Liquidated damages in a P&S

By Roger T. Manwaring

A real estate purchase and sale agreement almost always provides that if the buyer fails to fulfill his or her obligations, all deposits shall be retained by the seller as liquidated damages and that this shall be the seller's sole and exclusive remedy at law or in equity.

But are the seller's damages always limited to the deposit? What if the deposit is unreasonably small in comparison to the sale price, or the seller's claims against the buyer arise not from the buyer's breach of the sales contract, but from the buyer's intentional wrongdoing or breach of tort duties which exist independently of the P&S? In these circumstances the seller may be entitled to damages exceeding the deposit.

Suppose that the owner of a commercial property enters into negotiations to sell the property to a corporation that currently occupies the property under a lease. The owner is not a sophisticated businessperson, having acquired the property by inheritance and having little other commercial experience.

After the initial lease term expires, the owner/lessor continues to accept the same rent on a month-to-month basis, even though the lease provides that the tenant corporation must pay extra rent if it holds over after expiration of the initial term. He does so because he expects to recoup any lost rent in the proceeds from the eventual sale. The negotiations continue for years and lead to the execution of a P&S which lists a purchase price of $2.2 million but requires a deposit of only $1,000. The closing is to occur one year from the date of the P&S. In preparation for the sale of the building, the owner/lessor spends $100,000 on repairs necessary to make the building saleable.

After the closing date in the P&S is extended for a number of additional years, during which the corporation continues to pay reduced rent, the corporation notifies the owner/lessor that it intends to move elsewhere and will not complete its purchase of the building. The P&S contains a liquidated damages provision limiting the seller's damages if the buyer "fails to fulfill buyer's agreements herein" to the amount of the deposit.

Liquidated damages provisions are usually enforced.

A liquidated damages provision in a P&S will usually be enforced as long as, at the time the contract was executed, actual damages were hard to predict and the amount of liquidated damages was a reasonable prediction of the actual damages which might result from breach of the contract. In *NPS, LLC v. Minihane*, 451 Mass. 417 (2008), the Supreme Judicial Court explained that "Whether a liquidated damages provision in a contract is an unenforceable penalty is a question of law [and] the burden of showing that a liquidated damages provision ...." *Id.* at 419-20.

A liquidated damages provision "should be enforced, so long as it is not so disproportionate to anticipated damages as to constitute a penalty." *Id.* at 420. To be enforceable, a liquidated damages provision must satisfy two requirements: "first, that at the time of contracting the actual damages flowing from a breach were difficult to ascertain; and second, that the sum agreed on as liquidated damages represents a 'reasonable forecast of damages expected to occur in the event of a breach.'" *Id.* The NPS Court noted that because there is no "bright line" separating a valid liquidated damages provision from which functions as a penalty, the facts of each case must be examined. *Id.*

Is a liquidated damages provision an unenforceable penalty where the deposit is unreasonably small in comparison to the purchase price?

In the hypothetical outlined above, $1,000 in liquidated damages represents only 0.045 percent of the purchase price, which the seller would have received had the contract been performed. Can the seller argue that the liquidated damages provision is an unenforceable penalty because the amount of the damages specified is unreasonably and

