LIQUIDATED DAMAGES IN THE NATION'S CAPITAL

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Purchase agreements in the District of Columbia — particularly for residential properties — often purport to give the seller an option of remedies if the buyer fails to perform. For example:

> [T]he deposit herein provided for may be forfeited at the option of the seller, in which event the purchaser shall be relieved from further liability hereunder, or, without forfeiting the said deposit, the seller may avail himself of any legal or equitable rights which he may have under this contract.

Sheffield v. Paul T. Stone, Inc., 98 F.2d 250, 251 (D.C. Cir. 1938). The plain text gives the seller the best of three worlds; the seller can either keep the buyer's earnest money deposit or pursue legal or equitable remedies.

It will shock you to learn that buyers and sellers over the years have disagreed on how these clauses should be enforced. On the one hand, some buyers have argued that sellers should not be allowed to retain the earnest money deposit at all (particularly where the seller went on to sell the property for the same price or more). Other buyers have argued that the seller must refund the deposit immediately if the seller intends to seek legal or equitable damages. On the other hand, sellers have argued that they should be allowed to "wait and see" whether they are able to resell the property, and for how much, before electing a remedy (i.e., electing the liquidated damages option only if it exceeds the amount of their actual damages).

Courts in the District have relied primarily on three basic principles to determine the seller's damages when a buyer walks away in breach of a purchase agreement:

1. Look to the plain text of the contract to determine the intent of the parties.
2. Liquidated damages may be enforceable, particularly where traditional justifications exist.
3. Penalty clauses are generally unenforceable.

To help fill in the details of how these principles actually play out in the District, the ACREL Acquisitions Committee posed 13 questions about how D.C. courts approach remedy-options clauses. Here's what we found.

1. Are liquidated damages an exclusive remedy or may the seller also pursue specific performance?

D.C. courts will attempt to enforce the intent of the contracting parties and will look to the terms of the contract to determine whether liquidated damages are intended to be an exclusive remedy. See Barnette v. Sayers, 289 F. 567, 569 (D.C. 1923) ("'The question always is, what did the parties intend by the language used?'… [I]f the intent of the parties can be ascertained from the contract, it should be enforced." (quoting United States v. Bethlehem Steel Co., 205 U.S. 105, 119 (1907)); accord Vicki Bagley Realty, Inc. v. Laufer, 482 A.2d 359, 367 (D.C. 1984). In the context of liquidated damages, this principle is generally consistent with Powell on Real Property, which would allow parties to contract for liquidated damages as a non-exclusive remedy. See § 81.04 ("The mere fact that there is a liquidated damages provision does not necessarily force a party to forego the specific performance remedy."). And while D.C. courts have not explicitly endorsed Powell on this point, sympathy for the Powell rule can nonetheless be inferred from several holdings. For example, the D.C. Circuit in Sheffield (one of the more frequently cited cases on the issue) observed that:

> When plaintiffs' breach [occurred] two alternative remedies, apart from a suit for *specific performance,* were open to defendants: (1) to "forfeit" the deposit, i.e. to retain it as *liquidated damages*

> and call the deal off; (2) to establish the actual damages by selling the house to third persons, and hold plaintiffs for the damages so established.

98 F.2d at 252 (emphasis added); see also Rowe v. Shehyn, 192 F. Supp. 428, 431–32 (D.D.C 1961) (discussing Sheffield); In re Cooper, 273 B.R. 297, 304 (Bankr. D.D.C. 2002) (same). Accordingly, D.C. courts have enforced damages clauses that offer the non-breaching party the option to choose among other remedies, e.g., Barnette, 289 F. at 569, and have not held that liquidated damages are an inherently exclusive remedy.

It should be noted, however, that D.C. courts have sent mixed messages regarding the availability of specific performance as an equitable remedy for a buyer's breach of a real estate purchase agreement. In older cases, the D.C. Court of Appeals implied that a seller could pursue specific performance against a breaching buyer as a matter of course (e.g., Sheffield, 98 F.2d at 252 (1938)). But more recently, the court observed, in dicta, that because a buyer's breach "would be fairly compensable by monetary damages," a seller does not have a "corresponding right to require specific performance of the contemplated transaction." Stanford Hotels Corp. v. Potomac Creek Assocs., L.P., 18 A.3d 725, 740 n.11 (D.C. 2011) (citing Kesler v. Marshall, 792 N.E.2d 893, 896–97 (Ind. Ct. App. 2003)). Given the preference of D.C. courts for enforcing the intent of the parties, it is possible, but not certain, that a contract explicitly granting the seller the option of specific performance or liquidated damages would be enforced on its terms—subject to certain limiting principles discussed in the sections below.

