HN13[] **Exceptions to Discharge, Embezzlement & False Representations**

A creditor must prove by a preponderance of the evidence each of the following elements to support a *11 U.S.C.S. § 523(a)(2)(A)* cause of action: (1) the debtor made representations; (2) he knew that the representations were false at the time they were made; (3) the representations were made with the intention and purpose of deceiving the creditor; (4) the creditor relied on the representations; and (5) the creditor sustained the alleged loss and damage as the proximate result of the representations having been made.

Civil Procedure > ... > Preclusion of Judgments > Estoppel > Collateral Estoppel

Civil Procedure > Judgments > Preclusion of Judgments > General Overview

Civil Procedure > ... > Preclusion of Judgments > Estoppel > General Overview

HN14[] **Estoppel, Collateral Estoppel**

The generally accepted requirements for the application of collateral estoppel are: (1) the issue sought to be precluded from relitigation must be identical to that decided in a former proceeding; (2) it must have been actually litigated in the former proceeding; (3) it must have been necessarily decided in the former proceeding; (4) the decision in the former proceeding must be final and on the merits; and (5) the party against whom preclusion is sought must be the same as, or in privity with, the party to the former proceeding.

Counsel: David J. Cook, COOK, PERKISS PROFESSIONAL LAW CORPORATION, San Francisco, CA, for James S. Hayhoe, Appellant(s).

Irving J. Kornfield, KORNFIELD, PAUL & BUPP, Oakland, CA, for Richard A. Cole, Appellee(s).

Judges: Before: RYAN, JURY, [1] and RUSSELL, Bankruptcy Judges.

Opinion by: RYAN

Opinion

[*649] OPINION

RYAN, Bankruptcy Judge:

Creditor James S. Hayhoe ("Appellant") filed a complaint (the "Complaint") to determine the dischargeability of a debt pursuant to Bankruptcy Code (the "Code") [2] **[**2]** *§ 523(a)(2)(A)*. [3] Appellant relied

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[1] Hon. Meredith A. Jury, Bankruptcy Judge for the Central District of California, sitting by designation.

[2] ***HN1***[] The Code is set forth in ***11 U.S.C. §§ 101-1330 (1998)***.

[3] ***HN2***[] Code *§ 523(a)(2)(A)* states in pertinent part:

> (a) A discharge under *section 727*, *1141*, *1228(a)*, *1228(b)*, or *1328(b)* of this title does not discharge an individual debtor from any debt--
>
> . . . .
>
> (2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by--
>
> (A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition. . . .

solely on a state court stipulation (the "Stipulated Judgment") whereby debtor Richard A. Cole ("Appellee") stipulated that if he attempted to discharge in bankruptcy the debt that he owed Appellant, the debt would be deemed nondischargeable under § 523(a)(2)(A).

Appellant subsequently filed a motion for summary judgment (the "Motion"), arguing that the Stipulated Judgment and admissions in his answer set forth sufficient undisputed facts to require the court to grant the Motion. Appellee opposed the Motion and filed a counter motion for summary judgment (the "Counter Motion"), arguing that the Complaint failed to state sufficient grounds to support the § 523(a)(2)(A) claim. The bankruptcy court denied the Motion and granted the Counter Motion. The bankruptcy court held that the Stipulated Judgment could not be used to prove liability under § **[**3]** 523(a)(2)(A) because it was an impermissible attempt to waive the bankruptcy discharge. Also, collateral estoppel did not apply because the Stipulated Judgment did not establish the factual or legal basis for the nondischargeability of the underlying debt. We AFFIRM.

I. FACTS

In 1991, Appellant and Appellee entered into a business relationship to promote an auto racing team to compete in various auto races (the "Business"). As part of his contribution to the Business, Appellee executed a promissory note (the "Note") on his residence in favor of Appellant in the amount of $ 286,282 plus interest at three percent per annum. [4]

In May 1993, Appellant filed a complaint in the state court for nonpayment of the Note and other related causes of action. Shortly thereafter, Appellant obtained an ex parte writ of attachment (the "Writ of Attachment").

In July 1993, Appellee filed a cross complaint, alleging numerous **[**4]** causes of action, including breach of contract and fraud. Appellee also asserted that he owned part of the Business and that Appellant had breached **[*650]** their agreement by excluding him from involvement in the Business.

On August 20, 1993, the parties agreed that Appellant would release the Writ of Attachment and Appellee would release and transfer his interest in the Business to Appellant. Appellee also agreed to dismiss the cross complaint with prejudice.

The parties later agreed to the Stipulated Judgment which provided that Appellant had a judgment for $ 298,134.84 (the "Debt"), that the Debt would be paid per a schedule with interest of ten percent per annum, and that, as long as Appellee complied with the Stipulated Judgment, Appellee would be entitled to commissions earned on all sponsorship income that he obtained for the Business. Appellee also dismissed the cross complaint with prejudice.

The Stipulated Judgment also provided that: (1) Appellant agreed not to list the Debt in any bankruptcy petition or request that the Debt be discharged; (2) Appellee represented that he had sufficient monies to pay the Debt and Appellant relied on the representation in releasing the Writ of **[**5]** Attachment; (3) the Debt was nondischargeable pursuant to § 523(a)(2)(B); (4) Appellant would not have released the Writ of Attachment "but for the specific representations made by [Appellee] in relationship to the non-dischargeability of this debt"; and (5) "if, for any reason, [Appellee] attempts to discharge this debt through bankruptcy, [Appellee] hereby acknowledges, covenants and agrees that [Appellee] obtained a release of [Appellant's] security for this debt under false pretenses (and thus, this debt would be non-dischargeable under § 523(a)(2)(A) . . .)." Stipulation for Entry of J. and Order Thereon, at 6.

On August 29, 1994, Appellee filed a chapter 7 bankruptcy petition. On December 5, 1994, Appellant filed the Complaint. At trial, the bankruptcy court excluded certain testimony and documents disclosed in Appellant's late filings. This left Appellant with only his testimony in evidence. Appellee then moved for dismissal under Federal Rule of Civil Procedure ("FRCP") 41, which the court granted.

Appellant appealed the dismissal order to the district court. The district court held that the bankruptcy court abused its discretion in dismissing the case because **[**6]** dismissal was too severe a sanction for the inadvertent violation of the local rule and vacated and remanded the case.

Appellant then filed the Motion contending that the statements set forth in the Stipulated Judgment, in addition to the allegations in the Complaint and the admissions in the answer, constituted a sufficient basis for entry of summary judgment in his favor.

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11 U.S.C. § 523(a)(2)(A).

[4] The Note was executed as an equalizing payment to equalize the amount of money invested by each party.

Appellee filed the Counter Motion, asserting that the provisions in the Stipulated Judgment constituted an impermissible agreement to waive the dischargeability of the Debt, and thus, was void as against public policy. Appellee argued that the doctrine of collateral estoppel was inapplicable because the action on the Note was strictly a contract dispute and not a debt based on false pretenses, false representation, or actual fraud. Appellee also argued that Appellant failed to establish that any part of the Debt was obtained by false representation, false pretenses, or actual fraud. Finally, Appellee requested sanctions for having to defend against the Motion.

On September 4, 1997, the bankruptcy court denied the Motion and granted the Counter Motion. The court determined that the Stipulated Judgment was an unenforceable **[**7]** attempt to prospectively waive the bankruptcy discharge. In addition, the parties conceded that the state court complaint did not allege fraud in connection with the Note and there was no allegation or evidence of fraud in connection with the Stipulated Judgment and the Debt. The court also denied the Counter Motion as to unpled claims for relief and permitted Appellant to file an amended complaint. [5] In the event that Appellant **[*651]** did not file a timely amended complaint, the bankruptcy court held that Appellee could file a proposed order disposing of the entire case.

[8]** On November 19, 1997, after Appellant failed to file an amended complaint, the bankruptcy court entered an order (the "Order") granting the Counter Motion and denying the Motion in its entirety.

On November 26, 1997, Appellant filed a timely notice of appeal.

II. ISSUES

A. Whether the bankruptcy court erred when it determined that the prospective waiver of discharge was void as against public policy.

B. Whether the bankruptcy court erred when it denied the Motion and granted the Counter Motion on the basis that the Stipulated Judgment was not entitled to collateral estoppel application and the Complaint failed to state a claim for relief under § 523 (a)(2)(A).

III. STANDARD OF REVIEW

HN3[] We review the bankruptcy court's findings of fact for clear error and the court's conclusions of law de novo. *See* Neben & Stared, Inc. v. Chartwell Fin. Corp. (In re Park-Helena Corp.), 63 F.3d 877, 880 (9th Cir. 1995), *cert denied*, *516 U.S. 1049, 133 L. Ed. 2d 667, 116 S. Ct. 712 (1996)*(citing Sousa v. Miguel (In re United States Trustee), 32 F.3d 1370, 1372 (9th Cir. 1994)). We review the bankruptcy court's application of collateral estoppel de novo. *See* Lake v. Capps (In **[**9]** re Lake), 202 B.R. 751, 755 (9th Cir. BAP 1996); Gayden v. Nourbakhsh (In re Nourbakhsh), 67 F.3d 798, 800 (9th Cir. 1995).

Similarly, HN4[] we review rulings on summary judgment de novo. *See Bank of Los Angeles v. Official PACA Creditors' Comm. (In re Southland +* Keystone), 132 B.R. 632, 637 (9th Cir. BAP 1991).

IV. DISCUSSION

A. *The Bankruptcy Court Did Not Err In Concluding That Appellee's Prepetition Waiver Of Discharge Was Void As Against Public Policy*.

The bankruptcy court held that the Stipulated Judgment was "nothing but an attempt to waive the bankruptcy discharge prospectively, and [was] therefore . . . unenforceable." Tr. of Proceedings, Mot. for Summary J. (Sept. 4, 1997), at 3. No appellate court has expressly ruled on the validity of prepetition waivers of the bankruptcy discharge. However, the Seventh Circuit, in Klingman v. Levinson, 831 F.2d 1292, 1296 n.3 (7th Cir. 1987), stated in dictum that HN5[] a debtor cannot contract away his right to a discharge. In *Levinson*, a creditor filed a nondischargeability action against the debtor alleging that a state court consent judgment was nondischargeable. The bankruptcy court granted summary judgment in **[**10]** favor of the creditor and the debtor appealed. The district court affirmed. In affirming, the Seventh Circuit held that the stipulated judgment established fiduciary defalcation for purposes of § 523(a)(4). Id. at 1292-96. In a footnote, the court stated in dictum that, "for public policy reasons, a debtor may not contract away the right to a discharge in bankruptcy. However, a debtor may stipulate to the underlying facts that the bankruptcy court must examine

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[5] After determining that the underlying debt that was the subject of the state court litigation was a mere business debt, and thus, dischargeable in bankruptcy, the bankruptcy court provided Appellant an opportunity to amend the Complaint and allege that the Stipulated Judgment was entered into as the result of false representation, false pretenses, or actual fraud for purposes of § 523(a)(2)(A). The bankruptcy court determined that the Stipulated Judgment, by itself, did not support the § 523(a)(2)(A) claim.

to determine whether a debt is dischargeable." *Id. at 1296 n.3*. Because the stipulated facts in the judgment established all of the elements of the § 523(a)(4) cause of action, the court held that collateral estoppel applied. *Id. at 1295-96*. The court did not rely on the purported waiver of discharge for its affirmance. *Id. at 1296 n.3*.

