

# LIQUIDATED DAMAGES IN DELAWARE REAL ESTATE PURCHASE AND SALE AGREEMENTS



**ROBERT J. KRAPF** is a Director with Richards, Layton & Finger, PA, in Wilmington, Delaware. He is immediate past president of the firm, focuses his practice on a variety of transactional matters in the areas of real estate, commercial, and land use law. His clients include many of the regional and national developers, landlords, banks and other lenders, conservation organizations, institutions, businesses, and industries operating in and from Delaware. Mr. Krapf has held many leadership positions in the state and national bar and has served as a member and officer of the boards of many local, regional, and international business, charitable, and cultural organizations. He is a frequent speaker and author on topics of real estate and land use law.



**SARA T. TONER, ESQUIRE** is a Director with Richards, Layton & Finger, PA, in Wilmington, Delaware. She is chair of the firm's Real Estate Group. She focuses her practice on complex transactions involving the finance, acquisition, sale, lease, and development of commercial real estate properties. Sara has a particular emphasis on closing sophisticated commercial real estate loans, including CMBS financing, portfolio financing, and mezzanine and preferred equity transactions. She represents major real estate developers, financial institutions, significant holders of commercial real estate, and institutional clients in all types of commercial real estate transactions.

This article is for informational purposes only and is not intended to be and should not be taken as legal advice. In addition, this article is the statement by the authors only and does not necessarily reflect the views of Richards, Layton & Finger, P.A., any of its other attorneys, or its clients. Robert Krapf and Sara Toner are directors and vice-presidents of Richards, Layton & Finger, P.A., in Wilmington, Delaware. The authors are grateful for the assistance of John Fitzgerald, an associate at Richards, Layton & Finger, P.A.

Most contracts for the purchase and sale of commercial real property include among the remedies for breach a provision for the seller to receive or retain the contract deposit as liquidated damages for the purchaser's breach. At times, the contract will also provide for other remedies, whether damages or equitable relief (e.g., specific performance), in addition to the liquidated damages remedy. Including other remedies in the same contract can result in a court having to sort out the extent to which the different remedies are available to the non-breaching party and are not precluded on the basis that other remedies are available.

In particular, courts in various jurisdictions have attempted to address the issue of whether a liquidated damages clause in a contract is invalid because the contract gives the non-breaching party the option to choose between liquidated damages and actual damages. In a recent Colorado case, *Ravenstar, LLC v. One Ski Hill Place, LLC*,<sup>1</sup> the

Colorado Supreme Court held that such an option does not invalidate the liquidated damages provision based on the freedom of the parties to contract as they desire. The court went on, however, to hold that the option is an exclusive one, so the non-breaching party must elect one or the other remedy. Courts of various states are divided on this issue, with the courts in some states finding the liquidated damages provision to be unenforceable on the basis that providing an option of remedies creates a penalty against the breaching party and such a penalty negates the liquidated damages provision.<sup>2</sup> The rationale for that position is that the non-breaching party will choose only liquidated damages if it believes actual damages to be less than liquidated damages, hence the concept of a penalty. On the other hand, courts such as the one in *Ravenstar* find the election of remedies to be a penalty because a party may not want to engage in litigation to discover what actual damages may be.

There do not appear to be any reported Delaware cases directly on point. The closest reported case appears to be *Kysor Indus. Corp. v. Margaux, Inc.*,<sup>3</sup> where a letter of intent on a business acquisition provided for a \$300,000 termination fee and payment of certain expenses to be paid to the acquirer should the deal not proceed. On summary judgment, the court upheld the termination fee as enforceable liquidated damages. The court denied summary judgment on the claim for expenses because of ambiguity in the expense provision, but not because of an inherent inability to both pursue a damages action for those expenses and to claim the liquidated damages. The court did not find the concept of seeking liquidated damages in addition to actual damages troubling, largely because even if the aggregate of the termination fee together with the claimed expenses were granted to the acquirer, the total damages represented a reasonable percentage of the acquirer's offer.

There are a variety of related issues, however, that have been addressed by the Delaware courts in dealing with the enforceability of liquidated damages clauses and the exclusivity of certain remedies. This article provides a brief overview of these various issues under Delaware law.

