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ACCORD AND SATISFACTION IN CALIFORNIA: A TRAP FOR THE UNWARY

Scott J. Burnham*

I. INTRODUCTION

California law has been flexible in permitting resolution of disputes by accord and satisfaction.¹ This body of law has been accessible to both lawyers and lay persons, who are accustomed to using it on a regular basis. However, a statute enacted with little attention by the 1987 legislature, Civil Code section 1526,² dramatically changes this tradition. The statute displaces this body of law and threatens to disrupt this commonly used method of dispute resolution. This article places the statute in the context of the existing law of accord and satisfaction, analyzes its content, and suggests steps attorneys should take to comply with it.

II. THE COMMON LAW BACKGROUND

A. *Accord and Satisfaction*

Lawyers are frequently asked to resolve questions involving accord and satisfaction, usually when a client has received a "conditional check."³ A client says something like this: "I got a check from

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1. The statutory basis for this body of law is found in CAL. CIV. CODE §§ 1521-1526 (West 1982 & Supp. 1990). The law in California is discussed in 12 CAL. JUR. 3D *Compromise, Settlement, and Release* §§ 20-36, 37-42 (1974).

General sources include Burnham, *A Primer on Accord and Satisfaction*, 47 MONT. L. REV. 1 (1986); RESTATEMENT (SECOND) OF CONTRACTS §§ 278-282 (1981); 6 A. CORBIN, A COMPREHENSIVE TREATISE ON THE WORKING RULES OF CONTRACT LAW §§ 1268-1302 (1962); E. FARNSWORTH, CONTRACTS §§ 4.23-.25 (1982); J. CALAMARI & J. PERILLO, THE LAW OF CONTRACTS §§ 4-10 to -12, 5-16 (3d ed. 1987); Annotation, *Satisfaction of Debt by Payment of Less than Amount Claimed to be Due*, 35 P.O.F.2d 735 (1983).

2. CAL. CIV. CODE § 1526 (West Supp. 1990).

3. Other terms used to describe a situation in which the check is offered upon a condition and the payee understands that cashing the check constitutes assent to the condition in-

one of my customers for 80% of the amount due. On the back of the check, right over where I would endorse it, it says 'accepted in full satisfaction of my obligation.' If I cash the check, can I still go after him for the rest of the money?"

The parties' agreement to accept partial performance in full satisfaction of an unliquidated or disputed debt is known as an accord.⁴ Because an accord is a contract, the agreement must satisfy the traditional criteria of contract formation: consideration, offer, and acceptance.

To determine whether partial payment discharges an obligation, the first step is to determine whether the debt is either unliquidated or disputed, for the element of consideration is satisfied only in that event. For example, Matthew 18:23-24 tells the parable of the master who discharges the large debt of his servant. The servant, failing to learn the lesson of forgiveness, imprisons his own small debtor. When the master learns of this, he revokes the discharge and imprisons the servant.

This parable reflects not only good religion but good common law. The discharge was not effective because there was no consideration for it. If a creditor accepts \$800 to discharge an undisputed \$1000 debt, the creditor may then turn around and sue for the \$200 balance. Since the debtor owed the \$1000 in any event, there is no consideration for the creditor's promise to forego \$200.⁵ This is an application of the common law "pre-existing duty rule."⁶

Because the problem is consideration, the debtor may simply offer a new or additional performance in return for the discharge. For example, the creditor could accept \$800 and a peppercorn in satisfaction of the \$1000 debt. Or the creditor could accept \$800 on June 30 to discharge a \$1000 debt due July 1. Since the law does not inquire into the adequacy of consideration, it is the parties' business if they decide to exchange a peppercorn or performance a day in

clude "full payment check," "check in full settlement," and "conditioned check." See *Flambeau Prods. Corp. v. Honeywell Inf. Sys., Inc.*, 116 Wis. 2d 95, 98 n.3, 341 N.W.2d 655, 658 n.3 (1984).

4. CAL. CIV. CODE § 1521 (West 1982) provides:

Accord defined. An accord is an agreement to accept, in extinction of an obligation, something different from or less than that to which the person agreeing to accept is entitled.

5. American courts were quick to adopt this view after it was decided in the House of Lords in *Foakes v. Beer*, 9 App. Cas. 605 (1884). This rule has been subject to criticism. See, e.g., Eisenberg, *The Principles of Consideration*, 67 CORNELL L. REV. 640, 647 (1982): "The time has come to drop the legal-duty rule and substitute in its place a careful review of bargains involving the performance of a preexisting contractual duty, to determine whether they are unconscionable."

6. E. FARNSWORTH, *supra* note 1, § 4.21.

advance for \$200.

None of these devices is necessary to compromise unliquidated or disputed debts, however, for consideration is present in the determination of the debt and the extinguishment of the claim.⁷ Similarly, if a buyer refuses to pay a \$1000 bill for goods sold and delivered on grounds that the goods are defective, the seller's acceptance of \$800 in full satisfaction discharges the obligation. In consideration of the buyer giving up the claim, the seller has foregone \$200.

An interesting twist occurs if the buyer admits to owing \$800 but disputes the other \$200. The seller accepts \$800 in full satisfaction and then claims that there was no consideration for discharge of the disputed portion. In *Potter v. Pacific Coast Lumber Co.*,⁸ the California Supreme Court held that the seller's acceptance of the undisputed portion in full satisfaction settles the entire claim.⁹ While acknowledging that authority is divided on the point, the court reasoned that "[t]he consideration for the tender and acceptance of each check in a less amount was the termination of dispute, and the extinction of [the] obligation"¹⁰ In *Potter*, the court refused to apply a narrow view of consideration and correctly characterized the transaction as one intended to bring about a settlement.¹¹

The element of consideration is satisfied only if the debt is truly unliquidated or disputed. Liquidated means agreed upon by the parties or a court.¹² According to the doctrine of account stated, a debt may also become liquidated when it goes unchallenged by the debtor for a period of time.¹³ This doctrine, which has been well articulated

7. This, however, is the body of law displaced by CAL. CIV. CODE § 1526 (West Supp. 1990). See *infra* note 61 and accompanying text.

8. 37 Cal. 2d 592, 234 P.2d 16 (1951).

9. *Id.* at 602, 234 P.2d at 21.

10. *Id.*, 234 P.2d at 22 (quoting *Robertson v. Robertson*, 34 Cal. App. 2d 113, 118, 93 P.2d 175, 178 (1939)).

11. Similarly, in *Kilander v. Blicke Co.*, 280 Or. 425, 429, 571 P.2d 503, 505 (1977), the Oregon Supreme Court stated:

It would be too technical a use of the doctrine of consideration to release a well-counseled debtor who tenders a nominal amount beyond his admitted debt but to trap one less sophisticated who is induced to pay the undisputed amount in return for his creditor's illusory promise to forgive the rest.

12. See *Blumer v. Madden*, 128 Cal. App. 2d, 25-26, 16 P.2d 319, 321 (1932).

13. RESTATEMENT (SECOND) OF CONTRACTS § 282 (1981) provides:

Account stated.

(1) An account stated is a manifestation of assent by debtor and creditor to a stated sum as an accurate computation of an amount due the creditor. A party's retention without objection for an unreasonably long time of a statement of account rendered by the other party is a manifestation of assent.

(2) The account stated does not itself discharge any duty but is an admission by

in California, can be useful in determining whether a debt is liquidated.¹⁴ For example, an attorney is retained to perform services at an hourly rate of \$100. The debt at that time is unliquidated, as the amount has not been agreed upon. The attorney later renders a bill for \$1000. The client protests the amount of the bill and the attorney accepts \$800 in full satisfaction. The attorney has no claim for the balance, for the obligation never became liquidated. In consideration of the attorney liquidating the debt at \$800, the client has satisfied it. If the bill had been resubmitted for several months and had gone unpaid, then under the doctrine of account stated it would tend to become liquidated at \$1000 and a lesser payment would not discharge it.

For a debt to be disputed, there must be a good faith defense to payment. The debtor's desire to bargain a bill down is not enough. For example, in *Berger v. Lane*,¹⁵ the court held that plaintiff's acceptance of a conditional check did not create an accord and satisfaction when "the attitude of defendant appears to be that of a person endeavoring to release himself from the full consequences of a binding contract."¹⁶ Therefore, if a creditor accepts \$800 to settle a \$1000 debt, the creditor could nevertheless recover the balance if the creditor demonstrates the absence of a good faith dispute.¹⁷

In addition to consideration, the parties' accord must satisfy the elements of offer and acceptance. Courts favor settlement, but only when the settlement is knowingly and freely made.¹⁸ Courts often state that the offer to enter into an accord may be stated on the check itself or on an accompanying memorandum.¹⁹ In spite of the fact that a statement on the check itself is unlikely to bring the offer to the attention of the debtor, California courts have held such notice to be sufficient. In *Newsom v. Woollacott*,²⁰ plaintiff architect received

each party of the facts asserted and a promise by the debtor to pay according to its terms.

