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Liquidated Damages Clauses in California Real Estate Contracts

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When a real estate transaction fails, the non-breaching party may seek to determine whether recourse may be had against the breaching party. A “liquidated damages” clause in a purchase agreement may simplify the resolution of the dispute.

Liquidated damages clauses in real estate (and other types of) contracts allow parties to contracts to agree in advance, before a dispute arises, how much money the seller will be entitled to collect from the buyer in the event the buyer defaults on the purchase contract. The typical liquidated damages clause in California real estate contracts provides that, if the buyer fails to complete the purchase as a result of the buyer’s default, the seller is entitled to the buyer’s deposit (or some other amount of money) as compensation for the buyer’s breach.

Liquidated damages clauses must comply with certain requirements in order to be enforceable. First, the amount of liquidated damages must be reasonable. Second, liquidated damages clauses must comply with certain statutory requirements relating to the formatting of the contract language. Civil Code § 1676.

Liquidated damages clauses in California real property purchase contracts must, in order to be enforceable, represent a “reasonable estimate” of the actual loss the seller will suffer in the event of the buyer’s breach. Civil Code §§ 1671(b), 1676, 3275. See also, Ridgley v. Topa Thrift and Loan Ass’n, 17 Cal.4th 970 (1998). Although the “reasonableness” of a liquidated damages clause is determined by many factors, the objective of the law is to fairly compensate non-breaching sellers for the loss occasioned by a buyer’s breach, while not unfairly punishing buyers. For personal residences (including

properties containing four or fewer units), California law presumes three percent of the purchase price to be reasonable for purposes of liquidated damages. Civil Code § 1675.

Furthermore, to be valid, liquidated damages clauses in a real property purchase contracts must, if the contract is preprinted, be in at least 10-point bold type, or contrasting red print in at least 8-point bold type, and be separately signed by each party to the contract. Civil Code §§ 1676, 1677.

Liquidated damages clauses provide a buyer and seller with a degree of certainty; they know at the beginning of their transaction the amount of money the buyer might forfeit, and the amount the seller might recover, in the event the buyer breaches the contract. Although liquidated damages clauses might make resolution of any disputes comparatively easy, buyers and seller should understand that a seller’s actual damages in the event of a buyer’s breach may be more or less than the amount specified in the contract for liquidated damages.

Finally, non-refundable deposits are not the same as liquidated damages. A non-refundable deposit clause typically provides that the buyer must forfeit his or her deposit to the seller even if the buyer has a valid reason for not closing the transaction. On the other hand, a liquidated damages clause entitles a seller to the buyer’s deposit only if the buyer breaches the contract. Non-refundable deposit clauses in California real estate clauses are generally unenforceable.

Earle Law Offices provides trial and appellate litigation, as well as non-litigation, legal services in the areas of business law, constitutional and civil rights law, family law, real estate law, tax law, and trusts and estates.

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Mr. Earle received his law degree from the Santa Clara University School of Law, where he served as an Editor of the school's Law Review, and where he received awards for academic excellence. He received his undergraduate degree, with honors, in business administration from the University of La Verne.

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