Acquisitions Committee: Liquidated Damages Project

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The December 2017 issue of *ACREL Notes* contained an article about *Ravenstar, LLC v. One Ski Hill Place, LLC*, 401 P.3d 552 (Colo. 2017), which held that an optional liquidated damages clause (i.e., a clause giving the seller an option to choose either liquidated damages *or* actual damages) was enforceable. This case was a surprise to a number of lawyers, including the author, who had assumed that such an option could invalidate a liquidated damages clause because it reflects a lack of intent to liquidate damages. The author was even more surprised to learn that the Colorado Supreme Court is not the only court to uphold an optional liquidated damages clause: courts in several states have reached a similar conclusion.

The *Ravenstar* case prompted the ACREL Acquisitions Committee to seek a better understanding of the disparate treatment of optional liquidated damages in the United States. Originally, the Acquisitions Committee planned to answer only the following four questions (assuming a seller is entitled to liquidated damages for a buyer's breach of its obligation to purchase):

1. May the seller choose specific performance instead of liquidated damages (so that liquidated damages are not an exclusive remedy)?
2. May the seller choose actual damages instead of liquidated damages (so that liquidated damages are not an exclusive *damage* remedy)?
3. If the seller may choose liquidated damages or actual damages, may it have both?
4. If the seller may choose liquidated damages or actual damages, but not both, when must it decide?

But our committee soon discovered that this exercise may require a broader understanding of liquidated damages, which is far from a straightforward and simple subject. *See, e.g.*, Jeffrey B. Coopersmith, *Refocusing Liquidated Damages Law for Real Estate Contracts: Returning to the Historical Roots of the Penalty Doctrine*, 39 EMORY L.J. 267 (1990) ("The reporters are filled with a myriad of [liquidated damages] cases reaching contradictory conclusions and anomalous holdings." (footnote omitted)). Consequently, we expanded our analysis to include the following additional questions:

5. Is there an applicable statute addressing liquidated damages clauses?
6. What is the test for a valid liquidated damages clause?
7. Who has the burden of proof?
8. As of when is "reasonableness" tested?
9. What percentage of the purchase price is likely acceptable as liquidated damages?
10. Are actual damages relevant for liquidated damages and, in particular, will liquidated damages be allowed when there are no actual damages?
11. Is mitigation relevant for liquidated damages?
12. Is a "Shotgun" liquidated damages clause enforceable?
13. Does a liquidated damages clause preclude recovery of attorneys' fees by the seller?

Several members of the Acquisitions Committee are examining these questions in their respective jurisdictions and will be sharing their answers in future publications of ACREL NEWS & NOTES. What follows is the author's current impression of the general answers to these questions, based primarily on a review of secondary sources. Although some of these answers are based on cases, statutes and secondary sources that involve a different or broader context, our focus is primarily on commercial real estate purchase

contracts that give the seller the right to the deposit as liquidated damages if the buyer breaches its obligation to purchase.

1. MAY THE SELLER CHOOSE SPECIFIC PERFORMANCE INSTEAD OF LIQUIDATED DAMAGES (SO THAT LIQUIDATED DAMAGES ARE NOT AN EXCLUSIVE REMEDY)?

The parties to a commercial real estate purchase contract may agree that liquidated damages will be the sole remedy of the seller for a breach of the buyer's obligation to purchase. But in the absence of such an agreement, a right to liquidated damages may not be an exclusive remedy for such a breach. In particular, the seller might have the alternative right to specifically enforce the contract. As stated in POWELL:

> The mere fact that there is a liquidated damages provision does not necessarily force a party to forego the specific performance remedy. However, the exact wording in the parties' contract may provide that the liquidated damages provision is the exclusive remedy, in which case, the remedy of specific performance would no longer apply. (footnotes omitted).

14–15 RICHARD R. POWELL, POWELL ON REAL PROPERTY § 81.04[1][c], at 81-176–81-177 (Michael A. Wolf ed., 2000, 2017) [hereinafter POWELL]. *See also* 24–26 SAMUEL WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 67:67, at 440 (Richard A. Lord ed., 4th ed. 2002, 2003) [hereinafter WILLISTON] ("[A] liquidated damages provision is not necessarily a bar to specific performance unless the parties so intended it." (footnote omitted)); MILTON R. FRIEDMAN & JAMES C. SMITH, FRIEDMAN AND SMITH ON CONTRACTS AND CONVEYANCES OF REAL PROPERTY § 23:5.9, at 23-34 (8th ed. 2017) [hereinafter FRIEDMAN] ("A provision for liquidated damages does not bar an action for specific performance unless the contract gives the purchaser a choice between performing and paying." (footnote omitted)); RESTATEMENT (SECOND) OF CONTRACTS § 361 (1981) [hereinafter RESTATEMENT] ("Specific performance or an injunction may be granted to enforce a duty even though there is a provision for liquidated damages for breach of that duty.").

1.1 **Uniform Land Transactions Act**. One notable exception to the general rule quoted above is The Uniform Land Transactions Act, which reaches the opposite conclusion. Uniform Land Transactions Act, § 2-516(b), 13 U.L.A. 248 (2002) ("A party entitled to recover under a valid liquidated-damages clause has no other remedy for any breach to which the liquidated-damages clause applies unless other remedies are expressly reserved in the contract.").

1.2 **Seller's Right to Specific Performance**. Some members of our committee questioned whether specific performance would be available to a seller of real estate even in the absence of a liquidated damages clause. For a discussion of a real estate seller's right to specific performance generally, *see, e.g.*, POWELL, *supra*, § 81.04[1][a], at 81-165 ("The seller also qualifies for the remedy of specific performance. In the seller's case, however, the theoretical justification is far less compelling than in the case of the purchaser." (footnote omitted)); RESTATEMENT, *supra*, § 360 cmt. e. ("Contracts for the sale of land have traditionally been accorded a special place in the law of specific performance . . . . [T]he seller who has not yet conveyed is generally granted specific performance on breach by the buyer."); EDWARD YORIO & STEVE THEL, CONTRACT ENFORCEMENT – SPECIFIC PERFORMANCE AND INJUNCTIONS § 10.3.1, at 10-31–10-33 (2d ed. supp. 2017) (who observe, in their chapter on real estate, that although "[t]raditionally, . . . specific performance was almost universally available to remedy the [buyer's]

breach . . . a number of jurisdictions have limited specific performance to circumstances in which the seller's damages are likely to be inadequate"; however, they also note that several arguments may support the position that damages are an inadequate remedy, and that "[p]artly in reliance on these arguments, many courts continue routinely to grant specific performance to an aggrieved seller." (footnotes omitted)); FRIEDMAN, *supra*, § 23:4, at 23-13 ("Specific performance is generally given the seller as a matter of course." (footnote omitted)); WILLISTON, *supra*, § 67:113, at 612 ("Either party to a contract for the sale of land generally may have specific performance of the contract." (footnote omitted)). *But see Kesler v. Marshall*, 792 N.E.2d 893, 897 (Ind. Ct. App. 2003) and the cases it cites from various jurisdictions for the proposition that specific performance may not be available to a seller of real estate unless the remedy at law is inadequate; POWELL, *supra*, § 81.04[1][a], at 81-166 ("The Uniform Land Transactions Act reflects a trend away from the automatic availability of the specific performance remedy for the seller. The seller may recover in an action for the price under Section 2-506(b) 'only if the seller is unable after a reasonable effort to resell it at a reasonable price or the circumstances reasonably indicate the effort will be unavailing.'" (footnote omitted)).

1.3 **Importance of Wording**. As indicated in POWELL, *supra*, the wording of the purchase contract may be important in determining whether the liquidated damages clause is intended to be exclusive. But it may not be necessary to refer to a "sole" or "exclusive" remedy. For example, an exclusive remedy might be implied by language indicating that a liquidated damages remedy is mandatory (e.g., the seller "shall" receive the deposit as liquidated damages), especially (or at least) when the clause also provides for a termination of the purchase contract or a release of any further obligation of the parties. *See, e.g.*, *Dillard Homes, Inc. v. Carroll*, 152 So. 2d 738 (Fla. Dist. Ct. App. 1963) and the cases it cites from various jurisdictions; POWELL, *supra*, § 81.04[1][c], at 81-177 n.55. But some courts may require more than what appears to be mandatory language to find an intent to eliminate a specific performance remedy. *See, e.g.*, *Asia Inv. Co. v. Levin*, 204 P. 808, 809 (Wash. 1922) (no such intent found despite clause stating that "[f]ailure of purchaser to complete purchase within time stated, except for defect of title, shall operate as a forfeiture of sum hereby deposited, the same being in settlement of and being hereby fixed as liquidated damages.").

2. MAY THE SELLER CHOOSE ACTUAL DAMAGES INSTEAD OF LIQUIDATED DAMAGES (SO THAT LIQUIDATED DAMAGES ARE NOT AN EXCLUSIVE *DAMAGE* REMEDY)?

A purchase contract may expressly exclude other *damage* remedies when there is a liquidated damages clause. But when there is no such contractual exclusion, state law varies as to whether the seller may seek actual damages instead:

> [T]he courts have disagreed on whether a party for whose benefit a liquidated damages provision exists may elect between its benefits and proving and recovering actual damages. (footnote omitted).

WILLISTON, *supra*, § 65:31, at 361–62. The variance among the courts appears to exist both in cases where the liquidated damages clause includes an express option ("express" meaning that there is a specific reference to an alternative remedy to pursue "actual damages," a "legal" (vs. equitable) right or remedy, or a remedy "at law") and in cases where the liquidated damages clause does not include such an express option (but does not make the liquidated damages remedy exclusive). *See* WILLISTON, *supra*, § 65:32 and the cases it cites; *see also* 2.1, 2.2 and 2.4 below.

(While the contract in *Ravenstar* specifically referred to an "actual damages" alternative, most of the optional liquidated damages cases reviewed by the author do not.)

2.1 **Jurisdictions Enforcing**. Courts in some jurisdictions have been willing to honor and enforce the parties' agreement (sometimes express and sometimes implied) to give the seller an option to choose actual damages or liquidated damages. As noted by the Supreme Court of Idaho in November 2017:

> Idaho is one of several states that have upheld provisions allowing sellers to choose between liquidated and actual damages. (citation omitted).