14. See, e.g., *Gleason v. Klammer*, 103 Cal. App. 3d 782, 163 Cal. Rptr. 483 (1980); *Zinn v. Fred R. Bright Co.*, 271 Cal. App. 2d 597, 76 Cal. Rptr. 663 (1969).

15. 190 Cal. 443, 213 P. 45 (1923). See also *Kelly v. David D. Bohannon Org.*, 119 Cal. App. 2d 787, 260 P.2d 646 (1953).

16. *Berger*, 190 Cal. at 449, 213 P. at 48.

17. The creditor would not be able to recover the balance, however, if the debtor had complied with the steps necessary to settle a liquidated and undisputed debt under CAL. CIV. CODE § 1524 (West 1982). See *infra* note 103 and accompanying text.

18. *Whepley Oil Co. v. Associated Oil Co.*, 6 Cal. App. 2d 94, 44 P.2d 670 (1935).

19. "This sometimes is shown by the express words used in the body of the check or by an accompanying receipt stating that the amount sent is in full of all demands." *Berger*, 190 Cal. at 452, 213 P. at 49.

20. 5 Cal. App. 722, 91 P. 347 (1907).

and cashed defendant's check for part payment which contained the memorandum "In full for 9th and Grand Ave. fees."²¹ The jury, instructed to determine whether the check evidenced an accord and satisfaction, found that it did not. Plaintiff received judgment for the balance of his claim. The court of appeal reversed, holding that unless he controverted it, plaintiff was presumed to have knowledge of and be bound by the terms of the instrument.²²

Similarly, in *Potter v. Pacific Coast Lumber Co.*,²³ the communication was on a voucher attached to the draft. The voucher stated: "Payee will please detach and keep this statement. Payment of sight draft attached hereto is accepted in full settlement of account stated below, and endorsement thereof will constitute payee's receipt to the Pacific Coast Lumber Company of California."²⁴ The jury found that plaintiff's acceptance of the draft did not constitute an accord and satisfaction. The supreme court reversed, holding that insufficient evidence in the record supported this finding:

The record conclusively shows from plaintiff's own testimony that he knowingly accepted the remittances from defendants on the terms definitely stated on the accompanying vouchers in unequivocal expression of their intent as "full settlement," for he "figured that a bird in the hand was better than nothing."²⁵

A dissent adopted the opinion of the court of appeal that the issue was properly a question of fact.²⁶

As a practical matter, the view that a memorandum on a check or a voucher is sufficient to bring the offer to the attention of the creditor could be extremely prejudicial to a large volume creditor which cannot reasonably be expected to give careful scrutiny to its checks. The creditor could, however, be expected to examine those checks that arrived with an accompanying letter explaining the dispute that the check is offered to resolve.²⁷

In *Teledyne Mid-America Corp. v. HOH Corp.*,²⁸ plaintiff treated a conditional check received by its accounting department as a payment on account. The Ninth Circuit, applying California law,

21. *Id.* at 724, 91 P. at 347.

22. *Id.* at 725-26, 91 P. at 348.

23. 37 Cal. 2d 592, 234 P.2d 16 (1951).

24. *Id.* at 596, 234 P.2d at 18.

25. *Id.* at 601, 234 P.2d at 21.

26. *Id.* at 603, 234 P.2d at 22 (Carter, J., dissenting).

27. See, e.g., *Consolidated Edison Co. v. Arroll*, 66 Misc. 2d 816, 322 N.Y.S.2d 420 (1971).

28. 486 F.2d 987 (9th Cir. 1973).

affirmed the trial court's conclusion that acceptance of the check constituted an accord and satisfaction. The court reasoned that the cashing of the check by the accounting department did not by itself constitute an accord and satisfaction. Rather, an accord was formed when, after defendant brought the facts to the attention of the principals of the plaintiff corporation, plaintiff did not return the check in spite of the fact that it now had unmistakable knowledge of the terms of defendant's offer.²⁹

As with any other offer, the offeree must either accept the offer on its terms or reject it. A creditor who strikes off the restrictive endorsement or holds the check for an unreasonable amount of time may be found to have accepted the settlement offer.³⁰ In *Sheldon Builders, Inc. v. Trojan Towers*,³¹ the court held that a creditor who wishes to avoid the presumption that part payment has been accepted must return the check. On the other hand, in *Besco Enterprises, Inc. v. Carole, Inc.*,³² the court held that the parties had not entered an accord when the creditor kept the check but gave written notice that "we cannot accept the check as presented."³³

As with any contract, whether the parties have entered an accord depends on their intent, objectively expressed. In *Whepley Oil Co. v. Associated Oil Co.*,³⁴ plaintiff accepted conditional checks that were computed erroneously by defendant. The court properly held that there was no accord because plaintiff did not know the amounts tendered were less than the full amount due.³⁵ However, when it learned of the mistake, plaintiff continued to accept the checks while the parties attempted to resolve the dispute. The court held that there was no accord with respect to these checks either, stating that:

The acceptance by [plaintiff] of amounts smaller than it was demanding during the time when negotiations for arbitration were being carried on is not indicative of an accord. It may not be argued successfully that [plaintiff] who, during all of this period, was insisting that it was entitled to larger royalty payments, evidenced an intention to abandon its claim by its acceptance of smaller amounts.³⁶

29. *Id.* at 993-95.

30. *Potter v. Pacific Coast Lumber Co.*, 37 Cal. 2d 592, 598, 234 P.2d 16, 18 (1951).

31. 255 Cal. App. 2d 781, 63 Cal. Rptr. 425 (1967).

32. 274 Cal. App. 2d 42, 78 Cal. Rptr. 645 (1969).

33. *Id.* at 43, 78 Cal. Rptr. at 646 (emphasis omitted).

34. 6 Cal. App. 2d 94, 44 P.2d 670 (1935).

35. *Id.* at 112, 44 P.2d at 678.

36. *Id.* at 113, 44 P.2d at 678.

While the court in *Whepley Oil Co.* focused on the intent of the plaintiff, it should have focused on the defendant. The fact that the defendant continued to demonstrate willingness to resolve the problem after the plaintiff accepted the checks indicates that it did not intend an accord under the circumstances.³⁷

An accord hovers like Tinker Bell until it has been fully performed. The full performance is called satisfaction.³⁸ The formation of the accord and its satisfaction discharges the original obligation. But if the accord is not fully performed, the accord agreement is breached. The injured party may then sue either on the accord or on the original obligation, which is revived by the breach.³⁹ Any partial payment is treated as a payment on account. For example, in the case of the attorney's unliquidated \$1000 bill, assume the parties entered into an accord calling for discharge of the obligation by the payment of \$800 in thirty days. If the client pays only \$600 in thirty days, the attorney may treat the accord as breached, revive the \$1000 claim and sue for the \$400 balance due.

B. *Substituted Contract*

In the situation of the attorney's bill for \$1000, it would be unwise for the attorney to bill the client for \$800 when the accord is reached. If the client breaches the accord, the attorney wants to revive the original \$1000 claim. But the \$800 bill makes it appear that the consideration for the \$200 reduction was the client's agreement to liquidate the claim at \$800. In that case, the attorney has made a valid contract, limiting the recovery to \$800. This difficulty arises from the failure of the parties to distinguish between an accord and satisfaction and a substituted contract.⁴⁰

37. See *Work v. Associated Almond Growers*, 102 Cal. App. 232, 236, 282 P. 965, 966-67 (1929):

It is an essential element of an accord and satisfaction by tender of a check, that the tender is subject to the condition that the acceptance of the check is satisfaction in full. This condition is not shown by the mere fact that the debtor accompanies the check with an account showing a balance equal to the amount of the check, and it is disproved where the giving and acceptance of the check is followed by such conduct of both parties as clearly shows that they did not consider the check a final settlement of the debt.

38. CAL. CIV. CODE § 1523 (West 1982) provides:

Satisfaction, What. Acceptance, by the creditor, of the consideration of an accord extinguishes the obligation, and is called satisfaction.

39. *Holton v. Noble*, 83 Cal. 7, 23 P. 58 (1890).