Although no appellate court has decided the issue, many trial courts have held that prepetition waivers of the bankruptcy discharge are unenforceable. [6] **[**12]** Additional **[*652]** courts have held that prepetition waivers of other bankruptcy benefits are also unenforceable. [7] An analogy can also be drawn to the unenforceability of "ipso facto" clauses in bankruptcy. ***HN6***[↑] An ipso facto clause is **[**11]** a provision in an executory contract or unexpired lease that results in a breach solely due to the financial condition or the bankruptcy filing of a party. Such clauses are generally unenforceable in bankruptcy. *See* *Bruder v. Peaches Records and Tapes, Inc. (In re Peaches Records and Tapes, Inc.), 51 B.R. 583, 587 n.6 (9th Cir. BAP 1985)*(citing § 365(e)(1)); *In re Winters, 69 B.R. 145, 146 (Bankr. D. Or. 1986)*.

[13]** Appellant has not cited a single case that recognizes the validity of prepetition waivers of discharge resulting from state court litigation. We have only found three cases where courts have held that waivers of discharge in bankruptcy proceedings did not have to comply with the reaffirmation requirements of *§ 524*. *See* *Martinelli v. Valley Bank of Nev. (In re Martinelli), 96 B.R. 1011, 1014 (9th Cir. BAP 1988)*; *Saler v. Saler (In re Saler), 205 B.R. 737, 744 (Bankr.*

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[6] *See* *Giaimo v. Detrano (In re Detrano), 222 B.R. 685, 688 (Bankr. E.D.N.Y. 1998)*("As a matter of superseding federal bankruptcy policy . . ., a prepetition waiver of a discharge of a particular debt or of all debts is against public policy and unenforceable.")(citing *Levinson, 831 F.2d at 1296 n.3*)(other citation omitted); *Shaw Steel, Inc. v. Morris (In re Morris), 1998 Bankr. LEXIS 765, 1998 WL 355510*, at *8 (Bankr. N.D. Ill. June 30, 1998)("An agreement to waive the dischargeability of a debt is not enforceable as a matter of public policy. This is distinct from a factual stipulation entered into between parties in a prior . . . litigation which may properly serve as the basis for application of the doctrine of collateral estoppel . . . ."); *Minor v. Chilcoat (In re Minor), 115 B.R. 690, 694-96 (D. Colo. 1990)*(holding that a prepetition waiver of a bankruptcy discharge of an individual debt is invalid unless the waiver complies with the requirements for approval of a reaffirmation agreement under *§ 524(c)*); *Doug Howle's Paces Ferry Dodge, Inc. v. Ethridge (In re Ethridge), 80 B.R. 581, 586 (Bankr. M.D. Ga. 1987)*(holding that "the provisions of the consent judgment which pertain to the waiver of Defendant's right to a discharge are void"); *First Ga. Bank v. Halpern (In re Halpern), 50 B.R. 260, 262 (Bankr. N.D. Ga. 1985)*("Policy considerations dictate that dischargeability questions cannot be predetermined either by a state court or by agreement of the parties prior to or in anticipation of the possible filing of a bankruptcy case."), *aff'd*, *810 F.2d 1061 (11th Cir. 1987)*; *Bisbach v. Bisbach (In re Bisbach), 36 B.R. 350, 352 (Bankr. W.D. Wis. 1984)*(holding that a prepetition waiver in a divorce agreement that described the debt as maintenance or support, and thus, nondischargeable, was unenforceable); *Johnson v. Kriger (In re Kriger), 2 B.R. 19, 23 (Bankr. D. Or. 1979)*("It is a well settled principle that an advance agreement to waive the benefit of a discharge in bankruptcy is wholly void, as against public policy.").

[7] *See* *Fallick v. Kehr (In re Fallick), 369 F.2d 899, 904 (2d Cir. 1966)*(stating in dictum that advance agreements to waive the benefits of bankruptcy are void); ***In re Weitzen, 3 F. Supp. 698, 698 (S.D.N.Y. 1933)***("The agreement to waive the benefit of bankruptcy is unenforceable. To sustain a contractual obligation of this character would frustrate the object of the Bankruptcy Act . . . ."); *In re Shady Grove Tech Ctr. Assocs. Ltd. Partnership, 216 B.R. 386, 390 (Bankr. D. Md. 1998)*("Prohibitions against the filing of a bankruptcy case are unenforceable, self-executing clauses in pre-petition agreements purporting to provide that no automatic stay arises in a bankruptcy case are contrary to law and hence unenforceable, and . . . self-executing clauses in pre-petition agreements . . . to vacate the automatic stay are likewise unenforceable."); *In re Southeast Fin. Assocs., Inc., 212 B.R. 1003, 1005 (Bankr. M.D. Fla. 1997)*(recognizing that a prepetition waiver of bankruptcy benefits is not self-executing or binding on third parties); *In re Gulf Beach Dev. Corp., 48 B.R. 40, 43 (Bankr. M.D. Fla. 1984)*(stating in dictum that "the Debtor cannot be precluded from exercising its right to file Bankruptcy and any contractual provision to the contrary is unenforceable as a matter of law"); *In re Tru Block Concrete Prods., Inc., 27 B.R. 486, 492 (Bankr. S.D. Cal. 1983)*("It is a well settled principal that an advance agreement to waive the benefits conferred by the bankruptcy laws is wholly void as against public policy"); *In re Pease, 195 B.R. 431, 435 (Bankr. D. Neb. 1996)*("I conclude that any attempt by a creditor in a private pre-bankruptcy agreement to opt out of the collective consequences of a debtor's future bankruptcy filing is generally unenforceable. The Bankruptcy Code pre-empts the private right to contract around its essential provisions, such [as] those found in *11 U.S.C. § 362*."); *In re Madison, 184 B.R. 686, 690 (Bankr. E.D. Penn. 1995)*(holding that a prepetition agreement to waive a debtor's right to file further bankruptcies within 180 days from the filing of the debtor's last bankruptcy petition was unenforceable because it violated public policy). *But see* *In re Wald, 211 B.R. 359, 361 (Bankr. D.N.D. 1997)*(stating that a showing of special circumstances is required to relieve a party from a prepetition stipulation that permitted the creditor to commence foreclosure upon default).

E.D. Penn. 1997), *aff'd*, 217 B.R. 166 (E.D. Pa. 1998); Laing v. Johnson (In re Laing), 1993 U.S. Dist. LEXIS 21207, 1993 WL 732230, at *4 (N.D. Okla. Oct. 25, 1993), *aff'd*, 31 F.3d 1050 (10th Cir. 1994).

However, these cases are distinguishable from the situation here. In all three cases, the settlement occurred in nondischargeability litigation in the bankruptcy court and not litigation in state court. As stated in *Saler*, "the settlement of bankruptcy discharge litigation materially differs from **[*653]** agreements reached in prebankruptcy state court litigation. In prebankruptcy litigation, the question of the dischargeability of the debt is not in issue." Saler, 205 B.R. at 745-46 (citing Brown v. Felsen, 442 U.S. 127, **[**14]** 60 L. Ed. 2d 767, 99 S. Ct. 2205 (1979)). However, **HN7**[↑] dischargeability is the "central issue in bankruptcy dischargeability litigation," and bankruptcy courts have exclusive jurisdiction to determine the dischargeability of a claim under § 523(a)(2). 205 B.R. at 746. Consequently, a state court stipulated judgment where the debtor waives his right to discharge is unenforceable as against public policy. However, a stipulation in a related bankruptcy case that a debt is nondischargeable is enforceable and res judicata. Id. at 749. [8]

This makes sense for the following reasons. First, **HN8**[↑] pursuant to § 523(c), [9] bankruptcy courts have exclusive jurisdiction to determine the dischargeability of claims arising under § 523(a)(2). *See* Seven Elves, Inc. v. Eskenazi (In **[**15]** re Eskenazi), 6 B.R. 366, 368-69 (9th Cir. BAP 1980)(citing Brown, 442 U.S. at 138); Judd v. Wolfe, 78 F.3d 110, 114 (3d Cir. 1996); Saler, 205 B.R. at 742; 4 L. KING, COLLIER ON BANKRUPTCY P 523.26, at 523-11 (15th ed. rev. 1996). *See also* H.R. REP. No. 595, 95th Cong., 1st Sess. 365 (1977)("Subsection (c) requires a creditor who is owed a debt that may be expected [sic] from discharge under paragraph (2), (4), or (6) . . . *to initiate proceedings in the bankruptcy court* for an exception to discharge. . . ."(emphasis added); S. REP. No. 989, 95th Cong., 2d Sess. 80 (1978)(same). Thus, the bankruptcy court must make a determination regarding the dischargeability of a § 523(a)(2) claim notwithstanding a state court stipulated judgment or prepetition agreement that purports to determine the dischargeability of a debt. *See, e.g.,* Eskenazi, 6 B.R. at 368-69 (holding that res judicata cannot be applied to foreclose an adversary litigation of a nondischargeability "claim" in bankruptcy court).

[16]** Second, **HN10**[↑] there is no recognized exception to discharge for prepetition waivers of discharge or dischargeability. Section 727(b) states that all debts are discharged in bankruptcy unless specifically excepted under § 523. *See* 11 U.S.C. § 727(b). "Exceptions to discharge are to be narrowly construed in favor of the debtor." Aetna Fin. Co. v. Neal (In re Neal), 113 B.R. 607, 609 (9th Cir. BAP 1990)(citing Klapp v. Landsman (In re Klapp), 706 F.2d 998, 999 (9th Cir. 1983); American Fed'n of State, County and Municipal Employees, Local 2051 v. Stephens (In re Stephens), 51 B.R. 591, 595 (9th Cir. BAP 1985); Eisen v. Linn (In re Linn), 38 B.R. 762, 763 (9th Cir. BAP 1984)). Section 523 enumerates the exceptions to discharge, but does not except from discharge those debts that the debtor has agreed prepetition not to be discharged in bankruptcy. *See* 11 U.S.C. § 523(a). If bankruptcy courts enforced prepetition waivers of discharge, they would effectively be creating an exception to discharge that Congress had not enumerated.

