OPTIONAL LIQUIDATED DAMAGES IN MISSOURI COMMERCIAL REAL ESTATE PURCHASE AND SALE AGREEMENTS

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The purpose of this article is to inform sellers about Missouri law on liquidated damages clauses and alternative remedy clauses in commercial real estate purchase and sale agreements.

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

Answer: Yes, if the commercial real estate purchase and sale agreement expressly grants the seller the right of specific performance as an alternative remedy.

In Missouri, a seller entitled to recover under a liquidated damages clause may not pursue specific performance as an alternative remedy unless specific performance is expressly reserved as an alternative remedy in the real estate contract. Hoelscher v. Schenewerk, 804 S.W.2d 828 (1991) (Holding that where the real estate contract clearly stated that alternative remedies, including specific performance, were available to the seller upon a breach, the retaining of the earnest money as liquidated damages became the exclusive remedy only if so elected by the seller). However, where a real estate contract provides for liquidated damages, but fails to provide the seller with the ability to elect for the alternative remedy of specific performance, then liquidated damages is the exclusive remedy. Warstler v. Cibrian 859 S.W.2d 162 (Mo. App. W. Dist. 1993) (Holding that the seller was only entitled to the liquidated damages specified in the real estate contract, because the real estate contract did not contain language providing for alternative remedies, such as specific performance).

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

Answer: Yes, if the commercial real estate purchase and sale agreement expressly grants the seller the right to seek actual damages as an alternative remedy.

The rule for actual damages mirrors the rule for specific performance. If the real estate contract expressly provides for other remedies, including actual damages, as an alternative to liquidated damages, Missouri courts allow actual damages to be recovered in lieu of liquidated damages. Warstler v. Cibrian, supra.

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

Answer: No, but any earnest money held as liquidated damages may be applied toward payment of actual damages.

In real estate contracts where the seller has the ability to choose between actual and liquidated damages, the seller is only entitled to recover one or the

other, but not both. Missouri courts have stated several times that liquidated and actual damages may not be awarded as compensation for the same injuries. Twin River Const. Co. v. Public Water Dist., 653 S.W.2d 682, 694 (Mo.App.1983), Arnett v. Keith, 582 S.W.2d 363, 365–366 (Mo.App.1979), Germany v. Nelson, 677 S.W.2d 386, 388 (Mo. Ct. App. 1984) (Holding that the trial court's award of an additional $5,700 for actual damages gave the seller a double recovery that it was not entitled to receive). However, if the seller elects the actual damages remedy, any earnest money held may be applied toward payment of actual damages. Hoelscher v. Schenewerk 804 S.W.2d 828 (Mo. Ct. App. W. Dist. 1991).

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

Answer: Missouri courts have not yet directly addressed this issue.

In Hoelscher v. Schenewerk, the court concluded that the seller had not elected liquidated damages because the seller filed an action for specific performance the day of the breach, shortly after the buyer failed to close as scheduled. Over a year later, the seller filed an amended petition for actual damages after the property was sold to a third party. The court then permitted the earnest money, which had not been returned to the buyer, to be applied toward the actual damages awarded. While this case does not establish a clear timeline for when the election between liquidated damages and other remedies must be made, it supports the proposition that the initial election of a remedy other than liquidated damages must be made proximate to the breach.

Is there an applicable statute addressing liquidated damages clauses?

Answer: No.

There is no Missouri statute addressing liquidated damages in commercial real estate purchase and sale agreements.

What is the test for a valid liquidated damages clause?

Answer: Missouri courts have adopted the Restatement (First) of Contracts § 339 (1932) test for determining the enforceability of a liquidated damages clause. Missouri courts have also referenced the Restatement (Second) of Contracts § 356 (1981) test and have stated that the two tests mirror each other, even though the tests, as discussed below, actually differ in two important respects. No Missouri case has addressed the differences between § 339 and § 356. Missouri courts have departed from the Restatement (First) test by also requiring the seller to prove some actual damages to be entitled to the specified liquidated damages. Missouri courts have not yet tied this requirement for proof of some actual damages to the Restatement (Second) § 356 comment b. that provides if "no loss at all has occurred, a provision fixing a substantial sum as damages is unenforceable."

The Restatement (First) test provides:

> (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.

Grand Bissell Towers, Inc. v. Joan Gagnon Enterprises, Inc., 657 S.W.2d 378, 379 (Mo. Ct. App. 1983); see also Germany v. Nelson, 677 S.W.2d 386, 388 (Mo.App.1984); see also Highland Inns Corp. v. Am. Landmark Corp., 650 S.W.2d 667 (Mo. Ct. App. 1983).

