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To Forbear (Or Not)

The dispute settled for an agreed sum. Defendant offers to make payments under an installment plan. Plaintiff insists that the agreed sum be paid by a specified date, but if defendant defaults, a larger sum will be due as a stipulated judgment. Plaintiff hopes this will incentivize defendant to make all payments. One problem in this scenario is that California courts have deemed such deals for a larger sum as an unenforceable “penalty and forfeiture” because the sum bears “no reasonable relationship” to actual damages suffered as a result of delay.*

However, the parties in *Jade Fashion & Co., Inc. v. Harkham Industries, Inc.* (2014) 229 Cal.App.4th 635, made a similar deal that the court enforced. Harkham purchased \$341,000 in goods, but got behind on its payments. Jade agreed to allow Harkham to pay off the debt in three months with weekly payments until the entire balance was paid in full. Jade further agreed that if Harkham made each payment on time, \$17,500 would be deducted from the final payment. Time was of the essence.

Five of the 13 scheduled payments were late. Harkham deducted \$17,500 from the final payment, but because five payments were late, Jade demanded payment of the principal balance of \$17,500, plus interest, fees and costs. Harkham refused to pay the \$17,500, and Jade sued for breach of contract. Jade filed a motion for summary judgment, asserting that Harkham breached their agreement by failing to pay the \$17,500 principal balance. In response, Harkham argued that the \$17,500 discount provision was an unenforceable penalty or forfeiture.

The trial court found that the parties’ written agreement unambiguously provided that Harkham would receive a \$17,500 discount only if it timely paid all of the weekly installments, and that Harkham 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 \$341,000 debt that Harkham owed to Jade, and as such, it was not an unlawful penalty or forfeiture. Judgment was entered for Jade, who received \$17,500 in actual damages, plus interest, attorney’s fees, and costs. Judgment was affirmed on appeal.

Why did the court enforce this agreement? *Jade* offers helpful drafting tips to incentivize full installment payments without creating a deal-killing penalty:

1. The **sum was not disputed**. The parties expressly agreed that Harkham owed Jade the balance of \$341,000 for the goods it purchased.
2. The **discount was conditioned** upon receiving full installment payments when due.
3. This was not an agreement to **settle or compromise** a disputed claim. Rather, it was an agreement to “**forbear** on the immediate collection of the debt in full.”

4. The parties agreed that the \$17,500 discount was **not liquidated damages** for a breach of contract, **nor an additional payment** over and above any debt that was owed. Instead, the \$17,500 was part of the existing \$341,000 debt admittedly owed.

Keep these tips in mind so the payment incentive will not be deemed a penalty by another name.

* *Greentree Financial Group, Inc. v. Execute Sports, Inc.* (2008) 163 Cal.App.4th 495;
Purcell v. Schweitzer (2014) 224 Cal.App.4th 969.