40. A substituted contract is often called a novation in California. The common practice is to use novation when the new obligation is undertaken by a third party and substituted contract when it is undertaken by the same parties. 6 A. CORBIN, *supra* note 1, § 1293, at

In a substituted contract, the consideration for the discharge of the original obligation is the promise of performance, while in an accord, it is performance itself. For example, *A* has a \$10,000 tort claim against *B*. After negotiation, *A* agrees to release *B* in exchange for *B*'s promise of \$5000 in thirty days. *B* does not pay the \$5000. *A*, thinking an accord has been breached, revives the tort action. *B* raises the affirmative defense of substituted contract. *B* may prevail if the court determines that the parties intended a substituted contract rather than an accord. If *B* prevails, *A* is limited to suit on the \$5000 substituted contract. Recall that a contract arises from an exchange of promises, whether the parties perform or not. In the example, the parties have formed a contract even though *A* has received no money. There has been offer and acceptance and *A* has received good consideration for the release: *B*'s promise to pay the liquidated amount of \$5000.

As with any other contract, determining the parties' intent is a question of interpretation.⁴¹ In the absence of a clearly stated intention, however, the California courts have presumed that the parties intended an accord. In every reported case in which the issue has been raised, the California courts have never found that a creditor entered into a substituted contract when the creditor accepted a promise to pay in exchange for discharge.⁴² This rule holds even when the creditor obtains a promissory note, which is by definition a promise to pay, in return for the discharge. The courts have consist-

190. In the Restatement, novation is defined exclusively as a substituted contract that includes a third party. *RESTATEMENT (SECOND) OF CONTRACTS* § 280 (1981). The California Civil Code, however, defines novation to include a new contract between the same parties as well:

Modes of novation. Novation is made:

1. By the substitution of a new obligation between the same parties, with intent to extinguish the old obligation;
2. By the substitution of a new debtor in place of the old one, with intent to release the latter; or,
3. By the substitution of a new creditor in place of the old one, with intent to transfer the rights of the latter to the former.

CAL. CIV. CODE § 1531 (West 1982 & Supp. 1990).

41. See, e.g., *Gardiner v. Gaither*, 162 Cal. App. 2d 607, 621, 329 P.2d 22, 31 (1958), in which the court stated:

In the instant case there is no evidence that [plaintiff] agreed to accept Gran-Wood's promise to complete three of the five structures as satisfaction of the pre-existing debts. Certainly, the presumption is against any such conclusion. The most reasonable and sensible interpretation of the correspondence is that the creditors were willing to accept performance of the agreement to finish three of the five houses in satisfaction of their existing claims, but extinguishment of those claims was conditional upon performance of the second promise.

42. In addition to *Gardiner*, see *Silvers v. Grossman*, 183 Cal. 696, 192 P. 534 (1920).

ently held that when a debtor gives a creditor a promissory note, the debt is not extinguished unless the note was expressly received in payment of the debt.⁴³

Parties who intend an accord, with the agreement conditional on performance, should make that intention clear to avoid litigating the issue. The prudent attorney can easily protect against this problem. When sending the bill for services, the attorney should bill for \$1000, with a notation on the bill that it may be satisfied by the payment of \$800 within thirty days. In settling the claim, the order of dismissal should provide that if defendant does not pay as promised, plaintiff may enter judgment for the full amount of the claim less payments made. If the promise is for a substantial future performance, the payment should be secured.

III. THE CREDITOR'S DILEMMA

On the one hand, the law of accord and satisfaction allows people to resolve their disputes expeditiously. Simply by negotiating a conditional check, parties can enter into a binding settlement without the need to draft complex instruments, consult an attorney, or go to court. The procedure is available to anyone from the most unsophisticated debtor to the giant corporation.

On the other hand, this body of law has been described by one authority as "an exquisite form of commercial torture."⁴⁴ Reasoning that a bird in the hand is worth two in the bush, a creditor may feel compelled to accept the partial payment, even when the creditor believes the dispute is not bona fide. Of course, the creditor who spurns the part payment reserves the right to pursue the full amount of the debt. Or, if the debtor made part payment without raising a bona fide defense to full payment, the creditor may accept the part payment and pursue the balance.⁴⁵ As a practical matter, however, the creditor knows that the economic cost of collecting either the full amount or the balance will rarely justify the effort.⁴⁶

43. *Welch v. Allington*, 23 Cal. 322, 323 (1863) ("The law will not presume such an agreement, and it must be proved by the party relying on it."); *Dellapiazza v. Foley*, 112 Cal. 380, 44 P. 727 (1896); *Gardner v. Shreve*, 89 Cal. App. 2d 804, 202 P.2d 322 (1949).

44. J. WHITE & R. SUMMERS, *HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE*, §§ 13-21, at 544 (2d ed. 1980). A student note goes even further, suggesting that "[t]he positions of the parties to an accord and satisfaction are frequently the reverse of the classic debtor-creditor relationship, with the creditor practically at the mercy of the so-called debtor." Note, *Role of the Check in Accord and Satisfaction: Weapon of the Overreaching Debtor*, 97 U. PA. L. REV. 99, 100 (1948).

45. See *supra* note 17 and accompanying text.

46. See *infra* note 98 and accompanying text.

Courts have been mindful of these competing considerations. While encouraging dispute resolution, the courts have scrutinized the agreements carefully to ensure they have been entered freely and knowingly. If one party induced the agreement unscrupulously or raised no bona fide defense to payment, courts have been very willing to set aside the agreement. An analysis of 54 reported appellate cases on point reveals that in 44 of the 54 cases, the court held that there was no accord and satisfaction. The reasons include no communicated intent (13 cases), no bona fide dispute (11), no contract formed because of fraud, illegality, or insanity (5), and no agreement on basic terms (5).

The courts are clearly policing accord and satisfaction. Any legislative change in the mechanism of accord and satisfaction, therefore, should be evaluated by whether it, like the common law scheme, furthers these three objectives:

1. The expediting function. That is, does it encourage informal dispute resolution?
2. The discriminating function. That is, does it police agreements to ensure that debtors are not avoiding honest debts?
3. The communicating function. That is, does it ensure that both debtors and creditors are aware of the agreement they are making?

IV. LEGISLATIVE CHANGES

Common law accord and satisfaction has been affected by the enactment of Commercial Code section 1207⁴⁷ and Civil Code section 1526.⁴⁸ These statutes will be examined to determine whether they further the objectives of common law accord and satisfaction. It will be seen that Commercial Code section 1207, as interpreted by the courts, does not impede accord and satisfaction but that Civil Code section 1526 threatens to undermine its foundations.

A. *Uniform Commercial Code Section 1207*

In 1963, California enacted the Uniform Commercial Code.⁴⁹ Commercial Code section 1207 provides:

A party who with explicit reservation of rights performs or

47. CAL. COM. CODE § 1207 (West 1964 & Supp. 1990).

48. CAL. CIV. CODE § 1526 (West Supp. 1990).

49. CAL. COM. CODE. §§ 1101-9508 (West 1964 & Supp. 1990).

promises performance or assents to performance in a manner demanded or offered by the other party does not thereby prejudice the rights reserved. Such words as "without prejudice," "under protest" or the like are sufficient.⁵⁰

Creditors soon began to use this section in an attempt to circumvent the common law of accord and satisfaction.⁵¹

This use of the statute is illustrated by the case of *Connecticut Printers, Inc. v. Gus Kroesen, Inc.*⁵² Defendant debtor sent plaintiff creditor a check for part payment with the notation "This check represents payment in full for all obligations owed by . . . [defendant]"⁵³ Relying on the language of section 1207 which would permit it to reserve its rights, plaintiff wrote on the check, "Payment accepted without prejudice and subject to final determination of amount due."⁵⁴ After endorsing and depositing the check, plaintiff sued for the balance. Defendant moved for summary judgment, relying on the rule stated in *Potter v. Pacific Coast Lumber Co.*⁵⁵ that the offeree of a conditional check must either reject the offer or accept it in accordance with its terms.⁵⁶

The court of appeal acknowledged that the states were sharply divided on the issue of whether section 1207 operated to prevent an accord and satisfaction. Reconciling *Potter* with the Commercial Code, the court cited with favor a Washington case which held that the Code did not supersede the law of contracts except where expressly provided.⁵⁷ Citing the doctrine that when faced with conflicting authority it may adopt the better rule, the court held that the better rule is the rule of *Potter*, which encourages accord and satisfaction.⁵⁸

50. *Id.* § 1207.

