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Don't Penalize The Judgment

Have you heard this one? Two parties walk into a settlement agreement that provides for payments over time. In the event of default, plaintiff may file a stipulated judgment for \$700,000 more than the settlement amount, plus interest and attorney's fees. The punchline? The additional \$700,000 in the judgment constitutes an unenforceable penalty, according to *Red and White Distribution, LLC v. Osteroid Enterprises, LLC* (2019) 38 Cal.App.5th 582.

Osteroid settled a breach of contract action against R&W for \$2.1 million. To incentivize payment, if R&W paid the \$2.1 million within one year, it would avoid paying \$2.8 million as agreed in the stipulated judgment. When R&W missed some payments, Osteroid moved to enforce the stipulated judgment under Code of Civil Procedure section 664.6. The trial court found that R&W breached the settlement agreement, and that the additional \$700,000 in the judgment was "reasonable from [the parties'] perspectives as to the damages." The court entered judgment for \$3.6 million. R&W appealed.

The court of appeal reversed. The stipulated judgment constituted an unenforceable penalty under Civil Code section 1671(b), because the judgment for \$2.8 million bore no reasonable relationship to the range of actual damages the parties could have anticipated from a breach of the agreement to settle the dispute for \$2.1 million. The court noted *Jade Fashion & Co., Inc. v. Harkham Industries, Inc.* (2014) 229 Cal.App.4th 635, which held it is permissible under Civil Code section 1671 for the parties to agree to a discount for timely payment of an admitted debt.

But unlike *Jade Fashion*, R&W did not admit in the settlement agreement (or on appeal) that it owed Osteroid \$2.8 million. Instead, the settlement agreement states R&W is "liable to pay to the Osteroid Parties \$2.1 million." The court reasoned that if the parties intended to settle for \$2.8 million, with a discount for timely payments, they could have done so expressly. The parties could have stated in the agreement that "R&W is liable to pay the Osteroid Parties \$2.8 million, but so long as all payments are timely made in accordance with the payment schedule, the amount due shall be discounted to \$2.1 million."

The takeaway: A stipulated judgment will not be an unenforceable penalty if it contains:

1. An express admission of liability by defendant for the underlying claims and the resulting amount of damages caused by defendant; and
2. The discounted sum, conditioned on timely installment payments, is part of the original debt that defendant admits it owes, resulting in an agreement to forbear on the immediate collection of the debt in full.