

GAR FORMS **UPDATE**

CHANGES *to the*
LIQUIDATED
DAMAGES PROVISION



A RECENT COURT DECISION CAUSED THE GAR FORMS COMMITTEE TO MODIFY ITS LIQUIDATED DAMAGES PROVISION IN ALL OF ITS PURCHASE AND SALE AGREEMENTS EFFECTIVE IMMEDIATELY. AMONG OTHER THINGS, THE GAR LIQUIDATED DAMAGES PROVISION WAS CHALLENGED AS BEING AN ILLEGAL PENALTY, AND THE COURT AGREED. WHILE THE DECISION WAS A SUPERIOR COURT DECISION RATHER THAN AN APPELLATE DECISION, THE FORMS COMMITTEE DECIDED TO GO AHEAD AND CHANGE THE PROVISION BECAUSE THERE IS SOUND APPELLATE CASE LAW IN SUPPORT OF THE POSITION ARTICULATED BY THE TRIAL COURT. LET'S REVIEW THE CASE AND THE CHANGES WHICH THE GAR FORMS COMMITTEE MADE IN RESPONSE TO THE CASE.

{ THE CASE }

In the case of *Peachtree Road Realty Associates, LLC v. Rosen Custom Homes, LLC, et. Al*, the buyer paid \$25,000 in earnest money and agreed to pay an additional \$25,000, which was not paid. Both the buyer and the seller claimed that the other party breached the purchase and sale agreement and eventually the broker holding the earnest money filed an interpleader action and deposited the \$25,000 into the registry of the court. In striking down the liquidated damages provision as a penalty, the judge found a number of appellate cases to support its position. The most significant of these cases was *Southeastern Land Fund, Inc. v. Real Estate World*, 237 Ga. 227 (1976). In that case, the real estate contract provided that if the purchaser defaulted, the seller could retain the earnest money and additional earnest money as partial liquidated damages and pursue any and all other legal remedies.

In that case, the buyer paid \$5,000 in cash as earnest money and gave a promissory note for \$45,000 for the additional earnest money. The buyer defaulted and the seller sued to collect on the \$45,000 note. The buyer argued that the partial liquidated damages clause was a penalty and the Supreme Court of Georgia ultimately agreed. The Court first explained that for liquidated damages provisions to be enforceable: (1) the actual damages must be difficult or impossible to accurately estimate;

(2) the parties must intend to provide for liquidated damages rather than for a penalty; and (3) the sum stipulated must be a reasonable pre-estimate of the probable loss.

Additionally, the court stated that implicit in the concept of liquidated damages is that the liquidated damages will be the sole damages in the event of a default. A non-breaching party who has agreed to accept liquidated damages cannot elect after a breach to pursue actual damages. As the court saw it, the liquidated damages is a pre-agreement on the final damages to which a party may be entitled. It becomes both the minimum and the maximum that the non-breaching party can collect.

The judge in the Superior Court case stated that since the seller had a choice as to whether to accept the earnest money as liquidated damages or reject the earnest money and sue the buyer for damages meant that the liquidated damages was not the minimum and maximum that the seller could collect, and thus was not really liquidated damages. In other words, for a liquidated damages clause to be enforceable, it must be a specific pre-agreement of the parties as to what the final damages of a party will get in the event one or both of them breach the contract. The parties are then bound to stick to the agreement. Since the Court found the liquidated damages provision to be a penalty, the buyer was able to recover the \$5,000 in earnest money the buyer originally paid and also did not have to pay the \$45,000 the buyer had given in a promissory note.

{ REVISIONS }

In light of the Court's decision and the existing case law support for the Court's decision, the GAR Forms Committee voted to change its forms so that the seller no longer has a choice of remedies to pursue in the event of a breach of the contract by the buyer. Instead, if the buyer breaches the contract, the seller only gets the buyer's earnest money as liquidated damages. Specifically, the new language is as follows:

Revised Liquidated Damages Provision

Remedies of Seller: IN THE EVENT THIS AGREEMENT FAILS TO CLOSE DUE TO THE DEFAULT OF BUYER, SELLER'S SOLE REMEDY SHALL BE TO RETAIN THE EARNEST MONEY AS FULL LIQUIDATED DAMAGES. SELLER EXPRESSLY WAIVES ANY RIGHT TO ASSERT A CLAIM FOR SPECIFIC PERFORMANCE. THE PARTIES EXPRESSLY AGREE THAT

THE EARNEST MONEY IS A REASONABLE PRE-ESTIMATE OF SELLER'S ACTUAL DAMAGES, WHICH DAMAGES THE PARTIES AGREE ARE DIFFICULT TO ASCERTAIN. THE PARTIES EXPRESSLY INTEND FOR THE EARNEST MONEY TO SERVE AS LIQUIDATED DAMAGES AND NOT AS A PENALTY.