51. The many cases on this topic are collected at Annotation, *Application of UCC § 1-207 to Avoid Discharge of Disputed Claim Upon Qualified Acceptance of Check Tendered as Payment in Full*, 37 A.L.R. 4TH 358 (1985). Law review citations may be found in *Flambeau Prods. Corp. v. Honeywell Inf. Sys., Inc.*, 116 Wis. 2d 95, 102 n.4, 341 N.W.2d 655, 659 n.4 (1984). See also McLaughlin, *Section 1-207 and "Full Payment": Finding Concord Amidst Discord*, 7 NAT'L L.J. 20 (1984); J. WHITE & R. SUMMERS, *HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE*, §§ 13-24 (3d ed. 1988).

52. 134 Cal. App. 3d 54, 184 Cal. Rptr. 436 (1982).

53. *Id.* at 57, 184 Cal. Rptr. at 437.

54. *Id.*

55. 37 Cal. 2d 592, 234 P.2d 16 (1951).

56. *Connecticut Printers*, 134 Cal. App. 3d at 57, 184 Cal. Rptr. at 437 (citing *Potter*, 37 Cal. 2d at 597, 234 P.2d at 18).

57. *Id.* at 60, 184 Cal. Rptr. at 438-39 (citing *State Dept. of Fisheries v. J-Z Sales Corp.*, 25 Wash. App. 671, 610 P.2d 390 (1980)).

58. *Id.* at 60-61, 184 Cal. Rptr. at 439 (citing 6 B. WITKIN, *CALIFORNIA PROCEDURE* § 692(3), at 4609 (2d ed. 1971)).

Although the court in *Connecticut Printers* did not clearly articulate the objectives of accord and satisfaction, the decision is consistent with them. Creditors' use of the statute does not serve the expediting function, for it discourages dispute resolution. When offering an accord, a debtor does not know whether the dispute will be resolved by the part payment if the creditor may invoke the statute. It could be argued that, under the contract rule that the offeror is the master of the offer, the debtor could tender the offer conditional on the offeree's not invoking section 1207.⁵⁹ That level of sophistication, however, is beyond the reach of the ordinary debtor. Nor does use of the statute serve the discriminating function, for it allows creditors to take advantage of both honest and dishonest offers.

Although section 1207 makes sense in other contexts, when applied to accord and satisfaction it fails to serve the communicating function. For example, assume that the parties first agree to an accord and the debtor later performs by payment. The creditor could not invoke section 1207 when the debtor pays, for the statute contemplates reservation of rights in the face of defective performance.⁶⁰ There is no defective performance when the debtor performs pursuant to the terms of an accord that was clearly communicated. Assume, alternatively, that the debtor tenders a conditional check. The debtor is offering simultaneously to enter an accord and to perform it. By invoking the statute in these circumstances, the creditor must be characterizing as defective the performance under the original

59. For example, in a letter to the *National Law Journal*, December 24, 1984, a Chicago attorney recommended that the debtor use this language:

Payment in full. Upon cashing this check the creditor agrees to fully discharge the debtor from liability arising out of (specified obligation) and further agrees not to reserve any rights with respect to that obligation and waives his right to use Section 1-207 of the Uniform Commercial Code. The return or destruction of this check shall mean that the creditor has rejected these conditions, but the act of cashing it shall be deemed to be conclusive evidence that he has accepted them.

60. Uniform Commercial Code Comment 1 to CAL. COM. CODE §.1207 (West 1964 & Supp. 1990) states:

This section provides machinery for the continuation of performance along the lines contemplated by the contract despite a pending dispute, by adopting the mercantile device of going ahead with delivery, acceptance, or payment "without prejudice," "under protest," "under reserve," "with reservation of all our rights," and the like.

(emphasis added). For example, in the famous "chicken" case, buyer, who was shipped stewing chickens when it expected fryers, sent seller a cable stating that it was accepting the shipment without prejudice to its rights to recover damages and to receive frying chickens in future deliveries. *Frigalment Importing Co. v. B.N.S. Int'l Sales Corp.*, 190 F. Supp. 116, 120 (S.D.N.Y. 1960).

agreement. But this characterization misstates the transaction. The debtor is not defectively performing the original transaction; the debtor is offering to enter into a new transaction. The creditor should not be permitted to reject a communicated offer while accepting its benefits on the basis of a knowingly wrongful characterization.

The result in *Connecticut Printers*, therefore, appears correct. The support given accord and satisfaction by the court in *Connecticut Printers*, has, however, been taken away by the legislature's enactment of Civil Code section 1526.

B. Civil Code Section 1526

1. The Statute

The more recent impediment to the application of the principles of accord and satisfaction is Civil Code section 1526,⁶¹ enacted in 1987. On its face, the statute repudiates the common law of accord and satisfaction, replacing it with a statutory scheme that will prove a pitfall to unwary debtors. The section provides:

Section 1526. Check or draft tendered in full discharge of claim; acceptance; protest; composition or extension agreement between debtor and creditors; release of claim

(a) Where a claim is disputed or unliquidated and a check or draft is tendered by the debtor in settlement thereof in full discharge of the claim, and the words "payment in full" or other words of similar meaning are notated on the check or draft, the acceptance of the check or draft does not constitute an accord and satisfaction if the creditor protests against accepting the tender in full payment by striking out or otherwise deleting that notation or if the acceptance of the check or draft was inadvertent or without knowledge of the notation.

(b) Notwithstanding subdivision (a), the acceptance of a check or draft constitutes an accord and satisfaction if a check or draft is tendered pursuant to a composition or extension agreement between a debtor and its creditors, and pursuant to that composition or extension agreement, all creditors of the same class are accorded similar treatment, and the creditor receives the check or draft with knowledge of the restriction.

A creditor shall be conclusively presumed to have knowl-

61. CAL. CIV. CODE § 1526 (West Supp. 1990). The effective date of the statute is January 1, 1988. CAL. GOV'T. CODE § 9600 (West 1980 & Supp. 1990).

edge of the restriction if a creditor either:

(1) Has, previous to the receipt of the check or draft, executed a written consent to the composition or extension agreement.

(2) Has been given, not less than 15 days nor more than 90 days prior to receipt of the check or draft, notice, in writing, that a check or draft will be tendered with a restrictive endorsement and that acceptance and cashing of the check or draft will constitute an accord and satisfaction.

(c) Notwithstanding subdivision (a), the acceptance of a check or draft by a creditor constitutes an accord and satisfaction when the check or draft is issued pursuant to or in conjunction with a release of a claim.

(d) For the purposes of paragraph (2) of subdivision (b), mailing the notice by first-class mail, postage prepaid, addressed to the address shown for the creditor on the debtor's books or such other address as the creditor may designate in writing constitutes notice.⁶²

2. *A Critique of the Statute*

a. *Subdivision (a)*

Subdivision (a) restricts application of the statute to instances "[w]here a claim is disputed or unliquidated." The word claim is not used artfully, for, as discussed below, claim is used in a different context in subdivision (c). In subdivision (a), claim probably refers broadly to a right to payment, whether or not reduced to judgment, for common law accord and satisfaction arises in this broad context. At common law, any honest dispute, such as a tort claim, a debt, or an implied contract, could give rise to an accord and satisfaction. The statute correctly limits its scope to those claims that are "disputed or unliquidated," for, as discussed above, common law accord and satisfaction is concerned only with such claims.⁶³

Subdivision (a) goes on to address the instance where a conditional check is offered to discharge the debt "and the words 'payment in full' or other words of similar meaning are notated on the check or draft." It is not clear whether the legislature intended the statute

62. *Id.* Not the least of the problems with the statute is its awkward construction. In the Appendix to this article, the statute is rewritten in enumerated form.

63. Liquidated and undisputed obligations are addressed in CAL. CIV. CODE § 1524 (West 1982). See *infra* note 103 and accompanying text.

to apply in all cases in which a conditional check is presented or only in those cases where the restrictive notation appears on the check itself. A literal interpretation might hold that the statute does not apply in cases where an oral statement, separate communication, or accompanying letter, rather than the check itself, communicates the offer to the creditor.

It would, however, make little sense to apply one body of law where a notation appears on a check and another where it does not. The common law rule, repeatedly pronounced by the California courts, is that the offer to enter into an accord may be made either on the check or in a separate communication.⁶⁴ The notation on the check is therefore customary but has no legal significance.⁶⁵

On the other hand, if application of the statute were restricted to those instances in which the only knowledge the creditor has of the offer is the notation on the check, then the statute would fill an existing gap in the development of accord and satisfaction in California. It would serve the communicating function by encouraging offerors clearly to communicate the offer independently of the check.⁶⁶

The next portion of subdivision (a) represents the most critical change in the law of accord and satisfaction. At common law, a creditor who received a conditional check had two choices: accept the offer according to its terms or reject it.⁶⁷ According to the statute, the creditor may reject the offer to enter into an accord while accepting the conditional check as a payment on account. The creditor may do this in three alternative ways: (1) by striking out or otherwise deleting the notation, (2) by accepting the check inadvertently, or (3) by accepting it without knowledge of the notation.