### **1. May the seller choose specific performance instead of liquidated damages (so that liquidated damages are not an exclusive remedy)?**

In Delaware, specific performance is not a matter of right, and no party is unconditionally entitled to specific performance.<sup>4</sup> Specific performance is considered by Delaware courts to be "an extraordinary remedy" and thus not readily awarded.<sup>5</sup> The subject matter of the dispute must be that the demanding party: (1) is entitled to specific performance; and (2) has no other adequate remedy at law.<sup>6</sup>

On the first element, entitlement to specific performance, the demanding party must show all of the following: "(1) a valid contract exists, (2) he is ready, willing, and able to perform, and (3) that the balance of equities tips in favor of the party seeking performance."<sup>7</sup> On the second element, Delaware

has considered that "[r]eal property is unique; thus, specific performance of a real estate sale contract is often the only adequate remedy ... except in rare circumstances."<sup>8</sup>

If the contract is silent concerning specific performance, an aggrieved party still might obtain an award of specific performance, as the Delaware Supreme Court has held that the power to craft an "appropriate remedy for breach of contract is within a court's inherent jurisdiction and is not necessarily confined to the parties' contractual undertakings unless the parties clearly so indicate."<sup>9</sup> Accordingly, specific performance could in principle be awarded notwithstanding a liquidated damages provision if the contract did not expressly disclaim specific performance and if the aggrieved party shows the necessity of such a remedy.<sup>10</sup>

### **2. May the seller choose actual damages instead of liquidated damages (so that liquidated damages are not an exclusive damage remedy)?**

Delaware courts have held that the aggrieved party is allowed to recover actual damages despite a provision for liquidated damages in the contract.<sup>11</sup> In *Harris v. Conrad*, the plaintiffs had entered into a lease-to-purchase arrangement for a residence. Part of the monthly payments made to the defendant constituted rent and the balance were prepayments toward the purchase price. Under the terms of the contract, in the event of default by the buyer, the seller could elect to retain the payments made by the buyer either on account of the purchase price or as liquidated damages. If the latter, the contract would be considered terminated. The buyer defaulted in its payments and filed an action for specific performance to recover the "equity" portion of the monthly payments made to the seller that the seller was unwilling to return. The seller counterclaimed for damages suffered by virtue of the plaintiff retaining possession of the property for the period from the intended closing date on the purchase to when plaintiff finally vacated the residence. The court held that although the contract provided for liquidated damages, the seller should be allowed to recover its actual damages in lieu of

liquidated damages, though it could not retain the “equity” portion of rents it had received and also recover actual damages for the period the plaintiff remained in possession.<sup>12</sup>

### **3. If the seller may choose liquidated damages or actual damages, may it have both?**

Delaware courts have generally held that an aggrieved party may have either liquidated or actual damages—but not both.<sup>13</sup> However, Delaware courts have allowed both actual and liquidated damages in two circumstances.<sup>14</sup>

First, actual and liquidated damages may each be available for a different type of breach if the agreement so provides.<sup>15</sup> The court in *ISTI Delaware, Inc. v. Townsend* noted in dicta that in theory liquidated damages could be recoverable in the event of one type of damage, while actual damages could be recoverable for another type of damage. In this case, however, the court found the contract to be clear: the plaintiff was entitled only to liquidated damages for the buyer’s breach, and, under the facts of the case, the plaintiff had no right to claim special or consequential damages for that breach.

Second, a breach due to an event not contemplated by the parties in the liquidated damages clause may allow for the recovery of actual damages, presuming that the contract does not select liquidated damages as the sole remedy.<sup>16</sup> For example, in *Delware Limousine Services, Inc. v. Royal Limousine Services, Inc.*, the court analyzed the scope of the liquidated damages clauses in certain vehicle sublet and sales contracts. Because the contracts at issue did not make liquidated damages the exclusive remedy for all breaches and because the damage suffered by the plaintiff resulted from acts not within the scope of the liquidated damages clause, the plaintiff was entitled to seek actual damages in addition to liquidated damages.

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

Delaware courts have not yet directly addressed the question of when an aggrieved party with the right to do so must elect between liquidated and actual damages. In the reported Delaware cases, courts have addressed the parties’ choice of relief in the pleadings.<sup>17</sup> Of course, if the aggrieved party terminates the agreement by reason of the other party’s breach, the remedy of specific performance is no longer available.<sup>18</sup>

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

No Delaware statute addresses liquidated damages in the sale of real property. Of course, the Delaware Uniform Commercial Code contains a liquidated damages provision for contracts involving the sale of goods.<sup>19</sup> Accordingly, the issues surrounding liquidated damages in the sale of real property are addressed only by case law.

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

As with a majority of jurisdictions, the general rule for finding an enforceable liquidated damages remedy, as opposed to an unenforceable penalty, is where: (1) the damages that the parties might reasonably anticipate to result from a breach are difficult or impossible to ascertain (at the time of contracting) because of their indefiniteness or uncertainty; and (2) the agreed-upon sum is reasonable.<sup>20</sup> Courts have added that whether liquidated damages are reasonable is determined by whether the damages are either a reasonable estimate of damages that would likely be caused by a breach or reasonably proportionate to what damages have actually been caused by the breach.<sup>21</sup>

### **7. Who has the burden of proof?**

As liquidated damages are presumed valid, the party contesting the provision has the burden of proof.<sup>22</sup>

