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Liquidated Damages Issues in South Carolina Purchase and Sale Agreements

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In 2018, the Acquisitions Committee of the American College of Real Estate Lawyers ("ACREL") began focusing on the treatment of liquidated damages provisions in real estate purchase and sale agreements ("PSAs"), particularly under what circumstances liquidated damages might not be the exclusive remedy for a buyer default. This was primarily in response to *Ravenstar, LLC v. One Ski Hill Place, LLC,* 401 P.3d 552 (Colo. 2017), which held that an optional liquidated damages clause (i.e., a clause giving the seller an option to choose between liquidated damages and actual damages) was enforceable. *Ravenstar* was a surprise to many practitioners who felt that such an option would invalidate the liquidated damages clause because it reflected a lack of intent to liquidate damages. As a result, Stevens A. Carey looked deeper into how the various jurisdictions addressed liquidated damages and wrote a comprehensive article entitled *Liquidated Damages in a Real Estate PSA: A Closer Look*, 35 THE PRACTICAL REAL ESTATE LAWYER 24 (January 2019). This article created 13 questions regarding liquidated damages and provided an analysis of the disparate treatment of liquidated damages found in various jurisdictions. To provide greater assistance to real estate lawyers, ACREL Fellows have now been called upon by the Acquisitions Committee to provide specific responses to the 13 questions for their respective jurisdictions.

This article attempts to answer the 13 questions under South Carolina law and suggests that a careful review is required as to all liquidated damages provisions because minor changes in language may result in surprising consequences in an adversarial situation.[1]

1. MAY THE SELLER CHOOSE SPECIFIC PERFORMANCE INSTEAD OF LIQUIDATED DAMAGES (SO THAT LIQUIDATED DAMAGES ARE NOT AN EXCLUSIVE REMEDY)?

While there is limited judicial precedent in South Carolina, the case of *Bannon v. Knauss*, 282 S.C. 589, 320 S.E.2d 470 (Ct. App. 1984), sets forth what is believed to be the current law on the subject of whether optional remedies are permitted in PSAs which have liquidated damages provisions. In *Bannon*, the South Carolina Court of Appeals said:

> In the absence of clear language in the contract to the contrary, a nonbreaching party may normally elect either to pursue a remedy specified in the contract or to sue for any other remedy available for the breach. The presence of a liquidated damages clause in a contract does not in itself limit the remedies available

[1] This article does not attempt to analyze South Carolina cases dealing with liquidated damages provisions and other remedies under installment land sale contracts because the economic interests of the parties are normally vastly different than those found in the commercial acquisition, thereby limiting the guidance provided by such decisions.

> to the nonbreaching party. *Rubinstein v. Rubinstein*, 23 N.Y.2d 293, 296 N.Y.S.2d 354, 244 N.E.2d 49 (1968); *Fletcher v. United States*, 303 F.Supp. 583 (N.D.Ind.1967), aff'd, 436 F.2d 413 (7th Cir.1971). However, the parties may agree that the liquidated damages specified in the contract are the sole remedy for breach. *Cooley v. Call*, 61 Utah 203, 211 P. 977 (1922). If such a limitation is reasonable in the circumstances, the courts will enforce it. *Id*.; *Curran v. Williams*, 352 Mich. 278, 89 N.W.2d 602 (1958); cf., *Tate v. LeMaster*, 231 S.C. 429, 99 S.E.2d 39 (1957); *Owens v. Hodges*, 26 S.C.L. (1 McMul.) 106 (1841).
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> In a contract for sale of real estate, a clause providing forfeiture of the earnest money if the purchaser defaults is ordinarily construed as giving the seller the election to disaffirm the contract and retain the earnest money or to affirm it and sue for the purchase price. *First Trust & Savings Bank v. Pruitt*, et al., 121 S.C. 484, 113 S.E. 469 (1922); *Stewart v. Griffith*, 217 U.S. 323, 30 S.Ct. 528, 54 L.Ed. 782 (1910); *Biscayne Shores, Inc., to Use of New Biscayne Shores Co. v. Cook*, 67 F.2d 144 (3d Cir.1933). If the seller affirms the contract and sues for damages, the earnest money becomes a fund out of which the damages may be partially paid if the proven damages exceed the amount of the earnest money. *Southeastern Land Fund, Inc. v. Real Estate World, Inc.*, 237 Ga. 227, 227 S.E.2d 340 (1976).