The first alternative, striking out or otherwise deleting the notation, makes little sense, because, as discussed above, the offer to enter into an accord does not require a notation. Assuming there is a notation, a number of factual questions arise that will invite litigation. What does it mean to "otherwise delete" the notation? Would language borrowed from Commercial Code section 1207, such as "accepted with prejudice" suffice to show the creditor's intention to negate the notation? If so, the legislature will have changed the result

64. See *supra* note 19 and accompanying text.

65. See, e.g., *Keppard v. International Harvester Co.*, 581 F.2d 764 (9th Cir. 1978), holding that, under California law, even though plaintiff had no written or oral warning of the effect of the check, he should have known from the circumstances that he was entering into an accord and satisfaction.

66. See *supra* notes 18-27 and accompanying text.

67. See *supra* note 30 and accompanying text.

in *Connecticut Printers, Inc. v. Gus Kroesen, Inc.*, which held that such language was not effective.⁶⁸ If the legislature intended to change the result in that case, it could have addressed that issue with greater precision. A mundane problem that will arise from application of this section is that because many banks no longer return checks to the customer, debtors will lack evidence of the creditor's attempted preservation of the claim. Debtors who learn from creditors that their obligations have not been discharged will then have to retrieve and evaluate the check and endorsement.

The creditor's invocation of the second alternative, accepting the check inadvertently, may render unnecessary the preservation of any evidence. Under this alternative, the creditor need only claim, after the fact, that it would not have deposited the check had it noticed the endorsement. A creditor might claim, for example, that it uses a mechanical device for endorsement and does not examine each check individually. This provision will probably also invite litigation, for the debtor who has fallen prey to it may litigate the issue of whether the creditor acted inadvertently.

The final alternative for the creditor to prevent an accord and satisfaction is to accept the check "without knowledge of the notation." Again, a number of factual questions arise. What does it mean to lack knowledge? Is there knowledge if a separate conversation or memorandum alerts the creditor to the conditional check? Is there knowledge if the creditor endorses the check below the restriction? What if that endorsement is mechanical? If the legislature had defined knowledge, these questions would be resolved. It appears that there may be a statutory definition of knowledge, but that will require examination of subdivision (b), where the definition appears.

b. *Subdivision (b)*

Subdivision (b) creates an exception to the scheme of subdivision (a). The creditor's acceptance of a conditional check constitutes an accord and satisfaction if the check is tendered pursuant to a composition agreement and: (1) all creditors of the same class are treated similarly, and (2) the creditor receives the check "with knowledge of the restriction." At first blush, this exception seems unimportant, for it will generally be used by sophisticated parties who knowingly enter the agreement. The provision seems out of place in the statute, however, for the statute is concerned with disputed or unliquidated

68. See *supra* note 52 and accompanying text.

debts, while a composition agreement generally involves acknowledged obligations that the debtor is unable to pay.

Subdivision (b) applies when the creditor receives the check "with knowledge of the restriction." This phrase raises two questions. In subdivision (a), the phrase "knowledge of the *notation*" (emphasis added) is used, while in subdivision (b) the phrase becomes "knowledge of the *restriction*" (emphasis added). Did the legislature intend a different meaning when it used different language?⁶⁹ Knowledge of the restriction could be broader than knowledge of the notation in the sense that knowledge of an offer to enter into an accord could arise from sources other than the notation itself. The intent was more likely that the words mean the same thing: knowledge that the check is offered to discharge the obligation. If that is the case, then the language of subdivision (a) will be interpreted broadly to apply to all offers, whether a notation appears on the check or not.

The second question arising from the phrase "knowledge of the restriction" is more crucial to interpretation of the entire statute. Subdivision (b) goes on to define knowledge. The question then becomes whether the definition of knowledge in subdivision (b) also defines knowledge for purposes of subdivision (a). Let us examine the definition in subdivision (b):

A creditor shall be conclusively presumed to have knowledge of the restriction if a creditor either:

- (1) Has, previous to the receipt of the check or draft, executed a written consent to the composition or extension agreement.
- (2) Has been given, not less than 15 days nor more than 90 days prior to receipt of the check or draft, notice, in writing, that a check or draft will be tendered with a restrictive endorsement and that acceptance and cashing of the check or draft will constitute an accord and satisfaction.⁷⁰

The prefatory language of this provision contains the phrase "knowledge of the restriction," which reflects the earlier language of subdivision (b). This provision states that the creditor presumptively has knowledge in two instances. The first, subdivision (b)(1), clearly applies to the composition agreement described earlier in subdivision (b). The second, subdivision (b)(2), provides for a notice scheme by

69. The "Golden Rule" of drafting is that the drafter "always expresses the same idea in the same way and always expresses different ideas differently." R. DICKERSON, *FUNDAMENTALS OF LEGAL DRAFTING* § 2.3.1 (2d ed. 1986).

70. CAL. CIV. CODE § 1526(b) (West Supp. 1990).

which the debtor can ensure that the creditor has knowledge. Does this notice scheme apply only to subdivision (b) or does it apply to subdivision (a)?

Although subdivision (b)(2) uses the phrase "restrictive endorsement" used earlier in subdivision (b), it uses the key clause "acceptance and cashing of the check or draft will constitute an accord and satisfaction" if the notice scheme is complied with. This clause is parallel in structure to the clause in subdivision (a) which provides that "acceptance of the check or draft does not constitute an accord and satisfaction" if the creditor invokes one of the three alternatives, the third of which is accepting it without knowledge. The repetition of this language makes it appear that the definition of knowledge in subdivision (b)(2) also defines knowledge for purposes of subdivision (a).

In *Armco, Inc. v. Glenfed Financial Corp.*,⁷¹ defendant sent plaintiff a letter calculating its obligation and enclosing a check for that amount. The court was faced with the issue of whether, under California law, defendant clearly communicated to plaintiff that acceptance of the check constituted an accord and satisfaction. The court correctly concluded, citing *Potter* and other authority, that merely accompanying the check with an accounting is not enough to constitute clear notice.⁷² The court went on to state:

By way of analogy, although it appears the statute was not in existence at the time the Aircraft Agreement was signed, California recently enacted the following provision as an addition to its Civil Code:

Check or Draft Tendered in Full Discharge of Claim; Acceptance; Protest; Composition or Extension Agreement Between Debtor and Creditors; Release of Claim

(a) Where a claim is disputed or unliquidated and a check or draft is tendered by the debtor in settlement thereof in full discharge of the claim, and the words "payment in full" or other words of similar meaning are notated on the check or draft, the acceptance of the check or draft does not constitute an accord and satisfaction if the creditor protests against accepting the tender in full payment by striking out or otherwise deleting that notation or if the acceptance of the check or draft was inadvertent or without knowledge of the notation.

71. 720 F. Supp. 1129 (D.N.J. 1989). This is the only case to date that cites California Civil Code section 1526.

72. *Armco*, 720 F. Supp. at 1154-55.

. . . .

A creditor shall be conclusively presumed to have knowledge by [sic] the restriction if a creditor either:

(1) Has, previous to the receipt of the check or draft, executed a written consent to the composition or extension agreement.

(2) Has been given, not less than 15 days nor more than 90 days prior to receipt of the check or draft, notice, in writing, that a check or draft will be tendered with a restrictive endorsement and that acceptance and cashing of the check or draft will constitute an accord and satisfaction. [citation omitted]

Glenfed's argument that it is entitled to summary judgment on the deferred income issue because of the doctrine of accord and satisfaction is denied. The factual record (which includes a lack of clear notice to Armco), as it currently exists, does not support entry of summary judgment.⁷³

The court in *Armco* read the statute as it must reasonably be construed, viewing the definition of knowledge in subdivision (b)(2) as defining knowledge for purposes of subdivision (a). The ellipsis in the court's citation of the statute indicates that it read the definition as applying to subdivision (a). Perhaps more significantly, the court cited the statute on the issue of whether the offer to enter into an accord was clearly communicated. In this context, the court saw the statute as serving the communicating function.