In addition, **HN11**[↑] Congress has only provided two methods for a debtor to waive the discharge of all debts or the dischargeability of specific **[**17]** debts. Section 727(a)(10) permits a debtor to waive the discharge of *all* debts simply by executing a postbankruptcy written agreement that is approved by the bankruptcy court. *See* 11 U.S.C. § 727(a)(10). Similarly, a debtor may waive the dischargeability of a *specific* debt if the waiver satisfies the reaffirmation requirements of § 524(c). *See* 11 U.S.C. § 524(c). Where Congress has failed to include language in statutes, it is presumed to be intentional when it has used such language elsewhere in **[*654]** the Code. *See* Hohn v. United States, 524

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[8] *Cf.* FDIC v. Daily (In re Daily), 47 F.3d 365, 369 (9th Cir. 1995)(holding that a debtor's postpetition stipulation that a district court judgment against the debtor would be nondischargeable was binding as to the issues relevant to discharge).

[9] **HN9**[↑] Section 523(c) states in pertinent part:

> (c)(1) Except as provided in subsection (a)(3)(B) of this section, the debtor shall be discharged from a debt of a kind specified in paragraph (2), (4), (6), or (15) of subsection (a) of this section, unless, on request of the creditor to whom such debt is owed, and after notice and a hearing, the court determines such debt to be excepted from discharge under paragraph (2), (4), (6), or (15), as the case may be, of subsection (a) of this section.

11 U.S.C. § 523(c).

U.S. 236, 118 S. Ct. 1969, 1977, 141 L. Ed. 2d 242, 258 (1998)(citing Russello v. United States, 464 U.S. 16, 23, 78 L. Ed. 2d 17, 104 S. Ct. 296 (1983)). Here, Congress' failure to authorize prepetition waivers of discharge, while at the same time authorizing certain postpetition waivers of discharge pursuant to §§ 524(c) and 727(a)(1), must be viewed as intentional. Sections 524(d) and (c) "have been applied strictly by the courts to carry out their remedial purposes and to ensure that they are not evaded by agreements which, though not labeled as reaffirmations, have the effect of waiving the protections of the discharge." **[**18]** 4 L. KING, COLLIER ON BANKRUPTCY P 524.04, at 524-30 n.3. (15th ed. rev. 1998)

Finally, ***HN12***[⬆] an exception to discharge impairs the debtor's fresh start and should not be read more broadly than necessary to effectuate policy, e.g., preventing debtors from avoiding debts incurred by fraud or other culpable conduct. *See* Ellwanger v. Bette Joyce McBroom Estate (In re Ellwanger), 105 B.R. 551, 556 (9th Cir. BAP 1989), *abrogated on other grounds,* Bugna v. McArthur (In re Bugna), 33 F.3d 1054, 1059 n.6 (9th Cir. 1994).

> One of the primary purposes of the bankruptcy act is to "relieve the honest debtor from the weight of oppressive indebtedness and permit him to start afresh free from the obligations and responsibilities consequent upon business misfortunes." This purpose of the act has been again and again emphasized by the courts as being of public as well as private interest, in that it gives to the honest but unfortunate debtor who surrenders for distribution the property which he owns *at the time of bankruptcy*, a new opportunity in life and a clear field for future effort . . . .

Local Loan Co. v. Hunt, 292 U.S. 234, 244, 78 L. Ed. 1230, 54 S. Ct. 695 (1934)(citations **[**19]** omitted). This policy is also embodied in the Code. [10]

For the foregoing reasons, we conclude that a prepetition waiver of the dischargeability **[**20]** of a debt undermines the purpose of the Code to give an honest but unfortunate debtor a fresh start. The bankruptcy court correctly held that the prospective waiver of the dischargeability of the Debt was unenforceable.

B. *The Bankruptcy Court Did Not Err In Denying The Motion And Granting The Counter Motion*.

The bankruptcy court denied the Motion on the basis that (1) the Stipulated Judgment was not entitled to collateral estoppel application and (2) Appellant failed to state a claim for relief under § 523(a)(2)(A). Appellant argues that the bankruptcy court erred in denying the Motion because the facts set forth in the Stipulated Judgment, in addition to the admissions in Appellee's answer to the Complaint, established all of the elements of the § 523(a)(2)(A) cause of action. We disagree.

HN13[⬆] Appellant was required to prove by a preponderance of the evidence each of the following elements to support a § 523(a)(2)(A) cause of action: (1) the debtor made representations; (2) he knew that the representations were false at the time they were made; (3) the representations were made with the intention and purpose of deceiving the creditor; (4) the creditor relied on the representations; **[**21]** and (5) the creditor sustained the alleged loss and damage as the proximate result of the representations having been made. *See* Younie v. Gonya (In re Younie), 211 B.R. 367, 373 (9th Cir. BAP 1997)(citing *Eugene Parks Law Corp. Defined* **[*655]** Ben. Pension Plan v. Kirsh (In re Kirsh), 973 F.2d 1454, 1457 (9th Cir. 1992)).

1. *The Bankruptcy Court Did Not Err In Holding That Collateral Estoppel Did Not Apply To The Stipulated Judgment*.

The entire basis for Appellant's § 523(a)(2)(A) claim was the Stipulated Judgment. Specifically, Appellant argued that the Stipulated Judgment established that Appellant released the Writ of Attachment in connection with the Stipulated Judgment under false pretenses when Appellee represented that (1) he would not file for bankruptcy protection and (2) he had the ability to pay the Debt represented by the Stipulated Judgment. The Stipulated Judgment essentially provided that, in the

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[10] *See, e.g.*, H.R. REP. No. 595, 95th Cong., 1st Sess. 384-85 (1977)(Section 727(a) "is the heart of the fresh start provisions of the bankruptcy law."); S. REP. No. 989, 95th Cong., 2d Sess. 98-99 (1978)(same). *See also* In re Latanowich, 207 B.R. 326, 334 (Bankr. D. Mass. 1997)(stating that the purpose of the discharge injunction of § 524 is to ensure a debtor's "fresh start" by absolutely prohibiting a creditor from taking any action against the debtor personally to collect prepetition debts); Walker v. M & M Dodge, Inc. (In re Walker), 180 B.R. 834, 840 (Bankr. W.D. La. 1995)(stating that the "discharge is the legal embodiment of the 'fresh start'"); In re Bowling, 116 B.R. 659, 664 (Bankr. S.D. Ind. 1990)("A debtor's discharge and the protection of the permanent injunction are the most important components of the fresh start provided by the Bankruptcy Code.").

event that Appellee filed for bankruptcy and attempted to discharge the Debt, Appellee agreed that the release of the Writ of Attachment was obtained under false pretenses. [11] Appellant sought to use these stipulated facts to establish the elements of § 523(a)(2)(A) **[**22]** under the doctrine of collateral estoppel.

[23]** We have already concluded that the portion of the Stipulated Judgment that purported to waive Appellee's right to obtain a discharge of the Debt was unenforceable as against public policy. However, if the parties stipulated to the underlying facts that support a finding of nondischargeability, the Stipulated Judgment would then be entitled to collateral estoppel application. *See* Levinson, 831 F.2d at 1296 n.3.

Here, the Complaint was based entirely on the facts asserted in the Stipulated Judgment. It stated that the occurrence of a future act (i.e., the act of filing for bankruptcy and attempting to discharge the Debt) would be deemed an admission that the release of the Writ of Attachment was obtained under false pretenses for purposes of § 523(a)(2)(A) and that the Appellant reasonably relied on Appellee's deemed fraud. This stipulated fact was just another attempt by Appellant to have Appellee prospectively waive his right to discharge the Debt in bankruptcy, and thus, was unenforceable.

In effect, Appellant is arguing that at the time of entering into the Stipulated Judgment, Appellee was defrauding Appellant and that Appellant reasonably relied upon Appellee's deemed fraud. **[**24]** This would be an absurd result.

In addition, collateral estoppel could not possibly apply for several reasons. **HN14**[↑] The generally accepted requirements for the application of collateral estoppel are: (1) the issue sought to be precluded from relitigation must be identical to that decided in a former proceeding; (2) it must have been actually litigated in the former proceeding; (3) it must have been necessarily decided in the former proceeding; (4) the decision in the former proceeding must be final and on the merits; and (5) the party against whom preclusion is sought must be the same as, or in privity with, the party to the former proceeding. **[*656]** *See* Kelly v. Okoye (In re Kelly), 182 B.R. 255, 257 (9th Cir. BAP 1995), *aff'd* 100 F.3d 110 (9th Cir. 1996); Berr v. FDIC (In re Berr), 172 B.R. 299, 304, 306 (9th Cir. BAP 1994).

The stipulated facts relate to a possible future cause of action in a possible future bankruptcy case. Thus, the stipulated facts have nothing to do with the merits of Appellant's state court lawsuit against Appellee. Indeed, it would not have been possible to litigate the issue of fraud (dependent upon a future bankruptcy) in Appellant's state court lawsuit.

[25]** Therefore, the stipulated facts could not have been necessary to the Judgment. In addition, since not relevant to it, the stipulated facts could not have been actually litigated. Indeed, the state court clearly lacked jurisdiction to litigate a § 523(a)(2) claim. Accordingly, the stipulated facts were nothing more than an invalid agreement that the Debt would be nondischargeable in a future bankruptcy.

