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Litigation

HAMMERING SETTLEMENTS

By James R. Felton

This is a story about how the leverage, or "hammer," that you thought you had as part of a settlement might be worth little more than the paper it is written on. I recently represented a plaintiff and cross-defendant in a commercial dispute. My client was seeking several hundreds of thousands of dollars in damages. Good evidence supported \$65,000 in damages.

After months of litigation, the parties participated in a mediation. After hours and hours, the parties finally reached an agreement that was documented in writing. As part of the agreement, the defendant agreed to pay a total of \$20,000, with \$3,000 as a down payment and an additional \$1,000 a month until the amount was paid in full. Of course, as is common in virtually every settlement that includes a discounted payoff, the handwritten agreement provided that, should the defendant default on any one payment, my client could file an application to have judgment entered in the amount of \$66,000. Does this sound unusual so far? It shouldn't, and it isn't. Of course, there would be no reason for this article if I wasn't about to be thrown for a loop.

The 'Sybron' Syndrome

The defendant made the down payment and the second payment. The third payment bounced. My client filed a noticed motion to have judgment entered under Code of Civil Procedure Section 664.6 and the terms of written settlement agreement. The defendant opposed entry on the grounds that a judgment in the amount of \$66,000, after a \$1,000 payment was missed, amounted to a forfeiture under Civil Code Section 3275. In support of the opposition,

the defendant cited to *Sybron v. Clark Hospital Supply Corp.*, 76 Cal.App.3d 896 (1978).

In *Sybron*, the Court of Appeal reversed the trial court's refusal to vacate a stipulated judgment. There, the parties entered into a settlement agreement calling for monthly payments of \$6,000 for 12 months. The agreement also provided that, should the defendant default in the payments, the plaintiff could have judgment entered in the amount of \$100,000. By the way, the plaintiff's complaint sought \$143,000 in damages. As part of the agreement, the defendant signed a stipulated judgment.

OK, so you know what happens next: The defendant defaults, and the plaintiff has the stipulated judgment entered for \$100,000. The defendant's motion for relief from the entry of judgment was denied by the trial court, but the Court of Appeal reversed.

In very simple terms, the Court of Appeal found that the enforcement of the judgment in the sum of \$100,000 was a forfeiture and not tied to the actual damages suffered by the plaintiff as a result of the failure to get paid. The court noted, "[T]he creditor is entitled to bargain that if the installment debtor imposes upon the creditor by a continuing course of dilatory payment the creditor may accelerate and collect the entire obligation, plus a reasonable amount to compensate for delay. On the other hand, the equitable powers of the court exist to insure that the ultimate obligation imposed on the debtor is not unreasonable in proportion to the original obligation and the seriousness of the default."

Notably, the parties, within the written agreement, had said that the entry of judgment of \$100,000 in the event of default was not a forfeiture or penalty and that the amount was "a

fair sum" owed to the plaintiff in settlement of the dispute. The court rejected the terminology, calling it "form over substance."

Well, you might have guessed that the court's ruling in my case did not leave me jumping for joy. The court agreed with the defendant and found that entry of judgment amounted to a forfeiture. The court would not say whether any increased amount could be entered should the defendant fail to cure the default.

Thinking I had been blindsided, I contacted several mediators, as well as the mediator who had presided over the settlement in this case. None of them had any idea that the hammer provision of the written settlement agreement could be challenged on the basis espoused by the judge in my case and outlined in *Sybron*. In fact, the court in *Sybron*, as well as other nonpublished Court of Appeal opinions, demonstrates that the fact that the proposed judgment mirrored what was sought in the complaint was meaningless for purposes of determining whether judgment could be entered. Courts appear concerned only with the amount of actual damages incurred as a result of the default in the particular payment missed.

This was not a situation in which the proposed judgment amount was a ridiculous or made-up number bearing no semblance to the realities of the case. Here, the number chosen had a direct correlation to provable damages. The trial court was unmoved.

Through 20 years of practicing commercial law and 10 years as a mediator, I probably have participated in 200 settlements, representing both plaintiffs and defendants. The hammer provision is so routinely requested and granted that it has become an integral part of the standard terms and conditions entered into by settling parties. Plaintiffs see the hammer provisions as giving them some leverage over the defendant. Defendants see the hammer provisions as the embodiment of, in many cases, the large discount they will receive by making sure all required payments are made in a timely fashion.

New Problem, New Solutions

The trial court's ruling, if adopted by courts throughout the state, certainly would change the manner in which settlements are documented. If the hammer is unenforceable, then what leverage can a plaintiff have in requiring the defendant to pay?

So, now that I have identified the problem, I cannot just leave you hanging without some piece of advice on how to deal with the potential of confronting this issue. Although I certainly cannot tell you that my advice is tested through some appellate-court writings, I at least can offer what I think might work in handling this problem.

First, most debtor attorneys who understand that their clients may be required to sign a stipulation for entry of judgment as part of a settlement agreement ask that the stipulation be held by plaintiff's counsel, not filed. This technique could be helpful in preventing the public disclosure of judgments that could affect a client's credit rating. Creditors' counsel usually have no problem holding the executed stipulation, because they know that the entry of such stipulation, when and if necessary, could be challenged only on very limited grounds (for instance, if payment was actually made, etc.)

Yet, if *Sybron's* application is accepted statewide, then perhaps creditor's counsel must insist that judgments be entered, not held. Certainly, enforcement would be held, pending compliance with the terms of the discounted payoff. However, the actual entry of judgment certainly would take away the necessity of trying to have judgment entered and give the trial court an opportunity to deny such a request. This might be particularly helpful if several months or possibly years passed between the actual entry of judgment and the alleged default in the payment terms.

Of course, this would not have been effective in *Sybron*, because judgment had been entered and was later vacated. With that said, the entry of judgment certainly would put the onus on a defendant to file a motion to vacate, as opposed to a plaintiff's having to file a motion to enforce under Civil Code Section 664.6.

Whether the tenets of *Sybron* are somehow waivable in advance as part of the settlement is not entirely clear. The *Sybron* Court was not moved by the parties' attempt to expressly waive the forfeiture issue, but whether other language could have been used is not clear. In addition, if the parties agreed in writing, the entire matter would have to be reset for trial, should the trial court find a hammer provision unenforceable. Trial courts might be leery of the lack of finality of such overturning agreements.

Perhaps the parties could provide that, if a hammer provision was found unenforceable, then the defendant would agree to have its answer stricken and permit

a default judgment to be entered. By this agreement, a plaintiff certainly would be limited to the damages sought in the complaint, which is often expressly sought as part of a hammer provision. The trial court would have to determine whether the plaintiff had evidence, as part of a default prove-up, to support those damages. At least a plaintiff would have the potential of having judgment entered for the full amount of the prayer in the complaint.

Certainly, none of these alternatives is as satisfactory as the entry of judgment under the hammer provision. However, if, as *Sybron* suggests, such provisions are unenforceable, then crafty litigants are going to have to find other ways to provide leverage in settlement agreements. Otherwise, you can put the hammer away for good.

James R. Felton is the managing partner of Greenberg & Bass in Encino. He can be reached at jfelton@greenbass.com.

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