The effect of this construction is that the statute provides a notice scheme by which the debtor can conclusively demonstrate that the creditor accepted the conditional check with knowledge and is bound by the terms of the accord. In other words, while subdivision (a) provides the creditor with the means to prevent formation of an accord, subdivision (b) provides the debtor with a way to make the accord effective. This interpretation finds support in the legislative history of section 1526. In its initial draft, the statute contained only the language in subdivision (a) that permits the creditor to prevent an accord and satisfaction by striking or deleting the notation.⁷⁴ As later amended, the exception for a composition agreement was added, including the definition of knowledge.⁷⁵ In the final amendment, the language "or if the acceptance of the check or draft was

73. *Id.* at 1155 (ellipsis in original).

74. SB 1684, added by Stat. 1987, ch. 1268, § 1 (1987) (current version at CAL. CIV. CODE § 1526 (West Supp. 1990)).

75. *Id.* (amended in assembly July 9, 1987).

inadvertent or without knowledge of the notation" was added to subdivision (a).⁷⁶ When the legislature inserted the word knowledge in subdivision (a) that it had previously defined in subdivision (b), it may be assumed that it intended the same definition to apply to both subdivisions.

If this interpretation is correct, then subdivision (b)(2) provides a scheme by which the debtor may effectively bring about an accord and satisfaction. That provision states that the creditor is conclusively presumed to have knowledge when the creditor has been given written notice, not less than fifteen nor more than ninety days prior to receipt of the check, stating that a check will be tendered with a restrictive endorsement and that cashing of the check will constitute an accord and satisfaction. By negative implication, if the debtor gives the creditor less notice, as by enclosing a letter with the check, the notice would not constitute knowledge for purposes of subdivision (a). Without "knowledge" of the offer, the creditor would be free to accept the check as a payment on account and recover the balance.

Because of the ambiguous wording of the statute, however, there is no guarantee that compliance with the notice requirement will be effective to establish an accord and satisfaction. Recall that subdivision (a) provides the creditor with three ways to prevent an accord and satisfaction. If the debtor takes the correct steps, the creditor clearly has "knowledge." Nor could the creditor claim the check was accepted inadvertently. However, the creditor could in theory employ the third method, striking out the restrictive notation. A court should resolve this ambiguity by enforcing an accord and satisfaction when the debtor has given the creditor sufficient knowledge of the offer.⁷⁷ In this manner, the communicating function would be served.

c. *Subdivision (c)*

Turning to subdivision (c), that part of the statute creates an exception to subdivision (a). Subdivision (c) provides that acceptance of the check creates an effective accord and satisfaction when the check is presented in conjunction with release of a claim. This choice of words is unartful at best, for subdivision (a) begins by invoking the statute "where a claim is disputed or unliquidated." If the word

76. *Id.* (amended in assembly Sept. 2, 1987). In an earlier amendment, August 25, 1987, the substance of the present subdivision (c) was added.

77. CAL. CIV. CODE § 1526(a) (West Supp. 1990).

claim means the same thing in subdivision (c) as in subdivision (a), then (c) would totally vitiate (a). Presumably, then the meaning of claim in subdivision (c) is narrower than its meaning in subdivision (a). In its narrower meaning, claim probably means tort claims as opposed to claims based on debts and other contractual obligations.

If this interpretation of subdivision (c) is correct, then if a debtor sent a conditional check offering \$800 to settle a disputed \$1000 obligation arising from contract, the creditor could render the attempted accord ineffective by employing the alternatives outlined in subdivision 1526 (a). But if an alleged tortfeasor sent a conditional check offering \$800 to settle an obligation arising from a tort claim, the transaction would fall outside the statute and would be governed by the common law. Under the common law, acceptance of the check would result in an effective accord.⁷⁸ The exception seems written for the insurance industry, which could make settlement offers to claimants without concern that the claimant could invoke the statute.

d. *Conclusion*

In conclusion, the statute serves neither the communicating, expediting, nor discriminating functions of common law accord and satisfaction. If interpreted as enacting a notice scheme to bring about an effective accord, the statute would serve the communicating function of accord and satisfaction. It would ensure that debtors and creditors are aware of the agreement they are making. The communicating function would be served, however, at the expense of the expediting and discriminating functions. While sophisticated parties will be aware of the statute, unsophisticated parties will not become aware of it until after they have sent a conditional check that would have created an accord under the common law. This result will also follow if compliance with the notice scheme of subdivision (b) is not effective for purposes of subdivision (a).

Unwary debtors will find that their attempted resolution of a dispute has invited litigation. Trapped by the statute and lacking the resources to learn correct compliance, these parties will be discouraged from employing this dispute resolution mechanism. Nor does the statute serve the discriminating function, for it permits creditors to take advantage of both honest and dishonest offers.⁷⁹

78. See *supra* note 30 and accompanying text. Again, the creditor's alternatives would be to accept the offer as presented or reject it.

79. Similarly, the application of Commercial Code section 1207 rejected by the Califor-

If the statute is designed to serve the discriminating function by removing from the offeree the pressure to settle, the exception in subdivision (c) is inconsistent with that objective. Just as an unscrupulous debtor can abuse the agreement process by raising a claim in bad faith and proposing a settlement that the creditor accepts because the economic costs of refusing are too high, so may an insurance company take advantage of a tort claimant's need for a quick settlement.⁸⁰

3. *Complying with the Statute*

Attorneys for debtors should structure their accords to be effective in light of the statute. The only way for a debtor to ensure an effective accord is to secure the creditor's consent in advance of tender of the conditional check.⁸¹ To avoid any later claim that the debt was undisputed, the debtor should obtain the creditor's agreement to accept the partial payment in the form of a signed writing.⁸²

In the case of a composition agreement, subdivision (b)(1) requires the written consent of the creditor while subdivision (b)(2) requires that the same offer be made to all creditors of the same class. Attorneys for debtors seeking composition agreements should also take the following steps:

1. Send written notice to the creditor.⁸³
2. State that "a check will be tendered with a restrictive endorsement and that acceptance and cashing of the check or draft will constitute an accord and satisfaction."⁸⁴ To avoid any misunderstanding, track that statutory language expressly.
3. After sending the notice, wait at least 15 but not more than 90 days before sending the creditor the check.⁸⁵
4. State in an enclosed writing and on the check itself, "this check is tendered in accordance with my letter of [date]. Cash-

nia courts in *Connecticut Printers* did not serve this function. See *supra* note 52 and accompanying text.

80. Cases setting aside releases are collected at Annotation, *Avoidance of Release of Personal Injury Claims on Ground of Fraud or Mistake as to the Extent or Nature of Injuries*, 71 A.L.R. 2D 82 (1960).

81. Of course, the agreement is subject to the traditional defenses to contract formation.

82. See the discussion of CAL. CIV. CODE § 1524 (West 1982) *infra* note 103 and accompanying text.

83. CAL. CIV. CODE § 1526(b)(2) (West Supp. 1990). The debtor must follow the notice requirements of *id.* § 1526(d).

84. *Id.* § 1526(b)(2).

85. *Id.*

ing of the check will constitute an accord and satisfaction, discharging the obligation." This step is not required by the statute, but it will ensure that the creditor understands that this particular check is sent in accordance with the earlier notice.

In the expectation that a court will interpret the notice scheme as satisfying the knowledge requirement of subdivision (a), the attorney may wish to send a conditional check in compliance with that scheme. In addition to the four steps outlined above, the attorney should:

5. In the initial written notice, state facts that make clear that the obligation is either disputed or unliquidated.⁸⁶ The statute applies only to disputed or unliquidated debts. If the debt is liquidated and undisputed, follow the steps under Civil Code section 1524.⁸⁷

6. In the writing accompanying the check and on the check itself write, "Striking out this endorsement is of no effect."⁸⁸

C. *An Alternative Approach*

Civil Code section 1526 reflects a concern that many debtors use accord and satisfaction not to resolve good faith disputes, but to chisel down honest debts.⁸⁹ This concern is a legitimate one, which has been addressed successfully by the courts.⁹⁰ The reported cases in this area, however, undoubtedly under-represent the frequency with which creditors enter into suspect accords. Most creditors cannot litigate the issue and capitulate to the settlement. The statute goes too far the other way, however, making ineffective accords that are offered in good faith. This seems unfair to unsophisticated debtors, who are familiar with the common law but not the new statute.

Reform of accord and satisfaction should serve the discriminating function while not interfering with the expediting and communicating functions. This reform could be accomplished by making dishonest accords more costly and thereby discouraging them. A court could, for example, determine that a debtor who raises a defense in

86. *Id.* § 1526(a).

87. See *infra* note 103 and accompanying text.

88. Inadvertent acceptance and striking out of the endorsement are the other grounds a creditor may use to prevent an accord and satisfaction under CAL. CIV. CODE § 1526(a) (West Supp. 1990).

