

Liquidated Damages

What are liquidated damages? Liquidated damages are a pre-specified amount of damages identified during the formation of a contract for the injured party to collect as compensation for a specific breach. For example, the C.A.R. Residential Purchase Agreement (Form RPA) provides for liquidated damages as a remedy for a buyer's breach of contract.

If a seller believes a buyer breached a real estate contract, what must the seller do to prove damages?

If liquidated damages are not part of the contract – The seller must prove two things:

- (1) The buyer actually breached, and
- (2) The amount of damage, or harm, caused by the breach.

If liquidated damages are incorporated into the contract – The seller still must prove that the buyer breached, but there is no requirement to prove damage because both parties have agreed in advance what the damage will be.

When may a liquidated damage clause become part of the contract?

A liquidated damage clause becomes part of the contract only if either:

- A. Both parties initial the clause in the purchase agreement; **OR**
- B. There is a mutual agreement reached through a counter offer or addendum.

For residential 1-4 property that the buyer intends to occupy, the liquidated damage amount: 1) cannot exceed the deposit paid, regardless of the amount promised, and 2) under the C.A.R. Residential Purchase Agreement (Form RPA), cannot exceed 3% of the purchase price. Thus, it will be the lower of 3% or the deposit paid when the buyer intends to occupy a residential 1–4 property.

Example 1: House sold to buyer. Purchase price is \$1,000,000. Deposit required, \$100,000. Deposit paid, \$50,000.

- If buyer intends to occupy, the maximum liquidated damage is \$30,000 (the lower of the deposit paid or 3%).
- If buyer intends to rent the house, the maximum liquidated damage is \$50,000 (liquidated damages are limited to no more than the deposit paid).

Example 2: Same as example 1, except the deposit paid = \$25,000.

- If buyer intends to occupy, the maximum liquidated damage is \$25,000 (the lower of the deposit paid or 3%).
- If buyer intends to rent, the maximum liquidated damage is \$25,000 (limited to no more than deposit paid).

Remember, escrow will not automatically release a deposit if the liquidated damage clause signed. The seller still must prove the buyer breached. The seller may need to mediate and then file a lawsuit or go to arbitration to obtain the damage award.