2. Are liquidated damages an exclusive damage remedy or may the seller have an enforceable option to pursue liquidated damages or actual damages?

Parties may contract for an enforceable option to pursue liquidated damages or actual damages. D.C. courts have ruled on a series of cases involving substantially similar clauses in property sale contracts giving the seller the option to either retain the buyer's deposit as liquidated damages, or pursue any other available legal or equitable rights, such as actual damages. E.g., Sheffield, 98 F.2d 250; Barnette, 289 F. 567; Rowe, 192 F. Supp. 428.

3. If a seller has an option to choose liquidated damages or actual damages, may it have both?

Enforcing contracts with clauses that give the seller the right to choose liquidated damages or actual damages, D.C. courts have awarded liquidated damages or actual damages, but not both. E.g., Sheffield, 98 F.2d 250; Barnette, 289 F. 567.

Courts look to the words and actions of the non-breaching party to identify which remedy the non-breaching party has elected. For example, after the buyer in Sheffield failed to consummate the purchase, the seller sent a letter informing buyer of its intent to resell the house and hold buyer liable for any shortfall (i.e., actual damages). Seller then resold the house (at a higher price), and was not permitted to keep buyer's deposit as liquidated damages.

4. If a seller may choose liquidated damages or actual damages, but not both, when must it decide?

D.C. courts have attempted to discourage sellers from taking a "wait and see" approach—instead looking to the seller's actions following the breach to determine whether or not seller has elected liquidated damages:

> [Sellers] cannot be permitted to make their choice between liquidated and actual damages after they have determined which are 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, 98 F.2d at 252 (enforcing a contract with a liquidated damages "option"). This reasoning is also consistent with one of the core justifications for liquidated damages (i.e., reducing the burden on the non-breaching party where damages will be difficult to prove or ascertain). If the seller is allowed to sell the property to another buyer and then elect liquidated damages (that is, if liquidated damages are greater than seller's actual shortfall in the subsequent sale) then the liquidated damages clause looks more like a penalty than an attempt to ensure a fair and efficient outcome.

Despite this reasoning, the Sheffield court also emphasized that seller's retention of the deposit following buyer's breach does not, in and of itself, signal that the seller has opted for liquidated damages. The Sheffield court stated that the seller could be entitled to retain the deposit as an offset against actual damages

sustained. This approach would seem to encourage a seller to retain the deposit while it weighs its options, without committing itself to one course or the other until it has a sense of whether the liquidated damages or actual damages will be greater. To avoid this incentive, the parties can contract for a limited duration liquidated damages option, forcing the seller to elect one variety of damages over the other within a certain amount of time. E.g., Vicki Bagley Realty, 482 A.2d at 367 (the contract at issue here provided that in order to pursue a legal or equitable remedy, as opposed to forfeit of the deposit, seller must notify buyer within 30 days after buyer's breach).

5. Is there an applicable statute addressing liquidated damages clauses?

There is not a generally applicable statute governing liquidated damages in real estate transactions. Nonetheless, D.C.'s codification of the UCC reflects some of the same core principles on liquidated damages that guide courts in the context of real estate transactions:

> Damages for breach by either party may be liquidated in the agreement but only at an amount which is reasonable in the light of the anticipated or actual harm caused by the breach, the difficulties of proof of loss, and the inconvenience or nonfeasibility of otherwise obtaining an adequate remedy. A term fixing unreasonably large liquidated damages is void as a penalty.

D.C. Code § 28:2-718. The UCC diverges from the case law, however, by judging reasonableness *either* prospectively (i.e., the "anticipated" harm at the time of the agreement) *or* retrospectively (i.e., the "actual" harm caused by the breach). By contrast, the courts have construed liquidated damages clauses "as of the date of [] execution." See Question 8, below.

