

## Calif. Court Creates Settlement Agreement Pitfalls

*Law360, New York (March 26, 2014, 12:59 PM ET)* -- On March 17, 2014, the California Court of Appeal published its February decision in the matter of Purcell v. Schweitzer, a move that may cause some attorneys to rethink their approach to settlement agreements.

The underlying dispute arose when Purcell loaned Schweitzer \$85,000. Schweitzer executed a promissory note on which he eventually defaulted. Purcell brought suit to recover the amount of the loan. The parties reached a settlement requiring Schweitzer to pay Purcell \$38,000 at 8.5 percent annual interest in 24 payments between April 1, 2010, and April 1, 2012.

The installments were to be paid on the first day of each month and were to be considered late if not received by the fifth day of each month. In the event of a late or missed payment, the settlement agreement was to be considered breached and judgment could be entered against Schweitzer for the entire balance due on the \$85,000 loan. The parties expressly agreed that the provision agreeing to judgment of the entire balance was not a penalty; they also agreed that in the event of a breach, Schweitzer waived his right to contest or to appeal judgment.

Schweitzer was apparently ahead of schedule on his installments by October 2011, but he did not make his monthly payment until the 11th. Purcell cashed the late check, but also initiated proceedings to enter judgment for breach of the settlement.

On Oct. 17, 2011, the court entered default judgment of \$58,101.85 — with \$58,101.85 classified as “punitive damages.” Schweitzer made timely monthly payments in November and December of 2011. Although the opinion alludes to a disagreement between the parties as to whether or not the full settlement was satisfied at that time, an August 2012 payment satisfied the entire \$38,000.

Schweitzer then brought a motion to set aside the balance of the judgment entered against him as a result of the October 2011 breach. The trial court granted the motion, finding that Purcell’s judgment bore no relationship to the damages that he actually suffered as a result of Schweitzer’s breach, and that the waiver of right to appeal was unenforceable as against public policy. Purcell appealed.

The appellate court affirmed the lower court’s ruling after considering statutes and cases pertaining to liquidated damages provisions in contracts, and to the ruling of *Greentree Financial Group v. Execute Sports Inc.* (2008), 163 Cal.App.4th 495.

Greentree held that the failure to abide by the settlement agreement is to be analyzed on its own and not in concert with the contract underlying the litigation. (*Id.* at 499.) The court held that because the sum of the settlement was only \$38,000, the stipulated judgment exceeding \$58,000 was an

unenforceable liquidated damages penalty bearing no reasonable relationship to the actual damages from the breach. (See, *Morris v. Redwood Empire Bancorp* (2005) 128 Cal.App.4th 1305, 1314.)

The court also held that the judgment was improperly entered by the clerk as punitive damages, which are not recoverable in breach of contract actions.

While the court's final point would have been enough to support its ruling, the bulk of the opinion was devoted to the analysis of the stipulated judgment as a penalty for breach of the settlement agreement. The opinion's structure is something that ought to give litigators pause, if only because it seems that the court authored — and then chose to publish — the opinion to send a message about how it will be interpreting settlements in the future.

California has long had a “strong public policy ... to encourage the voluntary settlement of litigation,” (*Osumi v. Sutton* (2007) 151 Cal.App.4th 1355, 1359) and it seems reasonable that the courts would strive to enforce those settlements with an eye toward the litigation that brought them about.

Settlements, arguably, should be given more deference than other contracts because they are negotiated by trial counsel to resolve adversarial positions. The bargains are arms length in every way and there can be no leverage other than that exerted on the parties by the merits of their factual and legal positions.

The agreements are carefully analyzed and weighed against the prospects and expenses of continued litigation and trial. Few, if any, boilerplate or nonessential terms are included. Furthermore, should the courts later revise or strike terms of a settlement agreement, the parties do not have any opportunity to go back and reopen the litigation the settlement was intended to conclude.

Here, it reasonably can be argued that the judgment entered was not punitive because it was the sum that Schweitzer already owed. It can be further inferred that without the clause to enter judgment in the entire amount, Purcell would not have agreed to settle at all.

Once stripped of the stipulation to enter judgment on the balance of the initial loan, a breach by Schweitzer would put Purcell in a lesser position that he was in before ever filing his lawsuit. He would have been required to incur the same inconvenience and expense to pursue an action for breach of the settlement, but could only recover up to the discounted value of the breached settlement, and not the full amount he had loaned Schweitzer.

Finally, the parties agreed in writing that entering judgment in the entire amount was not a penalty. Instead of focusing on these factors, the court looked at the settlement agreement in a vacuum, as a standalone contract, and then disregarded the terms with which it did not agree. Although this view has precedent in *Greentree*, it may surprise many commercial litigators.

Provisions stipulating judgment exceeding the settlement sum are not uncommon in settlement agreements involving installment payments. Counsel drafting such agreements should be particularly careful to articulate the parties' perceived actual damages to the settling plaintiff should payments be missed or delayed. Stipulated judgments for more than such an amount may well be subject to the same scrutiny and outcome ordained by the court in *Purcell*.

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