LIQUIDATED DAMAGES IN KANSAS COMMERCIAL REAL ESTATE CONTRACTS


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The purpose of this article is to inform sellers about Kansas law on liquidated damages clauses in commercial real estate contracts.

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

Answer:

Yes, if the real estate contract is clear that liquidated damages are not intended as the exclusive remedy for a buyer's failure to perform.

In an old installment sales case, the Kansas Supreme Court permitted the seller to seek specific performance, holding that the deposit was "mere security" for performance, and not a liquidated damages remedy. The court noted that specific performance will be denied a seller if the contract clearly grants the breaching buyer "the option to perform or pay a stipulated amount in lieu thereof. . . ." Knisely v. Robinson, 111 Kan. 300, 206 P. 877, 878 (1922).

In Owen v. Christopher, 144 Kan. 765, 62 P.2d 860 (1936), the Kansas Supreme Court conducted a more thorough discussion of the relationship between the equitable remedy of specific performance and the legal remedies of liquidated or actual damages. The court noted that Kansas cases permit a plaintiff, in an action for the equitable remedy of specific performance, to also, as an alternative remedy, plead the legal remedy of damages. This makes sense. If the court ultimately determines that specific performance is impractical or cannot be compelled, then the plaintiff is entitled to recover damages.

In Owen, the Kansas Supreme Court reached four important conclusions: (1) the facts of the case prevented specific performance being a practical remedy; (2) the contract included a valid liquidated damages remedy for the breach (the court applied the test under Restatement (First) of Contracts § 339 (1932)); (3) the valid liquidated damages remedy precluded the plaintiff from seeking and recovering higher actual damages; and (4) if there had been no actual damages, the plaintiff would have been limited, notwithstanding the agreed-upon liquidated damages amount, to

nominal damages (See Carrothers, 288 Kan. at 754, 757, 207 P.3d at 241, 243, holding, contrary to Owen, that actual damages at breach are irrelevant to whether liquidated damages are enforceable).

Owen does not directly address two important issues: (1) whether a seller has the option, prior to a court determination that specific performance is not practical, of choosing specific performance or damages; and (2) if a seller does have such option, whether a seller has the option of electing the greater of liquidated damages or actual damages.

Kansas courts generally defer to the intent of the contracting parties "allowing parties to make, and live by, their own contracts." See Carrothers Const. Co. v. City of S. Hutchinson, 288 Kan. 743, 755, 207 P. 3d 231, 241 (2009) ("By placing the burden of proof on the party challenging a liquidated damages clause, we promote the public policy of favoring settlement and avoidance of litigation, *and allowing parties to make, and live by, their own contracts* [emphasis added]."). Whether Kansas courts would build on this general rule and allow parties to freely contract for multiple seller remedies upon a buyer breach remains an open issue. Certainly the first part of the foregoing sentence which favors liquidated damages for "settlement and the avoidance of litigation" could result in a court holding that a contract including a liquidated damages clause for a buyer breach cannot also allow, in the alternative, the remedy of actual damages for the same breach.

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

Answer:

Kansas courts have not yet addressed this issue. Kansas cases are clear, however, that actual damages are precluded where the contract is clear that liquidated damages were intended to be the sole remedy for a breach.

In *Owen*, as discussed above, the Kansas Supreme Court held that the parties to the contract intended, where specific performance was not a practical remedy, that the alternative liquidated damages remedy be the sole alternative remedy for the breach. As a consequence, the plaintiff was not entitled to the higher actual damages. Owen, 144 Kan. 765, 62 P.2d at 860 ("Damages recoverable for breach of contract for exchange of realty providing for $500 liquidated damages in case of breach held limited to $500, notwithstanding that plaintiff may have suffered a greater loss.").

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

Answer:

Kansas courts have not yet addressed this issue. However, it is reasonable to infer from Kansas cases that generally address liquidated damages that a seller would not have the right to recover both liquidated damages and actual damages for the same breach. See Owen, 144 Kan. 765, 62 P.2d 860; and Lawson v. Durant, 213 Kan. 772, 518 P.2d 549 (1974).

In Lawson, another real estate installment sales contract case, the Kansas Supreme Court held that "[a] provision in a contract liquidating certain items of damage will not prevent the recovery of actual damages for other items to which the liquidation provision does not apply, unless the contract expressly provides that damages other than those enumerated shall not be recovered." 213 Kan. at 775, 518 P.2d at 551. In other words, a contract can provide for liquidated damages for one category of breach (such as failure to pay a purchase price installment) and actual damages for another category of breach (such as waste during occupancy by the installment buyer).

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

Answer:

Kansas courts have not yet addressed this issue because Kansas courts have not yet addressed whether a seller may choose liquidated damages or actual damages for the same breach.

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

Answer:

No.

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

Answer:

Kansas courts have referenced the test under Restatement (First) of Contracts § 339 (1932). See Owen v. Christopher, 144 Kan. 765, 62 P.2d 860, 864 (1936); and Beck v. Megli, 153 Kan. 721, 114 P.2d 305, 308 (1941).

The test under § 339 provides that:

(1) An agreement, made in advance of breach, fixing the damages therefor, is not enforceable as a contract and does not affect the damages recoverable for the breach, unless

(a) the amount so fixed is a reasonable forecast of just compensation for the harm that is caused by the breach, and

(b) the harm that is caused by the breach is one that is incapable or very difficult of accurate estimation."

Further, in Carrothers, the Kansas Supreme Court reaffirmed its analysis under Beck by quoting from Beck as to when a contractual provision is a penalty, and not liquidated damages.