While this case dealt with the ability of the seller to pursue the alternate remedy of actual damages, the broad ruling would certainly appear to authorize pursuing specific performance. However, there may need to be somewhat unique circumstances before a seller can qualify for specific performance because of the requirements that there be no adequate remedy at law.

2. MAY THE SELLER CHOOSE ACTUAL DAMAGES INSTEAD OF LIQUIDATED DAMAGES (SO THAT LIQUIDATED DAMAGES ARE NOT AN EXCLUSIVE DAMAGE REMEDY)?

The *Bannon* court specifically answered this question affirmatively when there is no language making liquidated damages the exclusive remedy. *Bannon*, at 592.

3. IF THE SELLER MAY CHOOSE LIQUIDATED DAMAGES OR ACTUAL DAMAGES, MAY IT HAVE BOTH?

South Carolina courts will uphold liquidated damages clauses so long as the sums involved do not constitute a penalty. In general, the liquidated damages amount should be the predetermined measure of compensation for actual damages that might be sustained by reason of nonperformance. *See Tate v. Le Master*, 231 S.C. 429, 99 S.E.2d 39 (1957). Pursuing actual damages in addition to liquidated damages would seem to allow a recovery in excess of what the parties agreed upon as the measure of actual damages and is likely not to be allowed. However, in the event the non-defaulting party has suffered additional damages not arising from the subject default, depending on the language of the liquidated damages provision, it does appear possible that recovery of such additional damages might be permitted. However, there is no South Carolina case law to support this position.

4. IF THE SELLER MAY CHOOSE LIQUIDATED DAMAGES OR ACTUAL DAMAGES, BUT NOT BOTH, WHEN MUST IT DECIDE?

South Carolina courts have not ruled on this issue. However, in *Bannon* the court authorized the retention of the earnest money deposit as a fund out of which damages may be partially be paid if the proven damages exceed the amount of the earnest money deposit. *Bannon*, at 592. Irrespective of this statement in *Bannon*, if pursuit of actual damages is permitted, it is recommended that the PSA specifically authorize the retention of the earnest money deposit so that such conduct is not claimed to be an election to accept the earnest money as liquidated damages. If the seller sells the property or actual damages are otherwise determined before an election is made to seek only liquidated damages and the actual damages are less than the liquidated damages, a court could easily determine that in order to avoid imposing a penalty, an election has been made to limit liability to actual damages.

5. IS THERE AN APPLICABLE STATUTE ADDRESSING LIQUIDATED DAMAGES CLAUSES?

There are no South Carolina statutes applicable to liquidated damages clauses in PSAs.

6. WHAT IS THE TEST FOR A VALID LIQUIDATED DAMAGES CLAUSE?

The dispositive test on whether a provision in a contract is for liquidated damages or is an unenforceable penalty is contained in *Erie Insurance Co. v. Winter Const. Co*., 393 S.C. 455, 713 S.E. 2d 318 (2011) which reads as follows:

> Implicit in the meaning of 'liquidated damages' is the idea of compensation; in that of 'penalty,' the idea of punishment. Thus, where the sum stipulated is reasonably intended by the parties as the predetermined measure of compensation for actual damages that might be sustained by reason of nonperformance, the stipulation is for liquidated damages; and where the stipulation is not based upon actual damages in the contemplation of the parties, but is intended to provide punishment for breach of the contract, the sum stipulated is a penalty. [*Tate v. LeMaster*], 231 S.C. 429, 441, 99 S.E.2d 39, 45–46 (1957); *see also Kirkland Distrib. Co. of Columbia, S.C. v. U.S.,* 276 F.2d 138, 145 (4th Cir.1960). Moreover, "[w]hether such a stipulation is one for liquidated damages or for a penalty is ... primarily a matter of the intention of the parties." *Tate,* 231 S.C. at 441, 99 S.E.2d at 45; *see also Benya v. Gamble,* 282 S.C. 624, 630, 321 S.E.2d 57, 61 (Ct.App.1984), *cert. granted,* 284 S.C. 366, 326 S.E.2d 654, and *cert. dismissed,* 285 S.C. 345, 329 S.E.2d 768 (1985). Accordingly, we look to the language of the [contract] and the reasonable intention of the parties to determine if the liquidated damages provision was the predetermined measure of compensation.