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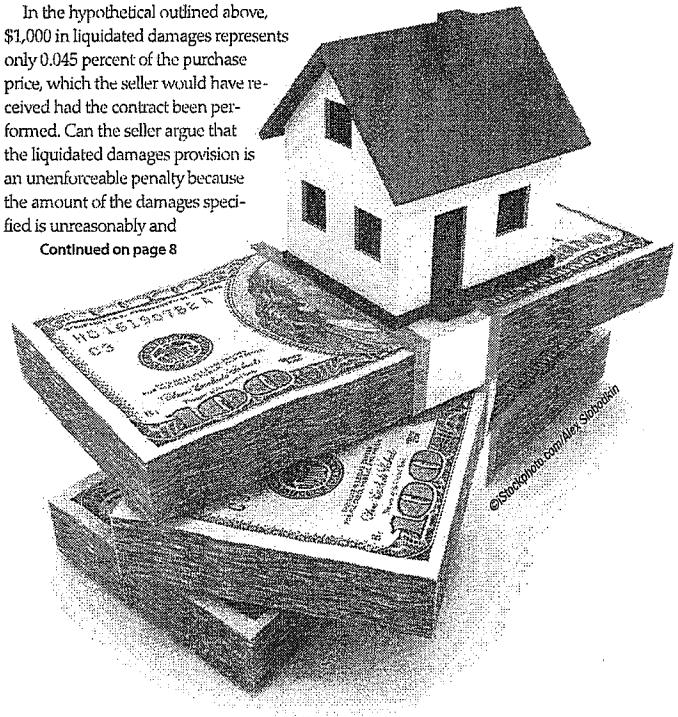

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Moving forward, giving back

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to continue to grow our organization in all directions.

To that end, I have begun speaking to various bar associations in all parts of Massachusetts and will continue to do so during the coming year. I want MATA members to know they belong to an inclusive organization that recognizes the different needs and areas of interest to individual members, and we will work to meet those needs and interests.

As we move forward I would also like to continue our great tradition of giving back to our community. In past years, MATA has donated to a number of charities, including The Inn-Between, a crisis home for women and children, The Italian Home for Children and The Home for Little Wanderers. For the past 20 years, MATA has made large contributions of toys to the U.S. Marines' "Toys for Tots" program during every holiday season. A committee of young lawyers that I chaired began the original "Toys for Tots" program for MATA and I am thrilled that it has continued each year. It speaks to the commitment of MATA members and their belief in helping others.

Last year MATA began what I believe is an important tradition in giving a percentage of the profits from two MATA events to worthwhile charities. The MATA Annual Holiday Celebration donated some of the event proceeds to a group that provides much-needed medical care for people in the remote villages of Nicaragua.

The MATA 2010 Golf Tournament donated some of its proceeds to the New England U.S.O., which helps families of people currently serving in the military. I believe both events were enhanced by the decision to donate some of the proceeds to a charity and I think it is essential for MATA to continue to do so.

I am proud that we as trial lawyers believe in giving back — in all aspects of life. As MATA moves forward I think we must continue to view giving back a part of who we are and what we do every day. As trial lawyers we work to keep people safe, help those who have suffered harm and give consumers a voice in the courthouse.

As an organization, I believe that it is critical that we continue defining who we are by both looking forward to the future and giving back to those in need. I am proud that my colleagues have honored me by electing me to be the president of MATA. I look forward to working with the MATA leadership, staff, members, other bar associations and our com-

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disproportionately low in comparison with the damages which the parties should have anticipated the seller would suffer (the loss of the payment of the sale price)?

The answer is not entirely clear. The 1st U.S. Circuit Court of Appeals recently indicated that under Massachusetts law, a liquidated damages provision can be challenged as an unenforceable penalty on the ground that it underestimates actual damages. In *Kunelius v. Town of Stow*, 2009 WL 3720925 (1st Cir. 2009), the deposit was about 2 percent of the purchase price. The court noted that it was far less than the 5 percent, which Massachusetts courts have held to be reasonable as a matter of law. 2009 WL 3720925, *12.

While acknowledging that the weight of authority rejected such an argument, the court noted that both the SJC in *Kelly v. Marx*, 428 Mass. 877 (1999), and the Massachusetts Appeals Court in *Howard v. Wee*, 61 Mass. App. Ct. 912 (2004), had left open the possibility that a liquidated damages provision could be set aside for underestimating actual damages. 2009 WL 3720925, *12. Although the *Kunelius* court ultimately held that the argument had been waived in the case before it, it clearly believed that the argument was a viable one. 2009 WL 3720925, *12.