There are two considerations which are given special weight in support of a holding that a contractual provision is for liquidated damages rather than a penalty—the first is that the amount stipulated is conscionable, that it is reasonable in view of the value of the subject matter of the contract and of the probable or presumptive loss in case of breach; and the second is that the nature of the transaction is such that the amount of actual damages resulting from default would not be easily and readily determinable. Carrothers, 288 Kan. 743, 755, 207 P.3d 231, 241 (2009) (quoting Beck, 153 Kan. at 726, 114 P.2d 305).

7. Who has the burden of proof?

Answer:

The party challenging the liquidated damages clause has the burden of proof. See Carrothers, 288 Kan. at 755, 207 P.3d at 241; and Wahlcometroflex, Inc. v. Westar Energy, Inc., No. 11-4017-EFM/JPO, 2012 WL 2366693, at *4 (D. Kan. June 21, 2012), aff'd, 773 F.3d 223 (10th Cir. 2014).

8. As of when is "reasonableness" tested?

Answer:

As of the date of execution of the contract.

In Carrothers, the Kansas Supreme Court, overturning the holdings in earlier Kansas Court of Appeals cases, held that "retrospective analysis is unnecessary in determining whether a liquidated damages clause is a penalty. The better test … is to determine reasonableness of a liquidated damages clause as of the time the contract was executed, not with the benefit of hindsight. … To that end … [we] embrace a prospective analysis as the sole basis for evaluating a liquidated damages provision in a contact." Carrothers, 288 Kan. at 754, 757, 207 P.3d at 241, 243; see also, Wahlcometroflex, Inc., No. 11-4017-EFM/JPO, 2012 WL 2366693, at *4 (D. Kan. June 21, 2012), aff'd, 773 F.3d 223 (10th Cir. 2014). In other words, actual damages at the time of the breach is irrelevant to determining the reasonableness of the agreed upon liquidated damages amount.

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

Answer:

There is no mathematical or mechanical formula that Kansas courts apply to determine whether a liquidated damage amount is reasonable. See Beck, 153 Kan. 721, 114 P.2d 305, 308 (the court held that five percent of the purchase price was a reasonable amount); Carrothers, 288 Kan. 743, 755–56, 207 P.3d 231, 241–42 (liquidated damages in amount of three percent of the contract price was reasonable); and Gregory v. Nelson, 147 Kan. 682, 78 P.2d 889, 892–93 (1938) (the court upheld a provision for liquidated damages in the approximate amount of 19 percent of the purchase price).

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

Answer:

Actual damages are not relevant for determining if liquidated damages are reasonable. Reasonableness, under Carrothers, is determined prospectively at the time of contract.

The holding in Carrothers overturns the statement in Owen that if there had been no actual damages, the plaintiff would have been limited, notwithstanding the

agreed-upon liquidated damages amount, to nominal damages. Carrothers broadly prohibited looking at actual damages at the time of breach in reviewing liquidated damages provisions. See also, Wahlcometroflex, Inc., No. 11-4017-EFM/JPO, 2012 WL 2366693, at *4 (D. Kan. June 21, 2012), aff'd, 773 F.3d 223 (10th Cir. 2014) ("Thus, the Court does not inquire as to actual damages, or even whether Westar was damaged, because that would require the Court to view the Contract with the benefit of hindsight.").

11. Is mitigation relevant for liquidated damages?

Answer:

There are no Kansas cases that specifically address this issue. Based on the holding in Carrothers, that reasonableness is determined at the time of contract, it is likely that a Kansas court would not find mitigation relevant.

12. Is a "shotgun" liquidated damages clause enforceable?

Answer:

It is unlikely that a "shotgun" liquidated damages clause is enforceable.

"Shotgun" clauses are clauses that fix a single large sum as the liquidated damages for any breach. Although there are no Kansas cases directly on point for real estate contracts, in the context of employment contracts and leases, Kansas courts have stated that when the liquidated damages sum is the "same for a total or partial breach, or for breach of minor or major contract provisions" it is more likely to be considered a penalty. Unified Sch. Dist. No. 315, Thomas Cty. v. DeWerff, 6 Kan. App. 2d 77, 80, 626 P.2d 1206, 1209 (1981) ("Generally, a contract provision will be considered a penalty where there is no attempt to calculate the amount of actual damages that might be sustained in case of breach. An indication of this lack of calculation is deemed present when the amount of stipulated damages is the same for a total or partial breach, or for breach of minor or major contract provisions."); and IPC Retail Properties, L.L.C. v. Oriental Gardens, Inc., 32 Kan. App. 2d 554, 562, 86 P.3d 543, 549 (2004), overruled on other grounds by Carrothers ("The fact that the accelerated rent provision under the contract could be invoked for all breaches, however minute or unimportant, renders this provision an unenforceable penalty under the standard set forth above.").

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

Answer:

Likely no, if the real estate contract provides for the recovery of attorneys' fees.

Because Kansas courts have cited various provisions of the Restatement Second of Contracts, including citing § 356, Comment A in Carrothers, 288 Kan. at 758, 207 P.3d at 243, it is likely Kansas courts would allow recovery of attorneys' fees by a seller if the contract provides for the recovery of attorneys' fees. See Restatement (Second) of Contracts § 356 (1981) ("Although attorneys' fees are not generally awarded to the winning party, if the parties provide for the award of such fees the court will award a sum that it considers to be reasonable. If, however, the parties specify the amount of such fees, the provision is subject to the test stated in this Section."). See also, Idbeis v. Wichita Surgical Specialists, P.A., 285 Kan. 485, 485, 173 P.3d 642, 644 (2007) ("As a general rule, attorney fees and expenses of litigation, other than court costs, incurred by a prevailing party are not recoverable against the defeated party in the absence of a clear and specific statutory provision or an agreement between the parties [emphasis added].").