

## A Reasonable Amount is How Much?

By Judith I. Johannsen

It's a fact – some purchase and sale contracts fall apart – sometimes because the buyer cannot qualify for a loan or a property condition inspection report is unsatisfactory. However, every now and then, a buyer simply changes his mind about buying, and that situation was the basis of a lawsuit begun by a jilted seller in 2006 and ended with the decision rendered June 2009.

In this case, a buyer submitted a purchase and sale offer and an initial deposit check of \$1,000 to the seller. The buyer also was to submit a \$50,000 deposit if and when the seller accepted the offer. The seller signed the buyer's offer the next day, converting the offer into a contract.

Three days later, the buyer informed the seller he would not be going through with the transaction. Six months later, the seller sold his house to buyer #2 for \$65,000 less than buyer #1's contract.

The seller filed suit against buyer #1 for breach of contract seeking \$50,000 as liquidated damages as, pursuant to the terms of their agreement, seller would be entitled to all initial and additional deposit monies, whether or not they had been paid.

"Liquidated damages" is the term for the amount of money the contract parties agree will be recovered by one party if the other party defaults or breaches their agreement. Moreover, since there's no crystal ball to foresee when a party might default or what the damages from a breach would be, the parties typically stipulate the amount of liquidated damages to be equal to the amount of the buyer's deposit.

Despite the stipulated liquidated damages amount of \$50,000, the seller claimed he was entitled to \$65,000 which was the difference between the price agreed to in buyer #1's contract and the selling price six months later to buyer #2.

Buyer #1 disagreed, believing the appropriate point at which to measure the seller's damages was when he breached the contract, so, when he breached the contract only three days after it had been signed, the damages should amount to no more than the loss of three days sales opportunity. Besides, the liquidated damages of \$50,000 in their contract provision was disproportionate and unreasonable.

This court, following a 1966 Connecticut Supreme Court case, *Norwalk Door Closer v. The Eagle Lock and Screw Company*, which held that a contract provision fixing liquidated damages for a breach of contract is not a penalty and is enforceable *if* it satisfies certain conditions, found the buyer's argument valid.

*Norwalk Door Closer's* conditions to enforceability were that the damage resulting from a breach would be hard to establish, the contracting parties intended to provide in advance a definite sum for damages, and the amount of the liquidated damages was reasonable.

So, how does a court assess the reasonableness of a liquidated damages provision? It evaluates it not only when the parties enter into the contract, but also the reasonableness of the results it leads to at the time and in the circumstances of the enforcement.

In the end, this court ruled in favor of the buyer, finding the seller was not entitled to \$65,000, that he had suffered significantly less than the \$50,000 stipulated in the liquidated damages clause, and to enforce that provision would be an unreasonable penalty to the buyer.

Prospective buyers should know that while this particular buyer won his case, not every buyer who tries to bail on his agreement will be successful, there is no three day right of rescission escape hatch in real estate contracts, and most sellers will not be agreeable to releasing a buyer from his contractual obligations.

Judith I. Johannsen is Assistant Counsel for the Connecticut Association of Realtors®, Inc.

*Connecticut Association of REALTORS®, Inc. is Connecticut's largest professional trade association representing approximately 17,000 real estate professionals engaged in all aspects of the real estate business. Founded in 1920, the Connecticut Association of REALTORS®, Inc. is dedicated to enhancing the ability of its members to conduct their business successfully while maintaining the preservation of private property rights. Use of the term "REALTOR®" is exclusive to the members of the REALTOR® Association and signifies their allegiance to a strict Code of Ethics.*