Phillips v. Gomez, 405 P.3d 588, 593 (Idaho 2017); *see also McMaster v. McIlroy Bank*, 654 S.W.2d 591, 594 (Ark. Ct. App. 1983) ("[I]t was not mandatory for [the seller] to sue for specific performance or for the amount of liquidated damages provided for. [Seller] had the added option of suing for actual damages."); *Ravenstar*, *supra*, at 553 ("We hold that such an option [to choose between liquidated damages and actual damages] does not invalidate the [liquidated damages] clause and instead parties are free to contract for a damages provision that allows a non-breaching party to elect between liquidated damages and actual damages."); *Noble v. Ogborn*, 717 P.2d 285, 287 (Wash. Ct. App. 1986) ("A liquidated damages clause does not preclude a party from suing for actual damages if that right is preserved in the contract . . . ."); DAN B. DOBBS, LAW OF REMEDIES: DAMAGES-EQUITY-RESTITUTION § 12.12(1), at 311 (2d ed. 1993) ("There is no reason to assume that the presence of a liquidated damages or forfeiture provision is an exclusive remedy unless the contract is reasonably construed to say so. If it does not, then the vendor is usually free to claim either the forfeiture or the actual damages, as his option." (citations omitted)), although the cases cited by DOBBS to support the statement that sellers may usually choose between liquidated and actual damages in the absence of reasonably construed exclusivity involve sellers seeking specific performance.

2.2 **Jurisdictions Not Enforcing (or Recognizing)**. But courts in some other jurisdictions have not been as willing to enforce (or recognize) options to seek liquidated damages or actual damages. A Massachusetts Superior Court indicated in 2013 (in an optional liquidated damages case involving a lease) that there were then at least five jurisdictions (in addition to Massachusetts) in which courts had found optional liquidated damages clauses to be unenforceable:

> The Court agrees with holdings by appellate courts in Florida, Georgia, Illinois, Iowa, and New York that the existence of an option to sue for actual damages has the effect of turning a liquidated damages provision into an unenforceable penalty provision. These holdings in other jurisdictions are consistent with the Supreme Judicial Court's holding in *TAL Financial*. (citations and footnote omitted).

Zuckerman v. Vanu, Inc., 2013 Mass. Super. LEXIS 94, at *25.

2.2.1 *Express Option*. A relatively common justification for invalidating an express optional liquidated damages clause is that a right to seek actual damages is inconsistent with an *intent* to liquidate damages:

> [T]he option has the effect of rendering the [liquidated damages] provision an unenforceable penalty, on the basis that the option negates the possibility that the parties intended, in agreeing to the provision, to establish a specific sum payable in respect of a breach, and instead intended the [liquidated damages] provision to be operative only where the deposit exceeded the actual damages incurred, establishing the implication that the parties intended to punish the defaulting party. (footnote omitted).

WILLISTON, *supra*, § 65:24, at 330–31. S*ee, e.g.*, *Lefemine v. Baron*, 573 So. 2d 326, 330 (Fla. 1991) ("The provision constituted a penalty as a matter of law because the existence of the option negated the intent to liquidate damages."); *Grossinger Motorcorp, Inc. v. American Nat'l Bank & Trust Co.*, 607 N.E.2d 1337, 1346 (Ill. App. Ct. 1992) ("[T]he optional nature of the liquidated damages clause shows that the parties never intended to establish a specific sum to constitute damages in the event of a breach."); *Sagatov Builders LLC v. Hunt*, 88 Va. Cir. 410, 412 (2014), quoting WILLISTON for the proposition that the "option negates the possibility that the parties intended [to liquidate damages]."

But some courts have invalidated express optional liquidated damages clauses based simply on a rule disfavoring liquidated damages. *See, e.g.*, *Southeastern Land Fund, Inc. v. Real Estate World, Inc.*, 227 S.E.2d 340, 342–44 (Ga. 1976) (while discussing a purchase contract, which provided that seller was "entitled" to "partial" liquidated damages and reserved "any and all remedies available . . . at law or equity," the Supreme Court of Georgia stated that "[t]he problem that this particular contract provision raises is whether the seller has tried to retain a right to elect to sue for actual damages rather than liquidated damages and in so doing has rendered the purported liquidated damages provision unenforceable"; citing a 1908 case, the court concluded that "a correct resolution of this issue must be found in the doctrine that 'in cases of doubt the courts favor the construction which holds the stipulated sum to be a penalty, and limits the recovery to the amount of damages actually shown, rather than a liquidation of the damages.'" (citation omitted)); more generally, *see* WILLISTON, *supra*, § 65:13, at 284 ("It . . . is still the rule in some jurisdictions, that in a doubtful case, the court would lean towards holding a provision for fixed penal rather than liquidated damages, and on that basis decline to enforce it." (footnote omitted)).

2.2.2 *Option Not Express*. A purported optional liquidated damages clause is not always express. Sometimes a seller argues that it has the option to seek actual damages (rather than liquidated damages) in a contract that does not specifically mention actual damages, legal remedies or remedies at law (e.g., because of a reservation of "other" or nonspecific remedies or because the liquidated damages remedy is stated as an option or a right). In such cases, some courts (particularly those that would invalidate an express optional liquidated damages clause) may be reluctant to find that the parties intended to give the seller an actual damage remedy.

Thus, one court refused to find that an actual damage remedy was intended even though the contract reserved other remedies, stating:

> While the contract does provide that the seller may retain the liquidated damages without prejudice to his "other" remedies, the "other" remedies refers to rights of a kind and character other than money damages. It would be inconsistent to provide in the contract for liquidated damages and also allow a party to pursue other remedies for money damages. (citation omitted).

Morris v. Flores, 528 N.E.2d 1013, 1015 (Ill. App. Ct. 1988) (but note that the contract provided that the seller "shall" retain the liquidated damages without prejudice to other remedies, so despite the language quoted above, this case may be distinguishable from cases stating that liquidated damages "may" be retained without prejudice to other remedies).

And even if the liquidated damages remedy is described as an option or a right, some courts may conclude that no actual damages remedy was intended. As stated by one court:

> We are not impressed with the plaintiffs' contention that the language in the contract which gives them the "right" to retain the cash deposit means that the plaintiffs have a right to refuse liquidated damages and sue for actual damages.

Brewer v. Myers, 545 S.W.2d 235, 237 (Tex. App. 1976) (although the court also stated that the parties "could have easily so stated in the contract," suggesting that the court might have been receptive to an express alternative to pursue actual damages). *See also Sweatt v. Int'l Dev. Corp.*, 531 S.E.2d 192, 195–96 (Ga. Ct. App. 2000) (the court rejected the seller's position that it had the right to seek actual damages in lieu of liquidated damages under a contract providing that the seller was "entitled" to retain the deposit as liquidated damages; however, the contract expressly reserved the alternative remedy of specific performance without mentioning any other remedy, so by negative implication one could argue that an actual damage remedy was implicitly excluded); *but see Catholic Charities of the Archdiocese of Chi. v. Thorpe*, 741 N.E.2d 651, 656–57 (Ill. App. Ct. 2000) (which invalidated a liquidated damages remedy "at the option of the seller," with no mention of any other remedies; the court found nonsensical the seller's argument that the "option" was intended to give the seller the alternative of not seeking liquidated damages, and concluded that "the addition of the clause 'at the option of the seller' would be totally redundant unless we assign to it an intent to preserve his alternate remedy of actual damages" (not mentioning specific performance presumably because, as indicated by *Lakshman v. Vecchione*, 430 N.E.2d 199, 203 (Ill. App. Ct. 1981), Illinois does not permit specific performance unless the remedy at law is insufficient)).

2.2.3 *Seller's Remedy When Optional Liquidated Damages Are Not Enforced or Recognized*. Thus, in some jurisdictions, a seller who thought it had the right to choose either actual or liquidated damages (whether expressly or by implication) may instead be left with a Hobson's choice for its damage remedy:

- only actual damages (if the liquidated damages clause is invalidated); or
- only liquidated damages (if the actual damages alternative is not recognized).

2.3 **Declining Relevance of Intent to Liquidate and Changing Attitude Toward Liquidated Damages?** As discussed in 2.2.1 above, *intent* is often the key to invalidating an optional liquidated damages clause. But, as discussed in the answer to question 6 below, the intent prong of the traditional test for a valid liquidated damages clause has declined in importance in many jurisdictions and is sometimes not even part of the test. And even when the intent prong is part of the test, at least one court has found that it does not conflict with the enforcement of an optional liquidated damages clause:

> The freedom to contract for the alternative damages remedies of liquidated damages and actual damages does not negate the parties' intent to liquidate damages. . . . An intent to liquidate damages should not be conflated with an intent to liquidate damages as the sole and exclusive remedy. The parties must only mutually intend to make liquidated damages one of the available remedies . . . .

Ravenstar, *supra*, at 556.

Also as discussed in 2.2.1, other cases invalidating optional liquidated damages clauses simply relied on a rule disfavoring liquidated damages. But, as suggested by the burden of proof discussion in the answer to question 7 below, that rule is no longer followed in many jurisdictions:

> Formerly the rule was that in doubtful cases, the court determined that the clause calling for payment or forfeiture after breach would be declared to be a penalty. Times have changed.

CORBIN, *supra*, § 58.5, at 428 (footnote omitted); *see also* WILLISTON, *supra*, § 65:13, at 284 ("It has historically been the majority rule, and is still the rule in some jurisdictions, that in a doubtful case, the court would lean towards holding a provision for fixed penal rather than liquidated damages, and on that basis decline to enforce it. . . . The opposite point of view has been adopted in recent years by some courts, particularly with respect to liquidated damages provisions entered into by experienced commercial parties with relatively equal bargaining power." (footnotes omitted)).

Query whether the declining importance of the intent prong (in the liquidated damages analysis) and the apparent shift in the general view toward liquidated damages are signals that in the future courts may be less likely to invalidate optional liquidated damages clauses.

2.4 **Importance of Wording**. In jurisdictions where optional liquidated damages clauses may be enforced, the wording of the liquidated damages clause may be important. *See, e.g.*, Linda A. Francis, Annotation, *Provision in Land Contract for Liquidated Damages Upon Default of Purchaser as Affecting Right of Vendor to Maintain Action for Damages for Breach of Contract*, 39 A.L.R. 5th 33, *2 (1996) ("[T]he courts have held that the use of such permissive terms as 'may' . . . or 'option' or 'election' . . . evidences the parties' intention not to limit the vendor's recovery to liquidated damages. . . . [Whereas] the use of mandatory terms such as 'shall,' . . . or the 'exclusive' or 'sole' remedy [may limit the vendor's recovery]." (footnotes omitted)). Thus, the use of a single word, such as "shall" or "may", might dictate the result in some jurisdictions:

> A "shall" provision for liquidated damages gives the party who does not breach the contract only one option; he can sue for specific performance, but he cannot sue for actual damages; the figure stipulated is the only option he has for damages. The "may" provision gives the party who does not breach the added option of suing for actual damages or for the liquidated damages provided for.

