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California Courts Make It Even Harder To Obtain Full Default Judgments After a Settlement Agreement is Breached[1]

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On March 17, 2014, California's Fourth Appellate Division published its decision in Purcell v. Schweitzer, holding that – despite the best efforts of the lawyers in that case to ensure that a breach of a settlement agreement would result in a default judgment for the full balance of a debt, rather than the settlement amount – California law does not permit such a default judgment.

This decision reaffirms California's approach that once a plaintiff settles a case for less than the full amount of a debt, s/he is likely limited to recovery of the lower settlement amount, even if the defendant has breached the settlement agreement and even if the parties entered into a carefully-crafted stipulation for default judgment for the full balance.

I. THE CASE

In Purcell v. Schweitzer, the defendant owed $85,000.00 on a promissory note. Schweitzer defaulted on the loan, and Purcell brought suit to recover the amount owed. The parties reached a settlement for $38,000.00, plus interest, to be repaid in monthly installments over the course of two years. The settlement agreement provided that if Schweitzer was late with his payments, he would be in breach of the agreementand Purcell could take a default judgment for the entire $85,000.00.

In the settlement agreement itself, the parties agreed that the default amount:

> is an agreed upon amount of monies actually owed, jointly and severally, by the Defendant … to the Plaintiff … and is neither a penalty nor is it a forfeiture.

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1 This article is designed to provide one perspective regarding recent legal developments, and is not intended to serve as legal advice, nor does it establish an attorney-client relationship with any reader of the article where one does not exist. Always consult an attorney with specific legal issues.

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They further explained that the $85,000.00 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 and performance by Defendant; and (5) Support for the public policy of judicial economy.

The agreement also included a provision that the defendant would not contest any default judgment (under Cal. Civ. Code § 3275 "or otherwise"), and waived any right to appeal.

After Schweitzer defaulted, the trial court granted Purcell's motion for default judgment to recover the full balance ($85,000.00), less what had been paid, for a total of $58,829.35. Schweitzer then brought a motion to set aside the default judgment as an unlawful penalty, and the court granted that motion. On appeal, the Fourth Appellate District affirmed

II. IMPORTANCE

The Purcell decision expands upon the decision in Greentree Financial Grp., Inc. v. Execute Sports, Inc. In reviewing cases involving a settlement agreement, California courts treat the settlement agreement as a contract separate and distinct from the underlying litigation. The breach of the settlement is at issue -- ***not*** the breach of the underlying contract. Therefore, the amount owed on the initial promissory note agreement is simply irrelevant in determining the damages in the event of a breach of the settlement agreement.

The Purcell Court held that that any stipulated sum in a settlement agreement must fairly represent the amount of damages as a result of the breach of that agreement – not the damages from the initial debt. The Court's view is that inclusion of the original outstanding balance as a stipulated sum in the settlement agreement is a *penalty for breach* that violates Cal. Civ. Code § 1671(b), [4] rather than an attempt to account for actual loss.

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[4] "[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." The California Supreme Court in Ridgley v. Topa Thrift & Loan Ass'n interpreted this statute to mean that a liquidated damages provision will be held to be unreasonable if it "bears no reasonable relationship to the range of actual damages that the parties could have anticipated would flow from a breach" and the parties must attempt to "estimate a fair average compensation for any loss that may be sustained." 953 P.2d 484, 488 (Cal. 1998). This loss can include the reasonable costs in pursuing the action and the loss of the use of the money that should have been available under the agreement. Id.

While the Greentree Court had reached a similar conclusion more than a half-decade earlier, this case is important because of the efforts that the parties made to specify the reasons that the default amount was reasonable and not a penalty. The parties recited five specific reasons that are familiar to any attorney or party who has ever negotiated a settlement – such things as reducing litigation costs, reducing the costs of enforcing a judgment, and eliminating uncertainty in the litigation process.

In addition, the parties here included a clause with an express waiver of the stipulated judgment – something conspicuously absent in Greentree. The Court, however, was unpersuaded by this distinction either. It reiterated that "the public policy expressed in Civil Code sections 1670 and 1671 may not be circumvented by words used in a contract…" Thus, the Court effectively put an end to parties' efforts to avoid Greentree through additional or better language in their settlement agreements.

III. GOING FORWARD

It is important for clients to understand that once they reach a settlement, they are likely now limited to that settlement amount even if the defendant breaches the settlement agreement. As discussed above, even though the parties in Purcell clearly laid out specific reasons, including "economic" considerations, for the $85,000.00 stipulated sum, the Court still found that the amount constituted a penalty. In light of this, it is hard to imagine that additional or different language will improve the odds of success in future settlement agreements. Thus, parties and attorneys should think carefully about their willingness to settle a case for less than the full amount sought, unless they are comfortable with that settlement agreement constituting a cap on their ultimate recovery.

IV. APPLICATION TO ARBITRATION

While Purcell involved a state court claim, many promissory note claims are now brought in arbitration, rather than in court. Because arbitration awards are reviewed under a deferential standard (as opposed to the *de novo* standard of review employed in Purcell and other state court decisions), there may be one last hope for settling parties. The Federal Arbitration Act provides that a court may only vacate an arbitration award in the limited circumstances prescribed in 9 U.S.C. § 10, but must otherwise confirm the award.[5]

Thus, parties who wish to settle should consider entering into a stipulated award for the full balance sought and then confirm that award as part of the settlement terms. Separately, they could agree not to enforce the award so long as some settlement amount is paid. While it is far from certain that California courts would look with favor on this approach, the plaintiff would then have a judgment in hand prior to the breach, and thus have a somewhat stronger ability to seek enforcement after a breach.

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[5] A similar standard is applied under Cal. C. Civ. P. § 1287.6.

If you have any questions about the issues discussed in this article, please contact Jason Murtagh at jmurtagh@rubinfortunato.com or 610-408-2000.