Thus, the Stipulated Judgment as to deemed fraud had absolutely no evidentiary effect in the § 523(a)(2) adversary proceeding. Therefore, because there was no

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[11] The Stipulated Judgment stated in pertinent part:

> 5. IT IS FURTHER STIPULATED AND AGREED that . . .
>
> a. As a material covenant of this Stipulation for entry of Judgment, [Appellee] reaffirms and ratifies that he will not list the debt established by this Stipulation in any bankruptcy petition and request discharge of this debt under . . . the Bankruptcy Code . . . .
>
> . . . .
>
> 10. . . . [Appellant] agreed to release the lien of the writ of attachment with respect to [Appellee's] property, *based upon written representations made by [Appellee] that he had sufficient funds to pay the entire amount of the debt in the installments set forth in the Stipulation. Those representations related to [Appellee's] financial condition*, and Appellee stipulated that [Appellant] was reasonably relying upon those representations in releasing the security which he held by virtue of the writs of attachment.
>
> 11. In the Stipulation for Entry of Judgment and Order thereon, [Appellee] specifically stipulated, gave his covenant and agreed that [Appellant] would not have released the security for the debt represented by the Stipulation but for the specific representations made by [Appellee] in relationship to the nondischargeability of the debt, and, further, [Appellee] stipulated . . . that *if [Appellee] ever attempted to discharge the indebtedness represented by the Stipulation for Entry of Judgment and Order thereon for bankruptcy, that [Appellee] had obtained the release of [Appellant's] security for the debt under false pretenses, and that aid debt would be nondischargeable under* § 523(a)(2)(A) . . . .

Stipulation for Entry of J. and Order Thereon, at 5-6 (emphasis added).

evidence to support Appellant's § 523(a)(2) claim, the Motion was properly granted.

Furthermore, Appellee's written statement that he had sufficient funds to pay the Debt qualifies as a financial statement which is expressly excluded from § 523(a)(2)(A). *See* 11 U.S.C. § 523(a)(2)(A). [12] Indeed, the Stipulated Judgment recognized that Appellee's representations about his ability to pay the Debt were representations related to Appellee's financial condition. Thus, § 523(a)(2)(A) did not apply.

[26]** Accordingly, we affirm on the basis that the Stipulated Judgment was not entitled to collateral estoppel effect because it contained an unenforceable waiver of discharge and did not establish the elements necessary for a nondischargeable debt under § 523(a)(2)(A).

2. *Appellant Did Not Assert Any Other Basis To Support A Finding Of Nondischargeability Under* § 523(a)(2)(A).

In addition, Appellant did not assert any other basis to support a determination of nondischargeability under § 523(a) (2)(A). The only documents that Appellant presented to support the § 523(a)(2)(A) cause of action, other than the Stipulated Judgment, were the state court complaint, the Complaint, Appellee's answer to the Complaint, and a declaration by Appellant's attorney, David J. Cook. The Motion stated that Appellant was entitled to summary judgment because Appellee admitted sufficient facts in the answer, in addition to the Stipulated Judgment, to support a finding of nondischargeability under § 523(a)(2)(A). However, as discussed *supra*, neither the state court complaint nor the Stipulated Judgment established sufficient facts to support the § 523(a)(2)(A) claim.

Additionally, while Appellee **[**27]** admitted in his answer all of the essential facts alleged in the Stipulated Judgment (other than the validity of the prepetition waiver of discharge), he did not admit to entering into the Stipulated Judgment for the purpose of obtaining **[*657]** a release of the Writ of Attachment under false pretenses, false representation, or actual fraud. Appellant also submitted the Cook declaration in support of the Motion. However, the declaration merely restated the terms and conditions of the Stipulated Judgment and asserted that the Stipulated Judgment was entitled to collateral estoppel application. Consequently, all of the evidence presented to the bankruptcy court in support of the Motion was related to the Stipulated Judgment, which did not establish the requisite facts to support the § 523(a)(2)(A) claim.

Finally, we note that, after the bankruptcy court granted the Counter Motion in part because the Stipulated Judgment was not entitled to collateral estoppel application, the bankruptcy court gave Appellant an opportunity to amend the Complaint to allege a new claim for fraud or false representation. However, Appellant failed to amend the Complaint, and the bankruptcy court granted the Counter **[**28]** Motion in full.

Because Appellant failed to assert any basis other than the Stipulated Judgment to support his § 523(a)(2)(A) claim, the bankruptcy court did not err when it denied the Motion and granted the Counter Motion.

V. CONCLUSION

In sum, the bankruptcy court did not err in denying the Motion and granting the Counter Motion. The clause contained in the Stipulated Judgment that purported to waive the bankruptcy discharge was unenforceable as against public policy. Additionally, the Stipulated Judgment upon which Appellant solely relied to support the § 523(a)(2)(A) claim was not entitled to collateral estoppel application because it did not satisfy all of the

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[12] *See also* Anastas v. American Sav. Bank (In re Anastas), 94 F.3d 1280, 1285 (9th Cir. 1996)("We emphasize that the representation made by the card holder in a credit card transaction is not that he has an *ability* to repay the debt; it is that he has an *intention* to repay. Indeed, section 523(a)(2) expressly prohibits using a non-written representation of a debtor's financial condition as a basis for fraud."); Tallant v. Kaufman (In re Tallant), 218 B.R. 58, 70 (9th Cir. BAP 1998)(and cases cited therein)(enunciating the narrow and broad definitions of statements respecting a debtor's financial condition); Citibank (S. Dakota), N.A. v. Michel, 220 B.R. 603, 605 (N.D. Ill. 1998)("We need not concern ourselves with any representation about ability to repay because fraud claims based on this kind of representation are not permitted under § 523(a)(2)(A)."); La Capitol Fed. Credit Union v. Melancon (In re Melancon), 223 B.R. 300, 322 (Bankr. M.D. La. 1998)("An assertion of ability to repay is a statement regarding financial condition, and § 523(a)(2)(A) bars consideration of such a statement." However, ability to repay may be a factor in determining the debtor's intent.)(citations omitted); Sears, Roebuck & Co v. Homschek (In re Homschek), 216 B.R. 748, 752-53 (Bankr. M.D. Pa. 1998)("I find that a representation of an ability to pay does, in fact, respect the debtor's financial condition."); First Card Servs., Inc. v. Kitzmiller (In re Kitzmiller), 206 B.R. 424, 426 (Bankr. N.D. W. Va. 1997)("A representation that the debtor has the ability to repay is a statement of the debtor's financial condition.").

elements of *§ 523(a)(2)(A)*.

Accordingly, we AFFIRM.

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Bank of China v. Huang (In re Huang)

United States Court of Appeals for the Ninth Circuit

December 6, 2001, Argued and Submitted, Pasadena, California ; January 14, 2002, Filed

No. 00-57056

Reporter
275 F.3d 1173 *; 2002 U.S. App. LEXIS 551 **; 47 Collier Bankr. Cas. 2d (MB) 1060; 38 Bankr. Ct. Dec. 269; 2002 Cal. Daily Op. Service 334; 2002 Daily Journal DAR 459

In re: AIPING HUANG, Debtor, THE BANK OF CHINA, Appellant, v. AIPING HUANG, Appellee.

Prior History: [1]** Appeal from the United States District Court for the Central District of California. D.C. No. CV-00-02533-TJH. Terry J. Hatter, Chief District Judge, Presiding.

Disposition: Prior to filing for bankruptcy protection the defendant/debtor signed a settlement agreement in which she agreed not to file for bankruptcy protection. After filing for bankruptcy, the defendant/debtor was sued by the plaintiff/creditor, Bank of China. The bankruptcy court granted summary judgement to the plaintiff, holding that the debt to plaintiff was not dischargeable in bankruptcy. On appeal to the bankruptcy appellate panel of the district court the judgement of the bankruptcy court was reversed. The plaintiff appealed the judgment of the district court reversing the summary judgment of the bankruptcy court in the plaintiff's favor. The court of appeals affirmed the judgment of the district court.

Core Terms

Settlement, collateral estoppel, bankruptcy court, district court

Case Summary

Procedural Posture
Appellant bank challenged the judgment of the United States District Court for the Central District of California, which reversed the summary judgment of the bankruptcy court in the bank's favor in its suit against appellee debtor.

Overview
The bank had sued the debtor, alleging, inter alia, fraud. They then entered into a settlement agreement. The district court held that the settlement agreement's provisions that the judgment and debt were not dischargeable, and that debtor would not enter bankruptcy, were unenforceable. The bank did not appeal the decision of the district court on this point. It was the law of the case. The court went on to note that if the debtor defrauded the bank, then her debt to it was non-dischargeable. To prevail, the bank had to prove the fraud, unless the bank succeeded by collateral estoppel. The court then noted that fraud, was not mentioned in the settlement agreement or in the judgment enforcing it. Fraud was alleged in the bank's underlying suit against the debtor, but there were other counts, not necessarily involving fraud, in the suit that was settled. The bank argued that the debtor could have been liable only on those counts involving fraud, but such a limitation on her possible liability was neither evident from the settlement agreement nor from the suit. As there was no admission of fraud, there was no basis for collateral estoppel.

Outcome
Judgment was affirmed.

LexisNexis® Headnotes

Bankruptcy Law > Discharge & Dischargeability > General Overview

HN1[] **Bankruptcy Law, Discharge & Dischargeability**

It is against public policy for a debtor to waive the prepetition protection of the United States Bankruptcy Code.

Bankruptcy Law > Discharge & Dischargeability > Exceptions to Discharge > Embezzlement & False Representations

Civil Procedure > ... > Preclusion of Judgments > Estoppel > Collateral Estoppel

Bankruptcy Law > Discharge & Dischargeability > Exceptions to Discharge > General Overview

Civil Procedure > Judgments > Preclusion of Judgments > General Overview

Civil Procedure > ... > Preclusion of Judgments > Estoppel > General Overview

HN2[] **Exceptions to Discharge, Embezzlement & False Representations**

Liability for fraud is not dischargeable in bankruptcy. *11 U.S.C.S. § 523 (a)(2)(A)*.

Civil Procedure > ... > Preclusion of Judgments > Estoppel > Collateral Estoppel

HN3[] **Estoppel, Collateral Estoppel**

Where it is sought to apply the estoppel of a judgment rendered upon one cause of action to matters arising in a suit upon a different cause of action, the inquiry must always be as to the point or question actually litigated and determined in the original action; not what might have been thus litigated and determined. Only upon such matters is the judgment conclusive in another action.

Counsel: John A. Blue, Los Angeles, California, for the appellee.

Joshua D. Wayser, Santa Monica, California, for the appellant.

Judges: Before: John T. Noonan, Kim McLane Wardlaw, Circuit Judges and William W Schwarzer **

** The Honorable William W Schwarzer, United States Senior District Judge for the Northern District of California, sitting by designation.

Senior District Judge. Opinion by Judge Noonan.

Opinion by: John T. Noonan

Opinion

[*1174] NOONAN, Circuit Judge:

Bank of China (the Bank) appeals the judgment of the district court reversing **[*1175]** the summary judgment of the bankruptcy court in the Bank's favor in its suit against Aiping Huang (Huang). Holding that Huang is not collaterally estopped by her settlement with the Bank from denying the Bank's allegations of fraud, we affirm the judgment of the district court.

