

PUBLICATION

Specific Performance: The Importance of a Clear Liquidated Damage Provision

January 3, 2007

In representing developers of real estate, one of the jobs we perform is the preparation of a Contract of Purchase and Sale that provides, in the event of a Buyer default, a liquidated damage clause; i.e., a provision that the earnest money shall be forfeited as liquidated damages to the Seller as Seller's "sole and exclusive remedy". In order to be effective, the provision must be clear that Seller's remedies are solely limited to the liquidated damages. If the provision is not clear, the Courts might allow Seller to seek other remedies including unlimited damages and/or specific performance.

In a recent case in Alabama, *Conner v. Auburn Partners, L.L.C.*, 852 So.2d 755 (2002), the Court of Civil Appeals reviewed the following default section of a Contract of Purchase and stated:

"In the current case, Section 12(a) of the contract gives the Seller "the right to terminate this Agreement by notifying purchaser thereof, in which event Escrow Agent shall deliver the Earnest Money to Seller and neither party hereto shall have any further rights or obligations hereunder."

At first glance, that seems to be a good liquidated damage clause. But, the Court held that the provision was permissive in nature. The Seller might terminate the Contract and accept the Earnest Money, but was not expressly precluded from seeking other remedies. In this case the Seller declared he was ready, willing and able to complete the transaction and sought specific performance against Buyer. The trial court granted summary judgment for the purchaser (developer). However, the Court of Civil Appeals concluded that the trial court erred when it entered summary judgment for the purchaser and sent the case back to the trial judge.

In this case, Buyer was a developer who used the contract form provided by a broker. The liquidated damage clause in the contract seemed to provide the protection the developer needed, but the protection contained in the poorly drafted provision was illusory, and the Court concluded that specific performance was an available remedy to the Seller.

The liquidated damage clause in the Contract of Purchase is absolutely critical to a developer. Too many things can go wrong after the due diligence period is over – failure to obtain permits, moratorium of some utility service, loss of critical anchor tenant, inability to obtain financing, death or disability of developer, etc. The developer must have the ability to walk away from the Contract losing only his earnest money. He cannot risk being subject to a claim for specific performance.

We have offices in Alabama, Georgia, Louisiana, Mississippi and Tennessee. Our lawyers in each of those States have explored the law relating to liquidated damages and specific performance. See below for a short analysis of the law with respect to each of those states. Generally, if a liquidated damage provision is carefully drawn, is a reasonable pre-estimate of the damages to be incurred by the breach and is not in the nature of a penalty, it should be enforced by the Courts. However, if the liquidated damage provision is defective and the purchaser breaches his obligations to close the purchase, he may face a claim for damages and/or a claim for specific performance.

We urge you to call us at the inception of the development in order that we might participate with you in the preparation of the Contract of Purchase and Sale. It is particularly important to review carefully the liquidated

damage clause if your offer is cast on a broker form of contract. We'll also be happy to assist you in the review or preparation of your form contracts.

In Georgia, a liquidated damages provision will be enforced if the liquidated damages amount contained in the contract, at the time the sales contract is executed, is a reasonable pre-estimate of the probable damages to be incurred by the breach and is not in the nature of a penalty. Since liquidated damages would be deemed an adequate remedy at law, Georgia would not allow the seller to pursue a specific performance remedy against the developer. However, if the liquidated damages provision is missing or is not as described above, the courts may decree specific performance provided the other pertinent terms of the contract are definite and specific. The developer would be wise to spend a little time determining the liquidated damages.

Mississippi law holds that specific performance is available as a remedy to a seller if a buyer defaults under a real estate purchase transaction. Although, "[m]ost specific performance cases arising from breached land sale contracts are seller's breach cases...the law well recognizes that the seller as well may have a specific performance remedy." *Osborne v. Bullins*, 549 So.2d 1337, 1340 (Miss. 1989). However, the remedy of specific performance can be avoided in Mississippi through the use of a properly drafted liquidated damages clause. The provision should clearly state that (a) the parties recognize the difficulty of evaluating the actual damages that would result from a breach; (b) the liquidated damages are considered by both parties to be reasonable in amount; (c) the liquidated damages will constitute the seller's sole remedy; and (d) the liquidated damages are intended strictly as compensation to the seller and not as a penalty to the buyer.

In Louisiana, liquidated damages are known as stipulated damages. Pursuant to La. C.C. art. 2005, parties may stipulate the damages to be recovered in case of non-performance, defective performance, or delay in performance of an obligation. An obligee may demand either the stipulated damages or performance of the principle obligation, but he may not demand both unless the damages have been stipulated for mere delay. See La. C.C. art. 2007. The stipulated damages may not be modified by the court unless they are so manifestly unreasonable as to be contrary to public policy. See La. C.C. art. 2012. Sellers should also take notice of the designation of a deposit as "earnest money" pursuant to La. C.C. art. 2624 as it may have the unintended consequence of limiting the stipulated damages recovery even if a greater amount is provided for elsewhere in the contract. Nevertheless, in Louisiana, the remedy of specific performance can be avoided through the use of a properly drafted liquidated damages clause. The provision, as in Mississippi should clearly state, at a minimum, that (a) the parties recognize the difficulty of evaluating the actual damages that would result from a breach; (b) the stipulated damages are considered by both parties to be reasonable in amount; (c) the stipulated damages will constitute the Seller's sole and exclusive remedy; and (d) the liquidated damages are intended strictly as compensation to the seller and not as a penalty to the Buyer. It is also advised to include a clause whereby the seller waives any and all rights to pursue specific performance and any other damages, such as consequential damages or lost profits.

Tennessee recognizes that the parties to a contract may stipulate an amount of liquidated damages, but if the stipulated sum amounts to a penalty, it will not be enforced. If actual damages are difficult to measure, the stipulated amount demonstrates a reasonable estimate of potential damages, and reflects the parties intention to compensate in the event of a breach, as opposed to punishment for a breach, the provision will be upheld. Tennessee recognizes that specific performance of a contract to sell real estate may be asserted against the buyer or seller of real estate, but the right to specific performance on the sale of real estate is not a matter of right. A court will decide if a seller is entitled to specific performance based on whether a contract is clear, definite, complete and free from any fraud or unfairness, the hardships on the party and whether damages are inadequate. While there is no court decision on point, if a contract clearly provides that stipulated damages are the sole remedy for a breach, it would be reasonable to anticipate that such a provision would be upheld.