LIQUIDATED DAMAGES IN OHIO PURCHASE AND SALE AGREEMENTS

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This article focuses on the enforceability of liquidated damages provisions in real estate purchase and sale agreements under Ohio law. The article was written to be incorporated within the American College of Real Estate Lawyers (ACREL) Acquisitions Committee's multi-state review of liquidated damage provisions.

As discussed herein, under Ohio law, the burden of proof to show that a liquidated damages clause is unenforceable lies with the party challenging its validity.[1] Ohio courts determine the validity of liquidated damage clauses based on whether the amount specified is determined to be a penalty.[2] To determine whether the amount of liquidated damages specified is a penalty, Ohio courts will apply a three-part test, discussed at question six, below.[3]

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

In Ohio, the seller may choose specific performance[4] instead of liquidated damages unless the language of the contract provides that the liquidated damages provision is the exclusive remedy. Courts have held that discretionary language inserted into liquidated damages clauses such as "may, in lieu of other remedies available" permits the non-breaching party to pursue alternate remedies.[5] However, where the liquidated damages provision is written with exclusive language, such as referring to liquidated damages as the "sole" remedy under the contract, courts have upheld the provision as the exclusive contractual remedy.[6]

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

Yes. Again, the option is dependent on the language that the parties agree to in the contract.[7] Where the language used in the liquidated damages provision is discretionary, the non-breaching party may pursue alternate remedies.[8] However, where the contract language provides that liquidated damages is the sole or exclusive remedy, the non-breaching

party will be limited to pursuing the specified liquidated damages.[9]

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

No. The non-breaching party may not elect both liquidated damages and actual damages when the contract creates an option between the two types of damages. As emphasized in *Williams v. Kondziela*, "the liquidated damages provision was merely a stipulated remedy available to the seller at his option that, if utilized, would preclude alternate remedies."[10]

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

In Ohio, it is likely that the non-breaching party must decide between pursuing liquidated damages and actual damages prior to filing the lawsuit.[11]

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

No. Ohio does not have a statute that specifically addresses liquidated damages in the context of commercial real estate transactions.

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

In Ohio, the test to determine the validity of a liquidated damages clause hinges on whether the court regards the amount specified as a penalty.[12] To determine whether the amount is a penalty, Ohio courts will apply a three-part test.[13] First, the court examines whether the amount of actual damages is uncertain and difficult to prove. Second, the court considers whether the amount of stipulated damages is reasonable and proportionate to the contract as a whole. Third, the court determines whether the parties' intent to stipulate to damages is clear and unambiguous.[14] If the liquidated damages clause at issue fails the foregoing test, then it is unenforceable as a penalty for non-performance.[15]

7. Who has the burden of proof?

In Ohio, the party seeking to invalidate the liquidated damages clause bears the burden of proof to establish that the liquidated damages clause is an unenforceable penalty.[16]

8. As of when is "reasonableness" tested?

Using a front-end analysis, Ohio courts test reasonableness by "'examin[ing] it in light of what the parties knew at the time the contract was formed.'"[17]

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

Ohio courts have not established a hard-and-fast rule concerning acceptable liquidated damages as a percentage of purchase price. In *Cochran v. Schwartz*, where there were no damages actually sustained by the seller, the Second District Ohio Court of Appeals held that "the 7¼% ratio between the earnest money deposit and the purchase price in the case [was] 'pushing the envelope'"; however the court ultimately was "satisfied that it [was] a reasonable liquidated damages provision, and [was] therefore enforceable."[18] Further, in *Adams v. Coleman*, the Eighth District Ohio Court of Appeals found a liquidated damage clause that amounted to 13.4 percent was valid without considering whether actual damages were sustained.[19]

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

No. Actual damages should not be relevant in determining whether or not liquidated damages are unconscionable and therefore an unenforceable penalty. Although a liquidated damages clause must bear "a reasonable (not necessarily an exact) relation to actual damages"[20] to be enforceable, the determination of whether or not a liquidated damages clause is unconscionable "'must be viewed by the court from the standpoint of the parties at the time of the contract, and not ex post facto when the litigation is up for trial.'"[21] The Ohio Supreme Court in

Lake Ridge Academy stated further that "when a stipulated damages provision is challenged, the court must step back and examine it in light of what the parties knew at the time the contract was formed and in light of an estimate of the actual damages caused by the breach."[22] These rules were followed by the courts in *Cochran*, which upheld a liquidated damages clause where no damages were actually sustained by the seller,[23] and in *Adams*, which did not even consider whether damages were actually sustained.[24]