McMaster, *supra*, at 594. *But see, e.g.*, dissenting opinion, *id.* at 595: "In my opinion, there is simply no such thing as *optional* liquidated damages. If damages are optional, they are not

liquidated"; *see also* Brewer, *supra* (finding that a "right" to liquidated damages, without any express right to alternative remedies, did not imply an alternative actual damages remedy).

Language may also be important in jurisdictions where optional liquidated damages have not been enforced. As discussed in 2.2.2 above, courts in such jurisdictions may be less willing to find that an alternative actual damages remedy was intended based solely on permissive language or a reservation of other remedies, or both. *See, e.g.*, *Morris*, *supra*, at 1014 (alternative actual damage remedy not found under clause stating that "liquidated damages shall not be the exclusive remedy of Seller, and Seller shall retain all monies deposited without prejudice to his other remedies"); *Sweatt*, *supra*, at 195–96 ("[A]ny recovery for actual damages was foreclosed as a matter of law" under a contract providing that when the buyer breaches, "*Seller shall be entitled to retain the earnest money as full and complete liquidated damages* . . ." and reserving the alternative right to bring an action for specific performance); *but see Catholic Charities*, *supra*, at 657 (which found that a liquidated damages clause was unenforceable because the only sensible construction of an "option" to pursue liquidated damages (that didn't mention any other remedies) is as an option to pursue liquidated damages or actual damages); *Southeastern*, *supra* (which invalidated a liquidated damages clause that reserved "any and all remedies available . . . at law for equity").

2.5 **Further Complications**. The world of liquidated damages is riddled with anomalies that may make this analysis challenging, including the failure (in some cases) to recognize and reconcile (or distinguish):

- the disparate facts and (somewhat) separate body of law associated with installment land contracts in some jurisdictions;
- the related (but different) right of a seller to a defaulting buyer's payments (as a forfeiture) in some jurisdictions; and
- the inconsistent treatment of actual damages and specific performance as an alternative to liquidated damages in some jurisdictions.

Each of these subjects is discussed briefly below.

2.5.1 *Installment Land Contracts*. Optional liquidated damages clauses may have been relatively common in many installment land contracts (under which the vendee (purchaser) typically takes possession when the contract is signed, pays the purchase price over time, and takes title when the purchase price is paid in full): Traditionally, the installment land contract often, if not usually, provided the vendor (seller) numerous alternative remedies, including specific performance, a right of termination and forfeiture (retention) of the payments made by the purchaser (sometimes with and sometimes without a liquidated damages clause), and actual damages. *See, e.g.*, Grant S. Nelson & Dale A. Whitman, *The Installment Land Contract—A National Viewpoint*, 1977 BYU L. REV. 541, 542 (1977), listing five alternative remedies of the vendor including quieting title (and simultaneously retaining all payments under a forfeiture clause as liquidated damages), specific performance, and damages; POWELL, *supra*, 84D.03[3], at 84D-34 ("Forfeiture is just one of seven overlapping remedies [including specific performance and contract damages] that courts in various jurisdictions make available to vendors when their purchasers materially default."); DOBBS, *supra*, § 12.13, at 327–28 ("The forfeiture provision in

the contract is usually not the exclusive remedy. Instead, the vendor usually has a number of options when the purchaser defaults [including specific performance and damages]." (footnote omitted)). And even if the vendor did not elect to retain the vendee's payments *as liquidated damages* under a forfeiture clause, many courts were reluctant to refund a defaulting vendee's payments. *See, e.g.*, Richard H. Lee, *Remedies for Breach of the Installment Land Contract*, 19 U. MIAMI L. REV. 550, 552 (1965) ("[B]y the weight of authority the purchaser in default cannot recover payments made from a vendor not in default." (footnote omitted)); FRIEDMAN, *supra*, § 23:3.6, at 23-12 (discussing installment land contracts: "A contract permitting seller on purchaser's default to treat payments theretofore made as liquidated damages does not require seller to exercise that option, but permits seller to pursue other remedies."). Thus, it should not be surprising that optional liquidated damages clauses were recognized and enforced in some cases (especially older cases) involving land installment contracts. *See, e.g.*, *Reiter v. Bailey*, 39 P.2d 370, 372 (Wash. 1934) (which involved a clause with permissive language: "may elect").

But installment land contracts are very different from the more typical real estate purchase contract under which the transfer of possession and the transfer of title occur simultaneously. GRANT S. NELSON ET AL., REAL ESTATE FINANCE LAW § 3.26, at 69 (6th ed. 2014) ("It is important to distinguish the installment land contract from the ordinary executory contract for the sale of land, variously known as a 'binder,' a 'marketing contract,' or an 'earnest money contract.'" (footnote omitted)). Among other matters:

- the installment land contract functions as a financing device, and when viewed in this light, a portion of the buyer's payments effectively constitutes interest to the seller (for loaning to the buyer the balance of the purchase price);

- alternatively, the installment land contract may be viewed as a lease/purchase, so that a portion of the buyer's payments effectively constitutes rent to the seller (for leasing the property to the buyer until the purchase price is paid);

- whether viewed as interest or rent, a portion of the buyer's payments has been earned and is never truly forfeited; and

- there is a significant body of law (which has evolved in different ways in different jurisdictions) regarding a seller's remedies under an installment land contract, only a portion of which intersects with the law regarding liquidated damages.

These differences might justify different outcomes when considering liquidated damages issues in the context of an installment land contract. Unfortunately, some courts have failed to distinguish land installment contracts from more typical real estate purchase contracts, which may make an already confusing area of the law even more confusing. *See, e.g.*, Richard H. Lee, *Defaulting Purchaser's Right to Restitution Under the Installment Land Contract*, 20 U. MIAMI L. REV. 1, 20 (1965) ("[T]he failure to distinguish between the deposit receipt agreement and the installment land contract is a source of much confusion."); Donna R. Roper, *Forfeiture Clauses in Land Installment Contracts: Time for Equitable Foreclosure*, 8 UNIV. PUGET SOUND L. REV. 85, 86 n.10 (1984) ("[M]any early Washington cases did not distinguish between earnest money contracts and

land installment contracts." (citations omitted)); *Noble*, *supra*, which relied on *Reiter*, *supra*, an installment land contract case, in reaching its conclusion that the seller had the option to choose between actual and liquidated damages, without ever mentioning the difference between the relevant purchase contract in *Noble* and the installment land contract in *Reiter*.

2.5.2 *Forfeiture of Defaulting Buyer's Payments*. To add to the confusion, there is yet another (somewhat overlapping) body of law in some jurisdictions (the common law forfeiture rule) permitting the forfeiture of a defaulting buyer's payments without a liquidated damages clause. *See, e.g.*, FREIDMAN, *supra*, § 23:5, at 23-17 ("Traditionally, a reneging purchaser may not recover the part payment from a seller willing and able to convey."); James O. Pearson, Jr., Annotation, *Modern Status of Defaulting Vendee's Right to Recover Contractual Payments Withheld by Vendor as Forfeited*, 4 A.L.R. 4th 993, *2 (1981) ("It is the general rule that a vendee in default cannot recover back the money he has paid on an executory contract to his vendor who is not himself in default." (footnote omitted)).

This forfeiture rule (when it applies) is not necessarily limited to *installment land contracts* or to amounts actually paid *to the seller*. It may also apply to deposits held in escrow under an ordinary purchase contract (providing for the simultaneous transfer of possession and title). *See, e.g.*, *Bruce Builders, Inc. v. Goodwin*, 317 So. 2d 868, 869 (Fla. Dist. Ct. App. 1975), in which the seller was entitled to the deposit held in escrow upon the buyers' default ("As a general rule a purchaser in default . . . cannot recover from the seller money paid in part performance of an executory contract. Therefore, the award of the deposit to [the purchasers] was error even had the contract not provided for its retention by appellant as liquidated damages." (citations omitted)); *Fingerhut v. Kralyn Enterprises, Inc.*, 337 N.Y.S.2d 394, 406 (Sup. Ct. N.Y. Cnty. 1971), in which the seller was entitled to all amounts held in escrow upon the buyer's default despite the deletion of the liquidated damages provision at the request of the buyer's counsel (the court quoted a treatise on New York Real Property: "it is the usual rule that, where the purchaser is in default, he cannot recover back the money paid on signing the agreement. This right of the vendor to retain the deposit is not aided by any contract clause. *Even without such a clause the right to retain the deposit exists*. It is only where such retention is to be the vendor's sole remedy that a provision to that effect is needed in the agreement.").

Sometimes, there is an express forfeiture clause that does not mention liquidated damages. Such a clause has sometimes been interpreted as a liquidated damages clause. *See, e.g.*, *Lyons v. Philippart*, 680 P.2d 172, 174 (Ariz. Ct. App. 1983) (involving a forfeiture clause that did not mention liquidated damages yet was treated as a liquidated damages clause, which precluded a suit for actual damages; "A provision for the forfeiture of earnest money on breach of a contract to purchase real estate has been held a stipulation for liquidated damages."); *Sampson v. McAdoo*, 425 A.2d 1, 3 (Md. Ct. Spec. App. 1981) (involving a forfeiture provision that did not mention liquidated damages yet was treated as a liquidated damages clause, which enabled the seller to claim the deposit because the option to pursue other remedies had lapsed; "'Forfeit' as used in such contract . . . means 'to keep as liquidated damages and call the contract off.'" (citation omitted)). But such a clause has sometimes not been interpreted as a liquidated damages clause. *See, e.g., In re Berlin & Denmar Distribs.*, No. 10-15519, 2014 Bankr. LEXIS 2287, at *15 (Bankr. S.D.N.Y. May 23, 2014) (involving a forfeiture clause that didn't mention liquidated damages and was not treated as a liquidated damages clause, which allowed a suit for actual damages; "liquidated damages must be expressly agreed to and will not be implied." (citations omitted)).