The *Kunelius* court acknowledged that the Appeals Court in *Howard* held that a deposit of $1,000 on a purchase price of $480,000 (2.08 percent) was reasonable and a liquidated damages provision was, therefore, enforceable. According to the court in *Kunelius*, however, the *Howard* Court had stressed that the deposit in that case was only meant to cover a period of 11 days. In *Howard*, although the court held $1,000 in liquidated damages was not "unreasonably low under the circumstances," it appeared to accept the possibility that, under appropriate circumstances, liquidated damages could be so low as to be unenforceable under Kelly.

In the hypothetical situation outlined above, the deposit was intended to cover a period of up to one year. Further, the $1,000 deposit in this case represented a far smaller percentage (0.045) of the sale price than the deposit in *Howard*. It would be difficult to argue that this deposit was a "reasonable forecast of damages expected to occur in the event of a breach."

Thus, the seller may have a viable argument that the liquidated damages provision is unenforceable and that he is entitled to recover actual damages on all of his claims. But see *NASCO, Inc. v. Public Storage, Inc.*, 1995 WL 337072 (D. Mass. 5/20/95) (holding that a liquidated damages provision can only be a penalty when it is an overestimate of actual damages, not when the liquidated damages are too low).

If the liquidated damages provision in the P&S is not a penalty, it may still be unconscionable and therefore unenforceable.

Even if a liquidated damages provision is not a penalty, it may still be unconscionable under the circumstances. In *NASCO*, the U.S. District Court for the District of Massachusetts adopted the opinion of a U.S. Magistrate who noted, that "Under Massachusetts law, unconscionability may be raised as a defense to the enforcement of a contract or any of its clauses ... If the contract involves the sale of goods, the unconscionability provision of the [UCC] will apply directly; if it does not, the same provision will apply by analogy." 1995 WL 337072, * 4. The comment to §2-718 of the UCC, concerning liquidated damages, provides,

> a term fixing unreasonably large liquidated damages is expressly made void as a penalty. An unreasonably small amount would be subject to similar criticism and might be stricken under the section on unconscionable contracts or clauses [UCC 2-302] (Emphasis added).

The NASCO court, reviewing Massachusetts case law and the Massachusetts UCC, outlined factors relevant to a determination of unconscionability. "The principle is one of prevention of oppression and unfair surprise ... and not of disturbance of allocation of risks because of superior bargaining power." 1995 WL 337072, *4. After noting that "Unconscionability is to be determined as a matter of law" (*Id.*) and "is to be determined as of the time of the making of the contract," (*Id.*) the court listed factors affecting whether a contract is unfair or oppressive:

> In determining whether a practice is unfair or oppressive, the court may take into account a myriad of factors, such as the commercial sophistication of the party claiming unconscionability; whether such party was represented by counsel; whether the clause was obscure or buried in fine print, or, conversely, whether it was out on the table and the subject of active negotiation; the frequency with which clauses of the type challenged are used in analogous situations; whether the relationship between the parties was arms length or quasi-fiduciary; whether there was a gross disparity between the value of the consideration given and received; and whether the party seeking to enforce the challenged provision took unfair advantage of the other party's weakness, vulnerability, or dependency, or used unfair or improper means to place the other party in such position.

1995 WL 337072, *4-5. (Emphasis added). See also: *Waters v. Min. Ltd.*, 412 Mass. 64 (1992), *Zapatha v. Dairy Mart, Inc.*, 381 Mass. 284 (1980); *NaviSite, Inc. v. Cloonan*, 2005 WL 1528903, *8-9 (Mass. Super. 5/11/05); *Sosik v. Albin Marine, Inc.*, 16 Mass. L. Rptr. 398, 2003 WL 21500516, *7 (Mass. Super. 2003).

As the foregoing quotation indicates, whether a liquidated damages provisions is unconscionable will depend on the unique facts of each case.