PRIOR PROCEEDINGS

On October 21, 1996, the Bank brought suit in the district court against SV International, Inc. (SV), ZP Tech Inc. (ZP), Ruigao Trading Inc., Jiannan Zhang, Aiping Huang, and Lianping Pan. **[**2]** The Bank noted that it was wholly owned by the government of China and that its principal place of business was Beijing. The defendants were alleged to be California corporations or permanent residents of California. Pan and Huang were said to be husband and wife and the sole directors of SV, identified as the parent of a wholly-owned Chinese subsidiary, Nantong Starvest Data Company, Ltd. Pan and Huang were also said to be the only directors of Ruigao. Pan and Zhang, Huang's first cousin, were alleged to be the sole owners of ZP. The Bank further alleged that Pan, Huang, and Zhang together controlled SV, ZP, Ruigao, and Nantong Starvest. They also were alleged to control another Chinese company, Nantong Hong Yang Industries Co.

According to the Bank's complaint in its 1996 suit, Nantong Starvest in 1992 and 1993 obtained approximately $ 11,910,000 in term loans from the Bank, and $ 10,786,785 and 506,743,360 Japanese yen in letters of credit from the Bank. In addition, the Bank guaranteed a loan of $ 10,000,000 by the Arab Bank to Nantong Starvest. Over $ 110 million of computer diskettes were alleged to have been shipped to SV and ZP by Nantong Starvest at artificial and concealed **[**3]** prices, with the alleged intention of avoiding repayment of the credit extended by the Bank.

On the basis of these and other related allegations, the Bank's complaint against the six defendants alleged twelve causes of action, as follows: (1) breach of a

written contract in failing to repay the loans; (2) money lent and received; (3) money had and received; (4) fraud; (5) breach of the covenant of good faith; (6) fraudulent conveyance; (7) intentional interference with the Bank's contractual relations with Nantong Starvest; (8) constructive trust; (9) injunctions; (10) accounting; (11) violation of *18 U.S.C. § 1962(c)* (Racketeer Influenced Corrupt Organizations Act or RICO), charged against Pan, Huang, and Zhang; and (12) violations of subsection (d) of the same act, charged against the same three individuals.

The suit, styled *Bank of China v. SV International, Inc.*, was met by the defendants' denial of all claims. The defendants were represented by Manatt, Phelps & Phillips (MPP); the Bank by Stern, Neubauer, Greenwald & Pauly of Santa Monica and by Hollyer Brady Smith Troxell Barrett Rockett Hines & Mone of New York City. Between December 1996 and February **[**4]** 1997, MPP moved to strike portions of the complaint; to dismiss for failure to state a cause of action; and to stay discovery. The defendants lost these motions. Eventually settlement negotiations began and were actively pursued during May. On June 5, 1997, the Bank and the defendants entered into what was denominated a "Settlement Agreement, Security Agreement, and General Release" (the Settlement Agreement), a detailed document 18 pages in length.

In the Settlement Agreement the six defendants admitted that they, jointly and severally, owed the Bank $ 42,740,813.03 and 572,911,136 Japanese yen plus interest from October 24, 1996. They stipulated to **[*1176]** entry of judgment in the Bank's favor in the amount of $ 47,733,937.79, plus interest of 8% from October 24, 1996. The Settlement Agreement set out a schedule of payments with an initial payment in December, 1997, and quarterly payments to be made beginning on March 31, 1998 and ending on December 31, 2006. The Bank was given a security interest in all personal property and certain identified real estate of the individuals. The Bank was given complete access to "all information and documents concerning Defendants," including the income **[**5]** tax returns of the three individuals. The compensation of these individuals from businesses in which they had an interest was limited to a total of $ 100,000. The following provisions of particular pertinence here were also part of the settlement:

> 3. A. *Judgment Final and Binding*. The Bank and the Defendants agree that the Judgment shall constitute a binding and final adjudication of the parties' rights and liabilities in the Action, except that the Bank shall retain all further rights stated in this Agreement. The Bank and the Defendants hereby fully and forever waive any right to appeal, to bring post-trial motions, or to bring any other challenges to the Judgment. The Defendants acknowledge that the Judgment is final, valid and in full force and effect.
>
> 3. B. *Judgment and Debt Not Dischargeable in Bankruptcy*. Defendants are familiar with the law
>
> concerning the dischargeability of debts in bankruptcy. Defendants are also familiar with the facts, including their actions with respect to the Bank. Accordingly, and on this basis, Defendants understand, represent and promise to the Bank that the Judgment and the Debt, and all other amounts owing to the Bank, are **[**6]** not dischargeable in any bankruptcy or bankruptcies filed by any of the Individual Defendants; and Defendants shall not, and represent that they have no factual or legal basis to, challenge or otherwise dispute the Bank's request for an order in any bankruptcy court to establish the nondischargeability of such obligations, and Defendants accordingly agree that such an order (and judgment thereon, if requested by the Bank) shall be issued by any bankruptcy court. Defendants further acknowledge and agree that the understandings, promises and representations set forth above, are essential to this Agreement and that, without such understandings, promises and representations, the Bank would not have entered into this Agreement, having done so based upon these understandings, promises and representations, without which the Bank would have proceeded with this Action….
>
> 15. B. *Bankruptcy*. Defendants hereby agree that, in consideration of the mutual covenants contained herein and for other good and valuable consideration (the receipt and sufficiency of which is hereby acknowledged): (a) Defendants shall not (i) file any voluntary petition under any Chapter of the Bankruptcy Code, **[**7]** Title 11, U.S.C.A. (hereinafter referred to as the "Bankruptcy Code") or in any manner to seek relief, protection, reorganization, liquidation, dissolution or similar relief for debts under any other local, state, federal or other insolvency laws or laws providing for relief of debtors in equity …. As consideration for the Bank's entering into this Agreement with Defendants, Defendants agree that should any of

> the Defendants be the subject of a bankruptcy proceeding, whether commenced voluntarily or involuntarily, the Bank shall have relief from the automatic stay to exercise the Bank's remedies under state and federal law, this Agreement **[*1177]** and the Judgment, and Defendants shall not contest the Bank's right to such relief. Defendants are aware that there may be case law which holds that such pre-petition waivers of relief from stay are unenforceable and agrees that in any bankruptcy, the Defendants will be deemed to have rejected and disavowed such case law. Defendants further agree and acknowledge that they are receiving valuable consideration under this Agreement, that the Bank is foregoing the exercise of its rights and remedies, that the Bank would be prejudiced if this waiver **[**8]** were not enforced in such bankruptcy proceeding and that Defendants' other creditors, if any, will not be prejudiced by enforcement of this waiver. But for Defendants agreeing to allow the Bank to have relief from the stay, the Bank would not have entered into this Agreement.

The Settlement Agreement was presented to United States District Judge Terry Hatter for approval. On July 10, 1997, Judge Hatter approved the settlement and entered judgment in the Bank's favor for the amount agreed upon.

PRESENT PROCEEDINGS

Fourteen months later, on September 10, 1998, Huang filed for bankruptcy under Chapter 7. On December 14, 1998, the Bank filed an adversary proceeding objecting to discharge of Huang's debt to it. The Bank moved for summary judgment on the basis of the provision in the Settlement Agreement that the debt was not dischargeable. On February 8, 2000, the Bankruptcy Court so ruled.

Huang appealed to the Bankruptcy Appellate Panel, which transferred the case to Judge Hatter. On November 3, 2000, Judge Hatter reversed the order of the Bankruptcy Court. Judge Hatter reasoned:

> Without a hearing, this Court received a settlement, a stipulation for the entry of a judgment, **[**9]** and a proposed judgment. The settlement, the parties' stipulation, and the Judgment did not include any of the underlying facts regarding Huang's allegedly fraudulent activities. Thus, Huang's fraud liability was not an essential part of this Court's Judgment and, on that basis, collateral estoppel does not apply in the bankruptcy proceeding. *United States v. International Bldg. Co., 345 U.S. 502, 505, 97 L. Ed. 1182, 73 S. Ct. 807 (1953)*.

The Bank appeals.

ANALYSIS

First. ***HN1***[⬆] It is against public policy for a debtor to waive the prepetition protection of the Bankruptcy Code. *Hayhoe v. Cole, 226 B.R. 647, 651-54 (B.A.P. 1998)*. This prohibition of prepetition waiver has to be the law; otherwise, astute creditors would routinely require their debtors to waive. Accordingly, the district court held that Settlement Agreement's provisions that the judgment and debt are not dischargeable, and that Huang will not enter bankruptcy, are unenforceable. The Bank did not appeal the decision of the district court on this point. It is the law of the case.

Second. ***HN2***[⬆] Liability for fraud is not dischargeable in bankruptcy. *11 U.S.C. § 523(a)(2)(A)*. **[**10]** If Huang defrauded the Bank, her debt to it is non-dischargeable. To prevail, the Bank must prove the fraud, unless the Bank succeeds by collateral estoppel.

Third. In all cases "***HN3***[⬆] where it is sought to apply the estoppel of a judgment rendered upon one cause of action to matters arising in a suit upon a different cause of action, the inquiry must always be as to the point or question actually litigated and **[*1178]** determined in the original action; not what might have been thus litigated and determined. Only upon such matters is the judgment conclusive in another action. " *United States v. International Bldg. Co., 345 U.S. 502, 505, 97 L. Ed. 1182, 73 S. Ct. 807 (1953)*, *quoting* *Cromwell v. County of Sac, 94 U.S. 351, 352-53, 24 L. Ed. 195 (1876)*. Accordingly, our inquiry is whether the fraud allegedly committed by Huang was "actually litigated and determined" in the prior proceeding.

Fourth. Fraud, or facts showing fraud, are not mentioned in the Settlement Agreement or in the judgment enforcing it. Fraud, as the Bank earnestly points out, was one of the counts in its prior suit. Fraud is also part of the two RICO violations alleged, and **[**11]** arguably part of several of the other counts. But there were other counts, not necessarily involving fraud, in the complaint that was settled. The Bank argues that Huang could have been liable only on those counts involving fraud. But such a limitation on her possible liability is neither evident from the Settlement Agreement nor from the complaint. Huang was a defendant throughout the complaint. She settled all

possible liabilities under it when she signed the Settlement Agreement.

The Bank argues that Huang's potential liability for fraud was part of the two months of negotiations that preceded settlement. That argument, in the end, cuts against the Bank. Fraud was being charged by the Bank. But, with apparent deliberateness, neither fraud, nor facts supporting the charge of fraud, are recited in the Settlement Agreement.