One may wonder whether it would simpler and safer for a seller not to include a liquidated damages clause at all, at least in a jurisdiction where the seller already has the right to retain the buyer's deposit if the buyer defaults in its obligation to purchase:

> Is it of any advantage to the seller to include such a liquidated damage provision? Not in the majority jurisdictions, where the down payment is subject to forfeiture whatever its amount. (footnote omitted).

FRIEDMAN, *supra*, § 23:5.9, at 23-34; *see also* WILLISTON, *supra*, § 68:33, at 386 (which observes the modern trend to take a more balanced approach to such forfeitures but states that "it remains the majority rule in this country that a buyer who defaults on a contract to purchase real estate after having made a down payment or otherwise given the seller earnest money or a deposit, may not recover its partial payment, or any portion of it . . . ."); *but see* 11–12 JOSEPH M. PERILLO, CORBIN ON CONTRACTS § 62.8 (2005, 2012) [hereinafter CORBIN], which notes at 171–73 that few of the cases allowing such a forfeiture "have been decided since the publication of Restatement (First) Contracts § 357 (1932), which has since been replaced by Restatement (Second) of Contracts § 374 (1979)" and suggests at 178 that while many courts have attempted to state a definite and dogmatic rule of law, they may suffer from an "illusion of certainty"; RESTATEMENT, *supra*, § 374, which provides for restitution to a defaulting buyer under certain circumstances and imposes a reasonableness test for contractual forfeitures; *Kutzin v. Pirnie*, 591 A.2d 932, 941 (N.J. 1991), in which the New Jersey Supreme Court overruled prior "New Jersey cases adhering to the common-law rule and [adopted] the modern approach set forth in section 374(1) of the Restatement (Second) of Contracts"; DOBBS, *supra*, § 12.9(4), at 264 ("Courts once treated forfeitures differently from penalty clauses partly because of the supposed rule that a party in breach could not seek restitution. Consequently some decisions have upheld forfeitures without regard to whether they otherwise count as penalties. The rule against allowance of restitution to a breacher is now somewhat moribund . . . ." (citations omitted)). Whether or not the common-law forfeiture rule continues to represent a majority view, it seems unlikely that real estate sellers and their counsel will stop using liquidated damages clauses any time soon. Hopefully, our jurisdiction-by-jurisdiction analysis will not be obfuscated by the law relating to installment land contracts or forfeiture of payments without a liquidated damages clause, or both.

2.5.3 *The Specific Performance Alternative*. It may seem odd that the alternative right to seek actual damages may be subject to challenge while the alternative right to seek specific performance (discussed in the answer to question 1 above) may not be. *See, e.g.*, Coopersmith, *supra*, at 302 ("These conflicting practices [of permitting specific performance but not actual damages as an alternative to liquidated damages] are difficult to reconcile, given the basic equivalence between the two remedies."). And it would be surprising if a seller in a jurisdiction that disfavors optional liquidated damages clauses would not simply provide for (or preserve) the specific performance alternative to liquidated damages rather than try to create an actual damages alternative (unless the availability to a seller of specific performance in the relevant jurisdiction is questionable). Actual damages and specific performance may achieve roughly similar economic results. Indeed:

> The purpose of an award of [actual] damages is to place the non-breaching party in a position through the payment of money that is roughly equivalent to the net worth position that would have been reached if the contract had been performed as promised. (footnote omitted).

POWELL, *supra*, § 81.04[2][a], at 81-182.1. For example, if the contract price is $100X and the property is worth $80X at the time of the buyer's breach, then (assuming no further fluctuation in value) an action for general damages may yield $100X of assets (seller retains the property and collects $20X of cash damages) and an action for specific performance may yield $100X of assets (seller collects $100X cash price).

Specific performance may even be preferable (avoiding, for example, the need to prove actual damages). *Id.* ("Because the non-breaching party is permitted to select the most favorable of the available remedies, the equitable remedy of specific performance is generally chosen instead of damages."); *see also id.* § 81.04[2], at 81-181 ("[T]he remedy of damages and the rough approximation [of specific performance] it is capable of satisfying is [generally] not as attractive [as specific performance]."). But neither alternative remedy may be particularly useful if the buyer is a special purpose vehicle with no assets other than its interest in the deposit.

3. IF THE SELLER MAY CHOOSE LIQUIDATED DAMAGES OR ACTUAL DAMAGES, MAY IT HAVE BOTH?

It may seem unlikely that any jurisdiction would permit a party to collect both liquidated damages and actual damages for the same breach. *See, e.g.*, *Jarro Bldg. Industries Corp. v. Schwartz*, 281 N.Y.S.2d 420, 422 (N.Y. App. Div. 1967) ("If appellant here could recover both liquidated damages and actual damages, there would be no question that the 'liquidated damages' provision was a penalty."); *Ravenstar*, *supra*, at 554 ("[s]uch an option must be exclusive, meaning a party who elects to pursue one of the available remedies may not pursue the alternative remedy set forth in the contract.").

3.1 **Multiple Injury Exception**. But a single breach might give rise to different types of damages and only one might be liquidated. *See, e.g.*, WILLISTON, *supra*, § 65:31, at 362:

> [T]here are some circumstances under which relief . . . in addition to contractual liquidated damages may be awarded even absent explicit authority for such action in the contract, . . . having to do with . . . the occurrence of separate injuries not intended by the parties to be covered by the stipulated damages provision. (footnote omitted).

In a commercial real estate purchase, there may be different types of damages that are recoverable for a breach of the buyer's obligation to purchase. CORBIN describes the seller's general damages as follows:

> In case of breach by the purchaser, the vendor's general damages are the full contract price minus the market value of the land at date of breach and also minus any payment received. (footnote omitted).

CORBIN, *supra*, § 60.12, at 696; *see also* DOBBS, *supra*, § 12.12(1), at 306; FRIEDMAN, *supra*, § 23:3.2, at 23-6–23-7; POWELL, *supra*, § 81.04[2][b], at 81-183; WILLISTON, *supra*, § 66:80, at 8–11. CORBIN goes on to state that other damages, namely consequential and incidental damages, might also be recoverable:

> Costs of making a resale may be allowed as consequential or incidental damages. If foreseeable, other consequential damages are available. (footnotes omitted).

CORBIN, *supra*, § 60.12, at 696–98; *see also* DOBBS, *supra*, § 12.12(1), at 308 ("[T]he vendor is entitled to recover special damages in addition to or in lieu of general damages, provided such damages are within the contemplation of the parties . . . ." (footnote omitted)); FRIEDMAN, *supra*, § 23:3.4, at 23-9 ("In an appropriate case, the seller may recover consequential damages in lieu of, or in addition to, damages for the loss of bargain based on the contract price-market value formula."); POWELL, *supra*, § 81.04[2][c], at 81-186 ("Incidental and consequential damages may be recovered in . . . an action for damages . . . ."); WILLISTON, *supra*, § 66:80, at 13 ("A vendor . . . may likewise recover consequential damages resulting from the breach, if they were reasonably within the contemplation of the parties . . . ."); CAL. CIV. CODE § 3307 ("The detriment caused by the breach of an agreement to purchase an estate in real property is deemed to be the excess, if any, of the amount which would have been due to the seller under the contract over the value of the property to him or her, consequential damages according to proof, and interest."). For a discussion of various types of a real estate seller's incidental damages and consequential damages, *see, e.g.*, POWELL, *supra*, § 81.04[2][c], at 81-185–81-186; DOBBS, *supra*, § 12.12(1), at 308.

Thus, it might be possible to have liquidated damages for only some of these damages and retain the right to seek the remaining damages separately. *See, e.g.*, FRIEDMAN, *supra*, § 23:5.9, at 23-35 ("A provision for liquidated damages limits its application to the claims covered by the provision."); *ISTI Delaware, Inc. v. Townsend*, No. 91C-08-017, 1993 Del. Super. LEXIS 146, at *13 (Super. Ct. Mar. 31, 1993) (quoting an earlier case: "'The parties to a contract can provide that a liquidated amount will be recoverable in the event of a particular type or types of damages, while actual damage will be recoverable in the event of other forms of damages.'" (citation omitted)); *Short Clove Assocs. v. Ilana Realty, Inc.*, 154 B.R. 21, 28 (Bankr. S.D.N.Y. 1993) ("It does not necessarily follow, however, that because a liquidated damages provision precludes pursuing recovery of contractual damages resulting from the breach that it bars all additional recovery.").

For example, in *Short Clove*, *supra*, the seller claimed (and was awarded by the lower court) not only liquidated damages, but also transactional attorneys' fees associated with the aborted sale, mortgage interest and taxes after the scheduled closing date, and attorneys' fees for defending a foreclosure and for bankruptcy counsel. On appeal, the court questioned the transactional attorneys' fees associated with the original sale. *See, e.g.*, DOBBS, *supra*, § 12.12(1), at 308 ("[E]xpenses incurred in connection with the original contract . . . are not recoverable, because they are expenses that would have been incurred even without a breach. Put differently, such reliance expenses are recouped by obtaining the market-contract differential." (footnote omitted)). But the court upheld the other damage claims (attributing them to the buyer's legal actions):

> As to the balance of the damages awarded, we find that they are chargeable against [the buyer]. [The buyer's] decision to tie up the property in litigation produced added costs for [the seller]. The interest due, taxes accrued, and legal fees incurred are certainly a consequence of [the buyer's] insistence on pursuing the matter in court after the closing fell through. These damages are not for the breach, but rather were incurred as a consequence of the breach and [the buyer's] subsequent legal actions. Regarding the legal fees in particular, [the seller] was forced to defend a

> state court action and seek shelter in bankruptcy under Chapter 11 only after [the buyer] refused to close on the transaction.

Short Clove, *supra*, at 29. *But see ISTI Delaware*, *supra*, at 15 (which found that the liquidated damages clause precluded recovery of consequential damages resulting from a failure to satisfy the seller's mortgage, a foreclosure and a failing business because they were not foreseeable); *Curtin v. Ogborn*, 394 N.E.2d 593, 598–99 (Ill. App. Ct. 1979) (which affirmed the lower court's award of liquidated damages but reversed the lower court's award of $150 of attorneys' fees incurred by the seller when "the property was sold to another party and [the seller] had to pay attorney's fees for the drafting of the contract" because it amounted to an additional recovery for actual damages).