## 8. As of when is “reasonableness” tested?

The “reasonableness” of the liquidated damages amount is tested as of the time of the contract’s formation.<sup>23</sup>

## 9. What Percentage Of The Purchase Price Is Likely Acceptable As Liquidated Damages?

Delaware courts have not established a bright-line test to determine when damages are too high in proportion to the purchase price, but rather have focused on the circumstances surrounding the parties’ adoption of liquidated damages as a remedy under the contract.<sup>24</sup> Moreover, Delaware courts have granted wide latitude to amounts of liquidated damages that were agreed upon by the parties. Liquidated damages provisions may be enforced even though the liquidated damages are “substantially larger than actual damages.”<sup>25</sup>

For example, in *W&G Seaford Assocs., L.P. v. E. Shore Markets, Inc.*, the Delaware District Court addressed the issue of whether a landlord could enforce a liquidated damages clause in a commercial lease.<sup>26</sup> In that case, the liquidated damages were triggered by the tenant’s failure to open its store in the landlord’s center and were equal to the accelerated rent for the entire term of the lease. The court held that this remedy was a liquidated damages provision, not penal in nature, and thus enforceable.<sup>27</sup> In other words, because the parties bargained for liquidated damages as the remedy for this particular breach and agreed upon the amount, the provision was enforceable even though it equaled the entirety of what the landlord might otherwise have received as rent and notwithstanding that the landlord was free to seek actual damages.

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

Liquidated damages provisions can still be enforced even if there is no proof of actual damages.<sup>28</sup>

## 11. IS MITIGATION RELEVANT FOR LIQUIDATED DAMAGES?

Although Delaware law generally requires the damaged party to mitigate its damages,<sup>29</sup> mitigation is not required for liquidated damages to be enforced.<sup>30</sup> This is because liquidated damages are not tied to actual damages, but only to what the parties entering into the contract have agreed to be a reasonable estimate of the damages that could be caused by the breach.<sup>31</sup>

## 12. Is a “shotgun” liquidated damages clause enforceable?

A so-called “shotgun” liquidated damages clause allows for complete recovery under the contract irrespective of the materiality of the breach. While Delaware has not directly addressed the enforceability of a “shotgun” clause, there exists competing authority on how a Delaware court might consider such a provision.

On one hand, some Delaware cases have considered the enforceability of a liquidated damages provision based on the reasonableness of the damages in relation to what the actual damages are forecasted to be or whether the liquidated damages are reasonably proportionate to the damages actually caused by the breach.<sup>32</sup> At least one Delaware court has held that an agreement to pay a “stipulated sum upon breach, irrespective of the damages sustained, constitutes a penalty...[and] is void as a matter of public policy.”<sup>33</sup>

On the other hand, Delaware courts have firmly held parties to their agreement on liquidated damages and broadly considered the parties’ intent to justify what may appear to be an inequitable result.<sup>34</sup>

Therefore, a “shotgun” clause could be considered to be in the gray area between a penalty and a valid, contracted-for provision. If parties wish to adopt an enforceable “shotgun” clause in Delaware, they should take care to acknowledge the materiality of the breach allowing the recovery of liquidated damages.

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

In instances where a liquidated damages provision specifically contemplates attorneys' fees, Delaware courts have at least not ruled out the enforceability of such a claim in addition to liquidated damages.<sup>35</sup> Even when the liquidated damages provision is silent on the inclusion of attorneys' fees, at least one court has held that courts generally have the power to award attorneys' fees in certain circumstances so long as there is no statute or contract provision to the contrary.<sup>36</sup>

### CONCLUSION

Given the importance of freedom of contract under Delaware law,<sup>37</sup> Delaware courts are generally willing to enforce liquidated damages clauses and broadly allow for the remedies that are otherwise available to parties except to the extent the contract has disclaimed or waived the remedy in question. 📌

