

Acquisitions Committee: Liquidated Damages Project in Louisiana

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As part of the ACREL Acquisitions Committee's Liquidated Damages Project, we have the following report on Louisiana law with respect to liquidated damages (termed stipulated damages in the Louisiana Civil Code) in purchase agreements and to some extent, other types of contracts.

Generally, stipulated damages are enforceable in Louisiana, and the buyer's deposit may be retained by the seller as its damages upon the buyer's breach if the contract permits that remedy. However, Louisiana Civil Code article 2012 permits a Louisiana court to modify the stipulated amount if the court finds that amount "so manifestly unreasonable as to be contrary to public policy."

Responses to the Committee's specific questions are as follows:

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

Yes, under Louisiana Civil Code article 2007, a seller may choose "either stipulated damages or performance of the principal obligation," but may not choose both unless "the damages have been stipulated for mere delay."

As an example of the application of article 2007, in *Rabin v. Blazas*, the seller of a house filed a breach of contract lawsuit against the purchaser who failed to deposit a sum of \$5,500 in liquidated damages with the seller's agent within 48 hours of the acceptance of the offer as required under the contract. 537 So. 2d 221, 222 (La. App. 4th Cir. 1988). At a bench trial, judgment was rendered in the plaintiff's favor for an amount of \$12,500.00 plus costs, including, \$5,500.00 for breach of contract and \$5,500.00 for liquidated damages. *Id.*

The purchaser appealed and contended that the court erred in awarding plaintiff damages in excess of the contractual liquidated damages amount. *Id.* at 223. The court stated that the buyer is liable only for either the liquidated damages **or** specific performance, but not both. La. Civ. Code art. 2007; *Rabin*, 537 So. 2d at 223. If the parties fix the liquidated damages amount and the non-breaching party chooses to exercise the liquidated damages clause, this means that the non-breaching party may only receive the liquidated damages amount, regardless of the greater amount of the actual damages. *Rabin*, 537 So. 2d at 223. The plaintiff chose the liquidated damages provision; consequently, the plaintiff was not entitled to anything more. *Id.* at 224.

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

No. In *Grimsley v. Lenox*, the trial court awarded the plaintiff seller actual damages in the amount of \$15,000.00 despite the fact that the purchase agreement stipulated damages at \$500.00, which was the amount of the deposit. 93-1618, p. 1 (La. App. 3 Cir. 9/14/94); 643 So. 2d 203, 204. The Louisiana Court of Appeal for the Third Circuit reversed the trial court's judgment and held that the defendants only had to forfeit their \$500.00 deposit to the plaintiff in accordance with the language in the purchase agreement. *Id.* at 206. In reaching its decision, the appellate court explained that a "stipulated damages clause fixes the amount of all damages that may be recovered, and actual damages may not be awarded." *Id.* See also, *Lombardo v. Deshotel*, 94-1172 (La. 11/30/04), 647 So. 2d 1086; *Rabin, supra*.

Although the *Grimsley* case is a residential real estate purchase agreement, a court would probably be less forgiving of a commercial seller. This means that a commercial seller would likely have fewer remedies, not more. Thus, if a residential seller is not entitled to actual damages when liquidated damages are stipulated, a commercial seller surely will not be entitled to actual damages instead of those stipulated damages. *Grimsley* illustrates the court's refusal to permit a seller to receive actual damages if it previously agreed to a liquidated damages clause.

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

No. The entire purpose of agreeing to a liquidated damages clause is to substitute the liquidated amount for a calculation of actual damages. It is supposed to approximate the parties' actual damages in advance and to "help ease the burden of proving loss." *Henderson v. Ayo*, 2011-1605, p. 8 (La. App. 4 Cir. 6/13/12); 96 So. 3d 641, 646 (citations omitted). For a court to award both liquidated damages and actual damages would be a form of double recovery that is not permitted by Louisiana courts. See *Mobley v. Mobley*, 37-364, p. 6 (La. App. 2 Cir. 8/20/03); 852 So. 2d 1136, 1139-40 (citation omitted); La. Civ. Code art. 2005, cmt. (c).

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

The seller may not choose actual damages over liquidated damages if liquidated damages were agreed upon.

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

Yes. Louisiana Civil Code articles 2005 through 2011, enacted in 1984 and effective January 1, 1985, as part of overall revisions to the Civil Code Conventional Obligations or Contracts Articles, govern stipulated (liquidated) damages and provide as follows:

Art. 2005. Secondary obligation

Parties may stipulate the damages to be recovered in case of nonperformance, defective performance, or delay in performance of an obligation.

That stipulation gives rise to a secondary obligation for the purpose of enforcing the principal one.