As another possible example, consider the practice of a builder/seller making alterations to a home at the buyer's request between the date of the purchase contract and the closing. At least one court has held that a liquidated damages clause did not preclude recovery for damages resulting from the failure to pay for the cost of such requested alterations. *Trapp v. Barley*, 897 S.W.2d 159, 166 (Mo. Ct. App. 1995) ("Because [the sellers'] liquidated damages and 'extra construction cost' damages remedied different injuries, they were not duplicative. Therefore, the trial court did not err in awarding both liquidated and actual damages to [the sellers]." (citations omitted)). But, in *Trapp*, the obligation to pay for "extras" was separate from the obligation to pay the purchase price (so it did not involve additional damages *from the same breach*). What if the purchase contract had added the cost of "extras" to the purchase price so that those damages did result *from the same breach* (i.e., failure to pay the purchase price)? In that event, should the multiple injury exception apply?

Further research may be necessary to get a sense of the lines of demarcation that separate recoverable from non-recoverable additional damages resulting from a buyer's failure to close (and the lines may be different in different jurisdictions). Unfortunately, the picture may be further clouded by inconsistent terminology as to, and confusion surrounding, the various types of damages involved. *See, e.g.*, Glenn D. West, *Consequential Damages Redux: An Updated Study of the Ubiquitous and Problematic "Excluded Losses" Provision in Private Company Acquisition Agreements*, 70 BUS. LAW. 971 (Fall 2015); Glenn D. West & Sara G. Duran, *Reassessing the "Consequences" of Consequential Damage Waivers in Acquisition Agreements*, 63 BUS. LAW. 777 (May 2008).

3.2 **Sum vs. Minimum**. Setting aside the multiple injury exception discussed above, when analyzing decisions indicating that a party may not collect actual damages in addition to liquidated damages for the same breach, it may be helpful to distinguish between using liquidated damages to operate (in effect) as:

- a fixed amount that is added to the actual damages (the *sum* approach); and
- a minimum amount of damages (the *minimum* approach).

3.2.1 *Sum Approach*. The *sum* approach (which would give the seller the sum of the liquidated damages amount *plus* the entire amount of actual damages) is unlikely to be enforceable. *See, e.g.*, 3 FARNSWORTH ON CONTRACTS § 12.18a, at 319 (3d ed. 2004; 2017-3 cum. supp.) ("[A]void what in restaurant parlance would be called a 'cover charge'—a sum that is to be

added to actual damages. Logically there is no way that such an addition can be rationalized as part of a reasonable forecast of damages." (footnote omitted)).

3.2.2 *Minimum*. The *minimum* approach (which would effectively give the seller the sum of the liquidated damages *plus* only the portion, if any, of actual damages in excess of the liquidated damages) may appear less objectionable (because it does not necessarily lead to a recovery of more than the seller's actual damages). However, the concept of a minimum has been rejected not only by some courts refusing to enforce optional liquidated damages (*see, e.g.*, *Grossinger*, *supra*, at 1347 and *Jarro*, *supra*, at 426, each of which characterized an optional liquidated damages provision as fixing a minimum that permits the seller to have its cake and eat it too), but also by some courts willing to enforce optional liquidated damages provisions (*see, e.g.*, *Sheffield v. Paul T. Stone, Inc.*, 98 F.2d 250, 252 (D.C. Cir. 1938), noting in dicta that the sellers could not be permitted to make their choice after they know which is greater).

On the other hand, some courts may appear to have allowed a *minimum* approach (as to excess actual damages beyond forfeited payments) in the context of installment land contracts (discussed in 2.5.1 above) with a liquidated damages clause or the common law forfeiture rule (discussed in 2.5.2 above), especially in older cases involving both contexts where a defaulting buyer abandons the property. (The reference to excess actual damages above is intended to mean the amount, if any, by which the contract price exceeds the sum of (x) the payments made by the buyer and (y) the market value of the property at the time of the breach; or equivalently, the amount, if any, by which outstanding balance of the contract exceeds the market value of the property at the time of the breach.) *See, e.g.*:

- *Reiter*, *supra*, at 372 (an installment land contract case stating that "[t]he rule for the measure of damages applicable here is . . . the difference between the unpaid balance of the principal and the market value of the property at the time of the breach." (citations omitted)); Robert Isham, *The Default Clause in the Installment Land Contract*, 42 MONT. L. REV. 110, 115 (1981) ("[T]he vendor may sue on the default. His damages are computed as the full contract price minus the market value of the land at the date of the default and any payment received." (footnote omitted)); and

- *In re Berlin & Denmar Distribs.*, *supra* ("[U]nless the vendor has elected to accept the deposit as liquidated damages and as its exclusive remedy, the vendor may recover the difference between the contract price and the market value of the property at the time of the breach, less any deposits paid by the purchaser." (citations omitted)); *Royer v. Carter*, 233 P.2d 539 (Cal. 1951) (seller in a declining market allowed to retain the deposit under a forfeiture provision (which applied at the option of the seller) as a setoff against actual damages).

However, further research is required to confirm whether, when and where the *minimum* approach has actually been permissible: the *minimum* approach is not established by the mere right to the excess actual damages not covered by the deposit *when the actual damages are more*; the seller must also have the right to the entire deposit *when the actual damages are less*. In many jurisdictions, a defaulting buyer may be entitled a refund of the portion of the deposit to the extent it exceeds the seller's actual damages. *See, e.g.*, 4 A.L.R. 4th 993, *supra*. Indeed, in the same year that Justice Traynor rendered the *Royer* decision noted above, he authored the opinion in *Freedman*

v. The Rector, 230 P.2d 629 (Cal. 1951), which held that a willfully defaulting buyer was entitled to restitution of the deposit to the extent it exceeded the seller's actual damages.

4. If the Seller May Choose Liquidated Damages or Actual Damages, but Not Both, When Must It Decide?

The purchase contract in *Ravenstar* specified when the election must be made: the seller was required to make (and the seller apparently made) a decision within 30 days of the expiration of the buyer's cure period. *Ravenstar*, *supra*, at 554.

But what if the purchase contract does not establish the timing of the election? The answer to this question may not be clear because courts will often find that the seller has made an election by its actions. *See, e.g.*, *Phillips*, *supra*, at 594 (election established by amendments to purchase contract and release of deposit to the seller: "Thus, although the amendments [which made the earnest money non-refundable and immediately available to the seller without restriction] did not specifically state that making the earnest money non-refundable was an advance election of remedies, when [the seller] availed himself of the earnest money, he foreclosed his ability to pursue actual damages." (citation omitted)); *Sheffield*, *supra*, at 252 (finding that sellers elected actual damages by letter to buyer indicating that sellers were going to offer the house for sale and hold the buyer liable for costs of sale and damages resulting from the breach); 39 A.L.R. 5th 33, *supra*, at *2 ("Even where the language of the contract is optional, a vendor may be restricted to recovery of the stipulated sum or actual damages, which may be less than the stipulated sum, where his actions following the purchaser's default evidence an election of his remedy."). However, some jurisdictions may be less willing to find an election before one is expressly made. *See, e.g.*, *Noble*, *supra*, at 287 ("[The buyer] also argues that [the seller] elected to sue for liquidated damages in his complaint, precluding him from seeking other relief. In [the seller's] complaint he pleaded in the alternative for specific performance, liquidated damages, or actual damages. This is permissible, and no election was made.").

But if the election is made (or may be made) after the actual damages are known, then the liquidated damages clause would appear to operate (or at least could be made to operate) as setting a *minimum*, which could doom the fate of the clause, as discussed in the answer to question 3 above.

For example, in *Grossinger* (which invalidated a liquidated damages clause, as discussed in 2.2 above), the seller had apparently sold the property to another buyer for an additional $1,250,000 profit before it amended its complaint to establish its election to seek only liquidated damages (and not pursue actual damages). *See Grossinger*, *supra*, at 1340–41 and 1347. That timing made it easy for the *Grossinger* court to conclude that "[i]n essence, such an optional liquidated damages provision fixes a minimum . . . ." *Id.* at 1347. The court in *Lefemine* also appears to assume that the liquidated damages clause, as written, would have allowed the seller to exercise its option after the actual damages were known: "if the actual damages are less than the liquidated sum, . . . the seller will take the deposit . . . ." *Lefemine*, *supra*, at 330.

In cases allowing optional liquidated damages, the timing of the election may also have been crucial. One court indicated in dicta that the election must be made before the actual damages are determined:

> [The sellers] cannot be permitted to make their choice between liquidated and actual damages after they have determined which are the greater; for the intent of the option clause is not to give them that advantage, but to make it unnecessary for them to ascertain actual damages.

Sheffield, *supra*, at 252. And although not expressly stated, the court in *Ravenstar* seemed to have similar sentiments. *Ravenstar*, *supra*, at 557 ("[A]t the time [seller] had to elect between remedies, the ultimate actual damages were difficult to ascertain . . . ."). The seller in *Ravenstar* presumably did not (and could not) know the actual damages with any certainty when it made its election because the seller was required to make (and apparently made) its election within 30 days after the expiration of the applicable cure period: although the property (i.e., a condominium unit in a yet-to-be constructed building) could have been sold to another buyer, as happened in *Grossinger*, any such sale would likely occur long after the 30-day election period expired and the future price would be highly speculative. *But see Noble*, *supra*, and the discussion at the end of 3.2.2 above.

5. Is There an Applicable Statute Addressing Liquidated Damages Clauses?

Some jurisdictions (e.g., California, Oklahoma and Washington) have statutes governing liquidated damages clauses in a commercial real estate purchase contract. *See, e.g.*:

- CAL. CIV. CODE § 1676 (2018) – "Except as provided in Section 1675 [relating to residential property], a provision in a contract to purchase and sell real property liquidating the damages to the seller if the buyer fails to complete the purchase of the property is valid if it satisfies the requirements of Section 1677 [imposing certain requirements, such as separate signing or initialing] and the requirements of subdivision (b) of Section 1671 [which, with certain exceptions, allows a party to invalidate the provision by establishing 'that the provision was unreasonable under the circumstances existing at the time the contract was made'].";

- 15 OKLA. STAT. § 15-215B (2018) – "A provision in a real estate sales contract, providing for the payment of an amount which shall be presumed to be the amount of damages sustained by a breach of such contract, shall be held valid and not a penalty, when such amount does not exceed five percent (5%) of the purchase price. In the event such amount exceeds five percent (5%) of the purchase price, such provision shall be held invalid and a penalty unless the party seeking to uphold the provision establishes that such amount is reasonable."; and

- WASH. REV. CODE ANN. § 64.04.005 (2018) – "(1) A provision in a written agreement for the purchase and sale of real estate which provides for liquidated damages or the forfeiture of an earnest money deposit to the seller as the seller's sole and exclusive remedy if a party fails, without legal excuse, to complete the purchase, is valid and enforceable, regardless of whether the other party incurs any actual damages. However, the amount of liquidated damages or amount of earnest money to be forfeited under this subsection may not exceed five percent of the purchase price."