6. What is the test for a valid liquidated damages clause?

D.C. courts have discussed certain criteria that tend to support the finding of an enforceable liquidated damages clause, as opposed to an unenforceable "penalty." E.g., Vicki Bagley Realty, 482 A.2d at 367-68. First and foremost, "[u]ncertainty in amount and difficulty of ascertainment of damages," support the validity of a liquidated damages clause. Barnette, 289 F. at 570; accord District of Columbia v. Harlan & Hollingsworth Co., 30 App. D.C. 270, 279 (1908); Emack v. Campbell, 14 App. D.C. 186, 194-95 (1899). Conversely, "agreements to pay fixed sums plainly without reasonable relation to any probable damage which may follow a breach will not be enforced." Vicki Bagley Realty, 482 A.2d at 368 n.22 (quoting Burns v. Hanover Ins. Co., 454 A.2d 325, 327 (D.C. 1982)).

7. Who has the burden of proof?

We have not seen any discussion of a departure from the generally applicable burden of proof in the context of liquidated damages.

8. As of when is "reasonableness" tested?

In evaluating a liquidated damages clause, "the contract must be construed as of the date of its execution." Barnette, 289 F. at 570; accord Schwartz v. Rettger, 83 A.2d 279, 280 (D.C. 1951) (citing Davy v. Crawford, 147 F.2d 574 (D.C. Cir. 1945)).

9. What percentage of the purchase price is likely acceptable as liquidated damages?

The purchase price may be relevant to the validity of a liquidated damages clause, but there does not appear to be a bright line numeric formula. The D.C. Court of Appeals has cited the "often applied" rule as follows: "[I]f the amount claimed to be liquidated damages is *disproportionate to the entire consideration of the contract*, some inference may arise that it was not intended in the contract to provide for such damages." Barnette, 289 F. at 570 (emphasis added).

10. Are actual damages relevant for liquidated damages and, in particular, will liquidated damages be allowed when there are no actual damages?

To the extent that the liquidated damages clause is "construed as of the date of its execution," Barnette, 289 F. 567 at 570, actual damages would seem to be irrelevant. Thus, the fact that a seller may have eventually recouped its loss and sustained no actual damages should "not [be] taken into consideration." Id.

11. Is mitigation relevant for liquidated damages?

To the extent that actual damages are not relevant to a court's enforcement of a liquidated damages clause, then a party's attempt (or lack thereof) to mitigate its damages would also seem to be irrelevant. However, the terms of a certain contract might explicitly assign either or both parties an affirmative duty to mitigate

their damages. Where both a liquidated damages clause and a mitigation of damages clause operate in the same contract, the D.C. District Court has reconciled the two as follows:

> [T]o reconcile the clauses, the court interprets the liquidated-damages clause to apply only when the seller is unable to resell the property. Papago [Tribal Util. Auth. v. Fed. Energy Regulatory Comm'n, , 610 F.2d 914, 929 D.C. Cir. 1979]. In other words, the defendant must use its best efforts to resell the property and upon doing so, the defendant shall remit to the plaintiffs any portion of the deposit not needed to make it whole. Id. If, however, the defendant is unable to resell the property, the liquidated-damages clause applies, allowing the defendant to retain the plaintiffs' entire deposit. Id. This construction of the termination agreement sacrifices neither clause on the altar of the other but rather assures the functionality of both.

Shulman v. Voyou, L.L.C., 251 F. Supp. 2d 166, 169 (D.D.C. 2003).

12. Is a "Shotgun Liquidated Damages Clause" enforceable?

We have not seen any discussion of shotgun liquidated damages clauses under District of Columbia law.

13. Does a liquidated damages clause preclude recovery of attorneys' fees by the seller?

Where the parties have contracted for the breaching party to pay the non-breaching party's legal expenses, D.C. law permits the non-breaching party to collect such costs in addition to liquidated damages. For example, in Swanson v. Martins, 232 F. Supp. 3d 23, 26 (D.D.C. 2017), the "contract provided that, if one party breaches the agreement and the other 'retains legal counsel to enforce its rights' under the contract, the non-breaching party 'shall be entitled to recover…all of its reasonable Legal Expenses incurred in enforcing its rights under this Agreement.'" The court held that Plaintiff was entitled to attorneys' fees as well as liquidated damages.