7. WHO HAS THE BURDEN OF PROOF?

There is no South Carolina case law expressly dealing with who has the burden of proof as to whether a liquidated damages provision is or is not a penalty. However, based upon the likelihood that the purchaser will be challenging a liquidated damages provision as constituting

an unenforceable penalty, the burden is likely to be placed on the party challenging enforceability of the contract provision. *See generally* 17 C.J.S. CONTRACTS §940 Westlaw (database updated Feb. 2019) (Presumptions in favor of validity).

8. AS OF WHEN IS "REASONABLENESS" TESTED?

There is no South Carolina case dealing with the specific time that the reasonableness of liquidated damages is to be measured. However, it is expected that South Carolina would follow the prevailing view, which appears to require a forward-looking test as of the time of contract. *See, e.g.*, SAMUEL WILLISTON, A TREATISE ON THE LAW CONTRACTS, 65:17, at 299-308 (Richard A. Lord ed., 4th ed. 2002, 2003).

9. WHAT PERCENTAGE OF THE PURCHASE PRICE IS LIKELY ACCEPTABLE AS LIQUIDATED DAMAGES?

South Carolina has not established a bright line test as to the percentage that equates to a sum reasonably intended by the parties as the predetermined measure of compensation for actual damages that might be sustained by reason of nonperformance. However, based on the uncertainties of the commercial real estate market, it is anticipated that unless there are extenuating circumstances, up to 10% is likely to be found acceptable. The estimate of 10% is submitted because this is generally the upper limit of the percentage that is normally agreed upon as an earnest money deposit in commercial real estate transactions in South Carolina. It is expected that if liquidated damages amounts exceed 10%, the sophistication of the parties and their bargaining power probably will at least indirectly influence a court's decision as to reasonableness.

10. ARE ACTUAL DAMAGES RELEVANT FOR LIQUIDATED DAMAGES AND, IN PARTICULAR, WILL LIQUIDATED DAMAGES BE ALLOWED WHEN THERE ARE NO ACTUAL DAMAGES?

South Carolina cases regarding liquidated damages do not impose the requirement of pleading or proving actual damages in seeking to enforce a liquidated damages provision. This is consistent with the belief that the reasonableness of the amount will be tested by South Carolina courts only at the time the contract is executed. *See generally* 11 SC. JUR. DAMAGES §65 Westlaw (update as of Dec. 2018) (Liquidated Damages and Penalties). However, if the actual damages are extremely disproportionate to the liquidated damages amount, the actual damages could have an impact on whether the agreed liquidated damages are so large that they are plainly disproportionate to any probable damages resulting from a breach of the contract. *See Benya v. Gamble*, 282 S.C. 425, 321 S.E.2d 57 (Ct. App 1984). Irrespective of actual damages, South Carolina does require a party seeking liquidated damages to establish that the party is ready, willing and able to support their part of the bargain at the appropriate time. *See Mozingo & Wallace Architect L.L.P. v. Grand*, 379 S.C. 478, 666 S.E. 2d 267 (Ct. App. 2008).

11. IS MITIGATION RELEVANT FOR LIQUIDATED DAMAGES?

No South Carolina cases discuss the role of mitigation in enforcing liquidated damages clauses in a commercial real estate transaction. Based on the fact that liquidated damages are intended to be a reasonable estimate of the actual damages which might be suffered, establishing

the agreed amount should take into consideration a duty to mitigate, and once liquidated damages are agreed-upon, mitigation has no further role. *See generally Austin-Griffith, Inc. v. Goldberg*, 22 S.C. 273, 79 S.E.2d 447 (1953).

12. IS A "SHOTGUN" LIQUIDATED DAMAGES CLAUSE ENFORCEABLE?

The phrase "shotgun" in reference to a liquidated damages provision is assumed to mean that the liquidated damages are triggered in connection with any breach of the PSA, even if the breach does not result in non-performance or termination. Based on the fact that it would seem difficult to establish a reasonable liquidated damages amount for material breaches that result in non-performance or termination and at the same time provide a reasonable amount for non-material breaches, it is likely that the amount constitutes a penalty as to non-material breaches. Also, the excessive nature of such amount for non-material breaches might make the entire liquidated damages provision unenforceable. In South Carolina, a non-material breach of a lease has been held not to permit a landlord to terminate a lease and cause a forfeiture of the leasehold interest. *See Litchfield Co. of South Carolina, Inc. v. Kiriakides,* 290 S.C. 220, 349 S.E.2d 344 (1986). It is expected that a non-material breach of a PSA with a shotgun liquidated damages provision would have a similar reception before a South Carolina judge.