In our hypothetical, the seller was not a sophisticated business person and it might be argued that the type of liquidated damages clause appearing in the P&S is not frequently used. Although its language is common, the extremely small amount of the liquidated damages provided is unusual. Similarly, the seller might argue that there was "a gross disparity between the value of the consideration given and received," in that the $1,000 deposit is grossly insufficient as liquidated damages given that the sale was to be for $2.2 million and the deposit and was not to occur for up to one year. If the seller was not represented by counsel when negotiating the P&S, that would further support a finding of unconscionability, as would a finding that the parties never discussed or negotiated the liquidated damages provision.

Even if a liquidated damages provision is enforceable, it arguably does not preclude the seller from bringing suit for breach of a tort or statutory duty owed by the buyer to the seller independent of the P&S contract.

Even if a liquidated damages provision is valid and enforceable, it arguably does not bar all claims by the seller against the non-performing buyer. A seller can reasonably argue that the liquidated damages provision limits only the recovery of damages on claims arising from the buyer's breach of the contractual duty to perform. The seller could further argue that a liquidated damages provision does not preclude or limit claims based on breaches of duties owed by the buyer (the corporation in our hypothetical) to the seller independent of the contract.

Under such an interpretation, the seller in our hypothetical could sue the corporation for fraudulent misrepresentations, breach of fiduciary duty, other tortuous conduct, or a tort-based violation of 93A (breach of a statutory duty), so long as the elements of those claims were otherwise established.

The conclusion that a liquidated damages provision governs only contract-based claims is supported by the language of the provision itself where, as in the hypothetical, the provision purports to apply if the buyer "fails to fulfill buyer's agreements herein." Such language indicates that the liquidated damages provision applies only to claims arising from breach of contractual duties.

Massachusetts cases imply such a limitation. In two cases a party has moved to apply a liquidated damages provision only to a breach of contract claim and not to tort and 93A claims asserted in the same case. In each case, the court has done so. In one case (*NASCO*, 1995 WL 337072) the court entered partial summary judgment leaving the tort and 93A claims standing. In the other, the court applied the liquidated damages provision only to the contract claim and disposed of other claims on

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What are focus groups anyway?

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the fixes to them.

Your client has one day in court and you have one chance to present the best case for them. Wouldn't it be better if you test-drive it first? Aren't we at our best when we have the chance to practice? A focus group lets you experiment with your presentation sequence, your analogies, your themes, your sequencing, and see if your exhibits say what you want them to.

Focus groups let you get a "dry run" on your case. Focus groups give you the chance to lose without a real jury so that you can find your landmines and fix them before they come to light in the jury room. Wouldn't you rather hear about a problem with your case while you still have the chance to fix it?

5) The case will probably settle

Let's face it: Most cases end in settlements. Attorneys often believe that they don't need to conduct focus groups because the case will settle. But doing focus groups two weeks before trial is probably two weeks too late. It is equally as important to learn about your case to prepare for settlement conferences as it is for trial. It is imperative to learn the catch phrases that jurors use to describe your case so that you can incorporate them into your deposition questions. And how about learning what a jury really thinks of the opposing side's case and explaining that at a settlement conference? You will always have the upper hand when you truly understand what a jury thinks of the entire case.

6) I had a professional prepare my exhibits

Studies show that lawyers spend hundreds of hours working on a case to get it prepared for trial: writing and practicing an opening statement, crafting the killer cross-examination. Yet lawyers often spend little time thinking about and creating the exhibits we use to explain the case, or, even worse, delegate the task to someone who does not know the case well.

Focus groups can describe what they want to see and critique exhibits with a "fresh eye." Focus groups will always help tweak the exhibits you have started so that they are the best they can be and send the right message to the jury.

7) I already have the "smoking gun" discovery

Too often, we have heard focus group participants ask for specific testimony or documents that they believe they need to determine the case or award significant damages and the lawyers don't have it. Why? Because they waited until discovery was closed before running a focus group. In any significant case, focus groups should be conducted while there is still time to send out discovery requests or lock in deposition testimony. Focus groups conducted during the pre-trial phase provide the opportunity to send discovery requests to the opposing side, obtain the documents and information that is important to the jury's decision and ask the right questions at depositions.