But many jurisdictions do not (e.g., Florida, Illinois and New York). In the absence of an applicable statute, a court may be influenced by the Uniform Land Transactions Act § 2-516

(1986), the Restatement (Second) of Contracts §§ 356, 361 (1981), and even the Uniform Commercial Code §§ 2-718, 2-719. *See, e.g.*, Gerald Korngold, *Seller's Damages from a Defaulting Buyer of Realty: The Influence of the Uniform Land Transactions Act on the Courts*, 20 NOVA L. REV. 1069, 1070 (1996) ("ULTA, while not adopted, has been an influential authority for various courts facing novel issues of law or considering new rules to replace existing doctrine." (footnote omitted)); *Illingworth v. Bushong*, 688 P.2d 379, 390 (Or. 1984), which was a liquidated damages case involving a real estate purchase contract in which the Oregon Supreme Court said that "[i]t is true that the [corresponding UCC liquidated damages statute, as adopted in the state of Oregon] . . . applies only to contracts for the sale of goods, but we are unable to perceive any good reason for not using that same rule as the initial point of departure for analyzing the validity of provisions for liquidated damages in contracts in general" and then found guidance interpreting that statute "by resort to *Restatement (Second) of Contracts, § 356(1*)."

6. WHAT IS THE TEST FOR A VALID LIQUIDATED DAMAGES CLAUSE?

In the absence of an applicable statute, the test to determine the validity of a liquidated damages clause traditionally had (and in many jurisdictions, still has) three prongs: (1) intent; (2) uncertainty; and (3) reasonableness. As explained by CORBIN:

> Courts ritualistically list three criteria by which a valid liquidated damages clause may be distinguished from an invalid penalty clause. In order to qualify as a liquidated damages clause: first, the parties must intend to provide for damages rather than for a penalty; second, the injury caused by the breach must be uncertain or difficult to quantify; third, the sum stipulated must be a reasonable pre-estimate of the probable loss.

CORBIN, *supra*, § 58.1, at 397–98. As indicated in the answer to question 2 above, the intent prong is the relevant factor used by several courts to invalidate an optional liquidated damages clause. But "in some jurisdictions the intention of the parties . . . has been recognized as an inappropriate guide to enforceability of a stipulated damages provision" and the three-prong test has been reduced to the remaining two prongs. WILLISTON, *supra*, § 65:3, at 251, and more generally, *see id.* § 65:11. The Restatement (Second) of Contracts adopts a two-prong test (uncertainty and reasonableness). *See* RESTATEMENT, *supra*, § 356(1) and cmt. a.

Even the uncertainty prong is of debatable value; and consequently, it has been suggested that the key prong is "reasonableness." *See, e.g.*, Coopersmith, *supra*, at 272 ("In practice, the 'difficult to measure' standard has been largely assumed or ignored, and most of the cases have focused on the reasonableness of the figure." (footnote omitted)); CORBIN, *supra*, at 398 ("[T]he third criterion is generally determinative . . . ."); FARNSWORTH, *supra*, § 12.18, at 305 ("The most important of the three conditions . . . is that the stipulated sum must be 'a reasonable one' in the light of the 'presumed loss.'" (footnote omitted)); WILLISTON, *supra*, § 65:16, at 291 ("In spite of the language of many cases regarding the intention of the parties, there is now little doubt that a liquidated damages provision, in order to be given effect, must be determined to be reasonable under the circumstances . . . ." (footnotes omitted)); *but see In re Schaumburg Hotel Owner Ltd. Partnership*, 97 B.R. 943, 953 (Bankr. N.D. Ill. 1989) ("The intention of the parties is often a key determinant in enforcing a liquidated damages provision." (citation omitted)).

7. WHO HAS THE BURDEN OF PROOF?

Jurisdictions vary with respect to the allocation of the burden of proof in establishing the validity or invalidity of a liquidated damages clause. "The more widely held view appears to be that the burden is on the party seeking to invalidate a stipulated damages provision . . . ." WILLISTON, *supra*, § 65:30, at 355–56. According to CORBIN:

> The burden of proof is now generally held to be on the breaching party to establish that such a clause is a penalty rather than a clause that liquidates damages. (footnote omitted).

CORBIN, *supra*, § 58.5, at 428–29. But there are many cases that do not follow this general rule. *See, e.g.*, WILLISTON, *supra*, § 65:30, at 357 ("[O]thers take the position that the burden rests on a party seeking to enforce the provision to establish that it meets the legal tests for validity." (footnote omitted)); *American Multi-Cinema, Inc. v. Southroads, L.L.C.*, 115 F. Supp. 2d 1257, 1262 (D. Kan. 2000) ("The choice of which state's law to apply appears to be critical to the resolution of this case. Under Oklahoma law, for example, the burden would be on . . . the party seeking enforcement of the stipulated damages provision . . . . By contrast, under Missouri law, the burden is apparently on . . . the party challenging the stipulated damages provision . . . ." (citation omitted)); FRIEDMAN, *supra*, § 23:5.9, at 23-33 ("One court . . . noted the wide split of authority on whether the burden of proof of reasonableness is on plaintiff or defendant." (footnote omitted)).

8. AS OF WHEN IS "REASONABLENESS" TESTED?

There are several possible answers to the question of when "reasonableness" is to be tested:

- The generally prevailing view appears to require a *forward looking* test as of the time of the contract. *See, e.g.*, WILLISTON, *supra*, § 65:17, at 299–308 ("The more popular view is that the reasonableness of a liquidated damages clause should be determined as of the time the contract was executed, not with the benefit of hindsight." (footnote omitted)).

- It is also conceivable that a court would instead apply a *backward looking* (hindsight) test of "reasonableness" as of the time of the breach. *See, e.g.*, *id.* ("The [forward looking] approach . . . is not universally applied, though, and in a number of jurisdictions the actual loss sustained by the party seeking to invoke a stipulated damages provision are [sic] pertinent to the provision's enforceability.").

- Another possibility is to require satisfaction of *both forward looking* and *backward looking* tests. *See, e.g.*, *id.* ("In some jurisdictions it is held that a liquidated damages provision must be reasonable both in relation to the anticipated damages from the breach and the actual damages that occur therefrom." (footnote omitted)).

- And yet another possibility is to require satisfaction of *either* a *forward looking* or a *backward looking* test. *See, e.g.*, RESTATEMENT, *supra*, § 356(1) ("Damages for breach . . . may be liquidated . . . but only at an amount that is reasonable in the light of the anticipated or actual loss caused by the breach . . . .").

This question addresses when to determine "reasonableness," which is only one of the three prongs in the traditional test for validity of a liquidated damages clause discussed earlier. A related but different question (not otherwise addressed in this article) is when the "uncertainty" prong of the test for liquidated damages is to be determined. *See, e.g.*, JOSEPH M. PERILLO, CONTRACTS § 14.31(c), at 560–61 (7th ed. 2014) ("The Restatement (Second) indicates that the . . . cases [holding that a reasonable pre-estimate of harm should not be sufficient to validate a liquidated damages clause if no damage ensues] are sound because the actual loss (or absence of loss) can be readily proved. This indicates that to the restaters the difficulty of proof is to be examined at the time of trial rather than at the time of contracting. Prior law has been in conflict as to the proper moment for testing uncertainty of damages, although the prevailing view appears to have been that the proper moment is the time of contracting." (footnotes omitted)).

9. WHAT PERCENTAGE OF THE PURCHASE PRICE IS LIKELY ACCEPTABLE AS LIQUIDATED DAMAGES?

There is no hard and fast rule as to what percentage of the purchase price would establish a valid clause liquidating the damages to a seller if the buyer breaches its obligation to close the sale. As stated by POWELL:

> Where the amount designated for liquidated damages is an unusually high percentage of the total purchase price, courts have refused to recognize the liquidated damages remedy. Usually, the down payment is a modest percentage of the contract price, so courts are generally willing to approve the reasonableness of a liquidated damages remedy that is tied to the down payment. . . . Down payments up to ten percent of the price are common in many locations and have been validated by courts as an acceptable amount for liquidated damages. (footnotes omitted).

POWELL, *supra*, § 81.04[2][d], at 81-189; *see also* FRIEDMAN, *supra*, § 23:5.9, at 23-32 ("[A] provision making the down payment liquidated damages is presumably valid if the down payment is reasonable in amount. A ten percent down payment is likely to be deemed reasonable . . . ." (footnotes omitted)).

In some jurisdictions, there may be statutory safe harbors. *See, e.g.*, CAL. CIV. CODE § 1675(c) (2018) (3% for residential property); 15 OKLA. STAT. § 15-215B (2018) (5%); WASH. REV. CODE ANN. § 64.04.005 (2018) (5%). But otherwise, the results may depend on the context, including the sophistication of the parties, the nature of the transaction, and the relevant jurisdiction. And absent bad facts, many courts have been willing to enforce liquidated damages equal to a substantial portion of the purchase price. *See, e.g.*, *Valenti v. Coral Reef Shopping Center, Inc.*, 316 So. 2d 589, 592 (Fla. Dist. Ct. App. 1975) ("If damages are not readily ascertainable at the time a contract for the sale of land is drawn, a liquidated damage clause in the form of forfeiture of a deposit does not constitute a penalty, since the land sale market in Florida fluctuates from year to year and it is generally impossible to say at the time a contract for sale is drawn what the vendor's loss will be . . . . Applying these rules to the instant case, we find that the amount of the liquidated damages [7.5% of the purchase price] is reasonable and does not amount to a penalty . . . ."); *Karimi v. 401 N. Wabash Venture, LLC*, 952 N.E.2d 1278, 1288 (Ill. App. Ct. 2011) (which found a 15% deposit in a condominium purchase contract to be reasonable); *Siegel v. Levy Organization Dev. Co.*, 538 N.W.2d 715 (Ill. App. Ct. 1989) (finding liquidated damages

of 20% in a condominium purchase contract to be reasonable); *but see Vines v. Orchard Hills, Inc.*, 435 A.2d 1022, 1029 (Conn. 1980) ("The presumption of validity that attaches to a clause liquidating the seller's damages at 10 percent of the contract price in the event of the purchaser's unexcused nonperformance is, like most other presumptions, rebuttable."); CAL. CIV. CODE § 1675(c) (2018), *supra*, which shifts the burden of proof to the seller (when it is seeking to uphold the clause) if the 3% residential safe harbor is exceeded; 15 OKLA. STAT. § 15-215B (2018), *supra*, which renders a liquidated damages clause that exceeds the 5% safe harbor invalid unless the party seeking to uphold the provision establishes that the amount is reasonable; *McIlvenny v. Horton*, 302 S.W.2d 70, 72 (Ark. 1957) (refusing to enforce a liquidated damages because "the amount agreed upon (. . . 16% of the purchase price) . . . was out of all proportion to the probable damages, and . . . should be construed as a penalty and not liquidated damages.").