The omission of any mention of fraud is all the more striking when it is observed that the Bank was advised by experienced counsel, who must have been aware of what was required to constitute collateral estoppel. That the Bank's counsel was well aware that a debtor might not be able to waive bankruptcy protection is evidenced by the careful drafting by which the **[**12]** Bank attempted to preclude Huang from contesting the lawfulness of the waiver. The Bank knew it was running the risk of the waiver being void. The Bank, which the Settlement Agreement shows to have been in a dominant position, was unable to secure the one provision that would have led to collateral estoppel, that is, Huang's admission of fraud.

We cannot help noticing that it was only fourteen months after signing the Settlement Agreement that Huang repudiated her agreement not to enter bankruptcy. But we are not asked to judge her good faith, nor are we informed by the record as to the circumstances of her signing the Settlement Agreement or the circumstances bringing about her bankruptcy. We judge upon the basis of the Settlement Agreement as it is written, dancing around any admission of fraud and constituting no collateral estoppel upon which the Bank can now rely.

AFFIRMED.

Caution
As of: September 21, 2021 5:40 PM Z

Facebook, Inc. v. Pac. Northwest Software, Inc.

United States Court of Appeals for the Ninth Circuit

January 11, 2011, Argued and Submitted, San Francisco, California; May 16, 2011, Amended

No. 08-16745, No. 08-16873, No. 09-15021

Reporter
640 F.3d 1034 *; 2011 U.S. App. LEXIS 10430 **

THE FACEBOOK, INC.; MARK ZUCKERBERG, Plaintiffs-Appellees, DIVYA NARENDRA; CAMERON WINKLEVOSS; TYLER WINKLEVOSS, Intervenors, v. PACIFIC NORTHWEST SOFTWARE, INC.; WAYNE CHANG; WINSTON WILLIAMS, Defendants.THE FACEBOOK, INC.; MARK ZUCKERBERG, Plaintiffs-Appellees, v. CONNECTU, INC., FKA ConnectU, LLC, Defendant-Appellee, and CAMERON WINKLEVOSS; TYLER WINKLEVOSS; DIVYA NARENDRA, Defendants-Appellants, and PACIFIC NORTHWEST SOFTWARE, INC.; WAYNE CHANG; WINSTON WILLIAMS, Defendants.THE FACEBOOK, INC.; MARK ZUCKERBERG, Plaintiffs-Appellees, v. CONNECTU, INC., FKA ConnectU, LLC, Defendant-Appellee, and CAMERON WINKLEVOSS; TYLER WINKLEVOSS; DIVYA NARENDRA, Defendants-Appellants, and PACIFIC NORTHWEST SOFTWARE, INC.; WAYNE CHANG; WINSTON WILLIAMS, Defendants.

Prior History: [1]** Appeal from the United States District Court for the Northern District of California. D.C. No. 5:07-cv-01389-JW. D.C. No. 5:07-cv-01389-JW. D.C. No. 5:07-cv-0l389-JW. James Ware, District Judge, Presiding.

Facebook, Inc. v. Pac. Northwest Software, Inc., 2011 U.S. App. LEXIS 7430 (9th Cir. Cal., Apr. 11, 2011)

Disposition: AFFIRMED.

Core Terms

parties, settlement agreement, mediation, district court, Confidentiality, shares, settlement, terms, negotiations, documents, stock, settlement negotiations, acquisition, valuation, releases, lawyers

Case Summary

Procedural Posture
Appellees, a social networking site and its founder, sued appellee competing site and appellants in the United States District Court for the Northern District of California, alleging misappropriation of user data and other claims. The district court dismissed appellants and ordered mediation. Appellees subsequently moved to enforce a settlement agreement. The district court found the agreement enforceable. Appellants sought review.

Overview

The parties signed a settlement agreement that called for appellants to transfer the competing site to the networking site in exchange for shares in the networking site. Appellants argued that the settlement agreement lacked material terms. The court of appeals found that appellants, who had been dismissed for lack of personal jurisdiction, were implicitly granted intervention by the district court and had standing to appeal. The terms of the settlement agreement were sufficiently definite and left no doubt that the agreement was intended to be binding, even if some material aspects of the deal were to be filled in later. Appellants also argued that they were misled as to the value of the networking site's shares, in violation of *17 C.F.R. § 240.10b-5*, and therefore were entitled to rescind the agreement under *15 U.S.C.S. § 78cc(b)*. However, appellants were sophisticated parties who were engaged in litigation, not buyers of securities on the open market. A release contained in the agreement was valid under *§ 78cc(a)* and applied to the securities claim; also, a confidentiality agreement precluded use of statements made during the mediation to support the securities claim.

Outcome
The district court's judgment was affirmed.

LexisNexis® Headnotes

Civil Procedure > Appeals > General Overview

Civil Procedure > Parties > General Overview

HN1[] Civil Procedure, Appeals

Those litigants who properly become parties may appeal an adverse judgment.

Business & Corporate Compliance > ... > Contract Formation > Offers > Definite Terms

Contracts Law > Contract Conditions & Provisions > General Overview

HN2[] Offers, Definite Terms

A contract term may be "material" in one of two ways: It may be a necessary term, without which there can be no contract; or, it may be an important term that affects the value of the bargain. Obviously, omission of the former will render the contract a nullity. But a contract that omits terms of the latter type is enforceable under California law, so long as the terms it does include are sufficiently definite for a court to determine whether a breach has occurred, order specific performance or award damages. This is not a very demanding test.

Contracts Law > Contract Conditions & Provisions > General Overview

Contracts Law > Contract Interpretation > Good Faith & Fair Dealing

Contracts Law > Contract Interpretation > Parol Evidence > General Overview

HN3[] Contracts Law, Contract Conditions & Provisions

California allows parties to delegate choices over terms, so long as the delegation is constrained by the rest of the contract and subject to the implied covenant of good faith and fair dealing. Delegation is not necessary for a contract to be enforceable, as the court may fill in missing terms by reference to the rest of the contract, extrinsic evidence and industry practice.

Securities Law > ... > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Deceptive & Manipulative Devices

HN4[] Implied Private Rights of Action, Deceptive & Manipulative Devices

17 C.F.R. § 240.10b-5 prohibits fraud, whether by commission or omission, in connection with the purchase or sale of any security.

Securities Law > ... > Releases & Waivers > Exchange Act Compliance > Void & Voidable Contracts

HN5[] Exchange Act Compliance, Void & Voidable Contracts

15 U.S.C.S. § 78cc(b) renders voidable every contract made in violation of any provision of the securities laws or of any rule or regulation thereunder, and every contract the performance of which involves such a violation.

Civil Procedure > Settlements > Rescission

Securities Law > ... > Releases & Waivers > Exchange Act Compliance > Void & Voidable Contracts

HN6[] Settlements, Rescission

For purposes of rescission of a settlement agreement under 15 U.S.C.S. § 78cc(b), a distinction is made between buyers of securities in the context of an exclusively business relationship and those acting in the adversarial setting that is characteristic of litigation. When adversaries in a roughly equivalent bargaining position and with ready access to counsel sign an agreement to establish a general peace, a court enforces the clear terms of the agreement. Parties involved in litigation know that they are locked in combat with an adversary and thus have every reason to be skeptical of each other's claims and representations. Parties signing a release of claims have a "duty of inquiry." They can use discovery to ferret out a great deal of information before even commencing settlement negotiations. They can further protect themselves by

requiring that the adverse party supply the needed information, or provide specific representations and warranties as a condition of signing the settlement agreement. Such parties stand on a very different footing from those who enter into an investment relationship in the open market, where it is reasonable to presume candor and fair dealing, and access to inside information is often limited.

Civil Procedure > ... > Settlement Agreements > Enforcement > General Overview

HN7 **Settlement Agreements, Enforcement**

There are very important policies that favor giving effect to agreements that put an end to the expensive and disruptive process of litigation. There is an overriding public interest in settling and quieting litigation.

Securities Law > ... > Releases & Waivers > Exchange Act Compliance > Void & Voidable Contracts

HN8 **Exchange Act Compliance, Void & Voidable Contracts**

15 U.S.C.S. § 78cc(a) voids any condition, stipulation, or provision binding any person to waive compliance with the securities laws.

Civil Procedure > Settlements > Releases From Liability > General Overview

Securities Law > ... > Releases & Waivers > Exchange Act Compliance > Void & Voidable Contracts

HN9 **Settlements, Releases From Liability**

For purposes of 15 U.S.C.S. § 78cc(a), parties possessing roughly equivalent bargaining strength can release all claims arising out of a transaction that gave rise to litigation, even though they have not yet discovered some securities claims when they sign the settlement. Such a release is valid if it is unambiguous in conveying the intent of the parties to release all unknown claims.

Civil Procedure > Settlements > Releases From Liability > Interpretation of Releases

HN10 **Releases From Liability, Interpretation of Releases**

An agreement meant to end a dispute between sophisticated parties cannot reasonably be interpreted as leaving open the door to litigation about the settlement negotiation process. A release in such an agreement would be useless to end litigation if it could not include claims arising from the settlement negotiations.

Business & Corporate Compliance > ... > Pretrial Matters > Alternative Dispute Resolution > Mediation

Civil Procedure > ... > Federal & State Interrelationships > Federal Common Law > Applicability

Evidence > Privileges > General Overview

Governments > Courts > Rule Application & Interpretation

HN11 **Alternative Dispute Resolution, Mediation**

A local rule, like any court order, can impose a duty of confidentiality as to any aspect of litigation, including mediation. N.D. Cal. ADR R. 6-12(a). But privileges are created by federal common law. *Fed. R. Evid. 501*. It is doubtful that a district court can augment the list of privileges by local rule.

Business & Corporate Compliance > ... > Pretrial Matters > Alternative Dispute Resolution > Mediation

Governments > Courts > Rule Application & Interpretation

HN12 **Alternative Dispute Resolution, Mediation**

Under N.D. Cal. ADR R. 3-4(b), a private alternative dispute resolution (ADR) procedure may be substituted for a court program if the parties so stipulate and the assigned judge approves. Such a mediation is not subject to the ADR Local Rules, including N.D. Cal.

ADR R. 6-11. Rule 3-4(b).

Securities Law > ... > Releases & Waivers > Exchange Act Compliance > General Overview

HN13[] **Releases & Waivers, Exchange Act Compliance**

15 U.S.C.S. § 78cc(a) applies only to express waivers of non-compliance, with the substantive obligations imposed by the Securities Exchange Act.