8) I know my case better than anyone

Except maybe the opposing counsel, because they are running focus groups. The fact is, you don't know what you don't know. During recent focus groups, the lawyer told us that he learned more about his case in the two focus groups we ran than he had with his experts during the entire pre-trial phase. Focus group participants say some amazing things and every time, it is a surprise to find out what they think.

Issues that we think are important or will be easily handled at trial may not be so clear to the focus group. Discussions of things we think are irrelevant (alcohol usage, or lack thereof, in a car crash case is one example) often are raised within minutes of the focus group deliberations. Questions or assumptions about routine documents like a police report are not so routine to focus group members. Much of the pre-trial phase is spent trying to obtain and learn the information in possession of the other side. Interrogatories are sent, depositions are taken, documents are reviewed and analyzed. Why would we then fail to conduct focus groups and allow the other side to be the only one with the knowledge? To create a level playing field, you must learn what the other side knows, and the other side knows to run focus groups.

9) That evidence will never come in

Maybe, maybe not. But sometimes you find out you want it in so you can explain it to the jury, as opposed to having the jury make up an answer you don't like. In a recent case, the lawyer wanted to exclude facts concerning why the client was in prison. It was evidence that clearly could be kept out. But we found out that the "juror" reasons for him being in jail were a lot worse than the real reasons. When the focus group was presented with the real reasons, they were less harsh on the plaintiff. In fact, some felt sorry for him. You need to know how to handle these issues and the other points that you think will never come into evidence but that the jury wants to know about. Questions left unanswered are problems for you.

10) I've been doing it this way forever

Times change. What worked 10 years ago doesn't work today. Jurors have biases and attitudes, including personal responsibility, anti-plaintiff, suspicion, anti-lawyer and "stuff happens." We need to use focus groups to find out how to use these biases and attitudes in our favor, not against us. Psychology plays a major role in decision making. By hearing the psychology of the focus group "juror" we can structure and sequence our case for the real juror.

Conclusion

The bottom line is that focus groups should be run so that you know the best way to present your case to the people that really matter most: the jury. Focus groups should be run before discovery is started and before structuring your trial presentation. That way, you will know who they want to hear from, what they want to see and what the "juror" proof is. Only then are you ready to win in today's climate.

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other grounds. *Carroll v. Barberry Homes, Inc.*, 1999 WL 1204020 (Mass. Super. 10/22/99).

In addition, language from two other Massachusetts cases implies that a liquidated damages provision, even when it purports to provide the vendor's sole remedy, limits only the vendor's contract based claims, and has no effect on claims based on non-contractual duties. In 24 Mass. L. Rptr. 487, 2008 WL 4635856 (Mass. Super. 9/30/08), the court held that a liquidated damages provision in a real estate offer to purchase precluded the vendors claims for violation of c.93A and breach of the covenant of good faith and fair dealing. The court essentially held that the vendor could not evade the liquidated damages provision by expressing its contract claims in non-contractual language: "Genesis gave up its right to seek damages in excess of the amount of the deposit, and attempting to use non-contractual language in its claims does not change the fact that the agreed-upon sole and exclusive remedy is liquidated damages." *Id.* at *2.

The implication is that if the claims had been for an independent wrong, not simply for non-performance of the contract, the liquidated damages provision would not have applied to them. See also *Showstead v. Holzman*, 2004 WL 1109820, *2 (Mass. Super. 4/7/04) (holding that claims for estoppel and breach of the covenant of good faith and fair dealing arose from the contract and were barred by liquidated damages provision. "The seller cannot circumvent [the liquidated damages provision] by calling his breach of contract action by a different name").

Courts from other jurisdictions have been more explicit.