What if the seller does not want the earnest money and wants to sue for damages? Without changing the GAR contract, the seller will be stuck. Of course, even under the present language, while some sellers might threaten to sue the buyer if the buyer breaches the contract, few ever do. With the market favoring sellers, most sellers simply take the earnest money, terminate their contracts and get their houses back on the market as quickly as possible.

If a seller wanted an alternative to keeping the earnest money, most would likely still opt for liquidated damages but would simply try to negotiate for a larger amount of liquidated damages than the earnest money in the contract. So, for example, the seller might want to include a special stipulation similar to the following:

SAMPLE STIPULATION { NO. 1 } BUYER TO PAY LARGER MONETARY SUM AS LIQUIDATED DAMAGES.

In the event the transaction fails to close due to the breach of the contract by the Buyer, the Buyer agrees to pay the Seller liquidated damages of \$50,000 [or whatever sum is negotiated for buy the Seller]. All parties agree that Seller's actual damages in this situation are difficult to estimate and the above sum is a reasonable pre-estimate of Seller's actual damages. All parties expressly intend this sum to be liquidated damages and not a penalty. In the event the Closing does not occur due to a breach by the Buyer, the earnest money paid to the Holder shall be applied against the liquidated damages owing from the Buyer to Seller.

Of course, rather than including a special stipulation to increase the amount of liquidated damages, a better solution is for sellers to simply demand that larger amounts of earnest money be paid by buyers. Expect that the amount of earnest money demanded by sellers will likely increase as sellers come to understand that the earnest money is all that they get in the event of a buyer breach of the contract.

If the seller does not want liquidated damages, the seller can add in a general damages clause. An example of such a provision is set forth here:

SAMPLE STIPULATION { NO. 2 }

SELLER MAY PURSUE BUYER FOR DAMAGES.

In the event of a breach of this Agreement by Buyer, Seller shall have the right to pursue any remedy available at law or in equity. This special stipulation is expressly intended to replace the liquidated damages provision contained elsewhere in this Agreement.

{ NO LIQUIDATION DAMAGES }

It should be noted that while the GAR Contract has always had a liquidated damages provision in the event of a breach by a buyer, it has never had a companion liquidated damages clause in the event of a breach of the contract by the seller. The rationale for this is that giving money to the buyer in the event of seller breach would do little to satisfy a buyer wanting the home. Moreover, such a provision would likely lead to sellers simply terminating existing purchase and sale contracts if better offers came along. However, if a seller wants to include such a provision in his or her purchase and sale agreement, a sample of such a provision is set forth below. The particular provision gives the buyer back their money, plus has the seller giving them back an additional \$1,000. If all the buyer gets is the buyer's earnest money back, with no additional payment, it is unclear whether it constitutes a liquidated damages provision because no damages are actually being paid.

SAMPLE STIPULATION { NO. 3 }

LIQUIDATED DAMAGES PROVISION IN THE EVENT OF A SELLER BREACH.

In the event this Agreement fails to close due to the default of Seller, Buyer's sole remedy shall be the return of Buyer's earnest money and any other sums being held by Holder plus \$1,000 paid by the Seller to the Buyer as full liquidated damages. Buyer expressly waives any right to assert a claim for specific performance. The parties expressly agree that the return of the earnest money plus the \$1,000 is a reasonable pre-estimate of Buyer's actual damages, which damages are difficult to ascertain. The parties expressly intend for the return of the earnest money plus the payment of \$1,000 from the Seller to the Buyer shall serve as liquidated damages and not as a penalty. This type of provision should never be used in a builder contract since it likely violates the Federal Interstate Land Sale Act.

The GAR Forms Committee regularly monitors court cases in Georgia to see how these cases affect our GAR Forms. When our GAR Forms are challenged in court, we are quick to defend them. In cases where the GAR Forms Committee concludes that the Form is vulnerable to attack on an issue, we are equally quick to revise the Form to try to eliminate the vulnerability. This is what the Forms Committee did in modifying our liquidated damages provision.

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