Business & Corporate Compliance > ... > Contracts Law > Types of Contracts > Releases

Securities Law > ... > Releases & Waivers > Exchange Act Compliance > General Overview

HN14[] **Types of Contracts, Releases**

15 U.S.C.S. § 78cc(a) has been applied to preclude the waiver of unknown claims by plaintiffs who were not acting in the adversarial setting that is characteristic of litigation. A totally different situation occurs where a plaintiff has affirmatively acted to release another party from any possible liability in connection with a transaction in securities. In such situations, the parties are not so concerned with protecting their rights as investors as they are with establishing a general peace.

Counsel: Jerome B. Falk (argued), Sean M. SeLegue, John P. Duchemin, Shaudy Danaye-Elmi and Noah S. Rosenthal, Howard Rice Nemerovski Canady Falk & Rabkin, San Francisco, California, for the defendants-appellants-cross-appellees.

E. Joshua Rosenkranz (argued), Orrick, Herrington & Sutcliffe LLP, New York, NY; I. Neel Chatterjee, Monte Cooper and Theresa A. Sutton, Orrick, Herrington & Sutcliffe LLP, Menlo Park, California; and Theodore W. Ullyot and Colin S. Stretch, Facebook, Inc., Palo Alto, California, for the plaintiffs-appellees.

James E. Towery, Alison P. Buchanan and Jill E. Fox, Hoge, Fenton, Jones & Appel, Inc., San Jose, California, for the defendant-appellee.

Judges: Before: Alex Kozinski, Chief Judge, J. Clifford Wallace and Barry G. Silverman, Circuit Judges.

Opinion by Chief Judge Kozinski.

Opinion by: Alex Kozinski

Opinion

[*1036] AMENDED OPINION

KOZINSKI, Chief Judge:

Cameron Winklevoss, Tyler Winklevoss and Divya Narendra (the Winklevosses) claim that Mark Zuckerberg stole the idea for Facebook (the social **[**2]** networking site) from them. They sued Facebook and Zuckerberg (Facebook) in Massachusetts. Facebook countersued them and their competing social networking site, ConnectU, in California, alleging that the Winklevosses and ConnectU hacked into Facebook to purloin user data, and tried to steal users by spamming them. The ensuing litigation involved several other parties and gave bread to many lawyers, but the details are not particularly relevant here.

The district court in California eventually dismissed the Winklevosses from that case for lack of personal jurisdiction. It then ordered the parties to mediate their dispute. The mediation session included ConnectU, Facebook and the Winklevosses so that the parties could reach a global settlement. Before mediation began, the participants signed a Confidentiality Agreement stipulating that all statements made during mediation were privileged, non-discoverable and inadmissible "in any arbitral, judicial, or other proceeding."

[*1037] After a day of negotiations, ConnectU, Facebook and the Winklevosses signed a handwritten, one-and-a-third page "Term Sheet & Settlement Agreement" (the Settlement Agreement). The Winklevosses agreed to give up ConnectU **[**3]** in exchange for cash and a piece of Facebook. The parties stipulated that the Settlement Agreement was "confidential," "binding" and "may be submitted into evidence to enforce [it]." The Settlement Agreement also purported to end all disputes between the parties.

The settlement fell apart during negotiations over the form of the final deal documents, and Facebook filed a motion with the district court seeking to enforce it. ConnectU argued that the Settlement Agreement was unenforceable because it lacked material terms and had been procured by fraud. The district court found the

Settlement Agreement enforceable and ordered the Winklevosses to transfer all ConnectU shares to Facebook. This had the effect of moving ConnectU from the Winklevosses' to Facebook's side of the case.

The Winklevosses appeal.

A. Because ConnectU switched sides, it no longer had any interest in appealing the district court's order. The Winklevosses sought to intervene after the district court entered judgment enforcing the Settlement Agreement. The court denied the motion as unnecessary, holding that they were "already parties to the[ ] proceedings to enforce the Settlement Agreement" and "may **[**4]** appeal that Judgment." In fact, the Winklevosses had earlier been dismissed from the case. But, by ruling that they were "already" parties, the district court implicitly granted them intervention nunc pro tunc. *See* Beckman Indus., Inc. v. Int'l Ins. Co., 966 F.2d 470, 474-75 (9th Cir. 1992). They therefore have standing to appeal. *See* Marino v. Ortiz, 484 U.S. 301, 304, 108 S. Ct. 586, 98 L. Ed. 2d 629 (1988) (**HN1**[] "[T]hose [litigants who] properly become parties[] may appeal an adverse judgment . . . .").

B. The Settlement Agreement envisioned that Facebook would acquire all of ConnectU's shares in exchange for cash and a percentage of Facebook's common stock. The parties also agreed to grant each other "mutual releases as broad as possible," and the Winklevosses represented and warranted that "[t]hey have no further right to assert against Facebook" and "no further claims against Facebook & its related parties."

Facebook moved to enforce the Settlement Agreement, and also asked the district court to order ConnectU and the Winklevosses to sign more than 130 pages of documents, including a Stock Purchase Agreement, a ConnectU Stockholders Agreement and a Confidential Mutual Release Agreement. Facebook's deal lawyers claimed **[**5]** that the terms in these documents were "required to finalize" the Settlement Agreement, and its expert dutifully opined that they were "typical of acquisition documents."

The Winklevosses argue that if these terms really are "required" and "typical," then they must be material, and their absence from the Settlement Agreement renders it unenforceable. *See* Weddington Prods., Inc. v. Flick, 60 Cal. App. 4th 793, 71 Cal. Rptr. 2d 265, 279-80 (Cal. Ct. App. 1998). But **HN2**[] a term may be "material" in one of two ways: It may be a necessary term, without which there can be no contract; or, it may be an important term that affects the value of the bargain. Obviously, omission of the former would render the contract a nullity. *See* Citizens Utils. Co. v. Wheeler, 156 Cal. App. 2d 423, 319 P.2d 763, 769-70 (Cal. Dist. Ct. App. 1958) (arms-length acquisition of a private company's shares **[*1038]** couldn'tt proceed because price was omitted from the contract). But a contract that omits terms of the latter type is enforceable under California law, so long as the terms it does include are sufficiently definite for a court to determine whether a breach has occurred, order specific performance or award damages. *See* Elite Show Sen's., Inc. v. Staffpro, Inc., 119 Cal. App. 4th 263, 14 Cal. Rptr. 3d 184, 188 (Cal. Ct. App. 2004); **[**6]** 1 B.E. Witkin, *Summary of California Law, Contracts* § 137 (10th ed. 2005) [hereinafter *Witkin on Contracts*]; *cf.* Terry v. Conlan, 131 Cal. App. 4th 1445, 33 Cal. Rptr. 3d 603, 612-13 (Cal. Ct. App. 2005). This is not a very demanding test, and the Settlement Agreement easily passes it: The parties agreed that Facebook would swallow up ConnectU, the Winklevosses would get cash and a small piece of Facebook, and both sides would stop fighting and get on with their lives.

The Settlement Agreement even specifies how to fill in the "material" terms that the Winklevosses claim are missing from the deal:

> *Facebook will determine* the form & documentation of the acquisition of ConnectU's shares [ ] consistent with a stock and cash for stock acquisition. (emphasis added).

HN3[] California allows parties to delegate choices over terms, so long as the delegation is constrained by the rest of the contract and subject to the implied covenant of good faith and fair dealing. *See* Cal. Lettuce Growers, Inc. v. Union Sugar Co., 45 Cal. 2d 474, 289 P.2d 785, 791 (Cal. 1955); *see also* 1 *Witkin on Contracts* § 139. Delegation isn't necessary for a contract like the Settlement Agreement to be enforceable, as the court may fill in missing terms by reference **[**7]** to the rest of the contract, extrinsic evidence and industry practice. *See* 1 *Within on Contracts* § 139; Sterling v. Taylor, 40 Cal. 4th 757, 55 Cal. Rptr. 3d 116, 152 P.3d 420, 428-29 (Cal. 2007). But the clause quoted above leaves no doubt that the Winklevosses and Facebook meant to bind themselves and each other, even though everyone understood that some material aspects of the deal would be papered later.

The Winklevosses' contractual delegation is valid because the Settlement Agreement obligates Facebook

to draw up documents "consistent with a stock and cash for stock acquisition." And, if Facebook should draft terms that are unfair or oppressive, or that deprive the Winklevosses of the benefit of their bargain, the district court could reject them as a breach of the implied covenant of good faith and fair dealing. *See* 1 *Within on Contracts* § 798. The district court got it exactly right when it found the Settlement Agreement enforceable but refused to add the stack of documents drafted by Facebook's deal lawyers.

C. After signing the Settlement Agreement, Facebook notified the Winklevosses that an internal valuation prepared to comply with Section 409A of the tax code put the value of its common stock at $8.88 per share. **[**8]** The Winklevosses argue that Facebook misled them into believing its shares were worth four times as much. Had they known about this valuation during the mediation, they claim, they would never have signed the Settlement Agreement. The Winklevosses charge Facebook with violating Rule 10b-5, and they seek rescission of the Settlement Agreement under Section 29(b) of the Securities Exchange Act of 1934 (the Exchange Act).

HN4[↑] Rule 10b-5 prohibits fraud, whether by commission or omission, "in connection with the purchase or sale of any security." 17 C.F.R. § 240.10b-5. We assume, without deciding, that a party negotiating an exchange of shares to settle a lawsuit could violate Rule 10b-5 by misstating or hiding **[*1039]** information that would materially change the other side's evaluation of the settlement. *Cf.* Green v. Ancora-Citronelle Corp., 577 F.2d 1380, 1382-83 (9th Cir. 1978); Foster v. Fin. Tech., Inc., 517 F.2d 1068, 1071-72 (9th Cir. 1975).

HN5[↑] Section 29(b) renders voidable "[e]very contract made in violation of any provision of [the securities laws] or of any rule or regulation thereunder, and every contract ... the performance of which involves [such a] violation." 15 U.S.C. §78cc(b); *see* Mills v. Elec. Auto-Lite Co., 396 U.S. 375, 387-88, 90 S. Ct. 616, 24 L. Ed. 2d 593 (1970). **[**9]** If Facebook violated Rule 10b-5, the Winklevosses would be entitled to rescission of the Settlement Agreement. *See* Mills, 396 U.S. at 387-88; Royal Air Props., Inc. v. Smith, 312 F.2d 210, 213 (9th Cir. 1962).

