2003

Liquidated damage provisions in sales contracts: Timney v Lin, 2003

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Illegal forfeiture provision, providing for forfeiture of buyer’s deposit, was unenforceable even when illegal provision was included in settlement agreement.


To settle their dispute over the purchase of residential property, Buyers and Sellers entered into a settlement agreement under which Sellers agreed to sell their 75-percent interest in the property to Buyers for $365,625. If the sale did not close due to Buyers’ fault, the settlement agreement called for a return of all funds placed in escrow, on Buyers’ deposit of a quitclaim deed in escrow within five days of the closing date. However, this provision also stated that if Buyers failed to place the quitclaim deed in escrow on time, their deposit of $31,250 would be forfeited to Sellers. Buyers cancelled the escrow but did not deposit the quitclaim within five days. The trial court granted Sellers’ motion to enforce the settlement under CCP §664.6. Buyers appealed, contending that forfeiture of the $31,250 deposit was an illegal forfeiture.

The court of appeal reversed, holding that the illegal forfeiture provision was unenforceable, regardless of its inclusion in the settlement agreement. If the provision authorizing the forfeiture of a substantial deposit by reason of a minor delay in delivery of the quitclaim deed were included in a real property sales contract, it would be void as an illegal forfeiture; and a settlement agreement is a contract subject to all the normal legal and statutory contractual requirements. Section 664.6 does not allow a court to endorse or enforce a provision in a settlement agreement that is illegal, contrary to public policy, or unjust. Because the validity of a settlement agreement is judged by the same legal principles applicable to contracts generally, the forfeiture of the deposit as a result of the delay in delivering the quitclaim deed—a delay that caused Seller no cognizable damage—constituted an illegal forfeiture provision and was invalid.

**THE EDITOR’S TAKE:** The opinion says that under CC §1675(d) a liquidated damages provision for more than 3 percent is “generally invalid”—but that section actually describes it as “invalid unless the party seeking to uphold the provision establishes that the amount actually paid is reasonable as liquidated damages.” Thus, that is a standard of only presumptive invalidity and the seller has the opportunity to overcome the presumption.

The opinion goes on to say that loss of a “substantial deposit by reason of a minor delay” is “void as an illegal forfeiture,” but that seems to me to be looking at what actually happened rather than at what the statute requires for proving reasonableness. Section 1675(e) states:

For the purposes of subdivisions (c) and (d), the reasonableness of an amount actually paid as liquidated damages shall be determined by taking into account both of the following:

1. The circumstances existing at the time the contract was made.
2. The price and other terms and circumstances of any subsequent sale or contract to sell and purchase the same property if such sale or contract is made within six months of the buyer’s default.
Since the only hindsight the statute allows is a subsequent resale, which did not occur in this case, the test should be one of pure foresight—*i.e.*, was it reasonable for the parties to provide, at the time they made the settlement, that the buyers would forfeit their 8-percent deposit if they did not deposit a quitclaim deed into escrow within five days after the closing date? Putting it that way eliminates the minor-delay feature, because I doubt that a liquidated damages clause has to provide for a schedule of penalties based on the number of days the quitclaim deposit is late. And, as an abstract matter, 8 percent for keeping the seller’s title clouded for an unknown period of time does not seem all that unreasonable to me. (In New York, the standard penalty is 10 percent. See *Maxton Builders, Inc. v Lo Galbo* (1968) 509 NYS2d 507, 502 NE2d 184).

If I were to fault this clause, I think I would do so on the ground that, as written, it blurred failure of conditions as well as breach of covenants. Normally, one expects buyers to recover their deposit if the loan contingency is not met, and to forfeit it if they go into breach. This clause appears to give them their deposit in either case, but only if they put the quitclaim deed in escrow in a timely way. That is certainly an odd way to allocate losses. — *Roger Bernhardt*