The Restatement (First) test is cited by all of the relevant Missouri cases determining the enforceability of a liquidated damages clause. However, some Missouri courts have also cited the Restatement (Second) § 356 test for additional support. Grand Bissell Towers, Inc. v. Joan Gagnon Enterprises, Inc., 657 S.W.2d 378, 379 (Mo. Ct. App. 1983) (Adding in a footnote that the Restatement (Second) § 356 restates the test in a more succinct fashion), Paragon Group, Inc. v. Ampleman, 878 S.W.2d 878, 881 (Mo. App. E. Dist. 1994) (Citing both the Restatement (First) and Restatement (Second) and adding that the Restatement (Second) amended the test, but retained the same basic analysis), Arcese v. Daniel Schmitt & Co., 504 S.W.3d 772, 778 (Mo. App. E. Dist. 2016) (Citing to the Restatement (First) § 339 for the test of validity, but also citing the Restatement (Second) § 356 for additional support; stating that the two tests "mirror" each other). Missouri courts, thus,

seem to have adopted the tests from both the Restatement (First) and Restatement (Second), believing them to be essentially the same.

The Restatement (First) and Restatement (Second) differ in two respects. First, the Restatement (First) provides for a single test of reasonableness—that "the amount so fixed is a reasonable forecast of just compensation for the harm that is caused by the breach." The Restatement (Second) allows reasonableness to be determined "in the light of the anticipated or actual loss caused by the breach"—creating an either-or proposition not in the Restatement (First). Second, the absence of actual damages under the Restatement (First) is generally not a defense to liquidated damages. However, the last sentence of Restatement (Second) § 356 comment b. does take in account actual damages (providing that if "no loss at all has occurred, a provision fixing a substantial sum as damages is unenforceable").

Missouri courts have held that the second prong of the Restatement (First) test—"the harm that is caused by the breach is one that is incapable or very difficult of accurate estimation"—is deemed satisfied simply by execution of a real estate contract. At contract execution, damages for breach are always "uncertain in amount and difficult to ascertain or prove." Highland Inns Corp. v. Am. Landmark Corp., 650 S.W.2d 667, 674 (Mo. Ct. App. 1983), Paragon Group, Inc. v. Ampleman, 878 S.W.2d 878 (Mo. App. E. Dist. 1994), Carmel v. Dieckmann, 617 S.W.2d 459, 461[4–5] (Mo. App. W. Dist. 1981), see also Goldberg v. Charlie's Chevrolet, Inc., 672 S.W.2d 177 (Mo. App. E. Dist. 1984). As a consequence, only the first prong of the Restatement (First) test needs to be proven—that "the amount so fixed is a reasonable forecast of just compensation for the harm that is caused by the breach." However, Missouri court references, without much distinction, to both the Restatement (First) § 339 and the Restatement (Second) § 356 leaves open the possibility that a court basing its decision solely on the Restatement (Second) § 356 might not reach the same conclusion as that reached under the Restatement (First) § 339—that the "difficulties of proof of loss" is not relevant to the test.

Missouri courts also require the seller to prove some actual damages to be entitled to the specified liquidated damages. Grand Bissell Towers, Inc. v. Joan Gagnon Enterprises, Inc., 657 S.W.2d 378 (Mo. App. E. Dist. 1983) (Holding that the liquidated damages clause at issue was unenforceable because no actual harm or damage was shown by the non-breaching party), see also Stand. Imp. Co. v. DiGiovanni, 768 S.W.2d 190, 193 (Mo. App. W. Dist. 1989) (Holding that some actual damage was indisputably shown in an action for breach of contract brought by a home improvement contractor because the record reflected that an estimator had spent 15 to 20 hours on the contract and the contractor had expended money to determine title to the property, prepared and recorded a deed of trust, obtained an appraisal, and paid other overhead expenses in anticipation of financing the project). Missouri courts have not yet tied this requirement for proof of some actual damages to the Restatement (Second) § 356 comment b. that provides if "no loss at all has occurred, a provision fixing a substantial sum as damages is unenforceable."

Who has the burden of proof?

Answer: The buyer has the burden of proof if the buyer is challenging the enforceability of the liquidated damages clause. However, the seller has the burden of showing that the seller incurred some actual damages.

Under Missouri law, the burden of establishing that a liquidated damages clause in a contract is a penalty, and thus invalid, is on the party challenging the reasonableness of the liquidated damages clause. Manufacturers Cas. Ins. Co. v. Sho-Me Power Corp., 157 F. Supp. 681, 684 (W.D. Mo. 1957). However, the party attempting to enforce a liquidated damages clause bears the burden of showing that they have incurred some actual damage. Grand Bissell Towers, Inc. v. Joan Gagnon Enterprises, Inc., supra (1983) (Holding that the liquidated damages clause at issue was unenforceable because no actual harm or damage was shown by the non-breaching party).

As of when is reasonableness tested?

Answer: There is no Missouri case that addresses this issue for commercial real estate purchase and sale agreements.

One Missouri case measured reasonableness of a liquidated damages clause in the context of a construction contract at the time the contract was made. Burst v. R.W. Beal & Co., Inc., 771 S.W.2d 87 (1989). However, because Missouri courts also cite the Restatement (Second) of Contracts § 356 (1981) rule, see Valentine's, Inc. v. Ngo, 251 S.W.3d 352 (2008) (Citing Restatement (Second) of Contracts § 356 comment b. for an explanation of how

difficulty of forecasting affects reasonableness), and Grand Bissell Towers, Inc. v. Joan Gagnon Enterprises, Inc., supra (Citing comment b. for the same purpose), it would be logical, if presented with an appropriate case, for Missouri courts to allow reasonableness to be satisfied either at contract execution or contract breach.