89. The sparse legislative history is of little use in determining the legislative intent. Concern about dishonest debtors was expressed to the author by the bill's sponsor, Senator Quentin Kopp.

90. See *supra* text following note 46.

bad faith has committed a tort. In *Seaman's Direct Buying Service, Inc. v. Standard Oil Co.*,⁹¹ the California Supreme Court stated:

It has been held that a party to a contract may be subject to tort liability, including punitive damages, if he coerces the other party to pay more than is due under the contract terms through the threat of a lawsuit, made "without probable cause and with no belief in the existence of the cause of action." There is little difference, in principle, between a contracting party obtaining excess payment in such manner, and a contracting party seeking to avoid all liability on a meritorious contract claim by adopting a "stonewall" position ("see you in court") without probable cause and with no belief in the existence of a defense. Such conduct goes beyond the mere breach of contract. It offends accepted notions of business ethics. Acceptance of tort remedies in such a situation is not likely to intrude upon the bargaining relationship or upset reasonable expectations of the contracting parties. [citations omitted]

If the court approves of tort damages in the situation where one party coerces the other to pay more than is due under the contract terms through the threat of a lawsuit, it requires no great leap to approve of tort damages where one party coerces the other to accept less than is due under the contract terms.⁹² One distinction is that the offeror of an accord does not threaten a suit but instead threatens that if partial payment is not accepted, the offeree will have to bring suit. As a practical matter, however, it is just as costly to prosecute as to defend.⁹³ Furthermore, the accord and satisfaction situation is factually analogous to *Seaman's*, for in that case Standard Oil, the party who allegedly acted in bad faith caused the other to bring suit. Most importantly, the accord is an analogous situation because, like coercing excess payment or adopting a stonewall position, coercing a lesser payment offends business ethics.

Support for this proposition may be found in *Mission Insurance Group, Inc. v. Merco Construction Engineers, Inc.*⁹⁴ In *Mission*, plaintiff tendered defendant a conditional check to settle an ob-

91. 36 Cal. 3d 752, 769-70, 686 P.2d 1158, 1167, 206 Cal. Rptr. 354, 363 (1984).

92. The use of such coercion falls short of the legal requirement for duress. It is generally held that "economic duress" is not a defense where the obligation is disputed and the offeree is "forced" to accept the offer because of its financial situation. See, e.g., *Selmer Co. v. Blakeslee-Midwest Co.*, 704 F.2d 924 (7th Cir. 1983) (Posner, J.).

93. Voltaire is reported to have said, "Only twice in my life have I felt utterly ruined: once when I lost a lawsuit and once when I won." Kosmin, *The Small Claims Court Dilemma*, 13 Hous. L. Rev. 934, 935 (1976).

94. 147 Cal. App. 3d 1059, 195 Cal. Rptr. 781 (1983).

ligation. Defendant, claiming the amount was erroneous, refused to accept the check. The trial court granted plaintiff summary judgment on its claim for a declaratory judgment. The court of appeal reversed, holding that there was a triable issue of fact as to whether plaintiff paid the proper amount of money. The court held that "a duty of good faith and fair dealing applies to the resolution of a dispute over the total amount of money due under a contract."⁹⁵ It may be noted that plaintiff was an insurance company, and the tort of bad faith has been well established with respect to insurers.⁹⁶ Nevertheless, the holding was not limited and may apply to any debtor who uses accord and satisfaction to chisel a creditor.

It would be possible to address the problem without invoking the doctrine of bad faith, which the California court seems reluctant to expand.⁹⁷ The heart of the problem is that a coerced creditor who agrees to an accord offered in bad faith and then successfully sues to have it set aside, can recover the balance due but is not made whole because of the transaction costs incurred, particularly attorneys' fees.⁹⁸ Under the "American Rule," each side pays its own attorneys'

95. *Id.* at 1068, 195 Cal. Rptr. at 786.

96. *Gruenberg v. Aetna Ins. Co.*, 9 Cal. 3d 566, 510 P.2d 1032, 108 Cal. Rptr. 480 (1973).

97. *See, e.g.,* *Foley v. Interactive Data Corp.*, 47 Cal. 3d 654, 765 P.2d 373, 254 Cal. Rptr. 211 (1988) (denying tort claim for breach of the implied covenant in employment contracts); *Moradi-Shalal v. Fireman's Fund Ins. Cos.*, 46 Cal. 3d 287, 758 P.2d 58, 250 Cal. Rptr. 116 (1988) (denying tort claim for breach of the implied covenant in insurance settlements).

98. *See* the discussion of transaction costs in Burnham, *Contract Damages in Montana Part I: Expectancy Damages*, 44 MONT. L. REV. 1, 47-49 (1983). Actual costs are not recovered because statutes provide for minimal taxable costs and low interest rates, and, with some exceptions, do not provide for attorneys' fees. *See* CAL. CIV. PROC. CODE § 685.010 (West 1987), § 1021 (West 1990).

One alternative is for the creditor to lower transaction costs by bringing the claim in small claims court. Unlike some jurisdictions, California permits a business to appear as plaintiff in a small claims case. The jurisdictional limit of these courts is \$2000 and \$2500 effective January 1, 1991. *See* CAL. CIV. PROC. CODE §§ 116-117.4, 904.3 (West Supp. 1990) and CAL. CIV. & CRIM. RULES 151-58, 532, 982.7, 1701-2, & 1725.

California Civil Code section 1525 encourages parties to use small claims courts to resolve the disputed portions of debts. For example, seller bills buyer \$10,000 for goods sold and delivered. Buyer claims that because of defects in the goods, his obligation is to pay \$9000. Seller's suit for \$10,000 would have to be filed in superior court. If the debtor paid \$9000 without condition, then seller could pursue the \$1000 claim in small claims court. If, however, the debtor offers the \$9000 on condition that the part payment discharges the entire obligation, the creditor is free to refuse the offer and pursue the claim for the entire \$10,000 in superior court. In *Mission*, 147 Cal. App. 3d at 1068, 195 Cal. Rptr. at 786, the court interpreted the section as expressing the policy that a party has a duty to pay the undisputed portion of its obligations.

fees, win or lose.⁹⁹ Because the courts are reluctant to expand traditional contract damages, the legislature might respond to this situation within existing doctrine by allowing a prevailing creditor to recover attorneys' fees.¹⁰⁰ With the incentive of recuperating transaction costs, creditors might pursue unscrupulous debtors.¹⁰¹

If the cost of dishonest accords were driven up, debtors would be discouraged from proposing them to creditors. Because honest debtors would not be discouraged, there would be no effect on the expediting function. The communicating function would continue to be monitored by the courts to ensure that only accords that were knowingly entered into, from the point of view of both the debtor and the creditor, were enforced.

V. LIQUIDATED AND UNDISPUTED DEBTS: CIVIL CODE SECTION 1524

As a practical matter, creditors may sometimes wish to discharge debts that are both liquidated and undisputed in return for part payment. The common law scheme of accord and satisfaction, which has proved adequate to deal with unliquidated or disputed debts, does not apply to liquidated and undisputed debts.¹⁰² The legislature filled this gap in 1872 by enacting Civil Code section 1524, which provides:

Part performance of an obligation, either before or after a breach thereof, when expressly accepted by the creditor in writing, in satisfaction, or rendered in pursuance of an agreement in writing for that purpose, though without any new consideration, extinguishes the obligation.¹⁰³

Like a number of other California statutes, this one makes a writing a substitute for consideration.¹⁰⁴ The attorney for the debtor seeking to discharge a liquidated and undisputed debt should care-

99. 22 AM. JUR. 2D *Damages* § 611 (1988).

100. See, e.g., Putz & Klippen, *Commercial Bad Faith: Attorney Feesnot Tort Liabilitythe Remedy for "Stonewalling,"* 21 U.S.F. L. REV. 419 (1987). In *Foley*, this approach was analyzed and rejected by the supreme court, which suggested it might more appropriately be considered by the legislature. *Foley*, 47 Cal. 3d at 694, 765 P.2d at 397, 254 Cal. Rptr. at 235.

101. Analogy may be made to the many statutes that permit recovery of attorneys' fees when the litigation serves the general public. See, e.g., CAL. CIV. PROC. CODE § 1021.5 (West 1980).

102. California Civil Code section 1526(a) expressly applies only to disputed or unliquidated debts. See *supra* text accompanying note 62.