13. DOES A LIQUIDATED DAMAGES CLAUSE PRECLUDE RECOVERY OF ATTORNEYS' FEES BY THE SELLER?

While no South Carolina cases have considered this issue, attorneys' fees are not considered part of actual damages. *See, e.g., Rimer v. State Farm Mut. Ins. Co.,* 248 S.C. 18, 148 S.E.2d 742 (1966). Therefore, it would seem to be difficult to contend that recovery of such fees is not independent of the liquidated damages amount and not collectible irrespective of a specific attorneys' fees provision in the PSA. Any issue would totally be avoided if the attorneys' fees provision included a statement that this obligation is independent of any other remedy contained in the PSA, including the retention of any earnest money deposit as liquidated damages, but this is probably not necessary based on the general exclusion of attorneys' fees from actual damages.

Conclusion

South Carolina courts generally recognize the freedom parties to PSAs have to contract for certain remedies, including but not limited to, liquidated damages that appear to reasonably approximate potential actual damages. However, parties to real estate transactions should never lose sight of the fact that South Carolina judges might at least indirectly be influenced by concepts of good faith and fairness, as well as give consideration to the sophistication of the parties. Based on the latitude that is provided in the case law as to when a liquidated damages provision might constitute a penalty, a conservative approach is recommended in establishing liquidated damages amounts. This follows the advice given by many South Carolina lawyers when discussing liquidated damages amounts with clients, which is: "pigs get fed and hogs get slaughtered."

The foregoing discussion of liquidated damages in South Carolina gives rise to the following suggestions in connection with the drafting of PSAs:

1. Because liquidated damages provisions are in part tied to the intention of the parties, it appears wise to include language to the effect that actual damages may be difficult to determine, the amount of the earnest money deposit represents a reasonable estimate of the actual damages that may be suffered as a result of non-performance by the purchaser, and that retention of the earnest money deposit as liquidated damages is the seller's sole remedy in the event of the purchaser's failure to perform.

2. If the seller desires the option of retaining the earnest money deposit as liquidated damages or suing for actual damages or specific performance, these options should be expressly stated. In addition, if there are optional remedies, the seller should be expressly entitled to obtain the earnest money deposit whether or not it elects to retain the same as liquidated damages, and if the seller elects to pursue actual damages, it will be entitled to utilize the earnest money deposit as a fund to be applied against the actual damages suffered.

3. It would seem that if the seller commences an action to collect actual damages, it is likely that the purchaser will contend that an election has been made precluding any further claim as to liquidated damages, and that the seller is obligated to remit to the purchaser any portion of the earnest money deposit which exceeds the actual damages that may be incurred by the seller. Therefore, this should be considered before any action to collect actual damages is commenced. Also, if the seller proceeds with the sale of the property to a third party before affirmatively electing to retain the earnest money as liquidated damages, the seller may be exposed to an obligation to refund any portion of the earnest money deposit that exceeds the actual damages suffered.

4. If the Seller refuses to make liquidated damages the exclusive remedy, the purchaser might consider insisting on a time period in which the seller must make an election to retain the earnest money as liquidated damages, and if this election is not made, the seller's sole remedy will be to pursue actual damages. In addition, the PSA might state that if seller pursues actual damages, seller will be deemed to have elected to forgo liquidated damages, and to the extent that the earnest money deposit exceeds the actual damages suffered, the excess must be remitted to the purchaser.

5. Based on uncertainty as to what role a jury might play in determining the enforceability of a liquidated damages provision, it is recommended that a waiver of jury trial provision be included in any PSA that contains a liquidated damages provision. In addition, because of the potential disputes that may arise regarding whether the earnest money deposit can be released, and the resulting delays that may be encountered as a result, if receipt of the earnest money is of significant consequence, an arbitration provision should be considered.