In *Kona Hawaiian Assoc. v. The Pacific Group*, 680 F.Supp. 1438 (D. Hawaii. 1988), the court stated:

> Finally, KHA asserts that, if in effect and enforceable, the liquidated damages clause precludes a suit for damages only on the contract causes of action. Here, KHA is correct. The clause is unambiguous and waives damages for breach of contract. A waiver of the parties' right to recover for the torts of negligent or intentional misrepresentation cannot be inferred absent some evidence supporting that interpretation ...
>
> Accordingly, the liquidated damages clause prohibits KHA from recovering damages in excess of $400,000 for its breach of contract claim only. The tort causes of action remain unaffected as to the damages actually incurred after the date of any misrepresentation or omissions which can be proven at trial.

Id. at 1450. (Emphasis added).

In *HGN Corp. v. Chamberlain, Hrdlicka, White, Johnson & Williams*, 642 F.Supp. 1443 (N. D. Ill. 1986), the court held that a lender, having recovered liquidated damages under a loan agreement, was not precluded from also recovering tort damages for fraud: "HGN can recover the entire loss occasioned by the Firm-Farrell fraud. That measure of damages is not automatically controlled by Agreement's liquidated damages provision ..." *Id.* at 1450-51. (Emphasis added). *Id.* at 187-88. (Emphasis added, footnote references omitted). See also *Lewis v. Methodist Hospital, Inc.*, 326 F.3d 851, 854 (7th Cir. 2003) (citing *Better Foods, infra*, for the proposition that one cannot avoid a liquidated damages clause merely by casting a suit for breach of contract as a tort claim); *Johnson v. Orkin Exterminating Co., Inc.*, 746 F.Supp. 627, 631-32 (E. D. La. 1990) (same); *Fireman's Fund Ins. Co. v. Morse Signal Devices*, 151 Cal. App. 681, 198 Cal. Rptr. 756 (1984) (same); *Better Foods Markets, Inc. v. American Dist. Tel. Co.*, 40 Cal.2d 179, 253 P. 2d 10 (1953); *Orkin Exterminating Co. of South Fla. v. Clark*, 253 So. 2d 884, 885 (Fla. App. 3 Dist., 1971) (same); *Lenny's, Inc. v. Allied Sign Erectors, Inc.*, 170 Ga.App.706, 318 S.E.2d 140 (1984); *Woodhull Corp. v. Saibaba Corp.*, 234 Ga.App. 707, 712-13, 507 S.E.2d 493, 497-98 (1998) (liquidated damages provision prevented plaintiff from recovering in tort any damages he could have recovered in contract, but where the damages in tort and contract are not duplicative and where separate transactions supported recovery under the tort and contract theories, there could be separate recoveries); *Wells v. Stone City Bank*, 691 N.E. 2d 1246, 1249 (Ind. App. 1998) (one cannot avoid a liquidated damages clause merely by casting a suit for breach of contract as a tort claim); *Eden United, Inc. v. Short*, 653 N.E.2d 126, 132 (Ind. App. 1995) (holding that plaintiff's recovery for tortious interference should not be offset by liquidated damages obtained for breach of contract); *Bremerton Central Lions Club, Inc. v. Manke Lumber Co.*, 25 Wash. App. 1, 604 P. 2d 1325 (1979) (holding that liquidated damages clause did not bar suit for separate tort of conversion).

In our scenario, if the corporation's conduct went beyond merely breaching the P&S, and involved fraudulent misrepresentations, breach of fiduciary duty, other tortuous conduct or a tort-based violation of 93A, then the liquidated damages provision of the P&S arguably would not limit recovery on those non-contractual claims.

When faced with a P&S or other contract containing a liquidated damages provision, it is worth asking whether the liquidated damages are grossly unfair under the circumstances and, therefore, unenforceable. Even if the clause is enforceable, consideration should be given to whether the breaching party's conduct constitutes an independent tort, as well as a breach of contract. If so, the liquidated damages provision may not limit the available damages.