---

#### Notes

- 1 401 P.3d 552 (Colo. 2017).
- 2 Williston on Contracts, §§ 65:24 and 65:32 (4th ed. 2002). The courts upholding the provision apparently do so on the basis of freedom of contract.
- 3 674 A.2d 889 (Del. Super. Ct. 1996).
- 4 *W. Willow-Bay Court, LLC v. Robino-Bay Court Plaza, LLC*, 2007 WL 3317551, at \*13 (Del. Ch. Nov. 2, 2007).
- 5 *Osborn ex rel. Osborn v. Kemp*, 991 A.2d 1153, 1158 (Del. 2010).
- 6 *Id.*
- 7 *Id.*
- 8 *Id.* at 1162-63, n.30 (quoting *Szambelak v. Tsipouras*, 2007 WL 4179315, at \*7 (Del. Ch. Nov. 19, 2007)).
- 9 *Topper v. Topper*, 553 A.2d 639 (Del. 1988) (unpublished disposition).
- 10 See *id.*
- 11 1984 WL 21876, at \*4 (Del. Ch. Sept. 19, 1984).
- 12 *Id.*
- 13 *Tropical Nursing, Inc. v. Arbors at New Castle Subacute and Rehab. Ctr.*, 2005 WL 8135148, at \*5 (Del. Super. Ct. Apr. 4, 2005).
- 14 *ISTI Delaware, Inc. v. Townsend*, 1993 WL 189467, at \*5 (Del. Super. Ct. Mar. 31, 1993); *Delaware Limousine Serv., Inc. v. Royal Limousine Serv., Inc.*, 1991 WL 53449, at \*5 (Del. Super. Ct. Apr. 5, 1991).
- 15 *ISTI Delaware, Inc.*, 1993 WL 189467, at \*5.
- 16 *Del. Limousine Serv.*, 1991 WL 53449, at \*2.
- 17 See, e.g., *S.H. Deliveries, Inc. v. TriState Courier & Carriage, Inc.*, 1997 WL 817883, at \*2 (Del. Super. Ct. May 21, 1997) (holding that if an aggrieved party's liquidated damages are void as they constitute a penalty, then the party's recovery could be based upon actual damages instead).
- 18 *Draper v. Westwood Dev. Partners, LLC*, 2010 WL 2432896, at \*5 (Del. Ch. June 3, 2010); *ISTI Delaware, Inc.*, 1993 WL 189467, at \*6.
- 19 6 Del.C. § 2-718.
- 20 See, e.g., *Lee Builders Inc. v. Wells*, 34 Del. Ch. 307, 309 (1954) (holding that a liquidated damages clause is enforceable when the damages are uncertain and the amount agreed upon is reasonable).
- 21 *Tropical Nursing, Inc. v. Arbors at New Castle Subacute & Rehab. Ctr.*, 2005 WL 8135148, at \*5 (Del. Super. Ct. Apr. 4, 2005); *Piccotti's Rest. v. Gracie's, Inc.*, 1988 WL 15338, at \*1 (Del. Super. Ct. Feb. 23, 1988).
- 22 *S.H. Deliveries, Inc.*, 1997 WL 817883, at \*3.
- 23 *Delaware Bay Surgical Servs., P.C. v. Swier*, 900 A.2d 646, 651 (Del. 2006); *Tropical Nursing, Inc.*, 2005 WL 8135148, at \*5.
- 24 For example, retention of a 5% down payment fee relating to a purchase of real estate is not considered an unreasonable amount. *Lee Builders, Inc.*, 34 Del. Ch. at 309.
- 25 *S.H. Deliveries, Inc.*, 1997 WL 817883, at \*2.
- 26 714 F. Supp. 1336 (D. Del. 1989).
- 27 *Id.* at 1346-48.
- 28 *Piccotti's Rest.*, 1988 WL 15338, at \*3 (holding that liquidated damages provisions are valid despite no actual damages being proven).
- 29 See, e.g., *Wise v. W. Union Tel. Co.*, 181 A. 302, 305 (Del. Super. Ct. 1935) (noting that injured parties are "under a duty to make a reasonable effort to minimize...damages"); *Hanner v. Rice*, 2000 WL 303458, at \*2 (Del. Super. Ct. Jan. 3, 2000) ("Under the common law of contracts, the measure of damages has always been tempered by the rule requiring the injured party to minimize, that is, mitigate, the losses."); *Wilson v. Pepper*, 1995 WL 562235, at \*4 (Del. Super. Ct. Aug. 21, 1995) (noting that "plaintiffs must take steps to mitigate their losses").
- 30 *Princess Hotels, Int'l Inc. v. Del. State Bar Ass'n*, 1997 WL 817853, at \*3 (Del. Super. Ct. Oct. 29, 1997).
- 31 *S.H. Deliveries, Inc.*, 1997 WL 817883, at \*2.
- 32 See footnote 22.
- 33 *CRS Proppants LLC v. Preferred Resin Holding Co., LLC*, 2016 WL 6094167, at \*3 (Del. Super. Ct. Sept. 27, 2016).

- 34 *W&G Seaford Assocs., L.P.*, 714 F.Supp. at 1348.
- 35 *ISTI Delaware, Inc.*, 1993 WL 189467, at \*1, 6 (considering but finding no clear-cut answer to the issue of whether liquidated damages provisions preclude the recovery of attorney's fees and asking the parties to brief the issue).
- 36 *Quinn v. Mitchell*, 1989 WL 12178, at \*3 (Del. Ch. Feb. 13, 1989).
- 37 *Libeau v. Fox*, 880 A.2d 1049, 1056 (Del. Ch.), judgment entered, (Del. Ch. 2005), *aff'd in part, rev'd in part*, 892 A.2d 1068 (Del. 2006).