Art. 2006. Nullity of the principal obligation.

Nullity of the principal obligation renders the stipulated damages clause null.

Nullity of the stipulated damages clause does not render the principal obligation null.

Art. 2007. Stipulated damages or performance.

An obligee may demand either the stipulated damages or performance of the principal obligation, but he may not demand both unless the damages have been stipulated for mere delay.

Art. 2008. Failure to perform justified.

An obligor whose failure to perform the principal obligation is justified by a valid excuse is also relieved of liability for stipulated damages.

Art. 2009. Obligees not bound to prove damage.

An obligee who avails himself of a stipulated damages clause need not prove the actual damage caused by the obligor's nonperformance, defective performance, or delay in performance.

Art. 2010. Obligor put in default.

An obligee may not avail himself of a clause stipulating damages for delay unless the obligor has been put in default.

Art. 2011. Benefit from partial performance.

Stipulated damages for nonperformance may be reduced in proportion to the benefit derived by the obligee from any partial performance rendered by the obligor.

Art. 2012. Stipulated damages may not be modified.

Stipulated damages may not be modified by the court unless they are so manifestly unreasonable as to be contrary to public policy.

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

The test for a valid liquidated damages provision in Louisiana is whether it is not so “manifestly unreasonable” as to be against public policy. La. Civ. Code art. 2012. *See also Indus. Mar. Carriers, Inc. v. Holnam Inc.*, 1991 A.M.C. 2196, 2197 (E.D. La. 1991). In *Mobley*, the court explained that the purpose of liquidated damages is to “reasonably approximate” the damages that will be suffered, but that these damages are not supposed to be penal in nature. 852 So. 2d at 1139 (citation omitted). When analyzing whether a liquidated damages clause is valid or reasonable, the court will determine whether the parties to the contract attempted to approximate what the damages would be, *Id.*, then give the liquidated damages clause effect only if the “court deems it to be a true approximation of actual damages.” La. Civ. Code art. 2005, cmt. (c).

7. WHO HAS THE BURDEN OF PROOF?

If one party is seeking to enforce a liquidated damages provision, and if the other party believes the stipulated damages provision would constitute a penalty, then the party resisting the enforcement (generally the purchaser in a purchase agreement case) has the burden of proving that the provision constitutes an impermissible penalty. *Indus. Mar. Carriers, Inc.*, 1991 A.M.C. at 2197 (citations omitted).

8. AS OF WHEN IS “REASONABLENESS” TESTED?

Neither the Civil Code nor the cases point to a date as of which “reasonableness” is tested. In practice, the court generally considers the actual damages at the time of the breach. *See Philippi v. Viguerie*, 606 So. 2d 577, 579 (La. App. 5th Cir. 1992). But when presented an argument by the buyer that liquidated damages are unreasonably greater than the actual damages, the seller could certainly assert that when the contract was executed, the liquidated damage were a reasonable and knowing approximation by the parties of the anticipated damages.

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

Although Louisiana courts have not established a specific percentage of a sale price as acceptable liquidated damages, in *Philippi*, the court held that if the liquidated damages are too close in value to the purchase price, it is considered “manifestly unreasonable.” 606 So. 2d at 578. In that case, the buyer purchased shares of stock in a company for a total purchase price of \$141,000.00, and to ensure the goodwill was truly transferred to the buyer, the parties entered into a non-competition agreement. *Id.* Under the non-competition agreement, the seller was prohibited from engaging in any competitive business in a twelve-parish area in Louisiana and a two-county area in Mississippi. *Id.* Additionally, the purchaser agreed not to expand the business to the Hattiesburg, Mississippi, or the Alexandria, Louisiana, areas, because the seller intended to do business in those areas. *Id.* The non-competition agreement provided for stipulated damages of \$1,000 for each violation of the agreement. *Id.* at 579. The seller violated the non-competition agreement, and the buyer sought injunctive relief and damages. *Id.* The trial court found that the seller had violated the agreement 137 times, but it held that the total stipulated damages amount of \$137,000 payable by reason of the 137 violations was manifestly unreasonable and contrary to public policy. *Id.* It therefore reduced the stipulated damages to

\$200.00 per violation, bringing the total amount of damages awarded to \$27,400.00. *Id.* The court noted that the total gross sales made by seller in the 137 violations totaled \$54,572.16, but the liquidated damages total at the \$1,000.00 price per violation would have amounted to \$137,000.00. *Id.* at 580. Because the trial court's factual determinations were not manifestly erroneous, the Fifth Circuit Court of Appeal of Louisiana affirmed its decision. *Id.*

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

Yes, only to the determination whether the liquidated damages stipulated are “manifestly unreasonable.” A clause stating the amount of liquidated damages will be enforced regardless of the extent of the actual damages, unless the liquidated damages are so manifestly unreasonable that they are against public policy. La. Civ. Code art. 2005, 2012. Thus, if there are no actual damages, or if the actual damages are far less than the liquidated damages, it is likely that a court will not enforce the liquidated damages clause.