And some courts have been willing to allow large forfeitures of a buyer's payments (without the benefit or burden of a liquidated damages analysis). *See, e.g.*, *Johnson v. Wortzel*, 517 So. 2d 42, 43 (Fla. Dist. Ct. App. 1987) ("The law in Florida is clear that a buyer in default is not entitled to recover from the seller money paid in part performance of an executory contract, even absent a forfeiture provision in the contract. . . . The amount forfeited by the buyers represents 18.2% of the total contract, a percentage that is not sufficient to shock the conscience of the court." (citations omitted)).

Such forfeitures may be even larger in the context of installment land contracts (where the buyer was able to use the property). *See, e.g.*, *Fullmer v. Blood*, 546 P.2d 606 (Utah 1976) (court found forfeiture of more than 25% of the price was not unconscionable). But, as suggested in 2.5 above, in the context of a typical purchase contract with a liquidated damages clause, it may be confusing (if not dangerous) to apply (or rely upon) the common law forfeiture rule, especially as it has been applied to installment land contracts. In *Fullmer*, the court reached its conclusion in light of the fact that the buyer had possession of the property and annual 6% interest on the purchase price over the term of the contract would have amounted to more than 23% of the price. *Fullmer*, *supra*, at 609–10; *see also* DOBBS, *supra*, § 12.12(1), at 310 ("Even if these forfeiture provisions would not survive the scrutiny given to ordinary liquidated damages clauses, they are ordinarily upheld as valid, at least as long as the earnest money represents a moderate percentage of the purchase price." (footnotes omitted)). Moreover, the law relating to forfeitures under land installment land contracts is far from a model of clarity. *See, e.g.*, Eric T. Freyfogle, *Vagueness and the Rule of Law: Reconsidering Installment Land Contract Forfeitures*, 1988 DUKE L.J. 609, 610 (1988) ("The law of installment land contract forfeitures is amazingly muddled . . . ."); POWELL, *supra*, 84D.03.

10. ARE ACTUAL DAMAGES RELEVANT FOR LIQUIDATED DAMAGES AND, IN PARTICULAR, WILL LIQUIDATED DAMAGES BE ALLOWED WHEN THERE ARE NO ACTUAL DAMAGES?

The applicable test for the validity of liquidated damages should determine whether *actual* damages are relevant. In the context of the traditional three-prong test, the answer may follow from the time as of which the reasonableness or uncertainty prong of the test is to be determined:

- to the extent a determination is made as of the time of the breach (i.e., using a *backward looking* test), actual damages would appear to be relevant; and

- if only *forward looking* tests are applied, actual damages would appear to be irrelevant.

The view that actual damages should be irrelevant may also be supported by the notion that the purpose (or at least one of the purposes) of a liquidated damages clause is to avoid the need to establish actual damages. *See, e.g.*, *Peterson v. McAndrew*, 125 A.3d 241, 255–56 (Conn. App. Ct. 2015) (quoting an earlier case: "[t]he very purpose for which [liquidated damages] provisions are sustained is to obviate the difficulties of [proof of actual damage] . . . ." (citations omitted; brackets in original)); WILLISTON, *supra*, § 65:1, at 230 ("one 'purpose of a liquidated damages provision is to obviate the need for the nonbreaching party to prove actual damages.'" (footnote omitted)); § 65:3, at 249 (in the case of a valid liquidated damages clause, "the purpose of the contract provision [may be] merely to obviate the need for the nonbreaching party to prove actual damages . . . ." (footnote omitted)); § 65:13, at 285 (quoting a New Jersey court: "'[Liquidated damages clauses] avoid the uncertainty, delay, and expense of using the judicial process to determine actual damages.'"); and § 65:30, at 357 (describing a Utah case: "Furthermore, the court noted, requiring the nonbreaching party to defend the enforceability of a stipulated damages provision would have the effect of defeating its major purpose: '[T]he purpose of a liquidated damages provision is to obviate the need for the nonbreaching party to prove actual damages.'").

As noted in the answer to question 8 above, often, if not usually, courts appear to use *forward looking* tests, and therefore, *actual* damages may generally be irrelevant. According to POWELL, this appears to be the general rule in the context of a commercial real estate purchase contract when the value of the property increases after the breach:

> If it later turns out that the seller has no actual damages because the value of the property has risen, that fact does not negate the availability of the liquidated damages remedy, as long as the amount specified as liquidated damages was not unreasonable at the time the parties entered into their agreement. (footnote omitted).

POWELL, *supra*, § 81.04[2][d], at 81-189. But some courts may be unwilling to award liquidated damages in a transaction where there are no *actual* damages:

> Courts have reached differing conclusions on the effect of the enforceability of forfeiture provisions in contracts for the sale and purchase of property where the value of the property rose . . . with the result that the seller was able to [sell] to another purchaser at a higher price. Some courts have held such provisions unenforceable, on the basis that in such circumstances no actual loss occurred, or that the profitable sale rendered the forfeiture amount unreasonable, while others have enforced the provisions . . . . (footnotes omitted).

WILLISTON, *supra*, § 65:27, at 341–42. *See also* RESTATEMENT, *supra*, § 356(1) cmt. b ("If, to take an extreme case, it is clear that no loss at all has occurred, a provision fixing a substantial sum as damages is unenforceable.").

11. IS MITIGATION RELEVANT FOR LIQUIDATED DAMAGES?

If actual damages are relevant (which, as discussed above, appears to be the case when a *backward looking* test is applied), then it would seem that mitigation principles should apply. But

if actual damages are not relevant, then one might conclude that mitigation has no place in the analysis:

> Since the effect of a stipulated damages provision is to substitute a predetermined amount for actual damages sustained by the party entitled to relief, the existence of an enforceable liquidated damages provision has the effect of making the mitigation of damages irrelevant. (footnote omitted).

WILLISTON, *supra*, § 65:31, at 364. *See also* PERILLO, *supra*, § 14.31(c), at 561 n.423 ("The majority of cases, do not deduct for mitigation.").

In particular, it may seem extremely unlikely that mitigation could be relevant in the context of a typical liquidated damages clause in a commercial real estate purchase contract (unless a court is testing the validity of the liquidated damages clause based on the actual damages that occur). Yet it has happened. In several cases involving a liquidated damages clause giving the seller the right to retain the amount of the deposit that was "paid," the seller was not allowed to obtain the liquidated damages amount it failed to collect (either by drawing down a letter of credit or receiving cash). *See, e.g.*, *Newcastle Properties, Inc. v. Shalowitz*, 582 N.E.2d 1165, 1171 (Ill. App. Ct. 1991) ("If plaintiff had mitigated its damages by presenting the letter of credit, [the amount of the letter of credit] would have been 'theretofore paid' and 'retained.' Having failed to present the letter of credit, plaintiff is not entitled to an award of [liquidated damages in the amount of the letter of credit]."); *see also Brown v. Real Estate Res. Mgmt., LLC (In re Polo Builders, Inc.)*, 388 B.R. 338, 364 (Bankr. N.D. III. 2008) (liquidated damages were not collectible under a clause stating that "seller may . . . receive the Earnest Money as liquidated damages," because the earnest money was not "received."). One might think that these cases involve unusual facts. But does the typical purchase contract clearly define the liquidated damages as the amount *to be* or *required to be* deposited? And is it uncommon for a purchase contract to define the *Deposit* to be an amount equal to a small initial deposit and *if paid*, a much larger additional deposit? (And even if liquidated damages were defined to include not only the amounts paid but also the amounts required to be paid, what good would it do if the buyer is a shell entity, as is often the case?) Admittedly, these cases could have been avoided by including provisions addressing the consequences of not funding the deposit, but they are nonetheless examples of a potential need to *mitigate* in the most fundamental way: by making sure the deposit is paid.

It may even be necessary to take mitigation principles into account in order to satisfy a *forward looking* "reasonableness" test. *See, e.g.*, FARNSWORTH, *supra*, § 12.18, at 316–17 ("[I]f the parties stipulate damages according to a formula that takes reasonable account of [the policy that mitigation serves by discouraging wasteful activity], the stipulation will be upheld." (footnote omitted)). For example, if a seller has a backup offer for $100X less than the purchase price that will stay in effect through the anticipated closing date, then it may be unreasonable to provide for liquidated damages that exceed the sum of $100X plus a reasonable estimate of the additional costs of proceeding with a second transaction and a reasonable amount to account for the possibility that second buyer defaults.

12. IS A "SHOTGUN" LIQUIDATED DAMAGES CLAUSE ENFORCEABLE?

Under a "Shotgun" liquidated damages clause, a party has the right to liquidated damages for *any* default by the other party, whether or not material. Such clauses may not reflect a

reasonable determination of the damages expected to result from a breach. As explained by WILLISTON:

> Generally, courts . . . take the position that, where potential [actual] damages from a breach of various covenants differ in amount, one stipulated fixed sum of liquidated damages cannot be construed as a reasonable approximation of compensation for breach of each covenant, and is generally construed instead as a penalty. (footnotes omitted).

WILLISTON, *supra*, § 65:18, at 309; *see also* PERILLO, *supra*, § 14.32, at 561–62; *XCO Int'l, Inc. v. Pac. Sci. Co.*, 369 F.3d 998, 1004 (7th Cir. 2004), in which Judge Posner observes: "One can see the problem: if a contract provides that breaches of different gravity shall be sanctioned with equal severity, it is highly likely that the sanction specified for the mildest breach is a penalty (that, or the sanctions for all the other possible breaches must be inadequate)."