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

Answer: Ten percent, but higher percentages may be upheld if deemed reasonable under the circumstances.

Missouri courts have held that 10 percent of the purchase price is a reasonable amount for liquidated damages in the event of a breach of contract to buy real estate. Stein v. Bruce, 366 S.W.2d 732, 737 (Mo. App. 1963), Germany v. Nelson, 677 S.W.2d 386 (Mo. App. S. Dist. 1984) (Stating that ten percent of the purchase price would be a reasonable amount for liquidated damages). It is unlikely that the 10 percent amount in these cases serves as a hard cap on reasonable liquidated damages because Missouri courts have held liquidated damages in higher percentages to be enforceable in non-real estate contracts: 16 percent (Paragon Group, Inc. v. Ampleman, 878 S.W.2d 878, 881 (Mo. App. E. Dist. 1994) (where a liquidated damages clause was 16 percent of the value of the entire lease), 30 percent (Stand. Imp. Co. v. DiGiovanni, 768 S.W.2d 190, 190 (Mo. App. W. Dist. 1989) (where the liquidated damages clause of a home improvement contract was equal to 30 percent of the sale price) and even 66 percent (Taos Const. Co., Inc. v. Penzel Const. Co., Inc., 750 S.W.2d 522, 525 (Mo. App. E. Dist. 1988) (where a liquidated damages clause equaled 66 percent of the damage caused by a subcontractor). In those cases, the courts relied on the rules of the Restatement (Second) to determine validity, stating that "the more difficult it is at the time of the contract to determine the actual damages due to a breach, we find less weight is given to the factor that requires the amount of liquidated damages to be a reasonable forecast of the harm caused by the breach." Valentine's, Inc. v. Ngo, 251 S.W.3d 352 (Mo. App. S. Dist. 2008) citing Restatement (Second) of Contracts § 356 comment b. (1981).

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

Answer: Liquidated damages will not be allowed if there are no actual damages. However, only minimal actual damages need be shown for the seller to be entitled to liquidated damages.

In Missouri, courts require proof of actual damage or harm as a result of the breach before a liquidated damages clause can be triggered. Grand Bissell Towers, Inc. v. Joan Gagnon Enterprises, Inc., supra. If challenged, the seller is required to show evidence of actual damages to recover liquidated damages. Id. However, minimal actual damages need be shown to be entitled to liquidated damages, and the amount of actual damages is not relevant to whether the liquidated damages are reasonable. Id., see also Kansas City Live Block 139 Retail, LLC v. Fran's K.C. Ltd, 504 S.W.3d 725, 732 (Mo. App. W. Dist. 2016).

Is mitigation relevant for liquidated damages?

Answer: Mitigation is likely irrelevant for liquidated damages in commercial real estate purchase and sale agreements because mitigation has been held irrelevant in a construction contract liquidated damages case and in a real estate contract actual damages case.

In Burst v. R.W. Beal & Co., Inc., 771 S.W.2d 87, 91 (Mo. App. E. Dist. 1989), the court held, in a construction contract case, that as long as the liquidated damages clause is valid, the amount stipulated becomes the measure of damages, making the non-breaching party's mitigation irrelevant. In Gilmartin Bros., Inc. v. Kern, 916 S.W.2d 324, 332 (Mo. App. E. Dist. 1995), a residential real estate contract between a builder/seller and a buyer, the court held that (i) "the appropriate measure of damages is the difference between the contract price and the market value of the property on the date the sale should have been completed" and (ii) "there is no obligation on the part of the seller … to mitigate damages."

Is a "shotgun" liquidated damages clause enforceable?

Answer: The presence of a "shotgun" liquidated damages clause *may* invalidate the entire liquidated damages clause in a commercial real estate purchase and sale agreement. However, the only applicable Missouri case addresses a seller breach, *not* a buyer breach.

A "shotgun" liquidated damages clause entitles a party to the same stipulated amount for each breach, whether minor or major. The only Missouri case that addresses this issue is a case where the buyer sought to invalidate a "shotgun" liquidated damages clause

due to a seller breach of a real estate contract. In Wilt v. Waterfield, 273 S.W.2d 290 (Mo. 1954), the court held that the seller could not enforce a "shotgun" liquidated damages clause against the buyer for the seller's failure to perform because the potential damages to the buyer for certain of the seller's breaches was disproportionate to the stipulated liquidated damages amount. Whether a Missouri court would reach a similar result in a case involving a buyer breach remains an open issue.

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

Answer: Likely no, if the commercial real estate purchase and sale agreement expressly grants the seller the right to attorneys' fees as an additional remedy.

In Missouri, attorney's fees are not recoverable as actual damages. Any recovery of attorneys' fees is based solely on statute or contract. Paragon Group, Inc. v. Ampleman, 878 S.W.2d 878 (Mo. App. E. Dist. 1994) (Holding that attorney's fees could be recovered in addition to liquidated damages because the lease provided so). Thus, as long as the real estate contract expressly provides for the recovery of attorney's fees, attorneys' fees should be recoverable in addition to liquidated damages. ■