The Winklevosses are sophisticated parties who were locked in a contentious struggle over ownership rights in one of the world's fastest-growing companies. They engaged in discovery, which gave them access to a good deal of information about their opponents. They brought half-a-dozen lawyers to the mediation. Howard Winklevoss—father of Cameron and Tyler, former accounting professor at Wharton School of Business and an expert in valuation—also participated. A party seeking to rescind a settlement agreement by claiming a Rule 10b-5 violation under these circumstances faces a steep uphill battle. *See* Petro-Ventures, Inc. v. Takessian, 967 F.2d 1337, 1341-42 (9th Cir. 1992); *see also* Harsco Corp. v. Segui, 91 F.3d 337, 343-44 (2d Cir. 1996); Locafrance U.S. Corp. v. Intermodal Sys. Leasing, Inc., 558 F.2d 1113, 1115 (2d Cir. 1977); *cf.* Mergens v. Dreyfoos, 166 F.3d 1114, 1117-18 (11th Cir. 1999) (applying Florida law).

In *Petro-Ventures*, ***HN6***[↑] we distinguished between buyers of securities **[**10]** in the context of "an exclusively business relationship," 967 F.2d at 1341, and those "acting in the adversarial setting that is characteristic of litigation," *id.* at 1342. When adversaries "in a roughly equivalent bargaining position and with ready access to counsel" sign an agreement to "establish[ ] a general peace," we enforce the clear terms of the agreement. *Id*. (citing Locafrance, 558 F.2d at 1115). Parties involved in litigation know that they are locked in combat with an adversary and thus have every reason to be skeptical of each other's claims and representations. *See* Mergens, 166 F.3d at 1118; *cf.* Goodman v. Epstein, 582 F.2d 388, 403-04 (7th Cir. 1978) (holding that parties signing a release of claims have a "duty of inquiry"); Moseman v. Van Leer, 263 F.3d 129, 133-34 & n.3 (4th Cir. 2001) (same). They can use discovery to ferret out a great deal of information before even commencing settlement negotiations. They can further protect themselves by requiring that the adverse party supply the needed information, or provide specific representations and warranties as a condition of signing the settlement agreement. *See* Harsco, 91 F.3d at 344. Such parties stand on a very different **[**11]** footing from those who enter into an investment relationship in the open market, where it's reasonable to presume candor and fair dealing, and access to inside information is often limited. ***HN7***[↑] There are also very important policies that favor giving effect to agreements that put an end to the expensive and disruptive process of litigation. *See, e.g.,* Franklin v. Kaypro Corp., 884 F.2d 1222, 1229 (9th Cir. 1989) ("[I]t hardly seems necessary to point out that there is an overriding public interest in settling and quieting litigation."). We analyze the Winklevosses' securities claims in light of these inhospitable principles.

Release of claims. The Settlement Agreement grants "all parties" "mutual releases **[*1040]** as broad as

possible"; the Winklevosses "represent and warrant" that "[t]hey have no further right to assert against Facebook" and "no further claims against Facebook & its related parties." The Winklevosses maintain that they didn't discover the facts giving rise to their Rule 10b-5 claims until after they signed these releases. They argue that the releases don't foreclose their challenge to the Settlement Agreement because Section 29(a) of the Exchange Act precludes a mutual release **[**12]** of unknown securities fraud claims arising out of negotiations to settle a pending lawsuit. *See* **HN8**[↑] 15 U.S.C. § 78cc(a) (voiding "[a]ny condition, stipulation, or provision binding any person to waive compliance with" the securities laws).

Petro-Ventures dealt with just such a settlement agreement. 967 F.2d at 1338-39. We held that **HN9**[↑] parties possessing roughly equivalent bargaining strength could release *all* claims arising out of the transaction that gave rise to the litigation, even though they hadn't yet discovered some of the securities claims when they signed the settlement. Id. at 1342. Such a release is valid if it "is unambiguous in conveying the intent of the parties to release all unknown claims." *Id*. The Settlement Agreement the parties negotiated granted "releases as broad as possible." As sophisticated litigants, the Winklevosses or their counsel should have been familiar with Petro-Ventures and understood that the broadest possible release includes both known and unknown securities claims. **HN10**[↑] An agreement meant to end a dispute between sophisticated parties cannot reasonably be interpreted as leaving open the door to litigation about the settlement negotiation process. *See* Petro-Ventures, 967 F.2d at 1342 **[**13]** (discussing the parties' "intent to end their various disputes . . . once and for all" (ellipses in original)). A release in such an agreement would be useless to end litigation if it couldn't include claims arising from the settlement negotiations. *Cf.* Sander v. Weyerhaeuser, 966 F.2d 501, 503 (9th Cir. 1992).

The Winklevosses point out that Facebook's alleged securities law violations took place in connection with the settlement itself, whereas the unknown securities claim in *Petro-Ventures* arose out of facts that occurred prior to the settlement. This is a distinction without a difference: Both here and in Petro-Ventures the parties gave up securities law claims they didn't know they had. If the release is effective in the one case, there's no principled reason it shouldn't be effective in the other. The district court correctly concluded that the Settlement Agreement meant to release claims arising out of the settlement negotiations, and that the release was valid under section 29(a).

Securities fraud claims. In any event, the Winklevosses' securities fraud claims fail on the merits. The Winklevosses make two related claims: that Facebook led them to believe during the settlement **[**14]** negotiations that its shares were worth $35.90, even though Facebook knew that its shares were, in fact, worth only $8.88; and that Facebook failed to disclose material information, namely the $8.88 tax valuation, during the negotiations.

In support of these claims, the Winklevosses proffered evidence of what was said and not said during the mediation. The district court excluded this evidence under its Alternative Dispute Resolution (ADR) local rule on "confidential information," which it read to create a "privilege" for "evidence regarding the details of the parties' negotiations in their mediation." **HN11**[↑] A local rule, like any court order, can impose a duty of confidentiality as to any aspect of litigation, including mediation. *See* N.D. Cal.' ADR L.R. 6-12(a); *see also* 28 U.S.C. § 652(d). **[*1041]** But privileges are created by federal common law. *See Fed. R. Evid. 501*. It's doubtful that a district court can augment the list of privileges by local rule. *Cf. In re Grand Jury Subpoena Dated Dec. 17, 1996, 148 F.3d 487, 491-93 (5th Cir. 1998)* (examining whether a federal statute created an evidentiary privilege). In any event, the parties used a private mediator rather than a court-appointed one. **[**15]** *See* **HN12**[↑] *N.D. Cal. ADR L.R. 3-4(b)* ("A private ADR procedure may be substituted for a Court program if the parties so stipulate and the assigned Judge approves."). Their mediation was thus "not subject to the ... ADR Local Rules," including Local Rule 6-11. *Id*.

Nevertheless, the district court was right to exclude the proffered evidence. The Confidentiality Agreement, which everyone signed before commencing the mediation, provides that:

> All statements made during the course of the mediation or in mediator follow-up thereafter at any time prior to complete settlement of this matter are privileged settlement discussions . . . and are non-discoverable and inadmissible for any purpose including in any legal proceeding. . . . *No aspect of the mediation shall be relied upon or introduced as evidence in any arbitral, judicial, or other proceeding*. (emphasis added).

This agreement precludes the Winklevosses from

introducing in support of their securities claims any evidence of what Facebook said, or did not say, during the mediation. *See* Johnson v. Am. Online, Inc., 280 F. Supp. 2d 1018, 1027 (N.D. Cal. 2003) (enforcing a similar agreement). The Winklevosses can't show that Facebook misled them about **[**16]** the value of its shares or that disclosure of the tax valuation would have significantly altered the mix of information available to them during settlement negotiations. Without such evidence, their securities claims must fail. *See* In re Daou Sys., Inc., 411 F.3d 1006, 1014 (9th Cir. 2005); *see also* McCormick v. Fund Am. Cos., 26 F.3d 869, 876 (9th Cir. 1994).

The Winklevosses argue that if the Confidentiality Agreement is construed to defeat their Rule 10b-5 claims, it is void under section 29(a) of the Exchange Act as an invalid waiver. But **HN13**[↑] section 29(a) "applie[s] only to express waivers of non-compliance," Levy v. Southbrook Int'l Invs., Ltd., 263 F.3d 10, 14, 18 (2d Cir. 2001), with the "substantive obligations imposed by the Exchange Act," Shearson/Am. Express, Inc. v. McMahon, 482 U.S. 220, 228, 107 S. Ct. 2332, 96 L. Ed. 2d 185 (1987). The Confidentiality Agreement merely precludes both parties from introducing evidence of a certain kind. Although this frustrates the securities claims the Winklevosses chose to bring, the Confidentiality Agreement doesn't purport to limit or waive their right to sue, Facebook's obligation not to violate Rule 10b-5 or Face-book's liability under any provision of the securities **[**17]** laws. *See* McMahon, 482 U.S. at 230.

Even if we were to construe the Confidentiality Agreement as a waiver of the Winklevosses' 10b-5 claims, it wouldn't violate section 29(a). *Petro-Ventures* expressly considered a section 29(a) argument in the context of a global settlement agreement between sophisticated parties engaged in litigation. 967 F.2d at 1341-43. The court distinguished an earlier case, Burgess v. Premier Corp., 727 F.2d 826 (9th Cir. 1984), which had **HN14**[↑] applied section 29(a) to preclude the waiver of unknown claims by plaintiffs who were "not acting in the adversarial setting that is characteristic of litigation." Petro-Ventures, 967 F.2d at 1342. *Petro-Ventures* held that "a totally different situation occurs where a plaintiff has affirmatively acted to release **[*1042]** another party from any possible liability in connection with a transaction in securities." *Id*. In such situations, the parties are "not so concerned with protecting their rights as investors as they [are] with establishing a general peace." *Id*. We are bound by Petro-Ventures to conclude that the Confidentiality Agreement did not violate section 29(a). *Cf.* Locafrance, 558 F.2d at 1115.

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The Winklevosses are not the **[**18]** first parties bested by a competitor who then seek to gain through litigation what they were unable to achieve in the marketplace. And the courts might have obliged, had the Winklevosses not settled their dispute and signed a release of all claims against Facebook. With the help of a team of lawyers and a financial advisor, they made a deal that appears quite favorable in light of recent market activity. *See* Geoffrey A. Fowler & Liz Rappaport, *Facebook Deal Raises $1 Billion*, Wall St. J., Jan. 22, 2011, at B4 (reporting that investors valued Facebook at $50 billion—3.33 times the value the Winklevosses claim they thought Facebook's shares were worth at the mediation). For whatever reason, they now want to back out. Like the district court, we see no basis for allowing them to do so. At some point, litigation must come to an end. That point has now been reached.

AFFIRMED.

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