11. Is mitigation relevant for liquidated damages?

No. In Ohio, mitigation is not relevant when considering liquidated damages. The Ohio Supreme Court held that "[a] valid liquidated damages clause contemplates the nonbreaching party's inability to identify and mitigate its damages … [therefore] [i]f damages are 'uncertain as to amount and difficult of proof,' as they must be, the nonbreacher cannot be expected to reduce them after a breach."[25] The Ohio Supreme Court went on to hold that as a matter of law, when a liquidated damages clause is valid, the non-breaching party has no duty to mitigate damages.[26]

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

Neither Ohio's statutes nor its case law specifically addresses so-called "shotgun" clauses, which fix a single large sum as the liquidated damages for any breach. Whether or not an Ohio court would uphold such a clause would likely depend on the specific facts of the dispute. Although a fixed sum of liquidated damages may appear disproportionately large on its face, a court could conceivably hold the liquidated damages clause to be enforceable if it passes Ohio's three-prong test.

13. Does a liquidated damages clause preclude recovery of attorney's fees by the seller?

No, the inclusion of a liquidated damages clause does not preclude recovery of attorney's fees.[27] Instead, attorney's fees are dependent on whether the parties to the contract have bargained for the recovery of attorney's fees within the contract and the "breaching party's wrongful conduct has led to the legal fees being incurred."[28]

Notes

1 See infra note 16.

2 See infra note 12.

3 See infra notes 13-14.

4 In Ohio, specific performance is an appropriate remedy for a breach of contract for the sale of real estate when the real estate is considered unique. Jad Rentals of Youngstown, LLC v. Cox, No. 19 MA 0096, 2021 WL 391690 at ¶ 21 (Ohio Ct. App. Jan. 27, 2021) (quoting Shrock v. Mullet, 2019-Ohio-2707, 2019 WL 2767002 at ¶ 60 (Ohio Ct. App. June 28, 2019)) ("'Real estate is almost always unique, and specific performance of a written contract for its sale is a common remedy for a breach of that contract.'"). Ohio courts have granted specific performance in favor of both the purchaser (see Jad Rentals, 2021 WL 391690 at *1) and of the seller (see Sandusky Properties v. Aveni, 473 N.E.2d 798 (Ohio 1984).

5 Williams v. Kondziela, No. 2002–L–190, 2004 WL 877727, at *2 (Ohio Ct. App. Apr. 23, 2004) ("The liquidated damages provision in question states that the seller *may, in lieu of other remedies available*, accept damages for default in an amount not exceeding fifteen percent of the agreed purchase price. The term 'may' implies the exercise of discretion. Consequently, the seller is not required to accept 15% of the agreed purchase price as damages in the event of default. Rather, a seller may use the liquidated damages provision as a mechanism for compensation in the event that he or she does not want to pursue other remedies. The provision does not foreclose the possibility of the seller pursuing alternate remedies") (emphasis in original); Arena v. Heather v. DeHoff Agency, NO. 6112, 1983 WL 13780, at *8 (Ohio Ct. App. Oct. 17, 1983) ("Th[e] provision [stating Seller may, in lieu of other remedies available to him] gives the plaintiffs the option of invoking the liquidated damages clause (sic) or pursuing their other available remedies.").

6 Kurtz v. W. Prop., L.L.C., No. 10AP–1099, 2011 WL 6916196, at *4 (Ohio Ct. App. Dec. 27, 2011) ("This 'sole remedy' language is crucial, as another provision of the agreement demonstrates that the parties could have negotiated for alternative remedies beyond liquidated damages. [Therefore] under the plain language of the agreement, the liquidated damages provision is the only remedy available to appellant.").

7 See supra notes 5-6.

8 Williams, 2004 WL 877727 at *3.

9 See Kurtz, 2011 WL 6916196 at *4.

10 Williams, 2004 WL 877727 at *3; see also Knight v. Hughes, No. 86AP-1106, 1987 WL 17379, at *5 (Ohio Ct. App. Sep. 17, 1987) (citing Alois v. Waldman, 219 Md. 369, 149 A.2d 406 (1959)) ("However, a seller should not be able to recover his actual damages and retain a forfeited deposit [deemed to be a liquidated damage clause] ... To allow the recovery of damages and the retention of the deposit would be to allow a penalty."); Avakian v. Avakian, No. 2014–P–0036, 2015 WL 3668461 at ¶ 51 (Ohio Ct. App. June 15, 2015) ("In lieu of actual damages, parties to a contract may agree to liquidated damages, which is '[a]n amount contractually stipulated as a reasonable estimation of actual damages to be recovered by one party if the other party breaches.'" (citing Black's Law Dictionary (7th Ed. 2000) 321)).

11 See Williams, 2004 WL 877727, at *3 (finding that at the time of filing "[a]ppellee, in his discretion, filed a complaint for breach of contract ... d[oing] so in lieu of utilizing the liquidated damages provision in the purchase agreement.").