The purpose of a liquidated damages clause is to fix the amount of damages in advance, which is intended to eliminate the burden of proving loss because there is no requirement of proof of actual or pecuniary damage to enforce the liquidated damages clause. *Henderson*, 96 So. 3d at 646 (citations omitted). Liquidated damages may not be assessed as a penalty. *Indus. Mar. Carriers, Inc.*, 1991 A.M.C. at 2197 (citations omitted). This means that even if damages were agreed on by the parties to the contract, the court may modify that agreement if the liquidated damages are “so manifestly unreasonable as to be contrary to public policy.” La. Civ. Code art. 2012. The court explained that the purpose of liquidated damages is to “reasonably approximate” the damages that will be suffered, but they are not supposed to be penal in nature. *Mobley*, 852 So. 2d at 1139-40 (citation omitted). When analyzing whether a liquidated damages clause is valid or reasonable, the court determines whether the parties to the contract attempted to approximate the actual damages, *Id.*, and it will only give the liquidated damages clause effect if the “court deems it to be a true approximation of actual damages.” La. Civ. Code art. 2005, cmt. (c).

For example, if the amount owed under the stipulated damages clause is double the amount of actual damages, the court might find the stipulated damages clause to be so manifestly unreasonable as to be against public policy. In *Philippi*, the seller would have owed the buyer liquidated damages of \$137,000.00. 606 So. 2d at 580. However, because the actual sales amount that accrued from the violations was only \$54,572.16, the court reduced the amount of damages to \$27,400. *Id.* at 579-80.

11. IS MITIGATION RELEVANT FOR LIQUIDATED DAMAGES?

No. A seller does not have a duty to mitigate damages when the parties have agreed to liquidated damages. *Lombardo, supra*, 94-1172, p. 9, 647 So. 2d at 1092.

In *Lombardo*, a seller sued a purchaser for specific performance, but later sold the property to a third party for far less than the original sale price, then asked the court for actual damages rather than stipulated damages. 647 So. 2d at 1086. The trial court held that the seller was right in selling the property to a third party because the seller had a duty to mitigate;

consequently, that court held that the liquidated damages clause no longer bound the seller and that the seller could receive actual damages. *Id.* at 1088. However, the court of appeal reversed the trial court, and held that the seller was still bound by the stipulated damages clause. *Id.* The Supreme Court of Louisiana affirmed the court of appeal's reversal. *Id.*

The Supreme Court held that the duty to mitigate does not apply when the parties have agreed to stipulated damages. *Id.* at 1091. Although Civil Code Article 2002 requires an obligee to make reasonable efforts to mitigate the damage caused by the obligor's failure to perform, this article only applies if the obligee's failure to mitigate will result in the obligor having to pay more damages. *Id.* at 1092. The court explained that when the damages are stipulated, failure to mitigate does not subject the obligor to more liability since the damages have already been agreed upon. *Id.* Thus, the seller was bound by the stipulated damages clause. *Id.*

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

No. Louisiana cases have used the term "shotgun" in connection with liquidated or other types of damages.

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

Whether a seller can recover attorneys' fees from the buyer for its breach depends on whether the contract provides for attorneys' fees, not whether it provides for liquidated damages. A contract may provide for both liquidated damages and attorney's fees. For example, in *Rabin*, the purchase agreement provided for "attorney's fees and costs regardless of whether liquidated damages or specific performance is granted." 537 So. 2d at 224. The trial court awarded attorney's fees of \$1,000.00 plus costs in addition to the award of liquidated damages. This portion of the award was not challenged, and the court of appeal found no issue with it. *Id.* On the other hand, in *Grimsley*, the court of appeal reversed the award of attorney's fees and held that the plaintiff was entitled only to the \$500.00 deposit as liquidated damages because that was all that was provided for in the contract. 643 So. 2d at 206.

CONCLUSION

Louisiana's Civil Code states that liquidated damages stipulated in a contract are enforceable unless so "manifestly unreasonable" as to be contrary to "public policy." La. Civil Code arts 2005, 2012. Consequently, a Louisiana court will give effect to a purchase agreement provision that characterizes the deposit as liquidated or stipulated damages and will award the seller exactly that deposit amount upon a default unless the purchaser can show that the award of the deposit amount is "manifestly unreasonable."