For example, in *Alexander v. Steining*, 398 S.E.2d 390, 392 (Ga. Ct. App. 1990), a lease-option agreement provided that the entire earnest money deposit would be retained by seller "[i]n the event of a default by [p]urchaser under the terms of this lease or the agreement for Purchase and Sale of Real Estate . . . ." (second brackets in original). The court found this clause to be a penalty based in part on the rule that a stipulation for the payment of a fixed, unvarying sum, upon the breach of any of several promises of varying degrees of importance will be construed as a penalty. *See id.* at 392–94; *see also GK Dev., Inc. v. Iowa Malls Fin. Corp.*, 3 N.E.3d 804, 823 (Ill. App. Ct. 2013) (which involved the treatment of a holdback, rather than a deposit, as liquidated damages in a real estate purchase contract; quoting an earlier case, the court said: "The element common to most liquidated damages clauses that get struck down as penalty clauses is that they specify the same damages regardless of the severity of the breach." (citations omitted)).

WILLISTON notes the following potential exceptions to this general rule:

- Partial Application: "[S]ome courts also take the position that, where a general liquidated damages clause appears in a contract with several clauses of varying importance, the clause will be held applicable and be deemed enforceable only with respect to material breaches." (footnote omitted); WILLISTON, *supra*, § 65:18, at 309–10. Alternatively, such a provision might be tested only as to the applicable breach and "the fact that the provision is unenforceable with respect to one clause is not by itself determinative of whether it is enforceable with respect to [another]." *Id.* at 310.

- Integrated Application: "[I]t has been said that '[t]he general rule that a liquidated damages clause is a penalty if applied to several independent covenants of varying importance does not apply . . . where the covenants are really interdependent and call for acts with one primary purpose.'" (footnote omitted). *Id.*

The author does not recall any cases implementing these exceptions in the context of a commercial real estate purchase contract giving the seller the right to the deposit as liquidated damages if the buyer breaches any of its obligations under the purchase contract. However, the author has encountered several cases involving a shotgun liquidated damages clause that was enforced (and not disputed on the basis that it was a shotgun clause). *See, e.g.*, *Siegel*, *supra*, in

which a shotgun liquidated damages clause in a condominium purchase agreement was honored with no discussion of the shotgun issue.

13. DOES A LIQUIDATED DAMAGES CLAUSE PRECLUDE RECOVERY OF ATTORNEYS' FEES BY THE SELLER?

If the seller is entitled to and elects to obtain liquidated damages for the buyer's failure to close, then, as discussed in the answer to question 3, the seller may not be entitled to recover any additional amount of actual damages for that breach. For example, a court may refuse to allow a seller to recover, in addition to retaining the deposit as liquidated damages, the attorneys' fees incurred by seller in preparing for, negotiating, documenting and closing the sale to the buyer or a sale to a replacement buyer. *See, e.g.*, *Short Clove*, *supra* (questioning the additional recovery of transactional attorneys' fees in aborted sale); *Curtin*, *supra* (refusing to allow the additional recovery of transactional attorneys' fees in subsequent sale).

But what about attorneys' fees incurred in litigation to recover (or retain) the liquidated damages? Sometimes, a liquidated damages clause will fix the amount of such attorneys' fees in the event of a breach. *See, e.g.*, WILLISTON, *supra*, § 65:23. While this approach may be taken in some promissory notes and other documents (*see, e.g.*, *Dalston Constr. Corp. v. Wallace*, 214 N.Y.S.2d 191 (Nassau Dist. Ct. 1960), involving a homeowner construction contract that provided for counsel fees equal to 10% of the contract price), the author has not encountered such a clause in a commercial real estate purchase contract. Instead, in the author's experience, the parties to a commercial real estate purchase contract often include a clause giving the prevailing party the right to attorneys' fees and other collection costs if there is litigation associated with the contract. The collection costs of the seller in seeking the deposit do not necessarily flow from a breach of the buyer's obligation to purchase. They arise only if the buyer resists the payment to (or retention by) the seller of the liquidated damages. In this context, it appears that an attorneys' fees clause may be enforced despite the presence and application of a liquidated damages clause. *See, e.g.*, *Paragon Group v. Ampleman*, 878 S.W.2d 878, 882 (Mo. Ct. App. 1994) ("[L]iquidated damages are merely a replacement for recovery of actual damages, a stipulation of actual damages. However, expenses of litigation and attorney's fees are generally not recoverable as actual damages. Any recovery of attorney's fees is solely based on statute or contract. In this case, the lease provided for recovery of . . . attorney's fees in the event of any breach by Tenant. . . . We find no error in allowing recovery for both liquidated damages and attorney's fees as provided in the lease." (citations omitted)); *Zlotoff v. Tucker*, 154 Cal. App. 3d 988 (1984) (court affirmed award of liquidated damages plus attorneys' fees in dispute relating to a real estate purchase contract); FARNSWORTH, *supra*, § 12.18, at 316 ("[A] provision allowing the injured party to recover attorney's fees and other legal expenses in addition to damages will be sustained . . . ." (footnote omitted)); *but see McEnroe v. Morgan*, 678 P.2d 595, 602 (Idaho Ct. App. 1984) (which included the "Attorney fees incurred in this action" as part of the "Total of actual damages" and stated "where such attorney fees and costs are found to be part of the liquidated damages which the seller is permitted to retain, then they cannot also be awarded against the defaulting purchaser as part of a money judgment for damages.").

CONCLUSION

Liquidated damages routinely appear in commercial real estate purchase contracts as a remedy of the seller for the buyer's breach of its obligation to purchase. A prudent attorney will

typically check for any applicable special statutory requirements (*e.g.*, Cal. Civ. Code § 1677(a) requires separate signatures or initials) and statutory safe harbors (*e.g.*, 15 Okla. Stat. § 15-215B (2018) and Wash. Rev. Code Ann. § 64.04.005 (2018) allow for deposits of up to 5%). And in many, if not most, jurisdictions, attorneys (or the forms they use) include self-serving language intended to convince the reader that the parties have satisfied any relevant intent, uncertainty and reasonableness requirements. Otherwise, real estate transactional lawyers may rarely think about the variations in different states in the treatment of liquidated damages for a buyer's breach of its obligation to purchase. The *Ravenstar* case is a useful reminder that liquidated damages and their treatment may differ materially depending on the relevant jurisdiction.

By answering the questions above for various jurisdictions, the Acquisitions Committee hopes to gain a better understanding of the relevant liquidated damages law and particularly the treatment of optional liquidated damages. In the meantime, the following preliminary conclusions may be worth noting:

- **Local Counsel**. It should go without saying, but it may be worth repeating: local counsel should always be engaged if counsel is not licensed in the relevant jurisdiction. Any questions regarding liquidated damages should be discussed with local counsel.

- **Test for Validity; Possible Safe Harbor; Burden of Proof**. When drafting a commercial real estate purchase contract, counsel for buyer and seller will want to (a) understand the relevant requirements for a valid liquidated damages clause and make sure these requirements are satisfied (to the extent they can be satisfied at the time the contract is signed), (b) determine whether their clients want to take advantage of any applicable safe harbor, and (c) understand who will have the burden of proof if the liquidated damages clause is challenged.

- **Exclusive Remedy**. The buyer's counsel will generally want the contract to state that the right to liquidated damages is the sole remedy for the buyer's breach of its obligation to purchase (to eliminate, not only the seller's right to specifically enforce the contract, but also any right the seller may have to seek actual damages). If the seller agrees to such an exclusive remedy approach, then the seller's counsel may want to make clear that the liquidated damages clause does not preclude: (a) any right the seller may have to collect its attorneys' fees if it goes to court to collect (or retain) the deposit; and (b) any other rights of the seller that expressly survive a termination of the purchase contract.

- **Non-Exclusive Remedy**. If the buyer is willing to give the seller a non-exclusive right to obtain liquidated damages (whether there is an alternative remedy to sue for actual damages or specifically enforce the contract, or both), then the seller's counsel may want: (a) to confirm that the clause is enforceable in the relevant jurisdiction (recognizing that either or both alternative remedies may not be available); (b) to make the clause clear and in particular to address the timing and terms of the seller's election and what happens to the deposit pending the election (to avoid having missing terms determined by implication and to avoid enforcement issues in jurisdictions that disfavor a *minimum* approach); and (c) to ensure that there is credit standing behind the obligation to pay actual damages or to complete

the purchase, as applicable (especially if, as is often the case, the buyer is a special purpose entity with no assets other than the deposit).

- **Addressing Nonpayment of Deposit**. Several cases mentioned in the answer to question 11 above involved a failure to pay the deposit that effectively eliminated the right to collect liquidated damages. To avoid this problem, counsel will want to address the consequences of nonpayment:
    - Does the purchase contract terminate (either at the election of the seller or automatically)?
    - If the seller has a right to terminate, is that right extinguished if payment is made before the right is exercised?
    - If the contract is terminated by reason of a failure to pay, is the seller entitled to all or a portion of the payments already made? If so, is that right addressed in the liquidated damages clause?
- **Scope of Clause; Shotgun Clauses**. Counsel should understand what the liquidated damages clause covers and what it does not cover. In particular, assuming the seller and buyer want the liquidated damages clause to be enforceable, then both seller's counsel and buyer's counsel may want to avoid having the clause apply to more than a breach of the buyer's obligation to purchase.

Whether our committee will achieve further clarity on this subject remains to be seen. The law regarding liquidated damages is confusing. And in the context of real estate purchase contracts, it is further complicated by the law regarding a seller's right to the payments of a defaulting purchaser and the law regarding installment land contracts. While buyers may generally want the comfort of a liquidated damages clause that is reasonable in amount and exclusive, they may not always get what they want. And while sellers may also want a liquidated damages clause (to avoid the burden of proving damages), whether they can also get and enforce alternative remedies may depend not only on their bargaining power, but also on the relevant governing law. In any event, as evidenced by the *Ravenstar* case, real estate practitioners may encounter, and will therefore want to understand, varying types of liquidated damages clauses. Consequently, a better understanding of liquidated damages in general and optional liquidated damages in particular may be worth pursuing.

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*** Stevens A. Carey** is a member of the ACREL Acquisitions Committee that was formed earlier this year. This article is not intended to provide legal advice. The author thanks Miranda Stuart and Krista Dyer for their research assistance, John Cauble and Kaleb Keller for providing comments on prior drafts of this article, and Miranda Stuart, Krista Dyer and Tim Durkin for cite checking. The views expressed (which may vary depending on the context) are not necessarily those of the individuals mentioned above, Pircher, Nichols & Meeks LLP, ACREL or the Acquisitions Committee. Any errors are those of the author.