12 Samson Sales, Inc. v. Honeywell, Inc., 465 N.E.2d 392, 394 (Ohio. 1984) (citing Sheffield-King Milling Co. v. Domestic Science Baking Co., 115 N.E. 1014 (Ohio 1917), Miller v. Blockberger, 146 N.E. 206 (Ohio 1924), and 30 Ohio Jur. 3d 138 Section 129 (1981)).

13 Samson Sales, Inc., 465 N.E.2d at 394 (quoting Jones v. Stevens, 146 N.E. 894, syllabus para. 2 (Ohio 1925)):

> [w]here the parties have agreed on the amount of damages, ascertained by estimation and adjustment, and have expressed this agreement in clear and unambiguous terms, the amount so fixed should be treated as liquidated damages and not a penalty, if the damages would be (1) uncertain as to amount and difficult of proof, and if (2) the contract as a whole is not so manifestly unconscionable, unreasonable, and disproportionate in amount to justify the conclusion that is does not express the true intention of the parties, and if (3) the contract is consistent with the conclusion that it was the intention of the parties that damages in the amount stated should follow the breach thereof.

14 Carter v. CPR Staffing, Inc., No. 94671, 2010 WL 5065110 at ¶ 16 (Ohio Ct. App. Dec. 9, 2010).

15 Id.

16 CosmetiCredit, LLC v. World Fin. Network Nat'l Bank, 24 N.E.3d 762, 776-77 (Ohio Ct. App. 2014) (citing Matchmaker Internatl., Inc. v. Long, 654 N.E.2d 161 (Ohio Ct. App. 1995) and Dykeman v. Johnson, 93 N.E. 626 (Ohio 1910)) ("A party seeking to invalidate a purported liquidated-damages clause is asserting an affirmative defense and bears the burden of proof establishing that the clause generates damages in the form of a penalty, rather than reasonably apportioned damages."); see also Kraft Elec. Contr., Inc. v. Lori A. Daniels Irrevocable Tr., 136 N.E.3d 951, 958, ¶ 25 (Ohio Ct. App. 2019) ("As the party seeking to invalidate the liquidated damages provision, the Trust bore the burden of proof to establish the $10,000 monthly charge constituted an impermissible penalty rather than valid liquidated damages.") (citations omitted).

17 Boone Coleman Constr., Inc. v. Vill. of Piketon, 50 N.E.3d 502, 513 (Ohio 2016) (quoting Jones, 146 N.E. 894, syllabus para 1).

18 Cochran, 696 N.E.2d at 658; see also Gaskins v. Young, No. 20148, 2004 WL 1178278 (Ohio Ct. App. May 28, 2004) (finding the reasonable liquidated damages percentage of 7.25% pushed the envelope of reasonableness but only in the absence of actual damages).

19 Adams v. Coleman, No. 36319, 1977 WL 201492, at *5 (Ohio Ct. App. July 7, 1977) ("We find the downpayment of $7,000, awarded as liquidated damages by the lower court, was a reasonable sum to cover the potential damage to plaintiff from the breach of a $52,000 contract for the sale of land.").

20 Lake Ridge Acad. v. Carney, 613 N.E.2d 183, 188 (Ohio 1993) ("If the provision was reasonable at the time of formation and it bears a reasonable (not necessarily exact) relation to actual damages, the provision will be enforced.") (citing 3 Restatement of Law 2d. Contracts (1981) 157, Section 356(1)); Harmon v. Haehn, No. 10 MA 177, 2011 WL 6296731, at ¶ 50 (Ohio Ct. App. Dec. 9, 2011) (same); Kindle Rd. Co., LLC v. Trickle, No. 03CA99, 2004 WL 1948689, at ¶ 28 (Ohio Ct. App. Sept. 2, 2004) (same).

21 Boone, 50 N.E. 3d at 514, at ¶17 (quoting Jacobs v. Shannon Furniture Co., 22 Ohio C.D. 51, 53, 1910 WL 1170 (Ohio C. Ct. 1910).

22 Lake Ridge Acad., 613 N.E.2d at 188.

23 Cochran, 696 N.E.2d at 658.

24 Adams, 1977 WL 201492, at *4.

25 Lake Ridge Acad., 613 N.E.2d at 190 (Ohio 1993).

26 Id.

27 Kurtz, 2011 WL 6916196 (holding that the trial court did not err in awarding both liquidated damages and attorney's fees per the bargained for contract).

28 Westfield Cos. v. O.K.L. Can Line, 804 N.E.2d 45, 54 (Ohio Ct. App. 2003) (citing Socony-Vacuum Oil Co. v. Cont'l Cas. Co., 144 Ohio St. 382, 59 N.E.2d 199 (Ohio 1945)).