103. CAL. CIV. CODE § 1524 (West 1982).

104. See Smith, *Exceptions to the Consideration Requirement in California*, 12 HASTINGS L.J. 377 (1961).

fully track the statute to determine whether all the elements are satisfied:

1. Is the debt liquidated and undisputed? This element is essential, for the statute applies only in the situation where consideration is an obstacle.¹⁰⁵

2. Is there an agreement to accept part performance? Common law standards of contract formation, analogous to those used to determine whether parties have entered into an accord,¹⁰⁶ are useful in making this determination.

3. Is the agreement in a writing, expressly accepted? Note that the writing, like a memorandum to satisfy the Statute of Frauds,¹⁰⁷ need be accepted only by the party against whom enforcement is sought, here the creditor.

4. Did the debtor fully perform under the agreement? The statute makes clear that performance and not merely the promise of performance is necessary to extinguish the original obligation.¹⁰⁸

If the debtor fails to satisfy any of these elements, then the creditor may treat any payment made as a payment on account.

While the role of the statute is clear from the historical perspective, many cases and commentators have misunderstood it. Its purpose was concisely stated in *Schwartz v. California Claim Service*,¹⁰⁹ which also made clear that judgments may be compromised under the statute:

Section 1524, Civil Code, does away with a rule which has long been regarded by the courts as supported by scarcely more than a superstition, and it gives recognition and validity to business practices that are of common occurrence. The satisfaction of judgments for less than their face value is of everyday occurrence, and since every such settlement represents an agreement mutually satisfactory to the parties and fraught with some benefit to each, it should not be the policy of the law to discourage such sensible arrangements under which a creditor can satisfy a

105. *B. & W. Engineering Co. v. Beam*, 23 Cal. App. 164 (1913). For an example of misapplication of the statute, see *Kelly v. David D. Bohannon Org.*, 119 Cal. App. 2d 787, 791-92, 260 P.2d 646, 649-50 (1953), in which the court cites California Civil Code section 1524 in support of the proposition that "[a]n accord and satisfaction must be predicated upon a bona fide dispute, a real dispute."

106. See *supra* note 18 and accompanying text.

107. See, e.g., CAL. COM. CODE § 2201(1) (West 1964 & Supp. 1990).

108. Therefore the agreement could never be a substituted contract or novation. See *supra* text accompanying note 40.

109. 52 Cal. App. 2d 47, 125 P.2d 883 (1942).

judgment for what he thinks it is worth and a debtor can settle it for what he can afford to pay.¹¹⁰

The statute was further discussed in *Petroleum Collections, Inc. v. Sulser*.¹¹¹ While the court did an excellent job of clarifying correct application of the statute, it neglected discussion of one element, that the writing must be "expressly accepted by the creditor in writing." The court left the impression that the creditor's mere endorsement is a sufficient writing. This interpretation, however, debilitates the communicating function of the statute. One purpose of the requirement of a writing is to ensure that the creditor has knowledge of the offer. If the creditor's endorsement manifests such a writing, a debtor could trick the creditor into accepting part payment of an undisputed debt merely by placing a condition on the back of the check. The artifice would often go unnoticed, particularly by those high-volume creditors who do not scrutinize each check. At least one other jurisdiction with a similar statute has properly held that the creditor's endorsement of a conditional check is not an express acceptance as contemplated by the statute.¹¹²

Misapplication of the statute may be seen in *Blumer v. Madden*.¹¹³ Plaintiff obtained judgment against defendant for \$465.06 plus interest and costs. Plaintiff agreed in writing to accept payment of \$483.34 in monthly installments of \$50 in full satisfaction of the obligation. Defendant made payments aggregating \$363.48 and then defaulted. Plaintiff sought execution for the unpaid balance of the original judgment and defendant moved to stay execution. The court of appeal allowed the execution on grounds that there was no satisfaction of the accord, stating that section 1524 "has no application to the circumstances of the present case."¹¹⁴

The result in *Blumer* is correct; the reasoning is not. This was a liquidated obligation, determined by the trial court that issued judgment. Because there was no consideration for the creditor's agreement to accept less than the full amount, no accord could be formed under the common law. The creditor's agreement to accept less was effective only because of section 1524. Applying the statute to the facts, the creditor agreed in writing to accept part performance, but the debtor did not fully perform under the new agreement.

110. *Id.* at 52, 125 P.2d at 888.

111. 265 Cal. App. 2d 976, 70 Cal. Rptr. 537 (1968).

112. *Sawyer v. Somers Lumber Co.*, 68 Mont. 169, 177, 282 P. 852, 854 (1929) (applying what is now MONT. CODE ANN. § 28-1-1403 (1989)).

113. 128 Cal. App. 2d, 16 P.2d 319 (1932).

114. *Id.* at 26, 16 P.2d at 321.

Therefore the original obligation was revived. The payments made were credited as payments on account and the creditor was entitled to execution for the unpaid balance.

VI. CONCLUSION

Application of the common law principles of accord and satisfaction has assisted parties in making knowing, deliberate, and expeditious resolution of their unliquidated or disputed obligations. Similarly, application of Civil Code section 1524 has permitted parties to compromise debts that are both liquidated and undisputed.

The principles of accord and satisfaction were clearly and correctly applied in the recent case of *Thompson v. Williams*.¹¹⁵ Plaintiff, an attorney, referred a personal injury case to defendant, who agreed to pay plaintiff one-third of the recovery in the underlying case. After receiving a fee of \$450,000, defendant tendered \$90,000 to plaintiff. Plaintiff claimed \$150,000, and after negotiation, the parties settled at \$114,000. Plaintiff then sued for the balance allegedly due.

Defendant moved for summary judgment. The trial court applied the three elements of accord and satisfaction as found in *Potter*: 1) that there was a bona fide dispute; 2) that the debtor made it clear that acceptance of the part payment would fully satisfy the obligation; and 3) that the creditor understood that acceptance constituted payment in full. Finding all three elements satisfied, the court granted summary judgment. The appellate court affirmed.

While the opinion of the court of appeal is a lucid application of the principles of accord and satisfaction, the court stated, "[t]he rule of *Potter v. Pacific Coast Lumber Co.* continues to be the law of this state."¹¹⁶ Ironically, this is not the case. The accord in *Thompson* was reached in 1984, prior to the effective date of Civil Code section 1526.

The common law has now been replaced with respect to unliquidated or disputed debts by Civil Code section 1526. Sophisticated parties will be aware of the statute prior to tendering a conditional check. The genius of common law accord and satisfaction, however, has been its availability as a dispute resolution device for the lay public. Persons accustomed to using the device to settle their disputes may now find that because of this statute, their attempted settlement is a snare and delusion. Moreover, because of the ambiguities in its

115. 211 Cal. App. 3d 566, 259 Cal. Rptr. 518 (1989).

116. *Id.* at 571, 259 Cal. Rptr. at 521.

language, the statute will invite litigation to determine its meaning.

Appendix: Civil Code section 1526 Rewritten in Enumerated Form¹¹⁷ section 1526

I.

(a) Where:

1. a claim is disputed or unliquidated;
2. a check or draft is tendered by the debtor in settlement thereof in full discharge of the claim; and
3. the words "payment in full" or other words of similar meaning are notated on the check or draft, the acceptance of the check or draft does not constitute an accord and satisfaction if:
 - a. the creditor protests against accepting the tender in full payment by striking out or otherwise deleting that notation;
 - b. the acceptance of the check or draft was inadvertent; or
 - c. the acceptance of the check or draft was without knowledge of the notation.

(b) Notwithstanding subdivision (a), the acceptance of a check or draft constitutes an accord and satisfaction if:

1. a check or draft is tendered pursuant to a composition or extension agreement between a debtor and its creditors;
2. pursuant to that composition or extension agreement, all creditors of the same class are accorded similar treatment; and
3. the creditor receives the check or draft with knowledge of the restriction; or if the check or draft is issued pursuant to or in conjunction with a release of a claim.

(c) A creditor shall be conclusively presumed to have knowledge of the restriction if a creditor:

1. has, previous to the receipt of the check or draft, executed a written consent to a composition or extension agreement; or
2. has been given, not less than 15 days nor more than 90

117. The purpose of this enumeration is to express more clearly the substance of the statute. I have resolved the ambiguity discussed at *supra* text accompanying note 70 by making the definition of knowledge in section 1526(b) clearly applicable to all creditors.

days prior to receipt of the check or draft, notice, in writing, that:

- a. a check or draft will be tendered with a restrictive endorsement; and
- b. acceptance and cashing of the check or draft will constitute an accord and satisfaction.

Mailing the notice by first-class mail, postage prepaid, addressed to the address shown for the creditor on the debtor's books or such other address as the creditor may designate in writing constitutes notice.